Notes

The Hopes and Fears of Foreign Direct Investment: A Comparative Evaluation of FDI Regulation in the People's Republic of China and Taiwan

The announcement by the People's Republic of China (PRC) of it's "Open Policy" toward foreign investment in 1978 raised great hopes for economic growth and prosperity both within the PRC and abroad. Rejecting past policies of autarky and strict "self-reliance," the PRC embarked on a new path, which sought to encourage the transfer of advanced technology from abroad and the investment of foreign capital in the PRC.[1]

In the years that have followed, reactions to the PRC's "Open Policy" have been mixed. While elements of optimism remain, sentiments of ambivalence, and even frustration have surfaced, especially among foreign writers.[2] In such analyses of the foreign direct investment (FDI) regime of the PRC, one often finds two implicit assumptions: 1) that despite significant liberalization in recent years, the PRC's legal regime for FDI remains significantly more closed than

1. S. HO & R. HUENEMANN, CHINA'S OPEN DOOR POLICY: THE QUEST FOR FOREIGN TECHNOLOGY AND CAPITAL 20-27 (1984).

2. *See, e.g.*, Cohen & Valentine, *Foreign Direct Investment in the PRC: Progress, Problems and Proposals*, 1 J. CHINESE L. 161 (1987); Hendryx, *The China Trade: Making the Deal Work*, HARV. BUS. REV., July-Aug. 1986, at 75; Pye, *The China Trade: Making the Deal, id.* at 74; Cohen, *Equity Joint Ventures—20 Potential Pitfalls That Every Company Should Know About*, CHINA BUS. REV., Nov.-Dec. 1982, at 276; Shellenbarger, *Beatrice Foods Finds the Pace Lags in China*, Wall St. J., Nov. 22, 1982, at 33, col. 2. For a more optimistic perspective, see Ruggles, *The Environment for American Business Ventures in the People's Republic of China*, COLUM. J. WORLD BUS., Winter 1983, at 67. For a discussion of recent negative experiences with FDI from the PRC's perspective, see Nournoff, *Transnational Corporation Investment in China: A View from the Outside*, in TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY 199, 209-18 (W. Teng & N.T. Wang eds. 1988).

those of other countries;[3] and 2) that obstacles to openness, such as government regulation and "interference" with "market forces," are detrimental not only to foreign investors in the PRC, but also to the PRC's own interests in its drive towards economic modernization.

Using Taiwan as a comparative basis, this paper will examine the validity of these two assumptions with respect to the government regulation of FDI in the PRC and Taiwan. After summarizing and comparing the basic legal structures of the FDI regimes in these two economies, this paper will compare their relative openness with regard to four apparent policy objectives: 1) the promotion of domestic capital accumulation; 2) the regulation of foreign exchange; 3) the promotion of advanced technology; and 4) the maintenance of domestic control over FDI activities. In addition, this paper will analyze the government regulation of FDI in the PRC and Taiwan in light of economic arguments set forth by both FDI proponents and critics. An attempt will be made to provide a theoretical background from which one may assess the economic rationality of relevant FDI laws and regulations.

From the perspectives of both PRC legal studies and development economics, Taiwan provides an interesting comparative basis for such analysis. As this paper will attempt to demonstrate, in addition to cultural, historical, and even ideological[4] roots shared by the PRC and Taiwan, the similarities between the legal regimes for FDI in the PRC and Taiwan undermine the conventional communist-capitalist dichotomy often associated with comparisons of the two economies. Not only is foreign private ownership of industrial enterprises in the PRC inconsistent with traditional notions of "communism;" the level of government regulation over FDI enterprises in Taiwan is inconsistent with traditional notions of "free market capitalism." Moreover, Taiwan's widely acknowledged "success story" of economic development challenges both conventional Marxist and conventional liberal economic development theories. Contrary to the expectations of conventional Marxist economic theories, Taiwan has achieved high levels of economic growth through a capitalist economy, while at the same

3. In its March 28, 1988 issue, FORTUNE Magazine gave the PRC a grade of "C" for "receptivity to foreign investment" while it gave Taiwan an "A." Kraar, *The New Powers of Asia*, FORTUNE, Mar. 28, 1988, at 126, 129.

While a multitude of extra-legal factors may affect a host country's attractiveness for FDI, e.g., costs of labor and raw materials, education levels, climate, political stability, geographic location, etc., the analysis in this paper will be limited to the legal aspects of the FDI environments in the PRC and Taiwan.

4. Both the PRC and Taiwan share political and ideological roots in the 1911 Revolution and the teachings of Dr. Sun Yat-sen. *See, e.g.*, SUN YAT-SEN, SAN MIN CHU I (The Three Principles of the People).

time maintaining relatively equal levels of income distribution.[5] Contrary to the expectations of conventional liberal economic theories, however, Taiwan also has achieved its "economic miracle" in spite of, if not because of, high levels of government regulation over FDI and other aspects of its domestic economy.

The impact of FDI on the economic development of less developed countries (LDCs) has been one of the most controversial issues in the study of economic development.[6] Proponents of FDI, which generally include business and government leaders of industrialized countries, as well as liberal economists, generally share the conventional view that FDI positively contributes to LDC economic development by providing host countries with missing factors of production such as capital, technology and management skills, as well as access to international export markets. These proponents contend that government "interference" with "market forces" should be minimized.[7] Critics, on the other hand, question the extent to which

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5. *See generally*, GROWTH WITH EQUITY: THE TAIWAN CASE (J. Fei, G. Ranis & S. Kuo eds. 1979).

6. For a concise summary of both the conventional and critical perspectives on FDI, see T. BIERSTEKER, DISTORTION OR DEVELOPMENT? 1-26 (1978). *See also*, R. HELLAWELL & R. PUGH, TAXATION OF TRANSNATIONAL TRANSACTIONS 1987-1988 6-35 (1987).

In the words of international economics Professor Chen Yin-fang of the PRC's Nankai University, "[O]pinions are widely divided on the role it [the multinational corporation] plays in world economic development—so much so that scholars with diverse views have made completely contradictory evaluations based on the results of their research." Chen Yin-fang, *Transnational Corporations and World Development: An Evolutionary View*, in TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY, *supra* note 2, at 33, 33.

7. T. BIERSTEKER, *supra* note 6, at 2. *See also*, I. FRANK, FOREIGN ENTERPRISE IN DEVELOPING COUNTRIES 2 (1980); Drucker, *Multinationals and Developing Countries: Myths and Realities*, 53 FOREIGN AFF. 134 (1974).

This "free market" ideology with respect to international capital flows has been central to United States policy. In the words of an official United States policy statement:

> International direct investment plays a vital and expanding role in the world economy. To ensure its maximum contribution to both global and domestic economic well-being, the United States believes that international direct investment flows should be determined by private market forces and should receive non-discriminatory treatment consistent with the national treatment principle.

U.S. DEPT. OF COMMERCE, INTERNATIONAL DIRECT INVESTMENT 85 (1984), *quoted in* Robock, *U.S. Policies Toward Transnationals*, in TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY, *supra* note 2, at 109.

With regard to inward FDI into the United States, since the end of World War II, the United States Government has maintained an essentially open policy, which was described by one French investor as a "no-door policy." *Id.* at 111. FDI critics might have predicted that such an open policy would have had a detrimental impact on the domestic United States economy. However, many of the potential problems associated with inward FDI may have been alleviated in the early post-war period by the United States' status as the world's largest creditor nation and the fact that inward FDI into the United States was only slightly more than one-fifth of the amount of outward FDI from United States. *Id.* However, in the 1980s, the United States has become the world's largest debtor nation and has a rapidly growing ratio of

LDCs actually receive the alleged benefits of FDI and emphasize negative results of FDI which are detrimental to host country economic development.[8] A primary source of this critical perspective has been the "dependency" school of theorists, whose work has been based primarily on the historical experiences of Latin America. Other critics of FDI have included both Marxist and non-Marxist scholars from Africa, Europe, North America, and the United Nations.[9]

Given this controversy over the impact of FDI on the economic development of LDCs, an analysis of the extent to which legal regimes regulating FDI address the concerns of both FDI proponents and critics is worthy of attention. The purpose of this paper is to elucidate the economic rationale underlying the legal regimes for FDI in the PRC and Taiwan. Conclusively resolving the theoretical and empirical economic debates over FDI, however, is beyond the scope of this paper. Specifically with regard to the PRC and Taiwan, one must consider not only the extent to which relevant laws and regulations encourage and maximize the benefits associated with FDI, but also the extent to which such laws and regulations minimize, for the host country, the risks and costs associated with FDI.

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inward to outward FDI. Whether this dramatic change in the international economic position of the United States will cause U.S. policymakers to consider more seriously the host country concerns emphasized by FDI critics remains to be seen.

8. *See, e.g.*, R. BARNET & R. MÜLLER, GLOBAL REACH: THE POWER OF THE MULTINATIONAL CORPORATIONS (1974); Cardoso, *Imperialism and Dependency in Latin America*, in STRUCTURES OF DEPENDENCY (F. Bonilla & R. Girling eds. 1973); Müller, *(More) on Multinationals: Poverty is the Product*, 13 FOREIGN POL'Y 71 (1973-74); Stallings, *Economic Dependency in Africa and Latin America*, III, 01-031 COMP. POL. SERIES 5 (1972); Sunkel, *Big Business and "Dependencia,"* 50 FOREIGN AFF. 517 (1972).

9. T. BIERSTEKER, *supra* note 6, at 1. Chinese leaders also have criticized FDI and the international economic order for impeding the economic development of LDCs. In the words of Premier Zhao Ziyang:

> The developing countries, which may differ in their conditions, are in the same plight. They were subjected to prolonged imperialist and colonialist domination and plunder in the past, and now are still heavily fettered by the unjust and inequitable international economic relationship . . . . The prosperity of the developed countries was, in the past, built on the impoverishment of underdeveloped countries.

Zhao Ziyang, For a New International Economic Order, Statement Delivered at the Cancun Meeting (Oct. 22, 1981).

For a discussion of multilateral efforts by the United Nations to curb abuses by multinational corporations, see Ebenroth & Karl, *Code of Conduct, International Investment Contracts, the Debt Crisis, and the Development Process*, 22 INT'L LAW. 179 (1988), *reprinted in* TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY, *supra* note 2, at 171.

I. THE BASIC LEGAL STRUCTURE FOR FDI IN THE PRC AND TAIWAN

A. *The PRC*

This paper will focus on three major forms of FDI in the PRC: equity joint ventures (equity JVs), cooperative enterprises, and wholly foreign owned enterprises (WFOEs).[10] All of these forms of FDI require examination and approval by the PRC's Ministry of Foreign Economic Relations and Trade (MOFERT) or its designates before they can be established. The approval process is conducted on a case by case basis.[11] The decision to grant approval is highly discretionary and is based in large part upon the perceived impact that an enterprise is expected to have on promoting the economic development goals of the PRC.

The primary legal provisions governing equity JVs in the PRC are contained in the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (JV Law),[12] promulgated in July 1979, and the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (JV Implementing Regulations),[13] promulgated on September 20, 1983 and amended on January 15, 1986. The JV Law contains fifteen articles which set the basic legal framework for equity JVs in very general terms. The JV Implementing Regulations contain 118 articles, divided into sixteen chapters, providing more detailed provisions governing equity JVs.[14]

The following are several key elements of the legal status of

10. Cooperative enterprises are sometimes referred to as "contractual joint ventures" or "cooperative ventures," and wholly foreign owned enterprises are sometimes referred to as "enterprises with sole foreign investment."

11. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa (The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment) art. 3 (adopted July 1, 1979, promulgated July 8, 1979) *trans. in* CHINA LAWS FOR FOREIGN BUSINESS (CCH) [CHINA L. FOR. BUS.] ¶ 6-500 [hereinafter JV Law]; Zhonghua Renmin Gongheguo Hezi Jingying Qiye Fa Shishi Tiaoli (Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment) arts. 3-5, 8 (promulgated Sept. 20, 1983, as amended Jan. 15, 1986) *trans. in* CHINA L. FOR. BUS. ¶ 6-550 [hereinafter JV Implementing Regulations]; Zhonghua Renmin Gongheguo Hezuo Jingying Qiye Fa (Law of the People's Republic of China on Sino-foreign Co-operative Enterprises) art. 5 (adopted Apr. 13, 1988) *trans. in* CHINA L. FOR. BUS. ¶ 6-100 [hereinafter Cooperative Enterprise Law]; Zhonghua Renmin Gongheguo Waizi Qiye Fa (Law of the People's Republic of China Concerning Enterprises with Sole Foreign Investment) art. 6 (promulgated Apr. 12, 1986) *trans. in* CHINA L. FOR BUS. ¶ 13-506 [hereinafter WFOE Law].

