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Darryll K. Jones

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THE NEGLECTED ROLE OF INTERNATIONAL ALTRUISTIC INVESTMENT IN THE CHINESE TRANSITION ECONOMY

DARRYLL K. JONES*

I. OVERVIEW

Altruistic investment occurs when individuals make gifts and donations, and when they engage in collective activities funded by gifts and donations for the direct benefit of others, without regard to immediate personal profit in the more classic sense of the word.¹ Charitable contributions and charitable organizations, for example, embody the notion of altruistic investment. Altruistic organizations are referred to by many names, including “nonprofit organizations,” “charities,” and “nongovernmental organizations.”

* Associate Dean and Associate Professor of Law, University of Pittsburgh School of Law. B.S., J.D., LL.M. University of Florida. Professor Jones is a member of the Florida Bar and is former Chair of the Tax Section, National Association of College and University Attorneys.

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1. The term “altruistic investment” is derived primarily from the writings of four authors. First, Professor Hansman’s seminal articles take an economic, rational person view of the reasons why people make gifts and donations to charities. See Henry B. Hansman, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Tax*, 91 YALE L.J. 835 (1981); Henry B. Hansman, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980). In general, Hansman views a person who makes a donation or otherwise patronizes a nonprofit organization as actually purchasing something – usually a public good – that is not reliably available from the normal market place. Professor Atkinson takes a more philosophical view and thinks that gifts and donations, and organizations typically referred to as charitable, are made and exist, respectively, as expressions of individual and collective altruism, though he acknowledges that individuals and collectives receive something other than classic “profit” for their activities. See Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501 (1990). Professors Colombo and Hall’s preferred definition of a charitable organization is one whose income is derived primarily from persons who receive no immediate financial *quid pro quo* from their transfer of wealth, although they too acknowledge that donors receive some other form of benefit by funding such organizations. John D. Colombo & Mark A. Hall, *THE CHARITABLE TAX EXEMPTION* (1995). These diverging but still related views can be synthesized into the conclusion that a donor is actually making an investment – seeking a yield – whether we take an economic view or a view based on the philosophy of “good works.”

The societal sector comprised of altruistic investors and organizations is referred to by various names including “civil society,” “third sector” and “independent sector.”²

Altruism constitutes an investment because it is motivated by the hope of profit, though not in the classical sense of the word.³ It is distinguishable from economic investment because it is explicitly conditioned upon a mutually beneficial result as between investor and recipient. Economic investment is not so necessarily conditioned, though mutual benefit is presumed, given equal bargaining strength and informational access.⁴ A creditor might gladly lend money at usurious rates provided he is reasonably assured of the debtor’s credit-worthiness. Altruistic investment depends on the recipient’s increased well-being and does not seek to profit at another’s expense. Unlike economic investment, altruistic investment does not exploit asymmetrical differences in bargaining strength and access to information to the detriment of the weaker party. In the most rudimentary sense, for example, when a pedestrian stops and gives spare change to a panhandler she does so because giving makes her feel better, perhaps alleviating her guilt for enjoying a relatively privileged existence. She profits from her generosity, but only if the recipient’s well-being improves. This rather cynical view—that altruism is ultimately a self-serving behavior—is debatable, and this Article does not attempt to resolve the debate.⁵ Instead, this Article accepts the cynical view because it speaks in the language that resonates most in a world increasingly characterized by capitalist motivations. Indeed, self-enhancing economic advancement is the primary motivator of the evolving relationship between China and the United States. Altruistic investment, conceptualized as a self-serving activity, is therefore not inconsistent with the motivations for better relations between both countries.

Capitalist societies, or societies in transition to market capitalism, should encourage altruistic investment. Doing so assists in the

2. Penina Kessler Lieber, *An Anniversary of Note*, 62 U. PITT. L. REV. 731, 738-40 (2001) (discussing the interchangeability, or lack thereof, of terms such as “civil society,” “independent sector” “third sector” “nongovernmental” and “nonprofit”).

3. For a discussion of the philosophical view that altruism is ultimately a self-serving activity, see Atkinson, *supra* note 1, at 526-33.

4. The classic tax definition of “fair market value,” for example, is “the price at which property or the right to use property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy, sell, or transfer property or the right to use property, and both having reasonable knowledge of relevant facts. Treas. Reg. § 53.4958-4T(b)(1)(i) (2002).

5. See *supra* note 3.

development and maintenance of the capitalist system.⁶ The market economy is entirely amoral, though it may be the best way to provide for social welfare and increase the quality of life. Market economies provide goods and services only to those able to pay. Those unable to pay are simply ignored. Discontent is inevitable in this winner takes all system. Discontent may perpetuate healthy competition, or it may result in resistance or revolution. Government and business prefer competition even while simultaneously recognizing that competition necessarily creates losers and provokes discontent; thus, governments often maintain social welfare programs to negate the discontent that losers in a market economy inevitably experience—a discontent that could fuel revolution if not eliminated or minimized. Governments' social welfare programs cannot be too successful though, because such programs impose a drag on the emerging or mature market economy and may potentially displace market economy motivations.⁷

Traditional Chinese socialism completely displaced market economy motivations. Instead, the State served as the exclusive and omnipotent provider of human needs and definer of human preferences. Altruistic investment became irrelevant as a result. When government withdraws from its omnipotent role and allows the market economy to grow, altruistic investment again becomes relevant. In short, altruistic investment adds a level of morality to a market society that is essentially amoral.⁸ Altruistic investment rescues those the market economy leaves behind. Social order, upon which the market economy depends, increases and the threat of political revolution decreases. It is therefore in the government's interest to encourage altruistic investment.

6. "Charities are an important source of humanitarian relief and development aid in an increasingly international community." Joannie Change et al., *Cross-Border Charitable Giving*, 31 U.S.F. L. REV. 563 (1997).

7. Indeed, there is recent evidence of this phenomenon in China:

Economic growth from the non-state sector is merely offset by losses in the state sector, as gains produced by the non-state sphere and deposited as household savings into state banks are turned into unrecoverable bank loans used by the government to salvage decrepit enterprises. . . . Continued subsidization of too many state firms [which subsidization is deemed necessary for the state to provide employment and social welfare benefits to a huge portion of the population] has meant the continuation of political, rather than commercially-based, provisions of capital, which has in turn meant too little, if any, bankruptcy-induced exit for economically insolvent enterprises.

Lan Cao, *Public Perspectives on Privatization: Chinese Privatization: Between Plan and Market*, 63 LAW & CONTEMP. PROB. 15-16 (2000).

8. Change, *supra* note 6, at 567 (noting that "voluntarism and philanthropy helps create a more ethical society").

Economic transition is historically associated with political upheaval or reform⁹ and that association would likely prevail in China if the dominant transition approach were applied. For this reason, and because transition holds the hope of a vast new consumer market, the United States is both encouraging and assisting China's transition process.¹⁰ China is no doubt aware of the U.S. hope for political change and is determined to resist that change while also succeeding in its quest for a market economy. It knows that social discontent usually results from the government's withdrawal from its role as omnipotent provider and that discontent provokes political challenges.¹¹ Although political challenges may result in reform, it is just as likely to provoke a backlash resulting in the imposition of even more stringent governmental control. China is therefore implementing a new approach to transition in an effort to avoid political challenges without having to re-impose governmental control. Re-imposing government control would jeopardize its economic transition by provoking trade sanctions from other economic powers. Even this new approach though will nonetheless require the government's withdrawal from the role of omnipotent provider.

9. "Rapid transition from a centrally-planned to a market-oriented economy invariably produces dislocation and social stress. When these reach extremes, national leaders must retrench and slow down the reform process." David Blumental, *"Reform or Opening"? Reform of China's State-Owned Enterprises and WTO Accession – The Dilemma of Applying GATT to Marketizing Economies*, 16 UCLA PAC. BASIN L.J. 198, 201 (1998).

10. America's policy of economic engagement with China rests on a belief that the transition to a free market economy and the development of the rule of law in China's business sector would likely lead to more political and social openness and even democracy. This belief, along with the desire to expand American commercial interests, drove U.S. support for China's entry into the World Trade Organization (WTO). Many also believe that a more prosperous China will be a more peaceful country, especially if it is fully integrated into the Pacific and world economies.

U.S. – CHINA SECURITY REVIEW COMMISSION, *THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA: EXECUTIVE SUMMARY I* (2002), available at <http://www.uscc.gov/excsum02.htm> (last visited Jan. 15, 2004).

11. The pattern of transition and retrenchment followed by transition holds true in China.

One can summarize the evolution of Chinese socialism as a series of vacillations. Total collectivization through people's communes, and an unrealistic 'Great Leap Forward' in the 1950's followed by some liberalization in the early 1960's, then by the fanatical Cultural Revolution in 1966. Less dramatic vacillations followed in the 1970's. The turn towards a more radical reform was taken in 1978, with a specific mixture of an increasingly strong private-sector co-existing with a traditional state sector, increasing autonomy to the provinces, macro-economic regulation replacing planning, and all this topped by unflinching political control of the party.

MARIE LAVIGNE, *THE ECONOMICS OF TRANSITION: FROM SOCIALIST ECONOMY TO MARKET ECONOMY* 27-28 (1995).

Instead of applying the “big bang” method, where government suddenly withdraws the social safety net to which citizens in socialist systems are accustomed,¹² China has adopted a gradualist method.¹³ The Chinese government is withdrawing slowly from its role as social welfare provider because it has determined that a slower pace will make economic suffering and the expected political challenge less likely.¹⁴ The slow pace may further the Chinese government’s political goals, but it is creating resentment among foreign trading partners upon whom China depends for a successful transition.¹⁵ In particular, China has transformed itself into a huge exporter, while maintaining its status as a relatively small importer. The U.S. trade deficit with respect to China has increased from \$11.5 million to nearly \$87 billion during the past twelve years.¹⁶ Some in the United States view China’s slow with-

12. For a discussion of the “big bang” versus gradualist approach in Central and Eastern European countries that have undergone transition, see *id.* at 118-25.

13. The fundamental approach of the leadership under Deng has been to introduce new policies experimentally, then to broaden their application, and to adjust them – repeatedly, if necessary – to take account of changing realities or perceptions of reality, and to cope with new problems and unanticipated consequences of policy changes as they arise.

A. Doak Barnett, *China’s Modernization: Development and Reform in the 1980’s*, in JOINT ECON. COMM., 99TH CONG., 1 CHINA’S ECONOMY LOOKS TOWARD THE YEAR 2000, S. PRT. 99-149 (Joint Comm. Print 1986).

14. The Russian experience of privatization, for example, represents the more dominant and more favored approach to privatization – certainly from the point of view of the West and its advisers – and is characterized by immediate privatization of the state sector, including the swift and unequivocal transfer of assets from the publicly owned state enterprises to private hands. On the other hand, “privatization with Chinese characteristics” emphasizes not the immediate privatization of the state sector but rather the retention of the state sector with concomitant creation of a parallel non-state sector designed to supplement the state sector and to serve as a social “shock absorber” in the event that the state sector itself is to be eventually “privatized.”

Cao, *supra* note 7, at 13-14.

15. Wayne M. Morrison, *CHINA’S ECONOMIC CONDITIONS 1* (Congressional Research Service Issue Brief, 1998), available at http://www.fas.org/man/crs/980717CRSEconomic_Conditions.htm (last visited Jan. 15, 2004) (noting that trade barriers “have been the cause of growing tensions with various trading partners, especially the United States”); see also A. DOAK BARNETT, *CHINA’S ECONOMY IN GLOBAL PERSPECTIVE* 261-62 (noting that Chinese efforts to increase exports, while resisting increased imports, will create “frictions in relations between the industrial powers and the Chinese.”).

16. U.S. – CHINA SECURITY REVIEW COMMISSION, *THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA: CHAPTER 2*, at 2 (2002), available at http://www.uscc.gov/ch2_02.htm (last visited Jan. 15, 2004); see also U.S. DEPARTMENT OF STATE, *BACKGROUND NOTE: CHINA 11* (2002). The U.S.-China trade deficit is larger than any other U.S. deficit. *Id.* at 3. The present trade deficit is even more startling when one considers that the 1973 export-import ratio was approximately 11:1 in the United States’ favor. By 1975 the ratio had dropped to 2:1 primarily because China began reducing its agricultural imports from the United States, while the United States began importing other goods from China. ALEXANDER ECKSTEIN, *CHINA’S ECONOMIC*

drawal of government control and continued subsidization of its domestic market as unjustifiable protectionism that is inconsistent with China's recent admission into the World Trade Organization (WTO). Indeed, China's accession agreement with the WTO mandates an acceleration of the transition process as well as the government's withdrawal from its role as omnipotent social welfare provider.¹⁷ The maintenance of what are viewed as protectionist measures threatens to place China in violation of its WTO obligations. Altruistic investment directed towards alleviating the transitional economic pain and suffering could serve as a substitute for China's use of protectionist measures. Such investment could remove the incentives for political challenge and the Chinese government could hasten its withdrawal as social welfare provider, thereby lessening the frustrations of other economic powers. Altruistic investment would therefore be in the best interest of all concerned.

One of the biggest threats to successful transition is social displacement—job loss and the consequences thereof.¹⁸ The pain and shock of widespread social displacement in any transitioning society will discourage those directly affected and their government from undertaking or hastening transition, but altruistic investment can help lessen the shock suffered by those who are most immediately affected by transition. In China, such investment will decrease the inevitable discontent that would otherwise fuel a retrenchment of the market economy or threaten the government's monopoly on power.

From the U.S. viewpoint, altruistic investment may therefore have both good and bad consequences. To the extent altruistic investment helps to ensure transition will succeed, it is consistent with U.S. goals. Its return to U.S. investors, admittedly obscure and uncertain, is both financial—the creation of a new consumer base—and geopolitical—the lessening of international tensions

REVOLUTION 269 (1977). But even as late as 1979, the trade imbalance between the United States and China was about \$1.2 million in the U.S.'s favor. BARNETT, *supra* note 15, at 597.

17. Protocol on The Accession of the People's Republic of China (Nov. 10, 2001).

18. "China's WTO accession may exacerbate economic and social strains and lead to further social unrest, political instability, and an economic downturn, with an uncertain outcome for U.S. – China relations." U.S. – CHINA SECURITY REVIEW COMMISSION, THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA: CHAPTER 3, at 1 (2002), available at http://www.uscc.gov/ch3_02.htm (last visited Jan. 15, 2004); see also *id.* at 6 (noting that some experts believe that China's economy is heading for "stagnation or collapse," in part because of the "lack of a social safety net to support the high levels of unemployed workers and the rise in large-scale worker protests").

that may cause costly conflicts between countries. Altruistic investment is inconsistent with U.S. goals, however, to the extent that investment decreases challenges to China's government. Thus, the United States may have logical reasons for discouraging altruistic investment in China, but a closer analysis reveals that the better course would be to encourage altruistic investment even though it may strengthen the present Chinese government.¹⁹ Despite the benefits from altruistic investment, China may also have logical reasons to discourage altruistic investment, particularly from U.S. sources. U.S. altruistic investors invariably adhere to democratic ideals relating to the diffusion of societal power, freedom of speech, association and belief. A Western-style independent sector usually criticizes, competes with and offers alternative goals and methods from those offered by the government.²⁰ Because the Chinese government abhors political competition such as might be encouraged by Western altruistic investors, it should have reason to discourage altruistic investment at least from U.S. sources.

The foregoing analysis may explain why the United States and China have given scant attention to altruistic investment in China even as they are actively encouraging economic investment and transition in China. A closer analysis, however, shows that altruistic investment is probably a no-lose proposition for both countries. It can help achieve both countries' mutually shared goals without increasing the potential that negative consequences, from either country's viewpoint, will result. This Article suggests that the WTO adopt efforts that would encourage altruistic investment in transition economies, and that the United States and China support those efforts. Whether altruistic investment will strengthen or chal-

19. The theory of this article is that China will more likely succeed as a capitalist state with the encouragement of altruistic investment. Some observers, however, do not think economic success without political reform is such a good idea. "If China becomes rich but not free, the United States may face a wealthy, powerful nation that could be hostile toward our democratic values, to us, and in direct competition with us for influence in Asia." U.S. - CHINA SECURITY REVIEW COMMISSION, *supra* note 10, at 2.

20. Western definitions of the term "NGO" tend to emphasize the private roots of social organizations, juxtaposing them against official government agencies. The American definition, in particular, draws heavily on the image of American nonprofit organizations as privately constituted, privately funded, independently operated organizations established by individual citizens who are united by a common vision of the collective good. Such a definition accords a grass-roots connotation to the term and envisions a clear delineation between governmental actors and the nonprofit sector. It also parallels Western theories of civil society, which tend to portray social organizations as alternate centers of political power whose presence helps neutralize the danger of excessive state authority.

C. David Lee, *Legal Reform in China: A Role for Nongovernmental Organizations*, 25 YALE J. INT'L L. 363 (2000).

lenge the Chinese government seems irrelevant because it will not change the likelihood of either outcome occurring. Altruistic investment can only help, not hurt, the United States, so both countries should do more to encourage it in China.²¹

Motivating people to make gifts and donations, and to engage in collective "good works," however, requires more than the hope of good feeling. This is particularly so when the immediate recipient of such altruism is too far away for the investor to really know its effect. Impersonal altruistic investment occurs when individuals make gifts and donations to individuals they never see or to overseas charities. Such investment increases when an immediate and easily discernable financial return results. Governments in many market economies therefore attempt to make altruistic investment competitive with other investment sources by providing a financial return on altruistic investment through their tax laws.²² This seems necessary because the yield from altruistic investment is obscure to the investor, particularly when that investment is made for the benefit of distant or unknown recipients. The yield may not come about for years and when it does, the investor may not even know. A tax benefit decreases the uncertainty that discourage altruistic investment. A charitable contribution generates an immediate tax deduction while collective charitable activity is presumptively tax-

21. It would be wrong to leave the impression that China is invariably and exclusively a welfare recipient in the world community. To the contrary, China has also engaged in what might be viewed as international altruistic investment:

China became a significant aid donor itself in the 1950's and, in fact, from 1956 was a net capital exporter [of altruistic investment]. . . . During 1950-64 China's deliveries on the credits and grants extended during those years totaled \$1.205 billion. Most went to other Communist nations (especially North Korea and North Vietnam, which, it is estimated together received \$1.065 billion,) but starting in 1956 the Chinese also began giving aid to non-Communist developing nations.

BARNETT, *supra* note 15, at 215.

22. Professor Infanti divides the world's tax laws into eight different categories—including a category for transition economies—and describes the tax laws pertaining to altruistic investment in each of those categories. Anthony C. Infanti, *Spontaneous Tax Coordination: On Adopting a Comparative Approach to Reforming the U.S. International Tax Regime*, 35 VAND. J. TRANS. L. 1105, 1159-1223 (2002).

Because charitable giving is the lifeblood of civil society, the question of tax treatment goes to the heart of the sector's sustainability. Without adequate tax incentives, it is unrealistic to assume that charitable dollars from individual donors, private foundations and/or corporate philanthropic programs will continue to generate enough funds to support the vast needs of newly independent or third world nations. Even though an increasing number of multinational corporations are now internationalizing their "corporate citizenship" activities, many companies still experience discomfort at the prospect of pouring corporate dollars into foreign communities without assurances of adequate accountability and without beneficial tax treatment.

Lieber, *supra* note 2, at 741.

exempt. Tax laws thus provide a more direct yield that motivates, at least in part, altruistic investment.

This Article discusses the positive role of altruistic investment in any transition economy by making specific reference to altruistic investment in the Chinese economic transition. The Article discusses the social welfare hardships arising from the transition process and then discusses the U.S. and Chinese tax incentives and barriers to altruistic investment that would lessen that hardship. After that, the Article discusses the reasons why both countries might prefer to retain those barriers. Finally, the Article concludes that altruistic investment has more positive than negative consequences and makes a simple proposal to stimulate altruistic investment in China in a manner that would assist the transition process without sacrificing either country's mutually exclusive goals. The proposal, that the WTO recognize, encourage, and integrate altruistic investment through international tax policy, is useful not only in China but in other developing or economically reforming countries.

II. THE ROLE OF ALTRUISTIC INVESTMENT IN A TRANSITION ECONOMY

International altruistic investment can significantly further the immediate economic goal sought by China and the United States. That goal is the successful transition to a market economy. Both countries pursue this goal only through international economic investment while ignoring the role international altruistic investment may play in achieving transition and its accompanying consequences.

Granted, the two countries have mutually exclusive political goals. China seeks not only to fuel economic growth, necessary to feed and provide other life necessities for its huge population,²³ but also to fund its goal of becoming a major world power without altering its political system.²⁴ The United States wants not only to gain access to a huge consumer population, but also hopes that a transition to a market economy will lead to a democratic political system in China.²⁵ Altruistic investment is conducive to both coun-

23. China's population is estimated at 1.3 billion. U.S. DEPARTMENT OF STATE, *supra* note 16, at 3.

24. U.S. - CHINA SECURITY REVIEW COMMISSION, THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA: CHAPTER 1, at 1 (2002), available at http://www.uscc.gov/ch1_02.htm (last visited Jan. 15, 2004).

25. *Id.*

tries' immediate goal of successful transition. In short, gifts, donations, and charitable activities originating from abroad decrease the economic pain and shock suffered domestically by those who undertake and are most directly affected by the transition from a socialist to a market economy. By doing so, international altruistic investment accelerates and increases the chances that a market economy will succeed, rather than be defeated by reactionary forces. Altruistic investment might also bring with it Western ideas of democracy, but at the same time it will lessen or eliminate economic motivations to challenge the incumbent political system. The impact on the two countries' differing political goals – strengthening (China's goal) or weakening (the United States' goal) the Chinese government – should therefore be neutral. That is, altruistic investment will expose Chinese citizens to democratic ideals but those same citizens' growing prosperity made possible by altruistic investment will decrease social discontent and the motivations to mount political challenges. The evident task, one undertaken in Section V, is to determine and then deconstruct the precise reasons for the neglect and discouragement of altruistic investment. After doing so, readers should conclude that the apparent disdain for international altruistic investment is not simply an anachronistic relic of the Cold War. There are logical reasons why both governments would actually want to discourage international altruistic investment, even as one country is required to accept immediate hardship for the sake of future economic gain beneficial to both countries. The larger issue is whether those reasons are of sufficient import to forego the benefits that arise from such investment. That question, too, is thoroughly addressed in Section V. In this section, I simply make the generic case that international altruism can effectively assist in the transition to a market economy and thus further the primary goals of both the United States and China.

