

Foreign Direct Investment in the People's Republic of China: Progress, Problems and Proposals

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"If there are shortcomings in implementing the open-door policy, the chief one is that the door is not opened wide enough."

*Deng Xiaoping,
January 20, 1987*

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This article is written from the point of view of foreign transnational corporations (TNCs) interested in making direct investments in the People's Republic of China (PRC or China), and reviews the progress that they have made to date, identifies what are generally perceived to be the major problems encountered by TNCs in China and presents practical proposals for dealing with some of those problems.¹ The authors do not attempt to speak for China. Yet we share with the Chinese authorities and those involved in investing in China the assumptions that foreign direct investment (FDI)² is good for China

1. This article is adapted from a background paper originally prepared for the May 1987 Roundtable on Foreign Direct Investment (FDI) in the People's Republic of China (The Roundtable), which was organized by the United Nations Center on Transnational Corporations and the Ministry of Foreign Economic Relations and Trade of the People's Republic of China (MOFERT).

2. Our article does not attempt to summarize and evaluate China's overall economic achievements or its domestic and foreign economic policies. Nor do we assess the wisdom of welcoming FDI or its relative utility in comparison with other instrumentalities for implementing the "Open Policy," such as importing plant and equipment, arranging for foreign technical assistance and training, importing foreign technology via licensing or borrowing foreign funds, all of which have been utilized wholly apart from FDI as well as in conjunction with it.

and that it is desirable to expand it.³

I. THE PROGRESS OF FDI TO DATE

A. Background

China's opening to FDI at the end of the 1970s, symbolized by the promulgation of the Chinese-Foreign Joint Venture Law on July 1, 1979 (the Joint Venture Law),⁴ represented a sharp departure from the policies that had been adopted since the founding of the PRC in 1949. With a few exceptions of a rather limited nature involving Soviet, East European or overseas Chinese capital,⁵ for the first three decades of its existence the PRC remained hostile to foreign investment. FDI was anathema for historical, ideological and practical reasons.

This did not mean that the PRC was opposed to international trade, the importation of machinery, equipment and even complete plants, or the acquisition of foreign technology.⁶ Throughout the 1950s China benefited from such forms of cooperation with the Soviet Union and the countries of Eastern Europe.⁷ It should be remembered that the United States, beginning in 1950 after the outbreak of conflict in Korea, had embargoed all transactions by American companies

3. We should note at the outset that China's definition of FDI is often broader than the ordinarily accepted usage of the term, embracing not only investment in equity joint ventures (JVs) and wholly foreign-owned ventures (WOVs) but also the use of foreign funds for cooperative ventures (CVs), cooperative development of oil resources, compensation trade and on some occasions even processing and assembly arrangements. We will use FDI in this broader sense unless otherwise indicated. See S. HO & R. HUENEMANN, CHINA'S OPEN DOOR POLICY: THE QUEST FOR FOREIGN TECHNOLOGY & CAPITAL 29 (1984); Nai-Ruenn Chen, *Foreign Investment in China: Current Trends* (Dept. Comm., Mar. 1986).

4. Unless otherwise indicated, the Chinese text and English translation of all laws cited in this article can be found in CHINA'S FOREIGN ECONOMIC LEGISLATION (Foreign Languages Press, vol. 1, 1982; vol. 2, 1986; vol. 3, 1987; other volumes forthcoming), or in the loose-leaf service collection of Chinese laws and regulations published by CCH Australia, China Laws for Foreign Business [hereinafter China L. For. Bus.].

5. Such as the Chinese-Soviet joint stock companies established in the early 1950s for the exploitation of oil and non-ferrous metals and the development of aviation and shipbuilding, which were, however, terminated in 1955, and the acceptance of some overseas Chinese investment in state-private companies that continued until the Cultural Revolution (1966-1976). Several Chinese-foreign shipping concerns were also established during the 1950s and 1960s, the most substantial of which was the Chinese-Polish Joint Stock Shipping Company that has continued through the present day. For a general discussion of these forms of foreign capital involvement in China, see D. BROWN, PARTNERSHIP WITH CHINA: SINO-FOREIGN JOINT VENTURES IN HISTORICAL PERSPECTIVE 56-61 (1986).

6. For a brief discussion of China's trade in the 1950s and 1960s and a useful statistical chart, see G. HSIAO, THE FOREIGN TRADE OF CHINA: POLICY, LAW AND PRACTICE 10-13 (1977). "Four waves" of technology imports by China are discussed in HO & HUENEMANN, *supra* note 3, at 13-15.

7. See YU GUANGYUAN, CHINA'S SOCIALIST MODERNIZATION 681 (1984).

with the PRC, while most other Western nations and Japan had sharply restricted their trade with the PRC. Following the withdrawal of Soviet economic assistance in 1960, however, the PRC engaged in significant similar cooperation with TNCs from Western Europe and Japan. Although interrupted from 1966-1969 by the turbulent period of the Cultural Revolution, this cooperation with TNCs resumed in the early 1970s, gradually developed substantial momentum and culminated in 1978 with the signing of foreign technology import contracts — including some with American companies — worth \$6.4 billion.⁸ Nevertheless, despite its interest in these other forms of cooperation, for a generation China did not utilize FDI as an additional means of importing technology.

China's decision to accept FDI was the result of a fundamental shift in political leadership and economic policy that began after the Cultural Revolution and that crystallized during the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party (the Third Plenum) in December 1978. No longer were political campaigns and class struggle to take precedence over economic progress. The new leadership resurrected the goal of achieving the "four modernizations" first proposed by the late Prime Minister Zhou Enlai prior to the Cultural Revolution and reiterated in his 1975 report to the Fourth National People's Congress (*i.e.*, the modernization of agriculture, industry, science and technology, and national defense). The new leadership declared that the primary national objective of China was to raise the living standards of its people through economic development.⁹

In order to achieve this objective, the new Chinese leadership realized that China had to have greater access to Western science and technology, and as early as the spring of 1978 had announced the extremely ambitious program for foreign economic cooperation that led to that year's surge in technology import contracts.¹⁰ This sudden expansion of cooperation with the developed Western economies had been part of the Ten-Year Plan (1976-85) approved in February 1978 by the Fifth National People's Congress. That plan had set unusually high economic goals for the nation and called for correspondingly high investments in order to achieve those goals. At the end of 1978, however, the Third Plenum recognized that China needed a develop-

8. HO & HUENEMANN, *supra* note 3, at 17.

9. See, e.g., *The Work Report of Premier Hua Guofeng to the Third Session of the Fifth National People's Congress, Sept. 7, 1980*, (trans. in MAIN DOCUMENTS OF THE THIRD SESSION OF THE FIFTH NATIONAL PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA 159, Foreign Languages Press ed. 1980) [hereinafter MAIN DOCUMENTS].

10. See BROWN, *supra* note 5, at 75-78.

ment strategy of more balanced growth, that the Promethean goals and investment programs of the Ten-Year Plan were unrealistic and that China had to undergo a period of "readjustment, restructuring, consolidation and improvement."¹¹ Not coincidentally, it was only then that the PRC decided to utilize FDI and thereby help accelerate the process of technology transfer as well as provide an additional foreign exchange supplement — beyond loans from international agencies, foreign governments and foreign commercial banks — to domestic sources of capital.

This decision to resort to FDI, like the earlier decision to welcome foreign economic cooperation generally, required many changes in China's domestic and foreign policies. These changes went hand-in-hand with strengthening the political system, restructuring the economic system and establishing a legal system capable of supporting these important changes. At the same time, China completed a major effort to forge diplomatic ties with foreign governments, culminating in the switch of diplomatic recognition by the United States from Taipei to Beijing as of January 1, 1979; that effort cleared the way for the gradual creation of a bilateral and multilateral infrastructure of international agreements designed to facilitate China's economic cooperation with the industrialized countries.

During 1978, Western companies' and their governments' enthusiasm for China's new "Open Policy" and ambitious Ten-Year Plan grew. China's new policy had already resulted in a number of technology import contracts. Talk of a billion-person market for Western consumer goods was not uncommon. Yet the euphoria expressed by some soon abated. By the spring of 1979, the "readjustment" and balanced growth strategy proclaimed by the Third Plenum caused PRC enterprises to cancel, postpone or renegotiate the bulk of the technology import contracts they had just signed.¹² Failure to implement those contracts created a crisis of confidence in the foreign business community concerning China's reliability in honoring its commercial commitments.

The PRC's eventual decision to honor those contracts if insisted

11. For a summary of the implementation of the economic "readjustment, restructuring, consolidation and improvement," see *The Work Report of Vice-Premier and Minister in Charge of the State Economic Planning Commission, Yao Yilin* (Aug. 30, 1980) (trans. in MAIN DOCUMENTS, *supra* note 9, at 5).

12. One of the most celebrated examples of this readjustment was the Baoshan steel plant project in Shanghai, whose demise and resurrection has been the subject of a large number of articles. See, e.g., *When the Chinese Suspend Your Contract*, CHINA BUS. REV., Sept.-Oct. 1979, at 58; Weil, *Collapse of Construction Projects*, CHINA BUS. REV., Jan.-Feb. 1981, at 9. See also Sneider, *The Baoshan Debacle: A Study of Sino-Japanese Contract Dispute Settlement*, 18 N.Y.U. J. OF INT'L L. 541 (1986).

upon by its contracting partners helped to improve the situation. This decision is illustrated by China's payment of over US\$40 million to Mitsubishi Heavy Industries as compensation for damage suffered in the Baoshan steel plant contracts. After China promulgated the Joint Venture Law in mid-1979 and gave an unprecedented welcome to FDI generally, many, but not all, TNCs gradually revived their interest in cooperating with China. This time, however, a more sober, realistic attitude prevailed on both sides of the bargaining table as Chinese Communist and foreign capitalist representatives undertook the arduous task of negotiating mutually beneficial forms for FDI in China.

China's reasons for seeking FDI and those of the foreign investors are, of course, not identical. The Chinese turn to FDI basically to supplement domestic sources of capital for economic modernization and, perhaps more importantly, to obtain greater access to advanced science, technology, management skills and international distribution channels. Although PRC enterprises hope to earn a profit from joint venturing with foreigners, at least to Chinese policymakers, the profitability of the venture usually does not appear to be as important a consideration as the factors previously mentioned. Most PRC negotiators, as well as the officials who approve these projects, have rather modest ideas about what constitutes a reasonable profit.

TNCs, on the other hand, wish to explore investing in China in order to maximize their profits — from dividends based on their equity, from fees received for licensing the venture and providing it with technical assistance, training and other services, and from income derived from selling to the venture or distributing the venture's products. They look for rewards commensurate with the substantial risks of pioneering investment in a developing, socialist country. They hope to earn such rewards by: (a) gaining a substantial share of the Chinese market (which may not be available for direct export sales because of lack of foreign exchange or import restrictions imposed for other reasons); (b) obtaining scarce raw materials; and (c) establishing a low-cost offshore base for manufacture and export.

B. Creation of a Legal Environment for FDI

1. Institution Building

Since enactment of the Joint Venture Law, which itself only provided a skeletal framework for establishing equity joint ventures, the PRC has made substantial progress in creating a legal environment attractive to foreign investors. At the same time as it enacted the Joint Venture Law, the National People's Congress (NPC) also adopted other laws regulating in detail the legislative, administrative and judi-

cial organs that had been revived in principle in 1978 by the PRC's post-Cultural Revolution Constitution.¹³ The reorganized people's courts include economic tribunals that are assigned the task of not only handling domestic business matters but also enforcing contracts and settling disputes arising out of economic relations between Chinese and foreign entities. Under subsequent legislation,¹⁴ Chinese lawyers began to reappear, forming collective "law offices" that have gradually come to play a role in advising foreign as well as Chinese companies in their efforts to develop new forms of international cooperation. The arbitration organization of the China Council for the Promotion of International Trade was also strengthened to assure its competence to deal with disputes relating to the new forms of foreign cooperation.¹⁵ The Civil Procedure Law promulgated in 1982¹⁶ made clear that China's courts, while encouraging arbitration outside of court, are themselves receptive to resolving disputes involving foreigners.

2. Constitutional Protection

In addition to creating relevant legal institutions, China has also been very active in enacting substantive rules for facilitating FDI. The current Constitution of the PRC, adopted in late 1982, for the first time in PRC history grants recognition and protection to FDI and related cooperation. Article 18 provides:

13. See Electoral Law for the National People's Congress and Local People's Congresses at all Levels (Zhonghua Renmin Gongheguo Renmin Daibiao Dahui He Difang Geji Renmin Daibiao Dahui Xuanju Fa); Organic Law for People's Courts (Zhonghua Renmin Gongheguo Renmin Fayuan Zuzhi Fa); Organic Law for the People's Procuracy (Zhonghua Renmin Gongheguo Renmin Jianchayuan Zuzhi Fa); Organic Law for Local People's Congresses at all Levels and Local People's Governments at all Levels (Zhonghua Renmin Gongheguo Difang Geji Renmin Daibiao Dahui He Difang Geji Renmin Zhengfu Zuzhi Fa); all were adopted at the Second Session of the Fifth National People's Congress on July 1, 1979 (trans. in LAW ANNUAL REPORT OF CHINA (Fang Chun-ie ed. 1982)) (for Chinese language texts, see ZHONGHUA RENMIN GONGHEGUO FALÜ HUIBIAN 1979-1984) [hereinafter FALÜ HUIBIAN 1979-1984].

14. Provisional Regulations of the People's Republic of China on Lawyers (promulgated Aug. 26, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 19-450).

15. See Notice of the State Council on Conversion of the Foreign Trade Arbitration Commission into the Foreign Economic and Trade Arbitration Commission (Guowuyuan Guanyu Jiang Duiwai Maoyi Zhongcai Weiyuanhui Gaicheng Wei Duiwai Jingji Maoyi Zhongcai Weiyuanhui De Tongzhi) (issued Feb. 26, 1980) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished). On arbitration see generally, Cohen, *The Role of Arbitration in Economic Co-operation with China*, in FOREIGN TRADE, INVESTMENT AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 508 (M. Moser 2nd ed. 1987).

16. Law of Civil Procedure for Trial Implementation (Zhonghua Renmin Gongheguo Minshi Susong Fa (Shixing)) (adopted Mar. 28, 1982, effective Oct. 1, 1982) arts. 192-95 (trans. in China L. For. Bus., *supra* note 4, ¶ 19-200 (192-95)).

The People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic co-operation with Chinese enterprises and other economic organizations in accordance with the law of the People's Republic of China.

All foreign enterprises and other foreign economic organizations in China, as well as joint ventures with Chinese and foreign investment located in China, shall abide by the law of the People's Republic of China. Their lawful rights and interests are protected by the law of the People's Republic of China.¹⁷

This provision was inserted in order to alleviate the worries of foreign investors who believed that, without such explicit constitutional protection, the Joint Venture Law and the ventures established under it might one day be declared unconstitutional because they provide for foreign ownership of the means of production, which under the 1978 Constitution were to be owned "basically" by the state and by collectives.¹⁸

3. Taxation Framework

The State Council, China's highest executive agency, promulgated a series of regulations concerning the establishment and operation of JVs that culminated in the relatively comprehensive 1983 Joint Venture Implementing Regulations.¹⁹ A Joint Venture Income Tax Law (JVITL),²⁰ an Individual Income Tax Law²¹ and a Foreign

17. Constitution of the People's Republic of China (Zhonghua Renmin Gongheguo Xianfa) art. 18 (adopted Dec. 4, 1982) (trans. in China L. For. Bus., *supra* note 4, ¶ 4-500).

