

The Joint Venture Law of the Peoples' Republic of China: Business and Legal Perspectives

David I. Salem

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/mjil>



Part of the [International Law Commons](#), and the [International Trade Commons](#)

Recommended Citation

David I. Salem, *The Joint Venture Law of the Peoples' Republic of China: Business and Legal Perspectives*, 7 Md. J. Int'l L. 73 (1981).
Available at: <http://digitalcommons.law.umaryland.edu/mjil/vol7/iss1/9>

This Notes & Comments is brought to you for free and open access by DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Journal of International Law by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.

Notes and Comments

THE JOINT VENTURE LAW OF THE PEOPLE'S REPUBLIC OF CHINA: BUSINESS AND LEGAL PERSPECTIVES

PREFACE

The purpose of this note is to outline and explain the nature of the Law of the People's Republic of China Using Chinese and Foreign Investment (the Joint Venture Law) for legal counsel and potential foreign investors. An analysis of the Joint Venture Law involves an examination of other, equally significant Chinese laws — chief among them being the recently adopted Joint Venture and Individual Income Tax laws and the labor management and special economic zone regulations. Much of this note, because of the paucity of published material on Chinese laws, is based on intensive research, interviews, conferences, round-table discussions, speeches, and other forms of largely undocumented, but up-to-date information provided by U.S. and People's Republic of China (PRC) trade and government officials. Cross-references to other socialist joint venture laws have also been made in order to more fully explain the principles and policies of the Chinese Joint Venture Law.

This study is an attempt to dissect the provisions of the pertinent laws in the hope of clarifying at least some of the reasons for what appears to be a drop in the initial enthusiasm of U.S. companies that sought to participate in joint ventures shortly after the promulgation of the Joint Venture Law in 1979. Though the Law is perhaps an ambitious undertaking, the realities of the last two years have proved somewhat disillusioning. Only a handful of joint ventures have been approved and only a small number of U.S. firms are currently engaged in negotiations. Much of this is due to the ambiguous and often obscure provisions of the laws. The Chinese, perhaps in their haste to attract foreign investment, simply omitted much of what a Western joint venture partner would consider essential to the legal framework of a cooperative agreement. Such omissions may, however, prove to be a blessing to future trade arrangements since they compel potential partners to resort to serious, in-depth, personal negotiations. The importance of such negotiations in surmounting the many legal and cultural differences between the PRC and Western nations should not be lost on the eager investor, who is often too impatient to eschew the short-term profit for the long-term benefits. This is not to deny that the PRC is our ideological adversary and that despite its good intentions, it probably seeks many of its gains at our expense. Nevertheless, the Joint Venture Law provides the foundation for successful

long-term penetration of the Chinese market. It is the author's intent to analyze the laws, point out their deficiencies and inconsistencies, and suggest potential considerations, strategies, and measures for their correction.

EXECUTIVE SUMMARY

The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Joint Venture Law) was promulgated by the National People's Congress on July 1, 1979 as part of the Chinese modernization program. The purpose of the Joint Venture Law is to attract foreign technology and expertise in the production of goods in order to satisfy the needs and expectations of the Chinese people. To implement this law, the PRC has had to pass a number of additional laws, including labor, tax, and banking regulations — all of which are designed to help procure additional foreign investment. Moreover, to do business with the new foreign participants, the Chinese have had to establish a number of agencies to authorize and oversee the operations of the joint venture in the People's Republic.

There are four main steps to establishing a joint venture in China. These are: (1) obtaining the assistance of the China International Trust and Investment Corporation; (2) negotiating the legal framework of the joint venture; (3) obtaining the authorization of the Foreign Investment Commission of the People's Republic; and (4) registering with China's General Administration for Industry and Commerce.

The China International Trust and Investment Corporation is responsible for working with foreign investors in finding business opportunities in China and assisting them in negotiating the terms of the joint venture. The broad scope of the Joint Venture Law leaves many of the legal and business issues of the venture unresolved, with the expectation that the parties will address them in the negotiated agreement. Under the Joint Venture Law, the joint venture consists of pooled assets, shared profits and losses, and joint management. The foreign partner is expected to contribute at least twenty-five percent of the venture's registered capital (although there are a number of different forms of permissible capital contributions — some of which raise a number of questions).

The Joint Venture Law offers a significant degree of flexibility in determining the composition of the venture's board of directors and in delimiting its authority over the operations of the venture. The recently-enacted Labor Management Regulations must also be consulted by the parties since these regulations provide guidance on some of the more essential issues involved in management and labor relations.

The venture is required to open an account with the Bank of China or a bank approved by the Bank of China and to register with the local tax

bureau for the payment of taxes. Tax provisions for the joint venture corporation and the individuals employed by it are found in the Joint Venture Income Tax Law and the Individual Income Tax Law, respectively. These laws address various aspects of Chinese taxation, including taxable income, tax rates, tax credits, tax incentives and tax payment. The Joint Venture Law permits the remission of profits abroad through the Bank of China, pursuant to foreign exchange regulations in the currency provided for in the venture contract.

Two of the broader provisions in the Joint Venture Law deal with technology transfer and the marketing of joint venture products. The parties to the venture must consider what technology is appropriate to China's needs and what marketing practices are compatible with the legal and economic regulations, not only of China, but also of potential third country recipients.

Joint venture operations may be terminated by mutual agreement of the venture parties, by a breach by one of the parties or by *force majeure*. Each of these terms must be further defined in the agreement itself. The Joint Venture Law provides for consultation, conciliation, arbitration, and judicial procedure (in that order of preference) for the resolution of disputes arising during the life of the venture. The foreign participant, in negotiating the terms of dispute settlement provisions, must keep in mind that the Chinese eschew adversarial techniques common in Western litigation practices.

Once the terms of the venture contract are agreed upon, the venture must seek the approval of China's Foreign Investment Commission and register with the General Administration for Industry and Commerce.

The Joint Venture Law is an ambitious undertaking, but many of its provisions are ambiguous and somewhat obscure — this has caused concern and even reluctance on the part of the foreign venture partner to invest in China. Moreover, foreign participants have expressed displeasure with China's management expertise, the lack of attention paid to consumer satisfaction in the PRC, the level of factory pollution, and the inadequacies of PRC factory infrastructures.

The concerns voiced by foreign venture partners are offset somewhat by the Chinese commitment to joint ventures and their desire to attract foreign technology. Despite the inadequacies and inexperience of its legal environment, the PRC's political environment is sufficiently stable so as to permit the Chinese to recognize the shortcomings of the Joint Venture Law and account for them in the negotiated joint venture contract. The basis of a workable and profitable venture agreement is the mutual consultation that precedes it. Both sides can negate the problems and shortcomings encountered in the law by careful and amicable negotiation.

I. INTRODUCTION

The leadership of the People's Republic of China has recently charted a course of economic modernization — through the development of industry, agriculture, science and technology, and defense¹ — the aim of which is to make the PRC a leading industrialized nation by the turn of the century. Crucial to the process of the "four modernizations" (as the PRC's plan is popularly known) is the acquisition of foreign technology,² increased cultural contacts with foreigners,³ and the development of bilateral and multilateral trade arrangements with foreign countries.⁴ To obtain foreign technology, the PRC must, of course, earn sufficient amounts of hard currency — to do this requires the development of manufactured goods and natural resources for export. Foreign trade is thus a crucial element in the PRC's future economic plans.

On January 28, 1979, PRC vice-premier Deng Xiaoping began his historic tour of the United States, symbolizing the increased Chinese interest

1. The "four Modernizations," as they are widely known, are a central element of the People's Republic of China's new 1978 Constitution, thus illustrating the significant role they play in contemporary China. See 1978 PRC CONSTITUTION, reprinted in *Text of Newly Adopted Constitution, Foreign Broadcast Information Service on China* (hereinafter "FBIS-CHI") no. 78-045 (March 7, 1978), preamble. See generally *Newspapers Note Three Tasks for 1980's*, FBIS-CHI-80-025 (Feb. 5, 1980), at L1 (noting that one of the three tasks for the 1980's is to develop the four modernizations).

Even the newly-adopted 1979 legal codes of the PRC are expected to serve, in part, the rapid development of the Chinese economy. See *Guangming Ribao Explains Role of Law in Modernization*, FBIS-CHI-79-144 (July 25, 1979), at L2. In addition, the PRC has justified its military development on the basis that by strengthening its self-defense, it can "create a peaceful environment for the realization of the four modernizations." See *Ba Yi Calls For New Sino-Soviet Friendship Treaty*, FBIS-CHI-80-038 (Feb. 25, 1980), at L23; *Tung Hsiang Comments on PRC War Preparedness*, FBIS-CHI-78-232 (Dec. 1, 1978), at N3.

2. The importance of the acquisition of foreign technology is illustrated by the promulgation of the Joint Venture Law of the PRC, discussed *infra*.

3. See, e.g., *Youth Federation to Increase Foreign Contacts*, FBIS-CHI-80-102 (May 23, 1980), at A6; *More Areas, Cities Open to Tourists*, FBIS-CHI-80-090 (May 7, 1980), at L23.

4. See H. CHIU, AGREEMENTS OF THE PEOPLE'S REPUBLIC OF CHINA, A CALENDAR OF EVENTS 1966-1980 (1981).

The author also learned that the PRC has often compromised its public stance on certain issues, such as on-site inspection, in order to acquire advanced technology through trade agreements. See *China Recognizes Form 629: Permits Monitoring of Sensitive Equipment*, 6 CHINA BUS. REV. 55 (No. 4, July-Aug. 1979). Form 629 is part of the COCOM regulations. It apparently requires that the selling country be permitted to inspect foreign facilities to ensure that the equipment sold has been used for the purpose for which it was intended (*i.e.*, civilian use).

in fostering more significant trade relations with Western countries. A number of large U.S. corporations shortly thereafter entered into cooperative arrangements with their Chinese counterparts.⁵ On March 2, 1979, the PRC and the United States entered into an agreement liquidating more than \$197 million in American assets.⁶ Almost a year later, on January 24, 1980, the United States Senate extended "most-favored-nation" treatment to the PRC,⁷ effective February 1, 1980.

On July 1, 1979, the Second Session of the Fifth National People's Congress (NPC) approved the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Joint Venture Law).⁸ Since then, in implementation of the policies expressed in the Joint Venture Law, a series of laws and regulations have been approved and promulgated by responsible organs of the Chinese government. The more significant of these laws and regulations are:

- (1) Regulations of Labor Management;
- (2) Regulations on Special Economic Zones in Guangdong Province;
- (3) Joint Venture Income Tax Law;
- (4) Individual Income Tax Law;
- (5) Charter of the Bank of China; and
- (6) Temporary Regulations on Foreign Currency Control of the PRC.⁹

Moreover, the PRC concluded four important agreements with the United States during this period: the Civil Aviation Agreement, the Maritime Agreement, the Textile Agreement and the Consular Convention Agreement.¹⁰ Since the Joint Venture Law is the foundation upon which rests

5. See, e.g., N. Y. Times, Mar. 8, 1979, at D9, col. 2; N. Y. Times, Feb. 4, 1979, S12 (Outlook), at 55, col. 1.

6. Washington Post, Mar. 2, 1979, at A1, col. 1. The claims in this dispute date back to 1949 when the Communists seized the mainland and "froze" Western assets there.

7. See *China's Status as Most Favored Nation Effective 1 Feb.*, FBIS-CHI-80-022 (Jan. 31, 1980), at B3. The European Economic Community also granted the PRC preferential trade treatment in 1980. See *EEC to Grant PRC Preferential Treatment in 1980*, FBIS-CHI-79-139 (July 18, 1979), at G1.

8. The law became effective on July 8, 1979. For an English translation, see FBIS-CHI-79-146 Part II: Supp. no. 020, at 31. See also Beijing Review (*hereinafter* cited as "BR") No. 29, July 20, 1979, at 24.

9. Speech by Mr. Liu Chu, a member of the PRC's Foreign Investment Commission, Washington Foreign Law Society (February 19, 1981) (*hereinafter* cited as "Liu Speech"). These laws and regulations were cited by Mr. Chu. *Id.* at 1-2.

10. *Id.* at 2.

the "investment environment" of the PRC, it is appropriate to begin with an analysis of that law.

