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Equity Joint Ventures in China: New Legal Framework, Continuing Questions

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EQUITY JOINT VENTURES IN CHINA: NEW LEGAL FRAMEWORK, CONTINUING QUESTIONS

By Stanley B. Lubman*

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SUMMARY

Foreigners participating in equity joint ventures in the PRC since such investments were authorized in 1979 have encountered a variety of problems. New legal institutions have been established to provide a framework for joint ventures but their reach and interpretation of the new rules in practice are still often uncertain. Changes in policy have affected, and will continue to affect, the operation of both joint ventures and the new legal rules. Potential investors need contractual protection against changes in laws, regulations and policies which may affect the joint venture. Some specific

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issues of importance to foreign investors in China include access to the domestic market for sale of joint venture products and for purchase of goods and services, convertibility and repatriability of profits earned on the domestic market, the joint venture's relationship to the state economic plan, valuation of land used by joint ventures, and the level of wages and benefits to be paid to Chinese employees. After ventures are established misunderstandings may arise because of differences between the parties' management styles as well as their different conceptions of the obligations created in their contract. Given variations in practice, changes in policy, and the limitations and continued flexibility of Chinese legal institutions, participants in joint ventures should carefully investigate each opportunity offered to them and insist on drafting contracts which adequately address likely problem areas. The Chinese leadership has taken important steps in creating a legal framework for foreign economic activity, but existing questions are likely to be solved only slowly.

I. INTRODUCTION

This is a discussion of some of the elusive but critical interactions among law, policy and practice which influence the conditions for foreign equity investment in the PRC. Since 1979, the Chinese leadership has energetically promoted the creation of a legal framework for such investment. However, integration of the new institutions into the Chinese economy has not been easy, and foreigners have encountered many problems in planning, negotiating, and administering joint ventures.

The future of Sino-foreign joint ventures will be affected by extensive reforms and reorganizations of the Chinese economy which will create uncertainties for foreign trade and investment. In the midst of institutional reform, the emerging legal institutions are likely to provide only a moderate amount of stability, and their content and effect must be considered in the context of policies and practice which surround them and practice which gives them reality.

II. POLICY

A. SOME MAJOR POLICY CURRENTS

To foreign observers, Chinese policy toward foreign investment has not appeared to be completely consistent even in the short period since 1979 when the Law on Joint Ventures Using Chinese and Foreign Investment (the "Joint Venture Law")¹ first ap-

¹ The text of the Joint Venture Law is found in "Law of the People's Republic of China on Joint Ventures using Chinese and Foreign Investment," in Franklin D. Chu, Michael J. Moser, Owen D. Nee, Jr., *Commercial, Business and Trade Laws: People's Republic of China*, Oceana Publications, 1983, at G3-G9. Analyses of the new law and of early developments are: William P. Alford & David E. Birenbaum, "Ventures in the China Trade: An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment," *Northwestern Journal of International Law & Business*, Vol. 3, Spring 1981, pp. 56-102; David A. Hayden, "Foreign Partners' Problems in Joint Ventures in China," *Asian Wall Street Journal* (AWSJ), June 30, 1981, p. 4 and July 1, 1981, p. 6; Wei Yuming, "China's Policy on Absorption of Direct Investment from Foreign Countries," *Beijing Review*, No. 30, July 26, 1982, pp. 18-22; and Jerome Alan Cohen, "Some Problems of Investing in China," in Cohen, ed., *Legal Aspects of Doing Business in China*,

Continued

peared. One important example has been the relationship between sales on the domestic market by joint ventures and the availability of repatriable profits in foreign exchange. When the new policy favoring foreign investment was instituted, much was made of the possibility that joint ventures could sell their products on the domestic market. However, it was also made clear that each joint venture had to maintain its own foreign exchange balance and had to guarantee its own foreign exchange through export sales.

Consistent with this policy, during the five years after promulgation of the Joint Venture Law, few joint ventures were created which were not heavily export-oriented. More recently, Chinese officials have expressed willingness to allow joint ventures that earn profits on the domestic market to convert some of them into foreign exchange. This important issue, discussed further below, is raised here only as an example of some of the important uncertainties which have confronted foreign investors.

Policy has changed, also, with regard to the organization of the foreign trade system. What previously appeared to foreigners as a rigidly centralized system was dramatically decentralized in 1979. However, the reforms initiated in that year were so extensive that they created considerable confusion among Chinese and foreigners alike on basic issues, such as the authority of Chinese agencies at the provincial, local and municipal level to enter into transactions with foreigners.² Decentralization was then followed by partial re-centralization.³

More recently, however, the decision to give 14 coastal cities special autonomy in matters of foreign investment raises new questions about the relationships between the center and other parts of China.⁴ Considerable decentralization of authority to approve foreign investment is apparent. At the same time further reforms have been announced in the administration of foreign trade, with the objectives of separating enterprise management from government administration, increasing decision-making powers of enterprises so that they become independent economic entities, and reforming trade planning and financial systems correspondingly.⁵

New York: Practising Law Institute 1983, pp. 65-118; Stanley Lubman, "Foreign Investment in China: Selected Legal Problems and Some Perspectives on Them", *Business Transactions With China, Japan, and South Korea*, Columbia University, 1983, pp. 1-41.

In 1983 the new law was supplemented by the "Provisions for the Implementation of the Regulations on Joint Ventures Using Chinese and Foreign Investment" ("Joint Venture Regulations"). For a discussion of the Chinese attitude toward joint ventures with foreign parties, see Zhao Kexue "Legal Problems of Chinese-Foreign Cooperative Ventures Surveyed," Joint Publications Research Service [JPRS], April 18, 1983, pp. 74-79.

² For a general discussion of the approval process and related problems of authority, see Chu Baotai, *Zhongwai Hezijingying Qian Tan* [A Discussion of the Chinese Foreign Joint Venture Law and the Experience of Its Implementation], Beijing, 1983, pp. 83-93.

³ See, e.g., "Organized Control of Foreign Trade Announced," Foreign Broadcast Information Service (FBIS), March 15, 1984, K3-4; Amanda Bennett, "Peking Exerts Control on Foreign Trade," *AWSJ*, March 16-17, 1984, p. 3; Christian Tyler, "Peking Tightens Grip on Foreign Trade," *Financial Times*, March 3, 1984, p. 8.

⁴ The fourteen cities are: Shanghai, Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhangjiang and Beihai. See, "Fourteen More Coastal Cities to be Opened," *Beijing Review*, Vol. 27, No. 16, April 16, 1984, p. 6, and see the discussion infra at Section III D. For discussion of the increased independence granted to individual enterprises in Shanghai, see *Xinhua New Bulletin*, February 3, 1985, p. 53.

⁵ See, e.g., "China Carries Out Reforms in Foreign Trade System," *China Economic News*, September 24, 1984, pp. 2-3. For an excellent summary of the reforms in the foreign trade system, see "That Old Sleeping Dragon is Awakening at Last," *China '85*, p. 75, *Far Eastern Economic Review* (FEER), March 21, 1985.

