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The Evolution of China's Foreign Investment Policy and Law

Shan Gao

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THE PENNSYLVANIA STATE UNIVERSITY

PENN STATE LAW

THE EVOLUTION OF CHINA’S FOREIGN INVESTMENT POLICY AND LAW

(1978-2016)

BY

Shan Gao

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A DISSERTATION IN LAW

SUBMITTED FOR THE DEGREE OF DOCTOR OF JURIDICAL SCIENCE
ABSTRACT

This study explores the evolution of China’s foreign investment policies and laws between 1978-2016. The main goal of this study is to provide an objective narrative about the past and present development of Chinese foreign investment from a legal perspective. The study includes discussions about the creation, development, and reforms of these policies and laws. In addition, this project considers problems and opportunities of Chinese foreign investment regulatory regime. The first chapter is the introduction, which offers detailed explanations for the main focus, issues, and structure of the thesis, the methodology of the study and the reason for conducting this study, an executive summary for each chapter is provided at the end. Second, the third, and the fourth chapter will respectively focus on China’s foreign investment regulatory framework during 1978-1991, 1992-2005, 2006-2016. A short summary is provided at the end of chapter four to conclude this study.
ACKNOWLEDGEMENTS

It is my great pleasure to have so many people being supportive in the process of this study. I greatly appreciate my supervisor and my mentor, Professor Larry Catá Backer, who provide his guidance, encouragement, wisdom, and humor. It is truly an honor for me to be his student.

My appreciation also extended to Staff and faculty members of Penn State Law and Penn State Community for helping me in various ways during the program. Last, My special thanks to my parents and friends, I cannot do this without their unconditional love and supports.
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<tr>
<td>AML</td>
<td>Anti-Monopoly Law</td>
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<td>BO</td>
<td>Beneficial owner</td>
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<td>BOC</td>
<td>Bank of China</td>
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<tr>
<td>BVI</td>
<td>British Virgin Island</td>
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<td>CBRC</td>
<td>China Bank Regulation Commission</td>
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<td>CJV</td>
<td>Contractual/ cooperative joint venture</td>
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<td>CPC</td>
<td>Communist Party of China</td>
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<td>CPPCC</td>
<td>China’s People’s Political Consultative Conference</td>
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<td>CSRC</td>
<td>China Security Regulation Commission</td>
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<tr>
<td>EJV</td>
<td>Equity Joint Venture</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FIE</td>
<td>Foreign Invested Enterprises</td>
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<td>FIAC</td>
<td>Foreign Investment Administration Committee</td>
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<td>FTZ</td>
<td>Free Trade Zone</td>
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<td>GPCL</td>
<td>General Principle of Civil Law</td>
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<td>GDP</td>
<td>Gross Domestic Products</td>
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<td>JV</td>
<td>Joint Venture</td>
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<tr>
<td>M&amp;A</td>
<td>Merge and acquisition</td>
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<td>MOC</td>
<td>Ministry of Commerce</td>
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<td>MOFERT</td>
<td>Ministry of Foreign Economic Relation and Trade</td>
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<td>MOL</td>
<td>Ministry of Labor</td>
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<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>NPC</td>
<td>National People’s Congress</td>
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<td>NSR</td>
<td>National Security Review</td>
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<td>OBOR</td>
<td>One Belt One Road Initiative</td>
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<td>ODI</td>
<td>Outbound Direct investment</td>
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<td>PBOC</td>
<td>People’s Bank of China</td>
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<td>PSB</td>
<td>Public Security Bureau</td>
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<tr>
<td>RMB</td>
<td>Renminbi (Yuan, Chinese currency)</td>
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<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<td>SAIC</td>
<td>State Administration of Industry and Commerce</td>
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<td>SAT</td>
<td>State Administration of Tax</td>
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<td>SASAC</td>
<td>State Asset Supervision and Administration Commission</td>
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<td>SFZ</td>
<td>Shanghai Free Trade Zone</td>
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<td>SOE</td>
<td>State-owned enterprises</td>
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<td>SPC</td>
<td>Supreme People’s Court</td>
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<td>SPE</td>
<td>Special Purpose Entity</td>
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<td>SPV</td>
<td>Special Purpose Vehicle</td>
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<td>WFOE</td>
<td>Wholly foreign owned enterprises</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Chapter 1 INTRODUCTION

The main focus of this study is the evolution of the FDI policy and law in China from 1978-2016. This study considers two important issues: first, what is the FDI regulatory framework and how has it developed and been reformed. It considers and analyzes the effectiveness and impact of such framework from a legal perspective. Second, what is the implication of China’s FDI regulatory framework for China’s investment environment within the context of the rule of law? It considers and analyzes the dynamic relationship between the regulator and market within the context of the FDI regulatory framework.

1. Concept definition
   “Law” and “Policy.”

   “Law” and “Policy” in this study refer to a general view shared by academics and public and internal views among those working within the system. In this sense, “law” refers to a structure of norms, regulations, and rules made by the authority for the purpose of social governance with specific enforceable details. The modern constitutional theory within the Chinese paradigm would strictly define law as rules made by the National People’s Congress and applied by the court. Government Ordinances, Decrees, or Regulations are rules made by the People’s Government with

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power authorized by the Constitution.² “Policy” refers to a structure of guidance with abstract principles produced by governing entities. It is quite common that “law” would adopt recommendations or goals established by “policy.”

A discussion about China’s foreign investment policy and law during the 1980s would be a challenge to the modern definition on “law” and “policy.” It is important to note that rules and “recommendations” made by the government were prevalent in China’s foreign investment regulatory framework, especially during the 1980s when China did not have a functioning commercial legal system. Also as one problem in China’s rule of law system, policies sometimes function as government rules, and government rule operates as the law. Thus, this study adopts a broader meaning of law and policy: the law and policy both refer to structures that guide people in a given area. Unless otherwise emphasized, Law could refer to rules made either by the National People’s Congress and government agencies.

FDI

Western scholars identified that Chinese adopt a broader definition of FDI, which considered all usage of foreign funds for commercial activities, such as equity joint venture (EJV), Wholly foreign owned enterprises (WFOE), and cooperative ventures, cooperative development of oil resources, compensation trade and even processing and

assembly arrangements. For example, the 1982 Foreign Investment Commission listed six forms of foreign investment:

1. Foreign loans
2. Foreign investment in joint ventures
3. Compensatory trade and cooperative management
4. Joint exploration and exploitation of offshore oil
5. Foreign investment in SEZ
6. Investment through China International Trust and Investment Corporation CITIC

A declassified 1984 CIA study on Chinese economic policy found that, “both forms of joint ventures, as well as joint oil exploration agreements and wholly owned foreign subsidiaries, would be considered as foreign direct investment.” The CIA study further pointed that the “Chinese would include other forms of business arrangements, such as licensing, processing, and compensation trade agreements, even though no foreign claims on real assets located in China exist as foreign investment. The Chinese sometimes use the term foreign investment loosely to refer to all forms of foreign participation, even including foreign loans to Chinese enterprises.”

It is noted that “compensation trade” was later removed from “FDI” under government statistics in the 90s.

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4 Ibid.
2. Structure of the thesis

This study is organized in four chapters in chronological order. The first chapter is the introduction, which explains the purpose, intent, and methodology of the study. It provides an executive summary of each chapter to illustrate the purpose, main content, and structure of these chapters. The second chapter focuses on the FDI framework between 1978-1991. The third chapter concentrates on the FDI framework between 1992-2005. The fourth chapter concentrates on the FDI framework between 2006-2016. In the end, it will provide a short summary to conclude the study. In addition, the thesis follows a simple structure for each chapter. Each chapter starts with a section of the introduction, which explains the focus and main issue of the chapter. Then it is followed by a section of the ideological and constitutional framework, which examines the constitutional and political context of the FDI legal framework during the time. The next section will concentrate on the legal framework for foreign investment. In order to help readers identify arguments and discussions in these two sections, each section would start with a mini introduction explaining the main focus and findings. Each chapter will end up with a short conclusion.

**Why discuss the ideological and constitutional framework in each chapter**

First, Chinese foreign investment policy and the law is an expression that is embedded within the overall political, ideological and social institutional framework: it reflects an agenda to revitalize national prosperity and to restore decent living and self-
respect, goals are also shared by individual private citizens. Many studies considered that Chinese culture is one important element in explaining China’s business practice, and the lack of the rule of law. But this study argues that Chinese culture does not have significant explanatory power for the creation and quality of China’s FDI framework. Chinese culture may explain a certain aspect of the policy tendency, but this study considers the ideological and constitutional framework to provide a theoretical and conceptual foundation for the creation and enforcement of laws and policies. These laws and policies are also common extensions of China’s ideological and constitutional framework.

Second, by outlining and discussing the political principles proposed by Chinese Communist Party, and how these principles and reform agenda are textualized by the Constitution of People’s Republic of China, the ideological and constitutional framework section can provide a necessary context to illuminate the form and substance of the law and policy, and the pattern of the development. Thus, each chapter provides a short section about China’s ideological and constitutional framework before the discussion of the legal framework for a better understanding of the subject.

Why exclude pre-1978 period from this study

1978 marked the end of the Chinese Cultural Revolution. The Cultural Revolution is one of the most important events in China’s history. It provided rich and meaningful implications that reshaped the politics, ideology and cultural system. The significance of
the Cultural Revolution is undeniable. However, this study will not include discussion of this topic mainly because it would distract from the main theme of the study.

The main purpose of this thesis is to provide an objective account of China’s foreign investment policy and law from the legal perspective. It is noted that politics and ideologies are an important part that shapes the view of the society and the substance of the law, which is why each chapter will include a section that discusses the ideological and constitutional framework. However, in the process of research and study, this study found the origins and development of the Cultural Revolution to be interesting and complex. The historical background is rich: the progress of domestic law and policy was largely influenced by the entanglement of China’s domestic political and economic agenda and international geopolitics during the Cold-war era. In addition, there was no meaningful FDI and no functioning legal framework during the Cultural Revolution.

Although the Cultural Revolution provides a rich and interesting insight into political leaders’ interpretation of China’s socialist system, an objective discussion on the subject would require extensive debates that may distract from the main theme of the study: a study of China’s foreign investment law and policy through a legal perspective. For this reason, the thesis would start the discussion right after the end of the Cultural Revolution in the late 70s.
3. Data and method

The information and data supporting this thesis come from two sources. One includes published journals, books, and newspapers. A significant amount of the published materials were collected electronically through online databases, university library services and other commercial databases such as Jstor. The second source of information comes from Chinese news media, databases, and official government websites. Unless cited otherwise, the majority of the Chinese law and policies cited in this study were collected from the Westlaw China database. Unless otherwise noted, the English translation of the laws and policies are provided by Westlaw China. For the convenience of the reference, this study does not change the translation provided by Westlaw China; this does not mean the author agrees with the translation. In addition, special thanks to those who work for government agencies who offered their personal views and insights on the function and operation of government policy, which provided necessary help in understanding certain issues.

4. Rationale for topic choice

It is in-part a personal reason for the author to choose this subject. I was born at the end of the 1980s, almost a decade since the Reform and Open Up policy. In fact, I consider myself as a beneficiary of this policy. I witnessed the transformation of China’s landscape, physically and metaphorically. I remembered the time when the grown-ups talked about life under the Planned Economy, and I was amazed by those stories. The evolution of FDI for the past decade and the change of China is the story that I live and breathe every day. It intimately affects everyone but still seems mysterious. Such
mystery facilitates a channel for exploration: to explore the meaning of myself and the other various academic interests.

I still vividly remember the first time when I dined at the first McDonalds in my city when I was 7 years old. Like the younger generation standing in line waiting for the first iPhone, my parents, along with many other thousands of people on that opening day in 1993, took me to this American restaurant to experience the taste of U.S.A. A piece of yellow square thing in the Big Mac was the first cheese I ever had in my life. “It tastes interesting, but what is that?” I still remember it. As one of the members of the post-cultural revolution generation, we have the luxury to consume, discuss, engage and be influenced by the West, or a certain form of the West created by certain views and imageries from the movies, magazines, music, and English textbooks. We do not have the historical burden with the West as my previous generation does. I still remember the security guard at my elementary school joking about “imperialist capitalist American” when he saw the letter of “U.S.A” on my friend's jacket. I also understand that the reality is always way more complex than what the surface shows us. As many Chinese students first come to the U.S., they are shocked that America is not the concrete jungle depicted by Hollywood but with different regional cultures and personalities. On the contrary, China has been trying to transform its urban landscape with more and more skyscrapers. I was also shocked and later understood there are more stories behind the separation of power; there are more shades under freedom of speech, and also there are more stories about my country and history.
The stories and meaning behind that Big Mac are way larger than what I can imagine when I first had it. Indeed, my personal experience is a representative slice of the experience of the larger post-Cultural Revolution generation. This generation of Chinese can be seen as beneficiaries or product of a society that was formed and shaped by many characters, teachers, politicians, academics, entrepreneurs, and most importantly, foreigners. Under globalization, foreigners in China bring in fresh new views, cultures, and perspectives. The Big Mac I had, the computer I typed on, and movie I watched are the creations of those foreign investors, Chinese partners, Chinese regulators, global treaties, and global banking infrastructure.

Today, a Chinese can sit in his or her apartment in Beijing and order a bottle of French wine from a French vineyard from the cell phone and have it delivered in a week. Decades ago, investors needed to work years of preparation and administration process to provide the same product to Chinese customers. “We, humans, crave myth, first because they are good stories, but second because they nurture our desire for meaning. We see struggle transformed into a righteous cause and from that, we draw purpose of applying in our own lives. The purpose is the catalyst for our actions. The purpose, therefore, sparks where we want to go (vision), what we want to accomplish (mission) and what we believe (values).” 5 I consider the evolution of FDI policy and law in China to be a great story with many interesting twists. It is a story of my generation. More importantly, it helps me understand my country, my culture, and my people.

5. Limitation of the study

FDI policy and law is a huge subject with various interests and focuses. It is impossible to cover all aspects of the FDI policy and framework in one essay. This study acknowledges the limits of the research and study due to such limitations. In order to illustrate the object of this study, it selects and highlights some areas of the FDI framework, including the registration and verification rules, the foreign exchange control framework in China, and the corporate governance under Chinese company law. Also, it considers the issue of corruption in relation to Chinese FDI regulatory framework. However, this study did not provide a comprehensive overview of China’s tax policy and law.

6. Executive summary of each chapter


The main focus of this chapter is the FDI framework during 1978-1991. The main theme of this period was the introduction of foreign investment under Chinese reform and Open Up program. The main issues are, first what was the basic framework of foreign investment in China at the beginning of the reform, and second, how it worked under Chinese centralized planning economic system. The main findings are, first, the Reform and Open Up reshaped China’s history with foreign investment. The foreign investment introduced new elements to Chinese centralized command system, which
facilitated economic, political and constitutional reform. Second, the basic legal framework of FDI contained many features of the centralized economic system, which caused massive criticisms from the investment community and criticisms from conservative politicians for being not centralized enough.

Chapter 3 FDI Policy and Law 1992-2005

The main focus of this chapter is the FDI Policy and Law in 1992-2005. The main theme during this period was the establishment of the socialist market economy with “Chinese characteristics,” which protected the private interest and promoted market competition. The main issues are, first, how FDI framework developed in this new period, and second, how foreign investment worked under these new developments. The main findings are, first, China developed a dualist commercial legal system, one exclusively for domestic firms and another designed for foreign investors. This system not only insulated SOE sector from competition but also created unfair treatments for foreign investors and domestic investors. Second, the FDI framework retained many central planning elements. In addition, these central planning elements raised the concern of corruption and problems for the rule of law.

Chapter 4 FDI Policy and Law 2006-2016

The main focus of this chapter is FDI Policy and Law 2006-2016. The main theme during this period was the new challenges and opportunities for Chinese FDI framework. The main issues are (1), Chinese traditional “dualist commercial” system proved to be
insufficient in further serving China’s new conditions. The traditional export-oriented FDI policy first cannot attract high-quality FDI, and secondly, the benefits of the policy reached its limits, causing China’s imbalanced trade relationship. (2) The dualist commercial system discriminated and alienated private sectors from the Chinese market, which caused capital outflow with possibly more restrictions to deter such outflow. The main findings are that, first, Chinese authorities acknowledged the issue with traditional FDI policy and dualist commercial system. The Shanghai Free Trade Zone experiment was designed to offer unified and fair market access for both domestic and foreign investors. In addition, China has been working in close collaboration with the international legal framework by promoting a new “public disclosure” scheme to create a robust regulatory framework. In addition, the development of China’s Wechat economy structure introduced an alternative regulatory approach to Chinese FDI framework, which empowers the individual consumer to enforce values and orders promoted by a central authority.

Changes occurred at the end of the 1970s that led to Chinese reform and Open Up. Externally, China returned to the world stage. For example, in 1971, China admitted to the UN. Nixon visited China in 1972 and started negotiation for establishing diplomatic relations. In 1979, China and US signed the Economic Cooperation Agreement, which awarded China Most Favored National (MFN) status. China joined the IMF and World Bank in 1980. During the late 1970s, the Chinese government launched many overseas economic delegations participated in by Chinese industrialists; bank, finance, and trade officials; and economists. These state-sponsored high-level economic delegations normally took weeks or even months touring a specific region of the world with a particular agenda: to learn firsthand information on modernization and

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6 Shanghai Communiqué laid out the foundation for the normalization of Sino-U.S. relationship, which removed many political obstacles for later rapprochement with the West. “Shanghai Communiqué, which laid the basis for future cooperation between the two countries even while acknowledging continuing disagreements on the subject of Taiwan…” See “China Policy,” Department of the State, Office of the Historian, accessed July 31, 2017, https://history.state.gov/milestones/1977-1980/china-policy.

7 “China was first awarded MFN in 1979, during the Jimmy Carter Administration. Two-way trade between the two countries more than doubled in a year, to $4.9 billion in 1980 from $2.4 billion the year before. By 1990, China enjoyed a $10.4-billion annual surplus in its trade with the United States, with exports totaling $15.2 billion and imports of U.S. goods worth $4.8 billion. U.S. officials have predicted that China’s surplus will be even larger this year. Chinese officials have said that over the long term, they seek balanced trade. But meanwhile, this surplus places China in a stronger position to service foreign loans and to finance future imports.” See, David Holley, “Briefing Paper : Most Favored Nation: What It Means for the Chinese,” LA Times, last modified June 4, 1991, http://articles.latimes.com/1991-06-04/news/wr-114_1_favored-nation-trading-status, (accessed August 10, 2011)
economic reform. These missions respectively produced great information as a resource for policy makers, which later contributed to the creation of Reform and Open Up policy with the goal of introducing foreign investment.

Internally, China started political, ideological and economic reform in preparation for the new economic and investment development. For example, the 1976 “Gang of Four” was purged and then arrested for trial. New political line “Four Modernizations” was proposed to develop the national economy. With constant policy debates and arguments, the reformers concluded that China’s central command economy lacked flexibility, which deterred productivity and competition. The “Reform and Open Up” policy was established through the Third Plenary Session of the 11th Central Committee of CPC, which started China’s experiment with foreign investment and economic reform.

This chapter focuses on the FDI policy and law between 1978-1991. The main purpose is to understand the genesis of the FDI regulatory framework during this period of the time. This chapter is divided into three parts. The first part gives a comprehensive

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8 The destination of these delegations including: Asian (including places such as Japan, Singapore and Hong Kong), West Europe (including countries such as France, Belgium, Denmark, Switzerland, and West Germany), East Europe (including Romania and Yugoslavia) and United States in North America. “In 1978, Gu Mu, then vice premier of the State Council, led an economic delegation to visit five Western European countries. It was the first time the Chinese government had ever officially dispatched representatives to Western countries since the founding of New China in 1949. See, Zhao linyun, Zhongguo guongchandang jingji gongzuo shi [CPC Economic Work History 1921-2011] (Beijing, Zhongguo Caijing jingji Press, 2011), 100.
overview of the historical events of the 3rd Plenary Session of the 11th Congress of CPC in the introduction, which led to the promulgation and development of Chinese reform and Open Up policy. In addition, it outlines the ideological and constitutional framework to support China’s foreign investment experiment in the next section. It provides a political and constitutional perspective to explore the third part of this chapter, the legal framework of FDI regulation during 1978-1991. This part would first identify the basis of FDI regulatory framework by introducing EJV Law and its implementing regulations. Then it gives special attention to China’s foreign exchange regulation and labor regulation to showcase China’s unique FDI regulation under China’s command economy.

The central issue of the FDI policy and law development during the 1978-1991 was the dynamic between the central authority’s traditional command economy setting and the development of the new foreign investment regime. The study of the ideological and constitutional framework and foreign investment legal framework during this time suggests a contentious relationship between the conventional understanding of socialism and the meaning of modernization, exemplified, implemented and introduced by foreign investors. The most obvious evidence would be foreign investors’ expectation for a large domestic consumer market and low labor cost played against China’s policymakers’ expectation for foreign capital and technology without an open domestic market. These issues had not been settled until the 14th Party Congress in 1992, a historical event that will be discussed in the next chapter.
1. Introduction

After rehabilitated from the political prosecution during the cultural revolution and restored to his political power within the Chinese Communist Party, Deng Xiaoping and his followers gradually re-established a pragmatic political line for the Party: to improve the living standard of Chinese people under the leadership of the Party through the program of Four Modernizations, which was originally proposed by the late prime minister Zhou Enlai, but was suspended due to the interference of the far-left faction and Zhou’s illness. Throughout the 1970s and 1980s, with multiple state official visits to major western countries, and numerous of close collaborations with specialists from international organizations (such as World Bank), Deng Xiaoping and his followers gradually formulated a notion that China cannot improve economic performance and productivity without the world market. Specifically, Deng believed a meaningful and successful modernization cannot be achieved without foreign capital, technology, managerial skills, market, and investment. Most importantly, modernization cannot achieve without the law to govern and protect people and society. 

A West German coal mining company produces 50 million tons of coals with two thousand employees while the same output requires 80 thousands employees. For the same amount of output, a Switzerland Hydroelectric power plant only require 12 staff while China requires almost three hundred. See Gu mu, “Guanyu Fangwen Ouzhou Wuguo de Qingkuang Baogao,” [Report on Visitation of Five Western European States], 1978, July, 22 reprinted in Dangde Wenxian 1 (2009), http://www.hprc.org.cn/pdf/DANG200901007.pdf, (accessed July 31, 2017)

Deng Xiaoping returned to power on a platform that emphasized the “two hands policy” and the “four modernizations.” The two hands policy meant that on the one hand, the economy must be developed while on the other hand, the legal system must be strengthened. The four modernizations referred to the need to modernize agriculture, industry, national defense, and science and technology. See Randall Peerenboom, “Globalization, Path Dependency and the
Deng’s visions were crystallized at the Third Plenary Session of the 11th Central CPC Congress, when China declared the Reform and Open-Up policy, which symbolized a new era for China’s relationship with socialism, with world economy, and with foreign investors. The new economic policy was supported by the revelation of two crucial and intertwined factors: first, the power of global commerce and foreign investment in improving the economy performance and living standard of the people, which was evidenced by the successful transformation of Japan and Singapore in the 1970s; second, a more connected and integrated global economic system indicated by increasingly stabilized international relationship between the West and China, which was considered as an unprecedented opportunity for China due to its ideological conflict with the Soviet Union and the U.S. during the 60s.

“Reform” in the context of the Reform and Open-Up meant to transform China’s ideology thinking, and to restructure the institution of the Party and State apparatus. “Open-Up” meant to reconnect with the West and the rest of world through trade and foreign investment. From late 1970s to early 1990s, there had been insufficient political,

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legal, and social infrastructure to implement the Reform and Open Up policy. But this did not stop the central authority to give it a try. It was a period of reconstruction between 1978-1993: political and ideological debates and institutional overhaul established new political and constitutional principles, which served as the foundation and guidance for the reform. During this period, massive amount of new legislation and regulations enabled and facilitated the inflow of foreign investment and trade.

The introduction of foreign investment under the Reform and Open Up policy has truly liberated the economy. According to the study by Shen jiaming, “since 1979, more than 2100 joint ventures, cooperative enterprises and business wholly owned by foreign firms have been established in China.” 13 There was no western business presence in China before 1978 and the rapid growth was unprecedented. “By the end of 1984, total paid-in foreign investment in these enterprises had grown to $3.7 billion, almost 60 percent higher than the year-end figure for 1983.” 14 The communication between China and the West also experienced rapidly increased since the implementation of the Reform and Open Up policy. “By September 1988, there were already 1,047 foreign representative offices in Beijing... P.R.C.'s exports in 1987 total

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14 Ibid.
34.6 billion dollars, 256% higher than that in 1978. Similarly, its imports in 1987 total 33.4 billion dollars, 210% greater than that in 1978.” 

A significant amount of foreign investment contracts was signed between 1979 to 1986. According to the study by Garry Dernelle, it was estimated that about “7,500 foreign investment contracts were signed with a value of approximately 19.1 billion U.S. dollars.” Economic data illustrated the initial enthusiasm of the foreign investors. However, this excitement soon fizzled when foreign investors encounter the reality of Chinese central planning economy. For example, the CIA reported that FDI rose about “10 percent to more than $2 billion in 1986, but the level of new foreign investment pledged fell nearly 50 percent.” Western observers noted that “disappointment toward new FDI regulation” and uncertainty derived from political debate over the “pace and direction of economic reform” were the causes of the change of the numbers.

With the enactment of the Contractual Joint Venture (CJV) Law and Wholly Foreign Owned Enterprise (WFOE) Law, some foreign investors organized their business

15 Ibid.
18 Ibid.
in the form of CJV or WFOE. The CIA report found that “[a]mong 1500 approved SFJV contracts in 1986, there were 870 EJV and 560 CJV and 18 WFOE.” During 1978-1992, FDI inflows increased steadily and rapidly. However, the distribution was uneven. Most of the inflows concentrated in coastal China. For example, Guangdong Province. “FDI has played a major role in Chinese economy, for instance by stimulating trade growth and promoting productivity improvements in the domestic economy. Hong Kong remains the largest source of FDI. Measured by the size of its population and other objective factors, China’s potential for attracting more FDI from OECD countries remains underexploited.”

Despite the rapid growth of the FDI, the central authority did not have consensus as to the extent and the political implication of the foreign investment. The central authority was divided into two factions: a moderate faction supporting foreign investors and market reform, and a traditionalist faction supporting central command economy.

19 Ibid.
21 China’s observers in the 1970s observed and labeled two groups of policies advocators. One was moderate and another was radicals. The “Moderator view China as a weak, vulnerable, underdeveloped country which must be transformed as rapidly as possible into a modern industrial state. They believe, among other things, that modernization requires scientific exchanges with and imports of technologically advanced investment goods from the West.” However, the radicals hold a different view, they “believe that large-scale imports of foreign goods undermine faith of the people in the success of the revolution and makes China vulnerable to economic ‘blackmail’. The Radicals believe that reliance on foreigners rekindles the sense of inferiority caused by a century of humiliation at the hands of the West and that
The traditionalists were struggling with the ideological debate on whether to accept foreign investors and their market economy practice on a longer term and larger scale. Traditionalist faction envisioned a curated command economy that private sector and the market alone are not trusted to be sufficient to generate long-term stable economic growth. The objection of traditionalists for foreign investment was ideological: foreign investment and relevant reforms represented capitalism economy, which is incompatible with the socialist economy.

Deng Xiaoping and his followers had a clear vision of the relationship between Socialism and market economy for the purpose of reform. In Deng Xiaoping’s mind, foreign investment and export-oriented industries were great policy tools to resolve China’s modernization problem. The export-oriented and foreign joint venture industry could serve as a means to pay importation of advanced machinery. In addition, with the possibility of the joint venture, China can finance the industry upgrade through foreign investments. Furthermore, foreign invested enterprises would establish examples to promote modernized corporate governance. This approach was supported by other exposure to capitalists, capitalist-made products, and capitalist business procedures erodes the revolutionary will of the masses, leading to revisionism.” See, Randall Peerenboom, “Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China,” BERKELEY J. INT'L L. 19 (2001): 161-163.

For example:“In early 1979, Chinese arranged commercial credit lines amounting to nearly 10 billion, mostly with Japanese banks. China also made major capital purchases, during mid-1979, over 17 billion worth of pledges for officially supported export credits from France 7, UK 5, and Japan 1.8, Canada 1.7 and Italy 1. China’s balance of payments position improved dramatically over the next year as a result of excellent export growth.”see: Central Intelligence Agency
senior leaders of the Party. For example, the vice prime minister Li Xiannian proposed that the state shall reduce the fiscal pressure of direct purchasing foreign technology by relying on compensatory trade and foreign investments. In order to convince the party cadres, Deng Xiaoping’s made public remarks that Mao Zedong supported economic cooperation with the West in the form of trade and joint ventures, as Deng stated that:

“While Comrade Mao was still living we thought about expanding economic and technical exchanges with other countries. We wanted to develop economic and trade relations with certain capitalist countries and even to absorb foreign capital and undertake joint ventures.”

However, not everyone believed it. Deng argued that one cannot convince the masses to follow socialism if the administration failed to maintain sustainable development. With a sense of relentless pragmatism, he emphatically refuted that a market economy only lives in capitalism. For example, in order to relax the tension

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26 For example, when Deng Xiaoping talked to Guinea first president Ahmed Sékou Touré, he argued that “the first thing about socialism is the development of productivity...the right or wrong of a socialist economic policy shall be determined by its effect on the development of productivity and people’s income. This is the overriding standard.” See “Zhongguo Gaige Kaifang
with the far-left in the Party, he skillfully packaged his reform agenda in a Maoist expression by stating that “modernization is a new Great Revolution.” Deng highlighted the main theme of the reform is to relax centralized planning.

Although reform and decentralization were inevitable, foreign investment experiment faced many political obstructions. Traditionalists, such as Chen Yun and his followers repeatedly emphasized the supremacy of the central planning and unapologetically pointed out the inherited defects of the market, such as opportunism, would cause the collapse of those fiscally irresponsible reform policies. As a major critique of the Reform, Chen opposed the expansion of the Special Economic Zone experiment and considered these experiments should be contained within the approved regions. Ironically, this idea was resonant by others after Deng Xiaoping’s retirement in the early 1990s. Chen Yun theorized his idea as the “bird-cage economy,” in which the

Da Shiji,” [Reform and Open Up Chronical 1977-2008]
27 Here is another example showing Deng Xiaoping explaining the meaning of the Modernization. “Modernization is a new Great Revolution. The object of our revolution is to liberate and develop productivity. It is certainly wrong to conclude that market economy only live in a capitalist society. Why socialist society cannot engage market economy. Our economy, or socialist market economy is a combination of market economy and plan economy, which plan economy is dominant.” Deng Xiaoping’s conversation with Paul T. K. Lin, director of East Asian Study Institution of McGill University, Dec. 26, 1979. Ibid.
28 For example: State Council, Economic System Reform Working Group issued Preliminary Opinion Concerning the Reform of Economic Administration System, which provided that economic mechanism shall be the primary means for government administration of the economy, and state shall expand autonomous operation by the enterprises. Also see, the MOFERT Report on Reforming Foreign Trade System provided that the main focus of the reform is to separate government agency and enterprise operation, decentralization of approving process and make trade company financially independent from the central planning.
cage represents central planning under Party leadership and the bird represents the market. “A bird can fly freely in the cage when the size of the cage is appropriate for the comfort of the bird,” as Chen explained. It is important to point out that Chen Yun did not principally oppose reform or improvements in productivity. Although many traditionalists had ideological reasons to object foreign investment, there were also other concerns. For example, Chen concerned a free market would threaten the effectiveness of central planning in maintaining economic balance and protect people’s economic rights.

A central command economy system is a self-proclaimed rule system that requires all transactions following the central government. The integrity of the central command economy system depends on the restrictions on the freedom of contract. The rationale was that the private sector could not achieve optimization of economic outcome. A centralized authority can produce an optimized outcome through central planning. One risk for Chinese reform and Open Up was the issue of opportunism and rent-seeking during the transition from central command economy to a more relaxed economy system. The condition went worse when there was no effective commercial law system during the 1980s. The launch of Reform and Open UP since the end of the 1970s entailed unprecedented waves of inflation, smuggling goods, corruption, which in return gave platforms for the critics from conservative members of the Party and massive protests by students. Deng realized the rise of official corruption and illegal activities at an alarming rate, which could jeopardize the central authority’s legitimacy.
and capacity in implementing the reform. For example, state and Party officials had unchecked access to obtain finance, natural resource, commodity, and information for business opportunities under the planning system. These officials and their family members and friends obtained unfair advantages over business transactions.

Many foreign investment laws and regulations during the 1980s reflected the struggles that the traditionalists experienced. The conflicts between the command economy and the notion of competition and profit were the main theme of the contradiction of the reform during the 1980s and early 90s. The contradiction was not truly settled until the beginning of the 1990s when the Party decided to build the “socialist market economy.” The terminology “socialist market economy” expressed a concession of political rhetoric against market and profit, which was extraordinary given the fact that a decade ago, China was vigorously condemning the market and profit.29

Unfortunately, the Reform and Open Up ended up with a series of setbacks and conflicts in the late 1980s, politically and economically. China still lacked a basic civil and commercial legal system at the end of the 80s. Inflation, corruption, an opportunism for short-term profit by state officials and enterprise managers, and other elements seeded and fomented a sense of conflicts and discontent between the reformers and

conservatives. There were also massive protests by students that led to strong reactions from political conservatives.\textsuperscript{30} Uncertainty shadowed China’s future at the beginning of the 1990s with the visible decline of foreign trade, and with foreign investment and public condemnation from the western societies. In 1991, the public narrative turned to a harsher tone on the reform with an ideological attack on the supporters of the reform. For example, an editorial in People’s Daily suggested that China cannot sustain a market economy. Another editorial openly revived Maoist expression of bourgeois liberalization, which openly attacked the new reform policies as the host of such right-wing tendency. The Premier openly stated that the development of the economy should slow down.

However, the story of foreign investment and reforms during the 1980s did not end this way. Deng Xiaoping was fully aware of the mood and narrative calling for retreating from further reform. He orchestrated a semi-private trip to the Special Economic Zone during the Chinese New Year of 1992.\textsuperscript{31} During the trip, his open remarks on Chinese administration revealed his frustration and concern for the

\textsuperscript{30} For example, the new year editorial of People’s Daily in 1987 proposed to uphold Four Cardinal Principle and against Bourgeois liberalization (\textit{Zi chan jie ji zi you hua} 资产阶级自由化思潮)

\textsuperscript{31} Between Jan 18 and Feb 21 of 1992, Deng Xiaoping scheduled a southern tour through train to visit Shenzhen, Zhuhai and Shanghai. He made public speech openly criticized the slowdown of reform process. He called for further liberal market reform. Initially, the southern tour was not publicized by the official press until later of the year. About the organization and subsequent implication of the trip, see Ezra Vogel, \textit{Deng Xiaoping and the Transformation of China}, (Cambridge, MA, and London, The Belknap Press of Harvard University Press, 2011): 876.
slowdown of the reform. He unapologetically proclaimed that the debate of central planning and market economy is not a defining element of socialist ideology, which was a position he repeatedly argued throughout the 1980s. To him, a much more appropriate benchmark or the predominant defining element for socialism would be the performance of the economy and living standard of the people. Deng’s public remark later resonated with his followers in the Party. The mood of uncertainty disappeared by the end of 1992. It is interesting, from a retrospective, to reconsider Deng’s reaction and remarks. It is clear that conservatives’ concern over reform derived from the classic problem of “opportunism” under market economy system without a strong protection from the rule of law. Although Deng himself mentioned the administration should concentrate on reforming and relaxing central planning and regulation on the one hand, on the other hand, he warned the administration the need to use law and legal system to punish illegal activities such as corruption and smuggling. The 1992 Deng Xiaoping’s Southern Tour ended the uncertainty of Chinese reform and entailed a new era of China’s development of the FDI legislation. In addition, an economy performance benchmark, such as GDP, GNP and other economic data had started to be a critical evaluation standard to determine the policy of the state and career path of state

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32 Deng Xiaoping told future premier Zhu Rongji during his Shanghai visit in 1991 that it is impossible to have economic development without open up. In addition, China cannot stop the reform because there were different opinions in the party. Ibid.

33 For example, “Fundamentally, the reason we cannot step forward on the path of reform linked to our fear for capitalism and capitalism path. The benchmark for socialism or capitalism debate should be whether the policy could improve socialist productivity, whether it could improve national power and the living standard of the people.” Ibid.
2. Ideological and Constitutional Framework

a. Ideological Framework

Acceptance is the first step of invitation for foreign investors. Before China opened the gate for foreign investment, the political rhetoric against market and private ownership had gradually declined but not disappeared throughout the 1980s. During the 1970s, the 11th Party Congress asserted that “defend socialist economy, against attacks from urban and rural capitalism.” At the end of the 1970s, although the official position on the privately owned or operated economy was less supportive, it turned a neutral and less combative tone. It considered such acts as the “supplement and addition” to a socialist economy. In 1981, the 6th Plenary Session of 11th Central CPC showed more supports, which affirmed that such economic activity is “necessary supplement.” The 12th Party Congress further relaxed the taboo by claiming private owned, or the operated economy is “necessary and beneficial.” The authority approved three economy forms during the early 1980s: State owned enterprises (SOE), Collective Ownership and Individual owned or operated economy. The term for individual owned

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or the operating economy in Chinese is “Geti jingji,” literally meaning individual economy of urban and rural working people, which de-emphasize the issue of ownership due to political sensitivity. In 1988, the political rhetoric dismissed the traditional taboo on the market and private ownership; it proposed a new term “Siying jingji” (private sector of the economy) in Chinese, which means a form of an economy managed and operated by private sector. This new policy also approved by 1988 Constitution. The 1988 Constitution amendment added a new paragraph to article 11, which stated that:

“The State permits the private sector of the economy to exist and develop within limits prescribed by law. The private sector of the economy is a complement to the socialist public economy. The State protects the lawful rights and interests of the private sector of the economy and exercises guidance, supervision, and control over the private sector of the economy.\(^{35}\)”

The pre-amendment article provided that:

“The individual economy of urban and rural working people, operating within limits prescribed by law, is a complement to the socialist public economy. The State protects the lawful rights and interests of the individual economy. The

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\(^{35}\)1988 Const Amendment.
State guides assists and supervises the individual economy by administrative control.\textsuperscript{36}

This section focuses on the ideological and constitutional framework between 1978-1991 that contribute to the development of China’s foreign investment policy and law. It will provide a brief overview over the 3\textsuperscript{rd} Plenary Session of the 11\textsuperscript{th} Central CPC and the promulgation of the 1982 Constitution, which offers a necessary historical context in understanding the FDI legal framework in the next section.

Various events occurred prior to the Third Plenary Session of the 11th Central Committee of CPC in 1978 suggested a growing consensus that questioning the legitimacy of the old thinking and structure on what defines as socialism. For example, left extremists and Mao’s followers’ political line was publicly debated and questioned. The supports for the reform grown stronger. The idea of rewarding one’s labor based on performance and contribution was no longer considered as capitalism practice.\textsuperscript{37} A new economic system “rural responsibility” was introduced and implemented, to allow peasants sell any products that exceed their assigned portion.\textsuperscript{38} The People’s Procuratorate was restored as a part of Chinese legal system rebuild after the Cultural

\begin{flushright}
\\textsuperscript{36} Art.11 PRC Const.
\textsuperscript{37} During the cultural revolution, the principle that “To each according to his contribution” (\textit{Anlao Fenpei 按劳分配}) was denounced as capitalism. Zhongguo gaige kaifang dashijibianxiezhu, [Reform and Open Up Chronical Committee] \textit{Chronical of Chinese reform and Open Up 1977-2008}, (Beijing: Zhongguo caijing Press, 2008) \texttt{http://www.reformdata.org/content/20080509/1272.html}.
\textsuperscript{38} Ibid.
\end{flushright}
Revolution. In multiple occasions, Deng revealed that “fundamental feature showing the superiority of the socialist system is to be able to have an unprecedented development of productivity than the old society [pre-1949 Republic of China time], and to be able gradually to satisfy the growing needs of the people.”\footnote{Ibid.} Two days before the meeting, on December 16, Beijing and Washington jointly issued Joint Communiqué on the Establishment of Diplomatic Relations, which was unimaginable when China acquiesced U.S. as imperialists just a few years ago. \footnote{Ibid.}

On December 22, 1978, Third Plenary Session of the 11th Central Committee of the Communist Party of China was held in Beijing.\footnote{Zhonggong shiyi jie sanzhong quanhui (中共十一届三中全会) [Communique of the Third Plenary Session of the 11th Central Committee of the Communist Party of China] adopted at the Third Plenary Session of the 11th Central Committee of the Communist Party of China on Dec. 22, 1978, accessed July 31, 2017, https://www.marxists.org/subject/china/peking-review/1978/PR1978-52.pdf.} Historians and Chinese authorities later consider this meeting as the beginning of a new era for China: it not only denounced left extremism political ideology but also opened a small gate to reconsider the role of central planning, which is essential for the decision for the Reform and Open Up policy and the policy of accepting foreign investment in China.

On the ideological side, this meeting officially ended the political line of class struggle as the main goal of the state, which was just affirmed in 1978 Constitution in
less than ten months.\(^4^2\) In assessing the past left extremist political movements, the meeting linked the connection between Party’s failure of enforcing democratic centralism and the expansion extremist political view. Thus, it called for restoring the principle of democratic centralism and collective leadership, and the need for restoring the rule of law in protecting people’s Constitutional rights-- a move that not only later successfully attacked Mao’s followers in the Party, but also made it possible to rehabilitate many Party cadres and intellectuals.\(^4^3\) For example, it emphatically stated the importance of law in safeguarding people’s democracy and socialism four modernization.\(^4^4\) Law is needed for building and improving the socialist legal system.\(^4^5\)

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\(^4^2\) The People's Republic of China is a socialist state of the dictatorship of the proletariat led by the working class and based on the alliance of workers and peasants. PRC Constitution. Art.1

\(^4^3\) “The plenary session unanimously endorsed the policy decision put forward by Comrade Hua Guofeng on behalf of the Political Bureau of the Central Committee on shifting the emphasis of our Party's work and the attention of the people of the whole country to socialist modernization.”

“The session highly evaluated the discussion of whether practice is the sole criterion for testing truth, noting that this is of far-reaching historic significance in encouraging comrades of the whole Party and the people of the whole country to emancipate their minds and follow the correct ideological line.” See, “Communique of the Third Plenary Session of the 11th CPC Central Committee,” Beijing Review.com October 10, 2008, [http://www.bjreview.com.cn/special/third_plenum_17thcpc/txt/2008-10/10/content_156226_5.htm](http://www.bjreview.com.cn/special/third_plenum_17thcpc/txt/2008-10/10/content_156226_5.htm).

\(^4^4\) Since for a period in the past democratic centralism was not carried out in the true sense, centralism being divorced from democracy and there being too little democracy, it is necessary to lay particular emphasis on democracy at present, and on the dialectical relationship between democracy and centralism, so as to make the mass line the foundation of the Party's centralized leadership and the effective direction of the organizations of production. See The Communique.

\(^4^5\) In order to safeguard people’s democracy, it is imperative to strengthen the socialist legal system so that democracy is systematized and written into law in such a way as to ensure the stability, continuity and full authority of this democratic system and these laws; there must be laws for people to follow, these laws must be observed, their enforcement must be strict and law breakers must be dealt with. From now on, legislative work should have an important place on the agenda of the National People's Congress and its Standing Committee. Procuratorial and
In addition, it announced to shift the focus from politics and ideology to a more moderate and practical goal: economic development and modernization. The meeting’s diagnosis on China’s economic performance linked the underperformance of the economy with China’s over centralized command economy system. It openly criticized that the entanglement between government agencies and enterprises under the centralization creating problems for the performance efficiency. The cautiously drafted language suggested the planning may not be compatible with the law of the economics and function of the value in economic activities. Thus, the meeting proposed for decentralization and liberalization based on its critique of a centralized command economy. The Communique proposed new policy designed to separate Party, government, and enterprise through introducing a new “responsibility system,”

judicial organizations must maintain their independence as is appropriate; they must faithfully abide by the laws, rules and regulations, serve the people's interests, keep to the facts; guarantee the equality of all people before the people's laws and deny anyone the privilege of being above the law. See, “Communique of the Third Plenary Session of the 11th CPC Central Committee,” Beijing Review.com October 10, 2008, http://www.bjreview.com.cn/special/third_plenum_17thcpc/txt/2008-10/10/content_156226_5.htm.

46 “The session points out that one of the serious shortcomings in the structure of economic management in our country is the over-concentration of authority, and it is necessary boldly to shift it under guidance from the leadership to lower levels so that the local authorities and industrial and agricultural enterprises will have greater power of decision in management under the guidance of unified state planning; big efforts should be made to simplify bodies at various levels charged with economic administration and transfer most of their functions to such enterprises as specialized companies or complexes. Ibid.

47 “It is necessary to act firmly in line with the law of economics, attach importance to the function of the value in economics, consciously combine ideological and political work with economic methods and give full play to the enthusiasm of cadres and workers for production.” Ibid.
performance evaluation and promotion system. Translate into plain language this was a half supports to private interest, private profits.

It is important to point out that the 1978 Meeting was not the end of the debate for the nature of the reform and legitimacy of foreign investment policy under a socialist system, on the contrary, the meeting cracked an opening on the supreme status of central planning. In fact, as the FDI policy and legislation expressed, China was not fully embracing the notion of the market economy during the entire 1980s. Questions and debates about the legitimacy of the new reform and the definition of socialism throughout the 1980s. For example, less than three months after the Third Plenary Session, the head of Plan Commission, Chen Yun published his essay on the issues of Central Planning and Market. He argued that socialist economy needs two defining feature: 1, centralized planning, which is the foundation; 2, the market as a supplement to adjust the central plan.