18. Constitution of the People's Republic of China (Zhonghua Renmin Gongheguo Xianfa) art.5 (adopted Mar. 5, 1978) (trans. in THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA (Foreign Languages Press ed. 1978)).

19. Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli) (promulgated Sept. 20, 1983) (trans. in China L. For. Bus., *supra* note 4, ¶ 6-550) [hereinafter JV Implementing Regulations].

20. The Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment (Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suodeshui Fa) (adopted Sept. 10, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 33-500) [hereinafter JVITL]; Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment (Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suodeshui Shixing Xize) (approved Dec. 10, 1980, promulgated Dec. 14, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 33-510).

21. Individual Income Tax Law of the People's Republic of China (Zhonghua Renmin Gongheguo Geren Suodeshui Fa) (adopted and promulgated Sept. 10, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 30-500); Detailed Rules and Regulations for the Implementation

Enterprise Income Tax Law²² and associated regulations were also promulgated from 1980 to 1982, establishing at least in principle a generally fair and rational tax regime. This legislation offers JVs certain incentives evidently designed to encourage the establishment of JVs over the other forms of cooperation. For example, although the combined national and local tax of 33% normally imposed on a JV's net income and the flat 10% tax levied on the foreign investor's repatriated profits from the JV are not especially attractive to TNCs, the JVITL allows a new JV that is scheduled to exist for a period of ten years or more to apply for a full exemption from income tax in its first profit-making year and a 50% reduction in the following two years. These periods have subsequently been expanded to two years of exemption and three following years at 50% reduction. The JVITL also allows a foreign joint venturer that reinvests its profits in a Chinese JV for at least five consecutive years to obtain a refund of 40% of the income tax paid on the reinvested funds. As we shall see, even further tax incentives have recently been granted to all foreign-invested enterprises, not merely to JVs, if they meet specified criteria.²³

4. Other National Legislation

Many other national laws have also been enacted. The PRC's handling of the foreign exchange issue appeared less arbitrary after a series of foreign exchange regulations was issued.²⁴ The domestic Eco-

of the Individual Income Tax Law of the People's Republic of China (Zhonghua Renmin Gongheguo Geren Suodeshui Fa Shixing Xize) (adopted Dec. 10, 1980, promulgated Dec. 14, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 30-520).

22. The Foreign Enterprise Income Tax Law of the People's Republic of China (Zhonghua Renmin Gongheguo Waiguo Qiye Suodeshui Fa) (adopted Dec. 13, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 32-50); Detailed Rules and Regulations for the Implementation of the Foreign Enterprise Income Tax Law of the People's Republic of China (Zhonghua Renmin Gongheguo Waiguo Qiye Suodeshui Fa Shixing Xize) (approved Feb. 17, 1982, promulgated Feb. 21, 1982) (trans. in China L. For. Bus., *supra* note 4, ¶ 32-510).

23. See *infra* notes 54-66 and accompanying text. For an excellent introduction to PRC taxation, see Gelatt & Pomp, *China's Tax System: An Overview and Transactional Analysis*, in FOREIGN TRADE, INVESTMENT AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 15, at 36.

24. Provisional Regulations for Foreign Exchange Control of the People's Republic of China (Zhonghua Renmin Gongheguo Waihui Guanli Zanzing Tiaoli) (promulgated Dec. 18, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-550); Rules for Implementation of Foreign Exchange Control Relating to Foreign Institutions in China and Their Personnel (Dui Waiguo Zhu Hua Jigou Jiqi Renyuan De Waihui Guanli Shixing Xize) (promulgated Aug. 10, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-590); Rules Governing the Carrying of Foreign Exchange, Precious Metals and Payment Instruments in Convertible Currency into or out of China (Dui Waihui Guijinshu He Waihui Piao Zheng Deng Jinchu Guojing De Guanli Shixing Xize) (promulgated Aug. 10, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-610); Rules for the Implementation of the Control of Foreign Exchange Relating to Individu-

nomic Contract Law promulgated in 1981,²⁵ and the associated dispute resolution system that was formalized soon thereafter²⁶ provided guidance for contracts between PRC legal entities, including foreign-invested PRC legal persons (JVs, WOVs and certain CVs) and other PRC legal persons such as state enterprises and collectives. The appearance in 1985 of the long-awaited Foreign Economic Contract Law²⁷ offered similar guidance for virtually all kinds of contracts between foreign companies and Chinese legal persons, including foreign-invested ventures. Shortly thereafter, the State Council promulgated important regulations that govern licensing and other contracts between foreign companies and PRC entities, including foreign-invested PRC ventures, for the importation into China of various types of technology.²⁸ At the same time, the PRC, responding to the wishes of both foreign and Chinese companies, instituted a comprehensive patent protection system,²⁹ as it had earlier established a similar system for protecting trademarks.³⁰ The government had also already provided special income tax incentives to encourage foreign transfer of advanced technology on preferential terms to PRC companies in strategic industries.³¹ In 1986 the NPC adopted a law author-

als (Dui Geren De Waihui Guanli Shixing Xize) (promulgated Dec. 31, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-630); Rules for the Implementation of the Examination and Approval of Applications by Individuals for Foreign Exchange (Shenpi Geren Waihui Shengqing Shixing Xize) (promulgated Dec. 31, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-650).

25. Economic Contract Law of the People's Republic of China (Zhonghua Renmin Gongheguo Jingji Hetong Fa) (adopted Dec. 13, 1981) (trans. in China L. For. Bus., *supra* note 4, ¶ 5-500).

26. Regulations of the People's Republic of China for Arbitration over Economic Contracts (Zhonghua Renmin Gongheguo Jingji Hetong Zhongcai Tiaoli) (promulgated Aug. 22, 1983) (trans. in China L. For. Bus., *supra* note 4, ¶ 10-620).

27. Foreign Economic Contract Law of the People's Republic of China (Zhonghua Renmin Gongheguo Shewai Jingji Hetong Fa) (adopted Mar. 21, 1985) (trans. in China L. For. Bus., *supra* note 4, ¶ 5-550).

28. Regulations on Administration of Technology Import Contracts of the People's Republic of China (Zhonghua Renmin Gongheguo Jishu Yinjin Hetong Guanli Tiaoli) (promulgated May 24, 1985) (trans. in China L. For. Bus., *supra* note 4, ¶ 5-570); Procedures for Examination and Approval of Technology Import Contracts (Jishu Yinjin Hetong Shenpi Banfa) (approved Aug. 26, 1985, promulgated Oct. 1, 1985) (trans. in China L. For. Bus., *supra* note 4, ¶ 5-573).

29. Patent Law of the People's Republic of China (Zhonghua Renmin Gongheguo Zhuanli Fa) (adopted Mar. 12, 1984) (trans. in China L. For. Bus., *supra* note 4, ¶ 11-600).

30. Trademark Law of the People's Republic of China (Zhonghua Renmin Gongheguo Shangbiao Fa) (adopted Aug. 23, 1982) (trans. in China L. For. Bus., *supra* note 4, ¶ 11-500).

31. Provisional Regulations of the Ministry of Finance of the People's Republic of China Regarding the Reduction and Exemption of Income Tax on Fees for the Use of Proprietary Technology (Zhonghua Renmin Gongheguo Caizhengbu Guanyu Dui Zhuanyou Jishu Shiyongfei Jianzheng, Mianzheng Suodeshui De Zanzheng Guiding) (promulgated Dec. 13, 1982) (trans. in China L. For. Bus., *supra* note 4, ¶ 39-600).

izing the nationwide establishment of WOVs.³² In addition, during the same year the State Council continued its relevant law-making activity, promulgating, among others, regulations on product liability,³³ on liability for nuclear accidents³⁴ and on allowing a range of further incentives to foreign investors.³⁵

5. General Principles of Civil Law

In the spring of 1986, the NPC enacted one of the most important pieces of legislation in China's law-building process. The General Principles of Civil Law (the Principles)³⁶ provide a large number of basic rules of potentially great significance to foreign investors as well as PRC citizens, for they affect a multitude of diverse elements of the business environment.

The Principles are not a comprehensive civil code in the classical continental legal tradition that was inherited by the socialist states of Eastern Europe. The PRC had originally intended to promulgate a civil code on the conventional socialist model, and as long ago as the mid-1950s the Standing Committee of the NPC had already prepared a draft; however, the draft code, like the rest of the then emerging Soviet-style legal system, was swept aside by the "anti-rightist" movement of 1957-58.³⁷ Work on a new version resumed in 1979, but, three years and four drafts later, China's legislators decided to postpone publication of a complete civil code until major economic reforms had taken root, in the belief that the reforms would inevitably have a profound impact on many aspects of civil law. Instead they decided temporarily to make do with separate laws on different civil law topics

32. The Law of the People's Republic of China Concerning Wholly Foreign-Owned Ventures (Zhonghua Renmin Gongheguo Waizi Qiye Fa) (adopted Apr. 11, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 13-506).

33. Regulations Concerning Liability for the Quality of Industrial Products (Gongye Chanpin Zhiliang Zeren Tiaoli) (issued Apr. 5, 1986) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished).

34. Regulations of the People's Republic of China for the Safe Supervision and Control of Civilian Nuclear Facilities (Zhonghua Renmin Gongheguo Minyong Hesheshi Anquan Jiandu Guanli Tiaoli) (issued Oct. 29, 1986) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished). For Chinese text, see 851 GUOWUYUAN GONGBAO (State Council Gazette) (1986).

35. State Council Regulations Concerning Encouragement of Foreign Investment (Guowuyuan Guanyu Guli Waishang Touzi De Guiding) (promulgated Oct. 11, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 13-509) [hereinafter 22 Articles].

36. General Principles of Civil Law of the People's Republic of China (Zhonghua Renmin Gongheguo Minfa Tongze) (adopted Apr. 2, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 19-150) [hereinafter Principles].

37. For a discussion of the background to and immediate motivation for enacting the Principles, see Epstein, *The Evolution of China's General Principles of Civil Law*, 34 AM. J. COMP. L. 705 (1986).

such as inheritance³⁸ and marriage,³⁹ as well as the above-mentioned contract legislation, while at the same time extracting fundamental principles common to the various laws for enactment as the Principles.

Although some portions of the Principles restate provisions found in China's Constitution as well as domestic and foreign legislation, other portions contain significant innovations. In addition, the restatement in the Principles of a provision already appearing in more specific domestic legislation is still worth noting since the Principles are applicable to both foreign-related and domestic matters.

The Principles clarify the concept of "legal persons"⁴⁰ and therefore provide some assistance to foreign businessmen in identifying which PRC organizations are authorized to sign contracts and whether or not these PRC organizations are acting within the scope of their authority.⁴¹ While the distinct legal status of JVs and WOVs as PRC legal persons is reaffirmed in the Principles, CVs remain in somewhat of a legal limbo. The Principles state that, to be considered legal persons in China, CVs must meet the conditions of a legal person as set forth in the Principles themselves,⁴² but do not make clear in what circumstances a CV will satisfy the condition that it "must be capable of assuming civil liability independently."⁴³ This issue should be resolved with the long-awaited adoption of a separate law regulating CVs, which is scheduled to be presented to the National People's Congress in 1988 for examination and adoption.

An entire section of the Principles regulates the creation and termination of the principal-agent relationship and the rights, duties and liabilities that derive from it.⁴⁴ Another section, on intellectual property, marks an advance in PRC law by recognizing "authorship rights (copyright)."⁴⁵ The Principles also contain a number of provisions that advance understanding of tort liability in China.⁴⁶ For instance, these provisions grant remedies for infringement of personal or property rights (in a similar way to trespass), protect an individual's rights

38. Inheritance Law of the People's Republic of China (adopted Apr. 10, 1985) (trans. in BBC Summary of World Broadcasts, FE/7931/C/1 (B) (Apr. 22, 1985)). For the Chinese text, see 339 GUOWUYUAN GONGBAO (State Council Gazette) (1985).

39. Marriage Law of the People's Republic of China (Zhonghua Renmin Gongheguo Hunyin Fa) (promulgated Jan. 1, 1981) (trans. in MAIN DOCUMENTS, *supra* note 9, at 209).

40. Principles, *supra* note 36, art. 41.

41. For a discussion of these issues, see Cohen, *China Adopts Civil Law Principles*, CHINA BUS. REV., Sept.-Oct. 1986, at 48.

42. Principles, *supra* note 36, art. 41.

43. *Id.* art. 37.

44. *Id.* arts. 63-70.

45. *Id.* art. 94.

46. *Id.* arts. 117-13.

to his name, reputation and likeness, reaffirm a kind of "product liability" concept, impose liability for damage or loss caused by negligence, and impose virtually strict liability upon those who engage in especially hazardous activities.

Other provisions introduce ethical concepts that relate to unjust enrichment,⁴⁷ fraudulent conduct⁴⁸ and equitable reimbursement for unsolicited services.⁴⁹ Not uncharacteristically, the Principles go further and require all civil acts to be carried out in accordance with the principles of "voluntariness, fairness, compensation of equal value, honesty and good faith."⁵⁰ Civil acts must also "be in accordance with social morality" and "not harm the social public interest, undermine the state economic plan or disrupt the social economic order."⁵¹ People's courts and arbitral bodies are given the power to change or rescind civil acts that are "manifestly unfair."⁵² While these provisions give the courts in China a broad discretionary jurisdiction that could be applied to ensure equitable and just solutions to questions not covered by specific legislation, their very vagueness constitutes a two-edged sword that could introduce an unwelcome element of uncertainty or instability into transactions. That Chinese ethical values in commercial transactions may differ from those of foreigners is hinted at by a curious statement in the Principles that an assignor of contract rights and obligations must not seek profit from the assignment.⁵³

6. The 22 Articles

The Provisions for the Encouragement of Foreign Investment, popularly known as "the 22 Articles,"⁵⁴ was promulgated in the fall of 1986 and signals a more sophisticated PRC approach to stimulating FDI. Although a number of articles simply repeat or elaborate on provisions that had previously been announced by the State Council or other bodies,⁵⁵ the approach adopted by the 22 Articles departs to

47. *Id.* art. 92.

48. *Id.* art. 61.

49. *Id.* art. 93.

50. *Id.* art. 4.

51. *Id.* art. 7.

52. *Id.* art. 59(ii).

53. *Id.* art. 91. This caveat is absent from the comparable provisions of the Foreign Economic Contract Law, *supra* note 27, arts. 26-27.

54. 22 Articles, *supra* note 35. For an introduction to this legislation, see Cohen & Chang, *New Foreign Investment Provisions*, CHINA BUS. REV., Jan.-Feb. 1987, at 11.

55. *Cf.* Provisions of the State Council on the Question of Balancing Foreign Exchange Receipts and Expenditures of Chinese Foreign Joint Ventures (Guowuyuan Guanyu Zhongwai Hezi Jingying Qiye Waihui Shouzhi Pingheng Wenti De Guiding) (promulgated Jan. 16, 1986) (trans. in Chang, *Foreign Exchange Balancing Provisions for Joint Ventures*, E. ASIAN EXEC.

a considerable extent from the earlier national policy of differentiating the incentives granted to FDI on the basis of the form of investment adopted, *i.e.*, greater benefits for JVs than for CVs and WOVs. Instead, the 22 Articles recognizes two basic categories of foreign investments regardless of whether they are JVs, CVs or WOVs: those productive ventures entitled to maximum, albeit somewhat different, incentives because they qualify as either "export enterprises" or "technologically advanced enterprises;" and other foreign-invested enterprises, which are allowed to enjoy only some of the benefits the new legislation makes available to enterprises in the first category. Moreover, non-productive ventures, such as hotels and other service enterprises, do not in practice receive all the benefits enjoyed by other enterprises in the second category.