Reports that state trading corporations would be made more distinct from the Ministry of Foreign Economic Relations and Trade ("MFERT") and changed into independent profit centers have not been followed with details on how the new policy is supposed to work, or whether it will also apply to trading corporations established by other ministries.⁶ The bureaucratic flux which has been produced by these changes has affected both foreign investment and trade. The decentralization of foreign trade is likely to create confusion as new companies are formed, and as local, provincial and central entities compete for the foreign trade business of domestic enterprises.⁷

The central government's decision in September 1984 to decentralize and reform the foreign trade system, intended as a means to encourage and facilitate commercial activities, has confused and complicated trading relationships. The state's previous monopoly over importing and exporting, exercised through the 14 national foreign trade corporations, has been superceded by a proliferation of new agencies anxious to negotiate deals independently. The results, as yet, are mixed. On the one hand, the liberalized trading environment increases the independence of the established foreign trade corporations, whose experience may give them an advantage over the new organizations. Competition between traders also encourages price differences for goods sourced in China, and increases the alternatives available to foreign companies. Concurrently, however, decentralization has encouraged organizations and enterprises to diversify into areas of business unrelated to their existing operations or expertise, creating uncertainty in sales authority and the participation of inexperienced traders.⁸

The retention of central control over foreign exchange despite commercial decentralization has compounded confusion over the types of business transactions local entities may legally conduct. Such uncertainty, and the emergence of a black market in foreign exchange, suggests that clarification by Beijing of the commercial reforms is already needed. At the same time, the administrative decentralization already accomplished may complicate the process of central clarification.⁹ China's foreign trade apparatus can be expected to reflect ongoing tensions between the center and various local agencies.

⁶ For a discussion, see Christopher M. Clarke, "Decentralization," *China Business Review*, Vol. II, No. 2, March-April, 1984, pp. 8-10.

⁷ See, e.g., "Laxer Laws To Attract Foreign Technology," *China Daily*, October 13, 1984, p. 1; Stanley B. Lubman, "Law: Problems of Extent and Applicability Remain," *Financial Times*, October 29, 1984. Also, a growing number of domestic enterprises have been given the power to engage in certain foreign transactions. See, e.g., "Policy easing grip on national firms," *South China Morning Post*, Bureau News, p. 8, February 8, 1985.

⁸ See Robert Delfs, "Reform upon reform," *FEER*, March 7, 1985, pp. 59-61; "What to Expect as PRC Trade Establishment Fragments and Reforms," *Business China*, January 24, 1985, p. 1.

⁹ The Guangdong provincial government, for example, has had to restrict the activities of localities in establishing joint ventures or cooperative foreign trade enterprises, and to limit the authority to sell imported goods to certain outlets (FBIS, November 23, 1984, Pl). See also, "New Rules for Foreign Trade Unveiled at Fair", *South China Morning Post*, November 7, 1984, p. 11, reporting that some export contracts were made by Chinese organizations which did not produce the goods contracted for, "hoping to buy them cheaply from other Chinese manufacturers to make up their own shortcomings."

B. JOINT VENTURE CONTRACTS AND POLICY CHANGES

The problems which changes and uncertainty in policies create for foreign investors are obvious, and need not be discussed at length here. Chinese officials have not been insensitive to the problems mentioned above; in the recent past they have repeatedly advised foreigners that contracts concluded for the establishment of joint ventures may also fix the legal position of the enterprise in China. Under such clauses, if law or policy change after the contract has come into effect, the provisions of the contract would take precedence over the supervening rules and regulations. This policy has now been given legislative expression in the Foreign Economic Contract Law adopted in March, 1985 ("Foreign Economic Contract Law"), which provides that contracts for joint ventures of various types, if they have been approved, may continue to be performed according to their original terms even though they are inconsistent with supervening laws.^{10 11}

III. LAW, POLICY AND PRACTICE

A. SOME LEGAL PROBLEMS IN NEGOTIATING JOINT VENTURES

The complex relationships between changing policies and the legal framework for equity joint ventures can be illustrated by considering some of the more important problems in negotiating such ventures. The section which follows immediately below discusses some of the issues which most concern foreign investors and their Chinese counterparts.

1. Access to the domestic market

The issue of domestic sale of products produced by joint ventures lies at the core of the very different foreign and Chinese perceptions of the purpose of co-production and investment. For the PRC, joint ventures are attractive as a source of foreign exchange earnings. Export sales also provide a means of entering international markets through the established marketing networks of the foreign partner. Guiding joint ventures toward export markets also helps protect domestic enterprises from competition with more advanced or higher quality joint venture products.¹² The foreign investor, in contrast, would like the joint venture to be a means of penetrating the domestic markets with its apparently vast sales potential.

In general, entry of joint venture products into the domestic market has been limited by Chinese restriction of permissible areas

¹⁰ Economic Contract Law of the PRC involving Foreigners, adopted at the 10th Session of the Stang Committee of the Sixth National People's Congress, March 21, 1985 effective July 1, 1985, Art. 40 in *Business China*, March 24, 1985, p. 44 and *East Asian Executive Reports*, May 1985, pp. 27, 29. See also for an example of application of the policy before the Foreign Economic Contract Law was adopted, Langston, "Laying Down the Law", FEER, January 24, 1985, pp. 64-65 at p. 65.

¹¹ The Foreign Economic Contract law was promulgated while this article was in press, and carried out promises previously made by Chinese leaders. For example, during a series of investment conferences in Shanghai and Dalian in November, 1984 in which this author participated as a member of a delegation led by former Secretary of State Cyrus Vance, Chinese officials and law professors repeatedly emphasized the primacy of the joint venture contract. See also *infra* note 15.

¹² For a Chinese view of the benefits of joint ventures generally, and a discussion of China's experience of joint ventures, see Chu Baotai, *supra* note 2.

of sales, insistence on export quotas, and the utilization of foreign exchange restrictions to limit repatriable profits so that they do not exceed the joint venture's foreign exchange earnings. A formal easing of Chinese resistance to domestic sales by joint ventures has, however, been evident since May, 1983.¹³ The primary change has been a willingness to grant joint ventures permission to sell products on the domestic market if they are "urgently needed,"¹⁴ usually at domestic prices, or to foreign trade corporations for foreign currency. Chinese policy in the foreseeable future seems likely to reflect continuing concern about outflow of foreign exchange by exhibiting great reluctance to provide guarantees that domestically-earned profits in local currency will be convertible into foreign exchange and repatriable.

A threshold issue concerning sales by joint ventures on the domestic market is the definition of the types of products which may be sold on the domestic market. Although import substitution is a major criterion, some products may embody technologies so new that they have not been imported before in substantial quantities. Perceptions of what is "urgently needed" are by no means uniform among Chinese agencies negotiating joint ventures.