12. JV Law, *supra* note 11.

13. JV Implementing Regulations, *supra* note 11.

14. For a more detailed discussion of other laws and supporting regulations for FDI in the PRC, see generally, Gelatt, *Legal and Extra-legal Issues in Joint Venture Negotiations*, 1 J. CHINESE L. 217 (1987).

equity JVs in the PRC. An equity JV in the PRC is a limited liability company, with the liability of each party limited by the amount of capital subscribed by it.[15] The profits, risks, and losses of an equity JV are "shared by the parties to the venture in proportion to their contributions to the registered capital."[16] The JV Implementing Regulations provide that equity JVs are Chinese legal persons, "subject to the jurisdiction and protection of Chinese law,"[17] with the right "to do business independently," with relevant government departments providing "support and assistance."[18]

The duration for ordinary equity JVs is between ten and thirty years and is to be agreed upon by the parties. Terms of fifty years or more may be available in special cases.[19] Early dissolution of an equity JV may occur, upon authorization by the proper governmental authorities, for reasons such as the incurring of heavy losses, force majeure, or failure by one of the parties to fulfill its obligations to the venture.[20] Disputes between parties to an equity JV which cannot be settled through friendly consultations may be resolved by arbitration, as agreed to by the parties, or suit may be filed with the Chinese People's Court.[21]

The Law of the People's Republic of China on Sino-foreign Cooperative Enterprises (Cooperative Enterprise Law)[22] was adopted on April 13, 1988. Prior to the recent adoption of this law, some provisions of the JV Law and JV Implementing Regulations for equity JVs were applied by analogy to cooperative enterprises. In addition, government officials often followed internal (*neibu*) guidelines, which were generally unavailable to foreigners. In spite of a high degree of legal uncertainty, however, even before the 1988 adoption of the Cooperative Enterprise Law, cooperative enterprises had been a popular form of FDI in the PRC.[23]

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15. JV Implementing Regulations, *supra* note 11, art. 19.
16. JV Law, *supra* note 11, art. 4.
17. JV Implementing Regulations, *supra* note 11, art. 2.
18. *Id.* arts. 6, 7.
19. JV Law, *supra* note 11, art. 12; JV Implementing Regulations, *supra* note 11, arts. 100, 101. Such special cases include "projects in which the amount of investment is large, or the construction period long and the return on investment low, projects producing sophisticated products using advanced or key technology provided by the foreign partner, or for projects producing internationally competitive products." *Id.* art. 100.
20. JV Law, *supra* note 11, art. 13; JV Implementing Regulations, *supra* note 11, art. 102.
21. JV Law, *supra* note 11, art. 14; JV Implementing Regulations, *supra* note 11, arts. 109-112.
22. Cooperative Enterprise Law, *supra* note 11.
23. Moser, *Foreign Investment in China: The Legal Framework*, in FOREIGN TRADE, INVESTMENT AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 106, 111 (M. Moser ed. 1984).

There are two basic forms of cooperative enterprises. The first, sometimes referred to as the "true" cooperative enterprise, does not result in the creation of a new legal entity. These enterprises are governed by a joint management body consisting of members appointed by both partners. Rights, obligations, and liabilities remain clearly separated between the partners to the venture, the terms of which are specified in the underlying contract. The benefits of limited liability enjoyed by equity JVs therefore are not available to true cooperative enterprises.[24] The second form of cooperative enterprise, sometimes referred to as the "hybrid" cooperative enterprise, has certain characteristics of both true cooperative enterprises and equity JVs. The establishment of a hybrid cooperative enterprise creates a new legal entity with legal person status, governed by a board of directors consisting of both Chinese and foreign members. The partners to a hybrid cooperative enterprise remain liable for debts in accordance with a ratio specified in the venture's underlying contract.[25] Whether hybrid cooperative enterprises may enjoy limited liability remains somewhat ambiguous. While the Cooperative Enterprise Law does not expressly provide for limited liability, the legal person status of hybrid cooperative enterprises might entitle them to limited liability under the General Principles of the Civil Law of the People's Republic of China (Civil Law).[26] The duration of a cooperative enterprise must be stipulated by its partners in the cooperative enterprise contract and must be approved by the government's examining authorities in the initial approval process. This term may be extended upon application to and approval by government authorities.[27]

WFOEs are enterprises established within the PRC, in accordance with PRC laws, with capital entirely owned by foreign investors.[28] The legal status of WFOEs is outlined in The Law of the People's Republic of China Concerning Enterprises with Sole Foreign Investment (WFOE Law),[29] promulgated on April 12, 1986. More detailed regulations on WFOEs are to be issued in the future by the PRC's State Council.[30] The WFOE Law guarantees that the PRC

24. *Id.*; Cooperative Enterprise Law, *supra* note 11, arts. 12, 22. *See also*, Cohen, *The Long-Awaited Cooperative Venture Law*, CHINA BUS. REV., Jul.-Aug. 1988, at 14, 16.

25. Moser, *supra* note 23, at 112; Cooperative Enterprise Law, *supra* note 11, arts. 12, 22.

26. Cohen, *supra* note 24, at 15-16. *See also*, Zhonghua Renmin Gongheguo Minfa Tongze (General Principles of the Civil Law of the People's Republic of China) art. 37 (adopted Apr. 12, 1986) *trans. in* CHINA L. FOR. BUS., *supra* note 11, ¶ 19-150 [hereinafter Civil Law].

27. Cooperative Enterprise Law, *supra* note 11, art. 25.

28. WFOE Law, *supra* note 11, art. 2.

29. *Id.*

30. *Id.* art. 23.

and its laws will protect "the lawful rights and interests" of WFOEs and their investors.[31] WFOEs are protected against nationalization and expropriation by the state, except under special circumstances, in which commensurate compensation will be paid.[32] Duly established and registered WFOEs, which conform with the definition of legal persons in the Civil Law, are recognized as having legal person status.[33] Unlike the JV Law, which explicitly states that equity JVs are limited liability companies,[34] the WFOE law has no such explicit statement, leaving some ambiguity as to whether the liability of a foreign investor in a WFOE can extend beyond his/her capital contribution to the venture.[35] The term of operation of a WFOE must be approved by government authorities as part of the venture's initial approval process. As with cooperative enterprises, this term may be extended upon application to and approval by government authorities.[36]

B. Taiwan

Unlike the FDI regime of the PRC, in which the major opportunities for FDI are limited to corporate forms specifically designed for foreigners and created under laws separate from those applicable to domestic entities,[37] Taiwan's Company Law applies to both foreign and domestic investors.[38] Under the Company Law, both foreign and domestic investors in Taiwan may choose from the following corporate forms: unlimited company, unlimited company with limited liability shareholders, limited company, or company limited by shares.[39] In addition, Taiwan's Company Law allows foreign investors to opt for establishing a foreign company branch.[40]

An unlimited company is a separate juristic entity which must

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31. *Id.* arts. 1, 4.

32. *Id.* art. 5.

33. *Id.* art. 8. These criteria require that the entity 1) be established in accordance with the law; 2) possess necessary property or funds; 3) have its own name, organizational structure, and premises; and 4) be capable of independently bearing civil responsibility. Civil Law *supra* note 26, art. 37. *See also*, Torbert, *Wholly Foreign-Owned Enterprises Come of Age*, CHINA BUS. REV., July-Aug. 1986, at 50.

34. JV Law, *supra* note 11, art. 4.

35. Torbert, *supra* note 33, at 51.

36. WFOE Law, *supra* note 11, art. 20.

37. At the time of this writing, the PRC has not adopted a general company law applicable to foreign investors.

38. *See generally*, Gongci Fa (Company Law) (as amended May 9, 1980) *trans. in* INVESTMENT LAWS OF THE WORLD—TAIWAN [INV. L. WORLD TAIWAN] 39 [hereinafter Company Law].

39. *Id.* art. 2.

40. *Id.* arts. 4, 370-386.

have two or more shareholders. The shareholders of an unlimited company have unlimited joint liability.[41] The provisions of chapter II of Taiwan's Company Law, which govern unlimited companies, apply *mutatis mutandis* to unlimited companies with limited liability shareholders unless otherwise provided by the statute. The primary difference between an unlimited company and an unlimited company with limited liability shareholders is that, in addition to unlimited liability shareholders, the latter also has shareholders whose liability is limited by the amount of their contributed capital.[42] Limited liability shareholders in this context cannot transfer their capital contribution without the majority consent of the company's unlimited liability shareholders.

A limited company must have at least five but no more than twenty-one shareholders.[43] The liability of shareholders of limited companies is limited to the amount of their contributed capital.[44] The articles of incorporation of a limited company must state the terms of profit and loss distribution and may prescribe that votes be allocated to shareholders in proportion to their respective capital contributions. If no such prescription is made, however, each shareholder shall have one vote irrespective of the amount of his/her contributed capital.[45] The minimum total capital required for a limited company is decided by a government authority "according to the nature of the [company's] operations . . . and in consideration of the existing situation."[46] A limited company is prohibited from reducing its authorized capital.[47] Majority shareholder approval is required for shareholders to transfer all or part of their contributed capital. In addition, dissenting shareholders have a preemptive right to purchase such shares.[48]

The longest and most complex chapter of Taiwan's Company Law governs companies limited by shares. This corporate form is most similar to that of a United States corporation and tends to be most attractive to foreign investors.[49] In addition to the rights and opportunities provided by the Company Law and the Statute for Investment by Foreign Nationals (SIFN), companies limited by

41. *Id.* arts. 2, 40.
42. *Id.* arts. 114-115.
43. *Id.* art. 98.
44. *Id.* art. 99.
45. *Id.* arts. 101-102.
46. *Id.* art. 100.
47. *Id.* art. 106.
48. *Id.* art. 111.
49. Wang, *Chinese Corporation Law*, in TRADE AND INVESTMENT IN TAIWAN 479, 486 (Cosway, Ma & Shattuck eds. 1973).

shares which obtain foreign investment approval (FIA) may be eligible for additional investment incentives provided for by the Statute for Encouragement of Investment (SEI).[50] A company limited by shares is initially formed by at least seven promoters,[51] and capital may be raised by soliciting shares to the public. The liability of shareholders is limited by the amount of their contributed capital.[52] A minimum requirement of invested capital may be fixed for a company limited by shares by a government authority in consideration of "the nature of the company's business and the circumstances thereof."[53] Subject to a few exceptions, shares of a company limited by shares are freely transferable.[54]

A foreign company branch in Taiwan, if it receives a certificate of recognition from government authorities,[55] with a few exceptions,[56] is entitled to the same rights and subject to the same obligations as a company formed domestically within Taiwan.[57] Government authorities may specify a minimum requirement of capital invested by a company branch in Taiwan.[58]

From a technical legal standpoint, both foreign and domestic investors in Taiwan are governed by the same Company Law, which gives foreign investors access to the same corporate forms that are available to domestic investors. From a practical standpoint, however, foreign and domestic investors are treated quite differently by the laws of Taiwan. In contrast to the PRC, where many of the basic rights and interests of the foreign investor are closely linked to the form of FDI that is chosen, analogous rights and interests in Taiwan seem to be less closely linked to corporate form. More important is whether a foreign investor receives FIA under Taiwan's SIFN.[59]

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50. Waiguoren Touzi Tiaoli (Statute for Investment by Foreign Nationals) (as amended May 14, 1986) [hereinafter SIFN]; Jiangli Touzi Tiaoli (Statute for Encouragement of Investment) art. 3 (as amended Jan. 26, 1987) [hereinafter SEI].

51. Company Law, *supra* note 38, arts. 2, 128.

52. *Id.* arts. 2, 154.

53. *Id.* art. 156.

54. *Id.* art. 163; Wang, *supra* note 49, at 495.

55. Without recognition, a foreign company in Taiwan may still engage in business, but with very limited capacity. To do so, the foreign company must file with government authorities a report which includes information required by article 386 of the Company Law. However, if a foreign company branch has applied for and/or been denied recognition, it may not conduct business as a foreign company branch without recognition. *See* Company Law, *supra* note 38, arts. 371, 386.

56. A foreign company branch with recognition may not own land, solicit shares or issue bonds in Taiwan if its home country does not extend the same privileges to companies from Taiwan. *Id.* arts. 376, 383.

57. *Id.* art. 375.

58. *Id.* art. 372.

59. SIFN, *supra* note 50, art. 8.

Although foreigners may invest in Taiwan without FIA, FIA allows foreign investors to have many important "privileges," the possession of which many would consider to be prerequisites to their investing in Taiwan. Among these privileges are: protection against government expropriation,[60] the right to outward remittance of profits and invested capital, foreign exchange settlement,[61] full foreign ownership of capital and control of management,[62] and various tax incentives.[63] With these privileges, however, come a variety of restrictions and requirements (discussed in greater detail below) that foreign investors must adhere to in order to qualify for FIA. In short, it is through the granting of FIA privileges, rather than the controlling of FDI entry per se, that the government seeks to shape the nature of FDI activities in Taiwan.

