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Pudong: Another Special Economic Zone in China?—An Analysis of the Special Regulations and Policy for Shanghai's Pudong New Area*

*Bin Xue Sang***

I. INTRODUCTION

The Open Door Policy instituted in the late 1970s marked the beginning of economic reform in the People's Republic of China ("China"). Leading these reforms was the establishment of five special economic zones¹ and the opening of fourteen coastal cities.² These special economic zones ("SEZs") and coastal cities, located along the east coast of China, serve as "windows" to attract foreign investment and technology.³ So far, each of the five SEZs and the fourteen coastal cities has been successful in achieving these goals.⁴ Together, they have taken on a

* Pudong is in the eastern part of Shanghai. See part II of this article *infra* for further discussion.

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¹ The five special economic zones are Shenzhen, Zhuhai, Shantou, Xiamen, and Hainan Island. Yue-man Yeung & Xu-wei Hu, *China's Coastal Cities as Development and Modernization Agents: An Overview*, in CHINA'S COASTAL CITIES 1, 9-11 (Yue-man Yeung & Xu-wei Hu eds., 1992).

² The fourteen coastal cities are Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai. *Id.* at 2.

³ Most of China today is open to foreign investment. See James McGregor, *Hong Kong Tycoon Aims to Help Bring Foreign Capital to China's Heartland*, WALL ST. J., Jan. 26, 1993, at A10. See also Robert Kleinberg, *China's Foreign Economic Relations After Tiananmen*, 8 UCLA PAC. BASIN L. J. 303, 325 (1990) (reporting that the Chinese government expanded the number of open coastal cities and counties to 284). However, the five SEZs and the fourteen coastal cities all benefit from certain types of special regulations and policy. See *infra* this section for further explanation.

⁴ For example, Shenzhen, which became a SEZ in 1980, has been transformed from a sleepy,

leading role in the process of economic reform and in the further development of the open-door policy,⁵ which has become wider.⁶ In fact, many observers attribute much of the success⁷ of China's economic re-

coastal fishing village to a big city with a bustling trade and vigorous industrial base. Owen D. Nee, *China's Special Economic Zones And Fourteen Coastal Cities*, COMMERCIAL, BUSINESS AND TRADE LAWS, PEOPLE'S REPUBLIC OF CHINA, BOOKLET 10 at 1-3 (1987). Between 1979 and October of 1992, Shenzhen signed approximately 9,800 contracts with foreign firms representing a total investment commitment of \$9.15 billion, of which over \$4.3 billion has already been actually invested. *Shenzhen Has More Than Five Thousand Foreign Capital Enterprises*, THE CHINA PRESS, Jan. 8, 1993, at 10 (in Chinese). Shenzhen has averaged 58% annual economic growth since 1980. Michael Duckworth, *China Stock Market Gets Mixed Reaction After Opening Itself to Foreign Investors*, WALL ST. J., Jan. 31, 1992, at B5C.

However, there exist sharply contrasting views as to this economic "success." One commentator believes that foreign investors in China have been faced with a real risk of bankruptcy. See T.K. Chang & Rolf Olofsson, *Worst Case Scenarios*, 16 CHINA BUS. REV., Sept.-Oct. 1989, at 16. But another states that "[i]n sum, most of the DFI in the PRC has been mutually beneficial, which is why its pace accelerated during the 1980s and why the Chinese authorities were happy to offer greater inducements to foreign investors." Richard Pomfret, *INVESTING IN CHINA; TEN YEARS OF THE OPEN DOOR POLICY* 130 (1991). Moreover, four American companies (Avon Products Inc., McCall Pattern Co., Procter & Gamble, and H.J. Heinz Co.) are reported to be doing well in China. James McGregor, *U.S. Companies in China Find Patience, Persistence and Salesmanship Pay Off*, WALL ST. J., Apr. 3, 1992, at B1.

⁵ In the ten years since the SEZs were created in 1980, the area of those zones has been increased by more than 100 times — including the addition of Hainan, which became a special economic zone in 1988. Zhang Yi, *The Ten Years' Great Changes of China's Special Economic Zones*, PEOPLE'S DAILY, Aug. 27, 1990, at 1 (overseas Chinese language ed.).

Between 1979 and the end of 1991, China approved 41,274 foreign-funded enterprises with a contracted total of \$47.9 billion, about \$20 billion of which has already been put into operation. See *China Attracts Investment*, WALL ST. J., Mar. 10, 1992, at A14. As part of that investment total, between 1986-1989, \$10.17 billion was invested in the SEZs and the coastal cities. Wang Yi Dong, *Coastal Cities Prove to Be Forefront of the Open-Door Policy*, PEOPLE'S DAILY, Nov. 20, 1990, at 1 (overseas Chinese language ed.). In 1992 alone, foreign investment in China was \$11 billion. Sheryl Wu Dunn, *Booming China Is a Dream Market for West*, N. Y. TIMES, Feb. 15, 1993, at A1. For the first half of 1991, the industrial output value from the five SEZs and the fourteen coastal cities was 23.1 percent of that for the entire country. Jiang Ming Qeng, *Rapidly-Increased Usage of Foreign Capital in Coastal Cities And Special Economic Zones*, PEOPLE'S DAILY, Aug. 15, 1991, at 3 (overseas Chinese language ed.).

⁶ See Jesse Wong, *China's Easing Of Some Rules Lures Investors*, WALL ST. J., May 7, 1992, at A10.

⁷ China's economic development was extremely rapid in 1992, with the economy expanding by about 12%. David Holley, *Economy Grew 12% in 1992, China Says*, L. A. TIMES, Dec. 31, 1992, at A11. China is seen as "an engine for countries around it." Bill Mellor, *A Year For Crowing*, TIME, Feb. 22, 1993, at 20.

China has approved more than 80,000 foreign capital enterprises and last year alone earned income of around \$2 billion from levying tax on them. *Last Year's Tax By Foreign Capital Enterprise Exceeds 10 Billion Yuan*, PEOPLE'S DAILY, Jan. 19, 1993, at 1 (overseas Chinese language ed.).

China's economic reform has certainly benefited the West, including the United States. For example, McDonnell Douglas Corp. has entered into a \$1.2 billion contract with China to produce 40 jetliners there. Jeff Cole & Jeremy Mark, *McDonnell Seals \$1.2 Billion China Job, But Taiwan Venture Seems to Be Fading*, WALL ST. J., June 29, 1992, at A3. See also Eduardo Lachica, *Clinton Stance on China Trade Is Seen to Have Big Impact on Asia*, WALL ST. J., Feb. 22, 1993, at A7E ("Procter & Gamble Co. sells more shampoo in China than in any other country besides the U.S.

form and its exciting economic development to the achievements of the SEZs and the coastal cities.⁸

No official definition of a "special economic zone" currently exists. However, as the term implies, it refers to a designated area whose economic system and policies are different from the rest of China. The Chinese central government has instituted policies to create a favorable environment for foreign investment in each of the five SEZs.⁹ Each zone has in turn enacted its own unique regime of local regulations.¹⁰

These favorable policies have a number of characteristics that set the SEZs apart from other areas of China.¹¹ First, a significant proportion of enterprise ownership is non-state-owned, being instead Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and exclusively foreign-owned enterprises (the "foreign capital enterprises").¹²

Avon Products Inc.'s success in selling cosmetics door-to-door in China already is the stuff of legend." See also Wu Dunn, *supra* note 5 ("The top three records for opening-day sales by McDonald's in outlets around the world, for example, are held by its three restaurants in China.").

In addition to luring foreign investment in China, China is also investing and purchasing overseas. See Zhang Yi Jun, *China's Overseas Enterprises Exceed Four Thousand*, PEOPLE'S DAILY, Feb. 25, 1993, at 1 (overseas Chinese language ed.); Marcus W. Brauchli, *Roaming Yuan: China's Newly Rich Go on Investing Spree From Paris to Peru*, WALL ST. J., Feb. 3, 1993, at A1.

⁸ See, e.g., Xu Yao Zhong, *Shenzhen Special Economic Zone's Ten Years Has Benefited the Whole Nation*, PEOPLE'S DAILY, July 19, 1990, at 3 (overseas Chinese language ed.). The number of foreign capital enterprises in the five SEZs constitutes one fourth of those for the entire country. Zhang, *supra* note 5. See also Nee, *supra* note 4, at 1-3 (discussing the growth of Shenzhen as an example of SEZ contribution to China's economic reform).

⁹ See *infra* part III.

¹⁰ See XIANFA [Constitution] art. 100 (1982) (P.R.C.) (stipulating that local governments may enact local regulations provided that they conform to the Constitution, the laws, and the administrative rules and regulations of the nation; such local regulations must also be filed with the NPC's Standing Committee).

See also Zhou Wang Sheng, SCIENCE OF LEGISLATION 284 (1988) (in Chinese) (local regulations enforce and supplement national law, but local governments cannot enact constitutions or laws, or sign treaties). However, as an exception, the Chinese National People's Congress has authorized Shenzhen to enact laws. Wei Yu Qin, *The Session Of Standing Committee of the National People's Congress Closes*, PEOPLE'S DAILY, July 2, 1992, at 1 (overseas Chinese language ed.).

It should be noted that the central government's special policy is the key factor, without which a region cannot make "economically special" local regulations as those effective in the SEZs.

¹¹ See Chen Zhao Bin, CHINA SPECIAL ECONOMIC ZONES 12 (1986) (in Chinese).

¹² *Id.* Shenzhen alone by 1987 had more than 5,000 foreign capital enterprises. See Nee, *supra* note 4. These enterprises, together with private entrepreneurs and collective factories (often run by an individual entrepreneur who uses the name of a village or social organization to avoid political problems), are considered by economists as China's private sector. In 1991, state-owned enterprises were responsible for only 52.8 percent of the country's industrial output, compared to 54.5 percent in 1990 and well over 80 percent a decade ago. James McGregor, *Reality Is Overtaking Ideology in China*, WALL ST. J., Mar. 2, 1992, at A9. More than a dozen state-owned enterprises have become bankrupt and 600 are closed. *Sixty-six Chinese Enterprises Bankrupted*, THE CHINA PRESS, Dec. 7, 1992, at 4 (in Chinese).

In Shenzhen, Shantou, Zhuhai and Xiamen, 51 percent of the total industrial output value, and in Hainan 23.8 percent, is from foreign capital enterprises. Zhang, *supra* note 5. In 1991, the output

Second, the economic system within the SEZs is more market-oriented than is the rest of China.¹³ Third, preferential tax regimes are available to foreign capital enterprises, e.g., the enterprise income tax rate can be as low as fifteen percent — with exemptions from customs duty and consolidated industrial and commercial tax also available.¹⁴ Finally, foreign capital enterprises in the SEZs are given a great deal of autonomy in the operation and management of their businesses, without suffering much interference from the central and local governments.¹⁵ Such enterprises generally enjoy expedited government approval proceedings that are much simpler than those existing elsewhere in China.¹⁶

The fourteen coastal cities, although similar to the SEZs, are governed by a different body of regulations and controlling authorities. Their legal and political systems are not as favorable to foreign investors as those in the SEZs, but they offer many benefits that are not available elsewhere in China.¹⁷ In comparison with the rest of China the coastal cities offer simplified governmental¹⁸ approval procedures for incorporation and management of enterprises.¹⁹ Furthermore, foreign capital enterprises in the coastal cities receive preferential tax treatment, although not as attractive as is offered in the SEZs.²⁰

In addition to the SEZs and the coastal cities, many other areas in China are open to foreign capital enterprises and strive to encourage foreign investment and technology.²¹ For example, although Beijing is neither a SEZ nor a coastal city, it remains attractive to foreign investors because of its industrial base, its location, and its special status as the nation's capital.²² Thus, there currently exist in China three area-based

of state industries grew 8 percent; collectives' output grew 18 percent; private entrepreneurs' output grew 24 percent; and foreign capital enterprises' output grew 56 percent. McGregor, *supra* this note.