Other important issues include the percentage of total production to be sold domestically, whether profits from domestic and international sales will be segregated or shared according to an agreed-upon formula, and uncertainty over whether local authorities will be allowed—or will agree—to supplement insufficient foreign exchange balances. Chinese negotiators and leaders alike express strong preference for deciding these issues on a case-by-case basis. Although Chinese limitations are understandable, there is no apparent immediate prospect that greater certainty—or less flexibility—will soon be manifested. The foreign investor must expect to negotiate hard on this issue, and to obtain only limited satisfaction.¹⁵

¹³ See, "Running Chinese Foreign Joint Ventures With Better Results," *Renmin Ribao*, May 14, 1983. The new policy was prefigured by the Sino-American Shanghai Squibb Pharmaceuticals Ltd. and Sino-Swede Pharmaceutical Corp. Ltd. joint ventures. Both of these joint ventures, which were started in late 1982, provided for the bulk of the product to be sold on the domestic market. See "Two Unique Pharmaceutical Ventures," *China Business Review*, Vol. IX, No. 6, November-December 1982, p. 2; "Squibb JV with PRC: Flexibility, Gray Areas at Outset," *Business China*, Vol. VIII, No. 24, December 22, 1982, pp. 185-186.

The policy has recently been taken a step further. Chu Baotai, a leading cadre of the Foreign Investment Administration of MFERT, has stated that in future if joint ventures match foreign exchange expenditures with income, the quotas will be set for the percentage of a company's products which may be exported. *China Trade Weekly Bulletin*, October 22, 1984, p. 1.

¹⁴ Joint Venture Regulations, Article 61.

¹⁵ See, e.g., "Emphasis on growth in special zones," *Financial Times*, September 4, 1984. Prospective investors repeatedly told me that as long as the joint venture contract and its supporting feasibility study reflected the need for foreign exchange supplements and were approved, such supplements would be forthcoming.

Premier Zhao Ziyang's discussion of this issue with participants at the investment conference in November 1984 mentioned supra note 11 was consistent. According to this author's contemporaneous notes of the meeting, Premier Zhao said that it is "out of the question" to assume that each enterprise will be able to assume its own foreign exchange balance. This question, he said, must be "solved on a case-by-case basis." These issues can be negotiated and agreed on, he continued. It is not possible to have "definitive rules" on this issue in the applicable legislation, and the parties must express their understanding in their contract. Earlier in the course of this discussion, Premier Zhao had stated that "in the absence of an adequate legal system, contracts have a binding legal force."

For a report on one joint venture contract that contains a guarantee of convertibility of Chinese profits into foreign exchange see "VW and China Complete Auto Production Pact," *Wall Street Journal*, October 11, 1984. A more recent report of continuing difficulty is "Shanghai

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2. *Integration of the joint venture into the Chinese economy*

Since the Joint Venture Law was promulgated, Chinese and foreigners alike concerned with investment in China have had to struggle to define the relationship between joint ventures and China's state plans. This section discusses some of the issues that have arisen.

(a) *Domestic purchase of goods and services*

Among the obvious problems is that of domestic sourcing of goods and services. It is no doubt with the purpose of encouraging development of domestic industry that Article 9 of the Joint Venture Law provides that a joint venture "should give first priority to purchases in China." At the same time, the article also makes clear that such priority for domestic purchases is not invariably required, and in recent years the policy has been liberalized, so that it seems fair to say that joint ventures may now import duty-free goods they need for their business activities in China which they cannot readily obtain on the domestic market.¹⁶

Nonetheless, there have been several instances in which foreigners have encountered difficulties in this regard. One was a joint venture established by Hitachi for the manufacture of television sets in Fujian, which reportedly encountered problems in importing the Japanese television tubes it required. In that case there was, apparently, considerable lack of clarity in the original agreement.¹⁷ An analogous problem was encountered by foreign oil companies which wanted to lease rigs and contract for other offshore services, so that they could begin operations under the contracts for offshore exploration which they had signed in 1983. In South China they were told that they could not obtain certain services using competitive bidding, but had to contract with Chinese agencies or with Sino-foreign joint ventures, although such a requirement would have violated both Chinese regulations and the contracts between the oil companies and the China National Offshore Oil Corporation.¹⁸ After the problem received some publicity and the companies complained competitive bidding was reinstated.

(b) *Integration into state plans*

The difficulties mentioned above may only be growing pains, but some issues are likely to persist such as the extent to which joint ventures are to be integrated into state plans.¹⁹ A policy of integrating the joint venture into the state-planned economy is vaguely enunciated in Article 19 of the Joint Venture Law, which requires that "the production and operating plans of a joint venture shall be

Snags Are Worrying Foreign Firms," AWSJ, March 12, 1985. During the first several years after the new policy was given expression in the Joint Venture Regulations, apparently very few guarantees were given.

¹⁶ See, Liu Chu, "Rules and Regulations For the Utilization of Foreign Funds, with Characteristics Special to China," JPRS Economic Affairs, No. 17, March 1, 1984, pp. 40-48.

¹⁷ See, John Makinson, "Chinese Handshake Has Its Pitfalls," *Financial Times*, March 28, 1983, p. 4; cf. Vigor Keung Fung, "Mr. You Runs Fujian Plant Japan Style," AWSJ, April 22-23, 1983, pp. 1, 3.

¹⁸ Horace Philips, "Braving the Labyrinth of Chinese Bureaucracy," AWSJ, June 3-4, 1983, p. 6.

¹⁹ For a recent statement by a Chinese official, see Liu Chu, *supra* note 16.

filed with the departments in charge and shall be implemented through economic contracts."

The Joint Venture Regulations provide somewhat more detail: Article 54 stipulates that the capital construction plan of the joint venture shall be "brought into the state or local capital construction plan." Article 56 further requires the production and operation plan of a joint venture to be "filed" with "the department in charge." Finally, Articles 58 and 64 require that the materials to be supplied or sold under the state's distribution plan be "brought under" the plan of the department in charge and be distributed or sold "in a planned way."

The dilemma for both Chinese economic planners and for China's foreign investment partners is clear: On the one hand, integration of the joint venture into the Chinese economy would strengthen the Chinese government's political and economic control over foreign policy equity ventures in China, while, for the foreign investor, integration into the state-planned economy would seem to provide needed access to critical supplies and raw materials.²⁰ On the other hand, however, rigorously-practiced integration would subject the foreign investor to dependence on a complex, often impenetrable system of bureaucratic allocations which is presently under severe criticism and is still undergoing extensive reform because of its rigidity and irrationalities. To impair the supply of items which are crucial to the venture's success and profitability would obviously be undesirable, as would forcing ventures to purchase more expensive supplies from inefficient domestic suppliers. Also, integration into the state economic plan does not guarantee freedom from shortages of supplies.