Procedurally, obtaining FIA requires the approval of Taiwan's Investment Commission, an investment screening committee established by the Ministry of Economic Affairs (MOEA).[64] A high level of discretion in granting FIA is implied by the very general language of the SIFN. The decision of the Investment Commission depends largely upon its appraisal of the potential impact that a particular FDI project will have on the social and economic development of Taiwan. Such discretion may be limited to some extent, however, by administrative guidelines established by the Executive Yuan.[65]

For enterprises which obtain FIA, Taiwan's SIFN provides protection against government expropriation. The SIFN guarantees that foreign investors with FIA who contribute and continue to hold more than forty-five percent of an enterprise's total capital, "shall not be subject to requisition or expropriation for a period of twenty years after the commencement of business."[66] Foreign investors holding less than forty-five percent of an enterprise's total capital are guaranteed that they shall be "reasonably compensated if the government requisitions or expropriates the enterprise because of national defense needs."[67]

60. *Id.* arts. 15-16.

61. *Id.* arts. 12-13, 15.

62. *Id.* art. 18.

63. *See, e.g.*, SEI, *supra* note 50, arts. 3, 6-65.

64. SIFN, *supra* note 50, art. 7.

65. Liu, *Encouragement of Foreign Investment in the Republic of China* in TRADE AND INVESTMENT IN TAIWAN, *supra* note 49, at 252.

66. SIFN, *supra* note 50, art. 16.

67. *Id.* art. 15.

C. Comparisons

The FDI regimes of both the PRC and Taiwan grant foreign investors legal capacity, rights, and protection in accordance with their respective laws. However, neither regime treats these elements of legal status as entitlements to which foreign investors have an inherent right. Rather, the underlying bases for legal status of FDI enterprises in both the PRC and Taiwan appear to be more in the nature of contractual rights, granted to FDI enterprises by administrative authorities with very high levels of discretion, in exchange for positive contributions to economic development. Nor is it assumed by either regime that all FDI enterprises are necessarily beneficial to host country economic development. As will be discussed in greater detail below, the qualitative requirements for FDI imposed by the PRC and Taiwan appear to serve the dual purpose of encouraging and facilitating FDI by beneficial enterprises, while at the same time screening out enterprises which are potentially detrimental to the pursuit of long run economic goals.

In the PRC, the discretionary approval process regulates the initial entry of virtually all FDI projects. In Taiwan, on the other hand, such discretionary approval does not regulate FDI entry per se, but rather the granting of FIA and its related privileges. Arguably, Taiwan's FDI regime appears to be more liberal than the PRC's in this regard since a foreign investor could invest in Taiwan without obtaining FIA and thus avoid the government's discretionary approval process. Prior to 1987, however, the practical effect of this difference was minimal, as invested capital and profits could not be repatriated by foreign investors without FIA due to strict foreign exchange controls. Taiwan's foreign exchange liberalization of 1987, however, makes it now possible for foreign companies without FIA to outwardly remit up to US$5 million per year.[68] Nevertheless, despite this foreign exchange liberalization, other legal rights important to foreign investors in Taiwan still are conditioned upon obtaining FIA, thus continuing in large part the subjection of potential foreign investors to the discretionary approval process of Taiwan's administrative authorities.

With regard to limited liability status, both the PRC and Taiwan allow both limited and unlimited liability FDI enterprises. In the

68. Liu, *supra* note 65, at 259; Minjian Huichu Kuanxiang Jiehui Banfa (Regulations for Non-Governmental Outward Remittances) art. 4 (amended and promulgated by the Central Bank of China July 13, 1987) *trans. in* INDUSTRIAL DEVELOPMENT AND INVESTMENT CENTER, REVISED OPERATIONAL GUIDELINES FOR FOREIGN EXCHANGE BUSINESS 23 (1987); Liu, *Taiwan's Deregulation of Foreign Exchange*, E. ASIAN EXECUTIVE REP., July 1987, at 7, 21-22.

PRC, equity JVs have limited liability while cooperative enterprises generally do not.[69] The WFOE law is silent regarding limited liability, leaving some ambiguity as to the status of WFOEs.[70] In Taiwan, limited companies and companies limited by shares have limited liability, while unlimited companies do not. Unlimited companies with limited liability shareholders have both shareholders with limited and unlimited liability.[71] In both the PRC and Taiwan, where limited liability status is allowed, such enterprises are not allowed to reduce their invested capital below prescribed levels.

The FDI regimes of both the PRC and Taiwan provide FDI enterprises with protection against government expropriation. However, in neither case is this protection absolute. In Taiwan, a foreign investor must obtain FIA in order to receive the protection against government expropriation provided by Taiwan's SIFN. Even with FIA, however, a foreign investor owning less than forty-five per cent of the total capital of an enterprise is only guaranteed to be "reasonably compensated if the government requisitions or expropriates the enterprise because of national defense needs."[72] A foreign investor with FIA owning forty-five per cent or more of an enterprise's total capital "shall not be subject to requisition or expropriation," but only "for a period of twenty years after commencement of business," and only "as long as the investor continues to hold forty-five per cent or more of the total capital."[73] In the PRC, the WFOE law provides that the "State will not nationalise or expropriate" WFOEs except under special circumstances "where it is necessary to the public interest." Expropriation is to be conducted "in accordance with legal procedures," and "appropriate compensation" is to be paid to the foreign investor.[74] With regard to equity JVs, the JV Law is less explicit, stating only that the PRC Government protects "the resources invested by a foreign participant . . . as well as his other lawful rights and interests."[75] The Cooperative Enterprise Law contains similar language, providing that "[t]he State shall protect the legal rights and interests of cooperative enterprises and Chinese and foreign partners in accordance with the law."[76]

69. JV Law, *supra* note 11, art. 4; JV Implementing Regulations, *supra* note 11, art. 19; Moser, *supra* note 23, at 112; Cooperative Enterprise Law, *supra* note 11, art. 22. *See also*, *supra* note 26 and accompanying text.

70. Torbert, *supra* note 33, at 51.

71. Company Law, *supra* note 38, arts. 2, 4.

72. SIFN, *supra* note 50, art. 15.

73. *Id.* art. 16.

74. WFOE Law, *supra* note 11, art. 5.

75. JV Law, *supra* note 11, art. 2.

76. Cooperative Enterprise Law, *supra* note 11, art. 3.

In summary, the basic legal structures for FDI in both the PRC and Taiwan grant FDI entry and other legal rights, but only on a discretionary basis of administrative approval, based upon the positive contributions that an FDI project is expected to make to host country economic development. The opportunity for both limited and unlimited liability enterprises are available in both the PRC and Taiwan. Guarantees against government expropriation also are provided, although such guarantees are not absolute.

II. Promotion of Domestic Capital Accumulation

A. *Comparisons Between the PRC and Taiwan*

The FDI regimes of both the PRC and Taiwan appear to promote domestic host country capital accumulation by imposing requirements with regard to: 1) the ratio and amount of foreign capital investment; 2) the nature of in kind capital contributions; 3) the distribution of profits and losses; 4) domestic linkages; and 5) qualitative requirements for FDI activities.

1. Ratio and Amount of Foreign Capital Investment

The FDI regimes of both the PRC and Taiwan strongly encourage domestic participation in the ownership of FDI enterprises. Although both regimes allow for full foreign ownership (in the form of WFOEs in the PRC, and limited companies with FIA and companies limited by shares with FIA in Taiwan), stricter requirements and restrictions apply to such enterprises. In the PRC, for example, the WFOE Law places a greater emphasis on high technology and exports than do the JV Implementing Regulations by explicitly requiring that WFOEs "adopt advanced technology and equipment or export all or most of their products."[77] In Taiwan, as a general rule, at least one half of the shareholders (or promoters in the case of companies limited by shares) of all companies formed in Taiwan must be "domiciled within the territory of the Republic of China"[78] This requirement can be waived, allowing for greater foreign ownership, for limited companies and companies limited by shares, but only after such companies qualify for and receive FIA. Such exceptions are not available for other corporate forms.[79]

The FDI regimes of the PRC and Taiwan also seek to ensure that FDI enterprises actually introduce foreign capital to their respec-

77. WFOE Law, *supra* note 11, art. 3; JV Implementing Regulations, *supra* note 11, arts. 3-5.

78. Company Law, *supra* note 38, arts. 40, 98, 115, 128.

79. SIFN, *supra* note 50, art. 18; Company Law, *supra* note 38, arts. 98, 128.

tive economies. When an equity JV is formally established in the PRC, both the Chinese and foreign parties must register the capital that they initially contribute to the venture with the government's registration authorities. This "registered capital," which is essentially the parties' equity investment in the venture, cannot be reduced during the entire term of the venture. In general, the foreign party must contribute at least twenty-five percent of an equity JV's registered capital.[80] Debt financing from domestic sources is available to equity JVs in the form of loans from the government-owned Bank of China. Loans may be obtained for working capital, for the settlement of accounts, or for the purchase of fixed assets. Such loans are not available, however, until after the venture is approved and registered. Collateral or a guarantee, often from the parent company of a party to an equity JV, must be pledged in order to obtain loan approval from the Bank of China.[81] The Cooperative Enterprise Law does not prescribe a specific minimum percentage for foreign equity contributions. However, article 9 of the Cooperative Enterprise Law requires both Chinese and foreign partners to a cooperative enterprise to "discharge their obligations both to subscribe their investment in full and to provide conditions for cooperation on schedule" in accordance with relevant laws, regulations, and contractual terms. Failure to do so may result in deadlines being set by administrative authorities, who may "handle the matter in accordance with relevant regulations."[82] With regard to WFOEs, the enterprise's total capital investment must be made within the approved time period and under the supervision and examination of administrative authorities.[83]

Taiwan is somewhat more liberal than the PRC with regard to minimum requirements for foreign capital contributions. Unlike the PRC's JV Law, Taiwan's SIFN does not explicitly set a required minimum percentage, although presumably government authorities have the discretion to deny FIA to ventures in which they think the capital contribution of the foreign party is too low.[84] In addition, as dis-

80. JV Law, *supra* note 11, art. 4; JV Implementing Regulations, *supra* note 11, arts. 20-22; Moser, *supra* note 23, at 121.

81. Moser, *supra* note 23, at 122; *See also* Zhongguo Yinhang Banli Zhongwai Hezi Jingying Qiye Daikuan Zanxing Banfa (Provisional Regulations for Providing Loans to Joint Ventures Using Chinese and Foreign Investment by the Bank of China) (promulgated March 13, 1981) *trans. in* CHINA L. FOR. BUS., *supra* note 11, ¶ 6-530; Zhongguo Yinhang Dui Waishang Touzi Qiye Daikuan Banfa (Measures of the Bank of China on Loans for Foreign Investment Enterprises) art. 7 (promulgated Apr. 24, 1987) *trans. in* CHINA L. FOR. BUS. ¶ 8-702.

82. Cohen, *supra* note 24, at 14; Cooperative Enterprise Law, *supra* note 11, art. 9.

83. WFOE Law, *supra*, note 11, art. 9.

84. SIFN, *supra* note 50, arts. 8-9.

cussed above, Taiwan's Company Law gives government authorities the power to prescribe minimum requirements of capitalization for companies with limited liability (i.e., limited companies and companies limited by shares) as well as for foreign company branches.[85]

2. Nature of In Kind Capital Contributions

In both the PRC and Taiwan, capital invested by a foreign party to a venture may take the form of in kind contributions,[86] subject to certain restrictions. For equity JVs in the PRC, in kind capital contributions must be indispensable to the venture, unavailable on substantially the same terms from domestic PRC sources, and priced at or below current international market prices.[87] Valuation of in kind capital contributions to equity JVs is to be made through consultation by the parties to the venture "on the basis of fairness and reasonableness" or by a third party agreed to by the parties.[88] The Cooperative Enterprise Law is less specific with regard to restrictions on in kind capital contributions and merely provides that "[i]nvestment or terms for co-operation by Chinese and foreign partners may be in the form of cash, [in] kind, land-use rights, industrial property rights, non-patented technology and other property rights."[89] While this lack of specificity in the Cooperative Enterprise Law might be interpreted to suggest that fewer restrictions apply to in kind contributions made to cooperative enterprises, it is possible that, as was the case for equity JVs, more specific restrictions will appear in the implementing regulations for cooperative enterprises, which are to be promulgated in the future.[90]

Taiwan's FDI regime also prescribes requirements for foreign capital investments made in the form of in kind contributions such as machinery, equipment, raw materials, technical know-how, or patent rights. According to the SIFN, in kind foreign capital contributions must be "domestically needed." In addition, according to regulations promulgated by Taiwan's MOEA, patent rights and technical know-how capitalized as equity investments must enable the production of new products not currently available in Taiwan, improve the quality of existing products, or reduce costs. The amount of capitalized patent rights cannot exceed twenty percent of an enterprise's total capital

85. Company Law, *supra* note 38, arts. 100, 156, 372.

86. For a discussion of in kind capital contributions of advanced technology, see *infra* notes 150-59 and accompanying text.

87. JV Implementing Regulations, *supra* note 11, art. 27.

88. *Id.* art. 25.

