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## COMMENT

# Investing in China's Telecommunications Market: Reflections on the Rule of Law and Foreign Investment in China

*Leontine D. Chuang\**

### I. INTRODUCTION

For two decades after Chairman Mao Zedong declared the formation of the People's Republic of China on October 1, 1949, China remained dormant in the international economic arena. But in 1979, the sleeping giant awoke when it voluntarily opened its doors to foreign investment and foreign trade by adopting an open door policy. Since that time, the Chinese have taken off on a rocky road to build their economy and the legal structures around which their economy is to thrive. Though the road has been bumpy, China's economy has grown by leaps and bounds since 1979. From 1978 to 1993, its economy grew between US\$2,000 and \$4,000 per

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\* J.D. Candidate, May 2001, Northwestern University School of Law. I would like to thank my parents for their support. I would also like to thank Warren G. Lavey of Skadden, Arps, Slate, Meagher & Flom (Illinois) for helping me with selecting this topic, Douglas C. MacLellan, William J. McMahon, and Jennifer Thompson for their comments and suggestions, and China Online for providing up-to-date information on business and legal issues in China.

capita and in the early '90's its economic growth was unprecedented at 13% a year.<sup>1</sup>

In 1979, the Chinese government enacted its first statute governing foreign investment, entitled the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (hereinafter "JVL").<sup>2</sup> Since then, the Chinese government has continued to enact laws and regulations that make up the legal framework governing foreign investment. One of the most important laws enacted was the Foreign Economic Contract Law, which governs all contracts with foreign parties (hereinafter "FECL").<sup>3</sup>

Even though almost 20 years have passed since the adoption of the first foreign investment law in China, the legal framework governing foreign investment still remains unfinished and often misleading for foreign investors. This is unfortunate because not only does China have an unidentified quantity of untapped resources, but it also has a population of 1.1 billion people, comprising an attractive market where untold profits lay waiting.<sup>4</sup>

The lack of clarity in China's investment laws has translated into an investment environment that is often uncertain, risky, and mired in red tape. In fact, there have been cases where foreign corporations have invested in joint ventures following what they thought to be all the requisite guidelines, only to find out after the money had exchanged hands that something was terribly wrong with the entire agreement. A perfect example of this is the birth, development, and eventual demise of the ill-fated China-China-Foreign (hereinafter "CCF") investment vehicles used for investment in China's telecommunications industry in the past few years. This comment will use CCF investment in China's telecommunications industry as a case study to show how the vague legal framework for foreign investment in China can make investment in China an unpredictable venture. It will also discuss how a weak rule of law has contributed to developing this vague legal framework through promoting the existence of multiple interpretations

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<sup>1</sup> See Neil Boyden Tanner, *The Yin and Yang of Foreign Economic Contract Law in The People's Republic of China-A Legalistic and Realistic Perspective*, 16 J.L. & COM. 155 (1996); Gary J. Dornelle, *Direct Foreign Investment and Contractual Relations in the People's Republic of China*, 6 DEPAUL BUS. L.J. 331, 333 n.13 (1994).

<sup>2</sup> See John Zhengdong Huang, *An Introduction to Foreign Investment Laws in the People's Republic of China*, 28 J. MARSHALL L. REV. 471, 472 (1995). The JVL was adopted at the Second Session of the Fifth National People's Congress on July 1, 1979, and revised at the Third Session of the Seventh National People's Congress on April 4, 1990. See *Access China, Law of the People's Republic of China: Sino-Foreign Joint Venture Law* (Apr. 4, 1990) (visited Sept. 3, 1999) <<http://www.accesschina.com/sinoeq.htm>>.

<sup>3</sup> See Huang, *supra* note 2, at 472; *China: Foreign Economic Contract Law*, translated in 24 I.L.M. 797 (1995). The Foreign Economic Contract Law of the People's Republic of China was adopted at the Tenth Session of the Standing Committee of the Sixth National People's Congress on March 21, 1985. See Mark C. Lewis, *Contract Law in the People's Republic of China-Rule or Tool: Can the PRC's Foreign Economic Contract Law be Administered According to the Rule of Law?*, 30 VAND. J. TRANSNAT'L 495, 508 (1997).

<sup>4</sup> See Dornelle, *supra* note 1, at 332.

of each law. Furthermore, this comment will reflect on the impact of the U.S.-China Bilateral WTO Agreement (hereinafter "U.S.-China WTO Agreement"), signed in November 1999, and China's impending accession into the World Trade Organization (hereinafter "WTO") on the case study. It will also touch upon the possible ramifications that entry into the WTO will have on the rule of law in China.

China has an unlimited potential to grow. Foreigners who invest in China, however, face many difficult hurdles and will often face tremendous setbacks. Therefore, it is vitally important for foreigners to understand the risks involved in investing in China and to be aware of the potholes created by the weak legal framework.

At the end of the day, investors will weigh the costs and benefits of doing business in China. For the past 20 years, most people have felt that the benefits outweigh the costs. For the benefits to continue to outweigh the costs, however, China must take steps to further develop the legal aspects of its foreign investment framework in all sectors of the economy and to develop a stronger rule of law. Many people hope that China's impending accession into the WTO will be the catalyst that will not only push China to provide more clarity to its legal investment framework, but will also drive China to strengthen its rule of law. Some tremendous changes, however, need to be made in order for this to happen. Though the Chinese leadership has signaled, by signing the U.S.-China WTO Agreement, that it is willing to make these changes in exchange for the ability to reinvigorate its economy and to secure its position as a world leader, these changes will not come easily, nor will they come quickly.

## II. HISTORY OF FOREIGN DIRECT INVESTMENT IN CHINA

Between 1949 and 1979, China shielded its economy from the outside world. During this period, the rule of law and formal legal institutions that had been in place prior to the Communist takeover were largely dismantled.<sup>5</sup> Furthermore, up until the late '70's, the communist-socialist system that was put in place in 1949 did its best to cast negative light upon Westerners.<sup>6</sup>

With the opening up of the economy, not only did China have to take steps to create an environment for foreign investment, but it had to take steps to prove to foreign investors that it did not view them negatively anymore. One of the first steps that it took was to enact the JVL. The JVL's main premise was to permit foreign companies to join Chinese companies in establishing joint ventures, approved by the Chinese government, that

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<sup>5</sup> See Michael J. Moser, *Introduction to FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA* 1-2 (Michael J. Moser ed., 1987).

<sup>6</sup> See Daniel J. Brink & Xiao Lin Li, *A Legal And Practical Overview of Direct Investment and Joint Ventures in the "New" China*, 28 J. MARSHALL L.REV. 567, 569 (1995).

were in accordance with the principle of equality and mutual benefit.<sup>7</sup> Through specifically listing the main industries in which foreign direct investment was permitted, the JVL implicitly stated that China did not plan to open its entire economy up for foreign investment.<sup>8</sup> The second major law that was enacted in an effort to create an investment environment where investors would feel comfortable was the FECL.<sup>9</sup> The FECL covered all economic contracts between Chinese enterprises and foreign enterprises.<sup>10</sup>

In addition to enacting foreign investment laws, China also amended its Constitution in 1982 to explicitly protect foreign investors' "lawful rights and interests in the People's Republic of China."<sup>11</sup> These legal enactments only represent a small number of changes that have taken place in the past 20 years in an effort to build up a legal environment for foreign investment. To this day, however, the legal framework for foreign investment is still not fully constructed. There are still some sectors of the Chinese economy that are not governed by any formal laws.

Another step that China took to build its legal framework for foreign investment was to create the Ministry of Foreign Trade and Economic Cooperation (hereinafter "MOFTEC"). MOFTEC was created as a functional department under the State Council and is in charge of the administration of China's foreign trade and economic cooperation.<sup>12</sup> MOFTEC's principal duties are to form strategic plans; to formulate policies, laws, and regulations; and to coordinate all foreign trade, foreign investment and economic development.<sup>13</sup> Its tasks also include inspecting and approving relevant foreign investment laws, regulations, and contracts involving foreign funded enterprises.<sup>14</sup> One of the regulations that MOFTEC has formulated is the Catalogue For The Guidance of Foreign Investment Industries (hereinafter "Catalogue").<sup>15</sup> In the past, the Catalogue has been a very important guide for all foreign investors because it lists the industries in which foreign investment is encouraged, restricted, or prohibited.<sup>16</sup> With China's impend-

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<sup>7</sup> See *Access China*, *supra* note 2.

<sup>8</sup> *Regulations for the Implementation of the Law of The People's Republic of China on Joint Ventures Using Chinese and Foreign Investment*, translated in 22 I.L.M. 1033 (1983).

<sup>9</sup> See Lewis, *supra* note 3, at 508.

<sup>10</sup> See *id.*

<sup>11</sup> See Brink & Xiao, *supra* note 6, at 569.

<sup>12</sup> See China Ministry of Foreign Trade & Economic Cooperation, *About MOFTEC* (visited Nov. 3, 1999) <[http://www.moftec.gov.cn/moftec/official/html/about\\_moftec/responsibilities.html](http://www.moftec.gov.cn/moftec/official/html/about_moftec/responsibilities.html)>.

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See China Ministry of Foreign Trade & Economic Cooperation, *Catalogue for the Guidance of Foreign Investment Industries* (visited June 20, 1995) <[http://www.moftec.gov.cn/moftec/html/laws\\_and\\_regulations/investment25.html](http://www.moftec.gov.cn/moftec/html/laws_and_regulations/investment25.html)> [hereinafter "Catalogue"].