The attractiveness of the Joint Venture Law lies, to some extent, in its stated purpose of "expanding international cooperation and technological exchange"¹¹ through a number of foreign investment guarantees circumscribed only by the rather broad legal parameters of joint venture operations. Pursuant to the Joint Venture Law and the dictates of practical necessity, there are four main steps in the establishment of a joint venture in the PRC. These are: (1) obtaining the assistance of the China International Trust and Investment Corporation (CITIC);¹² (2) negotiating the legal framework of the joint venture;¹³ (3) obtaining the authorization of the Foreign Investment Commission of the PRC (FIC);¹⁴ and (4) registering with the PRC's General Administration for Industry and Commerce (GAIC).¹⁵

Though contact with the CITIC is not mandated by the Joint Venture Law *per se*, Rong Yiren, the chairman of the Board of Directors and the president of CITIC, has issued a statement that joint venture arrangements should be initiated through this Chinese enterprise.¹⁶ CITIC is responsible to the PRC's highest executive organ, the State Council, and its responsibilities are, *inter alia*, "to introduce, absorb and apply foreign investment, advanced technology, and to import advanced equipment and to bring in advanced technology for purposes of China's national construction and promotion of

11. Art. 1 of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (*hereinafter* cited as "Joint Venture Law").

12. The information collected on the Joint Venture Law is an amalgam of intensive personal research, interviews, and the acquisition of the recent work on the Law by Tao-tai Hsia and Kay Haun, both of whom work in the Far Eastern Law Division of the Library of Congress. Their article appeared in the first two issues of the CHINA LAW REPORTER. The second half of their two-part article is entitled: *China's Joint Venture Law: Part II*, and is found in 1 CHINA LAW REPORTER 61 (No. 2, Winter 1981). This article (*hereinafter* cited as Hsia and Haun) is extensively cited in this paper.

Moreover, the author was fortunate to speak directly with Ms. Haun for further clarification and updates of the Joint Venture Law. This telephone interview served to confirm the legitimacy of previously procured material and offered some heretofore unpublished information as well. The interview (*hereinafter* Haun Interview) is cited mainly when it offers new material, though it may rightfully be used as support for much of this paper. This interview was conducted on April 23, 1980. Citations contained in this paper which refer to this interview were based on the author's impression of the information imparted. The material cited has not been confirmed by the interviewee.

13. See Arts. 8-14 of the Joint Venture Law.

14. Art. 3 of the Joint Venture Law.

15. *Id.*

16. See *Ta Kung Pao Weekly Supplement*, No. 699, Nov. 15-21, 1979, at 19.

socialist modernization."¹⁷ In addition to Rong Yiren, who is also a deputy to the PRC's highest legislative authority, the NPC, and vice-chairman of the All-China Federation of Industry and Commerce,¹⁸ Lei Renmin, a former vice-minister of foreign trade, is vice-chairman and one of three vice-presidents. Both are highly intelligent, energetic men whose desire for cross-cultural technological exchange is borne out by the fact that shortly after its inception, CITIC was contacted by mail, cable, and personal representatives from over 100 countries.¹⁹ CITIC has its main corporate headquarters in Beijing and is actively seeking the establishment of a Hong Kong branch office.²⁰

Among CITIC's forty-four directors are a number of former businessmen and industrialists from various Chinese cities, and some businessmen from Hong Kong and Macao.²¹ In addition to its own capital of 200 million yuan, CITIC

can also accept funds from foreign corporations, enterprises, other economic entities or individuals, or raise funds abroad for investment in China by issuing debentures of the corporation or by serving as agents in the issue of the shares related to investment in China, and handle trustee-businesses of short-term or long-term investment in China.²²

The formal responsibility of CITIC is to

. . . undertake under commission from foreign corporations, enterprises, other economic entities or individuals to negotiate and enter into short-term or long-term joint venture agreements and related contracts with the various local administrations and departments in China, and the corporations, enterprises, and other economic entities thereunder, and vice versa.²³

17. See Citic Charter, art. 2. An English translation appears in 1 CHINA LAW REPORTER (No. 1, 1980).

18. The practice of wearing "two hats" (i.e., heading up several posts) began with Mao Zedong, who was called "Chairman" because he was Chairman of the Chinese Communist Party, Chairman of the Governmental Council and Chairman of the People's Revolutionary Military Council, which controlled the People's Liberation Army. See L. PYE, CHINA: AN INTRODUCTION 178 (2d ed. 1978).

19. See Hsia and Haun, *supra* note 12, at 62.

20. *Id.* at 61.

21. *Id.*

22. See *China International Trust and Investment Corporation Founded*, Wen hui bao (Shanghai), Oct. 5, 1979, at 2.

23. *Id.*

Rong Yiren has himself stated that CITIC "will work with foreign investors in finding business opportunities . . . in China, putting them in touch with potential Chinese partners, assisting them in negotiating the terms of a joint venture and maintaining a friendly interest in their success."²⁴

Eaten-Shen Pacific Corporation of San Francisco recently initiated its trade contact with the PRC through CITIC. Though originally reported as a joint venture agreement, designating an annual investment of \$50 million to be made in the PRC through 1982, no joint venture company has been formed and neither partner owns equity in the planned venture.²⁵ The prototype for joint venture agreements is that consummated between Schindler Holding AG of Switzerland and the China Construction Elevator Machinery Corporation, which combined to form the China-Schindler Elevator Company, Ltd. With the assistance of CITIC, a carefully-worded joint venture contract was created and the joint venture approved. The enthusiasm which accompanied the execution of this agreement was marred somewhat by the PRC's unilateral decision to publish the contract in order to indicate to foreign investors the earnestness of Chinese intentions and the success of the Joint Venture Law — while disregarding Schindler's pleas to respect the privacy of the agreement.²⁶

The often zealous efforts of CITIC in setting up joint ventures are justified by the corporation's perceptions of a number of Chinese shortcomings that must be overcome through short-term business and legal incentives designed to attract direct investment. First, the PRC is seeking to reduce its balance of payments deficit with the West.²⁷ Second, the Chinese are seeking to offset somewhat the socio-economic problems generated by the PRC's high population density.²⁸ In addition, the vast expanse of territory in the PRC

24. See *Ta Kung Pao Weekly Supplement*, *supra* note 16, at 4.

25. For a report on the agreement, see *Asian Wall St. J. Weekly*, Oct. 8, 1979, at 4. During the Huan Interview, the author was made aware of the subtleties of the agreement which may prevent it from being designated a joint venture. For some of the reasons, see *infra* note 198.

26. Telephone interview by author with Ms. Elaine Difederico (Commerce Department), author of a number of articles on investment in the PRC (*hereinafter* cited as Difederico Interview), April 23, 1980. Citations contained in this paper which refer to this interview were based on the author's impression of the information imparted. The material cited has not been confirmed by the interviewee.

27. Note, *Joint Ventures in the People's Republic of China*, 14 J. OF INT'L. LAW AND ECO. 133, 142 (No. 1, 1979) (*hereinafter* cited as Joint Venture Note).

28. The PRC is exacting its own price from Party and other government officials who fail to enforce the strict birth control regulations of one child per family — in the form of castration. See *Guizhou Officials Punished for Birth Control Failures*, FBIS-CHI-80-126 (June 27, 1980), at Q1.

creates a number of transportation and communications problems which make consistent, coordinated development programs difficult. The PRC also has poor mechanisms for the refinement of its natural resources sorely needed for rapid industrial expansion.²⁹

The Joint Venture Law addresses a number of the PRC's more basic commercial concerns by providing for the acquisition of modern, sophisticated technology.³⁰ Moreover, political leaders have asserted that the Joint Venture Law is intended to grant the foreign trading partner a number of management opportunities³¹ — a claim evidencing a desire on the part of the PRC to examine and acquire Western management expertise. Finally, the promulgation of the Joint Venture Law is, in itself, an indication of the Chinese desire to modernize economically as rapidly as possible. The absolute non-existence of such legally-sanctioned Western direct investment in China only ten years ago, and the obvious ideological compromise the Chinese have needed to make in order to permit the influx of foreign equipment, technology and personnel, illustrates the Chinese willingness to forego cultural differences in order to help realize the PRC's dream of economic parity with the major Western powers by the year 2000.

The Joint Venture Law appears to deliberately avoid definition of what types of joint ventures are permitted. Surprisingly, there is no explicit requirement that joint ventures contribute to China's four modernizations, though this may be implied by Article 5, which mandates foreign technological contributions that are "truly advanced and appropriate to China's needs." Moreover, the Law does not specify particular areas of the Chinese economy which have been pinpointed for joint ventures. Rong Yiren has asserted that "the scope [of joint ventures] could be decided according to the intent of the foreign investor and the need of the PRC."³² As such, deductive business logic would seem to compel the conclusion that the broad scope of the Joint Venture Law is designed to permit maximum flexibility on the part of the PRC to extend approval to a wide range of joint venture activities. Nevertheless, such apparently attractive market potential must be punctuated with a caveat: Rong Yiren has unequivocally averred that "all the rights

29. Joint Venture Note, *supra* note 27, at 142.

30. Art. 5 of the Joint Venture Law.

31. Art. 6 of the Joint Venture Law. Deng Xiaoping also told former Commerce Secretary Juanita Kreps that Western joint venture participants would have the right to fire inefficient workers. See DiFederico, *China Marks New Policy with Joint Venture Law to Encourage Investment*, *BUS. AM.*, Aug. 27, 1979, at 19.

32. Hsia and Haun, *supra* note 12, at 63.

and consideration to be given to a foreign partner must not be harmful to the sovereignty of China."³³

The importance of such an assertion must not be lost on the eager businessman: the broad scope of the Chinese Joint Venture Law can also be used by the PRC as a pretext for limiting the relevant areas of joint venture arrangements when it is within the PRC's best interests to do so.³⁴ Rong Yiren has also somewhat circumscribed the parameters of joint venture domains by noting that the Chinese seek as their first priority, "enterprises which produce goods for export and hence create foreign exchanges [sic] . . . industry, agriculture, building and construction, transport, tourism, services, coal mining, oil, non-ferrous metals and so on, are the fields good for setting up joint ventures."³⁵ The CITIC statute appears to confirm Rong Yiren's assertions that first priority will be accorded joint venture arrangements with the potential to earn foreign exchange. Article 16 provides that "trust and investment items handled by the corporation shall only include those which have the capacity of repaying foreign exchange." Since CITIC serves, to some degree, as the "screening" organ for potential joint ventures, its statutory mandate is an important requisite consideration for foreign firms intent on negotiating for joint undertakings in the PRC.

The foregoing is not meant to suggest to potential joint venture participants that the PRC seeks solely those arrangements that yield foreign exchange.³⁶ Rather, the foreign participant is advised that the PRC decision

33. His comments are translated in *Rong Yiren on Joint Ventures*, BR No. 29, July 20, 1979, at 27.

34. Though such an assertion of national self-interest was denied by PRC Consulate officials in a telephone interview, one cannot help but feel that the Chinese leadership was swayed somewhat by national self-interest when it decided to readjust its plans for modernization at the Second Session of the Fifth National People's Congress on June 18, 1979. At the Session, Hua Guofeng called for, *inter alia*, curtailment of capital construction and greater emphasis on light industry, transportation, and communication. See *Report on the Work of the Government*, BR No. 27, July 6, 1979, at 9-20. The fact that the call for readjustment came before the promulgation of the Joint Venture Law seems irrelevant in light of the continued selected cutbacks of a number of projects. See, e.g., *China Wire*, 1 CHINA BUS. REV. 4-5 (Jan.-Feb. 1981) (noting that many companies in 1980 were concerned with the number of reassigned contracts, halted negotiations and cancelled orders).

35. Hsia and Haun, *supra* note 12, at 63.

36. Compare, for example, Art. 16 of the CITIC statute with comments made recently by Nicholas Ludlow, who has written extensively on the PRC in the *China Business Review*. Ludlow reported that the PRC has at least \$2 billion in the Eurocurrency market, which would seem to reduce the urgency for the procurement of foreign exchange by the PRC.

on approving a joint venture will be greatly influenced by the amount, type and quality of the technology that the foreign investor contributes.³⁷

Despite the major role played by CITIC in the formation of a joint venture, the Joint Venture Law requires formal authorization to issue from the PRC's Foreign Investment Commission (FIC) (established on July 8, 1979) to examine for approval "agreements and contracts concluded between the parties to the venture and the articles of association of the venture formulated by them."³⁸ In addition, the Import-Export Control Commission (IECC) was established to oversee foreign investment, including joint ventures. Gu Mu is the head of both the FIC and IECC. The task of the two commissions is to:

- (1) research and formulate plans of which the major content is foreign trade, foreign currency, acquisition of technology and utilization of foreign investment;
- (2) examine and approve joint venture projects;
- (3) research and formulate laws, decrees, and regulations;
- (4) organize, consider and conclude foreign economic cooperation agreements; and
- (5) investigate and study the general state of international economic development and trade.³⁹

The net effect of a procedure which compels the active participation of these four agencies, among others, is to assure the PRC, through what may be considered an oversight system of "mutual surveillance,"⁴⁰ of the most profitable and legitimate joint ventures. For foreign investors, however, the

37. Hsia and Haun, *supra* note 12, at 64.

38. Art. 3 of the Joint Venture Law.

39. Liu Speech, *supra* note 9, at 9.

40. The "surveillance" factor is further advanced by press reports calling for increased public security, by the reintroduction of organic regulations on local organizations, and by allegations of the existence of a Chinese secret police network.

