



Ventures in the China Trade An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment

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Ventures in the China Trade: An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment

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In this Article, Messrs. Alford and Birenbaum examine laws and regulations recently promulgated by the People's Republic of China to govern the conduct of business and investment in China. After establishing the cultural, historical, bureaucratic and developmental contexts within which the authors believe these laws and regulations must be understood, they comprehensively examine and discuss the new legal pronouncements.

The announcement, two years ago, of The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Joint Venture Law)¹ was greeted with much fanfare in the West.

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¹ 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), adopted at the Second Session of the Fifth National People's Congress on July 1, 1979 and formally issued and

To old China traders, would-be China lawyers and expectant China businesspersons, this pathfinding legislation promised new and even exotic opportunities to do business in the world's most populous nation.² To date, however, the promise remains largely unfulfilled. As of this writing, few foreign investors have been able to avail themselves of the invitation to do business in China (PRC).

Fortunately for all concerned, the romantic view of this new opening to China has been replaced by a more realistic assessment of the burdens as well as the benefits to be gained through engaging China in commercial entente.³ This is, therefore, a good time to analyze the problems and possibilities presented by China's conditional receptiveness to foreign investment.

At the outset, we would like to make plain our bias as to methodology. In our view, one cannot meaningfully undertake to study contemporary Chinese legal developments by simply dissecting statutory language, such as the Joint Venture Law, as if it stood alone, isolated from the rich context of Chinese thought and experience.⁴ We will, therefore, examine the cultural, historical, bureaucratic, developmental, and statutory contexts of the Joint Venture Law as a prelude to analyzing its limitations and suggesting steps a potential foreign investor should take in structuring his approach toward the Chinese. For, to paraphrase Justice Holmes, the Joint Venture Law and related Chinese laws governing foreign investment must be construed as one would a constitution: their significance is "to be gathered not simply by taking the words and a dictionary, but by considering their origin and the line of their growth."⁵

THE CULTURAL CONTEXT

The first and most basic aspect to be considered in evaluating the

made effective on July 8, 1979 [hereinafter cited as Joint Venture Law]. The Chinese text may be found in *Remin Ribao* (People's Daily), July 9, 1979, at 1. A translation by Xinhua, the New China News Agency, may be found at 18 INT'L LEGAL MATERIALS 1163, 1163-65 (1979). *Editor's Note:* The Pinyin system for romanizing Chinese names and titles will be used throughout this article, except where that would create confusion due to customary usage.

² *China Trade with PRC Could Triple, Council President Says* [1979] 237 INT'L TRADE REPORTER'S U.S. EXPORT WEEKLY (BNA) at A-5; DEPARTMENT OF STATE, BUREAU OF PUBLIC AFFAIRS, GIST: US-PEOPLE'S REPUBLIC OF CHINA ECONOMIC RELATIONS (1979); Surrey & Soble, *Chinese Removing Joint Venture Investment Barriers*, *Legal Times* of Washington, Oct. 22, 1979, at 19; *U.S.-China Trade Seen Soaring*, *J. COM.*, Jan. 22, 1980, at 10.

³ Birenbaum & Alford, *China's Law on Joint Ventures — The First Year in Review*, NAT'L L. J., July 21, 1980, at 26.

⁴ Birenbaum, *Doing Business With China*, *Wall St. J.*, Aug. 31, 1979, at 6, col. 3.

⁵ *Gompers v. U.S.*, 233 U.S. 604, 610 (1914).

Joint Venture Law is the attitude of the Chinese toward law itself. One of the clearest continuities between classical and Communist China is a common disdain for law as a means of regulating society.⁶ An ancient Chinese fable has it that law was the creation of barbarian peoples living beyond the reach of China and its civilized culture.⁷ For them, behavior could be governed only by means of rigid external guidelines. This is not to say that ancient China did not develop a system of law worthy of comparison with that of classical Greece or other societies. Indeed, it has been argued, on the basis of documentary evidence, that such a system may have existed as early as the reign of the Western Zhou (1122-700 B.C.).⁸ Chinese archaeologists have, in the past decade, found bamboo slips containing portions of cases that can be traced back to the 3rd century B.C.⁹ Nonetheless, the perception of law as an alien and dubious instrument was widely held throughout Chinese history.¹⁰

Confucianism did much to reinforce, if not actually create, this general perception of law.¹¹ The words of Confucius stress that in a properly ordered society the emperor and the people adhere to mutually reinforcing standards of behavior appropriate to their roles.¹² Thus, the emperor leads by force of example and moral suasion, rather than power and punishment. The people follow, not out of fear but because, through education and self-cultivation, they have internalized the *li*, which are the norms of social intercourse appropriate to their particular stations in life.¹³ Laws, being fixed and external, should have little place in a well-governed society.¹⁴ Nor can law possibly serve as a substitute for *li*, for if all that interdicts improper behavior is a set of written rules, Confucian doctrine holds that unworthy but crafty persons will be certain to find a way around them. As Confucius

⁶ V. LI, LAW WITHOUT LAWYERS (1978).

⁷ This tale is from the SHU JING (THE BOOK OF DOCUMENTS), one of the five fundamental works of Chinese culture, dating from the 2nd Century B.C., known as the five Classics. See *The Book of Documents*, 22 BULLETIN OF THE MUSEUM OF FAR EASTERN ANTIQUITIES 84 (B. Karlgren trans. 1950).

⁸ H. CREEL, THE ORIGINS OF STATECRAFT IN CHINA, VOLUME ONE: THE WESTERN CHOU 161-195 (1970). Indeed, it has even been suggested that elements of a legal system existed as early as the Shang dynasty (1766-1122 B.C.). See K. C. CHANG, SHANG CIVILIZATION 201-205 (1981).

⁹ THE T'ANG CODE: VOLUME I: GENERAL PRINCIPLES 7 (W. Johnson trans. 1979) [hereinafter cited as Johnson].

¹⁰ See LI, note 6 *supra*; Schwartz, *On Attitudes Toward Law in China*, reprinted in J. COHEN, THE CRIMINAL PROCESS IN THE PEOPLE'S REPUBLIC OF CHINA, 1949-1963: AN INTRODUCTION 62-70 (1968) [hereinafter cited as Cohen].

¹¹ *Id.*

¹² THE ANALECTS OF CONFUCIUS (2 vols.) (A. Waley trans. 1958).

¹³ *Id.*, Book II.

¹⁴ *Id.*

himself said: "[G]overn the people by regulations, keep order among them by chastisements, and they will flee from you and lose all self-respect. Govern them by moral force, keep order among them by ritual [礼] and they will keep their self-respect and come to you of their own accord."¹⁵

The dangers the Confucians saw of relying upon law as a primary tool of governance were borne out with the rise in the 3rd century B.C. of the state of Qin, a semi-barbaric people residing just beyond the Yellow River basin, the core of classical Chinese civilization. The Qin relied heavily upon the "rule of law," not to protect the rights of the individual, but rather to regiment a strict, martial society.¹⁶ All persons, save for the Qin emperor were regulated by imperial decree.¹⁷ Although the Qin succeeded where others had failed in bringing the warring states of the Yellow River region together into a single unified empire (hence, the name China), their hegemony was short-lived—a fact that the Confucians have been quick to ascribe in large measure to reliance on law to regulate behavior.¹⁸

Not long after the demise of the Qin, the views espoused by Confucius and his followers became state orthodoxy. Ensconced under the patronage of the Emperor Han Wudi (who reigned from 140 to 87 B.C.), this new dogma held grip over the people for a remarkably long period.¹⁹ In effect, the new orthodoxy became a cloak of legitimacy to be worn by all who aspired seriously to govern China throughout the imperial period until the final collapse of Imperial China in 1911.²⁰

With the assumption of responsibility for governance, Confucian oriented scholar-officials from the Han dynasty (206 B.C.-A.D. 220) onward had little choice but to deal with law.²¹ The Han commenced the preparation of a comprehensive legal code,²² known as the *Zhiuzhang lu*, that served as a basis for the Sui (A.D. 581-617) and T'ang

¹⁵ *Id.* Book II at 3.

¹⁶ To the extent that the Qin had a coherent ideology, it was best expounded by Han Fei-tzu (280?-233 B.C.). See *THE COMPLETE WORKS OF HAN FEI-TZU* (2 vols.) (W. K. Liao trans. 1939 and 1959). For a thorough account of the Qin, see D. BODDE, *CHINA'S FIRST UNIFIER: A STUDY OF THE CH'IN DYNASTY AS SEEN IN THE LIFE OF LI SSU 280?-208 B.C.* (1938).

¹⁷ See D. BODDE & C. MORRIS, *LAW IN IMPERIAL CHINA* 23-29 (1967); F. MOTE, *INTELLECTUAL FOUNDATIONS OF CHINA* 111-128 (1971).

¹⁸ SSU-MA CH'EN: *GRAND HISTORIAN OF CHINA* 33 (B. Watson trans. 1958).

¹⁹ CH'U T'UNG-TSU (QU TONGZU), *LAW AND SOCIETY IN TRADITIONAL CHINA*, 280-289 and passim (1961) [hereinafter cited as QU].

²⁰ *Id.* See also Schwartz, *supra* note 10, at 62-65.

²¹ A. HULSEWE, *REMNANTS OF HAN LAW*, 4-94 (1954).

²² *Id.*

(A.D. 618-907) codes. These codes in turn proved to be models, in both format and content, for subsequent Chinese codes through the Qing dynasty (A.D. 1644-1911), as well as for Japanese, Korean and Vietnamese codes.²³

But as Qu Tongzu and others have shown, in turning to law, and in ultimately developing a sophisticated legal system, Confucian scholar-officials of the Han and later dynasties did not merely see their function as that of applying abstract, objective rules.²⁴ Rather, they "confucianized" the law, molding it to reflect and reinforce Confucian norms.²⁵ As the famed early Qing scholar Gu Yenwu (A.D. 1613-1682) wrote:

[W]hen our predecessors initiated legislation, they could not thoroughly study the facts and circumstances and prepare in advance for future revision. Their successors followed what was already a corrupt practice, and were restricted by the established statutes which they could not change, or had to make by-laws, to amend them. Thereupon the more numerous the laws, the more they were abused. All the affairs of the empire became more vexatious. The result was that the laws were not understood and not enforced.²⁶

This result was to be avoided by substituting precept for prescription, while retaining the formal structure of law without which it would not be possible to govern effectively.

The disdain of ancient Confucian ideologues for law, notwithstanding their adroit use of it, has been matched by that of their latter-day Communist counterparts.²⁷ To be sure, building upon the laws developed in the Zhiangxi Soviet and later in the Shenxi-Gansu-Ningxia and Shaanxi-Chahar-Hobei border regions, the Communists strove in the early years of the PRC to use law as an aid in consolidating the revolution and achieving its goals.²⁸ Indeed, in their first four years in power, China's Communist rulers promulgated major new laws concerning subjects ranging from marriage to the ownership of industrial enterprises to political offenses.²⁹ But, ultimately, Communist mistrust of the Nationalist-trained legal professionals and populist impatience with "experts," generally coalesced with and reinforced traditional Chi-

²³ Having published his translation of the General Principles section of the T'ang Code, Wallace Johnson is presently translating the remainder of the Code. Johnson, *supra* note 9.

²⁴ See BODDE & MORRIS, *supra* note 17, at 27-29.

²⁵ *Id.*

²⁶ Gu Yenwu, *quoted in* S. Y. TENG & J. FAIRBANK, CHINA'S RESPONSE TO THE WEST 9 (1954).

²⁷ See LI, *supra* note 6, at 1-21.

²⁸ Lubman, *Form and Function in the Chinese Criminal Process*, 69 COLUM. L. REV. 535, 536-540 (1969).

²⁹ See Cohen, *supra* note 10.

nese attitudes.³⁰ Consequently, within the PRC, law was largely deemphasized as an effective instrument for accomplishing social change until the late 1970's.³¹

THE HISTORICAL CONTEXT

China's experience with the West over the past two centuries reinforced ancient Chinese antipathy toward foreigners and heightened Chinese suspicions about the role of law. From their first contact with the Dutch in the mid-seventeenth century until the Opium War (1839-1842), China's rulers sought to cordon off and control commercial and other interaction with the West.³² Foreign merchants were restricted to a temporary presence—without spouses and for no more than the four to five month trading season—in small compounds located on an island in the metropolis of Canton, itself a corner of China remote from the capital. All trade had to be carried on through a small circle of merchants, known collectively as the "Hoppos."³³ To the constant frustration of state chartered trading companies—such as the British East India Company—and their national governments, direct dealings with the Chinese government, as well as with Chinese producers and consumers, were barred.³⁴

The pact settling the Opium War intensified Chinese hostility toward Western institutions. Under pressure from aggressive English traders, the British prevailed upon the Chinese to grant a series of concessions, including year-round access to five major coastal ports, the authority to contact Chinese officials directly, the extension of British law to Her Majesty's subjects in China, and all other privileges that might in the future be granted to any other foreign power.³⁵ During

³⁰ See LI, *supra* note 6, at 22-32.

³¹ Since 1978, the Chinese have turned increasingly to law as a means through which to stabilize and organize society. During this period the Chinese have issued numerous laws and regulations, including the PRC's first substantive criminal code, a code of criminal procedure, an environmental law, regulations regarding lawyers, regulations regarding foreign offices in China and, as will be discussed, various laws and regulations regarding joint ventures and related commercial activities. See text accompanying notes 118-343 *infra*; Lubman, *New Developments in Law in the People's Republic of China*, 1 NW. J. INT'L L. & BUS. 122 (1980); Alford, *Law and Chinese Foreign Trade*, 28 PROBLEMS OF COMMUNISM 81 (1979).

³² Wills, *Ch'ing Relations With the Dutch, 1662-1690*, in THE CHINESE WORLD ORDER 225 (J. Fairbank ed. 1968); J. Fairbank, *The Early Treaty System in the Chinese World Order*, in *id.* at 257.

³³ Edwards, *The Old Canton System of Foreign Trade*, in LAW AND POLITICS IN CHINA'S FOREIGN TRADE 360 (V. Li ed. 1977).

³⁴ *Id.*

³⁵ The Treaty of Nanking is found in L. HERTSLET, VI HERTSLET'S COMMERCIAL TREATIES 221-225 (1908). See H. MORSE, I INTERNATIONAL RELATIONS OF THE CHINESE EMPIRE 298-341 (1910).

the remainder of the 19th century, Great Britain, as well as the United States, France, Germany, Japan and Russia, not to mention more than a dozen lesser nations,³⁶ continued to expand this list of territorial and jurisdictional concessions.³⁷ By 1900, the once proud Middle Kingdom had been carved up into a number of smaller spheres dominated by Western and Japanese "barbarians."³⁸ These foreign powers were not above using law and, particularly, their concept of extraterritorial legal privilege, to promote their various diplomatic, financial, commercial and religious objectives.