<sup>16</sup> See *id.*

ing accession into the WTO, the Catalogue, if not revised, will become obsolete as it would be superceded by the WTO agreements.

China has also developed five main business structures for foreign investment.<sup>17</sup> They are the equity joint venture, contractual joint venture, wholly owned foreign enterprise, the limited liability company, and the joint stock limited company.<sup>18</sup> The typical joint venture structure involves one foreign party and one Chinese party both injecting a certain amount of capital into the joint venture.<sup>19</sup> As its equity share of the joint venture, the foreign partner generally provides the technology, management expertise, and capital.<sup>20</sup> The Chinese partner usually provides the factory site, industrial equipment, and other facilities.<sup>21</sup> Earnings from the joint venture are used to purchase materials, to pay salaries and wages, and are also distributed to the partners as dividends from the venture.<sup>22</sup>

On the whole, foreign companies have not been shy to invest in China in the past 20 years. Between 1979 and 1998, foreign companies have invested an estimated US\$268 billion in China.<sup>23</sup> It appears, however, that since 1993 the amount of foreign direct investment in China has been decreasing.<sup>24</sup> In fact, the amount of foreign investment has dropped 7% in 1999 alone.<sup>25</sup> The decrease in foreign investment can be attributed to the fact that companies are losing money in their foreign investment ventures, foreign investors are tired of the bureaucratic red tape and regulatory hassles involved in investing in China, and China's economic growth has

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<sup>17</sup> See Brink & Xiao, *supra* note 6, at 568.

<sup>18</sup> See *id.* This article will only discuss joint ventures and not wholly-owned foreign enterprises, limited liability companies, or joint stock limited companies.

<sup>19</sup> See PHILLIP DONALD GRUB & JIAN HAI LIN, FOREIGN DIRECT INVESTMENT IN CHINA 68 (1991).

<sup>20</sup> See *id.* As this is only a description of a typical joint venture, variations may exist.

<sup>21</sup> See *id.*

<sup>22</sup> See *id.* at 69.

<sup>23</sup> The US \$268 billion is the actual amount that was utilized. The amount contracted for is US \$571 billion. See The United States-China Business Council, *Foreign and US Direct Investment in China 1979-98* (visited Nov. 3, 1999) <<http://www.uschina.org/press/invest-march99.html>>.

<sup>24</sup> See *id.* In the first six months of 1999, 8,052 foreign investment projects had been approved by MOFTEC; in 1998, 19,846 foreign investment projects were approved; and in 1997, 21,046 foreign investment projects were approved. See *China Ministry of Foreign Trade & Economic Cooperation, Statistics Data* (visited Sept. 13, 2000), <[http://www.moftec.gov.cn/moftec/official/html/statistics\\_data/e99-01-06d.htm](http://www.moftec.gov.cn/moftec/official/html/statistics_data/e99-01-06d.htm)>; see also *China Ministry of Foreign Trade & Economic Cooperation, Statistics Data* (visited Sept. 13, 2000) <[http://www.moftec.gov.cn/moftec/official/html/statistics\\_data/e98-01-12d.htm](http://www.moftec.gov.cn/moftec/official/html/statistics_data/e98-01-12d.htm)>.

<sup>25</sup> See *China-Signs of Weakening in Foreign Investor Confidence*, Telenews Asia, July 1, 1999, available in LEXIS, Nexis Library, RDS Business & Industry Database.

slowed in the past few years.<sup>26</sup> In addition, the shifting regulatory environment is wearing out an increasing number of investors.<sup>27</sup> This has been evidenced by the increasing number of foreign investors pulling out of China because of the failure of their joint ventures.<sup>28</sup>

From January to May 2000, China's actual foreign investment totaled only US\$12.8 billion, a decrease of 12% from the same period in 1999.<sup>29</sup> Contracted investment was on the rise, however, totaling US\$18.2 billion, a 25% increase over the same period in 1999.<sup>30</sup> Whether the actual money flowing into China will match up with the contracted investment dollar figure still remains to be seen.

Though the problems involving loss of revenues from China's economic slow-down is linked to the health of Asian economies as a whole, the problems of a constantly shifting regulatory environment and bureaucratic red tape are separate matters that can be solved by the government whenever it decides that it is time for reform. Foreign investors count on a strong legal framework to support and protect their investments. Even though China has tried to set up an environment that is friendly towards foreign investment, it appears that the unpredictability of China's regulatory environment, caused by its weak legal framework, is doing exactly the opposite. China's impending accession to the WTO, however, may be a catalyst for change that will create a more protective environment for foreign investors.

### III. CHINA'S IMPENDING ACCESSION INTO THE WTO

On November 15, 1999 China and the United States signed an agreement that would pave the way for China to enter the WTO.<sup>31</sup> This deal

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<sup>26</sup> See Craig S. Smith, *Multinationals Rethink Chinese Joint Ventures --- Red Tape and Red Ledgers Spur Some to Pull Out: Others Hold Out Hope*, WALL ST. J., Oct. 26, 1999, at A18.

<sup>27</sup> See *id.*

<sup>28</sup> In 1995, DaimlerChrysler AG's Freightliner subsidiary was approached by a Chinese company with a proposal to set up a joint venture to build trucks for China's container transport and construction industry. The Chinese company said that it would provide land and an unused business license. A third partner claimed to have connections needed to secure government approval. Freightliner agreed, set up an office in Shanghai, and began paying the \$30 million it agreed to invest in the project when all of a sudden, it realized that there was no way that the government would approve the project. The government said that they weren't in compliance with China's auto policy. Now, Freightliner is trying to negotiate the venture's liquidation, something that also needs government approval. See *id.*

<sup>29</sup> See *Money Mirage: Foreign Investment Floods China, But Where's the Liquid?* (visited June 20, 2000), <[http://www.chinaonline.com/issues/econ\\_news/currentnews/secure/c00061901.asp](http://www.chinaonline.com/issues/econ_news/currentnews/secure/c00061901.asp)>.

<sup>30</sup> See *id.*

<sup>31</sup> See *The Real Leap Forward*, ECONOMIST, Nov. 20, 1999, at 25. This agreement was adopted by the U.S. House of Representatives on May 24, 2000, by the U.S. Senate on September 19, 2000 and signed into law by U.S. President Bill Clinton on Oct. 10, 2000. See

holds tremendous significance for foreign investors in China because it is an important step towards China's accession into the WTO. China's eventual accession into the global trading body will not only promote increased trade activity with China through providing greater access to China's markets, but will also potentially give foreign investors greater protection for their investments.

The U.S.-China WTO Agreement was the culmination of 13 years of negotiations between the U.S. and China.<sup>32</sup> The conclusion of these bilateral talks, however, is only one of many steps towards formal accession into the WTO. China must also hold bilateral talks with other WTO members and sign similar trade agreements with them before they can formally join the global trade body.<sup>33</sup> After agreements have been signed with other WTO member governments, the WTO's Working Party on Chinese Accession must agree on a technical protocol for China's entry and create the legal framework for its entry.<sup>34</sup> All the bilateral agreements will be combined into a multilateral one that paves the way for China's accession.<sup>35</sup> The multilateral discussions within the WTO framework may not be the last step. Before China can accede, it will also have to amend its laws to comply with its WTO commitments and the WTO has to assess whether China has complied with the trade body's rules in different areas.<sup>36</sup>

Since China and the U.S. signed their WTO agreement, other WTO members have followed the United States' lead and have completed deals with China. On May 19, 2000 China and the EU reached a market access agreement that removed another major barrier to China's fourteen-year effort to join the WTO.<sup>37</sup> As of October 13, 2000, all but one of the 137 members of the WTO, Mexico, had concluded bilateral agreements with China.<sup>38</sup>

In June 2000, China's chief negotiator on entry to the WTO and WTO officials began drafting China's protocol of accession, which will serve as the document that combines all the agreements China has signed with individual WTO countries.<sup>39</sup> China's chief negotiator told reporters that an ac-

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*Urgent: Clinton Signs Bill on PNTR with China*, Xinhua General News Service, October 10, 2000, available in LEXIS, Nexis Library, News Group File.

<sup>32</sup> See *The Real Leap Forward*, *supra* note 31.

<sup>33</sup> See *The Remaining Hurdles*, *ECONOMIST*, Nov. 20, 1999, at 26.

<sup>34</sup> See *WTO's Moore Praises U.S.-China Deal, But Says Entry Not Likely Soon* (visited Nov. 15, 1999) <<http://www.chinaonline.com/issues/wto/newsarchive/secure/1999/november/c911523.asp>>.

<sup>35</sup> See *The Remaining Hurdles*, *supra* note 33.

<sup>36</sup> See *id.*

<sup>37</sup> See Paul Mooney, *China-EU Reach WTO Deal* (visited May 19, 2000) <<http://www.chinaonline.com/issues/wto/newsarchive/secure/2000/may/c00051924.asp>>.

<sup>38</sup> See *Winds of Change Blowing; The Biggest Milestone Since 1978*, *S. China Morning Post*, Oct. 13, 2000, available in LEXIS, Nexis Library, News Group File.