A number of recent articles have appeared in the PRC press, calling for the protection of state secrets and noting that violations are punishable as counterrevolutionary crimes, perhaps the most heinous category of crimes in the PRC and one that carries the death sentence under Art. 103 of the Criminal Code. *See, e.g., AFP: Beijing Ribao Urges Protection of State Secrets*, FBIS-CHI-79-100 (May 22, 1979), at L1; *Beijing Ribao Stresses Importance of Guarding Secrets*, FBIS-CHI-79-106 (May 31, 1979), at L1; *Renmin Ribao Article on Protecting State Secrets*, FBIS-CHI-80-072 (April 11, 1980), at L8; *Xinhua Publishes Regulations on Guarding State Secrets*, FBIS-CHI-80-073 (April 14, 1980), at L7; *Gongren Ribao Urges Guarding of Party, State Secrets*, FBIS-CHI-80-085 (April 30, 1980), at L14; *Beijing Ribao on Need to Help Stop Leaks, Improve Security*, FBIS-CHI-80-090 (May 7, 1980), at L23.

proliferation of agencies has caused uncertainty and confusion as to the proper authority of each.⁴¹

Needless to say, both Rong Yiren and Gu Mu are high-level Chinese Communist Party (CCP) members — a fact which helps to illustrate the CCP's control over each and every aspect of Chinese life and which emphasizes the often vital prerequisite to successful business dealings with the PRC — a fundamental knowledge of Communist Chinese ideology as it impacts on dealings with foreign corporations.

The Chinese have stressed the principle of economic self-reliance — a concept that seemingly contravenes the spirit of the Joint Venture Law, *i.e.*, joint venture undertakings with capitalist countries, the influx and use of Western technology, and the permissibility of loans from foreign banks. Recently, however, a *Guangming Ribao* news article cited Lenin for support of China's economic expansion, noting that the development of the Chinese economy involved the use of "external factors" and the acquisition of "foreign capital and advanced technology,"⁴² and deploring those who regard such factors as "forbidden."⁴³ Nevertheless, the Chinese press is occasionally punctuated with articles warning of the potential pernicious influence of foreigners and foreign items.⁴⁴

To increase administrative control over lower-level government organs and the general populace, the National People's Congress, the highest legislative authority in the PRC, reintroduced four sets of regulations in 1980 covering the establishment of neighborhood committees and other organizations in cities, the purpose of which is to allow public security organs of urban precincts to keep local inhabitants under total surveillance — reminiscent of the old Chinese system of registration and control known as "Waojia" (system of "ten households and hundred households"). See *Central Press Publishes NPC Regulations on Local Organizations*, FBIS-CHI-80-017 (Jan. 24, 1980), at L2-9. See also Yegorov, *Changes in the State Structure of the PRC*, 4 *FAR EAST. AFF.* 118, 124-25 (1980).

Sources available to the author indicate the existence of an intelligence network in the PRC, the sophistication of which probably pales when viewed against that of its better known counterparts, the KGB and the CIA. Nevertheless, the multiplicity of surveillance organs in China tends to compensate for the shortcomings of any single department and maintains total active control over the masses and, presumably, over foreigners as well. See generally J. TOWNSEND, *POLITICS IN CHINA* 289-337 (2d ed., 1980).

41. Haun Interview, *supra* note 12.

42. Reynolds, *The Joint Venture Law of the People's Republic of China: Preliminary Observations*, 14 *INT'L. LAWYER* 31, 34 (No. 1, Winter 1980).

43. *Id.*

44. See, e.g., *Guangming Ribao Discusses Proper Approach to Foreign Things*, FBIS-CHI-79-091 (May 9, 1979), at L10; *Shanghai Ribao Urges Proper Attitudes Towards Foreigners*, FBIS-CHI-79-084 (April 30, 1970), at 02 (one must distinguish between "flagrant [sic] followers and poisonous weeds").

Undoubtedly, CCP cadre opposition to the burgeoning import of foreign technology was partially responsible for the 1979 announcement by Hua Guofeng of a three-year program to readjust plans for modernization.⁴⁵ Any foreign investor needs to remain perceptive of and sensitive to the need of PRC officials to reconcile Communist doctrine with joint enterprises involving capitalist participants.

Despite Chinese wariness of foreign contacts, an increasing number of economic centers have been marked for joint venture development; including ports, roads, natural resource extraction, water transport, electric power, food processing, and communications.⁴⁶ Joint venture arrangements have been most prolific in the areas of hotel development and hydrocarbon exploration.⁴⁷ Japan has entered into such joint venture agreements with the PRC. Several American companies; including General Motors, Ford, International Harvester, and Occidental Petroleum, continue to negotiate for such arrangements.⁴⁸

II. THE JOINT VENTURE FORM OF COOPERATION: GENERAL PRINCIPLES

Basic to the conclusion of a joint venture contract is agreement on the connotation of the term "joint venture."⁴⁹ The PRC Joint Venture Law, the provisions of which were left deliberately broad, provides no specific definition. In principle, however, a joint venture is distinguished from other forms of cooperation⁵⁰ by three characteristics: pooled assets, shared profits and losses, and joint management.⁵¹ The result of such attributes is usually a venture with a common board of directors, joint utilization of financial resources, a particular objective, and fairly complex documents describing the structure of the venture.

45. See Leng, *Arms Control and Disarmament in Chinese Global Policy in CHINA IN THE GLOBAL COMMUNITY* 164-86 (J. Hsiung and S. Kim, eds. 1980).

46. Reynolds, *supra* note 42, at 34.

47. See, e.g., Wall St. J., Sept. 20, 1978 at 14, col. 2 (general hotel negotiations); Wall St. J., May 4, 1979, at 14, col. 4 (Pan Am proposals); WORLD BUS., Nov. 13, 1978, at 55. See also Tanner, *Promise of Major Funds Draws U.S. Oil Firms*, Wall St., J., Oct. 19, 1978, at 1, col. 1; BUS WK., Nov. 6, 1978, at 76.

48. Representatives of CITIC toured the United States for one month in order to promote joint ventures and other forms of foreign investment, EXPORT WEEKLY (No. 278), Oct. 16, 1979, at C2. See generally Reynolds, *supra* note 42, at 35.

49. See Klingenberg and Pattison, *Joint Ventures in the People's Republic of China: The New Legal Environment*, 19 VA. J. OF INT'L. L. 807, 813 (No. 4, Summer 1979).

50. The most basic forms of East-West cooperation are import/export sales contracts, industrial cooperation agreements and joint ventures. See C. McMILLAN & D. ST. CHARLES, *JOINT VENTURES IN EASTERN EUROPE: A THREE COUNTRY COMPARISON* 10 (1974).

51. Klingenberg and Pattison, *supra* note 49, at 814.

In addition to the obvious attractiveness of the PRC as a market for joint venture participation, the substantive business generated by the joint undertaking encourages local participation, permitting the foreign participant to exchange resources and capital for low-cost local labor, domestic market distribution expertise, and domestically-oriented business knowledge.⁵² The joint venture offers the potential for cross-cultural interaction, thereby permitting the resolution of certain conflicts through internal personalized bargaining within the enterprise and helping to bridge the often disparate cultural proclivities of different societies.

III. AN EXAMINATION OF THE JOINT VENTURE LAW

A. *The Joint Venture: Form and Capital*

Authorization for a proposed joint venture, under Article 3 of the Joint Venture Law, must be obtained from the FIC. Upon tender of the application, the FIC has three months to decide whether to grant or reject the proposal. According to sources available to this author, the FIC has a significant backlog of applications, and the three month proviso has yielded to somewhat lengthier periods of deliberation.⁵³ Once the application is accepted, the venture must then be registered, pursuant to Article 3, with GAIC before its operations are officially sanctioned.

The compulsory language of Article 4 contemplates the formation of a limited-liability company (something akin to a joint stock company) by the parties to the venture. Under Article 1, parties to a joint venture may include unincorporated associations, partnerships and individuals. In addition, the absence of nationality restrictions permits the possibility of multi-party ventures composed of foreign participants of varying nationalities. The PRC itself has published only one definitional statement of what a limited-liability company is: the responsibility that the limited-liability company assumes for the debts of the joint enterprise is limited to its registered capital, and the joint venture partners do not use their other capital to bear the risks of the venture enterprise or to pay its debts.⁵⁴ This appears to be consistent with Article 4, which states that "profits, risks and losses shall be shared by the parties to the venture in proportion to their contributions to the registered capital."

52. *Id.*

53. Haun Interview, *supra* note 12.

54. Wang Jiafu and Su Qing, *A Preliminary Discussion of the Law on Joint Ventures Using Chinese and Foreign Investment*, Faxue Yanjiu (Studies in Law), No. 3, 1979, at 23 *cited in* Hsia and Haun, *supra* note 12, at 69.

The foreign participant is expected to contribute twenty-five percent or more of the venture's registered capital; but the use of the terms "shall *in general* not be less than twenty-five percent" (emphasis added) suggests the possibility that certain exceptions could be made, perhaps when the potential return or the highly-useful nature of the technology contributed by the foreign partner so requires. The PRC does not confine itself to the common practice of permitting forty-nine percent foreign and fifty-one percent local ownership.⁵⁵ Vice-premier Li Hsien-nien has asserted that the "proportion of investment by foreign companies can be higher than fifty percent."⁵⁶ Rong Yiren has not discounted the possibility of one hundred percent foreign ownership (though legally speaking, this would not be defined as a "joint venture") through the adoption of special regulations.⁵⁷ To date, however, no foreign enterprise has maintained as much as one hundred percent ownership, and it is more likely that the Chinese will retain a substantial interest of at least twenty-five percent in all ventures.⁵⁸

Article 5 provides that

Each party to a joint venture may contribute cash, capital goods, industrial property rights, etc., as its investment in the venture The investment contributed by a Chinese participant may include the right to the use of a site provided for the joint venture during the period of its operation. In case such a contribution does not constitute a part of the investment from the Chinese participant, the joint venture shall pay the Chinese government for its use.⁵⁹

In addition, the Joint Venture Law provides that the various contributions "shall be specified in the contracts . . . or in [the venture's] articles of association, and the value of each contribution [excluding that of the site] shall be ascertained by the parties to the venture through joint assessment."⁶⁰ This provision generates a number of concerns. In the first instance, it compels rather intensive negotiations between parties, with each side stressing the particular valuation that most appeals to and protects its own interests. The result of such negotiations may be particularly complex joint venture provisions that assess specific values of specific items at specific

55. Wall St. J., Aug. 1, 1979, at 26, col. 2.

56. *Id.*

57. *An Exclusive Interview with Rong Yiren*, 5 CHINA BUS. REV. 6 (Sept. - Oct. 1979).

58. Wall St. J., Aug. 1, 1979, at 26, col. 2.

59. Art. 5 of the Joint Venture Law, paras. 1, 3.

60. Art. 5 of the Joint Venture Law, para. 4.

times and that have carefully-worded reservations covering unusual market fluctuations. Moreover, the Joint Venture Law excludes the Chinese-contributed site, a facet of the Law that invites speculation as to Chinese real estate valuations, and suggests the possibility that some PRC site valuations may be somewhat inflated as a "retaliatory" measure for the perceived inequities of the high valuation of Western technology at world market prices. In short, the lack of a suitable market for PRC land contributions simply adds to the problem of potentially arbitrary valuation.

The foreign participant must also ascertain from the Chinese whether the rent charged by the PRC for uncontributed sites includes the use of both the land *and* facilities for venture personnel and activities. It should be noted that the PRC has apparently enacted regulations on the use of land by joint ventures,⁶¹ but they have not been circulated to foreigners and their content remains a mystery.⁶²

Article 5 contemplates a number of different forms of capital contribution. Foreign participants should anticipate the contribution of non-cash resources by the PRC, since it is relatively cash-poor. With respect to industrial rights, there are two potential problems: (1) assessing a value agreeable to both parties to the venture; and (2) protecting those rights from unqualified use by third parties. The foreign participant, with the exception of the United States, is often left without significant guarantees of the protection of trademarks, copyrights and patents, because the PRC has not yet acceded to the Paris Convention for the Protection of Industrial Property.⁶³ Without such accession, foreign participants must rely on bilateral agreements (between the home country of the foreign partner and the PRC) or on the specific provisions of the joint venture document. In the absence of a bilateral agreement, the foreign investor should be aware of the difficulties of detecting unauthorized use in a country as vast and as closed as China and the special problems involved in obtaining enforcement.⁶⁴ Trademarks, for example, are protected by the China Council for the Promotion of International Trade,⁶⁵ but there is no PRC copyright or patent law.

The United States is in a more favorable position, having concluded with the PRC the Agreement on Trade Relations Between the United States of

61. *See Strengthen Economic Legislation, Renmin Ribao*, Sept. 3, 1980, at 1.

62. Hsia and Haun, *supra* note 12, at 64.

63. *Id.* at 65.

64. *Id.* at 67.

