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

William P. Alford
David E. Birenbaum

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

William P. Alford*  
David E. Birenbaum**

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.


1 Zhonghua Renmin Gungheguo 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. 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Fortunately for all concerned, the romantic view of this new opening to China has been replaced by a more realistic assessment of the burdens as well as the benefits to be gained through engaging China in commercial entente. 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. 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."  

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.


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

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\(^7\) 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).


\(^9\) *The T'ang Code: Volume I: General Principles* 7 (W. Johnson trans. 1979) [hereinafter cited as Johnson].


\(^11\) *Id.*


\(^13\) *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 [H] and they will keep their self-respect and come to you of their own accord."

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).
\(^{19}\) 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.
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. 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. Rather, they "confucianized" the law, molding it to reflect and reinforce Confucian norms. As the famed early Qing scholar Gu Yenwu (A.D. 1613-1682) wrote:

[When 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. 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. 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. 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. But, ultimately, Communist mistrust of the Nationalist-trained legal professionals and populist impatience with "experts," generally coalesced with and reinforced traditional Chi-

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24 See Bodde & Morris, supra note 17, at 27-29.
25 Id.
27 See Li, supra note 6, at 1-21.
29 See Cohen, supra note 10.
nese attitudes. Consequently, within the PRC, law was largely deemphasized as an effective instrument for accomplishing social change until the late 1970's.

**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. 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 "Hoppo." 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.

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. During

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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.
34 Id.
35 The Treaty of Nanking is found in L. HERTSLET, VI HERTSLET'S COMMERCIAL TREATIES 221-225 (1908). See H. MORSE, 1 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, continued to expand this list of territorial and jurisdictional concessions. By 1900, the once proud Middle Kingdom had been carved up into a number of smaller spheres dominated by Western and Japanese 'barbarians.' 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. Instead, the Chinese were forced to deal with these powers according to "modern" legal principles. 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. Financially, China found herself having to surrender control over her most vital source of revenue—the Imperial Customs—and to make numerous other concessions to satisfy a variety of obligations to Western governments, including payment of heavy reparations. Commercially, Western merchants in Shanghai and other treaty ports competed energetically with their Chinese counterparts. 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-

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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.
44 ChI SHU-FEN, JINGJI GINLUEXIA ZHI ZHENGGUO (ECONOMIC AGGRESSION IN CHINA) (1925) recounts numerous specific instances of foreign economic activity in China aided by extraterritoriality.
community from suit under Chinese law. 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.

Not surprisingly, the Chinese came to resent bitterly this Western presence. Although the Chinese attempted on occasion to use international law to fend off excessive incursions into their sovereignty, 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.”

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.

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:

[The] 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

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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 & Chi, supra note 41, at 10.
50 33 China Weekly Rev. 182-183 (Aug. 8, 1925).
China's customs, foreign trade and communications . . . .51

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).
53 Id.
55 Id.
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 economy 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. 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. Once the plans have been formulated, directives based upon them are developed. 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. Witness the shortages and distribution problems China has experienced during the past three decades. 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. As such, these traders, or "fixers," supply a market correction force for the system. 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. Vital decisions that have been made routinely pursuant to the state plans or related directives include access to

64 Often the plans are not made public until well after their effective date. ECKSTEIN, supra note 60, at 111-112.
66 Dernberger & Fasenfart, 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).
68 Butterfield, supra note 67, at 3.
69 Id.
"investment capital," 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), product mix, projected output, pricing, profitability and assigned "customers." Individual industrial entities, in effect, have been left with little operational discretion.

In recent years, however, China began gradually to decentralize decision making in the economic sphere. Local governments, plants and other enterprises were given broader power and concomitant responsibility for its exercise. 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. Astute Western observers saw Zhao's elevation as evidence that the Sichuan experience might become the fore-runner of a nation-wide experimentation with market oriented mechanisms. 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.