As discussed in further detail below, the United States and China have embarked upon an active, ongoing policy of economic engagement characterized primarily by China's transition to a "socialist market economy."²⁶ The success of that policy depends,

26. One definition of "market socialism" is an economic system in which:

(1) all enterprises and means of production are publicly owned; (2) planners' preferences prevail; but (3) the actual allocation of resources is still left to the price system so that planners' decisions concerning the resource-allocation mix are implemented through the market mechanism; and (4) this implementation is still based on material incentives and on highly differentiated rewards.

ECKSTEIN, *supra* note 16, at 38.

among other things, on the government and populace of China conceding to the State's withdrawal from ownership of wealth producing activities. A generic disincentive to that concession, however, is the loss of assurance to each individual of equal distribution of wealth throughout society, such that each person is guaranteed an absolute right to a certain level of subsistence. The sudden or even gradual withdrawal of the omnipotent social safety net exposes all members of society to the risk of sub-minimal subsistence and therefore discourages the adoption of a market economy.²⁷ In fact, the emergence of a market economy that motivates participants with the hope of profit and wealth necessarily presupposes both income inequality and a certain level of poverty.²⁸ When a society moves beyond a certain floor representing mere subsistence, wealth and poverty become mutually dependent concepts. One person cannot be wealthy unless another is poor. To the extent there are gradations of wealth, there is bound to be one status of absolute poverty. A transition to a market economy therefore requires individuals to assume the risk of absolute or relative poverty, knowing that some among them will suffer that fate but not knowing who among them will suffer. Rawlsian philosophy posits that it is neither moral nor rational that individuals would

The earliest acceptance of market socialism in China is traced to a July 1978 speech given by Hu Chio-mu, Director of the Chinese Academy of Social Sciences, to the State Council. BARNETT, *supra* note 15, at 37. The period of transition in China between 1978 and 2002, roughly, probably best exemplifies the academic definition of market socialism. The State still maintained ownership over the means of production, but China sought to "(1) improve planning, (2) relate production decisions to real costs, prices, and other market factors, (3) give professionals at the enterprise level more decision-making authority, and (4) strengthen incentive systems." *Id.* at 203. More recently, when China gained admission to the World Trade Organization, it essentially agreed to private ownership of enterprises and the means of production. See Raj Bhala, *Enter The Dragon: An Essay on China's WTO Accession Saga*, 15 AM. U. INT'L. L. REV. 1469 (2000). Doing so, of course, will create further variance between the academic and Chinese manifestation of market socialism. On the other hand, China's constitution continues to proclaim that "the whole people" own the means of production so perhaps there shall be no variance. XIANFA [Constitution] ch. I, art. 6 (P.R.C.) (1988) [hereinafter CHINESE CONST.]. It also remains to be seen whether preferences will continue to be defined exclusively by the State, rather than by individual consumers. This Article later argues that one reason why China neglects or even disdains altruistic investment is because such investment is purely a matter of individualism – consumer rather than state preference.

27. The incidence of poverty usually increases sharply during the first ten years of economic transition. THE WORLD BANK, *TRANSITION: THE FIRST TEN YEARS* 8 (2002), available at http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2002/02/09/000094946_02012504134954/Rendered/PDF/multi0page.pdf (last visited Jan. 15, 2004).

28. Various reports place the number of Chinese living in poverty (i.e., on less than \$1.00 per day) at approximately 100 million. See, e.g., U.S. – CHINA SECURITY REVIEW COMMISSION, *supra* note 16, at 14.

actually agree beforehand to accept such risks, particularly when there is no method by which to predict the outcome. Hence, there is a natural disincentive to adopt a market economy. Individuals would rather accept the safe "known" than embark upon the dangerous "unknown" even assuming that the unknown might eventually be better for everybody.²⁹

When the State withdraws the social safety net, according to the research on transition economies, an immediate and drastic drop in living standards results, followed by a gradual, less drastic recovery. Individuals suffer real personal economic hardship while waiting for the new market economy to alleviate their social and economic displacement. If the resulting decrease in living standards were depicted as points on an xy-plane and a line drawn from point to point, there would appear a "J," leaning away from the point of origin, with the points at earlier moments representing the drastic drop in living standards and the points at later times representing a more gradual recovery and increase in living standards.³⁰ Recovery may take years, even spanning the life of a generation. The transition to a market economy will therefore be delayed, resisted or thwarted altogether to the extent that personal hardship is severe and pervasive throughout society and suffering persons rebel.³¹ Indeed, for a market economy to take hold, the

29. There are generally three constituencies affected by transition: (1) state sector workers, (2) party insiders, and (3) new investors. THE WORLD BANK, *supra* note 27, at xxiii. The first two groups have the most to lose and therefore oppose transition entirely or favor only partial transition because in either case complete transition holds the greatest risk of loss. *Id.*

30. The fall in growth is initially dominated by the drag of old enterprises, which leads to a period of decline. With time, if the business environment favors production and innovation rather than rent seeking, restructured and new enterprises gain the critical mass to overcome the negative effects of old enterprises, leading to recovery and economic growth.

Id. at xvi (plotting the points of transition on an xy plane).

31. Today, the "Great Leap" is viewed, even in China, as a disastrous period of economic transition. This disastrous period of transition resulted in such great and widespread food shortages, famine, job loss, and production loss that it precipitated a severe retrenchment and the reinvigoration of political ideology, ultimately embodied in the short-lived, but economically debilitating Cultural Revolution. See Zhenmin Wang, *The Developing Rule of Law in China*, HARV. ASIA QUARTERLY, Autumn 2000, available at <http://www.fas.harvard.edu/~asiactr/haq/200004/0004a007.htm> (last visited Jan. 15, 2004) ("no natural or man-made disaster could rival the damage suffered by China from the 'Great Leap Forward' and the Cultural Revolution."); ECKSTEIN, *supra* note 16, at 90-91, 202-05. The Great Leap occurred during the period from 1958-1960 and sought to transform China into an industrial power within just two years. Arthur G. Ashbrook, Jr., *China: Economic Policy and Economic Results, 1949-71*, in JOINT ECON. COMM., 92ND CONG., PEOPLE'S REPUBLIC OF CHINA: AN ECONOMIC ASSESSMENT 20-22 (Joint Comm. Print 1972). The Cultural Revolution took place from 1966-69. *Id.* at 25-31.

present generation must be willing to suffer the hardship of the State's withdrawal of its ironclad safety net. The single reward is that a few within the present generation and more in subsequent generations might benefit to a degree greater than that which can be expected if the first generation does not undertake the immediate hardship. Those in any present generation should be expected to strive for the most immediate personal reward and conversely, strenuously avoid personal hardship.³² Yet in the midst of a transition economy, particularly during its early stages, personal reward is distant while personal hardship is immediately present.

It is precisely in those early stages, which might last for any number of years, that altruistic investment can encourage the individual behavior, specifically the acceptance of State withdrawal from the ownership of wealth, necessary to achieve the ultimate goal of the emergence and dominance of the market economy. A less rudimentary, but equally precise definition of altruistic investment, is the transfer of value without the immediate receipt of equal or greater value in return, for the purpose of satisfying the recipient's immediate need and the donor's future desire. Note that altruistic investment seeks to satisfy the recipient's immediate need, but yields no immediate return benefit to the donor. Because this article assumes that real altruism does not exist, it must further assume that altruistic investment necessarily depends on the expectation of return benefit. The return benefit is yielded later rather than sooner, hence the inclusion of the word "investment." The satisfaction of the recipient's immediate need, as well as the donor's future desire, is therefore an inherent component of altruistic investment. An eventual, if not immediate yield is a necessary precondition to a donor's undertaking of an activity—the making of a gift or donation—that would otherwise be characterized as contrary to her self-interest. The investment component, the future yield, is necessary to induce the donor to sacrifice a more immediate and direct opportunity for self-serving consumption in favor of the recipient's immediate need. Altruistic investment can further transition in this manner. The investor, by making gifts and donations and engaging in nonprofit activity, can address or reduce the recipient's hardship resulting from the transition process. The reduction of the recipient's hardship reduces the recipient's incentive to resist the transition and results in a valuable yield to the investor who benefits from the market economy. In short,

32. Severe unchecked hardship is likely to lead to the creation of interest groups that will act in opposition to the transition. THE WORLD BANK, *supra* note 27, at 16.

altruistic investment helps all parties affected by transition from a welfare to a market economy. Altruistic investment helps those recipients directly and immediately affected by the transition as well as those who will benefit, immediately and in the future, from the transition.

China may achieve the broader goal shared by the United States—encouraging directly affected individuals to concede and hasten the withdrawal of the State's guarantee of equal and no less than minimal wealth distribution—by alleviating affected individuals' immediate deprivation. "Re-employment centers," which are similar to, but more extensive in operation than U.S. unemployment offices, are one method by which the Chinese State provides relief for individuals adversely affected by the transition process.³³ Re-employment centers, though, are merely a form of continued state intervention and welfare, but on a much larger scale than is practiced in the West. State welfare, of course, is a compulsory means by which individuals who benefit from a market economy assist those who suffer in such an economy, and is normal even in a mature market economy. While eschewing direct ownership, the State maintains a certain lien on private wealth, thereby reserving a right of redistribution in favor of the relative few who suffer chronically under a system of unequal wealth distribution. Recall, however, that the ultimate goal is to stimulate the market economy. Ideally, market economies and welfare economies are mutually exclusive. Both cannot exist simultaneously because the former encourages production and supply of goods via the hope of profit (i.e., only in response to paying customers), and the latter elimi-

33. The significant difference between "re-employment centers" and American unemployment offices is that the cost for maintaining and operating the "re-employment center" is imposed directly on each state-owned enterprise. See GUO JING MAO, NOTICE REGARDING THE PRINTING AND DISTRIBUTION OF THE "INVESTIGATIVE REPORT [OF] SHANGHAI'S EXPERIENCES IN CARRYING OUT RE-EMPLOYMENT PROJECTS AND ESTABLISHING RE-EMPLOYMENT SERVICE CENTERS FOR STAFF AND WORKERS" (Gen. Office of the State Econ. and Trade Comm'n [P.R.C.], No. 549, 1997), available at <http://www.qis.net/chinalaw/prclaw68.htm> (last visited Jan. 15, 2004). The State-owned enterprise is required to pay the salary of the re-employment center staff. *Id.* The center is required to "conduct management of the laid off staff and workers separated from the enterprise, ensure a minimum standard of living for laid-off staff and workers, and help the laid-off staff and workers find re-employment. *Id.* The center is also responsible for providing food and medical care to the workers. *Id.* Although the notice states that local government and "society" must contribute to the center's budgetary needs, it further states that the enterprise must engage in fundraising to pay the center's expenses. *Id.*; see also LAO BU FA, NOTICE REGARDING FURTHER IMPROVEMENT OF THE WORK OF POVERTY RELIEF AND THE RE-EMPLOYMENT OF WORKERS (Ministry of Labor [P.R.C.], No. 166, 1997), available at <http://www.qis.net/chinalaw/prclaw62.htm> (last visited Jan. 15, 2004).

nates the requirement of payment for goods, siphons capital from the market economy, and may discourage innovation and labor. The State, therefore, cannot be overly involved in providing welfare assistance if its goal is to stimulate and encourage a market economy;³⁴ the State cannot successfully satisfy affected individuals' minimal needs, lest it reinstate the socialist system it seeks to dismantle.³⁵ Yet some system of pervasive and successful socialism is required to induce individuals to concede the State's withdrawal from its role as omnipotent provider of individual needs and desires, and thereby stimulate the market economy.

The answer is to encourage a private, voluntary welfare system funded by altruistic investment that can satisfy individual needs and desires without dampening or preventing the emergence of a vigorous, amoral profit-driven market economy. Domestic altruistic investors should be able to easily identify their future yield. Those who are most directly successful or expect to be so in a market economy do not want social unrest to delay or cause the retrenchment of that economy. The private wealth such persons derive or expect to derive from a capitalist society depends upon social stability and a consensus that the new economy is superior to the old economy. Two factors help achieve such a consensus, particularly amongst those who suffer the most during and after the transition. The first pertains to the extent to which individual suffering can be eliminated during the transition period. A theoretical premise of this Article is that for anybody to get rich somebody must be poor and, it is impossible to completely eliminate the suffering brought about by unequal wealth distribution. Rather, it is possible to make that suffering bearable both on an individual and societal basis. Second, those who do suffer during the transition must believe that their suffering in the midst of others' newfound wealth is temporary. Suffering persons must understand and believe that they have not been permanently assigned to the lower economic classes. There is value to those who succeed during and after the transition in bringing about these two factors. The value

34. "The challenge facing tax authorities worldwide is to respond to these changes in a manner that does not impede economic development and growth, but that at the same time will create a stable revenue stream for governmental operations." Milton Cerney, *Taxation and Transition: Nonprofit Organizations in a Market Economy*, 26 EXEMPT ORG. TAX REV. 235, 238 (1999).

35. THE WORLD BANK, *supra* note 27, at xx (noting that government cannot simultaneously introduce market discipline while also maintaining policies designed to protect state enterprises and their employees from the consequences of market discipline, lest the transition be defeated or at least delayed).

is embodied in social stability and relatively manageable social unrest. The factors may be brought about and enhanced when successful persons make altruistic investments—gifts and donations to charitable causes that assist unsuccessful persons—designed to increase the social stability upon which the market economy and private individual wealth is dependent. The return to the altruistic investor is the future continuation of the market economy. This theory assumes that the continuation of the market economy is more valuable than the original altruistic investment. Stated another way, private persons who are indeed successful during and after a transition to a market economy must understand that altruistic investment is actually a cost of that success to the extent it assures a stable social environment in which the market economy can thrive.³⁶ Private wealth owners might already recognize this correlation, but in general, their individualized efforts to help needy persons will be limited for several reasons. First, in a society where the State has monopolized wealth, there will be too few individual wealthy people to make a significant difference during the transition years. The few individual wealthy people will be unable to meet the needs of the many who suffer economic hardship and, in any event, they will likely be more concerned with consolidating their own immediate winnings. Second, in the absence of a formal program of stimulation and reward, many wealthy people, and this is true even in a mature market economy with sufficient numbers of wealthy individuals, will assume that somebody else will recognize and meet the individual needs of those who suffer hardships in the market economy. The individual, would-be altruistic investor might reasonably perceive a greater personal benefit in not participating in the private welfare system under the assumption that others will adequately supply the need. To compensate for the dearth of wealthy people and the tendency to free ride, the private system of welfare will need collective activity stimulated by the expectation of individual reward. Since true altruism does not exist, and the market economy punishes its occurrence in any event, the individuals who would participate in the collective, private action must perceive some private benefit from doing so, and that perceived benefit must be greater than the benefit they would achieve via free-riding. The implication is that tax-encouraged

36. Winners in a transition economy can either “compensate the losses of other groups” in the economy or “generate enough political pressure to neutralize opposition to continued reform.” *Id.* at xxiii. Altruistic investment would be one method of compensating losses.

individual and collective action aggregates the effect of few individuals and, by providing an immediate financial reward only for those who actually participate, discourages free-riding. Collective altruistic investment, though, depends upon an external organizing stimulus that neither dictates nor takes over that collective action but nevertheless provides a system of predictable reward. Tax provisions provide the necessary stimuli by providing an immediate yield to individual investors.

An obvious solution to the lack of wealthy people within the transitioning economy is to find wealthy people outside the economy who might benefit from the transition. China is, after all, the most populated country in the world and only a relatively small percentage of its population is wealthy enough to make altruistic investments. A significant portion of those wealthy enough to make such investments will instead direct most or all of their income in the early transition years towards establishing and maintaining their own relative superiority of wealth in the new economy.³⁷ Domestically, there are simply not enough donors to meet the needs that, if unchecked, could threaten the social stability upon which the newborn market economy depends. All of this is probably true in any transition economy and it is here, finally, that international altruistic investment becomes important.

It should not be difficult to demonstrate the available yield to potential international altruistic investors. The same motivations that apply domestically to those who are successful in the new market economy also apply to international altruistic investors. It is often said that China represents a huge "untapped market,"³⁸ implying the vast amount of potential wealth available to those who gain access to that market. In some respects that wealth is available to domestic and foreign persons alike. Foreign investors should therefore have similar motivations as domestic investors to see that the transition is successful.

Another potential yield for international altruistic investors involves larger geo-political issues. A thriving market economy and international trade system – one created when individuals are induced to undertake hardships during and even after a transition period – creates strong reasons for preserving peaceful co-existence. As the market economy grows and creates new wealth, it

37. See Lee, *supra* note 20, at 428-29 (noting the insufficient numbers of wealthy Chinese citizens and that those wealthy enough to make donations will normally do so only if they perceive some private benefit from doing so).

38. U.S. DEPARTMENT OF STATE, *supra* note 16, at 6.

becomes more expensive to provoke or engage in expensive international conflict even for persons whose wealth is derived solely from within their own country. Such conflict diverts labor and capital from the international market and will ultimately have a negative effect on any related domestic market. U.S. individuals, in particular, should therefore logically anticipate a future economic benefit from the emergence and success of the Chinese market economy.

In mythical Utopia, people share their wealth and engage in other forms of altruistic investment beyond their familial and geographic borders out of purely selfless motives. Humans are not selfless and do not inhabit an ideal world. Even the most humble and religiously pious among us can never be truly selfless, but instead are motivated by the hope of an unimaginably great reward in the afterlife. Other spurs to altruistic investment include the receipt of public accolade—seeing one's name on a building, perhaps—and even the hope of a large or small financial benefit such as might occur through a tax deduction or credit. The implicit premise is that humans do good things ultimately for self-serving reasons; to capture that self-serving purpose, this Article uses the phrase “altruistic investment” rather than just “altruism.” The term need not trouble the analysis because obviously the United States and China hold their self-interests paramount even while each invests time, labor and capital in a manner that apparently benefits the other. China's transition to a market economy will benefit the United States, but the transition is motivated by China's own interest. Likewise, altruistic investment flowing from the United States to China can be beneficial to China, but the highest motivation for such investment is that it will further the United States' own interest. Because altruistic investment is ultimately a self- rather than other-serving behavior, stimulating and encouraging altruistic investment portends no sacrifice or uncompensated cost with respect to the ultimate goals of both countries.

This article assumes that altruistic investment would not occur in the absence of a yield to the investor. It goes further, though, and argues that good feelings would be insufficient to generate the level of altruistic investment necessary to assist the transition process. China is geographically and intellectually far too remote from the United States for good feelings to play a significant role in motivating U.S. altruistic behavior there. Thus, as in life generally, financial wealth serves as a convenient, if not deceptive, substitute for good feelings.

In the United States, as in most market economies, the federal tax code is a primary source of private financial yield from altruistic investment. Citizens of market economies incur a tax cost by virtue of their existence within the jurisdictional reaches of their tax code. In the United States, that cost may be decreased or even eliminated altogether when citizens engage in charitable activity.³⁹ China's relatively new tax code and the country's transition from a socialist economy prevent the same conclusion with respect to the Chinese people. Indeed, there are some indications that in China public recognition is as equally rewarding as incremental gains in economic wealth.⁴⁰ Such a conclusion makes more sense in a socialist economy that theoretically prohibits inequalities in wealth than it would in a market economy that encourages or at least accepts wealth inequality.⁴¹ In the United States, public recogni-

39. For a concise summary of the economic assumptions (and debates) underlying the charitable contribution deduction, see STAFF OF JOINT COMM. ON TAXATION, 107TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2003 BUDGET PROPOSAL JCS-3-02, at 5-12 (Joint Comm. Print 2002) [hereinafter STAFF OF JOINT COMM., DESCRIPTION OF REVENUE PROVISIONS]. The Joint Committee on Taxation conceptualizes the charitable contribution deduction in a different manner than the conceptualization used in the text. According to the Joint Committee, instead of reducing a citizen's tax cost, a deduction for charitable contributions decreases the cost of giving and thus creates an incentive for giving. *Id.* Of course, this assumes that giving results in no other yield to the giver. If we assume instead that the giver receives a *quid pro quo* then the effect of giving is simply to reduce the giver's tax cost that he or she incurs as the price of citizenship. *Id.*

40. VICTOR N. SHAW, SOCIAL CONTROL IN CHINA: A STUDY OF CHINESE WORK UNITS 85-93 (1996) (discussing the use of public recognition in the Chinese reward system and how public recognition sometimes translates into financial reward). "The Maoists' goal was to inculcate the entire population with a new revolutionary ethic, based on a greater sense of social responsibility, and to stimulate the population to work hard for the collective good – to 'serve the people' – rather than to work for private gain." BARNETT, *supra* note 15, at 26.

41. The Chinese Communist Party sought but never really achieved a perfectly egalitarian wage structure, though it certainly came close to that goal. By 1973, income inequalities had been reduced to between 3:1 and 5:1. In the U.S. during the same time period, wage differentials were as high as 75:1. ECKSTEIN, *supra* note 16, at 301 (1977); see also BARNETT, *supra* note 15, at 23 (noting wage gaps amongst factory workers where the differential could sometimes be as great as 20:1, and between urban and rural workers). Anecdotal evidence also suggests the roughly egalitarian nature of China since 1949:

One of the most striking characteristics of Chinese society as seen by virtually any visitor is its apparently egalitarian character in terms of income. As one travels around China, be it in the city or in the countryside, one sees poverty but rarely abject misery or degradation, so frequently associated with the extremes of deprivation. One certainly has the impression that the Chinese have succeeded in placing a floor on real incomes. Firsthand visual impression, at least in areas to which foreigners have access, also shows that people seem well fed, adequately clothed – at times with a relatively narrow band of differentiation in quality of dress, be it men or women.

ECKSTEIN, *supra* note 16, at 299; see also BARNETT, *supra* note 15, at 23 (noting that China from 1950 to 1980, China was able to eradicate "most of the worst poverty," "maintain a

tion is paramount primarily to very wealthy philanthropists who are otherwise indifferent to marginal increases in wealth made possible via the U.S. tax code. Even in a socialist economy, the same public recognition is most likely valuable only to the extent it may be converted, in one form or another, into a yield that would otherwise require financial wealth to achieve.⁴² A market economy actually punishes altruistic investment because it immediately decreases the relative standard of living of those who engage in such actions relative to the free-riders who do not. Hence, the Chinese government will be required to implement measures to negate that punishment, short of reinstating a socialist economy, if it wishes to stimulate private sharing of wealth during and after its transition to a market economy. Tax incentives, targeted only to those who engage in altruistic investment, serve that purpose. Section IV contains a detailed comparison of the tax provisions in both countries that support and hinder a common and coordinated treatment of altruistic investment. The two countries' tax approaches to charitable activity and charitable organizations seem quite similar. Nevertheless, there are differences that, although they must be addressed, need not preclude a more effective system of mutual international altruistic investment.