<sup>39</sup> See *id.*



tion plan would be formulated detailing how China would tackle amending or deleting some of its laws and practices affecting international trade to make sure that they comply with WTO rules.<sup>40</sup> Some of China's old laws would be deleted as soon as China becomes a member of the WTO, while others would be phased out over a set period of time.<sup>41</sup>

One of the most important provisions of the U.S.-China WTO Agreement is the provision allowing foreign companies to invest in China's telecommunications market and Internet industry. This part of the agreement is directly contrary to MOFTEC's Catalogue, which has long prohibited foreign investment in China's telecommunications industry<sup>42</sup> because of national security concerns. The U.S.-China WTO Agreement states that foreign companies may own as much as 49% in Chinese telecommunications ventures upon China's entry into the WTO and up to 50% in the second year.<sup>43</sup> As WTO rules state that countries in the body or joining it must have extended the same level of market access to all other members, other WTO members will have the same level of access to China's telecommunications market.<sup>44</sup>

Once China accedes to the WTO they are bound by the rules and regulations of the organization and are also bound to participate in the WTO dispute resolution process if trade or investment conflicts arise. This may help decrease the investment risks caused by China's unpredictable regulatory environment, weak rule of law, and bureaucratic red tape. The main question, though, is whether or not the Chinese government will make actual changes to embrace these new rules.

#### IV. THE UNICOM CASE

The failure of China United Telecommunications Corporation's (hereinafter "Unicom") CCF foreign investment ventures with foreign investors is a perfect illustration of the risks created by China's shifting regulatory environment and its weak legal framework.

Prior to 1994, China's telecommunications industry was a monopoly market dominated by the state run China Telecom (hereinafter "CT").<sup>45</sup> In 1994, in an effort to liberalize China's telecommunications market, Unicom

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<sup>40</sup> See *id.*

<sup>41</sup> See *id.*

<sup>42</sup> Catalogue, *supra* note 15.

<sup>43</sup> See *Big Business Seeks Benefits Amid Details of China Deal*, WALL ST. J., Nov. 16, 1999, at A19.

<sup>44</sup> See Robert Evans, *China Sees 'Final Stage' of Bid to Join WTO* (visited August 13, 2000) <<http://www.chinaonline.com/issues/wto/currentnews/secure/C00051924.asp>>.

<sup>45</sup> See Douglas C. MacLellan, *The China Telecommunications Industry and Implications for Strategic Private Equity Investment 2* (Dec. 29, 1998) (unpublished paper for The MacLellan Group, Inc.) (on file with author).

was created to break CT's monopoly on domestic wireline and cellular telephony.<sup>46</sup>

The telecommunications industry in China is heavily regulated by the government.<sup>47</sup> Regulations for the telecommunications industry are issued and implemented by China's State Council and the Ministry of Information Industry (hereinafter "MII").<sup>48</sup> Though there are currently no laws regulating this industry, a telecommunications law is in the process of being drafted.<sup>49</sup> It will define the government's role in the industry, allow deregulation of tariffs, outline rules for new entrants, and foster orderly competition.<sup>50</sup> This law will be the first comprehensive telecommunications law in China and serve as the principal legal framework for telecommunications regulation.<sup>51</sup> According to the MII, the drafting of this law will be completed later on this year, but the legislative process could take much longer.<sup>52</sup> Legal analysts say that the law will standardize the regulatory framework for the nation's telecommunications industry.<sup>53</sup>

China's telecommunications industry, as it relates to foreign investment, is also governed by regulations set by MOFTEC. Section VII, Part 1 of the Prohibited Foreign Investment Industries Chapter of the Catalogue expressly prohibits foreign investment in the management of the telecommunications business.<sup>54</sup> When China accedes to the WTO, the Catalogue's prohibition will be superceded by the WTO agreements opening the telecommunications industry to foreign investment. The industry will continue to be governed by regulations set forth by the MII and MOFTEC.

Unicom has extensive political relationships with various ministries in the government.<sup>55</sup> Three government ministries, the former Ministry of Electronic Industry (hereinafter "MEI"; MEI is now a part of MII), the former Ministry of Power Industry (hereinafter "MOP"), and the Ministry of Railways (hereinafter "MOR"), are significant shareholders of Unicom.<sup>56</sup> When Unicom was formed, however, it was undercapitalized and lacked the

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<sup>46</sup> See *id.*

<sup>47</sup> See *id.*

<sup>48</sup> See *id.*

<sup>49</sup> See *id.* Wu Jichuan, the head of MII, has announced that a formal law will soon be passed that will govern the telecommunications sector. See China Online, *China's Telecom Law To Be Promulgated "Soon"* (visited Nov. 5, 1999) <<http://www.chinaonline.com/industry/telecom/currentnews/secure/c9105.asp>>.

<sup>50</sup> See Christine Chan, *Unicom Document Reveals New Law's Intent*, S. China Morning Post, May 18, 2000, available in LEXIS, Nexis Library, News Group File.

<sup>51</sup> See *id.*

<sup>52</sup> See *id.*

<sup>53</sup> See *id.*

<sup>54</sup> See Catalogue, *supra* note 15.

<sup>55</sup> See MacLellan, *supra* note 45, at 2-3.

<sup>56</sup> See *id.*

financial resources it needed to compete with CT, which was the undisputed the state giant.

As a result, in 1994, Unicom started to use a special financial scheme to finance its telecommunications network buildout.<sup>57</sup> This financial scheme was known as China-China-Foreign or *Zhong-Zhong-Wai* or simply CCF.<sup>58</sup> The end result of the scheme was to have foreign investors provide capital to finance Unicom projects in return for a share of revenues from them.<sup>59</sup> CCF was approved by the relevant government officials and between 1994 and 2000, 40 foreign companies invested around US\$1.4 billion into these telecommunications ventures operated by Unicom.<sup>60</sup>

To understand how these joint ventures fit through a legal loophole and sidestepped the regulation banning foreign investment in the telecommunications sector, it is important to understand what the CCF investment structure looked like. The CCF structure typically involved three parties. A foreign investor first formed a joint venture with a Chinese partner that was not prohibited from forming foreign joint ventures.<sup>61</sup> This joint venture company would then sign various contracts and agreements with a Chinese partner that was prohibited from forming foreign joint ventures.<sup>62</sup> The foreign investor injected capital into the first joint venture company (formed with the Chinese partner in the non-prohibited sector), which would then be used to fund the projects with the second joint venture company (formed with the Chinese partner in the prohibited sector).<sup>63</sup> In return, the foreign investor got a share of the revenues that were allocated to the joint ven-

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<sup>57</sup> See *China Sets Limit on Unicom-Invented "Chinese-Chinese-Foreign" Investment Model, Impact Hotly Debated at China Telecom 2000 Conference in New York*, PR Newswire, Oct. 7, 1998, available in LEXIS, Nexis Library, RDS Business and Industry Database; *Telecommunications in China-Ban on Chinese-Chinese Foreign Projects*, East Asian Business Industry, Dec. 10, 1998, available in LEXIS, Nexis Library, RDS Business and Industry Database.

<sup>58</sup> This scheme is not unique to the telecommunications industry.

<sup>59</sup> See Mark O'Neill, *Beijing May Scrap Unicom Foreign-Investment Formula*, S. CHINA MORNING POST-BUSINESS POST, Sept. 23, 1998, at 4.

<sup>60</sup> See *id.*; *Ministry Investigated for Overstepping Authority*, BBC Summary of World Broadcasts, Sept. 10, 1999, available in LEXIS, Nexis Library, News Group File. These companies include Sprint International, Wireless Electronique, Ltd. [hereinafter "WelCom"], Daewoo, Bell Canada International, France Telecom, and Deutsche Telecom. See Letter from Douglas C. MacLellan, Chairman, Wireless Electronique, Ltd., to Bill Corbet United States Trade Representative (Mar. 2, 1999) (on file with author); William J. McMahon, *South Korea's Daewoo Threatens to Sue China Unicom* (visited Sept. 3, 1999) <[http://www.chinaonline.com/top\\_stories/c9090116.asp](http://www.chinaonline.com/top_stories/c9090116.asp)>. The funding raised from the CCF ventures account for 72% of Unicom's funding. See PR Newswire, *supra* note 57.

<sup>61</sup> See PR Newswire, *supra* note 57.

<sup>62</sup> See *id.*

<sup>63</sup> See *id.*

ture.<sup>64</sup> Hence, the name CCF comes from the fact that there are two Chinese parties and one foreign party involved.

In the Unicom case, "China Unicom Shareholder Companies" were established to form China-based joint venture companies with foreign telecommunications investors.<sup>65</sup> At the other end of the transaction, Unicom set up provincial level operating companies, which were wholly-owned subsidiaries of Unicom having the right to construct and operate networks within their geographic area, to work with the China-based joint venture companies.<sup>66</sup> The China-based joint venture company had no ownership in the operating company, but had construction, financing, and services contracts with the provincial level operating companies.<sup>67</sup> The operating branch level companies distributed net earnings to the joint ventures that constructed its network, which in turn distributed earnings to the shareholder companies and the foreign investors.<sup>68</sup> The joint venture and, hence, the foreign investor had a right to sign ancillary contracts with the provincial branches to maintain, service, and provide consulting services for the network in return for a share of the revenues generated by the network.<sup>69</sup>

Using this investment scheme, the foreign investor did not have direct foreign equity ownership in the network operating ventures nor did they have direct ownership in the operation of the networks, two things that were prohibited by the government.<sup>70</sup> By taking the extra step and forming the extra joint venture, the foreign investor had successfully removed itself, theoretically, from directly engaging in business with Unicom.

Article 7, Chapter 2 of the FECL dictates that contracts are valid only when they are approved by the Chinese government, if such approval is required by law or by administrative decrees.<sup>71</sup> The law, however, does not list all the different types of contracts that need approval.<sup>72</sup> Contracts that involve importing technology and engaging in joint ventures all require approval.<sup>73</sup> Article 3 of the JVL states that "equity joint venture agreement[s], contract[s] and article[s] of association signed by the parties to the venture must be submitted to the relevant state department for examination and ap-

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<sup>64</sup> See *id.*

<sup>65</sup> See MacLellan, *supra* note 45, at 4-6. This example is given in reference to the general structure for most Unicom CCF projects.