¹³ Chen, *supra* note 11, at 12. China has adopted a socialist market economy. *Establish Socialist Market Economy System*, PEOPLE'S DAILY, Oct. 13, 1992, at 1 (overseas Chinese language ed.). See also Nicholas D. Kristof, *China's Congress Likely To Pick Younger Rulers*, N. Y. TIMES, Mar. 15, 1993, at A2 (reporting that China's Constitution will be amended).

¹⁴ Chen, *supra* note 11.

¹⁵ Chen, *supra* note 11.

¹⁶ Chen, *supra* note 11.

¹⁷ This point, however, does not appear to be applicable to Pudong. See *infra* part II.

¹⁸ Whether such approval is by the central government or local government depends on the nature and the amount of the investment. See *infra* part II.

¹⁹ Chen, *supra* note 11, at 13.

²⁰ In the 14 coastal cities, the special 15 percent income tax rate is limited to advanced technology enterprises, or energy, transportation or port construction projects. Furthermore, the majority of the enterprises in the coastal cities are not foreign capital enterprises, since all of the fourteen coastal cities have a traditional state-run industrial base. *Id.*; see also Nee, *supra* note 4, at 6.

²¹ See *supra* note 3.

²² See BEIJING MUNICIPAL FOREIGN ECONOMIC RELATIONS AND TRADE COMMISSION & BEIJING FOREIGN INVESTMENT SERVICE CENTER, WELCOME TO INVEST IN BEIJING 18 (1990). In

regulatory regimes for carrying out the process of modern economic reform: the five SEZs, the fourteen coastal cities and their environs,²³ and the remainder of China.

Shanghai is one of the fourteen coastal cities that enjoys a special regulatory regime, though not to the extent of that in the SEZs. However, since the opening up of Pudong New Area, the local authorities and the central government have instituted favorable policies that were previously only available in the SEZs.²⁴ The development of Pudong New Area demonstrates China's commitment to the process of economic reform and to its open-door policy²⁵ and has sparked a considerable amount of interest within China and around the world.²⁶

Part I of this article provides an overview of Shanghai and Pudong New Area ("Pudong"). Part II discusses and analyzes some of the most important regulations that are applicable in Pudong, and the issues that have arisen as a result of those regulations. Finally, part III concludes with some suggestions and observations that are germane to the success of China's economic reform and the development of Shanghai and Pudong.

II. SHANGHAI AND ITS PUDONG NEW AREA

Shanghai is the largest city in China, with an area of 6,340.5 square kilometers (including Pudong New Area) and a population of over thirteen million people.²⁷ Because of its size, its location on China's east coast, and its pivotal role in China's history, Shanghai has become the center of industry, commerce and transportation in China.²⁸

1992 alone, Beijing City government approved more than 2,000 foreign capital enterprises. *Pace of Using Foreign Capital in Beijing Accelerates*, PEOPLE'S DAILY, Dec. 30, 1992, at 1 (overseas Chinese language ed.).

²³ It was recently announced that the policy applicable to the fourteen coastal cities are also applicable to more than 20 other cities in China. Song Bin, *The Coastal Cities' Policy Is Applicable To Twenty Cities On River, Border And Inland*, PEOPLE'S DAILY, August 14, 1992, at 1 (overseas Chinese language ed.).

²⁴ For a discussion of policies applicable in Pudong, see *infra* part II.

²⁵ Julia Leung & James McGregor, *China Keeps the Investment Door Ajar*, WALL ST. J., Sept. 11, 1990, at A18.

²⁶ The author has personally received numerous inquiries in the United States about the development of Pudong. This article has been drafted in part as an attempt to answer those inquiries. See also Fidelia Chau, *Financial Joint Ventures May Be Set Up in Shanghai*, Reuters, Nov. 29, 1990, available in LEXIS, Nexis Library, Archive file (A banker with a European bank which was negotiating to join a joint venture bank in Pudong remarked, "Everybody wants a foothold in Shanghai because the trade finance market there is lucrative.").

²⁷ SHANGHAI FOREIGN INVESTMENT COMMISSION, GUIDE TO INVESTMENT IN SHANGHAI 1 (1991).

²⁸ Kai-Iu Fung, et al., *Shanghai: China's World City*, in CHINA'S COASTAL CITIES, *supra* note 1, at 124, 130-34. In terms of finance, since there is as yet no private bank in China and almost all

Before the Chinese Communist Party came to power in 1949, Shanghai attracted the majority of foreign investors and merchants who transacted business in China.²⁹ These foreign companies went to Shanghai, established businesses and employed local people.³⁰ For this reason, workers in Shanghai have historically had more contact with foreigners than those in other regions of China, and the people of Shanghai, in general, have been more receptive to the outside world.³¹

Today, Shanghai has a strong industrial base with a work force of several million.³² This includes an abundance of specialists in science, technology and management.³³ In addition, it possesses huge commercial and consumer markets,³⁴ and products from Shanghai have a reputation for quality throughout the rest of the nation.³⁵

Shanghai is divided by the Huangpu River into eastern and western districts of approximately equal size.³⁶ When people speak of Shanghai, they are usually referring to the western district ("Puxi"), a modern metropolis that accommodates most of the population.³⁷ In contrast, the eastern district, Pudong, has remained largely undeveloped, with a population of only 1.4 million people in spite of its close proximity to the

state-owned banks' headquarters are in Beijing, the capital of China, there is no compelling reason that Shanghai should today be considered the "financial" center of China. Shanghai was, however, the undisputed financial center of China before 1949. See GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 4.

See also David Holley, *The New Religion Is Money*, L. A. TIMES, Jan 15, 1993, at A14 (reporting that Shanghai's economy grew 15% in 1992).

²⁹ During the early years of the 20th century, it was not uncommon for Shanghai to be handling over fifty percent of China's international trade value. 3 ENCYCLOPEDIA OF ASIAN HISTORY 429-31 (Ainslie T. Embree et al. eds., 1988).

³⁰ *Id.*

³¹ *Id.* See also Holley, *supra* note 28 (reporting briefly about Shanghai's history as a world center).

³² Thomas B. Gold, *Can Pudong Deliver?*, CHINA BUS. REV., Nov. - Dec. 1991, at 28. See also GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 2. Shanghai is the industrial center in China. The annual output value of Shanghai industries constitutes roughly 7 percent of China's total. *Id.* However, other sources have reported this figure at 10 percent. Leung & McGregor, *supra* note 25; Zou Ting, *Shanghai's Vice-Mayor Huang Ju on Pudong's Development*, CHINA TODAY, Nov. 1990, at 25.

³³ After Beijing, Shanghai has more academic institutes and universities than any other city in China. There are 51 colleges and universities in Shanghai. GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 6. The large number of specialists represents one reason that E.I. Du Pont de Nemours & Co., among others, decided to invest in Pudong. See *Positive on Pudong*, CHINA BUS. REV. Nov.- Dec. 1991, at 28.

³⁴ Fung et al., *supra* note 28, at 133-34. See also Holley, *supra* note 28 (reporting how Shanghainese spend).

³⁵ See Holley, *supra* note 28.

³⁶ See THE TIMES ATLAS OF THE WORLD plate 23 (Times Books ed., 1980).

³⁷ "Pu" refers to the Huangpu River that flows through Shanghai. "Puxi" thus refers to that portion of the city located west of the city, and "Pudong" to the eastern portion.

ocean relative to Puxi.³⁸ For almost a century now,³⁹ the Chinese have attempted to develop Pudong into a modern harbor.⁴⁰

On April 18, 1990, the Chinese State Council declared that it would open Pudong to foreign investment⁴¹ and promised to apply many of the policies previously available only in the five SEZs.⁴² Shortly thereafter, the Shanghai government in turn announced that certain additional preferential policies — beyond those applicable in the SEZs — would also be adopted in Pudong.⁴³ The Shanghai municipal government has subsequently issued several important regulations relating to development of Pudong. These will be discussed in detail in the next part of this

³⁸ Gold, *supra* note 32, at 22. Pudong's population has increased by 300,000 since the project for its development was first announced in 1989. *Id.*

³⁹ Early in this century there was talk of building a bridge across the Huangpu, and Sun Yatsen, who led the overthrow of the Manchu dynasty in 1911, saw its potential as a port. Both before and after World War Two, development plans were drawn up but never implemented due to hostilities. Gold, *supra* note 32, at 26.

⁴⁰ Chen Mao Di, *The Great Project That Goes Beyond the Century: The Birth of the Decision to Open up Pudong*, PEOPLE'S DAILY, Oct. 1, 1991, at 3 (overseas Chinese language ed.).

⁴¹ Xiao Guan Gen, *Chinese Communist Party Central Committee and State Council Agree to Accelerate Development in Shanghai Pudong*, PEOPLE'S DAILY, Apr. 19, 1990, at 1 (overseas Chinese ed.).

The Shanghai government has decided to develop Pudong in three stages. First, from 1991 to 1995, it will emphasize improving the infrastructure. This will include construction of three bridges (the first of which, the Nanpu Bridge, has already been opened), a belt-way bypassing the city center and a 50,000-line computer-controlled telephone system, as well as gas and water works. Gold, *supra* note 32, at 26; Bai Guo Liang, *Project That Goes Beyond the Century*, PEOPLE'S DAILY, May 1, 1990, at 3 (overseas Chinese language ed.). The second stage, 1996-2000, will be marked by a new international airport, in addition to vehicle tunnels, a subway, a railroad, and updated laws, regulations and policies. *Id.* The final stage will extend for two or three decades into the next century and will focus on the continued modernization of the region. *Id.*

⁴² Xiao, *supra* note 41; Gold, *supra* note 32, at 26.

⁴³ Bai Guo Liang, *Pudong Uses Flexible and Various Methods to Absorb Foreign Investment and Applies Some Policies That Are More Preferential Than Those in the Special Economic Zones*, PEOPLE'S DAILY, May 29, 1990, at 1 (overseas Chinese language ed.); Gold, *supra* note 32, at 29. Pudong New Area is to be divided into five sub-districts: (1) Lujiazui Finance Trade Zone, (2) Jinqiao/Quingnansi Export Processing District, (3) Waigaoqiao Free Trade Zone, (4) Zhoujiadu/Liulu Industrial Zone, and (5) Beicai/Zhangjiang Zone. Gold, *supra* note 32, at 22-23.

However, it is unclear whether Pudong enjoys policy any more special than those of other SEZs. Over a year ago, it was written that "foreign companies, which are generally prohibited from establishing trading companies in China, are allowed to engage in entrepot trade in Waigaoqiao." Norman P. Givant, *Putting Pudong in Perspective*, CHINA BUS. REV., Nov.-Dec., 1991, at 32. Imports of goods into the sub-district will be tariff-free as long as they are used for the production of export goods. Leung and McGregor, *supra* note 25. And "foreigners will also be allowed to operate food and retail ventures." Elizabeth Cheng, *Balancing Act: Shanghai's Pudong Project Gets a Boost*, FAR E. ECON. REV., Mar. 26, 1992, at 61. Today, the policy may also be applicable to a limited number of other cities as well.

Shanghai authorities have drafted four regulations dealing exclusively with Waigaoqiao. These regulations contain measures detailing customs and foreign-exchange control procedures in the sub-district, as well as delineating the administration of the area. According to these measures, individuals are allowed to work, but not to live, in the sub-district. Moreover, import licenses are not re-

article.⁴⁴

Since the announcement of these various governmental developments, many foreign businesspersons have visited Pudong, and numerous overseas investors have already decided to invest there.⁴⁵ By early 1992, 157 foreign capital enterprises with total investments of \$770 million were reportedly approved,⁴⁶ a total which more than doubled by the end of 1992.⁴⁷ Banks and financial institutions have taken a conspicuous lead in investment in Pudong.⁴⁸ During the first year of the application of special policies, more than twenty projects involving the establishment of branches of domestic and foreign banks were approved by the Shanghai

quired for materials and components imported into the area for export processing. Givant, *supra* this note, at 32.