Recently, Chinese officials have made greater efforts to distinguish the integration of a joint venture into the Chinese economy from what foreign investors may characterize as inroads into their managerial autonomy. Although the regulations articulate a policy of integration, they also stress the power of a joint venture to be free from bureaucratic influences on economic decision-making. A Chinese official recently commented on these issues in the following manner:

In terms of self-governing power of management, Article 7 of the Regulation stipulates: "A joint venture has the right to operate on its own according to its own characteristics within the scope of the provisions of Chinese laws, decrees and pertinent regulations, and the joint venture. The departments concerned shall provide support and assistance." Article 6 says that "departments in charge are responsible for giving overall guidance and assistance and exercising supervision over the joint venture." It is therefore to be understood that the department in charge guides and not leads a joint venture. Joint ventures are not to be dealt with in the same way as state enterprises and no administrative interference is allowed."²¹

²⁰ See, e.g., Jiang Zehong and Lin Shuzhong, "Chinese-Foreign Joint Ventures in Shanghai, the Purchasing of Raw Materials and the Marketing of Exports," unpublished paper written for conference on international investment law, Shanghai, November, 1984, p. 3: "if 'joint ventures' want to purchase raw materials, especially materials which are distributed according to plan, if they have not signed contracts with the relevant department or enterprise so that their requirements are incorporated with the supply plan, there is no guarantee that they will be able to purchase the required raw material." See also Satoshi Imai, "Joint Ventures in China and Related Problems", *China Newsletter*, No. 51, July-August 1984, pp. 15-19 at p. 19, quoting a representative of a Shanghai-based U.S. Chinese joint venture as saying "we can hardly get supplies of even one ton of steel sheeting if it is not included in the plan of our supplier".

²¹ Hu Wenzhi, "The Legal Framework of Chinese-Foreign Joint Ventures," unpublished paper written for conference on international investment law, Shanghai, November 1984, p. 19, deny-

The skeptical prospective investor may well wonder about the message of this passage. Clearly, the boundary between "guidance" and "leading" is a fine one which may easily become blurred, and has been blurred in the past in the PRC. Given the current struggle between the opposing forces of decentralization and centralization in the Chinese economy, this all-important issue will continue to confront foreign investors. Precisely how a joint venture can operate within the parameters of the state plan, yet maintain a degree of autonomy from the "guiding" state organs and planners, remains unclear. The message in the statement quoted above is benign, but many questions remain.

It may be that the problem of defining the relationship of the plan to the joint venture will abate, as policies of commercial reform, involving a loosening of centralized planning, are implemented. Reforms of the price system, however, which have long been discussed and have recently been initiated, are scheduled to be implemented only gradually.²² The price of products of joint ventures must be established by consultation with price authorities, and problems may also arise in this area.

3. Valuation of Chinese land

China prohibits foreign ownership of land, which may either be rented or capitalized as part of the contribution to the venture by the Chinese partner. However, unlike other equity contributions, the value of which is determined jointly by the partners to the venture, Chinese legislation appears to give Chinese authorities the power to value land unilaterally.²³ In the absence of a real estate market in China, this seems to some foreigners to have created an opportunity to overvalue the land and overcharge the joint venture.

During the period immediately following the promulgation of the Joint Venture Law, complaints were heard about attempts to charge land use fees that seemed steep to foreigners who were aware of lower and often concessionary land use fees in other Asian jurisdictions, such as Taiwan, the Philippines, Malaysia and Sri Lanka. Since then, foreign protests have led to land valuations which appear to be more reasonable. Although Chinese officials have denied the existence of any unified national standard for land use fees, there have been persistent reports that in 1980 the State Council issued internally "Provisional Regulations on Land Use by Joint Ventures," which apparently sets maximum and minimum limitations on annual land use fees.²⁴

Recently, Chinese sensitivity to foreign equity investors' concerns had led to further adjustment of land use fees. In addition, officials have been more open in discussing the variety of factors used by local governments in determining land use fees. Such factors in-

ing that "the relationship of the superior and the subordinate" exists between joint venture enterprises and the agency with which it must file its plans.

²² See, e.g., Jonathan Mirsky, "No urban free-for-all yet," *China Trade Report*, March 1985, p. 4.

²³ See, for example, Joint Venture Law, Article 5.

²⁴ See, "Text of Wei Yunming Speech to Investment Meeting," *Hong Kong, Wen Wei Po*, June 8, 1982, in FBIS, June 10, 1982, pp. W3-W6; cf. Chu Baotai, *supra* note 2, pp. 99-101, 117; King La, "China Laws and Regulations on Use of Foreign Capital and External Economic Affairs," speech at a seminar convened by the National Council for US-China Trade, June 1, 1981.

clude the nature of the joint venture's activity (commercial/industrial or agricultural) and its location (urban or rural). Hopefully, the trend toward more frank discussion of the land valuation process will continue.

4. *Relevant approvals*

Foreign investors have often encountered difficulty in ascertaining which Chinese agencies must review and approve contracts for the establishment of joint ventures. Of paramount importance is MFERT, which must approve all joint venture contracts which involve investment of over a certain amount.²⁵ In addition to MFERT, government agencies such as the State Administration of Industry and Commerce, State Administration of Exchange Control, the Ministry of Finance (which handles tax issues) and the Customs Administration also play major roles in the life of a joint venture.

Although MFERT has a crucial role in approving the joint venture contract, MFERT is usually on the same governmental level as the other above-mentioned agencies and ministries. For this reason, MFERT is likely to resist attempts by foreign investors to insert into the contract language that appears to resolve issues which are within the jurisdiction of Chinese agencies that are not subordinate to MFERT itself. This problem commonly arises with respect to tax exemptions, some of which can be granted only by the Ministry of Finance, while others can be granted by the Tax Bureaus at lower (i.e., provincial or municipal) levels.

The Finance Ministry's policy is not to grant a tax exemption until the joint venture has been established and applies for such an exemption. As a result, the contract and MFERT's formal approval of it do not establish the joint venture's right to a tax exemption, even though by the time MFERT approval is given it would have already consulted the Ministry of Finance on the matter and received an indication that such an exemption would be granted.

Foreign investors are obviously uneasy about the prospects of having to apply for certain benefits crucial to the viability of the venture *after* the signing of the joint venture contract, as opposed to being assured that such benefits have already been approved. One method of dealing with this lack of certainty is to condition the obligation of the foreign investor to contribute capital on the receipt of official approval of the desired treatment or benefits.

5. *Wages, unions and labor discipline*²⁶

(a) *Wages of Chinese workers*

One aspect of China's²⁶ economy that has attracted foreign investment is the nation's low cost of labor. Experience in joint venture negotiations and in implementing those agreements which have been signed has often disappointed the expectations of foreigners about inexpensive Chinese labor. In practice, labor costs for

²⁵ At lower levels, where local governments such as provinces or municipalities may approve smaller investment transactions, the problems discussed below also exist, even though this discussion focuses on MFERT at the national level.

²⁶ On this subject generally, see Jamie P. Horsley, "Chinese Labor," *China Business Review*, Vol. XI, No. 3, 1984, pp. 16-25.

joint ventures in China are significantly higher than for comparable Chinese state enterprises, not to mention comparable investments in other Asian countries.