89. Cooperative Enterprise Law, *supra* note 11, art. 8.

90. *Id.* art. 27.

stock. Capitalized technical know-how may not exceed fifteen percent of an enterprise's total capital stock. In addition, an investor contributing capitalized technical know-how must, at the same time, make an additional capital contribution, of at least an equal amount, in cash or in kind. Both technical and economic specifications for capitalized patent rights and technical know-how must be examinied and approved by authorities designated by the MOEA.[91] Taiwan's SIFN further requires that the contributed capital of foreign investors be remitted in full within a prescribed time limit. Failure to meet this requirement can result in revocation of FIA.[92]

3. Distribution of Profits and Losses

The PRC's JV Law requires that after income taxes are paid and reserve, expansion, and workers' welfare and bonus funds are set aside, net profits of an equity JV be divided between the Chinese and foreign parties in proportion to their respective shares of registered capital.[93] Profits cannot be distributed, however, until the losses from previous years have been made up.[94] More flexibility is allowed with regard to the profit distribution schemes of cooperative enterprises, although government approval still is required. Unlike in equity JVs, the profits of cooperative enterprises do not have to be divided between the parties in proportion to their respective capital contributions.[95] Some differences with regard to expense allocation and profit distribution exist between hybrid and true cooperative enterprises. In hybrid cooperative enterprises, before profits are distributed to any of the partners, joint operating expenses of the venture are paid from gross income, and taxes are levied on net income. Deductions also are put aside for the venture's reserve, workers', and expansion funds. In a true cooperative enterprise, a fixed amount of total revenues is contributed to a common fund to cover joint operating expenses. Taxes and other expenses are paid by the individual partners themselves from the income they receive from the venture.[96] WFOEs in the PRC are free to remit their lawful profits and other lawful income abroad, subject to foreign exchange controls (discussed below).[97]

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91. SIFN, *supra* note 50, art. 3; Zhuanli Quan Ji Zhuanmen Jishu Zuowei Guben Touzi Banfa (Regulations Governing the Use of Patent Rights and Technical Know-How as Equity Investment) arts. 4-6 (approved May 9, 1968, promulgated June 3, 1968) [hereinafter Capitalized Technology Regulations].

92. *Id.* art. 9.

93. JV Law, *supra* note 11, arts. 4, 7.

94. JV Law, *supra* note 11, art. 7; JV Implementing Regulations, *supra* note 11, art. 88.

95. Moser, *supra* note 23, at 112-13; Cooperative Enterprise Law, *supra* note 11, art. 22.

96. Moser, *supra* note 23, at 113.

97. WFOE Law, *supra* note 11, arts. 18, 19.

Taiwan's SIFN does not prescribe a specific profit distribution scheme for FDI enterprises in Taiwan. However, whatever scheme is devised can be monitored by government authorities through the application process for FIA.[98] In addition, companies with FIA seeking foreign exchange settlement to repatriate profits under the SIFN must submit a profit distribution list, balance sheet, profit and loss statement, and other relevant documents to Taiwan's foreign exchange authorities for review.[99]

4. Promotion of Domestic Linkages

The FDI regimes of both the PRC and Taiwan seek to promote linkages between FDI enterprises and their domestic economies. In the PRC, equity JVs and WFOEs are allowed to import inputs needed for production. However, where conditions are the same, the JV Law and JV Implementing Regulations, as well as the WFOE Law, state that such enterprises should give priority to domestic Chinese sources.[100] Interestingly, the new Cooperative Enterprise Law does not require that such preferences be given to Chinese sources, possibly suggesting greater flexibility in this regard.[101] Taiwan's SIFN does not include explicit provisions requiring preferences to domestic input sources. However, similar objectives have been pursued in Taiwan through administrative guidelines for implementing the SIFN, which have included domestic content requirements ranging from 40 to 70 percent for products produced by companies seeking FIA.[102]

5. Qualitative Requirements

The qualitative requirements applied to FDI enterprises by the FDI regimes of the PRC and Taiwan are strikingly similar in several respects. First, at a very general level, both regimes contain explicit language requiring FDI enterprises to have a beneficial impact on economic development.[103] The PRC's JV Implementing Regulations provide that "[j]oint ventures established within China's territory should be able to promote the development of China's economy." Moreover, they prohibit the approval of projects which are antithetical to China's sovereignty, laws, national economic development,

98. SIFN, *supra* note 50, art. 8.

99. *Id.* art. 14.

100. JV Law, *supra* note 11, art. 9; JV Implementing Regulations, *supra* note 11, art. 57; WFOE Law, *supra* note 11, art. 15.

101. Cooperative Enterprise Law, *supra* note 11, art. 19.

102. Liu, *supra* note 65, at 252.

103. JV Implementing Regulations, *supra* note 11, arts. 3-5; Cooperative Enterprise Law, *supra* note 11, arts. 1, 3; WFOE Law, *supra* note 11, art. 3; SIFN, *supra* note 50, art. 5.

environmental interests, or which contain an "obvious inequity."[104] The Cooperative Enterprise Law prescribes that cooperative enterprises are established "in accordance with the principles of equality and mutual benefit," and that they "shall not harm the public interests of Chinese society."[105] The WFOE Law requires that WFOEs "benefit the development of the Chinese national economy," and that such enterprises "shall not harm the social order or public interest of China."[106] In Taiwan, the SIFN provides that FIA may be granted to investments which are conducive to the "economic and social development in the Republic of China."[107]

In both the PRC and Taiwan, where advanced technology (discussed below) is not involved, FDI enterprises generally are restricted with regard to competing with existing domestic producers. Most outputs must be exported or serve as import substitutes if sold to the domestic market.[108] In addition, Taiwan has allowed companies with FIA to sell to the domestic market goods for which there is a domestic shortage despite domestic production, goods for which domestic quality is below international or nationally prescribed standards, and goods for which domestic prices exceed import prices by ten percent or more.[109]

Finally, the FDI regimes of both the PRC and Taiwan give preferences to FDI enterprises producing for sectors of their respective economies targeted by the government for development.[110] In the PRC, these targeted sectors include: "(1) [e]nergy [d]evelopment[,] the building material, chemical and metallurgical industries; (2) [m]achine manufacturing, instrument and meter industries and offshore oil exploitation equipment manufacturing; (3) [e]lectronics and computer industries, and communication equipment manufacturing; (4) [l]ight, textile, foodstuffs, medicine, medical apparatus and packaging industries; (5) [a]griculture, animal husbandry and fish breeding; (6) [t]ourism and service industries."[111] In Taiwan, similar preferences have been given to "important industrial, mining or communication enterprises," and "service enterprises which are needed

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104. JV Implementing Regulations, *supra* note 11, arts. 3, 5.

105. Cooperative Enterprise Law, *supra* note 11, arts. 1, 3.

106. WFOE Law, *supra* note 11, arts. 3, 4.

107. SIFN, *supra* note 50, art. 5. *See also*, Liu, *supra* note 65, at 255.

108. JV Implementing Regulations, *supra* note 11, art. 4; Cooperative Enterprise Law, *supra* note 11, art. 4; WFOE Law, *supra* note 11, art. 3; SIFN, *supra* note 50, art. 5; Chiu, *The General Economic and Business Climate for Trade and Investment Between the United States and Republic of China*, in TRADE AND INVESTMENT IN TAIWAN, *supra* note 49, at 63.

109. Liu, *supra* note 65, at 252.

110. JV Implementing Regulations, *supra* note 11, art. 3; SIFN, *supra* note 50, art. 5.

111. JV Implementing Regulations, *supra* note 11, art. 3.

domestically."[112]

B. Economic Rationality

Perhaps the most common theoretical justification for FDI is that it promotes economic development by introducing foreign capital to a host country economy, thus supplementing host country savings and investment. This can be especially important at early stages of economic development, when the need for investment in infrastructure and long term productive capacity is great, but the availability of domestic capital is scarce. Proponents of FDI also contend that FDI by multinational corporations (MNCs) may further help to promote host country capital accumulation by providing host LDCs with greater access to international export markets and distribution channels.[113] Such export opportunities can be especially beneficial to an LDC's capital accumulation efforts since they not only increase demand for the country's productive outputs but also do so without raising the country's domestic consumption level with regard to the exported goods.[114]

Critics question, however, the extent to which LDCs actually receive these alleged benefits of FDI. They contend that as an empirical matter, FDI often does not promote host country capital accumulation due to disproportionately large outward repatriations of profits, which make such funds unavailable for domestic reinvestment or even consumption. According to a 1983 United Nations study, between 1970 and 1980, the annual capital outflows from LDCs associated with FDI were approximately twice the amount of capital inflows.[115] Critics thus charge FDI with promoting the "decapitalization" of LDCs.[116] Critics further charge that FDI often fails to provide host countries with access to international export markets due to the common MNC practice of limiting sales to domestic host country markets in order to protect the markets of other subsidiaries operating in neighboring countries.[117]

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112. SIFN, *supra* note 50, art. 5.

113. T. BIERSTEKER, *supra* note 6, at 2.

114. This contrasts with domestically produced consumer goods sold to the domestic market, which do increase a country's GNP, but raise domestic consumption at the same time, thus lowering the country's domestic savings/consumption ratio.

115. Cunningham, *Multinationals and Restructuring in Latin America*, in MULTINATIONAL CORPORATIONS AND THE THIRD WORLD 42 (C. Dixon, D. Drakakis-Smith & H. Watts eds. 1986).

116. T. BIERSTEKER, *supra* note 6, at 3.

117. *Id.* at 4; *See also* Sunkel, *National Development Policy and External Dependence in Latin America* in CONTEMPORARY INTER-AMERICAN RELATIONS 484 (H. Ferguson ed. 1972).

Several common practices may serve to inflate the profits repatriated by FDI enterprises. One such practice is the financing of FDI enterprises not through predominantly foreign capital, but rather through loans obtained from host country sources. By obtaining loans from host country sources as a form of leveraging, foreign investors can introduce relatively small amounts of capital to a host country in the form of initial investment, while in the long run repatriating a disproportionately large share of profits.[118] Such leveraging may further decrease host country ownership and profit reinvestment by displacing host country investors from obtaining the use of already limited domestic capital. According to one study, while United States-based MNCs in Latin America financed 83 percent of their operations from host country sources between 1957 and 1965, between 1960 and 1968, such United States-based MNCs repatriated, on average, 79 percent of their net profits to United States stockholders.[119] In its examination of specific sectors of Latin America's economy, one study concluded:

> Between 1965 and 1968, 52 percent of all profits of U.S. subsidiaries operating in Latin America in manufacturing—the most dynamic sector of the hemisphere's economy—were repatriated to the United States. This means that for every dollar of net profit earned by a global-corporation subsidiary, 52 cents left the country, even though 78 percent of the investment funds used to generate the dollar of profit came from local sources. If we look at the mining, petroleum, and smelting industries, the capital outflow resulting from the operations of global corporations is even worse. Each dollar of net profit is based on an investment that was 83 percent financed from local savings; yet only 21 percent of the profit remains in the local economy.[120]

Repatriated profits also may be inflated by monopoly profits, which may be available to foreign investors for several reasons related

118. A. AKINSANYA, MULTINATIONALS IN A CHANGING ENVIRONMENT 92 (1984). Furthermore, in very highly leveraged capital structures, host country creditors are not only denied the opportunity to share profits; they also incur levels of risk which may be as high as those incurred by the foreign owners of equity. In short, host country creditors to highly leveraged FDI enterprises can be stuck with the "worst of both worlds." For a discussion of the relationship between an enterprise's leverage and its creditors' levels of risk, see generally, CORPORATE FINANCE CASES AND MATERIALS 372, 430 (V. Brundey & M. Chirelstein eds. 1987).

119. R. BARNET & R. MÜLLER, *supra* note 8, at 152-54. *See also*, R. HELLAWELL & R. PUGH, *supra* note 6, at 30-31; A. AKINSANYA, *supra* note 118, at 98.

120. R. BARNET & R. MÜLLER, *supra* note 8, at 153-54, *reprinted in* R. HELLAWELL & R. PUGH, *supra* note 6, at 30.

to the underdeveloped nature of LDC economies. If the host country has a real shortage of the goods produced by an FDI enterprise (assuming a market economy), monopoly profits can be expected, at least in the short run. If an FDI enterprise selling to the domestic market lacks competition from both foreign and host country competitors, due to a significant competitive advantage derived from advanced technology, the enterprise could earn monopoly profits by reducing output and raising prices. FDI enterprises which sell to the domestic market also could earn monopoly profits in LDCs which pursue import substitution strategies[121] for economic development (as Taiwan did in the 1950s).[122]

Other common practices of foreign investors can exacerbate the problems of LDC "decapitalization" associated with FDI. The tendency of FDI enterprises to obtain raw materials and other inputs to production from foreign sources rather than form greater linkages with the domestic economy reduces potential earnings for domestic producers of intermediate products and reduces the positive "multiplier effect" that increased investment and consumption have on domestic GNP.[123] Tie-in clauses which require FDI enterprises to purchase raw materials, intermediate products, and/or capital goods from foreign sources (often the parent company of a foreign party to a joint venture) can not only deny host country producers potential earnings; they also can allow foreign suppliers to charge higher than competitive market prices.[124]

121. Governments pursuing such strategies impose tariffs and/or quotas on imports. One purpose of such a policy, often referred to as "infant industry protection," is to raise domestic prices of imported goods to enable domestic producers which are uncompetitive (i.e., have average costs exceeding import prices) in the short-run to stay in business and hopefully become competitive in the long run. A second purpose can be to enable domestic producers of import substitutes to earn economic rents in the short run, thus encouraging other domestic producers to enter the market in order to reduce the country's dependence on imports.