65. PRICE WATERHOUSE & CO., *DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA* 16 (1979).

America and the People's Republic of China (Bilateral Trade Agreement) in 1979. The Bilateral Trade Agreement provides that

- (1) Both Contracting Parties in their trade relations recognize the importance of effective protection of patents, trademarks and copyrights;
- (2) Both Contracting Parties agree that on the basis of reciprocity, legal or natural persons of either Party may apply for registration of trademarks and acquire exclusive rights thereto in the territory of the other Party in accordance with its laws and regulations; and
- (3) Both Contracting Parties agree that each Party shall seek, under its laws and with due regard to international practice, to ensure to legal or natural persons of the other Party protection of patents and trademarks equivalent to the patent and trademark protection correspondingly accorded by the other Party.⁶⁶

Ostensibly, these provisions indicate an intent to ensure certainty and uniformity in the protection of industrial property rights. Unfortunately, their potential strength is enervated by the following provision:

- (4) Both Contracting Parties shall permit and facilitate enforcement of provisions concerning protection of industrial property . . . and shall provide means, in accordance with their respective laws, to restrict unfair competition involving unauthorized use of such rights.⁶⁷

Although it calls for the enforcement of such rights, this provision fails to specify the exact method of protection, and thus leaves open a variety of interpretations as to what constitutes protection.

The applicability of Chinese law to both the industrial property rights mentioned in the Bilateral Trade Agreement and, by virtue of Article 2 of the Joint Venture Law,⁶⁸ to joint ventures as well, creates another cluster of

66. Agreement on Trade Relations, July 7, 1979, United States-China, art. VI, paras. 1-3, Fed. Reg. 61, 161 (1979), T.I.A.S. No. 9630.

67. *Id.*, art. VI, para. 4.

68. Art. 2 of the Joint Venture Law provides that

The Chinese Government protects, by the legislation in force, the resources invested by a foreign participant in a joint venture and the profits due him pursuant to the agreements, contracts and articles of association authorized by the Chinese Government as well as his other lawful rights and interests.

All the activities of a joint venture shall be governed by the laws, decrees and pertinent rules and regulations of the People's Republic of China.

concerns for both the foreign and Chinese investor due to the absence of PRC domestic legislation on patents. At present, the only existing law concerning patents is the Regulations on Rewards for Inventions, promulgated by the State Council on December 28, 1978.⁶⁹ Under the regulations, all inventions belong to the State and all work units in the PRC may make use of inventions as they deem necessary. Rewards are granted to inventors on the basis of the State's evaluation of the significance of the invention.⁷⁰ Yet, the Chinese themselves have criticized the regulations because they "do not completely comply with the requirements of the development of science and technology in China, nor can they satisfy the requirements of international cooperation."⁷¹ To date, the call for a PRC patent law has gone unanswered.

As such, the drafting and negotiation of the provisions of the particular joint venture contract take on extreme importance as they pertain to the special problems of designating and delimiting the protection to be accorded industrial property rights.

B. *The Joint Venture: Management and Labor*

Ownership and managerial control of the joint venture is provided for in Article 6 of the Joint Venture Law. Pursuant to Article 6, paragraph 2, the joint venture is to be controlled by a board of directors

empowered to discuss and take action on, pursuant to the provisions of the articles of association of the joint venture, all fundamental issues concerning the venture, namely, expansion projects, production and business programs, the budget, distribution of profits, plans concerning manpower and pay scales, the termination of business, the appointment or hiring of the president, the vice-president(s), the chief engineer, the

69. The State Council issued a circular on Dec. 28, 1978 on the promulgation of the revised *Regulations on Rewards for Inventions*. See *State Council Revises Invention Reward Regulations*, FBIS-CHI-79-013 (Jan. 18, 1979), at E15. (The revised regulations replaced the 1963 version.)

70. Under Art. VI of the 1978 Regulations, rewards for inventions are divided into four categories according to their importance. The rewards, including honor rewards and cash rewards, are as follows:

- (1) An invention certificate, a medal and 10,000 yuan;
- (2) An invention certificate, a medal and 5,000 yuan;
- (3) An invention certificate, a medal and 2,000 yuan; and
- (4) An invention certificate, a medal and 1,000 yuan.

Under Art. VII, inventions of "extraordinary importance" are given special treatment.

71. *Renmin Ribao Calls for Creation of Patent System*, FBIS-CHI-80-133 (July 9, 1980), at L12.

treasurer and the auditors as well as their functions and powers and their remuneration, etc.⁷²

The Chinese participant is accorded the power to appoint the chairman of the board of directors, although the foreign partner may appoint one or two vice-chairmen.⁷³ The remaining directors' seats are allocated between the parties to the venture and "each director [is] appointed or removed by his own side."⁷⁴ All decisions of the board of directors are to be reached "through consultation by the participants on the principle of equality and mutual benefit."⁷⁵

One of the most significant challenges in formulating the composition of the board of directors is that of apportioning risk and control so as to achieve the most complementary blend of the participant's respective resources.⁷⁶ Undoubtedly, a foreign investor would be reluctant to conclude a joint venture agreement which does not grant it significant managerial control or at least control commensurate with the risks assumed and the resources contributed. However, at least one foreign trade official has stated that there is "no requirement in the Joint Venture Law that the composition of the board of directors be in proportion to investment."⁷⁷

Apparently, the PRC, through the Joint Venture Law, offers a significantly greater degree of flexibility in determining the composition of the controlling organ of the joint venture than do a number of other socialist countries.⁷⁸ The resourceful foreign corporation, through consultation with its Chinese counterpart at the bargaining table, can probably procure a significant degree of managerial control, and thereby increase its participation in the wealth of issues the board of directors is empowered to resolve. By omission of any reference to the contrary, the Joint Venture Law permits the possibility of awarding management contracts to outside directors; in some instances, the result may be to alleviate the potential conflict caused by

72. Art. 6 of the Joint Venture Law, para. 2.

73. Art. 6 of the Joint Venture Law, para. 1.

74. *Id.*

75. *Id.*

76. Klingenberg and Pattison, *supra* note 49, at 817.

77. *An Exclusive Interview with Rong Yiren*, 5 CHINA BUS. REV. 6 (Sept. - Oct. 1979).

78. In Yugoslavia, for example, the Basic Organization of Associated Labor (BOAL), which exists in every enterprise, retains its supreme decisionmaking role. Under Romanian law, a U.S. company with a forty-five percent joint venture interest maintained three director seats on a seven-man board of directors. See CONTROL DATA CORP., JOINT VENTURE AGREEMENTS IN EASTERN EUROPE 9 (1973); See generally Klingenberg and Pattison, *supra* note 49, at 817-18.

disproportionate control of directorial seats by one party to the venture. The directors of the joint venture parties could, in turn, control the contracts of the outside directors through limitations on the term of the contract, restrictions on direct managerial power, limitations on hiring and firing powers, and other reservations.

Vice-premier Gu Mu, who heads the FIC and the IECC, has indicated that foreign management will be welcomed in order to "create favorable conditions [for] management experience and technical expertise [to be] brought into play."⁷⁹

Conspicuously absent from the powers of the board of directors is the power of hiring and firing — an omission that illustrates the general silence of the Joint Venture Law on labor issues. Article 6 provides that "procedures covering the employment and discharge of the workers and staff members of a joint venture shall be stipulated according to law in the agreement or contract concluded between the parties to the venture."⁸⁰ The apparent purpose of this provision is to protect foreigners who are anxious about the potential repercussions of firing an inefficient Chinese worker. Since hiring and firing must be done "according to law," it is worthy of note that the most relevant legal provisions are contained in the Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment, promulgated and put into force by the State Council on July 26, 1980 (Labor Regulations).⁸¹

Article 4 of the Labor Regulations permits the discharge of workers "who fail to meet requirements after training and are not suitable for other work" when there is a labor surplus "as a result of changes in production and technical conditions of the joint venture."⁸² However, such dismissed workers are to be compensated and reassigned by the authorities in charge of the joint venture. Article 5 admits, upon the approval of the joint venture authorities and the labor management department, to the possibility of discharging workers as punishment for the violation of venture rules and regulations. The provision calls for punishment to be meted out "according to the degree of seriousness of the case," and only when it results in "certain bad consequences." Presumably, the parties would, during venture negotiations, define the parameters of "serious violations" and "bad consequences."

79. Asian Wall St. J. Weekly, Oct. 8, 1979, at 4.

80. Art. 6 of the Joint Venture Law, para. 4.

81. The Chinese text of the regulations can be found in *Zhongguo Renmin Guowuyuan Gongbao* (Gazette of the State Council of the People's Republic of China), No. 10, Oct. 8, 1980, at 298-300. The English text may be found in 6 CHINA BUS. REV. 43 (Nov. - Dec. 1980).

82. Art. 4 of the Labor Regulations, para. 1.

Moreover, Article 7 of the Labor Regulations permits the intervention of the trade union established by the joint venture⁸³ on behalf of the dismissed employee where it feels the dismissal was unreasonable. The trade union's representatives are to "seek a solution through consultation with the Board of Directors"⁸⁴ and, in the event such consultations fail to resolve the issue, request "arbitration by the labor management department of the people's government of the province, autonomous region, or municipality where the joint venture is located."⁸⁵ If either party objects to arbitration, it may "file a suit at the appropriate people's court."⁸⁶ It is unlikely, however, that a foreign participant would choose court process due to the inefficiencies of the judicial system,⁸⁷ the poor publicity for the joint venture, the expense and the time involved.

The Labor Regulations also impact on a number of powers which have been delegated to the board of directors, including those relating to manpower and wages. Faced with operation in a nation so heavily structured around labor, while often basing much of the venture's program on low labor costs, the venture participants are likely to raise a number of questions concerning the use and treatment of personnel.⁸⁸ Through the implementation of the Labor Regulations, the joint venture partner(s) may prevent overstaffing through dismissals⁸⁹ and the foreign participants may prevent "the excessive use of rotation to increase the number of Chinese workers receiving training."⁹⁰

Under the Labor Regulations, wages are to be covered by the employment contract,⁹¹ which is to be signed collectively by the joint venture and the trade union formed within it.⁹² According to Article 8, the wage level of the

83. Art. 2, para. 2 of the Labor Regulations also mandates that a labor contract be signed collectively by a joint venture and the trade organization formed in the joint venture.

84. Art. 7 of the Labor Regulations.

85. Art. 14 of the Labor Regulations.

86. *Id.*

87. The PRC has recently established an international trade legal counsel division in Beijing to, *inter alia*, act as an agent in the litigation of commercial disputes between foreign parties and the PRC. See *International Trade Legal Council*, FBIS-CHI-80-056 (March 20, 1980), at A6. Despite the good intentions of the PRC, the Chinese are still plagued by a paucity of laws and legal personnel, the relative unsophistication of both, and inadequate attention given to publicizing legal norms and keeping them current. Hsia and Haun, *supra* note 12, at 81.

88. Klingenberg and Pattison, *supra* note 49, at 827.

89. Art. 4, para. 1 of the Labor Regulations.

90. Hsia and Haun, *supra* note 12, at 70.

91. Art. 12 of the Labor Regulations.

92. Art. 2 of the Labor Regulations.

workers and staff members in a joint venture will be determined at 120 to 150 percent of the real wages of the workers and staff members of state-owned enterprises of the same trade in the locality. Under Article 11, a joint venture must pay for the Chinese workers' and staff members' labor insurance, cover their medical expenses, and pay various kinds of government subsidies in line with the standards prevailing in state-owned enterprises. Of course, the problem of making an accurate assessment of what standards prevail in state-owned enterprises remains. The foreign partner is likely to be presented with PRC evidence of such standards, but it remains improbable that the Chinese would permit independent assessments — a fact which may permit some financial distortions, particularly in light of the PRC's propensity to grossly exaggerate its economic statistics.⁹³

Article 7 of the Joint Venture Law permits "bonus and welfare funds for the workers and staff members,"⁹⁴ and at least one PRC official has indicated that material incentives for workers will be granted in order to raise productivity.⁹⁵ Another PRC official has noted that foreign employees of joint ventures may be compensated at higher rates than their Chinese co-workers; but local employees should be apprised of the differences in salary structures, and the reasons for them, so as to foster a sense of confidence and pride in their own work.⁹⁶

Interestingly enough, the Chinese have not yet specified that PRC personnel must be compensated in Chinese currently — a facet of the law which may complicate accounting procedures should the venture conduct its daily operations through the use of hard currency and remit Chinese renminbi⁹⁷ to PRC personnel.

A number of other practical problems must simply be covered in the joint venture agreement, including the quality of living quarters, general living style, medical and dental services, travel privileges, and visa procurement for foreign personnel.

93. See J. COPPER, CHINA'S GLOBAL ROLE 38 (1980). Copper noted that the PRC encourages overestimates and grossly inflated surveys to enhance its global image.

94. Art. 7, para. 1 of the Joint Venture Law.

95. Klingenberg and Pattison, *supra* note 49, at 827.

96. See Liu Yaochu *Discusses the Investment Law*, Guang jiao jing (Wide angle) No. 83, Aug. 16, 1979, at 9.

97. Renminbi is known as "people's money." It is the unit of money in PRC foreign trade relations. See Reynolds, *supra* note 42, at 36. There are approximately 1.6 renminbi to \$1 U.S.

