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Enter the Dragon: Foreign Direct Investment Laws and Policies in the P.R.C.

George O. White III*

I. Introduction

The People’s Republic of China’s (China) entry into the World Trade Organization (WTO) forever changed the global foreign direct investment (FDI) landscape. For China, with the largest population in the world, this proved a momentous occasion. Even before being accepted into the WTO, not to mention hosting the Olympics and World Exposition, China was one of the premiere FDI destinations in the world.

China is a country of vast opportunities and considered by most foreign enterprises to be the last great commercial frontier. For these reasons, foreign investors are eager to invest in large and often complex projects and ventures, even without knowing what laws apply or having the ability to understand China’s complex legal system. Thus, due to the complex regulatory framework and business culture, commercial enterprises must be careful to properly structure a sound investment project for ultimate success.

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II. Advantageous and Popular FDI Vehicles

When the Chinese government instituted the "open door policy"\(^1\) there was virtually no legal structure acting as a regulatory mechanism.\(^2\) There were also virtually no codified laws or regulations pertaining to foreign commercial enterprise ventures/investments.\(^3\) Because of these endemic problems, the Chinese government set out to create a conducive investment environment by enacting laws and regulations providing foreign investors certain "rights and interests."\(^4\)

Since the passage of the Law on Chinese-Foreign Equity Joint Ventures of 1979\(^5\) – the fundamental piece of legislation dealing with foreign investment in China – the Chinese government has passed over 200 laws and regulations relating to, for example, foreign joint ventures, offshore oil exploration, foreign economic contracts, mediation and arbitration proceedings, and Special Economic Zones.\(^6\) For example:

[i]t has been claimed . . . that over the past 20 years (1979-99): (1) the NPC [National People’s Congress] and its Standing Committee have examined and adopted a total of 327 laws and decisions[;] (2) the State Council has enacted more than 750 administrative laws and regulations [;] and (3) the local People’s Congresses at various levels have formulated more than 53[,]000 local decrees.\(^7\)

It must also be mentioned that many countries have entered into bilateral treaties with China for the purpose of protecting FDI projects and ventures for their national enterprises.\(^8\)

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1 Kui Hua Wang, Chinese Commercial Law § 3.1.1, at 83 (Trish Mann ed., 2000).

2 See id. at 83, 84 n.5.

3 See id. The terms “foreign enterprise,” “venture,” and “investor” are all synonymous in this article.


6 Tai, supra note 4, § 2, at 24.

7 Wang, supra note 1, § 3.1.1, at 83 n.1.

8 Id. at 83-84 (stating that China has entered into forty-one bilateral treaties, twenty-four of which are currently in force). Some of the countries that have enacted such treaties are Germany, Great Britain, France, Italy, Austria, Denmark, Sweden,
In addition to enacting new foreign investment laws to protect foreign investors, the Chinese government also amended its constitution,\(^9\) which was adopted in December 1982.\(^{10}\) The revision stated, “foreign enterprises, economic organizations and individual entrepreneurs are permitted to invest in China and to take part in various forms of economic cooperation with Chinese enterprises and other economic organizations.”\(^{11}\)

The Chinese government also took a revolutionary step by establishing the Ministry of Foreign Trade and Economic Cooperation (MOFTEC).\(^{12}\) MOFTEC was formed to administer China’s foreign trade and economic cooperation arrangements.\(^{13}\) It has a number of responsibilities including: (1) to formulate laws, regulations, and policies; (2) to coordinate foreign trade, investment, and economic development; (3) to form nationally strategic plans; and (4) to administer all foreign investment contracts, laws, and regulations.\(^{14}\) Since China’s opening-up, it is estimated that MOFTEC has approved over 314,000 investment projects, “but less than half of them have begun operating .... These projects have a combined contractual foreign investment of US$545.366 billion, of which US$242.321 billion have already been invested.”\(^{15}\)

Among all of the important activities and functions that MOFTEC has executed, the most important was the Catalogue for the Guidance of Foreign Investment Industries.\(^{16}\) This system is

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\(^{10}\) See Tai, supra note 4, § 2, at 24.

\(^{11}\) Id.

\(^{12}\) See Chuang, supra note 9, at 512.

\(^{13}\) Id. This foreign ministry was originally named the Ministry of Foreign Economic Relations and Trade (MOFERT). See Michael J. Moser, Foreign Investment in China: The Legal Framework, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE’S REPUBLIC OF CHINA 90, 91 (Michael J. Moser ed., Oxford University Press 2nd ed. 1987).

\(^{14}\) Chuang, supra note 9, at 512.

\(^{15}\) Wang, supra note 1, § 3.1.2, at 85.