<sup>66</sup> See *id.*

<sup>67</sup> See *id.*

<sup>68</sup> See *id.*

<sup>69</sup> See *id.* at 5.

<sup>70</sup> See *id.* at 4.

<sup>71</sup> See China: Foreign Economic Contract Law, *supra* note 3.

<sup>72</sup> See *id.*

<sup>73</sup> See Zhang Yuqing & James S. McLean, *China's Foreign Economic Contract Law: Its Significance and Analysis*, 8 J. INTL. L. BUS. 120, 130-34 (1987).

proval."<sup>74</sup> Like other joint ventures, CCF joint ventures required governmental approval, and CCF foreign investors were required to obtain business licenses from relevant provincial authorities before commencing operations.<sup>75</sup>

Though the CCF contracts were either approved by MOFTEC, the State Administration of Industry and Commerce, or local level officials<sup>76</sup>, the foreign investors participating in the CCF schemes with Unicom could not escape the venture's eventual demise. In October 1998, the Chinese government, through the MII, issued a statement stating that the CCF project contracts executed between Unicom and foreign investment enterprises were "irregular" under state policy and regulation.<sup>77</sup> In August 1999, MII officially asked Unicom to ban CCFs and to correct the situation.<sup>78</sup> On September 29, 1999, Unicom notified their CCF investors that they planned to cease all cash flow distributions and compensation to their foreign partners' joint venture companies as of October 1, 1999.<sup>79</sup> This notification was seen as a formal declaration that Unicom was unilaterally rescinding all of their CCF contracts.<sup>80</sup>

To resolve this issue, Unicom had to go through difficult negotiations with their foreign partners to compensate them for the termination of the CCF projects.<sup>81</sup> In the beginning, the foreign investors had asked for more compensation than Unicom was ready to give.<sup>82</sup> Unicom was only willing

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<sup>74</sup> See *Access China*, *supra* note 2. Chapter 2, Article 8 of the Regulations for Implementing The Law on Chinese Foreign Joint Ventures also states that the establishment of a joint venture in China is subject to the examination and approval of MOFTEC. See *People's Republic of China: Regulations for Implementing The Law on Chinese Foreign Joint Ventures*, translated in 22 I.L.M. 1033 (1983).

<sup>75</sup> See MacLellan, *supra* note 45, at 6.

<sup>76</sup> See *Opening China's Telecom Market: Process is Slow, Nontransparent, Piecemeal and Often Frustrating*, East Asian Executive Reports, Nov. 15, 1998, at 6, available in WESTLAW, TP-ALL Database.

<sup>77</sup> See *China: Telecoms Firm Told to Abandon Foreign-Funded, Joint Ventures*, BBC Monitoring Asia Pacific-Political Supplied by BBC Worldwide Monitoring, Feb. 4, 1999, available in LEXIS, Nexis Library, News Group File.

<sup>78</sup> See *China-Telecom Service-No Foreign Fund*, FT Asia Intelligence Service, Oct. 27, 1999, available in LEXIS, Nexis Library, World News, Bus Anal. & Country Info, and Selected Legal Texts and Codes.

<sup>79</sup> See Douglas C. MacLellan, *China Unicom Against the Foreign Telecom World 1* (Oct. 21, 1999) (unpublished paper for The MacLellan Group, Inc.) (on file with author).

<sup>80</sup> See *id.*

<sup>81</sup> See *China-Telecom Minister Stresses Policies for Foreign Funds*, FT Asia Intelligence Wire, Sept. 19, 1999, available in LEXIS, Nexis Library, World News, Bus Anal. & Country Info, and Selected Legal Texts and Codes.

<sup>82</sup> See Telephone Interviews with Douglas C. MacLellan, Chairman, WeiCom (Sept. 27, 1999 & Oct. 14, 1999). The interviews lasted approximately 15-20 minutes each. Mr. MacLellan gave the author some background regarding his knowledge of doing business in China. He also explained the general Unicom situation, the specific situation surrounding

to pay back the money that each foreign investor had already put into the project, plus interest under terms set up by Chinese banks.<sup>83</sup> They were also willing to extend an invitation to the foreign investors to purchase shares of Unicom at the time of their initial public offering (hereinafter "IPO").<sup>84</sup> Unicom had offered large foreign telecommunications partners up to 15% of the total shares in the post-IPO Unicom.<sup>85</sup> Their IPO, which was originally planned for the end of 1999, was delayed until June 2000 largely because of the CCF disputes.<sup>86</sup>

As the negotiations were difficult and took a long period of time, Unicom decided that any CCF projects not concluded by the time of the IPO would not be included in the listed vehicle.<sup>87</sup> However, they were able to successfully negotiate settlements with all their CCF investors by their IPO date, June 21, 2000, and as a result were able to transfer all their assets to the vehicle that went public.<sup>88</sup>

Though the U.S.-China WTO Agreement opened up China's telecommunications market for foreign investment, the signing of the agreement had minimal effect on the negotiations to end the CCF projects. A foreign consultant involved in the negotiations stated that the agreement did not affect the CCF deals at all.<sup>89</sup> After the agreement was signed, an official of

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WelCom's CCF contracts in China, and also expressed his personal opinions regarding the situation.

<sup>83</sup> See *id.*

<sup>84</sup> See William J. McMahon, *China Unicom IPO Gains Momentum But Exit Strategy for Foreign Firms Still Unclear*, CHINAONLINE NEWS, June 28, 1999 (on file with author); Martyn Williams, *Newsbytes: Hong Kong, China*, NEWSBYTES, Aug. 23, 1999 (on file with author). The Chinese government has allowed its telecom companies, CT and Unicom, to list in foreign stock exchanges because this would help generate much needed capital. Though this would allow foreign operators to buy into the firm, they would not have direct involvement in its operation. See George Murray, *Door Slammed on Foreign Involvement in China Telecoms*, Japan Economic Newswire, Sept. 17, 1999, available in LEXIS, Nexis Library, World News, Bus Anal. & Country Info and Selected Legal Texts and Codes.

<sup>85</sup> See *Large Foreign Partners to Get 15% of China Unicom* (visited Jan. 24, 2000) <<http://www.chinaonline.com/topstroeis/000121/C00011906/asp>>.

<sup>86</sup> See *China Unicom Close to Settlement with Foreign Investors* (visited Mar. 31, 2000) <<http://www.chinaonline.com/topstories/000330/1/C00032904.asp>>.

<sup>87</sup> See *id.*

<sup>88</sup> Unicom first settled its CCF ventures in the coastal provinces before moving to the ones that were in-land. As of August 9, 2000 all the coastal CCF ventures had been finalized while some of the non-coastal ones were not. Terms and conditions, however, have been set for those settlements that have not been finalized yet. Follow-up Telephone Interview with Douglas C. MacLellan, Chairman, Welcom (Aug. 9, 2000). The interview lasted approximately 15 minutes. Mr. MacLellan gave an update of the situation as of August 9, 2000. See also Matt Forney & Jason Dean, *China Unicom Prepares for IPO by Ending Foreign-Firm Ventures*, WALL ST. J., Apr. 3, 2000, at A26.

<sup>89</sup> See Mark O'Neill, *Unicom in Talks Over CCF Deals*, S. China Morning Post Internet Edition, Nov. 17, 1999, (visited Sept. 14, 2000) <[http://www.scmp.com/News/Bu...ext.asp\\_ArticleID-19991117013038618.asp](http://www.scmp.com/News/Bu...ext.asp_ArticleID-19991117013038618.asp)>.

the MII reiterated that the CCF projects were "irregular" and not only stated that the issue of the CCF contracts was settled, but that it was not a WTO issue.<sup>90</sup> Furthermore, even in light of the agreement, Unicom officials continued to state that it would be in the interest of the foreign investors to end the use of irregular financing (from the CCF deals).<sup>91</sup>

The final settlement for the CCF ventures left some investors unhappy and disgruntled.<sup>92</sup> All the settlements were confidential, but it is most likely that investors received their initial investment back plus interest.<sup>93</sup> They did not, however, receive any administrative costs or expenses back as part of their settlement.<sup>94</sup> In addition, some investors may have received an allocation of shares at the IPO or warrants to purchase shares in the future (not to be triggered until 6 months after the date of the IPO).<sup>95</sup> Once the settlements were reached, the CCF ventures started the decommissioning process, which was estimated to take between 90 and 120 days.<sup>96</sup>

In the aftermath of the situation, the question is: how did this happen? The foreign investors went into China with a clear plan and investment scheme that was approved by the relevant government authorities. These joint ventures were all in the midst of being carried out with money having exchanged hands and construction having started on various projects. Why then did the government suddenly decide that these ventures were "irregular"? How did the foreign investors end up in such a quagmire? Will accession to the WTO stop situations like this from happening again?

## V. THE LEGAL FRAMEWORK FOR FOREIGN INVESTMENT IN CHINA

To answer some of the questions posed by the Unicom situation, it is necessary to look at the legal framework that underpins the foreign investment environment in China. China has learned, since it opened its doors in 1979, that one of the keys to attracting foreign investment is the development of a legal system that is acceptable to Western investors.<sup>97</sup> Statistics indicate that they have been successful in attracting foreign investors. It is questionable, however, whether the existing legal system can serve as a

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<sup>90</sup> See Christopher Parkes, *Investors fight for "Revised" Contracts*, FIN. TIMES (visited Nov. 17, 1999) <<http://www.ft.com/hippocampus/q2ddle6.htm>>.