On the diplomatic front, the foreign powers insisted that China abandon her traditional practice of conducting foreign relations through the "tribute system," under which all other states owed fealty to China.³⁹ Instead, the Chinese were forced to deal with these powers according to "modern" legal principles.⁴⁰ Yet, at the same time, Great Britain, Germany and others invoked international law to justify the seizure of suzerainty over Chinese territory and the imposition of their own laws upon China.⁴¹ Financially, China found herself having to surrender control over her most vital source of revenue—the Imperial Customs⁴²—and to make numerous other concessions to satisfy a variety of obligations to Western governments, including payment of heavy reparations.⁴³ Commercially, Western merchants in Shanghai and other treaty ports competed energetically with their Chinese counterparts.⁴⁴ In that effort, they were advantaged not only by more advanced business techniques, but by military power in the form of Western forces on Chinese soil, and legal privileges such as virtual im-

³⁶ The extraterritorial privileges exacted by those nations are described in W. FISHEL, *THE END OF EXTRATERRITORIALITY IN CHINA* 1-50 (1952). Many of the treaties embodying these relations are reproduced in *TREATIES BETWEEN THE EMPIRE OF CHINA AND FOREIGN POWERS* (W. Meyers ed. 1877).

³⁷ FISHEL, *supra* note 36, at 1-50.

³⁸ *Id.*

³⁹ Under this system, China was the center of civilization, to which all other states, at least nominally, paid tribute.

⁴⁰ J. FAIRBANK, *TRADE AND DIPLOMACY ON THE CHINA COAST: THE OPENING OF THE TREATY PORTS 1842-1854* 96-98 (1964).

⁴¹ I. HSU, *CHINA'S ENTRANCE INTO THE FAMILY OF NATIONS: THE DIPLOMATIC PHASE 1858-1880* (1960); Hsin, *What Does Bourgeois International Law Explain About the Question of Intervention?*, in KUO-CHI WEN-TI YEN-CHIU (1960), *quoted in* J. COHEN & H. CHIU, *PEOPLE'S CHINA AND INTERNATIONAL LAW: A DOCUMENTARY STUDY* 139-172 (1974).

⁴² J. SPENCE, *TO CHANGE CHINA: WESTERN ADVISORS IN CHINA 1620-1960* 93-128 (1969).

⁴³ M. YOUNG, *THE RHETORIC OF EMPIRE: AMERICAN CHINA 1895-1901* 172-218 (1968).

⁴⁴ CHI SHU-FEN, *JINGJI GINLUEXIA ZHI ZHUNGGUO* (ECONOMIC AGGRESSION IN CHINA) (1925) recounts numerous specific instances of foreign economic activity in China aided by extra-territoriality.

munity from suit under Chinese law.⁴⁵ At the same time, foreign missionaries held out to potential Chinese converts not only the promise of divine salvation but also of valuable, if worldly, exemptions from Chinese law.⁴⁶

Not surprisingly, the Chinese came to resent bitterly this Western presence.⁴⁷ Although the Chinese attempted on occasion to use international law to fend off excessive incursions into their sovereignty,⁴⁸ they came generally to regard the West's laws as little more than weapons used by the powerful to advance their interests. As the noted Chinese diplomat Tsui Kuo-ying said in 1891: "[I]nternational law is just like Chinese statutory law—reasonable but unreliable. If there is right without might, the right will not prevail."⁴⁹

Nor did these sentiments diminish, even after the Qing was toppled in 1911 and a Chinese republic established. In the words of a handbill circulated by a group of Cantonese student activists in the 1920's:

[A] cursory glance at the treaties which bind China today will readily show how unequal they are These unequal treaties . . . [have] for a long time relegated China to a position worse than an enslaved colony. . . . Thus it has been possible to permit even a common foreign policeman to exercise the power of killing and wounding Chinese citizens on their home soil.⁵⁰

The antipathy toward the West—and particularly toward its commercial and legal presence and practices—expressed by these Cantonese students was echoed by the leaders of China's Communist Revolution. Mao Zedong, himself, wrote in 1939:

[T]he imperialist powers have forced China to sign numerous unequal treaties by which they have acquired the right to station land and sea forces and exercise consular jurisdiction, and they have carved up the whole country into imperialist spheres of influence. . . . [They] have gained control of all the important trading ports in China by these unequal treaties and have marked off areas in many of these ports as concessions under their direct administration. They have also gained control of

⁴⁵ *Id.* See S. COCHRAN, *BIG BUSINESS IN CHINA: SINO-FOREIGN RIVALRY IN THE CIGARETTE INDUSTRY 1890-1930* (1979); A. FEUERWERKER, *CHINA'S EARLY INDUSTRIALIZATION* (1958).

⁴⁶ I. HSU, *THE RISE OF MODERN CHINA* 461-463 (1970). See P. COHEN, *CHINA AND CHRISTIANITY passim* (1963).

⁴⁷ *Id.* See CHI, *supra* note 44.

⁴⁸ In 1864, for example, the Tsungli Yamen (the equivalent of Qing China's foreign ministry) under the leadership of Prince Kung used Henry Wheaton's treatise *ELEMENTS OF INTERNATIONAL LAW* to persuade the Prussians to relinquish a Danish ship they had seized in Chinese waters. See HSU, *supra* note 41, at 132-145; TENG & FAIRBANK, *supra* note 26, at 96-98.

⁴⁹ COHEN & CHIU, *supra* note 41, at 10.

⁵⁰ 33 CHINA WEEKLY REV. 182-183 (Aug. 8, 1925).

China's customs, foreign trade and communications⁵¹

Within three years after the creation of the PRC, all commercial enterprises owned by United States citizens and other foreigners were nationalized.⁵² Nearly all Westerners fled or were imprisoned.⁵³ At the same time, a new foreign elite began to emerge, composed of Russian advisers who gained a status akin to that which Western merchants once enjoyed.⁵⁴ Not until the final, abrupt withdrawal of the Russians by 1960 was China at last free of a privileged class of foreigners.⁵⁵

THE BUREAUCRATIC CONTEXT

If the Chinese did not invent bureaucracy, they were among its earliest and most enthusiastic practitioners.⁵⁶ Notwithstanding the efforts of Chairman Mao and others to keep the bureaucracy in line, its influence over the translation of policy into practice remains decisive to this day.⁵⁷ Indeed, the most difficult task facing joint ventures may be to mesh what is meant to be an autonomous corporate entity with a state-controlled economy governed by bureaucrats.

Imperial bureaucrats tended to govern with an eye toward promoting Confucian values, which placed heavy emphasis upon the maintenance of harmony and the preservation of order and rank.⁵⁸ The present Chinese bureaucracy applies what might best be characterized as a mixture of socialist principles and bureaucratic conservatism.⁵⁹ In so doing, the PRC's mammoth bureaucracy is functioning in almost contradictory fashion, promoting socialist change in theory while retarding it in practice through bureaucratic inertia and rigidity.⁶⁰

Although the state, party and military bureaucracies all play roles in the formation and administration of the economic plans that guide China today, it would not be an overstatement to suggest that few people outside, or indeed, inside China really know how the plans are

⁵¹ MAO TSE-TUNG, 1 *SELECTED WORKS OF MAO TSE-TUNG* 311 (1965).

⁵² T. Thompson, *China's Nationalization of Foreign Firms: The Politics of Hostage Capitalism: 1949-57* (Occasional Papers/Reprints Series in Contemporary Asian Studies No. 6, 1979).

⁵³ *Id.*

⁵⁴ J. GITTINGS, *SURVEY OF THE SINO-SOVIET DISPUTE 1963-1967* 129-143 (1968).

⁵⁵ *Id.*

⁵⁶ H. Creel, *The Beginnings of Bureaucracy in China: The Origin of the Hsien*, 23 *J. ASIAN STUDIES* 155 (1964).

⁵⁷ J. Mathews, *China's Bureaucracy: Centuries of Training of Obfuscation*, Wash. Post, Apr. 10, 1980, § A, at 17.

⁵⁸ J. WATT, *THE DISTRICT MAGISTRATE IN LATE IMPERIAL CHINA* 78-98 (1972).

⁵⁹ See F. SCHURMANN, *IDEOLOGY AND ORGANIZATION IN COMMUNIST CHINA* (2d ed. 1968).

⁶⁰ A. ECKSTEIN, *CHINA'S ECONOMIC REVOLUTION* 92-93 (1977). [Hereinafter cited as Eckstein].

made and operate. Prominent Western analysts of China's economy⁶¹ suggest that data on basic economic needs and capabilities filters upward from individual enterprises through state, party, and military committees, which tend to have overlapping membership, especially at the higher levels.⁶² Sectional plans are then prepared by a relatively high level state elite, particularly in the State Planning Commission, State Economic Commission, State Agricultural Commission and State Capital Construction Commission.⁶³ Once the plans have been formulated, directives based upon them are developed.⁶⁴ As these directives are considered within the bureaucracy, they become increasingly detailed, fixed and inflexible.

Not surprisingly, performance on both the macro and micro levels has fallen short of the planned mark.⁶⁵ Witness the shortages and distribution problems China has experienced during the past three decades.⁶⁶ Witness also the seeming heresy of the need for professional middlemen (*caigou yuan*) whose unofficial but indispensable function is to enable the economy to work by procuring needed supplies not allotted by the state plan and disposing of production in excess of the state plan.⁶⁷ As such, these traders, or "fixers," supply a market correction force for the system.⁶⁸ Nonetheless, available evidence indicates that during the past twenty years state plans have determined the general manner and scope of operation of the vast majority of China's industrial enterprises.⁶⁹ Vital decisions that have been made routinely pursuant to the state plans or related directives include access to

⁶¹ *Id.*; C. HOWE, CHINA'S ECONOMY: A BASIC GUIDE 30-65 (1978); A. DONNITHORNE, CHINA'S ECONOMIC SYSTEM 457-511 (1967); N. LARDY, ECONOMIC GROWTH AND DISTRIBUTION IN CHINA 137-172 (1978).

⁶² J. WANG, CONTEMPORARY CHINESE POLITICS 92-126 (1980).

⁶³ *China's State Economic Commission (SEC)*, CHINA BUS. REV., July-Aug. 1979, at 16-17; *The Role and Functions of China's Commissions*, CHINA BUS. REV., Mar.-Apr. 1979, at 14.

⁶⁴ Often the plans are not made public until well after their effective date. ECKSTEIN, *supra* note 60, at 111-112.

⁶⁵ Chen, *Economic Modernization in Post-Mao China: Policies, Problems and Prospects*, in CHINESE ECONOMY POST MAO: A COMPENDIUM OF PAPERS SUBMITTED TO THE JOINT ECONOMIC COMMITTEE OF THE CONGRESS OF THE UNITED STATES 165 (J. Hardt ed. 1978) [hereinafter cited as Hardt].

⁶⁶ Dernberger & Fassenfart, *China's Post-Mao Economic Future*, in Hardt, *supra* note 65, at 8-16; Qian Junrai, *Readjusting and Restructuring the Chinese Economy* (unpublished paper available through the co-authors).

⁶⁷ DONNITHORNE, *supra* note 61, at 290-291; Butler, *China's Host of Buying Agents Patch Up Oversight of Planning*, Asian Wall St. J., July 25, 1978, at 8; Butterfield, *China Gingerly Gives Private Business a Try*, N.Y. Times, Mar. 8, 1981, § E, at 3.

⁶⁸ Butterfield, *supra* note 67, at 3.

⁶⁹ *Id.*

"investment capital,"⁷⁰ specific sources of supply for needed raw materials and utilities, availability of labor (or, more typically, the number of workers a plant would be required to take on),⁷¹ product mix, projected output, pricing, profitability and assigned "customers."⁷² Individual industrial entities, in effect, have been left with little operational discretion.⁷³

In recent years, however, China began gradually to decentralize decision making in the economic sphere.⁷⁴ Local governments, plants and other enterprises were given broader power and concomitant responsibility for its exercise.⁷⁵ For example, in the large and important province of Sichuan, Deng Xiaoping's birthplace, which Zhao Ziyang headed and used as an economic laboratory prior to assuming the premiership in September of 1980, many enterprises have been "free" to earn a profit, raise their own investment capital, select product lines in addition to those required by the state plan, market over-the-quota production, and utilize excess earnings for worker incentives, better worker benefits, advertising, reinvestment, or the direct acquisition abroad of needed foreign equipment.⁷⁶ Astute Western observers saw Zhao's elevation as evidence that the Sichuan experience might become the forerunner of a nation-wide experimentation with market oriented mechanisms.⁷⁷ As of this writing, the accuracy of that prediction and the likelihood that China's movement toward decentralization will survive remain very much in doubt, as the PRC continues to veer between its mercantilist and Maoist pasts.⁷⁸

THE DEVELOPMENTAL CONTEXT

In January of 1975, Premier Zhou Enlai called upon the Fourth National People's Congress to embark upon a comprehensive developmental program that by the year 2000 would upgrade Chinese agricul-

⁷⁰ *Id.*

⁷¹ ECKSTEIN, *supra* note 60, at 101-104.

⁷² *Id.* at 100-101.

⁷³ *Id.* at 86-158.

⁷⁴ Qian Junrai, *supra* note 66, at 9-11; *China's Slow Turn Toward a Free Market System*, BUS. WEEK, May 19, 1980, at 46.

⁷⁵ Ching, *China's Choice of New Premier Indicates a Desire to Break with Mao's Policies*, WALL ST. J., Aug. 29, 1980, at 17.

⁷⁶ Weil, *Sichuan Province*, CHINA BUS. REV., Jan.-Feb. 1981, at 31; Tian Yun, *More Authority for Enterprises Revives the Economy*, BEIJING REV., Apr. 6, 1981, at 21-29.

⁷⁷ Clarke, *Leadership Divisions*, CHINA BUS. REV., Mar.-Apr. 1981, at 43-46; Ching, *supra* note 75.

⁷⁸ Butterfield, *China at a Fork in the Road: How Much of the West Does it Want*, N.Y. TIMES, May 11, 1980, at 10, col. 1.

ture, industry, national defense and science to a level comparable to that of the world's great powers.⁷⁹ As a first step toward realizing this program, known as the Four Modernizations, the Chinese launched in 1976 a ten-year plan for development of the national economy.⁸⁰ Down-playing the emphasis upon self-reliant socialist development that had characterized previous five- and ten-year plans,⁸¹ the 1976-85 version set as China's goals for the decade the construction of one hundred and twenty major new infrastructure projects, including thirty electric power generating stations, ten steel complexes, eight coal fields, six trunk railways, five harbors, and an assortment of other projects, including fertilizer plants, communications satellites and color television, integrated circuitry and truck factories.⁸²

When finally made public in 1978, China's 1976-85 ten-year plan received enthusiastic reviews abroad and at home.⁸³ Foreign governments and companies, recognizing that tremendous infusions of foreign capital, heavy equipment and technology would be necessary to accomplish China's developmental goals, and facing sluggish demand for the most part in their home markets, they vied for access to the Chinese market.⁸⁴ On the financial side, in the year following Chairman Hua's initial exposition of the plan, government developmental banks and private institutions in Europe and Japan seeking to take advantage of China's reputation for credit-worthiness, offered to make more than \$26 billion of generally low-interest, long-term financing⁸⁵ available to the PRC, which had previously eschewed the assumption of foreign debt.⁸⁶ During that same period, the governments of Japan and France concluded agreements with the PRC calling for billions of dollars worth of trade.⁸⁷ For the most part, these agreements provided for the exchange of oil, coal and other raw or semi-finished materials for ad-

⁷⁹ Zhou Enlai, *Report on the Work of the Government* (delivered at the First Session of the Fourth National People's Congress), reprinted in BEIJING REV., Jan. 24, 1975, at 21-25.