C. *The Joint Venture: Registration*

On October 8, 1980, in Communiqué No. 10 of the State Council, the PRC promulgated the Supplementary Joint Venture Regulations.⁹⁸ These regulations were designed to help the PRC maintain control over new enterprises through a procedure of approval and registration. After approval from the FIC, registration documents must be forwarded to GAIC, which is the organ responsible for issuing licenses. GAIC issues these licenses based on an examination of the venture and the following documents:

- (1) the document of approval issued by the FIC;
- (2) the agreement on the joint venture reached by the various parties involved, the contract and the articles of association of the venture, in both Chinese and foreign languages, and each in triplicate; and,
- (3) a duplicate of the license and other documents issued by the departments concerned under the government of the country (or region) from which the foreign participants in the joint venture come.⁹⁹

The name of the venture, its directors, the size of the staff, the number of foreign workers, the forms of production and business, the registered capital of the parties and the scope of production and business are among the items that must be registered.¹⁰⁰ The joint venture must also pay its registration fee¹⁰¹ before it is issued a license — the official document necessary before the start of venture operations.¹⁰²

Because there has been no enumeration of the factors that the FIC will consider before approving the venture, it has been suggested¹⁰³ that foreign interests scrutinize the seven principles utilized by the Yugoslav Federal Committee of Energy and Industry under the Yugoslav Joint Venture Law¹⁰⁴ to determine if a joint venture proposal would be approved. The seven principles include a determination of the following factors: compliance with applicable laws and regulations; adequate resources; customary international terms for cooperation; economic benefit; realistic valuation of the foreign

98. The English translation of these regulations appears in *CHINA BUSINESS REVIEW*, Nov. - Dec., 1980, at 41.

99. Supplementary Joint Venture Regulations, Art. 3.

100. *Id.*, Art. 4 of the Supplementary Joint Venture Regulations.

101. *Id.*, Art. 8 of the Supplementary Joint Venture Regulations.

102. *Id.*, Art. 5 of the Supplementary Joint Venture Regulations.

103. See Klingenberg and Pattison, *supra* note 49, at 820.

104. Law on Investment of Resources of Foreign Persons in Domestic Organizations of Associated Labor is the official title of the Yugoslav joint venture law.

partner's share; and compliance with Yugoslav foreign trade and balance of payments policies.¹⁰⁵

D. *The Joint Venture: Banking*

Article 6 of the Supplementary Regulations requires the venture to open an account with the Bank of China or a bank approved by the Bank of China and to register with the local tax bureau for the payment of taxes. Moreover, Article 8 of the Joint Venture Law stipulates that a joint venture: (1) shall open an account with the Bank of China or a bank approved by the Bank of China, (2) shall conduct its foreign exchange transactions in accordance with the foreign exchange regulations of the PRC, and (3) may, in its business operations, obtain funds from foreign banks directly.

Although the Joint Venture Law does not specify the use of any particular currency, accounting, inventory valuations, calculations of costs and sales, and other procedures would be facilitated by the use of a foreign currency easily convertible in the international market. However, the foreign investor should be careful to stipulate, in the provisions of the articles of association, profit remission increases to coincide with exchange rate inflation in the designated joint venture currency, since it is unlikely that overseas price inflation would increase, *pari passu*, the value of the capital investment in the PRC.

105. See Klingenberg and Pattison, *supra* note 49, at 820 n. 45, citing Art. 42 of the Yugoslav joint venture law. Art. 42 of the Yugoslav law provides for review of a joint venture proposal to determine:

- (1) if it complies with the provisions of this law and with other regulations;
- (2) if it envisages business cooperation ensuring an increase in production, in business productivity and exports, or the construction of new capacities on the basis of modern technology and efficient business practices, the introduction and application of modern techniques, technology and organization of work and production . . . protection of the environment or . . . ;
- (3) if the envisaged total amount of resources which the partners invest in the joint venture can ensure the realization of the conditions from point 2 of this paragraph;
- (4) if the terms provided for business cooperation comply with the terms under which such cooperation normally proceeds in international economic relations;
- (5) if the foreign partner's share (patent rights, license, technology, etc.) is realistically valued;
- (6) if the resources to be invested by the foreign person are not smaller in volume, or in value, to that which is set by the Federal Executive Council; and
- (7) if it complies with Yugoslavia's policy of economic relations with foreign countries, and with Yugoslavia's balance of payments.

The Bank of China is the PRC's specialized institution for foreign exchange transactions.¹⁰⁶ It is subordinate to the PRC's central bank, the People's Bank of China (which sets the exchange rate for the renminbi), but its powers have recently been expanded due to its establishment as a "department under the direct control of the State Council."¹⁰⁷ Although the Bank of China is still the PRC's sole agent in the world of international finance, it is expected to work closely with the FIC and the IECC, as well as the growing number of regional investment companies, such as the Beijing Economic Development Corporation and the Fujian Provincial Investment Enterprise Company. The Bank of China will guarantee the borrowings of these regional investment companies¹⁰⁸ — a move that instills more confidence in the foreign investor who may have doubts about the financial solvency of the lower-level institutions. However, the Bank of China's future role in foreign investment is clouded not only by the emergence of regional investment institutions specializing in joint ventures and other forms of foreign trade enterprises, but by the emergence in June, 1980 of the State Finance and Economic Commission, which now handles long-range financial planning.¹⁰⁹ The best advice to a foreign investor at present seems to be to contact the Ministry of Finance, which oversees all the financial institutions, for instructions on the role of each financial agency in the establishment of a joint venture.

E. *The Joint Venture: Taxation*

Article 7 of the Joint Venture Law provides for the general applicability of PRC tax laws to the joint venture. On September 10, 1980, the NPC adopted tax laws on both joint venture income and individual income.¹¹⁰ The effect of the tax laws is to accord singular treatment to joint ventures.

106. See Stepanek, *A Ten-Year Profile of the Bank of China*, CHINA BUS. REV., Sept. - Oct. 1979, at 35. See also Ludlow and Stepanek, *Inside the Bank of China*, 4 CHINA BUS. REV. 9-13, (July-Aug. 1980). For an overview of China's financial institutions, see *China's Financial Institutions*, 4 CHINA BUS. REV. 15-18, (July-Aug. 1980).

107. Hsia and Haun, *supra* note 12, at 76. The same State Council directive also established the State General Administration of Exchange Control as a "form of exchequer over the country's foreign exchange reserves and watchdog over the Bank of China's international payments." Stepanek, *supra* note 106, at 40. See also *New Bank of China Regulations*, 6 CHINA BUS. REV. 45, (Nov.-Dec. 1980).

108. *New Bank of China Regulations*, 6 CHINA BUS. REV. 41, (Nov.-Dec. 1980).

109. *Id.* at 40.

110. See NPC Standing Committee Issues New Laws, FBIS-CHI-80-181 (Sept. 16, 1980), at L16-22.

1. *The Joint Venture Income Tax Law*

Under the Joint Venture Income Tax Law (JV Tax Law), a tax is levied on the income "derived from production, business, and other sources by any joint venture with Chinese and foreign investment" in the PRC. According to official PRC sources, the Chinese anticipate that joint ventures organized in China may operate in foreign countries through branches or subsidiaries.¹¹¹ Regardless of whether income is actually derived in the PRC, the venture's head office will be responsible for the payment of the tax. This raises a number of questions. Will the Chinese tax income earned by a foreign subsidiary in the same way as that earned by a foreign branch? Will the joint venture be deemed to have received income from a subsidiary in a taxable year on subsidiary earnings, or will such tax apply only to income remitted by the subsidiary?¹¹²

a. *Taxable Income*

According to the JV Tax Law, taxable income is defined as net income for a taxable year after deduction of costs, expenses and losses in that year.¹¹³ This provision should be read in conjunction with Article 7 of the Joint Venture Law, which provides that losses in an earlier year may be carried over to the current year to compute current net income. Article 7 also stipulates that if total losses exceed income for a taxable year, losses may be carried over and deducted from income for up to five subsequent years.

Article 7 of the Joint Venture Law also addresses taxation. Under this provision, net profit can be distributed only *after* income tax is paid on gross profits and after deductions for reserve, bonus, and welfare funds, as well as for joint venture expansion funds. Under such a reading, "net income" under Article 2 of the JV Tax Law corresponds to "gross profits" under Article 7 of the Joint Venture Law.

b. *Tax Rate*

Pursuant to the JV Tax Law and sources available to this author,¹¹⁴ the tax rate is thirty percent on net income plus a ten percent local surcharge on the assessed tax — an overall rate of thirty-three percent.¹¹⁵ In addition, there

111. Rasmussen and Theroux, *China's New Tax Laws for Joint Ventures and Individuals*, 6 CHINA BUS. REV. 36, (Nov.-Dec. 1980)

112. *Id.*

113. Art. 2 of the Joint Venture Tax Law.

114. Difederico Interview, *supra* note 26. Much of the information appearing in the tax section was obtained or confirmed during the interview.

115. Art. 3 of the Joint Venture Tax Law.

is a ten percent tax on profits remitted abroad.¹¹⁶ There is, however, no provision on how profits are to be sent abroad. This creates potential tax problems if currencies are converted or if profit is remitted in non-currency form since both require valuation before taxes can be levied.¹¹⁷ To add to the confusion, this income tax rate does not apply to ventures engaged in exploiting natural resources. Their rates are determined separately — as yet, no announced tax schedule exists (though one may have appeared at the August 1981 session of the NPC). A Chinese Embassy official confirmed that the PRC is considering a fifty-percent rate, though this is still noticeably lower than rates charged by other oil-exporting countries.¹¹⁸ In any event, offshore oil companies have been reluctant to pursue any potential ventures until new tax regulations appear.¹¹⁹

c. *Tax Credits*

Article 16 of the JV Tax Law permits a joint venture to credit against its income paid to the PRC any income tax paid to foreign countries on income earned by branches (or subsidiaries) in those countries. Moreover, where the PRC enters into or has entered into bilateral tax treaties with other countries to avoid double taxation, those treaties take precedence over the JV Tax Law.¹²⁰

This particular provision causes great concern among potential foreign investors. Ordinarily, a tax credit is a valuable commodity to a business. However, the JV Tax Law does not indicate what type of foreign income tax the Chinese will permit to be credited against their own. There has been no indication of whether joint venture subsidiaries and branches will be permitted the same credits. There also has been no official PRC statement on whether a limit will exist on the amount of credit for foreign income taxes that can be used to offset PRC income taxes — a point the Chinese will probably clarify soon. As it stands now, the thirty-three percent tax rate is significantly lower than corporate tax rates in Western countries — a fact that results in higher taxes being paid in those countries. Thus, the potential

116. Art. 4 of the Joint Venture Tax Law.

117. Rasmussen and Theroux, *supra* note 111, at 37. They note that Chinese officials may not tax remitted profits if they are deposited in a Chinese bank or in a foreign branch of the Bank of China. If the amount was instead deposited in the Chinese branch of a foreign bank, no exemption would be granted — a procedure which has an adverse effect on the operation of foreign banks in China.

118. The Embassy official was contacted in April 1980 by the author.

119. Haun Interview, *supra* note 119; Difederico Interview, *supra* note 26.

120. Art. 16 of the Joint Venture Tax Law.

exists for a joint venture to have overseas taxes that could be *fully* credited against the PRC tax, which would reduce it to zero.

d. *Tax Incentives*

A number of tax reductions and exemptions are provided in the JV Tax Law. Article 5 permits a joint venture to be exempted from income tax in its first profit-making year and to reduce its income tax in the subsequent two years by fifty percent if it is expected to operate for a minimum of ten years. Low-profit ventures, such as farming and forestry, may be allowed a fifteen to thirty percent reduction for a period of ten years after the expiration of the period in which the initial exemption or reductions in income tax were allowed.

Article 6 grants a forty percent refund for the reinvestment of a venture participant's share of the profits in China for a period of five years or more. Article 7 supports the reinvestment refund.¹²¹ Moreover, it alludes to an income tax reduction or exemption for the first two or three profitable years of a venture for the use of "up-to-date technology by world standards."¹²² The main question that arises, of course, is what type of technology the Chinese will consider as qualifying for this tax incentive. The relevant laws do not clarify this issue.

The establishment of special economic zones in the PRC has led to the formulation of separate regulations covering a number of other tax incentives, including tax holiday and ten percent corporate tax rate provisions in the Shekou Industrial Zone in Guangdong.¹²³ However, the lack of definitional clarity in the relationship between the JV Tax Law and the separate laws of the special zones creates uncertainty as to what law will apply to newly-formed ventures. Many companies are therefore justified in their reluctance to establish joint ventures until some of the more pressing tax problems are cleared up.

e. *Tax Payment*

Taxes are levied annually and may be paid in quarterly installments within 15 days of the end of each quarter.¹²⁴ Tax returns are filed with local authorities¹²⁵ and are paid in renminbi.¹²⁶ Overdue tax payments are assessed

121. Art. 7, para. 3 of the Joint Venture Tax Law.

122. Art. 7, para. 2 of the Joint Venture Tax Law.

123. Rasmussen and Theroux, *supra* note 111, at 38.

124. Art. 8 of the Joint Venture Tax Law.

125. Art. 9 of the Joint Venture Tax Law.

126. Art. 10 of the Joint Venture Tax Law.

a surcharge at the rate of one half of one percent of the overdue tax for every day in arrears.¹²⁷ Tax authorities retain the right to investigate the corporate books and require the joint venture to make full disclosure of relevant financial information.¹²⁸ Tax evasion may result in a penalty of up to five times the amount of the unpaid tax and gross violations *shall* (compulsory language) be handled by the people's courts.