<sup>91</sup> See *China Gains with WTO*, FT Asia Intelligence Wire, Nov. 21, 1999, available in LEXIS, Nexis Library, World News, Bus. Anal. & Country Info., and Selected Legal Texts and Codes.

<sup>92</sup> See MacLellan Follow-up interview, *supra* note 88.

<sup>93</sup> See *id.*; See also Forney & Dean, *supra* note 88.

<sup>94</sup> See MacLellan Follow-up interview, *supra* note 88.

<sup>95</sup> See *id.*; See also Forney & Dean, *supra* note 88.

<sup>96</sup> The decommissioning process is basically a liquidation process. See MacLellan Follow-up Interview, *supra* note 88.

<sup>97</sup> See Peter Howard Come, *Lateral Movements: Legal Flexibility and Foreign Investment Regulation in China*, 27 CASE W. RES. J. INT'L L. 247 (1995).

solid framework on which China can continue to successfully attract foreign investment.

Many of the problems that foreign investors face in China stem directly from the fact that the legal framework that guides foreign investment is vague and weak. Why is that so even though it should be evident that one of the keys to prosperity through foreign investment is a strong legal system? It can be partially explained by the fact that China has only had a very short period of time—20 years—to build up a legal system that is compatible with their socialist market economy. The fact that the legal system is relatively young, combined with the fact that the Chinese have a unique conception of the meaning of the rule of law helps explain why their legal system is so weak.

China's legal framework for foreign investment reflects a "tension between encouraging foreign investment and maintaining state control over the economy."<sup>98</sup> The framework is regulatory in nature and puts a large emphasis on state control of economic and social development.<sup>99</sup> Traditional Chinese culture has also played a large role in shaping the meaning of law and shaping how laws are enacted in China.

Confucian teaching has always influenced the development of Chinese law.<sup>100</sup> Confucianism favors seeking solutions by peaceful discussion rather than by taking disputes outside the realm of the parties involved and emphasizing the discord that is already existing.<sup>101</sup> In essence, anybody who brings a conflict to court is viewed as having disturbed social tranquility and as being disruptive and uncultivated.<sup>102</sup> Therefore, the law has always been subordinate to virtue and Confucian principles of harmony, peace, and conciliation. As a result, justice is not so much guided by the law as it is guided by reason and an individual's virtue. As a result, from a cultural standpoint, the rule of law is viewed in a different light in China than it is in many Western countries.

China's economy is different from the Western capitalist economy that most foreign investors are used to facing. These differences have influenced the development of the foreign investment legal framework. An important point to note is that China is trying to build a socialist market economy.<sup>103</sup> Though they have tried to move towards developing a capi-

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<sup>98</sup> See Pitman B. Potter, *Foreign Investment in the People's Republic of China Dilemmas of State Control*, in CHINA'S LEGAL REFORMS 155 (Stanley Lubman ed., 1996).

<sup>99</sup> See *id.* at 156.

<sup>100</sup> See ERIC LEE, COMMERCIAL DISPUTES SETTLEMENT IN CHINA 1 (1985).

<sup>101</sup> See *id.*

<sup>102</sup> See *id.*

<sup>103</sup> Along with socialist market economy terms like "socialist democracy" and "socialism with Chinese characteristics" have also been used to describe the new China. See Pat K. Chew, *Political Risk and U.S. Investments in China: Chimera of Protection and Predictability*, 34 VA. J. INT'L L. 615, 634 (1994).



talist economy by developing policies that allow markets to set prices and determine the allocation of resources, that permit private ownership, and that allow foreign investment and trade, the country still holds on to its Communist roots.<sup>104</sup> China is a one party state, a "people's democratic dictatorship," which some people say is a country ruled by men and not by law.<sup>105</sup> All the reforms and laws reflect the socialist influence of the Chinese Communist Party.

In addition to understanding the philosophical underpinnings of law in China, it is also important to look at how laws governing foreign investment are enacted. The development of the legal framework for foreign investment did not start until 1979. China's legal system and formal legal institutions were practically destroyed when their economic contact with the outside world was cut off between 1966 and 1976.<sup>106</sup> Only with the adoption of the open door policy in 1979 did the Chinese start to rebuild their legal system.

The highest legal authority in China is its Constitution, which was enacted in 1982.<sup>107</sup> Laws are enacted by the National People's Congress (hereinafter "NPC") and its various standing committees.<sup>108</sup> The State Council, ministries, and administrative agencies also issue regulations, rules, provisions or measures, decisions, resolutions, notices, and orders to refine the legislative purposes of the NPC or its standing committees.<sup>109</sup>

Access to published Chinese legislation is difficult as there are no officially published gazettes or compilations of Chinese laws and regulations that are updated regularly.<sup>110</sup> Moreover, internal rules that are applicable may not be publicly disclosed.<sup>111</sup> Judicial decisions are not considered precedents and therefore, are not considered sources of law.<sup>112</sup> As Chinese laws and regulations can come from many different sources, and as they are not often published, it is difficult for foreigners to be knowledgeable of all the laws and regulations that are applicable to them.

Once foreigners have jumped over the hurdle of finding out what laws apply to them, they face another difficulty that is even harder to overcome. Laws in China are inherently fluid and flexible. This is illustrated by the

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<sup>104</sup> See *id.*

<sup>105</sup> See *id.*

<sup>106</sup> See Moser, *supra* note 5, at 2.

<sup>107</sup> See Daniel A. Lapres, Christian Lamonin, & Liu Kefu, *Introduction to the Chinese Business and Legal Environment*, in BUSINESS LAW IN CHINA 19 (Daniel A. Lapres & Zhang Yuejiao eds., 1997).

<sup>108</sup> See *id.*

<sup>109</sup> See *id.*

<sup>110</sup> See Moser, *supra* note 5, at 3.

<sup>111</sup> See Daniel A. Lapres, Christian Lamonin, & Liu Kefu, *Introduction to the Chinese Business and Legal Environment*, in BUSINESS LAW IN CHINA, *supra* note 105, at 19.

<sup>112</sup> See *id.*

characteristics of Chinese legal drafting that are employed in formulating the law. Chinese laws are often filled with principle-like pronouncements, vagueness and ambiguity, broadly worded discretions, undefined terms, omissions, and general catchall phrases.<sup>113</sup> These drafting techniques produce laws that are often subject to varied interpretations by different parties. Instead of being a form of protection for foreign investors, these laws can create risks that are built into the investment environment and hard to avoid.

In places where the rule of law is strong, such risks are minimized because the law is viewed as being absolute, as embodying a set of ethical norms that are embraced by the society, and as being normative.<sup>114</sup> Normative law serves as a clear guide for people's actions and behavior.<sup>115</sup> There are three general principles that are reflected in laws that are normative: certainty, generality, and equality.<sup>116</sup> The certainty principle guarantees that the law is stable and can not be manipulated by arbitrary power.<sup>117</sup> The generality principle guarantees that the law is not particularized to policies, goals, or individuals.<sup>118</sup> The equality principle guarantees that the law is applied to everyone equally.<sup>119</sup> These three elements provide protection against the exercise of arbitrary power by private individuals as well as government officials.

In China, however, there is a gap between the law on its face and the legal norms that are actually implemented. Chinese law is not normative, but instead is instrumentalist.<sup>120</sup> As a result, it is not characterized by the fundamental characteristics of normative law, that is, certainty, generality, and equality. Law in China is used as a vehicle to promulgate the policies and goals of the state.<sup>121</sup> It is state policy and not law that stands supreme. Therefore, legislative enactments and laws do not represent norms that are applied consistently in different situations, but instead represent ways to exercise state power. As goals and policies of the state change, so will the interpretation of the law. Laws are intentionally left vague to provide room for different interpretations that may apply at different times and by different people. This characteristic of the law, along with the fact that so many different state organs can enact laws and regulations, makes it hard to determine exactly what laws are applicable and how those laws should be interpreted.

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<sup>113</sup> See Corne, *supra* note 97, at 253.

<sup>114</sup> See Lewis, *supra* note 3, at 500.

<sup>115</sup> See *id.* at 522.

<sup>116</sup> See *id.*

<sup>117</sup> See *id.*

<sup>118</sup> See *id.*

<sup>119</sup> See *id.*

<sup>120</sup> See *id.*; see also PITMAN B. POTTER, FOREIGN BUSINESS LAW IN CHINA - PAST PROGRESS AND FUTURE CHALLENGES 5 (1990).

<sup>121</sup> See Lewis, *supra* note 3, at 522.

As a result of this instrumentalist approach and the lack of normative principles, the rule of law in China is often subordinated to the rule of the individual.<sup>122</sup> The rule of law prevents arbitrary abuse of power by individuals and also protects enterprise and individual rights.<sup>123</sup> But, in a place where it is trumped by the rule of the individual and where law is subject to interpretation by government officials who have to follow government policies and directives, an environment is created where there are autocratic and unpredictable rules.<sup>124</sup> Furthermore, frequent political infighting in China often leads to policy inconsistencies that promote different interpretations of the law.<sup>125</sup> There is an increased fear of unpredictability in an environment that has multiple government agencies enacting laws and regulations and where it is not uncommon for those agencies' political egos to clash.