The 22 Articles has spawned a body of detailed "implementing rules" at both the national and local level to flesh out the fairly general concepts it contains. Chinese officials responsible for foreign economic relations had indicated that sixteen or more sets of national implementing rules would be promulgated before the end of March 1987; however, there was a hiatus of eight months following the seven sets of national implementing rules that came out in rapid succession between November 10, 1986 and January 31, 1987.⁵⁶ It is difficult to

REP., Feb. 1986, at 7) [hereinafter Foreign Exchange Balancing Provisions]; Notice of the State Council on Resolutely Curbing Indiscriminate Levy of Charges on Enterprises (Gouwuyuan Guanyu Jianjue Zhizhi Xiang Qiye Luan Tanpai De Tongzhi) (issued Apr. 23, 1986) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished); Joint Venture Regulations, *supra* note 19, arts. 7, 10, 62, 63, 65(3) and 71.

56. Regulations on the Right of Autonomy of Foreign Investment Enterprises in Hiring of Personnel and on Employees' Wages, Insurance and Welfare Expenses (Guanyu Waishang Touzi Qiye Yongren Zizhuquan He Zhigong Gongzi, Baoxian, Fuli Feiyong De Guiding) (issued Nov. 10, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 12-590(1)); Measures of the Customs of the People's Republic of China for the Control of the Import of Materials and Parts Required by Foreign Investment Enterprises for the Fulfillment of Export Contracts (Zhonghua Renmin Gongheguo Haiguan Dui Waishang Touzi Qiye Luxing Chanpin Chukou Hetong Suoxu Jinkou Tiaojian Guanli Banfa) (promulgated Nov. 24, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 50-637(4)); Provisional Measures of the People's Bank of China on Foreign Exchange Secured Renminbi Loans for Foreign Investment Enterprises (Zhonghua Renmin Yinhang Guanyu Waishang Touzi Qiye Waihui Diya Renminbi Daikuan Zanzing Banfa) (promulgated Nov. 26, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-694(7)); Measures of the Ministry of Foreign Economic Relations and Trade for Foreign Investment Enterprises Purchasing Domestic Products for Export to Achieve a Balance of Foreign Exchange Income and Expenditure (Duiwai Jingji Maoyibu Guanyu Waishang Touzi Qiye Goumai Guonei Chanpin Chukou Jiejue Waihui Shouzhizhi Pingheng de Banfa) (issued Jan. 20, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 13-526(5)); Implementing Measures of the Ministry of Foreign Economic Relations and Trade Concerning Application for Import and Export Licenses by Foreign Investment Enterprises (Duiwai Jingji Maoyibu Guanyu Waishang Touzi Qiye Shenqing Jinchukou Xukezheng De Shishi Banfa) (promulgated Jan. 24, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 51-617(4)); Implementing Measures of the Ministry of Foreign Economic Relations and Trade on the Confirmation and Examination of

tell whether this delay was due to uncertainty engendered by the ill-defined struggle against "bourgeois liberalization" that was such a major political theme in 1987 or because of difficulties encountered in matching detailed incentives with the PRC's current economic circumstances and goals.⁵⁷ Nevertheless, various local regulations for the encouragement of foreign investment, and related regulations at the national level clarifying foreign exchange guaranties,⁵⁸ debt-equity ratios for foreign investments⁵⁹ and registration of foreign exchange loans⁶⁰ were also issued. Two sets of implementing rules on import substitution⁶¹ were issued in October 1987, and there were signs early in 1988 that the legislative pace was again quickening. Regulations on the contribution of capital for JVs and CVs were issued in January 1988.⁶²

Export-oriented Enterprises and Technologically Advanced Enterprises with Foreign Investment (Duiwai Jingji Maoyibu Guanyu Queren He Kaohe Waishang Touzi De Chanpin Chukou Shishi Banfa) (promulgated Jan. 27, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 13-530(3)); Measures of the Ministry of Finance for the Implementation of the Preferential Tax Treatment Provisions of the State Council Regulations Concerning Encouragement of Foreign Investment (Caizhengbu Guanche Gouwuyuan "Guanyu Guli Waishang Touzi De Guiding" Zhong Shuishou Youhui Tiaokuan De Shishi Banfa) (issued Jan. 31, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 32-650(2)).

57. *E.g.*, Senior officials in MOFERT have indicated to the authors that one of the reasons why detailed national rules on foreign exchange "adjustments" (i.e., swapping renminbi profits for foreign exchange) have not been adopted (as some Chinese officials had previously promised), is that China fears that to do so may affect its application to join GATT. The Chinese fear that such rules would be tantamount to admitting in black and white that China still uses discriminatory multiple renminbi exchange rates.

58. Provisional Measures for the Control of the Issue of Foreign Exchange Guarantees by Organizations within Chinese Territory (Jingnei Jigou Tigong Waihui Danbao De Zanzing Guanli Banfa) (promulgated Feb. 20, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 8-698(5)).

59. Provisional Regulations of the State Administration for Industry and Commerce on the Ratio between the Registered Capital and Total Investment of Sino-Foreign Joint Equity Enterprises (Guojia Gongshang Xingzheng Guanyu Zhongwai Hezi Jingying Qiye Zhuze Ziben Yu Touzi Zonghe Bili Zanzing Guiding) (promulgated Mar. 1, 1987) (trans. in China L. For. Bus., *supra* note 4, ¶ 6-554(3)).

60. Interim Provisions for the Monitoring of Statistics on Foreign Debt (Waizhai Tongji Jiance Zanzing Guiding) (promulgated on Aug. 27, 1987) (trans. in China Daily, Aug. 31, 1987, at 4).

61. Measures Concerning Import Substitution for the Products of Chinese-Foreign Equity and Cooperative Joint Ventures (Guanyu Zhongwai Hezi Hezuo Jingying Qiye Chanpin Yichandingjin Banfa) (promulgated Oct. 19, 1987) (trans. in E. ASIAN EXEC. REP., Dec. 1987, at 11). *See also* Measures for the Administration of Import Substitution for the Mechanical and Electrical Products of Chinese-Foreign Equity and Cooperative Joint Ventures (Zhongwai Hezi Hezuo Jingying Qiye Jidian Chanpin Yichandingjin Guanli Banfa) (promulgated in Oct. 1987) (trans. in E. ASIAN EXEC. REP., Dec. 1987, at 13). For an early commentary on these measures, see Horsley, *China Announces National Import Substitution Rules*, E. ASIAN EXEC. REP., Dec. 1987, at 8.

62. Certain Provisions for Equity Contribution by the Parties to Chinese-Foreign Joint Ventures (Zhongwai Hezi Jingying Qiye Heying Gefang Chuzi De Ruogan Guiding) (Issued Jan. 1, 1988) (trans. by Paul, Weiss, Rifkind, Warton & Garrison, unpublished).

While the legislative intent underlying the 22 Articles is clear, it is not yet certain that implementation of the 22 Articles — especially those provisions relating to foreign exchange balancing — will live up to its promise. Where implementation is in the hands of “old-guard” local officials, the prospects must be considered dubious.

The non-appearance of detailed national rules on foreign currency “adjustments”⁶³ has resulted in continuing uncertainty for foreign investors who have often been promised new, regularized means for transforming renminbi profits into a form that could be used for realizing and repatriating foreign exchange income. Some of the foreign-exchange balancing provisions in the 22 Articles repeat provisions in the January 1986 provisions,⁶⁴ which many PRC officials admitted were unworkable in the absence of specific implementing rules. The regulations on purchasing locally produced goods with renminbi for export by foreign-invested enterprises to earn foreign exchange⁶⁵ are a move in the right direction, but fail to address the basic question of how to induce PRC enterprises to sell their products for renminbi to foreign-invested enterprises for export when they could themselves earn foreign exchange by exporting their own products directly or through PRC foreign trade organizations.

Provisions in the 22 Articles on autonomy in labor matters and the outlawing of indiscriminate levies on foreign-invested enterprises are desirable to restrain local authorities and “departments in charge” that have tended to view foreign-invested enterprises (along with other PRC enterprises under their charge) as “fair game” for bureaucratic interference and excessive revenue collecting. It may well be that the positive atmosphere towards foreign-invested enterprises engendered by extensive nationwide publicity, together with the influence of the various national and local “foreign investment coordinating groups,”⁶⁶ will prove to be the most enduring and positive element to come out of the 22 Articles.

The host of local supplementary regulations to which the 22 Articles has given rise confer additional benefits on certain foreign-invested enterprises, for example by granting an exemption from or a reduction of local income or turnover taxes or land use fees for certain periods. Several dozens of such local regulations have appeared, as

63. Provisional Measures for the Control of the Issue of Foreign Exchange Guarantees by Organizations within China, *supra* note 58.

64. Foreign Exchange Balancing Provisions, *supra* note 55.

65. *Id.*

66. See, e.g., Jingji Ribao (Economic Daily), Oct. 9, 1986, at 1; Asian Wall Street Journal, Oct. 13, 1986, at 1.

many provinces, cities and areas have sought to attract foreign investment by this means.

7. Special Economic Zone Legislation

Local legislation had played an important role in stimulating FDI long before the publication of the 22 Articles. Following the establishment in 1980 of four Special Economic Zones (SEZs) in Shenzhen, Zhuhai and Shantou in Guangdong Province adjacent to Hong Kong and in Xiamen (Amoy) in neighboring Fujian Province, a body of SEZ-related legislation began to take shape, most of it emanating from the provincial governments.⁶⁷ The Shenzhen SEZ especially became a center for legislative experiments. For example, the regulations in Shenzhen governing contracts between foreign and Chinese companies⁶⁸ and those relating to foreign technology import contracts⁶⁹ were precursors of similar regulations adopted by other localities and of the national counterpart legislation.

Unlike the early PRC national tax and other incentives granted to foreign-invested ventures (which essentially singled out JVs for preferential treatment), however, incentives granted in Shenzhen and the other SEZs are generally the same regardless of the form taken by the foreign-invested venture. Thus, whether a JV, a CV or a WOV, a venture is usually subject to a 15% income tax and no tax is imposed on repatriated profits.⁷⁰ Moreover, under the recent 22 Articles, for each year that an SEZ-based "export enterprise" exports 70% or more of its production and for each of the three years that a "technologically advanced enterprise" is entitled to a special reduction in tax, such enterprises are subject to an income tax rate of only 10%.⁷¹ A similar regime of special incentives has also been created by "the fourteen coastal cities" and the economic and technological development zones (ETDZ) that each such city has established under the authority

67. See, e.g., Regulations of the People's Republic of China on Special Economic Zones in Guangdong Province (Zhonghua Renmin Gongheguo Guangdongsheng Jingji Tequ Tiaoli) (approved Aug. 26, 1980) (trans. in China L. For. Bus., *supra* note 4, ¶ 70-800(5)).

68. Regulations of Shenzhen Special Economic Zone on Economic Contracts Involving Foreigners (Shenzhen Jingji Tequ Shewai Jingji Hetong Guiding) (promulgated Feb. 7, 1984) (trans. in China L. For. Bus., *supra* note 4, ¶ 73-505(3)).

69. Provisional Regulations of Shenzhen Special Economic Zone Governing the Import of Technology (Shenzhen Jingji Tequ Jishu Yinjin Zanxing Guiding) (promulgated Feb. 8, 1984) (trans. in China L. For. Bus., *supra* note 4, ¶ 73-510(6)).

70. Provisional Regulations on Reduction and Exemption of Enterprise Income Tax and Consolidated Industrial Income Tax for the 14 Coastal Cities and the Special Economic Zones (Guanyu Jingji Tequ He Yanhai Shisige Chengshi Jianzheng Mianzheng Qiye Suodeshui He Gongshang Tongyi Shui De Zanxing Guiding) (promulgated Nov. 15, 1984) (trans. in China L. For. Bus., *supra* note 4, ¶ 70-845(1)).

71. 22 Articles, *supra* note 35, arts. 8 and 9.

granted by central government legislation.⁷²

Much more investment-related legislation is on the way both at the national and local levels. Still to come at the national level are such important laws as those regulating CVs, domestic companies, foreign trade and investment institutions, copyright, mortgages, insurance, banking and negotiable instruments. In addition, we can expect implementing regulations interpreting the foreign economic contract law and the law on WOVs.

8. Treaties

Foreign investors from many countries also benefit from the treaties concluded by the PRC in recent years. Bilateral agreements on the avoidance of double taxation had been signed with nineteen countries by mid-1987,⁷³ providing such advantages as a reduction in the withholding tax otherwise payable on fees received by foreign licensors of technology and on interest received by foreign lenders. Similarly, the eighteen bilateral agreements for the mutual promotion and protection of investments concluded by the end of September 1987⁷⁴ protect foreign investors against certain political risks such as those relating to repatriation of funds and compensation for expropriation. The broader bilateral infrastructure including trade and consular agreements and agreements promoting cooperation in specific industries also plays a valuable role. Moreover, China has begun to adhere to the principal multilateral conventions affecting FDI, such as the Paris Convention for the Protection of Industrial Property Rights⁷⁵ and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.⁷⁶

72. *Supra* note 70.

73. China has signed such treaties with the U.S., Japan, the United Kingdom, France, West Germany, Belgium, Singapore, Malaysia, Canada, Finland, Denmark, Norway, Sweden, New Zealand, Italy, Thailand, East Germany, the Netherlands and Yugoslavia (not all of these treaties have been ratified, however). Other treaties have been initialled or are under negotiation. *See, e.g., Six More Agreements on Avoidance of Double Taxation*, CHINA ECON. NEWS, Feb. 9, 1987, at 13.

74. China's first bilateral investment protection treaty was signed with Sweden on March 29, 1982, and has been followed by treaties with Romania, the Federal Republic of Germany, France, Belgium-Luxemburg Economic Union, Finland, Singapore, the Netherlands, Canada, Thailand, Denmark, Norway, Italy, Austria, Switzerland, the United Kingdom, Kuwait and Sri Lanka. *See* Guoji Shangbao (International Business), Feb. 10, 1987, at 1.

75. Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, as revised, 21 U.S.T. 1583, 24 U.S.T. 2140, T.I.A.S. 6923, 7727.

76. Convention on the Recognition and Enforcement of Foreign Arbitral Awards [New York Convention], June 10, 1958, 21 U.S.T. 2517, T.I.A.S. 6997, 330 U.N.T. 3.

C. *Achievements of FDI to Date*

Both PRC officials and foreign businessmen have expressed disappointment at the results of their initial efforts to introduce FDI into China. Nevertheless, despite all the difficulties thus far encountered, the record of these first eight years of the FDI process is in many respects quite impressive.⁷⁷

According to MOFERT, from 1979 until the end of 1987, the PRC had approved 10,008 contracts covering the major forms of FDI (Major FDI) — JVs, CVs, WOVs and cooperative development of oil resources. These contracts committed foreign companies to make investments in cash (usually foreign exchange), equipment, machinery and technology totalling \$21.96 billion. Of this pledged amount, some \$8.47 billion had actually been contributed.