⁸⁰ Hua Guofeng, *Report on the Work of the Government* (delivered at the First Session of the Fifth National People's Congress), reprinted in BEIJING REV., Mar. 10, 1978, at 7-40.

⁸¹ *Id.*

⁸² *Id.*

⁸³ Chen, *supra* note 65.

⁸⁴ Huan Xiang, *Western Economy in the 1980's*, BEIJING REV., May 4, 1981, at 16-19.

⁸⁵ *China Won't Use Its Vast Credits at Foreign Banks*, WALL ST. J., Sept. 10, 1980, at 30, col. 1; M. Liu, *Rock-bottom Terms are a Must for Foreigners*, FAR E. ECON. REV. Sept. 21, 1979, at 61-63.

⁸⁶ N. Lardy, *Recent Chinese Economic Performance and Prospects for the Ten-Year Plan*, in Hardt, *supra* note 65, at 50.

⁸⁷ *China: A Precarious Piecemeal and Feeble Presence*, FAR E. ECON. REV. Apr. 27, 1979, at 44-46; *China Fixes Long-Term Trade Agreements to Ten-Year Plan*, CHINA BUS. REV., Mar.-Apr. 1979, at 69. *China Shokku Hits Japan—"Beware of Getting Duped When Developing Foreign Trade,"* CHINA BUS. REV., Mar.-Apr. 1979, at 68-69 [hereinafter cited *China Shokku*].

vanced industrial equipment and data.⁸⁸ Countless private companies—offering everything from oil drilling equipment to disco records—also sought to sell their wares in China.⁸⁹

The impact of Chairman Hua's invitation to foreign business together with the opening of direct access to Chinese producers and consumers took the Chinese leadership by surprise.⁹⁰ Finding themselves with far greater access to the West than had previously been the case, ministries, provincial and local governmental authorities and even individual factories competed for sorely needed foreign technology and supplies.⁹¹ It soon became apparent to the leadership that China was unable to evaluate, allocate and absorb the full scope of what she was being offered.⁹² Moreover, China's limited foreign exchange holdings, estimated variously at \$2 to \$7 billion, were clearly inadequate to cover all the imports.⁹³

Rather than incurring heavy foreign debt to make up the shortfall, the leadership decided in early 1979 to postpone implementation of the ten-year plan in order to enter into a period, intended originally to last through 1981, but now likely to extend at least until 1983, during which China's goals could be reassessed and her priorities clearly established.⁹⁴ The first and most dramatic result of this period of "readjustment," as the Chinese have characterized it, was the suspension, announced in February of 1979, of preliminary arrangements with Japanese companies for steel mills, coal mine development and major undertakings in heavy industry.⁹⁵ These projects had called for aggregate expenditures of more than \$2 billion.⁹⁶ Over the course of the next four months, British, French, German, United States and additional Japanese companies were informed of delays in the construction of nuclear power plants, iron ore processing facilities and international class ho-

⁸⁸ *Id.*

⁸⁹ Chen, *Spotlight on U.S.-P.R.C. Trade: Review of 1978 Transactions and Prospects for Expansion*, BUS. AM., Sept. 24, 1979, at 8-10.

⁹⁰ Rowan, *China Halts U.S. Mine, Petrochemical Deals*, Wash. Post, Feb. 12, 1981, § D, at 1.

⁹¹ Prior to 1978, most foreign trade negotiations were conducted by China's state foreign trading corporations. Approximately a dozen in number, those corporations interposed themselves between foreign business and Chinese producing and consuming entities. Since 1978, their importance has diminished, although their numbers have grown.

⁹² *China Economic Notes*, CHINA BUS. REV., May-June 1979, at 48-50.

⁹³ Stepanek, *A Ten Year Profile of the Bank of China*, CHINA BUS. REV., Sept.-Oct., 1979, at 42.

⁹⁴ Stepanek, *China's New Economic Priorities*, CHINA BUS. REV., July-Aug. 1979, at 36; Hey, *Big Spender*, ECONOMIST, Feb. 14, 1981, at 83.

⁹⁵ *China Shokku*, *supra* note 87, at 68.

⁹⁶ *China Readjusts*, CHINA BUS. REV., Mar.-Apr. 1979, at 4-5.

tels.⁹⁷ These decisions effectively ended the honeymoon phase of the opening to the West, as the Chinese came to appreciate the hard trade-offs that had to be made in rationing one of their most precious and limited resources: foreign exchange. With that, Western exporters were forced to recognize that China could hardly hope to buy all they had to sell.⁹⁸

The reappraisal of priorities has produced a significant change in direction. In place of the major capital construction projects previously planned, attention has been focused increasingly on "light industry," Chinese-style, a classification that encompasses many projects that would be considered "heavy" if undertaken in the West.⁹⁹ With the exception of such vital fields as agriculture, energy, and transportation, emphasis is now being placed on projects with the potential to generate foreign exchange rapidly.¹⁰⁰

This policy is intended to produce political as well as economic payoffs. The shift toward light industry means more "plums" to distribute throughout the country in the form of projects capable of absorbing large numbers of China's growing unemployed and underemployed, and of producing those consumer goods that China's workers lately have been encouraged to expect.¹⁰¹ Thus, Deng and his colleagues hope to begin to deliver on their promise to provide a better material life; a promise which Deng, although not a charismatic leader in the manner of Mao, is under considerable pressure to fulfill.¹⁰²

China's determination to limit spending on imports to foreign exchange earned through exports and to concentrate foreign investment in light industry was repeatedly underscored throughout the Third Session of the Fifth National People's Congress, held in September of 1980 in Beijing.¹⁰³ Delivering the "Report on Financial Work," the Minister of Finance, Wang Bingqian, criticized the fact that China's projected deficit for 1980 would surpass \$4 billion, notwithstanding proposed

⁹⁷ *How Companies Can Respond to China's Slowdown*, CHINA BUS. REV., May-June 1979, at 37-40.

⁹⁸ *Letter from Peking*, FAR E. ECON. REV., Apr. 18, 1980, at 82.

⁹⁹ *China Trade Profits Hard to Come By*, J. COM., Nov. 19, 1980, at 1.

¹⁰⁰ *Id.*

¹⁰¹ *CBR Interview: Vice Premier Bo Yibo on China's Current Priorities*, CHINA BUS. REV., Nov.-Dec. 1980, at 11; *China Unable to Attain High Industrial Status by 2000*, J. COM., June 27, 1980, at 30.

¹⁰² Hsia & Haun, *China's Joint Venture Law: Part II*, 1 CHINA L. REP. 61, 78-83 (1981).

¹⁰³ MAIN DOCUMENTS OF THE THIRD SESSION OF THE FIFTH NATIONAL PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA (1980) [hereinafter cited as MAIN DOCUMENTS].

belt-tightening measures¹⁰⁴ that would promote greater accountability in borrowing and thus reduce China's debt.¹⁰⁵ The foreign exchange saved would become available for development of light industry.¹⁰⁶ Wang's message was reinforced in key addresses by outgoing Premier Hua Guofeng¹⁰⁷ and by the new Chairman of the State Planning Commission, Vice Premier Yao Ilin.¹⁰⁸

Developments since the September 1980 session of the Congress have made it clear that the Chinese leadership meant what it said. Hundreds of millions of dollars of orders have been cancelled or postponed.¹⁰⁹ The most celebrated of the project cutbacks is the Baoshan steel complex.¹¹⁰ Launched in 1978 with great fanfare, the Baoshan project was planned to include a cold rolling steel mill, a hot strip steel mill, an iron ore sintering plant, a continuous tubing mill and a chemical plant, as well as new port and rail facilities to connect Baoshan to nearby Shanghai and other key ports.¹¹¹ The project, with much of its equipment and technology to come from Japanese, German and, to a lesser extent, U.S. firms, had an initial projected cost of more than \$5 billion.¹¹² But, as has happened with a number of other major capital projects, the estimates proved low; projected needs for the complex's output appeared too high, and unexpected difficulties—particularly related to infrastructure—were all too abundant.¹¹³ The result was that Baoshan was both a severe problem in itself and an embarrassing symbol of the shortcomings in the developmental course embarked upon only two years earlier. In late November of 1980, the Chinese informed Nippon Steel and other key suppliers that phase II of the project, which had been intended to double the complex's capacity to 6 million tons per year, had been postponed indefinitely.¹¹⁴ In January of 1981, much of the rest of the Baoshan endeavor was halted, prompt-

¹⁰⁴ Wang Bingqian, *Report on the Final State Accounts for 1979, the Draft State Budget for 1980 and the Financial Estimates for 1981*, in MAIN DOCUMENTS, *supra* note 103, at 48-85; Bonavia, *The Red Ink on China's Ledger*, FAR E. ECON. REV., Sept. 5, 1980, at 69.

¹⁰⁵ See Wang, *supra* note 104, at 77-85.

¹⁰⁶ *Id.*

¹⁰⁷ Hua Guofeng, *Speech at the Third Session of the Fifth National People's Congress*, in MAIN DOCUMENTS, *supra* note 103, at 143-201.

¹⁰⁸ Yao Ilin, *Report on the Arrangements for the National Economic Plans for 1980 and 1981*, in MAIN DOCUMENTS, *supra* note 103, at 5-47.

¹⁰⁹ *Chinese Bull in a China Shop*, ECONOMIST, Feb. 21, 1981 at 78. [Hereinafter cited as *Chinese Bull*].

¹¹⁰ Jones, *The Baoshan Contracts*, CHINA BUS. REV., July-Aug. 1980, at 47.

¹¹¹ *Id.*

¹¹² Foreign supplies and services were valued at \$1.5 billion. See Rowan, *supra* note 90.

¹¹³ *Id.*

¹¹⁴ *Id.*

ing the Japanese government, under pressure from Japanese firms, to demand that China, at a minimum, compensate Japanese companies for their "out of pocket" losses.¹¹⁵ Notwithstanding the expressed intent of the Chinese leadership to make just recompense in accord with conventional international practice, negotiators have yet to work out formulae for such payments.¹¹⁶

Nor has Baoshan been the only major project subject to recent reassessment. Agreements for the construction of chemical, fertilizer and petrochemical plants have reportedly been deferred or cancelled, as have contracts for many smaller purchases.¹¹⁷

THE STATUTORY CONTEXT

The Joint Venture Law

The focal point of any discussion of the statutory context surrounding joint ventures in the PRC, of course, is The Law on Joint Ventures Using Chinese and Foreign Investment.

China's Joint Venture Law was many months in the making.¹¹⁸ Aided by foreign consultants, Chinese officials examined the joint venture codes of Romania, Yugoslavia, Japan and Singapore; analyzed what was necessary to attract foreign investment; and most importantly, considered what would best serve China's objectives.¹¹⁹ The product, effective immediately upon its promulgation on July 8, 1979, was a three page document containing a mere fifteen broadly-worded articles.¹²⁰ Very much in keeping with the PRC's practice of general and aspirational legislation,¹²¹ the Joint Venture Law is best understood as an enabling act, leaving specific details and programs to be

¹¹⁵ Mitsubishi alone is said to have hundreds of millions of dollars worth of contracts at stake. *Mitsubishi Gets Orders From China*, J. COM., Mar. 26, 1980, at 10.

¹¹⁶ *Mitsubishi Mining to Assist China in Coal Venture*, J. COM., Mar. 26, 1981, at 33. One impediment to reaching a solution has been China's insistence on receiving more than 2.5 billion dollars in low interest loans in return for making compensation. *Chinese Aide Assures Japan on Future Ties*, Asian Wall St. J., Aug. 24, 1981, at 8. Latest reports indicate that the Japanese government has decided to provide the Chinese with a loan package worth 1.21 billion dollars to help salvage part of phase I of the Baoshan project and other industrial undertakings using Japanese supplies. Hashimoto, *Japan Sets \$1.21 Billion Loan Package For Chinese Steel, Petrochemical Plants*, Asian Wall St. J., Sept. 14, 1981, at 3.

¹¹⁷ *Chinese Bull*, *supra* note 109, at 78.

¹¹⁸ DiFederico, *China Marks New Policy with Joint Venture Law to Encourage Investment*, BUS. AM., Aug. 27, 1979, at 18-21.

¹¹⁹ *Id.*

¹²⁰ See Joint Venture Law, *supra* note 1.

¹²¹ Hsia & Hahn, *China's Joint Venture Law: Part I*, 1 CHINA L. REP. 1 (1980).

worked out either in regulations or the joint venture documents themselves.

In essence, the law provides for the establishment of equity joint ventures between Chinese and foreign entities, subject to the authorization of China's Foreign Investment Control Commission (FICC).¹²² The ventures will take the form of limited liability companies.¹²³ The foreign participant must contribute at least 25% of the venture's registered capital.¹²⁴ That contribution may take any of a variety of forms, including capital goods, industrial property rights or cash.¹²⁵ Theoretically, the foreign share can be as high as 100%.¹²⁶ Profits and losses are to be divided according to each party's capital contributions.¹²⁷ With the exception of the site, which the Chinese side may contribute or lease to the venture, the value of all such contributions must be jointly ascertained.¹²⁸ Any technology invested by the foreign party must be both "truly advanced and appropriate to China's needs."¹²⁹

Subject to the "laws, decrees and pertinent rules and regulations of"¹³⁰ the PRC, the joint venture is to be governed by a Board of Directors, composed of individuals chosen by each party and headed by a Chairman appointed by the Chinese and one or two Vice Chairmen named by the foreign participant.¹³¹ The Board is to have authority to act on "all issues concerning the venture,"¹³² including, but not limited to, production and business programs, labor plans and the appointment of the president, chief engineer, treasurer and auditors.¹³³ However, "the production and business programs . . . shall be filed with the authority concerned and . . . shall be implemented through business contracts."¹³⁴ First priority in the acquisition of "required raw and semi-processed materials, fuels, auxiliary equipment, etc." should be given to Chinese sources, although a venture will be allowed to acquire such items abroad "with its own foreign exchange."¹³⁵

¹²² Joint Venture Law, *supra* note 1, art. 3.

¹²³ *Id.* art. 4.

¹²⁴ *Id.* art. 4.

¹²⁵ *Id.* art. 5.

¹²⁶ Hsia & Hahn, *supra* note 121, at 14.