It has been reported that former Shanghai Mayor Zhu Rongji requested that Pudong be allowed to grant even more attractive incentives to foreign investors, but the State Council refused for fear the existing SEZs would demand equal treatment. *Id.* at 30.

⁴⁴ It appears that there is disagreement on the protection afforded under those regulations. One set of commentators believes that Pudong has offered potential investors virtually the same treatment as the SEZs. Gold, *supra* note 32, at 26; Givant, *supra* note 43, at 30. Another believes that Pudong's regulations are only slightly more attractive than those already available elsewhere in China. Leung & McGregor, *supra* note 25. As will be discussed below, the first view may be more accurate. See *infra* part III.

⁴⁵ However, it has been noted that foreign investment in Pudong up to end of 1991 had been relatively minor, Gold, *supra* note 32, and most of the individual projects have averaged around \$1 million. Cheng, *supra* note 43, at 61.

One of the exceptions was the April 1990, E.I. Du Pont de Nemours & Co. \$25 million joint venture with the Shanghai Pesticide Factory and the Shanghai Pesticide Research Institute in Pudong. *Positive on Pudong*, *supra* note 33. According to Du Pont, the Shanghai government has been very supportive and encouraging of its venture, and the central government has expressed a strong desire to protect Du Pont's intellectual property. *Id.*

Recently four foreign capital projects in Pudong with total \$250 million investment were approved. Pan Yan Xi, *Pudong Becomes A Hot Place For Foreign Investment*, PEOPLE'S DAILY, Mar. 18, 1993, at 1 (overseas Chinese language ed.).

⁴⁶ Richard L. Holman, *Shanghai Targeted As Boomtown*, WALL ST. J., Mar. 12, 1992, at A8.

⁴⁷ See *The Newly Approved Foreign Capital Enterprises for the First Nine Months in Shanghai Exceed the Total for the Past 12 Years*, THE CHINA PRESS, Dec. 12, 1992, at 10 (in Chinese).

⁴⁸ Xia Ru Ge, "Finance Pioneer" in Pudong, PEOPLE'S DAILY, Oct. 1, 1991, at 3 (overseas Chinese language ed.).

"A Canadian-Australian joint venture has signed a \$1-million contract with the Asian Development Bank to review and recommend economic, institutional and planning reforms that could lead to the development of Pudong." *A \$10-billion Living Laboratory In China*, ENGINEERING NEWS REC., Nov. 11, 1991, at 38. Shanghai also set up a joint venture financial firm, the Shanghai International Finance Co. Ltd, in early October of 1990, and the shareholders are Bank of China's Shanghai Branch, Shanghai-based Bank of Communications, the Hong Kong-based Bank of East Asia and Japan's Sanwa Bank Ltd. Chau, *supra* note 26.

A German consortium has extended credit for more than half the \$500 million subway project in Pudong. Jim Abrams, *Shanghai's Urban Renewal Expected to Take 40 Years*, L. A. TIMES, June 17, 1990, at A5.

It has been noted, however, that the only foreign loan awarded to Pudong by the end of 1991 came from the Asian Development Bank. Gold, *supra* note 32, at 28.

government in Pudong.⁴⁹

Pudong has also attracted investment and business from neighboring provinces, reflecting a pattern experienced by the SEZs.⁵⁰ Over 100 Chinese enterprises from other provinces have established themselves in Pudong.⁵¹ An increase in population has accompanied the economic expansion in the area. Last year, approximately 2,400 families moved from Puxi to Pudong.⁵² The condescending Shanghainese attitude that "one bed in Puxi is better than one flat in Pudong" is now rapidly changing.⁵³ Perhaps, absent any governmental restrictions on movement, Pudong may someday become as or more crowded than Puxi.⁵⁴

III. KEY SPECIAL POLICIES APPLICABLE TO PUDONG

As discussed above, development in Pudong is impressive — primarily as a result of its preferential policies — although certain problems do remain.⁵⁵ The new policies in Pudong parallel many of the regulations already established in the SEZs. The SEZs accord preferential treatment to foreign capital enterprises in operations, real estate and taxation that is not available in other regions of China. The policies of the SEZs are not identical, however.

An investor who has made the decision to invest in a given area of China will have to consider some basic issues, including (a) what type of

⁴⁹ Xia, *supra* note 48; Givant, *supra* note 43, at 32.

Among those foreign banks that have established branches in Pudong are Citibank and Bank of America from the United States, Industrial Bank of Japan Ltd., Sanwa Bank Ltd. and Bank of Tokyo from Japan, and Credit Lyonnais and Banque Indosuez from France. *Pudong on the March*, CHINA TODAY, Jan. 1992, at 25.

⁵⁰ See *Pudong on the March*, *supra* note 49, at 25 (reporting that every province and region of China has shown enthusiasm in investing in Pudong).

⁵¹ Shao Yu Dong & Bai Ge Liang, *Pudong, A New Area Full of Hope*, PEOPLE'S DAILY, Oct. 1, 1991, at 3 (overseas Chinese language ed.); Givant, *supra* note 43, at 32 (reporting that the Shanghai government in May 1991 approved the Provisional Measures of Shanghai Municipality to Encourage Investment In Pudong by [Domestic] Regions Outside [Shanghai]). It is also reported that "several provincial governments have announced plans to build their headquarters in Pudong, including the \$28 million Jiangsu Mansion to be built by nearby Jiangsu province." Cheng, *supra* note 43, at 61.

⁵² Xia Ru Go, *Pudong's First Year*, PEOPLE'S DAILY, Apr. 23, 1991, at 3 (overseas Chinese language ed.). It has also been suggested, however, that "it is too early to tell if Shanghainese will be willing to move to Pudong or make the cross-river trip to work." Gold, *supra* note 32, at 29.

⁵³ Guo Chang Xi, *Pudong — The Bright Future of Shanghai*, PEOPLE'S DAILY, May 31, 1990, at 2 (overseas Chinese language ed.). Most Shanghai residents have traditionally lived in Puxi in extremely crowded conditions. Pudong, on the other hand, possesses relatively more room in which to live.

⁵⁴ Based on the experience of the five SEZs, it appears that many people from other parts of China will move into Pudong as well. See Nie Chuan Qing, *Special Zones — A Big Platform for People to Show Their Capacities*, PEOPLE'S DAILY, Mar. 5, 1992, at 1 (overseas Chinese language ed.); Nee, *supra* note 4.

⁵⁵ See *infra* part IV; Gold, *supra* note 32, at 22-23, 26-27.

enterprise to establish, (b) what type of business to operate, (c) the availability of real property for business uses, (d) the nature and availability of labor, (e) the type of government approval that is required, and the procedure to obtain it, (f) whether any preferential tax regime is applicable, and (g) the availability of bank financing, either from foreign-owned banks or from joint venture banks. In this context, it is helpful to compare and contrast the investment environment in Pudong with that in other areas of China.

A. Types of Enterprise

The majority of enterprises in China are state-owned,⁵⁶ although an increasing number of private enterprises have been established as a result of the modern economic reform process.⁵⁷ However, since there is as yet no corporation code within the Chinese legal system, the structure and operations of numerous private enterprises are not as precisely defined as they might be.

Nonetheless, Chinese law does provide a well-defined set of categories of foreign investment vehicles. Currently, three types of legal entity are available to foreign enterprises for investing in China:⁵⁸ (1) the Chinese-foreign equity joint venture,⁵⁹ (2) the Chinese-foreign contractual joint venture,⁶⁰ and (3) the wholly foreign-owned enterprise.⁶¹ These

⁵⁶ See XIANFA [Constitution] art. 7 (P.R.C.).

⁵⁷ See *supra* note 12. The *Provisional Regulations of the People's Republic of China Governing Private Enterprises* was also promulgated by the State Council on June 25, 1988. See, *supra* note 4, Booklet 2 (1991), at 239.

China will soon ease some restrictions on private enterprises. *China Will Further Widen Policy Concerning Individual and Private Enterprises*, THE CHINA PRESS, Dec. 7, 1992, at 4 (in Chinese). There are so far around 140,000 registered private enterprises in China. Zhao Xin Bing, *China Has Nearly 140,000 Private Enterprises*, PEOPLE'S DAILY, Feb. 20, 1993, at 1 (overseas Chinese language ed.).

⁵⁸ However, a foreign capital enterprise in Guangdong province has been reorganized as a stock corporation, *The First China-Foreign Joint Venture in Guangdong Reorganized as a Stock Company*, THE CHINA PRESS, Jan. 9, 1993, at 4 (in Chinese), and the Chinese government encourages the establishment of high-tech stock companies. *China Widens Policy and Enacts Important Regulations*, THE CHINA PRESS, Dec. 8, 1992, at 2 (in Chinese).

⁵⁹ The governing law is the *Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment*, adopted on July 1, 1979 at the 2nd Session of the 5th NPC, promulgated on July 8, 1979, and amended at the 3rd Session of the 7th NPC on Apr. 4, 1990. THE ABC OF INVESTING IN CHINA 82 (Beijing Review Press 1989).

⁶⁰ Chinese-foreign contractual joint ventures are governed by the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures*, adopted at the 1st Session of the 7th NPC on Apr. 13, 1988. *Id.* at 254.

⁶¹ The governing law is the *Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Investment*, adopted at the 4th Session of the 6th NPC on Apr. 12, 1986. *Id.* at 188.

three are collectively called "the three capital enterprises" in China.⁶² Each of the three types of foreign capital enterprises is also available to foreign investors in Pudong.⁶³

Each of these three types of enterprise is also available in any part of China open to foreign investment. However, as discussed above, in each non-SEZ area, such as in Puxi, there are already numerous, well-established, state-owned enterprises. Pudong, unlike any such non-SEZ area, is an "open" land with far fewer pre-existing enterprises.⁶⁴ Like the SEZs, the majority of the businesses that become established in Pudong will be foreign capital enterprises. Thus, the applicable policies in Pudong are inclined to be as unique as those in the SEZs,⁶⁵ with foreign capital enterprises acting as a major force that is capable of influencing further "pro-business" policy changes.

Having made the decision to invest in Pudong, a foreign investor will need to make another decision: whether to form an equity-based or contractual joint venture, or to simply go ahead and establish a fully foreign-owned enterprise.⁶⁶ Regardless of the corporate form the investor selects, however, the special policies and regulations will be equally applicable.

B. Types of Business

It has been observed that SEZs are more competitive and attractive in terms of business.⁶⁷ Beyond this, it should also be noted that all of the five SEZs in China are creatures of China's economic reform policies.⁶⁸ It follows naturally that the operation of business in those places is policy-oriented.

The same is true of the overall purpose behind the opening up of

⁶² As mentioned in the text above, there is as yet no corporation code in China (one is, however, being drafted). Foreign capital enterprises, therefore, are mostly governed by the three laws listed *supra* notes 59-61.

⁶³ See *Regulations of the Shanghai Municipality for the Encouragement of Foreign Investment in the Pudong New Area*, promulgated by Shanghai Municipal Government on Sept. 10, 1990 [hereinafter *Pudong Regulations*], art. 27, reprinted in *GUIDE TO INVESTMENT IN SHANGHAI*, *supra* note 27, at 117. Actually, article 2 of the *Pudong Regulations* suggests that these three types of enterprises may be established in Pudong.

⁶⁴ In Puxi, the industrial enterprises number as many as 13,000. *GUIDE TO INVESTMENT IN SHANGHAI*, *supra* note 27, at 2. Pudong by 1991 had only about 2,000 industrial enterprises. Gold, *supra* note 32, at 22.

⁶⁵ Preferential treatment is the key factor in attracting foreign investment. See Chen, *supra* note 11, at 61.

⁶⁶ There are both advantages and disadvantages that attach to each of the three types of enterprises; however, discussion of such advantages and disadvantages is beyond the scope of this article.