**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-

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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.
ture, industry, national defense and science to a level comparable to that of the world's great powers.\textsuperscript{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.\textsuperscript{80} Down-playing the emphasis upon self-reliant socialist development that had characterized previous five- and ten-year plans,\textsuperscript{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.\textsuperscript{82}

When finally made public in 1978, China's 1976-85 ten-year plan received enthusiastic reviews abroad and at home.\textsuperscript{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.\textsuperscript{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 financing available to the PRC, which had previously eschewed the assumption of foreign debt.\textsuperscript{85} During that same period, the governments of Japan and France concluded agreements with the PRC calling for billions of dollars worth of trade.\textsuperscript{86} For the most part, these agreements provided for the exchange of oil, coal and other raw or semi-finished materials for ad-

\textsuperscript{81} Id.
\textsuperscript{82} Id.
\textsuperscript{83} Id.
vanced industrial equipment and data.\textsuperscript{88} Countless private companies—offering everything from oil drilling equipment to disco records—also sought to sell their wares in China.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{92} Moreover, China’s limited foreign exchange holdings, estimated variously at $2 to $7 billion, were clearly inadequate to cover all the imports.\textsuperscript{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.\textsuperscript{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.\textsuperscript{95} These projects had called for aggregate expenditures of more than $2 billion.\textsuperscript{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-

\textsuperscript{88} Id.
\textsuperscript{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.
\textsuperscript{92} China Economic Notes, CHINA BUS. REV., May-June 1979, at 48-50.
\textsuperscript{93} Stepanek, A Ten Year Profile of the Bank of China, CHINA BUS. REV., Sept.-Oct., 1979, at 42.
\textsuperscript{95} China Shokku, supra note 87, at 68.
\textsuperscript{96} China Readjusts, CHINA BUS. REV., Mar.-Apr. 1979, at 4-5.
tels. 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.

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. 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.

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. 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.

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. 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

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

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belt-tightening measures\textsuperscript{104} that would promote greater accountability in borrowing and thus reduce China’s debt.\textsuperscript{105} The foreign exchange saved would become available for development of light industry.\textsuperscript{106} Wang’s message was reinforced in key addresses by outgoing Premier Hua Guofeng\textsuperscript{107} and by the new Chairman of the State Planning Commission, Vice Premier Yao Ilin.\textsuperscript{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.\textsuperscript{109} The most celebrated of the project cutbacks is the Baoshan steel complex.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{114} In January of 1981, much of the rest of the Baoshan endeavor was halted, prompt-


\textsuperscript{105} See Wang, supra note 104, at 77-85.

\textsuperscript{106} Id.

\textsuperscript{107} Hua Guofeng, Speech at the Third Session of the Fifth National People’s Congress, in MAIN DOCUMENTS, supra note 103, at 143-201.


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

\textsuperscript{110} Jones, The Baoshan Contracts, CHINA BUS. REV., July-Aug. 1980, at 47.

\textsuperscript{111} Id.

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

\textsuperscript{113} Id.

\textsuperscript{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.\(^\text{115}\) 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.\(^\text{116}\)

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.\(^\text{117}\)

### 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.\(^\text{118}\) 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.\(^\text{119}\) The product, effective immediately upon its promulgation on July 8, 1979, was a three page document containing a mere fifteen broadly-worded articles.\(^\text{120}\) Very much in keeping with the PRC's practice of general and aspirational legislation,\(^\text{121}\) 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). The ventures will take the form of limited liability companies. The foreign participant must contribute at least 25% of the venture's registered capital. That contribution may take any of a variety of forms, including capital goods, industrial property rights or cash. Theoretically, the foreign share can be as high as 100%. Profits and losses are to be divided according to each party's capital contributions. 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. Any technology invested by the foreign party must be both "truly advanced and appropriate to China's needs."

Subject to the "laws, decrees and pertinent rules and regulations of" 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. The Board is to have authority to act on "all issues concerning the venture," including, but not limited to, production and business programs, labor plans and the appointment of the president, chief engineer, treasurer and auditors. However, "the production and business programs . . . shall be filed with the authority concerned and . . . shall be implemented through business contracts."

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."

122 Joint Venture Law, supra note 1, art. 3.
123 Id. art. 4.
124 Id. art. 4.
125 Id. art. 5.
126 Id. art. 5.
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, is subject to a "joint venture income tax" imposed pursuant to the "tax laws of the PRC." 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, as are tax "incentives" for those reinvesting net profits in China. 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.

The products manufactured by a joint venture may be distributed in China as well as abroad throughout the term of the venture, as agreed upon between the parties. 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. Finally, disputes are to be resolved by the Board of Directors "through consultation by the participants on the principle of equality and mutual benefit," and if that fails, through arbitration.