¹²⁷ Joint Venture Law, *supra* note 1, art. 4.

¹²⁸ *Id.* art. 5.

¹²⁹ *Id.* art. 5.

¹³⁰ *Id.* art. 2.

¹³¹ *Id.* art. 6.

¹³² *Id.* art. 6.

¹³³ *Id.* art. 6.

¹³⁴ *Id.* art. 9.

¹³⁵ *Id.* art. 9.

The joint venture's gross income, after deductions for worker bonus and welfare funds, expansion funds and reserve funds,¹³⁶ is subject to a "joint venture income tax" imposed pursuant to the "tax laws of the PRC."¹³⁷ Tax holidays are potentially available for joint ventures equipped with "up-to-date technology by world standards" for the first two to three profit-making years,¹³⁸ as are tax "incentives" for those reinvesting net profits in China.¹³⁹ Through "the legislation in force," the Chinese government has vowed to protect all lawful rights and interests of the foreign participants including "resources invested" and "profits due," which may be repatriated, according to the law.¹⁴⁰

The products manufactured by a joint venture may be distributed in China as well as abroad¹⁴¹ throughout the term of the venture, as agreed upon between the parties.¹⁴² The foreign venture partner has a right, under certain circumstances, to terminate the venture before its expiration date, provided authorization has been received from the proper authorities.¹⁴³ Finally, disputes are to be resolved by the Board of Directors "through consultation by the participants on the principle of equality and mutual benefit,"¹⁴⁴ and if that fails, through arbitration.¹⁴⁵

The Joint Venture Law did not evoke the level of foreign interest the Chinese leadership initially had anticipated.¹⁴⁶ In some measure, this was a consequence of the many questions the law left unanswered.¹⁴⁷ Responding to this criticism, the Chinese have accelerated and intensified their efforts to issue laws and regulations fleshing out the basic Joint Venture Law. To date, new laws or sets of regulations concerning five key areas have been promulgated. These concern joint venture income tax,¹⁴⁸ personal income tax,¹⁴⁹ labor management,¹⁵⁰

¹³⁶ *Id.* art. 7.

¹³⁷ *Id.* art. 7.

¹³⁸ *Id.* art. 7.

¹³⁹ *Id.* art. 7.

¹⁴⁰ *Id.* art. 2.

¹⁴¹ *Id.* art. 9.

¹⁴² *Id.* art. 9.

¹⁴³ *Id.* art. 13.

¹⁴⁴ *Id.* art. 6.

¹⁴⁵ *Id.* art. 14.

¹⁴⁶ See, e.g., *China's Economy: Big Deals*, *ECONOMIST*, Sept. 29, 1979, at 85; Fung, *China, Cool to Foreign Joint Ventures, Looks to Overseas Loans for its Projects*, *Asian Wall St. J.*, Aug. 24, 1981, at 8.

¹⁴⁷ See Birenbaum, *supra* note 4, at 6.

¹⁴⁸ *Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suodeshuifa* (Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment), adopted at the Third Session of the Fifth National People's Congress (Aug. 26, 1980),

the registration of joint ventures¹⁵¹ and foreign exchange.¹⁵² Work reportedly is progressing in other related areas, including a civil code, civil procedure law, further foreign exchange regulations and revamped patent and copyright laws.¹⁵³ In addition, under a directive of the Standing Committee of the National People's Congress issued on November 29, 1979, the validity of more than 1,500 laws, regulations and directives issued prior to 1957, many of which may have an impact upon joint ventures, has been reaffirmed.¹⁵⁴

Joint Venture Income Tax

China's Income Tax Law Concerning Joint Ventures With Chinese and Foreign Investment was formulated after extensive consultation with foreign business leaders and scholars and promulgated by the Fifteenth Session of the National People's Congress Standing Committee on August 26, 1980.¹⁵⁵ Regulations elaborating the provisions of this law were issued on December 14, 1980.¹⁵⁶ Akin to the basic Joint

and formally issued and made effective on September 10, 1980 [hereinafter cited as Income Tax Law]. A translation by Xinhua, may be found in MAIN DOCUMENTS, *supra* note 103, at 230.

¹⁴⁹ Zhonghua Renmin Gongheguo Geren Suopeshuifa (Individual Income Tax Law of the People's Republic of China), *adopted* by the Third Session of the Fifth National People's Congress and formally issued and made effective on September 10, 1980 [hereinafter cited as Individual Income Tax Law]. A translation by Xinhua may be found in MAIN DOCUMENTS, *supra* note 103, at 238.

¹⁵⁰ Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding (Regulations on Labor Management in Joint Venture Using Chinese and Foreign Investment), *adopted* at Fifteenth Session of the National People's Congress Standing Committee and formally issued and made effective on August 26, 1980 [hereinafter cited as Labor Management Regulations]. A translation by Xinhua may be found at E. ASIAN EXECUTIVE REP., Oct. 15, 1980, at 26.

¹⁵¹ Zhongwai Hezi Jingying Qiye Denji Guanli Banfa (Regulations on the Registration of Joint Ventures using Chinese and Foreign Investment), *adopted* at the Fifteenth Session of the National People's Congress Standing Committee and formally issued and made effective on August 26, 1980 [hereinafter cited as Registration Regulations]. A translation by Xinhua may be found at E. ASIAN EXECUTIVE REP., Oct. 15, 1980, at 25-26.

¹⁵² Zhonghua Renmin Gongheguo Waihui Guanli Zaxing Tiaoli (Provisional Regulations for Exchange Control of the People's Republic of China), *promulgated* by the State Council on December 18, 1980 [hereinafter cited as Exchange Control Regulations]. A translation by Xinhua may be found at CHINA BUS. REV., Mar.-Apr. 1981, at 49-50.

¹⁵³ See Alford, note 31 *supra*, at 83-84. The Chinese have also recently promulgated regulations governing the activities of lawyers and local offices of foreign businesses.

¹⁵⁴ Renmin Ribao (People's Daily), *reprinted in* FOREIGN BROADCAST INFORMATION SERVICE Nov. 30, 1979, at L 3-4. The directive provides that all such laws shall be in force, save for those that clearly are in conflict with the Constitution of the PRC or any laws passed or decrees issued by the Fifth National People's Congress. See Torbert & Thomson, *China's Joint Venture Law: A Preliminary Analysis*, 12 VAND. J. TRANS. L. 821 (1979).

¹⁵⁵ Based on discussions of co-author Alford with Chinese officials, Feb. 1981.

¹⁵⁶ Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suodeshuifa Shixing Xize (Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China), *approved* on December 10, 1980 by the State Council and *promulgated* by the

Venture Law in its brevity and generality, the Joint Venture Income Tax Law is a mere eighteen articles long. It subjects joint ventures to tax on net income derived from "production, business and other sources by branches within or outside the territory of China . . . after deduction of costs, expenses and losses."¹⁵⁷ The basic rate of taxation is 30%,¹⁵⁸ but the effective rate, inclusive of the local surtax of 10%, is 33%.¹⁵⁹ A further tax of 10% will be withheld on all income the foreign participant chooses to repatriate,¹⁶⁰ while a refund of 40% of income taxes paid is available, if the income subject to taxation is reinvested in a joint venture for a five-year period.¹⁶¹ Even without the potential refund, the tax is comparable to the industrial and commercial income tax to which Chinese entities without foreign investment are subject.¹⁶² Joint ventures scheduled to operate for more than ten years are eligible to receive tax holidays of 100% for their first profit making year,¹⁶³ 50% for the second and third such years,¹⁶⁴ and in the case of ventures engaged in such "low profit operations as farming and forestry or located in remote, economically underdeveloped areas," 15% to 30% for an additional ten years.¹⁶⁵

Separate formulae are laid out in the Regulations for computing taxable income earned from industrial, commercial and service activities, while "[f]or other lines of operations," reference is to be made to the most appropriate of these three categories.¹⁶⁶ In each instance, taxable income is defined as the enterprise's income net of permissible deductions.¹⁶⁷ Permissible deductions include manufacturing, selling

Ministry of Finance on December 14, 1980 [hereinafter cited as Detailed Rules and Regulations]. A translation by Xinhua may be found at CHINA BUS. REV., Mar.-Apr. 1981, at 53-54.

¹⁵⁷ Income Tax Law, *supra* note 148, art. 1.

¹⁵⁸ *Id.* art. 3. A lower rate is promised for joint ventures searching for and exploiting petroleum, natural gas and mineral resources. *Id.* art. 3.

¹⁵⁹ *Id.* art. 3. Detailed Rules and Regulations, *supra* note 156, art. 3. Local authorities have the authority to waive part or all of the local surtax.

¹⁶⁰ Income Tax Law, *supra* note 148, art. 4.

¹⁶¹ Detailed Rules and Regulations, *supra* note 156, art. 6. The Tax Law itself does not specify that the reinvestment must be made in a joint venture.

¹⁶² The net income of Chinese entities earning 10,000 *yuan* (approximately \$6,000) or more a year is subject to tax at a rate of 34.5%, plus surtaxes which may run as high as 60%, leading to a potential effective tax rate of 55.2%. Reynolds, *Doing Business with the People's Republic of China: Tax Considerations*, 14 INT'L LAW. 49 (Winter, 1980).

¹⁶³ Income Tax Law, *supra* note 143, art. 5.

¹⁶⁴ *Id.* art. 5. Losses may be carried forward for as many as five years. *Id.* art. 6.

¹⁶⁵ *Id.* arts. 8, 9.

¹⁶⁶ Detailed Rules and Regulations, *supra* note 156, art. 8.

¹⁶⁷ *Id.*

and administrative expenses, taxes on sales,¹⁶⁸ wages and certain other costs of doing business,¹⁶⁹ but explicitly exclude capital expenditures,¹⁷⁰ expenditures on the purchase of intangible assets, interest on capital,¹⁷¹ taxes (other than taxes on sales),¹⁷² penalties, losses covered by insurance,¹⁷³ "donations and contributions other than those for public welfare and relief purposes," and more than a very limited amount of entertainment expenses.¹⁷⁴

Depreciation of fixed assets "shall generally be computed on average by the method of straight line,"¹⁷⁵ although the joint venture may seek permission to accelerate depreciation.¹⁷⁶ For purposes of computing depreciation, the minimum useful life of houses and buildings is twenty years, "machines and equipment and the facilities for the purpose of production," ten years, and electronic equipment and most means of transportation, five years.¹⁷⁷ Intangible assets such as "technical know-how, patent rights, ownership of trade marks, copyright, ownership of sites and other royalties used as investment" are to be amortized over ten years, unless alternative periods of use are set.¹⁷⁸ "Expenses arising during the period of preparation for a joint venture" may also be amortized, provided not more than 20% of such costs are deducted in any one year.¹⁷⁹

Accounts are to be maintained on the accrual basis,¹⁸⁰ using First-In-First-Out (FIFO), shifting average or weighted average.¹⁸¹ Raw materials, finished products, by-products and inventories are to be computed "according to the cost price."¹⁸² "Vouchers for accounting, accounting books and reports" are to be kept in Chinese or in both Chinese and a foreign language and should be retained for at least

¹⁶⁸ *Id.* "Taxes on sales" here presumably refers to China's Consolidated Industrial and Commercial Tax. See text accompanying notes 286-294 *infra*.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* art. 9.

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.* Entertainment expenses are deductible only if "relevant to production and operation" and then only not "above the quota of three per thousand of the total sale income in the tax year or above the quota of ten per thousand of the total operational income."

¹⁷⁵ *Id.* art. 10.

¹⁷⁶ *Id.* art. 13.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* art. 16.

¹⁷⁹ *Id.* art. 17.

¹⁸⁰ *Id.* art. 23.

¹⁸¹ *Id.* art. 18.

¹⁸² *Id.*

fifteen years.¹⁸³ In addition, the Regulations acknowledge that an enterprise may choose to keep separate books for tax and financial purposes.¹⁸⁴

Taxes are to be reported for calendar years¹⁸⁵ on annual returns¹⁸⁶ accompanied by "reports on auditing by the chartered public accountants registered in the [PRC]."¹⁸⁷ Payment is to be made quarterly¹⁸⁸ in Chinese currency at official exchange rates.¹⁸⁹ Foreign tax credits are available for income tax paid "by a joint venture or its branch against tax assessed" by the Chinese.¹⁹⁰ The Ministry of Finance has the right to interpret the tax law and regulations,¹⁹¹ but amounts in dispute must be paid before reconsideration is sought from such "higher tax authorities" or before the matter is brought to court.¹⁹² By way of enforcement, the tax authorities have the right "to investigate the financial affairs, account work, and tax situation" of any joint venture¹⁹³—although they must maintain the confidentiality of such information¹⁹⁴—and the right to impose surcharges¹⁹⁵ for overdue payments. They may also exact penalties of as much as five times the amount of tax owed (up to a maximum penalty of 5,000 *yuan*),¹⁹⁶ and in instances of "gross violations," may recommend prosecution under China's new criminal law.¹⁹⁷

The Individual Income Tax

Under the Individual Income Tax Law of the PRC and its implementing Regulations,¹⁹⁸ each individual residing for more than five

¹⁸³ *Id.* art. 25.

¹⁸⁴ *Id.* art. 24.

¹⁸⁵ *Id.* art. 7. The Gregorian calendar is to be used.

¹⁸⁶ *Id.* art. 20.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* art. 15.

¹⁸⁹ *Id.*, art. 22.

¹⁹⁰ Income Tax Law, *supra* note 148, art. 16; Pomp, Gelatt and Surrey, *The Evolving Tax System of the People's Republic of China*, 16 TEX. INT'L L.J. 11, 69-77 (1981), provides the best discussion to date of the creditability of taxes paid in China against U.S. taxes and taxes paid in the U.S. against Chinese taxes.

¹⁹¹ Fields, *Taxation: The People's Republic of China Income Tax Laws*, 22 HARV. INT'L L.J. 234 (1981).

¹⁹² Income Tax Law, *supra* note 148, art. 15.

¹⁹³ *Id.* art. 12.

¹⁹⁴ Detailed Rules and Regulations, *supra* note 156, art. 27.

¹⁹⁵ Income Tax Law, *supra* note 148, art. 13. The surcharge to be assessed for each day in arrears is one half of one percent of the amount owed.

¹⁹⁶ Detailed Rules and Regulations, *supra* note 156, art. 27.

¹⁹⁷ Income Tax Law, *supra* note 148, art. 14.