Through the grant of a charitable contribution deduction, the U.S. tax code rewards individuals and corporations when they spend wealth on the accomplishment of a charitable goal. In addition, the U.S. tax code grants tax exemption when groups of individuals join together to engage in collective charitable activity. Without the yield made available through the U.S. tax code, a significant portion of private wealth and collective activity would not be spent on or directed to charitable causes but would instead be directed towards more explicitly self-serving endeavors.

The Chinese tax incentives are less predictable, at least from a U.S. viewpoint, for two reasons. First, Chinese tax laws are relatively new. The modern charitable provisions in Chinese law are only about ten years old and do not have benefit of years of application and interpretation. In contrast, provisions in the U.S. tax regarding charitable activities have existed virtually unchanged for nearly one hundred years. Second, while China is evolving into a

floor under the country's standard of living," eliminating "conspicuous consumption" and "guarantee a minimal level of consumption" for its citizens); SUZANNE OGDEN, CHINA'S UNRESOLVED ISSUES 107 (3d ed. 1995) (discussing the implementation of an eight grade wage scale that reduced wage disparities between the highest and lowest paid workers to 3:1).

42. See *supra* note 40.

nation in which law supersedes ideology, that evolutionary process is far from complete.⁴³ The State still maintains and occasionally exercises the power to ignore law when law would result in conflict with ideology.⁴⁴ In such instances, ideology is explicitly superior to law.⁴⁵ Instead of having a relatively transparent legal system with respect to tax exemption, the Chinese system of tax exemption is often characterized as opaque,⁴⁶ indicating the difficulty of predicting an outcome merely by reference to written rules. The same might be true in the United States, except that ideology's influence is implicit rather than explicit. This is a difficult and debatable proposition because even in the United States, a country that claims a much longer history of governance by law rather than ideology, it is difficult to ascertain and prove that a legal consequence is derived purely from law as opposed to ideology. In the United States, ideology might very well dictate a legal decision but we refer instead to the application of "public policy," or "judicial interpretation" rather than explicit political ideology.⁴⁷ Third, Chinese tax law is more standard- than rule-based. While the U.S. tax code is rule-based and detailed to the point of absurdity in some cases, the relative brevity of Chinese tax law leaves plenty of room for ambi-

43. For an historical analysis of the rule of law in China, see Wang, *supra* note 31.

44. For example, the Chinese constitution states that the State may not "compel citizens to believe in, or not to believe in, any religion; nor may [the State] discriminate against citizens who believe in, or do not believe in, any religion." CHINESE CONST. ch. 1, art. 35. And yet, American observers believe that the Chinese State routinely suppresses religion. See U.S. DEPARTMENT OF STATE, *supra* note 16, at 2.

The Constitution provides for freedom of religious belief and the freedom not to believe; however, the Government seeks to restrict religious practice to government-sanctioned organizations and registered places of worship and to control the growth and scope of the activity of religious groups. Membership in many faiths is growing rapidly; however, while the Government generally does not seek to suppress this growth outright, it tries to control and regulate religious groups to prevent the rise of groups or sources of authority outside the control of the Government and the Chinese Communist Party (CCP), and cracks down on groups that it perceives to pose a threat.

U.S. DEPARTMENT OF STATE, ANNUAL REPORT ON INTERNATIONAL RELIGIOUS FREEDOM 122 (2001), available at <http://www.state.gov/documents/organization/9001.pdf> (last visited Jan. 15, 2004) [hereinafter Report on International Religious Freedom].

45. Barnett, *supra* note 13, at 5 (noting that "it will not be easy to overcome long-standing Chinese traditions, which have stressed rule by men rather than by laws and, more recently, Party dominance of legal institutions").

46. Uncertainty with regard to legal rights and obligations increases transaction costs and thereby discourages potential market actors from entering. ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, CHINA IN THE WORLD ECONOMY: THE DOMESTIC POLICY CHALLENGES 364-68 (2002) [hereinafter OECD, CHINA IN THE WORLD ECONOMY]. This conclusion is no less applicable to altruistic investors.

47. See, e.g., *Bob Jones University v. Comm'r*, 461 U.S. 574 (1983) (holding that public policy prohibits tax exemption for a charitable organization that engages in racial discrimination even though no such prohibition is stated in the relevant statute).

guity and unpredictability that will require a period of practical application to resolve. Application, rather than formalism, will provide more needed predictability.

Nevertheless, the approach in China's generally stated tax laws appears consistent with that taken by the U.S. tax code. Under its income tax laws, China grants a deduction from taxable income for "the part of individual income donated to educational and other public welfare undertakings."⁴⁸ Goods and services commonly associated with charitable endeavors in the United States, such as equipment used in scientific research or teaching, health care or cultural performances, are exempted from China's value added and business taxes.⁴⁹ As in the United States, China encourages collective charitable activity, but only under closely monitored circumstances, and groups of individuals so engaged are apparently exempt from taxation.⁵⁰

When the U.S. tax code makes a financial concession to an individual by a deduction, credit or exemption, one can easily detect an attempt to coordinate national policy and individual behavior. Granting a deduction to employers and employees when they contribute to a retirement account for the employee's benefit is consistent with the national policy of providing for the care and support for the elderly without draining the resources of the working market economy. There are many more examples. Suffice it to say that the coordination of individual behavior and national policy characterizes almost all tax expenditures, most notably the charitable contribution deduction and the exemption for collective charitable activity. For example, beginning with the Reagan administration and continuing through the second Bush administration, the executive branch has explicitly championed the charitable contribution deduction and tax exemption for collective charitable activities as a means to justify and counteract the hardships resulting from the retrenchment of the welfare system in the

48. Individual Income Tax Law [P.R.C.], art. 6 (1999).

49. Provisional Value-Added Tax Regulations [P.R.C.], art. 16 (1994); Provisional Regulations of The People's Republic of China on Business Tax (1994).

50. Curiously, none of the laws pertaining to altruistic organizations in China explicitly state that such organizations shall be exempt from taxes. It seems implicit in the various tax statutes that taxation occurs when organizations engage in profit-seeking activities. Actual statements of this proposition are scarce, primarily applying to foreign altruistic organizations. See Notice of the State Administration of Taxation on Issues Concerning Improvement of Taxation Collection Administration for Foreign Enterprises Resident Representative Offices [P.R.C.], art. I(II) (Sept. 13, 1996) (stating that foreign "nonprofit" organizations will not be subject to tax in China).

United States.⁵¹ As one means to induce individuals to allow the withdrawal of the government safety net, the U.S. government encourages altruistic investment, whether individually or via collective action. The withdrawal of the welfare state under those administrations, moreover, was put forth as one method to reinvigorate the market economy. The existence and invigoration of a market economy necessarily implies or perhaps requires unequal distributions of wealth, the resentment from which can be dampened by altruistic investment. This is why Republican administrations, in particular, tout altruistic investment in the United States.

In a socialist economy that theoretically prohibits the private ownership of wealth and wealth disparities, encouraging altruistic investment is entirely irrelevant. Now that China has shifted from an attempt to guarantee equal and no less than minimal wealth distribution to a system that necessarily accepts some level of unequal and sub-minimal wealth distribution, a policy that encourages altruistic investment is entirely relevant and China has tentatively adopted such policies. The axiomatic point of these observations is that both countries attempt to define tax laws in a manner that is most conducive to their national priorities:

III. THE NEED FOR ALTRUISTIC INVESTMENT IN THE CHINESE TRANSITION ECONOMY

The phrase, "iron rice bowl," best explains the period of time during which altruistic investment was entirely irrelevant in the Chinese socialist economy. It embodies the legal, economic and cultural measures by which the State guaranteed an equal and no less than minimum level of subsistence for every individual in Chinese society.⁵² The State controlled the various market and legal

51. See Atkinson, *supra* note 1, at 505 n.11 (discussing the Reagan and first Bush Administration's strategy of encouraging charitable activities while also reducing the government's role in providing for social welfare); see also STAFF OF JOINT COMM., DESCRIPTION OF REVENUE PROVISIONS, *supra* note 39 (regarding the second Bush Administration's proposal to expand the charitable contribution deduction to non-itemizers).

52. The iron rice bowl was constructed via the "command economy," described as a system whereby:

[the] planners articulate a very detailed bill (list) of the final (consumer and capital) goods and services they desired. They would then have to decide, on the basis of the technological choices open to them, how much land, labor, capital, raw materials, various kinds of technical skill, and managerial inputs were required to produce this desired final bill of goods and services. . . . Having decided on the desired bill of goods and services and on the quantity and quality of factor inputs necessary to produce them, these factors then would be allocated to the desired uses through direct orders, by commands transmitted through administrative channels. . . . The commands in turn may be based either on coercive and/or normative appeals. That is, factors, particularly labor, may be

mechanisms in a manner intended to eliminate and prohibit inequalities of wealth. Beyond the minimal level of subsistence, individual preference was disregarded.⁵³ The "iron rice bowl" metaphor is applicable not only to individual biological needs, but cultural, entertainment, education and expressive (intellectual) desires as well. Thus, in a system in which "everyone eats from the same bowl," that bowl being inviolate and omnipotent, there is no need for or tolerance of extra-governmental activity, whether the goal is to meet basic human needs or satisfy individual preferences.⁵⁴

It will be necessary to reform the legal mechanisms that enforced the irrelevancy of altruistic investment as the Chinese government presently withdraws its omnipotent hand from society.⁵⁵ The withdrawal of the government's overall equalizing authority with

directed to particular sectors, localities, and production units on the basis of appeals to patriotism or to communist values without any resort to differentiated rewards. [i.e., higher or lower wages] Alternatively and under certain circumstances, factors, particularly labor, may actually be forced to submit themselves involuntarily to certain types of work in certain localities and under certain conditions.

ECKSTEIN, *supra* note 16, at 40. Other writers described China's command economy as involving (1) State ownership and operation of industry and transport, (2) collectivization of agriculture, (3) periodic economic planning by bureaucrats, (4) emphasis on investment in military and heavy industry, and (5) centralized provision of consumer goods sufficient to sustain the population. Ashbrook, *supra* note 31, at 18. Still others add that (6) profits are entirely remitted to the government which then reallocates profits to cover losses of state enterprises, government administrative costs and defense, (7) prices and wages are set by the state, and (8) trade and transport of most commodities are carried out by state enterprises, including the distribution of consumer goods through state retail-trade stores. Robert F. Dernberger, *Economic Policy and Performance*, in JOINT ECON. COMM., 99TH CONG., 1 CHINA'S ECONOMY LOOKS TOWARD THE YEAR 2000, S. PRT. NO. 99-149, at 22 (Joint Comm. Print 1986).

53. The subordination of individual interests to those of the Communist Party, which is the State itself, is a theme thoroughly interwoven with Chinese socialism. See ECKSTEIN, *supra* note 16, at 34 (quoting various Party leaders on the need for self-denial).

54. "Citizens' identities were based on their work assignments, and the government supervised citizens' behavior and provided a social safety net. This situation left little opportunity or incentive for citizens to create social organizations outside the government structure." XIN CHUNYING & ZHANG YE, *PHILANTHROPY AND LAW IN ASIA* 88 (Thomas Silk ed., 1999).

55. Facing an open world, China needs greatly to build up its NGO sector. The demands originating from an open world: economic globalization, new types of international aid, the formation of international civil society, and so on, require Chinese NGO's to react and play a positive role both at home and abroad. The demand originating from China's reform and development: the transition towards the market economy and the new role and functions of the Chinese government, require Chinese NGO's to assume many essential functions previously taken by the government and to provide various social services.

Li-Quing Zhao, *Strategic Options for Building the Chinese NGO Sector in an Open World*, 2 INT'L J. NOT FOR PROFIT L. (2000), available at http://www.icnl.org/journal/vol2iss2/ar_chinaoptions.htm (last visited Jan. 15, 2004).

respect to the allocation of goods and services will quickly lead to inequalities and resulting discontent, if those inequalities are not otherwise addressed.⁵⁶ Reform of the mechanisms intended to prevent unequal wealth distribution and profit-making will necessitate reform of the mechanisms by which altruistic investment is encouraged and regulated.

Intuitive assertions and arguments for reform make little sense without an understanding of social, political, historical, and economic context. A broad understanding of that context will assist in the analysis of the reforms presently occurring with respect to altruistic investment. This section continues with an overview of the major factors that have rendered altruistic investment irrelevant. These factors begin with State ownership of the “means of production”⁵⁷ and the use of the “work unit”⁵⁸ not only to eliminate the concept of profit and social inequality, but as the primary means of social welfare delivery.⁵⁹ In essence, the State exercised ownership over all property and dominion over all citizens according to state-defined desires.⁶⁰ As discussed in detail below, this historical aversion to individualism in Chinese culture is a surmountable obstacle to mutual recognition of charitable organizations in the United States and China.

China also rendered altruistic investment irrelevant by its control over geographical living preferences. For example, under a system known as *hukou*, the State strictly regulates internal migration and

56. Ideally, the Communist Party exercised authority via normative measures – instilling and bringing about a sense of idealism based on nationalism and patriotism – to motivate individuals to share in the allocation and mobilization of resources. If normative appeals failed, coercive appeals – legal orders relating to the allocation of labor, capital and raw materials, or physical terror. ECKSTEIN, *supra* note 16, at 37. Remunerative appeals (higher or lower wages) were not part of the Maoist ideal because they implied wealth inequalities. *Id.* at 40-41.

57. When the CCP gained power in 1949, business ownership was divided into three types. The State had exclusive ownership of approximately 35% of all business and joint ownership with private individuals of another 2% of business properties. The remaining 63% of business was privately held. *Id.* at 76. By 1956 the State had exclusive ownership of 67% of all business, and shared ownership in the remaining 33%. *Id.* The State nationalized the business sector not by outright seizures but through “relentless high pressure gradualism” – predatory pricing, and confiscatory levies (fines and taxes), both of which eventually forced private enterprise from the marketplace. *Id.*

58. SHAW, *supra* note 40, at xi, 1.

59. Social welfare delivery includes food, shelter, transportation, recreation, education, health care, and retirement.

60. SHAW, *supra* note 40, at 173 (life necessities delivered via the work unit include salary and subsidies, housing, coal, fruit, bus passes, medical care, child care and education, recreation facilities, libraries, gardens, sports, entertainment, vacation, and welfare for the aged, sick and disabled).

vocational occupations of individuals.⁶¹ Essentially, individuals are assigned to the geographical area of their birth and to one vocation for their entire lives.⁶² Those persons who reside outside of their assigned area are not entitled to housing, medical care, education or other social services.⁶³ Such restrictions assist in the administration and maintenance of the iron rice bowl,⁶⁴ but they also constitute an extreme manifestation of the State's disregard for individual preference. Still another relevant factor relating to the maintenance of the iron rice bowl is the State's control over entry and exit of firms. In a market economy, entry and exit of firms is related to the satisfaction of market demand in a manner that results in profit to firm owners. Stated very simply, profit potential leads firms to enter the market and lack of profit causes firms to exit, either through liquidation, bankruptcy or acquisition by another firm. Socialist ideas alter this pattern, particularly as

61. See generally KAM WING CHAN & LI ZHANG, *THE HUKOU SYSTEM AND RURAL-URBAN MIGRATION IN CHINA: PROCESSES AND CHANGES* (1998), available at <http://csde.washington.edu/pubs/wps/98-13.pdf>. (last visited Jan. 15, 2004).

62. The "hukou registration" determines a person's permanent residence, while the "hukou status" determines one's occupation. *Id.* at 4. Hukou registration in a particular locale determines the registrant's rights to participate in the locale's social welfare system (e.g., food subsidies). *Id.* Hukou registration (normally either urban or rural) and hukou status (traditionally either agricultural or nonagricultural) is inherited from the mother and not at all a matter of personal choice. *Id.* at 5. Changing one's registration or status is very difficult, particularly with regard to changing one's registration and status from rural/agricultural to urban/nonagricultural; the process might be analogized to gaining an entry visa to the United States (hence, subject to the applicant's qualifications and the sought after new locale's quota). *Id.* at 6. The overriding goal is to prevent uncontrolled internal migration into urban areas where economic opportunities exceed those available in rural areas. *Id.* at 10-11. Thus, it is much easier to migrate out of cities to rural areas than vice-versa. *Id.* Although the hukou system has experienced some relaxation, its essential features remain the same. See China Labour Bulletin, *Residence Registration to Stay; Migration Eased*, Feb. 26, 2002, available at http://iso.china-labour.org.hk/iso/article_pv.adp?article_id=2053. (last visited Jan. 15, 2004) (quoting the Deputy Director of China's Public Security Bureau, Bao Suijian, on the importance of maintaining the residence registration system for the purpose of keeping public order, economic and social planning).

63. OECD, *CHINA IN THE WORLD ECONOMY*, *supra* note 46, at 552.

64.

Unlike population registration systems in many other countries, the Chinese system was designed not merely to provide population statistics and identify personal status, but also to directly regulate population distribution and serve many other important objectives desired by the State. In fact, the hukou system is a major tool of social control by the State.

CHAN & ZHANG, *supra* note 61, at 2. The State's control of internal migration helped prevent the ills normally associated with rapid urbanization, such as homelessness, crime, and large scale unemployment. BARNETT, *supra* note 15, at 25.

those ideas were implemented in China.⁶⁵ On the entry side, autarkic policies encouraged severe redundancy of firms across Chinese regions.⁶⁶ Thus, despite comparative advantages and the insufficiency of market share, duplicate firms existed and still exist across regions.⁶⁷

Because firms existed not to generate profit but as a means of social welfare delivery, exit was severely limited and prohibited in most cases. Mergers, acquisitions and liquidations were not approved and undertaken for reasons relating to economies of scale or profit availability. Instead, consolidating activities short of liquidations were undertaken only as necessary to repair the social welfare delivery system—to keep an unprofitable enterprise going because of social policy concerns—and liquidations were rarely allowed.⁶⁸ The allocation of surplus capital within the socialist economy was closely related to the control of entry and exit. Credit allocations are a means by which capital is directed to the most efficient uses within a market. In the Chinese socialist economy, though, credit was allocated not on the basis of profitability and efficiency but on the need to continue the delivery of social welfare, as well as the maintenance of social control.⁶⁹ Profits escheated to the State and were redistributed in accordance with

65. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 174-178 (providing a detailed discussion of the governmental barriers and mandates with regard to consolidation of enterprises in China).

66. *Id.* at 134 (regarding the “chronic oversupply” of industries across regions, the consequence of which has been deflationary pressures).

67. The Chinese drive for complete self-reliance extended deep into Chinese society and meant that counties and prefectures were “supposed to establish independent industrial systems and function as virtually independent economic units.” OGDEN, *supra* note 41, at 63. This resulted in severe manufacturing and agricultural redundancies across China. *Id.* For example, there are presently more than 120 automobile companies in China, more than the aggregate number in the United States, Japan, and all of Europe combined. *Id.* at 148.

68. *Id.* at 136-37 (discussing the “non-commercial objectives” that restricted mergers and acquisitions). “Inefficient producers are very slow to exit, as they are under the umbrella of local protectionism and are helped by subsidies (disguised in the form of loans) from the banking system.” *Id.* at 166. For a contemporary example of potentially inefficient consolidations, see Charles Hutzler, *China's Big 3 Airlines Gear up to Expand*, WALL ST. J., Dec. 10, 2002, at B4 (discussing state mandated merger of profitable and redundant, unprofitable airlines).

69. One example of inefficient use of credit involves the continued governmental support of inefficient state owned enterprises in China. Small business fueled much of the economic growth in the late 1980's and early 1990's, in particular by absorbing employees who had lost their agricultural jobs as economic transition continued. See generally OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 83-88. But China's continuing diversion of credit to its money-losing state owned enterprises has hampered the ability of small business to expand and continue absorbing displaced agricultural workers. *Id.* at 90-91.

social policy rather than economic efficiency.⁷⁰ In theory, these contextual factors resulted in the complete absence of profit incentive and social inequality. A natural consequence was the irrelevancy of altruistic investment,⁷¹ there being no admission or recognition of poverty or individual preference such as would be manifested by charitable giving and the emergence of private charitable organizations.

Although China is most often described and understood as a socialist nation, its implementation of the socialist ideas has been relatively short-lived.⁷² China is at least 3500 years old,⁷³ and the contextual factors discussed above were not fully implemented until 1956, seven years after the Chinese Communist Party (CCP) defeated the Kuomintang.⁷⁴ By 1978 reformers within the CCP began to advocate "consumerism," with its implicit acceptance of profit incentive and social inequalities.⁷⁵ Hence, the irrelevancy of

70. ECKSTEIN, *supra* note 16, at 107-08.

71. Constitutionally, China's political system is unitary and highly centralized. In such a centralized society, public and private spheres are never clearly distinct. This state of affairs provides little room for non-governmental organizations (NGO's) to exist. Especially in the pre-reform era, public ownership of organizations – with the government monopolizing all resources – did not allow NPO's independent access to financial and other resources. Thus independent NGOs were impossible.

CHUNYING & YE, *supra* note 54, at 88.

72. In fact, the great majority of China's history prior to 1949 is characterized more by a trade and barter system in which Western countries, possessing greater military power, imposed unfair economic terms on China. U.S. DEPARTMENT OF STATE, *supra* note 16, at 3 (discussing the United States and Great Britain's acquisition via force of trading "concessions" during the nineteenth century); *see also* Robin Hutcheon, *Capitalist Bulls in the Socialist China Shop: How the Two Learned to Co-exist*, in GREATER CHINA: LAW, SOCIETY AND TRADE 11 (Alice E-S Tay & Conita S.C. Leung eds., 1995); ECKSTEIN, *supra* note 16, at 11-12, 28-29 (describing China's pre-modern economy as a "highly organized market system [with] a hierarchy of local, intermediate, and inter-regional markets []").

73. U.S. DEPARTMENT OF STATE, *supra* note 16, at 3.

74. Immediately after the communist takeover, China's foreign trade was confined primarily to exchanges with the Soviet Union. Ashbrook, *supra* note 31, at 19. But even after the takeover, China never limited its foreign trade exclusively to exchanges with other socialist countries, as was the case with the former Soviet bloc and other Asian socialist countries. LAVIGNE, *supra* note 11, at 65. Because of its deteriorating relationships with the Soviet Union, China began engaging in trade with non-communist nations as early as 1950 and this process likely would have continued unabated were it not for the Korean war, which involved the United States and China on opposite sides. *See* BARNETT, *supra* note 15, at 3 (referring to the period during which China's limited its foreign trade to Soviet bloc nations as an aberration). Foreign trade, though, was often viewed by some Chinese political ideologists as antithetical to communist ideas of self-reliance and denounced because it implied that China was inferior to other countries. *Id.* at 123.