The Joint Venture Law did not evoke the level of foreign interest the Chinese leadership initially had anticipated. In some measure, this was a consequence of the many questions the law left unanswered. 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, personal income tax, labor management,
the registration of joint ventures and foreign exchange. 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. 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.

**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. Regulations elaborating the provisions of this law were issued on December 14, 1980. Akin to the basic Joint
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.” The basic rate of taxation is 30%, but the effective rate, inclusive of the local surtax of 10%, is 33%. A further tax of 10% will be withheld on all income the foreign participant chooses to repatriate, 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. 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.

Joint ventures scheduled to operate for more than ten years are eligible to receive tax holidays of 100% for their first profit making year, 50% for the second and third such years, 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.

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. In each instance, taxable income is defined as the enterprise’s income net of permissible deductions. Permissible deductions include manufacturing, selling

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

Depreciation of fixed assets "shall generally be computed on average by the method of straight line," although the joint venture may seek permission to accelerate depreciation. 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. 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. "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.

Accounts are to be maintained on the accrual basis, using First-In-First-Out (FIFO), shifting average or weighted average. Raw materials, finished products, by-products and inventories are to be computed "according to the cost price." "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

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

Taxes are to be reported for calendar years on annual returns accompanied by "reports on auditing by the chartered public accountants registered in the [PRC]." Payment is to be made quarterly in Chinese currency at official exchange rates. Foreign tax credits are available for income tax paid "by a joint venture or its branch against tax assessed" by the Chinese. The Ministry of Finance has the right to interpret the tax law and regulations, but amounts in dispute must be paid before reconsideration is sought from such "higher tax authorities" or before the matter is brought to court. By way of enforcement, the tax authorities have the right "to investigate the financial affairs, account work, and tax situation" of any joint venture—although they must maintain the confidentiality of such information—and the right to impose surcharges 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), and in instances of "gross violations," may recommend prosecution under China's new criminal law.

The Individual Income Tax

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

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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.

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.
198 Zhonghua Renmin Gunghguo Geren Suodeshuifa Shixing Xize (Detailed Rules and Reg-
years in the PRC is subject to tax on his entire world-wide income.\textsuperscript{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.\textsuperscript{200} Persons living in China for less than one year but 90 days or more, are taxed only on “income gained within China,”\textsuperscript{201} while those residing in the PRC for less than 90 consecutive days are exempt from Chinese income tax.\textsuperscript{202} Income from wages and salaries is taxed at specified rates ranging from 5\% to 45\%,\textsuperscript{203} after a monthly deduction of 800 yuan (approximately $500).\textsuperscript{204} Given that the average annual income in the PRC is considerably less than 800 yuan,\textsuperscript{205} the tax, in effect, applies primarily to foreigners.\textsuperscript{206} Personal service income, royalties or rental income is taxed at a flat 20\% rate,\textsuperscript{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.\textsuperscript{208} Apart from providing that income tax will be withheld at the source, if possible,\textsuperscript{209} the procedural and enforcement aspects of this law closely approximate those of the Joint Venture Income Tax Law.\textsuperscript{210}

\textit{Labor Management Relations}

The Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment\textsuperscript{211} set out general standards for dealing with what are described as “labor management problems.”\textsuperscript{212} Subject to these standards,\textsuperscript{213} joint venturers are free to conclude contracts