When only domestic producers are involved, import substitution strategies might create problems of income inequality by transferring wealth from consumers to producers. However, capital accumulation should not be adversely affected in aggregate terms since surplus profits earned by protected producers can be reinvested into the domestic economy (assuming, of course, that such funds are not allowed to be sent abroad or consumed).

Import substitution strategies also are often criticized because of the "loss of consumer surplus" caused by higher prices. However, in an LDC, this could be a beneficial form of "forced savings" if the corresponding producer surplus is reinvested in new productive enterprises.

Import substitution strategies are much less defensible, however, if foreign producers with technological advantages prevent the entry of new domestic firms, and the economic rents earned by such producers are not reinvested in the host country economy but are instead repatriated abroad as profits. *See* I. FRANK, *supra* note 7, at 48.

122. C. LIN, INDUSTRIALIZATION IN TAIWAN, 1946-72 64 (1973).

123. T. BIERSTEKER, *supra* note 6, at 5.

124. *Id.* United States antitrust law has recognized the detrimental economic effects of

The use of transfer pricing is another practice contrary to the goals of host country capital accumulation. Foreign investors can use this mechanism to avoid host country taxes as well as to disguise profits earned by FDI enterprises. Transfer pricing may operate by a subsidiary in an LDC importing inputs and equipment from its parent company at inflated prices. The subsidiary also exports finished products to the parent company at highly discounted prices. The result is high profits on such transactions for the parent company[125] and significant losses on the books of the subsidiary, enabling it to avoid income taxes otherwise payable to the host country government.[126]

Finally, FDI enterprises which mass market luxury consumer products within a host country can increase the host country's consumption levels and thus adversely affect capital accumulation. To use a simplified example, if in one year, each person in the PRC purchased and consumed one bottle of Coca-Cola for one Renminbi (RMB) instead of putting that RMB in the bank, at the end of the year, the PRC economy would have one billion less RMB to invest in its long-run productive capacity.

While the FDI financing schemes and practices discussed above can be very profitable for foreign investors,[127] one must not forget that such benefits are at the expense of host country capital accumulation and economic development. Moreover, it is important to note that even if foreign profits are not "artificially" inflated for the reasons discussed above, one would still expect that, over the long run, repatriated profits flowing out from a host country would exceed a foreign investor's initial capital investment, since an economically "rational" investor only would invest in an FDI project for which the discounted present value of expected profits exceeds the value of initial investment. Nevertheless, it would be a mistake to characterize all FDI as

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tie-in arrangements. *See generally* TRADE REGULATION CASES AND MATERIALS 672 (M. Handler, H. Blake, R. Pitofsky & H. Goldschmid eds. 1983).

125. Of course, increased profits from transfer pricing could raise the tax liability of the parent company. However, if, for example, the parent company is subject to a lower tax rate, does not receive the benefits of a foreign tax credit, and/or is entitled to deductions such as accelerated depreciation, transfer pricing could reduce the total amount of taxes actually paid by the parent company and subsidiary.

126. T. BIERSTEKER, *supra* note 6, at 4. *See also*, Nishikawa, *The World Crisis and Transnational Corporations*, in TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY, *supra* note 2, at 93, 93-100. For a discussion of efforts by the United States Internal Revenue Service to address problems of transfer pricing, see R. HELLAWELL AND R. PUGH, *supra* note 6, at 163-84.

127. For example, one study found that between 1908 and 1928, a mining company in Mexico paid annual average dividends of 124.5 percent. Another company paid an annual average dividend of 945.8 percent between 1903 and 1927. A. AKINSANYA, *supra* note 118, at 99.

having a negative effect on host country capital accumulation for this reason. FDI may positively contribute to LDC capital accumulation where alternative domestic capital or debt financing is unavailable.[128] Profit repatriation and other negative aspects of FDI make it, as a form of financing per se, a second-best alternative to domestic ownership,[129] but it still may be better than no investment.

One possibly could resolve the conventional-critical FDI debate over host country capital accumulation in the financing of new enterprises by analogizing FDI to the role of equity capital in the financing of corporations. Three sources of financing are generally available to such companies: retained earnings, debt, and equity. Which of these three sources of funds is used to finance a given investment project generally has no bearing on the gross earnings that are created by that project. However, the form of financing used does greatly impact how such earnings are to be distributed. If a project is financed solely through retained earnings, all new profits can be retained by existing shareholders. If debt financing is used, interest charges must be paid before profits are distributed. If the project is financed through the issuance of new shares of stock, new (and future) profits must be shared with new shareholders. Thus, the "cost of capital" is generally lowest for existing shareholders if an investment project is financed through retained earnings. If sufficient retained earnings are unavail-

128. Historically, however, this has not always been the case. A study commissioned by the United Nations, for example, found that during the late 1950s and early 1960s, an estimated 46 percent of United States-based multinational corporation investment funds in Latin America went into the acquisition of existing local firms. *Id.* at 98.

129. Conventional liberal economists might argue that notwithstanding repatriated profits, FDI, in whatever amount, always will have a positive effect on host country capital accumulation since it "frees up" domestic capital to be reinvested elsewhere in the domestic economy. However, several factors could undermine the logic of this argument. 1) Without host country government regulation of FDI, domestic producers might be forced to sell existing enterprises to foreign investors at discounted prices under the threat of competition from FDI enterprises with immediate technological advantages. 2) While capital is, at least in theory, fungible and interchangeable, investment opportunities are not. Alternative investments opportunities with at least equal rates of return might be unavailable to domestic investors, especially in an LDC. Uncontrolled FDI together with inefficient capital markets could enable foreign investors to dominate and exclude domestic investors from equity ownership in the most profitable sectors of the host country's economy. 3) High transaction costs in financing alternative investments, due to inefficient capital markets and other factors, could exceed the net benefits of capital contributed by FDI.

The foreign acquisition of existing domestically owned productive enterprises has an effect on host country capital accumulation which is analogous to that of a corporation which sells off its assets. While such foreign acquisitions might provide a host country economy with large amounts of cash and foreign exchange in the short run, over the long run, such acquisitions deny the host country economy the future (repatriated) earnings of foreign acquired enterprises. Thus, such transactions only will promote host country capital accumulation if their proceeds are used to reinvest in more productive enterprises within the host country and are not consumed or reinvested in less productive enterprises.

able, debt financing is generally a second-best alternative unless high interest rates, a company's existing high level of debt, and/or high risks of an investment project make debt financing undesirable. Equity financing is generally used as a last resort since it generally requires a higher "cost of capital" to existing shareholders than would be required by financing through retained earnings or debt.

In the context of LDCs, domestic savings are analogous to retained earnings. If an economic enterprise is financed solely by domestic savings, all of the subsequent profits of the enterprise may be retained in the domestic economy. If foreign debt financing is used, interest must first be paid to foreign lenders. If FDI is used, repatriated profits, which generally impose a higher "cost of capital" on host countries, must be shared with foreign economies. Thus, with all else being equal, it is in the interest of host countries to forbid FDI in enterprises for which sufficient domestic capital is available.[130] It also can be advantageous for host countries to reserve the most profitable sectors of their economies for domestic investors. However, if domestic funds are unavailable, and increasing the nation's foreign debt is not a viable alternative, FDI can benefit a host country economy just as the ability to raise equity capital can benefit a private corporation, notwithstanding the fact that the "rate of return" to domestic capital would be much lower. As liberal economists are quick to point out, FDI under such circumstances can enable a host country to invest in capital goods and add even more productive capacity to its domestic economy than it has to "pay back" to the home country in the form of repatriated profits.[131] One should not ignore the possibility, however, that if sufficient domestic funds are available for such capital investment, it might be possible to "add" that same productive capacity to the host economy without having to "pay back" any interest or repatriated profits to a home country's economy.

Thus, from a theoretical standpoint, the role of host country administrative authorities in selectively accepting or rejecting FDI as a form of financing in light of existing circumstances appears to be analogous to, and just as legitimate as, corporate managers exercising discretion in selecting optimal forms of financing to maximize their existing shareholders' returns. With regard to inward FDI, this critical choice should be made by a governmental body and not left up to

130. Conventional liberal economists might argue that there is no valid distinction between domestic enterprises for which domestic capital is available and those for which domestic capital is not available since in theory, all domestic investors have access to the same domestic capital pool. However, such an argument assumes the existence of efficient capital markets, which are unlikely to exist in an LDC or in a socialist economy such as the PRC's.

131. P. SAMUELSON & W. NORDHAUS, ECONOMICS 884 (12th ed. 1985).

"market forces," as the benefits of domestic over foreign financing discussed above are primarily of a public rather than private nature. Individual enterprises in a host country seeking financing generally will be indifferent as to whether the source of such funds or the recipient of future interest and/or dividend payments is foreign or domestic.

In summary, increasing FDI per se does not necessarily promote host country capital accumulation. The value of outwardly repatriated profits must generally exceed the amount of foreign capital initially invested in a host country in order for an FDI project to be "profitable" for a foreign investor. Moreover, common practices and circumstances surrounding FDI often artificially inflate the size of repatriated profits. Thus, from the perspective of host country capital accumulation, FDI is only a second-best form of financing, and unless an FDI project offers special benefits (e.g., advanced technology and/or management skills), it is in the interest of host countries to allow FDI only where alternative domestic ownership and financing are not available. In addition, it is in the interest of host countries to prevent the practices and circumstances which allow for the artificial inflation of repatriated profits.

Given the potentially dual impact of FDI on host country capital accumulation, the various requirements imposed on FDI by the PRC and Taiwan appear to be justified from an economic standpoint. Both regimes seek to attract FDI, as FDI proponents would encourage, but both regimes do so only on a selective basis, thus addressing many of the concerns of FDI critics. Administrative screening enables FDI entry to be at the discretion of the host country. Moreover, it allows FDI entry to be conditioned, at least in part, upon the financial and technological needs of the host country, rather than solely upon the potential for foreign investors to earn profits. Where FDI is allowed, various requirements seek to ensure that the benefits of host country capital accumulation derived from FDI are actual rather than just theoretical. Prescribed conditions for foreign equity contributions and profit distributions help to prevent foreign investors from using loans from host country sources as a means for excessive leveraging and help to ensure that repatriated profits are not excessive. The emphasis on exports at the initial approval stage helps to ensure that the international export markets and distribution channels of foreign investors are actually utilized to benefit the host country. Prohibitions against tie-in clauses together with domestic content and other requirements for utilizing domestic suppliers of raw materials and intermediate products promote linkages with the host country economy. Consequently, the positive "multiplier" effect from FDI on

GNP may be increased, and the integration of FDI benefits with a broader segment of the host country economy may be promoted. Requirements that in kind capital contributions are domestically needed prevent foreign investors from artificially inflating their equity share in an enterprise. Such requirements also close a potential "loophole" with regard to domestic linkages by preventing foreign investors from disguising imported productive inputs, otherwise available in the host country, as "in kind capital contributions." Restrictions on sales to the domestic market help to prevent not only the displacement of domestic producers, but also the unnecessary lowering of domestic savings through the increased consumption of mass-marketed luxury consumer goods. Finally, preferences given for FDI enterprises with shared domestic ownership help to ensure that FDI profits, which may be unusually large due to a lack of competition in less developed economies, are at least shared with domestic investors rather than being totally repatriated abroad. Such shared equity structures appear to be mutually beneficial to the extent that they reduce the aggregate amount of profits repatriated out from a host country, while at the same time enabling foreign investors to maintain a relatively high rate of return.