Although debates about the nature of socialism in the context of introducing foreign investment never ends during the 1980s, the central authority made the

48 “It is necessary, under the centralized leadership of the Party, to tackle conscientiously the failure to make a distinction between the Party, the government and the enterprise and to put a stop to the substitution of Party for government and the substitution of government for enterprise administration, to institute a division of responsibilities among different levels, types of work and individuals, increase the authority and responsibility of administrative bodies and managerial personnel, reduce the number of meetings and amount of paperwork to raise work efficiency, and conscientiously adopt the practices of examination, reward and punishment, promotion and demotion. Ibid.
decision for the Reform and Open Up. In fact, the decision of reform and open up, using foreign investment and establishing special economic zone was the result of some careful policy studies and debates. The information pool for the policymaker came from two sources. First, a massive wave of state-sponsored economic delegation around the world to investigate and study economic development in other countries. Second, close academic cooperation with an international organization, such as World Bank. 49

b. Constitutional Framework

The 3rd Plenary Session of the 11th National Congress of CPC established an ideological and conceptual framework for the development of China’s socialist modernization. It fundamentally shifted Authority’s focus from politics to economic development by redefining China’s socialism. After the Third Plenary Session of 11th Central Committee of CPC, the Party openly denounced the Cultural Revolution and announced a new political line of focusing modernization and economic development.

49 “The World Bank’s first official mission to China to discuss Beijing’s request was led by its president, Robert McNamara in April 1980. The mission was received by Deng Xiaoping who told the mission: “We are very poor. We have lost touch with the world. We need the World Bank to catch up. We can do it without you, but we can do it quicker and better with you.” The change in China’s representation in the World Bank was arranged with amazing speed; in May1980 the Board approved Beijing’s request. The first mission was led by “thirty two Bank staff (economists, agronomists, engineers, health experts, education experts and other sector specialists) participated at various times, from October through December ... The Chinese organized a counterpart team which included Zhu Rongji (China’s PM from 1998 – 2003)...Mission findings were reflected in a 1,000-page multi-volume report entitled ‘China: Socialist Economic Development’ which was submitted to the Bank’s Board before the first project loan was presented for approval in June 1981.” see Pieter Bottelier, “China and the World Bank: How a Partnership Was Built,” Working Paper No. 277, accessed July 31, 2017, https://pdfs.semanticscholar.org/84e3/99cb8a4029d3bba20d34a754ce98da230dd8.pdf.
Since then, the central authority started the process of drafting constitution amendment, to restore and rebuild China’s legal infrastructure. According to Peng Zhen’s report to the National People’s Congress (NPC), the NPC started this process by establishing a Constitution Amendment Committee to charge the draft in 1980. This Constitution amendment later has become the basis of China’s current constitutional framework. The report particularly highlighted that:

Our country follows the policy of opening to the outside world while adhering to the principle of independence and will continue to do so in the days to come. China will continue to expand economic, technological and cultural exchanges with other countries on the principle of equality and mutual benefit. The draft stipulates that foreign economic organizations and individuals foreign may invest in China and enter into economic cooperation with Chinese economic organizations. Of course, all foreign economic organizations in China must abide by the laws of the People’s Republic of China, and their lawful rights and interests will be protected by the law of the People’s Republic of China.

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The 1982 Constitution is one landmark legislation that affirmed the principles of the 3rd plenary session, which established the constitutional basis for Chinese reform and Open Up. It provides a legal basis for China’s new economic reform and foreign investment. Although it has limits, it is a necessary tool for the later development. The Preamble provided that:

“The future of China is closely linked with that of the whole world. China adheres to an independent foreign policy as well as to the five principles of mutual respect for sovereignty and territorial integrity, mutual nonaggression, noninterference in each other’s internal affairs, equality and mutual benefit, and peaceful coexistence in developing diplomatic relations and economic and cultural exchanges with other countries.”

The article 6 of the Constitution defined China’s economic system; it provided that:

The basis of the socialist economic system of the People’s Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people. The system of socialist public ownership supersedes the system of exploitation of man by man;

52 Preamble, PRC Constitution.
it applies the principle of "from each according to his ability, to each according to his work.\textsuperscript{53}

As later discussion indicated, between 1978-1991, China’s foreign investment legal framework operated within a centralized planning economy. The government functioned as the central planner with unchecked power, and China’s legal system was underdeveloped. Other articles in the Constitution can also highlight this central planning economy. For example, article 11 defined the relationship between private sector and public sector:

The individual economy of urban and rural working people, operating within limits prescribed by law, is a complement to the socialist public economy. The State protects the lawful rights and interests of the individual economy. The State guides assists and supervises the individual economy by administrative control.\textsuperscript{54}

The statutory language clearly stated the words “control,” which indicated that the supports to the private sector were minimum. Article 12 further emphasized that: “Socialist public property is inviolable. The State protects socialist public property.”\textsuperscript{55} However, no similar treatment was awarded to “private sector,” which

\textsuperscript{53} PRC. Const art. 6.
\textsuperscript{54} PRC. Const art. 11.
\textsuperscript{55} PRC. Const art.12.
affirmed a clear and differentiated treatment by the Constitution. Article 18 stipulated basic principle of the foreign investment. It provided that:

The People's Republic of China permits foreign enterprises, other foreign economic organizations, and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other Chinese economic organizations in accordance with the provisions of the laws of the People's Republic of China. All foreign enterprises, other foreign economic organizations as well as Chinese-foreign joint ventures within Chinese territory shall abide by the laws of the People's Republic of China. Their lawful rights and interests are protected by the laws of the People's Republic of China.

The restrictive tone over China’s private-sector under the Constitution create a shocking contrast with the article 18. As the discussions in next section suggested, the development of FDI framework between 1978-1991 displayed a dualist regulation system. China’s private sector was oppressed by the central planning system. The foreign investments were treated as tools for creating foreign exchange and technology for China’s economic development.

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56 This changed in 2004 Constitution amendment. See next chapter discussion.
57 PRC. Const art.18.

On July 1st of 1979, the second session of The Fifth National People’s Congress adopted Sino-Foreign Equity Joint Venture Law (hereinafter EJV Law). This was the first foreign invested enterprise (hereinafter FIE) related legislation since the 3rd Plenary Session of the 11th National Congress of CPC proclaiming the decision of Reform and Open Up. The 1979 EJV Law was an “enabling act” for containing only 15 short articles. Supplementary legislation such as Implementing EJV Regulations was adopted to provide necessary guidance for the investor and regulator. The 1979 EJV Law and its implementing rules formed the foundation for China’s foreign investment framework.

The first generation of the foreign investment legal framework demonstrated various features of the centralized command economy system. For example, (1) the Sino-foreign joint venture (JVs) adopt the principle of “equal share, equal rights,” which negated the rights of majority shareholder by requiring a unanimous decision. (2) The chairman of the board of director in a foreign invested enterprise (FIE) must be served by a Chinese. (3) FIE must submit detailed production and operation plan to China’s planning authority for inspection and review before, during and after production. (4) The FIE cannot sell its products to China’s domestic market without obtaining

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58 Law of the People’s Republic of China on Sino-Foreign Equity Joint Venture (promulgated July 1, 1979 by the Second Session of The Fifth National People’s Congress) [hereinafter EJV Law]. Many studies and publications during the 80s also translated the title of this law as Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment.
administrative permission. Even with permission, the products must be sold to a government agency that is in charge of the distribution because there was no private distribution network and market. (5) The employee of the FIE must be appointed or recommended by the local labor authority. Any disciplinary punishment or discharge must be approved by such authority. In addition, due to a shortage of foreign exchange, strict foreign exchange rule was placed on FIE. (6) Employees can only remit 50% of their salary outside China. Initial enthusiasm from the investment community soon declined due to market restrictions, the lack of meaningful and clear legal guidance, and strict rules on foreign exchange.

The central authority was not unaware of these unpopular restrictions and regulations. The State Council issued 1986 Encouragement Provision, which designed to relax some unpopular restrictions. With this new measure, FIE can hire or discipline an employee at their will. The restriction on Chinese chairman was also removed. In 1986 the NPC adopted WFOE Law, in 1990 State Council adopted WFOE Implementing Rules. These two laws allowed foreign investors to establish a wholly owned business in China. The Contractual Joint Venture Law (hereinafter CJV Law) was enacted in 1988. The EJV, WFOE (Wholly foreign owned enterprises), and CJV referred to different forms of investment structure for foreign investors. The Contractual Joint Venture is a special form of a business venture based on contract. The venture itself would not be an independent legal entity. Each investor would be held responsible in accordance with their shares of contribution. Legally, this form of investment remembered to the
structure of a partnership. The EJV Law, WFOE Law, and CJV Law and their implementing rules formed the basis of China’s FDI regulatory framework. Under this foreign investment legal framework, China later adopted relevant tax regulations, labor regulations, foreign exchange regulations and contract regulations. In addition, as many ignored, China adopted special investment measures for investors from Hong Kong, Macau, and Taiwan with less restrictive rules. Throughout the 1980s, China had signed series bilateral treaties of investment protection with different countries around the world to gain MFN status. These treaties became the foundation for China’s future investment regime.

It is important to point out that there was no formal commercial legal infrastructure during the 1980s. Thus most of the FIE related legislation were fulfilled by administrative rules and decrees created by State Council or relevant departments. In addition, foreign investment laws promoted arbitration as dispute resolution when China’s litigation system was not ready to adjudicate disputes involved foreign investors.


Art. 3.1: Direct or indirect investment made by investors of one Contracting Party in the territory of the other Contracting Party shall enjoy equitable treatment.

Art. 3.3: The treatment and protection provided in paragraphs 1 and 2 of this Article shall not be less favorable than that enjoyed by investors of a third State.

Art. 11: Investors of one Contracting Party shall enjoy the most favored nation treatment in the territory in the of the other Contracting Party in respect of all the matters subject to this Agreement. Or see: Agreement between the Federal Republic of Germany and the People’s Republic of China on the Encouragement and Reciprocal Protection of Investments: Neither Contracting Party shall subject investments and activities associated with such investments by the investors of the other Contracting Party to treatment less favorable than that accorded to the investments and associated activities by the investors of any third State.
The FDI framework during the 1980s subject to various criticisms from the investment community. The most prominent one was a lack of coherency and clarity. Corruption and rent-seeking issues were also quite serious throughout the 1980s. However, as Deng famously stated: it is better to have some law than not, and we can improve it later. Massive legislation during the 1990s started China’s judicial system modernization, which focuses on the quality of the legislation and the professionalism of judicial system.

This section exclusively focuses on the legal framework of FDI between 1978-1991. The purpose is to illustrate how the foreign investment policies and laws were created and developed through analysis of the laws and regulations. This section will first discuss the EJV Law and supplementing regulations. In this part, it will provide an article by article analysis of the first EJV Law. Then it will provide a shorter analysis on WFOE Law and CJV Law because these laws are sharing similar regulations with the EJV Law. In addition, this section will also discuss the foreign exchange regulations and labor regulations. The purpose of this section is to provide a comprehensive overview of the basic framework of foreign investment regulation. At the end of this section, a short summary will be provided to highlight issues and complaints of China’s FDI framework between 1978-1991.

a. EJV Law Framework

On July 1st of 1979, the second session of The Fifth National People’s Congress
adopted Sino-Foreign Equity Joint Venture Law (hereinafter EJV Law).60 This EJV Law was later amended in 1990 and 2001. The current 2016 EJV Law is based on 2001 version with one minor change. There were only fifteen articles for the 1979 EJV Law. As one scholar concluded that the law was “too vague and too skeleton.”61 Thus, supplementary legislation was created during the 1980s to form an EJV regulatory framework.

The main purpose of the EJV Law, as the article one stated, was to “expanding international economic cooperation and technological exchange.”62 Interestingly, the phrase “international economic cooperation and technological exchange,” widely used in diplomatic context played down the economic implication of foreign investors.

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60 Law of the People’s Republic of China on Sino-Foreign Equity Joint Venture (promulgated July. 1, 1979 by the Second Session of The Fifth National People’s Congress)中华人民共和国中外合资经营企业法. Many studies and publications during the 80s also translated the title of this law as Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment.


62 Art.1, EJV Law. “With a view to expanding international economic cooperation and technological exchange, the People’s Republic of China shall permit foreign companies, enterprises, other economic organizations or individuals (hereinafter referred to as "foreign joint venturers") to establish equity joint ventures together with Chinese companies, enterprises or other economic organizations (hereinafter referred to as "Chinese joint venturers") within the territory of the People’s Republic of China, on the principle of equality and mutual benefit and subject to approval by the Chinese Government.”
because capitalism was still a sensitive issue. Foe example, one of the issues at the planning stage of establishing SEZ was how to name the special experiment. The term “trade zone,” “export zone” or even “industrial park” were refused because they were considered as the too bourgeoisie.

With only fifteen articles, the signature 1979 EJV Law covered very basic aspect of foreign investment without any supports from a functioning domestic legal system due to lack of contract law, civil code or other essential commercial law. Thus, the 1979 EJV Law was more of a political statement than a meaningful legal guidance, which affirmed the will of enforcing the open up policy. As Deng himself admitted “an imperfect law is better than nothing,” because it could be the first step for later improvement. In addition, the 1979 EJV Law did serve some practice interests. First, as


64 China do not have any form of contract law until the promulgation of Economic Contract Law in 1981. The first Civil law in China was 1986 General Principle of Civil Law. China do not have company law until 1993.

65 “There is a lot of legislative work to do, and we don't have enough trained people. Therefore, legal provisions will have to be less than perfect to start with, then be gradually improved upon. Some laws and statutes can be tried out in particular localities and later enacted nationally after the experience has been evaluated and improvements have been made. Individual legal provisions can be revised or supplemented one at a time, as necessary; there is no need to wait for a comprehensive revision of an entire body of law. In short, it is better to have some laws than none, and better to have them sooner than later. Moreover, we should intensify our study of international law.” See, Deng Xiaoping, “Emancipate the Mind, Seek Truth from Facts, and
Deng insightfully pointed out, it established a legal foundation for future improvement. Second, it officially proclaimed China’s commitment to Reform and Open Up through the expression of legislation by NPC. This announcement not only dismissed the protest against foreign investment in China’s politics circle but also assured foreign investors China’s plan for Reform and Open Up.

Article one and two outlined the purpose of FDI and the eligibility of investors. As previously indicated, the purpose of FDI was to “expand international economic cooperation and technological exchange.” Foreign companies, enterprises, individuals and other economic organizations are permitted to establish EJV with only Chinese business entity (excluding Chinese individual). It is important to point out that the “foreigner” presumed anyone outside mainland China (including Hong Kong and Taiwan even China claiming sovereignty over these regimes at the time). But China would adopt the term “Overseas Chinese” to categorize this special group.

Article 3 governed the basic principle of establishing FIE, which provided that a


66 Art.1, EJV Law.

67 Art. 1, and art. 2 of EJV Law. see “The Chinese Government shall protect, in accordance with the law, the investment of foreign joint ventures, the profits due them and their other lawful rights and interests in an equity joint venture, pursuant to the agreement, contract and articles of association approved by the Chinese Government. All activities of an equity joint venture shall comply with the provisions of the laws, decrees and pertinent regulations of the People’s Republic of China.”
FIE applicant must obtain administrative approval from a designated agency prior to the process of applying for a business registration. This practice did not change until a recent adjustment in 2016 after the success of Shanghai Free Trade Zone, which allowed certain investors exempt from foreign investment verification. Such agency will develop a set of rules, directives, and regulations concerning the qualification and required conditions for the investors and investment project. Article 3 required prior obtaining a business license through State Administration for Industry and Commerce (SAIC), the signed joint venture agreements, contracts and article of association must be approved and permitted by PRC Foreign Investment Commission.

Article four specified the corporate form of the joint venture and minimal contribution standard. It required foreign investor must contribute no less than 25 percent of its registered capital. The established joint venture would be a limited liability company that investors would share the profit and risk in accordance with their contribution. Article five concerned the forms of contribution. It specified that foreign

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68 See last chapter on Shanghai Free Trade Zone.
69 Art. 3, EJV Law “Article 3The equity joint venture agreement, contract and articles of association signed by the parties to the venture shall be submitted to the Foreign Investment Commission of the People’s Republic of China, which shall then decide to approve or disapprove the venture within three months. When approved, the equity joint venture shall register with the General Administration for Industry and Commerce of the People’s Republic of China, acquire a business licence and start operations.”
70 Art.4 EJV Law “An equity joint venture shall take the form of a limited liability company. The proportion of the foreign joint venture’s investment in an equity joint venture shall be, in general, not less than 25 percent of its registered capital.
investor could contribute cash, in kind or industrial property. It strongly emphasized that
the foreign investor could subject to compensation request from China when such
contribution was made by outdated technology and equipment. The Foreign investor
must also pay for land use rights when land use rights were not part of the contribution
to the joint venture.71

Perhaps one of the most controversial regulations of the EJV Law was the article
six, which governed the board of the directors. This article required the chairman of the
board of the director must be served by a Chinese person appointed by the Chinese
partner in the JV. Without specifying the decision-making process in EJV board, article
six only vaguely stated that both parties should make a decision under the principle of
equal and mutual benefits.72 Clearly, this meant China negate “majority share control”

The parties to the venture shall share the profits, risks and losses in proportion to their
contributions to the registered capital. If any of the joint venturers wishes to assign its
registered capital, it must obtain the consent of the other parties to the venture.”

71 Art. 5, EJV Law,
“The parties to an equity joint venture may make their investment in cash, in kind or in
industrial property rights, etc. The technology and equipment contributed by a foreign
joint venturer as its investment in kind must be advanced technology and equipment
that really suit China’s needs. In case of losses caused by a foreign joint venturer
practicing deception through the intentional provision of outdated technology and
equipment, it shall compensate for the losses. A Chinese joint venturer’s investment may
include the right to the use of a site provided for the equity joint venture during the
period of its operation. If the right to the use of the site is not taken as a part of the
Chinese joint venturer’s investment, the equity joint venture shall pay the Chinese
Government for its use. The above-mentioned investments shall be specified in the
contract and articles of association of the equity joint venture, and their value
(excluding that of the site) shall be assessed by all parties to the venture.”

72 Art. 6 EJV Law
in corporate governance. However, the chairman of the board was also vested other important authorities: such as signature JV contract. This meant foreign managers in JV might need Chinese chairman’s support to greenlight an important business dealing.

Distribution of profits and taxation was set forth in article seven. Under article seven, the after-tax profit would be distributed in accordance with the proportion of their investment in joint venture. This means investors cannot privately determine the share of profit. Article seven also provided a less clear tax incentive: an equity joint venture equipped with world advanced technology can enjoy income tax reduction or exemption for the first two to three profit-making years. Clearly, the definition of

An equity joint venture shall have a board of directors, the size and composition of which shall be stipulated in the contract and articles of association, after consultation between the parties to the venture; the directors shall be appointed and replaced by the relevant parties. The board of directors shall have a chairman, whose office shall be assumed by the Chinese side, one or two vice-chairmen, whose office(s) shall be assumed by the foreign joint venturer(s). In handling important problems, the board of directors shall make decisions through consultation by the parties to the venture on the principle of equality and mutual benefit.
The functions and powers of the board of directors are, as stipulated in the articles of association of the equity joint venture, to discuss and decide all major issues concerning the venture, namely, the venture’s development plans, proposals for production and business operations, the budget for revenues and expenditures, the distribution of profits, the plans concerning manpower and wages, the termination of business, and the appointment or employment of the general manager, the vice-general manager(s), the chief engineer, the treasurer and the auditors, as well as the determination of their functions, powers and terms of employment, etc.
The offices of general manager and vice-general manager(s) (or factory manager and deputy manager(s)) shall be assumed by the respective parties to the venture.
The employment and discharge of the workers and staff members of an equity joint venture shall be stipulated in accordance with the law in the agreement and contract concluded by the parties to the venture.”

73 See Art. 7 EJV Law
“world advanced technology” required further explanation by the authority.

There were other restrictions related to capitals. For example, FIEs must deposit their profit and money at Bank of China [hereinafter BOC] or any other bank approved by BOC. In order to save foreign exchange reserve, EJV Law further specified a preference of domestic supplier over the foreign supplier for manufacturing purchasing. Because China did not allow FIEs to pay domestic supplier with foreign exchange, FIEs

“The net profit of an equity joint venture shall be distributed among the parties to the venture in proportion to their respective contributions to the registered capital, after payment out of its gross profit of the equity joint venture income tax, pursuant to the provisions of the tax laws of the People's Republic of China, and after deductions from the gross profit of a reserve fund, a bonus and welfare fund for workers and staff members and a venture expansion fund, as stipulated in the venture's articles of association. An equity joint venture equipped with advanced 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 joint venturer that reinvests its share of the net profit within Chinese territory may apply for a partial refund of the income tax already paid.”

Art. 8, EJV Law

“An equity joint venture shall open an account with the Bank of China or a bank approved by the Bank of China. An equity joint venture shall handle its foreign exchange transactions in accordance with the regulations on foreign exchange control of the People's Republic of China. An equity joint venture may, in its business operations, directly raise funds from foreign banks. The various kinds of insurance coverage of an equity joint venture shall be furnished by Chinese insurance companies.”

Art. 9 EJV Law

“The production and business operating plans of an equity joint venture shall be submitted to the competent authorities for the record and shall be implemented through economic contracts. In its purchase of required raw and semi-processed materials, fuels, auxiliary equipment, etc., an equity joint venture should give first priority to purchases in China. It may also make such purchases directly on the world market with foreign exchange raised by itself. An equity joint venture shall be encouraged to market its products outside China. It may sell its export products on foreign markets directly or through associated agencies or China's foreign trade
must sell foreign exchange to BOC to obtain Chinese currency. Moreover, additional restrictions could be found in Article 10 and 11 specified that profit or wage earned in China by a foreign investor or an employee could only be remitted abroad through the Bank of China under a less desired official exchange rate.\textsuperscript{76}

The EJV Law also sent some uncertain signals about China’s commitment to the future of JV program when it placed a mandatory time limits on the existence of EJV. Under article 12, the equity joint venture only lasted to a period of time agreed by the investors, although investors can apply for an extension through the Foreign Investment Commission.\textsuperscript{77} There was a strong presumption that supporting a limited and restricted agencies. Its products may also be sold on the Chinese market. When necessary, an equity joint venture may set up branches and subbranches outside China.”

\textsuperscript{76}See art. 10 “The net profit which a foreign joint venture receives as its share after performing its obligations under the laws, the agreements and the contract, the funds it receives upon the expiration of the venture’s term of operation or its early termination, and its 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 contract concerning the equity joint venture. A foreign joint venture shall be encouraged to deposit in the Bank of China the foreign exchange which it is entitled to remit abroad.”

\textsuperscript{77}Art. 12 EJV Law “The contract period of an equity joint venture may be decided through consultation by the parties to the venture according to its particular line of business and circumstances. Upon its expiration, the joint venture contract period may be extended if the parties have reached an agreement and obtained the approval of the Foreign Investment Commission of the People’s Republic of China. An application for such extension shall be
foreign presence for the purpose of facilitating domestic companies obtain modern business operation skills and technology. Article 13 set forth reasons for ending an equity joint venture, which includes: several losses, fail to perform obligations under joint venture agreement, force majeure, etc.\(^\text{78}\) Article 14 concerned dispute resolution, which provided that investors can settle their disputes through mediation or arbitration in China or other agency agreed by investors.

The 1979 EJV Law was revolutionary, it directly confronted with value and faith vested within the 1978 Constitution by permitting the representatives of “bourgeois and imperialist,” which tested Chinese policy makers and reformers’ understanding of modernization and beneficiary of the socialism.\(^\text{79}\) The legislation of EJV Law was led by Peng Zhen, who started China’s legislative work after rehabilitation from the Cultural Revolution. The first wave of legislation after Cultural Revolution included Election Law, made six months before expiration of the contract.”

\(^\text{78}\) Art.13 EJV Law
“If, prior to the expiration of the contract period of an equity joint venture, there occur heavy losses, failure of a party to perform its obligations under the contract and the articles of association or force majeure, etc., the contract may be terminated before the expiration date through consultation and agreement by the parties, and subject to approval by the Foreign Investment Commission of the People’s Republic of China and to registration with the General Administration for Industry and Commerce. In cases of losses caused by a breach of contract, the financial responsibility shall be borne by the party that has breached the contract.”

Organization Law for People’s Congress and People’s Government, Organization Law for People’s Court, Organization Law for People's Procuratorate, PRC Criminal Code, PRC Criminal Procedural Law, and EJV Law. He proclaimed that “the development of socialist democracy requires future improve and complete socialist rule by law...” During the draft of the EJV Law, there was an intensive discussion on whether the law should place a restriction on the percentage of foreign investors’ share. The original draft restricted foreign investor share shall not exceed 49%, and major business decision required ⅔ of the investor approval. After consultation with experts and investors, Deng Xiaoping and Peng Zhen believed such restriction would be detrimental to the foreign investors, which might not be what policymaker wanted. Although China did not adopt any share restrictions, it negates majority shareholder principle by asserting all major corporate affairs must be determined unanimously.

Although 1979 EJV Law was considered as an “enabling legislation,” it jumped started China’s foreign investment policy. Few months after the promulgation of 1979 EJV Law, the first SFJV Beijing Air Catering was established in April 1980. On April 1990, 


82 For example, see the administrative approval from PRC Foreign Investment Administrative Committee Notice: On April 4th of 1980, Foreign Investment Administrative Committee
Seventh National People's Congress adopted a new amendment to the EJV Law.\(^{83}\) This was the only amendment to EJV Law between 1978-1991, it was later amended again in 2001 and 2016. The 1990 amendment covered about 9 articles, focused on sections with strong criticisms and complaints from the foreign investment community.\(^{84}\) For example. The EJV Law emphatically stated that the state would not nationalize FIE unless for the purpose of public interest with “proportional compensation.”\(^{85}\) As one could expect, the vague wording “proportional” could not satisfy investors’ concern. The 1990 amendment further removed one extremely unpopular rule about the board of director. Under article 6 of the amended EJV Law, the authority no longer required the chairman of the board to be a Chinese appointed by a Chinese investor. However, the rule for unanimous voting remained, which meant it continues refusing the interest of the majority. The amendment rewrote tax incentive part by removing strict conditions

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\(^{83}\) Quanguo renmin daibiao dahui guanyu xiugai zhonghua renmin gongheguo hezi jingying qiye fa de jueding(全国人民代表大会关于修改《中华人民共和国中外合资经营企业法》的决定) [Decision of the National People's Congress Regarding the Revision of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures] adopted at the Third Session of the Seventh National People's Congress of the People's Republic of China on April 4, 1990, [hereinafter 1990 amendment].


\(^{85}\) Art.2 1990 EJV Law
that preserving tax benefits only to FIEs with advanced technology. The amendment also allowed FIEs open bank account at any institution approved by SAFE. The amendment took a more flexible attitude toward the term of operation, which allowed investors to decide if they want to put a time limit on JV contract.

On July 26, 1980, State Council promulgated Measures on Administration of Sino-Foreign EJV Registration [hereinafter Registration Measure]. The Registration Measure was a piece of administrative legislation centered on the procedure and implementing rules regarding equity joint venture’s application for a business license through SAIC in pursuant to the article 3 of EJV Law. The Registration Measure clearly defined the time limit, the required files, and items for business license registration. According to article 2, the registration must occur within 1 months after FIE obtain permission from Foreign Investment Administration Committee (FIAC). Three types of files must be provided during registration in accordance with article 3:

1. Approval from FIAC,
2. EJV agreement, Contract, Article of Association (both English and Chinese with 3 copies),
3. Copies of business license or other licenses issued by a foreign government.

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86 Zhongwai Hezi Jingying Qiye Dengji Guanli Banfa (中外合资经营企业登记管理办法) [State Council, Measures on Administration of Sino-Foreign Equity Joint Venture Registration] (adopted July. 26, 1980 by State Council) [hereinafter EJV Registration Measure].
87 Art. 2 Registration Measure.
88 Art. 3 Registration Measure.
Article 4 detailed listed information must be provided for business license registration:

1. Name, location, address, scope of operation and method of operation of the EJV
2. The registered capitals and shares of each investor,
3. Board of directors, and chairman of the board, senior manager, and vice manager,
4. Number of the employee (Chinese and foreigners),
5. File number of the relevant approval documents.\(^{89}\)

As some FIEs later complaint, Chinese authority was restrictive over the items listed on the registration. For example, the registration demand investors to register their contract with SAIC. However, it was quite difficult for such investors to amend the contract without permission from SAIC later.

In addition, the authority followed a strict interpretation of the “scope of operation,” changes from one category into another proved to be difficult. Article 8 requiring investors to pay the registration fee, which was detailed by 1982 Interim Measures on EJV Registration Fee.\(^{90}\)

\(^{89}\) Art. 4 Registration Measure.

\(^{90}\) Guanyu Zhongwaihezi jingying qiye jiaona dengjifei biaozhun de guiding (关于中外合资经营企业交纳登记费标准的暂行规定) [Interim Measures on EJV Registration Fee] adopted by SAIC February 2 1982. Table 2-1. Registration fee

<table>
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<tr>
<th>Registered capital</th>
<th>Registration fee</th>
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<tr>
<td>10 million RMB and below</td>
<td>1% of registered capitals</td>
</tr>
<tr>
<td>Above 10 million RMB</td>
<td>0.5% of the registered capital</td>
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</tbody>
</table>
Four years after the promulgation of the EJV Law in 1979, in response to criticisms of vagueness and lack of guidance from the business community and western academics, the State Council promulgated the Regulations for the Implementation of the Law of the People’s Republic of China on Sino-Foreign Equity Joint Venture on September 20 of 1983. Based on the 1979 EJV Law, this was a piece of administrative legislation designed to provide comprehensive guidance on issues concerning the establishment, operation, and management of a joint venture through sixteen chapters and one hundred and eighteen articles. The title “Implementing Regulation” signified

<table>
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<tr>
<th>Chinese overseas, Hong Kong, Marco Investors</th>
<th>50% discount on registration fee</th>
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<tbody>
<tr>
<td>Registration amendment</td>
<td>Registration fee</td>
</tr>
<tr>
<td>● Relocate JV</td>
<td>100 RMB</td>
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<tr>
<td>● Change production</td>
<td></td>
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<tr>
<td>● Increase or transfer registered capital</td>
<td></td>
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<tr>
<td>● Change of Board of Director or senior manager</td>
<td></td>
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<tr>
<td>● Extension of JV contract</td>
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</tbody>
</table>

91 Regulations for the Implementation of the Law of the People’s Republic of China on Sino-Foreign Equity Joint Venture (promulgated Sept. 20, 1983 by the State Council) [hereinafter EJV Law Implementation Regulations]

92 The EJV Law in 1979 only had 15 articles. There are sixteen chapters of this legislation. To make a comparison, I list chapters in below:
Chapter 1 General Principle
Chapter 2 Establishment and Registration
the supplementary nature of the legislation, to compensate the deficiency of the EJV law. It was an important part of China’s FDI regulatory framework when there was no domestic legal infrastructure, such as Company Law, Bankruptcy Law, labor laws, Intellectual Property Laws, and other business-related legislation. Many rules under EJV Law Implementing Regulation reaffirmed rules or measures adopted by the regulatory agencies throughout the years since the initial promulgation of 1979 EJV Law. Under EJV Law Implementing Regulation, MOFERT is the designated agency in charge of the application and enforcement of the EJV registration related the laws and rule. In addition, it specifically excluded Special Economic Zone from the application of this regulation unless NPC or State Council stated otherwise.3

Structurally, the Implementing Regulation provided a better and clearer

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Chapter 3 Structure and Registered Capital
Chapter 4 Contribution
Chapter 5 Board of Director and Management
Chapter 6 Importation of Technology
Chapter 7 Land use Rights and Fees
Chapter 8 Sales and Purchases
Chapter 9 Taxation
Chapter 10 Foreign Exchange Control
Chapter 11 Finance and Accounting
Chapter 12 Employee
Chapter 13 Labor Union
Chapter 14 Period of Operation, Dissolution and Liquidation
Chapter 15 Dispute Resolution
Chapter 16 Miscellaneous
EJV Law Implementing Regulation.
93 Art. 117, EJV Law Implementing Regulation.
94 Art. 116, EJV Law Implementing Regulation.
guidance for the investors. Chapter one General Principle laid out principles for the
eligibility of a foreign investment project. For example, article 3 and 4 respectively
defined the industry sector allowed for FIE, and basic conditions must meet for such
investment. Article 5 provided conditions deny a FIE application. The problem with
this article was the ambiguity of the criteria listed in the statutory language. For

95 Art. 3, Joint ventures established within China's territory shall be able to promote the
development of Chinese economy and the raising of scientific and technological levels for the
benefit of socialist modernization. Joint ventures permitted are mainly in the following
industries:
(1) Energy development, the building material, chemical and metallurgical industries;
(2) Machine manufacturing, instrument and meter industries and offshore oil exploitation
equipment manufacturing;
(3) Electronics and computer industries, and communication equipment manufacturing;
(4) Light, textile, foodstuffs, medicine, medical apparatus and packing industries;
(5) Agriculture, animal husbandry and fish breeding;
(6) Tourism and service trades.
Art.4, “Applicants to establish joint ventures shall lay stress on economic results and shall
comply with one or several of the following requirements:
(1) They shall adopt advanced technical equipment and scientific management which enable the
increase of the variety of products, the raising of quality and output and the saving of energy
and materials;
(2) They shall provide benefits in terms of technical renovation of enterprises and result in less
investment, quicker returns and bigger profits;
(3) They shall enable the expanded production of products for export and result in increasing
income in foreign currency;
(4) They shall enable the training of technical and managerial personnel.” See, Art. 4, EJV Law
Implementing Regulation.
96 Article 5, “Applicants to establish joint ventures shall not be granted approval if the project
involves any of the following conditions:
(1) Detriment to China's sovereignty;
(2) Violation of Chinese law;
(3) Nonconformity with the requirements of the development of China's national economy;
(4) Environmental pollution;
(5) Obvious inequity in the agreements, contracts and articles of association signed, impairing
the rights and interests of one party.” See Art. 5. EJV Law Implementing Regulation.
example, the project “incompatible with China’s national economic development” or the project “violate China’s sovereignty” would not be granted permission. These three articles formed a conceptual framework indicating the conditions for accepting or denying a FIE application. These rules became the prototype of the Catalogue of Industries for Guiding Foreign Investment developed during the 1990s. Read it together, the EJV Implementing Regulation stated a clear preference for industry involving high technology, such as energy development, electronics and computer industries, and communication equipment manufacturing, medical apparatus; and industry provided fast return on investment, such as textile, food staff, and packing industries; and industry generate foreign exchange, such as tourism and service trades.

It further defined the legal nature of JV as “Fa ren” (Legal person), which protected by Chinese law under Chinese jurisdiction. “Legal person” is a legal concept originated from German Law as “juristische Person,” it refers to a non-human entity that

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97 Article 5, “Applicants to establish joint ventures shall not be granted approval if the project involves any of the following conditions:
(1) Detriment to China’s sovereignty;
(2) Violation of Chinese law;
(3) Nonconformity with the requirements of the development of China’s national economy;
(4) Environmental pollution;
(5) Obvious inequity in the agreements, contracts and articles of association signed, impairing the rights and interests of one party.” See Art. 5. EJV Law Implementing Regulation.
98 Catalogue of Industries for Guiding Foreign Investment, see next chapter.
99 Art. 3 Implementing Regulation.
100 Normally it can be an incorporated forprofit organization or not-for-profit organization. Art. 2, EJV Law Implementing Regulation, Ibid.
recognized by the legal system through legislation or registration. Moreover, in order to assure the independent operation rights of the investor, article 7 emphasized that joint venture “has the right to do business independently within the scope of the provisions of Chinese laws, decrees, and the agreement, contract and articles of association” and the relevant government agencies shall provide support and assistant.  

Chapter two concerned issues related to the administrative examination and approval for establishing a FIE project. Article 8 designated MOFERT as the agency in charge the FIE permission. Certain projects can be reviewed and approved by a lower level authority when certain criteria are met. Article 9 detailed outlined the required documents for application, which is:

1. application form,
2. project feasibility study jointly conducted by Chinese and foreign investors,
3. the signed article of association, joint venture agreement and contract,
4. candidate list for Chairman, vice-chairman, and board of directors.
5. Local government and Chinese partner’s supervising authority’s opinion and recommendations.

Under article 10, the MOFERT or other authority has three months to review and make a decision. When joint venture project obtained permission from the MOFERT, the

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101 See Art. 7. EJV Law Implementing Regulation.
102 See Art. 8, and 9(1). EJV Law Implementing Regulation.
applicant must apply for a business license with the provincial administrative bureau for industry and commerce within a month since the grant of permission. The joint venture would be officially established since the date of issuing business licenses.

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103 Article 9 The following procedures shall be followed for the establishment of a joint venture:

1. The Chinese participant in a joint venture shall submit to its department in charge a project proposal and a preliminary feasibility study report of the joint venture to be established with foreign participants. The proposal and the preliminary feasibility study report, upon examination and consent by the department in charge, shall be submitted to the examination and approval authority for final approval. The parties to the venture shall then conduct work relevant to the feasibility study, and based on this, negotiate and sign joint venture agreements, contracts and articles of association.

2. When applying for the establishment of a joint venture, the Chinese participant is responsible for the submission of the following documents to the examination and approval authority:
   
   (a) Application for the establishment of a joint venture;
   (b) The feasibility study report jointly prepared by the parties to the venture;
   (c) Joint venture agreement, contract and articles of association signed by representatives authorized by the parties to the venture;
   (d) List of candidates for chairman, vice-chairman and directors appointed by the parties to the venture;
   (e) Written opinions of the department in charge and the people's government of the province, autonomous region or municipality directly under the central government where the joint venture is located with regard to the establishment of the joint venture.

The aforesaid documents shall be written in Chinese. Documents (b), (c) and (d) may be written simultaneously in a foreign language agreed upon by the parties to the joint venture. Both versions are equally authentic.

Article 10 Upon receipt of the documents stipulated in Article 9 (2), the examination and approval authority shall, within three months, decide whether to approve or disapprove them. Should anything inappropriate be found in any of the aforementioned documents, the examination and approval authority shall demand an amendment to it within a limited time. Without such amendment no approval shall be granted.

Article 11 The applicant shall, within one month after receipt of the certificate of approval, register with the administrative bureau for industry and commerce of the province, autonomous region or municipality directly under the central government in accordance with the provisions of the Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures (hereinafter referred to as registration and administration office). The date on which it is issued its business license is regarded as the date of formal establishment of a joint venture.
Joint venture will continue operating until the expiration of the term listed on the JV contract. Joint ventures are normally granted for 10-30 years. Certain project can last more than 30 years with permission from state council. Liquidation and dissolution started after the expiration of the term.  

Article 13, 14 defined two legal concepts: Joint Venture Agreements [合营企业协议 Heying Qiye Xieyi] and Joint Venture Contracts [合营企业合同 Heying Qiye Hetong]. In pursuant to the definition provided by article 13, the “Agreement” would be something similar to the “letter of intent.” The distinction seems irrelevant to the enforceability of the agreement. The need for such distinction may relate to the content of the agreement. Sometimes, a foreign investor found it was quite difficult to amend a signed or approved contract even private contract provide conditions for renegotiation. Thus, the Implementing Regulation allowed investors to sign “agreement” with less

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104 Article 102. EJV Law Implementing Regulation.

105 Article 13 The "joint venture agreement" mentioned in this chapter refers to a document agreed upon by the parties to the joint venture on some main points and principles governing the establishment of a joint venture.

"Joint venture contract" refers to a document agreed upon and concluded by the parties to the joint venture on their rights and obligations.

"Article of association" refers to a document agreed upon by the parties to the joint venture indicating the purpose, organizational principles and method of management of a joint venture in compliance with the principles of the joint venture contract.

If the joint venture agreement conflicts with the contract, the contract shall prevail.

If the parties to the joint venture agree to sign only a contract and articles of association, the agreement can be omitted.
detailed terms. Article 14 stipulated items must be included in the contract.\footnote{106}

Article 15 might be the most controversial one, which excluded the choice of law for Joint Venture Contract. It stated that “The formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by the Chinese law.\footnote{107}” This restriction contradicted to common practice among many market economies. It was unfair to foreign investors when China’s legal infrastructure was limited. Article 16 outlined the items must be included in the article

\footnote{106 Article 14 The joint venture contract shall include the following main items:
(1) The names, the countries of registration, the legal address of parties to the joint venture, and the names, professions and nationalities of the legal representatives thereof;
(2) Name of the joint venture, its legal address, purpose and the scope and scale of business;
(3) Total amount of investment and registered capital of the joint venture, investment contributed by the parties to the joint venture, each party’s investment proportion, forms of investment, the time limit for contributing investment, stipulations concerning incomplete contributions, and assignment of investment;
(4) The ratio of profit distribution and losses to be borne by each party;
(5) The composition of the board of directors, the distribution of the number of directors, and the responsibilities, powers and means of employment of the general manager, deputy general manager and high-ranking management personnel;
(6) The main production equipment and technology to be adopted and their source of supply;
(7) The ways and means of purchasing raw materials and selling finished products, and the ratio of products sold within Chinese territory and outside China;
(8) Arrangements for income and expenditure of foreign currency;
(9) Principles governing the handling of finance, accounting and auditing;
(10) Stipulations concerning labor management, wages, welfare, and labor insurance;
(11) The duration of the joint venture, its dissolution and the procedure for liquidation;
(12) The liabilities for breach of contract;
(13) Ways and Procedures for settling disputes between the parties to the joint venture;
(14) The language used for the contract and the conditions for putting the contract into force.
The annex to the contract of a joint venture shall be equally authentic with the contract itself.}

\footnote{107 Article 15. EJV Law Implementing Regulation.}
of association, which provided a clear guidance for establishing joint ventures. Article 17 stipulated that joint venture agreement, contract, and article of association only come to effect after obtaining approval from the regulatory authority.

Chapter three and chapter four governed the business structure of the joint venture and contributions. Under article 19, joint ventures could be formed as limited liability company. Shareholders of the company bore the risk in proportionate to their contribution, or as the Implementing Regulation referred to as “liable to the joint venture within the limits of the capital subscribed.” Although Article 19 adopted the common practice of limited liability, this might not be a true limited liability as many

108 Article 16 Articles of association shall include the following main items:
   (1) The name of the joint venture and its legal address;
   (2) The purpose, business scope and duration of the joint venture;
   (3) The names, countries of registration and legal addresses of parties to the joint venture, and the names, professions and nationalities of the legal representatives thereof;
   (4) The total amount of investment, registered capital of the joint venture, each party's investment proportion, stipulations concerning the assignment of investment, the ratio of profit distribution and losses to be borne by parties to the joint venture;
   (5) The composition of the board of directors, its responsibilities, powers and rules of procedure, the term of office of the directors, and the responsibilities of its chairman and vice-chairman;
   (6) The setting up of management organizations, rules for handling routine affairs, the responsibilities of the general manager, deputy general manager and other high-ranking management personnel, and the method of their appointment and dismissal;
   (7) Principles governing finance, accounting and auditing;
   (8) Dissolution and liquidation;
   (9) Procedures for amendment of the articles of association.

109 Art. 17, EJV Law Implementing Regulation.

110 Article 19: A joint venture is a limited liability company. Each party to the joint venture is liable to the joint venture within the limits of the capital subscribed by it.
investors soon discovered that majority contribution would not automatically translate into controlling right in business management. Article 36 of chapter 5 specifically listed four categories in business management that must be decided through a unanimous decision by board members. These four areas are:

(1) Amendment of the articles of association of the joint venture;
(2) Termination and dissolution of the joint venture;
(3) Increase or assignment of the registered capital of the joint venture;
(4) The merger of the joint venture with other economic organizations.\footnote{Art. 36, EJV Law Implementing Regulation.}

The article 106 also allowed investors to distribute remaining assets of the joint venture in proportion to their investment or any other ways agreed under joint venture agreement, contract or article of association in case of liquidation.\footnote{Art. 106, EJV Law Implementing Regulation.} Other restrictions included the joint venture could not reduce the registered capital during the term of the joint venture. In addition, one could not transfer his or her shares or increase the registered capital without approval from regulatory agency first.\footnote{See Article 23, Article 24. EJV Implementing Regulation.} Although EJV Law Implementing Regulation allowed non-cash contribution, it placed strict requirements. These restrictions caused many complaints.\footnote{Zhang Lixing, “The statutory Framework for Direct Investment in China,” \textit{FLA. IT’L.J.} 4(1989):289-290.} For example, article 27 stipulated that contribution in the form of machinery equipment and other materials must meet three conditions:

\begin{itemize}
\item \footnote{See Article 23, Article 24. EJV Implementing Regulation.}
\end{itemize}
(1) They are indispensable to the production of the joint venture;

(2) China is unable to manufacture them or manufactures them only at too high a price, or their technical performance and time of availability cannot meet the demand;

(3) The price fixed shall not be higher than the current international market price for similar equipment or materials.\textsuperscript{115}

In effect, this was an extremely narrowed definition for a qualified non-cash contribution.

Chapter five of the law concerned issues related to the board of director. As the above analysis pointed out, the limited liability principle was not truly reflected in the Implementing Rules because majority share will not translate into control of the joint venture. Article 32 even stipulated that the chairman of the board of director would be held by a person appointed by a Chinese investor. Under article 37, the chairman would be the legal representative of the joint venture. A limited liability company is an entity created by law (as a natural person is created naturally), legal representative. The legal representative of the legal person represented the affairs of such entity. His or her signature would have legal effect on any contract or agreement that involve a legal person.

Chapter six of the Implementing Regulation produced many unpopular...

\textsuperscript{115} Art. 27, EJV Law Implementing Regulation.
protective measures restricted the rights of intellectual property holder in the business of joint venture. First, the Implementing Regulation asserted that technology must be “appropriate, advanced with the great and obvious return on investment and competitiveness in the global market.” Second, the technology transfer agreement must be reviewed and approved by Chinese authority prior to effective date. The Foreign investor must provide information about such technology as a reference. These requirements remained as a fixture of China’s FIE regulatory framework and thus subject to strong criticisms by the foreigners. Third, the law outlined other restrictions as review conditions for the agreement. For example, Article 46 laid out a laundry list of rules restraining the rights of the intellectual property holders. For example, the intellectual property right holder “shall not put any restrictions on the quantity, price, or region of the sale of the products that are to be exported.” The term of technology transfer could not exceed ten years, but the licensee could still have the right keep using the technology. In addition, no restriction was allowed on the part of the licensee for purchasing any parts or raw material needed in the process of utilizing such technology. Moreover, there was one catch-all clause that prohibits any restrictive terms deemed unreasonable by Chinese laws and decrees. This was problematic because the statute did not provide any guidance on what consider as “unreasonable.”