⁶⁷ See Nee, *supra* note 4, at 1-5.

⁶⁸ See *infra* part IV.

Pudong. Pudong is to be developed into a comprehensive, modern regional industrial base, heavily oriented towards foreign businesses.⁶⁹ With this in mind, the Shanghai government has adopted several principles to guide the development of businesses in Pudong. Basically, these principles mandate that businesses in Pudong must be beneficial to China, and Shanghai in particular, in that they are able to (1) absorb capital and investment, (2) expand international trade, and participate in international labor division and competition, (3) acquire foreign advanced technology and help the development of export industries, (4) further the supplementation, coordination and integration of industries between Pudong and Puxi, and (5) contribute to Shanghai's development into a multi-functional economic, trading and financial center.⁷⁰

In accordance with these principles, the Shanghai government has provided a clearer picture of the types of business enterprises that are encouraged to develop in Pudong.⁷¹ Permissible enterprises need to produce, manufacture or construct energy and transportation facilities,⁷² urban infrastructure facilities,⁷³ or products for export⁷⁴ or advanced technology.⁷⁵ These aims are generally consistent with the content of China's foreign investment law.⁷⁶ Foreign investors in Pudong may be afforded preferential treatment provided their investment projects fall within one of these categories.⁷⁷ Since 1990, Pudong has expanded the scope of these industries to include service businesses in finance, trade,

⁶⁹ See Xiao, *supra* note 41. It has also been noted that China has opened up Pudong apparently hoping to regain for Shanghai its lost status as one of Asia's most important manufacturing centers. See Leung & McGregor, *supra* note 25.

⁷⁰ See *Guidance of Business and Investment of Shanghai Pudong New Area*, ratified by Shanghai Government on Sept. 6, 1990 [hereinafter *Pudong Guidance*], art. 1, *reprinted in* GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 137.

⁷¹ Givant, *supra* note 43, at 30.

⁷² This includes (a) power plants (including transmission facilities and transformers) and integrated thermal supply facilities; (b) industries involved with the development, transportation, storage and processing of oil and natural gas; (c) ports, wharves, warehouses and accessories; and (d) railroads and highways. *Pudong Guidance*, *supra* note 70, art. 2(1).

⁷³ Including (a) gas; (b) water supply and drainage; (c) roads and bridges; (d) postal and telecommunication facilities; and (e) environmental protection facilities such as sewage, etc. *Pudong Guidance*, *supra* note 70, art. 2(2).

⁷⁴ These products include: communication equipment; computers; electronic components and devices; semi-conductor components; precision instruments and meters; precision machinery and high efficiency forging equipment; precision medical and clinic diagnosis equipment; office automation equipment; precision molds; electric motors; automobile parts and components; etc. *Pudong Guidance*, *supra* note 70, art. 2(3).

⁷⁵ *Pudong Regulations*, *supra* note 63, art. 2(1).

⁷⁶ See *Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment*, promulgated by the State Council on September 20, 1983, art. 3, *reprinted in* THE ABC OF INVESTING IN CHINA, *supra* note 59, at 88.

⁷⁷ *Pudong Regulations*, *supra* note 63, art. 25.

real estate, tourism and others.⁷⁸

Although, like the SEZs, Pudong will be economically "special," there remain some constraints on the types of businesses that may be established there. These prohibitions affect industries whose development is restricted or prohibited by the national government's industrial policy, industries that produce substantial amounts of waste and fail to meet environmental protection requirements for waste discharge, and industries engaged in pornographic, obscene or superstitious activities, or that are involved in areas sensitive to Chinese national security, or are detrimental to the economic and social development of the country.⁷⁹

These regulations do not stipulate whether or not a foreign capital enterprise of a type not specifically mentioned in this regulatory scheme will be permitted to operate. However, the implication is that a proposal to establish such an "unmentioned" enterprise would be unlikely to be approved by the responsible government authority.⁸⁰ Nevertheless, the regulations leave open the possibility that the categories of permitted business may change with time.⁸¹ Today's administrative "guidance" may not be the same as tomorrow's.

C. Land Use

Land use rights can be obtained in Pudong for up to seventy years,⁸² and investors may be granted preferential treatment for the development and utilization of tracts of land,⁸³ together with the projects mentioned in Part III.B. of this article, *supra*.⁸⁴

Land use rights have only recently been introduced in China. Unlike the United States and other industrialized countries, the scope of land use rights available to individuals and enterprises in China is limited, similar to the rights of a tenant under a ground lease. There is

⁷⁸ Bai Guo Liang, *Great Support for Pudong Development*, PEOPLE'S DAILY, Jan. 25, 1991, at 1 (overseas Chinese language ed.). Shanghai's development will focus on 10 major sectors: banking, trade, real estate, tourism, telecommunications, steel, petrochemicals, other chemicals, cars and household electrical appliances. Holley, *supra* note 28, at A16.

⁷⁹ Pudong Guidance, *supra* note 70, art. 3.

⁸⁰ Eldon Reiley & Hu Run Fu, *Doing Business in China after Tiananmen Square: The Impact of Chinese Contract Law and the U.N. Convention on Sale of Goods in Sino-American Business Transactions*, 24 U.S.F.L. REV. 25, 34 (1990). Note, however, that the exact term used in the regulations is "encouraged," not "permitted." Therefore, how the responsible government authorities will exercise their discretion remains an open issue.

⁸¹ Givant, *supra* note 43, at 30.

⁸² *Provisions of Land Administration In Shanghai Pudong New Area*, promulgated by Shanghai Government on September 10, 1990 [hereinafter Pudong Land Regulations], art. 7, *reprinted in* GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 128.

⁸³ These are usually referred to as open or undeveloped tracts of land.

⁸⁴ Pudong Regulations, *supra* note 63, art. 2(2).

virtually no private ownership of land in China, as it is owned exclusively by the state in urban areas and by agricultural collectives in the countryside.⁸⁵ The right to use land only vests for a limited time, and is distinct from ownership.

Organizations and individuals that have been able to obtain land use rights, as lessees, may only use and develop the land for a statutory period. This includes the right to acquire certain interests other than ownership interests in the real property.⁸⁶

Prior to its amendment in 1988, Article Ten of China's Constitution provided that "no organization or individual could appropriate, buy, sell, lease land, or in any way unlawfully transfer land" (emphasis added). The same prohibition is found in the China Land Administration Law (the law that governs real property in China)⁸⁷ and the China General Principles of Civil Law (the law that governs general civil matters).⁸⁸ However, prior to the amendment of the constitution these laws were ambiguous as to whether the constitutional prohibition on the "transfer" of land included transfers of the right to utilize land (e.g., by lease). One source of authority which is not ambiguous on this point and expressly prohibits transfers of land use rights is China's equity joint venture regulations,⁸⁹ which govern Chinese-foreign equity joint ventures in China and which are currently being amended. Currently, these regulations still contain language that clearly forbids the transfer of *any* type of land use rights.⁹⁰

Nevertheless, in an apparent effort to further speed up the process of economic reform and the opening up of China to the rest of the world, Article Ten of China's Constitution was amended on April 12, 1988. The amendment deleted the word "lease" from the prohibition on the transfers of real property, and added the following text: "land use rights may be transferred according to law." This constitutional amendment makes it clear that land use rights throughout China are to be treated differently from land ownership and that land use rights are transferrable.

The theory behind this change in constitutional law would appear to be clear. In effect, the amendment tells the world that, although China is

⁸⁵ See XIANFA [Constitution] art. 10 (P.R.C.).

⁸⁶ See *infra* this part.

⁸⁷ Adopted at the 16th Session of the Standing Committee of the 6th NPC on June 25, 1986 and became effective on Jan. 1, 1987 (The author has a copy of this law in Chinese.).

⁸⁸ Adopted at the 4th Session of the 6th NPC on April 12, 1986. 52 LAW & CONTEMP. PROBS. 27 (Spring & Summer 1989).

⁸⁹ See *supra* note 76.

⁹⁰ See *supra* note 76, art. 53.

a socialist country and as such does not recognize private land ownership, land use rights will no longer be a problem for foreign investors who contemplate doing business in China.⁹¹

Furthermore, on May 19, 1990, the State Council promulgated the Administrative Measures on Foreign Investment in and Development and Operation on Tracts of Land (the "Tracts of Land Regulations").⁹² The Tracts of Land Regulations affect only the five SEZs and the fourteen coastal cities.⁹³

Under this change in constitutional and regulatory authority, Pudong Land Regulations permit investors, both foreign and domestic, to obtain land use rights in Pudong,⁹⁴ provided they are acquired with due compensation.⁹⁵ Investors may utilize land that either already houses public utilities or that has remained undeveloped.⁹⁶

After investors develop and construct structures on land in Pudong in accordance with the terms and conditions of a land-use contract, they may transfer, lease and secure the land use rights, or use them in other kinds of economic activities that are permitted by law within the stipulated term.⁹⁷ In addition, portions of tracts may be transferred.⁹⁸ The first reported lease for a piece of land in Pudong was executed in early November of 1991 for a term of fifty years.⁹⁹

⁹¹ It appears unlikely that China will, at any time in the near future, amend its laws to permit private land ownership. Therefore, China's new policies separating land use rights from land ownership are significant changes regarding real property. To foreign investors interested in investing in the comparatively inexpensive land and labor market of China, these are no doubt most welcome changes. It appears that the change has attracted many investors. Jesse Wong & Hongmin Qi, *Land Rush in China Hypnotizes Small Investors of Hong Kong*, WALL ST. J., Sept. 10, 1992, at A10.

⁹² See CHINA CURRENT LAWS, Sept. 1990, at 1.

⁹³ The Tracts of Land Regulations, art. 18. In fact, however, numerous other cities have also permitted use of such tracts of land.

As discussed above, under the Tracts of Land Regulations, both Chinese and foreign investors have rights similar to lessees under a ground lease — although the investors are called "development enterprises," not lessees or developers. After obtaining land use rights from the appropriate governmental agencies, development enterprises are permitted to engage in general development and construction on a large area of land. They may build projects such as drainage, transportation and communication systems, and projects that provide electricity, heat, etc.; and then, upon the completion of these projects, transfer the land use rights in the real property to another party for the operation of public services in the area. Within that area they may also continue to build industrial buildings and other structures with production and service facilities that can be used for various types of industry, and then in turn transfer or lease these structures. *Id.* art. 2.

⁹⁴ Pudong Land Regulations, *supra* note 82, art. 4.

⁹⁵ Pudong Land Regulations, *supra* note 82, art. 3. Foreign investors must pay for such land use rights with foreign currency. *Id.* art. 9.

⁹⁶ Pudong Land Regulations, *supra* note 82, art. 5.

⁹⁷ Pudong Land Regulations, *supra* note 82, art. 6.

⁹⁸ Pudong Land Regulations, *supra* note 82, art. 6.

⁹⁹ Ji Jin Cheng, *A New Step for Pudong Development*, PEOPLE'S DAILY, Nov. 7, 1991, at 1

As stated, land use rights can be obtained in Pudong for varying terms depending on the intended use of the land.¹⁰⁰ The maximum term of a lease for which land-use rights may be granted in Pudong is seventy years.¹⁰¹ This contrasts with Puxi (which belongs to the group of the fourteen coastal cities), where the maximum term can only be fifty years.¹⁰² Upon expiration of the contractual term for land use rights, an investor may apply for a renewal of the term.¹⁰³

It is unlikely that any land use rights that are granted by the authorities in Pudong will include any mineral or other subsurface rights.¹⁰⁴ Although this is not expressly stated in Pudong Land Regulations, it is typical of the land use regulations adopted by the SEZs that no exploration, usage or disturbance of underground resources is permitted without prior approval from the appropriate governmental authorities.¹⁰⁵ Shanghai's regulations specifically provide that underground natural resources, minerals, etc, are not within the scope of either the grant or transfer of land use rights.¹⁰⁶

D. Labor Force

Shanghai's large labor force is comparatively well-trained.¹⁰⁷ Moreover — and this is probably one of the factors which motivates certain

(Chinese language ed.). A lease for a 40-hectare piece of land, the largest tract of land that has so far been leased to a foreign capital enterprise in Pudong, was executed on April 16, 1992. Xiao Guan Gen, *Execution of the Largest Tract of Land Contract for Pudong Development*, PEOPLE'S DAILY, Apr. 17, 1992, at 1 (overseas Chinese language ed.).