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{199} Id., art. 3.
\item \textsuperscript{200} Id.
\item \textsuperscript{201} Individual Income Tax Law, \textit{supra} note 149, art. 1.
\item \textsuperscript{202} Detailed Rules and Regulations for the Individual Income Tax Law, \textit{supra} note 198, art. 5.
\item \textsuperscript{203} Individual Income Tax Law, \textit{supra} note 149, art. 3.
\item \textsuperscript{204} Id. art. 5.
\item \textsuperscript{206} Loong, \textit{China Leaves Some Grey Areas}, \textit{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, \textit{supra} note 190, at n.170.
\item \textsuperscript{207} Individual Income Tax Law, \textit{supra} note 148, arts. 3, 5.
\item \textsuperscript{208} Id.
\item \textsuperscript{209} Id. art. 6.
\item \textsuperscript{210} Income Tax Law, note 148 \textit{supra}.
\item \textsuperscript{211} See Labor Management Regulations, \textit{supra} note 150, arts. 8-11.
\item \textsuperscript{212} Id. art. 8.
\item \textsuperscript{213} Such standards are subject to interpretation by the State Bureau of Labor. Id. art. 15.
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with "the trade union organization formed in the joint venture," provided they implement the "relevant rules and regulations of the Chinese government on labor protection and ensure safety in production . . . " Those contracts, which must be approved by the "labor management department of the provincial, autonomous, regional, or municipal people's government," 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." The general standards set forth in the Labor Regulations permit joint ventures to select workers and staff members "through examination for their qualifications." Appropriate labor management departments must, however, approve the examinations used, or the recommendations of local authorities must be obtained. 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." Workers, too, have the right to sever their relationship with the joint venture.

In addition to setting broad parameters for hiring and firing, the Labor Regulations spell out wage and benefit standards. 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," although the venture's Board of Directors has discretion in determining "wage standards, the form of wages paid, and bonus and subsidy systems." 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." Any disputes arising between labor and management are to be resolved "through consultation," if possible, and if not, by the provincial level labor management department through arbitration or by the people's courts.

**Registration Regulations**

The Regulations on the Registration of Joint Ventures Using Chinese and Foreign Investment specify various registration requirements for joint ventures. The process starts after FICC authorization, with registration with the General Administration for Industry and Commerce (GAIC). Then, the GAIC "authorizes the administrative bureaus for industry and commerce in the provinces, municipalities and autonomous regions" to register the joint venture. Subsequently, the venture must open an account with the Bank of China and register with the local tax bureau. 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. 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."

**Foreign Exchange Regulations**

The Provisional Regulations for Exchange Control of the PRC, which took effect on March 1, 1981, 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.

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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.
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." 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. 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.

The Foreign Exchange Regulations also apply to "staff members and workers of foreign nationality" employed by joint ventures. 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."

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. 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. 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-

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236 Id. art. 22.
237 Id.
238 Id. art. 24.
239 Id. art. 24.
240 Id. art. 22.
241 Id. art. 25.
242 Id.
243 Hsia & Haun, supra note 102, at 77-83.
gestions in this connection are made later in this article.\textsuperscript{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.

\textit{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.\textsuperscript{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.\textsuperscript{246} These contracts are then subject to provincial and local government approval.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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

\textsuperscript{244} See text accompanying notes 364-381 infra.
\textsuperscript{245} See Joint Venture Law, supra note 1, art. 6.
\textsuperscript{246} See Labor Management Regulations, supra note 150, arts. 3-8, 10, 11.
\textsuperscript{247} Id. art. 2.
\textsuperscript{248} See Registration Regulations, supra note 151, art. 2.
\textsuperscript{249} Id. art. 7.
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.
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 filed 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.

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. 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. This will reduce the advantage of locating in the PRC compared with elsewhere in Asia, although in all likelihood, these premiums will not be passed along by Chinese authorities to workers in joint ventures.

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-

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261 Joint Venture Law, *supra* note 1, art. 9.
264 See Labor Management Regulations, *supra* note 150, art. 8, 11.
266 Hsia & Haun, *supra* note 102, at 77-83 (quoting Liu Yaochu).
cially trained workers. The Labor Regulations do grant joint ventures the right to choose workers on the basis of tests approved by local labor management bureaus. 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.

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. When they buy abroad, the Chinese have insisted on thorough inspections coupled with comprehensive representations and warranties, but the Chinese have been reluctant to provide the same treatment for exports of domestic manufactured goods. 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.

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). Overstaffing and low productivity are serious and widespread problems particularly for Chinese factory managers who have to account for profits and losses. 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.

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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.
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).
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.
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.