In addition, a myriad of compensation trade and processing and assembly contracts that fall within the usual Chinese definition of FDI were also approved since 1979. As of January 1, 1987, roughly \$1.5 billion in FDI commitments had been made under such contracts, of which roughly \$1 billion had been transferred, according to MOFERT figures.

1. JVs

Perhaps the single most impressive achievement has been the recent rapid increase in the number of JVs. A JV is a limited liability company organized in China by PRC and foreign investors in accordance with the Joint Venture Law and implementing regulations. The contract and articles of association are agreed upon by the parties. It is jointly managed under the direction of a board of directors that is usually selected by the investors in rough proportion to their respective shares of the investment. Profits are distributed in proportion to such shares. By the end of 1987, 4,632 JV contracts had been

77. Before introducing this record, we are obliged to note that the compilation of PRC statistics is a notoriously uncertain business. PRC statistics on FDI are not released in a systematic way. They are found scattered in a variety of sources and the statistical bases and assumptions are often not reported. While the authors have relied largely on figures supplied to them by MOFERT and other statistics published by MOFERT, these are sometimes incomplete and inconsistent in themselves. Chinese and other sources are often inconsistent in the definition of the various forms of FDI and, because of the existence of many common elements, it is sometimes difficult to distinguish between certain forms, for example, between compensation trade and processing and assembly arrangements, or even between some JVs and CVs. While the PRC has made progress recently in some areas of statistical compilation and analysis, the decentralization of various approval and other functions relating to foreign trade and investment over the past few years has brought with it an element of unreliability in the compilation of statistics. We therefore emphasize that the statistical information in this article is intended only as an indicative guide and not as a definitive source of statistics on FDI in the PRC.

approved.⁷⁸ JV commitments up until January 1, 1987 totalled \$6.22 billion, of which \$2.92 billion had been contributed. Well over 90% of these contracts were concluded recently: 741 in 1984; 1,412 in 1985; 891 in 1986; and 1,399 in 1987.⁷⁹ This suggests that China's preference for JVs, expressed in various incentives and based on the JV's desirability with respect to transferring technology and management skills while assuring PRC control, is finally paying off. Although most JVs are relatively small, they can now be found in virtually every province and region and in most industries.

2. CVs

Until 1986 the CV or contractual joint venture was an even more popular investment vehicle than the JV, although, like compensation trade and processing and assembly arrangements, it is not included within the customary international definition of FDI. CV is the name given by the PRC to a collection of arrangements that are not designated as JVs but that nonetheless have as their common thread long-run investment cooperation in joint projects in China by Chinese and foreign parties in accordance with a contract between them that sets forth their responsibilities and rights. In some instances the CV is a legal entity with its own articles of association and board of directors, and occasionally even limited liability, so that the distinctions between CVs and JVs become blurred. More usually, no new entity is created, and the parties simply agree to perform tasks prescribed by the contract, with specified resources contributed by each, often under the management of a group composed of their representatives. In this case, the CV will not normally be a taxable entity and the parties will be taxed separately.

The most distinctive attribute of the CV is its flexibility, which is enhanced by the fact that, as of January 1988, over eight years after the enactment of the Joint Venture Law, the PRC had yet to enact comparable legislation regulating CVs. Thus, for example, there is no legal requirement that the output or profit of a CV be shared by the investors in proportion to their respective contributions to capital, as is the case with JVs. This frees the parties from having to agree on the precise value of their contributions and also enables them to arrange whatever distributions in cash or in kind seem to make sense. Such flexibility, suitable for both small and large projects, accounts for the

78. Base figures supplied to the authors by MOFERT in April 1987, supplemented by 1987 figures released by a spokesman for MOFERT and reported in "Foreign-Invested Top 10,000", *Ta Kung Pao*, Jan. 28, 1988, at 4.

79. *Id.*

popularity of the CV. By the end of 1987, 5,189 CVs had been approved. CV commitments up until January 1, 1987 totalled \$10.92 billion, with only \$1.6 billion actually contributed. Over 75% of these contracts were recently approved: 1,009 in 1984; 1,611 in 1985; 500 in 1986; and 786 in 1987.⁸⁰ Most CVs have been formed with Hong Kong firms and have been established in Guangdong Province.

3. WOVs

Although the JV and the CV have been by far the predominant investment forms to date, the PRC has been willing to experiment on a limited basis with WOVs, even though this form does not transfer to China as much technology or management skills as the JV or CV, nor allow China the same degree of control of the enterprise. The WOV is a company organized in China solely by a foreign company that contributes the entire equity required, receives the entire profit and independently manages the enterprise. By the end of 1987 China had approved 183 such ventures.⁸¹ WOV commitments up until January 1, 1987 totalled \$569 million, of which \$127 million had been contributed.⁸² Most WOVs have been organized in the SEZs while a small number have been established in other places including Shanghai, Beijing, Fujian and Hunan provinces and the Guangxi Zhuang Autonomous Region.⁸³ Almost all were approved prior to promulgation of the legislation authorizing WOVs, which did not appear until April 1986,⁸⁴ and which in any event provides only a modest amount of guidance regarding establishment of such ventures. Most WOVs established to date are small.

4. Cooperative Development of Natural Resources

Although relatively few in number, cooperative development contracts providing for the exploration and development of mineral resources, particularly offshore oil, have accounted for a substantial proportion of the FDI actually contributed to date. The offshore oil contracts, concluded pursuant to special 1982 legislation⁸⁵ promulgated to facilitate and regulate the contracting process, have usually

80. *Id.*

81. *Id.*

82. *Id.*

83. BEIJING REV., May 5, 1986, at 16.

84. The Law of the People's Republic of China Concerning Wholly Foreign-Owned Ventures, *supra* note 32.

85. Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises (Zhonghua Renmin Gongheguo Duiwai Hezuo Kaicai Haiyang Shiyu Ziyuan Tiaoli) (promulgated Jan. 30, 1982) (trans. in China L. For. Bus., *supra* note 4, ¶ 14-6604(4)).

authorized a two-stage operation. During the first stage the foreign companies undertake geophysical exploration at their own expense and risk; during the second or development stage the foreign companies and their Chinese partner share the investment and risk. If the project reaches the stage of commercial production, after taxes and production costs are deducted, the output is divided between the parties according to a prescribed formula. By the end of 1987, 44 cooperative oil development contracts had been approved. They authorized FDI of over \$2.063 billion. Of that sum, \$2.051 billion has already been spent, at least \$470 million of which was spent, unfortunately, on dry holes.⁸⁶ The second round of bidding conducted pursuant to the above-mentioned legislation was completed on March 11, 1987, and since then the China National Offshore Oil Corporation has announced its intention to relax the requirements that must be met by foreign oil companies undertaking exploration work in China's offshore waters.⁸⁷

5. Compensation Trade, Processing and Assembly

Compensation trade and processing and assembly have proved to be other valuable instruments of cooperation that the PRC regards as functionally similar to an investment. In the classic example of "direct compensation trade," the foreigner provides equipment, machinery and technology to the Chinese party, which combines what the foreigner has provided with its own land, building, labor and materials, to produce goods that are then exported over perhaps the next three to five years to repay the foreigner, with profit, for its contribution. Some contracts call for "indirect compensation trade," which means that the foreigner is paid in goods or commodities that are not produced with what the foreigner has provided.

Processing of materials and assembly of components are included under FDI to the extent that they, like compensation trade, result in foreign contribution of equipment, machinery and technology to the Chinese side. In the ordinary processing or assembly arrangement the foreigner pays the Chinese party a fee for transforming the materials or components that the foreign party has provided into a product that is then exported to the foreigner. If the foreigner has also provided any equipment, machinery or technology, it is repaid for these by deductions made from the service fee collected by the Chinese party.

86. China Daily, Mar. 12, 1987, at 1.

87. China National Offshore Oil Corp., Press Release, Mar. 11, 1987.

6. Trends

Closer analysis of the progress made since 1979 reveals some facts worthy of our attention. The most sobering for our purposes is that the amount of Major FDI contracted for in 1986 was only about half that contracted for during the previous year, and in the first six months of 1987 this amount declined by a further 23.4%.⁸⁸ However, newspaper reports at the end of 1987 indicated that the level of FDI for the whole year was comparable to 1986, suggesting an upsurge in the latter half of the year.⁸⁹ Admittedly, 1985 had been an unprecedentedly good year in which Major FDI contracts were approved for new investment totalling \$6.31 billion, which was almost 40% of the total approved 1979-85 FDI. Nevertheless, the decline in newly-approved Major FDI projects to a mere \$3.30 billion in 1986, despite a number of announced efforts to improve the investment environment, constituted a warning that all was not well. Specifically, compared to the previous year, the number of approved JVs dropped from 1,412 to 891, the number of new CVs fell from 1,611 to 500, and the number of WOVs fell from 46 to 18. Among Major FDI forms only cooperative oil development contracts increased in number, from four in 1985 to six in 1986.

To be sure, the picture is not as bleak as it might first appear. Although in 1986 the amount of Major FDI contracted for dropped sharply, the amount actually utilized rose 10% over 1985 to \$2.15 billion. In the first six months of 1987, increases were recorded in both the number of JVs, CVs and WOVs approved (totalling 738, up 34.7%) and the actual sum of FDI utilized (\$728 million compared to \$692 million in the first six months of 1986).⁹⁰ Moreover, as MOFERT Vice Minister Zhang Haoruo pointed out in March 1987, "we should not only look at the figures but the nature" of FDI.⁹¹ He also stated that between 1979 and 1985, the amount of pledged FDI

88. S. China Morn. Post, July 25, 1987, at 2.

89. *Beijing Attracting More Foreign Money*, S. China Morn. Post (Business News), Dec. 30, 1987, at 1.

90. Ta Kung Pao (weekly supplement), July 30-Aug. 5, 1987, at 1.

91. *Moves Aim to Attract Foreign Investment*, China Daily, Mar. 7, 1987, at 3. Vice Minister Zhang also pointed out that the foreign loan agreements concluded by the PRC during 1986 soared to a total of \$6.94 billion, that the amount of foreign loans actually utilized in 1986 reached \$4.83 billion and that both figures were almost double those of 1985. The significance of the loan data is unclear, however. Surely it demonstrates that the PRC is not hostile to expanding its foreign borrowing. Whether this data has any significance for the PRC's attitude toward or success in attracting FDI is another matter. It could be argued, of course, that the increase in foreign borrowing suggests a policy of relying more on debt than on equity for foreign funds. Yet no such assertion has been made and it could also be argued that the PRC's increase in borrowing is a reaction to its greater difficulty in attracting FDI. It may also be that the increase in borrowing is unrelated to FDI.

under approved contracts for productive enterprises represented only 45% of the total FDI commitments; the remainder of the commitments were for hotels, other tourist projects, taxi companies and other service industries. In 1986, by contrast, 76% of the total FDI approved was for productive projects in fields such as industry, agriculture, transport and telecommunications. The Vice Minister implied that at least some of the decline in approved FDI in 1986 was attributable to the PRC's increasingly selective policy of screening out many non-productive projects rather than to loss of interest on the part of foreign investors.

Recent figures announced by Beijing municipality also suggest that the downward trend of FDI in 1986 turned during 1987. Of 261 foreign-invested enterprises established in Beijing from 1979 until the end of 1987, 71 were approved in 1987 alone. Contracted FDI in 1987 rose by 45% over the (admittedly low) level of 1986 to \$1.22 billion, and the amount actually contributed rose by 47.6% to \$620 million.⁹²

The predominance of service industry projects in FDI was quite pronounced until 1986. Although proper statistics are lacking on this point, it can be illustrated by the fact that between 1979 and 1984 69% of the investment committed to the PRC for Major FDI by Hong Kong and Macao companies and 59% of that committed by Japanese companies was in service industries, and those companies had together provided 78% of Major FDI during that period.⁹³ Subsequently, both Chinese authorities and foreign investors have become increasingly concerned that too many hotel and apartment projects may have been approved in China's major cities relative both to the anticipated demand for accommodation and to China's need for FDI in this sector.⁹⁴ As the 22 Articles indicates, the PRC, instead of giving maximum incentives to investment in the services sector, now favors productive ventures that are either export-oriented or designed to introduce advanced technology and lead to import substitution and perhaps exports as well.

Consideration of the sources of foreign investment by country suggests that the PRC has hardly begun to take advantage of the

92. *China Daily (Business Weekly)*, Jan. 11, 1988, at 1.

93. N. Campbell, *The Challenge of Equity Joint Ventures in China*, at 9-11 (Manchester Business School 1987).

94. The State Council reportedly issued a document numbered 101 on Nov. 17, 1986, that required all hotel projects in major cities that had not been formally approved to be screened by the State Planning Commission and China Travel Service in addition to the normal approval process by MOFERT and registration by the State Administration for Industry and Commerce, the effect of which was to halt approvals on all but a few exceptional hotel projects in cities such as Beijing, Shanghai, Guangzhou, Tianjin and Xian.

opportunity to attract investors from North America, Japan and Western Europe. As of June 1985, Hong Kong and Macao companies had provided 66.5% of Major FDI and Japanese companies 11.5%. The United States was placed third with 9.5%, trailed by the United Kingdom (2.9%), France (2.6%), Singapore (1.6%) and West Germany (1.3%).⁹⁵ A miscellany of investments from other countries including Australia, Italy, Belgium and the Netherlands provided the rest. During the first six months of 1987, Hong Kong and Macao companies continued to provide over 60% of Major FDI, while Japan and the United States had both declined to 6-7%.⁹⁶ Of course, Hong Kong investors included a number of companies that are wholly-owned subsidiaries of "Western" TNCs. Other Hong Kong investors represent a combination of Western companies and local investors. For example, the Hong Kong investor in the so-called Schindler Elevator JV is a Hong Kong joint venture formed by a Swiss company and a local company dominated by British interests. Therefore the "Western" investment in China has not been as slight as the figures indicate.

The interest of investors from various countries in China's different industries has been far from uniform. Although Hong Kong investors have thus far been preeminent, they have tended to shun the oil industry. By contrast, Japanese and Western investors have emphasized offshore oil cooperative development projects and have provided almost all of the foreign capital required for them. Over 60% of the total pledged investments of those countries as of 1985 had been for offshore oil projects.⁹⁷ Moreover, these projects accounted for almost a quarter of the total pledged FDI (excluding processing and assembly) as of that time.

Not surprisingly, foreign investors have favored the accessible coastal areas of China, especially the traditional industrial centers among the fourteen coastal cities⁹⁸ and the Shenzhen SEZ. Spurred on by Shenzhen's location across from Hong Kong, its tax incentives and its other efforts to attract FDI, investors as of January 1, 1986, had signed over 4,400 contracts with Shenzhen companies calling for pledged investment of almost \$3.7 billion, approximately 23% of the national total.⁹⁹ Investor interest in the fourteen coastal cities has varied dramatically. Guangzhou and Shanghai have far and away led

95. Nai-Ruenn Chen, *supra* note 3, at 10.

96. S. China Morn. Post, *supra* note 89.

97. Nai-Ruenn Chen, *supra* note 3, at 7.

98. *Viz.*, Dalian, Qinghuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Fuzhou, Wenzhou, Guangzhou, Zhanjiang and Beihai.