The JV Tax Law is devoid of any provision that permits, as the United States does, a taxpayer to resort to judicial procedure to determine the proper amount of taxes owed *before* paying them. In the PRC, the joint venture is required to remit its taxes first before applying to higher tax authorities for reconsideration,¹²⁹ a procedure which may result in significant hardship for smaller joint ventures. "A joint venture participant that is not able to pay a large amount of assessed tax may find the appeals procedures to be meaningless if its financial condition is impaired by the payment of a tax that is later found to be excessive."¹³⁰ It is hoped that the NPC will, at its next session, resolve a number of these issues in supplementary regulations.¹³¹

2. Individual Income Tax Law

The Individual Income Tax Law (Income Tax Law) taxes the incomes "gained within or outside China by any individual residing for one year or more" in the PRC.¹³² By definition, the Income Tax Law applies to Chinese citizens; however, since their average income is less than 800 yuan annually,¹³³ the Law applies mainly to foreigners.¹³⁴

A number of issues arise in connection with the Income Tax Law. First, there has been no dispositive standard proffered by the Chinese for determination of "residency" status. At least one report indicates that the Chinese will use a subjective intent standard — rather than a physical presence rule or some other standard for residency¹³⁵ — but the criteria for subjective intent are unknown. Second, the plain meaning of the law evinces

127. Art. 13 of the Joint Venture Tax Law.

128. Art. 12 of the Joint Venture Tax Law.

129. Art. 15 of the Joint Venture Tax Law.

130. Rasmussen and Theroux, *supra* note 111, at 38; Difederico Interview, *supra* note 26.

131. The author notes that inquiries directed to the Chinese Consulate in Washington, D.C. as to the content of the proposed regulations were largely unanswered.

132. Art. 1 of the Individual Income Tax Law.

133. Rasmussen and Theroux, *supra* note 111, at 38.

134. Haun Interview, *supra* note 12. See also Rasmussen and Theroux, *supra* note 111, at 38.

135. *Id.*

an intention to tax the worldwide income of individuals residing in the PRC. Since there is no provision for tax credits as there is in the JV Tax Law, the net result is to subject these individuals to double taxation. One can only imagine the sort of loopholes or the kinds of employment guarantees foreign residents may seek in order to avoid the applicability of the Income Tax Law or at least some of its harsher consequences.

Though certain categories of income are exempted from tax,¹³⁶ the income subject to taxation includes wages and salaries, compensation for personal services, royalties, interests, dividends, bonuses, income from leased property, and other income designated by the Ministry of Finance.¹³⁷

Tax rates range from five to forty-five percent,¹³⁸ and both the tax collection provisions and the provisions for tax avoidance are similar to those of the JV Tax Law.¹³⁹

Many questions still remain, in spite of the promulgation of these tax laws. Foreign investors and employees may be justifiably apprehensive about business with the PRC until supplementary regulations appear.

F. *The Joint Venture: Profit Remission and Repatriation of Funds*

Article 10 of the Joint Venture Law provides that the net profit of a foreign participant, as well as the capital funds it realizes upon dissolution of the venture, may be remitted abroad through the Bank of China, pursuant to foreign exchange regulations, in the currency provided for in the venture contract. Article 11 permits the wages, salaries, and other legitimate income earned by a foreign worker to be remitted abroad after payment of income taxes. The JV Tax Law encourages the deposit of funds in the Bank of China by permitting a tax refund on the reinvested amount.¹⁴⁰ Though no such refund provisions exists in the Income Tax Law, Article 10 of the Joint Venture Law grants "encouragements" to all foreign participants who deposit any funds permitted to be remitted abroad in the Bank of China. Presumably, such "encouragements" include preferential interest rates.¹⁴¹

136. Art. 4 of the Individual Income Tax Law recites nine categories.

137. Art. 2 of the Individual Income Tax Law.

138. Art. 3(1) of the Individual Income Tax Law.

139. Arts. 8-13 of the Individual Income Tax Law.

140. Art. 6 of the Joint Venture Tax Law.

141. Klingenberg and Pattison, *supra* note 49, at 822.

The PRC foreign exchange regulations are currently undergoing revision. Therefore, it is essential that the foreign investor negotiate carefully for the rate of profits to be remitted abroad under the venture agreement.¹⁴²

G. *The Joint Venture: Technology Transfer*

Article 5 of the Joint Venture Law addresses the issue of the transfer of technology and serves to protect the PRC from exploitation.¹⁴³ Under this provision the technology or equipment contributed by any foreign participant as investment is to be truly advanced and appropriate to China's needs. In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation must be paid for the losses.

Article 5 should be read in conjunction with Article 7, paragraph 2 of the Joint Venture Law, which provides tax incentives for the contribution of "up-to-date technology by world standards." Somewhat paradoxically, the JV Tax Law omits any mention of tax incentives for advanced technology — a facet of the tax law which seems to emasculate the potential for tax breaks.

The technology transfer provision of the Joint Venture Law raises a number of issues for the foreign investor. First, there is the definitional problem of "truly advanced or appropriate to China's needs." The law does not specify what is "truly advanced or appropriate," nor does it consider the possibility that, at this stage of economic development in the PRC, what may be appropriate may fall short of being truly advanced. The phrase is simply too imprecise and amenable to unilateral Chinese interpretation. The law also fails to mention who bears the responsibility for the determination of what is appropriate or advanced (*ie.*, the FIC, Chinese partner, or both partners through consultation). Moreover, there is no precise definition of "intentional" deception, nor is there a stipulation of who is responsible for that determination. Finally, there is no definitive interpretation of the proper amount of compensation for intentional deception.

Article 5 may have been deliberately worded as amorphously as possible in order to prevent unnecessary exploitation by foreign enterprises (to which the PRC remains extremely sensitive). It is suggested that the foreign participant emphasize, through careful wording of the venture agreement, that there is no intention to impinge upon China's sovereignty or to exploit its resources. This will at least evidence a substantial degree of good faith on

142. Compare the Romanian, Yugoslav, Soviet, and Korean joint venture laws on repatriation *cited in* Klingenberg and Pattison, *supra* note 49, at 822–23, and accompanying footnotes.

143. For an analysis of provisions in the PRC Joint Venture Law that serve to protect Chinese interests, see Hsia and Haun, *supra* note 12, at 74–77.

the part of the foreign partner. Accurate descriptions of the technology provided and of its purposes will help to avoid serious misunderstandings as to "intentional" deception. The wording of Article 5 is such that the foreign partner's only recourse may be to obtain a "definitive statement [from the Chinese partner] that the technology satisfies the requirements"¹⁴⁴ of the law.

While the wording of Article 5 is compulsory (through the use of the word "shall"), the first paragraph indicates that each party "may contribute cash, capital goods, industrial property rights, etc., as its investment in the venture" (emphasis added). This language is merely permissive and does not, therefore, require technology transfer where other investment contributions are possible. Thus, Article 5 offers protection to foreign participants with patented or otherwise-protected intellectual property. Therefore, such foreign participants are not obligated to relinquish their rights to the joint venture.

H. *The Joint Venture: Pricing and Marketing*

Pricing is a key variable in the economic decision-making process of a joint venture. Unfortunately, pricing provisions are conspicuously absent from the Joint Venture Law. According to one source available to this author, an FIC member recently addressed some of the guidelines the Chinese will use in pricing raw materials, fuel, packaging, and other items supplied by the Chinese partner to the venture:¹⁴⁵

- (1) The price of raw materials, packages, fuel, and power required for the daily use of the joint venture enterprise can be set with reference to international market prices;
- (2) The price of miscellaneous goods and office supplies required by the venture can be set with reference to the price paid for those supplies by China's domestic enterprises;
- (3) The price of all products set out by China for export can be set with reference to the FOB price for Chinese products of the same type. The price of imported products can be set by reference to the purchase price plus computed factory shipping expenses; and
- (4) For services communication, and transportation fees, domestic enterprise fees will be used as a standard.¹⁴⁶

A foreign partner is advised to resort to the venture agreement to formalize pricing arrangements in order to avoid problems with what have been rather

144. *Id.* at 76.

145. See Art. 9, para. 2 of the Joint Venture Law, which notes that the PRC should be given first priority as a source for these supplies.

146. Liu Speech, *supra* note 9, at 7-8.

inelastic state-controlled pricing regulations¹⁴⁷ for domestic products in socialist countries. To prevent misunderstandings, consultation with the Chinese partner prior to the adoption of the agreement will maximize pricing flexibility and minimize conflict.

Article 9 of the Joint Venture Law is perhaps one of the most liberally-worded provisions of the entire law. Under it, "a joint venture is encouraged to market its products outside China. It may distribute its export products in foreign markets through direct channels or its associated agencies or China's foreign trade establishment. Its products may also be distributed in the Chinese market."¹⁴⁸ The liberal construction of this provision "stems from China's desire to benefit from the marketing network that the foreign participant has already developed before coming to China and seeks to accommodate also the foreign participant's expectation of penetrating the Chinese market."¹⁴⁹

Despite its broad construction, Article 9 must be considered in the context of potential markets for venture products. Though the Joint Venture Law grants a venture substantial freedom to market its products, U.S. venture partners who wish to distribute a product in the United States must be wary of American laws — specifically the Countervailing Duty Act,¹⁵⁰ the Antidumping Act,¹⁵¹ and the Trade Act of 1974.¹⁵² All of these laws impact on import pricing and its potential consequences.¹⁵³ The Countervailing Duty Act is intended to offset the unfair competitive advantage otherwise enjoyed by foreign producers as a result of export subsidies, bounties, or grants provided by their governments. The Antidumping Act is similar in its protection and is frequently used to redress injuries caused by the sale in the United States of foreign products for less than fair value. The Trade Act of 1974 deals specifically with imports from Communist countries and is likely to be invoked if joint venture products are marketed in the United States.

147. Prices of state plan items in the PRC are set by the State Council's Bureau of Prices. Difederico Interview, *supra* note 26. See also Stepanek, *Why U.S. Firms are Cautious*, 4 CHINA BUS. REV. 33, (July-Aug. 1980).

148. Art. 9, para. 3 of the Joint Venture Law.

149. Hsia and Haun, *supra* note 12, at 72.

150. 19 U.S.C. § 2436 (1978).

151. 19 U.S.C. §§ 160-71 (1978).

152. 19 U.S.C. § 1303 (1978).

153. A discussion with David Simon, Esq., of the law firm of Abell and Kay, Washington, D.C., was conducted at the University of Maryland Law School on March 25, 1981 for the benefit of students of international trade law. Mr. Simon provided this author with substantial insight into the consequences of violations of the three most significant acts in U.S. domestic legislation regarding international trade.

The International Trade Commission has already investigated two cases¹⁵⁴ involving PRC products (though not joint venture products) and recommended import quotas in one.¹⁵⁵ The underlying rationale for all this legislation and litigation has been the strong U.S. business doctrine that price must bear some direct relation to costs. Market potential is often only as significant as a nation's laws permit it to be and joint ventures must remain cognizant of domestic protective legislation when marketing and pricing a product.

It thus becomes extremely important that pricing and marketing policies be flexible and free from state control — conditions which should be designated in the venture agreement.

I. *The Life of a Joint Venture*

Specific terms for joint ventures should be decided by consultation between the parties.¹⁵⁶ A fifteen-year life will be the general rule for light-industry ventures and a twenty-five year life for heavy-industry ventures.¹⁵⁷ Article 12 of the Joint Venture Law designates mutual agreement as the appropriate means of terminating the joint venture at the proper time.

In addition, the parties may decide through consultation, subject to FIC approval, to delay (or presumably accelerate)¹⁵⁸ the date of termination. Article 13 provides for early termination of the enterprise in the event of "heavy losses, breach, *force majeure*" or other extraordinary circumstances. Under normal conditions, it would appear that Article 2 compels joint venture partners to absorb losses in proportion to their equity ownership. The only exception to proportional losses seems to be that indicated in Article 13, which obligates a breaching party to absorb any financial loss caused by a

154. In March of 1978, the ITC investigated market disruption claims in a case involving the import of PRC cotton gloves. Certain Gloves from the People's Republic of China, U.S. I.T.C. Pub. No. 867 (1978). In August, 1978, the ITC investigated a similar claim involving the import of PRC clothespins. Clothespins From the People's Republic of China, the Polish People's Republic, and the Socialist Republic of Romania, U.S. I.T.C. Pub. No. 902 (1978). The ITC found no market disruption in the former case, but did in the second case against the PRC (though not against the Polish or Romanian products).