However, due to recent real estate development in China in a whole and in Shanghai in particular, it appears that the Shanghai government is concerned with losing control of use of the land in Pudong. *Use of Land in Pudong Seriously out of Control*, THE CHINA PRESS, Nov. 19, 1992, at 2 (in Chinese). It apparently will emphasize projects relating to the service industry and the infrastructure. *Id.*

¹⁰⁰ However, the high price of land deters foreign investment. *Taiwan Businesspersons Hesitate Due To Pudong's High Price For Land*, THE CHINA PRESS, Nov. 18, 1992, at 4 (in Chinese).

¹⁰¹ Pudong Land Regulations, *supra* note 82, art. 7. The 70 year term is applicable to a lease of residential land, while a lease for business is 40 years and one for industries is 50 years. *Id.* The SEZ of Hainan (Island) province also permits lease terms of up to 70 years. See *Provisions of the State Council Of the People's Republic of China for the Encouragement of Investment and Development in Hainan Island*, promulgated on May 4, 1988, art. 6. THE ABC OF INVESTING IN CHINA, *supra* note 59, at 263.

¹⁰² *Measures of Shanghai Municipality on Compensated Transfer of Land Use Rights*, promulgated by Shanghai Government on Nov. 29, 1987, art. 8. LAW & CONTEMP. PROBS., *supra* note 88, at 215.

¹⁰³ *Id.* art. 9.; Pudong Land Regulations, *supra* note 82, art. 10.

¹⁰⁴ There is no particular provision that covers this issue in the Pudong Land Regulations.

¹⁰⁵ See article 6 of the Tracts of Land Regulations, *supra* note 92, at 25.

¹⁰⁶ *Measures of Shanghai Municipality on Compensated Transfer of Land Use Rights*, *supra* note 102, art. 3.

¹⁰⁷ See *supra* part I.

foreign investors to establish enterprises in China — the labor force is also relatively inexpensive when compared to most industrialized countries or even to many Asian countries.¹⁰⁸ However, there are some problems that remain of great concern for foreign investors, such as a “shortage of trained managers and skilled workers.”¹⁰⁹

In Pudong, much like one of the special policies applicable in the SEZs, a foreign capital enterprise is free to create its own organizational structure and personnel system according to its own production and management plan.¹¹⁰ Any personnel needed in the foreign capital enterprises “may”¹¹¹ be recruited from Shanghai.¹¹² Recruitment of personnel from outside Shanghai is also possible, although the approval of the Shanghai Municipal Labor and Personnel Department is required.¹¹³ If the individual recruited by a foreign capital enterprise is already employed by a domestic business or government entity, that entity should assent to the employee’s transfer.¹¹⁴

Foreign capital enterprises in Pudong should execute employment contracts with their employees.¹¹⁵ Normally, these contracts should in-

¹⁰⁸ It has been reported that employing skilled staff in China for inexpensive compensation is much easier than in some other developing Asian countries. *China and Indonesia Loom as Major Labor Exporters*, ASIAN WALL ST. J. WKLY., Mar. 9, 1992, at 23. It has also been noted that “the abundance of low cost, good quality labor” is one of the key factors supporting foreign investment in China. See Joseph Battat, *Foreign Investment in China In The 90s: Developing Trends*, E. ASIAN EXECUTIVE REP., Aug. 1991, at 13.

However, there is a contradictory view that, in China, “while the take-home pay of workers is low by international standards, the various additional costs imposed by labor regulations can drive the price up so that Chinese workers are no less expensive than those of competing Asian countries.” See Nee, *supra* note 4, BOOKLET 3, at 31 (stating that foreign capital enterprises are required to pay subsidies for housing, health care, transportation, food and retirement, in addition to wages).

¹⁰⁹ Cecelia Wagner, *A Survey of Sino-American Joint Ventures: Problems and Outlook For Solutions*, E. ASIAN EXECUTIVE REP., March 1990, at 7. Wagner’s opinion conflicts with Battat’s view that Chinese labor is of good quality. See Battat, *supra* note 108.

Another problem is the “internal guideline to the effect that Chinese counterparts must receive the same basic pay as expatriate staff on the basis of equality.” Nee, *supra* note 4, BOOKLET 3, at 30.

¹¹⁰ Pudong Regulations, *supra* note 63, art. 23.

¹¹¹ The word used in the regulation is properly translated as “may.” However, it should actually be replaced with the word “should,” since most of the personnel in foreign capital enterprises in China are from local areas.

¹¹² Pudong Regulations, *supra* note 58, art. 23.

¹¹³ Pudong Regulations, *supra* note 58, art. 23.

¹¹⁴ Pudong Regulations, *supra* note 58, art. 23. Any dispute arising from such a transfer of personnel is to be subject to arbitration by the Shanghai Municipal Labor and Personnel Department. *Id.*

¹¹⁵ Pudong Regulations, *supra* note 58, art. 23. The Pudong Regulations are silent on the issue of how the employment contract should be executed. In a Chinese-foreign equity joint venture, the contract can be signed between the enterprise and its individual employee or the labor union. See *Measures For Labor Management in Joint Ventures Using Chinese and Foreign Investment*, promulgated by the Labor and Personnel Ministry of China on Jan. 19, 1984 [hereinafter *Measures for*

clude provisions relating to employment, dismissal, remuneration, welfare, occupational safety and worker's insurance.¹¹⁶ In Pudong, the establishment of levels of compensation, forms of payment, rewards, allowances and other similar issues remain within the discretion of the foreign capital enterprises.¹¹⁷ It is required, however, that any employment, recruiting, dismissal or discharge of staff by foreign capital enterprises in Pudong be filed with the Shanghai Municipal Labor and Personnel Department.¹¹⁸

In most regions of China, the operation and management of enterprises are carried out in accordance with the dictates of central or local planning authorities. Furthermore, in virtually all the state-owned enterprises, it is almost impossible to discharge any employee, even for cause. In an area that is not a SEZ, the local authorities must approve any discharge from a foreign capital enterprise.¹¹⁹ Therefore, as far as employment relations are concerned, regulations in Pudong appear to be more liberal than those in any other part of China.¹²⁰

E. Approval

Although China is striving in all possible ways to bring in foreign investment and technology, it seems that many foreign investors do not feel comfortable with the governmental approval process necessary for

Labor Management], art. 5. 2 COLLECTION OF CHINA'S LAWS AND REGULATIONS RELATING TO FOREIGN ECONOMY 880 (1985) (in Chinese).

¹¹⁶ See *Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Investment*, *supra* note 61, art. 12; *Provisions for Labor Management in Joint Ventures Using Chinese and Foreign Investment*, promulgated by the State Council of the People's Republic of China on July 26, 1980 [hereinafter Labor Regulations], art. 2. 2 COLLECTION OF CHINA'S LAWS AND REGULATIONS RELATING TO FOREIGN ECONOMY, *supra* note 115, at 877. The Pudong Regulations are silent on this point.

¹¹⁷ Pudong Regulations, *supra* note 63, art. 24. Article 8 of Labor Regulations, *supra* note 116, provides that the wage standard of the employees of Chinese-foreign equity joint ventures is determined at 120-150 percent of that of state-owned enterprises of the same trade in the locality.

¹¹⁸ Pudong Regulations, *supra* note 63, art. 23. The Pudong Regulations are silent on whether discharge of employees requires approval from the authorities. Labor Regulations, *supra* note 116, article 5, does have such a requirement. The silence in the Pudong Regulations should be considered against the background that few discharges from state-owned enterprises are ever permitted. See *infra* following text.

¹¹⁹ Labor Regulations, *supra* note 116, art. 5. However, article 10 of the Measures for Labor Management, *supra* note 115, provides a similar rule on this point, as do the Pudong Regulations. It is unclear which is superior: the Labor Regulations by the State Council in 1980 or the Measures for Labor Management by the Labor and Personnel Ministry of the State Council in 1984. However, it has been noted that the latter makes the former "unworkable." Nee, *supra* note 108, at 30.

¹²⁰ Note that there are additional employment-related issues which require further clarification. For example, it is unclear whether an employee who is discharged by a foreign capital enterprise is entitled to return to his or her former job with a state-owned enterprise, or to seek another job with a different foreign capital enterprise.

investment in China.¹²¹ To alleviate the concerns of foreign investors, the Shanghai government has adopted certain regulations regarding governmental approval to further improve the business environment and promote work efficiency.¹²² This effort on the part of Shanghai is laudable and represents a challenge to the existing approval system in place in the rest of China.

The Pudong Approval Regulations establish a relatively simple governmental approval procedure, provided that foreign capital enterprises "meet the requirements of the overall planning and investment direction of Pudong."¹²³ First, a foreign capital enterprise must submit a project proposal, a feasibility study report and copies of the proposed contract and articles of association to the responsible governmental authorities.¹²⁴ The possible governmental authorities to approve a new foreign capital enterprise are: (1) the district or county governments of Shanghai;¹²⁵ (2) the Shanghai Foreign Investment Commission;¹²⁶ or (3) the State Council.¹²⁷ Second, after the appropriate authority examines all the required documents and is satisfied that all of the requirements are met, it will issue a certificate of approval.¹²⁸ Finally, when all these necessary steps have been taken, the foreign capital enterprise may apply for an operating license.¹²⁹

¹²¹ Givant, *supra* note 43, at 32.

¹²² See *Examination and Approval Measures of Enterprises with Foreign Capital in Shanghai Pudong New Area*, ratified by the Shanghai government on Sept. 6, 1990 [hereinafter *Pudong Approval Regulations*]; *Preamble*, GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 135.

¹²³ Pudong Approval Regulations, *supra* note 122, art. 1.

¹²⁴ Pudong Approval Regulations, *supra* note 122, art. 3(1)(i), (ii).

¹²⁵ The local governments have authority to examine and approve a non-restricted project with an investment of less than \$5 million dollars. Pudong Approval Regulations, *supra* note 122, art. 2(2).

¹²⁶ The Shanghai Foreign Investment Commission is authorized to examine and approve projects with an investment of \$5-30 million dollars, or a restricted project whose investment is under \$5 million dollars, or exclusively foreign-owned enterprises. Pudong Approval Regulations, *supra* note 122, art. 2(1).

Recently, however, the central government delegated further approval authority to the Shanghai government. This additional authority includes the discretion to approve establishment of enterprises doing entrepot trade in Waigaoqiao and manufacturing projects with an investment of up to \$200 million in Pudong. Xiao Gun Gen, *Central Government Enlarges Shanghai's Authorities in Approval And Raising Fund*, PEOPLE'S DAILY, Mar. 12, 1992, at 1 (overseas Chinese language ed.).

¹²⁷ The State Council, before March 12, 1992, had the authority to examine and approve any manufacturing project with an investment of over \$30 million dollars. Pudong Approval Regulations, *supra* note 122, art. 2(3). However, at this time the State Council probably can only exercise such authority when investment totals over \$200 million. See *supra* note 126.

¹²⁸ Pudong Approval Regulations, *supra* note 122, art. 3(3).

¹²⁹ Pudong Approval Regulations, *supra* note 122, art. 3(1), (4). The Pudong Approval Regulations, however, are silent on how to obtain such a license. Generally speaking, however, an enterprise must register with the administrative bureau for industry and commerce in the jurisdiction where the enterprise will be located.