99. Nai-Ruenn Chen, *supra* note 3, at 7.

the pack, with the southern oil port of Zhanjiang, the port of Qinhuangdao near Tianjin, Tianjin itself, Fuzhou and Dalian also gradually coming into prominence. The PRC has had to recognize that most of the other coastal cities are destined to remain obscure and remote until major infrastructural improvements make them more accessible.

The FDI participation of Hong Kong's neighboring Guangdong Province, containing the coastal cities of Guangzhou and Zhanjiang, the Shenzhen, Zhuhai and Shantou SEZs and the Pearl River Delta open economic zone, has been staggering. By the end of 1985 it had signed over 50,000 FDI contracts and had actually absorbed almost \$2.5 billion, 46% of the national total. By mid-1987 half of all foreign-invested enterprises in China were located in Guangdong Province.¹⁰⁰ Although not as important as Shanghai, the southeastern province of Fujian, containing the industrial coastal cities of Fuzhou and Xiamen and the Xiamen SEZ, has also played a useful role.¹⁰¹

II. PROBLEMS CONFRONTING FDI

Before recounting some of the problems confronting FDI in the PRC, we should note that many of the problems encountered by foreign investors in China are due to their unrealistic expectations of what can be achieved in a country that has only very recently opened its doors to FDI and that has an infrastructure woefully inadequate to meet all the demands imposed by FDI. Moreover, the Chinese people, conditioned by decades of self-reliance rhetoric and anti-foreign political movements, were unprepared for the sudden influx of foreign capital, technology and ideas.

In addition, the impressive progress that the PRC has made in attracting FDI has itself given rise to various factors that have made the conduct of business in the PRC more difficult. As the "gaps" in the legal environment for investors are gradually filled, the sophistication of economic transactions in the PRC increases, and the facilities for foreigners to conduct business improve, the impression that the PRC is becoming a more and more "normal" place to do business also increases. Such an impression will, however, lead to misunderstandings and friction, because the more "normal" some aspects of the investment environment become, the more expectations are raised, and the more frustrated the foreign investor becomes when

100. BEIJING REV., July 20, 1987, at 28.

101. Nai-Ruenn Chen, *supra* note 3, at 13.

difficulties and delays continue to block its efforts in the PRC.¹⁰²

In this section we shall attempt to identify and analyze some of the more important obstacles to FDI in China from the point of view of the TNCs. To embark on a discussion of these obstacles is a perilous matter that runs the risk of arousing the ire and misunderstanding of our Chinese colleagues. Of course, what we have to say below does not apply to all Chinese individuals or organizations, and we recognize and applaud the work done by many to overcome the obstacles. It is clear, however, that real problems do exist, and that only by discussing them openly can solutions be devised. Indeed, after discussing the obstacles, the remainder of this paper is devoted to proposals for acceptable solutions. We trust that both our Chinese and foreign colleagues will accept the following discussion in a positive spirit. If China is to attract the FDI that its "four modernizations" drive requires, practical solutions to these obstacles must be identified and implemented by both Chinese officials and foreign investors.

A. *Political Stability*

TNCs prefer to direct their investment to politically stable countries. Foreign banks also assess the acceptability of the political risks when deciding whether and on what terms to grant the loans that foreign-invested projects require. Despite the turbulence of the Cultural Revolution, the impression of political stability that China has conveyed since the Third Plenum in December 1978 has offered foreign investors considerable reassurance, particularly when compared to some other countries in the region. However, rightly or wrongly, doubts about China's long-term political stability were rekindled by the reaction to the student demonstrations of November and December 1986 and by the circumstances surrounding the sudden resignation of Party General Secretary Hu Yaobang in January 1987.

Foreign companies that are already familiar with China have continued their largely successful cooperation with Chinese counterparts despite the ensuing struggle against "bourgeois liberalization," which appeared to have run its course by the autumn of 1987 when the 13th Party Congress convened. Yet many other companies that are contemplating investment in China have become cautious and are hesitating before initiating the investment process, waiting to see how the new leaders of the Party and the government fare, whether they will continue to endorse the Open Policy and welcome FDI and whether the country appears likely to enjoy further political stability.

102. Cf. Fitzgerald, *Genuine Friendship, Genuine Frankness: Some Frank Comments on our Friendly Economic Relations*, In *Business with China* (Fincher & Pan eds., 1986).

Some TNCs, believing that successful long-run cooperation in China will require implementation of many of the economic reforms planned for the period of the Seventh Five Year Plan, are also waiting to ascertain the impact of current events upon the spirit of innovation that has been manifest in China in recent years.

Political stability is the indispensable prerequisite to attracting new FDI. Unless it prevails, relatively few potential foreign investors will concern themselves with the problems discussed below.

B. Foreign Exchange

1. Non-Convertibility of the Renminbi

Because China's currency, the renminbi, is not freely convertible, the biggest dilemma facing most foreign companies that have invested in the PRC or are considering doing so is how to recover their investment and repatriate their earnings. Those ventures established with FDI that are export-oriented or provide services to foreign tourists are able directly to earn foreign exchange and have been the most successful in avoiding serious foreign exchange deficits. However, a large proportion of the ventures established with FDI in China are unable to earn sufficient foreign exchange to cover their foreign exchange obligations, including distribution of profits to foreign investors. Often the world market for the product to be produced is already saturated or the venture to be established has no immediate prospect of producing a product that can compete in quality and price with goods made elsewhere. Many negotiations have failed because of the foreigner's refusal to assume export commitments in these circumstances. Recent Chinese legislation has attempted to address this question,¹⁰³ but its scope is limited, and many uncertainties and obstacles remain for foreign investors.

2. Foreign Exchange Controls

When China first opened its doors to FDI, extremely tight controls were placed on the conversion of renminbi to foreign exchange for purposes of repatriation of the investment and profits of foreign investors.¹⁰⁴ Under normal circumstances, renminbi cannot be converted into foreign exchange for these purposes. Chinese authorities actively encourage foreign-invested enterprises to concentrate on exports in order to earn foreign exchange needed to meet the enter-

103. See *supra* notes 54-66 and accompanying text.

104. See rules and regulations, *supra* note 24.

prises' foreign exchange requirements. In principle, each venture is thus supposed to balance its own foreign exchange account.

Yet, because the authorities came to recognize that such tight controls present great difficulties to foreign investors in the recovery of their investment and repatriation of profits, and thus discourage FDI, controls were relaxed somewhat in 1983. The State Administration for Exchange Control issued rules¹⁰⁵ that permit ventures with foreign investment in China to sell some products to Chinese entities for foreign exchange, provided the products meet certain criteria relating to import substitution and the ventures first go through a special approval procedure. The Joint Venture Implementing Regulations,¹⁰⁶ which were issued later that year, confirm the rather restricted availability of such import substitution. More importantly, Article 75 of these Regulations opens up the possibility for JVs with approval to sell their products mainly on the domestic market for renminbi and authorizes Chinese government authorities to provide undertakings to such ventures to make up foreign exchange deficits that might be incurred. However, not only has the securing of government approval for import substitution proved to be extremely difficult, but also the negotiation under Article 75 of foreign exchange undertakings by local or central authorities, which had been possible though not common in 1984, became virtually impossible to negotiate in 1985 and 1986 with the dwindling of the PRC's foreign exchange reserves.¹⁰⁷

3. Foreign Exchange Balancing Provisions

In January 1986, the State Council issued a set of provisions (the "Foreign Exchange Balancing Provisions")¹⁰⁸ specifically designed to address the foreign exchange quandary of foreign investors in JVs and CVs. While those provisions re-emphasize the role of exporting to balance a venture's foreign exchange receipts and expenditures, they restate and add to procedures for a venture to supplement its foreign exchange earnings. Those procedures are:

- (1) import substitution,

105. Rules for the Implementation of Exchange Control Regulations Relating to Enterprises with Overseas Chinese Capital, Enterprises with Foreign Capital, and Chinese-Foreign Joint Ventures (Dui Qiaozi Qiye, Waizi Qiye, Zhongwai Hezi Jingying Qiye Waihui Guanli Shishi Xize) (promulgated Aug. 1, 1983) (trans. in *Collection of Laws and Regulations of China Concerning Foreign Economic and Trade Relations*, at V-52).

106. JV Implementing Regulations, *supra* note 19, arts. 61 and 64(4).

107. Gelatt, *The Foreign Exchange Quandary*, CHINA BUS. REV., May-June 1986, at 28.

108. Foreign Exchange Balancing Provisions, *supra* note 55.

- (2) reinvestment of renminbi profits in Chinese foreign exchange-generating enterprises open to foreigners,
- (3) export of products purchased from other Chinese enterprises for renminbi, and
- (4) "adjustment" of foreign exchange surpluses and deficits among related JVs established by the foreign investor.

While the fact that the PRC authorities had reacted to the very real and pressing foreign exchange problem by formulating these provisions was universally welcomed, the terms of the Foreign Exchange Balancing Provisions did not promise a resolution of the problem. The first two procedures had already been available under PRC law,¹⁰⁹ but had proven of little assistance in practice. The third procedure is also extremely difficult to implement, because Chinese enterprises that manufacture exportable products are reluctant to sell their goods for renminbi, as they can earn highly sought-after foreign exchange by selling abroad directly or through a foreign trade corporation. The fourth procedure grew out of foreign interest in establishing "holding company"-type JVs in an attempt to balance foreign exchange on a broader basis than a single JV. After a few experiments were organized by the China International Trust and Investment Company (CITIC),¹¹⁰ however, the holding company idea was overtaken by the concept of allowing related JVs of a foreign investor to adjust their foreign exchange surpluses and deficits. Yet this idea itself is too narrow, as few foreign investors have set up more than one JV in China as yet, and it would be extremely difficult to implement because the consent of all parties to each of the JVs making the adjustment is required by the Foreign Exchange Balancing Provisions. Moreover, the fourth procedure raises more questions than it answers; for example, it gives no indication of whether the official exchange rate must be used or whether the seller of foreign exchange can charge a premium and thus have an incentive to sell it.

4. Effect of the 22 Articles

In October 1986 the State Council issued the 22 Articles,¹¹¹ which offers, among other things, some relief for the foreign exchange requirements of *all* "enterprises established with foreign investment," *i.e.*, WOVs as well as JVs and CVs. The 22 Articles significantly extends the concept of "adjusting" foreign exchange surpluses and deficits by omitting the requirement in Article 9 of the Foreign

109. JV Implementing Regulations, *supra* note 19.

110. See Shijie Jingji Daobao (World Economic Herald), Dec. 1, 1986, at 15.

111. 22 Articles, *supra* note 35.

Exchange Balancing Provisions that the ventures involved have to be "related" and by allowing any JV, CV or WOV to trade renminbi for foreign exchange with any other such enterprise.¹¹²

Although no detailed rules for such adjustments are specified, including whether they have to be made according to the official exchange rate, various localities have subsequently begun to use "foreign currency adjustment centers" to supervise such adjustments or "foreign currency swaps."¹¹³ A number of swaps have already taken place, apparently with minimal interference by the supervisory authorities. The exchange rate in late 1986 and 1987 tended to be at least one renminbi over the official rate, *i.e.*, about US\$1.00 = RMB 4.70.¹¹⁴ This procedure has the potential to provide relief to a certain number of ventures, but there is no way that the amount of foreign exchange surpluses accumulated by a small number of ventures in the PRC can meet more than a fraction of the requirements of all the ventures established with FDI that have foreign exchange deficits.

The 22 Articles authorizes another innovation. Where ventures established with FDI have a surplus of foreign exchange, but need renminbi to pay local costs, they are now allowed to deposit the excess foreign exchange in a PRC bank as collateral and borrow the equivalent amount in renminbi.¹¹⁵ This permits the venture to maintain ownership of the foreign exchange, instead of being forced to sell it to the Bank of China for renminbi, for the foreign exchange deposit is to be returned when the venture pays back the loan with renminbi earnings. Again, this provision will have limited effect, but it does at least provide somewhat more flexibility in the management of renminbi and foreign exchange accounts of ventures with foreign investment.

The promulgation in January 1987 of detailed measures concerning the purchase and export of domestic PRC products by all ventures with foreign investment¹¹⁶ is an attempt to implement the third procedure referred to in the January 1986 Foreign Exchange Balancing Provisions. While clarifying the limited extent to which such ventures

112. *Id.* art. 14.

113. *China's Reforms and Foreign Exchange Market*, CHINA ECON. NEWS, Jun. 22, 1987, at 1.

114. Based on the experience of various clients of Paul, Weiss, Rifkind, Wharton & Garrison. Rates of RMB 5.60 or even 6.00 to US\$1.00 are not unusual in certain cities.

115. 22 Articles, *supra* note 35, art. 14. See Provisional Measures of the People's Bank of China on Foreign Exchange Secured Renminbi Loans for Foreign Investment Enterprises that detail how such loans are to be made, *supra* note 56.

116. See MOFERT Measures for Foreign Investment Enterprises Purchasing Domestic Products for Export to Achieve a Balance of Foreign Exchange Income and Expenditure, *supra* note 56.

can buy domestic products for export and thereby earn foreign exchange, these measures do little to encourage domestic enterprises to sell products to such ventures for renminbi instead of exporting the products themselves (or through foreign trading corporations) for foreign exchange. Until this basic problem is solved, it is difficult to see how these measures can have a significant impact on the foreign exchange problems experienced by ventures established with FDI.

Another article of the January 20, 1987 measures¹¹⁷ authorizes provincial-level governments, after fulfilling their state-set export plans, to use their retained foreign exchange earnings from exports of products produced in the province to balance the foreign exchange accounts of enterprises with foreign investment. This method, which had previously been used on an *ad hoc* basis to assist JVs in need of foreign exchange, offers another possible source of help to foreign investors, even though it gives the local administration complete discretion in deciding whether or not to make up foreign exchange deficits.

Most recently, the State Council has promulgated new, detailed national import substitution measures¹¹⁸. While clarifying certain procedural aspects of import substitution, these measures do not appear to significantly expand the availability of import substitution as a means of balancing foreign exchange. The import substitution measures apply only to technologically advanced enterprises that are having temporary difficulties balancing foreign exchange in the early periods of production, and, to be eligible, they must meet, and continue to meet, a variety of strict requirements including increasing localization of production components and compliance with foreign quality standards. Beyond this problem of limited scope, however, is the problem of finding domestic enterprises willing to participate in an import substitution transaction. Article 8 of the import substitution measures states only that "Import control departments . . . shall guide and encourage domestic endusers . . ." to purchase goods from JVs or CVs which qualify for import substitution. It is not at all clear that "guidance and encouragement" alone will get the job done. Although some foreign-invested enterprises (including the China Schindler elevator venture and the Shanghai Foxboro venture) have already received approval to carry out import substitution, past experience has demonstrated that, unless the proper authorities step in to force the issue, domestic Chinese enterprises are usually unwilling to pay foreign exchange for goods purchased in China even if the goods sat-

117. *Id.*, art. 8.

118. *See supra* note 61.

isfy the requirements for import substitution. Until this problem is properly addressed, the benefit of the measures to foreign-invested enterprises trying to balance foreign exchange will be limited.

The foregoing laws and regulations represent a genuine attempt to mitigate the problems faced by foreign investors in recovering their investment and remitting their profits from the PRC. Yet, they cannot, of course, completely offset the effects of the non-convertibility of the renminbi. The laws and regulations only offer the possibility of partial solutions, and the degree to which they will prove effective will depend on the sympathetic exercise of discretion by administration at various levels. While export-oriented ventures are less likely to develop serious foreign exchange deficits, such ventures are by no means the only ones currently operating or encouraged, and, because many of the advanced technology ventures so keenly sought by China today are unable to export their products or services to a sufficient extent, the PRC can expect to be faced with further requests to provide such ventures with access to foreign exchange.