116 Art. 44. EJV Implementing Regulation.
117 Art. 45. EJV Implementing Regulation.
118 Art. 46 (2) EJV Implementing Regulation.
119 Art. 46(3),(4) EJV Implementing Regulation.
120 Art. 46 (6) EJV Implementing Regulation.
Chapter 7 and 8 respectively focused on site using rights and purchase and sale of the FIE. Regulation regarding the purchase and sale was the most representative feature of China’s command economy. Under a command economy, everything was allocated in accordance with the central plan, which was why there was no modern price market. Since the introduction of FIE, the legislator must provide means and mechanism to accommodate this new reality. Under the EJV framework, FIE was required to produce an annual plan for operation, production or construction. The FIE would send their plan to the “department in charge,” an administrative agency in charge of JV’s Chinese partner.\(^\text{121}\) This department would coordinate with other government agencies in charge of the resources, to ensure supply of these resources. Even China’s command economy system provided undesired domestic material supply. The EJV Implementing Regulation specifically asked FIE to purchase supplies from domestic vendors “given the same conditions.”\(^\text{122}\) In addition, contrary to many investors’ expectation of taking advantage of China’s large consumer market, the EJV Regulation restricted FIE’s capacity of selling to domestic consumers. Only products “urgently needed by Chinese market” was allowed to be sold in China under article 61.\(^\text{123}\) Even when one can qualify to sell the product in China, the seller must go through a special government department. Because the lack of free market, the government would purchase the goods then redistribute to another buyer in accordance with the central plan.

\(^{121}\) Art. 54, 55, 56 EJV Implementing Regulation.

\(^{122}\) Art. 57 EJV Implementing Regulation.

\(^{123}\) Art. 61 EJV Implementing Regulation.
Although the 1983 EJV Implementing Regulation provided more detailed rules related to FIE affairs, the law itself revealed its central planning economy nature through multiple restrictions. For example, (1) a FIE investment project would not be granted if the consumption of the resource by FIE would affect the enforcement of the central or regional plan. (2) Share transfer by a foreign investor was not allowed unless reviewed by the relevant authority. (3) Although the board of director was the highest authority of the company, the chairman must be served by a Chinese appointed by the Chinese investor. (4) In addition, the board voting followed the rule of unanimous, which excluded majority voting right rule. (5) The intellectual property right holder could not sign contract exceed certain years, and the law can strike down any restrictive terms it deemed as “unreasonable.”

The implementing Regulation had been amended twice during the 1980s. the 1986 amendment extended maximum operation time for JV. It allowed state council to grant 50 years of JV contract for any project with huge investment or involved advanced technology. The 1987 amendment concerns specific accounting rules, which is not the focus of this study. The EJV Law and Implementing Regulation established two important legal concepts for China when there was no developed commercial legal system. The first important legal concept was “legal person.”\textsuperscript{124} Under the central

\textsuperscript{124} 1986 Article 41 of General Principle of Civil Law adopt the concept of legal person, it provided that:“Sino-foreign equity joint venture enterprises, Sino-foreign contractual joint venture enterprises and wholly foreign owned enterprises established in the territory of the PRC that
planning, firms were viewed as the apparatus of the administration. Thus, they were not endowed with a separate legal identity. The second important legal principle is the “alienability of ownership and the associated benefit right from owning the assets.”

The transferable interest and the adoption of the board of director in corporate governance were revolutionary considering China’s socialist system. The shareholders’ benefit and alienation rights for the SOE sector were not recognized until the early 1990s. The promulgation of Company Law in 1994 formalized and enshrined the limited liability reform experiments into the national legislation. The legislative recognition of the decision right came much earlier to FIEs than to SOEs. Probably the most important control right was the right to appoint managers when FIEs could not hire employee independently at the beginning of the 1980s. However, The recognition of legal independence may not automatically translate into a political autonomous. The legal independence only referred to civil or criminal liability. Politically, the business entity is considered as an extension of the political program of socialism.

On October 11, 1986, State Council adopted Provisions for Encouragement of

meet the requirements for legal persons acquire the status of Chinese legal persons upon approval and registration in accordance with law by the administrative agencies for industry and commerce.”

126 Ibid.
Foreign Investment (hereinafter Encouragement Provision), also known as Article 22.\textsuperscript{128} The main purpose of this administrative legislation was to resolve two issues. First, it provided legislative solutions for many problems and criticisms asked by foreign investment communities and western academics.\textsuperscript{129} Second, it provided new tax incentives to counter the sharp drop in FIEs investment during the preceding years since the beginning of the 1980s.\textsuperscript{130} The main subject of the Encouragement Provision, as it stated clearly at the very beginning, was to promote two types of FIEs, “Products Export Enterprises” and “Technologically Advanced Enterprises,” with various specific policies and incentives related to site using fee, financing, profit remittance, tax, staff and labor management, government service and support, and etc.\textsuperscript{131} These policies and incentives can be deconstructed into following categories:

1. Tax related incentives
2. Government service
3. Foreign exchange


\textsuperscript{131} Art.2, Encouragement Provision.
4. Labor management

There were two main functions of these new policies and incentives. Tax incentive designed to attract more investors with economic benefits. Government service and supports designed to improve investment environment with clear and standardized regulations and rules. In order to attract foreign investment, the Encouragement Provision outlined additional tax incentives in the form of tax deduction and tax holiday extension. Article 7, 8, 9, 10, and 11 concerned tax incentives. Under the new provision, Product-for-export FIEs and technologically advanced FIEs enjoy zero tax when they remit abroad the profit. Product-for-export FIEs enjoy additional 50% off tax reduction if FIE export 70% or more of the output value. If such FIEs located in SEZ, it will enjoy 10% income tax rate. Technologically advanced FIEs will enjoy an extended tax holiday of three more years. In pursuant to the article 10, the provision provides tax return for a portion of profit used for reinvestment by qualified FIEs.

The Encouragement Provision clarified and standardized three types of

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132 art. 7 Encouragement Provision.
133 art. 8 Encouragement Provision.
134 art. 9 Encouragement Provision.
135 “Foreign investors who reinvest their shares of profits from their enterprises in order to establish or expand product-for-export enterprises or technologically advanced enterprises for a period of operation of not less than five years, after application to and approval by the tax authorities, shall be refunded the total amount of enterprise income tax already paid on the reinvested portion. If the investment is withdrawn before the period of operation reaches five years, the amount of enterprise income tax refunded shall be repaid.” See Art. 10, Encouragement Provision.
administrative practice. Firstly, it lifted mandatory export agent service requirement. Secondly, it standardized the site using fee. Thirdly, it placed a maximum time limit on administrative reviewing process. In addition, it emphasized the principle of respecting FIEs’ labor management without undue interference by local labor authority. Article 12 and 13 concerned the export and import license. Under this provision, FIEs can apply the export license to export product without using the service of an agent. In addition, FIEs can apply for such license every 6 months. Any semi-products, raw materials utilized for the manufacturing of the products can be exempt from the requirement of the importation license unless they are later resold to domestic customers. In response to complaints from investors that local authority or Chinese partners abuse site using fee to obtain rents from foreign investors, article 4 specifically defined the standard of the site using fee, as it provided that:

1. five to twenty RMB yuan per square meter per year in areas where the development fee and the site use fee are computed and charged together;
2. not more than three RMB yuan per square meter per year in site areas where the development fee is computed and charged on a one-time basis or areas

136 art. 12 Encouragement Provision. “Enterprises with foreign investment may arrange the export of their products directly or may also export by consignment to agents in accordance with state provisions. For products that require an export license, in accordance with an annual export plan of the enterprises, an application for export licenses shall be made every six months.”
137 art. 12 Encouragement Provision.
138 Ibid.
139 art. 13 Encouragement Provision.
which are developed by the above-mentioned enterprises themselves.\footnote{art. 4 Encouragement Provision.} It further allowed local government to exempt site using fee on a case by case basis.\footnote{“Exemptions for specified periods of time from the fees provided in the foregoing provision may be granted at the discretion of the local people's governments.” see art. 4 Encouragement Provision, accessed July 26, 2017, \url{http://english.mofcom.gov.cn/aarticle/lawsdata/chineselaw/200211/20021100053822.html}.}

Under the EJV Law and supplementing regulations, FIE could not independently hire an employee. All hire decision must be made by a local labor authority. The labor authority would send labors for the job, and the employer could not fire or discipline the employee without approval from the authority. Foreign investors were frustrated by these regulations when the local authority could not provide qualified labors. Article 15 specifically asked the local authority to respect FIEs staff management and wage system. It stipulated that FIEs have rights to freely hire or fire any staff without prior approval by the labor authority.\footnote{See art. 15 Encouragement Provision.} One of the highlights under Encouragement Provision was to place a maximin 3 months time limit for all FIEs related administrative approving process. As the article 17 stated:

Article 17 The people's governments at various levels and relevant departments in charge shall strengthen the coordination of their work, improve efficiency in handling matters and shall promptly examine and approve matters reported by enterprises with foreign investment that require a response and resolution. For the agreements, contracts and articles of association of enterprises with foreign
investment to be examined and approved by the departments in charge under the State Council, the relevant examination and approval authorities must, within three months from the date of receipt of all documents, decide whether to approve or not to approve the documents.

Although the Encouragement Provision provided multiple benefits to FIEs, there were many issues that might deter the function of those benefits. The main issues were ambiguity and the lack of an effective and meaningful mechanism to prevent local government authority from interfering with the rights of the foreign investors. Two most representative examples, one concerning the scope of FIEs receive benefits, another concerning type of remedies to the injury from arbitrary administrative charges and fees. Article 2, article 18, and 19 defined the scope of the benefited FIEs, which were:

Article 2:(1) Production-type enterprises whose products are mainly export, which have a foreign exchange surplus after deducting from their total annual foreign exchange revenues the annual foreign expenditures incurred in production and operation and the foreign exchange needed for the remittance abroad of the profits earned by foreign investors (hereinafter referred to as "Products Export Enterprises")

(2) Production-type enterprises possessing advanced technology supplied by foreign investors which are engaged in developing new products, and upgrading
and replacing products in order to increase foreign exchange generated by exports or for import substitution (hereinafter referred to as "Technologically Advanced Enterprises").

Production Enterprises (生产型企业) normally refers to business entity involves export-oriented manufacturing or processing and assembling sectors, which would exclude service sector. Article 2 basically established two types of FIEs with preferred treatments. One is Products Export Enterprises with products mainly for exportation, and another is technologically advanced enterprises. Unfortunately, definition under article 2 was ambiguous and confusing. For example, there is no clear statutory language to describe what constitutes as “product mainly for export.” One may conclude 90% product could qualify as “mainly.” What about 60% or 65%? Also, the statutory language “mainly” failed to specify whether it referred to the value of the products or the quantity of the products. In addition, under the article 2 (2) “technologically advanced enterprises” was defined as an entity with three qualifying conditions: first, FIEs needed to be an entity engage in developing new products, second, such products had to be a kind that could upgrade and replace any product, which could increase foreign exchange through exportation or to save foreign exchange through import substitution. This definition was ambiguous and confusing because it failed to clarify whether the products needed to be “new” for the domestic market or

143 Art.2 Encouragement Provision.
international market. A Certain type of products or technology can be quite common in a market economy but fairly new in China, would such products fall into the definition of the article 2 (2)? In order to further clarify which FIE met these conditions, article 18 delegated the power of evaluation to the local MOFERT authority. As it stated:

Product-for-export enterprises and technologically advanced enterprises mentioned in these Provisions shall be confirmed by the foreign economic relations and trade departments where such enterprises are located in conjunction with the other relevant departments in accordance with the enterprise contract, and certificates of confirmation shall be accordingly issued. If the actual results of the annual exports of a product-for-export enterprise are unable to reach the target of a surplus in the foreign exchange balance as set in the enterprise contract, the taxes and fees which have already been reduced or exempted in the previous year shall be paid in the following year.  

Clearly, this arrangement provided great discretionary power to the local authority, which may increase the risk of rent-seeking. Article 19 further provided that Products Export Enterprises must pay all deducted taxes in the following year if FIE failed to meet target foreign exchange surplus. This additional restriction created

144 Art.18 Encouragement Provision.

145 “These Provisions shall be applicable to those enterprises with foreign investment that obtained approval for establishment prior to the date of these Provisions became effective and that conform to the preferential terms of these Provisions.” see art. 19 Encouragement
great uncertainties for foreign investors because the global market could not ensure a stable product price and provide stable foreign exchange surplus.

Arbitrary administrative charges and fees had been a systematic issue plagued the development of Chinese foreign investment and domestic economy.\textsuperscript{146} During the 1980s, due to the lack of fiscal supporters from the central government, effective intergovernmental regulations and judicial oversight and an adequate tax revenue system, a local government would finance its operation through various arbitrary, illegal charges and fees from the FIEs and domestic firms. Although central authority had repetitively issued multiple directives requiring local officials stop such behavior, those directives did not propose any sanctions or punishments. Thus, the Encouragement Provisions provided two statutory solutions.

Concerning Firmly Curbing the Indiscriminate Levy of Charges on Enterprises.” 147 It was questionable that these measures could resolve the problem of arbitrary charges. If the central authority wished to end local authority’s illegal administrative charges, she could simply announce nationwide sanctions with clear rules. However, the central authority delegated sanction power to lower provincial governments with self-discipline. In addition, although FIEs would have a statutory right for refusing payment demands from the local authority, there was no legal infrastructure to support FIEs claim. The foreign investors bore great risk for not paying demands from a local authority.

The only recourse seems to be filing a complaint at local MOFERT authority. 148 However, there is another problem for FIEs, what consider as “unreasonable fee”? Since the Encouragement Provision designed local MOFERT to process complaints concerning “unreasonable fee,” such authority would obtain interpretive power through this article. Unfortunately, local MOFERT authority’s interpretive power may not be helpful to the foreign investor in theory and in practice. For example, a local MOFERT is part of the

148 “Article 16, Encouragement Provision “All regions and departments must implement the Circular of the State Council Concerning Firmly Curbing the Indiscriminate Levy of Charges on Enterprises. The people's governments at the provincial level shall formulate specific measures and strengthen supervision and administration in this regard. Enterprises with foreign investment may refuse to pay indiscriminately apportioned charges if such cases occur, and may also appeal to the local economic committees up to the State Economic Commission.”
local people’s government. When a local People’s Congress adopted an ordinance requiring all FIEs within its jurisdiction to pay construction fee for a local theater, which may be unreasonable, the local MOFERT would not have the constitutional power to struck down such ordinance, even on a case by case basis. Thus, the mechanism provided by this Provision cannot resolve illegal administrative charge issues.

The Encouragement Provision, also known as Article 22, outlined a set of policies and incentives designed to resolve some of the issues related to the FIEs operation and application. One of the greatest policies would be the maximum 3 months’ time limit on MOFERT’s reviewing process. Additional tax incentives were provided to attract export-oriented enterprises and technologically advanced enterprises. The problems with the Provision, as above discussion and analysis indicated, mainly concentrated on the ambiguity of the statutory language and the lack of a mechanism to interpret, enforce and remedy injured party.

The EJV Law and its implementing regulations; the registration regulations, and the Encouragement Provision were the basis of China’s EJV legal framework. in addition, the implementing regulations for EJV law formed the basis for other foreign investment regulations, such as WFOE and CJV laws. The EJV Law and its implementing regulations demonstrated many features of China’s central commanding economy. First, the central authority refused to give foreign investors controlling rights. China’s EJV structure negated “majority shareholder rules.” Under the principle, “equal share, equal rights,”
major corporate affairs must be determined unanimously. Second, the central authority transplanted central command system into FIE corporate governance. Any amendment of JV contract or change of registered capitals required permission from the government authorities. In addition, foreign investors were not allowed to freely negotiate “choice of law” clause under the contract because all JV contract must be interpreted by Chinese law. However, China did not have a functioning commercial legal system and private legal service market. The EJV Law specifically instruct investors to take arbitration when a dispute arose.

b. WFOE Law framework

On April 12, 1986, 6th Meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China adopted the Wholly Foreign-Owned Enterprise Law of the People's Republic of China (WFOE Law).\(^{149}\) This was the first legislation concerning WFOE, and it was not amended until 2000. The last amendment was 2016.

Like the EJV law, the 1986 WFOE Law was a short legislation with only 24 articles. Article 2 defined WFOE as enterprises established exclusively by foreign investors’ own

capital.\textsuperscript{150} It excluded branches of a FIE.\textsuperscript{151} Article 3 laid out basic principle for a WFOE, which required the FIE must be the kind “benefit Chinese economy with advanced technology and machinery or a majority of the products for exportation.”\textsuperscript{152} It designated State Council to implement detailed rules for conditions disqualify a WFOE project. The establishment of WFOE shared the similar registration process with EJV except for verification period. Applicant must first obtain permission from MOFERT before applying for business registration.\textsuperscript{153} The verification and reviewing period was 90 days, which was longer than EJV.\textsuperscript{154} In addition, WFOE shared same punishment (revocation of the license) if the investor failed to invest within a certain period of time.\textsuperscript{155} Like EJV Law, WFOE Law also installed statutory language stating a preference of domestic vendor as the supplier for the FIE.\textsuperscript{156} Under article 18, FIE must maintain payment of balance.\textsuperscript{157}

\textsuperscript{150} Art. 2, WFOE Law, “As mentioned in this Law, ‘enterprises with foreign capital’ refers to those enterprises established in China by foreign investors, exclusively with their own capital, in accordance with relevant Chinese laws. The term does not include branches set up in China by foreign enterprises and other foreign economic organizations.”

\textsuperscript{151} Ibid.

\textsuperscript{152} Art. 3, WFOE Law.

\textsuperscript{153} Art. 6, WFOE Law.

\textsuperscript{154} Art. 6, WFOE Law.

\textsuperscript{155} Art. 9, WFOE Law. “An enterprise with foreign capital shall make investments in China within the period approved by the authorities in charge of examination and approval. If it fails to do so, the industry and commerce administration authorities may cancel its business licence. The industry and commerce administration authorities shall inspect and supervise the investment situation of an enterprise with foreign capital.”

\textsuperscript{156} Art. 15, WFOE Law.

\textsuperscript{157} Art. 18, WFOE Law.
The EJV Law and Implementing Regulation formed the basis for EJV framework.

On December 12, 1990, State Council adopted Implementing Regulation on Wholly Foreign-Owned Enterprises [hereinafter WFOE Implementing Rules], which formed the basis of WFOE regulatory framework.\textsuperscript{158} The WFOE Implementing Rule formed a similar structure as the EJV Implementing Rule. The first chapter General Principle defined the conditions for establishing WFOE, and conditions disqualifying the WFOE project. Under the Implementing Rule, there were three categories: conditions, restrictive sector, prohibited sector. Under article 4, the prohibited sectors included:

1. the press, publication, broadcasting, television, and movies;
2. domestic commerce, foreign trade, and insurance;
3. post and telecommunications; and
4. other trades in which the establishment of foreign-capital enterprises is forbidden by the Chinese government.\textsuperscript{159}

The restrictive sectors included:

1. public utilities;
2. communication and transportation;
3. real estate;


\textsuperscript{159} Art.4 Implementing Rules of the Law of the People's Republic of China on Foreign-Capital Enterprises
4. trust investment; and
5. leasing.\textsuperscript{160}

These projects must be verified and approved by MOFERT. Article 3 also laid out general conditions for a WFOE project, which must be advanced technology or export-oriented. Unlike the EJV Law had ambiguous statutory language requiring the “majority of the products” for export. Article 3 clearly stated that WFOE project must meet the general condition of more than 50% value of the whole production would be exportation.\textsuperscript{161} The WFOE Implementing Rule laid out clear registration process: applicant would directly apply for permission from provincial authority when the total investment below a threshold setup by the State Council. The local authority would file a record of the permission to MOFERT within 15 days.\textsuperscript{162} In order to ensure the supply of water, electricity or another social service, the WFOE demand investor to file a project plan to the local authority. The authority must provide a reply within 30 days to the investor.\textsuperscript{163}

\textsuperscript{160} Ibid.
\textsuperscript{161} Art. 3, WFOE Implementing Rule. “the annual output value of its exported products accounts for more than 50% of the annual output value of all products, thereby resulting in a balance between revenue and expenditure in foreign exchange or a surplus.”
\textsuperscript{162} Art. 8 WFOE Implementing Rule.
\textsuperscript{163} Art. 10 WFOE Implementing Rule.

“A foreign investor shall, prior to the filing of an application for the establishment of a foreign-capital enterprise, submit a report to the local people's government at or above the county level at the place where the proposed enterprise is to be established. The report shall include: the aim of the establishment of the proposed enterprise; the scope and scale of business operation; the products to be produced; the technology and equipment to be adopted and used; the proportion of the sales of products between the domestic market and the foreign market; the area of land to be used and the related requirements: the condition and quantities of water, electricity, coal, coal gas and other forms of energy resources required; and the public facilities”
WFOE can be organized either as an LLC or other forms under the Implementing Rule, although it failed to clarify what were the other forms. 164 Unlike the legislation in the 1990s, in 1986, the rule still prohibited FIE to reduce registered capital.165 The Rule laid out similar regulations regarding contribution in the form of machinery and intellectual property. For example, article 28 demonstrated that authority dislikes that intellectual property is valued more than 20% of the registered capital. In addition, detailed information regarding the intellectual property must be provided to the authority for verification.

The Implementing Rule also installed sanctions on the promptness of the contribution. For example, payment of contribution by the foreign investor can be made in several different times. However, the last payment must be made within 3 years of obtaining business licenses. Otherwise, the license would be revoked.166

c. CJV Law framework

In order to promote and encourage overseas Chinese investors, especially investors from Hong Kong and Macau, the State Council adopted Provisions of the State Council Concerning the Encouragement of Investments by Overseas Chinese and Compatriots From Hong Kong and Macao [hereinafter Encouragement for overseas

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164 Art. 19 WFOE Implementing Rule.
165 Art. 22 WFOE Implementing Rule.
166 Art. 30, WFOE Implementing Rule.
Chinese investor]. This legislation was designed to provide special treatment for investors from Hong Kong, Macau, or Chinese overseas. However, this decree had been overlooked by many studies. Special treatments under this Provision presented a shocking contrast with the other FIE related regulations. For example, the EJV framework placed strong restrictions over the appointment of a board of directors. Such restrictions were later partially lifted. The Chinese overseas investor provision directly provided that the investors can freely negotiate the representation of board members based on their contribution or other agreed conditions. In addition, it specified that overseas Chinese investors could hire their friends or relatives in China as their agents to process the FIE issue. Interestingly, the Chinese overseas investor Provision established one unified verification process time limit. Normally, the EJV project has to be verified within 30 days, and WFOE project has to be verified within 90 days, and CJV project has to be verified within 45 days. Under this provision, disregard form of the investment project, it will all be verified within 45 days.

d. Foreign exchange control framework

Foreign exchange control was an important aspect that could substantially affect the rights and interests of the foreign investor. However, China’s foreign exchange

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167 Guanyu guli huaqiao hexianggang aomen tongbao touzi deguiding (关于鼓励华侨和香港澳
门同胞投资的规定) [Provisions of the State Council Concerning the Encouragement of
Investments by Overseas Chinese and Compatriots From Hong Kong and Macao] adopted by
168 Art. 14, Encouragement for overseas Chinese investor.
169 Art. 18, Encouragement for overseas Chinese investor.
system or control was tied up with China’s currency policy. Between 1973 and 1979, China adopted a material based currency in order to maintain a stable currency value for international trade when the western market economy is suffering from the disruptions after the fall of Bretton Woods system. RMB currency remained as non-convertible due to such arrangement, during the 1980s, the state implements a dual exchange rate system. Trade sector following 1:2.8 rate while non-trade sector following 1:1.5 rate. At the very beginning of the Reform and Open Up, the central authority builds a comprehensive foreign exchange control framework. There were two main mechanisms of the control: first is foreign exchange coupon. The coupon system was established to accommodate the need for the transaction without affect China’s non-convertible RMB system. What the enforcement of the foreign exchange control requires is not always smooth, especially many FIE facing foreign exchange shortage under China’s strict rules. \(^{170}\)

\(^{170}\) For example, the chart illustrate foreign exchange framework:

PR on Foreign Exchange Control Of the P.R.C
- Detailed Regulations for the Implementation of Exchange Control with Respect to Foreign Representative Offices and Their Employees
- Rules Governing the Carrying of Foreign Exchange, Precious Metals and Payment Instruments in Convertible Currency into or out of China
- Detailed Rules and Regulations on Exchange Control Relating to Individuals,
  - Rules for the Implementation of the Examination and Approval of Applications by Individuals for Foreign Exchange
- Implementing Rules on Punishment of Violation of Foreign Exchange Control
Right after the promulgation of the 1979 EJV Law, the central authority adopted a comprehensive foreign exchange regulation. China’s RMB was non-convertible. In order to accommodate the need for the tourism industry and foreign investment without producing significant impacts on RMB exchange rate, the BOC adopted foreign exchange coupon system on March 19, 1980.\textsuperscript{171} Essentially, foreign exchange coupon was a special intermediary currency designed to accommodate the need for a foreigner without making RMB available for foreigners.\textsuperscript{172} The foreign exchange coupon could be used in certain domestic vendors, which only accepted foreign exchange coupons. The value of the coupon was the same as RMB, and it could be transferred to other countries. The foreign exchange coupon system lasted throughout the 1980s until the foreign exchange rate reform in 1994. As the state enforced two-track foreign exchange rate (one for international trade, and one for domestic buyers), there were various illegal transactions took advantage of the different rates. Many foreign invested companies involved such profit-seeking behavior. For example, a shop only opened to foreigners should accept foreign exchange coupon. However, the shop might list discounted price when the buyer paid with foreign exchange, which encouraged the circulation of the foreign exchange.

\textsuperscript{171} Zhongguo yinhang waihui duihuan zanxing guanli banfa (中国银行外汇兑换券暂行管理办法) [BOC Interim Regulation on Administration of Foreign Exchange Coupon] [hereinafter BOC Foreign Exchange Coupon] adopted by BOC on March 19, 1980.

\textsuperscript{172} Art.3 BOC Foreign Exchange Coupon.
On December 18, 1980, the State Council adopted People’s Republic of China Interim Regulations on Foreign Exchange Control [hereinafter 1980 Interim Regulation]. This was the first administrative legislation concerning the foreign exchange since the Reform and Open Up and it never been updated until later in 1996, it was then amended in 1997 and 2008. Between 1978-1992, China’s foreign exchange regulation framework was compiled by sets of supplementary rules and guidelines created by SAFE and State Council. Other important agencies were involved in creating related rules: BOC was responsible for rules related to foreign exchange loans and transactions, SAFE enforced and interpreted the Interim Regulations. Different individual and different purpose would result in different regulations. The foreign exchange regulations were complicated and detailed. Under China’s foreign exchange framework, Chinese individual subjected to strictest rules. Officials had slightly more relaxed rules. Foreign investors or individuals enjoyed special treatments than Chinese business entities. Short-term visitors and government staffs enjoyed more relaxed rules than business personals.

The main purpose of the Interim Regulation, as the article one under General Principle, asserted: “increasing China’s foreign exchange reserve and improving

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prudence foreign exchange expenditure.”174 Article 1 paragraph 2 outlined the scope of the application, which included “inflow and outflow of all foreign exchange revenue and spending, all kinds of payment instruments in foreign currency, and the carrying of foreign exchange, precious metals and payment instruments in foreign currency.”175

Foreign exchange under Interim Regulation referred to:176

1. foreign currencies, including banknotes, coins,
2. securities in foreign currency, including government bonds, treasury bills, corporate bonds and debentures, stocks, and interest coupons,
3. instruments payable in foreign currency, including bills, drafts, checks, bank deposit certificates, postal savings certificates.177

China’s foreign exchange policy, as it clearly laid out by article 4 “prohibition on free circulation, use, and mortgage of foreign currency; sale and purchase with authorizations.”178 It further stipulated that all foreign exchange revenues by any entity or individual must be sold to BOC unless exempted by laws, decrees other regulations.179 The Interim Regulation designated State Administration of Foreign Exchange (hereinafter SAFE) as the agency enforce the law, and BOC is the designated

174 Art. 1, 1980 Interim Regulations.
175 Art. 1 ¶ 2, 1980 Interim Regulations.
176 Art. 2, 1980 Interim Regulations
177 Ibid.
178 Art. 4, 1980 Interim Regulations
179 Ibid.
bank to process foreign exchange transaction\textsuperscript{180}. The 1980 Interim Regulation had seven chapters with 34 articles, which established the foundation for China’s foreign exchange framework.\textsuperscript{181} Chapter two, three, four, and five respectively dedicated to special groups of entities or individuals, which were: state and collective ownership entity and their representatives, a private Chinese citizen, foreign official entities and their representatives, and Chinese overseas enterprises and EJV and WFOE and their representatives. In order to fully implement regulations related to the foreign business entities and Chinese individuals, SAFE adopted following administrative legislation:

1. 1981 Rules for the Implementation of the Examination and Approval of Applications by Individuals for Foreign Exchange,\textsuperscript{182}

\textsuperscript{180} Art. 3, 1980 Interim Regulations
\textsuperscript{181} For example:

- Chapter I: General Provisions
- Chapter II: Foreign Exchange Control Relating to State Units and Collective Economic Organizations
- Chapter III: Foreign Exchange Control Relating to Individuals
- Chapter IV: Foreign Exchange Control Relating to Foreign Resident Representative Offices in China and Their Personnel
- Chapter V: Foreign Exchange Control Relating to Enterprises with Overseas Chinese Capital, Foreign-Capital Enterprises, and Chinese-Foreign Equity Joint Ventures and Their Personnel
- Chapter VI: Control Relating to Carrying Foreign Exchange, Precious Metals and Payment Instruments in Foreign Currency into and out of China
- Chapter VII: Supplementary Provisions

2. 1981 Rules for the Implementation Foreign Exchange Control Relating to Individuals FE Control,\textsuperscript{183}


4. 1985 Implementing Rules on Punishment for Violation of Foreign Exchange Control.\textsuperscript{185}

These regulations formed the basis of China's foreign exchange control framework.


\textsuperscript{185} Weifan waihui guanli chufa shixing xize(违反外汇管理处罚施行细则) [Implementing Rules on Punishment of Violation of Foreign Exchange Control] [hereinafter FE Control Punishment adopted by SAFE on April 5, 1985, and replaced by Foreign Exchange Control Regulation in 1996.
The 1980 Interim Regulation installed a strict foreign exchange control. For example, all domestic entities’ spending and receiving of foreign exchange subject to the central plan.\textsuperscript{186} Such entity could not privately hold foreign exchange or deposit foreign exchange (including payment instrument) abroad.\textsuperscript{187} This means such entity needs permission from SAFE for any foreign exchange transaction. Article 10 further stipulated Chinese Custom must inspect the payment of balance and trade receipt to ensure compliance of the foreign exchange control by state trading company.\textsuperscript{188} At the beginning of the Reform and Open Up, the central authority placed strict regulations on domestic firms. At the end of the 1980s, the authority lifted some bans in response to decriminalize profit-seeking behavior by increase foreign exchange retention quota for domestic firms.\textsuperscript{189}

The 1980 Interim Regulation and 1981 Individual FE Examination and 1981 Individuals FE Control governed foreign exchange transactions conducted by Chinese

186 Art. 5, 1980 Interim Regulations.
187 Art. 6, 1980 Interim Regulations. “Unless approved by the SAFEC or its branch offices, organizations within the territory shall not possess foreign exchange, deposit foreign exchange abroad, offset foreign exchange expenditure against foreign exchange income, or use the foreign exchange belonging to State organs stationed abroad or enterprises and institutions established by the State in foreign countries or in the Hong Kong and Macao regions, by way of borrowing or acquisition.”
188 Art. 10, 1980 Interim Regulations.
individual. These regulations placed a strong bias against a private citizen. For example, an individual could privately hold foreign exchange revenue if the revenue originated from his service as a state representative or state-sponsored students. However, if a private citizen obtains foreign exchange through other venues, such as publishing or rewards, he or she cannot retain the money without permission from the authority. In addition, a private citizen is not allowed to retain any foreign exchange received from overseas privately. If one receives money more than 3000 RMB, then he or she can only retain 10%, the rest of the money must be sold to BOC. These regulations demonstrated a strong position that against a private individual possess any economic capacity independent from the central authority.

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190 Art. 5 and art. 6 1981 Individuals FE Control. Art. 5 “When personnel are sent by the State to work in foreign countries or in Hong Kong Macao or other regions return home upon completion of their missions/assignments, they must promptly remit or bring back to China the remaining/balance foreign exchange from wages, allowances, etc. that belongs to them, and such remaining/balance shall not be kept abroad. They shall be permitted to retain the foreign exchange based on the certification issued by the Chinese organization stationed abroad.” Art. 6 “Students, trainees, postgraduate students, scholars, teachers, coaches and other personnel who are sent by the State to study in foreign countries or in Hong Kong, Macao or other regions must, upon their return, promptly remit or bring back to China the remaining amount of the foreign exchange that they have received during their stay abroad, and it shall not be kept abroad; they shall be permitted to retain the foreign exchange that they are entitled to receive, based on the certification issued by Chinese organization stationed abroad.”

191 Art. 7, 1981 Individuals FE Control. “The foreign exchange from fees for publication, copyright royalties, awards, stipend, author’s remuneration, etc. earned by individuals for publications of their inventions, writings and the like abroad, for speeches and lectures made in their own names outside China, for their contributions to foreign newspapers, magazines and specialized journals, etc., must promptly be repatriated and shall not be kept abroad; individuals shall be permitted to retain the foreign exchange that they are entitled to receive according to the relevant provisions approved by the State Council or the ministries or commissions concerned, or with the approval of the State Administration of Foreign Exchange Control.”

There were also various restrictions over the foreign business. For example, all foreign exchange revenue and spending must be processed through bank account from the BOC. SAFE would conduct periodical inspection over the company book to ensure the compliance in pursuant to article 2 of the Foreign Business foreign exchange control.\footnote{Article 2 provided that “In Chapter V of the Interim Regulations on Foreign Exchange Control of the People's Republic of China, the term "enterprises with overseas Chinese capital" refers to corporations, enterprises or other economic entities registered in China with overseas Chinese capital or capital of compatriots from the Hong Kong and Macao regions, and managed independently or jointly with Chinese enterprises; the term "foreign-capital enterprises" refers to corporations, enterprises or other economic entities registered in China with foreign capital, and managed independently or jointly with Chinese enterprises; the term "Chinese-foreign equity joint ventures" refers to enterprises jointly established, owned and run in China by corporations, enterprises, other economic entities or individuals with overseas Chinese capital, capital from compatriots in the Hong Kong and Macao regions or foreign capital and Chinese corporations, enterprises or other economic entities.” see, article 2 Foreign Exchange Regulation on FIEs.} The most controversial restrictions perhaps related to the article 24 and article 25 of the 1980 Interim Regulation, which allows the business entity, such as EJV, CJV or WFOE to remit all profit overseas but discriminate against a foreign employee, which stated only 50% of the post-tax salary could be remitted outside China.\footnote{Art. 25 Interim Regulations on Foreign Exchange Control. “An amount not exceeding 50% of their after-tax legitimate net earnings from wages, etc. may be remitted or taken out of China in foreign currency by staff members and workers of foreign nationality and those from the Hong Kong and Macao regions employed by enterprises with overseas Chinese capital, foreign-capital enterprises and Chinese-foreign equity joint ventures.”} With strong criticism and complaints from the foreign investment community, article 25 of the 1983 foreign business FE Control stipulated that employee’s salary can be remitted
outside China with SAFE permission, provided such portion of foreign exchange would be taken out from foreign business entity’s bank account.  

Table 1. *Foreign Exchange Control during the early 1980s.*

<table>
<thead>
<tr>
<th>Government, SOE, and Collective Ownership Entities</th>
<th>Individual Chinese resident</th>
<th>Foreign Government and Civil entity and employee</th>
<th>Foreign Joint Ventures and Foreign investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free to Deposit</td>
<td>No, must deposit in Bank of China</td>
<td>Partially, amount exceed the quota must sell to Bank of China</td>
<td>Free</td>
</tr>
<tr>
<td>Free to spend</td>
<td>No, unless</td>
<td>No, must sell to</td>
<td>Free</td>
</tr>
</tbody>
</table>

195 Art. 15 Rules for the Implementation of Foreign Exchange Control Regulations Relating to Enterprises with Overseas Chinese Capital, Foreign-Capital Enterprises and Chinese-Foreign Equity Joint Ventures. “Staff members and workers of foreign nationality and those from the Hong Kong and Macao regions employed by enterprises with overseas Chinese capital, foreign-capital enterprises and Chinese-foreign equity joint ventures may remit abroad their wages and other justified earnings, after taxation according to law, and if the remittance exceeds 50% of their wages and other earnings, they may apply to the SAFEC or its branch offices. The amounts remitted shall all be debited to the foreign exchange deposit accounts of the enterprises concerned.”

<table>
<thead>
<tr>
<th></th>
<th>SAFE approves under the PLAN</th>
<th>Bank of China</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Free to transfer</td>
<td>No, unless SAFE approves under the PLAN</td>
<td>Cannot privately bring it across the broader.</td>
<td>Free</td>
<td>Require SAFE Approve, Foreign employee of JV can only transfer 50% of salary outside China unless approved by SAFE</td>
</tr>
<tr>
<td>Free to obtain/ receive foreign loan/ funds</td>
<td>No, unless SAFE approves under the PLAN</td>
<td>Must sell to Bank of China</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Possession of foreign bank</td>
<td>No, unless SAFE</td>
<td>No</td>
<td>Free to have</td>
<td>No, unless SAFE approves</td>
</tr>
</tbody>
</table>
On April 5, 1985, SAFE adopted Detailed Rules on Violation of Foreign Exchange Control [hereinafter FEC Punishment]. This was the first comprehensive administrative regulation concerning how to punish acts violate foreign exchange control until it was replaced by 1996 Foreign Exchange Control Regulation. This rule defined three types of illegal conducts:

1. Unlawful procurement of foreign exchange
2. Evasion of foreign exchange control
3. Disruption of financial stability

Under this rule, depends on the nature of the conduct, there were three different agencies to enforce the rule and sanction. For example, for cases involving smuggling of goods, it would be handled by Custom. For cases involving payment instrument, it would be handled by SAIC. Multiple transactions were provided by the rule, normally, depends on the consequence of the conduct, the sanction could range from oral

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197 Art. 13 FEC Punishment.
warning and self-criticism to large monetary penalty. The penalty could be either confiscation or additional penalty fees.\textsuperscript{198}

Chinese foreign exchange control prohibits the Chinese partner in JV obtains large disposable foreign exchange without control from the central authority. On September 24, 1985, SAFE issued General Reply on Certain issues concerning FIE Foreign Exchanges, which specified that FIE couldn't accept foreign exchange coupon without permission from SAFE. In addition, Chinese partners in JV cannot provide RMB for the foreign investor when a foreign partner has RMB shortage for any domestic business.\textsuperscript{199}

In accordance with the central authority's foreign exchange control, local government would adopt detailed implementing rules to enforce foreign exchange control. For example, on July 1, 1988, Beijing government adopted Provisional Measures of Beijing FIE Foreign Exchange control [hereinafter Beijing FIE FE Control].\textsuperscript{200} The main purpose of such regulation was to provide detailed guidance to any FIE registered with Beijing municipality or located within the jurisdiction of Beijing

\textsuperscript{198} Art. 5 Punishment.

\textsuperscript{199} Guojia waihui guanliju guanyu sanzi qiye waihui guanli ruogan wenti de zonghe dafu (国家外汇管理局关于“三资”企业外汇管理若干问题的综合答复) [General Reply on Certain issues concerning FIE Foreign Exchanges] [hereinafter 1985 SAFE Reply] issued by SAFE on September 24, 1985.

\textsuperscript{200} Beijing shi waishang touzi qiye waihui guanli zanxing banfa (北京市外商投资企业外汇管理暂行办法) [Provisional Measures of Beijing FIE Foreign Exchange control] adopted by People’s Government of Beijing on July 1, 1988.
municipality. One of the highlights for this regulation was to list some exceptions for FIE domestic, foreign exchange transaction. Under Beijing FIE rule, FIE could pay the domestic vendor with foreign exchange under certain exceptions.\textsuperscript{201} Such as FIE purchased service to produce domestic shortage product or purchase products from the export trading company. Other situations required written permission from the SAFE branch office. For example, for the business involved with advanced technology or import substitute products, written permission from SAFE was required. FIE could open a foreign bank account after obtaining permission from SAFE.\textsuperscript{202} However, such practice was not absolute. According to the Regulations on FIE Overseas Bank Account, the overseas bank account is only permitted under certain conditions.\textsuperscript{203} Besides these conditions, FIE must submit board of director resolution on the overseas bank account and accountant opinion on whether FIE fully paid subscribed investment.

The Interim Foreign Exchange Regulations, Individual Foreign Exchange Controls, Individual Foreign Exchange Purchase Application Regulations, Regulations on WFOE, EJVs and CJVs, and Punishments for Violations of Foreign Exchange Controls formed the basis of China’s foreign exchange regulatory framework during the 1980s. Foreign

\textsuperscript{201} Art. 10 Provisional Measures of Beijing FIE Foreign Exchange control
\textsuperscript{202} Art. 4 Provisional Measures of Beijing FIE Foreign Exchange control.
\textsuperscript{203} Guanyu waishang touzi qiye zai jingwai kaili zhanghu de guanli guiding (关于外商投资企业在境外开立帐户的管理规定) [Regulations on FIE Overseas Bank Account] adopted by SAFE on January 7, 1989. For example, FIE would have frequent foreign exchange income and such income would later transfer to China. Or FIE would have frequent foreign exchange spending. Other special needs.
investors were frustrated by China’s currency issues. The central authority designated this framework for two purposes: 1) to maintain a balance of payments by limit the outflow of foreign exchanges. 2) to maintain a stable foreign exchange rate to protect RMB. These two purposes concerning the stability of the foreign exchange rate because the central authority was struggled from a lot of foreign debts resulted from “unplanned” purchases made by previous political leaders. China’s strict foreign exchange rules were biased against Chinese individual and foreign employees. The state trading company enjoy special exchange rate while Chinese individual must sell the majority of the foreign exchange to BOC at an undesired rate. A foreign employee could only remit 50% of the salary oversea. Permissions from SAFE was required for remittance beyond 50%. These restrictions prevent foreign investors from future investment. In addition, they promoted rent-seeking behavior for foreign exchange control evasion.

e. Labor regulation framework

During the 1980s, State Council and Ministry of Labor and Personnel adopted series administrative legislation and directives, which formed the FIE labor regulatory framework. Under this framework, Provisions on Labour Management in Chinese-Foreign Equity Joint Ventures [Hereinafter EJV Labor Provision] and Implementing Measures of the EJV Labor Provisions were the basis of the framework. 204 The local

204 Zhongwai hezi jingying qiye laodong guanli guiding (中外合资经营企业劳动管理规定) [Provisions on Labour Management in Chinese-Foreign Equity Joint Ventures ] adopted by State
authority would make their implementing rules, for example, Beijing Municipality Supplementary Rule on Implementing Provisions on Labour Management in Chinese-Foreign Equity Joint Ventures [Hereinafter Beijing labor rule]. According to the MOL Reply concerning whether accept labor dispute arbitration for FIE employee under three conditions, labor dispute would be governed by arbitration provided under Interim Regulation on SOE Labor Dispute.  

Labor management had always been an issue for FIEs during the 1980s. The main conflicts concerned the policy of China’s labor welfare, particularly job security, and FIE’s autonomous rights of profit incentive-based labor management. According to the EJV Law article 6, the employment, the discharge will be governed by JV agreement and contract. This rule only provided a basic principle for the labor issue. Because all JV agreements and contracts must be verified and approved by the relevant authority, FIE’s freedom of contract was much limited, which means local authority could interfere FIE’s

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205 Beijing shi shishi zhongwai hezi jingying qiye laodong guanli de guiding (北京市实施中外合资经营企业劳动管理规定)  

207 Art. 6 EJV Law.
labor management through the verification process. On July 26, 1980, State Council adopted EJV Labor Provision.\textsuperscript{208} Later, the MOL adopted Implementing Rule in 1984.\textsuperscript{209} These two laws formed the basis of FIE labor management during the 1980s until they were replaced by PRC Labor Law in 1994.\textsuperscript{210} The 1980 EJV Labor Provision demonstrated China’s socialist command economy labor management system, which disregarded free labor market and incentive-based labor management. Under 1980 EJV Labor Provision, the FIE could not independently hire an employee without permission from local labor authority.\textsuperscript{211} Otherwise, labor authority would provide the employee in accordance with the regional labor plan.\textsuperscript{212} Instead of signing contract with each individual, FIE had to sign a contract with the labor representative, which subject to labor Authority's approval prior to the date of the contract. \textsuperscript{213}The power of punishing and discharging labor was limited under article 5. The FIE cannot independently punish or discharge an


\textsuperscript{210} See 1994 PRC Labor Law

\textsuperscript{211} Art. 3 EJV Labor Provision. “The workers and staff members of a joint venture who have been either recommended by the authorities of the locality in charge of the joint venture or the labor management department, or recruited by the joint venture itself with the consent of the labor management department, shall all be selected by the joint venture through careful examinations. Joint ventures may run workers' schools and training courses to train managerial personnel and skilled workers.”

\textsuperscript{212} Ibid.