¹⁹⁸ Zhonghua Renmin Gongheguo Geren Suodeshuifa Shixing Xize (Detailed Rules and Reg-

years in the PRC is subject to tax on his entire world-wide income.¹⁹⁹ Individuals residing in China for less than five years but more than 12 months are subject to tax on income earned in the PRC and income remitted from abroad to the PRC.²⁰⁰ Persons living in China for less than one year but 90 days or more, are taxed only on "income gained within China,"²⁰¹ while those residing in the PRC for less than 90 consecutive days are exempt from Chinese income tax.²⁰² Income from wages and salaries is taxed at specified rates ranging from 5% to 45%,²⁰³ after a monthly deduction of 800 *yuan* (approximately \$500).²⁰⁴ Given that the average annual income in the PRC is considerably less than 800 *yuan*,²⁰⁵ the tax, in effect, applies primarily to foreigners.²⁰⁶ Personal service income, royalties or rental income is taxed at a flat 20% rate,²⁰⁷ after specified deductions for residents of the PRC. Income from interest, dividends, bonuses and other non-exempt sources is assessed at a flat 20% without any deductions.²⁰⁸ Apart from providing that income tax will be withheld at the source, if possible,²⁰⁹ the procedural and enforcement aspects of this law closely approximate those of the Joint Venture Income Tax Law.²¹⁰

Labor Management Relations

The Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment²¹¹ set out general standards for dealing with what are described as "labor management problems."²¹² Subject to these standards,²¹³ joint venturers are free to conclude contracts

ulations for the Implementation of the Individual Income Tax Law of the People's Republic of China), approved by the State Council on December 10, 1980 and promulgated by the Ministry of Finance on December 14, 1980. (*Detailed Rules and Regulations for the Individual Income Tax*). A translation by Xinhua may be found at CHINA BUS. REV., Mar.-Apr. 1981, at 55-56.

¹⁹⁹ *Id.*, art. 3.

²⁰⁰ *Id.*

²⁰¹ Individual Income Tax Law, *supra* note 149, art. 1.

²⁰² Detailed Rules and Regulations for the Individual Income Tax Law, *supra* note 198, art. 5.

²⁰³ Individual Income Tax Law, *supra* note 149, art. 3.

²⁰⁴ *Id.* art. 5.

²⁰⁵ *Personal Incomes in China*, CHINA BUS. REV., Mar.-Apr. 1981, at 19-20.

²⁰⁶ Loong, *China Leaves Some Grey Areas*, FAR E. ECON. REV., Sept. 26, 1980, at 108. Knowledgeable observers suggest that at present less than 100 citizens of the PRC will be subject to the Individual Income Tax. Pomp, Gelatt and Surrey, *supra* note 190, at n.170.

²⁰⁷ Individual Income Tax Law, *supra* note 148, arts. 3, 5.

²⁰⁸ *Id.*

²⁰⁹ *Id.* art. 6.

²¹⁰ Income Tax Law, note 148 *supra*.

²¹¹ See Labor Management Regulations, *supra* note 150, arts. 8-11.

²¹² *Id.* art. 8.

²¹³ Such standards are subject to interpretation by the State Bureau of Labor. *Id.* art. 15.

with "the trade union organization formed in the joint venture,"²¹⁴ provided they implement the "relevant rules and regulations of the Chinese government on labor protection and ensure safety in production . . ."²¹⁵ Those contracts, which must be approved by the "labor management department of the provincial, autonomous, regional, or municipal people's government,"²¹⁶ may address "[m]atters pertaining to employment [and] dismissal . . . of . . . workers, tasks of production, wages, awards and punishment, working time and vacation, labor insurance and welfare, labor protection and labor discipline."²¹⁷

The general standards set forth in the Labor Regulations permit joint ventures to select workers and staff members "through examination for their qualifications."²¹⁸ Appropriate labor management departments must, however, approve the examinations used, or the recommendations of local authorities must be obtained.²¹⁹ Those workers who "fail to meet requirements after training and who are not suitable for other work," together with "surplus workers," may be discharged according to the Labor Regulations, provided they are given "compensation."²²⁰ Workers, too, have the right to sever their relationship with the joint venture.²²¹

In addition to setting broad parameters for hiring and firing, the Labor Regulations spell out wage and benefit standards.²²² The wage level for workers and staff members employed by a joint venture is to be "120 to 150 percent of the real wages of the workers and staff members of state-owned enterprises of the same trade in the locality,"²²³ although the venture's Board of Directors has discretion in determining "wage standards, the form of wages paid, and bonus and subsidy systems."²²⁴ In terms of benefits, the Regulations require joint ventures to "pay for the Chinese workers' and staff members' labor insurance, [and] cover their medical expenses and various kinds of government subsidies in line with the standards prevailing in state-owned enter-

²¹⁴ *Id.* art. 2.

²¹⁵ *Id.* art. 13.

²¹⁶ *Id.* art. 2.

²¹⁷ *Id.*

²¹⁸ *Id.* art. 3.

²¹⁹ *Id.*

²²⁰ *Id.* art. 4.

²²¹ *Id.* art. 7.

²²² *Id.* arts. 8-11.

²²³ *Id.* art. 8.

²²⁴ *Id.* art. 9.

prises.”²²⁵ Any disputes arising between labor and management are to be resolved “through consultation,” if possible,²²⁶ and if not, by the provincial level labor management department through arbitration or by the people’s courts.²²⁷

Registration Regulations

The Regulations on the Registration of Joint Ventures Using Chinese and Foreign Investment²²⁸ specify various registration requirements for joint ventures. The process starts after FICC authorization, with registration with the General Administration for Industry and Commerce (GAIC).²²⁹ Then, the GAIC “authorizes the administrative bureaus for industry and commerce in the provinces, municipalities and autonomous regions” to register the joint venture.²³⁰ Subsequently, the venture must open an account with the Bank of China²³¹ and register with the local tax bureau.²³² It must give notice to FICC and the provincial level Administration Bureau for Industry and Commerce “within one month after approval by the [FICC]” of proposed changes, such as moving to a new site, shifting production, increasing, decreasing or transferring registered capital and extending or cutting short the term of the venture.²³³ To enable the GAIC and its local counterparts to enforce the relevant requirements, the Registration Regulations authorize these bodies to “supervise and inspect” the joint venture and if need be, warn or fine it “in accordance with the varying degrees of seriousness in each specific case.”²³⁴

Foreign Exchange Regulations

The Provisional Regulations for Exchange Control of the PRC, which took effect on March 1, 1981,²³⁵ endeavor to synchronize all foreign exchange earnings and expenditures by routing all transactions in foreign exchange through accounts in the Bank of China and requiring the approval of the State General Administration of Exchange Control

²²⁵ *Id.* art. 11.

²²⁶ *Id.* art. 14.

²²⁷ *Id.* Access to the courts is available if either party “disagrees to the arbitration.” *Id.*

²²⁸ *See*, Registration Regulations, *supra* note 151.

²²⁹ *Id.* art. 2.

²³⁰ *Id.*

²³¹ *Id.* art. 6.

²³² *Id.*

²³³ *Id.* art. 7.

²³⁴ *Id.* art. 10.

²³⁵ *See* Exchange Control Regulations, *supra* note 152.

(SGAEC).²³⁶ Article 22 of the Exchange Control Regulations requires that "all foreign exchange receipts" of joint ventures "be deposited with the Bank of China" and that all "foreign exchange disbursements" of these ventures be paid only "from their foreign exchange deposit accounts."²³⁷ A foreign joint venturer is entitled to remit its net profits after taxes only to the extent that the joint venture's account with the Bank of China contains the foreign exchange required, and then only if the SGAEC has approved an application for transfer.²³⁸ To ensure that these restrictions are followed, the Exchange Control Regulations also require that all joint ventures submit "periodic reports and statements of their foreign exchange business to the SGAEC," which will have the power to review their activities.²³⁹

The Foreign Exchange Regulations also apply to "staff members and workers of foreign nationality" employed by joint ventures.²⁴⁰ Article 25 prohibits such persons from remitting or otherwise taking out of China in foreign currency more than 50% of their "net wages and other legitimate earnings after tax."²⁴¹

SOME OF THE PROBLEMS NOT RESOLVED BY THE JOINT VENTURE LAWS

As both Chinese and experienced Western observers understand, neither the Joint Venture Law, nor those laws and regulations designed to elaborate various of its terms ultimately do more than provide a general framework.²⁴² It should come as no surprise then, that many problems remain unresolved, and therefore, will have to be addressed in the process of negotiating a joint venture agreement.

Certainly, the most significant obstacle to conclusion of a joint venture in China is the scarcity of foreign exchange.²⁴³ This problem, of course, could not be overcome by the Joint Venture Law or the surrounding legal and regulatory requirements. It can be dealt with only through creative use of the venture as a means of generating foreign exchange, directly or indirectly, or by otherwise identifying sources of hard currency which can be linked or teamed with the venture. Sug-

²³⁶ *Id.* art. 22.

²³⁷ *Id.*

²³⁸ *Id.* art. 24.

²³⁹ *Id.* art. 22.

²⁴⁰ *Id.* art. 25.

²⁴¹ *Id.*

²⁴² Hsia & Haun, *supra* note 102, at 77-83.

²⁴³ Kaufman, *Euphoria on China Yields to Realism at Trade Seminar*, Wall St. J., Feb. 25, 1980, at 22, col. 1.

gestions in this connection are made later in this article.²⁴⁴

Turning then to some of the other potential stumbling blocks in the path of the prospective joint venture partner, we would identify the following considerations, which call for considerable advance planning.

Living with the Bureaucracy

There is simply no escaping the fact that a joint venture will have to deal continually with China's large and slow-moving bureaucracy. Government bureaucrats have much to say, not only about the joint venture's interaction with the general economy, but also as to the management of the venture itself. Under Article 6 of the Joint Venture Law, a joint venture must be governed by its Board of Directors, which has responsibility over such matters as procurement, production, employment and marketing.²⁴⁵ This seemingly broad grant of management discretion has been significantly constrained by the Labor and Registration Regulations. According to the Labor Regulations, joint ventures must negotiate with state controlled labor unions for contracts that meet prescribed wage and benefit levels and conform with the rules governing worker welfare, hiring and discharges.²⁴⁶ These contracts are then subject to provincial and local government approval.²⁴⁷ Under the Registration Regulations, a joint venture must obtain a license from the local office of the GAIC before it can do business, even though it has already received FICC approval.²⁴⁸ Amendments to an approved joint venture agreement and other significant changes in business operations must pass muster with both the FICC and the GAIC.²⁴⁹

Of far greater importance than these formal, legal restraints are those limitations on the autonomy of the Joint Venture's Board which are certain to result from the entity's inevitable interaction with the Chinese bureaucracy.²⁵⁰ As experience to date demonstrates, a prospective foreign venture partner's determination will be sorely tested by having to deal with a welter of bureaucracies, at the central, provincial

²⁴⁴ See text accompanying notes 364-381 *infra*.

²⁴⁵ See Joint Venture Law, *supra* note 1, art. 6.

²⁴⁶ See Labor Management Regulations, *supra* note 150, arts. 3-8, 10, 11.

²⁴⁷ *Id.* art. 2.

²⁴⁸ See Registration Regulations, *supra* note 151, art. 2.

²⁴⁹ *Id.* art. 7.

²⁵⁰ Ludlow, *Who's the Boss? After Ten Years They Still Don't Know*, CHINA BUS. REV., Jan.-Feb. 1981, at 14; Garcia, *China Trade Optimism Tempered*, J. COM., Nov. 4, 1980, at 10.

and local levels.²⁵¹ Each of these entities has a defined area of responsibility and competence, which it guards closely.²⁵² Intra-governmental coordination is often not in evidence, even when there is no apparent conflict of objectives or jurisdiction.²⁵³

In many respects, the process of negotiating one's way through this bureaucratic maze to form a joint venture is good training for what lies ahead when the joint venture does business in the predominantly state-controlled Chinese economy. The game starts, in effect, with the process of negotiating a joint venture agreement. Here too, there are multiple players on the Chinese side and much confusion.

For example, the China International Trust and Investment Company (CITIC) was established in the autumn of 1979 to act as a broker, matching prospective foreign ventures with suitable Chinese partners and serving as a general ombudsman in solving the problems that arise as joint venture arrangements are negotiated.²⁵⁴ Yet despite the highly publicized foreign travels of its Chairman, former capitalist Rong Yiren,²⁵⁵ CITIC's functions so far appear to be peripheral rather than central, designed as much to reassure foreign investors as to actually resolve major problems. Established in 1979, the FICC plays a more substantive role.²⁵⁶ Headed by Vice Premier Gu Mu, who has been a key figure in China's macroeconomic planning,²⁵⁷ the FICC has reviewed proposed joint venture arrangements with much closer scrutiny and for a longer period than foreign observers originally considered would be the case. The FICC has even suggested that changes be made in joint venture documents.²⁵⁸ Once the FICC has approved a joint venture, the relevant documentation²⁵⁹ must be registered with a third entity, the GAIC.²⁶⁰

In addition to these three organizations, which constitute the joint

²⁵¹ Ludlow, *supra* note 250, at 14.

²⁵² *Id.*

²⁵³ See Hsia & Haun, *supra* note 102, at 79-83.

²⁵⁴ Statute of the China International Trust and Investment Corporation, *adopted* by the State Council and formally issued and made effective on Oct. 4, 1979. A translation by Xinhua is reprinted in *SELLING TECHNOLOGY TO CHINA* 297-300 (N. Ludlow ed. 1979); Ling, *The Investment Matchmaker*, CHINA TRADE REP., July 1980, at 2.

²⁵⁵ [1979] 278 INT'L TRADE REPORTER'S U.S. EXPORT WEEKLY (BNA), at C-2.

²⁵⁶ *The PRC's Investment Control and Import-Export Commissions*, CHINA BUS. REV., Mar.-Apr. 1980, at 12-13.

²⁵⁷ D. KLEIN & A. CLARK, BIOGRAPHICAL DICTIONARY OF CHINESE COMMUNISM 447-448 (1971).

²⁵⁸ Birenbaum & Alford, *supra* note 3, at 26-27.

²⁵⁹ Joint Venture Law, *supra* note 1, art. 3.

²⁶⁰ *Id.*

venture bureaucracy on the national level, there are a growing number of provincial level entities with at least partial jurisdiction over joint ventures. These include but are not limited to "the [provincial and local] authorities with whom each joint venture's production and business programs" must be filed²⁶¹ and such specialized entities as the Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones, the Fujian Investment and Enterprise Corporation, the Beijing Economic Development Corporation, the Shanghai Foreign Investment Commission, the Zhejiang Province Overseas Chinese Investment Corporation and the local arms of the GAIC.²⁶²

Problems of bureaucratic coordination are not hypothetical. Prospective joint venturers have been strongly encouraged by central government bureaus, only to learn that a provincial agency is on the verge of concluding an agreement with a competitor or that basic requirements such as power and water are not available.²⁶³ Recent efforts at decentralizing economic responsibility and promoting financial accountability, however shortlived they may be, are a mixed blessing in this connection. Joint venturers may have more freedom to make decisions formerly reserved to central authorities, but the number of bureaucracies in the act seems certain to increase.