While the Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment (hereafter "Joint Venture Labor Regulations") apparently give the board of directors the authority to decide the framework for labor compensation,²⁷ this seemingly broad power is restricted by Article 8, which states:

The wage levels of the staff and workers of joint ventures shall be fixed at 120 to 150% of the real wages of the staff and workers of state enterprises in the locality in the same line of business.²⁸

A further problem arises from the interpretation of the "real wages" mentioned in Article 8. Are they the basic cash wages received directly by the worker, or the basic wage *plus* costs for labor insurance, medical expenses, housing costs, and various other subsidies normally contributed by state enterprises? The difference in definitions involves a significant difference in costs, since the various subsidies provided by state enterprises usually amount to at least 100% of the basic wages. In informal discussion with knowledgeable Chinese officials, some investors have been advised to assume that such subsidies should be calculated at approximately 130% of such wages. However, if the venture must pay 120-150% of the combined basic wage and all the subsidies, the venture's wage bill may reach a sum more than three times the average worker's take-home pay. There has not yet been any official clarification of this issue, and practice has not been uniform. Foreign investors must therefore press the Chinese negotiators into breaking down their wage proposal into its component parts so that they can identify the subsidies which are included.

Although the meaning of "real wage" is not entirely clear, it does seem fairly certain that the term does *not* include bonuses and collective welfare costs, such as costs for clinics and nurseries. These are required by the Joint Venture Labor Regulations to be paid separately from a special fund to be established out of after-tax profits.²⁹

The issue is further complicated by the lack of uniformity in practice. The city of Shanghai promulgated regulations in November 1984 which provide that "the level of real wage (including basic wage, subsidy and bonus) . . . shall be . . . at least 120% of the real wage level of the workers and staff members of state-owned enterprises of the same trade in Shanghai. . . ." ³⁰ The regulation further provides that to this basic wage shall be added a monthly percentage of 30% of the real wage for "premiums" for old-age pensions for each worker, and 30 RMB monthly per worker for housing subsidies. Whether other subsidies must be included in calculating the "real wage" and, if so, how the result would compare with such calculation elsewhere in China are issues which remain

²⁷ Regulations on Labour Management in Joint Ventures Using Chinese and Foreign Investment (Approved by State Council on July 26, 1980), Article 9.

²⁸ *Ibid.*, Article 8.

²⁹ *Ibid.*, Article 10.

³⁰ "Regulations of Shanghai for the Implementation of Labor Management in Joint Ventures Using Chinese and Foreign Investments (for Trial Implementation)," *China Economic News*, November 19, 1984, pp. 2-3.

unclear. The Shanghai regulations appear to fix a lower wage level than that which has been established in practice elsewhere in China other than in the Special Economic Zones. If Shanghai is free to set a lower wage level than that which pertains in practice elsewhere in China, the question arises of whether other cities and provinces will attempt to do the same, and engage in competition to attract foreign investors.

(b) Wages of Chinese officers and managers

Among other wage-related issues are the wages of Chinese officers and high-level managers. The Chinese usually ask for wages which approach the level of wages received by the foreign officers and managers at the venture. The laws and regulations are silent on this issue, the resolution of which must be bargained for in the negotiations. Wage increases must also be the subject of negotiations. Although the Joint Venture Labor Regulations are silent on the issue, recently issued implementing provisions for the Regulations provide that the Board of Directors has the power to decide wage increases. Regulations on the Special Economic Zones require a 5-15% annual increase in wages. Outside the zones, the Chinese often ask for increases of up to 15%.³¹ In view of impending nation-wide wage increases in the context of large-scale price reform, pressure to include clauses on wage escalation may increase.

(c) Labor discipline

Although, as noted above, the joint venture's Board of Directors possesses the legal authority to determine labor policy, joint ventures are required to permit the organization of trade unions, which have the power to express their views on all labor-related issues, such as hiring and firing of workers, bonuses, and wage adjustments. Under Article 98 of the Joint Venture Regulations, the union has the right to send non-voting representatives to board meetings in order to represent employee opinions and demands. If the union refuses to accept a board decision on a labor matter, Article 14 of the Joint Venture Labor Regulations gives it the right to submit the dispute to arbitration before the local labor bureau and ultimately to the local people's court.

Finally, it is important to note that labor discipline is of concern not only to the foreign investor but to the Chinese as well. In an effort to eradicate the "iron ricebowl" mentality, China has emphasized worker responsibility and discipline. Workers can theoretically be dismissed if their performance is substandard. Article 5 of the Joint Venture Labor Regulations allows joint ventures, in accordance with the seriousness of the case, to impose sanctions on employees who violate labor regulations and "thereby cause bad consequences." Possible sanctions are "education through criticism," fines, and dismissal.³² Any decision to discharge an employee must be reported to the department in charge of the joint venture and the local labor management department for approval and in practice dismissal of workers is rare. Nevertheless, there have been re-

³¹ J. Horsley, *supra*, note 26, at p. 19.

³² *Cf.*, Joint Venture Regulations, Article 10.

ported cases in which unsatisfactory workers were dismissed.³³ If and to the extent job mobility and worker responsibility at China's domestic enterprises increase, these problems should shrink in significance.

B. PROBLEMS IN CONTRACT IMPLEMENTATION

This section would no doubt be longer in a discussion of equity joint ventures in China written five years from now, because a body of experience is sure to grow and provide instruction to prospective investors. Presently, information is scarce on the problems which have been encountered in the course of implementing contracts to establish joint ventures. The number of equity joint ventures is still small, and the contracts to create most of them have been signed only within the last few years. Moreover, even when problems have already appeared, foreign and Chinese partners alike are reluctant to discuss their difficulties.

However, it is already possible to identify some problems that have already arisen. They are discussed only generally here, on the basis of impressionistic evidence, chiefly conversations with foreigners and Chinese who do not wish to be quoted.

Perhaps the most common general problems originate in differences between the expectations of the two sides. Illustratively, in one joint venture the Chinese expressed impatience at the slowness of with which advanced technology was transferred; the foreign partner found that the Chinese side consistently underestimated the complexity of introducing advanced designs into a Chinese factory to replace older Chinese products.

Differences in managerial style are another and inevitable problem that has arisen. It is not uncommon, for instance, to hear foreign managers and Chinese alike to say, "at the beginning we were unfamiliar with their logic."³⁴ Chinese expectations about the degree of concern which managers must have over mundane, even trivial aspects of operations may be considerably higher than those of their foreign counterparts,³⁵ which foreign expectations regarding quality control and performance standards are often higher than those on the Chinese side.³⁶

In the largest Sino-American joint venture, the Great Wall Hotel in Beijing, the problems mentioned above occurred together, according to a report on the difficulties that led to the signing of an agreement in March, 1985, under which the management of the hotel was taken over by the Sheraton Hotel chain.³⁷ The Chinese partner, China International Travel Service, reportedly wanted to manage the hotel directly, while the American partner wanted it managed by a major hotel chain. The parties first compromised on a Chinese-American manager, but when he left after a year and

³³ See, J. Horsley, *supra* note 24, at pp. 24-25, for a discussion of several reported instances of worker dismissals.

³⁴ "China Pursues the Promise of Oil Riches," *ASWJ*, February 6, 1985.

³⁵ *Ibid*; see also "Shanghai Snags Are Worrying Foreign Firms," March 12, 1985.