In contrast to the three-month limitation for examination and approval provided under the Regulations for Chinese-Foreign Equity Joint Ventures,¹³⁰ in Pudong it will be possible to obtain the requisite governmental approval more quickly. If approval is required from the Shanghai government, the documents must be examined and a prognosis given in compliance with the following time constraints: twenty days for the project proposal; thirty days for the feasibility study report, contract and articles of association; seven days for granting of the approval certificate; and fifteen days for issuance of the license.¹³¹

In addition to a comparatively short approval period, government control, as exercised through the approval process, is limited or non-existent in certain other matters. For example, foreign capital enterprises in Pudong do not need to apply for governmental approval to obtain import licenses when they need to import machinery, equipment, etc. (even equipment that is restricted by the state from importation) if the goods are necessary to fulfill their obligations under product export contracts.¹³² These imports are to be supervised and cleared by the Chinese customs authorities based on the enterprise contract or the import-export contract.¹³³

Furthermore, a foreign capital enterprise in Pudong that needs short-term working capital in the course of production and circulation may be given priority in obtaining such a loan, after the examination and approval of the bank with which it has opened an account.¹³⁴

F. Preferential Tax Treatment

The issue of taxation is nearly always a crucial factor that an investor or businessperson must consider before setting up a business enterprise. In the United States, for instance, many people choose an "S" corporation or partnership form to avoid the "double taxation" of corporate revenues and dividends.

In China, manufacturing foreign capital enterprises should pay thirty percent enterprise income tax plus an additional three percent local tax.¹³⁵ However, if such an enterprise is located in one of the coastal

¹³⁰ See *supra* note 76, art. 10.

¹³¹ Pudong Approval Regulations, *supra* note 122, art. 3(4). This implies, however, that when the State Council is to be the authority for approval, the process will not be simplified and expedited.

¹³² Pudong Regulations, *supra* note 63, art. 19.

¹³³ Pudong Regulations, *supra* note 63, art. 19.

¹³⁴ Pudong Regulations, *supra* note 63, art. 21.

¹³⁵ *Income Tax Law of People's Republic of China Concerning Enterprises with Foreign Capital and Foreign Enterprises*, adopted at the 4th Session of the 7th NPC on April 9, 1991, and effective on

cities, it pays enterprise income tax at a rate of twenty-four percent.¹³⁶ In a SEZ, it pays only fifteen percent.¹³⁷

Pudong incorporates the same fifteen percent tax rate of the SEZs.¹³⁸ Moreover, as is the case elsewhere in China, manufacturing enterprises in Pudong with operations of over ten years may be exempt from enterprise income tax in the first and the second years after the enterprises become profitable and are entitled to a fifty percent reduction from the third through the fifth profitable years.¹³⁹ In addition, foreign capital enterprises in Pudong "will be completely exempt from local income tax until the end of the year of 2000."¹⁴⁰ Finally, foreign capital enterprises in Pudong that engage in airport, port, railway, highway, power station and other energy resource or transportation construction projects may also enjoy the same 15 percent tax rate.¹⁴¹ And those enterprises with a period of operation over 15 years may be exempt from income tax starting from the first profit-making year for five years, and enjoy a 50 percent reduction from the sixth to the tenth profitable years.¹⁴²

The foreign party to a Chinese-foreign joint venture located in Pudong may remit its share of profits made from operation of the enterprise outside China, and is exempt from the tax that would ordinarily be levied on such remittance.¹⁴³ A foreign capital enterprise also enjoys cer-

July 1, 1991, art. 5 [hereinafter Foreign Enterprises Tax Law], reprinted in PEOPLE'S DAILY, Apr. 17, 1991, at 3 (overseas Chinese language ed.).

¹³⁶ *Id.* art. 7.

¹³⁷ *Id.*

¹³⁸ Pudong Regulations, *supra* note 63, art. 5.

¹³⁹ Pudong Regulations, *supra* note 63, art. 5; Foreign Enterprises Tax Law, *supra* note 135, art. 8. In accordance with national regulations, when the period of such an exemption expires, the enterprises with foreign capital in Pudong that export products with annual value of over 70 percent of their total annual production may pay at a reduced rate of 10 percent of the enterprise income tax. Pudong Regulations, *supra* note 63, art. 5. Also, enterprises with advanced technology may pay the tax with a reduced rate of 10 percent for another three years beyond the exemption expiration date. *Id.*

¹⁴⁰ Pudong Regulations, *supra* note 63, art. 12.

¹⁴¹ Pudong Regulations, *supra* note 63, art. 5.

¹⁴² Pudong Regulations, *supra* note 63, art. 5; *Income Tax Regulations of the People's Republic of China Concerning Enterprises with Foreign Capital and Foreign Enterprises*, art. 75(3) [hereinafter Foreign Enterprises Tax Regulations], reprinted in PEOPLE'S DAILY, July 2 and 3, 1991, at 3.

¹⁴³ Pudong Regulations, *supra* note 63, art. 10. This statement is, however, merely the author's interpretation of article 10, which is not at all clear as to whether the foreign party to such a joint venture would not have to pay any tax on the remitted amount after having paid the enterprise income tax, or whether such party simply does not need to pay enterprise income tax at all for the remitted amount. However, the latter interpretation could not realistically be what the legislators had intended, since most foreign investors would like to remit their profits outside China; foreign investors would not have to pay any income tax at all if such was the case.

tain other preferential tax treatments.¹⁴⁴ By contrast, in other parts of China, a foreign party to such a joint venture would probably have to pay a 10 percent tax on the remitted amount.¹⁴⁵

G. Banks and Other Financial Institutions

One of the major characteristics of the SEZs that distinguish them from the rest of China is that of the state's special policies allowing the establishment of foreign capital banks.¹⁴⁶ Pudong New Area, like the five SEZs, enjoys the same special policy which permits the establishment of such banks within its territory.¹⁴⁷

In discussing this aspect of Pudong's development, it is important to keep in mind that foreign capital banks or financial institutions were not a well-known concept to the Chinese people ten years ago during the early years of economic reform.¹⁴⁸ Although there had been four foreign bank branches in Shanghai since 1949,¹⁴⁹ foreign capital banks were not permitted to be established in the SEZs until some time approaching 1985.¹⁵⁰

¹⁴⁴ Pudong Regulations, *supra* note 63, arts. 5-18.

¹⁴⁵ See article 4 of *Income Tax Law of the People's Republic of China Concerning Joint Ventures Using Chinese and Foreign Investment*, adopted at the 3rd Session of the 5th NPC and promulgated on Sept. 10, 1980, reprinted in *THE ABC OF INVESTING IN CHINA*, *supra* note 59, at 195, which was replaced by the Foreign Enterprises Tax Law, *supra* note 135, on July 1, 1991. Note, however, that the Foreign Enterprises Tax Law is silent on this point.

¹⁴⁶ See *Shanghai Eases Its Curbs On Foreign Banks' Branches*, WALL ST. J., Sept. 11, 1990, at A16; *Regulations Governing Foreign Banks and Joint Chinese-Foreign Banks in Special Economic Zones of the People's Republic of China*, promulgated by the State Council on April 2, 1985 [hereinafter *Banking Regulations of the SEZs*]; Nee, *supra* note 4, at 39.

However, the State Council recently permitted establishment of foreign capital banks in seven other cities: Dalian, Tianjin, Qingdao, Nanjing, Ningbo, Fuzhou, and Guangzhou. *China's 7 Cities Permit Establishment of Foreign Capital Bank*, THE CHINA PRESS, Aug. 26, 1992, at 4 (in Chinese).

Therefore, "lured by strong business prospects as China pushes ahead with economic reform, many banks are looking to expand their branch networks in the country. Foreign lending to China, which has recovered fully from the post-Tiananmen retreat, is rising along with soaring foreign direct investment." Julia Leung, *Foreign Banks Renew Interest in China, Ending Hiatus After Tiananmen Uproar*, WALL ST. J., Aug. 4, 1992, at A7.

¹⁴⁷ See *Regulations for Administration of Financial Institutions with Foreign Capital and Financial Institutions with Chinese and Foreign Joint Capital in Shanghai*, promulgated by the People's Bank of China on Sept. 8, 1990 [hereinafter *Financial Regulations*], GUIDE TO INVESTMENT IN SHANGHAI, *supra* note 27, at 97, which govern the approval, regulation and supervision of banks with foreign investment. Yet, joint venture banks and foreign banks in Shanghai will only be allowed to do business in foreign currency. Reuters, *supra* note 26; Leung & McGregor, *supra* note 25.

¹⁴⁸ Liu Yan, *The Activity of Banks with Foreign Investment in China*, PEOPLE'S DAILY, Apr. 3, 1991, at 3 (overseas Chinese language ed.).

¹⁴⁹ See Mark Baker et al., *Foreign Banks in China*, 6 CHINA L. REP. 87, 89 (1990). However, these four banks were permitted to do foreign currency transactions only. *Banks of the Yangtze*, CHINA TRADE REP., Apr. 1990, at 6.

¹⁵⁰ That year, the Banking Regulations of the SEZs were promulgated. See *supra* note 146.

Pudong also permits the establishment of "foreign banks,"¹⁵¹ foreign bank branches,¹⁵² and joint Chinese and foreign capital banks.¹⁵³ As in many other countries, however, banks and financial institutions — as well as banks with foreign investments — are heavily regulated by government authorities.¹⁵⁴ While there are as yet no private banks in China, it appears that the existing regulations will probably form the basis for regulation of private banks when and if they are established in the future.

Foreign capital banks in Pudong are also entitled to preferential tax treatment. Such a bank that has invested an amount of over ten million dollars, for a business period of over ten years during which the invested amount is not drawn down, is entitled to pay the enterprise income tax at

¹⁵¹ These are banks that are formed exclusively with foreign capital. The requirements for establishing such an institution are: (1) the investor should be a financial institution; (2) it should have had a representative office of over three years' standing inside China; and (3) it should have total assets of over \$10 billion dollars at the end of the year prior to the application for such establishment. Financial Regulations, *supra* note 147, art. 5.

An application for establishment of a foreign bank in Pudong should be accompanied by the following documents and information: (1) name of the foreign bank, registered capital and actually paid-in capital and proposed types of business transactions; (2) feasibility study report; (3) financial statements of the investor(s), for the last three years prior to its application; (4) draft articles of association; (5) a copy of the business license of the investor(s) approved and issued by the competent authorities of its home country; and (6) any other documents and information required by the People's Bank of China. Financial Regulations, *supra* note 147, art. 8.

¹⁵² The requirements are: (1) the bank should have had a representative office of over three years' standing inside China; (2) it should have total assets of over \$20 billion dollars at the end of the year prior to the application for such establishment; and (3) its home country or region should have a sound financial supervising system. Financial Regulations, *supra* note 147, art. 6.

An establishment of a foreign bank branch needs the following information and documents: (1) an application signed by the chairman or general manager of the foreign bank, including the name of the branch, amount of operating funds approved and assigned by the foreign bank and the proposed types of business transactions; (2) annual reports for the last three years prior to the application; (3) a copy of the business license of the foreign bank approved and issued by the competent authorities of its home country; and (4) any other documents and information required by the People's Bank of China. Financial Regulations, *supra* note 147, art. 9.

¹⁵³ The requirements are that each investing party should be a financial institution, and that the foreign investor should have a representative office inside China. Financial Regulations, *supra* note 147, art. 7.

Establishment of a bank with joint Chinese and foreign capital in Pudong requires: (1) an application, including the name of the bank to be established, the names of each investing party, registered capital and actual amount of paid-in capital, ratio of the contributions of the parties and proposed types of business transactions; (2) a feasibility study report jointly prepared by the parties to the bank; (3) the agreement, contract and draft articles of association of the bank to be established; (4) financial statements of each party to the bank for the last three years prior to the application; (5) copies of business licenses of each party to the bank approved and issued by the competent authorities of each party's home country; and (6) any other documents and information required by the People's Bank of China. Financial Regulations, *supra* note 147, art. 10.