Working with the Chinese Worker

Notwithstanding the Labor Regulations, many questions concerning relations with the Chinese work force remain unanswered. These questions assume considerable importance because joint ventures are required to provide salaries for their workers at a level appreciably greater than workers in comparable Chinese enterprises.²⁶⁴ This will reduce the advantage of locating in the PRC compared with elsewhere in Asia,²⁶⁵ although in all likelihood, these premiums will not be passed along by Chinese authorities to workers in joint ventures.²⁶⁶

The principal problems yet to be resolved concern the selection, quality, size and control of the work force. Since the Joint Venture Law was promulgated, Chinese leaders have indicated that joint ventures would be able to draw their workers from a select pool of spe-

²⁶¹ Joint Venture Law, *supra* note 1, art. 9.

²⁶² Loong, *Special Zones, Special Rules*, FAR E. ECON. REV., Sept. 12, 1980, at 56. Guangdong Sheng Jingji Tequ Tiaoli (Regulations on Special Economic Zones in Guangdong Province).

²⁶³ Weil, *Technology Transfer*, CHINA BUS. REV., Mar.-Apr. 1981, at 21-29.

²⁶⁴ See Labor Management Regulations, *supra* note 150, art. 8, 11.

²⁶⁵ D. BONAVIA, THE CHINESE 200 (1980).

²⁶⁶ Hsia & Haun, *supra* note 102, at 77-83(quoting Liu Yaochu).

cially trained workers.²⁶⁷ The Labor Regulations do grant joint ventures the right to choose workers on the basis of tests approved by local labor management bureaus.²⁶⁸ Still, doubts remain as to the number of reasonably well trained Chinese staff and workers, the willingness of local labor bureaus to make them available for joint venture enterprises and the nature of the job selection tests to be administered.²⁶⁹

The suitability of the available work force is of particular importance for prospective foreign joint venturers because the West's experience with Chinese quality control has been mixed.²⁷⁰ When they buy abroad, the Chinese have insisted on thorough inspections coupled with comprehensive representations and warranties,²⁷¹ but the Chinese have been reluctant to provide the same treatment for exports of domestic manufactured goods.²⁷² Recently, however, preshipment inspections by foreign buyers have been permitted. These inspections have proved necessary, as the quality of Chinese manufacturers in many fields has been uneven and foreign insistence on quality assurance has all too often been ignored by the Chinese.²⁷³

Quality control is not the only potential concern. There is an overabundance of unskilled Chinese workers or as the Chinese euphemistically term them, "youth waiting for work" (*daiye jingnian*).²⁷⁴ Overstaffing and low productivity are serious and widespread problems particularly for Chinese factory managers who have to account for profits and losses.²⁷⁵ The Labor Regulations empower state authorities to approve virtually every aspect of the labor contracts with the appropriate Chinese labor unions, so it is hard to imagine that joint ventures could somehow escape the employment problems plaguing China.²⁷⁶

²⁶⁷ Based on an interview of Vice Premier Yao Ilin by co-author Alford in Aug. 1979.

²⁶⁸ Labor Management Regulations, *supra* note 150, art. 3.

²⁶⁹ LaForce, Joint Ventures and Labor Relations: A Preliminary Analysis of China's Joint Venture Labor Regulations (Jan. 1981) (unpublished paper available through the co-authors).

²⁷⁰ Rosenbaum, *Chinese Products Stir Complaints*, J. COM., Nov. 10, 1980, at 1.

²⁷¹ See, e.g., the purchase contracts typically employed by MACHIMPEX, reprinted in NATIONAL COUNCIL FOR U.S.-CHINA TRADE, CHINA'S STANDARD FORM CONTRACTS AND RELATED LEGAL ISSUES IN U.S.-CHINA TRADE (Special Report No. 13, 1975).

²⁷² Theroux, *Technology Sales to China: New Laws and Old Problems*, 14 J. INT'L L. & ECON. 185, 222-224 (1980).

²⁷³ See Rosenbaum, *supra* note 270, at 1.

²⁷⁴ Vice Premier Li Xiannian reportedly has set the number of unemployed at more than 20,000,000. J. Wang, *China's Jobless Youths: A Mounting Problem*, N.Y. Times, Sept. 30, 1979, § F, at 11.

²⁷⁵ Sterba, *China Experimenting With Labor Discipline*, N.Y. Times, Sept. 3, 1981, § A at 3.

²⁷⁶ LaForce, *supra* note 269.

The greatest challenge presented by the employment situation in China is not one which any legislation or regulation can effectively address. It is one familiar to businesspersons everywhere—how to motivate the workforce. Notwithstanding all the claims to the contrary, Chinese workers are not immune from motivational ailments. Absenteeism, low productivity and indifference have been all too evident in Chinese industry during the past decade.²⁷⁷ The policy of the present political leadership to provide material incentives, particularly bonuses, has helped, but the problem remains a serious one. The Labor Regulations authorize joint ventures to deliver bonuses and dismiss workers.²⁷⁸ The effective use of these carrots and sticks to motivate workers in one of the world's most socialist environments will require exceptional management skills.

Unresolved Tax Issues

The Joint Venture Income Tax Law and the Individual Income Tax Law lay down the basic ground rules and as such, are welcome complements to the Joint Venture Law. Yet, even when supplemented by their respective sets of implementing regulations,²⁷⁹ each leaves many questions unanswered both as to the manner in which a joint venture or foreign national's income will be taxed, the mechanics for securing one's full rights under the law, and the potential applicability of other Chinese taxes.

The most obvious questions remaining about the income tax are definitional and jurisdictional. Such fundamental terms as "costs," "losses," "remitted" and "residing" are not fully defined, as a consequence of which it is difficult to compute net income.²⁸⁰ The question of whether the term "joint venture" should be read to include compensation trade or coproduction agreements that have extensive foreign involvement, if not foreign investment, is unanswered.²⁸¹ A third outstanding issue involves breadth. For example, the Joint Venture In-

²⁷⁷ *Id.* at 23-24.

²⁷⁸ Labor Management Regulations, *supra* note 150, art. 9. Notwithstanding the fact that the Labor Management Regulations authorize joint ventures to discharge inadequate workers, it is hard to imagine that foreign-owned enterprises will be able to end the concept of the "iron ricebowl"—the idea that, once employed, a worker and his factory form a virtually inalienable bond.

²⁷⁹ See Detailed Rules and Regulations, note 156 *supra*; Detailed Rules and Regulations for the Individual Income Tax Law, *supra* note 198.

²⁸⁰ See Fields, *supra* note 191, at 238.

²⁸¹ See Income Tax Law, *supra* note 148, art. 1. Recent reports suggest that the Chinese intend to apply a separate, higher rate of income tax to enterprises in China with considerable foreign investment that are not joint ventures.

come Tax leaves unclear its relation to the income tax, to be imposed at the rate of 15% by the Regulations on Special Economic Zones in Guangdong Province on joint ventures established in those zones.²⁸²

A related problem concerns multiple taxation. Xue Muqiao, the noted economist whose writings have reportedly had a great influence upon the current leadership,²⁸³ recently asserted that the 33% rate established by the Joint Venture Income Tax Law might be reduced in particular cases to avoid excessive, aggregate taxation.²⁸⁴ Yet the relationship between other Chinese taxes and the special joint venture income tax regime remains unclear, raising the spectre of heavy, multiple taxation. In addition to the income tax, China has at least ten distinct taxes, certain of which may apply to joint ventures and their owners.²⁸⁵ The most important is the Consolidated Industrial and Commercial Tax.²⁸⁶ A composite of four separate taxes, the consolidated tax—akin to a cascading turnover tax²⁸⁷—in essence taxes goods and services at the stages of production and retail sales.²⁸⁸ Calculated on the item's sales price inclusive of tax, the tax can be passed on to purchasers to the extent that the state will permit it to be reflected in the item's price.²⁸⁹ Although the rates vary according to the importance of the goods and services involved²⁹⁰ and the location of the taxpaying enterprise,²⁹¹ they can run as high as 66% of an item's value: thereby making the question of whether it will apply to a joint venture anything but academic.²⁹² Preliminary indications from negotiations held thus far are that contributions from foreign partners will not be subject to the tax.²⁹³ The provision in the Income Tax Regulations permitting the deduction of taxes on sales does suggest, however, that the products of a joint venture factory will be subject to this tax, barring a negotiated

²⁸² See Loong, *supra* note 262, at 56-57; Pomp, Gelatt and Surrey, *supra* note 190, at 63-66.

²⁸³ P. Loong, *Capitalising on New Socialism*, FAR E. ECON. REV., Aug. 15, 1980, at 40-41.

²⁸⁴ Interview with Xue Magiao, CHINA BUS. REV. 58-60 (July-Aug. 1981); Kramer, *Chinese Official Says Tax on Earnings of Foreign Investors Likely to be Cut*, Asian Wall St. J., Oct. 13, 1980, at 5.

²⁸⁵ Pomp & Surrey, *The Tax Structure of the People's Republic of China*, 20 VA. J. INT'L L. 1 (1979).

²⁸⁶ Pomp & Surrey, *supra* note 285, at 12-22; Gelatt, *The Consolidated Industrial and Commercial Tax: Its Impact on Foreign Investment*, 2 E. ASIAN EXECUTIVE REP. 2 (1980).

²⁸⁷ Gelatt, *supra* note 286, at 2.

²⁸⁸ *Id.*

²⁸⁹ *Id.*

²⁹⁰ Luxury goods are taxed far more heavily than necessities. Reynolds, *supra* note 162, at 57-58.

²⁹¹ Tax relief is available for entities situated in areas of unemployment. See Pomp, Gelatt & Surrey, *supra* note 190, at n.38.

²⁹² *Id.*

²⁹³ Based on co-author Alford's discussions with Chinese officials, Jan. 1980.

exemption.²⁹⁴

Apart from these substantive issues, the new tax laws and regulations raise a number of vital concerns of an administrative or procedural nature. As presently written, neither the law nor the regulations provides a means to obtain advance rulings or contest tax assessments prior to making payment.²⁹⁵ This deficiency is accentuated by the surcharge provisions of the laws. These may be triggered for "failure to pay within the prescribed time limit," even, apparently, if the taxpayer is taking issue with or in doubt as to the amount of tax due.²⁹⁶ Additionally, the laws and regulations are vague as to a number of procedural matters of importance to foreign investors, such as tax holidays or credits. Taking the former as an example, beyond setting out a very general standard, little is said about the criteria or methods for securing tax holidays.²⁹⁷ How, after all, is the determination to be made that technology provided by a foreign investor is truly advanced by world standards and appropriate to China's needs, as the Joint Venture Law says is necessary to take a tax holiday?²⁹⁸ How, for example, is a foreign investor to receive binding confirmation that a tax holiday will be granted before actually making its investment? What documents are to be submitted, by whom, to whom, and when? In practice, answers to many of these questions may be negotiated out between the parties, but the on-going lack of clear, firm, visible rules in this area hardly serves as an incentive to prospective foreign partners.

Bringing the Profits Back Home

The Joint Venture Law entitles foreign participants to repatriate profits earned in China.²⁹⁹ Yet potential foreign investors remain concerned over the extent to which this promise will be effected in practice. As discussed above, China lacks sufficient foreign exchange to undertake significant foreign procurements, and because of her historical experience, is reluctant to borrow heavily in foreign markets to finance imports of Western goods and technology.³⁰⁰ Of late, the central government has come to appreciate the magnitude of this problem and has intensified its efforts to discourage Chinese and foreign investors alike

²⁹⁴ See Rules and Regulations, *supra* note 156, art. 8.

²⁹⁵ Income Tax Law, *supra* note 148, arts. 8, 13.

²⁹⁶ *Id.* art. 13; Individual Income Tax Law, *supra* note 149, art. 11.

²⁹⁷ Joint Venture Law, *supra* note 1, art. 7; Income Tax Law, *supra* note 148, arts. 5, 6; Detailed Rules and Regulations, *supra* note 156, arts. 5, 6.

²⁹⁸ *Id.*

²⁹⁹ Joint Venture Law, *supra* note 1, art. 10.

³⁰⁰ See text accompanying notes 90-108 *supra*.

from moving foreign exchange outside of China.³⁰¹ Through the Joint Venture Income Tax Law,³⁰² the Government has imposed an additional 10% withholding tax upon net earnings repatriated by foreign joint venture participants, while through the Exchange Control Regulations, it has sought to limit each joint venture's foreign exchange disbursements to its foreign exchange earnings.³⁰³ Additionally, in its most important currency conversion action, the Government, in January of 1981, carried out what was effectively the PRC's first devaluation.³⁰⁴ Under the new system, the rate of exchange for Chinese state enterprises and government corporations purchasing foreign currency to pay for overseas transactions is fixed at 2.8 *yuan* per dollar, although the rate for *yuan* received in exchange per foreign dollar earned will stay at 1.5.³⁰⁵ As a result, China's exports are now more competitively priced on the world market, but correspondingly, the price of imports has risen by almost 50%.³⁰⁶ And, notwithstanding protests by Japanese and other trading partners, the Chinese have continued to cut back drastically on major projects because of foreign exchange problems.³⁰⁷

Protecting Intellectual Property Rights

The Joint Venture Law does not explicitly provide for the protection of intellectual property. Article 5 of the Law, however, recognizes that a foreign participant's contribution to a joint venture may be in the form of intellectual property rights, thereby acknowledging that such rights are a valued form of property.³⁰⁸ Article 2 of the Law asserts that the Chinese government will respect and protect foreign participants' legitimate property rights and interests; a category that in light of Article 5, presumably includes intellectual property rights.³⁰⁹

At present, the Chinese lack a comprehensive statutory framework for the protection of intellectual property rights. To be sure, China has trademark³¹⁰ and invention laws.³¹¹ Pursuant to the Law on Trade-

³⁰¹ Ludlow, *China Wire*, CHINA BUS. REV., Mar.-Apr. 1981, at 3.

³⁰² Income Tax Law, *supra* note 148, art. 4.

³⁰³ Exchange Control Regulations, *supra* note 152, arts. 22-24.

³⁰⁴ Dessertine, *In Double Taux de Change*, COMITE FRANCE CHINE, Dec. 19, 1980; Ching, *China Confirms Separate Currency Rate to be Set Internally for Foreign Trade*, Wall St. J., Dec. 16, 1980, at 37.

³⁰⁵ Ching, *supra* note 304, at 37.

³⁰⁶ *Id.*

³⁰⁷ See text accompanying notes 109-117 *supra*.

³⁰⁸ Joint Venture Law, *supra* note 1, art. 5.

³⁰⁹ *Id.* art. 2.

³¹⁰ Regulations of the People's Republic of China Governing Trademarks, *adopted* April 10,

marks, which was initially issued in 1963, registration and a degree of protection have been obtained for certain well-known American marks, such as "The Encyclopedia Britannica."³¹² Issued late in 1978, China's revised Regulations on Rewards for Inventions reward only those inventors who turn their inventions over to the state which then may make them available to any Chinese entity.³¹³ As such, the invention law offers little comfort for potential foreign joint venture participants seeking to protect their intellectual property rights.