\(^{16}\) Id. § 3.1.5, at 93.
vitally important because it serves as a guide for all foreign investors and lists the industries in which foreign investment is "encouraged, restricted, or prohibited." However, unless the catalogue is quickly modified to meet WTO specifications, it will become defunct and eventually be replaced by WTO guidelines and agreements.

The two most popular forms of FDI encouraged by the Chinese government are equity joint ventures and wholly foreign-owned enterprises (100% foreign-owned enterprises). These two forms of FDI are the primary mechanisms by which foreign-owned enterprises structure their investments and operate. They comprise an overwhelming majority of all FDI vehicles. It must be noted that these investment vehicles have been revised and amended on numerous occasions. The most recent revisions were authorized in April of 2001.

A. Wholly Foreign-Owned Enterprises

Wholly foreign-owned enterprises (WFOEs) are formed by foreign investors with their own capital under Chinese law, without a Chinese partner involved in the investment. WFOEs are generally formed as limited liability companies. As limited liability companies, WFOEs become "legal persons" under the

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17 Id.
18 See id.; see also Wei Gu, China Enters The WTO, GLOBAL FIN., Nov. 1, 2001, at 59 (describing that China's membership in the WTO will force it to open its "severely restricted distribution channels" and that this "will be the most profound change for foreign investors").
19 See generally RALPH H. FOLSOM ET AL., LAW AND POLITICS IN THE PEOPLE'S REPUBLIC OF CHINA 403-04 (Ralph H. Folsom ed., West 1992); see also WANG, supra note 1, § 3.1.1, at 84 & n.4.
1986 Chinese Civil Law. Therefore, a WFOE may possess "the corporate characteristics of continuity of life, centralization of management, and free transferability of interests." But, "mergers and other important changes in WFOEs must be approved by the relevant Chinese authorities."

These investment vehicles originated from legislation adopted on April 12, 1986, at the fourth session of the Sixth National People's Congress (NPC). At this session it was stated that:

[with a view to expanding economic cooperation and technological exchange with other countries, and promoting the development of its national economy, the People's Republic of China permits foreign firms, other economic entities or individuals... to set up enterprises exclusively with foreign capital in China, and protects the lawful rights and interests of the enterprises so established.]

Before the WFOE law came into existence, very few companies were permitted to conduct any form of business in China via a wholly owned subsidiary model. Virtually all FDI was required to be within the confines of Special Economic Zones (SEZs).

23 See FOLSOM ET AL., supra note 19, § 9, at 404.
24 Curley & Fortunato, supra note 22, at 545.
25 Id.
26 See Tai, supra note 4, § 2, at 30.

Under Article 57 of the Constitution of the PRC, the NPC is the highest State legislative body. It is entitled to amend the Constitution and also to enact and amend basic laws concerning criminal offences, civil affairs, State organs, [etc.]... [The NPC has a permanent standing committee called "The Standing Committee."] There are approximately 3000 members comprising the NPC. Members hold office for a term of five years... The full NPC meets once a year for a period of 1 or 2 weeks. In theory, the NPC plays the role of parliament in the PRC. It is the highest organ of State power.... Apart from its legislative power, the NPC also has the power to: (a) appoint and remove leaders and members of the highest State organs, (b) make decisions on national development plans and the State budget, and (c) supervise the implementation of the Constitution.

WANG, supra note 1, § 1.2.4.2, at 20-21.
28 Tai, supra note 4, § 2, at 30.
29 See id. at 30-31.
WFOEs are now the wave of the future for FDI in China. Today, with the new and improved FDI regulations in place, WFOEs are by far the most popular investment vehicle for foreign investors in terms of contracts signed and projects developed. In 2000, “over 40 percent more WFOE contracts than joint venture contracts were signed, and the value of contracted investment in WFOEs was 70 percent more than . . . joint ventures . . . .”

The reasons for WFOE popularity are simple and obvious. While the other two major investment vehicles allow for certain advantages, they also have a significant number of disadvantages. For instance, Equity Joint Venture Law (EJVL) requires that foreign investors use certain equipment in investment that is “appropriate” to the needs of the Chinese government. Also, something that has become extremely controversial and quite problematic for many foreign investors is that the EJVL requires foreign investors to allow their Chinese partners access to all pertinent documentation regarding such things as industrial property and know-how (i.e., research and development). This requires “including photocopies of patent certificates or trademark registration certificates, statements of validity, [and] their technical characteristics and practical value.” These disclosures must be annexed to the joint venture contract.

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30 Foreign Investment Laws: Changes, May 2001, supra note 20; see James Kynge & Edward Young, Wal-Mart Wins Go-Ahead for Beijing Opening, FIN. TIMES, Nov. 8, 2001, at 29 (describing the fact that Wal-Mart, a U.S. retail company, has already opened its first supermarket in Beijing and has secured permission from the Chinese government to open five more supermarkets in Beijing within the next few years). Wal-Mart has already opened several stores in the cities of Shenzhen, Kunming, Fuzhou, Dalian, Shenyang, Shantou, and Dongguan (fifteen stores altogether). Id. These stores are WFOEs. See id.