III. Regulation of Foreign Exchange

A. Comparisons Between the PRC and Taiwan

Foreign exchange control has been a central feature of the FDI regimes of both the PRC and Taiwan. Foreign exchange is regulated on two levels by the PRC's FDI regime. First, the foreign exchange impact of an FDI enterprise is given serious consideration in the initial approval process, with strong preferences given to enterprises that are expected to earn large amounts of foreign exchange (e.g., through exports). Article 9 of the JV Law states that a "joint venture is encouraged to market its products outside China."[132] Article 4 of the JV Implementing Regulations gives preference to joint ventures that "shall enable the expanded production of products for export and result in increasing income in foreign currency."[133] Article 4 of the Cooperative Enterprise Law provides that "[t]he State shall encourage the establishment of export-oriented or technologically advanced production-type co-operative enterprises."[134] According to the WFOE Law, in order to gain approval, WFOEs which do not adopt advanced technology and equipment must "export all, or the

132. JV Law, *supra* note 11, art. 9.
133. JV Implementing Regulations, *supra* note 11, art. 4.
134. Cooperative Enterprise Law, *supra* note 11, art 4.

majority of, their products."[135]

The PRC also requires that FDI enterprises, with few exceptions, are required to earn sufficient foreign exchange on their own to cover repatriated profits and expenditures which must be paid for in foreign exchange. If special approval granted to an FDI enterprise to sell to the domestic market creates a foreign exchange deficit, the government authorities which grant such approval are responsible for resolving the imbalance.[136]

Unlike the PRC, Taiwan does not specifically require individual FDI enterprises to maintain their own foreign exchange balance. However, like the PRC, in its screening process for FIA, Taiwan encourages "investments which have an export market" and/or a potential to increase Taiwan's foreign exchange earnings.[137] Prior to 1987, an FDI enterprise could not legally remit profits or invested capital from Taiwan in the form of foreign exchange without FIA.[138] This made obtaining FIA approval virtually essential for most foreign investors. Taiwan's liberalization of its foreign exchange controls in June 1987, however, has reduced the importance of FIA for the outward remittance of funds. Under the 1987 regulations promulgated by the Central Bank of China, pursuant to a June 1987 amendment to the Statute Governing Foreign Exchange, any properly established enterprise (with or without FIA) is allowed to outwardly remit up to the equivalent of US$5 million per year, subject to a ten day waiting period for amounts over US$1 million.[139] Thus, foreign investors who intend to repatriate less than US$5 million per year in profits and invested capital no longer need FIA to do so. FIA still can be of great importance, however, to foreign investors who want to repatriate more than the annual US$5 million limit and/or wish to enjoy the other privileges that FIA confers.

135. WFOE Law, *supra* note 11, art. 3.

136. JV Implementing Regulations, *supra* note 11, arts. 74-75; Cooperative Enterprise Law, *supra* note 11, art. 20; WFOE Law, *supra* note 11, arts. 18-19.

Efforts are being made, however, further to facilitate obtaining foreign exchange in the PRC through foreign exchange adjustment centers and other measures. *See, e.g.*, Yowell, *Swap Center System to Expand*, CHINA BUS. REV., Sept.-Oct. 1988, at 10-12.

137. SIFN, *supra* note 50, art. 5; *See also*, Liu, *supra* note 65, at 252.

138. SIFN, *supra* note 50, arts. 12, 13; Liu, *supra* note 65, at 259. Moreover, under earlier versions of the SIFN, even with FIA, outward repatriations of profits and invested capital from Taiwan were limited to fifteen percent of total capital investment. U.S. DEPT. OF COMMERCE, INVESTMENT IN TAIWAN (FORMOSA)—BASIC INFORMATION FOR THE UNITED STATES BUSINESSMAN 109-13, 128 (1959).

139. Regulation for Non-Governmental Outward Remittances, *supra* note 68, art. 4; Liu, *supra* note 68, at 21.

B. Economic Rationality

While problems of domestic capital accumulation relate to the long-run productive capacity of an LDC, foreign exchange and balance of payments relate to the short run. LDCs have a tendency to suffer from annual foreign exchange and balance of payments deficits for several reasons.[140] The general export capacity of an LDC is often limited due to the country's general low level of productivity, as well as a heavy reliance on export commodities such as agricultural products, which are highly vulnerable to weather conditions on the supply side, and/or price devaluation due to global overcapacity on the demand side. LDCs also often have a great need to import due to an inability to domestically produce necessities for domestic consumption and production. Finally, most forms of advanced technology, which most LDCs now realize are essential to increasing productivity and sustaining long term economic development, must be imported from abroad and paid for in foreign exchange.

Increasing foreign exchange deficits can be detrimental to an LDC's economy in several respects. In order to settle a current accounts deficit in one year, a country must borrow foreign exchange from foreign or international sources (e.g., the International Monetary Fund). This foreign debt implies that the country's consumption and/or investment must be constrained in future years in order to repay the principal on the debt, as well as interest charges. As a country's foreign debt increases, its risk of default generally increases, which in turn generally increases the interest rates charged to it (i.e., its cost of capital). In extreme cases, a very large foreign debt could have geopolitical consequences for an LDC, by forcing the LDC to accept otherwise undesirable terms as conditions for future loans and possibly giving creditor countries a justification for interfering with the LDC's internal affairs in the name of "protecting" their "investments."

Proponents of FDI contend that by introducing foreign exchange to a host country through their initial investments, FDI enterprises can help to alleviate the foreign exchange deficits of LDCs. However, while this may be true for the year of initial investment, critics emphasize that for subsequent years, FDI enterprises increase rather than decrease their host country's foreign exchange deficit through the repatriation of profits. In 1974, for example, MNCs on a global basis repatriated profits of more than $16 billion from LDCs while

140. *See, e.g.*, C. FULDA & W. SCHWARTZ, CASES & MATERIALS ON THE REGULATION OF INTERNATIONAL TRADE AND INVESTMENT 595 (1970).

they provided only $7 billion in the form of new investment.[141] Thus, it seems possible that an LDC that seeks to solve its foreign exchange deficits through FDI alone could soon find itself in a rapidly increasing spiral of foreign exchange deficits. It would need to attract more new FDI every year to compensate for the foreign exchange deficits created by the repatriated profits and/or capital of FDI enterprises established in previous years. However, new FDI in a current year would imply a greater foreign exchange burden from repatriated profits in future years, as well as greater foreign control over the domestic economy. Moreover, over the long run, the foreign exchange outflows of a single FDI enterprise will likely exceed foreign exchange inflows to its host country since, as already discussed, economically "rational" foreign investors will only invest in enterprises in which the discounted present value of expected future earnings (i.e., future capital outflows from the host country) exceeds the value of their initial capital investment (i.e., capital inflows to the host country).[142] In addition, unlike interest payments on foreign debt, which end when the principal is repaid, the foreign exchange burden of repatriated profits continues for an LDC as long as the enterprise is owned by foreigners. Finally, many of the practices discussed above which inhibit host country capital accumulation also exacerbate the foreign exchange deficits of host countries.

The exceptions to the foreign exchange/balance of payments deficits created by FDI are FDI enterprises which earn foreign exchange themselves or reduce their host country's foreign exchange expenditures in amounts which are at least equal to the amounts of foreign exchange that they repatriate. Thus, FDI enterprises in service industries such as tourism, and productive industries which export their products and/or produce import substitutes for the domestic market, can improve a host country's balance of payments and increase its foreign exchange reserves. However, FDI enterprises which neither earn foreign exchange nor reduce host country foreign exchange expenditures (e.g., those which sell non-import substitute products exclusively to the domestic market), but repatriate their profits in the form of foreign exchange, will likely exacerbate rather than alleviate the foreign exchange and balance of payments deficits of their host country.

The FDI regimes of the PRC and Taiwan appear to recognize the potential foreign exchange burdens of FDI. Both regimes give

141. I. FRANK, *supra* note 7, at 30.

142. F. VON KIRCHBACH, ECONOMIC POLICIES TOWARDS TRANSNATIONAL CORPORATIONS C569-70 (1983).

strong preference to FDI enterprises which export, and both restrict FDI access to their domestic markets, especially with respect to goods already available domestically (i.e., non-import substitutes). The PRC's requirement that FDI enterprises maintain their own foreign exchange balance not only protects against foreign exchange deficits created by FDI profit repatriation; it also provides a strong incentive for FDI enterprises to maximize their foreign exchange earnings (e.g., through exporting finished products), while minimizing foreign exchange expenditures (e.g., through avoiding unnecessary and/or overpriced imports of equipment, technology, raw materials, or intermediate products).[143] In short, the PRC's foreign exchange balance requirements for FDI enterprises at the microlevel force a convergence of interests between the PRC's need to maintain its national foreign exchange balance and the need of FDI enterprises to repatriate profits.

Although Taiwan's foreign exchange controls have been significantly liberalized as of June 1987, such liberalization should not be viewed as a repudiation of past policies. Indeed, one could argue that the recent foreign exchange liberalization in Taiwan results from the success of past controls, which enabled Taiwan to accumulate foreign exchange reserves of more than US$62 billion.[144] The legislation authorizing Taiwan's Executive Yuan to liberalize foreign exchange controls is expressly conditioned upon "the occurrence of (i) long term trade surplus, (ii) excess foreign exchange reserves, (iii) material changes in the global economy." The legislation also authorizes the Executive Yuan to reinstate stricter foreign exchange controls upon review and approval of the Legislative Yuan.[145]

IV. Promotion of Advanced Technology

A. *Comparisons Between the PRC and Taiwan*

Both the PRC and Taiwan encourage FDI enterprises that are expected to transfer advanced technology, know-how, or training. The PRC's JV Implementing Regulations, for example, give preference to enterprises which "adopt advanced technical equipment and scientific management," which "provide benefits in terms of technical renovation of enterprises," and which "enable the training of techni-

143. Such foreign exchange regulation also encourages FDI enterprises to form greater linkages with the domestic economy in obtaining inputs of raw materials, equipment, and intermediate products, thus promoting host country capital accumulation.

144. Liu, *supra* note 68, at 7.

145. Liu, *supra* note 68, at 7. *See also* Guanli Waihui Tiaoli (Statute Governing Foreign Exchange) art. 26-1 (as amended June 16, 1987).

cal and managerial personnel."[146] The Cooperative Enterprise Law provides that the "State shall encourage the establishment of . . . technologically advanced production-type co-operative enterprises."[147] The WFOE Law expressly requires that WFOEs in the PRC "utilize advanced technology and equipment or export all, or a majority of, their products."[148] In Taiwan, the SIFN allows FIA to be granted for "[i]nvestments in enterprises which are engaged in scientific and technical research and development."[149] In addition, as already discussed, both the PRC and Taiwan allow advanced technology to take the form of in kind capital contributions to FDI enterprises and make it possible to waive requirements such as those for domestic ownership and management, where the transfer of advanced technology is involved.

However, although they encourage advanced technology, the FDI regimes of the PRC and Taiwan also regulate technology transfer with regard to the types of technologies which are approved as well as the terms of transfer and valuation. The PRC's JV Implementing Regulations require that the "technology acquired by the joint venture shall be appropriate and advanced and enable the venture's products to display conspicuous social and economic results domestically or to be competitive on the international market."[150] Where industrial property or know-how is contributed as foreign capital, it must be capable of manufacturing new products urgently needed in the PRC or suitable for export, markedly improving quality and productivity, or allow significant savings in raw materials, fuel or power.[151]

Taiwan's Statute for Technical Cooperation, which applies to technology transferred in forms other than capital stock, requires that transferred technology promotes the production or manufacturing of new products, increases the volume of production, improves product quality or reduces production costs, or improves administration, management, design, operations, or other areas.[152] As discussed above,

146. JV Implementing Regulations, *supra* note 11, art. 4.

147. Cooperative Enterprise Law, *supra* note 11, art. 4.

148. WFOE Law, *supra* note 11, art. 3.

149. SIFN, *supra* note 50, art. 5.

150. JV Implementing Regulations, *supra* note 11, arts. 44, 46; *See also* Zhonghua Renmin Gongheguo Jishu Yinjin Hetong Guanli Tiaoli (Regulations on Administration of Technology Import Contracts of the People's Republic of China) art. 9 (promulgated May 24, 1985) *trans. in* CHINA L. FOR. BUS., *supra* note 11, ¶ 5-570 [hereinafter Technology Import Regulations].

151. JV Implementing Regulations, *supra* note 11, art. 28.

152. Jishu Hezuo Tiaoli (Statute for Technical Cooperation) art. 4 (as amended May 29, 1964) *trans. in* INV. L. WORLD TAIWAN, *supra* note 38, at 247.

Taiwan's SIFN requires that machinery and technology contributed as capital be needed domestically.[153] In addition, Taiwan's Regulations Governing the Use of Patent Rights and Technical Know-How as Equity Investment require that capitalized patent rights and technical know-how make possible the production of new products not currently available in Taiwan, improve existing product quality, or reduce costs.[154]

With regard to the terms of technology transfer and valuation, the PRC requires that charges for the use of technology be "fair and reasonable" and generally must not exceed international rates. Restrictive clauses such as those limiting the export of goods produced by the transferred technology, the improvement of the technology, and the purchase of related equipment, parts, and raw materials, generally are prohibited.[155] The JV Implementing Regulations, for example, prohibit tie-in clauses relating to technology transfer, stating that the "technology importing party shall have the right to buy the equipment, parts and raw materials needed from sources they deem suitable," and that "[n]o irrational or restrictive clauses prohibited by Chinese law and regulations shall be included."[156] Valuation of in kind capital contributions in the PRC is to be made through consultation by the parties to the venture "on the basis of fairness and reasonableness," or by a third party agreed to by the parties.[157] The language of Taiwan's SIFN appears to be stricter with regard to technology valuation. It prescribes that such valuation "shall be determined by the Investment Commission at the time of application for investment."[158] In both the PRC and Taiwan, the terms of technology transfer agreements must be reviewed and approved by government authorities.[159]

B. *Economic Rationality*

Low levels of technological development are a primary con-

153. *See supra* note 91 and accompanying text; SIFN, *supra* note 50, arts. 3, 5.