\textsuperscript{213} Ibid.
employee without approval from the local labor authority. 214 The EJV Labor Provision outlined dispute resolution mechanism. Because China did not have modern HR system under command economy during the 1980s, the employee could first resolve the dispute internally with the board of director.215 If the board of director cannot settle, then both party can try arbitration. However, such arbitration was not final because any party disagrees with the outcome can file litigation to people’s court.216

The 1980 EJV Labor Provision demonstrated a biased policy against FIE’s freedom of contract and autonomous rights of labor management, which caused many complaints from the investors. However, such policy may result from China’s command economy labor system. China’s command economy provided job security and various labor welfares. Under this system, each individual would be allocated to a specific position after the graduation. The central authority would manage and determine the benefits of the labor in accordance with the central plan. Thus, when the employee was hired by a FIE, the central authority wished to maintain a form of labor policy coherency at the cost of the FIE. In order to balance the conflict between the policy of labor welfare and FIE internal operation, MOL adopted Implementing Measures for EJV Labor Provision in 1984.217 The Implementing Measures took a compromise that FIE could

214 Art. 5 EJV Labor Provision.
215 Art.6 EJV Labor Provision.
216 Art. 14 EJV Labor Provision.
stipulate a trial session for labors recommended by the local authority. If such person failed his or her duty or failed to pass the employment exam, then FIE could dismiss such person.\textsuperscript{218} One of the progress for the new Measures was to remove the requirement of obtaining permission from labor authority prior to punish or discharge an employee.\textsuperscript{219} The punishment or discharge decision must be made by either manager or vice-manager. In addition, such decision must be filed with local labor authority for the record.\textsuperscript{220} The 1984 Implementing Measures also allow FIE to decide the standard of salary and benefit without reference or on par with local SOE.\textsuperscript{221} Last but not the least, FIE can negotiate labor insurance and benefits standard with local labor authority if such FIE disagreed with the general standard.\textsuperscript{222}

To further promote FIE’s right of internal labor management, State Council adopted Further Implementation of the Policy of Granting Decision-Making Power to Enterprises with Foreign Investment for the Employment of Working Personnel [Hereinafter State Council FIE Employment Policy] in 1988.\textsuperscript{223} This policy further relaxed

\textsuperscript{218} Art. 3 EJV Labor Provision.
\textsuperscript{219} Art. 10 EJV Labor Provision.
\textsuperscript{220} Art. 10 EJV Labor Provision.
\textsuperscript{221} Art. 12 EJV Labor Provision.
\textsuperscript{222} Art. 14 EJV Labor Provision.
\textsuperscript{223} Guowuyuan Ban gongting zhuanfa laodongbu, renshibu, guanyu jinyibu luoshi waishang touzi qiye yongren zizhongquan de yijian (国务院办公厅转发劳动部、人事部关于进一步落实外商投资企业用人自主权意见的通知) [Circular of the General Office of the State Council on the Approval and Transmission of the Proposals Submitted by the Ministry of Labour and the Ministry of Personnel Concerning Further Implementation of the Policy of Granting Decision-Making Power to Enterprises with Foreign Investment for the Employment of Working Personnel]
restrictions on FIE’s freedom of contract on labor management. For example, article 1 and article 2 supported FIE to fire anyone they need from the community without permission from local labor authority. The chart illustrates the labor management framework during the 1980s:

Table 2. Labor regulations during the 1980s.

<table>
<thead>
<tr>
<th></th>
<th>Free to hire labor</th>
<th>Free to discharge or punish labor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980 EJV Labor Provision</td>
<td>NO, need labor authority permission</td>
<td>No, need labor authority permission</td>
</tr>
<tr>
<td>1984 Implementing Measures on EJV Labor Provision</td>
<td>Can install trial session and examination, dismiss unqualified applicant prior to former employment</td>
<td>Yes, but need to file a record to local authority</td>
</tr>
<tr>
<td>1988 Hereinafter State Council FIE Employment Policy</td>
<td>Yes, local authority must provide assistant</td>
<td>Yes, local authority must provide assistant</td>
</tr>
</tbody>
</table>

224 Art.2 State Council FIE Labor Opinion.
One of the recurring themes of Chinese FDI policy and law between the 1980s and early 1990s was the flexibility of the law enforcement. The need for decentralized reform is incoherent with the goal for strict law enforcement. Early FDI laws were vague and ambiguous, which relied greatly on administrative interpretation. The central authority normally issued different internal directives in order to accommodate the need for the political object and further reform. For a state proclaimed the superiority of the central planning, the flexible law enforcement seemed to be arbitrary and lack of consensus over the extent and area of the reform. As Edward Duff pointed out, this is not an indication of “absence of law, but rather a pragmatic reaction to China’s highly political environment.²²⁵”

Based on previous discussions on the FDI legal framework, there were problems concerning the substance and operation of the FDI framework during the 1978-1991 as well as China’s management style. There were four major problems presented within the substance of the FDI regulations. First, a lack of domestic legal infrastructure. For example, the concept of LLC under EJV Law was hard to define due to the lack of company Law. The concept of limited liability was hard to enforce when there was no

mortgage law in China, which means loan might have to be guaranteed by the parent company of the foreign investors. This effectively eliminated the benefits of limited liability.\textsuperscript{226} Thus, the limited liability company under EJV Law was merely a title without substance.\textsuperscript{227} Second, limited guidance from the EJV Law created vagueness and confusions. For example, in the process of registration, the authority rarely explained the basis for their decision, which made it harder for the investor to reduce the risk by studying the policy. Third, rigid rules concerning the choice of law. For example, Foreign Economic Contract Law did not provide statutory tools for an investor to apply the choice of law in the JV contract. On the contrary, all contract performed within the territory of the People's Republic of China were subject to the law of the People's Republic.

Other restrictions related to China’s investment policy. For example, the EJV Law established a narrow and strict definition of advanced equipment, which limited the non-cash contribution by the foreign investors. The article 27 of the EJV Law provided that:

such equipment or material must be indispensable to the operation of the joint venture, must be unable to be produced in China or the production cost is too high.

The price for such contribution must not higher than the international market price.


\textsuperscript{227} Ibid.
for same or similar items. In addition, such industrial property must use to produce products urgently need in China or suitable for export.\textsuperscript{228}

In addition, there were some labor issues, such as the problem of independently hire or discharge labors. The lack of autonomous right in the hiring process and the difficulty in discharging employee became one of the problems for the effective operation of the JV. For example, any dismissal must be reported to the local labor bureau for approval, and labor union can file an objection to dismiss.\textsuperscript{229}

Another type of issues related to the operation of the FDI regulation. First, the socialist system created a conflict of interests between regulators and the business, which triggered risks of corruption. For example, there was no private legal service provider; legal service providers are also employed by the state regulatory agency, which results in a conflict of interest for many western investors.\textsuperscript{230} Many complaints by the foreign investors concerned the valuation of noncash contribution. For example, valuation of contribution by building or land-use rights is controlled by the Chinese government. These arrangements provided the basis for potential abuse of power

\textsuperscript{228} Art. 27, 28 EJV Law.
\textsuperscript{229} Art. 4 Labor Provisions.
\textsuperscript{230} For example, the Great Wall Law Office, which is often retained by foreign investors to prepare joint venture documentation, is staffed by lawyers from MOFERT, which is responsible for joint venture authorization. See Crawford Brickley, “Equity Joint Ventures in the People’s republic of China: the Promised Land is not yet in Sight For foreign investors,” \textit{U. Pa. J. Int’l L.} 10 no. 2 (1988): 261, accessed July 31, 2017, http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1622&context=jil.
because there was no third-party independent valuation service or an effective judicial system to control government behavior.

Second, the FDI verification and approval process was complicated and full of bureaucracy. For example, investors and their Chinese counterpart must obtain permission prior to applying for a business license. Investors were burdened by the requirements for “project proposal” and “feasibility study.” Proposed terms under project proposal were hard to change once it approved by the authority. 231 There were confusions as to who bore the cost of these preparations, and there were confusions regarding the appropriate level of approving authority. 232

There were also problems with the corporate governance under EJV Law. China’s approach to corporate governance under EJV Law was incompatible with international customs. Shares in equity/ ownership are not necessarily proportional to its power, although the liability is proportional to the contribution. For example, Majority shareholder would not automatically translate into majority voting rights under the “equal share equal rights principles.” 233 A number of directors appointed by each party determined by consultation between the parties with reference to their equity shares. The chairman must be a Chinese national. In addition, a major decision by the company

232 Ibid.
233 Art. 34, Implementing Regulation,
must be made through consultation under equal and mutual benefit principle. In practice, the governments interfered with the operation of the joint venture. For example, the Chinese government would make final decisions on product pricing and raw materials and energy resources allocation, in order to satisfy the enforcement of central planning.

Conclusion

Between 1978-1991, the Chinese central authority established the conceptual framework for the foreign investment through ideological and constitutional reform. However, the debates over the legitimacy of the foreign investment program, the notion of the market, and profit within a conventional central planning economy continued throughout the 1980s. The EJV Law, CJV Law, and WFOE Law and supplemental regulations formed the basis of Chinese FDI regulatory framework. The foreign exchange and labor regulations were important elements affected core interests of the investors as well as the development of China’s investment environment.

The FDI regulatory framework during the 1980s demonstrated the nature of China’s centralized command economy: (1) a multiple leveled administrative structure

\(^{234}\) Art. 6 EJV Law.

\(^{235}\) For example, the Chinese government makes final decisions on product pricing and raw materials and energy resources allocation to permit conformity with the national economic plan.
was placed on foreign investment regulation, (2) a restrictive market without a functioning commercial judicial system. (3) Transactions were regulated and managed through the central plan and regional plan by the government entities, which naturally caused rent-seeking and corruptions. The problem of corruption became even worse when the line between legal and illegal was blurred by China’s constantly changing policies and rules during the reform era. (4) There was no free domestic market and free labor market. Foreign investors initially could not hire or discipline labors without local labor authorities’ permission. (5) Foreign investors’ capacity of profiting from the domestic market or intellectual property had been limited by the FDI regulatory framework under the centralized planning economy. Foreign investors were encouraged to sell products overseas. Permissions were required for any domestic sale. (6) Foreign investors could not appoint a foreigner to serve the chairman of the board of the directors. All major corporate decisions must be determined by unanimous votes.

Essentially, the FDI regulatory framework had expressed the conflicts of interest between the authority and the foreign investors. With all these restrictions, the central authority failed to create policy and regulations to attract multinational corporations. The central authority essentially created policy and regulations to promote a particular form of foreign investment: an investment with a singular investor that invested in export-oriented sectors. The economic data affirmed such conclusion. A singular investor from South Asia or Hongkong regions with investment in export-oriented industry was the major form of FDI during the 80s. The labor management restrictions,
the board of director nationality restrictions, and foreign exchange restrictions could not
attract modern corporate management teams in China. In fact, such framework
translated FDI into a form of bridge loans or compensation trade: a foreign investor
contributed financial, technological means into a production of goods later could be sold
in the international market. The FDI regulatory framework in the 1980s facilitated an
environment of protection: first, it protected the core interests of the central planning
and political structure associated with the central planning, and second, it used FDI as
the foreign exchange generator to provide financial means and technological means in
preserving China’s central planning economy. The effect of such FDI regulatory
framework fitted with the reality: the majority of FDI inflow concentrated in textile, toy
and other export-oriented labor-intensive sectors.

To some, such FDI regulatory framework was not enough to support Chinese
modernization, because the benefits of export-oriented labor-intensive sectors were
marginal to a sustainable and modernized industrial powerhouse. Modernization could
not center on a conventional central planning system without a modernized private
market and judicial system. As the next chapter illustrated, the new Party Congress and
Constitution amendments changed the “conventional vision,” and redefined the
relationship between central planning and market. This ended the debates over
socialism and the market, which affirmed Deng Xiaoping’s vision of China’s future.
Chapter 3 THE FDI POLICY AND LAW BETWEEN 1992-2005

1. Introduction
Since Deng Xiaoping’s 1992 “southern tour,” China speeded up the pace of the Reform and Open Up. The term “socialist market economy” was officially endorsed and adopted to normalize any pro-market reform measures and laws. “Socialist market economy” established the foundation for China’s modernized legal and economic system. The establishment of the “socialist market economy” was beneficial to China’s foreign investment. FIEs transformed Chinese economy and society. The penetration of the global market with “Made in China” indicated a story about China’s industral and modernization reform far beyond the common narrative of developing “export-oriented or labour-intensive sectors.” The 14th National Congress of CPC officially ended the ideological debate on the market and socialism by proclaiming the main path to modernization is the “Socialist Market Economy.”

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236 In 1992, after Deng step down from the Party post, Deng Xiaoping orchestrated a semi-private winter tour of China’s southern provinces and Special Economic Zone. The “southern tour” designed to send a political message that Deng Xiaoping personally supports the Reform and Open Up and foreign investment. He would not accept any polices or laws reverse Reform and Open Up. See last chapter on Deng Xiaoping’s “southern tour.”


officially removed the ideological obstacles of the new reform measures.\textsuperscript{239} The 1999 and 2004 constitutional amendments textualized these new policies by stating the state will “encourage, support and protect private sector,” and it added that the “state protect human rights.”\textsuperscript{240} The 15th and 16th National Congress of CPC established the principle of “rule the state in accordance with the law,” and it proclaimed that the legitimate interests of the private sector, as well as public sector, are “inviolable.”\textsuperscript{241} In addition, the 16\textsuperscript{th} Party Congress adopted a pro-market and pro-competition ideological doctrine commonly known as Jinag Zeming’s “Three-Represents,” which asked the Party to reconsider its relationship with the market because the Party must “represent advanced social productive forces.”\textsuperscript{242} Interestingly, the Party line, the “scientific outlook on development,” proposed in 2003, highlighted the need for a “scientific” development, which implied the central authority’s role in monitoring and managing the

\begin{itemize}
\item[\textsuperscript{239}] “The old economic structure has its historical origins and has played an important and positive role. With changing conditions, however, it has come to correspond less and less to the requirements of the modernization programme. see: “Full Text of Jiang Zemin's Report at 14th Party Congress,” October 12, 1992, accessed July 31, 2017, http://www.bjreview.com.cn/document/txt/2011-03/29/content_363504.htm.
\item[\textsuperscript{240}] Art. 11, PRC. Constitution. “The State protects the lawful rights and interests of the non-public sectors of the economy such as the individual and private sectors of the economy. The State encourages, supports and guides the development of the non-public sectors of the economy and, in accordance with law, exercises supervision and control over the non-public sectors of the economy.”
\item[\textsuperscript{241}] “we must go on steadily and surely with political restructuring, extend socialist democracy and build socialist political civilization in order to build a socialist country under the rule of law and consolidate and develop the political situation characterized by democracy, solidarity, liveliness, stability and harmony.” See, “Full Text of Resolution on CPC Central Committee Report,” Zhongguo wang, accessed July 31, 2017, http://www.china.org.cn/english/2002/Nov/48801.htm.
\end{itemize}
market to ensure a “scientific development.” These new political and constitutional principles established the conceptual basis for crafting a better foreign investment law and policy framework.

Two decades of outstanding economic performance since the launch of the Reform and Open Up policy in the late 1980s drew great attention from researchers around the globe. Many prominent studies linked China’s economic growth with the following factors: (1) domestic infrastructure investment, (2) the institutional reform and restructuring to promote investment-friendly regulations and cross-border economic and technological exchanges.243 From the 1990s and early 2000s, China gradually established the basis of the modernized commercial legal system by massive waves of legislation (such as Company Law, Contract Law, General Principle of Civil Code, and Security Law, Anti-Monopoly Law, and many others). Academics predicted FDI could further benefit from these reforms in the sectors of banking, finance, and equity market.244

Although these reforms displayed a strong pattern of pro-SOE and pro-centralized planning, visible progress was made: freedom of contract and private will

243 Ibid.
were promoted and respected during 1992-2005. Openness, transparency, accountability, and accessibility were no longer ideologically taboo, but treated with pragmatism as commonly accepted principles for the development of a mature and healthy investment environment. The development of the Foreign Investment Guiding Catalogue and the amendments of the equity joint venture (EJV) Law, contractual joint venture (CJV) Law, and wholly foreign owned (WFOE) Law demonstrated great improvements of transparency and stability of the FDI regulatory regime. The development of the Company Law provided a necessary basis for modernizing China’s corporate governance.

However, problems and challenges remained. Foreign investment suffered from the clashes between the political vision and the market reality. Foreign investment laws and regulations extended these conflicts. The policymakers displayed a tendency of interpreting market realities as inconvenience and problems for their political vision. The market behavior was commonly understood as “disruptions” to the “order” of the economy developed and guarded by the authority. In this context, “order” was an expression of political visions of the economy. However, the “order” could not provide necessary guidance to the investors because it was unpredictable and unreliable. As some researchers identified, the most complained issues by foreign investors were the

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central authority’s unfair preference of the SOE in a variety of issues. Such preference created unpredictable regulations for FDI. As a result, these regulations created less competitive SOE sector on the one hand and further alienated private sectors on the other hand. As the next chapter discusses, the alienated private sectors found their ways of obtaining financial means and investment tools outside the orbit of the central authority due to the development of globalization. Also, the SOE sector was victimized by such self-fulfilling paradox: more preferential policy, poorer performance; more protective measures against foreign competition, the weaker position for the SOE and the central government.

As many foreign investors complained, special policies and incentives for SOE sector, in the form of loans, administrative approval, and resource allocation, discriminated against both foreign investors and private sectors in China. It created not only fiscal problems for the Chinese government but also created legal risks for violating WTO commitments. In addition, the political preference of SOE, created a risk of corruption. Corruption and ideological prejudice became the greatest threats to foreign

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investors’ interests in the area of market access and resource distribution.\textsuperscript{251} China’s intrusive administrative, regulatory regime had effectively undermined Chinese foreign investment market. Foreign investment turned into a form of bridge loan or non-voting right equity due to various discriminatory regulations and laws.\textsuperscript{252} Despite challenges, there were many opportunities for business to grow during the 1990s, FDI data presented a bright future for Chinese market during that period.

This chapter mainly focuses on the FDI regime between 1992-2005. The purpose is to show the development of FDI regulatory regime in the context of the Chinese ideological and Constitutional framework, as well as its legal framework. The first section of this chapter gives an overview of the economic status and characteristics of the foreign investment during the period between 1992-2005. It acknowledges that foreign investment’s contribution to China’s industrial and trade development is undeniable. It concludes that even falling short by the market economy standard, China’s legal system demonstrated great development over the years. In addition, China’s accession to WTO created a new reality that the central authority’s regulatory power was limited by the scrutiny of international law.


\textsuperscript{252} For example, “Business China argues that foreign capital is a kind of bridge loan that has allowed China to grow rapidly while it tries to fix the mess in its financial system. Domestic savings remain stunningly high (around 40% of GDP). But the financial system is woefully bad at using them. Money does not flow to the deserving. Rather it goes to the inefficient, largely loss-making, state sector.” See, “China’s private surprise,” \textit{Economist}, June 17th 1999, accessed July 31, 2017, \url{http://www.economist.com/node/214423}
The second section exclusively discusses the ideological framework and constitutional framework during 1992-2005. The purpose of this section is to provide a necessary ideological and constitutional basis that assists readers in understanding the principles and contexts, within which the FDI legal framework operated. The main theme during this time was the end of the debate over the definition of socialism in relation to the market and profit. The “socialist market economy” was officially recognized by the Party and the state constitutions. “Protecting and developing state and private-sectors interests” was considered as an important obligation of the Vanguard Party. This new development, on the one hand, promotes “freedom of contract,” for both Chinese and foreign investors, while on the other hand, presented a dilemma for the policymakers in the context of maintaining socialist economic order.

The third section exclusively discusses the legal framework of the FDI regime during 1992-2005. The purpose is to illustrate the new progress of China’s foreign investment policy and law through the example of EJV Law, CJV Law, WFOE Law, and the Catalogue for Guiding foreign investment. In addition, this section would also focus on one feature of China’s commercial system (dualist legal system) in the context of PRC Company Law. It concludes that although far from western market economy standard, there was liberation and progress in the area of promoting “freedom of contract,” and

“transparency and clarity.” It also notes that the dualist legal system, one system designed for domestic firms (particularly private firms) and another system for foreign-invested firms, was a natural product of China’s conflicting positions on the market and socialism. It may be self-defeating in creating undesired consequences for both SOEs and the private sector in the long run, as the next chapter illustrates.

The background

The FDI development during the 1990s and early 2000s displayed some interesting features and data. First, the impact of China’s economic development was reflected in China’s export sector. For example, exportation of natural resources had been gradually replaced by industrial products, especially textile and apparel. IMF reported that “By 2002 processed exports reached $180 billion and accounted for 55 percent of China's total exports.” Similar situations China’s textile exportation almost doubled, “from 4.6 percent in 1980 to 8.5 percent in 1998.” China’s share of global exports for apparel “more than quadrupled, from 4.0 percent to 16.7 percent over the

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254 For example, “the share of primary product exports fell by almost “four-fifths, from an average of 45 percent of total exports in the first half of the 1980s to only 10 percent by 1999.” Labor intensive manufacturing sectors, such as “textiles, apparel, footwear, and toys are China’s fastest growing exports during the 191990s.” Study reported that export for these items “rose more than tenfold, from $4.3 billion to $53.5 billion between 1980 and 1998. Among these items, textile is the prime example, the share of textile almost doubled from 4.6 to 8.5 between 1980 and 1998. The rapidly increasing share of total exports contributed by processing suggests the importance of this initiative.” See, Nicholas R. Lardy, “Trade Liberalization and Its Role in Chinese Economic Growth,” (paper presented at International Monetary Fund and National Council of Applied Economic Research Conference, New Delhi, November 14-16 2003), 8, https://www.imf.org/external/np/apd/seminars/2003/newdelhi/lardy.pdf.

255 Ibid.
same period. Faster yet was the expansion of the world market share for toys—from 2.3 percent in 1980 to 17.9 percent in 1998.”

The similar situations occurred in the footwear sector. “China’s share of the world market for footwear rose the fastest of all, soaring from 1.9 percent in 1980 to 20.7 percent in 1998.”

Table 3. *China’s Absorption of Foreign Fund (2001) billion USD.*

<table>
<thead>
<tr>
<th>Approved Projects</th>
<th>Approved Contract Value</th>
<th>Actual Utilized Contract Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>20549</td>
<td>56.727</td>
</tr>
<tr>
<td>FDI</td>
<td>20549</td>
<td>52.201</td>
</tr>
<tr>
<td>EJV</td>
<td>7033</td>
<td>13.773</td>
</tr>
<tr>
<td>CJV</td>
<td>1267</td>
<td>6.702</td>
</tr>
<tr>
<td>WFOE</td>
<td>12237</td>
<td>3.4369</td>
</tr>
<tr>
<td>Share Holding Investment</td>
<td>8</td>
<td>0.324</td>
</tr>
<tr>
<td>Cooperation exploration</td>
<td>3</td>
<td>0.019</td>
</tr>
<tr>
<td>others</td>
<td>1</td>
<td>0.013</td>
</tr>
<tr>
<td>International leasing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Processing and assembling</td>
<td></td>
<td>1.521</td>
</tr>
</tbody>
</table>

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256 Ibid.
257 Ibid.
Secondly, a globalized economy benefited China’s economic development. China doubled its exportation in auto parts in just one year. China’s massive industrialization and domestic investment made China become the consumer of “40 percent of the world's cement in 2003.”

Observers and researchers noted China’s excellent development in foreign trade and investment. As the 1997 World Bank report suggested, the transition from command to market “in one or two generation for what rich industrial economies took centuries to help Chinese out of absolute poverty.”

The Chinese economy expanded dramatically in the past decades. Between “1978 and 1995 real GDP per capita grew at the blistering rate of 8 percent a year and lifted 200 million.” “Three indicators suggest that increased competition is having a transforming influence on China's domestic economy. First, the decline in employment in the state sector; second, the dramatic shrinkage in the rate of inventory accumulation; third, the upturn in profitability of China's state-owned manufacturing firms.”

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259 Chris Miller, “An intricate ALLIANCE” Aftermarket Business 115.5 (2005) 46-48, accessed July 29, 2017, http://www.searchautoparts.com/searchautoparts/article/. For example, China exported $6.5 billion in auto parts in 2003, more than double what it did the previous year, according to Fishman. Another effect of China’s growth is a spike in raw material costs. Copper, aluminum, zinc and oil prices have all increased due to China's demand. (Recent gas price increases can also be attributed, in part, to a hefty demand from China’s factories.

260 Ibid.


263 Ibid.
It is estimated that China "will absorb $57.6 billion worth of direct foreign investment in five years, which will control 6.5% of the global economy. This estimate is an increase from the intake of FDI in 2001 equaling an astonishing record $46.8 billion."²⁶⁴ Studies emphasized the significance of FDI in Chinese economy. For example, FDI provided a significant contribution to the growth of Chinese economy during the 1990s.²⁶⁵ It is impossible to ignore the needs of the foreign investors in order to harness the benefits from the FDI to develop China's modernization and reform further.²⁶⁶ By the end of the 1990s, China has “one-third of the emerging markets’ total stock of FDI.”²⁶⁷ The links between China’s growth and FDI is undeniable. During the 1990s, China

²⁶⁵ For example: “The increase in China’s trade to GDP ratio—from 10 percent in 1975-1979 to 36 percent in 1990-2004 was the 7th most rapid among 120 countries. And the increase in its foreign direct investment to GDP ratio-from almost zero in 1975-1979 to about 3.5 percent in 1990-1994 was the 6th most rapid.” See, Nicholas R. Lardy, “Trade Liberalization and Its Role in Chinese Economic Growth,” (paper presented at International Monetary Fund and National Council of Applied Economic Research Conference, New Delhi, November 14-16 2003), 1-10, https://www.imf.org/external/np/apd/seminars/2003/newdelhi/lardy.pdf.
²⁶⁷ For example: A World Bank 1997 report states that “the nature of China’s economic growth in the past twenty years has been both productivity-driven and input-driven. Each of these two factors contributed around half of the 9.4 percent annual GDP growth rate for the period 1978 to 1995 and is likely to do so after these dates. The input factor is attributed to the significant increase in capital in which foreign direct investment (FDI) played an important role. Therefore, to sustain the growth momentum, China ... needs to continue to secure a critical input factor –
became the world’s second-largest recipient of foreign direct investment (FDI) after the United States. In addition, reform created many benefits for China’s FDI and domestic forms. For example, China’s trade company increased rapidly since the reform. “Trade company and joint ventures enjoyed direct trading rights without restrictions licensing for products and inputs.” 268 “Joint venture in 1994 accounted for a third of China’s imports, and almost 20 percent of exports” WFOE accounted for 12 percent of imports and 9 percent of exports.” 269

Since China’s accession to WTO, FDI development maintained a steady growth. “By the end of April 2003, 436,394 foreign investment enterprises obtained approvals from the Chinese competent administrative authority. Meanwhile, the total amounts of foreign investment on contracts were USD 858.588 billion and the amounts of foreign investment actually used were USD 465.789 billion.” 270 From Jan to Nov 2005, “China approved and set up 39,679 foreign invested enterprises, up by 1.17% than the previous year; the contractual value of the foreign fund was US$167,212million, up by 23.99%; actual utilized foreign fund value was US$53,127million, decreased by 1.90% year-on-year.”

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268 Ibid.
269 Ibid.
South Asian countries and regions ranked high in regions and countries investing China. The top regions and countries were: “(according to actual invest value) were Hong Kong, British Virgin Islands, Japan, Korea, US, Singapore, Taiwan, Cayman Islands, Germany, and Samoa. The actual investment value of the top 10 countries and regions constituted 84.37% of China’s actual utilized foreign fund value.”

Third, researchers acknowledged that although China became the largest FDI recipient in 2002, high-quality FDI investment from OECD countries was still inadequately represented. Investors and academics agreed that China's FDI framework needed to pay attention to factors that promote and facilitate a high-quality and sustainable development. Most frequently mentioned factors included “a transparent and predictable legal system, streamlined investment approval procedures, good corporate governance, pro-competition policies, and a competent and practical

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272 Ibid.

273 For example, although China became the world’s largest recipient of FDI in 2002, the country continues to rank below OECD economies and several major developing countries in terms of FDI inflows per capita. Also, while OECD countries provide over 90% of FDI globally, their share of FDI in China is much smaller. Accordingly, China has now a goal of attracting long-term, relatively capital-intensive and high-tech projects from multinational enterprises in OECD countries. Improvements in the business environment that will help achieve this goal will also have the broader effect of increasing domestic investment. OECD, “OECD Investment Policy Review of China 2003,” accessed July 31, 2017, https://www.oecd.org/investment/investmentfordevelopment/oecd-investment-policy-review-of-china-2003.htm.
financial system.” Since the 2000s, China started to adopt new policies to develop structures that were more compatible with the WTO commitment and sustainable development. This change also mirrored the fact that more and more high-quality FDI replaced labor-intensive and export-oriented small size FDI.

With the development of China’s legal infrastructure and economic system, more and more foreign investors choose WFOE as the form of their business investment. For example, “Since 1997, WFOEs have begun to outnumber JVs. Factors such as Chinese partners’ competence, joint-venture (JV) management control, and frustration from JV failure examples, have been cited as reasons why a strict adoption of WFOE for conducting business in China might be preferable.” Some researchers highlighted the fact that China adopted different strategies in approaching FDI. FDI incentives were tailored to fit local advantage.

274 Ibid.
275 Freenstra, Robert C. and Alan M. Taylor, *International Economics. fifth edition* (New York: McGraw Hill Publishers, 2013), 213-223. For example, “since the early 2000s, Hong Kong manufacturing FIEs have been pressured by the rising labour and production costs and the strict environmental regulations. As the result, both total and partial relocation patterns are identified. Relocation destinations include designated industrial parks within the peripheral regions in Guangdong (the most popular destination), Western and Central China, and other low-cost South East Asian countries such as Vietnam.”
277 Freenstra, Robert C. and Alan M. Taylor, *International Economics. fifth edition* (New York: McGraw Hill Publishers, 2013), 213-223. For example, “Branstetter and Freenstra examined determinants of FDI into China during 1984-1995 period, and concluded that policies played a critical role in attracting FDI and policies were different for different provinces. For example, in 1979 Guangdong and Fujian provinces became sites of “special economic zones” that gave very
Fourth, joining WTO transformed China’s implementing policy and law on international trade and FDI regime. With the signature with the U.S. and EU for the bilateral agreement on China’s accession to WTO in 1999 and 2000, China broke ground for its path to WTO admission.\textsuperscript{278}

Table 4. \textit{China’s Path to WTO.}

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>• China obtained observer status in GATT</td>
</tr>
<tr>
<td>1986</td>
<td>• China notified GAT of intent to renegotiate terms of membership</td>
</tr>
<tr>
<td>1987</td>
<td>• GATT established Working party on China membership</td>
</tr>
<tr>
<td>1995</td>
<td>• China applied for accession to WTO</td>
</tr>
<tr>
<td>1997</td>
<td>• China agreed to Nondiscrimination and Judicial Review under WTO, signed bilateral agreements with New Zealand, Korea</td>
</tr>
<tr>
<td>1999</td>
<td>• The United States and China signed bilateral agreement on China’s accession</td>
</tr>
<tr>
<td>2000</td>
<td>• U.S. Congress passed legislation, EU and China signed bilateral agreement on China’s accession</td>
</tr>
<tr>
<td>2001</td>
<td>• China’s accession to WTO became effective</td>
</tr>
</tbody>
</table>

- The average statutory tariff, which stood at the relatively high level of 56 percent in 1982, was reduced to 15 percent by 2001. The share of all imports subject to favorable tax and administrative treatment to foreign firms (more favorable treatment than to domestic Chinese firms!)

licensing requirements fell from a peak of 46 percent in the late 1980s to fewer than 4 percent of all commodities by the time China entered the WTO. 279

Lee Branstetter and Nicholas Lardy emphasized that “China’s aggressive liberalization of trade and investment in advance of deadlines built into the agreements surrounding China’s accession to the World Trade Organization (WTO).”280 China’s growth demonstrated a pattern of development that was coherent with the basic experience of Japan and Korea.281 More importantly, WTO served as an external discipline over China’s administrative interference of the economy through principles and guidelines


280 For example, “Starting in the mid-1990s, the SOE reforms reflected the state’s desire to seek effective management and make this suit the needs of a market economy through innovative operations and mechanisms. Thus far, the government still aims to reform the SOEs in the hope that the latter can stand on their own feet... Areas like corporate governance, entrepreneurship and internationalization receive more and more attention. To counteract the problem of surplus labour in SOEs, the state resorts to the survival of the fittest, resulting in downsizing in SOEs” see Daniel Yan and Malcolm Warner, “Research Papers in Management Studies Sino-Foreign Joint Ventures’ Versus ‘Wholly Foreign Owned Enterprises’ in The People’s Republic Of China,” https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/workingpapers/wp0111.pdf. Also see, Loren Brandt, Thomas G. Rawski, Lin Gang, “Inside Chinese economy : Retrospect And Prospect,” Asia Program Special Report (2005):1, https://www.wilsoncenter.org/sites/default/files/AsiaReport_129.pdf (accessed September 04, 2017).

embedded in a matrix of multinational, bilateral treaties. Thus, WTO formed an external framework that checked China’s administrative power. 282 These external rules, to some extent, forced the Chinese government to take actions that were more compatible with the global standard, particularly in the area of market access, subsidies, and transparency.283

Fifth, China established a dualist legal system between 1992-2005 under China’s socialist economy. Between 1992-2005, China started massive commercial lawmaking. These laws formed the basis of China’s dual legal system or two-track legal system: one for foreign investors and one for domestic firms. This system intended to provide a set of policies and regulations for foreign investment, which could be more compatible with the international practice and norms. Another set of regulations for domestic firms were created to accommodate the experience of the “socialist market economy.” However,

282 For example, one interviewer told a BBC journalist that China has traditionally been an authoritarian state. WTO framework provided alternative source of regulations that breakthrough such tradition. See “分析：入世 13 載 中國經貿得與失”(Analysis, the Gain and Loss of China’s Trade and Economy since WTO Accession 13 years ago), BBC November 10, 2014, http://www.bbc.com/zhongwen/trad/indepth/2014/11/141110_china_wto_13_years

283 For example, by signing on to the Agreement on Subsidies and Countervailing Measures (SCM Agreement), China agreed to countervailing duty actions and to gradually remove export subsidies. See: The concept of transparency is central to the WTO agreements. Article X of the GAiT 1994 requires that all trade-related laws, regulations, and rulings be promptly published and administered in an "impartial and uniform" manner. See: General Agreement on Tariffs and Trade, Oct. 30, 1947, art. X, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194.
as one scholar noticed, such system might create confusion and conflicts. For example, EJV Law, CJV Law, and WFOE Law were created for FIEs. The Company Law was tailored for the domestic firm, which had many rules incompatible with the foreign investment legal framework. It was acknowledged that “Chinese law treats Chinese and foreigners unequally, or more accurately, treats Chinese nationals and legal persons, including those established by foreign investors, less favorably in terms of the establishment of enterprises and income tax than foreign investors coming directly from abroad.” The design of such dualist structure, as Huang asserted, was “to insulate SOEs from the reform while using FIE to reform the ‘socialist market economy.’” The PRC Company Law and SOE Law illustrated this issue. For example:

“The Company Law, in theory, is supposed to be a unified legislation governing firms of all ownership types, but in fact, separate laws designed for firms of different ownership types have remained in force. Indeed, the Company Law has specifically stipulated the continuation of the separate legal regime for FIEs.

Thus, for the FIE sector, the three landmark laws, the PRC Law on Sino-Foreign

285 For example, under EJV Law, WFOE Law and CJV Law, the board of directors is the highest power of the company. Under P.R.C. Company Law, the shareholder meeting is the highest power of the company.
Equity Joint Ventures (1979), the PRC Law on Wholly Foreign-Owned Enterprises (1986), and the PRC Law on Sino Foreign Contractual Joint Ventures (1988) remained in effect. For most of the SOEs, a critical prerequisite for SOEs to come under the jurisdiction of the Company Law has not been met—that they are reorganized into either “companies limited by shares” or “limited liability companies.” Thus, for the SOEs, the relevant piece of legislation continues to be the PRC Law on Industrial Enterprises Owned Wholly by the People promulgated in 1988 (hereafter SOE Law)\(^{288}\)

This dualist nature of the legal system attracted academic interest, some entertaining the thought that such design perfectly fits in the structure of “socialism conservation,” to preserve SOE rather than eliminate it.\(^ {289}\) Interestingly, some researchers pointed out that with China’s accession to WTO and decades of FDI development, Chinese leadership experimented with a new tactic, such as M&A, to restructure SOE in the hope of creating world-class enterprises through soft government planning.\(^ {290}\)


\(^{289}\) Ibid.

\(^{290}\) For example, “In particular, beginning with the creation of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003, China’s new leaders de-emphasized their predecessors’ move toward a greater reliance on market forces and a lesser reliance on Chinese government economic planners and state-owned enterprises. Instead, the new leaders set out to bolster the state sector by seeking to improve the operational efficiency of state-owned enterprises and by orchestrating mergers and consolidations in order to make these enterprises stronger. These actions soon led to institutionalized preferences for state-owned enterprises and the creation of national champions in many sectors.” United States Trade Representative, 2016 Report to Congress On China’s WTO Compliance, January 2017, accessed July 2017, https://ustr.gov/sites/default/files/2016-China-Report-to-Congress.pdf.
Last, since the 1990s and China’s massive business law legislation, the rule of law started to be a frequent topic among western academics. One of the frequent themes were whether China could maintain the current pace of development in the 1990s without meaningful development in China’s legal infrastructure. One of the common comments from Western academics was “China’s story defies western assumptions about the relationship between capitalism and the rule of law.” As one scholar observed, obstacles created under China’s FDI policy and law linked to these issues, “the regulation either rigid without flexibility or flexible but lack transparency, there is no consensus on to what extent foreign capital is allowed in China’s socialist economy reform,” except, perhaps, a decision from leadership after long and closed internal debates.

2. Ideological and Constitutional Framework

As the second chapter discussed, during the 1980s, Deng Xiaoping proposed the “two hands theory,” which referred to the authority would one hand focusing on economic development while the other hand is focusing on the regulations and laws in

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response to complaints about legal system by foreign investors. During the 1990s, a massive wave of commercial, civil, administrative, criminal laws designed to build China’s legal system. Legislation benefited FDI tremendously. These laws and regulations were the extensions of China’s foreign investment policies and underlying ideological and constitutional framework. Thus, it is important to exam the ideological and constitutional context of China’s judicial modernization. These discussions provide a necessary context to understand the extent and forms of China’s commercial system reform, which would be helpful in understanding the conflicts between the goal of preserving a revolutionary socialist agenda and the goal of promoting freedom of contract and foreign investments under a market system.

The first part of this section outlined the progress in China’s ideological reform, which identified that the authority relaxed the ideological prejudice against market and profit. This progress provided an excellent basis for China’s further relaxation on FDI regime, as the next section FDI legal framework demonstrated. The second part of this section focused on the constitutional development of the China’s economic system, which suggested that the consistency between the ideological reform and constitutional reform. It further provided a textual analysis considering the issue of a socialist

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294 The two hands policy meant that on the one hand, the economy must be developed while on the other hand, the legal system must be strengthened. The four modernizations referred to the need to modernize agriculture, industry, national defense, and science and technology. See Randall Peerenboom, “Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People’s Republic of China,” Berkeley J. INT’L L. 19 (2001): 161-163. See the previous chapter on Deng Xiaoping “Two hands” Theory.
economic order under the Constitution, which illustrated the dilemma between the political agenda of the authority and the economic interests of the foreign investors for securing freedom of contract.

a. Ideological Framework

In 1997, the 15th National Congress of CPC report proposed “rule the state in accordance with the law.” It highlighted the implication of this new agenda, as it pointed out “Rule the state in accordance with the law is the basic strategy, the necessity of developing the ‘socialist market economy’ and important sign of civic progress, and an important guarantee for the long-term stability and security of the state.” In 1990, Administrative Law and Litigation Procedure Law clarified the scope of administrative litigation, the responsibility of the government agency under different conditions. This legislation gave investors and private citizens a chance to ask court review government action. In 1994, the Standing Committee of the NPC adopted State Compensation Law, which stipulated the scope of compensation, standard, procedure, and applicability. This legislation offered a legal framework for investors and private citizens to settle their disputes with the government agency in the courthouse. Although

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296 See: PRC Administrative Law and Litigation Procedure Law
these laws were far from perfect in theory and in practice, the significance was undeniable. In addition, Administrative Reconsideration Law was promulgated in 1999, which provided statutory oversight on the government action.\textsuperscript{297} These measures improved the accountability of the government. On a side note, since China restored the judicial system, China started to rebuild people’s court, people’s procuratorate, arbitration system and lawyer system. Until 2006, there are about 190,000 judges, 140,000 prosecutors, and 130,000 lawyers.\textsuperscript{298} These new professionals formed the basis of China’s rule of law system.

The most important ideological reform between 1992-2005 focused on the relationship between socialism and the role of the market. The reform involved with three stages. The first stage normalized the notion of the market economy by establishing the new party line the “socialist market economy with Chinese characteristics” in 1993.\textsuperscript{299} The goal is to desensitize the negative connotation of the market and profit. The second stage further opened the market by removing practices of a centralized command economy, creating free price market, restructuring SOE management, and developing the commercial legal system. These measures substantially transformed China’s command economy. It also introduced a new notion

\textsuperscript{298} Ibid.
\textsuperscript{299} Ibid.
of replacing government command with market and court. The third stage was to
decriminalize bourgeoisie by allowing them to join the communist party. These new
developments expressed a historical coherence after Deng Xiaoping’s legacy policy of
the Reform and Open Up, which were all embedded and reflected in the Constitutional
amendments. These reforms officially ended the debates of socialism and capitalism
throughout the 1980s and concluded that the old system existed for historical reasons,
and now it is time to move forward to the “socialist market economy,” which is more
appropriate to serve the socialist modernization.300 FDI policy and law during this period
benefited tremendously from these new reform measures because first, a free domestic
market started to emerge in China when government gradually stepped back from their
intrusive role in the economic transaction. Second, the expansion of market reform
created a domestic market with practices compatible with the global common standard.
China gradually adopted Company Law, Contract Law, Security Law, Antitrust Law,
Insurance Law and many others to build a modernized legal system and professional,
and competent legal service industry.

On the part of political development, the 14th National Congress of CPC
redefined China’s economic system by concluding China would move away from the

300 Zhonggong zhongyang guanyu jianli shehui zhuyi shichang jingji tizhi ruogan wenti de jueding
(中共中央关于建立社会主义市场经济体制若干问题的决定)[Resolution of the Central
Committee of the Communist Party of China on Some Issues concerning the Establishment of
the System of Socialist Market Economy], December 17, 1993, accessed July 31, 2017,
“old system,” 301 It concluded that previous economic system “existed for historical reasons” with “certain great contributions.” 302 However, it was time to move forward because such system had been increasingly inadequate to serve the “development of modernization.” 303 The 14th National Congress of CPC proposed a new party line of developing the “socialism with Chinese characteristics.” 304

On the part of the economic reform, The Third Plenary Session of the 14th National Congress of CPC adopted Some Issues Concerning the Establishment of the Socialist Market Economy [hereinafter the Resolution on the Socialist Market Economy]. 305 The 1993 Resolution on the Socialist Market Economy ended ideological debates and reaffirmed the necessity of further Open up. It declared that the socialist market economy is embedded with a socialist system. 306 The nature of the “socialist

301 “The old economic structure has its historical origins and has played an important and positive role. With changing conditions, however, it has come to correspond less and less to the requirements of the modernization programme. The most profound change brought about by the reform in the last 14 years is that many ideological and structural shackles have been shaken off. This has released the initiative of the masses, so that China, with its 1.1 billion people, is now creating a vigorous socialism.”  see: Full Text of Jiang Zemin's Report at 14th Party Congress, October 12, 1992, accessed July 31, 2017, http://www.bjreview.com.cn/document/txt/2011-03/29/content_363504.htm.
302 Ibid.
305 Resolution of the Central Committee of the Communist Party of China on Some Issues concerning the Establishment of the System of Socialist Market Economy.
306 §1 ¶2 Resolution of the Central Committee of the Communist Party of China on Some Issues concerning the Establishment of the System of Socialist Market Economy.
market economy” was to let market allocate the resources with state macroeconomic regulation and control. The resolution outlined area of reform, which included tax, bank, SOE corporate governance, and legal system.\(^{307}\)

The Resolution first explained that the “socialist market economy” system embedded with China’s socialist system. The main purpose of the socialist system was to let the “market played a vital role in the allocation of the resource under the state macroeconomic regulation and control.”\(^{308}\) In addition, the Resolution redefined the role of the central planning. According to the Resolution, central planning “study and create a strategic plan based on the market.”\(^{309}\) This new policy substantially transformed the conventional role of the intrusive central planning under the command economy system.\(^{310}\) The 1993 Resolution continued the export-oriented FDI policy, which focused on creating a desirable investment environment to attack export-oriented or technologically advanced foreign investment.\(^{311}\) One of the highlights under

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\(^{309}\) Resolution of the Central Committee of the Communist Party of China on Some Issues concerning the Establishment of the System of Socialist Market Economy.

\(^{310}\) §4 ¶(21) Resolution of the Central Committee of the Communist Party of China on Some Issues concerning the Establishment of the System of Socialist Market Economy.

\(^{311}\) §4 ¶(39) Resolution of the Central Committee of the Communist Party of China on Some Issues concerning the Establishment of the System of Socialist Market Economy.
the Resolution was the fact that the political rhetoric relaxed the tone on the market, it further emphasized that the important role of the market and law in balancing the economic development. As the Resolution pointed out: “The main measure is economy and law, and the administrative interference is supplementary.”

In response to the Resolution on the Socialist Market Economy, State Council adopted series implementing directives on economic reform, which further relaxed the market access and transparency for the foreign investors. On June 8, 1994, State Council issued Key points in Implementing Economic System Reform. This program provided a detailed explanation on areas of the reform. Which can be categorized by the following:

1. Financial System Reform,

312 Ibid.


314 For example, the Government Law and Order Reform, Investment System Reform, Foreign Trade System Reform and Foreign Exchange Reform were the four programs related to FDI regulatory regime. The foreign exchange reform ended foreign exchange retention system and foreign exchange coupon. It calls for establishing foreign exchange market between banks. RMB under general account can be converted to foreign exchange without administrative permission. The foreign trade system reform call for decentralization of regulation by delegating more power to local authority.

2. Tax Division Reform, \(^{316}\)

3. Foreign Exchange Reform, \(^{317}\)

4. Economic System Restructuring, \(^{318}\)

5. Foreign Trade System Reform, \(^{319}\)

6. Investment System Reform, \(^{320}\)

7. Government Law and Order. \(^{321}\)

With the developments of the ideological reforms, the 16th National Congress of the CPC adopted the Decision on Improve the “Socialist Market Economy” System, which established a new theoretical framework for China's modernization. It proclaimed to

\(^{316}\) Ibid.