¹⁵⁴ See Financial Regulations, *supra* note 147. For further restrictions on foreign capital banks in China, see Baker et al., *supra* note 149.

a reduced rate of only fifteen percent and be exempt from this tax entirely in its first profit-making year, paying fifty percent reduced tax for the second and third profitable years.¹⁵⁵

A recent exciting development which further demonstrates Pudong is both economically and financially special is that Shanghai, along with Shenzhen, is allowed to issue securities directly to foreign investors.¹⁵⁶ Trading is conducted through Chinese and Hong Kong brokerage houses.¹⁵⁷ It appears that the new development may be well-rooted and enlarged in the future,¹⁵⁸ although it remains to be seen how well it will further proceed.¹⁵⁹

IV. SUGGESTIONS AND OBSERVATIONS

As discussed above, Pudong New Area enjoys some of the same preferential policies that the Chinese central government has instituted in the SEZs to attract foreign investment and technology. Although not officially a SEZ yet,¹⁶⁰ it appears that Pudong will for all intents and

¹⁵⁵ Pudong Regulations, *supra* note 63, art. 7. By August of 1992, twelve foreign banks had established branches in Shanghai. Leung & McGregor, *supra* note 25.

¹⁵⁶ *Foreigners Trade Chinese Stock*, WALL ST. J., Feb. 24, 1992, at A10. On February 21, 1992, for the first time in China's history since 1949, Shanghai offered to sell 100 yuan worth of Type B stock to foreign investors in its exchange. Xia Ru Ge, *Shanghai Is Open in All Aspects*, PEOPLE'S DAILY, Mar. 4, 1992, at 1 (overseas Chinese language ed.).

There are two types of stock in China's securities market thus far: Type A stock, which is exclusively issued to local Chinese, and Type B stock which is for foreign investors. The two parallel markets are to remain wholly independent of each other. Duckworth, *supra* note 4.

¹⁵⁷ *Foreigners Trade Chinese Stock*, *supra* note 156. However, Merrill Lynch & Co. has been named lead underwriter for a Chinese company for listing in Hong Kong and China. *Merrill Lynch Named As Lead Underwriter For Chinese Offering*, WALL ST. J., Jan. 11, 1993, at A7C.

Up to early 1993 around 18 companies' B-shares are listed on China's two exchanges, Shanghai and Shenzhen. *China to Allow More Firms To Publicly Issue Securities*, WALL ST. J., Jan. 4, 1993, at C15.

¹⁵⁸ China's senior leader Deng Xiao Ping specifically praised the stock markets in the two exchanges and was quoted as saying "if capitalism has something good, then socialism should bring it over and use it." *Deng Presses Chinese to Return to the Path of Economic Reform*, WALL ST. J., Jan. 29, 1992, at A10.

"Average daily transactions on Shanghai's [stock] market in the week ending Feb. 12 reached a record \$250 million at official exchange rates. This is nearly as much volume as on a reasonably slow day in the Hong Kong Market." Wu Dunn, *supra* note 5. And China's securities law is in the final drafting stage and will be likely to be passed very soon. Kathy Chen, *China Is Drafting a Securities Law; Plan Is Lauded, but Doubts Are Raised*, WALL ST. J., Mar. 15, 1993, at A9H.

¹⁵⁹ There exist contrasting views as to the significance attending the issuance of Type B stock. Duckworth, *supra* note 4. However, one Chinese company's stock has been listed on the New York Stock Exchange, Wu Dunn, *supra* note 5, and nine others are planning to be listed in Hong Kong. *Nine Chinese Enterprises Plan To Sell Stock In Hong Kong*, THE CHINA PRESS, Feb. 12, 1992, at 4 (in Chinese).

¹⁶⁰ Neither the Chinese central government nor the Shanghai government has announced officially that Pudong is a SEZ.

purposes become a *de facto* SEZ.¹⁶¹ It seems clear that Chinese authorities hope this status will attract investors to come to Pudong and Shanghai, and that Pudong's development will become increasingly important to modern China and its economic reform.¹⁶²

However, some observations and suggestions on the development of Pudong and its special policies would appear to be in order. While some of these observations and suggestions may not directly relate to Pudong, Pudong is nevertheless a useful point of reference from which to address certain issues that are important to the continued success of modern Chinese economic reform.

First, there has yet to be any legislative action approving Pudong as a SEZ.¹⁶³ The establishment of each of the five SEZs was mandated and ratified by the NPC.¹⁶⁴ In contrast, the opening up of Pudong and the application to it of some of the special policies previously available only in the SEZs were brought about by nothing more than an announcement made in Shanghai by Chinese Prime Minister Li Peng, on behalf of the State Council and the Communist Party Central Committee.¹⁶⁵ Whether or not Pudong will ever be a *de jure* SEZ, legislative recognition of its position is probably desirable, at the very least, in order to assure the most cautious of investors and businesspeople of Pudong's future as a business center.

The different type of recognition that Pudong has so far received may also lead to distinctive impacts on the development of Pudong. Investors know that Shanghai, and Pudong, will be unique. But how so? It seems probable that investors will not really know until they have had the opportunity to fully understand and test the merits of Pudong's regulatory regime. They will be able to do this in two ways: through comparison with regulations applicable to the SEZs, and by actually attempting to set up business in Pudong. This process of examination and testing

¹⁶¹ Indeed, a Shanghai official once said that Pudong is more special than any of the five SEZs. Xiao Guan Gen, *Pace of Shanghai Pudong New Area Development Becomes Hastened*, PEOPLE'S DAILY, Mar. 10, 1992, at 1 (overseas Chinese language ed.).

¹⁶² However, it has been noted that foreign investors have not rushed to invest in Pudong, "opting instead to pour money into southern China or other parts of Shanghai." See Elizabeth Cheng, *Balancing Act: Shanghai's Pudong Project Gets A Boost*, FAR E. ECON. REV., Mar. 26, 1992, at 61.

¹⁶³ The NPC merely approved the plan to develop Pudong in the spring of 1991 and designated it a key state-level project for the 1990s. See *Pudong on the March*, *supra* note 49, at 25.

¹⁶⁴ For example, the NPC officially ratified Shenzhen, Zhuhai and Shantou as SEZs with the *Resolution on Ratification of "Special Economic Zones Provisions of Guangdong Province"* by the Standing Committee of NPC, adopted at the 15th Session of the Standing Committee of the 5th NPC on August 26, 1980, reprinted in COLLECTION OF LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 221 (1984) (in Chinese).

¹⁶⁵ See Xiao, *supra* note 41.

will more likely than not delay many investors' decisions on investment in Pudong. This is certainly not what the people in Shanghai want to see.

Second, although Pudong's various preferential policies will provide an incentive to investors, they may also present some potential problems. Pudong, like the five SEZs, benefits from preferential policies adopted by the central government that are not available in the rest of China. Moreover, it is true that in the last ten years, the five SEZs have generally achieved some success; it is probably also true that through enjoyment of similar "special policies," the development of Pudong will be likely to proceed well. However, the success in SEZs did not come naturally, and will not do so in Pudong either; it will apparently come only as a result of special government policies.¹⁶⁶ Thus, to a certain extent, success will only be possible — and visible — at the expense of other parts of China which are not entitled to any preferential policies, although this is not at all what has been intended by the Chinese government.

Many foreigners planning to invest in China usually do not have a specific location in mind unless and until they have some contact with local Chinese officials and some assurance that their investment will be encouraged. Otherwise, there would seem to be no doubt that foreign investors would like to do business in a location where they are entitled to enjoy preferential treatment. Most foreign investors seem to come to the SEZs — and will probably go to Pudong — rather than other parts of China, largely because of the special policies applicable in these areas.

Another inherent potential problem is that the special policies may lead to a situation where the legal protection accorded to employees in different parts of China vary greatly. As discussed above, most of the enterprises in the SEZs are foreign capital enterprises, to which special laws and regulations pertaining to employment are applicable. As a consequence, Chinese employees of foreign capital enterprises in the SEZs have legal rights that are different from employees of the state-owned enterprises throughout the rest of China, and different even from those who are employed in foreign capital enterprises that are not located in the SEZs — whether these rights and protection provide for relatively better or worse conditions.¹⁶⁷

Similarly, the special policies may also lead to the development of a form of unfair competition within China. Products and technology from

¹⁶⁶ For example, it has been acknowledged that one of Shenzhen's advantages in economic reform is the very existence of its "special" policies. See Peng & Zhang, *Ten Advantages That Economic Reform and Open Door Policy Have Brought to Shenzhen*, PEOPLE'S DAILY, Oct. 30, 1991, at 3 (overseas Chinese language ed.).

¹⁶⁷ See *supra* part III.D.

the foreign capital enterprises in the SEZs are almost certain to be superior to those produced elsewhere in China, due to the greater availability of investment funds and increased know-how. The preferential policies encourage foreign capital and advanced technology to flow mainly to the "special" areas. Accordingly, the foreign capital enterprises and technology of the SEZs may easily overpower their state-owned competitors in the market place.

The special policies may in addition lead to destructive regionalism or localism. The undertaking of economic reform with different policies applicable to different parts of China has enlarged the gaps in attitudes and living standards that exist among the Chinese people.¹⁶⁸ Those parts of China which do not benefit from the special policy regimes will not be able to develop as fast as the areas so empowered and will not have the same incentives to cooperate in the national or central scheme of economic reform.¹⁶⁹

Thus, it will be interesting to observe the attitudes of the people in places like Pudong towards the nature and pace of development in the rest of China. The SEZs may be positive role models in leading to the development of other parts of China, but there is the possibility that they may become a root cause of regionalism, which, after many centuries of bitter experience, few Chinese people want to see again threaten their nation.

Furthermore, SEZ-type development is very costly.¹⁷⁰ It has been extremely expensive to establish the necessary infrastructure for the desired industrial and high-tech investments in the SEZs, and such infrastructure has yet to meet China's complete satisfaction.¹⁷¹ And in

¹⁶⁸ "There exists not one but many 'Chinas.'" Gregory C. Wajnowski & Stanley B. Lubman, *A Legal Opinion*, CHINA TRADE REP., Jan. 1990, at 7.

¹⁶⁹ It has been reported that recent events suggest the onset of regionalism has already begun in earnest. The gap that is developing is particularly broad between coastal areas and landlocked provinces. See generally Robert Delfs, *Saying No to Peking*, FAR E. ECON. REV., Apr. 4, 1991, at 21-30.

¹⁷⁰ Development of Pudong is a \$10-billion project. *A \$10-billion Living Laboratory in China*, *supra* note 48. Some outsiders are skeptical of its chances for success. Gold, *supra* note 32, at 22.

The central government originally committed 6.5 billion *yuan* (\$1.4 billion) to Pudong through 1995, while Shanghai aims to invest 1 billion *yuan* annually until the end of the decade. Gold, *supra* note 32, at 26. Now, the central government has increased the allocations by more than a third to 300 million *yuan* (\$54.8 million) a year to Pudong, and Shanghai will be allowed to issue 500 million *yuan* worth of bonds and \$100 million worth of Type B stocks each year. Xiao, *supra* note 126; *Shanghai Targeted as Boomtown*, *supra* note 46.

¹⁷¹ See Nee, *supra* note 4, at 4. It has also been reported that both Chinese officials and foreign investors say that the development of Pudong could initially do more harm than good to Shanghai industries. Leung & McGregor, *supra* note 25.