154. Capitalized Technology Regulations, *supra* note 91, art. 4.

155. JV Implementing Regulations, *supra* note 11, arts. 44, 46; *See also* Technology Import Regulations, *supra* note 150, art. 9.

156. JV Implementing Regulations, *supra* note 11, art. 46; Article 9 of the Technology Import Regulations also prohibits contract provisions (except those with specific administrative approval) which restrict "the freedom of choice of the recipient to obtain raw materials, parts and components or equipment from other sources." Technology Import Regulations, *supra* note 150, art. 9.

157. JV Implementing Regulations, *supra* note 11, art. 25.

158. SIFN, *supra* note 50, art. 9.

159. Technology Import Regulations, *supra* note 150, art. 4; JV Implementing Regulations, *supra* note 11, arts. 10, 11; SIFN, *supra* note 50, art. 7; Capitalized Technology Regulations, *supra* note 91, art. 5.

straint to economic development in LDCs. The level of technology that a country possesses in large part determines its potential levels of productivity and output (i.e., potential GNP). For LDCs, acquiring technology from abroad offers them the opportunity not only to raise levels of productivity, but also to do so within a time frame that can be as much as decades shorter than what would be necessary if they were to use solely their own research efforts to "reinvent the wheel."

Proponents contend that FDI provides LDCs with a complete package of technology, know-how, and management skills that can significantly increase their levels of productivity, improve the quality of goods produced, or introduce new products into the LDC economy. Other benefits, such as the training of local personnel to operate, maintain, and even develop advanced technologies also may result from FDI.

However, critics charge that these potential benefits of technology transfer often are not realized by host LDCs. In their view, FDI often introduces technologies to LDCs which are designed for advanced countries and are inappropriate for the conditions in LDCs. Capital intensive production processes appropriate for labor-scarce/capital-abundant advanced countries, for example, might be inappropriate for the factor endowments of labor-abundant/capital-scarce LDCs. Critics also allege that the contractual terms by which technology is transferred to LDCs are often unfair and preclude LDCs from actually receiving the alleged benefits of technology transfer.[160] Extensive disclaimers, indemnification provisions, strict controls on technology use,[161] restrictions on exporting goods produced by transferred technologies, tie-in clauses for productive inputs, prohibitions against improving transferred technologies, and other standard provisions often are imposed on the LDC technology recipient. In a recent study of technology transfer in Bolivia, Colombia, Ecuador, and Peru, approximately eighty-one percent of the contracts surveyed prohibited exports totally, and eighty-six percent had some restrictive clauses on exports. Among technology transfer contracts in Bolivia, Ecuador, and Peru, sixty-seven percent contained tie-in clauses.[162] Finally, critics allege that excessively high prices are charged for technologies transferred to LDCs.[163] In the words of one PRC commentator, "As is proved by a great deal of experience, when they transfer

160. *See, e.g.*, T. BIERSTEKER, *supra* note 6, at 9.

161. Cohen & Valentine, *supra* note 2, at 235.

162. Prasartset, *Technological Domination by the Transnational Corporation in Thailand*, in TRANSNATIONAL CORPORATIONS AND CHINA'S OPEN DOOR POLICY, *supra* note 2, at 145, 148.

163. *See, e.g.*, T. BIERSTEKER, *supra* note 6, at 9.

their technology, transnational corporations impose a large number of restrictive conditions as well as demand colossal prices."[164]

Without government regulation, an individual enterprise in an LDC often can be at a disadvantage when buying technology from an MNC. In this context, the LDC buyer may have less international access to information and technical expertise than does the MNC seller. From the perspectives of individuals interviewed in the PRC in 1981, this problem has been especially critical in the PRC, where "the inexperience of . . . Chinese negotiators, whose skills were more in the area of foreign language than in economics, was fully exploited by the multinational-capital side."[165] Where proprietary information is involved, the seller may have a kind of "monopoly" bargaining power since such technology is not available from other sources. Finally, valuation of technology can be a very difficult task since the uniqueness of a technology often precludes the existence of a "market value" on which the parties can base their negotiations. Even where market prices are available, however, inexperience can lead to very costly consequences for host country enterprises. The PRC's Qing Hai County granite quarry on Hainan Island, for example, accepted its foreign partner's valuation of equipment contribution as being US$1.42 million, only to find out within a year that the open international market value was no higher than US$700,000. On the marketing side, the same enterprise agreed to a unit price of US$19 per square foot of finished granite while the international market price was US$50 per square foot.[166]

Both the PRC and Taiwan recognize the importance of advanced technology for economic development. Both strongly encourage technology transfer in their FDI regimes, and both allow for the waiver of other requirements, such as those for domestic ownership and control, where advanced technology is involved. However, both regimes appear to recognize the potential problems associated with technology transfer, and both require government monitoring of technology transfer agreements through their respective discretionary approval processes. The FDI regimes of both the PRC and Taiwan prescribe that transferred technology is appropriate and actually needed, and both provide for governmental review of the appropriateness of the contractual terms of transfer and valuation.

164. Chen, *supra* note 6, at 43.
165. Nournoff, *supra* note 2, at 209.
166. *Id.* at 214.

V. MAINTENANCE OF DOMESTIC CONTROL OVER FDI ACTIVITIES

A. *Comparisons Between the PRC and Taiwan*

The FDI regimes of both the PRC and Taiwan seek to maintain a relatively high degree of domestic control over FDI enterprises. Such control is achieved through: 1) requiring domestic representation in the internal management structures of FDI enterprises; and 2) monitoring by government administrative authorities.

1. Domestic Representation in Management

In the PRC, both the foreign and Chinese parties to an equity JV appoint their own directors "with reference to the proportion of investment contributed."[167] Since an equity JV, by definition, must have some of its registered capital contributed by a Chinese party, Chinese representation on the board of directors of an equity JV is assured. In addition, the JV Implementing Regulations require that the chairman of the board of an equity JV be appointed by the Chinese party.[168] This seems to ensure a significant degree of Chinese control even in cases in which the Chinese party appoints less than a majority of the board. In addition to being able to influence the major corporate decisions of an equity JV,[169] the Chinese party, through its directors, can help to ensure Chinese representation among managers and other high office holders. Finally, the status of legal representative given to the chairman of the board of an equity JV[170] seems to give the Chinese party at least a de facto veto power over unfavorable corporate actions. The Cooperative Enterprise Law requires that either the chairman or deputy chairman of a board of directors, or either the head or deputy head of a joint management body of a cooperative enterprise, be appointed by the Chinese partner.[171] Although cooperative enterprises may enjoy more flexibility than equity JVs with regard to management structure, if a true cooperative enterprise and its foreign partner lack legal person status and must rely on its Chinese partner to execute contracts with other Chinese parties, this

167. JV Implementing Regulations, *supra* note 11, art. 34.

168. *Id.*

169. With regard to 1) amendments to an equity JV's articles of association, 2) termination and dissolution of the venture, 3) increase or assignment of the venture's registered capital, and 4) merger of the venture with other economic organizations, articles 35 and 36 of the JV Implementing Regulations require unanimous agreement by all directors present at a board meeting with a quorum of at least two-thirds of the entire board. JV Implementing Regulations, *supra* note 11, arts. 35, 36.

170. JV Implementing Regulations, *supra* note 11, art. 37.

171. Cooperative Enterprise Law, *supra* note 11, art. 12.

could give the Chinese partner to the cooperative enterprise an even higher degree of management control than is available to its counterparts in equity JVs.[172]

Taiwan's Company Law also contains requirements of domestic representation in the corporate structures of companies formed in Taiwan. In unlimited companies and unlimited companies with limited liability shareholders, more than half of the shareholders must be domiciled in the Republic of China (ROC). In addition, more than half of the shareholders with capacity to conduct business for such companies must be domiciled in the ROC.[173] In a limited company without FIA, more than one half of the shareholders, who must contribute at least one half of the company's total capital, must be of Chinese nationality and domiciled within the ROC.[174] Voting rights may be allocated equally among all shareholders irrespective of capital contributions, or they may be allocated in proportion to each shareholder's contributed capital.[175] In either case, however, a Chinese majority is guaranteed. Such shareholders have the power to elect directors and managerial officers. The chairman of the board of directors (or sole director if only one is elected) is vested with the power to represent the company externally and must be of Chinese nationality and domiciled within the ROC.[176] In a company limited by shares without FIA, more than half of the promoters,[177] more than half of the managing directors,[178] and at least one supervisor[179] must be domiciled in the ROC. In addition, the chairman and vice-chairman of the board of directors must be of Chinese nationality and domiciled within the ROC.[180]

Despite these general requirements for domestic representation in the management structures of FDI enterprises, the FDI regimes of both the PRC and Taiwan do provide opportunities for greater foreign control, in the forms of WFOEs in the PRC and limited companies with FIA and companies limited by shares with FIA in Taiwan.

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172. Moser, *supra* note 23, at 113.
173. Company Law, *supra* note 38, arts. 40, 45, 115.
174. *Id.* art. 98.
175. *Id.* art. 102.
176. *Id.* arts. 29, 108.
177. *Id.* art. 128.
178. *Id.* art. 208.
179. *Id.* art. 216. The role of a supervisor has no counterpart in an American corporation. A supervisor, elected by the shareholders from among themselves, is responsible for monitoring the financial condition and business operations of a company. He/she may require reports, records, and documents to be submitted to him/her by the board of directors. A supervisor has the power to call a shareholders' meeting and must report to the shareholders his/her findings. *Id.* arts. 216-227.
180. *Id.* art. 208.

WFOEs in the PRC, being wholly owned by foreigners, are not required to have Chinese representation in management. However, this greater degree of foreign autonomy is coupled with the stricter qualitative requirements and restrictions which are imposed on WFOEs. Most important is the explicit requirement that WFOEs introduce advanced technology to China or export all or most of their products. In addition, WFOEs are excluded from certain industries.[181] Thus, it seems that the PRC government is willing to accept a greater degree of foreign internal control of WFOEs in exchange for greater potential contributions to the PRC's economic development in the form of advanced technology and exports.

Taiwan seems to take a similar approach with regard to foreign control. Limited companies and companies limited by shares[182] which obtain FIA are allowed a greater degree of foreign control. Nationality and domicile requirements are waived with regard to shareholders and directors of limited companies, and promoters, managing directors, chairmen and vice chairmen of the board, and supervisors of companies limited by shares, if such companies receive FIA.[183] However, as discussed above, in order to qualify for FIA, a company must fulfill certain qualitative requirements relating to its positive contribution to Taiwan's economic development, as well as pass the discretionary screening of the Investment Commission.[184]

In this regard, Taiwan's regime might be more liberal than that of the PRC to the extent that the SIFN contains broader statutory language, merely encouraging that enterprises receiving FIA are conducive "to the economic and social development in the Republic of China".[185] This compares with the more specific requirement in the PRC that WFOEs "utilize advanced technology and equipment or export all, or a majority of, their products."[186] In both contexts, however, the highly discretionary nature of the approval processes seems to enable government authorities to liberalize or constrict requirements for domestic corporate control in accordance with their appraisal of the potential risks and benefits that an enterprise will bring to the economic development of their country.

181. WFOE Law, *supra* note 11, art. 3; Torbert, *supra* note 33, at 50.

182. Similar exemptions are not available for unlimited companies and unlimited companies with limited liability shareholders that receive FIA. SIFN, *supra* note 50, art. 18.

183. SIFN, *supra* note 50, art. 18; Company Law, *supra* note 38, arts. 98, 108, 128, 208, 216.

184. SIFN, *supra* note 50, arts. 5, 7.

185. *Id.* art. 5.

186. WFOE Law, *supra* note 11, art. 3.

2. Government Monitoring

Monitoring of FDI enterprises by the PRC government can take place in three contexts:[187] 1) through the initial approval process;[188] 2) through the registration process after approval, by which the venture obtains a business license;[189] and 3) on a continuing basis throughout the life of the enterprise.[190] With regard to continued monitoring, officially, production and operating plans of equity JVs and WFOEs are to be submitted "for the record," and governmental authorities are to refrain from excessive interference with management. It is reported that in practice, however, government officials play a more interactive role in helping to shape production and operating plans, and that their actions are sometimes more than mere "guidance".[191] Like the JV Law and the WFOE Law, the Cooperative Enterprise Law provides that a cooperative enterprise's "right of autonomy in the area of business management shall not be interfered with."[192] However, the Cooperative Enterprise Law does not prescribe that production and operating plans be submitted to government authorities, possibly suggesting that regulation of cooperative enterprises is meant to be more liberal in this regard than that of equity JVs and WFOEs. Nevertheless, cooperative enterprises still are required to obtain government approval for major actions such as the assignment of rights and liabilities and the appointment of a third party as general manager. In addition, cooperative enterprises, like equity JVs and WFOEs, are required to report to government authorities for accounting and tax purposes.[193]

Taiwan's Investment Commission screens companies seeking FIA through an approval process similar to that used in the PRC for the initial approval of equity JVs, cooperative enterprises, and WFOEs.[194] In addition to the initial screening process for FDI enterprises seeking FIA, all companies formed in Taiwan must go through

187. Torbert, *supra* note 33, at 51.

188. JV Law, *supra* note 11, art. 3; JV Implementing Regulations, *supra* note 11, art. 8; Cooperative Enterprise Law, *supra* note 11, art. 5; WFOE Law, *supra* note 11, art. 6.