The implementation of state policy through the use of law is illustrated by the FECL. The FECL sets a legal foundation for legitimate state intervention in almost all foreign business transactions.<sup>126</sup> One of the main principles of the FECL is the protection of national sovereignty and social welfare.<sup>127</sup> As a manifestation of this principle, the FECL codifies the requirement of government approval for most contracts involving a foreign party.<sup>128</sup> It sets out the processes by which the government will use to review contract terms and the processes by which contracts are to be negotiated.<sup>129</sup> This guarantees that there is some degree of regulatory review by the government before any contract is actually approved. The goal of the review and approval process is to make sure that the projects comply with the policies set out by the government.<sup>130</sup> Therefore, the law allows the government to make sure that all foreign economic contracts conform with state policy and goals.

Two articles in the FECL to pay special attention to are Articles 4 and 9 of Chapter 1. Together, they express the principle of sovereignty that is embodied in the FECL.<sup>131</sup> Article 4 states that "contracts must be made in accordance with the law of the People's Republic of China and should not be prejudicial to the public interests of society of the People's Republic of

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<sup>122</sup> See Chew, *supra* note 103, at 637.

<sup>123</sup> See *id.*

<sup>124</sup> See *id.*

<sup>125</sup> See *id.*

<sup>126</sup> See Pitman B. Potter, *Foreign Investment in the People's Republic of China Dilemmas of State Control*, in CHINA'S LEGAL REFORMS, *supra* note 98, at 168.

<sup>127</sup> In addition to this principle, the FECL is based upon three other guiding principles, equality and mutual benefit, primacy of international treaties to which China is a party, and honoring contracts and maintaining good faith in business activities. See Zhang & McLean, *supra* note 73, at 126.

<sup>128</sup> See *id.*

<sup>129</sup> See *id.*

<sup>130</sup> See *id.*

<sup>131</sup> See Lewis, *supra* note 3, at 510.

China.”<sup>132</sup> Article 9 states that “contracts that violate...the public interest of the People’s Republic of China are invalid.”<sup>133</sup> Foreign investors should be wary of terms like “public interest.” Such terms are never clearly defined and can be used by the Chinese government to terminate agreements or deny business licenses with no explanation.<sup>134</sup>

## VI. UNRAVELING THE UNICOM MYSTERY

Applying an understanding of the Chinese foreign investment legal framework to the Unicom case will help illuminate how the foreign investors got into this situation. Foreign investors that participated in the CCF scheme with Unicom, for the most part, took all the right steps to protect themselves. The Unicom quagmire was not caused by their actions. The policy indeterminacy of the Chinese government and the inability of the legal framework to protect investors from this indeterminacy were the main causes of the situation.

Using the details of WelCom’s (one of the U.S. CCF investors) CCF ventures with Unicom as an example, it is easy to see that the foreign investors tried to take steps to protect their investment. In forming the CCF joint ventures, WelCom took all the necessary steps that were mandated by the government to set up a joint venture.

To form a joint venture, the first step for a foreign party to take is to find a Chinese partner and have that partner submit a letter of intent for approval to the proper Chinese office.<sup>135</sup> As relationships still continue to be the heart of the Chinese contract process, it is important not only for foreign investors to cultivate a good relationship with the government, but for them to find a Chinese partner who has a good relationship with the government.<sup>136</sup> The Chinese company chosen must have the authority to negotiate joint venture contracts.<sup>137</sup> Though finding a Chinese partner with a good relationship with the Chinese government may not guarantee success, it is one step that the foreign investor can take to improve their chances of success.

In WelCom’s case, the investors probably could not have chosen a partner that had a better relationship with the government or one that had more authority to negotiate. WelCom had three fifteen-year CCF joint

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<sup>132</sup> *See id.*

<sup>133</sup> *See id.*

<sup>134</sup> *See id.*

<sup>135</sup> *See Tanner, supra* note 1, at 158.

<sup>136</sup> *See id.*

<sup>137</sup> Not all Chinese companies have the authority to negotiate. To find out if a particular company has such authority, foreign parties may ask to see a copy of the Chinese company’s license issued by the State Administration of Industry and Commerce or a copy of their articles and look for a clause indicating such authority. *See id.*, at 159.

venture contracts with Unicom.<sup>138</sup> Their investment partners were both highly respected Chinese state-owned enterprises: Chinese Railroad Telecommunications Center, Ltd., the subsidiary company used to hold MOR's ownership in Unicom, and China Everbright Ltd.<sup>139</sup> Choosing a state-owned company as a joint venture partner was probably one of the safest choices one could make because state-owned companies are controlled by the State, and therefore should be familiar with State policies.

In addition to choosing a safe partner, WelCom should have been further protected by the fact that Unicom itself put a clause into the joint venture contract stating that it had the right and authority to enter into such contracts.<sup>140</sup> WelCom's joint ventures, as well as all the other CCF ventures, were not only duly approved by Unicom, a State-owned company whose high ranking executives were appointed by the State Council, but also by China's foreign investment administration authorities.<sup>141</sup> In addition, central government leaders personally attended the contract signing ceremonies, indicating their tacit endorsement of these contracts.<sup>142</sup>

The joint ventures allowed WelCom to participate in the build-out of 230,000 network lines.<sup>143</sup> By the time the Government declared the CCF contracts "invalid," Welcom had already negotiated equipment contracts for its joint ventures and a credit facility to underwrite a majority of the equipment and operating costs of the joint ventures.<sup>144</sup> By May 20, 1999, they had invested approximately US\$22.8 million into their CCF joint ventures, all of which had commenced commercial operations.<sup>145</sup> Before any joint venture could be started, the FECL and JVL both dictate that MOFTEC has to approve the contracts involved. With money already invested and the commercial operations of the ventures already started, WelCom had no reason to think that it did not have approval from the government to go forward. Furthermore, the relevant authorities had not only allowed the implementation of the CCF contracts with WelCom, but had allowed the implementation of CCF contracts with the other 39 foreign investors. Unicom had also gotten approval from the State Administration of Foreign Exchange to use US\$1.4 billion in foreign investment capital to purchase telecommunications equipment and to build out various telecommunica-

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<sup>138</sup> Memorandum from Douglas C. MacLellan, Chairman of WelCom, to WelCom Shareholders 2 (May 20, 1999) (Memorandum used with the permission of Douglas C. MacLellan) (on file with the author).

<sup>139</sup> See *id.*; see also MacLellan, *supra* note 45, at 4.

<sup>140</sup> See MacLellan interviews, *supra* note 82.

<sup>141</sup> See MacLellan, *supra* note 79, at 2.

<sup>142</sup> See *id.*

<sup>143</sup> See MacLellan, *supra* note 138, at 2.

<sup>144</sup> See *id.*

<sup>145</sup> See *id.*

tions networks throughout China.<sup>146</sup> Logic dictates that these contracts would not have been approved in the first place if they had been illegal.

So what did the MII mean when, in 1998, it stated that CCF ventures were "irregular" and must be "rectified"? The MII never stated that the projects were "illegal." Their statements, however, implied that the CCF structures should not exist because they were illegal.

Technically, though, the schemes were not illegal. The foreign investors were able to take advantage of a legal loophole in the system. The government policy prohibited joint ventures that allow foreign management and administration of post and telecommunications services.<sup>147</sup> It did not prohibit a joint venture between a foreign investor and a Chinese company that did not directly own and build telecommunications networks. Nor did it prohibit a joint venture between a Chinese-based joint venture company and Unicom. In the case of the CCF ventures, the foreign investor did not have direct control or ownership over the management or operations of the telecommunications networks. Unicom's provincial branches retained all the ownership and operation rights.<sup>148</sup>

The problem in this case was that the law prohibiting foreign investment in the telecommunications sector was broad enough so as to allow one interpretation of the law by MOFTEC, which obviously allowed these investments in the beginning, and a completely opposite interpretation by the MII, which later deemed these investments irregular.

Where the rule of law is weak and is mainly an instrument of the party, the interpretation of the law can change. In this case, neither the law, MOFTEC, nor the foreign investors' Chinese partner could protect and guide the foreign investors because the rule of law was subordinated to the rule of the individual. The gap between the normative reality of the law (the actual letter of the law) and the actual implementation of the law was evident. It did not matter what the law said, because two completely different interpretations were derived from it by two different agencies at two different times.

In this particular case, the interpretation changed partly because of a clash of political egos. The telecommunications industry is at the center of a clash between the liberal forces of the government which favor market reform and the conservative forces which do not.<sup>149</sup> Liberal forces won the battle when the State Council created Unicom in order to liberalize this sector of the economy in 1994. But the conservative forces, led by Wu Jichuan, the head of MII, struck back by persuading the government that the

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<sup>146</sup> See MacLellan, *supra* note 79, at 2.

<sup>147</sup> See Catalogue, *supra* note 15.

<sup>148</sup> See MacLellan, *supra* note 45, at 4.

<sup>149</sup> See Leslie Pappas, *Telecom Tug-of-War*, NEWSWEEK, Aug. 30, 1999, at 33.

CCF schemes were only quasi-legal.<sup>150</sup> This is not only an example of the rule of the individual triumphing over the rule of law, but also an example of how the instrumentalist approach taken by the Chinese in interpreting law can be highly detrimental to foreign investors.

In the Unicom situation, the foreign investors had no protection from the law. The legal safeguards that foreign investors put into their contracts had little to no effect. Sometimes, foreign investors are blinded by the possibility of large profits and forget to adequately weigh the risks inherent in this relatively young socialist market economy. This is especially the case in markets like the telecommunications market because of the indeterminacy of state policy towards this sector, the internal political struggle between liberal and conservatives in this sector, and the lack of a law governing it.