However, lack of infrastructure is the major disadvantage of Pudong at this time, although water and power supplies are currently sufficient. *Positive on Pudong*, *supra* note 33. Foreign investors generally will not invest in an area without an established infrastructure; yet, without foreign

certain of the SEZs, some of the same types of corruption that have plagued Hong Kong and Macao has surfaced.¹⁷²

This does not necessarily mean, however, that the special policies are undesirable, or that the outcome of the economic reform process will necessarily be harmful and unpleasant. To the contrary, most people in China support such policies and few people want to see the process of reform stopped.¹⁷³ However, the problems that result from this will have to be resolved. One suggestion is that until most people and parts of China "catch up," i.e., equally enjoy the same "special" policies, economic reform cannot be deemed successful. The reasoning here is that the whole undertaking of economic reform should benefit the entire nation, not just certain well-placed areas. Therefore, logically, to speed up and carry through the economic reform, the "special" policies should sooner or later be applied across the board to the rest of China.

The third point which needs to be observed at this juncture is that the nature of the relationship between Pudong and the five SEZs is also unclear.¹⁷⁴ In the 1980s, the SEZs played a very important role in the economic reform process in China. Pudong will probably begin to develop in earnest in the 1990s and in the next century.¹⁷⁵ This development will not be a problem if enough foreign investors come to China to meet China's needs. However, what will the consequences be if there is competition for foreign investment?¹⁷⁶ The five SEZs obviously need further development. Fair competition is the ideal, but special economic policies unequally applicable between the SEZs and Pudong could create difficulties.¹⁷⁷

investment, the infrastructure cannot become established. Gold, *supra* note 32, at 29. Therefore, the Shanghai government is counting on infrastructure improvements. In November 1991, the \$150 million Nanpu Bridge was opened, connecting Puxi and Pudong, and in addition, "the 25-km-long Yanggao Road that runs through Pudong is being expanded into a six-lane highway at a cost of nearly \$100 million[US]." Cheng, *supra* note 43, at 61.

¹⁷² See Nee, *supra* note 4, at 4-5.

¹⁷³ Deng Xiao Ping recently traveled to the south of the country and called for further development of the SEZs. See *Deng Presses Chinese to Return To the Path of Economic Reform*, *supra* note 158.

¹⁷⁴ It has been observed that the opening up and development of Pudong can be seen as a counterbalance to the five SEZs. See Gold, *supra* note 32, at 32; Abrams, *supra* note 48, at col. 2.

¹⁷⁵ While acknowledging that China's open door policy has focused on the five SEZs, Shanghai officials have said that, with the development of Pudong, China will focus on the Yantze River region. *Pudong on the March*, *supra* note 49; Xiao, *supra* note 161. It will thus draw select foreign business activity from south to central China. Gold, *supra* note 32, at 22.

¹⁷⁶ It has been noted that some Pudong officials fear that the SEZs will try to use their influences to obtain permission from the central government to provide incentive packages more favorable than Pudong's. See Gold, *supra* note 32, at 29.

¹⁷⁷ A Shanghai official once said that Pudong benefits from all the preferential policies applicable to the five SEZs; and, moreover, Pudong enjoys some special policies that are not applicable in the

Fourth, it remains to be seen what kind of a relationship will develop between Shanghai and Hong Kong after the British colony's return to China in 1997. If Pudong develops as planned, Shanghai will no doubt become the financial and commercial (in addition to industrial) center of China.¹⁷⁸ Hong Kong is also a financial and commercial city, and will probably continue to be even after its return to China.¹⁷⁹ Yet, the two are not that far from each other geographically and it remains to be seen whether both can survive in such proximity to each other.¹⁸⁰ Absent unusual political repercussions, the developing relations and relationship between Shanghai and Hong Kong should prove to be of great interest and may have an impact — hopefully a positive one — in terms of Pudong, the five SEZs and the fourteen coastal cities generally.

Fifth, the relationship that develops between Puxi and Pudong will also prove to be of great interest. Unlike many of the SEZs that were established in rural areas, Pudong — despite its relative under-development — is a part of the Shanghai metropolis and is physically the same size as Puxi. Shanghai, i.e., Puxi, is already one of China's industrial and commercial centers. While individuals and enterprises in Puxi should cooperate in the development of Pudong, it is unlikely that Pudong's development was intended to take place at the expense of Puxi.

Sixth, as has been noted throughout this article, there are numerous gaps and silences within the various regulations applicable to Pudong. Investors would doubtless welcome clearer policies. More specifically, explicit guidance as to whether a foreign party to a Chinese-foreign equity joint venture should pay any tax on the amount of remitted profits outside China is desirable and would be beneficial to the Shanghai government.

Seventh, one of the most important factors for an investor in doing business in Pudong will likely be the simplified governmental approval process. However, it appears that Pudong's simplified procedures only apply to approvals required by the Shanghai local governments,¹⁸¹ not to those by the State Council, which is the body that has sole authority to

SEZs — therefore, Pudong is more "special" than any of the five special economic zones. Xiao, *supra* note 161.

¹⁷⁸ This is the Shanghai government's plan. *Huang Jun Represent the Goal for Pudong's Next 20 Years*, THE CHINA PRESS, Dec. 2, 1992, at 1 (in Chinese).

¹⁷⁹ It is said that the big threat to "Hong Kong's status in the world may come from the possibility that Shanghai just might succeed." Holley, *supra* note 28, at 16.

¹⁸⁰ Pudong (or Shanghai) is seen as a rival to Hong Kong. See *A \$10-Billion Living Laboratory in China*, *supra* note 48.

¹⁸¹ Shanghai, like many other big cities in China, is divided into several districts. Pudong itself, as discussed earlier, is divided into five sub-districts. Each district or sub-district, depending on the amount and type of investment, may also have authority to approve certain investments.

examine and approve larger amounts of investment in Pudong.¹⁸² There is always the possibility that more substantial foreign investment in Pudong could be lost if foreign investors shy away from all but the simplified governmental approval procedures.¹⁸³

Eighth, the potentially greatest obstruction to foreign investment in Pudong, and probably anywhere else in China, is China's foreign exchange control policy which prohibits Chinese yuan from being freely convertible into foreign currency. Although the Chinese government is currently tackling this problem,¹⁸⁴ no clear solution appears likely in the near future.

Ninth, supervision and enforcement of actual foreign investment is necessary. Since foreign capital enterprises in China enjoy certain types of special tax treatments as discussed above, many Chinese companies have established such enterprises with China's offshore holding companies,¹⁸⁵ and some others do not even seek commitment of overseas investors at all.¹⁸⁶ Local officials may try to please their superiors by counting vague letters of intent signed by foreign investors as "contracts" when compiling statistics.¹⁸⁷ Thus, a lot of improvement needs to be made in calculations of actual non-Chinese investment.¹⁸⁸

Finally, and outside the scope of this article, improvement of China's overall foreign investment and business climate and stabilization of its foreign investment policy have become more urgent in the 1990s.¹⁸⁹

¹⁸² See *supra* note 127.

¹⁸³ Indeed, it appears Shanghai will have to simplify and shorten contract negotiation and approval procedures. See Givant, *supra* note 43, at 32.

¹⁸⁴ China has established several swapping centers in the SEZs where foreign capital enterprises can buy and sell foreign funds at floating rates. Julia Leung, *Chinese Officials Signal They Are Prepared To Revive Experiment in Wider Stock Trading*, WALL ST. J., Apr. 11, 1991, at A10. For a detailed discussion of swap centers in China, see Hiram E. Chodosh, *Swap Centers in the People's Republic of China: A Step Toward Partial Convertibility of Local Currency*, 25 INT'L LAW. 415 (1991).

¹⁸⁵ James McGregor, *Investment Is Pouring Into China, But Beware the Penchant for Hype*, WALL ST. J., Nov. 25, 1992, at A10. There are about 4,000 such overseas companies in total. Zhang, *supra* note 7.

¹⁸⁶ See *Serious Problem for Foreign Investors' Failure to Invest On Time*, THE CHINA PRESS, Feb. 26, 1993, at 10 (in Chinese).

¹⁸⁷ McGregor, *supra* note 185.

¹⁸⁸ That is probably why it is reported that "the Chinese data can be deceptive in that they include huge sums of Chinese domestic investment masquerading as foreign investment." Wu Dunn, *supra* note 5.

¹⁸⁹ Battat, *supra* note 108, at 11. Surveys reveal additional problems such as souring materials, poor quality control, difficulties in exporting goods, and cash shortages. Wagner, *supra* note 109, at 8-10.

However, the American Chamber of Commerce indicates that the investment climate in China has improved significantly. *Investment In Hong Kong, China*, WALL ST. J., June 10, 1992, at A10. China is seen by some as the best investment environment in the world. Wu Dunn, *supra* note 5.

V. CONCLUSION

Despite certain present and potential difficulties, as well as other questions that have been pointed out in part IV of this article, the process of modern economic reform in China has been proceeding very well¹⁹⁰ and will likely continue to do so in the future.¹⁹¹ Pudong New Area appears destined to become a distinct new "special" economic area and this status will add more fuel to the continuing process of China's economic reform.¹⁹² Although Pudong has not been designated a SEZ yet, it already possesses all of the unique characteristics of the five SEZs.¹⁹³ Accordingly, Pudong would appear to be at least equally as attractive to foreign investors as the SEZs.

With the help of huge and "open" tracts of land, a natural coastal line, the well-trained work force of neighboring Puxi, as well as the advantage of proximity to metropolitan Shanghai — and, especially, the favorable policies applicable only to SEZs — Pudong's future seems no worse than those of the SEZs.¹⁹⁴

Furthermore, China now no longer requires foreign capital enterprises to export most of what they make; instead they can sell their products in China. McGregor, *supra* note 3.

Despite these considerations, "China remains a difficult place for foreigners to do business." Sheryl Wu Dunn, *For Foreigners, Pitfalls Abound*, N.Y. TIMES, Feb. 15, 1993, at A6 (reporting problems of transportation, unsophisticated banking and financing, friction with Chinese partners, and hidden costs in China).

¹⁹⁰ See *supra* notes 4-7. China has engaged in opening in all directions. *China Is Open In All Directions*, PEOPLE'S DAILY, Oct. 8, 1992, at 1 (overseas Chinese language ed.). Many formerly-restricted areas are now also open. See James McGregor, *China to Open Oil Frontier to Foreigners*, WALL ST. J., Feb. 18, 1993, at A13; James McGregor & John J. Keller, *AT&T, China Set Broad Pact On Phones, Gear*, WALL ST. J., Feb. 24, 1993, at A3; *China Widens Door to Retailers*, WALL ST. J., Jan. 28, 1993, at A10; Xu Ke Hong & Wang Yan Rong, *China Will Permit Use Of Foreign Capital To Build Railroad*, PEOPLE'S DAILY, July 16, 1992, at 1 (overseas Chinese language ed.).

¹⁹¹ This is very well evidenced by China's Constitution which was amended in March of 1993 and stresses adherence to economic reform. Kristof, *supra* note 13. Chinese officials indicated that China no longer treats capitalism as a "dirty word," and China has begun to further the process of economic reform by planning to "break the three irons," which include the iron ice bowl (guaranteed employment for workers), the iron chair (guaranteed posts for managers) and the iron salary (the guarantee that wages will not be cut). McGregor, *supra* note 12. Further, China is seen as being rapidly integrated into the world economy. Wu Dunn, *supra* note 5.

¹⁹² Pudong's development is significant simply because it is the first time that the Chinese central government has allowed the development of a large, economically special area in the center of China's industrial base. See Gold, *supra* note 32, at 23; David Holley, *Market Scene: Transfusing Life Into A Stagnant Shanghai*, L.A. TIMES, Sept. 11, 1990, at H5.

¹⁹³ See Xiao, *supra* note 161.

¹⁹⁴ Based on its experiences thus far, E.I. Du Pont de Nemours & Co. would encourage other foreign companies to invest in Pudong. *Positive on Pudong*, *supra* note 33. Today's Pudong already looks like a huge construction site. *Shanghai Uses Market System To Accelerate Development Of Pudong*, THE CHINA PRESS, Jan. 21, 1993, at 4 (in Chinese). It is reported that China's senior leader Deng Xiao Ping once said that it was his biggest mistake not to include Shanghai among the SEZs established in 1980. Holley, *supra* note 28.