155. See U.S.I.T.C. Pub. No. 902, *supra* note 154. See generally Klingenberg and Pattison, *supra* note 49, at 825 and accompanying footnotes.

156. Liu Speech, *supra* note 9, at 6. See also Art. 12 of the Joint Venture Law.

157. Liu Speech, *supra* note 9, at 6.

158. Art. 12 of the Joint Venture Law mandates FIC approval for extensions of the venture contract, but this author feels that proper coordination of, and control over, venture activities compels FIC approval for early termination, as well.

breach.¹⁵⁹ Potential conflict exists since the definition of "breach" is susceptible to varying interpretations, depending on the particular jurisdiction and the significance of the breach. *Force majeure* may also take on different connotations to different parties and a foreign partner should be aware, for example, of Chinese ideological objection to "strikes" as a principle excusing performance of the venture. The venture agreement should stipulate all the requisite elements of "breach" and of "*force majeure*."

There is no provision in the Joint Venture Law designating formal procedures for action when liabilities exceed assets. Once again, the venture contract should serve as the medium for explicit treatment of insolvency and what Chinese agencies, if any, will order dissolution upon its showing.

J. *The Joint Venture: Dispute Settlement*

Article 14 of the Joint Venture Law provides for the resolution of disputes through consultation, conciliation, or arbitration — a sequence of modes that is important to a basic understanding of the Chinese.¹⁶⁰ The Chinese have traditionally avoided courts as a means of dispute settlement. They have instead turned to non-adversarial and non-litigious techniques, such as friendly negotiations and other forms of interpersonal and amicable resolution. When consultation among the directors of the venture fails to achieve the desired settlement, Article 14 permits the use of an "arbitral body of China" or another mutually agreeable arbitration body. Dispute settlement through arbitration is quicker, less expensive, less formal, and results in less acrimonious confrontation than that traditionally found in courtroom litigation.¹⁶¹ Undoubtedly, the joint venture agreement should stipulate the terms of arbitration. If the venture participants decide to resort to domestic arbitration, protocol seems to require that each party choose an arbitrator from among the 15-21 members of the Foreign Economic Trade Arbitration Commission (FETAC), which exercises jurisdiction over joint

159. Art. 13 of the Joint Venture Law reads, in relevant part: "In cases of losses caused by breach of the contract(s) by a party to the venture, the financial responsibility shall be borne by the said party." Breach, of course, is a term that often tests the intellectual dexterity of attorneys in the United States. Lawyers must be extremely meticulous in defining this term in the joint venture contract. In addition, it is worthy of note that standard *force majeure* clauses are probably useless, because the term "Act of God" often appears in them. Since the Chinese, on the whole, do not recognize the existence of God, they are unlikely to accept the term in the contract.

160. Ellis and Shea, *Foreign Commercial Dispute Settlement in the People's Republic of China*, 6 INT'L. TRADE L. J. 155 (No. 2, 1980-81).

161. *Id.* at 161, n. 29.

ventures between foreign companies and Chinese corporations and enterprises.¹⁶²

FETAC operates on the basis of three guiding principles: (1) equality and mutual benefit; (2) independence and initiative; and (3) consideration of international practice.¹⁶³ Under the first principle, all countries, regardless of size or influence, must be treated on an equal basis. The second and third principles seek to strike a balance between Chinese domestic interests and the requirements of international arbitration practices, to which the PRC must conform in order to develop its foreign trade.¹⁶⁴

When a disagreement arises, an application containing the following information must be submitted to FETAC:

- (1) names and addresses of the parties to the arbitration;
- (2) the claim of the plaintiff and the facts and evidence on which it is based;
- (3) the name of the arbitrator chosen by the plaintiff from among the FETAC members; and
- (4) certified duplicates of all relevant documents.¹⁶⁵

The plaintiff must also deposit a sum equivalent to one-half the amount of his claim. The defendant has fifteen days to respond in the form of an answer or counterclaim and should indicate his selection for arbitrator.¹⁶⁶

The Provisional Rules of FETAC require the case to be heard in open session¹⁶⁷ unless either party requests a closed hearing. Hearings are usually held in Beijing, unless the FETAC chairman approves a request for a hearing to be held elsewhere.¹⁶⁸ Both parties are responsible for the production of supporting evidence, the evaluation of which shall be handled at the discretion of the tribunal.¹⁶⁹ The tribunal also has provisional authority to take custody of the property in dispute (particularly in cases involving perishable goods) in order to protect the interests of the parties and prevent the sale or removal of the property.¹⁷⁰

162. *Id.* at 164 and 165.

163. *Id.* at 165. See also Klingenberg and Pattison, *supra* note 49, at 831.

164. Ellis and Shea, *supra* note 160, at 165 and 166.

165. *Id.* at 166. See also Yuan Li-wu, *China's Foreign Trade Arbitration*, CHINA HANDBOOK (1973), at 69.

166. Ellis and Shea, *supra* note 160, at 166.

167. Provisional Rules of FETAC, *cited in* Ellis and Shea, *supra* note 160, at 166.

168. *Id.* at 167.

169. *Id.* at 166 and 167.

170. *Id.* at 167.

Under relevant Chinese law, it appears that representation for all parties must be provided by PRC counsel.¹⁷¹ The Legal Office of the China Committee for the Promotion of International Trade (CCPIT) has a list of Chinese lawyers who are available to represent foreign businesses in all arbitration proceedings.¹⁷²

Foreign partners may opt for outside arbitral bodies as well, though the PRC has yet to ratify any international arbitration conventions. However, despite the fact that the PRC is not a signatory to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards,¹⁷³ it has apparently abided by foreign arbitration awards involving Chinese domestic corporations.¹⁷⁴ In spite of the PRC's good record, the foreign participant would be better advised to resort to domestic arbitration provisions, which would more likely indicate to the Chinese good faith on the part of the foreign partner.¹⁷⁵

Another hedge against potential disputes is the procurement of insurance. The Overseas Private Investment Corporation (OPIC) recently extended political risk insurance covering private U.S. investment in the PRC.¹⁷⁶ Under the OPIC agreement, China accepted the principle of subrogation, which allows the United States government to acquire the rights of an aggrieved company, and thereby transform a PRC-private corporation dispute into a PRC-United States dispute. The agreement also allows OPIC to seek redress under prevailing norms of international law, including arbitration if necessary.¹⁷⁷ The signing of the OPIC agreement is an indication of the Chinese willingness to streamline the process of settling claims due to such factors as the inconvertibility of currency and expropriation.

171. The recently enacted Regulations on Lawyers require that a lawyer practicing in the PRC courts be of Chinese nationality. See *Text of Provisional Regulations on Lawyers*, FBIS-CHI-80-169 (Aug. 28, 1980), at L7, Art. 8 (Lawyers practicing in PRC courts must have studied law in the PRC and "cherish . . . and support the socialist system").

172. Ellis and Shea, *supra* note 16, at 167. Ellis and Shea point out that PRC attorneys do not operate under the same conflict of interest strictures as U.S. attorneys do.

173. *Id.* at 159.

174. See Ren Tsien-hsin and Liu Shao-shan, *People's Republic of China, 3 YEAR-BOOK-COMMERCIAL ARBITRATION* (1978), at 160.

175. *But see* the recent joint venture arrangement between the Swiss Schindler Holding Co. and China Construction Machinery Corp., which provides for a British forum. Ellis and Shea, *supra* note 160, at 169 and n. 67.

176. See *OPIC Agreement Reached*, 6 *CHINA BUS. REV.* 42, (Nov.-Dec. 1980). The PRC has also recently established the People's Insurance Company to handle foreign commercial insurance matters as they relate, *inter alia*, to joint ventures.

177. *Id.*

The essence of dispute settlement in joint ventures remains bilateral negotiations without the use of third parties. The foreign participant should plan settlement provisions carefully, paying special attention to legal terms that may have different connotations in Chinese and English. Moreover, in the event arbitration becomes necessary, the joint venture agreement should cover such factors as the completion of the arbitration panel, location, notice procedures, standards of judgment, the language in which the proceeding will be conducted, the procurement of necessary visas to negotiate settlements in appropriate cities, and the character of the award.

The foreign participant must exhibit a significant degree of patience and an understanding of the Chinese system in order to avoid communicating the impression that satisfactory results may be achieved only through adversarial techniques. The Chinese are extremely sensitive to conflict. Special care should be paid to the more technical areas of a joint venture agreement, including the treatment of trade secrets, technical licenses, assignability, and potential competition among original participants,¹⁷⁸ in order to avoid the need to resort to more extreme forms of dispute settlement. Where necessary, mutually agreeable technical experts should be designated to resolve technical disputes. Judicial procedure should be utilized only as a last resort.

IV. CONCLUSION

This note has devoted itself to an analysis of the Joint Venture Law, with consideration given to a number of additional laws and regulations impacting on foreign investment opportunities in the PRC. The purpose of the note has been to present the law to legal counsel and foreign investors in order to clarify its provisions and illustrate their shortcomings, as well as to suggest possible strategies in contract negotiations.

From a purely juridical standpoint, the Joint Venture Law is consistently imprecise, significantly ambiguous and marginally advantageous. Legal disputes have emerged on a number of occasions. Recent West German investment project proposals, for instance, have been met with reticence and often recalcitrance in the PRC. Problems arose over German and Chinese interpretations of remittance guarantees, payment terms, and the definition of capital.¹⁷⁹

178. See Klingenberg and Pattison, *supra* note 49, at 831.

179. See *German-Chinese Joint Venture: The Familiar Slowdowns*, 6 CHINA BUS. REV. 42, (Nov.-Dec. 1980).

The initial enthusiasm of U.S. companies for joint ventures in the PRC has also diminished.¹⁸⁰ A number of U.S. companies¹⁸¹ have cooled negotiations with the PRC pending supplementary legislation that will clarify the ambiguities of a number of Joint Venture Law and tax provisions. Moreover, after taking a dispassionate look at the realities of Chinese factory management, many U.S. companies are apprehensive about the power of the joint venture's board of directors, which may be insufficiently independent to permit the venture to function profitably and guarantee a quality product.¹⁸²

From a purely business standpoint, the Joint Venture Law is an ambitious undertaking with broad provisions designed to ensure maximum pragmatic flexibility and to encourage individual negotiation to resolve potential business conflicts. U.S. executives have, however, voiced a number of concerns that reflect on the PRC as a reliable, long-term business partner. Among them are:

- (1) Chinese enterprises pay insufficient attention to consumer satisfaction,¹⁸³
 - (2) Factories selected by Beijing ministries for joint ventures often lack infrastructure,¹⁸⁴
 - (3) Chinese factories sometimes tolerate hazardous levels of pollution,¹⁸⁵
 - (4) Chinese managers have very little real authority,¹⁸⁶
 - (5) Chinese factories are burdened with extraneous responsibilities,¹⁸⁷
- and

180. See Stepanek, *supra* note 147, at 32. See also Butterfield, *New Wariness Over China Deals*, New York Times, Oct. 1, 1980, p. D1, col. 3; cf. *China Cancels More Contracts*, New York Times, Feb. 12, 1981, at D6, col. 3.

181. Some of the U.S. companies cited include General Motors, Smith Kline and Xerox. *Id.* See also Difederico Interview, *supra* note 26.

182. Stepanek, *supra* note 147, at 33.

183. Stepanek notes that U.S. companies are concerned about the PRC managers' lack of emphasis on such marketing concepts as quality control, maintenance and promotions. *Id.* at 32. See also *CEMA: China Starts Learning to Manage*, 4 CHINA BUS. REV. 7, (July-Aug. 1979).

184. PRC partners cause U.S. companies to forego certain deals because suggested sites have inadequate infrastructure facilities. Stepanek, *supra* note 147, at 32.

185. The PRC has tried to remedy this through the recent adoption of an environmental law which, *inter alia*, provides for warnings, fines, compensation for losses, or cessation of production for environmental pollution. See *NPC Decree on Environmental Protection Law*, FBIS-CHI-79-182 (Sept. 18, 1979), at L7 (esp. Art. 32). See also Martin Weil, *Cleaning Up China's Environment*, 1 CHINA BUS. REV. 50, (Jan.-Feb. 1981).

186. PRC factory managers are apparently exercising little authority because of the recent policy of decentralization, which brings managers under the direct personal control of superiors. Stepanek, *supra* note 147, at 33.

187. Large plants are often expected to double as housing and schooling facilities. *Id.*

- (6) Management ground rules for joint venture operations are in a state of controversy and flux.¹⁸⁸

Many potential foreign investors have posited alternative strategies designed to circumvent a number of these problems. One of the more popular strategies has been to negotiate for single-process undertakings in the PRC, leaving the less suitable parts of the production process to be carried out in Japan, Hong Kong, or elsewhere.¹⁸⁹

Thus, from both legal and business vantage points, the Joint Venture Law breeds a significant degree of anxiety among foreign investors. A prospective joint venture participant must not only examine the relevant laws and regulations, but assess the risks of the political, economic and social environment in which the Joint Venture Law will be implemented.