Looking back, however, there are two additional precautions, one legal and one economic, that the foreign investors could have taken to provide some protection for their investment.<sup>151</sup> The legal precaution they could have taken was to insert an arbitration clause into their contract that required arbitration outside of China.<sup>152</sup> Though all the contracts had arbitration clauses, the clauses called for arbitration within China.<sup>153</sup> Some investors felt that they would not have gotten a fair arbitration in China.<sup>154</sup> The economic precaution that the foreign investors could have taken was to buy political risk insurance from an institution like the Multilateral Investment Guarantee Agency of the World Bank.<sup>155</sup>

China's foreign investment policies as well as its legal framework for investment are relatively young. The combination of a vast state bureaucracy enacting laws and regulations and a Confucian tradition of de-emphasizing the rule of law does not help the government build a legal framework that is attractive and workable for foreign investors. The vastly diametrical political forces within the Chinese Communist Party are also a cause for concern for foreign investors because these forces often cripple the existing weak legal framework.

#### VII. THE IMPACT OF THE U.S.-CHINA WTO AGREEMENT AND CHINA'S IMPENDING ACCESSION INTO THE WTO ON THE RULE OF LAW IN CHINA

The U.S.-China WTO Agreement and China's impending accession into the WTO raises many questions about the future of China. Is China, a socialist-democracy with its own brand of market capitalism, ready to carry

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<sup>150</sup> See *id.*

<sup>151</sup> See MacLellan Follow-up Interview, *supra* note 88.

<sup>152</sup> See *id.*

<sup>153</sup> See *id.*

<sup>154</sup> See *id.*

<sup>155</sup> See *id.*

out all of its promises to the WTO and further open up its markets, or will resistance from conservative hard-liners cause continued uncertainty in the foreign investment and trade arena? Many say that China is going to change for the better and that WTO membership will bring China in line with the rest of the world, forcing them to strengthen the rule of law and to increase transparency for foreign investors.<sup>156</sup> This would, in turn, increase protection for foreign investors and help them avoid such situations as the one with Unicom. But, this would mean that the Communist Party, which has always seen itself as above the law, would have to give up some of its sovereignty to the rules-based, supranational trade body and to individual consumers and private companies.<sup>157</sup> Once in the WTO, China will be subject to the WTO dispute resolution procedures and disgruntled investors will not be slow in lobbying their respective governments to use the system as an arena to air their grievances. To hypothesize about how the WTO will change China, it would be useful to first look at China's compliance with past international agreements.

With respect to the legal system in China, enforcement has always been the area of most concern.<sup>158</sup> Earlier economic agreements have often required extensive renegotiations after they have been signed but before they were truly put into effect.<sup>159</sup> Some people say that China's record of compliance with international agreements is not very good, with the most glaring examples being its record with the United Nations Treaty on Political and Civil Rights and its record on intellectual property rights.<sup>160</sup>

Based on a study of China's compliance with its recent obligations, however, it appears that China's record, though mixed, is better than most

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<sup>156</sup> See *China Opens Up*, *ECONOMIST*, Nov. 20, 1999, at 17. After the signing of the agreement, U.S. President Bill Clinton was quoted as saying "Today, China embraces principles of economic openness, innovation, and competition that will bolster China's economic reforms and advance the rule of law." William J. McMahon, *China-U.S. Reach WTO Deal* (visited Nov. 16, 1999) <<http://www.chinaonline.com/issues/wto/newsarchive/secure/1999/november/c9111521.asp>>.

<sup>157</sup> See *China Opens Up*, *supra* note 156, at 17.

<sup>158</sup> See Steven Mufson, *In WTO China Deal, Hard Part Starts Now*, *THE WASH. POST*, Nov. 26, 1999, at A6.

<sup>159</sup> For example, an agricultural agreement reached in April 1999 was a hostage to WTO talks until the week before the U.S.-China WTO Agreement was signed. The official reasons for the delay was that China had not yet come up with a suitable Chinese translation for the document. See *id.*

<sup>160</sup> See *The Rule of Law in China*, *THE WASH. POST*, Nov. 16, 1999, at A30; Paul Eckert, *WTO a Great Leap Into Unknown for China* (visited Nov. 17, 1999) <[http://www.dailynews.yahoo.com/h/nm/19991116/bs/wto\\_china\\_49.html](http://www.dailynews.yahoo.com/h/nm/19991116/bs/wto_china_49.html)>. Five years ago, the U.S. Trade Representative negotiated an agreement with China guaranteeing protection of U.S. intellectual property rights in China. But that protection is arguably worse today. See Craig Smith, *China May Prove Difficult Despite WTO*, *WALL ST. J.*, Nov. 16, 1999, at A22.



detractors think.<sup>161</sup> The record shows that China's compliance with sovereign treaties and agreements is better than its enforcement of commercial agreements between private parties.<sup>162</sup> This is a very bad sign for foreign investors. According to the study, China's score in the area of Private Agreements is only poor to fair.<sup>163</sup> The report states that the China International Economic and Trade Arbitration Commission, which dominates arbitration of foreign disputes in China, has, in the past, ignored evidence presented by foreign parties and has favored Chinese parties.<sup>164</sup> Furthermore, the report indicated that even if outcomes of venture capital disputes are favorable judgements for foreign parties, they are often difficult to enforce.<sup>165</sup> So even though China has signed many bilateral WTO agreements, it is possible that foreign investors may not get the protection that they need. This spotted record does not indicate that there will be immediate smooth sailing for foreign investors after China's accession into the WTO.

Though the WTO rules require governments to stand back and allow businesses to decide whether they want to buy foreign or domestic goods and services, China does not yet have the culture, habits, or legal institutions needed to restrain its own officials from controlling or influencing business deals.<sup>166</sup> Chinese-style socialist market capitalism has always dictated that commerce is a state responsibility and trading decisions, as well as foreign investment ones, have been made based on central-planning requirements.<sup>167</sup> Some say that though the economic arena is changing in China, politics and ideology have changed very little.<sup>168</sup> Thus, even if the reformist sector of the Chinese government is willing to adhere to all the WTO rules, it is questionable whether they will be able to control the protectionist behavior of countless officials and Communist Party leaders who not only have their own agendas, but are not used to ceding power to others.<sup>169</sup>

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<sup>161</sup> The record is compiled by scholars at the Georgetown University Law Center and lists compliance as either good, fair, or poor. See Daniel H. Rosen, *China and the World Trade Organization: An Economic Balance Sheet* (visited Nov. 18, 1999) <[http://www.chinaonline.com/commentary\\_analysis/wtocom/currentnews/secure/ca\\_990707\\_rosen\\_pg1.asp](http://www.chinaonline.com/commentary_analysis/wtocom/currentnews/secure/ca_990707_rosen_pg1.asp)>.

<sup>162</sup> See *id.*

<sup>163</sup> See *id.*

<sup>164</sup> See *id.*

<sup>165</sup> See *id.*

<sup>166</sup> See Robert Herzstein, *Is China Ready for the WTO's Rigors?*, WALL ST. J., Nov. 16, 1999, at A30.

<sup>167</sup> See *id.*

<sup>168</sup> See Elisabeth Rosenthal, *Riding Winds of Reform, Yet Mired in Orthodoxy*, WALL ST. J., Nov. 17, 1999, at A15.

<sup>169</sup> See Herzstein, *supra* note 166. Some say that MOFTEC is isolated among the ministries under the State Council, as most of the ministries are reserved on the WTO matter, if not publicly opposed to opening their regulated industries. See Gary Chen, *China's View of*

Although U.S. negotiators call the agreement "comprehensive," China can still hamper foreign investment because under the agreement, foreign investors still need government-issued licenses to do business.<sup>170</sup> Even though markets may be opened by the WTO, foreign investors will still be subject to many rules and regulations. As one Beijing-based lawyer noted, "[At] the end of the day, they have a million ways to write rules to frustrate an agreement. China will find itself in perpetual litigation in WTO dispute panels."<sup>171</sup> Furthermore, though China has stated that it stands by the pledges it made in the bilateral agreements, it has so far resisted demands from WTO members to specify precisely how it will follow through with many of its pledges.<sup>172</sup>

Legal tribunals for impartial and speedy resolution of disputes with Chinese authorities do not exist right now.<sup>173</sup> If the WTO does become the primary forum for enforcing China's compliance with the rules, there are questions as to whether the WTO will be capable of handling the workload of all the potential complaints to be filed against China.<sup>174</sup>

The opening up of the telecommunications industry is a perfect example of the uncertain days that lay ahead for foreign investors. Almost immediately after the signing of the U.S.-China WTO Agreement, Wu Jichuan stated that the agreement would not dramatically impact China's information industry.<sup>175</sup> This is a rather bizarre statement, considering the fact that the agreement had opened up the telecommunications industry, an industry that previously had, theoretically, been completely closed to foreign investment. Wu further stated that though China's telecommunications sector would be open to foreign investment, China would not only continue to reinforce regulatory efforts in the telecommunications industry by carefully examining the qualifications of all foreign investors, but would facilitate orderly competition according to the relevant regulations.<sup>176</sup> Wu also said

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*WTO: Neither Boon Nor Bane* (visited Nov. 19, 1999) <[http://www.chinaonline.com/comm/entary\\_analysis/vtocom/currentnews/secure/c91117wtogary.asp](http://www.chinaonline.com/comm/entary_analysis/vtocom/currentnews/secure/c91117wtogary.asp)>. Municipalities and local governments have previously resisted implementing initiatives, such as the recent value-added tax, until a time that suited them. See Alejandro Reyes, *Just A Start: The Long WTO Negotiations Look Easy Compared to What Comes Next* (visited Nov. 24, 1999) <<http://www.cnn.com/ASIANOW/asiaweek/magazine/99/1126/cover1.html>>.