As they have pledged to do in Article VI of their Trade Agreement with the United States, the Chinese are endeavoring in short order to put into effect patent and copyright laws that meet the minimal standards of the World Intellectual Property Organization (WIPO).³¹⁴ Toward that end, China joined WIPO in February of 1980.³¹⁵ In addition, study groups have gone to Japan, the United States and other major industrial nations, and patent specialists have been sent to the United States Patent and Trademark Office for extended stays.³¹⁶ Even prior to the promulgation of the Joint Venture Law, it had been anticipated that the Chinese would issue laws of their own meeting WIPO standards and might accede to the Paris Convention.³¹⁷ They have not yet done either, but these laws are rumored now to be in the final stage of drafting.³¹⁸ It has been suggested that in drafting their patent law, the Chinese are looking toward the model emanating from the United Nations Conference on Trade and Development in their drafting.³¹⁹

In the absence of comprehensive laws protecting intellectual property rights, the only alternative means of safeguarding such interests is by so providing in the joint venture agreement. That is difficult to do.

1963. A translation by Xinhua may be found at G. HSIAO, *THE FOREIGN TRADE OF CHINA* 219 (1977). [Hereinafter cited as Hsiao].

³¹¹ Regulations on Rewards for Inventions, *promulgated* Jan. 16, 1979. A translation by Xinhua is reprinted in FOREIGN BROADCAST INFORMATION SERVICE, Jan. 18, 1979, at E-15.

³¹² See Theroux, *supra* note 272, at 232.

³¹³ See Regulations on Rewards for Inventions, *supra* note 211; Hsia & Haun, *Laws of the People's Republic of China on Industrial and Intellectual Property*, 5 L. & POL'Y INT'L BUS. 743 (1973); Gale, *The Concept of Intellectual Property in the People's Republic of China: Inventors and Inventions*, 74 CHINA Q. 335 (1978).

³¹⁴ See S. Landers, *Industrial Property Rights in the People's Republic of China* (Jan. 1981) unpublished paper (available through co-authors).

³¹⁵ *China May Adopt Patent Law for International Trade*, Agence France Press, May 13, 1980, reprinted in FOREIGN BROADCAST INFORMATION SERVICE, May 16, 1980, at A-7.

³¹⁶ *Patent Conference Explores International Developments*, [1980] 460 PATENT, TRADEMARK & COPYRIGHT J. (BNA) at 3-5.

³¹⁷ Lichtenstein, *China's Participation in International Organizations*, CHINA BUS. REV., May-June 1979, at 28.

³¹⁸ Berney, *China's Draft Patent Law*, CHINA BUS. REV., May-June 1981, at 39.

³¹⁹ *Id.*

As Western companies are increasingly coming to learn through examples such as the "708"—supposedly a pirated version of the Boeing 707³²⁰—China's considerable reputation for honoring foreign patent rights is not without its exceptions, for which there is little practical remedy.³²¹ The situation is even more problematic when it comes to non-patentable technical and managerial expertise.

As experience suggests, the proprietary nature of intangible information is one of the more elusive concepts in the Sino-American commercial dialogue.³²² This should not be surprising since the upholding of rights to unpatented know-how can entail barring technicians from using for the benefit of the state information they obtained from foreign sources, even though the information has been fully absorbed in their general body of knowledge. Such a dichotomy in allegiances is unlikely to prove acceptable to the Chinese, since it runs counter not only to Communist ideology, but to traditional Chinese thought, as well.³²³

These problems go beyond the conceptual level. Despite—or, maybe, because of—the post-Mao opening to the West, China's leaders continue to worry that excessive reliance on imported equipment will impair her independence.³²⁴ Imports of goods entail greater levels of foreign debt and dependence on foreign supplies. Present policy favors the acquisition of technology and know-how, on the theory that this will enable the next generation to fend for itself.³²⁵ Is it little wonder, then, that the Chinese could, for example, promise to protect the confidentiality of foreign technology imparted to a particular factory's management, while insisting on the right to rotate chief engineers in order to disseminate that very technology?³²⁶

Living in China

The Joint Venture Law purports to assure that needed foreign personnel will be able to take up residence in China. The Law, however, says nothing about the circumstances of their stay. As discussed above,

³²⁰ Mathews, *China Set to Clone a '708' From Boeing Jet it Bought*, Wash. Post, May 9, 1980, § A, at 1.

³²¹ *Id.*

³²² Landers, *supra* note 314.

³²³ Chen Shuhua, *It is Entirely Necessary to Establish a Patent System*, Renmin Ribao (The People's Daily), June 19, 1980, reprinted in FOREIGN BROADCAST INFORMATION SERVICE, July 9, 1980, at L 1-14.

³²⁴ *Id.*

³²⁵ *Id.*

³²⁶ Based on co-author Alford's discussions with Chinese officials, Feb. 1981.

the Personal Income Tax Law establishes basic rules of taxation applicable to resident aliens,³²⁷ and the Exchange Control Regulations restrict the amount of net wages a foreign worker can remit from China.³²⁸ The Consular Agreement between the United States and the PRC assures Americans residing in China such basic privileges as notification of the consul within four days of arrest or detention, a visit by a consular official within two days of notification, and attendance by two consular officials at any trial in order to provide necessary legal and translation assistance.³²⁹ Nonetheless, fundamental issues, largely of an extralegal nature, remain.

The paramount problems concern the basics of living and working in China as an alien. For example, provision must be made for access to housing, education, food and medical services at a standard that ultimately will be vastly superior to what is available to Chinese workers.³³⁰ Yet every effort must be made to prevent this privileged status from unleashing a xenophobic reaction. Perhaps a more immediate threat is the impact on Chinese society of such blatant discrimination in the provision of material benefits. For as Orville Schell's fascinating recent study of the underside of China's new openness to the West—replete with prostitutes, pimps and punks in fedora hats—indicates,³³¹ and as the recent regulations restricting the acceptance by Chinese officials of gifts from foreigners confirm,³³² the influence of foreigners resident in China has not been entirely salutary.

Resolving Disputes with the Chinese Venture Partner

Perhaps to a greater extent than any other single issue in the joint venture area, the approach to dispute resolution taken in the Joint Venture Law shows the sway of classical Chinese culture, intensified by Communist ideology. The Law directs the parties to resolve their disputes through consultation on the bases of "equality and mutual benefit," informal mediation and, as a last resort, formal arbitration.³³³ No

³²⁷ See text accompanying notes 98-227 *supra*.

³²⁸ See text accompanying notes 240-241 *supra*.

³²⁹ Consular Convention Between the United States of America and The People's Republic of China, Sept. 19, 1980, arts. 3, 35, reprinted at 19 INT'L LEGAL MATERIALS 1119 (1980). See Cohen and Gelatt, *China: The Foreigner and the New Criminal Code*, Asian Wall St. J., Feb. 7, 1980, at 4.

³³⁰ Sterba, *Moving in China: A Puzzled Isolation*, N.Y. Times, Mar. 26, 1981, § C, at 1.

³³¹ O. SCHELL, WATCH OUT FOR THE FOREIGN GUESTS (1980).

³³² State Council Decision on not Giving or Receiving Gifts in Foreign Affairs Activities, adopted by the State Council on Nov. 7, 1980. A translation by Xinhua may be found in 2 E. ASIAN EXECUTIVE REP., Feb. 15, 1981, at 10. See *Modernization's Black Side*, FAR E. ECON. REV., Apr. 4, 1980, at 15.

³³³ See Joint Venture Law, *supra* note 1, art. 14.

mention is made of China's new economic courts.³³⁴ This policy effectuates the long-standing Chinese preference for resolution of disputes informally through compromise, rather than litigation.³³⁵ Rarely during the past thirty years have trade disputes been referred to arbitration, let alone litigation, whether in China or abroad.³³⁶

The Chinese have agreed in recent years to arbitration clauses specifying foreign sites, including Stockholm (most often), Geneva, London and Toronto.³³⁷ Generally, if unable to bring the arbitration under the rules of China's Foreign Trade Arbitration Commission,³³⁸ the Chinese have indicated a preference for the Stockholm Chamber of Commerce or United Nations Commission on International Trade Law rules, rather than those of the International Chamber of Commerce, to which Taiwan still belongs.³³⁹

The Information Gap

The Hung-wu Emperor, founder of the Ming Dynasty (A.D. 1368-1644), reputedly refused to make public the basic laws regulating the behavior of his subjects. He thought that by publicizing the laws he would only encourage those of mean spirit to circumvent them. The present day successors of the Hung-wu Emperor have retained more than vestiges of that approach. To be sure, during the past two years the Chinese government has made unprecedented strides in educating the public about the basic criminal and other laws that affect their lives.³⁴⁰ Still, especially in the economic area, the nature and extent of Chinese law or those rules, regulations and directives having the effect of law remains shrouded in secrecy.³⁴¹

In part because of foreign persistence, the Chinese government is now in the process of publishing a compendium of major economic laws.³⁴² That work is certain to be helpful, yet it will still leave the

³³⁴ The role and procedures of these new courts are discussed in Ellis & Shea, *Foreign Commercial Dispute Settlement in the People's Republic of China*, 6 INT'L TRADE L.J. 155, 168-172 (1980-81).

³³⁵ G. HSIAO, *supra* note 310, at 154.

³³⁶ NATIONAL COUNCIL FOR U.S.-CHINA TRADE, ARBITRATION AND DISPUTE SETTLEMENT IN TRADE WITH CHINA (1974).

³³⁷ *Id.*; Rabb, *Chinese Policy Seems Moderate In Settling Shipping Disputes*, J. COM., Sept. 17, 1980, at 9.

³³⁸ Ren Jianxin, *Some Legal Aspects of Our Import of Technology and Utilization of Foreign Investment*, 1 CHINA L. REP. 97-102 (Fall, 1981).

³³⁹ Hsia & Haun, *supra* note 102, at 73.

³⁴⁰ Lubman, *supra* note 31; Alford, King & Williams, *Laws, Lawyers, and Legal Education in the PRC*, KENNEDY INST. Q. 47-49 (1979); Gelatt & Snyder, *Legal Education in China: Training for a New Era*, 1 CHINA L. REP. 41-60 (1980).

³⁴¹ Lubman, *China's Joint Venture Laws Leave Questions Unanswered*, Asian Wall St. J., Nov. 24, 1980, at 6 (special supplement).

³⁴² *Id.*

would-be foreign joint venturer partially in the dark, for it will not cover provincial, municipal or local legal pronouncements, such as the rules of the provincial labor management departments. Nor will it identify internal directives and pronouncements, such as the standards of review by the FICC of petitions for changes in a joint venture's operations, which may not be called "law," but will nonetheless be binding when applied.

STRUCTURING AN APPROACH TO THE CHINESE

The Chinese are well aware of the difficulties facing potential foreign investors. To Westerners frustrated with the pace of China's movement toward more comprehensive and detailed laws in the joint venture area, they counsel patience: patience while a poor China, with many competing developmental needs, establishes priorities, patience while China learns from her experience in obtaining goods and technology from foreign suppliers and patience while China decides what further laws and regulations governing joint ventures it is prepared to adopt, although it is a safe bet they will be neither as many, nor as specific, as most foreign venturers would desire.³⁴³ The Chinese are right to counsel patience, for without great patience, a foreign company would be ill-advised to involve itself in a joint venture with the Chinese.

Reasons for Investing in China

Given these daunting difficulties, why should a potential joint venturer invest in China? We see four major reasons.

The first is access to China's domestic markets. The image of more than one billion Chinese hungry for long-denied Western goods casts a powerful spell. Today's would-be China tycoons, like their predecessors a century ago, are enthralled by the prospect of "supplying oil for the lamps of China."³⁴⁴ For the most part, these dreams of millions of new consumers of jeans and junk food are just that; fantasies which the Chinese cannot now afford.³⁴⁵ Yet for entrepreneurs in the electrical, transportation, energy and agricultural industries, access to the domestic market through the joint venture mechanism is a possibility worth exploring. These are fields which the Chinese want to develop as part of the new, pragmatic leap forward. Even more

³⁴³ Powers, *China Interested in Mississippi Crops, says Chinese Ambassador*, Jackson Daily News (Miss.), Jan. 25, 1981, § B, at 4.

³⁴⁴ BONAVIA, *supra* note 265, at 199.

³⁴⁵ See Kaufman, *supra* note 243 at 22.

importantly, such projects have the potential for generating foreign exchange through exports.

A second rationale is to exploit the growing market for tourism. Here, too, the objectives of the Chinese and the foreign investor are congruent. The commercial prospects are encouraging. In 1980, the number of foreign visitors to the PRC soared to almost 6,000,000,³⁴⁶ and this despite increases in hotel, food and related travel prices that have run ahead of China's official 6% inflation rate.³⁴⁷ The foreign business and journalistic communities have been other sources of business for hotel, office and similar projects.³⁴⁸

Many of the joint venture proposals that have received serious consideration involve tourism in one way or another. Three of the first five joint venture proposals approved by the FICC seek to tap this growing market. The most noteworthy of these ventures was the agreement between E-S Pacific Development and the China International Travel Service to build and operate a flagship, international-class hotel in Beijing to be known as "The Great Wall."³⁴⁹

China's massive but largely untapped raw material wealth provides a third attraction for American companies. To be sure, the notion that China would soon become a large-scale exporter of oil has faded in the face of domestic political wrangling,³⁵⁰ production shortfalls³⁵¹ and the disappointing composition of Chinese oil.³⁵² Indeed, recent reports suggest that the Chinese are trying to import oil to keep major petrochemical projects alive.³⁵³ Still, to the capitalist world, which has seen supplies of tin, manganese, tantalum, tungsten and many other critical metals and minerals dwindle or come under the control of unstable third world suppliers or cartels, China's vast mineral reserves retain a powerful attraction, particularly since Western technology would be of great value to the Chinese in extracting those

³⁴⁶ State Statistical Bureau of the People's Republic of China, *Communique on Fulfillment of 1980 National Economic Plan*, issued April 29, 1981 by the State Statistical Bureau, reprinted in *BEIJING REV.*, May 18, 1981, at 17.

³⁴⁷ Kramer, *Currency-Starved Chinese Charge Visitors Whatever Market Will Bear for Services*, *Wall St. J.*, July 25, 1980, at 34; *Modernization's Black Side*, *supra* note 332 at 15.

³⁴⁸ *China Trade Projects Hard to Come By*, *J. COM.*, Nov. 19, 1980, at 1.

³⁴⁹ See Birenbaum & Alford, *supra* note 3.

³⁵⁰ Breeze, *Safety First in Industry*, *FAR E. ECON. REV.*, Oct. 10, 1980, at 61; *Petroleum Minister Ousted in China*, *J. COM.*, Aug. 20, 1980, at 2.

³⁵¹ *Oil & Coal: A New Shocker from Peking*, *ASIaweek*, Feb. 27, 1981, at 43.

³⁵² Alford, *Practical and Legal Problems of Doing Business with China* (Sept. 27, 1979) (speech delivered at the Federal Bar Association Annual Convention, San Antonio, Texas). Most Chinese petroleum has such a high paraffin content that it would be unsuitable for the American or European markets without additional, costly refining.