\(^{321}\) Guowuyuan guanyu jiaqiang zhengfu fazhi gongzuo de jueding (国务院关于加强政府法制工作的决定) Decision on Strengthen the Law and Order of Government work
establish “a unified, open modernized market system that is competitive with the order.” In addition, it called for a sustainable socio-economic development system.322

The 16th National Congress also ratified Jiang Zemin’s “Three Representatives” theory, a theory essential to further decriminalize and normalize bourgeois. Jiang Zemin's "three represents" campaign, which emphasized the CCP's role in representing the interests of people, including capitalists and workers and peasants.”323 In the second chapter, the Party vocally questioning the role of the bourgeoisie in Chinese economy. The foreign investment policies and laws extended the central authority’s limited supports to the market economy and private sectors. The new “three representatives” implied Party’s relaxation on the market and central control. The CCP had opened its party membership to entrepreneurs.324 The “three” refers as:


323 Comrade Jiang Zemin first propounded the important thought of Three Represents during his inspection tour of Guangdong Province in February 2000. He emphatically pointed out, "An important conclusion can be reached from reviewing our Party's history over the past 70-odd years; that is, the reason our Party enjoys the people's support is that throughout the historical periods of revolution, construction and reform, it has always represented the development trend of China's advanced productive forces, the orientation of China's advanced culture, and the fundamental interests of the overwhelming majority of the Chinese people. See “Three Represents Three Represents,” CPC News. June 23, 2006. Accessed April 20, 2017. http://english.cpc.people.com.cn/66739/4521344.html.

• “Represents advanced social productive forces” stands for economic production

• "Represents the progressive course of China's advanced culture" stands for cultural development

• "Represents the fundamental interests of the majority" stands for political consensus.  

The above reform further removed cultural and political obstacles against market and profit, which were unprecedented for foreign investment in the 1980s. Under this new agenda, China’s private sector no longer needed to hide behind the veil, which established a foundation for the development of Chinese market system by promoting an open and inclusive investment environment.

b. The Constitutional Framework

The ideological reform that benefited China’s investment environment had been affirmed by the Constitution Amendments. Few months prior to 14th Central CPC Congress, the NPC adopted the 1993 Constitution Amendment. This landmark amendment involved certain paragraphs in the Preamble and the General Principle section, which laid out a new foundation to assure China’s economic modernization. The main theme of the amendment was the “socialist market economy,” which removed

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ideological taboo of private ownership by constitutionally supporting private sector and replacing central planning economy with the less intrusive economy management system. The amended paragraph of the Preamble established a theoretical basis for the “socialist market economy” and foreign investments, as it provided that:

“China is at the primary stage of socialism. The basic task of the nation is to concentrate its effort on socialist modernization in line with the theory of building socialism with Chinese characteristics.”

To implement modernization, the Preamble asked that:

“Under the leadership of the Communist Party of China and the guidance of Marxism-Leninism and Mao Zedong Thought, the Chinese people of all nationalities will continue to adhere to the people’s democratic dictatorship and the socialist road, persevere in reform and opening to the outside world, steadily improve socialist institutions, develop socialist democracy.”

The 1993 Constitution Amendment adopt new economic system the “socialist market economy” under article 15, and redefined the state economy and its relationship with socialism, as it provided that:

“The State practices “socialist market economy.” The State strengthens economic legislation, improves macro-regulation and control.” "The State prohibits in accordance with law any organization or individual from disturbing the socio-economic order.”

326 Preamble, Constitution 1993.
327 Preamble, Constitution 1993.
328 Article 15, Constitution 1993.
The 1993 Amendment signified a major transition of the narrative over the nature of the private sector. On many levels, it ended the vacuum of silence and uncertainty around the Reform and Open up after the Tiananmen Protest with full confident on the further economy and institutional reform. New national economic policy and ideology reform had been contextualized by the 1993 Constitution amendment. The Amendment provided that “China is at the primary stage of socialism. The State practices socialist market economy.” 329 The Constitution amendment specified the new expression of state economy as the “socialist market economy.” The second part of the article 15 seems provided additional information to explain the part of “socialism” as it pointed out "The State strengthens economic legislation, improves macro-regulation and control." "The State prohibits in accordance with law any organization or individual from disturbing the socio-economic order." 330

The socioeconomic order was a common term under command economy system, which normally referred to the central command or central plan. Clearly, this new amendment was troublesome for its lack of precision and clarity under the legal text. As the previous chapter illustrated, many government’s intrusive plans created more problems than it solved for foreign investors. The 14th National Congress of CPC

proposed a new line, which moved away from the central command by redefining the relationship between market, central plan, and law. The new political line established a basis of interpretive principle with better and clearer guidance.

Although the Constitution did not further specify the precise meaning of this term, it did not stop the central authority to emphasize the importance of the socioeconomic order. For example, China’s 1997 Criminal code dedicated one chapter with the title “Crimes of Disrupting the Order of the Socialist Market Economy.” Based on the relevant articles under Criminal Law, crimes categorized as “Disrupting the Order” were common white collar crime, such as tax evasion, smuggling, piracy, fraud, insider trading. In addition, this SPC’s internal directive might also shed some lights and help you understand the different dimension of the Social-economic order. Based on the internal directive, there were both legal aspect and political aspect of the socio-economic order. The legal aspect could be found in criminal law, and other commercial laws, such as bankruptcy. The political aspect of the “socio-economic order” was a little complicated. The internal directive judged the political aspect based on the consequence of the law enforcement or the impact of the law enforcement on a community. For example, in bankruptcy cases, SPC had issued directives ask local court pay attention to political implication of the case or to maintain socioeconomic order by

asking a local court to coordinate with the local authority in cases with potential impacts on the local community in large:

After debtors enter into the bankruptcy procedure, as it involves the interests of many parties including creditors, debtors, investors and employees, the contradictions among them are particularly prominent, improperly handling such contradictions would lead to mass incidents or unexpected events and sabotage social stability. Therefore, in the trial of enterprise bankruptcy cases, the people's courts shall adhere to the leadership of the local Party committees and give full play to the role of the risk warning mechanism, the cooperation mechanism, the capital guarantee mechanism and other coordination mechanisms established by the local governments so as to provide assistance for the governments to maintain stability in handling enterprise bankruptcy cases.³³²

The above quotation demonstrated a unique feature of Chinese constitutional system concerning the relationship between the party and the state in the context of commercial law, which was also a contentious issue for many interested academics and investment community. This internal directive provided reasons justified foreign investors concerns over the independence and fairness of China’s judicial system. The

internal directive asked the court to “coordinate” with local political and government entities raised many questions. Although, a textual analysis of the Constitution would found a constitutional basis to support government’s interest in maintaining social orders, for example, in bankruptcy cases, the forms and manners of carrying out this duty by the court suggested by the internal directive raised many questions. It is undeniable that there is a legitimate government interest in ensuring social order and basic rights of the victims under bankruptcy cases. However, the above internal directive presented a more troubling message: a lower court is not trusted by governments and people to reach professional opinion in measuring and judging different interests.

Although there have been problems with the enforcement of Rule of Law, the Constitution did pledge to support a better legal system for private sectors. The 2004 Constitution Amendment clearly stated to “encourage support and guide non-public sectors in accordance with the law,” and it protects “human rights.” Article 16 of the Constitution, which reads, "State enterprises have decision-making power with regard

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333 China’s Constitution provided conceptual framework and legal basis for Party’s leadership in forming guiding principles for social governance. The problem with such directive, was the manner of implementation. For example, see PRC. Const. Art.1.

334 “The State protects the lawful rights and interests of the non-public sectors of the economy such as the individual and private sectors of the economy. The State encourages, supports and guides the development of the non-public sectors of the economy and, in accordance with law, exercises supervision and control over the non-public sectors of the economy.” PRC. Const. Art. 11. For example: Art. 33. "The State respects and preserves human rights." The original third paragraph is changed to be the fourth.
to operation and management within limits prescribed by law, on condition that they submit to unified leadership by the State and fulfill all their obligations under the State plan. State enterprises practice democratic management through congresses of workers and staff and in other ways in accordance with law”, was revised to read, "State-owned enterprises have decision-making power with regard to their operation within limits prescribed by law. State-owned enterprises practice democratic management through congresses of workers and staff and in other ways in accordance with law. 335 This amendment further removed the central planning system from Chinese economy, which promoted the modernized economy system for both private and foreign investors.

3. FDI Legal Framework 1992-2005

EVJ Law was the first comprehensive legislation concerning foreign investment in mainland China. This short fifteen articles legislation was later supplemented by EVJ Implementing Rule in 1983, and other various administrative laws concerning tax, labors, land use, foreign exchange, and business legislation. 336 The CJV Law and WFOE Law were created in 1986, but the Implementing rule for CJV Law was not promulgated until 1995. With the ideological, political and constitutional reform throughout the 1980s, China further relaxed regulations in investment and market access. On the one hand, new amendments removed multiple restrictions plagued the investment

336 See EJV Law, previous chapter discussions.
communities in the 1980s, such as restrictions on labor management, restrictions on market access, or exportation. On the other hand, new policies opened new industries for foreign investors, especially after WTO accession. The development of the security and insurance market since 1993 also opened new opportunities for the foreign investors. However, structural issues remained: the lack of transparency and predictability of the FDI legal system not only created an unfair treatment for investors but also created risks of corruptions. This happened when the central authority produced policies and regulations without proper consideration of the market reality. One common example would be foreign investors use Chinese firms as the straw man to invest or control a restricted industry. 337

This section mainly focused on new developments between 1992-2005: first, the emerging of the new FIE registration process and regulatory agency restructure. It will outline the basic FIE registration process and regulatory framework. Second, the development of the EJV, CJV, and WFOE regulatory framework. It will pay special attention to the differences between the regulations in the 1980s and 1990s to showcase the relaxation of the investment regulations. In addition, it highlights the special legislation that protects Taiwanese investors. Next, it will focus on the publication of Catalogue for the Guidance of Industries for Foreign Investment. Fourth, it will discuss the promulgation of People’s Republic of China Company Law and its

implication to China’s FDI regulatory framework. Last, it will briefly discuss the issue of the rule of law during this period with special attention to Chinese business culture that interpreted by western writers. The main purpose of this section is to show: first, the progress of FDI regime under the “socialist market economy”; second, the effects of China’s FDI regime expressed conflicted agenda between the revolutionary principle of supporting central planning under socialism and the principle of socialist modernization in supporting freedom of contract.

a. Development of the framework

Before examining the new developments in EJV, CJV, WFOE framework, it is necessary to have an overview of the regulatory agency and the general registration process that evolved between 1992-2005. To better serve China’s “socialist market economy,” legal and institutional reforms started simultaneously between 1992-2005. MOFERT, the department used to charge the verification and approval of the FIE project, had been restructured as Ministry of Commerce (MOC).³³⁸ Under the new administrative system, MOC’s duties had been separated into three areas:

³³⁸ Guowuyuan bangongting guanyu shangwubu lvxing xianxing xingzhengfagui, guowuyuanwenjianzhong xiangying zhize de tongzhi(国务院办公厅关于商务部履行现行行政法规、国务院文件中相应职责的通知)[General Office of State Council Notice on MOC Carrying Out certain Duties prescribed by Current Administrative Law and State Council Directives], issued by State Council General Office on October 20, 2003. For example, this document outlined the jurisdiction of MOC:

1. Any duties involved with MOFERT or MOFEC under laws and decrees will be carried out by MOC.
2. Recording of the cases processed by local authorities.
1. FDI Policy study and draft,
2. Verification for special FDI project involving investment above statutory threshold,
3. Supervising and coordinating local authority's work.

A multi-level approval process for FIE registration developed between 1992-2005. Under this process, FIE started from the step of submitting a letter of intent describing the proposed JV to the MOC branch office. The branch office would send the proposal to a corresponded industrial supervisory department. This department would review the business proposal. State Planning Commission would involve in this process if the proposed project exceeded the amount of investment, which required a further review to ensure such project would not disrupt the state annual economic plan.  

3. Verification and recording of the FIE contract, agreement, feasibility study involving oil, natural gas exploitation
4. Exportation license involving exportation of goods subject to quota regulation;
5. Verification and approval cases involving FIE establish oversea branches

See: General Office of State Council Notice on MOC Carrying Out Certain Duties prescribed by Current Administrative Law and State Council Directives. A list of MOC duties can be found on the State Council Notice:

1. policy studying and policy drafting (study and analysis nationwide FDI status, routine report to State Council, policy draft, and legislation),
2. verification and approval for a certain project (verification, approval for JV contract, article of association for the project above a threshold or restricted industry sector, or involved quota) or verification and approval for an amendment of JV contract or article of association; increase or reduce registered capital; transfer of shares, and M&A,
3. supervision JV contract and article of association,
4. comprehensive coordination, internal department management for policy enforcement, statistic,
5. NDRC and MOC jointly produce and issue the Catalogue.

the meantime, a joint feasibility study must be conducted by both Chinese and foreign parties as the part of the application. If the project is below the $30 million thresholds, then this application can be processed by agencies at municipality or provincial level. Logistically, it was easier for foreign investors to have a local authority process their applications.

*Figure 1.* FIE establishment process evolved during 1992-2005.

1. Permission from MOC,
2. Business license, Enterprise with Foreign Investment or an investment from Hong Kong or Macao Investment (FIE) shall apply business license or amendment of license from SAIC within 30 days of receiving Certificate of Approval for Establishment of Enterprise with Foreign Investment in People’s Republic of China or Certificate of Approval for Establishment of Enterprises with Investment of Hong Kong, Macau, and Chinese Oversea in People’s Republic of China (FIE certification).
3. Other registration, for example, applicable SAFE or Custom registration.

This multiple leveled registration was not without problems. One of the problems was the delay. To avoid the complex and time-consuming approval process, some investors would, even under recommendations of certain local officials, to intentionally separate an intended investment project into several smaller projects. For example, the provincial authority could verify and approve a project below 30 million dollars. In order to attract more investors, local authorities might recommend foreign **Provincial government examination and approval (project below 30 million dollars)**

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investors to register a smaller investment project with the local authority. An investor could either set up numbers of smaller projects and later merge them together or later increase the investment of the initial small project. Such practice was prohibited by the central authority. The Central authority issued multiple directives to prohibit local authority or investor explore such mechanism to bypass the investment threshold. For example, Kumho Tire and Nanjing Tire formed an EJV in 1994, the total investment was 119 million dollars, which would trig approval process from the central authority. However, Nanjing authority and Kumho Tire conspired together with an investment project under the provincial authority threshold. The investor later increased investment and shares in four separate times, which discovered by the State Council. The central authority revoked all beneficial tax policy for Kumho Tire and issued Tax charges. Although Kumho received monetary punishments, an official at Nanjing government only received a warning from the government. It was true that such sanctions were unfair to the investor because it only sanctioned foreign investors (such

as revoke the permission for FIE project) without imposed strong punishments against officials violate these rules.  

The 1979 EJV Law, later amended in 1990 established the basis of China’s FIE regulatory framework throughout the 1980s. During the 1990s, China started a massive wave of commercial legal system construction with legislation such as Company Law, Contract Law, Labor Law, etc. Many laws adopted during the 1990s was later then amended after China’s accession to WTO. On March 15, 2001, The Ninth National People’s Congress adopted EJV Law amendment, which focused on the following area:

1. Labor
2. Domestic Purchase
3. Dispute resolution

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345 See: Guowuyuan bangong ting guanyu dangqian shenpi waishang touzi qiye youguan wenti de jingjitongzhi (国务院办公厅关于当前审批外商投资企业有关问题的紧急通知) [State Council General Office Urgent Notice on Certain Issues Concerning Verification and Approval of FIE Project]


Article 6 of the amended EJV Law requiring all employees of FIE must sign a contract.\textsuperscript{347} In addition, in pursuant to article 7, FIE must provide necessary assistance to the operation of a labor union.\textsuperscript{348} The amended EJV Law no longer requiring FIE purchase insurance from Chinese insurance company. As a compliance to WTO, FIE can purchase any insurance plan from an insurance company located in mainland China.\textsuperscript{349} Moreover, FIE could freely purchase supplies from any vendor or supplier. The article 10 of the amended EJV Law removed the preference of domestic vendor. It provided that FIE can purchase material and goods from the domestic or international market on the basis of “fair and reasonable.”\textsuperscript{350} Last but not the least, the amended EJV Law now specified that JV could litigate their dispute in court when no arbitration clause was provided by the JV contract or both parties failed to agree for arbitration.\textsuperscript{351}

The 2001 EJV Law Implementing Regulation Amendment was the first amendment since the end of the 1980s. China’s commercial environment and the

\textsuperscript{347} Art. 6 2001 EJV Law. “The matters of an employee of a joint venture, such as employment, dismissal, remuneration, welfare, labor protection, and labor insurance shall be specified by concluding a contract in accordance with the law.”

\textsuperscript{348} Art. 7 2001 EJV Law. “An EJV shall provide, to the labor union of its own, the necessary conditions for carrying out activities.”

\textsuperscript{349} Art. 9 2001 EJV Law. “All insurances of an EJV shall be covered by insurance companies within China.”

\textsuperscript{350} Art. 10 2001 EJV Law. “The raw materials, fuel, and other materials as needed by an EJV within the approved business scope may be purchased on the domestic or international market based on the principles of fairness and reasonableness.”

\textsuperscript{351} Art. 15 2001 EJV Law. “Where each Party thereto has neither provided an arbitration clause in the contract nor subsequently reached a written arbitration agreement, an action may be filed with a people’s court.”
economic system changed dramatically since the 1980s. With the massive price, tax and SOE reforms since the 14th National Congress of CPC, China established an economic system with a mix of market economy and small central planning elements. The 2001 amendment largely removed sections concerning the central planning system. For example, all sections concerning the “department in charge” had been removed.352 “Department in charge” was part of the central planning system: each enterprise or business entity would be assigned to one corresponded government entity. This government body would monitor, enforce and coordinate business operation with the central planning. During the 1980s, even FIE had to work with a “department in charge.” In addition, the EJV Implementing Regulation ended the policy of asking FIE to purchase supplies from domestic vendors. Another important development was the publication of State’s Provisions on Guiding the Direction of Foreign Investment and Industry Catalog. The catalog provided a comprehensive guidance on which industry enjoy relaxed regulations and which industry require a special approval process.353 During the 1990s, the central authority started SOE reform. As one of the reform measures, foreign investors were allowed to purchase shares or even engage in SOE operations from certain industry sectors. Other new measures include: first, FIE could reduce registered capital with permission from the authority.354 Second, the EJV Law amendment

352 The title of chapter 8 changed into purchase and sale without mention of planning.
353 Art. 4, 2001 EJV Law.
354 Art. 19, 2001 EJV Law Implementing Rules. “An EJV shall not decrease its registered capital within the duration of operation thereof. If the decrease is truly necessary due to change of the total investment, production and operation scale, etc., the approval of the relevant Examination and Approval Authority shall be obtained.”
removed all restrictions placed on non-cash contributions. The authority no longer required contribution in the form of the machinery need to the kind of machinery that would be unavailable to produce domestically.\textsuperscript{355} However, intellectual transfer agreement still requires the investor to transfer information to the authority.\textsuperscript{356} Last, the amendment removed payment of balance rule for FIE. The new amendment no longer requires FIE to maintain a balance of payment for foreign exchange.

The CJV Law, the Implementing Regulation, and MOFERT CJV Implementing Regulation Explanation formed the basis of the Sino-foreign Cooperative Enterprises regulations. The CJV Law offered basic framework and principle. The Implementing Regulation provided details regarding a certain aspect of the CJV enterprises.\textsuperscript{357} It specified the conditions of a permitted project and approval process. The Explanation provided necessary interpretation for the enforcement of the regulation. As the previous chapter discussed, the CJV Law adopted very similar regulatory framework with the EJV Law.

\textsuperscript{355} Art. 24, 2001 EJV Law Implementing Rules. “he machinery and equipment or other supplies contributed to the capital of an EJV by the foreign party thereto shall be necessarily required by the production of the EJV. The valuated price of the machinery and equipment or other supplies shall be no higher than the then-current prevailing price on the global market for the same type of machinery and equipment or other supplies.”

\textsuperscript{356} Art. 26, 2001 EJV Law Implementing Rules. “he machinery and equipment or other supplies contributed to the capital of an EJV by the foreign party thereto shall be necessarily required by the production of the EJV. The valuated price of the machinery and equipment or other supplies shall be no higher than the then-current prevailing price on the global market for the same type of machinery and equipment or other supplies.”

\textsuperscript{357} Zhongwai hezuo jingying qiye fa shishi xize (中外合作经营企业法实施细则) [CJV Law Implementing Rule] adopted by MOFERT on September 4, 1994.
The 2000 CJV Law amendment removed the preference of asking FIE to purchase from a domestic supplier. In addition, it removed the general article describing the tax benefits for the CJV company. The CJV Implementing Regulation was the first supplementary regulation for the CJV Law.\textsuperscript{358} The CJV Implementation regulation provided more details regarding the nature and conditions of CJV enterprises.\textsuperscript{359} Based on the reading of CJV Law and CJV Implementing Regulation, the CJV enterprise is a form of a business entity without legal person status. It cannot independently be held liable for outsiders. The CJV contract can specify the liability of each investor. Interestingly, unlike the EJV Law require unanimous board decision, the CJV Implementing Regulation adopted majority vote rule for operation issues: “Each resolution adopted at a meeting of the board of directors or joint management committee shall be approved by a majority of the directors or members present at the meeting.”\textsuperscript{360} For important matters, the CJV Implementing Regulation still followed unanimous decision rule, but it allowed the investors to specify other additional scenarios require unanimous votes in the CJV contract.\textsuperscript{361}


\textsuperscript{359} Zhonghua renmin gongheguo zhongwai hezuo jingying qiyefa shishi xize (中华人民共和国中外合作经营企业法实施细则) [PRC Contractual Cooperative Joint Venture Detailed Implementing Regulation] [Hereinafter Implementing Regulation], adopted by MOFERT on September 4, 1995.

\textsuperscript{360} Art. 28 CJV Implementing Regulation.

\textsuperscript{361} See article 29 CJV Implementing Regulation.
WFOE law had been amended by Standing Committee of NPC in 2000. The Implementing Rule was amended in 2001. These amendments represented China’s relaxation of WFOE regulation. For example, the central authority no longer required a WFOE project must be a kind that involving advanced technology.\textsuperscript{362} FIE was no longer required to purchase from a domestic supplier.\textsuperscript{363} The 2001 WFOE Implementing Regulation removed the exportation and domestic sale quota restriction. It further allowed WFOE to sell their product in the domestic market independently or through an agent.\textsuperscript{364}

Table 5. A brief comparison between the EJV, CJV, and WFOE regulations in the 1980s and 1990s.

<table>
<thead>
<tr>
<th>Contribution must be advanced technology</th>
<th>The 1980s regulation</th>
<th>1990s regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>NO NEED</td>
<td></td>
</tr>
</tbody>
</table>

(1) Amendment to the articles of association of the Cooperative Joint Venture;
(2) Increase or decrease of the registered capital of the Cooperative Joint Venture;
(3) Dissolution of the Cooperative Joint Venture;
(4) Mortgage of assets of the Cooperative Joint Venture;
(5) Merger, division or change of organizational form of the Cooperative Joint Venture; or
(6) Other matters that need to be unanimously approved by the directors or members present at the meeting of the board of directors or joint management committee as agreed upon by the parties to the Cooperative Joint Venture.

\textsuperscript{362} Art. 3, 2000 WFOE Law.
\textsuperscript{363} Art. 15, 2000 WFOE Law.
<table>
<thead>
<tr>
<th>Reduce Registered Capital</th>
<th>NO</th>
<th>YES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic supplier</td>
<td>YES, PREFERRED</td>
<td>NO NEED</td>
</tr>
<tr>
<td>Balance of Payment</td>
<td>YES</td>
<td>NO NEED</td>
</tr>
<tr>
<td>Domestic sale quota or restrictions</td>
<td>YES</td>
<td>NO NEED</td>
</tr>
</tbody>
</table>

*since the 14th National Congress of CPC on Reforming investment system, China further relaxed its FDI regulatory framework by removing many central planning restrictions.

Unlike the 1980s, the central authority did not provide clear guidance on which industry was restricted to the foreign investors. The central authority created to new guidelines to help foreign investors understand the investment policy. Some industry sectors were restrictive to foreign investors. There were multiple ways to deter an investment. Normally these restrictions ranging from qualification of the investor, the registration process, and operation restriction, profit restrictions. Take the example of commercial enterprise sector. The retail sector was one of many protected industries in China during the 1990s, the 1999 Measures on the Pilot Project for Foreign-invested Commercial Enterprises (hereinafter 1999 Commercial Investment Measure) provided an excellent example illustrating these restrictions.\(^\text{365}\) For example, under 1999 Commercial Investment Measure, the registered capital for JV in retail must exceed 50 million RMB. wholesale business must exceed 80 billion RMB. A qualified foreign

investor only limited to an investor whose annual sales exceeded 20 billion dollars in three consecutive years prior the application.\footnote{art.5 (1) 1999 Commercial Investment Measure.} In addition, the foreign investor’s asset must exceed 200 million dollars in the preceding year prior to application.\footnote{Art. 6 (2)1999 Commercial Investment Measure.} In order to limit investment in retail sectors, the measurement created a laborious application process. The feasibility study must be submitted and approved by local economic and trade commission. The local authority would file the report to state economic and trade committee before this committee would consult with MOFERT for making the final decision.\footnote{Art. 8, 1999 Commercial Investment Measure.} Even the authority approved JV; there were various restrictions on the structure of the JV. For example, Chinese investor shares must exceed 51% in such JV if the retail business expanded for more than 3 branches. In the wholesale business, the Chinese investor’s shares must exceed 51%.\footnote{Art. 6 (4) 1999 Commercial Investment Measure.} Moreover, such JV could only operate within a limited year. JV operation could not exceed 30 years unless the business was in the western rural regions.\footnote{Art. 6 (6) 1999 Commercial Investment Measure.} In retail JV, the authority limited the foreign investors’ capacity to profit from trademark and importation by requiring that trademark royalty could not exceed 0.3% of the annual profit of the JV.\footnote{Art. 7, 1999 Commercial Investment Measure.} Importation of products could not exceed annual sales value for 30%.\footnote{Art. 15, 1999 Commercial Investment Measure.}
Table 6. Restrictions on foreign investors in the retail industry (in comparison with the 2004 regulation).

<table>
<thead>
<tr>
<th>Foreign-invested Commercial Enterprises</th>
<th>1999</th>
<th>2004 (repealed in 2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Verification process</td>
<td>Must be verified and approved by local and central economic and trade committee before consultation and determination with MOFERT</td>
<td>Local MOC preliminary examination, MOC final decision. Local MOC authority preliminary review, Central MOC authority makes decision</td>
</tr>
<tr>
<td>Registered capital</td>
<td>50 million RMB for regular commercial enterprises 80 million RMB for wholesale</td>
<td>Same as domestic firm</td>
</tr>
<tr>
<td>Restrictions on years of JV operation</td>
<td>30 years (rural middle west region 40 years)</td>
<td>30 years (rural middle west region 40 years)</td>
</tr>
<tr>
<td>Shares in JV</td>
<td>Chinese investor must exceed 51% shares</td>
<td>Except for agricultural and related products, no restrictions by 2016.</td>
</tr>
<tr>
<td>Trademark restriction</td>
<td>Trademark royalty cannot exceed 0.3% of the annual profit of the JV.</td>
<td>No</td>
</tr>
<tr>
<td>-----------------------</td>
<td>---------------------------------------------------------------------</td>
<td>----</td>
</tr>
<tr>
<td>Importation restriction</td>
<td>Importation of products cannot exceed annual sales value for 30%.</td>
<td>No</td>
</tr>
</tbody>
</table>

*The regulations on foreign-invested retail or commercial sectors had been through a long history. The first regulation was adopted by MOFERT on April 4, 1995. Supplementary regulations were created in 1996 and 2001. The Interim regulation was then amended in 2004 and again amended in 2006 and 2015 until it was officially appealed in 2016. ³⁷³

One of the highlights of the FDI regime development was the regulations concerning Taiwanese investors. On March 5, 1994, the Standing Committee of the NPC adopted the Law of the People's Republic of China on the Protection of Investment of Taiwan Compatriots [hereinafter Protection of Taiwan Investors]. ³⁷⁴ Due to Taiwan’s special condition, investors from Taiwan were not protected by any bilateral treaties.

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protecting foreign investors. In addition, Taiwanese are not technically considered as “foreign investors.” In addition, there was no formal judicial channel or cooperation between Taiwan and China during the early 1990s. Thus, the NPC adopted new laws, which designed to protect the interests of the Taiwanese investors. In general, the conceptual framework established by Protection of Taiwan investor was consistent with China’s foreign investment policy. The only noticeable difference was the time limits for authority reviewing and verifying the project. Under Protection of Taiwan Investor, all investment projects, whether it was a JV or WFOE or CJV, the project must be reviewed within forty-five days by the authority. 

In 1999, in order to specify terms and conditions for enforcing Protection of Taiwan Investor, the State Council adopted Implementing Regulations. Interestingly, the article 8 of the Implementing Regulation listed permittable forms of the investment including stock holding, purchasing of real estate and even purchase small and medium-size SOE.

It was noticed that the EJV

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375 Art. 8 Protection of Taiwan Investor.
377 See art.8 of the Protection of Investment of Taiwan Compatriots:

Investment of Taiwan compatriots may take any of the following forms of investment in accordance with the law:

(1) to establish equity joint ventures, contractual joint ventures or enterprises with all capital invested by investors who are Taiwan compatriots (hereinafter generalized as enterprises with investment of Taiwan compatriots);
(2) to cooperate in the exploration and exploitation of natural resources;
(3) to engage in compensatory trade, processing and assembling or cooperative production;
(4) to purchase stocks or bonds of enterprises;
(5) to purchase house property;
framework did not specify whether a foreign investor could engage in these activities, although local ordinance permit investor to purchase stocks or real estate. Thus, under this rule, Taiwanese investors enjoy an extra privilege that supported by statutory language: to invest China’s small and medium-sized SOEs. In order to further facilitate investors from Taiwan, the central authority Taiwan Affair Office established coordinator networks, which provide communication service between the Taiwanese investors and China’s regulatory agencies. Some local government, such as Beijing established Taiwanese investor service center to accept complaints from the investors. Fujian People’s Court established special Taiwanese tribunal exclusively handling commercial disputes involved Taiwanese investors. These mechanisms were developed to mitigate the lack of bilateral investment treaties between Taiwan and China.

b. The Catalogue for Guiding Foreign Investment

During the 1980s and early 1990s, the EJV Law, WFOE Law and CJV Law and implementing regulations established the basis of FDI regulatory framework, which defined the conditions of the qualified and disqualified FIE projects. One of the most

(6) to acquire a land use right for development and operation;
(7) to purchase a small State-owned enterprise or collective or private enterprise; or
(8) other forms as permitted by laws or administrative regulations.

378 For example, the Si Chun Provincial Ordinance on Encourage Foreign Investment allow foreign investor to purchase property or invest in stock market. See Sichuan sheng guliwaishangtouzi tiaoli (四川省鼓励外商投资条例) [Si Chun Provincial Ordinance on Encourage Foreign Investment] adopted by Sichuang PC on December 24, 1996.

379 National People’s Congress Report on the Enforcement of Taiwanese investor protection law
significant legislation about China’s foreign investment was the Interim Provisions on Guiding Foreign Direct Investment [hereinafter the Investment Guideline] adopted by State Planning Commission, the Ministry of Foreign Trade and Economic Cooperation and the State Economic and Trade Commission on June 20, 1995. It provided a comprehensive and detailed guidance for investors, which largely improved the transparency, accessibility, and predictability for the FIE regulation. The main purpose of this regulation was to design a new investment guideline system. Under this new regulation, a foreign investor can refer to Catalogue for the Guidance of Industries for Foreign Investment for relevant administrative verification and review information.\textsuperscript{380} This catalog had been amended several times (1997, 2004, 2007, 2011, and 2015). The current version is 2017 Catalogue. Under this new system, all investment projects are categorized into four categories:

1. encouraged,
2. permitted,
3. restricted,
4. prohibited

The catalog only listed three types of industry: encouraged, restricted and prohibited. Any industry outside the catalog would consider as permitted. The catalog signified

\textsuperscript{380} Waishang touzi chanye zhidao mulu (外商投资产业指导目录) [Catalogue for the Guidance of Industries for Foreign Investment], Decree No. 7 of the State Planning Commission, the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation, December 31, 1997.
China’s new approach with the FDI. On the one hand, it offered a clear and easy guidance on the conditions and benefits for foreign investors. On the other hand, it borrowed some elements from China’s planned economy: the authority can manipulate the development of the economy. The publication of the catalog improved transparency, efficiency, and reliability for the investor community: the investor could investigate the relevant policy through the publication before starting project planning. Under the Interim FDI Guidance, the restricted industries normally were subject to the following restrictions:

- the JV contract must state terms of JV operation.\(^{382}\)
- Fixed asset investment by Chinese investor must be funded by funds belong to the Chinese investor or owned by a Chinese investor.\(^{383}\)
- The verification and approval must be conducted by the central authority (state council relevant industrial department) \(^{384}\)

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\(^{381}\) Zhidao waishang touzi fangxiang zanxing guiding (指导外商投资方向暂行规定) [Interim Provisions Guiding Foreign Investment] adopted by State Planning Commission; State Economic and Trade Commission; Ministry of Foreign Trade and Economic Cooperation on June 20, 1995. It was later amended in 2002

\(^{382}\) Art. 9 Interim FDI Guidance. “Restricted foreign investment projects must comply with the relevant laws and administrative regulations of the State, as well as the following provisions: (1) Chinese-foreign joint venture projects coming under the restricted category must have an agreed term of operation; and (2) In restricted foreign investment projects (A), the fixed assets invested by the Chinese party shall be the funds owned by the Chinese party itself or the assets owned by it.”

\(^{383}\) Ibid.

\(^{384}\) Ibid.
• Restricted industry project can turn into permitted if 70% of products are for exportation.\textsuperscript{385}

In addition, the interim FDI guidance laid out sanctions for project violating these conditions: the project permission would be revoked within 30 days of discovery. In addition, the contract, article of association, would be voided.

One of the issues for the above regulation was the part restrict the asset ownership for Chinese investor in a restricted industry. The intent of the regulator was to avoid foreign investor investing in a restricted project. Particularly, it tries to prevent foreign investor using Chinese investor as a straw man to circumvent these regulations. However, the statutory language was poorly drafted, which cannot fully meet the expectation of the policy maker. For example, the term “asset belongs to Chinese investor” was quite ambiguous.\textsuperscript{386} In practice, some foreign investors would agree to transfer funds to a Chinese investor in exchange for managerial rights or equity rights in the enterprise under a private “shareholding agreement.” The term “belong to” could not precisely identify this problem. It is important to note that, China’s public disclosure system was not fully developed during this period. New approaches and globalized

\textsuperscript{385} Art. 11 Interim FDI Guidance. “Restricted foreign investment projects (A) within the scope specified in subparagraph (1) of Article 6, if their export sales of products account for over 70 percent of the total sales of products, with due approval, may be deemed as permitted foreign investment projects, and shall not be subject to the restriction of Article 9 of these Provisions. Restrictions may be appropriately eased to the above mentioned foreign investment projects that can really make full use of the superiority in resources in the mid-west regions, and conform to the industrial policies of the State.”

\textsuperscript{386} Art. 9 Interim FDI Guidance.
public disclosure system have been advanced for the past few years, which would be discussed in the next chapter.

**Figure 2. How to bypass China’s investment restrictions.**

1. Chinese investor with funds sponsored by foreign investor
2. Chinese investor agrees to transfer all managerial rights or any rights and benefits of equity to foreign investor
3. Chinese investor register business entity with the funds provided by foreign investor
4. The Foreign investor uses Chinese investor structure as a straw man to invest restricted industry.

The interim FDI guidance was later amended in 2004. The 2004 amendment demonstrated a liberalized view on FDI. Take the example of the general principle laid out by the FDI guidance on the definition of the restricted industry:

**Table 7. Restrictive investment industry (1995 and 2004).**

<table>
<thead>
<tr>
<th>1995 Interim FDI Guidance</th>
<th>2004 FDI Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Projects involving technology that has been developed in or has been introduced into the country, and the production capacity can already meet the demands of the domestic market;</td>
<td>(1) Lagging behind on a technological level;</td>
</tr>
<tr>
<td>(2) Projects in industries designated by the State as pilot industries to absorb foreign investment or as industries wherein monopoly of sales is practiced;</td>
<td>(2) Detrimental to saving resources and improving the ecological environment;</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>(3) Projects for exploring or mining rare or precious mineral resources;</td>
<td>(3) Exploring or exploiting the specific types of minerals that are under protective exploitation as specified by the State;</td>
</tr>
<tr>
<td>(4) Projects involving industries that call for the State's overall planning; or</td>
<td>(4) Falling within the industries to be gradually deregulated by the State; or</td>
</tr>
<tr>
<td>(5) Other projects that are restricted by laws and administrative regulations of the State.</td>
<td>(5) Other circumstances specified in laws and administrative regulations.</td>
</tr>
</tbody>
</table>

The above comparison displayed the central authority’s relaxed view on FDI. Compared with 2004 Guidance, the 1995 Guidance was more protective. For example, the 2004 Guidance would deny an investment project if it involved outdated technology. 1995 Guidance would deny a project when the market is balanced. Another great improvement under the 2004 Guidance was to remove the sanction that a JV contract and article of association would be voided if they violate Guidance. As an administrative guidance, the 1995 Interim FDI Guidance lacked the legitimate constitutional authority to void an agreement between two private parties. Such regulation itself might violate China’s constitution. In fact, whether the contract is void or not would be a legal question determined by the court. State Council could not announce the validity of a contract without a specific delegation by the Constitution. Thus, it was a good
development when the 2004 FDI Guidance removed such sanction. In addition, the Supreme People’s Court even stated that “although FDI project may violate state law, certain relevant contract clause can still be effective and enforceable under the principle of separation.”

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c. PRC company law and corporate governance

The promulgation of 1993 PRC Company Law was an important development in China’s commercial legal system and FDI regulatory regime. Another great legislation was the General Principle of the Civil Code. On the one hand, these landmark laws fulfilled the gap of China’s modern corporate governance system. On the other hand, these laws created a dualist legal system that potentially conflicts and confuse foreign investors. The intention of the dualist system was clear: one legal framework specially dedicated to foreign investors and another one regulate domestic firms. However, the conflict between the PRC Company Law and China’s FIE regulation framework was inevitable. First of all, the PRC Company Law did not specifically exclude the application of the Company Law to FIEs. For example, the article 18 only established a very vague principle for the applicability of the law:

387 See Art. 57, P.R.C Contract Law. “If a contract becomes invalid, or is rescinded or terminated, the validity of the independent clauses therein that pertain to dispute resolution methods shall not be affected.” 
388 The Company Law of the People’s Republic of China (promulgated Dec. 29, 1993 by the Fifth Meeting of the Standing Committee of the Eighth National People's Congress of the People's Republic of China) [hereinafter PRC Company Law][zhonghua Renmin Gongheguo Gongsi Fa 中华人民共和国公司法]
389 See discussions about legal person from pervious chapters.
“The present Law shall apply to limited liability companies with foreign investment. Where laws concerning Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and foreign-funded enterprises provides otherwise, such provisions shall prevail.”

For example, the application of the PRC Company Law article 36 and article 53 concerned the procedure of establishing a board of supervisor. These rules might conflict with the corporate governance under article 36 of the EJV Law Implementing Regulation. The EJV Law was modeled on American corporate law, which established the board of directors as the highest authority in the corporation. The PRC Company Law article 36 stipulated shareholder meeting as the governing body exercising powers.

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390 Yuan Anyuan, “Foreign direct investments in China--practical problems of complying with China's company law and laws for foreign-invested enterprises,” in Northwestern Journal of International Law & Business 3 (2000): 484. Also see art. 36, P.R.C. Company Law, “The shareholders' meeting of a limited liability company shall be composed of all shareholders. The shareholders' meeting is the company's governing body, and shall exercise its powers in accordance with this Law.” art. 53 P.R.C. Company Law “The board of supervisors or, in the absence thereof in a company, the supervisors shall exercise the following powers: (1) Conducting inspection of the financial issues of the company; (2) Supervising the performance of duties by the directors and senior management personnel, and submitting a proposal on the removal of any director or senior management person who violates laws or administrative regulations, the company's articles of association, or any resolution of the shareholders' meeting; (3) Requiring the directors or senior management personnel to correct their conducts that prejudice the interests of the company; (4) Proposing to convene interim shareholders' meetings, and convening and presiding over shareholders' meetings when the board of directors fails to perform the duties of convening and presiding over shareholders' meetings as specified in this Law; (5) Putting forward proposals to the shareholders' meeting;”

391 Art. 36 EJV Law Implementing Regulation. “The general manager executes the various resolutions of the board meetings, and organizes and leads the daily operation and management of the EJV. Within the scope of authority granted by the board, the general manager externally represents the EJV and internally appoints and dismisses the personnel under his/her management as well as exercises other authorities granted by the board.”
In addition, PRC Company Law stipulated that the board of the director is responsible for the budget and profit distribution. Additional observations under Chinese company law including:

1. The Chinese company law did not recognize the fiduciary duty and derivative proceeding. This might be an issue for minority shareholders.

2. During the early 90s, the administration would enforce strict rules on “scope of the business,” the investors could not easily amend the business registration. For example,

The business of manufacturing chocolate could not suddenly engage in soft drink production because the government agency would follow a strict interpretation on the business registration.

The differences between 1993 PRC Company Law and western corporate practice reflected China’s unique economic system. The law stipulated that the shareholder meeting is the highest authority of the company, a different approach compared with other western market countries. China adopted an approach of shareholder activism, which gives more emphasizes on the. The 1993 Company Law

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392 See Art. 45 Company Law, Art. 37 EJV Implementation rule regarding legal representative creates some corporate governance issues when the legal representative, who has statutory authorization to bind entity for transaction and contract, appointed by the shareholder meetings as the president of the board of directors or executive director in smaller LLC, may disagree with a transaction approved by the board by refusing to sign on the contract. The available solution for this was a time consuming bureaucratic application process.
gave liberty to investors to let them decide if it is necessary to have a formal board of
director or supervisory board.\textsuperscript{393} Considering the limited development of China’s
commercial market and legal system, the idea of establishing a supervisory board
seemed to be an appropriate policy.\textsuperscript{394} In the United States, shareholders are the owner

\textsuperscript{393} See art. 37 P.R.C. Company Law. “The shareholders' meeting of a company shall exercise the
following powers:
(1) Making decisions on the company's operation guidelines and investment plans;
(2) Electing and replacing the directors and supervisors who are not the representatives of the
staff members, and making decisions on the matters concerning the remunerations of the
directors and supervisors;
(3) Approving the reports of the board of directors through deliberation;
(4) Approving the reports of the board of supervisors or those of the supervisors through
deliberation;
(5) Approving the annual financial budget plans and final accounts of the company through
deliberation;
(6) Approving the profit distribution plans and loss recovery plans of the company through
deliberation;
(7) Making resolutions on the increase or decrease of the company's registered capital;
(8) Making resolutions on the issuance of corporate bonds;
(9) Making resolutions on the merger, division, dissolution or liquidation of the company or on
the conversion of the corporate form;
(10) Modifying the company's articles of association; and
(11) Exercising other powers specified in the articles of association.
Where all the shareholders have reached a written consensus on a matter listed in the
preceding Paragraph, a decision may be directly made without convening a shareholders'
meeting, provided that all the shareholders shall affix their signatures and seals to the decision
document.”

\textsuperscript{394} See Anna M. Han, “China’s Company Law: Practicing Capitalism In a Transitional Economy,”
http://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1488&context=facpubs.
“China currently lacks any meaningful securities regulation to ensure that the market reflects
the value of the stock and to prevent manipulation of the market by individuals or government
entities. Although China issued Provisional Regulations on the administration of the Issuing and
Trading of Stocks on April 23, 1993 ("Provisional Regulations") and Interim Procedures for
Prohibiting Securities Fraud ("Interim Procedures"), aimed at trading on inside information and
fraud such as use of material information to affect the market, these measures do not provide
clear definitions or remedies to stockholders who are harmed by these activities.” Ibid.
of the company, which enjoy the fruits of their investment from the success of the corporation managed and controlled by the management, such as the board of the directors. This regulatory model largely relied on the development of an advanced security market, competent public disclosure system, and highly sophisticated legal system. During the early 90s, it might not be realistic to have China directly transport the western corporate regulatory framework. However, as the next chapter indicated, with the development of Chinese economy, China gradually adopted regulatory frameworks that are compatible with the common practice of the West market economy. PRC Company Law limited the distribution of dividends, transferability of the shares. PRC Company Law adopted supervisory board instead of relying on security market and security commission.\textsuperscript{395} In other words, China’s Company Law focused more on small size LLC that resembling American limited partnership. \textsuperscript{396} For example, the numbers of shareholder were limited to 50 peoples. \textsuperscript{397}

\textsuperscript{395} There were quite a lot discussions by western academics questioning Chinese supervisory board scheme. For example, “To monitor corporate activities, China could adopt mechanisms currently used in other markets. For example, stock markets and securities commissions can regulate such behavior as insider trading and stock manipulations by management. Outside creditors can also monitor the decisions of the management for profit maximization. Boards of directors can monitor management and respond to inefficiency by firing and hiring. The existence of a supervising board with broad powers will frustrate the desired market efficiency if the supervisors are not familiar with the company’s business and have no incentive to see the company profit.” Ibid.

\textsuperscript{396} Interestingly, the distribution of profits in a limited liability company is almost like a limited partnership in the United States. The distribution of profits is according to the percentages of contributed capital by the shareholders, not according to their shareholdings... For companies limited by shares, distribution is in accordance with the shareholders' shares. \textsuperscript{1} See Art. 45 Company Law, Art. 37 EJV Implementation Rule.