189. JV Law, *supra* note 11, art. 3; Cooperative Enterprise Law, *supra* note 11, art. 6; WFOE Law, *supra* note 11, art. 7.

190. JV Law, *supra* note 11, art. 9; JV Implementing Regulations, *supra* note 11, art. 56; Cooperative Enterprise Law, *supra* note 11, arts. 7, 10, 12, 15; WFOE Law, *supra* note 11, art. 11.

191. JV Implementing Regulations, *supra* note 11, art. 56; WFOE Law, *supra* note 11, art. 11; Fang & Tang, *The Wholly Foreign-Owned Enterprise Law: Defining the Legislative History and Interpreting the Statute*, 2 J. CHINESE LAW 153, 174-76 (1988).

192. Cooperative Enterprise Law, *supra* note 11, art. 11.

193. *Id.* arts. 10, 12, 15; JV Implementing Regulations, *supra* note 11, art. 89; WFOE Law, *supra* note 11, art. 14.

194. SIFN, *supra* note 50, arts. 7-8.

a registration process through which they obtain a certificate which entitles them to transact business.[195] Companies in Taiwan also must file with government authorities, on an annual basis, "a report of the year's business, a balance sheet, an inventory, a statement of profit and loss and a list showing distribution of surplus profits or their appropriation."[196] If an examining authority "entertains any doubts" about these items, "it may order the company to produce certificates, vouchers, receipts, documents and books, provided that they be kept confidential and returned after examination within thirty days from the time of receiving them."[197] In addition, government authorities "may, at any time, dispatch officers to examine the business and financial condition of a company, and, upon finding that the company is not properly managed, may order rectification."[198]

Thus, in both the PRC and Taiwan, opportunities are available for government authorities to monitor FDI enterprises prior to initial approval and registration, as well as on a continuing basis. Arguably, the degree of such monitoring in Taiwan may be less than in the PRC for several reasons. First, the nature of the PRC's planned economy necessitates greater coordination between individual enterprises and the government's overall economic plans. Second, annual reporting in Taiwan is retrospective and primarily of a financial nature.[199] By contrast in the PRC, at least for equity JVs and WFOEs, production and operating plans are filed prospectively, and governmental officials have statutory authority to "examine and supervise" and to "provide support and assistance."[200] Finally, the needs of the PRC's less developed stage of economic development, together with its limited prior experience with FDI, possibly could induce PRC authorities to exercise their discretionary powers more aggressively than their counterparts in Taiwan. One should not underestimate, however, the level of discretionary power that Taiwan officials are statutorily authorized to exercise, should they perceive a greater need to monitor the activities of an FDI enterprise in their economy.[201]

B. *Economic Rationality*

The degree of domestic control which should be maintained over

195. Company Law, *supra* note 38, arts. 387-389.
196. *Id.* art. 20.
197. *Id.* art. 22.
198. *Id.* art. 21.
199. *Id.* art. 20.
200. JV Implementing Regulations, *supra* note 11, arts. 7, 56; WFOE Law, *supra* note 11, art. 9, 11.
201. *Cf.* Company Law, *supra* note 38, arts. 21-22.

FDI enterprises poses a dilemma for host LDCs. On one hand, one of the expected benefits of FDI is its ability to bring to the host country technology, management skills, and more efficient production processes. Such benefits cannot be realized, however, if excessive interference from the host country prevents foreign investors and managers from acting as they see fit. Moreover, a foreign perception of excessive interference by a host country might discourage foreign investors from investing there in the first place.

On the other hand, the history of FDI in other LDCs, as well as in China near the turn of the century, suggests that even if their technology, management skills, and expertise provide foreign investors with the capacity to promote the economic development of a host country, such foreign investors may lack the will to do so. While foreign investors may be willing to promote host country economic development when such efforts and the goals of profit maximization converge, it is less clear how they will act when these interests diverge. Indeed, in their fiduciary duty to maximize shareholders' returns, foreign investors may have a legal obligation to choose profit maximization over host country economic development if the promotion of these two goals should conflict. For example, given a choice between exporting its finished consumer products and selling them to a host country's domestic market, a foreign investor would likely choose to sell to the domestic market if it wanted to protect neighboring markets where it had other subsidiaries selling similar products. This would be in spite of the fact that, for reasons discussed above, exports are much more beneficial to a host country in terms of earning foreign exchange and promoting host country capital accumulation.

Thus, given foreign expertise on the one hand, but potentially divergent interests on the other, the line between excessive host country interference and domestic control needed to protect legitimate national economic interests can be a very fine one. The FDI regimes of the PRC and Taiwan attempt to address this dilemma by imposing various requirements to preserve domestic control over FDI generally, but allowing greater independence for FDI enterprises which are expected to transfer advanced technology.

In addition to historical experience, government monitoring of FDI activities might be justified on other grounds. Where externalities are involved (e.g., pollution), "market forces" alone cannot be expected to protect a host country's national interest.[202] Policies, such as those imposing qualitative requirements on FDI activities,

202. Article 5 of the JV Implementing Regulations, for example, prohibits granting

would be difficult to enforce without some form of government monitoring. In the case of the PRC, given its relatively undeveloped stage of economic and legal development, no practical alternative for regulating FDI may be available to it other than broadly worded statutes and regulations, implemented with high levels of discretion. However, this does not necessarily suggest that such a system is antithetical to the objectives of economic development. Given the highly qualitative nature of FDI regulation in the PRC and Taiwan, the multiplicity of often countervailing factors, and the many "loopholes" potentially open to innovative foreign lawyers, a system of highly discretionary administrative screening may be the only means by which the PRC and Taiwan can ensure that FDI enterprises conform to their economic policy objectives. Of course, high levels of discretion increase the risks of administrative abuse, thereby increasing the need to prevent corruption and to develop technical competence among government officials. However, the historical successes of Taiwan, as well as those of Japan and other countries where "administrative guidance" and discretion have been central to economic policy,[203] suggest that it is at least possible for such legal regimes to be very effective in promoting economic development. The successes of other countries, however, do not necessarily imply success for the PRC. While the economic rationale and legal framework for FDI regulation in the PRC appear to be sound, the ultimate success or failure of the PRC's FDI regime will depend in large part upon the degrees of rationality and fairness with which PRC officials exercise their administrative discretion.

Requirements of domestic representation at the enterprise level also appear to have economic justification. Domestic investors and managers, who are likely to have greater economic, social, and cultural ties to the host country, may possibly have a greater willingness to form greater linkages with suppliers and other sectors of the host country economy. In addition, there may be a greater likelihood of the personal interests of domestic investors and managers converging with host country economic development goals than might be the case with foreigners. After all, unlike foreigners, domestic investors and managers must personally live with the level of economic development that their host country achieves. Finally, domestic representation in the internal structures of FDI enterprises may facilitate policy

approval to projects involving "[e]nvironmental pollution." JV Implementing Regulations, *supra* note 11, art. 5.

203. *See e.g.*, Endoh, *Direct Investment in Japan*, in DYNAMICS OF JAPANESE- UNITED STATES RELATIONS 139 (T. Schoenbaum, M. Matsushita & D. Dallmeyer eds. 1986).

enforcement for the government, thus reducing the need for more regulation at the macro-level.

VI. CONCLUSIONS

While the PRC's planned socialist economy might differ in many respects from the capitalist market mechanisms operating in Taiwan, to characterize the two systems as being diametrically opposed would be to ignore their significant similarities. At least with regard to FDI, both the PRC and Taiwan appear to have legal regimes which promote similar policy objectives through similar policy instruments, which include a significant level of government intervention. In their regulation of FDI, both the PRC and Taiwan seek to promote domestic capital accumulation, regulate foreign exchange, promote the transfer of advanced technology, and maintain a significant degree of domestic control over FDI enterprises. While both the PRC and Taiwan seek to encourage FDI, selectivity through administrative discretion appears to be a central component of both regimes.

On a theoretical level, the economic rationale underlying the regulation of FDI in the PRC and Taiwan appear to be sound. In addition, the economic success of Taiwan, together with the economic failures of other LDCs (e.g., in Latin America) which have exercised less government control over FDI, suggest that government regulation over FDI is not only needed in LDCs, but also that such regulation can be effectively implemented. Moreover, the level of government regulation in the PRC's legal regime for FDI does not appear to be excessive in comparison not only to Taiwan, but to other Asian countries as well. Commenting on a recent United States Department of Commerce study, one Commerce Department official wrote, "China's investment legislation now compares favorably with that of the other countries surveyed. Its restrictions on foreign equity holdings are less stringent than those of South Korea, the Philippines, or Thailand."[204]

Despite their similarities, however, the apparent success of Taiwan's FDI regime does not guarantee success for the PRC. Extralegal factors, such as difficulties associated with the large size of the PRC economy, its socialist economic planning mechanisms, political instability, and the general level of underdevelopment that remains in the PRC economy, may impede the successful implementation of the PRC's legal regime for FDI. In addition, the future success of FDI in the PRC will in large part depend upon the levels of rationality and

204. Dean, *How Does China Stack Up? Investment Incentives Throughout Asia*, CHINA BUS. REV., Mar.-Apr. 1988, at 49-51.

fairness with which government authorities exercise the high levels of discretion which the PRC's FDI regime reserves for them. While PRC authorities should fully enforce the safeguards and protections of national interest provided by law, they must guard against exercises of authority which are arbitrary or overly aggressive, which could deter potentially beneficial FDI enterprises.

For the foreign investor, the legal regimes for FDI in the PRC and Taiwan provide useful guidelines of where the economic interests of private foreign investors and less developed host countries both converge and diverge. Both the PRC and Taiwan realize that FDI can raise the technological levels and export capacities of their respective economies. However, as a form of financing per se, for purposes of host country capital accumulation and foreign exchange balance, FDI is only a second best alternative to domestic ownership, due in large part to the need of FDI enterprises to repatriate profits and the costs associated with displacing domestic producers. Both the PRC and Taiwan appear to realize, and history seems to confirm, that uncontrolled FDI can exacerbate rather than alleviate the capital accumulation problems of LDCs. If FDI enterprises sell non-import substitutes primarily to the domestic markets of host countries, foreign exchange deficits will likely ensue. Given these criteria for evaluating FDI, the success of the legal regimes for regulating inward FDI in the PRC and Taiwan must be measured not only in quantitative terms, but in qualitative terms as well.

The economic interests focused on by the PRC's FDI regime suggest that "equality and mutual benefit" is more than just empty rhetoric; it appears to be a serious policy priority. Thus, at least for the immediate future, both the economic interests and policies of the PRC suggest that foreign investors who intend to enhance their wealth by "cornering" the PRC's domestic market should lower their expectations—especially if they neither produce import substitutes nor offer advanced technology. Such FDI activity is unlikely to be "mutually beneficial," at least from the PRC perspective, at least until the PRC economy further matures. Even if one ignores the negative effect domestically oriented FDI has on foreign exchange balance, growth in discretionary income for consumers and growth by domestic producers to reasonable levels of competitiveness appear to be prerequisites for such domestic market oriented FDI activity truly to benefit host country economic development. This does not necessarily imply, however, that there currently is no money to be made from FDI in the PRC. Cost savings (e.g., from labor) still can give FDI enterprises in the PRC a competitive advantage in international export markets. In short, at least for the immediate future, the primary benefits that the PRC potentially has to offer to foreign investors are cost savings on the supply side. Expectations to benefit primarily from the PRC as a source of increased demand, however, are less realistic and less consistent with the PRC's economic interests and apparent policy objectives.

A greater understanding of the economic rationale underlying the legal regimes for FDI will be mutually beneficial for both foreign investors and host countries. Especially where government authorities act with high levels of discretion, as in the PRC and Taiwan, such understanding will enable foreign investors better to distinguish legitimate policy promotion from arbitrary or bad faith bargaining. Taiwan's increased liberalization of its FDI regime in response to successful economic development suggests that even if foreign investors, as economically "rational" businessmen, choose to ignore the moral imperatives of alleviating the poverty and human suffering of LDCs, achieving a greater understanding and concern for the economic needs of their host countries will be, over the long run, in their own self interests.

In short, foreign investors, like their host countries, must seek a greater understanding of the legitimate hopes, as well as the legitimate fears, of foreign direct investment.

*Jeffrey K. D. Au**

* A.B. 1985, Political Science, A.M. 1986, International Policy Studies, Stanford University; J.D. 1989, Columbia Unversity.