³⁶ "Shanghai Snags are Worrying Foreign Firms", *supra* note 36. An interesting account of the quality problems encountered by one U.S. firm, which, though not in the context of a joint venture, tried to make a major commitment to sourcing its products in China is "Running Into Trouble", *China Trade Report*, October 1984, p. 6.

³⁷ The discussion of the problems of the Great Wall Hotel in this paragraph is based on a "A New Team Checks In at the Great Wall Hotel", *New York Times*, March 24, 1985, p. F13.

the hotel's financial condition required a renegotiation of repayment of the loan which had raised the funds for the construction of the hotel, a management contract was signed with Sheraton. One of the issues in the operation of the venture is the extent to which expatriate personnel will be used to manage it:

The Chinese have mandated that expatriates should be withdrawn as quickly as possible, and . . . Sheraton hopes to have the hotel run entirely by local people in three to five years.³⁸

It might be noted that the Great Wall Hotel was one of the first large joint ventures established. Since then, Chinese and foreigners involved in negotiating investment contracts have learned more about the expectations on each side. With regard to the alleged reluctance of the Chinese partner in that venture to have foreigners involved in its management for more than a relatively brief period of time, while not uncommon; it is not invariable, and other Chinese partners are often more flexible.

Difficulties in carrying out contracts to establish joint ventures may arise from a variety of other causes, of course. Most notable are disagreements caused by differences between Chinese and foreign views and non-contractual obligations, and delays or inefficiencies resulting from limitations of authority within the Chinese bureaucratic system. Basic differences in professional standards and relative social and economic values may also contribute to difficulties in contract implementation. All of these problems between Chinese and foreign counterparts are quite distinct from alleged failure to observe contract provisions.

The discussion which follows notes examples of problems which have been classified into three separate categories. Although the categories are themselves artificial, they have been used here tentatively to identify and distinguish among different causes of difficulty. Illustrated below are difficulties caused by different perceptions of the obligations created by the contract, by characteristics of the Chinese bureaucracy, and by differences in cultural values.³⁹

A common procedural issue for American counterparts is how to respond to Chinese requests for special services not specified in the contract at no additional fee. From the Chinese perspective, successful conclusion of a contract with a foreign company may be accompanied by the expectation of special services or beneficial terms in future contracts. This attitude is sometime fostered by the American investor's eagerness to establish a business relationship in China and his generosity in initial contract provisions. The ability to respond to special requests from Chinese counterparts is often complicated by insufficient information on the part of the American project manager about unwritten commitments which may have been made by contract negotiators.

A second major difficulty arises from limitations engendered by the Chinese bureaucracy on the ability of the Chinese counterpart to meet contract responsibilities.⁴⁰ Joint venture enterprises may

³⁸ *Ibid.* Not discussed here is the need to provide in the contract for an adequate presence in the joint venture of personnel chosen by the foreign partner.

³⁹ See generally, Genevieve Dean, "After the Contract is Signed: The Experience of U.S. Companies in Shanghai," January 24, 1984, American Consulate General Shanghai, cable.

⁴⁰ For a discussion of this problem see Ruben Kraiem, "The All-Too-Easy Path to Misunderstanding in China," AWSJ, October 10, 1984, p. 10.

be unable to obtain required materials although the Chinese side may have assured the foreign partner of their availability when they signed their contract to establish the joint venture. Such problems may result from the fact that the contract negotiation was handled by one bureaucratic "system" or hierarchy—such as import/export corporations under the Ministry of Foreign Trade—while many aspects of implementation are the responsibility of Chinese organizations which are part of a different bureaucratic hierarchy. As already observed, commitments made by one bureaucratic "system" cannot necessarily be successfully fulfilled by another. Further, the focus of authority in a specific situation is often unclear, because responsibility may be shared or delegated in ways that are not explained to the foreign counterpart.

It should be noted also that as economic reforms are carried out, the ability of the Chinese counterpart which has signed the agreement to establish a joint venture to fulfill its obligations may be impaired. Chinese agencies may have encouraged foreigners to have certain expectations about availability and prices of raw materials, only to find that economic reforms had changed the situation.⁴¹

The personal living arrangements of company representatives may also become an important area of conflict with the Chinese counterpart. Dissatisfaction most commonly focuses on visa status, living accommodations and customs exemptions, issues which the company should attempt to clarify in contract provisions, but which are often overlooked. In short, implementation may differ markedly from negotiators' expectations. To minimize these problems, it is necessary to develop appropriate contract clauses, which, like many other things in China, is often easier said than done.

C. DISPUTE SETTLEMENT

Making provision for the settlement of disputes has been a subject that has probably received far more attention than it deserves; from the optimism-tinted perspectives of the present the number of disputes likely to be arbitrated or adjudicated seems small. Perhaps there has been so much discussion of this topic because in no area of legal and practical concern has there been a wider difference between the attitudes of foreigners and Chinese.

Until recently the China trade was conducted in a legal vacuum, in which conventional transactions for the purchase or sale of commodities were dealt with by means of more or less standard form contracts. In such an atmosphere, little attention was paid to the choice of a forum in which a dispute might be settled or to the law that might be applied. Moreover, the traditional Chinese preference for negotiating a compromise solution to any problems that might arise during implementation was not as alien to foreigners as is commonly supposed, especially to dealers in commodities.

However, the growing complexity of the transactions for trade and investment that have become possible within the last five years has provoked Chinese and foreigners alike to direct their attention to these matters. The Joint Venture Regulations provide

⁴¹ "Shanghai Snags are Worrying Foreign Firms," ASWJ, March 12, 1985.

that "the formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by Chinese law."⁴² Recently promulgated legislation on contracts between foreigners and Chinese parties makes specific provision for the applicability of Chinese law to disputes arising out of such contracts.⁴³

The Joint Venture Law permits the parties to choose arbitration outside China.⁴⁴ At the same time, Chinese legal specialists have stressed the desirability of conciliation in international dispute settlement,⁴⁵ there has also been a definite increase, if the impressionistic conclusions of this author are valid, in Chinese emphasis on the desirability of arbitrating in China if at all. Problems remain, however, because of the difficulty of ascertaining the content of the law which might be applied in an arbitration in which the PRC was the governing law.

If a dispute arises, the parties and the institutions which attempt to settle it should be able to refer to a well-developed and readily ascertainable body of codified rules. In common law and civil law countries alike, the rules are supplemented by the interpretations of courts and legal scholars. In China today the rules are not extensive, practice is diffuse, variations in practice are common, and the workings of the system may not readily be ascertainable by the foreigner. Both sides could regret a failure to designate clearly, in the contract itself, a developed body of substantive law to govern their relationships and the resolution of disputes growing out of them.

There remains some possibility of providing in the joint venture contract that arbitrators must refer first to Chinese law and, if they find it insufficient, to the law of another nation or to general principles of international law. In this connection, there is some lack of clarity. The Foreign Economic Contract Law provides that contracts for joint ventures, including contractual joint ventures, must be subject to Chinese law. The Foreign Economic Contract Law is consistent, but also states that if Chinese law has "not been stipulated," "international practice" may be used. "Stipulation" may mean that as long as a statute or regulation has been promulgated on a particular subject, the application of foreign laws has been preempted. An alternative view would allow the arbitrators to

⁴² Article 15.