\(^{280}\) 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 Quangdong Province on joint ventures established in those zones.\textsuperscript{282}

A related problem concerns multiple taxation. Xue Muqiao, the noted economist whose writings have reportedly had a great influence upon the current leadership,\textsuperscript{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.\textsuperscript{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.\textsuperscript{285}

The most important is the Consolidated Industrial and Commercial Tax.\textsuperscript{286} A composite of four separate taxes, the consolidated tax—akin to a cascading turnover tax\textsuperscript{287}—in essence taxes goods and services at the stages of production and retail sales.\textsuperscript{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.\textsuperscript{289} Although the rates vary according to the importance of the goods and services involved\textsuperscript{290} and the location of the taxpaying enterprise,\textsuperscript{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.\textsuperscript{292}

Preliminary indications from negotiations held thus far are that contributions from foreign partners will not be subject to the tax.\textsuperscript{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

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

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

\textsuperscript{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.


\textsuperscript{287} Gelatt, supra note 286, at 2.

\textsuperscript{288} Id.

\textsuperscript{289} Id.

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

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

\textsuperscript{292} Id.

\textsuperscript{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.\textsuperscript{301} Through the Joint Venture Income Tax Law,\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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%.\textsuperscript{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.\textsuperscript{307}

\textit{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.\textsuperscript{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.\textsuperscript{309} At present, the Chinese lack a comprehensive statutory framework for the protection of intellectual property rights. To be sure, China has trademark\textsuperscript{310} and invention laws.\textsuperscript{311} Pursuant to the Law on Trade-

\textsuperscript{302} Income Tax Law, supra note 148, art. 4.
\textsuperscript{303} Exchange Control Regulations, supra note 152, arts. 22-24.
\textsuperscript{305} Ching, supra note 304, at 37.
\textsuperscript{306} Id.
\textsuperscript{307} See text accompanying notes 109-117 supra.
\textsuperscript{308} Joint Venture Law, supra note 1, art. 5.
\textsuperscript{309} Id. art. 2.
\textsuperscript{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." 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. 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). Toward that end, China joined WIPO in February of 1980. 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. 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. They have not yet done either, but these laws are rumored now to be in the final stage of drafting. 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.

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.
As Western companies are increasingly coming to learn through examples such as the "708"—supposedly a pirated version of the Boeing 707—China's considerable reputation for honoring foreign patent rights is not without its exceptions, for which there is little practical remedy. 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. 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.

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. 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. 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?

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,

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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.
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, and the Exchange Control Regulations restrict the amount of net wages a foreign worker can remit from China. 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. 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. 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, and as the recent regulations restricting the acceptance by Chinese officials of gifts from foreigners confirm, 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.

327 See text accompanying notes 98-227 supra.
328 See text accompanying notes 240-241 supra.
331 O. SCHELL, WATCH OUT FOR THE FOREIGN GUESTS (1980).
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.


\(^{339}\) Hsia & Haun, *supra* note 102, at 73.


\(^{342}\) *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. 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." 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. 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

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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 shortfalls\(^{351}\) 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


\(^{349}\) See Birenbaum & Alford, supra note 3.


\(^{351}\) 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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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,\textsuperscript{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.\textsuperscript{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.


\textsuperscript{356} Kurata, \textit{Lower Costs Lure China Trades}, FAR E. ECON. REV., Feb. 27, 1981, at 68.


\textsuperscript{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. 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. 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

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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 Rule 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. 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. 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. 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. 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. These parts will then be assembled by Chinese labor, together with other Chinese produced parts, for sale by the Chinese, largely in the PRC. 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. 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.
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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{371}

A variation on this theme involves marketing a different product and possibly utilizing a marketing company on the foreign side of the transaction.\textsuperscript{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).\textsuperscript{373} The more players, of course, the greater the complications.\textsuperscript{374}

The counter trade concept has been put into practice in the context of trade with several Eastern European countries.\textsuperscript{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.\textsuperscript{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-


\textsuperscript{371} \textit{Id}.

\textsuperscript{372} VERZARIU, \textit{supra} note 355, at 57-59.

\textsuperscript{373} \textit{Id}.


\textsuperscript{375} Verzariu, \textit{supra} note 355, at 34-48 and 78-97.

\textsuperscript{376} \textit{Id}. at 98-102.
ests. 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. 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, 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.

**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. 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

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378 Based on discussions of co-author Alford with Chinese officials, Feb. 1981.
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. Ultimately, to paraphrase one of China's Vice Premiers, China's joint venture law is largely what the

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venture partners agree, contractually, to make it.  

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.  

383 Birenbaum & Alford, note 3 supra.