75. "At the pivotal December 1978 Third Plenum (of the 11th Party Congress Central Committee), the leadership adopted economic reform policies aimed at expanding rural income and incentives, encouraging experiments in enterprise autonomy, reducing central planning, and attracting direct foreign investment in China." U.S. DEPARTMENT OF

altruistic investment is scarcely more than a twenty-year phenomenon.

In fact, altruistic investment ceased to be completely irrelevant in 1978 when the CCP began actively encouraging foreign investment, primarily through the establishment of "special economic zones."⁷⁶ In addition, the CCP instituted the "household responsibility system" and began a limited reformation of state-owned enterprises.⁷⁷ Within special economic zones the profit incentive, rather than the iron rice bowl, constituted the primary means to deliver essentials and luxuries of life to the populace.⁷⁸ The State encouraged foreign investment⁷⁹ and allowed the market and individual preference to thrive. Under the household responsibility

STATE, *supra* note 16, at 5; *see also* Dernberger, *supra* note 52, at 17 (noting that "open consumerism" was approved and encouraged). "The reformers felt that they could ideologically rationalize some people becoming wealthier than others as long as those who got rich did not trample on the socialist principle of non-exploitation of labor." OGDEN, *supra* note 41, at 91. The term "reformers" is used in a relative sense, primarily referring to post-Maoist leaders such as Liu Shaoqi, Zhou Enlai, and Deng Xioping, all of whom advocated China's move away from strict egalitarianism and towards market principles coupled with socialist values. *See* BARNETT, *supra* note 15, at 12-13. After Mao's death, a new generation of leadership actually began to advocate disparate material incentives as a means to stimulate productivity. *Id.* at 46-47. They even went so far as to explicitly proclaim that "absolute equality is wrong." *Id.* The shift, of course, resulted from a more pragmatic, less idealized view of the world and human nature:

In general, many of the planners, economists, and technocrats were preoccupied with technical considerations and requirements, the need for technical skills, material incentives, and more or less balanced growth with proper attention paid to complementarities and inter-relations between different sectors of the economy. These same groups tended to favor a greater scope for the market mechanism, private plots, population control policies, and generally a less ideological approach to economic policy problems and economic management.

ECKSTEIN, *supra* note 16, at 47-48.

76. Special economic zones were originally instituted as "special export zones" designed only to manage foreign trade under closely controlled circumstances. Thomas Chan et al., *China's Special Economic Zones: Ideology, Policy and Practice*, in CHINA'S SPECIAL ECONOMIC ZONES: POLICIES, PROBLEMS AND PROSPECTS 88 (Y.C. Jao & C.K. Leung eds., 1986). By 1981, however, special economic zones had become a tool for the experimental introduction of capitalism in China. *Id.* at 99.

77. OGDEN, *supra* note 41, at 93 (regarding the household responsibility system).

78. The idea of special economic zones originated from Lenin's "New Economic Policy" which allowed for concessions made to foreign investors that were thought to be helpful to the building of a socialist society. Chan et al., *supra* note 76, at 93. A concession was defined as "a contract between the government and a capitalist who undertakes to organize or improve production and to pay the government a share of the product obtained, keeping the rest as his profit." *Id.* Thus, within special economic zones, the State tolerated and encouraged private ownership of the means of production and the private retention of profit. The State also allowed for market based wages and for limited, rather than lifetime employment contracts. *Id.* at 95, 100.

79. U.S. companies alone account for over 20,000 joint ventures and wholly foreign-owned enterprises in China and more than 100 U.S. based corporations are engaged in China. U.S. DEPARTMENT OF STATE, *supra* note 16, at 17.

system, individual households were required to contribute crops in satisfaction of a rural collective's assigned quota, essentially a tax paid in kind,⁸⁰ but could retain and sell surplus crops in rural free markets.⁸¹ During the same period, the central government began to allow managers of state-owned enterprises to retain and reinvest profits in the enterprises' on-going operations and to do so in the most profitable manner.⁸² Still, these limited experiments with free, profit-based markets did nothing to weaken the inviolate social safety net. Whatever incentive might have existed for altruistic investment could not have been very significant.

In contrast, emerging social inequalities often led to resentments that were most commonly assuaged through forced contributions—extracted for social welfare purposes—above and beyond those extractions required to meet the collective's centrally assigned quota.⁸³ These forced extractions can be viewed as precursors to China's present need for altruistic investment. In a sense, altruistic investment made by capitalists are necessary or "forced" to the extent they are required to maintain the social stability on which a capitalist economy is dependent. Capitalists must make those investments if they want the market economy to thrive. Similarly, local government officials in China sought to maintain social stability while experimenting with capitalism by demanding extra-legal, forced contributions from those profiting from special economic zones, the household responsibility system or township

80. In addition, the small, owner-operated farms were required to purchase assigned amounts of supplies and necessities from the State. ECKSTEIN, *supra* note 16, at 77.

81. When collectivization was instituted, farmers were permitted to retain a small garden-sized parcel of land for their own use, usually referred to as a *private plot*. This parcel of land, adjacent to the homestead, would be used for raising livestock, particularly poultry and pigs, and for growing vegetables and occasionally some other crops. Private plots could not occupy more than 5 percent of the village's cultivated land area. The produce from the private plots could be disposed of by the peasants in so-called free rural markets, subject to minimal restrictions as to price, quantity sold, and other terms of sale.

Id. at 70. Indeed, in almost all socialist countries, individuals were allowed to farm a small portion of collectivized land and sell the produce in free markets – known as "kolkhoz markets" in the USSR. LAVIGNE, *supra* note 11, at 9.

82. Barnett, *supra* note 13, at 9; *see also* Blumental, *supra* note 9, at 231 (summarizing regulations relating to the implementation of new management procedures for state-owned enterprises).

83. As of 2000, farmers were required to pay Government taxes, township levies (used for education, social expenses, family planning, public transportation and militia), village levies (i.e., contributions to local public accumulation funds, welfare funds, and administrative fees) and other arbitrary fees, levies, and fines. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 107. In addition, farmers were required to contribute about a month's worth of labor to the local government. *Id.*

and village enterprises (TVEs).⁸⁴ Thus, altruistic investment gained limited relevancy with the experimental introduction of profit incentives in Chinese society.⁸⁵

If and when the profit incentive is loosed wholesale on Chinese society, altruistic investment will become absolutely necessary.⁸⁶ The State's dismantling of the iron rice bowl and its explicit reliance on profit incentives for the efficient delivery of goods and services to the populace will lead to displacements and inequalities that invariably precede social unrest and grass roots resistance.⁸⁷ In fact, the State is presently replacing the iron rice bowl with the profit incentive and is therefore facing the very types of resentments and hardships that altruistic investment can alleviate.⁸⁸ The

84. The TVE burden can be defined as additional fees, penalties and contributions imposed on TVE's by authorities at various levels that go beyond regular taxes and contributions based on the TVE Law and other national regulations. These various institutions impose more than 1000 payments on TVEs that can be classified into four categories: apportionments, penalties, funds collection and fees. Some administrative units charge arbitrary fees for their services that are much higher than the amounts set by state regulations. Others force TVEs to make financial contributions under "donations" or "support." . . . According to some estimates, in 1999 the "TVE burden . . . [accounted] for about 20 percent of TVE after-tax profit.

Id. at 92.

85. Similarly, altruistic investment began to emerge as a relevant factor when Central and Eastern European states transitioned from socialist to market economies.

The drive to recreate nonprofit organizations in Central and Eastern Europe comes not only from a desire to restore these institutions, but also from the pressing needs in these countries, where many support systems, including health care, are in the midst of a sudden and often traumatic transition from state to private control. While these needs have created great risks, they have also provided remarkable opportunities for international nonprofit partnerships.

Cerny, *supra* note 34, at 236.

86. CHUNYING & YE, *supra* note 54, at 88-89 (noting that the transition process has "eroded the central government's ability to meet societal needs and created demands and 'space' for nonprofit organizations"). THE WORLD BANK, *supra* note 27, at 33 (noting that amongst the public goods that will be necessary will be "a social system that promotes the development and maintenance of human capital").

87. "The cultural and social impact of increasing inequities and changing social status, resulting from progressively differential incentive systems, may be substantial. The economic restructuring or reform process may create an upper and an under class in rural and urban settings that could generate social and ideological backlash." John P. Hardt, *Summary*, in JOINT ECON. COMM., 92D CONG., PEOPLE'S REPUBLIC OF CHINA: AN ECONOMIC ASSESSMENT, at XI (1972). An example of severe social unrest occurred in February 2000, when more than 20,000 workers at the Yangjiazhangzi Mine near Beijing staged a violent riot after the State announced that it was closing the state-run mine as part of the transition process. Bhalal, *supra* note 26, at 1483. In March 2002, another 20,000 workers in Daqing and 10,000 workers in Liaoyang protested the government's decision to shut down state-owned oil drilling operations. *Hope and Despair*, ASIAN WALL ST. J., Mar. 22, 2002, at A9.

88. A wide variety of social problems have arisen from China's rapid economic growth and extensive reforms, including pollution, a widening of income disparities between the coastal and inner regions of China, and a growing number of

early 1980s experiments with the household responsibility system, the reformation of state-owned enterprises, and the introduction of special economic zones have each evolved into accepted economic planning tools throughout China. The ideas underlying the household responsibility system are now further embodied in TVEs,⁸⁹ and the market forces previously confined to special economic zones have been introduced throughout China.⁹⁰ Likewise, the reforming or closing of state-owned enterprises has proceeded, though at a much slower pace, to the point that profit incentive dictates entry, investment, operations, and exit.⁹¹ As a result, urban overcrowding and overall unemployment is rising.⁹²

bankruptcies and worker layoffs. This poses several challenges to the government, such as enacting regulations to control pollution, focusing resources on infrastructure development in the hinterland, and developing modern fiscal and tax systems to address various social concerns (such as poverty alleviation, health care, education, worker retraining, pensions, and social security).

Morrison, *supra* note 15.

89. Township and village enterprises include "rural non-agricultural" household based enterprises, generally employing eight people or less. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 85 (2002). As of 2002, these small businesses employed about 20% of the total labor force and provided nearly 50% of China's total industrial output. *Id.* From 1984 to 1996, TVE's took in about 83 million former agriculture workers. *Id.* at 88. By 2010 they are expected to absorb about one-third of the nearly 80 million agricultural workers that will be displaced during the further transition process. *Id.*

90. There were originally only 4 special economic zones and now there are over 2000. U.S. DEPARTMENT OF STATE, *supra* note 16, at 9.

91. [C]yclical changes are most pronounced in respect to the role of politics and the Communist Party in the management of the industrial firm. Thus, roughly between 1952 and 1955, the Party was somewhat in the background; from 1956 to 1958 it began to play a more important policy role, leaving the actual day-to-day operations to management and technical personnel. The Great Leap placed politics in command and with it the Party assumed responsibility not only for policy direction but for management, thus in many cases virtually displacing or closely controlling and directing the firm's executives and engineers. With the collapse of the Great Leap and the onset of the Great Crisis in 1960 or 1961, the importance of technical and managerial considerations was recognized once again. However management remained subordinated to the Party, with the latter providing policy and ideological direction and the former being responsible for factory operations under the overall direction of the enterprise Party committee or branch.

ECKSTEIN, *supra* note 16, at 84.

92. As of 1998, observers estimated that the "floating population" in China – i.e., the number of persons residing outside of their assigned area and thus not entitled to certain social benefits – was between 50-200 million. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 552. Most are migrating to the cities in search of economic opportunity. Chan & Zhang, *supra* note 61, at 23.

A report in China Daily (11 March) states that half of the country's 60 million poor and needy people are in urban areas. The majority of the 30 million urban needy are laid-off and unemployed workers, accounting for 7-10 percent of the total urban population. According to the report, more than five million workers laid-off from state-owned enterprises failed to find new jobs by the end of 2001. The actual number of unemployed is estimated to be much higher than the official statistics.

Accession to the WTO represents China's high water mark with regard to the dismantling of the iron rice bowl and its embrace of the profit incentive.⁹³ The WTO is dedicated to the improvement of international trade through the elimination of tariff and non-tariff barriers that impede the profit-induced, free flow of goods and services across borders.⁹⁴ The WTO implicitly embodies the rejection of the socialist goal of State-mandated equal wealth distribution and no less than minimal levels of material subsistence. Instead, the WTO embraces the profit incentive as the exclusive and best means of ensuring and increasing individual welfare.⁹⁵ Hence, China's sixteen-year pursuit⁹⁶ and ultimate attainment of WTO membership represents that unleashing of the profit incentive such that altruistic investment will become indispensable.

WTO membership requires that China withdraw from its omnipotent position with respect to the delivery of goods and services.⁹⁷ Because that role was ostensibly for the purpose of maintaining social order and welfare, the State's withdrawal leaves a severe vacuum.⁹⁸ Free market societies are grounded on a certain

China Labour Bulletin, *Unemployment and Urban Poverty Cause Concerns at NPC*, Mar. 3, 2002, available at http://iso.china-labour.org.hk/iso/news_item.adp?news_id=1836 (last visited Jan. 15, 2004).

93. China gained admission to the World Trade Organization on November 10, 2001. Accession of the People's Republic of China, Dec. 11, 2001, WTO B.I.S.D. [Doc No. 01-5996] (2001). Protocol on Accession of The People's Republic of China Done at Doha on 10 November 2001, *entered into force*, Nov. 20, 2002, WTO B.I.S.D. [Doc. No. 01-5902] (2002); *see, e.g.*, Bhala, *supra* note 26 (discussing the history of negotiations leading to China's admission to the WTO).

94. The World Trade Organization came into being on April 15, 1994, and is the successor to the organization established under the 1994 General Agreement on Tariffs and Trade. *See generally* Marrakesh Agreement Establishing The World Trade Organization [hereinafter WTO Agreement], April 15, 1994. *See also* Blumental, *supra* note 9, at 219.

95. Blumental, *supra* note 9, at 238 ("[T]he basic premise of GATT is that free trade promotes increased wealth, which in turn means that people will live better and in peace.").

96. China began seeking WTO membership in 1986. Bhala, *supra* note 26, at 1469.

97. In general, China's protocol of accession requires that it (1) apply all of its "laws, regulations and other measures" pertaining to trade in goods, services and intellectual property in a uniform, impartial and reasonable manner, (2) provide a mechanism to receive and redress complaints of violations of (1) above, (3) create a transparent system of laws and regulations, (4) create an independent judiciary, (5) treat foreign business the same as domestic business, (6) extend the right to trade in goods (except certain listed commodities) to all enterprises in China, (7) ensure that import purchasing procedures of state trading enterprises are transparent, (8) phase out all non-tariff barriers to trade, (9) eliminate price controls, and (10) eliminate all subsidies, including those provided to state owned enterprises. Protocol on The Accession of the People's Republic of China, *supra* note 93.

98. For example, WTO accession is expected to result in severe job loss in China's agricultural areas (which account for nearly 70% of China's 1.3 billion population).

faith that the maintenance of social welfare is a natural consequence of peoples' mad and selfish pursuit of profit. That faith is premised upon the existence of a mature market economy in which opportunities ebb and flow to a populace collectively able to seize them.⁹⁹ Prior to China's transition, the State owned, operated and insisted upon the continued existence of redundant and inefficient enterprises employing large numbers of idle and unnecessary workers unconcerned with positioning themselves for new opportunity.¹⁰⁰ State-owned enterprises were the very means by which the State guaranteed social welfare.¹⁰¹ In the transition economy, and consistent with the terms of the WTO Protocol, the State has undertaken to eliminate these economically inefficient operations¹⁰² and rely upon the market to deliver social welfare. Yet the market is only in its infancy and cannot immediately fill the resulting social welfare vacuum.¹⁰³ Even if the market were able to immediately fill the vacuum by creating new opportunities, the populace would be unprepared to efficiently extract those opportunities.¹⁰⁴ Predictably, this convergence of facts has led to widespread unemployment.¹⁰⁵ Because employment was the exclusive

OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 130. But nearly 90% of the rural population is completely cut-off from any formal welfare system. *Id.* at 105.

99. According to a Chinese Ministry of Labor and Social Security survey, nearly 50% of urban job seekers lacked basic technical skills. At the same time, 50% of available jobs required such skills. China Labour Bulletin, *Harsh Reality of China's Labour Market*, Aug. 23, 2001, available at http://iso.china-labour.org.hk/iso/newsbrief_pv.asp?news_id=1601 (last visited Jan. 15, 2004).

100. "The largest [state operated enterprises], like the mammoth Capital Steel, are literally small cities unto themselves, responsible for providing medical care, housing, child care and education benefits to over several hundred thousand employees, pensioners and dependents." Blumental, *supra* note 9, at 210.

101. Even after a state worker is laid-off, the state enterprise remains obligated to re-train workers, find them new jobs, and pay their living expenses. Regulations on the Placement of Surplus Staff and Workers of State-owned Enterprises [P.R.C.] (Apr. 20, 1993); *see also supra* note 31 (regarding re-employment centers).

102. "During the 15th National Congress of the Chinese Communist Party that met in September 1997, President Jiang Zemin announced plans to sell, merge, or close the vast majority of SOE's in his call for increased "non-public ownership." U.S. DEPARTMENT OF STATE, *supra* note 16, at 9. As of 1999 SOE's employed 24 million people. *Id.*

103. After all, by 1998, there were nearly 305,000 state-owned enterprises responsible for the livelihood and welfare of more than 200 million employees, families, and retirees. Blumental, *supra* note 9, at 202.

104. *See supra* note 99.

105. In the early stages of the transition, western observers estimated that China would need to create a half billion new jobs by the early 21st Century just to maintain an unemployment rate of five percent. Hardt, *supra* note 87, at VIII. Chinese officials estimate, perhaps too conservatively, that by the year 2006 there will be twenty million jobless people in China. China News Digest, *Jobless to Reach 20 Million: Labor Minister*, Apr. 30, 2002, available at <http://cnd.org/Global/02/04/30/020430-1.html> (last visited Jan. 17, 2004). Those

means by which social welfare benefits were delivered, the precipitous rise in unemployment quite naturally has brought with it a sudden surge in the demand for extra-market social welfare delivery.¹⁰⁶

Worker displacement and the withdrawal of the iron rice bowl is also a consequence of other measures mandated by China's entry into the WTO. China's commitment to eliminate tariff and non-tariff barriers—import quotas, prohibitive and discriminatory license fees, and other protectionist measures¹⁰⁷—will stimulate competition from foreign vendors of the sort that will punish economic inefficiencies. Such inefficiencies include employing too many people to do a single job and the maintenance of redundant firms, both of which result from the iron rice bowl's drive for autarky and its insistence on full employment;¹⁰⁸ social mergers and acquisitions;¹⁰⁹ credit policies that condone non-performing loans, many or most of such “policy loans”¹¹⁰ were made to assist enterprises in meeting social welfare delivery burdens when revenues were insufficient to do so; and other types of subsidies.¹¹¹ Foreign competition from individuals and business not burdened

officials also estimate that twelve to thirteen million people will enter the job market during each year from 2002 to 2006, but that the economy is not likely to create more than eight million jobs over the same period. *Id.*

106. Blumental, *supra* note 9, at 2011-12 (discussing, in general, the impact of transition on social welfare, unemployment and social stability).

107. Other non-tariff barriers to trade include restrictive product standards, testing and certification requirements that are difficult to comply with by foreign businesses. Bhala, *supra* note 26, at 1485. For an exhaustive discussion of non-tariff barriers in China, see JINGZHOU TAO & DIARMUID O'BRIEN, *NON-TARIFF TRADE BARRIERS IN CHINA* (2003).

108. China doggedly pursued a policy of full employment well into the 1980's and even after it abandoned that policy in favor of greater managerial flexibility, managers continued to shun layoffs and dismissals because of the administrative burdens that accompanied such reductions:

Although the reforms in the 1980's endorse firing a person on the grounds of inability, laziness, or redundancy, few state-run enterprises actually did so until the mid-1990's. This is in part because of the system's structure: If a unit dismisses an employee, it then must either find that person alternative work or continue to provide the discharged employee with housing and an adequate if substantially reduced living wage.

OGDEN, *supra* note 41, at 113.

109. See *supra* note 68 (regarding the consideration of social welfare factors with regard to consolidations).

110. Not only do “policy loans” take capital away from more efficient uses, they are also the source of the Chinese banking system's high level of non-performing loans that, in turn, threaten the solvency of China's banks. See generally OECD, *CHINA IN THE WORLD ECONOMY*, *supra* note 46, at 231-258.

111. To survive transition, old, state-run enterprises will be required to “divest themselves of social assets – such as housing, health clinics, and kindergartens.” THE WORLD BANK, *supra* note 27, at 26.

by social obligations will discipline many sectors of the Chinese economy and that discipline will manifest itself primarily by those sectors limiting their social welfare spending. At the same time, direct government spending on social welfare must necessarily be limited because such spending is counterproductive to the nurturance of the market economy.¹¹² The surging demand for social welfare will then become a matter of perpetual motion. The era of the individual profit motive to deliver social welfare will require the State's withdrawal as the sole and primary provider of social welfare, and that withdrawal will increase the demand for state provided social welfare as unprepared or left behind persons suffer hardships. The State's failure to respond to increased demand will create discontent which, in turn, will discourage the government's determination to allow market forces to provide for social welfare. Although increased demand may be temporary, it may also become permanent if the temporary demand is not alleviated in the short run and is also sufficient to create a backlash against the new market economy.

China's transition to a market economy creates more than just social welfare consequences. The transition is also generating certain needs more directly related to market economies. The failure to meet those needs will stimulate just as much risk of transition failure as do the immediate social welfare consequences. First, internal and external competition was irrelevant in the iron rice bowl and, as a result, there was little, if any, reason to strive for innovation, education, training, labor and capital mobility, and improved qualities of life. Setting aside military needs, such goals were sought only to the extent necessary to maintain or achieve the commune ultimately manifested by the iron rice bowl.¹¹³ The active pursuit of more formal learning and individual betterment, to the extent those pursuits were separate from political ideology, was more often viewed as contrary to "right" thinking or "Maoist Thought."¹¹⁴ A market economy, though, is explicitly based on

112. *Id.* at xvi, 29 (noting the drag on transition economies when state subsidies are maintained).

113. China embraced the idea of modern technology, new strategies, education and better training with regard to its military in the late 1970's. U.S. DEPARTMENT OF STATE, *supra* note 16, at 13.