⁴³ Foreign Economic Contract Law of the PRC, Art. 5, and *Business China*, March 28, 1985, p. 44, *People's Daily*, March 22, 1985, p. 2; Regulations on Contracts Involving Foreigners in the Shenzhen Special Economic Zones (promulgated February 7, 1984), Article 35.

⁴⁴ Although Chinese negotiators have shown increasing willingness to agree to third-country arbitration clauses, particularly ones which designate Stockholm as the place of arbitration, and the Institute of Arbitration of the Stockholm Chamber of Commerce as the forum, they continue to resist agreeing on the law which the arbitrators may apply. See, e.g., "Australia and China Agree on Talks on Trade Arbitration Procedure," *Financial Times*, July 9, 1984, p. 4. Since in many cases, according to the procedural rules of the Arbitration Institute, this may result in the application of Chinese law, the Stockholm arbitration clause in the form in which Chinese negotiators usually prefer it does not offer much comfort to the foreigner. See, Hjerter, "Choice of Law Problems in Intentional Arbitration with Particular Reference to Arbitration in Sweden," *Yearbook of the Arbitration Institute of the Stockholm Chamber of Commerce*, 1982, p. 22. Since it is standard practice for Chinese negotiators to insist that the contracts for joint ventures state that they are to be governed by Chinese law, there seems to be little leeway for the foreigner.

⁴⁵ See, e.g., Shao Xunyi, "Conciliation is a Good Method for Settling International Economic and Trade Disputes—An Introduction to China's Practice of Conciliation," paper presented to the 7th International Arbitration Congress, Hamburg, West Germany, June 7-11, 1982; cf., Tang Hongzhi, "Arbitration—A Method Used by China to Settle Foreign Trade and Economic Disputes," *Pace Law Review*, Vol. 4, No. 3, 1984, pp. 519-536.

apply international practice if promulgated Chinese rules fail to provide a clear answer to a particular issue.

Of importance is the commonly expressed Chinese views that equity joint ventures are partnerships,⁴⁶ and that if the partners cannot agree on all important issues which may arise the venture will not work. That is why the percentage of ownership which the foreigner may have in the joint venture may not be critical; in a system in which all "important questions," in the language of the Joint Venture Law, must be settled unanimously,⁴⁷ the difference between majority and minority ownership does not seem to be very important so far as control—and dispute settlement—are concerned.

At a time when Chinese legal institutions are undergoing remarkable growth and evolution and China's international economic activity is increasing rapidly, it is not surprising that China's lawmakers should want Chinese law to apply to economic activity involving foreigners within China. The considerable gaps in Chinese law, however, suggest that the application of third-country law to disputes should not be regarded as an infringement of Chinese sovereignty, but a symbol of the PRC's membership in the international economic community of nations. The leaders of the PRC, have viewed the situation—and the symbols—in this manner, except as to investment disputes, in which Chinese law is basically applicable. As noted above, however, some hospitality has been shown to the application of "international practice" even in investment disputes.⁴⁸

D. THE 14 COASTAL CITIES AND THE SPECIAL ECONOMIC ZONES

Special attention is compelled by the emerging Chinese policy of choosing certain coastal areas as places where foreign investment should be specially encouraged. In 1979, the State Council created four Special Economic Zones ("SEZ's"), three in Guangdong Province and one in Fujian. In 1984, 14 coastal cities were declared open to foreign investment, and special incentives were created to make them attractive to foreign investment. Statements by Chinese leaders have suggested that other coastal areas in addition to the 14 cities may also receive special treatment for the same purposes.

The principal incentives offered are related to taxation: A 15% tax rate on equity joint ventures will apply to projects in which factories are being upgraded by foreign investment as well as to any projects located in Economic and Technical Development Zones which are to be established in each of the 14 cities. In addition, certain tax exemptions are available and the 10% tax on remittances of profits earned by foreign partners in joint ventures will not apply in these areas. Somewhat different tax incentives are offered in "Original Urban Districts" in the 14 cities.

⁴⁶ See, e.g., Zhao, *supra*, note 1.

⁴⁷ Article 6. The law does not by its terms require unanimity, but states that such questions must be settled "through consultation". The effort is to give each party a veto, regardless of the percentage of its equity interest.

⁴⁸ The Foreign Economic Contract Law allows the parties to choose the governing law in contracts other than for joint ventures which are performed in the PRC for contracts for the exploitation of Chinese natural resources.

Other incentives also include increased local authority to approve projects without the necessity to obtain approval from Beijing. The cities of Shanghai and Tianjin will have authority to approve projects costing less than \$30 million, while the threshold for Guangzhou and Dalian is \$10 million and for the other cities is \$5 million.

Until new legislation is developed, laws and regulations governing the SEZ's are also applicable to the 14 coastal cities.⁴⁹ The rush to open new areas for foreign investment, the need to develop appropriate legislation, and continuing questions caused by decentralization of authority have stimulated competition among the SEZ's and the coastal cities for foreign investors. In the scramble for foreign funds and technology, the "open" cities and zones are trying to develop preferential treatment packages in regard to taxes, land use fees, wages, customs duties, and access to the domestic market.⁵⁰ At the same time, inland provinces are also hastening to extend investment incentives to foreigners.⁵¹

It is too early to predict the fate of the experiment in the 14 coastal cities. The four SEZ's have had a mixed record: They have not attracted the high-technology investment that was sought for them, and the great majority of enterprises located in the zones are small assembly and simple manufacturing operations. Although the figures for the amount of foreign investment in the SEZ's often quoted in Chinese sources are high, they apparently include pledged as well as actual investment. The developing legal framework for foreign investment in the SEZ's has not resolved problems arising from bureaucratic complexity, from differing labor management practices, and from ambiguities regarding protection of imported technology. The SEZ's are still not fully competitive with investment alternatives elsewhere in Asia.

IV. CONCLUSION

A. LAW AND THE CHINESE INVESTMENT ENVIRONMENT

The difficulties discussed here are significant enough by themselves, but they also symbolize deeper problems. Some have argued that because the present uncertainties are inevitable and China is necessarily in a period of transition, foreign investors must simply make a leap of faith:

⁴⁹ For the text of one of the eight sets of implementing rules and regulations for the Shenzhen SEZ, the Rules of Economic Contracts with Foreign Elements, promulgated on February 7, 1984, see *China Economic News*, October 15, 1984, pp. 1-5. Considerable description of the coastal cities and special economic zones may be found in *The China Business Review*, Vol. 11, No. 6, November-December, 1984, pp. 14-40.

⁵⁰ See, e.g., "More Preferential Treatment for Foreign Enterprises in Xiamen Special Economic Zone," *China Market*, December 1984, pp. 50-51; Timothy A. Gelatt, "Interim Provisions Sharpen EDZ's Competitive Edge," *East Asian Executive Reports*, December, 1984, pp. 9-10; Zheng Baoming, "Shanghai's New Inducements to Foreign Investors," *China Daily*, February 16, 1985, p. 2.