C. Costs

Next to foreign exchange problems, perhaps the most widely-aired complaint of foreign investors in China is the escalation of costs for the investors and their enterprises.¹¹⁹ One of the most important considerations for any foreign investor in targeting a country for investment is the cost structure. This will always be a significant factor unless the investment is made for reasons that mitigate the effect of a high cost structure, such as securing access to raw materials not available elsewhere or penetrating a market that may not otherwise be open.

Foreign investors compare today's PRC investment environment with that in Hong Kong, Taiwan, South Korea, the ASEAN countries and other places around the world offering low cost and relatively stable business environments. It is these places that the PRC must compete with by providing lower costs, better services, reliable supplies of high quality and reasonably priced raw materials, and other incentives.

Perhaps because of the initial burst of enthusiasm by foreign investors following the adoption of the Open Policy, many PRC offi-

119. Cf. P. Sham, *Soaring Business Costs Hit China Investment Drive*, S. China Morn. Post, Jul. 14, 1986 at 1. All of the examples cited in this section have appeared time and time again during negotiations that the authors and their colleagues have conducted in China, or have been experienced by numerous clients. Specific references have been omitted due to reasons of client confidentiality.

cialists appeared to be slow to realize that China has to offer a sufficiently competitive investment environment compared to other countries and areas in the region in order to continue to attract foreign investors. One reason why Chinese officials may have been slow to realize this may be the special interest in the PRC thus far displayed by Hong Kong investors, by investors interested in developing offshore petroleum resources and by those eager to develop China's tourist facilities. For their own good reasons, these types of investors have often been willing to invest in the PRC despite the fact that the cost structure is comparatively high.¹²⁰ The great interest displayed by these investors may not, therefore, give a true indication of the overall attractiveness of China's environment for the world investment community at large.

If the PRC is to open its door wider to FDI, it will have to attract more non-Hong Kong investors and more foreign investors in fields outside oil development and tourism. To restore FDI levels to those of 1984-85, one of the most important tasks in the eyes of many foreign investors is to stem and reverse the cost spiral of the past few years.

Many foreign investors complain of being bombarded by unjustifiably high prices wherever they turn in China.¹²¹ Prices and charges often bear no relation to the quality of the goods or services provided, or to the prices and charges paid by PRC enterprises or nationals. Many of the complaints are colored by the personal experiences of the expatriate employees of foreign investors in China who feel they are being consciously and systematically discriminated against in daily

120. Hong Kong investors, who, as we have seen, accounted for most major FDI from 1979 to 1985 (*see supra* text accompanying note 96), are well situated to take advantage of small "windows of advantage," especially in the adjacent Shenzhen SEZ and in Guangdong Province generally. For example, they can utilize PRC quotas for textile exports to the United States or provide services to foreign tourists or businesspeople. Familial ties or concern for the implications of Hong Kong's reunion with the PRC in 1997 have also provided strong incentives for some wealthy compatriots to demonstrate their loyalties by investing in China.

Oil companies have also been largely motivated by factors that minimize the effect of high costs. As we have seen, (*see supra* text accompanying note 97), as of 1985, over 60% of the total FDI pledged by American, Western European and Japanese companies had been for offshore oil development. These companies came to the PRC for essentially strategic reasons — the effects of the so-called "oil shocks" of the 1970's had vividly demonstrated the need to diversify sources of oil — and the PRC represented one of the last untapped frontiers.

The story is similar with respect to a third type of investor, one committed to development of China's tourist facilities. We have seen that until 1986, the majority of FDI was pledged to non-productive enterprises including hotels, other tourist projects, taxi companies and other service industries (*see supra* text accompanying note 91). Because of the unique developmental opportunities perceived, such foreign investors are less likely to be deterred by high costs in China than more analytically comparative investors in productive industries.

121. Fitzgerald, *supra* note 102.

life because they are foreigners. When they buy air or rail tickets or book a restaurant banquet, they must pay much more than PRC citizens;¹²² when they telephone overseas, they are charged considerably more than the average international rates;¹²³ and housing costs for expatriates, whether in hotels or apartment buildings, are very high, even by world standards.¹²⁴

Attempts to justify such high personal costs have done little to mitigate their effect on the expatriate representatives of foreign investors. In fact, these expatriates often come to feel that they are being exploited personally, and they begin to wonder whether the treatment their companies receive in China reflects similar discrimination and price escalation. An observation often made by foreign businessmen is that it is not merely the cost levels that are of concern; it is also the way in which they are arrived at and justified. The following paragraphs serve to illustrate some of the areas in which foreign investors have been most affected by high costs.

1. Hidden Costs

One of the aspects of investment negotiations that foreign investors find most frustrating is the Chinese parties' rather common practice of not disclosing full costs until late in the negotiations or sometimes until after the contract is signed. Despite the fact that feasibility studies for joint ventures are supposed to be joint efforts, significant cost factors are often omitted by the PRC party, and they later come as unpleasant surprises to the foreign party. The Chinese side sometimes refuses to disclose the full cost of workers' subsidies or land-use fees because they are contained in confidential "internal" documents. Connections to public utilities are often only possible upon the payment of a premium. It is not unusual for various payments or favors to be necessary to smooth the process of setting up operations (banquets, "study tours," and other entertainment of officials are not uncommon). Such unproductive costs frequently have an impact on profitability.

122. Compare, for example, the separate fare schedules for domestic and foreign travelers printed by the Civil Aviation Administration of China.

123. This statement is based on a comparison of PRC tariffs for PRC-US and PRC-Hong Kong long-distance calls with the Hong Kong tariffs for Hong Kong-PRC calls and various U.S. tariffs for US-PRC calls. The tariffs were provided to the authors by a telecommunications company in Hong Kong.

124. For example, tenants in Beijing's newest (and trouble-plagued) office block, Noble Tower, have recently been asked to pay rent of \$45 per square meter per month. This compares with a rent of \$25 to \$35 in Hong Kong's most prestigious and best serviced office block, Exchange Square.

2. Labor

A whole range of hidden costs exists in relation to labor. It is not unknown for a worker to be replaced just after he has gone through a special training period, or reached a certain level of technical competence, or if he is viewed as identifying too clearly with the interests of his employer. If the venture loses experienced talent, it must bear the costs of retraining.

The common Chinese insistence upon salary parity as between PRC and foreign management personnel of a JV is difficult to justify in economic terms.¹²⁵ The local managers are often essentially trainees who lack the experience, technical skills and knowledge of production management of the foreign staff. Moreover, they personally receive only a fraction of the salaries paid ostensibly to them by the venture; most of these "salaries" go to the organizations from which these managers come or to the PRC's treasury. Thus, to the extent accepted by the foreign party, the demand for "equal pay for equal work" merely becomes a form of disguised taxation.

While the take-home wages of workers in China are relatively low in comparison with those of some other countries in the Asian region, labor costs to ventures established with FDI in China are often much higher than might be expected.¹²⁶ In some localities, subsidies for housing, health care, transport, food, retirement, etc. have been levied indiscriminately, and ventures have sometimes been required to pay some of these costs in foreign exchange. Labor productivity in the PRC lags behind that of places such as Hong Kong, Taiwan, Singapore and South Korea because ventures are often pressed to hire more staff than they need, they are burdened by excessive charges and subsidies, and workers lack incentives to perform efficiently.

The 22 Articles recognizes the need for reducing labor costs. Yet it only promises relief to the preferred categories of "export enterprises" and "technologically advanced enterprises", and the relief promised — exemption from all state labor subsidies except those for

125. Cohen & Harris, *Equal Pay for Equal Work*, CHINA BUS. REV., Jan.-Feb. 1986, at 10.

126. According to Article 8 of the Regulations of the People's Republic of China on Labour Management in Chinese-Foreign Joint Ventures (Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding) (promulgated Jul. 26, 1980) (trans. in China L. For. Bus., *supra* note 4 ¶ 6-520), the wage levels of the staff and workers of JVs are to be fixed at 120% to 150% of the "real wages" of the staff and workers of state enterprises in the same locality. Typically, an unskilled employee of a JV will receive a take-home pay of approximately \$40 per month in the north of China, while the direct cost to the JV (including subsidies) will be approximately \$140. See the scale of charges distributed to foreign firms in Beijing by the Foreign Enterprise Service Corporation (FESCO).

labor insurance, welfare costs and housing — is couched in vague terms.¹²⁷ Surprisingly, the national measures designed to implement the labor provisions of the 22 Articles,¹²⁸ although sensitive to the needs of attracting and retaining skilled personnel for enterprises with foreign investment and to other labor matters, do not clarify the extent of relief from the excessive subsidies that such enterprises can expect. To make matters worse, by removing the previous ceiling on wage levels for JV workers — 150% of the wages of workers of state enterprises in the same area in the same business¹²⁹ — the new measures raise the specter of higher labor costs.

3. Land-Use Fees

Until promulgation of the 22 Articles, there were no published national standards for land-use fees in China. The fees varied greatly from locality to locality, and local regulations were often so broad as to permit virtually arbitrary decisions as to how much enterprises with foreign investment would pay. For example, when values have been assigned to the items to be capitalized as the Chinese party's contribution to the registered capital of a JV, the value of the right to use the site, the utility connections and any existing or scheduled building to be contributed by the PRC party often magically add up to an amount equal to the Chinese party's predetermined equity share in the JV. As the renminbi was devalued in 1985 and 1986, the value of the Chinese party's contribution increased at a corresponding rate, despite the fact that PRC land-use fees, as well as utility charges and construction costs, should not have been directly affected.

The 22 Articles provides for generally lower land-use fees for "export enterprises" and "technologically advanced enterprises".¹³⁰ Subsequently issued local investment encouragement regulations contain similar provisions, sometimes allowing for an exemption from land-use fees altogether. However, there is an exception in the 22 Articles for ventures located in "busy urban areas" where fees are allowed to be higher. Because for various reasons many enterprises with foreign investment are located in or near industrialized cities, there is a concern among foreign investors that the exception for "busy urban areas" may be interpreted so broadly as to effectively negate the intention of the provisions. Moreover, a good case can be made that ventures that do not qualify as "export enterprises" or

127. 22 Articles, *supra* note 35, art. 3.

128. See rules, regulations and provisions, *supra* note 56.

129. See *supra* note 126.

130. 22 Articles, *supra* note 35, art. 4.

“technologically advanced enterprises” also deserve relief from high land-use fees.

4. Other Inputs

Would-be joint venturers are often surprised to find that Chinese raw material prices are very high. It is difficult to believe, as one company recently discovered when it sought to establish a JV to produce fruit juice concentrate, that at least for this purpose China has the most expensive oranges in the world! Moreover, because of low productivity and inefficiency, processed or semi-processed goods in China are often more expensive than on the world market. Also, foreign investors continually find themselves having to pay more for raw materials, fuel, electricity, water, telecommunications and other items than do state-owned enterprises.

Some ventures sell their products at a loss on the world market because their production costs are higher than those of their competitors in other countries. Yet, because of their foreign currency obligations, they must export to earn the necessary foreign exchange. This often causes them to raise their prices to Chinese consumers in the hope of earning a profit.

Availability of quality inputs at any price is often a problem. The 22 Articles assures priority treatment to the two preferred types of foreign-invested enterprises with respect to water, electricity, transport and communications. Some local governments are also striving to help them solve raw material shortages, but this is a matter of importance to all enterprises. Ironically, problems of scarcity have been exacerbated in some instances by the domestic economic reforms which have removed some raw materials from the state plan, placing them in the higher priced and less predictable market economy.

5. High Negotiation Costs

Negotiations on Chinese investment projects tend to be notoriously time-consuming and expensive. The reasons are many: for example, understandable caution on the part of both sides due to inexperience; misunderstandings due to differences in language, culture and economic systems; the need to assure that the Chinese and foreign language texts of all relevant documents are identical in substance; changes in China's economic policies that require postponement or modification of the project or selection of a new Chinese partner; the frequent need to consult and obtain the approval of various agencies about matters under discussion; delays in obtaining necessary information for the feasibility study; and differing concepts

of time and urgency. Because most negotiations take place in China, foreign companies become acutely aware of the high costs of a long negotiating process. Frequent travel to China for negotiations, staying in expensive hotels for weeks, and employing interpreters and other specialist advisors to assist in the discussions, all add up rapidly.

While the larger TNCs sometimes take a strategic view of developing business in China and may be able to absorb relatively high costs in the short term in return for perceived longer term benefits, there are many substantial companies possessing technology China needs that are frightened off by high initial costs. In some technological fields, small and medium-sized firms are the leaders and are keen to develop partnerships with organizations in potential new markets. China should be wary of losing one of its greatest attractions for such firms — low costs.

D. Attitude Towards Contracts

One of the major complaints of TNCs concerns Chinese attitudes towards the negotiation, approval, administration and enforcement of contracts.

1. Negotiation

Foreign investors are often frustrated by the common practice of Chinese negotiators, at least when foreign interests are at stake, to try to make contracts simple and vague regardless how complex the circumstances may be. Although the Chinese party will frequently show a commendable zeal to protect its own interests with detailed language, when foreigners seek similar protection the Chinese party tends to respond that, because the two parties are “old friends” with the same interests at heart, they should avoid the possibility of conflict over “small details” and make the contract a statement of broad principles, allowing the board of directors to work out the details after the venture is launched. If the foreign party still objects, the Chinese may declare that “this is not the way it’s done in China,” treating the statement as an unanswerable argument.

Time and again, foreign investors who have acquiesced to this approach later bemoan the omission from the contract of what turn out to be vital details. Agreeing on a contract that deals in broad generalities with respect to important matters will only postpone misunderstandings and conflicts to a date when it is too late for the foreign party to back out and when his bargaining position is considerably weaker. Although reluctant to add to the negotiating costs, most foreign companies appreciate the desirability of spending the time

required to achieve genuine understanding on important matters before signing the contract.

2. The Approval Process

As virtually all investment-related contracts in the PRC must go through an approval process, review of the contract by the examination and approval authority will usually become the occasion for re-opening negotiations and a cause for further delay.¹³¹ Sometimes the process is extended even beyond the approval stage, as when MOFERT insists on again re-opening discussion of a locally-approved contract that has been filed with it "for the record."

While government examination of investment contracts is a legitimate exercise that is common to many countries, foreign investors have become frustrated by the frequency with which PRC examination and approval authorities demand changes in crucial terms which the parties can agree on between themselves under Chinese law (*e.g.*, the valuation of technology contributed by the foreign party or the percentage of production that is to be exported). In principle, no one can complain if such bodies act as a kind of "big brother" to ensure that all terms of the contract are "reasonable" for the Chinese party. The result, however, is that the foreign company often feels that it has been placed in an unfair bargaining position, especially when, as frequently happens, it is informed of the conditions for approval shortly before the date scheduled for the festivities announcing the contract.

Inconsistent attitudes taken by different members of an examination and approval authority also add to the problem. Sometimes, during the contract negotiations, the parties will consult closely with some members of the relevant authority to ensure that the terms of their agreement will be acceptable. Yet it is not unknown for such contracts later to be rejected by superior or newly-arrived officials of the same authority. Inconsistency of interpretation by examination and approval authorities in different localities is also very common. The terms that one's competitor negotiates in Beijing one week may be significantly different from those one can obtain in Shanghai or Xian in the same week, or in Beijing the following week. In early 1987 one company's JV contract was rejected by the authorities in the Shenzhen SEZ only weeks after an almost identical contract had been approved in Shanghai.