³⁵³ *ASIaweek*, *supra* note 351.

natural resources.³⁵⁴ Again, the crucial foreign exchange problem is potentially soluble, at least in principle and over time.

The fourth, and for many the most alluring appeal of joint ventures in China is the Chinese people and their tremendous potential as a labor force to produce goods for export markets. During the past three years, numerous foreign concerns have entered into compensation, countertrade, processing or related agreements with the Chinese.³⁵⁵ Pursuant to these agreements Chinese workers engage in the assembly of products for the export market. Payment is made in goods or from export earnings. Despite labor, quality control and infrastructure problems, many of these projects have proved profitable for both sides.³⁵⁶ For the Chinese, they offer Western capital, technology, managerial expertise and a new source of jobs, at tolerable foreign exchange costs. For the Western venture partners, the main attraction is relatively inexpensive labor and, in certain cases, raw materials.

Without a greater willingness by foreigners to purchase Chinese products, however, the promise will not be realized. The United States and other nations eager to promote their trade with China have been reluctant to accept imports of Chinese manufactured goods in volumes comparable to their exports to China.³⁵⁷ In the United States, this problem is most graphically illustrated by the resistance to imports of textile products. In spite of the fact that the Chinese are now the largest purchaser of cotton exported from the United States,³⁵⁸ the United States government, succumbing to domestic political pressure, insisted upon rigid limitations upon Chinese textiles in the bilateral textile agreement negotiated in 1980.³⁵⁹ Yet if China cannot earn through exports the foreign exchange needed to pay for Western high technology and advanced equipment, the prospects for substantial trade with China are not bright.

³⁵⁴ Crown, *China Markets First Tungsten Powders in U.S.*, *Amer. Metal Mkt.*, Aug. 27, 1981; Jabs, *Chinese Offer to Sell U.S. Three Strategic Metals*, *Am. Metal Mkt.*, Sept. 15, 1980, at 1.

³⁵⁵ P. VERZARIU, *COUNTERTRADE PRACTICES IN EAST EUROPE, THE SOVIET UNION AND CHINA* (1980). Chinese countertrade transactions are listed at 98-102.

³⁵⁶ Kurata, *Lower Costs Lure China Trades*, *FAR E. ECON. REV.*, Feb. 27, 1981, at 68.

³⁵⁷ Goldsmith, *Protectionism: Several U.S. Industries Form A Front in Washington Against Burgeoning Chinese Imports*, *CHINA BUS. REV.*, Jan.-Feb. 1981, at 19.

³⁵⁸ The Chinese purchased more than \$700 million in U.S. cotton in 1980. George, Gullo & Stein, *Trade with the People's Republic of China: Current Status and Future Prospects*, 3 *Nw. J. INT'L L. & BUS.* 21 (1981).

³⁵⁹ See Goldsmith, *supra* note 357, at 20-21.

Selecting the Right Venture Partner

Having considered the reasons for engaging in a joint venture with the Chinese, the prospective foreign investor must next determine which Chinese enterprise to approach about a possible collaboration. CITIC stands ready to assist in this matching process.³⁶⁰ Experience suggests, however, that CITIC's objectives may not always parallel those of the prospective foreign joint venturer. Indeed, although China-hands are reluctant to publicly voice criticism of CITIC, some caution that CITIC has tried to direct foreign investment to locales in China in need of development projects even if they lack the necessary infrastructure or utilities, or are less than ideal from a strictly commercial vantage point.

Instead of depending solely on CITIC, a potential foreign investor would be well advised to conduct or commission the research necessary to identify appropriate Chinese venture parties. Approaches can then be made to the entities in question and to the concerned provincial and national governmental units. Notwithstanding the greater autonomy granted of late to local enterprises and governing units, any joint venture with a value of more than 3 million *yuan* is likely to require from an early stage onward at least the tacit approval of higher authorities.³⁶¹ As a consequence, prospective joint venturers will enhance their chances of attracting attention to their proposal and subsequently securing approval for it by reaching out broadly from the beginning.

Negotiating Strategy—Overcoming the Foreign Exchange Barrier

The core of any effective strategy in negotiating with the Chinese is to identify the wants and needs of the Chinese side and to develop proposals which match their interests with those of the Western venture partner. This will require an understanding of Chinese development priorities and the other factors that, as discussed above, shape her attitude to foreign investment. Key elements in this analysis are arranging suitable sources of foreign exchange and developing an appropriate structure for the relationship between the parties.

Projects which promise to generate foreign exchange in the near term by means of export sales present something of a solution to this problem. There are numerous examples of successful assembly shop

³⁶⁰ Comments of Rong Yiren at Washington Hilton Hotel, Oct. 9, 1979.

³⁶¹ Terry, *More Power to the Cities: An Interview with Vice Mayors of Beijing and Shanghai on the Expanded Role of Municipalities in Foreign Trade*, CHINA BUS. REV., Mar.-Apr. 1980, at 18.

operations—basically, contracted Chinese labor—which involve hiring Chinese workers to put together parts manufactured outside of China, such as in Hong Kong, for sale of products in the domestic, tourist or export markets.³⁶² These ventures, which do not entail equity investment in China and thus are not carried out through a joint venture as that term is defined in the Joint Venture Law, have become fairly common, particularly in Guangdong and Fujian, with overseas Chinese entrepreneurs.³⁶³ For example, Millie's Holdings Ltd. of Hong Kong has in recent years supplied the Chinese with equipment and materials made in Hong Kong to facilitate the manufacture of textiles, shoes and handbags in the Shenzhen special export zones located close by the Hong Kong border.³⁶⁴ To take a variant, Reynolds Tobacco is supplying the Amoy Cigarette Factory with processed tobacco and the necessary machinery to produce Camel filter cigarettes for sale in China Friendship Stores, which serve tourists and the resident foreign community.³⁶⁵ At a somewhat more complex level, in late 1980 Westinghouse and Combustion Engineering signed an agreement with the First Ministry of Machine Building under which they will, at least at the outset, supply the Chinese with the bulk of parts needed for 600-megawatt thermal turbine generators and boilers.³⁶⁶ These parts will then be assembled by Chinese labor, together with other Chinese produced parts, for sale by the Chinese, largely in the PRC.³⁶⁷ Such projects ultimately present limited possibilities, however, in that the foreign party lacks control over the work performed in China, does not participate in any profits earned in China and enjoys only indirect access to the domestic Chinese market. Further, not all enterprises can be carried out in this fashion: international class hotels and steel mills are ventures which are too complicated to be contracted out and require substantial hard currency financing.

An intermediate approach between merely assembling foreign-made parts and a full-fledged joint venture is that of counter or compensation trade.³⁶⁸ Here the Western party makes an investment in the form of technology or equipment, and is paid, in whole or in part, in the products produced by the Chinese. Usually, these are the direct

³⁶² See Kurata, *supra* note 356 at 68.

³⁶³ *Id.*; Kamm, *Exporting Some of Hong Kong . . . Exporting Some of China, Guangdong SEZS*, CHINA BUS. REV., Mar.-Apr. 1980, at 28.

³⁶⁴ See Kurata, note 356 *supra*.

³⁶⁵ Weil, *supra* note 263, at 68.

³⁶⁶ *Id.* at 25-26.

³⁶⁷ *Id.*

³⁶⁸ VERZARIU, *supra* note 355, at 1-14 and 19-33.

products of the invested technology or equipment, which are then sold on the world market for hard currency. For example, Container Transport, Inc. (CTI) of White Plains, New York entered into an agreement with the Chinese National Machinery Import and Export Corporation (MACHIMPEX) in February of 1979 to help the Chinese build a factory in Canton capable of producing more than 10,000 twenty-foot equivalent containers per year.³⁶⁹ In return for its assistance, CTI obtained the exclusive right of first refusal to buy a minimum of 50,000 containers at a fixed price over a five year period from the plant.³⁷⁰ Similarly, the Chinese are now producing landing-gear doors in China for McDonnell Douglas, thereby acquiring needed technology and, in effect, giving McDonnell Douglas a prototype of what a joint venture with the particular Chinese entity might be like at a low cost to all involved.³⁷¹

A variation on this theme involves marketing a different product and possibly utilizing a marketing company on the foreign side of the transaction.³⁷² This was the approach of one Australian firm which proposed to exchange prefabricated hotel rooms with the Chinese for frozen and canned foods (in addition to blocks of hotel reservations).³⁷³ The more players, of course, the greater the complications.³⁷⁴

The counter trade concept has been put into practice in the context of trade with several Eastern European countries.³⁷⁵ It has been used in various transactions with China calling for the exchange of such items as fishing trawlers for shrimp and fish, electronic watch machinery for watches, knitting and sewing machines for textile products and the machinery to manufacture road building equipment for cement spreaders.³⁷⁶

Countertrade, however, has certain built-in limitations. Such arrangements may cross bureaucratic lines, making it necessary to obtain approvals from several ministries which may have conflicting inter-

³⁶⁹ Jones, *Four Marine Container Agreements Cause Competition Socialist Style*, CHINA BUS. REV., Nov.-Dec. 1980, at 47; Kraar, *A U.S. Company's Risk-Proof China Deal*, FORTUNE, Mar. 23, 1981, at 95.

³⁷⁰ Kraar, *supra* note 369, at 96; Cohen & Nee, *China: All About Compensation Trade* (Pt. II), ASIAN WALL ST. J., July 4, 1979, at 4.

³⁷¹ *Id.*

³⁷² VERZARIU, *supra* note 355, at 57-59.

³⁷³ *Id.*

³⁷⁴ Verzariu, *Countertrade*, BUS. AM., Sept. 8, 1980, at 11-12.

³⁷⁵ VERZARIU, *supra* note 355, at 34-48 and 78-97.

³⁷⁶ *Id.* at 98-102.

ests.³⁷⁷ By definition, there is no continuing investment in an enterprise in China. Countertrade offers limited direct access, at best, to the domestic Chinese market. And, in at least some instances, the Chinese bureaucracy is seeking to increase foreign exchange earnings by requiring Chinese factories to pay in foreign currency for the goods obtained from other Chinese factories that would be used as barter with foreigners, on the theory that these items could otherwise be sold directly to foreign purchasers.³⁷⁸ Finally, countertrade is probably unsuitable for large projects that involve substantial management responsibilities, external financing and long lead time before revenue is generated.

If one or more of these problems is present, the joint venture mode may offer a better alternative. If so, it will be up to the prospective Western partner to devise a means to circumvent the foreign exchange problems. This may mean selecting projects—such as tourism—which are capable of generating foreign exchange, involving overseas and local Chinese investors who hold Rmb received as compensation for nationalizations,³⁷⁹ securing low interest foreign development or export bank financing, devising methods of reducing foreign exchange expenditures of the Chinese or arranging back-to-back marketing schemes selling Chinese raw materials or manufactures unrelated to the project itself. Obviously, this will require imagination and financial ingenuity.³⁸⁰

Negotiating Style

Issues of style or approach take on great importance in negotiations with the Chinese. Anxious to maintain bureaucratic caution, eager to sort carefully and comparatively through the raft of foreign proposals put forward lest China's limited foreign exchange holdings be wasted, and wary about unfamiliar Western business ways, China's trade negotiators generally have proceeded at a pace with an eye for detail many American businesspersons have found difficult, if not frustrating.³⁸¹ Yet patience and a sensitivity that should not imply a lack of firmness are indispensable to avoid succumbing to less than desired terms and to engender confidence in the Chinese, who will take the manner of the negotiations as evidence of the Western party's sincerity. Such a negotiating style will contribute importantly toward developing

³⁷⁷ Goldsmith, *The Uncertain Winds of Countertrade*, CHINA BUS. REV., Jul.-Aug. 1980, at 30-31.

³⁷⁸ Based on discussions of co-author Alford with Chinese officials, Feb. 1981.

³⁷⁹ Roselle, *Local Leaders May Aid China Ventures*, Asian Wall St. J., Sept. 7, 1981, at 12.

³⁸⁰ Birenbaum & Alford, *supra* note 3, at 26.

³⁸¹ Theroux, *supra* note 272, at 210-213.

a backlog of goodwill to buttress the still weak formal legal protections available and to facilitate conclusion of a comprehensive agreement.

That an ill-conceived approach can spell failure is evidenced vividly by the experience of one of the first American multinationals to conclude a major deal with the Chinese in the charged atmosphere of the commercial breakthrough of the late 1970's. Enthralled by their success in reaching a tentative understanding about a multimillion dollar venture, the American company ignored the stated desire of the Chinese to keep their agreement confidential while the Chinese clarified details and secured further internal approvals, and instead called a press conference to announce their triumph to the world, only to have the Chinese react bitterly by cancelling the agreement. This unfortunate story is not unique.

Writing it All Down

Notwithstanding the spurt of activity on the legal front in recent months, the PRC's codified economic laws and legal institutions are at most still in a formative stage and as such, provide an unfamiliar setting for foreign businesspersons accustomed generally to operating in more established and accessible legal contexts. Ironically, the relative absence in China of an on-going and transparent commercial legal system—the absence of which may be attributable in part to the traditional Chinese skepticism about formal law—dictates that even greater attention be paid to drafting careful and comprehensive legal instruments than would ordinarily be the case in transnational transactions. In essence, the new and as yet untested and incomplete commercial legal context mandates that any joint venture agreement with the Chinese address all imaginable concerns and, in effect, create its own set of rules. The alternative is to leave unarticulated problems to be resolved by unclear and uncertain standards.

The post-contract conduct of the Chinese strongly supports a strategy of getting it all in writing. Foreign parties who have failed to press for comprehensive coverage of their positions in their contracts have learned that accordingly they may have less than full protection. Other foreigners have found the Chinese willing, through the vehicle of commercial contracts, to grant tax and other concessions that are not publicized in existing laws or elsewhere.³⁸² Ultimately, to paraphrase one of China's Vice Premiers, China's joint venture law is largely what the

³⁸² See Hsia & Haun, *supra* note 102, at 79-83; BUSINESS WITH CHINA (N. Wang ed. 1980) at 14-15.

venture partners agree, contractually, to make it.³⁸³

CONCLUSION

At the end, we come back to our beginning. The extreme swings in Western attitudes toward China are no basis on which to make an important commercial decision concerning investment in that country. In the final analysis, the real China changes less than does China's image in the minds of her many Western suitors. Only by coming to understand the enduring continuities in Chinese thought and experience can one begin to assess what is truly changing in China. So despite the alternating moods of extreme enthusiasm and deep despair, the attraction of doing business in and with China remains; but only if the business serves China's needs as well as those of the prospective investor, and only if a prospective investor has the commitment, determination and understanding of China required to overcome the many and inevitable problems which lie ahead. Updating Confucius, only he who by understanding the Old can gain knowledge of the New is fit to meet the challenge of investing in China's future.³⁸⁴

³⁸³ Birenbaum & Alford, note 3 *supra*.

³⁸⁴ *See*, THE ANALECTS OF CONFUCIUS, *supra* note 12, at 11.