\textsuperscript{397} See art. 24 PRC Company LAW “The establishment of a limited liability company shall be subject to the capital contribution by not more than 50 shareholders.”
d. The rule of law
At the beginning of the new millennium, China’s legal and investment environment still rated poorly by the westerns. For example: “The Wall Street Journal and Heritage Foundation rated China in 2002 as a “mostly unfree economy (given a bright yellow color to join the likes of India, Cambodia, Romania, and Bulgaria)” even after more than 20 years of remarkable economic reforms. According to the cited study, “China’s legal and regulatory structure remains so riddled with contradictory internal (neibu) unpublished guidelines and exceptions that foreign businesses say progress in the rule of law has actually slowed in recent years.”\textsuperscript{398}

Complaints about China’s FDI law concentrated on the substance of the law and operation of the law. The law was obscure, ambiguous, and lack of transparency, conflict of rules between different levels of bureaucracy, inconsistent interpretation of the law, and regulation incompatible to global practice. \textsuperscript{399} With China’s painful process of massive business law legislation and reform, foreign investors and academics acknowledged the problems of the rule of law in China. On the one hand, it was important and necessary to have a modern legal infrastructure with transparent and


predictable legal guidance for business transactions, on the other hand, they were frustrated by China’s painful process of cultivating and building a modern legal system. As one concluded that “law is equated with a numbing bureaucratic process, entangling sound business projects in an endless review, overlapping government ministries with no evident purpose and endless opportunities for corruption and gratuities.”

Regulatory obstacles for business entities during the 1990s concentrated in three areas, which related to China’s industrial policy of protecting SOEs and inherited issues of China’s transition from a central planning economy to a market economy. The first area concerned on the role of industrial association and self-regulation. During the 1990s, to further promote self-regulation, many government agencies had been restructured as industrial associations. These associations tended to create a preferential treatment to SOEs or promote measures protect the industry at the cost of the consumer and the competition. The second area concerned regional bias by the

400 “Western academics noticed the discrepancy between the law in practice and law in book. This became problematic for foreign investors when Chinese legal system or administrative procedure law did not provide an adequate mechanism to prevent, punish and correct government’s behavior of not following EJV Law or PRC Company Law. The analysis also pointed out the core of the conflicts lies on the superiority of Communist Party in China’s constitutional framework.” Gary J. Dernelle, “Direct Foreign Investment and Contractual Relations in the People’s Republic of China,” DePaul Bus. L.J. 6 (1993):331-360.


402 For example, see: In those key industries, the dominant firms remain mostly state owned. As a result, the government plays a double role; it is both the owner of the major players and the referee, i.e. the regulator. Second, in the sectors where the government has retained its regulatory presence, many of the government ministries or regulatory agencies have 'affiliate companies' and give preferential treatment to them. This problem is particularly serious at the
government agencies. For example, local authorities would produce laws and rules to protect local business with discriminatory ordinances. The third area related to the government function. Certain government entities with approval authority might require business purchase service from certain business as a condition for administrative approval.

Unstable legal and regulatory framework” was one of many problems and challenges deterred foreign investors. The uncertainty was a great threat to China’s foreign investment regime. The lack of predictability and coherence was one critical

local levels. A good example of this phenomenon is that some local civil affair agencies in charge of issuing marriage licenses require applicants to take pictures only at designated photo shops, which are ‘affiliates’ of the agencies. Third, the governments at provincial and local levels are well known for creating and maintaining barriers to competition from other localities. For example, many local governments force dealers of beer, fertilizer, and medicines to only sell goods that are produced within their own jurisdictions.” Gary J. Dernelle, “Direct Foreign Investment and Contractual Relations in the People’s Republic of China,” DePaul Bus. L.J. 6 (1993):331-360.

Ibid.

For example, “Administrative monopolies have been subject to extensive criticisms by China’s policy-makers and intellectuals. There is a national consensus that more competition needs to be introduced into the industries that are dominated by the state, and some concrete measures have already been taken to achieve that goal. The restructuring of China’s telecommunication industry provides an example of China’s commitment to promoting competition in state-dominated industries.” David L. Weller, “The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge,” 98, no. 5 Columbia Law Review (1998): 1238-1282, accessed July 31, 2017, http://www.jstor.org/stable/1123382.

Ibid. David Weller, in his paper, detailed documented the excruciating administrative examining and approving process for the establishment of a FIE. he analyzed the regulatory framework and identified the decline of FDI with China’s overreaching and abusive regulatory regime.
issue for a foreign investor. Foreign investors normally relied on the published rules and regulations to make business plans, the sudden disruptions of the policy would create an undue burden for the investors. One of the most striking examples would be the pilot program of investing commerce industry in China during the early 1990s. The State Council failed to predict the market, which later suspended the investment approval for a period of time until the central authority developed new regulatory schemes. Many approved projects were restricted for any expansion because of the State Council ban. Another quite controversial example was China’s telecommunication industry. Foreign investors fell into a similar predicament when the central authority suddenly revoked approvals from lower government authority. When the central authority believed massive inflow of FDI projects in telecommunication created regulatory difficulties, the central authority just issued blank ban in all telecommunication sector by forcing foreign investor selling their investment to the state.

406 For example, See “The China Syndrome,” Economist, June 9th, 2012, difficulties of doing business in China, local competition, and "some unfriendly political decisions" including a "sudden and arbitrary tax on imported capital Goods.


These problems encountered by foreign investors illustrated the lack of internal coordination between China’s complex bureaucratic bodies. A bureaucratic agency might approve one FIE project, but a different agency might take a different position or change its position without proper coordination or notification to stakeholders. This became worse when there was no adequate legal system provided any meaningful remedies to foreign investors. 410 The problem with the central planning also reflected by Chinese authority’s ignorance to EJV property rights. For example, the local government would revoke pre-approved land using rights when the government later decided to have a public transportation project build on the same land that previously allocated for EJV without any compensation.411

These problems also perfectly illustrated the underdevelopment of the rule of law: the central authority cannot establish a credible and accountable system that serving national and political interests in the desired manner. One may conclude that Chinese authority’s reaction to the market demonstrates a difficulty in managing a

Japanese joint venture being directed to stop selling television sets outside the local province because it was "taking advantage of disparate regional pricing," apparently making the joint venture guilty of "profiteering"; a joint venture's general manager being removed by the company's department-in-charge; and reluctance of foreign exchange and bank officials to release hard currency earned from international sales by JV.”


411 Ibid.
modern regulatory framework with a variety of interests. A lack of experience in managing conflicted interest can be mitigated by more reforms and more practice. However, what truly troubling was a notion that “the rule of law” would be inconvenient in building China’s socialist market. Similar narratives can be found both in China and the West within the context of developing a better investment environment. One may argue China’s economic data tended to gloss over the quality of the development with the quantity.

In fact, the issue with China’s FDI regime expressed the conflicts between coherence, reliability, and predictability of the law and the changing nature of the FDI reform progress. FDI framework in the 1980s included a strong element of centralized planning. The FDI regime in the 1990s presented a more relaxed tendency. However, the extent and pace of the change have always been in debates. Although the centralized authority created general or abstract expressions about Chinese reform agenda through the Party Congress and Five-Year Plan, these vehicles lacked the level of certainty that a reasonable investor would normally require in formulating an investment project. With this reality in mind, it was not hard to explain most FDI projects during the 1990s were large JVs associated with the government for large

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412 See generally Richard H. Fallon, Jr., "The Rule of Law" as a Concept in Constitutional Discourse, 97 Colum. L. Rev. 1, 8 (1997). Indicating that one of the elements generally identified as necessary to the rule of law is "the supremacy of legal authority" and that "law should rule officials."
infrastructure constructions or smaller FDI projects associated with export-oriented labor-intensive industry sectors.

In summary, there are two forms of deviations from rule of law in the context of foreign investment regulatory framework. First, weaponizing laws to serve Beijing’s political interest. This type of deviation disregards the reliability and internal coherence of the law for political interest. Such interests are normally justified by the recognition or understanding or misunderstanding of a social-economic theory or ideological preference. The telecommunication sector is one good example explaining this issue. Second, commodifying judicial or administrative authority to serve personal interest. This type of deviation disregarded the integrity and honesty of the governance power, which is a form of corruption. Both forms of deviation share similar mechanism by taking advantages of an ambiguous law. However, while the second form of deviation is illegal and common around the world, the first form of deviation compromises the authority of the law because it suggests that administrators are either unable to utilize the law for the public good or unable to devise a reliable and coherent mechanism to serve complex political objectives. The Party possesses the supremacy of authority under China’s party-state system, the disciplinary framework of CPC established a foundation to explore a meaningful mechanism to check on officials in connection with the state government and legal system.  

413 In fact, the rule of law recognize that law

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could be a tool for social governance. The core of the rule of law requires that people
aware and understand the law. This means the rule must be communicated to the
audience in a fashion that the audience can understand and then take it as a guide for
their behavior. However, the development of China’s foreign investment regime
demonstrated a troubled pattern: the authority would disregard the reliability of the
law when it considers investors could outsmart the regulators. In fact, this was the
dilemma in China: well-defined rules could not be used to achieve complex governing
goals by the authority.

During the 1990s, Chinese business culture had been intensively discussed by
many western writers. From a retrospective, these views depicted a pattern of the
business transaction during the 1990s, which provided us more insights over China’s
foreign investment development. Two of the most iconic views about Chinese business
culture during the 1990s could be identified: first, Chinese businessmen or negotiators,
unlike their western counterparts, tend to ignore the details of the contract during the
business transaction. Second, Chinese partners prefer mediation or arbitration over
litigation. This study concluded that Chinese culture is not the cause or the reason to
explain such business behavior. On the contrary, this study considers Chinese culture

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*Between Culture, Commerce and Ethics,* in Greater China: Law, Society and Trade (A. Tay & C.

“The Chinese official and the Chinese citizen are part of a political structure in which the Party’s
will and policies have been the most effective law .... Laws and regulations have to be
understood in this wider context of a society in which the formal legal position is only one
consideration and still often not the most important.
plays an insignificant role in shaping Chinese business behavior. The legal system and rules helped to form China’s business culture.

First, it is true that Chinese investors tend to act in a more sensitive manner when personal authority or reputation is perceived to be threatened. However, avoiding contact details or litigations may not be the result of Chinese investors’ psychological tendency or Chinese culture. During the 1990s, most Chinese partners that a western investor worked with were linked to government or semi-government entities. SOE managers are de-facto government officials. Thus, in the contract negotiation settings, “being diplomatic” is one feature of government official language. For example, many investors and academics asserted that Chinese partners prefer abstract principle instead of detailed facts through a nonbinding letter of intent during the joint venture negotiations. Many explanations or theories for Chinese investors behavior linked to Chinese Confucian Cultural and psychological factors such as for avoiding public humiliation or confrontation to protect one’s personal authority or reputation.  

414 “Foreigners at the Gate: Sweeping Revolutionary Changes on the Central Kingdom’s Landscape—Foreign Direct Investment Regulations & Dispute Resolution Mechanisms in the People’s Republic of China,” Rich. J. Global L. & Bus 3 (2003): 128-129. For example, “Generally speaking, contract negotiations in China are broadly based, where the Chinese "seek general principles," rather than detailed rules explicitly built into to contract... Chinese step back from an actual agreement and begin negotiations by presenting a letter of understanding that outlines general principles. US managers are often put off because they want to get to details. They’re not averse to the rhetoric of the preambles, but they want to build a relationship on facts. For their part, the Chinese stress friendly introductions as a way of establishing their relationship. Therefore, the Chinese do not place priority on contractual specificities, but on "other social precepts such as mutual benefit, social harmony and long-term objectives as their guiding principles in observing the spirit of the transaction.” Nicholas R. Lardy, “Trade
Unlike small and middle-sized export-oriented FIE in the southern province operated by Hong Kong or Taiwan investors, western FIE project normally involved large investments with Chinese SOE partners. Thus, it was quite normal that these projects were negotiated and managed by Chinese SOE managers or officials tended to treat the project as one political task rather than a business task. With the development of China’s private sector and reforms, new generations of contract negotiators or business cultural speak the similar language with their western counterpart.

Western academics and investors accurately pointed out that Chinese prefer non-litigation forms of dispute resolution. Many westerns attributed such preference for Chinese Confucian cultural, the reality was far more complex. Although traditionally Asians preferred non-confrontational mechanism to resolve a personal dispute, it was important to note that the underdeveloped legal system would be the main reason shaped China’s business practice. There was no meaningful judicial system could handle most commercial litigations during the 1980s and early 1990s. China did not have a modern legal service market at the beginning of the 1990s. The most commercial laws were developed throughout the 1990s. The litigation system and litigation market were not fully developed until the late 1990s. Litigation was formal and transparent, which

was standard practice for a multinational corporation in resolving commercial disputes. However, China’s undeveloped legal system did not create sufficient litigation experience for Chinese business community. The first generation of the EJV Law framework acknowledged this reality and asked disputed parties to resolve disputes through arbitration; litigation was an option. Thus, the lack of meaningful litigation system would be the true reason for these transaction behaviors.  

Conclusion

Since the launch of the Reform and Open Up in 1978, Chinese foreign investment inflow expanded rapidly. The foreign investment inflow between 1992-2005 maintained the momentum of the domestic and foreign investment, which fueled economic growth. The central authority’s investment policy suggested two important transitions. First, the central authority recognized the importance of market and private interest by claiming to establish the “socialist market economy.” The Constitution further proclaimed that “private interest is protected and guided as part of the socialist market economy.”

Secondly, China needed to attract high-quality foreign investment through promoting the rule of law. This period signified China’s massive waves of commercial rulemaking.

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415 For example, one scholar observed that “Most foreign investors generally consult with lawyers before and during the process of FDI negotiations. However, it is normal for the Chinese to not consult with lawyers because this would infer that they did not trust the parties involved in the negotiations. Nicholas R. Lardy, “Trade Liberalization and Its Role in Chinese Economic Growth,” (paper presented at International Monetary Fund and National Council of Applied Economic Research Conference, New Delhi, November 14-16 2003), 1-10, https://www.imf.org/external/np/apd/seminars/2003/newdelhi/lardy.pdf.

416 PRC Constitution Preamble.
China gradually established a “dualist” regulatory framework with one system concerning China’s domestic firms, and another concerning foreign firms. This chapter concluded that although the dualist legal system accommodated China’s economic reality, it promoted discriminatory treatment among SOEs, private sectors, and foreign sectors. As next chapter points out, such arrangement became problematic and counterproductive in promoting a fair, transparent and open market under globalization. In addition, this chapter considered that the underdevelopment of China’s legal system shaped China’s business behavior of avoiding litigation during the dispute resolution and avoiding the contract details during the business negotiation. The study concluded that Chinese culture played an insignificant role in creating such behavior.
1. Introduction

The increasing demands for the relaxation of commerce and investment regulations and the goal of maintaining balanced and steady economic growth presented an acute tension to China’s policymakers since the emergence of new conditions and issues between 2006-2016. China needed new channels to ensure future economic growth because the traditional pattern of that development reached its limits. First, the economic benefit of the export-oriented manufacturing industry with cheap labor reached its limits due to the labor cost increases, global consumer market saturation and environmental and labor rights concerns.417 Second, the economic benefits of domestic infrastructure investment led by local government reached its limits due to market saturation and the risk of nonperforming government loans. A relaxed and investment-friendly environment might largely restrain the central authority’s capacity of enforcing regulations and rules designed to reduce market risk and fluctuation of the national economy in a more effective manner.418 In essence, the reformers and policymakers were facing a quagmire from which it could not escape, as

one put beautifully: the low-hanging fruits for reforms were all picked, now we are in a new situation. 419

Currently, China’s policymakers proposed multiple new policies and regulations targeting these issues. First, the central authority started Shanghai Free Trade Zone (SFZ) experiment in 2013, which was designed to streamline the foreign investment verification system.420 By 2016, many policies implemented in SFZ are now expanded nationwide and written into new FDI regulations with legislation proposals.421 Second, the central authority proposed One Belt One Road program, a multinational investment project designed to find solutions for the Chinese saturated infrastructure investment market and SOEs, although suspicions for the risk of economic errors by many western academics have been strong.422 Third, the central authority pushed a series of new policies and measures to relax restrictions on domestic entrepreneurship. On the part of private equity (PE) market, the authority had been taking precautionary moves: in order to avoid the negative effects and risks for the large inflow and outflow of the capital, the central authority developed a complexed capital control regime with rules and

regulations covering various economic sectors, such as PE market, finance, insurance and foreign exchange.\textsuperscript{423} The prime example for such control includes Qualified Domestic Institutional Investors (QDII) and Qualified Foreign Institutional Investors (QFII) experiments and foreign exchange regulations.\textsuperscript{424} Essentially, QDII and QFII regimes and other foreign exchange control measures were expressions of the central plan system 2.0. Only certain screened large institutional investors were allowed to engage in investment activities under the supervision of the central authority while individuals, and smaller investors are blocked out. However, there were exciting developments in the last few years. The success of the Shanghai Free Trade Zone experiment resulted in a new foreign investment regulatory framework that provided a certain level of national treatment for a foreign investor in certain industries. The policymakers started preferred share experiment, which ended “equal share, equal rights” corporate law principle by allowing investors to diversify their investment options and enabling modern corporate governance reform. The exciting new


\textsuperscript{424} The Qualified Foreign Institutional Investor program (QFII) is pilot capital investment program designed to allow qualified foreign institutional investors to invest Chinese stock market under certain restrictions since 2002. A variation of this program, RMB Qualified Foreign Institutional Investors (RQFII) was established in 2011 to enable permitted institutional (entity/ legal person) to use oversea RMB funds for security investment in Mainland China. See Article2, Measures on the Pilot Program of Securities Investment in Mainland China by RMB Qualified Foreign Institutional Investors. Ma Guonan, Robert N McCauley, “Do China’s capital controls still bind? Implications for monetary autonomy and capital liberalization,” BIS Working Papers No 233, accessed July 31, 2017, \url{http://www.bis.org/publ/work233.pdf}.
development of the business structure “Wechat economy,” as the latter section would discuss, created cashless, government-less, and self-regulating investment and business model that would revolutionize China’s foreign investment framework in the future. In the meantime, the central government started to work with the international legal framework by entering into various international agreements, such as the one targeting money laundry or tax evasion. Recently, China adopted new CSR (Common Standard Reporting system) and developing China’s public disclosure framework to promote a transparent and robust investment market.425

In this chapter, the main focus is the new development of the foreign investment policy and law from 2006 to 2016 with new opportunities and challenges. A brief overview of the economic data of the FDI development for the past decades would be presented in the rest of the introduction as a reference. The data acknowledged that the impact of China’s foreign investment on the world order is undeniable, and the relationship between China and the world is reciprocal. In order to illustrate how the central authority interpreted China’s new foreign investment framework, this chapter follows the same structure from previous chapters. The ideological and constitutional frameworks provide a necessary ideological and constitutional basis that assists readers in understanding the principles and contexts, within which the FDI legal framework

The main theme during this time was the recognition of rebalancing the relationship between market and the government by promoting a unified market access and market self-regulation. In addition, it has been promoting a transparent, fair and open market. It called for further reform on the government function in order to provide convenience for foreign investors.

Before the fourth section summarizes this study, the third section exclusively discusses the legal framework of the FDI regime during 2006-2016. This section would cover three issues: first, the new developments of the foreign investment regulatory framework with the Preferred Stock experiment; second, the new challenges of Chinese foreign investment framework in maintaining a reasonable government control without hurting the market activities; third, the new opportunity for Chinese foreign investment regulatory framework with China’s “wechat economy” and the international legal framework of public disclosure schemes in managing market behavior for public good. It concludes that the current policymakers acknowledged the importance of market freedom and the legitimate interest of protecting the public good. However, more reforms are necessary to maintain a reasonable, fair and transparent investment framework. This chapter will start with a brief overview of the foreign investment performance between 2006-2016. Then it follows the same structure of previous chapters by discussing the ideological framework and legal framework before the end of a short conclusion.
During the past thirty years, China has maintained a rapid rate of economic growth, “the average annual growth rate of real gross domestic product (GDP) has been 9.4 percent, and the average annual growth rate of real GDP per capita is 8.2 percent.”\textsuperscript{426} Although China had taken the position for the largest exporting country in 2013, almost half of the exports has come from firms “in which foreign investors have at least some ownership.”\textsuperscript{427} World Bank data indicate that China's GDP grew by 10.6 percent from 1990 to 2000 and by 9.6% from 2000 to 2010. Some of the reasons for this tremendous increase have been the increased liberalization, freer markets, freer trade, higher labor productivity, efficient use of resources, and also the role of foreign direct investment.”\textsuperscript{428} With Chinese economic development, export oriented and labor-intensive sectors have been facing pressures from the rising labor and production costs and the strict environmental regulations. As a result, relocation to “Western and Central China, and other low-cost South East Asian countries such as Vietnam” became inevitable.\textsuperscript{429}

\textsuperscript{428} Ibid.
\textsuperscript{429} For example, “in contrast to the supply chain of the Taiwanese PC industry and the clustering of the Japanese auto industry, the US food and chemical industries need not organize a wide spectrum of suppliers producing raw materials or components for their final products... Moreover, the US FIEs tend to focus on institutional environment in the expansion destinations and expect high transparency in government procedures and decision-making. Compared with Hong Kong and Taiwanese investors, the Americans are relatively unfamiliar with Chinese culture and are reluctant to become involved in the guanxi-based communication.” Xu zhihua, Yeh Anthony, “Origin Effects, Spatial Dynamics and Redistribution of FDI in Guangdong, China”
Between 2006-2016, the foreign investment performance was steady. “From January to October 2016, Newly Approved Foreign-invested Enterprises amounted to 22580, up by 7.4% year on year; and the actual use of foreign investment reached RMB 666.3b (USD 103.91 billion, up by 4.2% year on year.” 430 The top ten nations and regions with investment in China were still concentrated in South and East Asia: “Hong Kong (USD71.16 billion), Singapore (USD 4.89 billion), Republic of Korea (USD 4.12 billion), United States (USD 3.49 billion), Macao (USD 3.35 billion), Taiwan Province (USD 2.98 billion), Japan (USD 2.46 billion), Germany (USD 2.44 billion), U.K. (USD 2 billion) and Luxembourg (USD 1.38 billion). Investments from these countries accounted for 94.6% of the total actual use of foreign investment in the country.” 431

Table 8. FDI data 2006-2016.

<table>
<thead>
<tr>
<th>Year</th>
<th>Newly approved</th>
<th>Actual use contract value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>22580</td>
<td>$103.91 billion</td>
</tr>
<tr>
<td>2009</td>
<td>18,163</td>
<td>$70.871 billion</td>
</tr>
<tr>
<td>2008</td>
<td>27,514</td>
<td>$92.395 billion</td>
</tr>
<tr>
<td>2006</td>
<td>41485</td>
<td>$63.21 billion</td>
</tr>
</tbody>
</table>


431 Ibid.
On the part of the Outbound Direct Investment (ODI), Chinese enterprises made a nonfinancial direct investment of “US$14.53 billion in 53 countries along Belt and Road. The investment mainly flew to Singapore, Indonesia, India, Thailand, and Malaysia.” The number of the contracts “signed by the Chinese enterprises in 61 countries along the Belt and Road reached 8,158 in 2016, and the value of the newly-signed contracts amounted to US$126.03 billion, taking up 51.6% of China’s total contract value of the contracted projects over the same period, The turnover reached US$ 75.97 billion, taking up 47.7% of the total, up 9.7% year on year.”

432 In January-October 2009, the number of newly approved and established foreign-funded enterprises in China totaled 18,163, down by 20.11% year-on-year, and the foreign investment in actual use reached US$70.871 billion, down by 12.61% year-on-year. In October, the number of the newly approved and established foreign-funded enterprises in China reached 1,815, down by 6.2% year-on-year; and the foreign capital in actual use was US$7.105 billion, up by 5.7% year-on-year. From January to October this year, the top ten countries/regions (calculated by the actually utilized value of foreign capital) investing in China were: Hong Kong (US$41.062 billion), Taiwan (US$5.607 million), Japan (US$3.609 billion), Singapore (US$2.985 billion), USA (US$2.831 billion), Korea (US$2.261 billion), UK (US$1.168 billion), Germany (US$1.088 billion), Canada (US$ 770 million) and Macao (US$643 million). The actual inflow of foreign capital of the said ten countries/regions accounted for 87.5% of the country’s total.


434 Ibid.
A new draft of the Foreign Investment Law was released in the spring of 2015 to reform the governance of foreign investment by granting national treatment to foreign investors in both admission and operation. However, such draft had not yet been finalized due to China’s complicated foreign exchange issue, an important obstacle to China’s foreign investment. Currently, the lawmakers are still working on the draft. Various new reforms and new legislation were created to promote the FDI regime. For example, the Shanghai Free Trade Zone was designed to streamline the verification and approval process for foreign investors. It was designed to provide national treatment for foreign investors in industries that the central authority considered less important. For important industry sectors listed on the “negative list,” the investor would be subject to the traditional investment verification process. This reform designed to simplify the registration process for foreign investors. Under the new rules, a foreign investor does not have to prepare feasibility study if the investment project is not named on the negative list. The amendment of the EJV Law, CJV Law, and WFOE Law later affirmed these new reform measures. A new National Security Review was also created to balance the growing interest of the M&A by foreign investors and the need for protecting national security.

In addition, in order to maintain a payment of the balance, China imposed strict foreign exchange control, which strongly affected normal commerce and foreign investment activities. Due to China’s close connection with the world economy, China’s mega foreign exchange reserve started to cause concerns from both domestic and foreign watchers. Theoretically, Yuan’s revaluation would attract foreign investment in China and lower the cost of imports, but it could also cause financial risk when China’s bank sector has a large number of bad loans that cannot provide a healthy and sustainable investment environment. 436 The issue with China’s foreign exchange control demonstrated the difficulty of maintaining a strong central controlling economy and a market system.437

With China’s rapid FDI development, academics realized that the impact of global trade and investment is reciprocal: the world is changing China and Chinese people, vice-versa the West became more and more susceptible to China. 438 “China represents 23 percent of the world’s population”, put in perspective, China’s impact is undeniable. More than 10 percent of what China ships to the U.S. ends up on Wal-

Mart's shelves. The rise of China’s economic power under globalization connects China and the global market. China’s impact on global trade, investment, transaction behavior and the legal system is undeniable. More importantly, China’s experience provides an alternative narrative and discourse about the social and legal system, which will be discussed in this chapter.

When sizable investment and transaction made by corporations in China under China’s system embedded with Chinese cultural values and ideology, one cannot venture the idea to what extent the world will be affected by China. China’s growth will inevitably inject its influence over the pattern and culture of business transactions globally. Particularly, China’s legal system and legal culture, in the area such as “contract law, property law, dispute resolution” would cause interest and comparison with the common practice in other areas of the world. Such comparison would both create more knowledge of China and more bias toward China. It is important to point out that the

440 “As such, Chinese expropriation law offers policies and goals that U.S. citizens may find appealing because they fall within American legal norms and traditions and therefore could possibly be adopted. At the very least, Chinese expropriation law may offer a model to further embolden the current just compensation debate.” See Michael T. Colatrella, Jr., "Court-Performed Mediation in the People's Republic of China: A Proposed Model to Improve the United States Federal District Courts' Mediation Programs,” OHIO ST. J. ON DISP. RESOL 1, no. 5 (2000) 391.
441 See Michael T. Colatrella, Jr., "Court-Performed Mediation in the People's Republic of China: A Proposed Model to Improve the United States Federal District Courts' Mediation Programs,” OHIO ST. J. ON DISP. RESOL 1, no. 5 (2000) 391. For example, “the U.S. Consular reported that in 1979, 523 visas were issued to students and scholars from China. U.S. DEPT. OF STATE, 1979-1986: CONSULAR REP. tbl. 5-1 (1987). "In 2002, about 65,000 Chinese students were enrolled in
meaning of Chinese characteristics is still subject to debates and developments and it is more of a symbol to signify people who identify and acknowledge a pattern of problem analysis and solutions under certain abstract and evolving principles and ideology. The Western paradigm acknowledged the extraordinariness of China’s transformation. However, China’s story and experience in FDI is extraordinary in a sense that it engaged in many compromises that would be considered culturally, politically, and constitutionally unique for a different country. These compromises may have implied the difficulty of duplicating.

2. Ideological Framework

Since the establishment of the principle of socialist modernization at the 3rd plenary session of the 11th National Congress of CPC in 1978, the main theme of China’s past decades of development was the Reform and Open up. Each era gives a new meaning to this term. As previous chapters discussed, during the 1980s, the main focus of the authority was to define the role of the market and profit under China’s centralized planning system. The 1980s established the foundation of the FDI framework. During the 1990s, China reformed the centralized planning system by

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442 See chapter 2, 3rd plenary session of the 11th Central CPC.
establishing a socialist market economy.\textsuperscript{444} A dualist commercial law system was
developed to curate Chinese economy with the intent to revitalize China’s SOE sector,
on the one hand, to develop foreign invested economy sectors on the other hand. The
most significant ideological and constitutional progress has been the recognition of the
legitimate interest of China’s private sectors. This progress further affirmed China’s
commitment to the market economy.\textsuperscript{445}

Since 2006, new conditions and issues emerged: the rapid growth of China’s ODI,
return investment and outflow of the capital raised concerns about the sustainability of
China’s FDI policy and investment environment. The emerge of wechat economy under
globalization presented new opportunities to central authority’s understanding of the
role of the government and market participants. The rapid outflow of capital and the
complexity of money laundry scheme presented new challenges to China’s foreign
investment regime.

Thus, the main issue of the foreign investment framework since 2006 has been
the relationship between the market and central authority within the context of
developing the socialist modernization. This means, how to balance the political interest
of the central authority in maintaining goal-oriented prosperity, the interest of the
freedom of contract, and the interest of the rule of law. This section focused on new

\textsuperscript{444} See discussion on FDI policy and law during 1992-2005.
\textsuperscript{445} See discussion on 2004 Constitution amendment in previous chapter.
developments in ideological framework between 2006-2016 within the context of foreign investment by reviewing policies and principles proposed by the 17th and 18th Party Congress. The discussion will provide a necessary context for better understanding the foreign investment legal framework discussed in the next section. It is noted that there was no constitutional amendment during the selected period of the time.

a. The 17th Party Congress

Between October 15-21, 2007, the 17th National Congress of the Communist Party of China was held in Beijing. This meeting elected new Party cadres and summarized the past reform and policies. In this meeting, it redefined socialism with Chinese characteristic and called for reforms to build a “reasonable, efficient and secure” financial system. It restated the principle of the Reform and Open Up and pledged to keep developing FDI regime under the globalization, and guided by the principle of mutual benefit. The 17th National Congress of CPC defined a socialist path with Chinese characteristic as:

socialism with Chinese characteristics means we will, under the leadership of the CPC and in light of China's basic conditions, take economic development as the central task, adhere to the Four Cardinal Principles and persevere in reform and

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opening up, release and develop the productive forces, consolidate and improve the socialist system, develop the socialist market economy, socialist democracy, an advanced socialist culture and a harmonious socialist society, and make China a prosperous, strong, democratic, culturally advanced and harmonious modern socialist country. The main reason this path is completely correct and can lead China to development and progress is that we have adhered to the basic tenets of scientific socialism and in the meantime added to them distinct Chinese characteristics in light of China's conditions and the features of the times. In contemporary China, to stay true to socialism means to keep to the path of socialism with Chinese characteristics.\textsuperscript{447}

The Party Congress’ definition of the socialist path with Chinese characteristic demonstrated a historical continuity since the establishment of the socialist modernization and Four Cardinal Principle. This pattern represented China’s policy commitment to the foreign investment.

The 17th Party Congress restated socialism with Chinese characteristic theory, which included principles developed by past leaders.\textsuperscript{448} On the part of financial and

\textsuperscript{447} Ibid.

\textsuperscript{448} “Theories of socialism with Chinese characteristics constitute a system of scientific theories including Deng Xiaoping Theory, the important thought of Three Represents, and the Scientific Outlook on Development and other major strategic thoughts. This system represents the Party's adherence to and development of Marxism-Leninism and Mao Zedong Thought and embodies the wisdom and hard work of several generations of Chinese Communists leading the people in carrying out tireless explorations and practices. It is the latest achievement in adapting Marxism to Chinese conditions, the Party's invaluable political and intellectual asset, and the common
investment regime reform, the 17th Party Congress showed supports but with self-restraint, as it called for building “reasonable structure, complete function, efficient and secure” modern financial system. Perhaps due to the complexity of the foreign exchange issue, the 17th Party Congress made a more pragmatic promise that calls for future instead of present RMB reform. As it provided that:

We will improve the RMB exchange rate regime and gradually make the RMB convertible under capital accounts. We will deepen reform of the investment system and improve and strictly enforce market access rules. We will improve the state planning system.

The Speech also took the same position on the future of market regulation, as it stated:

Deeper fiscal, taxation and financial restructuring and improve macroeconomic regulation. We will proceed with financial reforms to develop various types of financial markets and build a modern financial system that is inclusive of different forms of ownership and different ways of operation and that features a reasonable structure, complete functions, efficiency and security. Ibid.


We will give play to the guiding role of national development plans, programs, and industrial policies in macroeconomic regulation and combine the use of fiscal and monetary policies to improve macroeconomic regulation.\textsuperscript{451} It is noted the Party Congress acknowledged the issue with the RMB exchange system but only stated it “will” reform the system. In fact, SAFE issued stricter rules weakening individual’s capacity in purchasing foreign exchange by placed a quota of 50,000 dollars a year for foreign exchange purchasing. Although Chinese economy improved drastically, the central authority never increases the quota since 2007.\textsuperscript{452} As discussions in the next section suggested, this measure showed a tension between the private interest and public policy. China’s investors could not freely invest their own property because the central authority could not predict the fluctuation of the market or maintain a balanced growth. In addition, the quota restriction, like its predecessors (i.e., dual foreign exchange rate system in the 1980s) could not fully curtail the market behavior as it used to.

b. The 18\textsuperscript{th} Party Congress

On the part of foreign investment and trade, the 18\textsuperscript{th} Party Congress called for “integration” and “win-win” cooperation with foreign business under the

\textsuperscript{451} Ibid.

\textsuperscript{452} Guojia waihui guanliju guanyu wanshan waizi binggou waihui guanli wenti de tongzhi (国家外汇管理局关于完善外资并购外汇管理有关问题的通知) [Notice of the State Administration of Foreign Exchange on Relevant Issues on Perfecting Administration of Foreign Exchange Relating to Merger and Acquisition with Foreign Funds] adopted by SAFE on January 24, 2005.
globalization. Furthermore, it made a promise that “innovative” channel would be adopted to utilize foreign investment, which suggested the possibility of a more relaxed regulatory regime. However, these new policies might be conditioned, as the Party Congress emphasized that foreign investment would be constructed under the principle of mutual benefit.

453 “Expand opening up in scope and depth and improve our open economy. Adhering to the basic state policy of opening up, we will better integrate our ‘bring in’ and ‘go global’ strategies, expand the areas of opening up, optimize its structure, raise its quality, and turn our open economy into one in which domestic development and opening to the outside world interact and Chinese businesses and their foreign counterparts engage in win-win cooperation, and one that features security and efficiency, in order to gain new advantages for China in international economic cooperation and competition amid economic globalization.” See, Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, November 15, 2013, available at: http://www.china.org.cn/china/third plenary session/2014-01/16/content_31212602.htm.

454 We will make innovations in the way of using foreign capital, improve the structure of foreign investment utilized, and let the use of foreign capital play a positive role in facilitating independent innovation, industrial upgrading and balanced development among regions. We will make innovations in our way of overseas investment and cooperation, support domestic enterprises in carrying out international operations of R&D, production and marketing, and accelerate the growth of Chinese multinational corporations and Chinese brand names in the world market. : Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, November 15, 2013, available at: http://www.china.org.cn/china/third plenary session/2014-01/16/content_31212602.htm.

455 “We will deepen the opening up of coastal areas, accelerate that of inland areas and upgrade that of border areas, so that opening up at home and opening to the outside world will promote each other. We will expedite transformation of the growth mode of foreign trade, stress quality, adjust the mix of imports and exports, promote transformation and upgrading of processing trade, and energetically develop service trade. We will vigorously carry out mutually beneficial international cooperation in energy and resources. We will implement a strategy of free trade zones and expand bilateral and multilateral trade and economic cooperation. We will adopt comprehensive measures to maintain a basic equilibrium in the balance of payments. We must guard against international economic risks.” Ibid.
On November 15, 2013, the 3rd Plenary session of the 18th National Congress of Communist Party of China adopted Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensive Deepening the Reform [the Resolution]. The Resolution acknowledged the necessity and inevitability of continuing reform. More importantly, it acknowledged the main theme of the reform is to “strike a balance between the role of the government and that of the market.” The Resolution understood the difficulty of the task, which was why it laid out a cautiously worded assessment about China’s problems:

To deepen the reform comprehensively, we must bear in mind the fact that China is still in the primary stage of socialism and will remain so for a long time to come. We should adhere to the major strategic judgment that development is still the key to solving all problems in China, take economic construction as our

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456 “Economic system reform is the focus of deepening the reform comprehensively. The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better.” See, Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, November 15, 2013, available at: http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm.

457 It is a general rule of the market economy that the market decides the allocation of resources. We have to follow this rule when we improve the socialist market economy. We should work hard to address the problems of market imperfection, too much government interference and poor oversight. Also see: We must actively and in an orderly manner promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition, so as to maximize the benefits and optimize the efficiency. See, Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, November 15, 2013, available at: http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm.
central task, give full play to the leading role of economic system reform, balance the relations of production with the productive forces as well as the superstructure with the economic base, and promote sound, sustainable economic and social development.458

This assessment implied the relationship between policy and development: policy is created to serve development, if the policy fails, it must move forward to ensure the progress of development.459 In the context of foreign investment framework, the Resolution suggested that “too much intervention” from the government without proper oversight.460 It emphasized the importance of “market rule”: letting market instead of the government directly allocate the resource. The Resolution redefined the duty of the government as:

- maintain the stability of the macroeconomy,
- strengthen and improve public services, safeguard fair competition, strengthen oversight of the market, maintain market order,

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458 Ibid.
459 “the national business system has carefully implemented the decisions and deployments of the CPC Central Committee and the State Council, built a favorable business environment and cultivated and consolidated the new advantages of foreign investment focusing on constructing a new open economic system, strengthened the mission and took the initiative to make contributions.” See MOC, “2017 National Foreign Investment Work Conference Held in Beijing,” MOC, March 1, 2017, http://english.mofcom.gov.cn/article/newsrelease/significantnews/201703/20170302525718.shtml.
460 Ibid.
• promote sustainable development and shared prosperity, and intervene in situations where market failure occurs.\footnote{Ibid.}

One of the highlights for the Resolution was to call for unified market access without invisible barrel discriminate against private sectors and foreign investors. The 2004 Constitution proclaimed to protect “private property ownership.”\footnote{Art. 11, PRC. Constitution. “The State protects the lawful rights and interests of the non-public sectors of the economy such as the individual and private sectors of the economy. The State encourages, supports and guides the development of the non-public sectors of the economy and, in accordance with law, exercises supervision and control over the non-public sectors of the economy.”} The political rhetoric under the Resolution expressed a more modernized view, which provided that “public property ownership, as well as private property ownership, are inviolable.”\footnote{Improving the property rights protection system. Property rights are the core of ownership. We need to improve the modern property rights system with clear ownership, clear-cut rights and obligations, strict protection and smooth flow. The property rights of the public sector are inviolable, as are those of the non-public sector. See, Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, November 15, 2013, available at: \url{http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm}.}
The Resolution listed numbers of guidelines to promote new market reform, as it provided:

1. Private sector and public-sector property are equally inviolable.\footnote{The resolution also emphasized the importance of the non-public sectors. “Supporting the healthy development of the non-public sector. The non-public sector plays an important role in sustaining growth, stimulating innovation, increasing employment, increasing tax revenues and so on. We will persist in equality of rights, opportunities and rules, abolish all forms of irrational regulations for the non-public economy, remove all hidden barriers, and adopt specific measures for non-public enterprises to enter franchising fields.” See, Resolution of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively}
2. Unified transparent market access,

3. Promoting mixed economy with cross holding by both state and non-state sectors,


It is important to point out that the first principle concerning the interest of private sector is an extension of the commitment made by the 16th Party Congress. The second principle “unified market access” concerning market reform, which refers to the


Vigorously developing a mixed economy. A mixed economy with cross holding by and mutual fusion between state-owned capital, collective capital and non-public capital is an important way to materialize the basic economic system of China...Enacting market rules that are fair, open and transparent. We will implement a unified market access system; and on the basis of making a negative list, all kinds of market players may enter areas not on the negative list on an equal basis and according to law. We will explore a management model for foreign investors with pre-entry national treatment plus the negative list. We will make the business registration system more convenient by reducing the number of items that require qualification verification, turning certification before licensing into licensing before certification, and gradually changing the paid-in capital registration system into a subscribed capital registration system. We will propel reform of our domestic commodity distribution structure while building a business environment under the rule of law. Ibid.

The state protects the property rights and legitimate interests of all economic sectors, ensures that they have equal access to the factors of production according to the law, participate in market competition on an open, fair and just footing, and are accorded with equal protection and oversight according to the law. Ibid.

We will reform the market oversight system, implement uniform market oversight, tidy up and annul all sorts of regulations and methods that impede the national unified market and fair competition, strictly ban and punish all unlawful acts extending preferential policies, combat regional protection, and oppose monopoly and unfair competition. We will establish and improve a social credit system to commend honesty and punish dishonesty. We will improve the market exit system in which the good eliminates the bad, and perfect the enterprise bankruptcy system. Ibid.
proposed policy of reforming “dualist legal system” by giving domestic firms and foreign-invested firms equal status and treatment. In addition, this principle was evidenced by the Shanghai Free Trade Zone experiment.\(^{468}\)

Comparing with the general expression of 17th CPC Party Congress, the 3rd plenary session of the 18th Party Congress stated more detailed policies on China’s financial reform. First, it clearly indicated qualified private sector could engage in the banking sector. Financial innovation is encouraged.\(^{469}\) Second, it started to speed up RMB exchange rate market reform and convertibility under capital account.\(^{470}\) Third, it

\(^{468}\) Shanghai Free Trade Zone Zhongguo Shanghai ziyou maoyi shiyanqu zongti fangan (中国（上海）自由贸易试验区总体方案)

\(^{469}\) Improving the financial market. We will open the financial industry wider, and allow qualified non-governmental capital to set up, in accordance with law, financial institutions such as small or medium-sized banks on the precondition that this comes under stronger oversight. We will push ahead with reform of policy financial institutions. We will improve the multi-layer capital market system, promote reform toward a registration-based stock-issuing system, promote equity financing through diverse channels, develop and regulate the bond market, and increase the proportion of direct financing. Ibid.

\(^{470}\) We will improve the mechanism for market-based Renminbi exchange rate formation, accelerate interest-rate liberalization, and improve the national debt yield curve that reflects the relationship between market supply and demand. We will promote the opening of the capital market in both directions, raise the convertibility of cross-border capital and financial transactions in an orderly way, establish and improve a management system of foreign debt and capital flow within the framework of macro-management, and accelerate the realization of Renminbi capital account convertibility...We will carry out reform measures and stability standards for financial oversight, improve the mechanism for oversight and coordination in the financial sector, and define the oversight functions and risk management responsibilities at both the central and local levels. We will build a deposit insurance system, and improve the market-based exit mechanism for financial institutions. We will strengthen financial infrastructure construction to ensure that the financial market operates in a safe, efficient and stable way. Ibid.
asserted that the government would stay out of investment barrel in cases not involving strategic resource and substantial public interest by reforming administrative verification process. An objective and historical observation on these statements would come to some cautionary conclusions. For example, although the authority clearly acknowledged the structure issues with current investment regulations and pledged to reform such system, it emphasized “strategic and public interest” would be excluded from these reforms. It was noted that the 1992-2005 investment framework adopted similar rhetoric to insulate SOEs from market reform, which did not lead to desired results.

The 3rd Plenary Session of the 18th Central CPC Congress focused on the market access and administrative verification process. The 4th Plenary Session focused on

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471 We will deepen the reform of the investment system, and ensure the dominant role of enterprises in investment. All enterprise investment projects, except for those concerning national security or ecological security, distribution of the major productive forces, strategic resources development and major public interests, should be decided by the enterprises independently in accordance with the law, and no longer require government approval. Market access standards will be reinforced regarding energy, land and water conservation, environment, technology, security, etc. and a long-term mechanism will be established and improved for preventing and dissipating excess production capacity. We will improve the development progress evaluation system, correct the bias of evaluating political achievements merely by the economic growth rate. We will increase the weight of other evaluation indicators such as resources consumption, environmental damage, ecological benefits, excess production capacity, sci-tech innovation, production safety and new debts, while more emphasis will be put on employment, residents' income, social security and public health. We will establish a unified national accounting system, formulate national and local balance sheets, and promote information sharing between government departments by setting up a nationwide database containing real estate and credit and other basic information. Ibid.
judicial system reform. On October 23, 2014, the 4th Plenary Session of the 18th Central CPC Party Congress adopted Resolution concerning Some Major Questions in Comprehensively Moving Governing the Country According to the law Forward [hereinafter the Resolution on Law]. The Resolution stated that rule of law construction still falls short of the expectation of the popular masses, which require a sober understanding by Party and State. The Resolution further outlined some issues, which can be categorized as legislative issues and law enforcement issues. These issues are either technical issues of the legislation, which can be fixed with better law making;

472 “The effectiveness of implementing the rule of law will be a significant indicator in judging the work of officials at various levels and will be taken into consideration when evaluating their performance. The government will promote the implementation of the rule of law at the community level by giving full play to the key role of community-level Party organizations.” See “Communiqué of the Fourth Plenary Session of the 18th Central Committee of the Communist Party of China (Excerpts),” Beijing Review, accessed July 31, 2017, http://www.bjreview.com/Beijing_Review_and_Kings_College_London_Joint_Translation_Project/2014/201703/t20170321_800091805.html.
474 “At the same time, we must soberly be aware that, in comparison with the development needs of the undertakings of the Party and the State, in comparison with the expectations of the popular masses, and in comparison, with moving ruling the country according to the law forward and modernizing our governing ability, rule of law construction still displays many problems where it is not adapted or unsuited.” See: CCP Central Committee Decision concerning Some Major Questions in Comprehensively Moving Governing the Country According to the law Forward, October 28, 2014, https://chinacopyrightandmedia.wordpress.com/2014/10/28/ccp-central-committee-decision-concerning-some-major-questions-in-comprehensively-moving-governing-the-country-according-to-the-law-forward/.
or principal issues, which would be harder to fix without a comprehensive economic and judicial reform and an effective anti-corruption structure. On the part of the legislation, the Resolution pointed out the lack of transparency and clarity and the tendency of place department interest over the legislative goal and people’s will.475 On the part of the law enforcement, the Resolution criticized the problem of lack of transparency and corruption.476 As the Resolution concluded that:

“These problems violate the principles of the Socialist rule of law, harm the interests of the popular masses, impede the development of the undertakings of the Party and the country, and we must spend great efforts to resolve them.”477

475 Some laws and regulations have not been able to completely reflect objective laws and the will of the people, they are not strong in terms of focus or feasibility, there are tendencies of departmentalization in legislative work, turf battles and shifting of responsibility are relatively prominent; See, CCP Central Committee Decision concerning Some Major Questions in Comprehensively Moving Governing the Country According to the law Forward, October 28, 2014, https://chinacopyrightandmedia.wordpress.com/2014/10/28/ccp-central-committee-decision-concerning-some-major-questions-in-comprehensively-moving-governing-the-country-according-to-the-law-forward/.