131. There is no evidence that the promulgation of the 22 Articles and the principles it espouses (such as simplifying procedures and giving the parties more autonomy) have altered this practice. Indeed, in our experience, the old practice of approval authorities re-opening negotiations on business terms has continued through 1987.

3. Administration of Contracts

Implementing investment contracts in a still largely planned economy is not a simple process, and foreign-invested enterprises are often unable to act with the autonomy that is repeatedly assured them by legislation.¹³² Foreign investors that are not familiar with the importance of personal relationships in China especially encounter all sorts of bureaucratic hurdles after conclusion of their contracts. In one case, for example, a newly built joint venture hotel in a busy city with a shortage of hotel rooms was unable to achieve its projected occupancy rate because the foreign party had neglected to establish a close enough relationship with the city's foreign trade bureau, which was responsible for directing foreign businessmen and tourists to the city's hotels.

Sometimes, government agencies will directly interfere with the performance of the contract by imposing new rules, conditions or fees that affect the profitability of the venture. The sources of supply of raw materials or other Chinese inputs may be selected by the department-in-charge of the venture, preempting what should normally be a commercial decision by the venture itself. Or the costs of local inputs may be arbitrarily increased if the official hierarchy thinks that the venture is making too much profit.

Other bureaucratic problems arise from the overlapping responsibilities of various government authorities that are manifested in competition and jealousy between them and lead to uncertainties or long delays in the decision-making process. The recent establishment of special foreign investment coordinating groups in the State Council and in various localities¹³³ should help to cut through red tape, but the effectiveness of these bodies is yet to be proven.

Perhaps the most baffling and irritating aspect of the administration of contracts concluded with China is the frequency with which either the Chinese parties or Chinese officials insist that signed and approved contracts later be renegotiated. Foreign investors normally treat approved contracts as binding and final. Yet Chinese organizations often assume that it is acceptable to make "a few small changes," even regarding matters of substance that had been agreed on only after long negotiation. Because of this it is frequently said that contract negotiation never ends in China, and this unenviable reputation is a deterrent to prospective investors. We note, however, that Chinese organizations frequently have the virtues of their vices and

132. See e.g., JV Implementing Regulations, *supra* note 19, art. 7; and 22 Articles, *supra* note 35, art. 15.

133. See, e.g., text accompanying *supra* note 66.

are willing to show similar flexibility in responding to the request of a foreign party to modify the contract in light of unexpected developments.

4. Enforcement of Contracts

China must still deal with the legacy of the cancellation of a large number of contracts relating to the Baoshan steel plant and other projects during the period of economic "adjustment" of 1979-80.¹³⁴ Although, as noted above, the PRC eventually agreed to honor those contracts to the extent that its contracting partners insisted, the incident left foreign investors with a concern that similar cancellations of investment contracts might occur. Indeed, in 1985-86, when the drain on China's foreign exchange reserves became serious, the central authorities clamped down on the expenditure of foreign exchange; many foreign trading partners found themselves confronted by a de facto "force majeure" argument in which Chinese parties alleged that they no longer had the foreign exchange to pay for what they had contracted to buy and either had to cancel the contracts or be allowed to pay less for the goods. This concern of foreign investors was reawakened in 1987 by press reports of fresh warnings by high Chinese leaders that some approved contracts might be rejected or restudied.¹³⁵

These worries are magnified because foreign investors often believe that, despite China's establishment of active judicial and arbitration systems and many laws regulating commercial contracts with foreigners, in practice contracts concluded with Chinese entities lack legal enforceability. This adds to the uncertainty of doing business in China. The strength of the traditional Chinese preference for settling disputes informally by "friendly consultation" between the parties or at most by the mediation of a third party continues to be felt. If informal means fail, most investment contracts provide for resolution of disputes by binding arbitration either in China or abroad. Yet foreign parties that propose to invoke arbitration are frequently made to feel that this would be an "unfriendly act" that would terminate meaningful cooperation with their Chinese partners. Thus foreign investors come to feel that in the real world their contract rights cannot be protected, for to do so might mean that they would win the battle but lose the war.

134. See *supra* note 12 and accompanying text.

135. See the reported remarks by the then Vice Premier Li Peng to a special envoy of the French Foreign Minister: "You must be psychologically prepared for some projects to be rejected or restudied." S. China Morn. Post, Feb. 26, 1987, at 8.

E. Inadequate Legislation

Many national and local laws and regulations have been promulgated in order to provide a more stable, predictable business environment in China for both domestic and foreign investors. However, many of the laws and regulations are couched in broad, ambiguous and sometimes conflicting terms, leaving local or central implementing agencies a wide scope for interpretation and leading to inconsistent treatment. Reliable English language translations of many implementing rules, and sometimes even of laws themselves, are slow in appearing, compounding the foreigners' uncertainty about what is required.

Moreover, foreign investors still eagerly await the promulgation of such basic legislation as a company law,¹³⁶ a law regulating CVs¹³⁷ and a law providing protection for copyright and computer software,¹³⁸ and implementing regulations have yet to appear for laws governing foreign contracts¹³⁹ and WOVs.¹⁴⁰

In an environment where new laws and regulations are appearing one after another to govern previously unregulated sets of circumstances, the fear of retroactive legislation effectively amending the approved contractual terms and adversely affecting the interests of the foreign party has caused concern among foreign investors. Although

136. Guangdong Province has, however, adopted regulations governing JVs, CVs, WOVs and Chinese-foreign companies limited by shares located in Guangdong's special economic zones (Shenzhen, Shantou and Zhuhai). See Regulations on Foreign Related Companies in the Special Economic Zones in Guangdong Province (Guangdongsheng Jingji Tequ Shewai Gongsì) (adopted Sept. 28, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 70-865). Various elements of a "companies law" can already be found in quite a number of laws and regulations. See, e.g., General Principles of Civil Law, *supra* note 36, arts. 41-49; the draft State Enterprise Law (Zhonghua Renmin Gongheguo Quanmin Suoyouzhì Gongye Qiye Fa Cao'an) (published in Renmin Ribao (People's Daily), Jan. 12, 1988) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished); Law of the PRC on Enterprise Bankruptcy (Trial Implementation) (Zhonghua Renmin Gongheguo Qiye Pochan Fa (Shixing) (adopted Dec. 2, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 13-522); Rules Concerning Bankruptcy of Foreign Related Companies in the Shenzhen Special Economic Zones (Shenzhen Jingji Tequ Shewai Gongsì Pochan Tiaoli) (adopted Nov. 29, 1986) (trans. in China L. For. Bus., *supra* note 4, ¶ 73-540) (as well as other experimental bankruptcy laws in cities such as Shenyang, Wuhan, and Chongqing); Circular Concerning Further Clearance and Consolidation of Companies (Guanyu Jinyibu Qingli He Zhengdun Gongsì De Tongzhi) (promulgated Aug. 20, 1985) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished). See also Ong, *China Speeds Up Company Law Work*, CHINA LAW REPRINTS (Chinese University of Hong Kong Chinese Law Program, 1986); Lam, *Foreign Corporate Identity*, CHINA BUS. REV., Mar.-Apr. 1987, at 45.

137. See *supra* text accompanying note 43.

138. See *supra* text accompanying note 45.

139. Foreign Economic Contract Law of the PRC, *supra* note 27.

140. See The Law of the People's Republic of China Concerning Wholly Foreign-Owned Ventures, *supra* note 32 and text accompanying notes 81-84.

Article 40 of the Foreign Economic Contract Law¹⁴¹ provides desirable protection to certain kinds of investors against adverse changes in law after their contract is approved, it is vague in content¹⁴² and only effective where the contract specifically addresses the matters in question. Nor does it apply to contracts for the licensing of technology, compensation trade, assembly and processing arrangements or wholly foreign-owned investments. We should note that the Ministry of Finance has set an encouraging precedent with its view that new tax legislation should not nullify tax provisions favorable to foreigners in existing contracts,¹⁴³ however, this only affects taxation and could still be set aside at any time in the absence of clear legislative requirement of such protection.

It is a common practice of PRC negotiators to refer to internal (*neibu*) regulations that are said to govern certain aspects of a contract, but that the foreign investor is not permitted to see. Often the issue at hand will be of central concern to the foreign investor, such as the method of payment for transferred technology, the amount of labor subsidies the venture will have to pay for its workers, or the maximum value of technology the foreign company is allowed to contribute as part of its investment in the venture.¹⁴⁴ On some occasions the foreign investor is given varying versions of the content of these regulations, and in certain negotiations they are referred to in ways that make the foreign side even doubt their existence. This has led some TNCs to believe that the practice of referring to internal guidelines has been abused by some Chinese negotiators merely to take advantage of the foreigner's ignorance. In any event, virtually all TNCs agree that full and timely disclosure of all regulations governing investment contracts is required by the principles of equality and mutual benefit.

141. Foreign Economic Contract Law of the PRC, *supra* note 27. Article 40 states: "Even if the law makes new provisions, contracts for Chinese-foreign equity joint ventures, Chinese-foreign co-operative enterprises and for Chinese-foreign co-operative exploitation and development of natural resources to be performed within the territory of the People's Republic of China, which have already been approved by a competent authority of the State and made, may still be performed according to the stipulations of those contracts."

142. Note the use of the word "may" in Article 40.

143. *See, e.g.*, Ministry of Finance tax notice (80) 214, Questions Concerning the Levying of or Exemption from Tax on Wages and Salaries of Technical Personnel Sent by Foreign Enterprises to Work in China in Performance of Contracts Signed Prior to the Promulgation of the Tax Law (Guanyu Waishang Wei Luxing Shuifa Gongbu Qian Qianding De Hetong, Pai Jishu Renyuan Lai Gongzuo De Gongzi Xinjin Suode Zhengmian Shui Wenti) (Issued Nov. 20, 1980) (trans. by Paul, Weiss, Rifkind, Wharton & Garrison, unpublished).

144. Some "neibu" guidelines are gradually refined and eventually published.

F. Taxation

From the very beginning of the Open Policy, China's central tax officials have labored mightily to create a tax system and a set of incentives that would be attractive to the foreign business community.¹⁴⁵ Their accomplishments in just a few years have been truly impressive. Furthermore, they have generally sought to administer the law in a reasonable way, most notably giving up the right to interfere with approved contractual arrangements by subsequently imposing higher taxes than contemplated by the contract.¹⁴⁶ Nevertheless, foreign investors coming to China today are faced by an increasingly complex web of tax legislation, regulations and rulings that appear to lack consistency in their interpretation and implementation from one locality to another. Allegedly arbitrary taxation is frequently mentioned as a deterrent to investment. Although not strictly relevant to investment, China's 1985 decision to impose rather high taxes on a broad spectrum of representative offices of foreign companies undoubtedly added to the general climate of concern about the taxation of foreign enterprises.¹⁴⁷

Perhaps the main headache that confronts foreign investors is that it is extremely difficult to obtain a ruling in advance on the tax consequences of a contemplated investment, just as it is difficult to obtain similar advance rulings from the customs, foreign exchange, land use, environmental and other agencies whose approvals may be crucial to the success of a venture. Given the increasingly complex tax environment, the discretionary nature of many important tax incentives and inconsistencies in application of the law, this issue of obtaining advance rulings is becoming more and more acute. Taxation is a major factor in determining a venture's profitability, and the exact impact of national and local taxation should be known to the parties at the time they draft their feasibility study and their contract in order to confirm that a project will be viable. Yet most local tax bureaus refuse to cooperate at that stage, insisting that the necessary application for confirmation not be filed until the contract is in effect and the venture established or at least until the contract is signed. In either event it is then too late for a foreign investor who is disappointed with the tax treatment to change his mind about the project.

145. See Gelatt & Pomp, *supra* note 23.

146. See tax notice, *supra* note 143.

147. Provisional Regulations for Collection of Consolidated Industrial and Commercial Tax and Enterprise Income Tax from Resident Representative Offices of Foreign Enterprises (Dui Waiguo Qiye Changzhu Daibiao Jigou Zhengshou Gongshang Tongyishui, Qiye Suodeshui De Zanxing Guiding) (issued May 15, 1985) (trans. in China L. For. Bus., *supra* note 4, ¶ 31-600).

Some PRC officials are willing, as a compromise, to allow the parties to an investment to agree upon contractual language authorizing their venture to "apply for" specified tax advantages after the enterprise receives its business license. Some officials imply that, in the Chinese context, such language in an approved contract virtually assures that the desired treatment will ultimately be granted. Yet foreign investors, aware that in other countries anyone may "apply for" anything, with no assurance it will be granted, are rarely convinced. They often try to protect themselves, with varying degrees of success, by seeking to persuade the Chinese parties and the contract-approving authority that the contract should make the written confirmation of the relevant tax bureau a condition precedent either to the contract's legal effectiveness or to the obligation of the parties to contribute their capital to the project. Some would-be investors simply regard the non-cooperation of the tax bureau as the straw that breaks the camel's back and go home.

The list of problems confronting the expansion of FDI could be extended, of course. As the PRC has tightened up on debt-equity ratios, eliminated certain tax benefits originally accorded to CVs, made financial guarantees from authorized Chinese financial institutions hard to come by and subjected such guarantees to a stricter legal regime, the financing of foreign-related projects has become more difficult; the recent decline in the number of newly-approved CVs is in part a reflection of these developments. Customs questions have also become an increasing concern due to the inadequacies of customs legislation, the frequent failure of parties to obtain written confirmation of customs treatment before signing their investment contract and numerous examples of arbitrary imposition of duties. Yet the basic problems have been covered, and we should turn our attention to what more might be done to alleviate them.

III. SOME PROPOSALS FOR EXPANDING FDI

Plainly, PRC officials are well aware of the obstacles to expanding FDI mentioned above and they have taken steps to improve the situation within the limits imposed by China's circumstances, values and overall priorities.

To be sure, some of the most basic obstacles to FDI do not lend themselves to immediate solution and assume an importance that goes far beyond FDI. China is a poor, developing country and will remain so for some time. Thus, whether one focuses on infrastructure, power resources or education, progress can only be expected gradually, and

any steps to improve the environment for FDI in these respects will have to take account of the country's other needs as well. We will concentrate below on proposals of a specific nature that are directly related to FDI and that should be capable of implementation in the near future.

Before turning to these specific proposals, however, we wish to emphasize the overriding importance of creating an appropriate acceptance on the part of Chinese officials and Chinese contracting partners of the legitimacy of FDI and of foreign investors earning what in the non-socialist world would be recognized as a reasonable profit. Without some greater degree of economic sophistication and ideological understanding in this respect, implementation of any specific proposals will lack the spirit necessary to make them successful.¹⁴⁸

A. Foreign Exchange

The most important step that China could take immediately to heighten the interest of foreign investors would be to expand the possibilities for resolving the foreign exchange imbalance suffered by many foreign-invested ventures.

At a minimum, this would involve assuring that the procedures now available in theory for supplementing a venture's foreign exchange account actually prove workable in practice.¹⁴⁹ Many TNCs greeted the foreign exchange section of the 22 Articles with skepticism, if not cynicism, because of their previous inability to persuade local officials to use the powers already conferred upon them to approve solutions to the foreign exchange problem. If Chinese officials can be induced to aid many ventures by exercising their discretion in positive, imaginative ways, the cumulative impact of such actions will soon be widely known and appreciated.