⁵¹ See, e.g., "Sichuan's Governor on Investment Incentives," *China Economic News*, March 4, 1985, pp. 1-2.

By mid-1985, public statements by Chinese leaders reflected a decline in their enthusiasm for emphasizing all 14 cities at once. See, e.g., "The Not-so-open Cities", *China Trade Report*, Vol. XXIII, December 1985, p. 1.

Really, rather than the laws, what is now necessary are foreign companies willing to overlook minor gaps in the legal framework and go ahead boldly, based on friendship, economic cooperation and a long-term prospect.⁵²

Another observer, writing more recently than the one quoted above, has argued that the promulgation of implementing regulations for equity joint ventures and tax, foreign exchange, labor and patent legislation has "done much to fill in the basic framework for such investments".⁵³ Such legislation has indeed eased somewhat the task of negotiating equity joint ventures in China, but neither the new rules nor their application in practice have dispelled many difficulties which are likely to continue to characterize the PRC's investment environment.

Decentralization and reform of the foreign trade system have encouraged Chinese organizations with little experience to enter into new business relationships with foreigners. As a result, problems arising from differing business practices, perceptions and expectations, which have troubled joint ventures to date, are likely to be aggravated. Decentralization also compounds existing difficulties in identifying appropriate partners and ensuring that all aspects of the transaction are properly authorized.⁵⁴ Concurrently, continuing central government control over foreign exchange insures that the foreign investor must still gain the approval of various bureaucratic departments.

The present uncertainties are more than transitional. A recent discussion states,

* * * given a traditional antipathy towards written law, reinforced by the fact that foreign consumers are still willing to come to China without many legal assurances, the vague language [of much recent Chinese legislation on many aspects of foreign investment] serves Chinese purposes well. "They can now say they have laws without worrying too much about their binding effect," said one Western lawyer.

One American businessman who has participated in numerous negotiations reckons the laws have helped to reduce the negotiating period * * * However, he cautioned: "Even now the laws are not rights but privileges that must still be bargained for."⁵⁵

Consistent with the hard-bitten view quoted immediately above are the observations of several scholars of the Chinese economy, who, after reviewing the relationship between Chinese foreign trade policy and domestic economic reform, have concluded that Chinese policy has failed to give foreign investors clear and unambiguous encouragement. They conclude that the standard corporate income tax rate not only fails to provide "strong incentives", that the nominal rates have to be read with the "arbitrary character of official price formation practices and * * * pervasive cost-price irrationalities", and that the provisions for tax exemptions and reductions do not give adequate guidance to the prospective investor. Their general assessment of the attractiveness of equity investment should be pondered by prospective investors:

The upshot is to leave potential investors with the impression that the standard tax rates contain large margins within which the Chinese can discriminate from

⁵² Masao Sakurai, "Investing in China: The Legal Framework," *China Newsletter*, No. 37, March-April, 1982, pp. 7-10 at 10.

⁵³ Cohen, "A Legal Opinion," *China Trade Report*, October, 1984, p. 13.

⁵⁴ Langston, "Laying Down the Law," *FEER*, January 24, 1985, p. 64.

⁵⁵ *Ibid.*, at p. 65.

case to case. The individualized approach is indeed characteristic of Chinese trade practices, and has long been a source of confusion and complaint.⁵⁶

This view was expressed about equity joint ventures generally, without reference to the 14 coastal cities. Policies with respect to those cities have been described by the same authors as "an even more drastic attempt to encourage foreign investors."⁵⁷

In the face of confusing and rapidly changing developments, how should the prospective investor regard his possibilities in China? May he hope that his expectations may be made more certain by the new legal institutions? Through promulgation of new laws and the evolution of a body of interpretation and practice which increasingly gives them life and reality, a framework is evolving to provide guidance to foreigners and their Chinese counterparts alike in establishing joint ventures and implementing the contracts for such projects.

However, the new legal framework is increasingly complex, practice is neither uniform nor easy to ascertain. Not enough time has elapsed to permit the growth of doctrine and the authoritativeness of the new laws. Of fundamental importance is that the habits of thought which officials must have in order to give support and strength to regularity and legality are likely to take a long time to appear. Some Chinese laws and regulations remain secret, for "internal use only", so that promulgated Chinese law is the tip of an iceberg whose true contours remain unknown and unmappable. We have not yet seen the appearance of a legal *system*. Many issues crucial in the creation of a joint venture are matters settled by hard negotiating to which the law may be quite irrelevant. And, as discussed above, policies may change; at the same time, the bureaucracy may not change enough.

B. SUGGESTED APPROACHES TO INVESTMENT IN THE PRC

It is possible without being cynical to avoid a leap of faith and to avoid suspending judgment. Each prospective opportunity must be assessed on its own merits. Even before approaching the specific legal issues, prospective investors must try to understand their prospective partners and the lines of bureaucratic authority in which they are involved, as well as the expectations on both sides, such as how the burden of infrastructural costs will be borne by the parties.

Initial investigations and discussions must be pursued in an effort to ascertain the existence of technical and business complementarities of interest. If such explorations ripen into genuine commercial discussions, an appropriate course suggests itself for investors: Vague letters of intent, protocols and other preliminary understandings which Chinese negotiators so often want to obtain to show their superiors should be avoided, and investors should try instead to define the relationship among all of the essential parties in the contemplated transaction, including suppliers and purchasers of the products of the proposed joint venture. The feasibility

⁵⁶ Y. Y. Kueh and Christopher Howe, "China's International Trade: Policy and Organizational Change and their Place in the 'Economic Readjustment,'" *China Quarterly*, December 1984, p. 836.

⁵⁷ *Ibid.*, at p. 837.

study required by Chinese law is a key document, and the investor must take care to assure that it contains the results of rigorous examination rather than the wishes and dreams of both sides.

Ultimately, the investor must place heavy emphasis on the contract as the principal instrument which will define the relationships between the parties and between their venture and third parties. Even though Chinese preferences for simplicity and avoidance of precise clauses on legal issues continue to linger, a new tendency is evident in the growing emphasis on the need for Chinese parties to be represented by Chinese lawyers in negotiations on equity joint ventures. At the same time, Chinese negotiators seem increasingly more understanding of Western attempts to draft contracts which adequately address problems which the parties can contemplate at the time of their negotiations.

None of the foregoing is intended to discourage investors, as long as they are willing to be questioning and tough-minded. The efforts made by the current Chinese leadership to put into place a legal framework for foreign economic activity are impressive. At the same time, the influences that may inhibit development of a legal system are many and powerful. Investors should welcome the appearance of the new institutions but must still draft contracts which as much as possible create the rules by which they and their Chinese partners will live together in their investments. Careful drafting of the agreement can help protect the parties against continuing inadequacies of the legal system and against the strong influences in Chinese society which inhibit the growth of legal regularity.