The stability of the present PRC political environment seems to be one major reason for the influx of foreign investment in China. The contentious, often violent clashes of the Cultural Revolution have ended. The Gang of Four, the members of whom have become a symbol of the radical, disruptive element of the recent anarchic era, has been successfully prosecuted and the political upheavals its members were accused of advocating have been extinguished. Deng Xiaoping, often recognized as one of the most powerful Chinese leaders, has more firmly entrenched his own position in the government by appointing two of his protégés, Zhao Ziyang and Hu Yaobang, to powerful government and Party posts.¹⁹⁰ The positioning of these men in the Chinese state infrastructure makes them likely candidates to succeed Deng¹⁹¹ and continue his policies. Chinese policies in the past five years have promoted a significant degree of internal consistency that is highly compatible with foreign investment opportunities.

For the most part, every aspect of Chinese life is touched in some way by the present appeal for economic modernization. Even the PRC Constitution addresses the issue of economic development by noting its importance and prohibiting any person from using any means whatsoever to "disrupt the economic order of the society and undermine the economic plans of the state."¹⁹² Though it appears that the present stability of the political system,

188. Lack of consistent rules often makes U.S. businesses reluctant to participate in joint ventures. *Id.* at 33.

189. *Id.*

190. Zhao Ziyang was recently named Premier at the Twelfth Session of the NPC. Hu Yaobang has been General Secretary of the Communist Party since February 1980. Hsia and Haun, *supra* note 12, at 78.

191. *Id.* at 79.

192. PRC 1978 Constitution, Art. 8. For the English text, see *Text of Newly Adopted Constitution*, FBIS-CHI-78-045 (March 7, 1978), at D39.

the promulgation of the recent legal codes, the recent proliferation of contacts between foreign visitors and Chinese citizens, and the zeal with which the PRC has approached economic modernization have all contributed to increased foreign investment, the fact remains that the Chinese system, despite its good intentions, has engendered a number of difficulties.

State Council directors have permitted the establishment of special economic zones in four provinces,¹⁹³ each with its own regulations.¹⁹⁴ Combined with the burgeoning number of other municipal organizations involved in foreign trade (in such provinces as Beijing, Shanghai and Tianjin), these zones have caused a substantial amount of frustration and delay in executing trade agreements. Many foreign companies are simply uncertain of the authority of each organization. "The poor lines of communication, the competition between ministries, and the lack of an experienced bureaucracy, is [sic] a millstone around the necks of China's negotiators."¹⁹⁵

The complexity of the system demands "far greater disclosure of things that have until now been regarded as China's affair alone — how local and central authorities coordinate with each other to move China forward on the road to . . . modernization."¹⁹⁶ Foreign investment companies must know whom to seek in the PRC at particular stages of planning and negotiation, and must have information on the nature of and the limits on the authority of any organization with which it must deal.¹⁹⁷ A foreign participant must remain aware of the potential for involvement in the venture operations by the Chinese Communist Party, which will exert its control over Chinese affairs at any time it deems necessary.

The sincerity of the Chinese commitment to joint ventures is probably not to be questioned. The PRC has introduced a number of market and labor

193. The State Council has authorized Special Economic Zones in Beijing, Shanghai, Guangdong, and Fujian provinces. Haun Interview, *supra* note 12. See also *China's Export Zones*, 2 CHINA BUS. REV. 28-35, (March-April 1980).

194. See e.g., *New Regulations for Guangdong SEZs*, CHINA BUS. REV., Sept.-Oct. 1980, at 54.

195. See Stepanek, *supra* note 147, at 32. See also Edith Terry, *Doing Business With China's Three Great Cities*, CHINA BUS. REV. 24-25, (March-April 1980).

196. Stepanek, *supra* note 147, at 32.

197. Hsia and Haun, *supra* note 12, at 80. They note that PRC commercial legislation has designated that at least the following organizations be contacted during the planning stages and early operations of a joint venture: the CITIC, the FIC, the GAIC, the administrative bureau for industry and commerce in the province, municipality, or autonomous region in which the venture will operate, the Bank of China, the local tax bureau, the trade union organization formed in the venture, the labor management department in the area where the venture operates, and possibly FETAC and/or a people's court. *Id.*

mechanisms, including employee bonuses, bank loans, greater managerial autonomy, tax incentives, and foreign marketing practices designed to give the joint venture employee a greater sense of responsibility, to increase productivity, and to enhance the attractiveness of the Chinese market. Though only a handful of joint ventures have actually been approved in the PRC,¹⁹⁸ the promotional efforts of the Chinese will no doubt increase their number.

The Chinese system of government and politics is intricate in its design and somewhat unpredictable in its conduct. Yet, crucial to the success of any business dealings with the PRC is an awareness of and a sensitivity to the dynamics of the system and the momentous changes which have, in recent years, offered promise for the future. The Chinese desire to acquire foreign technology must be weighed against the Chinese desire to retain the essence of their culture. Western understanding of this, above all else, will promote the kind of confidence, respect, and understanding that breeds cooperation, trust, and inevitably, peace.

David I. Salem

198. This assertion may be only partly correct if one believes the recent statement made by Liu Chu of the FIC. Though Western and Chinese statistics often differ, Chu reported that the United States, as of early 1981, had about \$1.4 billion invested in joint ventures already approved, including 37 equity joint ventures (17 in China and 20 abroad) and 289 arrangements of a contractual kind. Liu Speech, *supra* note 9, at 10.

At least one of the joint ventures approved by the PRC may not truly be classified as a joint venture. The E-S Pacific Development and Construction Co. and the China International Travel Service entered into an agreement to construct the Chang-cheng Hotel in Beijing. However, neither party owns equity in the hotel, which technically precludes its designation as a joint venture. The PRC, though, continues to refer to it as one because it is a legally independent entity with joint management. Haun Interview, *supra* note 12. See also Stepanek, *supra* note 147, at 32.

APPENDIX

LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON JOINT VENTURES USING CHINESE AND FOREIGN INVESTMENT

*(Adopted at the Second Session of the
Fifth National People's Congress on July 1, 1979)*

ARTICLE 1. With a view to expanding international economic cooperation and technological exchange, the People's Republic of China permits foreign companies, enterprises, other economic entities or individuals (hereinafter referred to as foreign participants) to incorporate themselves, within the territory of the People's Republic of China, into joint ventures with Chinese companies, enterprises or other economic entities (hereinafter referred to as Chinese participants) on the principle of equality and mutual benefit and subject to authorization by the Chinese government.

ARTICLE 2. The Chinese government protects, by the legislation in force, the resources invested by a foreign participant in a joint venture and the profits due him pursuant to the agreements, contracts and articles of association authorized by the Chinese government as well as his other lawful rights and interests.

All the activities of a joint venture shall be governed by the laws, decrees and pertinent rules and regulations of the People's Republic of China.

ARTICLE 3. A joint venture shall apply to the Foreign Investment Commission of the People's Republic of China for authorization of the agreements and contracts concluded between the parties to the venture and the articles of association of the venture formulated by them, and the Commission shall authorize or reject these documents within three months. When authorized, the joint venture shall register with the General Administration for Industry and Commerce of the People's Republic of China and start operations under license.

ARTICLE 4. A joint venture shall take the form of a limited liability company.

In the registered capital of a joint venture, the proportion of the investment contributed by the foreign participant(s) shall in general not be less than 25 percent.

The profits, risks and losses of a joint venture shall be shared by the parties to the venture in proportion to their contributions to the registered capital.

The transfer of one party's share in the registered capital shall be effected only with the consent of the other parties to the venture.

ARTICLE 5. Each party to a joint venture may contribute cash, capital goods, industrial property rights, etc. as its investment in the venture.

The technology or equipment contributed by any foreign participant as investment shall be truly advanced and appropriate to China's needs. In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation shall be paid for the losses.

The investment contributed by a Chinese participant may include the right to the use of a site provided for the joint venture during the period of its operation. In case such a contribution does not constitute a part of the investment from the Chinese participant, the joint venture shall pay the Chinese government for its use.

The various contributions referred to in the present article shall be specified in the contracts concerning the joint venture or in its articles of association, and the value of each contribution (excluding that of the site) shall be ascertained by the parties to the venture through joint assessment.

ARTICLE 6. A joint venture shall have a Board of Directors with a composition stipulated in the contracts and the articles of association after consultation between the parties to the venture, and each director shall be appointed or removed by his own side. The Board of Directors shall have a Chairman appointed by the Chinese participant and one or two Vice-Chairmen appointed by the foreign participant(s). In handling an important problem, the Board of Directors shall reach decision through consultation by the participants on the principle of equality and mutual benefit.

The Board of Directors is empowered to discuss and take action on, pursuant to the provisions of the articles of association of the joint venture, all fundamental issues concerning the venture, namely, expansion projects, production and business programs, the budget, distribution of profits, plans concerning manpower and pay scales, the termination of business, the appointment or hiring of the president, the vice-president(s), the chief engineer, the treasurer and the auditors as well as their functions and powers and their remuneration, etc.

The President and Vice-President(s) (or the General Manager and Assistant General Manager(s) in a factory) shall be chosen from the various parties to the joint venture.

Procedures covering the employment and discharge of the workers and staff members of a joint venture shall be stipulated according to law in the agreement or contract concluded between the parties to the venture.

ARTICLE 7. The net profit of a joint venture shall be distributed between the parties to the venture in proportion to their respective shares in the registered capital after the payment of a joint venture income tax on its gross profit pursuant to the tax laws of the People's Republic of China and after the deductions therefrom as stipulated in the articles of association of the

venture for the reserve funds, the bonus and welfare funds for the workers and staff members and the expansion funds of the venture.

A joint venture equipped with up-to-date technology by world standards may apply for a reduction of or exemption from income tax for the first two to three profit making years.

A foreign participant who re-invests any part of his share of the net profit within Chinese territory may apply for the restitution of a part of the income taxes paid.

ARTICLE 8. A joint venture shall open an account with the Bank of China or a bank approved by the Bank of China.

A joint venture shall conduct its foreign exchange transactions in accordance with the Foreign Exchange Regulations of the People's Republic of China.

A joint venture may, in its business operations, obtain funds from foreign banks directly.

The insurances appropriate to a joint venture shall be furnished by Chinese insurance companies.

ARTICLE 9. The production and business programs of a joint venture shall be filed with the authorities concerned and shall be implemented through business contracts.

In its purchase of required raw and semi-processed materials, fuels, auxiliary equipment, etc., a joint venture should give first priority to Chinese sources, but may also acquire them directly from the world market with its own foreign exchange funds.

A joint venture is encouraged to market its products outside China. It may distribute its export products on foreign markets through direct channels or its associated agencies or China's foreign trade establishment. Its products may also be distributed on the Chinese market.

Wherever necessary, a joint venture may set up affiliated agencies outside China.

ARTICLE 10. The net profit which a foreign participant receives as his share after executing his obligations under the pertinent laws and agreements and contracts, the funds he receives at the time when the joint venture terminates or winds up its operations, and his other funds may be remitted abroad through the Bank of China in accordance with the Foreign Exchange Regulations and in the currency or currencies specified in the contracts concerning the joint venture.

A foreign participant shall receive encouragements for depositing in the Bank of China any part of the foreign exchange which he is entitled to remit abroad.

ARTICLE 11. The wages, salaries or other legitimate income earned by a foreign worker or staff member of a joint venture, after payment of the

personal income tax under the tax laws of the People's Republic of China, may be remitted abroad through the Bank of China in accordance with the Foreign Exchange Regulations.

ARTICLE 12. The contract period of a joint venture may be agreed upon between the parties to the venture according to its particular line of business and circumstances. The period may be extended upon expiration through agreement between the parties, subject to authorization by the Foreign Investment Commission of the People's Republic of China. Any application for such extension shall be made six months before the expiration of the contract.

ARTICLE 13. In cases of heavy losses, the failure of any party to a joint venture to execute its obligations under the contracts or the articles of association of the venture, force majeure, etc., prior to the expiration of the contract period of a joint venture, the contract may be terminated before the date of expiration by consultation and agreement between the parties and through authorization by the Foreign Investment Commission of the People's Republic of China and registration with the General Administration for Industry and Commerce. In cases of losses caused by breach of the contract(s) by a party to the venture, the financial responsibility shall be borne by the said party.

ARTICLE 14. Disputes arising between the parties to a joint venture which the Board of Directors fails to settle through consultation may be settled through conciliation or arbitration by an arbitral body of China or through arbitration by an arbitral body agreed upon by the parties.

ARTICLE 15. The present law comes into force on the date of its promulgation. The power of amendment is vested in the National People's Congress.

(Above is an unofficial English translation of the text of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, which was adopted on July 1, 1979 at the Second Session of the Fifth National People's Congress and became effective on July 8, 1979.)