<sup>170</sup> See Charles Hutzler, *China Faces New Enforced Rules* (visited Nov. 17, 1999) <[http://dailynews.yahoo.com/h/ap/19991117/wl/china\\_breaking\\_rules\\_1.html](http://dailynews.yahoo.com/h/ap/19991117/wl/china_breaking_rules_1.html)>.

<sup>171</sup> See *id.*

<sup>172</sup> See *WTO & China*, FIN. TIMES, Oct. 13, 2000, available in LEXIS, Nexis Library, News Group File.

<sup>173</sup> See Herzstein, *supra* note 166.

<sup>174</sup> See *id.*

<sup>175</sup> See *China's Net Czar Downplays WTO Effect on High Tech Industry* (visited Nov. 20, 1999) <<http://www.chinaonline.com/issues/wto/newsarchive/secure/1999/november/c9111805.asp>>.

<sup>176</sup> See *id.*

that just because foreign investors would be allowed to hold a certain percentage of share capital does not mean that they must reach that figure.<sup>177</sup> This is a clear indication that approvals for foreign investment will still be done on a case by case basis.

The statements made by Wu are a cause for concern. In the past, ministries and agencies have provided any number of reasons to reject foreign investment, including rejecting applications because they "are not in China's interest."<sup>178</sup> Foreign investors certainly hope that accession to the WTO will make China's policies more transparent and less arbitrary. But with a spotty record of compliance with international agreements and private contracts, politics and ideology slow to change, and a large bureaucracy filled with officials used to conforming the law to state policy, changes will not happen quickly. On its face, China will comply with their WTO promises because they have to. It is possible, however, for them to formulate regulations and rules that will frustrate the spirit of the agreements until they are ideologically and politically ready to truly embrace all the WTO rules and regulations. There are already plenty of examples of other WTO countries that have skirted WTO regulations.<sup>179</sup> If these countries have done so in the past, so can China.

China, however, does appear to be making efforts to conform their laws to WTO rules and regulations and to make their transition into the WTO smoother. For example, in its new five-year plan for 2001-2005 as well as its long-term goals for 2015, the MII stated that it will draft laws and regulations that are in line with WTO market principles.<sup>180</sup> The MII also stated that administrative statutes, including the Regulations on the Administration of Foreign Investment in the Telecommunications Service Sector and the Regulations on Computer Networks and Information Safety Management, would be adopted to facilitate China's entry into the WTO.<sup>181</sup> China has also set up a ministry-level mediation agency to ensure that all

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<sup>177</sup> See *Wu Jichuan Optimistic for the Restructuring of China's telecom Industry* (visited Jan. 19, 2000) <<http://www.chinaonline.com/topstories/000119/b200011425-SS.asp>>.

<sup>178</sup> See Lester J. Gesteland, *Internet Not Fully Open to Foreigners Under China WTO-Experts* (visited Nov. 18, 1999) <<http://www.chinaonline.com/topstories/991117/c9111751.asp>>.

<sup>179</sup> Japan, a member of the WTO, agreed in the mid-1980's to remove codified trade barriers and eliminate legal cartels. But this has made little difference in the ability of importers to penetrate the Japanese economy because with Japan's informal governance structure, the corporatist Japanese State could conduct business as if the codified legalities were still in place. China too has an equally efficient informal governance structure, which they administer through the operations of the Communist Party. Therefore, China may continue to be able to follow old state policies despite admission into the WTO. See Peter Brain, *Chinese Economy is Food For Thought* (visited Nov. 22, 1999) <<http://www.afr.com.au/content/991117/world/world4.html>>.

<sup>180</sup> See *Beijing Urged To Reshape Telecom Policies*, (visited Apr. 18, 2000) <<http://www.chinaonline.com/topstories/000417/2/B100040638.asp>>.

<sup>181</sup> See *id.*

the promises made during negotiations concerning WTO membership are met.<sup>182</sup> This agency is headed by a Vice-Premier and will coordinate relations on all sides, hear complaints from foreign businesses, and make sure that all of China's promises are fulfilled.<sup>183</sup>

Even so, China's rule of law will not change overnight. The "people's democratic dictatorship" that Mao set up is simply too strong to be dismantled right away. Laws like the FECL, which legitimize state intervention in foreign business transactions, will still exist. Political infighting between reformist liberals and conservatives will still exist. Things will not change until the Communist Party is no longer above the law and an open and transparent judiciary system has been put into place. It will take more than WTO membership to change China's weak legal framework.

The WTO though, is definitely a step in the right direction. By signing the agreement, China has shown that they are willing to consider changes that will fundamentally alter the way they have done business in the past 50 years. These changes will not come easily, but China's further integration into the global economy will enhance the ability of China's trading partners to influence China's behavior.<sup>184</sup> China's membership in the WTO will also have the potential to change China's internal politics, lending support to the liberal reformist officials who hopefully understand that there needs to be legal, social, and political reform to support the economic reforms that are being implemented. Not until China formally accedes to the WTO, however, will it be possible to determine exactly how quickly the much needed changes will take place.

### VIII. CONCLUSION

Reflecting on the Unicom CCF situation, it appears that the legal and political risks associated with investing in China are outweighed by the economic windfall that the Chinese market can provide for foreign investors. When Unicom went public in Hong Kong in the middle of June 2000 it became the largest IPO in Hong Kong's history.<sup>185</sup> On its first day of trading in the New York Stock Exchange, June 21, its shares rose 10%.<sup>186</sup>

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<sup>182</sup> See *A Promise Made...China Sets up Ministry-Level Agency to Make Good on WTO Vows*, (visited Aug. 13, 2000) <<http://www.chinaonline.com/issues/wto/currentnew/secure/C00071306.asp>>.

<sup>183</sup> See *id.*

<sup>184</sup> See Mark W. Frazier and Peter M. Hansen, *China's Accession To The WTO: A Candid Appraisal From U.S. Industry* (visited Sept. 30, 1999) <<http://www.nbr.org/publications/briefing/frazierhansen99.index.html>>.

<sup>185</sup> Unicom's IPO raised over US\$4.92 billion. See *China Unicom's IPO Rings Up \$4.92 Billion*, *ASIAN WALL ST. J.*, June 19, 2000, at 14.

<sup>186</sup> See Lester J. Gesteland, *China Unicom IPO Exceeds Expectations, Closes at US\$22*, (visited June 22, 2000) <<http://www.chinaonline.com/topstories/000621/1/c00062153.asp>>; See also Ricardo Lachica, *China Unicom Gets Strong Welcome in First Session*, *ASIAN WALL ST. J.*, June 22, 2000, at 2.

Investors were apparently quite eager to purchase Unicom shares even after the CCF debacle, which clearly showed that investing in China is accompanied by a plethora of legal and political risks. This eagerness can be attributed to the almost limitless growth potential for the Chinese telecommunications market. Financial analysts say that this potential is enough to outweigh any political or legal risks.<sup>187</sup> It would, however, still behoove smart investors to be well aware of the legal risks that exist in investing in China.

Investing in China has the potential to be a very lucrative venture. Since China opened its economy in 1979, billions of dollars worth of foreign investment have been poured into the country. But images of dollar signs have overshadowed some of the legal and political risks of investing in a country with an economy and foreign investment legal structure that is young and unpredictable.

Law in China is fundamentally instrumentalist and therefore is controlled by state policy. This opens up the possibility for the state apparatus to dictate how a law should be interpreted. The legal framework that has been built up has been, at times, weak and ineffectual, creating an unpredictable environment where investors are subject to many risks that are often unavoidable. The foreign investors in the Unicom case were casualties of this unpredictable environment. This case has also shown that the risks of foreign investment are especially great in politically sensitive sectors of the economy, like the telecommunications industry.

The beginning of this comment stated that the reason investors are turning away from China is primarily because they are losing money, because of bureaucratic red tape, and because of the shifting regulatory environment. These three issues must be resolved in order for China to revive the level of foreign investment to its previous heights. With the Asian economy turning around, revenues will start increasing. Therefore, to revitalize its economy and increase the amount of foreign investment, China must start to strengthen its rule of law and must start providing a stronger legal framework that shields foreign investors from the political whims of the vast bureaucracy. But this will not be an easy task.

China's accession to the WTO will help them start to strengthen the rule of law, but only if the Communist Party is truly willing to alter some of the bedrock principles of their one party system. This will require not only changes in their political system, but their ideological system and their administrative bureaucracy also. China's rule of law will not be strengthened overnight because the system is too entrenched in its old ways for changes to happen quickly. But as time goes on, China will realize that political and

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<sup>187</sup> See Jessica Wohl, *IPO View-China Unicom Seen Climbing in Large Debut*, (visited June 20, 2000) <[http://www.chinaonline.com/reuters/China/06\\_18\\_2000.reutr-story-N15147923.html](http://www.chinaonline.com/reuters/China/06_18_2000.reutr-story-N15147923.html)>.

ideological change must come with the opening of its economy. The Chinese will also realize that to become a true world power, China must strengthen its rule of law. In addition, they will feel pressure from their trading partners, foreign investors, and the WTO bureaucracy to change and will have no choice but to start making their regulatory environment more transparent and fair to their economic partners. When China starts doing this, the rule of law will inevitably be strengthened.