476 “One of the significant achievements was the Plan designed to improve the quality of the judges. Prior to the First Reform Plan it was common to find judges who were not legally qualified or who lacked experience in commercial transactions. In 2001, the Judges Law of the PRC was amended to impose stringent qualification requirements. In addition to holding a university degree, judges appointed after January 1, 2002 have to pass a national judicial examination, the same bar examination taken by private practitioners.12 On January 1, 2001, the Supreme People’s Court’s Judge Training Regulation came into effect, which requires courts to provide continuing legal education to judges, regardless of seniority. Another objective of the First Reform Plan has been the enforcement of anti-corruption regulations. One example of this effort was the issuance of guidelines regulating interaction between judges and lawyers, the breach of which will give rise to disciplinary sanctions, and, in more serious cases, criminal liability.” Eu Jin Chua, “The Laws of the People’s Republic of China: An Introduction for International Investors,” Chicago Journal of International Law 7 no.1 (2006): 133-140.

477 “Laws exist but are not followed, law enforcement is not strict and law-breakers aren’t punished are relatively grave, separation of powers and responsibilities in the law enforcement; multi-headed law enforcement and selective law enforcement still exist, law enforcement and
The ideological and constitutional framework within the context of foreign investment law and policy mainly focused on the issue of market access and transparency of the investment environment. The Party Congress acknowledged these issues by proposing new reform policies and measures, such as the Shanghai Free Trade Zone experiment and Yuan Internationalization. The Party Congress also acknowledged the challenge of the reform, such as China’s foreign exchange issue, by offering cautious assessment and promise for “future reform.” In general, the ideological and constitutional framework during this period demonstrated a historical continuity by further relaxing the restrictions on the market with reasonable readjustment on the role of government intervention. The results were not always perfect, but the commitment to a better and open investment environment with further global integration did not change.

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the judiciary are quite prominently not standardized, not strict, not transparent and uncivilized, the masses’ strongly react against the problems of judicial unfairness and corruption; the consciousness of a number of members of society to abide by the law, trust in the law, respect the law, use the law, and safeguard their rights according to the law is not strong, some State personnel and especially leading cadres’ consciousness about handling affairs according to the law is not strong, and their abilities are insufficient, and it still occurs that laws are knowingly violated, one’s word replaces the law, the law is suppresses through power, and the law is bent for relatives and friends.” See: CCP Central Committee Decision concerning Some Major Questions in Comprehensively Moving Governing the Country According to the law Forward, October 28, 2014, https://chinacopyrightandmedia.wordpress.com/2014/10/28/ccp-central-committee-decision-concerning-some-major-questions-in-comprehensively-moving-governing-the-country-according-to-the-law-forward/.
3. New Development in FDI Legal Framework
   a. Preferred Stocks
   On November 30, 2013, State Council issued State Council Guiding Opinion on launching Preferred Share Pilot Program, which signified a new era of preferred share experiment, as an alternative to China’s long established “equal share, equal rights” Company Law principle. A month later, CSRC and CBRC (China Banking Regulatory Commission) and other regulatory agencies adopted supplementary rules to enforce this reform. “According to the pilot project, companies listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange are allowed to issue preferred stocks to qualified public investors. Blue-chips listing companies are expected to gain support from the first stage of the preferred stock pilot project as they are likely to be among the first batch piloting the new program.” Unlike US rules and regulations concerning preferred stocks, the Chinese experiment was silent on conversion rights. The preferred stock enjoyed preference on dividends distribution, attendance of the shareholders’ meeting and voting rights.

   Two principals were outlined by the educational material on preferred share provided by CSRC (China Securities Regulatory Commission), “an effective and functional legal and policy system is the foundation of market development, otherwise small

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480 Ibid.
investors interests will be harmed” and “Financial Innovation is beneficial to the further development of the market.”

CSRC listed a few reasons for China’s preferred share reform, which are:

1. China’s A Share Market (RMB quoted shares only listed in Shanghai Stock, Exchange and closed for purchasing by Chinese investors) underperformance since the fall of 2007,

2. Majority public listed company do not provide dividends,

3. Chinese bank needs new financing tools to supplement capital market,

4. Diversifying investment market.

The legal basis for China’s preferred shares experiment by CSRC rested in PRC Company Law. PRC Company Law Article 132 provided that: State Council can issue

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482 A-shares are defined in opposition to B-shares. B-shares are quoted in foreign currencies (such as the U.S. dollar) and are open to both domestic and foreign investment, although they are difficult to access for most Chinese investors, most notably for currency exchange reasons. A-shares, on the other hand, are only quoted in Chinese renminbi. Some companies have their stock listed on both the A-shares and B-shares market. Due to the limited access of Chinese investors to B-shares, stock of the same company often trades at much higher valuations on the A-shares market than on the B-shares market. Available at: http://www.investopedia.com/terms/a/a-shares.asp#ixzz4oWjLLCab.


additional rules or regulations regarding different types of shares for a company to issue permitted shares under this law.\textsuperscript{485} Article 2 of PRC Security Law provided that “this law applies to stocks, bonds, any other state Council recognized security instruments...” \textsuperscript{486} The preferred share pilot project ended the traditional principle under Company Law was “equal share, equal rights.” This project was one step forward of the voting rule under the WFOE Law, EJV Law, and CJV Law, which adopted the unanimous voting rule for major corporate affairs.\textsuperscript{487} As the previous chapter discussed, an LLC under China’s Company Law is similar to a limited partnership under U.S. corporate law.\textsuperscript{488} This new reform concerning preferred shares could be an important boost to China’s investment and equity market because it offers alternative financing tools to help investors develop modern corporate governance. In addition, to protect the minority shareholder’s rights under the pilot project, the project stipulated that “preferred stockholders gained the right to attend the shareholders’ meetings and the ability to vote together with

\textsuperscript{485} Art. 132, PRC Company Law.
\textsuperscript{486} Art. 2, PRC Company Law
\textsuperscript{487} Art. 32, EJV Implementing Rule “The resolutions on the following matters shall be subject to unanimous adoption by the directors who attend the board meeting:
(1) Amendment of the articles of association of the EJV;
(2) Suspension or dissolution of the EJV;
(3) Increase or decrease of the registered capital of the EJV; and
(4) Merger or division of the EJV.
The resolution on other matters may be made in accordance with the rules of procedure set forth in the articles of association of the EJV.”
\textsuperscript{488} See chapter 3 on PRC Company Law.
common stockholders if, in three cumulative fiscal years or two consecutive fiscal years, the dividend payments owed to preferred stockholders were missed.” 489

b. Shanghai Free Trade Zone experiment

China’s traditional FDI registration and verification framework required foreign investors to study the Foreign Investment Catalogue first and then use the catalog as the reference to prepare administration permit from relevant government entities. The current FDI verification system requires a MOC verification and approval for a FIE project. Depends on the forms of the investment structure, the verification period can last from 30 days to 90 days.490 Taiwanese investors enjoy a special 45 days verification period for all types of investment projects.491 Thus, preparation works for establishing a FIE could last quite a long time even before the investor started the registration process. In response to the complaints from the investment communities and 3rd Plenary Session

489 See article 11 of the Rule for Preferred Stocks. Also see article 10 “Preferred stockholders shall be entitled to attend the shareholders’ meeting and vote separately from common stockholders for the following items, each preferred stock has one voting right except for preferred stocks owned by the company itself: (1) Amendment of the articles of association of the issuing company about items in connection with preferred stocks; (2) Reduction of the registered capital of the issuing company up to more than 10% though one time or cumulatively; (3) Merger, split, or dissolution of the issuing company, or to change the legal form of the issuing company; (4) Issuance of preferred stocks; (5) Other items determined by the articles of association of the issuing company. He resolution of the above items needs the consent of two-thirds of the common stockholders attending the shareholders’ meeting, in addition to the consent of two-thirds of the preferred stockholders attending the shareholders’ meeting.”

490 Typically, EJV project generally requires 30 days verification, CJV project requires 45 days, and WFOE requires 90 days. See relevant discussion in previous chapters.

491 See Taiwanese Investor Protection law in previous chapters.
of the 18th National Congress of the CPC policy of promoting foreign investment and improving transparency and market access, China adopted Shanghai Free Trade Zone experiment. On August 30, 2013, Standing Committee of NPC adopted Decision of the Standing Committee of the National People's Congress on the Administrative Examination and Approval on Authorizing the State Council to Temporarily Adjust Relevant Legal Provisions in the China (Shanghai) Free Trade Zone [Hereinafter Adjustment of Law in SFZ], which officially started the SFZ experiment.  

A few weeks later, State Council adopted Overall Plan for the China Shanghai Pilot Free Trade Zone [hereinafter SFZ Overall Plan] on September 18, 2013.  

The main purpose of the SFZ was to streamline China’s complicated FDI regulatory framework by allowing certain FIE project register the business without prior administrative permission. According to the Adjustment of Law in SFZ, certain provisions under EJV, CJV, and WFOE Law and supplementing regulations would be suspended for

492 Quanguo renmin daibiaodahui changwuweiyuanhui guanyu shouquan guowuyuan zai zhongguo shanghai ziyou maoyi shiyanqu zanshi tiaoheng youguan falv guiding de xingzheng shenpi de jueding (全国人民代表大会常务委员会关于授权国务院在中国（上海）自由贸易试验区暂时调整有关法律规定的行政审批的决定) [Decision of the Standing Committee of the National People’s Congress on the Administrative Examination and Approval on Authorizing the State Council to Temporarily Adjust Relevant Legal Provisions in the China (Shanghai) Free Trade Zone] adopted by Standing Committee of the National People’s Congress on August 30, 2013.  
Based on the Adjustment of the Law in SFZ, the FIE would obtain national treatment under this reform. In addition, the SFZ reform removed various additional review and approval process for foreign investors’ business. Traditionally, government agencies must approve the establishment or major changes in corporate finance or contract disputes between the investors in JVs. The SFZ experiment removed such cumbersome mechanism by implementing the new “record filing” mechanism. Essentially, this was a form of public disclosure, a common form of regulatory mechanism in a market economy. This public disclosure mechanism allowed investors to file a public record with the agency for any major changes in the company business. The beneficial policies apply to FIEs not on the “negative list.”

*Figure 3. Old verification and approval mechanism.*

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494 “It has been decided at the fourth session of the Standing Committee of the 12th National People’s Congress that the State Council is authorized to temporarily adjust relevant administrative examination and approval items (see Appendix hereto for the list) prescribed under the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises, the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures and the Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures that are applicable to foreign investments other than those subject to special market entry management measures of the State within the China (Shanghai) Free Trade Zone” see: Overall Plan for the China Shanghai Pilot Free Trade Zone.

495 The suspended the laws listed here:

1. Art. 6, Art. 10, Art. 20, WFOE Law
2. Art. 3, Art. 13, 14 EJV Law
3. Art. 5, 7, 10, 12, 24 CJV Law
Under traditional FDI regulatory framework, the foreign investor must obtain a permit for the project. In the course of the business, major changes in JV contract or changes of registered capital also require permits from government authority.\textsuperscript{496}

\textit{Figure 4. SFZ verification and approval mechanism.}

Under the new FDI mechanism, any investment project not on the “negative list” can enjoy the national treatment, which means the investors can be exempt from the verification process. The investor can file record to the agency for registration.

State Council SFZ Overall Plan offered an overview of the proposed FDI regulatory reform plan. It proposed to further open financial service, shipping sector, and consulting sectors by promoting open market access, and the rule of law.\textsuperscript{497} With

\begin{itemize}
    \item Relevant permit restrictions can check previous chapters.
    \item “accelerating the transformation of government functions; actively promoting further liberalization of the service sector and the reform of the foreign investment management system; vigorously developing headquarters economy and new trade patterns; quickening the exploration of capital account convertibility and full liberalization of the financial services industry; exploring the establishment of a classified regulatory model based on cargo status; striving to create a policy support system promoting investment and innovation; exerting efforts to foster an internationalized business environment emphasizing the rule of law; and striving to build the FTZ into a world-class pilot free trade zone boasting investment and trade facilitation, free currency exchange, efficient and convenient regulation and a sound legal environment, so that the FTZ can be used to explore new ideas and channels for China to expand opening-up and deepen reform, and be relied upon to better serve national development.” See SFZ Overall Plan
\end{itemize}
the progress of the reform, the SFZ experiment expanded to Tianjin and Guangdong in 2015.\textsuperscript{498} The Tianjin, Guangdong, and Fujian Free Trade Zone. There were few noticeable differences between the 2015 FTZ and 2013 SFZ. First, the 2015 FTZ experiment acknowledged the interest of Taiwanese investors, which were not duly represented by the SFZ experiment.\textsuperscript{499} Since Taiwanese investors have not been categorized as a foreign investor for obvious reasons, the 2015 FTZ particularly highlighted that certain verification rules under Taiwanese Investor Protection would be suspended under the 2015 FTZ experiment.\textsuperscript{500} Second, the main task of 2015 FTZ emphasized the part of promoting the rule of law by creating advanced investment legal environment. It asked for public participation in the legislation process. In addition, it encouraged private professionals in participating legislation process for a better lawmaking.\textsuperscript{501}

The FTZ experiment started in 2013 and ended in 2016. It expanded to western regions in China between 2014 and 2015. It was a success for the foreign investors and

\textsuperscript{498} See Notice of the State Council on Printing and Distributing the "Overall Plan for the China (Guangdong) Pilot Free Trade Zone" and Notice of the State Council on Printing and Distributing the "Overall Plan for the China (Tianjin) Pilot Free Trade Zone," adopted by State Council on April 8, 2015.

\textsuperscript{499} See previous chapters on Taiwanese investor protection.

\textsuperscript{500} See NPC Standing Committee Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Temporarily Adjust Relevant Administrative Examination and Approval Items Prescribed by Pertinent Laws in the China (Guangdong) Pilot Free Trade Zone, the China (Tianjin) Pilot Free Trade Zone, the China (Fujian) Pilot Free Trade Zone and the Expanded Areas of the China (Shanghai) Pilot Free Trade Zone.

\textsuperscript{501} For example, see Notice of the State Council on Printing and Distributing the "Overall Plan for the China (Guangdong) Pilot Free Trade Zone."
policymakers. The Standing Committee of 12th National People’s Congress adopted these reform measures by promulgating Decision of the Standing Committee of the National People's Congress on Revising the Law of the People's Republic of China on Foreign-invested Enterprises and Other Three Laws on September 3, 2016. This legislation affirmed that all relevant verification and approval process would be removed if the FIE project not on the “negative list” of the regulation. Under the “negative list” mechanism, the process of establishing FIE mirror to domestic firms. For example, the Shenzhen government illustrated the registration process as the follows:

Figure 4. New FDI registration process under Shenzhen local rules.

Figure 5. required documents for FIE registration under Shenzhen local rules

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502 Decision of the Standing Committee of the National People's Congress on Revising the Law of the People's Republic of China on Foreign-invested Enterprises and Other Three Laws（全国人民代表大会常务委员会关于修改《中华人民共和国外资企业法》等四部法律的决定） adopted by Standing Committee of National People’s Congress on September 3, 2016. For example: A new article shall be added as Article 23, which shall read: "Where the establishment of a foreign-invested enterprise does not involve the special market entry management measures prescribed by the State, the examination and approval matters prescribed by Article 6, Article 10 and Article 20 herein shall be subject to administration by record-filing. Special market entry management measures stipulated by the State shall be promulgated by the State Council or promulgated upon approval by the State Council."
The negative list is a new generation of the catalog. Any industry outside of the “negative list” can be treated as a domestic investor. However, investment involved certain industry may require Nation Security Review, some M&A and Shareholding investment require traditional Antitrust Review. For example, the 2017 Negative list require foreign investor in internet news service sector must approve by National Security Review.

c. National security review
Although the new reform measures removed complex verification process for the foreign investor, this does not exempt them from a new form of reviewing process.

On February 12, 2011, the State Council announced national security review (NSR). It formally set up the rules on the scope, content, mechanism, and procedures of the NSR in enforcing relevant articles of Anti-Monopoly Law. These rules will operate in parallel with the AML's anti-monopoly merger review provisions (AML Merger Review).\textsuperscript{503} The

\textsuperscript{503} On February 12, 2011 the State Council of China announced that China would institute a new national security review (NSR) regime applicable to a proposed foreign investment in, or acquisition of, a domestic Chinese enterprise. It did this by publicly announcing a Circular (adopted on 3 February 2011) which formally implements certain articles of China's Anti-
NSR framework designed to assess concerns raised by a proposed M&A transaction. A special panel formed by NDRC and MOFCOM would review and assess the transaction. The panel could make a request ask the foreign investor to provide a written explanation to explain why such project should be allowed under NSR.

The NSR Review defined the scope of the review, which including two scenarios:

1. M&A between certain Chinese firms and foreign investors
2. Foreign Investor become the actual controlling shareholder of the firm

The companies mentioned by above quotations include:

- domestic enterprises that engage, or are involved, in military industry, are located close to a military site that is key or sensitive, or any other entities related to defense and national security.
- key domestic market players in certain industries or sectors (such as agriculture, energy, and resources, infrastructure, transportation, technology, and

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Monopoly Law (AML) and sets out rules on the scope, content, mechanism and procedures of the NSR. These rules will operate in parallel with the AML’s anti-monopoly merger review provisions (AML Merger Review) Lucas Xu, Hannah CL Ha, Timothy J Keeler and Michael A Wallin, Mayer Brown, “China’s new M&A review rules: a comparison with the US,” THOMSON REUTERS PRACTICAL LAW, March 1, 2011, https://content.next.westlaw.com/6-505-9049?transitionType=Default&contextData=(sc.Default)&__lrTS=20170503180652541&firstPage=true&bhcp=1.

505 See NSR Review
506 Art. 1 (2) NSR Review
507 Art. 1(3) NSR Review
manufacturing) but only if the transaction may affect the interests of Chinese national security; and that as a result of the transaction, the foreign purchaser would obtain control of the new entities. 508

The NSR review further defined what constituted as control:

- a foreign investor, together with its parents and subsidiaries, or several foreign investors together, obtaining ownership of 50% or more of the share capital of the relevant Chinese enterprise as a result of the transaction;
- a foreign investor, holding voting rights (though less than 50%) that are sufficient to exercise a major influence on corporate decisions; or
- taking actual control over decision-making, finance, human resource or technology of domestic enterprise through any other means.

Figure 6. NSR Review Process.

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The NSR review is a substance review, which concerned the effect of M&A on economic stability, national security, and social services, and impacts on key technology development. According to the NSR Review, the process of review involved several stages. First, the M&A investors must apply for NSR review through MOC. The MOC then forward the application to the review panel. The panel would forward the application to relevant department within five days. These departments provide written recommendations to the panel within 20 days. Upon receiving opinions from relevant department, the panel would issue opinions within five days for approval or disapproval. A special investigation process would be initiated within five days since the disapproval opinion. The panel must investigate within 60 days. State Council would make the final
decision when the panel cannot reach an agreement.\textsuperscript{509} The problem with this NSR review system was the lack of clear dispute resolution process. The review detailed the process of the review and application procedure without mention to any complaints mechanism, which means there is no remedy provided under NSR to address such concern.

3. Challenges to FDI framework
   a. Outflow of the capital
      In 2014, China’s foreign exchange reserves “fell by $100bn in the third quarter, which was the largest drop ever, despite a trade surplus and foreign direct investment inflows. China had registered a $51 billion outflow beyond the current account in the second quarter.”\textsuperscript{510} “The reserve shrinking $323 billion in four months during 2006 before the PBOC sold dollars to limit declines in the yuan. The number declined to $3.17 trillion in September 2006.”\textsuperscript{511} “The problem has only worsened in 2016,” as Bloomberg reported, “it was estimated that outflows would total more than $900 billion this year, despite new restrictions on yuan movements, including prohibitions on using credit and

\textsuperscript{509} Art. 4 (3) NSR Review.
debit cards to pay for insurance products in Hong Kong.” Chinese media have categorized the outflow of the capital as “capital flight” (资本外逃 pinyin: Ziben Waitao): as refugee escaped from a war zone, the term capital flight captured an undesired economic reality, which awkwardly in juxtaposition to China’s pledge for economic leadership and Yuan internationalization.

The free flow of capital presented an increasing tension between Chinese authority’s political interest of maintaining a stable economic development and the reality of globalization. China tried to maintain a desired economic growth by caging the “freedom of the contract.” This form of thinking followed the traditional pattern of centralization, a familiar form of regulation in the 1980s and 1990s. However, the effectiveness and impact of this strategy have consistently been challenged by the decentralized global economic reality. The new globalization reality required the

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513 “Capital outflows began gathering steam in 2012, when the government liberalized current-account payment transactions in goods and services. Enterprising Chinese figured out that while they couldn't officially move money abroad to buy a house via the capital account -- individuals are barred from moving more than $50,000 out of the country each year -- they could create false trade invoices that would allow them to deposit money where they needed it. The result was a huge discrepancy between payments recorded for imports and the declared value of goods passing through customs, amounting to $526 billion in hidden outflows last year.” “significant part of the new capital is likely to find its way abroad through mis-invoicing in international trade, smuggling, and other channels of capital flight since the people who are creating the new capital have strong incentives to diversify domestic risks and to seek better protection of property rights.” See Ibid. Also see Geng Xiao, People’s Republic of China’s Round-Tripping: FDI: Scale, Causes and Implications (Mandaluyong: Asian Development Bank, 2004), accessed July 31, 2017, http://hdl.handle.net/11540/3595.
application of new forms of soft regulations or smart regulations to manage, guide and facilitate freedom of contract, rather than mechanically restrict it. This section would exclusively discuss the conventional foreign investment regulations and challenges it faces.

The purpose of this section is to illustrate that conventional regulation has difficulty in successfully manage and channel market resource into a more reasonable and beneficial space for the betterment of everyone in the case of managing free flow of capital, which also offers a sharp contrast with the new regulatory approach that would be discussed in the next section. First, it will introduce the development of return investment scheme under Chinese foreign investment regime: how investor use special purpose vehicle (SPV) to conceal the identity of the true controller in order to bypass Chinese foreign investment regulations. Second, it will discuss the issue of corruption under central authority’s foreign investment framework. Third, it will conclude that these restrictive regulations created a self-fulfilling that affected China’s economic modernization. The next section will focus on the opportunity of China’s FDI framework and new regulatory measures and soft law regulation through the case of “wechat economy.”

The outflow of capital can be categorized into three scenarios based on the purpose of the capital. First: liquidate Chinese investment for cashing profits or minimize investment losses. Second, outbound investment; the holder of the capital
transfer funds overseas for an investment project. Third, return investment (round-trip investment).\textsuperscript{514} It is a subcategory of the outbound investment. Under return investment scheme, outbound investment project is an intermediary for capital to come back to China. The investor transfers funds overseas for creating an overseas entity (commonly known as Special Purpose Vehicle). The overseas entity will be a foreign investor investing Chinese projects. In this process, foreign entity served as a strawman for the convenience of domestic investment. This happens either because of poor domestic PE market requiring offshore financing, or preferential tax policy favoring foreign investors. The second and third scenarios require the application of an overseas entity. To engage in ODI or return investment, the investor must establish a special purpose entity (SPE) or special purpose vehicle (SPV).

Special Purpose Entities (SPE) or Special Purpose Vehicle (SPV) is a legal creation designed to circumvent China's security and foreign exchange control, and FDI framework by concealing the identity of the actual beneficiary or actual controller of the investment activity.\textsuperscript{515} There are five main reasons for a company to apply SPV. As the following indicates:


1. Strict rules by CSRC on public offering make it impossible to be listed in the domestic stock market. SPV is applied for domestic company to be listed in a foreign market;

2. Strict rules by CSRC, SAFE, and NDRC on overseas financing make it impossible to be listed overseas stock market. SPV is applied for domestic market directly obtain funds from private investors.

3. A Foreign investor cannot invest in restricted industry. SPV is applied for concealing foreign investor’s identity.

4. Domestic firm intent to enjoy the special privilege of a foreign investor. SPV is applied for concealing the true controller of the business.

5. Money laundry, tax evasion or conceal the identity of the company. SPV is applied for concealing the actual controller of the business.

Figure 7. SPV legal structure explain. Domestic firm overseas IPO.

Under this model, the domestic firm A wishes to be listed in a foreign stock market because it cannot meet the minimum standard under Chinese IPO regulations. (many internet companies cannot meet this standard) a Variable Interest Entities (VIE) was created to resolve this problem. The SPV B would be established in a foreign jurisdiction.
The SPV B would enter into a private agreement with A that agrees all equity and security of the A would be transferred to B. Although SPV B is listed in a foreign jurisdiction, A is the actual firm operate in reality.

*Figure 8. SPV legal structure explain. Domestic firm offshore financing.*

Under this VIE scheme, domestic A operated in a restrictive industry that prohibits foreign investments (internet company). Domestic A would form SPV B in a foreign jurisdiction. SPV B establishes WFOE C in China. C and A would enter into private agreement to transfer all equity and security from A to C. Thus, B became the actual owner of the A through the private agreement between A and C.

*Figure 9. SPV legal structure explain. Domestic firm tax evasion.*
Under this SPV scheme, a foreign entity B would be established by A. A and B entered into an international trade agreement for sale of goods at an extremely low price. B would sell the goods to international market with high profit. In this process, firm A avoided high tax.

The above diagrams illustrate the application of SPV in bypassing China’s investment regulations. The first two examples relate to China’s strict PE market regulations and foreign exchange control. It is important to note that, China’s foreign exchange control policy seems disconnected with the rhetoric expressed by Chinese reform agenda. Foreign exchange control designed to maintain payment of balance strictly. It was recorded that the central authority would take intrusive and disruptive measures to insulate Chinese foreign exchange reserve from the demands of the market. Such practice created an unpredictable foreign exchange regulatory framework for foreign investors. For example, investment community complained that State Administration of Foreign Exchange (SAFE) would issue regulations require the bank to process transactions involving foreign exchange for trading company only if the buyer deposit equivalent amount of RMB to the bank. Or WFOE could not distribute stock dividends in foreign exchange because Chinese authority wants to maintain annual payment of balance.

The above diagram illustrates domestic firms’ aggressive offshore financing practice. The domestic firm would establish an SPV for debt financing. The second step
for SPV offshore financing would bring the money back to China, which is commonly known as return investment or round-trip investment. Return investment or round-trip investment is an important part of the foreign investment, although some would argue this is a pseudo foreign investment because the actual investor is not a foreign-born citizen. 516 This study defined return investment as a domestic investor, Chinese investor or domestic Chinese investor registered domestic firms transfer assets, in the form of capital or equity, to an overseas entity. Such entity would then engage foreign direct investment in China. Another form of return investment refers to reverse merger and acquisition between a domestic firm and foreign entity. Normally return investment requires direct control of multiple levels of shell companies with affiliated transactions. Through these shell companies (registered in tax haven: BVI, Cayman island), the actual owner is normally a Chinese investor. The most common reason for return investment was offshore financing. Another reason for return investment was to obtain the privileges and benefits of a foreign investor. Foreign investor enjoys certain preferential treatments that a domestic firm cannot have. Private sectors have been discriminated in the area of tax, land use fees, and public utility fees. Return investment transformed a domestic firm into a foreign firm, which opened a gate to various “privileges” to domestic firms. Interestingly, Chinese scholar support to punish return investment for the reason of disrupt government plan.

516 “The World Bank 2002 studies showed the scale of China’s round tripping investment could be as high as a quarter of the total FDI inflows into PRC, Geng Xiao’s study later indicated the percentage might be higher with a range of 30%-50%. "Geng Xiao, People’s Republic of China’s Round-Tripping: FDI: Scale, Causes and Implications (Mandaluyong: Asian Development Bank, 2004), accessed July 31, 2017, http://hdl.handle.net/11540/3595.
Although some voices in mainland criticized return investment by emphasizing it is a dishonest act deceived government, Geng Xiao offered different opinions: first, round tripping investment created revenues for investors and jobs for China. Second, part of return investment was a reasonable market behavior in reaction to China’s inadequate PE market and property right system. 517 This study holds the same position with Geng for the following reasons. First, the Chinese government has a legitimate interest and constitutional obligation to create investment policy that it sees fit to the socio-economic development and China’s reality. To that end, the Chinese government can pick and choice preferential policy for one group over another. However, such pick and choice is reciprocal, which means the investor has a legitimate interest and financial obligation to make the best possible business decision based on the market condition. The investors have no obligation to promote political agenda of the central authority. Since private sectors are not designated beneficiary of central authority’s policy, there is no contractual or legal obligation for them to avoid legally acceptable solutions in making a business decision.

One direct consequence of the return investment is the outflow of the capital. Thus, strict foreign exchange control has been adopted to curtail the outflow of the

China’s current foreign exchange framework is quite massive and complicated. Depends on the target of the regulation, it can be categorized as regulation concerning banks, regulations concerning individuals, or regulations concerning business entities. According to the Catalogue of Current Effective Foreign Exchange Laws and Decrees, by the end of December 31, 2016, 209 foreign exchange related regulations and rules issued by SAFE were effective. The Administrative Measures for Personal Foreign Exchange and its Implementing Rules and Regulations of the People’s Republic of China were two important administrative regulations concerning the purchase and sale of foreign exchange by Chinese individuals. The 2007 Individual Foreign Exchange Implementing Regulation formerly established the annual

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519 “Xianxing youxiao waihui guanli zhuyao fagui mulu,” (现行有效外汇管理主要法规目录) [Catalogue of Current Effective Foreign Exchange Laws and Decrees], SAFE, December 31, 2016, see http://www.safe.gov.cn/wps/wcm/connect/97d532004004cf9e848c94bf3842e0e1/%E7%8E%B0%E8%A1%8C%E6%9C%89%E6%95%88%E5%A4%96%E6%B1%87%E7%AE%A1%E7%90%86%E4%B8%BB%E8%A6%81%E6%B3%95%E8%A7%84%E7%9B%AE%E5%BD%95%EF%BC%88%E6%88%AA%E8%87%B32016%E5%B9%B412%E6%9C%8831%E6%97%A5%EF%BC%89.pdf?MOD=AJPERES&CACHEID=97d532004004cf9e848c94bf3842e0e1

520 List of effective Foreign exchange control regulations based on category:
1. General regulations, 20
2. Current account (23)
3. Capital account (76)
4. Financial Institute and foreign exchange business regulation (40)
5. RMB Currency and foreign exchange market (19)
6. Balance-of-Payments statistical declarations (12)
7. Inspection and rule application (11)
8. Management and technology (8)
individual foreign exchange purchase quota. The article 2 provided that:

“Administration of the annual total amount shall apply to the settlement of personal foreign exchange and domestic purchase of personal foreign exchange. The annual total amount is the equivalent of USD50,000 per capita per year. The State Administration of Foreign Exchange may adjust the annual total amount based on the balance of payments.” Although China’s Household Income per Capita increased from 1960 dollars to 4805 dollars in 2013, this quota has never changed since 2007.


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522 Ibid.
523 Ibid.
525 Guojia waihui guanliju guanyu wanshan waizi binggou waihui guanli wenti de tongzhi (国家外汇管理局关于完善外资并购外汇管理有关问题的通知) [Notice of the State Administration of Foreign Exchange on Relevant Issues on Perfecting Administration of Foreign Exchange Relating to Merger and Acquisition with Foreign Funds ] adopted by SAFE on January 24, 2005.
The main purpose of the 2009 Notice was to assist financial institution further implement foreign exchange quota control by defining some techniques applied in foreign exchange quota evasion. 2009 Notice provided a detailed description on what considered as “irregular transaction” triggered the suspicion of foreign exchange quota evasion. For example:

1. Same foreign institute or individual transfers foreign exchange to 5 different individuals or above in mainland on the same day, every other day or on a consecutive day basis.

2. Five individuals or above purchase foreign exchanges in the mainland at the same day, every other day or on a consecutive basis, transfer foreign exchange to a same individual or institute.

3. Individual withdraws the amount of foreign exchange through five different times within 7 days from the same bank account in the mainland, and the total of the withdraw equal to or close to 10,000 dollars. Alternatively, five or more

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\[\text{526} \text{The 2009 Notice of the State Administration of Foreign Exchange on Further Improving the Administration of the Business of Individual Foreign Exchange Settlement and Sale (国家外汇管理局关于进一步完善个人结售汇业务管理的通知). Available at:} \]

\[\text{527} \text{The 2009 Notice of the State Administration of Foreign Exchange on Further Improving the Administration of the Business of Individual Foreign Exchange Settlement and Sale (国家外汇管理局关于进一步完善个人结售汇业务管理的通知). Available at:} \]
individual purchase foreign exchange about 5000 dollars within the same day from the same bank.

4. One individual transfers funds from the bank account to five or more direct relatives. Such relatives would then purchase and transfer foreign exchange to such individual within the same year.

If the buyer of the foreign exchange or recipient of the foreign exchange meets any of the conditions listed above, the bank would require the customer provides details documents and papers showing the purpose of foreign exchange.  

Chinese individuals have been prohibited from purchasing investment instruments or foreign property, such as real estate, stocks or insurance. A large amount of foreign exchange control concerned capital account regulations. The punishments normally including a 2-year ban from buying foreign exchange, 30% penalty on the amount of foreign exchange involved in the transaction. The market was not impressed by these new measures, as one buyer told the news media “any transaction below 10 million dollars” would not be substantially prevented by these measures. Reasons for individual buyers’ need for foreign exchange includes investment,


education, and traveling. For example, some individual buyer may wish to purchase foreign assets as a form of long-term investment when Chinese market is less profitable.

In order to further managing the negative impact and reduce the risk of the inflow and outflow of the foreign exchange, the SAFE issued 2016 Notice of the State Administration of Foreign Exchange on Further Improving the Administration of the Business of Individual Foreign Exchange Settlement and Sale [hereinafter 2016 Notice] with new countermeasures. According to the 2016 Notice, individual foreign exchange business such as settlement and purchases of foreign exchange must be handled through “individual foreign exchange business monitoring system” by the qualified banks. Such bank must forward full and accurate transaction information to authority promptly. Any irregular transactions suspected of foreign exchange quota evasion would trigger a “watch list” warning. The bank would issue a “Risk Reminder Notification for Individual Foreign Exchange Business as a risk reminder to individuals who lend their quota to another individual

530 Ibid.
531 2016 Notice of the State Administration of Foreign Exchange on Further Improving the Administration of the Business of Individual Foreign Exchange Settlement and Sale (国家外汇管理局关于进一步完善个人结售汇业务管理的通知), December 31, 2015 adopted by SAFE, accessed July 31, http://www.safe.gov.cn/wps/portal/lut/p/c4/04_SB88K8xLLM9MSSzPy8x8z9CP0os3gPZxdnX293QwN_f0tXA08zR9PgYgd3Yx8fe_2CbEdFAM9sw9YI/?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/safe_web_store/state+administration+of+foreign+exchange/rules+and+regulations/19f518804b4b7d33b1abf5196274af30
532 Art.1 2016 Notice of the State Administration of Foreign Exchange on Further Improving the Administration of the Business of Individual Foreign Exchange Settlement and Sale.
533 Foreign exchange authorities will issue the Risk Reminder Notification for Individual Foreign Exchange Business as a risk reminder to individuals who lend their quota to another individual
Notification” as a warning for the first time. When it happened again, the recipient of the notice will be placed on a “watch list.” The foreign exchange buyer (individual) would be required to present identification card and other papers showing the legitimate reason for buying foreign exchange for three consecutive years.

*Figure 10. Forms of foreign exchange quota evasion.*

**Conspiracy with relatives and friends**
- When one individual's foreign exchange quota used up, the buyer can borrow quota from friends or relatives.

**HK bank account**
- Chinese buyer opens HK bank account with RMB then obtain foreign exchange through HK bank.

**FIE**
- A foreign FIE obtains foreign exchange from overseas, then privately sell the foreign exchange to Chinese buyer.

**Virtual currency**
- Foreign exchange buyer uses RMB purchase virtual currency, such as Bitcoin. Bitcoin will be the intermediary to obtain foreign exchange.

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for the evasion of quota and authenticity management. If this happens again, these individuals will be put on a watch list by foreign exchange authorities. See 1 (1) 2016 Notice.

534 Foreign exchange authorities will put individuals who borrow another individual's quota for the evasion of quota and authenticity management on a watch list and notify them through the Notification on Watch List for Individual Foreign Exchange Business issued by banks. See 1(2) 2016 Notice.

535 “The watch period of an individual on a watch list is the year the individual is put on the watch list and the two consecutive years that follow. During this period, the individual has to present his/her valid ID card and evidencing materials indicating the trading amount to go through procedures for settlement and sales of foreign exchange for individuals. Banks shall review relevant evidencing materials in strict accordance with the authenticity review principles.” See 1 (3) 2016 Notice.
The World Bank 2002 studies showed the scale of China’s round tripping investment could be as high as a quarter of the total FDI inflows into PRC, Geng Xiao’s study later indicated the percentage might be higher with a range of 30%-50%.  

The above chart lists four most common forms of foreign exchange evasions. Although an individual is restricted for only $50,000 annual foreign exchange quota, such individual can conspire with his or her friends and families by ‘borrowing’ their quotas. The HK bank account scheme requires gray financial institute. HK Bank regulation restrict the applicant of bank account to HK resident. Thus, a local underground Institute would open a bank account in China to accept RMB cash. Such Institute would then transfer equivalent dollars to Chinese individual’s mainland bank account. The third method involves a FIE selling foreign exchange to the individual. The last scheme requires individual to turn one commodity into currency. As many reports indicate, the skyrocketing of virtual currency value relates to China’s foreign exchange control.

Disregard the effectiveness of these measures; it already produced undesired negative effects on China’s investment market. The first victim of these actions was China’s FDI market and economy. The latest data shows, “foreign direct investment

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537 Gabriel Wildau, “Chinese regulators have taken steps to ensure bitcoin is not used to facilitate capital flight, even as investors in the cryptocurrency say they doubt it is being used to transfer large amounts of cash out of China.” Financial Times, January 10, 2017, https://www.ft.com/content/bad16a88-d6fd-11e6-944b-e7eb37a6aa8e.
(FDI) into the Chinese mainland dropped 1.2 percent year on year in the first seven months to 485.42 billion yuan ($72.79 billion). In the first seven months, 17,703 new foreign-funded companies were established, up 12 percent year on year.” 538 “Non-financial outbound direct investment (ODI) by Chinese companies dropped 44.3 percent year on year in the first seven months to $57.2 billion, mainly due to government measures to curb irrational investment. Outbound investment in real estate, culture, sports, and entertainment sectors saw substantial declines during the period, the ministry said.” 539

In fact, China’s countermeasures against capital outflow presented a self-fulfilling quagmire. The stronger the reaction by the authority, the weaker Chinese economy perceived from the outside. These measures have been sending wrong signals about the Chinese market, which might defeat investors’ interest and confidence. In return, the decline in investors might cause politicians to take more extreme measures. Thus, it has become a self-fulfilling nightmare: the market fluctuation causes political intervention, the intervention sends a wrong signal about the market, which causes the decline of investment. The decline of investment would justify more interventions by the government. More importantly, these measures suggest a form of thinking that the freedom of contract or freedom of the will belong to a “superior group” in the power structure. The superior group must maintain the order and law by restricting the

539 Ibid.
“freedom of the contract “because such freedom cannot produce desired outcomes that defined by such group.

*Figure 11. The paradox of China’s foreign exchange control.*

Chapter 3 explained Chinese State-Owned Enterprise (SOE) policy paradox: the more preferential policy for SOE sector, the poorer the performance. The poor performance requires more policy supports, which lead to a self-fulling loop. The same paradox applies to China’s foreign exchange control. China’s obsession with the payment of balance put great pressure on China’s currency policy. This means China have to rely on the value of dollars by anchoring the value of Yuan on dollars. The only solution for China’s currency independence requires Yuan’s Internationalization. This means China
needs to promote an open and robust market with free flow of the capitals. The free flow of the capitals would result in capital outflow, which led to the beginning of the loop that requires payment of balance.

The short-term solution to foreign exchange control might create more problems than solutions in this self-fulfilling quagmire. Although the authority has legitimate interest and obligation in maintaining a sustainable and balanced investment environment without illegal and unethical transactions, the reactions by the authority to the outflow capital created a self-fulfilling prophecy of the unstable economy without properly addressing the true motivations caused the capital flight. In response to the outflow of capital, the authority enforced stricter rules to pressure the investors and banks. For example, in order to prevent outflow of capital, Chinese authority restricted China’s outbound investment, offshore financing, and payment of trade by foreign investors.540

540 For example, “In other words, balance wasn't achieved by increasing exports or investment into China, but rather by preventing Chinese from buying from and investing in the rest of the world. Some of the government's restrictions on currency-exchange transactions-- such as cracking down on fake trade data and overpayments for imports -- were justified and sensible. But others were more dubious and have led to significant distortions.” “Last week, the government added yet another restriction. It announced that all international capital-account transactions of more than $5 million will need to be approved by the State Administration of Foreign Exchange. This has businesses deeply concerned, given that the administration likely doesn’t have the manpower for the sheer number of transactions it will need to review. And if such restrictions can be placed on the capital account, it seems only a matter of time until they're imposed on goods and services transactions.” see Christopher Balding, “China Finally Halts Outflows. Now What?” Bloomberg, accessed July 31, 2017, https://www.bloomberg.com/view/articles/2017-04-10/china-finally-stems-capital-outflows-now-what.
The outflow of capital is a sensitive issue for Chinese policymaker due to economic and political reasons. A free movement of capital is a sign of modern economic power because it shows confident of a robust and healthy investment market. China’s uncomfortable position with the outflow of the capital shows the gap between China and world-class capital institutions. However, China does have a legitimate interest in maintaining a stable and ordered economy. The economic and political implication of the outflow of capital makes this task harder than it sounds. There are sufficient economic reasons to support China’s concern for outflow of capital. This negative impact can be explained by the following: when an investor sold his or her RMB to the bank in exchange for dollars in cash, the bank would have fewer dollars and more RMB in cash. A large wave of outflow would result in a substantial loss of dollars in foreign exchange reserve and a large increase in RMB cash. There would be two undesired consequences result from this scenario. First, devaluation of RMB and revaluation of dollars. This happens because a large loss of dollars and sudden increase in RMB cash would force the bank to pay more RMB to purchase dollars to satisfy market demands. Second, sudden domestic inflation. Sudden surplus of RMB supply would cause inflation in the domestic market, which further destabilizes the market. Under the conventional theory, a sudden devaluation of RMB would be beneficial to China’s export-oriented economy. However, this theory has its limits. The power of export industry reached to its limits since China became the world factory. The benefit of a sudden RMB devaluation is marginal to China’s export and national economy. In
addition, the increase in foreign trade could not mitigate the loss results from increasing domestic production cost. On the contrary, a sudden RMB devaluation has an adverse effect on the internationalization of Chinese currency. Also, it produces negative publicity for Chinese investment market.

Chinese authority concerned the political implication of the outflow of the capital. Although the outflow of capital can be explained by profit-seeking behavior under most market economy without strong reactions by the authorities, Chinese authority has always been extremely sensitive to market fluctuation. Political rhetoric normally portraits financial fluctuations as war, crisis or enemy. On the one hand, investment and economy are about people, about creating the best possible conditions for prosperity and greater goods. The authority has a legitimate interest in maintaining an ordered economy. Since the Reform and Open up, the principle of economic growth and modernization had been contextualized by the Party and the State Constitution. Economic data, such as the inflow and outflow of the investment are the benchmark to evaluate the career path of a politician, and a basis for a new policy to policy makers. The outflow of the capital paints a bad image of Chinese economy. It signified a weak and declined economy, which raised concerns by many savvy politicians. Thus, a politician not only has an ideological interest in preventing outflow of capital but also a personal interest in preventing outflow of the capital.
The outflow of the capital also produces another legal and ethical issue for Chinese policy makers. It is interesting that China’s sudden restrictions over foreign exchange regulation aligned with the launch of China’s Anti-Corruption campaign and expansion of outflow of the capital.\textsuperscript{541} In fact, money laundry or transfer of illegal funds by corrupt officials might also contribute to China’s sudden outflow of the capital. For example, 200 million RMB, the equivalent of 31 million dollars, in cash was discovered by prosecutors from one of the residents of “Wei Pengyuan, a former deputy director of the coal department at the National Development and Reform Commission, China’s economic planning agency.”\textsuperscript{542} The news report suggested that “anti-corruption campaign may also be spurring a growing number of wealthy Chinese to send their money out of the country – accelerating capital outflows at a time when concerns about weaker growth are also making the Chinese currency less attractive.”\textsuperscript{543}

\textsuperscript{541} It is formally understood by the outsider that China’s anti-corruption campaign started since the 18th National Congress of CPC in 2012. The most high profile case was the case of Bo xilai, the former Chongqing Party Chief. Buckley, Chris, "China’s Antigraft Push Snares an Ex-General”. \textit{The New York Times}, June 30, 2014, accessed July 31, 2017, \url{https://www.nytimes.com/2014/07/01/world/asia/china-move-against-one-of-its-top-leaders.html}.