114. Mao viewed the pursuit of material gain – closely related to personal achievement – as corrupting. BARNETT, *supra* note 15, at 30. A recurring ideological conflict in China since 1949 was between "redness" and expert. At times, fervent political ideology was viewed as sufficient and even superior to technical expertise, and technical expertise was sometimes viewed with suspicion or as a sign of class inequality. ECKSTEIN, *supra* note 16, at 35-36, 46. During the Cultural Revolution, for example, universities were actually closed

competition, and is fed by innovation, education, training, opportunity, and mobility, among other things.¹¹⁵ China's successful transition to a market economy therefore requires improvements in science and technology training,¹¹⁶ education,¹¹⁷ and labor and capital mobility.¹¹⁸ Labor and capital mobility, in particular, is important so that competitors can adapt to market demand and quickly take advantage of new opportunity.¹¹⁹ Both types of mobil-

down for 4 years. John P. Hardt, *supra* note 87, at IX. "Senior professors, respected Communist officials, and dedicated scientists suddenly found themselves [during the Cultural Revolution] paraded with dunce caps and placards, beaten up, subjected to merciless interrogation, and dispatched to tours of hard labor in remote areas." Ashbrook, *supra* note 31, at 27.

For an in-depth discussion of China's suspicion and disdain of the intelligentsia immediately after the revolution, see Leo Orleans, *China's Science and Technology: Continuity and Innovation*, in JOINT ECON. COMM., 92D CONG., PEOPLE'S REPUBLIC OF CHINA: AN ECONOMIC ASSESSMENT 185 (1972).

115. WTO, *supra* note 27, at 90-94.

116. China's already very low ratio of science and technology research and development (R&D) expenditure to GDP actually experienced a decline in the 1990s. Furthermore, Chinese enterprises are far from being the leaders in innovation. China still relies on foreign supply of advanced industrial technologies, and the lack of domestic progress in this area has further increased reliance on foreign technology. Poor domestic technological capability could lead to serious structural weaknesses in the Chinese economy.

OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 195.

117. For example, in 1999, less than forty percent of China's rural population (numbering approximately 910 million) had attended junior high school (i.e., fewer than 3,640,000 rural Chinese citizens have attended junior high school). *Id.* at 549. And less than five percent of the rural population (i.e., fewer than 6,500,000) had attended high school. *Id.* "For these reasons, a rapid expansion of senior secondary and higher education is highly desirable insofar as it can be afforded . . . China undoubtedly will need to establish many additional institutions for upper secondary and higher education in the near future, and these should be spread more evenly across the territory than existing ones." *Id.* at 549. "Private [tax exempt] universities that respond rapidly and nimbly to the changing demands of the labour market of the new economy could provide some of the diversity and flexibility that the Chinese education system will require." *Id.* at 799.

118. The educational "reforms" imposed during the Cultural Revolution – which have greatly subsided but are still somewhat present – included abolishing entrance exams, shortening traditional curriculum and increasing political indoctrination, eliminating all theoretical study and research unrelated to productive pursuits, and including more productive labor at all levels of education. Orleans, *supra* note 114, at 198. As a result, though, of the attacks on "intellectualism" China experienced an "acute shortage" of skilled and technical expertise, leading the State to take the "audacious" step of sending "large numbers of students abroad to study science and technology in the industrialized capitalist countries – including the United States, Japan, several Western European countries, Canada, and Australia." BARNETT, *supra* note 15, at 3.

119. Of course, in the pre-reform era, the Chinese State did not want individuals' place of residence or occupation to be influenced by market conditions but determined instead by socialist planning. The hukou system served to override economic motivations:

China's resource endowments were characterized as capital-scarce but labor-abundant. The economy was largely agrarian in the early days of the PRC. Influenced by the Soviet model, China placed high priority on heavy industry to speed up its industrialization. In order to finance the expansion of heavy industry, the

ity are hampered by the inability of the social welfare system to deliver goods and services to burgeoning populations, the mobility of which is important to the market economy. For example, China continues to maintain artificial barriers to internal migration because of fears that people will move to and overcrowd areas offering the best opportunities relative to their skills, needs, and preferences. Likewise, surplus capital continues to be tied up in loss generating investments because to immediately withdraw capital from state-owned enterprises would drastically and suddenly increase the demands for social welfare. Even if China's social welfare delivery system were to remain as omnipotent during and after transition—a possibility that is inherently inconsistent with a mature market economy—the transition would nevertheless create other economic needs that, unmet, would generate serious challenge to the permanence of the market economy. Altruistic investment, such as occurs when people contribute to colleges, universities, hospitals, and cultural organizations, can address all of the foregoing needs.

A final resulting need with regard to China's transition to a market economy involves stemming what has been referred to as the "brain drain." As China becomes more successful in stimulating the education and training necessary to successfully compete in a global capitalist system, it will need to provide its educated and trained citizens with incentives to remain in those areas most lacking in skilled labor.¹²⁰ Observers have previously noted that a large percentage of Chinese people who receive advanced education either leave or, with regard to those who are educated abroad, do not return to China.¹²¹ This phenomenon is attributed to the relative lack of cultural and other quality of life amenities, the demand for which is no doubt stimulated by education and training.¹²² In contrast to the strictly economic goal of a market economy, there

state underpriced agricultural products and overpriced industrial products to induce unequal exchange between the agricultural and industrial sectors. To maintain this artificial imbalance under the condition of dual economy, the state had to create a system which blocked free flows of resources (including labor) between industry and agriculture and between city and the countryside.

CHAN & ZHANG, *supra* note 61, at 3.

120. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 212 (discussing the major "brain drain" from China over the last two decades).

121. U.S. DEPARTMENT OF STATE, *supra* note 16, at 3 (noting that most Chinese students who study abroad do not return, though they do increase opportunities for international contacts with China from the host country).

122. On the other hand, the U.S. - China Security Commission views the presence of large numbers of Chinese scholars as a troubling source of technology transfer from the United States to China. U.S. - CHINA SECURITY REVIEW COMMISSION, *supra* note 16, at 10.

should be a sort of autarkic policy with respect to individual cultural, educational, and entertainment preferences. Redundancies across regions with regard to cultural, educational, and entertainment opportunities reduce incentives for over-migration to more culturally diverse coastal or urban areas,¹²³ those that are most likely to already have sufficient sources of skilled and educated human capital.¹²⁴

Altruistic investment is, as has been shown, entirely irrelevant in a society that maintains an omnipotent and inviolate social welfare delivery system. It should not be surprising, then, that modern China lacks any tradition of altruistic investment. On the other hand, altruistic investment is both relevant and necessary in a market economy that disdains welfare, but instead relies on self-serving pursuit of profit and the inequalities such pursuits invariably create. Because socialism and capitalism are mutually exclusive, competitive market-based economies necessarily create pockets of absolute poverty, even as they increase the efficient delivery of goods and services for most people. Nonetheless, in the absence of absolute poverty social inequalities can lead to resentment and social disorder, though perhaps to a lesser degree than absolute poverty.¹²⁵ Altruistic investment is thus relevant in a market economy not only as a tool to address absolute poverty, but also to address resentments from relative poverty as well. While the primary effect of altruistic investment is to ensure, or at least increase the social order upon which the market economy depends for its continued existence, altruistic investment also assists with the maintenance of the market economy by helping provide educated and skilled labor, as well as technological innovations. China's headlong pursuit of a market economy, with the United States' encouragement, creates the relevancy and necessity for altruistic investment if the market economy is to succeed.¹²⁶

123. For a complete discussion of the growing financial and cultural inequalities as between urban and coastal regions, and rural and central regions see OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 679-87.

124. The service sector provides a variety of crucial functions – the distributive infrastructure for extractive and manufactured goods, financing for enterprises, the administrative functions that enable a society to exist, the maintenance and recycling (renting/leasing) facilities for durable goods and *the activities (health, education, recreation) that enhance the quality of the labour force*.
Id. at 130 [emphasis added].

125. “The fact that during the reform era China has experienced an exceptional increase in [income] inequality is cause for concern.” *Id.* at 109.

126. How can social policies support a [transition economy]? By targeting social safety nets to the most vulnerable, such as those affected by the increase in utility prices and by the labor shedding resulting from hard budget constraints on enter-

The next Section shows that the two countries share a common approach to the stimulation of altruistic investment. However, both countries ignore and in certain ways even discourage international altruistic investment. After reviewing the technical rules that prove these points the Article considers why both countries might rationally decide not to alter the present state of affairs, and then proposes a course of action that would be helpful if both countries sought to reverse the present state of affairs.

IV. TAX INCENTIVES FOR ALTRUISTIC INVESTMENT IN THE PEOPLE'S REPUBLIC OF CHINA: OPPORTUNITIES AND BARRIERS

The two previous sections present the case for altruistic investment in China. It should be noted, though, that while altruistic investment is an ultimately self-serving activity, the reward or yield from an altruistic investment is not at all obvious. It is therefore not unreasonable for individuals to ignore altruistic investment. There are a variety of other investments, especially in a market economy, from which individuals may obtain more immediate, less remote and uncertain yields. The challenge, then, is to transform altruism from an abstract, long-term investment to one that is more short-term and concrete. Providing a tax benefit to altruistic investors is the most common way to accomplish this goal in capitalist economies.¹²⁷ The U.S. tax code adopted this approach nearly one hundred years ago. The Chinese have only more recently published a set of tax laws but those laws appear to adopt the approach of creating immediate financial incentives for altruistic investment. While both countries have sought to coordinate their efforts in establishing the Chinese capitalist economy, they have not sought to coordinate their respective pursuits of altruistic investment. This Section describes each country's tax laws as they pertain to altruistic investment. The description includes references to barriers to the efficient operation of tax incentives in both countries, particularly those barriers relating to altruistic investment by Amer-

prises. By helping local governments take over divested social services previously provided by enterprises, such as housing, kindergartens, and clinics, to permit enterprise restructuring to go ahead. And by reforming expenditures on education and health to allow workers to acquire skills more adapted to new market realities and, more generally, to ensure that the benefits of growth, once it resumes, are widely shared.

THE WORLD BANK, *supra* note 27, at 81.

127. For a summary of the world's tax laws pertaining to altruistic investment, see Infanti, *supra* note 22.

icans in China.¹²⁸ The following Section acknowledges and discusses reasons why both countries might want to maintain those barriers and then provides a possible means by which the two countries could encourage altruistic investment without necessarily sacrificing their differing long term goals.

A. Survey of Chinese Tax Incentives for Altruistic Investment

1. Tax Incentives for Individual Altruistic Investment

What will be referred to as the Chinese tax code consists of five different taxing statutes: the Individual Income Tax, Enterprise Income Tax, Value Added Tax, Business Tax, and Consumption Tax. The first, the "Individual Income Tax Law of the People's Republic of China" (Individual Income Tax Law), imposes a tax on "individual income," a phrase that is apparently defined in the same manner as "gross income" in the U.S. tax code.¹²⁹ The Individual Income Tax Law appears to reach all forms of accessions to wealth not specifically exempted from taxation. Article 6 of the Individual Income Tax Law authorizes a deduction from taxable income for donations to "educational and other public welfare undertakings."¹³⁰ The "Detailed Rules for the Implementation of the Individual Income Tax Law of the People's Republic of China" (Individual Income Tax Regulations) specify that the deduction cannot exceed thirty percent of a taxpayer's taxable income, but they do not provide for a carryover of excess donations.¹³¹ The failure to provide for carryovers, of course, discourages larger one-time donations in excess of thirty percent of a donor's taxable income because the excess can never be deducted. Neither the Individual Income Tax Law nor Regulations define "educational and other public welfare undertakings," though the Income Tax Regulations specify that donations made to social organizations or government organs for disaster or poverty relief qualify for the deduction.¹³²

128. "Despite the importance of charitable giving for international purposes, significant limitations are imposed by the U.S. tax system." Change et al., *supra* note 6, at 563-64.

129. See also *Detailed Rules for the Implementation of the Individual Income Tax Law of the People's Republic of China*, arts. 5, 8 (1994) (defining income to include wages and payments for services, rental income, gains derived from dealings in property, royalties, interest, and dividends, and income from the conduct of business) [hereinafter *Rules for the Implementation of Individual Income Tax*].

130. Individual Income Tax Law of the People's Republic of China, art. 6 (1999).

131. *Rules for the Implementation of Individual Income Tax*, art. 24 (1994).

132. *Id.*

Similarly, the "Provisional Rules of the People's Republic of China on Enterprise Income Tax" (Enterprise Income Tax) subject the income of "enterprises" to a flat thirty-three percent tax. Article 6 provides for a deduction for "donations used for public welfare and relief purposes." The deduction is limited to three percent of the enterprise's taxable income. The "Enterprise Income Tax Implementing Rules" (Enterprise Income Tax Rules) provide a bit more guidance with regard to the donation deduction than do the Individual Income Tax Law and Regulations. In particular, Article 12 states:

Donations used for public welfare and relief purposes . . . shall refer to donations made by taxpayers to educational, civil administration and other public welfare undertakings, as well as to areas suffering from severe natural disasters or poverty stricken areas through non-profit-making social organizations, or government organs in China. Donations made directly to donees by taxpayers shall not be permitted to be deducted.

Article 12 continues by defining "social organizations" as "public welfare organizations established with the approval of civil administration organs."

The Enterprise Income Tax does not apply to business owned in whole or part by foreign persons. Those businesses are instead taxed under "The Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprise" (Foreign Enterprise Tax Law).¹³³ Parity exists nevertheless between domestic and foreign business with regard to altruistic investment because the Foreign Enterprise Tax Law similarly provides for a contribution deduction of up to three percent of taxable income.¹³⁴ Jurisdiction under the Foreign Enterprise Tax Law is triggered when a Chinese-foreign joint venture or wholly foreign-owned enterprise creates an "establishment" in China.¹³⁵ Significantly, the Chinese State Administration of Taxation (SAT) has held in an administrative ruling that foreign non-profit organizations that are recognized as tax exempt in their home country may be granted tax exempt status in China solely on the basis of

133. Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprise (1991).

134. Neither the Foreign Enterprise Tax Law nor the implementing regulations specify that the deduction is limited to three percent. *See generally* OWEN D. NEE, JR. ET AL., BUSINESS OPERATIONS IN THE PEOPLE'S REPUBLIC OF CHINA, at A-46 n.213 (Tax Mgmt., Foreign Income Series No. 957-2d, 2001).

135. Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprise, art. 2 (1991).

their home country tax exempt.¹³⁶ At least in theory, then, China has a formal and broadly stated mutual recognition provision in its tax laws. A U.S. charity, according to the administrative ruling, need only present its determination letter to the SAT and thereafter be accorded tax exempt status in China.¹³⁷

As is apparent, neither the Individual Income Tax Law or Regulations nor the Enterprise Income Tax or Regulations sufficiently define the type of organizations to which donations will generate a deduction. The recently adopted "Public Welfare Donation Law,"¹³⁸ (Welfare Donation Law) however, provides an apparently non-exclusive list of activities which would lead to the treatment of an organization as one to which donations would generate a deduction. These activities include disaster and poverty relief, education, scientific, cultural, public health and athletic activities, environmental protection and construction of public facilities, and "other public welfare undertakings promoting social development and progress."¹³⁹ This broad definition is nearly identical, in effect, to that found in the U.S. tax code's definition of organizations to which contributions generate a deduction.¹⁴⁰

In addition to the Individual and Enterprise Income Taxes, China imposes national sales and import taxes on goods and certain services relating to repair of goods. China's value added tax (VAT) is essentially a seventeen percent tax on value added, that is, "the difference between the value of a firm's sales and the value of the purchased material inputs used in producing goods sold."¹⁴¹ Certain goods normally associated with altruistic investment are exempt from VAT. These include "instruments and equipment imported for direct use with scientific research or experiments, and teaching," and "goods imported as gratuitous aid from foreign governments and international organizations."¹⁴² Perhaps the most detailed and broadest statement of tax exemption in Chinese law is contained in the "Provisional Regulations of the People's Republic of China on Business Tax" (Business Tax Law). That stat-

136. Notice of the State Administration of Taxation on issues Concerning Improvement of Taxation Collection Administration for Foreign Enterprises Resident Representative Offices, art. I(II) (Sept. 13, 1996) (stating that foreign "nonprofit" organizations will not be subject to tax in China).

137. *Id.*

138. Welfare Donations Law of the People's Republic of China (1999).

139. *Id.* at ch. 1, art. 3 (1999).

140. *Cf.* I.R.C. § 501(c)(3) (1986).

141. Provisional Value-Added Tax Regulations of the People's Republic of China, art. 2 (1994).

142. *Id.* art. 16 (1994).

ute imposes what is essentially a sales tax on services that are not covered by VAT. The following services, however, are specifically exempted from the Business Tax and, because those services are not covered by VAT, they are effectively exempt from all national sales taxes:

- (1) educational and nursing services rendered by nurseries, kindergartens, homes for senior citizens, and welfare organizations for disabled persons, matchmaking agencies and funeral homes;
- (2) services rendered by individual disabled persons;
- (3) medical services rendered by hospitals, clinics or other medical institutions;
- (4) educational services rendered by schools or other educational institutions; services rendered by students under the work-study program;
- (5) businesses related to mechanized cultivation, irrigation and drainage, pests prevention and control measures, plant protection, farming and animal husbandry insurance, and any related technical training businesses, breeding and disease prevention for domesticated animals, livestock and aquatic animals;
- (6) income obtained from sale of tickets for cultural activities held by memorial halls, museums, cultural centers, art institutes, exhibition halls, Chinese calligraphy and painting centers, libraries, and units in charge of protection of cultural relics, and income obtained from sale of tickets for cultural and religious activities held at religious centers.¹⁴³

B. *Incentives for Collective Altruism*

Making sense of China's approach to altruistic organizations seems like an almost hopeless endeavor until one suddenly realizes that privately conceived and operated altruistic organizations are virtually nonexistent in China. Yet groups routinely referred to as "nongovernmental organizations" comprising "civil society" are said to number between 70,000 and 180,000 in China.¹⁴⁴ In reality, the vast majority of those organizations are more accurately

143. Provisional Regulations of the People's Republic of China on Business Tax, art. 6 (1994).

144. OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 370 (stating that there are 70,000 NGO's in China); *see also* CHUNYING & YE, *supra* note 54, at 90-91 (stating that there were 180,538 registered NGO's and NPO's in China as of 1995, but also stating that Chinese NGO's and NPO's are not equivalent to western style organizations because there is no clear demarcation between government and non-governmental organizations). The most official estimate of what are described as "nongovernmental" organizations puts the number at 165,600. Guangyao Chen, Deputy Bureau Director, Nongovernmental Organizations Administrative Bureau, China's Nongovernmental Organizations: Status, Government Policies, and Prospects for Further Development, Address Before the World

described as government auxiliaries.¹⁴⁵ They are thoroughly conceived, born, staffed, operated, and controlled by and in accordance with various government agencies and policies.¹⁴⁶ They exist not to provide policies or means of social welfare delivery alternate to government or business, but solely to extend such policies and delivery systems without deviation from the ways and means of government.¹⁴⁷ The use of the label “nongovernmental organization” is therefore as much a confusing misnomer¹⁴⁸ as the phrase “independent sector” would be if applied to such organizations. There is simply no real community of private social organizations in China at the present time.¹⁴⁹ Nevertheless, an understanding of these “government-nongovernment organizations,” as one Chinese writer candidly calls them,¹⁵⁰ furthers an understanding of China’s approach to truly private charitable organizations.¹⁵¹ As further explained below, the suspicion animating China’s State supervision of government-nongovernment organiza-

Congress of Association Executives (Aug. 12, 2000) (transcript available at http://www.icnl.org/journal/vol3iss3/ar_guangyao.htm) (last visited Jan. 17, 2004).

145. After the CCP took power, the three main organizations that would most likely be referred to as nonprofit organizations were the Trade Union, the Youth League, and the Women’s Federation. CHUNYING & YE, *supra* note 54, at 87. Chinese scholars candidly note, however, that these organizations were “in reality peripheral organizations of the Party. The Trade Union and Women’s Federation became ‘assistants to the party,’ and the Youth Federation became both ‘the assistant and the reserve of the party.’” *Id.*

146. “NGOs and NPOs [are] not pure citizens’ groups, independent of the government.” Instead, they are “given the responsibility of carrying out some of the Party’s and government’s policies. Chinese NGOs and NPOs served as intermediaries between the political system and civil society or as supplements to government bodies. *Id.* at 88.

147. Zhao, *supra* note 55 (“most social organizations are controlled by the Chinese government, and few are genuine NGOs”).

148. The term “NGO” is a misnomer, because, while some of these bodies are private, particularly those concerned with environmental protection, health care, education for poor children, women’s issues, and rural development, most are privatized state-owned NGOs, such as trade unions, the Chamber of commerce, and the All-China Women’s Federation.

OECD, CHINA IN THE WORLD ECONOMY, *supra* note 46, at 370.

149. *But see* Lee, *supra* note 20, at 378 (concluding, without explanation, that “the close nexus between government actors and NGOs does not mean that Chinese NGOs are nothing more than unofficial extensions of the state”).

150. Zhao, *supra* note 55.

151. One American scholar divides Chinese civil society into four groups: (1) mass organizations that play an “officially sanctioned political role” – an historical European example of notorious distinction would be the Hitler Youth; (2) social organizations, which include business groups, cultural clubs and academic societies; (3) unofficially groups the State informally condones, such as “lineage associations”; and (4) unofficial groups the government seeks to suppress, such as adherents of Falun Gong. *See* Lee, *supra* note 20, at 376.

tions helps explain its reluctance to support and advance the formation of a truly independent sector.¹⁵²

China's enabling law for government-nongovernment organizations is entitled "Regulations on the Registration and Management of Social Organizations" (Social Organization Law)¹⁵³ and it is simple yet deceptive in its implications. While it does not affirmatively define those activities that justify classification as a "social organization" it prohibits such organizations from engaging in profit-making activities.¹⁵⁴ Recall, too, that both the Welfare Donation Law and the Enterprise Tax Law define activities of organizations donations to which generate a tax deduction. It would seem logical that the definitions in those laws would apply or at least influence the interpretation of the term, "social organization" under the Social Organization Law. The striking additional feature added by the Social Organization Law, and the one that creates the oxymoronic nature of government-nongovernment organizations is that social organizations claiming legal status under the Social Organization Law must seek the approval and submit to the supervision of a "professional responsible authority."¹⁵⁵ Sparse, but relevant literature confirms that this requirement provides the mechanism by which the State can exercise central planning of the sort previously utilized with respect to all other aspects of Chinese life.¹⁵⁶ As it turns out, the "professional responsible authority" is actually a government department and it is that department that sets the social organization's agenda and ensures that the organization adheres to that agenda.¹⁵⁷ This explicit reservation of authority illustrates the stark difference between Chinese social organizations and organizations that comprise the independent sector in most other countries.

152. "The leaders of the Chinese government are very cautious towards any movement in this newly emerging sector. They are on guard against any threats to the political stability and social order in China." Zhao, *supra* note 55.