In the past, plans by foreign investors to give up sourcing materials in other countries in order to allow their proposed China ventures to earn foreign exchange by sourcing the materials in China for renminbi and exporting them were usually rejected by local officials even though this would have added to PRC exports and was encouraged by MOFERT. Now that such renminbi sourcing is plainly authorized,¹⁵⁰ a more receptive response from officialdom would be

148. The highest echelons of China's leadership have publicly acknowledged this basic fact. See *Investors Must Profit, Deng Says*, Ta Kung Pao (Weekly Supplement) Sept. 11, 1986, at 4.

149. See *supra* notes 103-118 and accompanying text.

150. 22 Articles, *supra* note 35.

desirable.

Import substitution is the most promising of the procedures already formally authorized to improve the foreign exchange position of many ventures. If, instead of being allowed to import needed products, Chinese enterprises throughout the country were required to purchase the products of foreign-invested enterprises and pay for them, at least in part, in foreign exchange — as is already being done in some cases in Guangdong Province — this would help balance the foreign exchange accounts of many ventures as well as conserve China's foreign exchange.

Similarly, it would be very important for national rules soon to be published regulating the details of how foreign-invested enterprises may "adjust" their foreign exchange deficits and surpluses. Although TNCs appreciate the significance of the experimental "foreign currency swaps" that have occurred and of the relevant local rules that are beginning to appear, many companies will remain uneasy about the acceptability and duration of this practice until it is authorized in detail by the central government.¹⁵¹

Expansion and regularization of other promising experiments would also be desirable, such as the establishment of "evidence accounts" that record a foreign investor's purchases from China and allow that investor to convert its renminbi profits into foreign exchange in accordance with a formula that reflects the amount of foreign exchange the evidence account shows the investor has provided China through its purchases.

Greater official flexibility in approving proposals to reduce a foreign-related venture's local foreign exchange costs would also be welcome. Although the Joint Venture Implementing Regulations relieved JVs of much of this burden,¹⁵² the problem persists, especially for WOVs and CVs. Some ventures have been released from obligations to pay for certain local expenses, such as income taxes and the cost of materials, in foreign exchange. A broad and sympathetic review leading to release of other such ventures from similar obligations would help to reduce their foreign exchange demands significantly.

Obviously the need to encourage foreign investment must be balanced against the actual availability of foreign exchange and the overall needs of China's economy. For the foreseeable future, foreign exchange in China is sure to be in short supply, and many PRC economists and officials are understandably concerned that greater efforts to help foreign investors resolve their foreign exchange difficulties will

151. But note the obstacles to promulgation of such rules pointed out *supra* note 57.

152. See JV Implementing Regulations, *supra* note 19, art. 65.

only exacerbate the nation's problems with foreign exchange. For this reason PRC officials are not eager further to open China's domestic market to foreign investment in fear of adding to the pressures on the PRC's foreign exchange reserves.

Yet many foreign observers believe that significantly opening the China market, rather than further draining China's foreign exchange reserves, would improve the situation. It would, they believe, increase the amount of foreign capital invested in China, including the amount reinvested there, to such an extent that the foreign exchange inflow would substantially exceed the outflow. Moreover, they point out, the competition that foreign-invested ventures would give China's currently protected and inefficient industries would stimulate them to greater efficiency and thus enable them to earn more foreign exchange by increasing their exports as a result of becoming more competitive on the world market.¹⁵³

Our view is that the PRC should gradually increase the access of foreign-invested enterprises to the domestic market while continuing the current effort to improve the country's overall foreign exchange position and expanding opportunities for foreign investors to repatriate their profits by judicious use of the methods we have discussed.

Whatever the degree of relief the PRC chooses to provide regarding foreign exchange imbalances, one relevant procedural suggestion might be helpful. It would be wise in every negotiation for the parties and the government agencies involved to deal with the matter of the venture's foreign exchange balance as early as possible. In many negotiations, because of the difficulty of the question, there is a natural tendency to delay its resolution until all other problems are solved and the documents are perfected. Only then do the parties confront the reality of the non-convertibility of the renminbi, and if no acceptable solution is available regarding foreign exchange, the negotiations will frequently fail. Failure at that late date, however, adds to the mutual disappointment and makes much of the negotiating cost appear wasted, reinforcing China's reputation as an expensive and often frustrating place to try to do business.

B. Costs

It is clear from the 22 Articles that China's leadership takes very seriously the barrier that high costs pose to foreign investment. This new legislation makes applicable to foreign-invested ventures the rather general provisions of the Notice of the State Council on Reso-

153. See Harding, *The Investment Climate in China*, BROOKINGS REV., Spring 1987, at 39.

lutely Curbing the Indiscriminate Levy of Charges on Enterprises¹⁵⁴ and instructs provincial governments to adopt specific measures and to strengthen their supervision over these matters. More extraordinarily, the 22 Articles provides that ventures "that encounter unreasonable charges may refuse to pay them and may also appeal to the local economic commissions and up to the State Economic Commission."¹⁵⁵

How effective any of these measures will prove in practice is an open question at this early stage. Unless provincial officials pursue price gouging more vigorously than in the past, it will be up to foreign companies to take the initiative in actually refusing to pay unreasonable charges and resorting to the new appeal channels. Whether foreign companies will feel comfortable in this novel role is uncertain. What is clear from recent experience is that a basic change of attitude will be required on the part of both China's officials and its business representatives if the problem of excessive costs for foreign investors is to be brought under control. Until now there has been a widespread belief in China that a foreign company is fair game for any costs and that no matter how many it is loaded down with the foreign company will nevertheless be able to earn a profit and retain its enthusiasm for China. The PRC should undertake a major nationwide educational effort to alter this belief.

Specifically, the government authorities that approve feasibility studies and investment contracts ought to show the same zeal in protecting foreign parties against excessive costs as they do in protecting Chinese parties against unfair contract provisions. The authorities should make certain that there has been full disclosure of all costs by the time the feasibility study and contract documents are prepared, and they, as well as the economic commissions that have recently been authorized to receive complaints, should make clear their willingness to act on reports of improper or excessive charges.

Further measures should be taken under the 22 Articles to reduce artificially inflated labor costs, so that China can exploit one of its main advantages in attracting foreign investment and foreign-invested enterprises can compete more effectively on the world market. The management of such enterprises should be given sufficient independence so that wages can reflect those generally prevailing in the locality, wage increases can be linked to increased productivity, and bonuses can be devised to enhance productivity. Moreover, the

154. See *supra* note 55.

155. 22 Articles, *supra* note 35, Article 16 and rules, regulations and provisions, *supra* note 56.

extent to which such enterprises are to be freed from paying labor subsidies must be clarified, not only for "export enterprises" and "technologically advanced enterprises" but also for others. Chinese managers should be paid in accordance with their attainments and China's domestic standards rather than in accordance with the attractive-sounding but economically arbitrary and deceptive principle of equal pay for foreign and Chinese managers.

Additional steps to improve the pricing and availability of other inputs would also be welcome. No foreign enterprises should be charged more than state enterprises for raw materials and components, and "export enterprises" and "technologically advanced enterprises" should also be assured of priority access to such items. Moreover, other foreign-invested enterprises should enjoy the same protection against discrimination as the two preferred categories do with respect to the cost and availability of labor, land, utilities, telecommunications and transport facilities.

C. Attitude Towards Contracts

Several measures should be taken to diminish foreign dissatisfaction with FDI contracts in China. It would be very desirable, first of all, if PRC contract negotiators and officials were authoritatively informed that it is legitimate for contracts to be as detailed and precise as the circumstances of the investment warrant. As experience in the Shenzhen SEZ and elsewhere has demonstrated, the failure of contracts either to provide for handling foreseeable contingencies or to provide for dealing with them in an unambiguous way is very likely to result in disputes. Such disputes not only expose the interests of the Chinese party to the contract to unnecessary risks but also damage China's reputation as a place to do business.

Second, Chinese contract-approving agencies should seek to minimize the number of occasions when their review leads to renegotiation of the contract already agreed upon by the parties. Reviewing agencies should respect the extent to which the law leaves it to the parties to decide upon various terms. Regarding those matters that are properly subject to review, closer official monitoring of the negotiations would help the approving authority to detect objectionable clauses early in the process, before the parties had agreed upon the overall terms. In any event, it would be very helpful if the approving authority did not pose additional objections just prior to the scheduled public announcement of the contract, for this practice has aroused considerable resentment.

Third, after a contract has been approved, its integrity should be

respected. Not only the foreign party but also the Chinese party and PRC officials should act in accordance with the contract as well as the relevant provisions of law. Officials should not interfere with legally valid arrangements that confer autonomy on foreign-related ventures. Greater sensitivity to the significance of a contract, and commensurately greater restraint in seeking its revision, would do much to improve China's reputation for honoring contracts.

Finally, it is very important for Chinese parties and officials to recognize, in those rare instances when a contract dispute cannot be settled by friendly consultation or informal mediation, that it is perfectly acceptable for either side to invoke the formal dispute resolution provisions of the contract. In other words, resort to arbitration is not an unfriendly act but one that is occasionally essential to the clarification of the parties' contractual rights and duties. The premise on which China has established arbitral and judicial systems, enacted civil procedure, contract and other legislation and recently adhered to the leading international convention facilitating enforcement of arbitration awards is that, in order to promote economic cooperation, a contract must ultimately be enforceable before an impartial tribunal, in fact as well as in theory.

D. Legislation

Although enormous progress has been made on the legislative front, much remains to be done. Legislation for which foreign investors have long been waiting, such as that regulating CVs, Chinese companies, copyright and computer software, should be enacted as soon as possible. So too should the implementing rules for the foreign contract law, the law on WOVs and other laws, so that issues such as the scope of protection against retroactive legislation under Article 40 of the foreign contract law can be spelled out for foreign investors. In addition, timely, accurate English translations of not only national and local laws but also their implementing measures and the growing body of administrative and judicial interpretations of all this legislation would be very valuable.

A law enacted by the National People's Congress or its Standing Committee to the effect that no Chinese agencies or parties may require foreign companies to adhere to "internal" guidelines would do much to strengthen the confidence of foreign investors. Although TNCs come from various legal traditions, they all share the belief that a rule that is not published and available to all parties is so unfair and subject to abuse as to be illegitimate.

The suggestion that new laws should be better drafted and more

clearly related to one another may be so general as to be of little use. Specifically, however, in order to promote this general objective, we suggest that, in considering the enactment of new legislation, China's law-making institutions do what their counterparts in so many other countries do; adopt an open, public procedure that will enable foreign investors as well as others to comment on the text of a proposed law or regulation. On a limited, ad hoc basis, Chinese agencies have occasionally solicited foreign comments on draft laws. A significant initiative was taken on January 12, 1988, when a draft of the State Enterprise Law was published in *Renmin Ribao* (People's Daily) for public discussion and comment. If the PRC would institutionalize this practice, it would not only improve the quality of its legislation but also reinforce the belief that the host country is determined to create a reasonable and fair environment for foreign investment through advance consultation. By giving notice of proposed action and offering an opportunity to be heard about it, Chinese law-making institutions would do much to relieve the anxieties of foreign investors that a Sword of Damocles is about to descend without warning.

Finally, China should conclude mutual protection of investment treaties with the United States, Japan and other countries that have not yet reached such agreements with China and agreements for the avoidance of double taxation with countries that still lack them. The special status of Hong Kong investors should be recognized with respect to both types of agreement.

E. Taxation and Other Reforms

If China's Ministry of Finance would instruct all of the tax bureaus under its jurisdiction to grant would-be investors advance rulings on the tax consequences of their proposed investments, it would be taking a major step toward promoting FDI. Similarly, if the central agencies in charge of the customs, foreign exchange, land use, environmental and other important aspects of an investment contract that do not fall under the jurisdiction of MOFERT and its subordinate units were to instruct their respective organizations to grant advance rulings on the acceptability of the contemplated contract provisions relating to their responsibilities, they too would be rendering an important service. Such bureaucratic innovations would cost China nothing in foreign exchange but pay substantial dividends.

These innovations would not be necessary, of course, if in establishing its investment approval process in 1979 the PRC had decided to follow the example of certain other governments and authorize one central agency to approve all provisions of an investment contract in a

way that would bind all other central and local government agencies. Because the PRC decided not to do so, MOFERT's approval of investment contracts, we are told, merely signifies that such contracts are legal and at most calls upon MOFERT's sister ministries and other institutions to "actively support" the contract. This is why the foreign investor, in the absence of advance rulings by the other agencies, is left uncertain about those aspects of the contract that lie within their competence. To the outside observer, it would seem easier for the PRC to decide that those agencies should grant advance rulings than that the entire FDI process should be placed under the control of one super-agency whose approval of the contract would bind the Ministry of Finance and all other agencies. Yet, if the latter should prove possible, as some press reports have indicated, that would solve the problem.⁵

If neither of these administrative changes is possible, then a third option should be adopted. MOFERT should make clear to all Chinese parties and contract-approving authorities that a contract's legal effectiveness may be made subject to the condition precedent that the parties to the contract shall receive written confirmation of the contract's contemplated tax and other treatment from the relevant agencies. At least the parties' obligations to make their capital contributions should be allowed to be subject to such a condition.

Other reforms in tax administration would also be desirable. Publication of all relevant tax notices, interpretations and rulings in English as well as Chinese, without revealing the identity of particular taxpayers, would add to foreign understanding and presumably demonstrate the workings of a rational and fair system. Greater efforts would also be welcome to assure uniformity of treatment as between taxpayers in the same geographic area and as between those in different areas.

IV. CONCLUSION

In presenting the basic problems confronting FDI in China in Part II of this article and our proposals for improving the situation from the viewpoint of the TNCs in Part III, we do not mean to minimize the very substantial progress recited in Part I. Nor do we intend to imply that the responsibility for improving prospects for FDI in China is solely the PRC's. Obviously, the host country always has the principal burden for creating an appropriate FDI environment. Yet much must be done by the investor countries and by the TNCs themselves, and this is surely true with respect to encouraging FDI in China.

The principal investor countries should, for example: further ease their individual and multilateral restrictions on technology transfer to China;¹⁵⁶ make available greater developmental assistance to China bilaterally and via international organizations; offer tax, financing and other incentives to foster TNC investment there; complete the framework of bilateral agreements with China that promote FDI; reduce protectionist barriers against Chinese exports, enabling China to earn more of the foreign exchange that can facilitate FDI; and expand support for programs for the training and education of Chinese managers, scientists and technicians both in China and abroad.

As for the TNCs, they must pay attention to not only China's economic potential but also its economic priorities and channel their investment into those sectors that are of interest to China as well as themselves. They should: provide technology that is appropriate for and desired by China on reasonable terms; take a long-term view of profits; demonstrate as much flexibility and imagination in coping with the problems of exports and foreign exchange as they expect of the Chinese; be patient and positive contract negotiators capable of taking into account China's circumstances and needs and working out fair compromises; allocate managerial and technical personnel to China who are both professionally competent and culturally sensitive; be able and willing teachers; and at the same time be fair and equal partners in what is surely one of the most significant and hopeful efforts at international business cooperation the world has seen.

156. This should be supervised by COCOM, the Paris-based Coordinating Committee for Export Control.