\textsuperscript{543} For example: “Today, private bankers in Hong Kong are offering mainland clients a panoply of investment choices abroad that have the added attraction of qualifying the buyer for a foreign passport. Henny Sender One prominent lawyer who used to specialize in corporate mergers and acquisitions now helps groups of wealthy Chinese acquire real estate in the US. Such
b. Corruption

“China’s ranking on Transparency International’s (TI) 2016 Corruption Perception Index (CPI) continues to improve, moving up four places to 79.”544 “The CPI was initially introduced in 1995 as a composite indicator used to measure perceptions of corruption in the public sector in countries around the world. Since then, it has been used as an important gauge of companies in managing corruption risks when conducting businesses in foreign countries.”545 “Scholars and experts stressed that, the anti-corruption measures should be founded on the basis of respecting human nature and protecting human rights, correcting the traditional anti-corruption views that "emphasize attacks and ignore protection" and "emphasize punishing decadent acts and ignore human rights protection", and correcting acts that are carried out under the influence of the traditional views.”546 According to findings of a survey conducted by the Central Discipline Inspection Commission, “people were least satisfied with the anti-corruption work in 1996, with only 32.8 per cent of the interviewees saying they were transactions do not attract as much scrutiny and often come with residency rights for the buyers and their families.” Ibid.


545 Ibid.

satisfied. The rate only reached beyond 50 percent for the first time in 2003 when 51.9 per cent of the interviewees expressed satisfaction.” 547

More critically, Chinese state-owned business sector creates a risk of corruption by blurring the line between official corruption and business corruption. Senior managers in SOE are also appointed government officials. These officials move back and forth between the government and SOE sector with both business and political positions. Thus, the conflict of interest became quite prevalent in China’s commercial system. Critics of China, for example, Pan Wei asserted that “there is rampant corruption in China that stems from the ‘the contradiction between China’s newly installed market system and the Party-State’s unchecked power...decentralization has led to the feudalization of administrative power, and power monopoly of the Party has become the personal power monopoly of each chief administrators...” 548

The issue of corruption is nothing new during the recent years, in fact, it already widespread at the beginning of the 21st century. Various forms of bribes by FIEs: 549

1. Direct bribe in the form of refunds, rebates, or inflated “referral fees,” “commissions.”

547 Ibid.
2. Bribery through Intermediaries

3. An inducement in the form of pre-sale/ post-sale traveling expenses and cash allowance.

The main purpose of the bribes:

1. Bending the rules or obtaining special treatments by the administrators

2. Obtain administration’s supports for statutory rights guaranteed by laws

3. Winning government contract with an inflated price

4. Conspired with government official to push competitor out of business

For example, one corporate executive from a U.S. WFOE explained in a 2002 interview that because the main business for his company is to sell products to SOEs or government through government procurement, he needed to maintain “close relationship” with staffs and procurement officers. The WFOE would devise special training sessions to display technics of building a relationship with local officials. Normally, such relationship involved conferring monetary interest or gift to those officials. Clearly, since the increasing exposure of corruption and criminal prosecution, later FIEs already abandoned that early practice by hiring PR firms to manage such relationships. One corporate executive explained that senior officials, as well as his subordinates and staff members in the target department, needed to be taken care of in

the process. When each offeror provided special private financial incentives to the targeted official and his staff members, you have to go after such official’s superior or family members of an influential politician to pressure the target.\textsuperscript{551}

Foreign investment verification and approval process have been one of the most criticized areas for lacking transparency and accountability. Foreign investors, while attracted to China’s booming economy and huge consumer market, “have found it difficult to seal deals, in part because of government intervention.”\textsuperscript{552} For example, The process of establishing FIEs, M&A, Shareholding investment must be approved by MOC, particularly reviewed by Department of Foreign Investment and Department of Treaty and Law. This process also triggers other compliance requirement involved with SAFE,

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551 For example, “in addition to direct bribes, some foreign companies relied on an indirect technique wherein they bribed engineers and planners to draw up plans that would ensure the purchase of the company's products. Beginning in 2003, for example, Rockwell Automation Power Systems (Shanghai), a subsidiary of Rockwell Automation, a Milwaukee-based maker of industrial automation products used in coal mines, gave $615,000 (¥3.03 million) to employees of state-owned design institutes and paid $450,000 (¥3.60 million) for sightseeing trips During 2002-5, employees of Avery China, a subsidiary of California-based Avery Dennison, hired a former employee of the Wuxi-based Traffic Management Research Institute whose wife still worked for the institute. They conspired to award Avery China a contract worth $677,494 (¥5.43 million) to provide reflective materials for 15,000 police cars. The contract, from which Avery would have earned profits of over $360,000 (¥2.88 million), included a 3 percent margin of $41,000 (¥328,000) that Avery China would kick back in the form of a "consulting fee."

Eventually, these companies offered "inducements in the form of tourist junkets. UTStarcom, a California-based telecommunications manufacturer, spent $7 million (¥56 million) on trips to the United States for 235 employees of firms that bought its equipment. UTStarcom not only paid for the trips, which included stops in popular tourist destinations, but also gave travelers an $800 to $3,000 (¥6,400 and ¥24,000) cash allowance (US SEC 2009c)." Ibid. Also see Andrew Wedeman, “The Dark Side of Business with Chinese Characteristics,” \textit{Social Research} 80, No. 4 (2013):1225, accessed July 31, 2017, http://www.jstor.org/stable/24385657.

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CSRC, National Development, and Reform Commission (NDRC), State-owned Assets Supervision and Administration Commission (SASAC). This time-consuming process would create rent-seeking behavior, such as a bribe.

“Guo Jingyi, a former high-ranking inspector of the treaty and law department of the Ministry of Commerce, was sentenced to death with a two-year reprieve for accepting 8.45 million yuan ($1.24 million) in bribes.”553 According to the procuratorate, “from 2004 to 2007 Guo accepted bribes twice, totaling 1.1 million yuan, from home appliance giant Gome Group to help it transfer equity and pass an anti-monopoly inspection.”554 Huang Guangyu, former chairman of Gome Group and once China’s richest man, was sentenced to 14 years in jail for illegal business dealings, insider trading, and corporate bribery.

In Guo’s case, he was the “director-general of the treaty and law department at the commerce ministry is responsible for interpreting China’s foreign investment rules, making his role particularly important when a deal is considered sensitive to China. Deng, deputy head of the foreign investment division at the ministry, is responsible for

554 Ibid.
issuing approvals and licenses to foreign investors and often works with Guo to review deals. Foreign investors must seek approval from the commerce ministry for any deal valued at over $50 million when it involves investment in a sector that Beijing defines as a restricted industry.\footnote{George Chen, “China probe may curb foreign deals: sources,” \textit{Reuters} October 31, 2008, accessed July 31, 2017, \url{https://www.reuters.com/article/us-china-foreigninvestment-approvals-idUSTRE49U3I120081031}.} “For a deal valued at more than $100 million in an area where the government encourages foreign investment, commerce ministry approval is also required. The case has attracted growing concern among China-focused foreign investors, including big multinational corporations and global private equity firms fearful that the probe will lead to a crackdown on planned deals.”\footnote{George Chen, “China probe may curb foreign deals: sources,” \textit{Reuters} October 31, 2008, accessed July 31, 2017, \url{https://www.reuters.com/article/us-china-foreigninvestment-approvals-idUSTRE49U3I120081031}.} Guo, Zhang, Du, and Deng conspired together to pressure foreign investors provide special interests to them.\footnote{See: Caijing, “Chai jie waishang touzi shenpi xunzulian,” (Deconstruct the rent seeking wring behing FDI administration) \textit{Caijing}, November 9, 2008, see, \url{http://misc.caijing.com.cn/chargeFullNews.jsp?id=110064675&time=2008-11-09&cl=106}.} In Guo Jingyi’s case, FIE would hire lawyers from a law firm run by Guo’s co-conspirator, Zhang, to lobby Guo’s office. The law firm would serve as an intermediary to communicate with Guo and foreign investors. Through such intermediary, FIEs would pay inflated “consulting fee” to the targeted official. In this case, Guo conspired with Deng and Du by taking advantage of their authority and position to make sure FIE’s application would pass the administrative screening process. Guo’s experience in
legislation, policymaking, and rule interpretation helped him taking advantages of the loophole in the existed rules and regulations.

**Figure 12. Guo Jingyi Corruption ring explained.**

- **Guo Jingyi**: Inspector of MOC Department of Treaty and Law
- **Zhang Yudong and Liu Yang**: lawyers work for FIEs
- **Deng Zhan**: Deputy Director-General of MOC Department of Foreign Investment
- **Du Baozhong**: Director of the Administrative Law Office of MOC Department of Treaty and Law.
- **Liu Wei**: Deputy Director of Foreign Investment Registration of SAIC

Caijing news commented that the case of Guo suggested a pattern of regulatory prejudice and twist: the enforcement of law alienated from the central authority's policy of promoting law and order to attract high-quality FDI. By arbitrarily blank ban on all forms of investment with strict rules in hope to protect domestic industry, the
administration of the law created a strong demand for rent-seeking. The fact that officials selectively lift the “ban” in exchange for personal favor reminiscent to the time when black foreign exchange market supplement the market demands during the 1980s and early 1990s.

The booming of offshore financing has produced tremendous pressure on China’s policymakers due to its undesired political implication. First, it facilitates a narrative of the undesired domestic investment market, an aversion to modernization and political commitment to fostering economic growth. To further legitimize those investment restrictions or defend those limitations, Chinese investors need to be perceived as a destructive force of the market, which is the classic thinking reminiscent China’s central command era. The problem of China’s offshore financing presents a perfect case for China’s financial market reform. Most importantly it presents an imminent question, whether the past three decades reform designed to build “a society based on economic power and rights or societies developed on politico-social relations with economic power reinforce institutions expand their control and favor development advance their power and rights.”

Second, China’s foreign exchange control for the past few years seems anti thematic. On the one hand, the 2004 Constitution Amendment and Three

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Representative Theory suggested bourgeois’ interest will be represented by CPC. On the other hands, recent counter capital outflow measures seem to part away from the interest of those savvy investors and business person. The new economic policy appears to facilitate a narrower scope of real economy excluding significant capital player. In addition, these restrictions increase the risk of corruption by forcing the market to seek politicians for favors.

When political rhetoric paints China as a new super star on the world stage with glorified economic data, these regulations and rules are the sober reminders of China’s challenges and potential. These regulations suggest Chinese authority’s frustration with the globalization, more importantly, they indicate a lack of confidence in the global market in providing a stable long-term growth through a mechanism controlled or managed by the central authority. Also, these regulations illustrate the incompatibility between China’s economic power and inadequate market mechanism.

Third, globalization is the winner for the past decade's development in China. These “walls” created by Chinese authority not only failed to protect and facilitate meaningful SOE development as they were intended to but also alienated Chinese investors from the domestic PE (private equity) market in an unexpected manner. As a consequence, the mechanism designed to protect China’s SOE through the discriminatory regulations and policies dominated by protective thinking ultimately created an undesired domestic environment that pushes creative investors into the arm
of offshore financing market. This issue mirrored to China’s two-track foreign exchange policy in the 1980s. As a result, it created more problem than it resolved.

5. Opportunity of the FDI framework

With the growing popularity of corporate pyramid scheme, offshore corporate vehicle, gray banking and fraudulent trade invoice scheme, traditional mechanism of anti-corruptions, anti-money laundry and anti-tax evasion by the sovereign state suffered from challenges induced by creative minds to conceal their identity and assets in a decentralized global economy. However, there are also exciting new opportunities for the regulatory authority when the decentralized economy itself offering new perspective and approaches to the regulatory issue by creating new conceptual and implementing framework that could be applied for the public good.

This part of the discussions exclusively focuses on mechanisms adopted by foreign jurisdictions and Chinese authority in fighting against illegal financial activities for a transparent and robust investment environment. In addition, it considers China’s “wechat economy,” which provides a new and smart approach to China’s FDI regulatory challenges. First, the section would outline the public disclosure mechanism adopted by sovereign state and international law. Then it will provide an in-depth analysis of China’s new wechat economy to illustrate the future of soft regulation.
a. New international legal framework on public disclosure

   i. OECD Beneficial Owner

   In November 2014, G20 Summit in Brisbane adopted “High-Level Principles on Beneficial Ownership and Transparency.” The Principals, which builds on existing international instruments and standards, encourage countries

   (1) to have a definition of “beneficial owner” that captures the natural person(s) who ultimately owns or controls the legal person or legal arrangement,

   (2) to ensure that beneficial ownership and control information is adequate, accurate, current and accessible, and

   (3) to have a legal framework that enables national authorities (including law enforcement and prosecutorial authorities, supervisory authorities, tax authorities and financial intelligence units) to participate in information exchange on beneficial ownership both domestically and internationally.560

   “High-Level Principles on Beneficial Ownership and Transparency” is only the first step of establishing next generation of a global regulatory framework designed to enhance the transparency and reduce the market risk and illegal activities for cross-broader investment. OECD defined beneficial owner as, “a natural person who is ultimately entitled to the benefits accruing from the beneficial ownership of the securities, and/or has power to exercise controlling influence over the voting rights

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560 Ibid.
attached to the shares (even if another person holds the legal title) of an entity, or as the ultimate beneficial owner of an organization.”

As OECD research shows, each jurisdiction has different regulations. HK law adopted the concept of the substantial shareholder, which is also a BO under OECD definition, is required to notify the company of his interests and subsequently any change in his interests. The Chinese law referred BO as “actual controller.” Under Chinese law, “persons who have an interest in 5% or more of the voting shares of a listed company; and directors and chief executives who have an interest in any shares of a listed company are required to comply with public disclosure.” Offshore corporate vehicles and pyramid structures are common methods for investors who intend to conceal the identity. Chinese law requires disclosure of the ultimate layer for the BO. However, the regulatory framework is not equipped well to prevent these activities.

561 “Although it is usually argued that a beneficial owner is always a natural person, it must be noted that a legal person can also be the ultimate owner if the ultimate beneficial owner is the State or a state-owned entity.” See Erik Vermeulen, Disclosure of Beneficial Ownership and Control in Listed Companies in Asia, OECD, 2016, accessed July 31, 2017, https://www.oecd.org/daf/ca/Disclosure-Beneficial-Ownership.pdf.

562 China require disclosure of ultimate BO See, Ibid.

563 For example, “The natural person, the state-owned asset management department, or the other institution that could be considered as the ultimate controlling shareholder must be disclosed. If the ultimate controlling shareholder(s) cannot be determined, the ultimate beneficial owners who own more than 5% must be disclosed.” Ibid.

564 For example, “Most jurisdictions distinguish between “de jure” and “de facto” beneficial ownership. Because it is the rule rather than the exception to look at de facto beneficial ownership in addition to de jure beneficial ownership, a pertinent issue is the content of such de facto ownership. In general language, applying such a concept will result in shares held under the name of third parties also being counted under the control of the beneficial owner.” Ibid.
Table 9. Disclosure requirement for investors under different jurisdictions.

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<thead>
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<th></th>
<th>China</th>
<th>HK</th>
<th>Malaysia</th>
</tr>
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<tbody>
<tr>
<td><strong>Disclosure requirement</strong></td>
<td>disclosure is required from persons who have an interest in 5% or more of the voting shares of a listed company; and directors and chief executives who have an interest in any shares of a listed company.</td>
<td>No express requirement for update info unless substantial shareholder</td>
<td>No express requirement for update info unless substantial shareholder</td>
</tr>
<tr>
<td><strong>BO definition</strong></td>
<td>NA</td>
<td>Proposed for amendment</td>
<td>ultimate owner and is entitled to all rights, benefits, powers and privileges and subject to all liabilities, duties, and obligations, and does not include a nominee of any description.</td>
</tr>
<tr>
<td><strong>Substantial shareholder</strong></td>
<td>10% threshold of entire equity securities of an issuer</td>
<td>10% threshold</td>
<td>10% threshold</td>
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Source of information and data: see OECD Report on Disclosure of Beneficial Ownership and Control in Listed Companies in Asia\(^{565}\)

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ii. UK Practice and US Practice
The United Kingdom adopted a similar mechanism of requiring public disclosure for “Person of Significant Control” (PSC) through the 2015 amendment to Company Act. Under this new amendment, PSC must make information available to the public by April 6, 2016. Failure of disclosure would result in a criminal offense, which may result in fines or imprisonment. In addition, the relevant transaction would be void under this new mechanism. Two types of business entities are excluded from disclosure. First, this new public disclosure ruled out companies that subject to Chapter 5 of the Financial Conduct Authority’s Disclosure and Transparency Rules (“DTR 5”), which reserved for public traded companies. Second, limited partnership is excluded from disclosure because it does not have a separate legal personality “Individuals who are limited partners will not be registrable themselves under any of the first three PSC

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567 “Companies and directors who fail to comply will commit an offence (punishable by imprisonment or fine). If a registrable person fails to comply with the disclosure obligations, the company can serve a warning notice that it intends to follow-up with a restrictions notice. A restrictions notice can be served one month later if the original notice has still not been complied with. This means that any transfers of those shares are void, no rights may be exercised in respect of them and the company may not pay any sums due on them except in a liquidation.” See White & Case LLP, “PSC Regime: Register of People with Significant Control for Sponsor controlled companies,” LEXOLOGY March 14, 2016, accessed July 31, 2017, https://www.lexology.com/library/detail.aspx?g=d39a971e-ed86-4f92-bb8a-bd235fa87d58.

conditions solely by virtue of being a limited partner in a limited partnership with an interest in a company, as long as they do not participate in management of the partnership business and there is no separate basis of SIOC.”569 The amendment defined the SPC as any individual, legal entity or government or government departments meet any of these conditions:

1. holding, directly or indirectly, more than 25% of the shares in the company;
2. holding, directly or indirectly, more than 25% of the voting rights;
3. holding the right, directly or indirectly, to appoint or remove a majority of the board;
4. having the right to exercise, or actually exercising, significant influence or control over the company ("SIOC");
5. being an individual, which has the right to exercise, or actually exercises, SIOC over a trust or firm which itself satisfies at least one of the above conditions.570

The required disclosure includes information such as name, country of residence, nationality, and date of birth for an individual. For legal entities, it contains information

569 “However, the general partner will usually be a PSC and, depending on the legal form and structure, either the general partner and/or individuals or RLEs behind the general partner who are PSCs will usually be registrable.” White & Case LLP, “PSC Regime: Register of People with Significant Control for Sponsor controlled companies,” LEXOLOGY March 14, 2016, accessed July 31, 2017, https://www.lexology.com/library/detail.aspx?g=d39a971e-ed86-4f92-bb8a-bd235fa87d58.

such as the name of the entity, registered office, legal form and law under which it was formed. 571

Align with the SPC mechanism; the amendment also proposed the concept "significant influence or control" (SIOC). The purpose of the SIOC was to create catch-all conditions that designed to prevent some creative ways to circumvent SPC regulation. For example, this included:

● “such as adopting or amending the business plan, changing the nature of the business or making additional borrowing from lenders.

● However, veto rights for the purpose of protecting a minority interest are unlikely alone to be so. "Absolute" for this purpose means a person has the ability to make or veto a decision without referring to or collaborating with anyone else.” 572

It is noted that the determination of SIOC would be a case by case situation based on many factors.573

572 Ibid.
The U.S. security regulation adopted a different definition on BO, under CFR Title 17 Commodity and Securities Exchanges Determination of Beneficial Owner, the BO was defined as: 574

(a) For the purposes of sections 13(d) and 13(g) of the Act a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:

(1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or,

(2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

(b) Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose or effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security.

(c) All securities of the same class beneficially owned by a person, regardless of

the form which such beneficial ownership takes, shall be aggregated in
calculating the number of shares beneficially owned by such person.575

iii. HK FSTB Proposal

Recently Hong Kong’s Financial Services and Treasury Bureau (FSTB) issued a
consultation document on amending the Companies Ordinance law, which concerning
the disclosure of BO with Hong Kong Companies Registrars.576 Unlike the UK Company
Law 2016 amendment excluded limited partnership, this proposal included those
limited by shares, by guarantee, and unlimited companies.577 The proposal adopted a
similar definition of BO as other western jurisdiction.578 It provided that:

576 Dezan Shira, “Hong Kong Announces Changes to Beneficial Ownership Regime, ” China
briefing.com/news/2017/03/22/hong-kong-announces-change-beneficial-ownership-
regime.html.
577 Ibid.
578 “The FSTB adopts a similar definition of “beneficial owner” as that proposed by Financial
Action Task Force, an inter-government body developing and promoting policies to combat
money laundering and terrorist financing, and that adopted by the UK, Italy, Spain, Belgium, and
Switzerland. Under the proposed amendments, a beneficial owner in relation to a company is an
individual who meets one or more of the following specified conditions” “Hong Kong Announces
Changes to Beneficial Ownership Regime, “ Also “Hong Kong has been a member of the FATF
since 1991. As the international community strengthens regulation in accordance with the FATF
recommendations, Hong Kong is obliged to implement a credible regime to enhance
transparency of beneficial ownership, so as to safeguard the integrity of our financial markets,
and to ensure that our reputation as an international financial center is reinforced by an open,
trusted and competitive business environment.” See, “Enhancing Anti-Money Laundering
Regulation of Designated Non-Financial Businesses and Professions,” HK Financial Services and
Directly or indirectly holding more than 25 percent of the shares;

Directly or indirectly holding more than 25 percent of the voting rights;

Directly or indirectly holding the right to appoint or remove a majority of directors;

Otherwise having the right to exercise, or actually exercising, significant influence or control;

Having the right to exercise, or actually exercising, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees alternatively, members satisfy any of the first four conditions (in their capacity as such) in relation to the company, or would do so if they were individuals.\textsuperscript{579}

Scholars and legal experts commented that with Hong Kong’s reputation for promoting world-class financial institution, this new proposal would revolutionize the HK’s regulatory framework. More importantly, HK’s geographic proximity to Mainland attracted many offshore shell corporation schemes. This new proposal might be able to contain a certain level of illegal and unethical investment that abuse HK’s investment environment.

iv. China Practice

On December 16, 2015, China became the 77th signature states of OECD Multilateral Competent Authority Agreement, MCAA, which support the Common Reporting Standard, CRS. The MCAA mechanism is an international legal framework designed to curtail global tax invasion and money laundry by enhancing transparency and the rule of law through public disclosure. The advantage of MCAA is to have information sharing between tax authorities. The shortcoming of the MCAA framework linked to its limited information sharing between tax authorities. The new developed BO information sharing framework would make information available for anti-money laundry, anti-terrorist, and even anti-corruption operations.

China’s CRS legislation adopted the popular concept of the “actual controller” from the foreign market. The article 13 provided that:

(1) An individual who, directly or indirectly, holds over 25% of the company's equities or voting rights;

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(2) An individual who controls the company via personal or financial arrangements or other means; or

(3) A senior management person of the company. The controller of a partnership enterprise shall refer to an individual who owns over 25% of the rights and interests in the partnership. The controller of a trust shall refer to the settlor, trustee or beneficiary of the trust or any other individual who exercises ultimate and efficient control of the trust. The controller of a fund shall refer to a person who owns over 25% of the equity units of the fund or any other individual who controls the fund.\(^{581}\)

The actual controller framework could be found in the PRC Company Law, SSE Regulations on Public Listed Shares, SZSE Regulations on Public Listed Share, Measures for the Administration on Acquisition of Listed Companies. These laws formed the framework of China’s actual control regulations. It is important to note that the SSE Regulation does not mention the situation where the person has a substantial impact on shareholder meeting, in addition, it takes a different approach by recognizing the actual controller, which is defined as the largest shareholder in the register. Below is the

\(^{581}\) Fei jumin jingrong zhanghu sheshui xinxi jinzhi diaocha guanli banfa (非居民金融账户涉税信息尽职调查管理办法) Administrative Measures for the Due Diligence Investigation of the Tax-related Information of Non-resident Financial Accounts, adopted by SAT, MOF, CSRC, CIC and POB on May 9, 2017.
detailed description of the statutory language under these rules. Art. 216 of PRC Company Law provided that:

(3) "actual controller" shall refer to a person who is not a shareholder of a company but who is able to actually control the acts of the company through investment relations, agreements or other arrangements; and

(4) "affiliation" shall refer to the relationship between a controlling shareholder, actual controller, director, supervisor or senior management person of a company with an enterprise under the direct or indirect control thereof, or any other relationship that may lead to the transfer of the interests of the company, provided that the enterprises in which the State is the controlling shareholder are not necessarily affiliated with each other solely on the ground that the State controls the shares thereof.

The actual controller does not need to be a shareholder of a company, but it has to be someone who is able to actually control the acts of the company through investment relations, agreements or other arrangements. The control means the

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582 Fei jumin jingrong zhanghu sheshui xinxi jinzhi diaocha guanli banfa (非居民金融账户涉税信息尽职调查管理办法) Administrative Measures for the Due Diligence Investigation of the Tax-related Information of Non-resident Financial Accounts, adopted by SAT, MOF, CSRC, CIC and POB on May 9, 2017.
capacity to determine the financial and operational decision for the company for-profit.

Control would be found when at least one of the following conditions are met:

1. The largest shareholder in the register of shareholders,

2. Can direct or indirectly invoke voting rights as the largest shareholder in the register of the shareholders,

3. The voting rights can determine more than half of the board of the director member,

4. Other conditions recognized by CSRC.\textsuperscript{585}

Under Shenzhen Stock Exchange (SZSE) Regulation on Public listed shares, The actual control means person able to actually control the acts of the company through investment relations, agreements or other arrangements. The control means the capacity to determine the financial and operational decision for the company for-profit.

Control would be found when at least one of the following conditions are met:

1. Hold more than 50% of shares of a public traded company,

2. Actual control more than 30% of the voting rights of a public trade company,

3. The voting rights can determine more than half of the board of the director member,

4. Voting rights can have substantial impact on shareholder meeting,

\textsuperscript{585} SH Stock Exchange (SSE) Regulation on Public listed Shares, art. 18.1
5. Other conditions recognized by CSRC. 586

Under CSRC Measures for the Administration on Acquisition of Listed Companies, Control existed when it met at least one of the following conditions:

1. Hold more than 50% of shares of a public traded company,
2. Actual control more than 30% of the voting rights of a public trade company,
3. The voting rights can determine more than half of the board of the director member,
4. Voting rights can have substantial impact on shareholder meeting,
5. Other conditions recognized by CSRC. 587

As the above discussion indicates, China’s actual owner regulatory framework is formed by the PRC Company Law, stock exchanges rules, and stock commissions’ regulations. This framework is fairly new, which subjects to future adjustment. More importantly, it established a foundation for China’s investment market by promoting the “public disclosure” mechanism. Also, the fact that China entered into OECD CSR agreement

587 Zhongguo zhengjianhui shangshi gongsi shougou guanli banfa (中国证监会上市公司收购管理办法) Measures for the Administration on Acquisition of Listed Companies, adopted by CSRC in 2014.
suggested China’s interest in continuing reforming China’s regulatory framework and promoting principles compatible with the global standard.  

b. The future: Wechat Economy

In fact, China’s new economy cultural and transaction pattern has already emerged and integrated with the globalization: free and open-access without “walls” created by sovereign states, although not fully displaying its potential yet. This government-less and self-regulating commerce cultural have been cultivated by the robust growth of E-commerce economy. A true freedom of contract can be liberated by this new phenomenon. More importantly, this new structure should be read as a good sign because it is offering new and creative approaches to China’s regulatory issue. This can be exemplified by wechat economy. This new structure has the following features:

● Cashless
● Web-based virtual transaction
● Government-less

Wechat is a web-based message application on your cell phone, tablet, and computer. The power of wechat comes from its add-on social media function and virtual

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money transfer function (wechat pay). The social media function creates a member-based social media platform. Users can display their products or service to the public, but only “friends” can make transaction or transfer of funds (through wechat pay). Any interested user can contact the seller directly through wechat and finish the transaction through money transfer function. This modern transaction model demonstrated three features: 1. Cashless. 2. The virtual transaction, 3. Government-less. First, Under this model, the transaction of funds are tied up in the bank accounts of the user, which is regulated by the contract between bank and user, and the contract between bank and operator of the wechat, and Chinese bank regulations. With the development of e-commerce, China’s cashless transaction increased dramatically. Under such decentralized business structure, users do not need to worry about any regulations or risk involved with the cash. Business savvy investors would not ignore this, just this month, Caesars Palace became the first casino in Las Vegas to accept wechat pay.

589 “WeChat Pay is part of WeChat, a Chinese social media giant that also offers a popular messaging service similar to Facebook’s Whatsapp and e-commerce. WeChat has 938 million monthly active user accounts globally while WeChat Pay has 600 million active users.” Todd Prince, “Caesars launches WeChat Pay for Chinese visitors,” Las Vegas Review, August 8, 2017, available at:https://www.reviewjournal.com/business/tourism/caesars-launcheswechat-pay-for-chinese-visitors/.

590 “In the first quarter alone, smartphone-originated QR code-based payments saw transaction growth of a staggering 113 percent according to the consulting firm iResearch. That increase carries a dollar value of about $337 million, and it was split nearly entirely by Alibaba’s Alipay and WeChat Pay, as the two firms collectively represent 94 percent of the QR code payments market.” see PYMNTS, “UnionPay’s Cashless Headache,” August 9, 2017, available at:http://www.pymnts.com/ecosystems/2017/unionpays-payments-market-battle-in-china/.

591 Caesars Entertainment Corp. this week become the first Strip operator to allow tourists from the world’s most populous country to pay for goods and services using one of their nation’s leading mobile payment apps. Todd Prince, “Caesars launches WeChat Pay for Chinese visitors,” Las Vegas Review, August 8, 2017, available
Second, the cost of investing a virtual store or displaying of the commodities is basically free. The investor does not need to pay for storage space or WeChat because WeChat can profit from advertising or data mining. Unlike traditional market, the investor needs to ensure the inflow of customer to the established business, WeChat is a semi-private social media platform, which means transactions can only occur between users identify as the circle of “friends.” This inner circle design ensures both the buyer and seller that transaction occurs at a less casual buy-sale relationship. In addition, it is beneficial to the investor because the business owner can directly contact with the user in a more intimate manner.

Third, the WeChat transaction model promoted a government-less and self-regulative commerce structure. In fact, the WeChat transaction was the true embodiment of the globalization: free and open-access without “walls” created by sovereign government. It revolutionized the foreign investment and trade. A French vineyard in southern France can open a public account on WeChat display fine wine on such account. Users can either order wine directly through WeChat or through an agent appointed by the vineyard. The cost related to conventional sale network and overseas branch office could be saved by this new transaction structure.

In fact, the beauty of the new economic model is the pattern of decentralized business transaction structure without intrusive government involvement. Without a physical store, there is no need to pay any cost associated with space or business license or even an accountant for a smaller business. Without a business license, it is harder for the government to enforce soft regulation through loan qualification or tax incentive. More importantly, this lucky French vineyard from the above example can enjoy unique privileges that any foreign investor could ever dream of in the 1980s: there is no foreign exchange control because the cashless payment will be conducted on Chinese banks and foreign banks through cashless wechat pay channel. There is no import license or import quota, or royalty restrictions because the French vineyard is not “officially” presence in China. The only investment for this French vineyard, maybe a small “contribution” to China’s e-commerce in the form of agency fees. This truly revolutionizes the way conduct business for smaller foreign investors.

In addition, this new economic model is self-regulatory in nature. A “friend” based virtual transaction demonstrated the feature of self-regulation. Since a “friend” based virtual transaction business relies more on the user experience and customer satisfaction, it reduced the incentive for an investor or business owner to engage short-term profiting behavior. For example, a florist can easily lose business under this model by selling inferior quality products to the customer because “friends” based customers can spread the words and “block” the seller faster and cheaper than a conventional business model does.
Wechat economy liberates freedom of contract for investors and marketplace participants. The essence of this wechat economy is the new free and open access to the marketplace. Under the conventional economic structure, the government asserted regulatory power through physical presence in the marketplace in the form of tax, loan, ordinance, court and economic policy to manage the relationship between the participants of the marketplace. Freedom of contract is restrained, maintained and regulated by the government with different political agenda. Occasionally, political power can be corrupted and commoditized to satisfy the needs and demands of the market.

Under this new commerce structure, the business transaction occurred on a virtual platform. E-commerce provider creates a framework to manage the relationship between the buyers and sellers in the form of mediation and public disclosure. This structure established new conceptual and practical framework for us to approach the idea of “regulation.” The transition from public regulation in the form of legislation and policy guidance transformed into the private regulation through the vehicle of “contract.” “Freedom of contract,” the most conventional and basic structure, yet most powerful tools that managing human relations was given new meaning to China’s new economic reality.
In fact, the freedom of contract is the most democratic and powerful tools that empower each individual consumer as the guardian of law and order. Unlike individuals passively accept orders from the centralized authority under a central planning economy to enforce rules censor behaviors that the leaders dislike, freedom of contract and “wechat economy” empower each consumer to enforce the basic values and ethics that promoted by the authority through guidance and inspiration. With proper guidance and education, the consumer can engage the behavior of self-monitoring and self-regulating. Chinese consumer protest Korean pop-star or Chinese consumer pressure Apple or KFC are the perfect examples to illustrating this idea.\textsuperscript{592}

In addition, “We chat economy” is not a substitute but a useful supplementary to China’s regulatory framework. As a Chinese company, Wechat has an obligation to obey Chinese law and regulations. Although the physical location of Wechat’s users may be outside China’s jurisdiction, the digital virtual presence of these users and their behaviors are located in the server of Wechat, which subject to the jurisdiction of Chinese law. With the free flow of information, wechat not only invite more integrated communication and business transactions, but also invite Chinese law and regulations into the global space without Chinese authority to invest a great deal of political and

diplomatic transaction. Although globalization creates challenges for Chinese regulators, Wechat presents a new venue for the modernization of Chinese regulatory framework.

Thus, Wechat transaction structure offered alternative channels for China’s next generation of foreign investment regime in the context of Yuan Internationalization and One Belt One Road. A decentralized transaction pattern not only fits into the narrative of China’s “go out” policy in the context of socialist modernization but also compatible with the globalization. The popularity of Wechat transaction is not “directed” by the government or “promoted” by the government, but decided by the collective consumer power of the Chinese people through the market decisions. It is the triumph of the “freedom of contract,” an important vehicle to truly realized the core of Deng Xiaoping’s political legacy: to improve the welfare of the people, to improve the living standard of the people. Wechat structure represents a new thinking that restored the freedom of contract by giving the power back to the individual, investor, and the market.

c. New approach to Rule of Law under public disclosure scheme and Wechat economy

As an abstract concept or meaning referring to a form of human activity and phenomenon, the law has a peculiar relationship with power. Although fallen out of favor by modern thinkers, the traditionalist natural law view developed since the early Roman Empire of Cicero day asserted law in society as “part of eternal nature of the
universe as organized by the divine.” Such view later intrinsically linked to another source of power, institutionalized Christian religion in the western society. The founding father of the United States designed a new principle of “separation of church and state” manifested the need to decouple the link between the law and power that vested within institutionalized religion in order to form the New Republic without disturbance and complication from multiple sources of power in the early 19th centuries.

Discourses about Chinese feudal times indicating the naturalist view of the law in Chinese culture. The source of law is divine power, which vested within institutionalized empire political system. The empire, a sign or intermediary connect law and order on earth with the divine power in heaven. Functionally, the law is taken as a tool to manage and regulate the subject of the state, which refers to as “rule by law.” Apparently, comparing with the modern conception of “Rule of Law,” the law in China’s feudal time manifest the expression of supreme order due to its lack of transparency, clarity, fairness, and predictability.

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594 Church of England has had considerable power for several centuries in most Anglo Jurisdictions except the United States... Anglo governments have traditionally been keen to nicate their separation from religion and the church. See Benedict Sheehy, “Fundamentally Conflicting Views of the Rule of Law 26,” Northwestern J. of Int’ Law & Bus’ no. 225 (2006):232.
Confucian view of Law has been a hot topic for the academics, Confucian school craft a philosophical view on the relationship between enforcement of rule or law and self-regulation motivated by shame, as he provided that:

The Master said if the people be led by fa (rule/ order/ law), and uniformity sought to be given them by punishment, they will try to avoid the punishment but have no sense of shame. If they be led by virtue (li), and uniformity sought to be given them by the rules of propriety, they will have the sense of shame, and moreover will become good. 595

Confucius’ argument provides us a fresh perspective over Rule of Law in a postmodern, globalized world. It is preferable to have rule or law enforced willingly by an individual that motivated by their own interest for the utility of virtue than to have rule or law enforced by an external party. 596 The development of modern legal mechanism such “disclosure” by business and government entity, the UN Business and Human Rights Accord, Norwegian Sovereign Wealth Fund model and China’s social credit initiative all illustrate new approaches to the meaning of law and justice in regulating rights and obligations in different forms of human interactions. A traditional approach would consider divine power, religious institution, or political institution as a source of law, which requires a mechanism of external enforcement. However, a thousand years ago,

595 Stanford Encyclopedia of Philosophy, Confucius, see https://plato.stanford.edu/entries/confucius/
Confucius would point out that the source of law comes from ourselves, designed by our nature, our society, the pattern of communication, enforced naturally by our desires. This law, as he considers as “li” is far superior because it is truly universal and intricately connected with anyone. In other words, everyone is equal before li, and li is above everyone.

The superiority of “li” lies on the part of “self-regulation,” which is a powerful element create a sustainable legitimacy for the rule. An inadequately developed law not only being perceived as a command that hurting the interest of the subject but also self-defeating because the legitimacy of the law is unsustainable. By modern design, the law is not command; the law provides a forum of fairness, openness, and reasonableness when conventional “li” fails or inadequate to function in a given context. There has been a strong opinion that Chinese prefer informal and unconventional ‘li’ over law and such preference might be the basis for China’s lawless society or even lack of interest for the rule of law. This legal “orientalism” just as its predecessor, “cultural orientalism” romanized a vision of China and West that may or may not mirror the reality. The development of the wechat transaction pattern provided one great example of future generation of the rule of law development in promoting a fair, open and efficient investment environment.
Summary: The Evolution of FDI Policy and Law in the Context of China’s Rule of Law Development

A centralized command economy in its pure condition is naturally accompanied by a society that lacks basic legal infrastructure, as there is no need for “law” to adjudicate the dispute; or, one may argue that the “law” was understood differently under such a system. Theoretically, when all meaningful decisions concerning social production are made by the central command and its branch offices, it excludes private entities from engaging in economic activities, which lowers the possibilities of private disputes involving social production. Essentially, the whole society is incorporated into a central command system, and the central authority would develop goals and plans for the whole nation. A complicated and layered bureaucratic system affiliated with enterprises and trading companies would be installed to enforce, monitor and control the process of production and transaction. Factories, trade companies, banks, farmers, and any other economic units are merely the tools to implement central or regional commands. There is no labor market everyone is assigned to a job based on the plan, not based on his or her merit or talent. There is no need or incentive for individuals to create anything since everything is planned. Thus, under a centralized command economic system, the concept of private disappears when the individual or other entity is “merged” into a centralized unit. The purpose of the individual is constructed as an enforcer of the centralized plan.
In addition, the concept of “law” may also disappear under the centralized command structure. One of the functions of law is to adjudicate conflict of private actions based on individual’s freedom of choice. When everything is controlled, monitored and planned by the authority, there is no space for freedom of choice because there is no private will. Thus, failure to implement a plan or violation of a plan by any unit can be easily fixed through plan readjustment.

Essentially, the structure of the command system extended a logic that free will is inefficient and prone to abuse. The freedom of contract “belongs” to a certain group in the power structure. The private market “takes” the power from the authority, disturbs the order and causes trouble. However, the reality is opposite. Although a central authority can plan the price, the distribution and supply of the resource, and output, it cannot control and manage the natural needs of the people. The free will of production can be socialized, but the free will of consumption is harder to control. If we consider a perfectly functioning central plan as a modern computer, then we would understand no computer can satisfy a user’s changing demands. Thus, no central plan system is humanly possible to adapt to the unpredictable free will of demands. The inherited issue with the planned system was that the central authority’s political agenda is incoherent and incompatible with the economic needs of the people.

The central authority can manipulate the process of production and sale to facilitate certain political goals, but it cannot control basic needs for individuals.
Essentially, the centralized command system is unsustainable because one cannot socialize the private will of consumption. People’s role as a consumer is incompatible with people’s role and function as the operator of the planned system.

In a planned system, there is no sufficient institutional capacity to know or an incentive to know the needs of the people because people are the element to enable and operate goals set up by the authority, an authority without sensibility to promptly and efficiently respond to people’s demands. When resources are allocated for central planning that disregarded the needs and demands of people, shortage occurred. The chronic shortage under the central command economy system illustrated the failure of the plan, which triggered more dated plan adjustments.

However, such practices all started to change when China started Reform and Open up, although much of the FDI regulatory framework in our discussion demonstrated the strong tendency of central planning. During the 1980s, Chinese EJV regulatory framework introduced a concept “jingji zhixu” (economic order). Economic order is the element built on the need for law and order because, for the first time in the mainland China, there would be free will by the foreign investors to compete with the state plan. As foreign investors cannot be “commanded” to act as a Chinese entity, the government needed “law” to regulate and manage the action of free will. Interestingly, the nature of “economic order” is more complex than it appeared to be. On the one hand, economic order is a legal concept derived from the needs of the
government to manage and control the free will of the foreign investors. Violation of the “economic order” would result in punishments and compensations. On the other hand, “economic order” is not a conventional legal concept because there is no clear definition of the essence of “economic order.” The central authority and regional authority may adopt conflicting plans, or the central authority may change its mind on certain plans. Thus, there is no consistency, predictability, and coherence of the “economic order.”

In a market-based system, the market will be the source to reflect the needs and demands of people, which allows individual actors to make independent decisions in the transaction. Due to that fact that the consumer has almost no restricted freedom of contract besides his or her financial capacity under the market system, it requires a highly sophisticated and independent entity to optimize and resolve issues within transactions activities. A highly developed legal system and a professional legal service market both serve and regulate the freedom of contract under a market system. Without political obligation to a system, people’s freedom of contract can be only regulated and restricted by its financial capacity and social, legal norms and values.

The evolution of China’s FDI policy and law in the context of the rule of law perfectly demonstrated a struggle between government legitimate regulatory interest for the public good, which is expressed by the central authority’s intent of maintaining stable, balanced, and long-term economic growth as it planned, and the interest of the
freedom of contract in promoting efficiency and prosperity, as expressed by transparent, unified market access, and fair regulatory treatment. Such struggle facilitates a strange narrative of “China’s exceptionalism” in defending or criticizing China’s FDI regulatory framework. There are two types of arguments developed during the past decades within the academics and investment communities. As the second chapter discussed, the first type, which was popular at the beginning of the 1980s but now faces more questions, attributed Chinese attitude on the rule of law to Chinese culture, and the concept of Guanxi. The second type argues that Chinese political and constitutional system is incompatible with the rule of law. The “cultural argument,” unfortunately was a form of “cultural prejudice,” as it simplifies a problem by confusing the symptom and cause of the issue. The evolution of Chinese FDI policy, and law and the complexity and legal creativity involved in China’s return investment are the best example showing that the lack of a sophisticated market economy for the past decades is the real reason that Chinese consumers and investors cannot fully enjoy the benefits of the rule of law. The development of China’s ODI and China’s Wechat economy are the best examples showing Chinese culture does not necessarily reject the rule of law.

The second type of the argument relates to a more complex issue with the meaning of the rule of law. In fact, the evolution of FDI framework implied that China could not develop a robust foreign investment environment without the rule of law. The traditional pattern of Chinese FDI policy has three features: first, the centralized planning system produces a preferential policy for foreign investors targeting labor-
intensive exportation sectors. Second, a dualist legal and regulatory framework that insulates SOE from the competition of the market. Third, a strong and powerful central authority changes the market rule as it sees fit without external restriction. Under traditional FDI policy and law, the framework is ambiguous, unpredictable and unaccountable. However as the last chapter indicated, the traditional pattern has reached its limits.

The core of the problem as the previous chapters and last chapter discussed is not Chinese culture, but the difficulty in understanding the relationship between freedom of contract and the public good. The traditional centralized planning, in essence, is a form of economic censorship: it curated a vision of an economic system that pleased the central authority by filtering and censoring any elements that the central authority sees unfit. The quality and effect of economic censorship are questionable because it cannot coordinate everyone’s desire for different things; it is unsustainable. Foreign investment introduces a new element to China’s economic censorship, as it showcased the possibility of an alternative approach to protect the public good. The rule of law is compatible with the desire and interests of Chinese people. The new economic structure in China and the new international legal framework produce challenges to the traditional pattern of FDI framework, but they also facilitate opportunities for a more sustainable, effective and less intrusive and disruptive regulatory system in the future.
Appendix

Here is the list chronologically list foreign investment related law, policies, government rules, order from 1978-216:

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>3rd Plenary Session of 11th Central CPC</td>
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</tbody>
</table>
| 1979 | Standing Committee of NPC, Sino-Foreign Equity Joint Venture Enterprise Law (EJV Law)  
Measures for the Import and Export Goods by Enterprises Doing Processing, Assembling and Small & Medium-Scaled Compensation Trade |
| 1980 | State Council, Interim Regulation on Foreign Exchange Control, repealed and replaced by 1996 Regulations on Foreign Exchange Control  
NPC, Income Tax Law of Sino EJV  
State Council, Measures on Administration of Sino-Foreign EJV Registration, repealed by Regulations on the Administration of Enterprise Legal Person Registration  
Standing Committee of NPC, Resolution of the Standing Committee of the National People's Congress Approving the Regulations on Special Economic Zones in Guangdong Province  
Measures for Providing Short-Term Loans in Foreign Currency by the Bank of China, revised and repealed by 1995 Law on PRC Bank, Law on PRC Commercial Bank  
Interim Provisions of the State Council on the Administration of Foreign Enterprises' Permanent Representative Organizations |
<table>
<thead>
<tr>
<th>Year</th>
<th>Document Title and Details</th>
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</thead>
</table>
Interim Regulations on Foreign Exchange Control  
**BOC Interim Measures on processing loan application for Sino-Foreign EJV repealed by 1987 BOC Measures on loan application for Foreign Invested Enterprise.**  
**General Bureau of Industry and Commerce Notice on Implementing Sino-Foreign EJV Registration Approval Procedure.**  
**Interim Measures on BOC Processing Loan Application by Sino-Joint EJV repealed by BOC FDI Loan Rules**  
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