153. Regulations on the Registration and Management of Social Organizations (1989), reprinted in CHUNYING & YE, *supra* note 54, at 110.

154. *Id.* art. 4.

155. *Id.* art. 9.

156. To be registered, a social organization must first be affiliated with a government line agency. Such linkage can occur when a government agency takes the initiative to set up an association or foundation to supplement its role. Or a group of people, interested in a particular task and with funds to do the work, can approach a government organization whose work is similar to their interests and seek support and protection. With the support and approval of a line agency, a social organization can then apply for legal registration.

CHUNYING & YE, *supra* note 54, at 94.

157. *Id.*

The same broad implication is present in a more recently enacted law designed, ostensibly, to encourage “private” nongovernmental organizations. Such organizations, too, must seek and submit to the approval and regulation of a competent business unit.¹⁵⁸ As with the Social Organization Law, the Private Social Organization Law’s use of “competent business unit”¹⁵⁹ actually refers to a government agency that is empowered to supervise the organization’s activities.¹⁶⁰ Thus, altruistic organizations that are conceived and organized by private citizens must nevertheless find a government agency willing to act not only as their sponsor but also as the State’s watchdog and veto authority over the private organizations’ activities. Anecdotal evidence suggests that this requirement creates an insurmountable barrier to the growth of a truly independent sector in China.¹⁶¹ Most government agency personnel reject applications for exemptions from private organizations because they do not want the responsibility of supervising the organization and they fear that the organization’s extra-governmental, potentially subversive activities will be attributed to them.¹⁶² One Chinese scholar candidly admits that “there is not much possibility” for the creation of private charitable organizations in China.¹⁶³ This prognosis is attributable to the belief, candidly articulated by Chinese scholars, that private social organizations contain “threatening elements.”¹⁶⁴ Quite curiously,

158. Zhao, *supra* note 55.

159. The Interim Provisions on the Registration and Administration of Private Non-enterprise Units, ch. I, arts. 3, 5 (1999).

160. Zhao, *supra* note 55.

161. *Id.* The Interim Provisions on the Registration and Administration of Private Non-enterprise Units requires that an application for recognition be rejected if there is evidence that the organization might endanger reunification [apparently referring to Taiwan], cause social unrest or breach social ethics and morality.” The Interim Provisions on the Registration and Administration of Private Non-enterprise Units, ch. I, art. 11 (1999).

162. *China’s Charity Case*, ASIAN WALL ST. J., July 20, 2001, at W1 (“Official agencies don’t want to take the opportunity for private nonprofits because it is bothersome and if something goes wrong, officials will lose their posts.”).

163. Zhao, *supra* note 55. The writer goes on to state:

Chinese NGO’s should become independent in society, but keep a close, cooperative relationship with the government. They should be friends, partners, and collaborators of the government. By that time, the government will not worry too much about negative possibilities with a NGO sector as before. The crucial time for the Chinese government to release strict control on private NGO’s will be coming, and the current provisional regulations concerning the NGO sector will be replaced by relevant laws which are rational, sound and permanent. The NGO sector combined with the market sector and the state sector in China will play its ideographic role in China as well as in global sustainable development.

Id.

164. *Id.*

though, even the government-nongovernment organizations have been described by Chinese authorities as "congenitally defective"¹⁶⁵ precisely because they are too dependent on government. Whatever the import of this seeming schizophrenia,¹⁶⁶ the broader implication arising from the Chinese approach is that the State will take a dimmer and more restrictive approach to foreign altruistic organizations seeking legal status in China. Indeed, while the government has stated its intention to enact a law pertaining to foreign charitable organizations, it has yet to do so.¹⁶⁷

C. *Survey of U.S. Tax Incentives for Altruistic Investment*

1. Incentives for Individual Altruistic Investment

Although the U.S. tax code's approach to altruistic investment is nearly one hundred years old, it is nevertheless subject to ambiguity and controversy. Both the ambiguity and continuing controversy result primarily from the complexity of I.R.C. § 170, a complexity that invariably acts as a disincentive for charitable giving.¹⁶⁸ The effect is amplified when altruistic investment is made across international boundaries. Rules directly pertaining to cross-border altruistic investment, though they are not so very complex, simply magnify the negative effect to a greater extent. A brief overview of the authorizing and limiting provisions contained in the U.S. code suffices to prove these contentions.

Under the U.S. tax code, individuals may deduct charitable contributions to public charities and certain other specified recipients to the extent such contributions do not exceed fifty percent of their adjusted gross income.¹⁶⁹ For corporations, however, the charitable contribution is limited to ten percent of taxable income.¹⁷⁰ Contributions to private foundations are deductible at

165. Chen, *supra* note 144.

166. While on the one hand Chinese officials complain that Chinese NGO's are too dependent on government, on the other they state: "The Chinese government will hold fast to the principle of 'scientific planning, correct guidance, improved legal framework, and normalized development' to develop and nurture China's NGOs." *Id.*

167. *Id.*

168. For a thorough and still timely discussion of the complexities and disincentives in the U.S. Tax code provisions relating to altruistic investment (charitable contributions and charitable organizations), see C. Eugene Steuerle & Martin A. Sullivan, *Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations*, 12 AM. J. TAX POL'Y 339 (1995).

169. I.R.C. § 170(b)(1)(A) (1986).

170. I.R.C. § 170(b)(2) (1986).

rates of thirty percent¹⁷¹ and ten percent¹⁷² for individuals and corporations, respectively. One significant incentive for both individual and corporate altruistic investors is that if a donor owns property for more than twelve months prior to the donation, the amount of the deduction will equal the fair market value of the property.¹⁷³ That is, a donor can escape taxation of the appreciation in the property and still earn a tax deduction for that appreciation. Two complicating factors potentially act as disincentives for cross-border altruistic investment in this regard. First, the appreciation in the property is not deductible if the contribution is made to a private foundation¹⁷⁴ and second, the appreciation is not deductible if the property is unrelated to a public charity's charitable goals.¹⁷⁵ Both limitations create potential bias against cross border giving, although the former limitation does so to a greater extent. This is because a foreign recipient is more likely to be classified as a private foundation.¹⁷⁶ Note that these rules apply only to in-kind contributions. Contributions of long-term appreciated property is therefore more advantageous for the altruistic investor than is a contribution of cash, because the cash will likely have been subject to taxation in the hands of the donor prior to its contribution.¹⁷⁷ An investor seeking a deduction equal to the before tax fair market value of her contribution is therefore better advised to invest appreciated property domestically rather than internationally. An overall disincentive to individual, but not corporate, altruism is that the deduction is available only to those individual taxpayers who forego the standard deduction and instead itemize their deductions.¹⁷⁸ Because relatively few individuals itemize, the charitable contribution is considered generally ineffective as a motivator of individual altruistic investment.¹⁷⁹

There are even more explicit disincentives to international altruistic investment, whether individual or corporate. Since 1935 the

171. I.R.C. § 170(b)(1)(B) (1986).

172. I.R.C. § 170(b)(2) (1986).

173. Treas. Reg. § 1.170A-1(c) (2002).

174. I.R.C. § 170(e)(1)(B)(ii) (1986).

175. I.R.C. § 170(e)(1)(B)(i) (1986).

176. See I.R.C. § 508(b) (charitable organizations not recognized by the IRS are presumed to be private foundations).

177. A cash gift that is later donated to a charitable organization would not have been subjected to tax in the donor's hands. See I.R.C. § 108 (1986).

178. I.R.C. § 63(a) (1986).

179. STAFF OF JOINT COMM., DESCRIPTION OF REVENUE PROVISIONS, *supra* note 39, at 7-10 (summarizing the evidence in support of the notion that providing a deduction for non-itemizers would increase charitable giving).

U.S. tax code has imposed geographical limitations on the recipient's place of origin. I.R.C. § 170(c)(2)(A) requires that a recipient organization be created or organized under U.S. domestic law.¹⁸⁰ Contributions directly to a foreign charity—that is, a charity organized under the authority of a non-domestic law—are not deductible.¹⁸¹ The geographical limitation has never been enforced beyond the requirement that a foreign charity apply for recognition in the United States. Contributions to a domestic organization generates a tax deduction even if all parties to the transaction expect that the contribution will be used in a foreign country.¹⁸² The geographical limitation still requires that the recipient organization undertake the time and expense of seeking legal recognition in a domestic jurisdiction, as well as submit to the regulation of that jurisdiction. A Chinese altruistic organization seeking U.S. investors would need to either apply for legal status in the United States or establish a relationship with a domestic organization that, in turn, transferred donations made to the domestic organization to the Chinese organization.¹⁸³ As a practical matter, then, the geographical limitation probably removes the most grass roots of organizations from gaining access to U.S. altruistic investment.

For corporate taxpayers, the geographical limitation is even more stringent, yet also surmountable via a curious loophole in I.R.C. § 170. Like individual altruistic investment, corporate altruistic investment generates a deduction only if made to a domestically recognized organization. In addition, the investment must actually be used domestically, but only if the investment is made to a “trust, chest, fund, or foundation.”¹⁸⁴ For reasons never adequately explained, a corporate investor is entitled to a deduction

180. For a history of the geographical limitations of I.R.C. § 170, see Change et al., *supra* note 6, at 568.

181. The stated justification for the restriction was that the United States gained no benefit from extra-territorial donations. H.R. REP. NO. 75-1860, at 19-20 (1938).

182. Treas. Reg. § 1.170-A-8(a)(1) (2002) (“A charitable contribution by an individual to an organization described in section 170(c) is deductible even though all, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes.”). As long as a domestic organization is not required to use donations in a foreign country, donations to the organizations will be considered made to a domestic organization even if the organization is expected to and ultimately decides to use the donation in a foreign country. Rev. Rul. 63-235, 1963-2 C.B. 210; Rev. Rul. 66-79, 1966-1 C.B. 48; Rev. Rul. 75-65, 1975-1 C.B. 79. Thus, donations to an organization entitled, “Friends of China” would be deductible if the organization is organized under domestic law even if the donation is to be used, at the organization's sole discretion, in China.

183. *See id.*

184. I.R.C. § 170(c) (1986).

regardless of where the investment is used if the recipient is something other than a trust, chest, fund, or foundation.¹⁸⁵ If the recipient is a corporation, then the investment may be used anywhere in the world and the corporate investor will nevertheless be entitled to a deduction.¹⁸⁶ Again, as a practical matter, the truly grass roots organizations—those that do not bother or are not sophisticated enough to form a domestic corporation—are essentially excluded from another source of international altruistic investment.

Another barrier, though not as explicit, to the receipt of corporate donations arises from the application of the foreign tax credit.¹⁸⁷ A U.S. multinational corporation is entitled to claim a credit against its taxable income for taxes paid to a foreign government. That credit in any one year is limited to a figure derived by multiplying the corporation's tax rate by the corporation's taxable income from foreign sources.¹⁸⁸ Consequently, the more foreign source taxable income a corporation has, the larger its foreign tax credit will be. Foreign source taxable income is reduced, however, to the extent that a charitable contribution is used in the foreign jurisdiction. Under proposed regulations, if a corporation knows or has reason to know that a charitable contribution is to be used solely in a foreign jurisdiction, the foreign source income must be reduced by the deductible amount thereof.¹⁸⁹ As a result, a corporate altruistic investor gets a higher yield when its charitable contribution is designated solely for use in the United States. In such instances, it may claim both the charitable contribution deduction and the undiminished foreign tax credit, resulting in a higher after-tax yield. Further, if a taxpayer is unable to claim credit for all foreign taxes in any one year, the taxpayer may claim the excess as a credit for the prior two, and succeeding five years, subject to the same overall limitation.¹⁹⁰ A corporation in such an "excess credit" position would gain less by making foreign use charitable contributions during those carryback or carryover years than it would if it restricted its altruistic investments to domestic causes. If nothing else, the foreign tax credit limitation encourages sporadic, as opposed to regular and annual, international altruistic investments.

185. *Id.*

186. Change et al., *supra* note 6, at 584-85.

187. I.R.C. § 901(a) (1986).

188. *Id.*

189. Prop. Treas. Reg. § 1.861-8(e)(12), 56 Fed. Reg. 10,395 (Mar. 12, 1991).

190. I.R.C. § 904(c) (1986).

The effect of the allocation rules with respect to corporate charitable contribution is to create an indirect disincentive for international altruistic investment.¹⁹¹ The disincentive results from the fact that domestic altruistic investment, all other things being equal, will result in a higher yield. A similar disincentive applies with respect to certain U.S. domestic tax exempt charities that want to make international altruistic investments. Recall that as a practical matter, it is exceedingly difficult for a private nonprofit organization to gain legal recognition and thereafter conduct tax free charitable operations in China.¹⁹² One alternative would be for the U.S. nonprofit organization to conduct such operations indirectly by providing grants and other funding to Chinese "friends of" organizations.¹⁹³ That is, a U.S. nonprofit organization could altruistically invest in a Chinese organization organized under U.S. domestic law for the purpose of making altruistic investments in China. Indeed, this is the most available option for U.S. individuals and organizations in light of the geographical limitations of I.R.C. § 170 and the lack of any Chinese legal structure or desire for the recognition of foreign nonprofit organizations. The U.S. nonprofit organizations that would most effectively utilize this alternative are known as nonoperating private foundations. Essentially, these are nonprofit organizations that are neither the recipient of widespread public donations nor directly engaged in charitable activities.¹⁹⁴ Instead, nonoperating private foundations are funded by a relatively small number of individuals and conduct charitable activities indirectly, by funding other altruistic organizations or by making grants to individuals. Typically, though not uniformly, private foundations are wealthier than other U.S. charitable organizations and thus represent a significant source of altruistic investment.

There are two tax statutes, however, that create disincentives for private foundations seeking to make international altruistic investments. The first, I.R.C. § 4942, requires that nonoperating private foundations annually distribute at least five percent of the net value of their assets held for investment (noncharitable assets), rather than for direct use in a charitable activity. A violation of that requirement subjects a foundation to a tax equal to first, fifteen,

191. Change et al., *supra* note 6, at 588 (international charities "feared that the new regulation increased the marginal benefit of giving to U.S. charities and would thus reduce corporate funding of international charities[]").

192. See *supra* notes 141-62 and accompanying text.

193. See *supra* note 182.

194. See generally I.R.C. § 509 (1986).

and then one hundred percent of the amount by which annual distributions fall short of the five percent requirement.¹⁹⁵ Because nonoperating foundations do not directly engage in charitable activities, the value of noncharitable assets and the minimum payout for any year are normally relatively high. On the other hand, private foundations stereotypically prefer large endowments, a preference that is inconsistent with high annual spending or distributions.¹⁹⁶ Distributions to organizations that are not recognized as U.S. public charities do not count towards the five percent payout required by I.R.C. § 4942.¹⁹⁷ Foreign organizations are naturally less likely to apply for recognition in the United States.¹⁹⁸ As a result private foundations are less likely to make international altruistic investments and more likely to make distributions to domestic organizations since the former investments do not help them meet the five percent payout requirement.

The second tax statute that creates a disincentive for international altruistic investment by private foundations is I.R.C. § 4945, which imposes a similar two tier tax on “taxable expenditures.”¹⁹⁹ Significantly, the tax applies if a foundation makes any payment to an organization that is not recognized as a U.S. public charity.²⁰⁰ The section 4945 tax, as with the I.R.C. § 4942 tax, would presumptively apply whenever a private foundation transfers wealth to a Chinese social organization that is not recognized as a public charity under U.S. law.

Private Foundations can avoid the section 4942 and 4945 taxes by making an “informed” decision based upon sufficient financial data that the recipient qualifies for public charity status under U.S. law, even though the recipient has not actually applied for such status.²⁰¹ If the private foundation cannot make such a determination, it may still avoid the I.R.C. § 4945 tax by exercising continuing administrative oversight – “expenditure responsibility” – over the recipient’s use of any payments received from the private foun-

195. I.R.C. § 4942(a)-(b) (1986).

196. See *Maverick Charities Boost Donations to Attack Ills Now*, WALL STREET J., Sept. 10, 2002, at A1 (noting that private foundation assets have increased while charitable giving has decreased since 1981, and that most foundations prefer to accumulate large endowments over immediate spending).

197. I.R.C. § 4942(g)(1) (1986).

198. See Harvey Dale, *Foreign Charities*, 48 TAX LAW. 655, 658 (1995).

199. I.R.C. § 4945(a)-(b). The tax is 10% of the expenditure, followed by a 100% tax if the expenditure is not corrected within a certain period of time.

200. I.R.C. § 4945(d).

201. Rev. Proc. 92-94, 1992-46 I.R.B. 34.

dation.²⁰² Expenditure responsibility, though, is rather burdensome even with regard to a domestic recipient and most private foundations seek to avoid that method of escaping the I.R.C. § 4945 tax.²⁰³ In any event, the presumptive applicability of the taxes and the need for administrative measures or oversight to avoid the taxes make international altruistic investment riskier and more costly, thus resulting in a lower yield than an otherwise equivalent domestic altruistic investment.

Because the yield on altruistic investments is obscure, governments that wish to stimulate such investments need to create an obvious reward that renders such investments competitive with other available investments. Both the United States and China have sought to do so domestically through their tax codes, though the United States has a much longer history in this regard. Both countries also seem somewhat schizophrenic towards the idea of international altruistic investment. China has no provision at all with regard to its citizens taking a deduction for contributions to be used outside of China, and discourages, at best, foreign altruistic investors. The United States grants a deduction for cross border investments but only in a manner that makes such international altruistic investments less attractive relative to other forms of investments. Both countries are actively encouraging cross-border economic investments in China but they both seem nervous and ambivalent regarding altruistic investment in China, even though such investments would assist China's more rapid and successful transition to a market economy. The next Section discusses some of the reasons why both countries might hesitate to change this situation. It then offers some suggestions for addressing the neglect of altruistic investment while taking into account the reasons for the initial hesitancy.

V. REASONS FOR BARRIERS TO INTERNATIONAL ALTRUISTIC INVESTMENT IN CHINA

Whenever the United States has found it advantageous to encourage international altruistic investment, it has adopted and implemented a clear treaty mechanism by which to do so. There are only three such treaties in existence. Nevertheless, those trea-

202. I.R.C. § 4945(h) (1986).

203. See Treas. Reg. § 53.4945-5(b) (2002).

ties—with Canada,²⁰⁴ Mexico,²⁰⁵ and Israel²⁰⁶—manifest a certain recognition with regard to altruistic investment and U.S. self-interest. Each treaty provides a mechanism that supports international altruistic investment by (1) granting a U.S. deduction for contributions made to entities organized under the foreign country's laws, and (2) allowing for U.S. recognition of foreign altruistic organizations based upon their recognition under the foreign country's laws and without requiring those organizations to organize under U.S. domestic law. The treaty with Canada is most likely related to fostering open borders, signifying the historically symbiotic relationship between the United States and Canada. The treaty with Israel, obviously, is based upon complex religious and geopolitical factors that apparently make such a treaty advantageous to the United States. The motivations for the treaty with Mexico, though, are most analogous to the motivations that might justify encouraging altruistic investment in China. Altruistic investment in Mexico can assist in bringing about a better economic environment in Mexico and thus pay dividends in the form of less legal and illegal immigration into the United States.

China, too, has demonstrated the ease with which it encourages international altruistic investment when such investment is in its self-interest. The Red Cross Law of China, granting legal recognition to the International Society of the Red Cross, is but one example. Other ad hoc encouragement of altruistic investment includes programs such as the "Smile Train," through which Western volunteers provide treatment to Chinese children suffering from cleft lip and cleft palate.²⁰⁷ Unlike the United States, China has a reciprocity statute that grants domestic recognition and tax exemption to foreign charitable organizations, based on the organization's recognition in its home country, although in practice such recognition and tax exemption is exceedingly difficult, if not impossible, to achieve.²⁰⁸ Thus, when self-interests dictate, both countries have demonstrated mechanisms by which to stimulate international altruistic investment.

204. Convention With Respect to Income and on Capital, Sept. 26, 1980, U.S.-Can., art. XXI, *reprinted in* 1 Tax Treaties (CCH) ¶1901, 1901.21 (1990).

205. Convention For Avoidance of Double Taxation and Prevention of Fiscal Evasion With Respect to Income, Sept. 18, 1992, U.S.-Mex., art 22, *reprinted in* 3 Tax Treaties (CCH) ¶5903, 5903.24 (1990).

206. Convention With Respect to Taxes on Income, U.S.-Isr., Nov. 20, 1975, art. 15A, *reprinted in* 2 Tax Treaties (CCH) ¶4603, 4603.32 (1990).

207. See The Smile Train Website, <http://smiletrain.org> (last visited Jan. 18, 2004); www.edu.cn/20020322/3023300.shtml (last visited Jan. 18, 2004).

208. See *supra* note 136 and accompanying text.

One should wonder why both countries are hesitant to encourage such investments between their countries. There must be countervailing interests that cause the United States and China to ignore or discourage international altruistic investment. In this Section, I hypothesize as to those countervailing interests, beginning with Chinese and then considering U.S. countervailing interests.

A. *Chinese Countervailing Interests Regarding Altruistic Investment*

Earlier, the Article briefly noted the opinion of one Chinese scholar who candidly admitted the unlikelihood that a true, independent sector will emerge in China because organizations that traditionally comprise the independent sector contain "threatening elements." An understanding of the phrase "independent sector" as that phrase is used in Western society, explains much of the apparent Chinese antipathy against Western-style altruistic organizations. The phrase implies that society may be divided into distinct sectors, one of which, the "independent sector," is populated by charities and other nonprofit organizations. The independent sector is loyal to no particular authority or philosophy except the accomplishment of "good works" and the diffusion and decentralization of authority.²⁰⁹ The other two sectors, government and business, compete with each other and with the independent sector for influence in the tripartite society.²¹⁰ For reasons related to the monopolization and maintenance of power, the governmental sector seeks (but rarely attains) total allegiance and reacts suspiciously and defensively to criticism, whether implicit or explicit. The governmental sector pursues its own social theory, however just or unjust that theory may seem to those outside of the governmental sector. Authoritative governments attack, discredit and destroy social theories that are not in accord with their own, and just as often attacks methodologies that are not in accord with their own.

209. The unique culture that resulted from America's principles of free association and pluralism shaped a fresh new spirit of philanthropy markedly different than that of other contemporary single-sector societies dominated by Crown or Church. Philanthropy has continued to play a vigorous role as change-agent and risk-taker in American society. Because it is neither beholden to an electorate nor driven by shareholders, the American philanthropic sector has been free to experiment and innovate in ways that government and business dare not.

Lieber, *supra* note 2. Chinese scholars, too, recognize the tripartite nature of capitalist society: "Hence, it is increasingly obvious in China that a NGO sector is inevitably needed in addition to the enterprise sector, which is profit-oriented, and the government sector, which is power driven." Zhao, *supra* note 55.

210. Lieber, *supra* note 2, at 737 (noting the distinct boundaries between the three sectors of society).

The business sector, however, is entirely amoral. Despite its commercial speech to the contrary, the business sector is unconcerned with anything other than the pursuit of profit. It adheres to a “winner takes all” ethic and thus is viewed sometimes as a threat to the governmental sector and, at other times, as a necessary compliment to that sector. In either event, the business sector can be “bought” by any bidder willing to assist in the sector’s pursuit of profit.

The independent sector considers itself morally superior to the other sectors. Participants in the independent sector decry the mad pursuit of profit that ultimately benefits, or seems to benefit, only a few winners.²¹¹ Ironically, the independent sector seeks the sort of Utopia that China previously sought via the iron rice bowl. The independent sector is more similar to the governmental sector than to the business sector. Despite any similarities, though, the independent sector is nonetheless fiercely independent²¹² and it disdains the very essential characteristics of government, which are the concentration of power and the standardization of methodology.²¹³ The independent sector is instead governed by principled expediency and particularized methodology with regard to the accomplishment of goals that are sometimes consistent with government goals. The independent sector is, almost by definition, invariably critical of government methodology,²¹⁴ especially insofar as the allocation of power and influence within society are concerned.

Because the business sector is amoral, it should come as no surprise that it might align itself with whatever other sector is most likely to further the goal of profit seeking.²¹⁵ Despite occasional examples to the contrary, it is more efficient for the business sector

211. One example of an organization that does so is Global Exchange, whose website at <http://www.globalexchange.org> contains position statements against the WTO and global capitalism.

212. “The Third Sector was said to be inhabited by a congeries of tribes who acknowledged fealty to neither Caesar nor the Invisible Hand, who were accountable in neither arena of politics nor the marketplace of economics.” Atkinson, *supra* note 1, at 503.

213. *Id.*

214. The nine essential functions of the nonprofit sector are: (1) initiating new ideas and processes; (2) developing public policy; (3) supporting minority or local interests; (4) providing services that the government cannot constitutionally provide; (5) overseeing government; (6) overseeing the marketplace; (7) bring the business and government sector together; (8) furthering active citizenship; and (9) giving aid abroad. Lieber, *supra* note 2, at 737.

215. A concrete example with regard to the U.S. business sector’s amoral interaction with the Chinese government is contained in U.S. – CHINA SECURITY REVIEW COMMISSION, *supra* note 16, at 9-11 (discussing U.S. business’ willingness to transfer sensitive technology

to become an ally, rather than an adversary of government and thus, business may direct funds to incumbents in hopes of maintaining or creating friendly relations with government. The business sector may submit to and even champion government when doing so is most consistent with its amoral purpose. In less authoritative mature market societies, such as the United States, the business sector may even capture government to some degree by investing funds sufficient to control incumbents. On the other hand, through the forcible and discriminatory application of its regulatory power, the government sector can make the business sector so dependent upon the government that the business sector no longer actually competes with government but is instead a tool of government. Observers have speculated that this is precisely the approach China has taken in its transition process. Rather than adopting the Central and Eastern European "big bang" approach, whereby government simply withdraws its regulatory hand almost overnight,²¹⁶ the Chinese government has adopted a more gradualist approach through which it undertakes a much slower withdrawal from public life, and then only in incremental steps to ensure that the business sector never constitutes or encourages threats to the government's political authority.²¹⁷ For highly centralized, authoritative governments, implicit or explicit criticisms and challenge are threatening.²¹⁸ Less centralized governments with diffused powers, such as the United States, normally react to the criticisms inherent in the existence of an independent sector by incorporating, co-opting, encouraging, or logically rejecting the

with military capability in order to gain access to the Chinese market and without regard to U.S. national interests).

216. See *supra* notes 11-12 and accompanying text.

217. Indeed, China's constitution sounds quite paternalistic with regard to the business sector. "The State guides, helps, and supervises the individual economy by exercising administrative control." CHINESE CONST. ch. I, art. 1; see also Joseph Kahn, *China's Communist Party, 'to Survive,' Opens Its Doors to Capitalists*, N.Y. TIMES, Nov. 4, 2002, at A10 (noting that although the market is gaining clout in China, it is doing so only under the close supervision of the Communist Party).

218. A number of provisions in the Chinese Constitution indicate intolerance for criticism or dissent. For example, Chapter I, Article 1: "The socialist system is the basic system of the People's Republic of China. Sabotage of the socialist system by any organization or individual is prohibited." CHINESE CONST. ch. I, art. 1. Another states, "The state maintains public order and suppresses treasonable and other counter-revolutionary activities . . ." *Id.* ch. I, art. 28. Still another provision states, "Citizens of the People's Republic of China, in exercising their freedoms and rights, may not infringe upon the interests of the state, of society or of the collective, or upon the lawful freedoms and rights of other citizens." *Id.* ch. II, art. 51.

goals or methodology advocated by an independent sector.²¹⁹ Authoritative governments respond by simply attacking and seeking to eliminate what is viewed as a source of competition.²²⁰ And there are even occasions when even a decentralized, less authoritative government will feel threatened enough that it will actively seek the destruction of competition.²²¹ Gradualism, though, would not address the threat inherent in the presence of an independent sector. Regardless of how gradual the Chinese government's nurturance of a truly independent sector may be, such a sector will still bring with it "threatening elements" because those elements—diffusion of power and freedoms of speech, association and belief—define the very nature of independent sector inhabitants. A gradualist approach to the independent sector will therefore not be effective in creating a subordinate ally in a truly independent sector, as is apparently occurring with regard to the Chinese business sector.²²² The presence of even a gradually emerging independent sector necessarily represents implicit and explicit criticism of gov-

219. "Nations with a vibrant civil society have produced more effective and accountable public institutions." See SOCIAL DEVELOPMENT STAFF OF THE WORLD BANK, WORLD BANK-CIVIL SOCIETY COLLABORATION – PROGRESS REPORT FOR FISCAL YEARS 2000 AND 2001 (2002), available at http://www-wds.worldbank.org/servlet/WDS_IBank_Servlet?pcont=details&eid=000160016_20031107153808. In extreme cases, of course, even less authoritative governments react defensively to the very presence of altruistic organizations. For example, under authority of Executive Order 13,224, the United States has taken action to shut down charities (and other organizations) it believes advocates, supports or is connected with anti-American terrorism. Exec. Order 13,224, 66 Fed. Reg. 49,079 (Sept. 23, 2001); see also UNITED STATES DEPARTMENT OF STATE, COMPREHENSIVE LIST OF TERRORISTS AND GROUPS IDENTIFIED UNDER EXECUTIVE ORDER 13,224, <http://www.state.gov/s/ct/rls/fs/2001/6531.htm> (last visited, Jan. 18, 2004) (listing organizations such as the Holy Land Foundation); Glenn R. Simpson, *Tracing the Money, Terror Investigators Run Into Mr. Qadi*, WALL ST. J., Nov. 6, 2002, at A1 (regarding the U.S. legal attack on Islamic charities such as the Quranic Literacy Institute and the International Relief Organization, both of which are recognized as tax exempt under I.R.C. § 501(c)(3) and are allegedly associated with Yasin al-Qadi, a person listed as a terrorist under Executive Order 13,224).

220. The diffusion of power and influence within society is particularly anathema to what one scholar refers to as China's "Democratic Centralism." OGDEN, *supra* note 41, at 135. Such a system is premised upon "unity and acceptance of party policy being achieved by guided discussion" amongst small groups of citizens. *Id.*

221. A fascinating example of the U.S. executive branch fearing and attacking the very presence of an altruistic organization is contained in *Center on Corporate Responsibility, Inc. v. Shultz*, 368 F. Supp. 863 (D.C. Cir. 1973). That case gives a glimpse into the Nixon Administration's blatant but clumsy efforts to deny tax exemption to a charitable organization that it viewed as acting in opposition to the Presidents' constituencies.

222. "The Chinese leadership has seemingly developed a far greater tolerance for market forces of supply and demand, which challenge communist ideology, than for Western values that might pollute Chinese culture. Outside the economic realm, the appeal of Western models and values is limited by the central leadership's concern for protecting China's Chineseness." OGDEN, *supra* note 41, at 7.

ernment's failure to provide for the entire needs of society or the methods by which government seeks to influence its population. Criticism, no matter how legitimate and slowly emerging, is nevertheless threatening to authoritative governments.

The existence of an independent sector represents many ideals of Western democratic society. Western style independent sectors implicitly advocate the superiority of a society that believes in the sharing and diffusion of power, freedoms of speech, belief, dissent, and association.²²³ Observers, however, have noted that China seeks both economic democracy and also concentrated and centralized governmental power.²²⁴ China's gradual approach to transitioning from a planned to a market economy is motivated by a metaphorical desire to have its cake and eat it too.²²⁵ Some economists believe that a market economy can truly exist only within the context of a democratic political society and that, inevitably, China's strategy will fail.²²⁶ China's twenty-year transition process challenge's that conventional wisdom.²²⁷

China refers to its new economic order as "market socialism" or "socialism with Chinese characteristics."²²⁸ The existence of a truly independent sector is either completely anathema to market socialism or at least much more threatening to market socialism than is the existence of a relatively unregulated, but closely supervised, business sector. The threat exists because the independent sector,

223. In early Twentieth Century China (i.e., around 1911), "organizing social groups became a major activity of political advocacy forces, through which progressive intellectuals disseminated Western democratic ideas and sought ways to bring about social transformation." CHUNYING & YE, *supra* note 54, at 86.

224. See Joseph Kahn, *China's Communist Party, 'to Survive,' Opens Its Doors to Capitalists*, N.Y. TIMES, NOV. 4, 2002, at A10 (discussing the Chinese Communist Party's goal of maintaining control over Chinese society while also introducing capitalism).

225. Immediately after the CCP gained power in China, it declared that Chinese citizens had the right of free association. At the same time, however, it stated that all "counter-revolutionary" activities must be suppressed. The latter declaration formed the basis for the complete elimination of western style altruistic organizations in China by 1958. CHUNYING & YE, *supra* note 54, at 86, 88.

226. See generally Lan Cao, *The Cat That Catches Mice: China's Challenge to the Dominant Privatization Model*, 21 BROOKLYN J. INT'L L. 97 (1995) (discussing China's challenge to the notion that democracy invariably follows economic reform).

227. "It is of the utmost importance to maintain a stable political environment and public order . . . We must uphold the leadership of the Party . . . eliminate all factors jeopardizing stability, and guard against . . . subversive . . . domestic hostile forces." Blumental, *supra* note 9, at 216 (quoting former Party Secretary, Jiang Zemin).

228. See Hardt, *supra* note 87, at VII (referring to "a unique mixture of central planning and market forces, referred to as 'socialist system with Chinese characteristics').

idealized, represents an alternative sovereign²²⁹ that answers to discovered moral principle – the environment is to be protected at all costs, profits should give way to affordable housing, or social order does not justify the death penalty, to name a few such principles. The independent sector cannot be “bought out” the way business eventually will; it seemingly has no ultimate goal for which it will trade its critical and alternative nature. China might successfully incorporate Western economic theory and still maintain its present governmental structure, that is, China may indeed achieve market socialism – by allowing for the gradual emergence of a business sector while also maintaining its present form of government. It is unlikely, however, that China can maintain a centralized authoritative government alongside a Western-style independent sector.

Consider three examples that demonstrate the above hypothesis in a pragmatic fashion. As part of its transition to a market economy, China is required to implement transparent rules and regulations to govern economic relationships.²³⁰ In accord with that requirement and with the support of foreign economic investment, China has opened its service markets to foreign participants, including foreign business law firms. Foreign law firms, of course, assist in attracting foreign economic investment while presenting no threat to the government’s monopoly on power. But what if a foreign public interest law firm sought entry into China? Such a law firm might exist not to participate in the market economy but, for example, to provide legal defense to those who protest against the *hukou* system; such a firm might involve itself in labor movements. It might simply participate in the Chinese criminal system, advocating on a case-by-case basis for constitutional change. In any event, such a firm’s very existence would represent both a criticism and a challenge to the governmental sector and, indirectly, to the business sector. Contemporary and more obvious examples include the 1989 student democracy protests in Tiananmen

229. See Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585 (1998) (conceptualizing the independent sector as a “separate sovereign”); Lieber, *supra* note 2, at 738, n.33 (discussing civil society as a political concept).

230. See *supra* note 97.

Square²³¹ and the ongoing Falun Gong movement.²³² The former involved an explicit criticism of and threat to the government's power monopoly,²³³ while the latter manifests an implicit but apparently no less dangerous threat to that monopoly. Both epitomize characteristics most often associated with Western style independent sectors including diffusion of power, free speech and association, critical dissent, and freedom of belief. The Falun Gong is the more useful example for present purposes because Falun Gong involves a type of independent sector entity that expresses neither explicit criticism nor a threat to the government, and yet the Chinese government's reaction is hardly distinguishable from the suspicious and violently defensive reaction it took in response to the Tiananmen Square protest.²³⁴ It is as if both the

231. The death of Hu Yaobang [CCP General Secretary and former Youth League chairman, generally viewed as an economic and political reformist] on April 15, 1989, coupled with growing economic hardship caused by high inflation, provided the backdrop for a large-scale protest movement by students, intellectuals, and other parts of a disaffected urban population. University students and other citizens camped out in Beijing's Tiananmen Square to mourn Hu's death and to protest against those who would slow reform. Their protests, which grew despite government efforts to contain them called for an end to official corruption and for defense of freedoms guaranteed in the Chinese Constitution. Protests also spread to many other cities, including Shanghai, Chengdu, and Guangzhou. Martial law was declared on May 20, 1989. Late on June 3 and early on the morning of June 4, military units were brought into Beijing. They used armed force to clear demonstrators from the streets. There are no official estimates of deaths in Beijing, but most observers believe that casualties numbered in the hundreds.

U.S. DEPARTMENT OF STATE, *supra* note 16, at 6.

232. Falun Gong is a self-improvement movement incapable of easy classification. Although it is sometimes associated with Buddha and Tao, adherents state that Falun Gong is not a religion. The simplest explanation would describe Falun Gong as a movement emphasizing five sets of yoga-type exercises designed to "cultivate" one's mind, body, and spirit and thereby gain access to one's inner energy. Inner energy is related to energy in the Universe. Access to that energy, according to adherents, results in increased spiritual and physical well-being. For a comprehensive description and bibliography, see <http://www.religioustolerance.org/falungong.htm> (last visited Jan. 18, 2004).

233. "At least in the minds of China's conservative leaders, the anti-CCP statements of the students, workers, and masses threatened the very foundations of CCP rule." OGDEN, *supra* note 41, at 75.

234. The government's response to the Tiananmen Square protests resulted in "hundreds" of casualties. See *supra* note 231. Its reaction to the Falun Gong movement – one that is decidedly apolitical – is quite similar:

During the period covered by this report, the Government's respect for freedom of religion and freedom of conscience worsened, especially for some unregistered religious groups and spiritual movements such as the Falun Gong. The government intensified its repression of groups that it determined to be "cults" in general, and of the Falun Gong. Various sources report that thousands of Falun Gong adherents have been arrested, detained, and imprisoned, and that approximately 100 or more Falun Gong adherents have died in detention since 1999. . . . In July 1999, the Government officially declared Falun Gong illegal and began a nationwide repression of the movement. Throughout the country, tens of thousands of practitioners were rounded up and detained for several days – often

explicitly anti-government Tiananmen Square protest and the Falun Gong movement represent precisely equivalent threats. The government's reaction is somewhat generic in the sense that there are many historical examples of varied governments engaging in defensive actions with regard to seemingly harmless altruistic activity.²³⁵ Authoritative governments simply perceive altruistic investment of the sort manifested in Western society as invariably challenging, if not threatening, to their own self-interests.

The final barrier from a Chinese viewpoint is one that is particular to U.S. altruistic investment. Despite the many instances in which the Chinese and U.S. governments have engaged in tension-reducing, cooperative endeavors, the Chinese government still sometimes views and portrays the United States as an aggressive "hegemon," bent on forcing the international community to conform to U.S. desires.²³⁶ By some accounts, the Chinese government views U.S. international engagements, regardless of how benevolent a specific engagement may appear to or actually be, as merely a means to achieve an ultimately hegemonic goal.²³⁷ U.S. altruistic investment in China therefore presents a very particularized threat to the Chinese governmental sector. Consequently, U.S. altruistic investors, unlike altruistic investors from other countries, will have to overcome a Trojan horse syndrome of sorts in order to gain legitimacy in China.

B. *Countervailing Interests of the U.S. Regarding Altruistic Investment*

Altruistic investment is not inconsistent with the U.S. governmental sector's preferred economic goals relating to China. It is

in open stadiums under poor and overcrowded conditions with inadequate food, water, and sanitary facilities. Many Falun Gong practitioners lost their jobs or were expelled from universities; Falun Gong practitioners continued to experience discrimination in job and educational opportunities. Falun Gong members who "disrupt public order" or distribute publications can be sentenced to three-seven years and leaders up to seven years or more in prison.

U.S. DEPARTMENT OF STATE, *supra* note 16, at 122, 130. Other observers estimate the number of detainee deaths at 200. U.S. – CHINA SECURITY REVIEW COMMISSION, *THE NATIONAL SECURITY IMPLICATIONS OF THE ECONOMIC RELATIONSHIP BETWEEN THE UNITED STATES AND CHINA: CHAPTER 4*, at 8 (2002), available at http://www.uscc.gov/ch4_02.htm (last visited Jan. 18, 2004).

235. See Lieber, *supra* note 2, at 739 (noting the explicitly anti-governmental, anti-tyrannical historical roots of the term "civil society").

236. U.S. – CHINA SECURITY REVIEW COMMISSION, *supra* note 24, at 2-3. "Chinese leaders believe that the fundamental drive of the United States is to maintain global hegemony by engaging in the shameless pursuit of 'power politics,' often disguised as a quest for democratization." *Id.* at 3.

237. *Id.* The report lists the United States' humanitarian intervention in the Balkans as one example of what China views as hegemony disguised as humanitarian assistance.

entirely inconsistent, though, with what the United States views as a possible undesirable political consequences of China's successful transition. The U.S. governmental sector supports China's transition to a market economy not merely to assist the U.S. business community, but because it views the market economy as a tool to achieve political and civil reform in China. Political and civil reform—to the extent that reform makes China more like the United States—is considered desirable because such reform would militate against China aggressively competing for geopolitical power with the United States. The European experience with market transitions demonstrates that transitions often precede or facilitate the decentralization of authority within society²³⁸ and the U.S. hopes for the same consequence in China. The U.S. governmental sector acknowledges, though, that economic reform in China might simply create a wealthier and stronger Chinese governmental sector. The Chinese government's management of the transition process, and particularly its gradualist as opposed to big bang approach, is designed to achieve that very result.²³⁹ China, according to some observers, would then be a much more aggressive, stronger and militarily capable geopolitical competitor.²⁴⁰ Any investment that furthers that outcome is, of course, inconsistent with the U.S. governmental sector's goals.

From a different standpoint, altruistic investment in China is entirely consistent with the immediate goals of the U.S. business sector, although the U.S. business sector's desired goals do not necessarily conform to the U.S. governmental sector's goals in China. Consistent with its characteristic amorality, the U.S. business sector seeks only a stable, ongoing, accessible market from

238. LAVIGNE, *supra* note 11, at 98-99. (providing a chart showing the correlations between economic and political reform in Central and Eastern Europe during the period 1989 to 1991).

239. "The late Premier Chou's statement to the National People's Congress in January 1975 that China wants to build a powerful modern socialist country by the end of the century probably encapsulates Chinese Communist objectives in their clearest and most succinct form." ECKSTEIN, *supra* note 16, at 278.

240. Exports of capital goods to China, accompanied by foreign technical assistance and partially financed by foreign loans and credits, should . . . support China's modernization and accelerate the buildup of its economic strength. This will strengthen the economic foundations for China's military power in the future. From a long-term perspective, what are the possible implications of this, not only for China's immediate neighbors but for the major powers that must deal with it? Should other nations assume that, from the perspective of their national interests, accelerated economic development in China is desirable and deserving of support, or should they be concerned about the potential dangers that a stronger China might pose?

BARNETT, *supra* note 15, at 256.

which to draw profits. It is concerned about the concentration of authority in China, and the relative lack of political and civil freedoms, only insofar as that status quo thwarts its profit-seeking goals. Earlier the Article noted that business can be bought by any customer willing to assist its pursuit of profit and because the Chinese government is presently encouraging and assisting the pursuit of profit, the U.S. business sector has no fundamental complaints regarding the Chinese government. The U.S. business sector is thus unconcerned that altruistic investment may indirectly strengthen, without reforming, Chinese government. In effect, the business sector has determined that it is more efficient to concede centralized authority to the Chinese government, provided that concession results in stable market access. Because altruistic investment assists with the social stability necessary for a market economy, the U.S. business sector should also have no complaints in regard to such investment.

The U.S. governmental sector, therefore, should logically be of two minds with regard to altruistic investment in China. First, to the extent altruistic investment helps China achieve its goal – a transition to a market economy while also sustaining its present monopoly on power – it may be viewed as severely counterproductive to U.S. governmental interests. This view holds, though, only if one assumes away any of the political influences that invariably accompany the activities of a Western-style independent sector. Economic investment should strengthen the Chinese government, even in the absence of accompanying altruistic investment. Altruistic investment can both help and hurt, in roughly equal amounts, the further strengthening of the State. It will help by eliminating social welfare hardships that provoke challenge to governmental authority. Altruistic investment can hurt the Chinese government because altruistic investors exemplify and practice ideals – diffusion of power, freedom of association, belief, and speech – that are, at the very least, implicitly inconsistent with authoritative government.²⁴¹ As a result, altruistic investment could hurt the Chinese government's efforts to maintain centralized authority.

241. The Chinese Constitution provides:

Citizens of the People's Republic of China have the right to criticize and make suggestions to any state organ or functionary. Citizens have the right to make to relevant state organs complaints and charges against, or exposure of, any state organ or functionary for violation of the law or dereliction of duty; but fabrication or distortion of facts for the purpose of libel or frame-up is prohibited.

. . . No one may suppress such complaints, charges and exposure, or retaliate against citizens making them.

CHINESE CONST. ch. 2, art. 41.

Taken together, these positive and negative effects should logically be viewed as canceling each other out with regard to the secondary effects concerning the Chinese government. Altruistic investment should result in neither a net gain nor net loss with regard to the United States' and China's differing ultimate goals.

The second and more logical view with regard to altruistic investment is that such investment is more consistent than inconsistent with U.S. governmental goals in China. Altruistic investment is likely to indirectly strengthen the authoritative nature of China's government in the short term, but it will also necessarily demonstrate and passively encourage the political and civil reforms sought by the U.S. government sector and over the long term that encouragement may result in a more democratic political system. China seems to accept this second view. This acceptance explains why China's government has demonstrated so much reticence not only with regard to the establishment of a true independent sector domestically, but also with regard to the establishment of a formal legal basis for the recognition of foreign altruistic investors in China. In a narrow sense, then, the U.S. governmental sector may view altruistic investment in China as undesirable. In a more logical and broader sense, altruistic investment in China is consistent with the U.S. governmental sector's goal, particularly so long as the U.S. government continues to encourage economic investment. Amoral economic investment alone is more likely to bring about the feared result – a stronger, aggressive, militarily capable, geopolitical competitor – than is amoral economic investment coupled with principled altruistic investment.

VI. A PROPOSAL TO INCREASE INTERNATIONAL ALTRUISTIC INVESTMENT IN THE PEOPLES REPUBLIC OF CHINA

A successful transition to a market economy is the one immediate goal shared by both the United States and China. The two countries disagree, however, with regard to the intended consequences of that successful transition. The United States hopes that transition will result in political reform, while China hopes for a strengthening of the present political system.²⁴² Both countries

242. China's accession to the WTO carries high stakes for both the United States and China. While they have some complementary goals for supporting China's WTO accession – e.g., promoting market-oriented economic growth and reform – they have very different long-term objectives; the United States seeks a democratic and more open China, while Chinese leadership seeks an economically strengthened nation that continues to be governed by one-party communist rule.

U.S. – CHINA SECURITY REVIEW COMMISSION, *supra* note 18, at 18.

therefore have reasons to both encourage and discourage altruistic investment. On the one hand, altruistic investment will assist the transition and both countries want transition; but on the other hand, altruistic investment will either strengthen the Chinese government by dampening discontent caused by the transition or encouraging political reform. The challenge for both countries, then, is to employ all means necessary to achieve the economic goal, while also insuring that those means are neutral with respect to the divergent political consequences.

The divergence between the intended secondary consequences is most profound if it is assumed that altruistic investment will flow primarily from the United States to China. The United States' form of government, of course, represents the preeminent antithesis of the Chinese form of government. The threat to the Chinese government is most profound to the extent altruistic investors are exercising not just Western-style democratic values, but U.S.-style democratic values. Altruistic investment from any source is nonetheless likely to have as much effect on assisting the transition, never mind the political consequences, as if such investment were flowing solely from the United States. Thus, altruistic investment will provide the most assistance to China's economic transition and be as neutral as possible with regard to the secondary consequences when that investment comes from countries other than the United States.

The foregoing analysis suggests a potential solution regarding the need to assist transition without affecting secondary outcomes. Logically, China should be most receptive to altruistic investment flowing from countries other than the United States. Non-U.S. altruistic investment would assist the transition process without necessarily introducing U.S.-style democratic values in China. Again, such investment would not be neutral with regard to strengthening China's present governmental reform, but neither would anything else that actually assisted the transition process by dampening social discontent. Meeting social welfare needs, though doing so is essential to the transition process, will invariably decrease motivations to challenge the present form of government. From a U.S. perspective, then, the choice is really only between assisting and not assisting the transition irrespective of any secondary consequences because China's failure to achieve a market economy is fraught with as many negative consequences, if not more, than a successful transition that also strengthens its present

governmental system.²⁴³ A failure to achieve a market economy would result in China's remaining isolated and defensive with regard to the global community and it is this isolated and defensive posture from which conflict becomes more likely.²⁴⁴ A successful transition, even one that also strengthens the present political structure, would at least decrease China's isolation and defensiveness. Successful transition would also make it more expensive for China and the United States to engage in geopolitical conflict. To the extent China becomes vested in a smoothly functioning global economy, it is more likely to cultivate friendly and open relations with the United States and other countries. Non-U.S. altruistic investment comes closest to achieving the immediate goal shared by both China and the United States, while also remaining neutral with respect to negative consequences, or at least not increasing the chances that what are viewed as negative consequences by either country will come to fruition.

The solution, then, is that the international community insist upon a legal framework that would encourage altruistic investment in China and other developing or transitioning economies. Tax law and other legal barriers to altruistic investment, identified above, should be dismantled to the same degree that barriers to economic investment have been and continue to be systematically dismantled. With regard to the present problem relating to the lack of altruistic investment in China, that solution could be achieved by China's legal recognition of an independent community of altruistic investors, both domestic and foreign. This is particularly necessary because under the present circumstances Chinese altruistic organizations are actually government auxiliaries and there are no legal provisions by which foreign altruistic investors may operate in China other than on an ad hoc basis. While the solution requires that the United States assume a subordinate role in stimulating altruistic investment, it does not follow that the United States play no role whatsoever. The United States has a larger trading imbalance with China than with any other country. The U.S. trade deficit, the dollar amount by which U.S. imports from China exceed U.S. exports to China, has grown to almost \$90

243. BARNETT, *supra* note 15, at 257 (noting that a "strong and secure" China might also be consistent with U.S. interests because domestic stability will decrease motivations to mount international challenges).

244. Bhala, *supra* note 26, at 1476 (noting that not admitting China into the WTO might isolate China and cause her to "become increasingly hostile to the outside world"); Blumental, *supra* note 9, at 202-03 (arguing that immediate opening would be "fatal" to China's enterprises and would cause "severe dislocations" and "massive unemployment").

billion since China began its transition to a market economy. The most common explanation is that while China is encouraging U.S. and other foreign investors to establish export manufacturing platforms in China, it continues to block access to its domestic consumer market.²⁴⁵ Blocking access to domestic consumer markets, in turn, is commonly attributed to the desire to protect domestic jobs, industry, and people from the shock of transition.²⁴⁶ The barriers are inconsistent with the WTO's goals of free trade, but they are tolerated on a temporary basis in an effort to lessen the shock and discontent of transition in developing countries.²⁴⁷ Lessening shock and discontent is related to the desire to prevent social upheaval that is likely to occur in, and stimulate resistance to, a transition economy.²⁴⁸ Altruistic investment would be a more efficient means of lessening shock and discontent because it would decrease the need to maintain barriers to a transitioning economy's domestic consumer market and thereby increase the speed of transition. Hence, if the United States continues to be China's largest export market, it will also have the highest interest in encouraging altruistic investment as an efficient replacement for barriers to China's domestic consumer market. The United States should pursue this interest not only by encouraging the international community to open the Chinese market to altruistic invest-

245. During the negotiations leading to China's entry into the WTO, China sought to be classified as a developing nation so that it would gain the right under GATT to maintain protectionist barriers for longer periods of time without being subject to counter-measures from other WTO members. Bhala, *supra* note 26, at 1474. The final accession agreement strikes a compromise by requiring China to phase out its protectionist measures but at a faster rate than that applicable to developing countries. That compromise originally appeared in the bilateral agreement between the U.S. and China, which agreement eventually became part of China's WTO accession agreement. *Id.* at 1509-10.

246. THE WORLD BANK, *supra* note 27, at xvii.

247. "China contends that implementing reforms too quickly would force several Chinese firms into bankruptcy, leading to widespread layoffs and social unrest." Morrison, *supra* note 15, at 13.

248. On the other hand, some economists do not believe that a gradualist approach to transition results in any less economic shock than does a big bang approach:

The gradualist line of thought usually stresses two arguments. The first is obviously that shock [i.e., big bang] therapy cannot apply to structural reforms: one cannot privatize overnight, even in the most radical give-away schemes; one cannot reform the banking system overnight. The second is that the beneficial outcomes attributed to shock thereby might have been obtained at lesser social costs. Both arguments are rejected by the 'shock therapists.' Structural transformation does require time, they admit, but its efficiency is enhanced by quickly conducted stabilization. Nobody can tell whether the social costs of transformation would have been lower under an alternative policy, and in any case these costs may be alleviated by proper compensation schemes.

LAVIGNE, *supra* note 11, at 153.

ment but also by eliminating its own domestic disincentives to altruistic investment in China.

The WTO is the most likely vehicle by which to stimulate altruistic investment in China without violating the assumption that U.S. altruistic investors should not play a primary role. The United States cannot effectively pursue or stimulate altruistic investment on a unilateral or bilateral basis because doing so would be viewed as a U.S. effort to pursue its own, rather than mutually shared, goals. Instead, the WTO with U.S. support should encourage international altruistic investment from diverse sources. Tax laws, like international trading laws, should be harmonized to the extent possible and taking into account legitimate domestic concerns, within the international community. It appears that China's administrative provision allowing for local recognition of foreign altruistic organizations based on those organizations' home country status seems to meet this need. Yet arbitrary governmental discretion, supported by official but unwritten ideology, means there are very few instances, if any, in which foreign altruistic organizations are actually recognized on other than an ad hoc basis. The international community should therefore advocate for the elimination of arbitrary decision-making with regard to the recognition of altruistic organizations, just as it has with regard to economic investors and organizations. The WTO is the best candidate for this process not only because it can be considered neutral with regard to U.S.-Chinese geopolitical competition, but also because altruistic investment is conducive to the goal of creating a singular, unhindered global market economy, which is the goal pursued by the WTO.²⁴⁹

Unfortunately, the WTO reflects the same ambivalent attitude of China and the United States (and no doubt other countries) with regard to altruistic investment. That ambivalence is skewed in the direction of less international altruistic investment rather than more.²⁵⁰ Officially, at least, the WTO completely ignores, or intentionally excludes, the potential beneficial effect altruistic invest-

249. Of course, the WTO needed China almost as much as China needed the WTO. Without China's participation, the WTO could be criticized as not be truly representative of the "world." Blumental, *supra* note 9, at 203.

250. Although the institutions, funding streams and volunteer reserves of civil society are internationalizing, the laws that control it are still overwhelmingly domestic. In other areas of international private tax and business law, geographic barriers are being dismantled; in the area of transnational civil society, however, the laws remain landlocked. Few coherent legal principles apply cross-border or from country to country. Few legal standards or norms transcend their borders. Lieber, *supra* note 2, at 740.

ment may bring about in transitioning the world to a singular global market economy.²⁵¹ The starkest example of this behavior is evident in the General Agreement on Trade in Services (GATS).²⁵² That multilateral WTO agreement is designed to open signatories' domestic markets to foreign service vendors. The elimination of barriers to foreign entry is accomplished primarily by the mandate that signatories apply to foreign service-providers within their respective jurisdictions the same laws and regulations as are applicable to their domestic service providers.²⁵³ Signatories may not discriminate against foreign service-providers and services covered by the agreement include those from all economic sectors.²⁵⁴ Significantly, "services supplied in the exercise of governmental authority" are excluded,²⁵⁵ thus permitting signatories to continue to block access to their domestic markets with regard to such services. More significantly, "services supplied in the exercise of governmental authority" are defined as "any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers."²⁵⁶ Readers familiar with the U.S. tax rules relating to the nonprofit sector will immediately recognize the similarity of that definition to the legal doctrines, however amorphous they may be, that define organizations entitled to charitable tax exemption under the U.S. tax code.²⁵⁷ In its most official legal pronouncements, then, the WTO actually ignores or excludes the possibility that cross-border altruistic investment ought to be stimulated and barriers thereto dismantled as part of the effort to create a free-flowing global market economy.

Even when the WTO recognizes the relevance of altruistic investment, it does so in a tentative, even half-hearted manner. For example, its organizing document (Marakeesh Agreement) con-

251. The Marrakesh Agreement states: "The General Council may make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related to those of the WTO." WTO Agreement, *supra* note 94, art. V, 2. However, the General Council later opined that "there is currently a broadly held view that it would not be possible for NGO's to be directly involved in the work of the WTO or its meetings." WORLD TRADE ORGANIZATION, GUIDELINES FOR ARRANGEMENTS ON RELATIONS WITH NON-GOVERNMENTAL ORGANIZATIONS (1996), available at http://www.wto.org/english/forums_e/ngo_e/guide_e.htm (last visited Jan. 18, 2004).

252. General Agreement on Trade in Services, Apr. 15, 1994, 33 I.L.M. 44 [hereinafter GATS]. GATS comprises Annex 1B of the Agreement Establishing the World Trade Organization.

253. *Id.* arts. II, XVII.

254. *Id.* arts. I.3(b).

255. *Id.*

256. *Id.* art. I.3.(c).

257. See I.R.C. § 501(c)(3) (1986).

tains an explicit declaration that the WTO may consult and cooperate with nongovernmental organizations "concerned with matters relating to those of the WTO."²⁵⁸ In a later pronouncement, the WTO limited the role of altruistic investors to one of merely generating greater awareness and encouraging greater transparency with regard to WTO economic activities and policies. The pronouncement states that the WTO would make its official documents and publications accessible to the public and to non-governmental organizations in particular. Most telling, is the pronouncement's conclusion that "there is currently a broadly held view that it would not be possible for NGO's to be directly involved in the work of the WTO or its meetings."²⁵⁹ The statement does not address the feasibility of WTO members entering into agreements and undertaking formal activities designed to decrease the barriers to international altruistic investment, just as they do with regard to economic investment. Instead, the WTO seems to take exactly the opposite approach by specifically excluding altruistic investors as direct beneficiaries of agreements designed to dismantle barriers to international trade and access.

GATS' use of the phrase "services supplied in the exercise of governmental authority" is illuminating because it suggests that WTO members view altruistic investments as somehow encroaching upon government's exclusive domain.²⁶⁰ Earlier, the Article posited that the independent sector is inherently critical and challenging to the governmental sector. The WTO's exclusion of altruistic investment from its agreements designed to eliminate international barriers is confirmation that most governmental sectors are suspicious and defensive with regard to the independent sector.

There remain several reasons as to why the United States should push for greater inclusion of altruistic investment in WTO policies designed to bring about a global market economy transition. Pre-

258. See *supra* note 251.

259. *Id.*

260. In a speech before a group of non-governmental organizations from around the world, Deputy General Secretary Mike Moore stated:

Our owners [i.e., WTO members] jealously defend their rights and prerogatives. Even having these symposia [with NGO's] is controversial and not universally supported. Let me share why. Many Ministers and Ambassadors say it is not the job of the WTO to embrace NGO's and civil society. They say that should be done at the national level in the formation of national policy positions. They are correct but only 90% correct.

Mike Moore, Open Societies, Freedom, Development and Trade, Address Before the Plenary Opening WTO Symposium on Issues Confronting the World Trading System (July 6, 2001) (transcript available at http://www.wto.org/english/news_e/spmm_e/spmm67_e.htm) (last visited Jan. 18, 2004).

vious Sections provide discussions of two primary reasons, increasing the speed with which transition economies such as China dismantle barriers to domestic markets and lessening the shock and discontent suffered by a population undergoing transition. Both of those effects of altruistic investments raise the chances that the market economy will succeed. Other reasons include lessening the need for China and indeed other transition governments to provide social services and thereby reducing hidden subsidies, taxes, and various costs derived from or imposed on market investors, including foreign investors who will remain at a competitive disadvantage even in a completely open market.²⁶¹ Another reason is that WTO members are essentially correct in viewing the independent sector as inherently critical and challenging of government and this conception should encourage inclusion. In the United States, for example, ongoing criticisms and challenges are viewed as essential for good government. Altruistic investors are valued, at least in part, precisely because the criticisms and challenges inherent in their activities are viewed as constructive, not destructive. Thus, the United States should logically conclude that foreign transition governments might be made better (i.e., more like the U.S. government, to be quite honest and perhaps somewhat ethnocentric) by the presence of a barrier-free international market for altruistic investors. Moreover, the United States is in a particularly "high road" position with regard to dismantling barriers to international altruistic investment. Non-U.S. altruistic organizations are presently free to register and operate in the United States just as are U.S. altruistic investors.²⁶² Many foreign based charities present implicit or explicit challenges and criticisms to U.S. governmental policy and yet those charities are permitted to exist under the protection of U.S. law. For these reasons, the United States has the moral authority to encourage and advocate that China and other transition countries provide the same degree of openness with regard to U.S. altruistic investors in their jurisdictions.

A final, very brief case study regarding the World Bank confirms the arguments presented in this Article. The World Bank is a membership organization owned by 184 member countries, includ-

261. THE WORLD BANK, *supra* note 27, at 54-57 (discussing the use of implicit subsidies to protect state run enterprises).

262. The recent enactment of I.R.C. § 501(p) (2003), which grants authority to the IRS to revoke the tax exempt status of charities believed to be supporting "terrorism," signals a retrenchment of the previous openness with which the United States welcomed foreign nonprofit organizations.

ing the United States and China.²⁶³ The Bank can be viewed, consistent with the perspective and terminology presented in this Article, as a mutual fund for altruistic investment. Essentially, it provides development assistance through market and below-market loans and other “concessional assistance” to developing countries. The Bank’s fundamental goal is the eradication of poverty via economic development. The intended investment yield for member countries and other suppliers of altruistic capital is obviously one that occurs as market economies are encouraged and sustained in developing nations. The Bank has placed its religious-like faith, essentially, in the market apparatus as a means to achieve the social goals that are also sought by altruistic investment. At the same time, the Bank has explicitly concluded that altruistic investment must play a direct and indispensable role in economic development if that development is to achieve social goals. Accordingly, the Bank maintains a formal program designed to ensure the involvement of altruistic investors in the consultative, deliberative, prioritizing, implementation, and appraisal process leading to the use of its funds in developing countries.²⁶⁴

Unlike their role in the WTO, altruistic investors involved with the World Bank are encouraged and allowed to have as much input into the ultimate social goals as are the government and business sectors of developing countries.²⁶⁵ Clearly, that policy of inclusion is furthered by the presence of remote altruistic investors, that is, passive altruistic investors who provide capital to be used in developing countries but who are not involved in implementing strategies funded by their capital. The process is more efficient and effective, however, when altruistic investment is made or managed by groups that are actually resident in the developing country. For this reason, the World Bank has explicitly championed “enabling environments” in developing countries.²⁶⁶ The phrase, “enabling environment” refers to an appropriate legal, fiscal, political, informational and institutional environment in which altruistic organizations can thrive.²⁶⁷ As has been previously dis-

263. The general summary of the World Bank, its mission and goals is taken from the Bank’s website at <http://www.worldbank.org> (last visited Jan. 18, 2004).

264. See SOCIAL DEVELOPMENT STAFF OF THE WORLD BANK, *supra* note 219.

265. See *id.* at 4-6.

266. See *id.* at 7, 26-27.

267. Legal reform is an essential and required characteristic of China’s transition to a market economy, but most commentators ignore the role of law as it relates to altruistic investment in a transitioning economy. Nevertheless, the same considerations that relate to legal reform in a market economy also apply to altruistic investment:

cussed, China lacks any real legal or fiscal policy that could remotely be described as an enabling environment.²⁶⁸ Indeed, this might be confirmed by two startling statistics. In 2000 and 2001, the World Bank worked with altruistic organizations to approve and fund forty-three Country Assistance Strategies designed to achieve social welfare goals around the world. None of those strategies involved China.²⁶⁹ Likewise, the World Bank worked with altruistic investors to develop and fund Poverty Reduction Strategy Papers in forty countries and China was, again, conspicuously absent from the list of countries.²⁷⁰ These exclusions do not mean that China has failed to implement development policies funded by the World Bank. To the contrary, China continues to be a huge beneficiary of World Bank funds but primarily via economic rather than altruistic investments from the World Bank.²⁷¹ The statistics clearly suggest, though, that altruistic organizations are largely absent from China. The status quo, therefore, would benefit from a sustained effort by China, the United States and the international community to create the sort of enabling environment contemplated by the World Bank.

VII. CONCLUSION

All that is lacking with regard to increasing international altruistic investment in China is an understanding of the positive and integral role altruistic investment may have in the Chinese transi-

Regulatory reform in a transition economy is not essentially a deregulatory task, but a mix of new regulation, deregulation, and re-regulation, backed up by legal and institutional reforms, to support increasingly competitive markets. Pro-market regimes are composed of economy-wide policies (such as commercial law, competition law, consumer protection, and corporate governance) and sector-specific policies (such as banking and telecommunications regulatory regimes), operating within the rule of law.

OECD, *CHINA IN THE WORLD ECONOMY*, *supra* note 46, at 364. A legal regime relating to altruistic investors and the independent sector would fall within both categories – economy wide and sector-specific policies.

268. “The legal system is unsound. Regulations for running non-profit organizations are not yet perfected. A disconnect exists between policies and regulations and the objective, practical requirements. The legal system is lagging behind and that definitely affects the smooth development of China’s NGO’s.” Chen, *supra* note 144.

269. See SOCIAL DEVELOPMENT STAFF OF THE WORLD BANK, *supra* note 219, at 30-34.

270. See *id.* at 35-39.

271. The World Bank has invested about \$35 million in China on over 234 projects, about half of which are still being implemented. THE WORLD BANK, THE WORLD BANK AND CHINA: COUNTRY BRIEF, available at <http://lnweb18.worldbank.org/eap/eap.nsf/a71f97484cde7250852567c900767289/2ac5444a2002378e852567c90076824b?OpenDocument> (last visited Nov. 19, 2000). If the years 2000 and 2001 are any indication, none of the investments (admittedly for infrastructure, health and education, and other social welfare purposes) were spent with the influence of altruistic investors.

tion economy. Neither the United States, China, nor the international community (for which the WTO is merely one representative) demonstrate sufficient awareness of altruistic investment as a beneficial factor in a transition economy. Altruistic investment, stimulated by tax benefits, can create positive results by filling the social welfare vacuum created by a State's sudden or even gradual withdrawal from its role as omnipotent provider of the social welfare. It can hasten transition by lessening the need or justification for transition governments to maintain barriers to their own domestic consumer markets while also exploiting the consumer markets of trading partners. Just as explicit economic competition can enhance the marketplace, the implicit competition of altruistic investors can enhance government.

Perhaps China and the United States ignore altruistic investment because its effect is easily minimized. Providing food and shelter, for example, to a few families suffering in a transition economy that impacts millions might be deemed insignificant, but so too might the establishment of a single new corporation that would have an insignificant impact when viewed in isolation. There persists a certain faith that the birth of a new commercial corporation will ultimately lead to benefits for the millions of citizens toiling away in a transition economy. At the same time, history shows that there are inevitable losers in a market economy, particularly during a transition period. It is therefore unlikely that a market economy will develop successfully in the absence of altruistic investors. There has always been an accompanying faith that the harshness and amorality of capitalist economies can and ought to be alleviated by altruistic investment. That faith should be no less applicable in the most populated country in the world.