32 See infra Part II.B.

33 WANG, supra note 1, § 3.2.1, at 94.

34 Id. § 4.8.3, at 130.

35 See id.

36 Id. Consider the possible ramifications of these measures in today’s world of economic and corporate espionage.

37 See id.
1. Recent WFOE Law Revisions Positively Affecting FDI

In October 2000, the NPC agreed to various revisions of the WFOE law and subsequently approved implementing regulations in April 2001. These revisions were predominantly very positive and pragmatic. Some of the most important positive revisions were the elimination or revocation of: (1) export performance requirements (i.e., "rules that required companies to export certain percentages of [their] product[s]"; (2) advanced technology and import substitution requirements that a WFOE must use "to develop new products, promote conservation, and upgrade products for import substitution"; (3) foreign exchange balance requirements demanding "that WFOEs balance their foreign exchange receipts and expenditures"; (4) prohibitions opposing WFOE direct domestic sales of products without prior government approval; (5) the prerequisite "that raw materials and fuel for WFOEs be obtained solely within China unless unavailable from the domestic market" and the requirement that "imports of capital equipment and technology" be used from the domestic economy; (6) the requirement that "WFOEs submit production

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38 Foreign Investment Laws: Changes, May 2001, supra note 20. Please note that Chinese laws are generally drafted very ubiquitously; implementing regulations are, on top of the Chinese laws, approved to provide more thorough and detailed guidance. See generally id.


40 Foreign Investment Laws: Changes, May 2001, supra note 20. Now, exports are generally encouraged but not obligatory. Id. However, "[I]t is unclear whether export performance requirements contained in existing contracts [will] remain valid." Id.

41 Id. The new law merely encourages these activities. Id.

42 Id. "The State Administration of Foreign Exchange (SAFE) had not seriously enforced the balancing requirement in recent years, reflecting China’s relatively strong foreign exchange reserves. Nevertheless, the law had remained on the books." Id.

43 See id. This is one of the most monumental steps the Chinese government has taken to date with regard to the open door policy and restructuring of its FDI laws in an effort to crystallize foreign investor confidence and harmonize its laws with those of many western countries.

44 Id.

45 Id. This was, again, an incredible leap forward for the Chinese government to make.
and operation plans to local authorities;\textsuperscript{46} (7) the requirement that "WFOEs sell products in accordance with China’s price control regulations or record the prices with price control and tax authorities;\textsuperscript{47}" and (8) the law regarding particular "limitations or prohibitions to WFOE investment in certain business lines, including media, real estate, communications and transportation, and public utilities.\textsuperscript{48}

Now, most of the provisions relating to "limitations or prohibitions" will be published annually in the Catalogue for the Guidance of Foreign Investment Industries, guiding foreign investment in the particular industries listed.\textsuperscript{49} To say the least, the changes recently made in the WFOE laws were colossal steps by the Chinese government in showing the world that they are now extremely serious about restructuring their FDI laws for the purpose of opening up to the rest of the world and fostering positive investor sentiment.\textsuperscript{50}

Essentially, the basic underlying theme spelled out by the WFOE laws is that these enterprises will be developed while taking China’s national economy into consideration.\textsuperscript{51} In many circumstances, although these requirements are changing at a very rapid pace, WFOEs can be in areas such as advanced technology and equipment "[and/]or [be willing to] market all or most of their products outside China."\textsuperscript{52} Furthermore, to date, the progressive WFOE model for FDI in China allows for complete protection of the investment, profits derived from the investment, and rights and interests of the foreign investor under Chinese law.\textsuperscript{53}

\begin{footnotes}
\textsuperscript{46} Id.; see also supra note 15 and accompanying text (regarding comments made about "opening-up").

\textsuperscript{47} Foreign Investment Laws: Changes, May 2001, supra note 20.

\textsuperscript{48} Id.

\textsuperscript{49} See id.; see also supra notes 16-18 and accompanying text (explaining the importance and risk to the Catalogue for the Guidance of Foreign Investment Industries).

\textsuperscript{50} See generally supra notes 38-48 and accompanying text (describing the radical changes made by the Chinese government).

\textsuperscript{51} See Tai, supra note 4, § 2, at 31-32.

\textsuperscript{52} Id. at 32. But see supra notes 40-48 and accompanying text (describing the restrictions previously placed on WFOEs).

\textsuperscript{53} Tai, supra note 4, § 2, at 32.
\end{footnotes}
2. The WFOE Screening Process

Because there is not much of a mechanism for regulatory supervision by governmental authorities once the WFOE has been approved, WFOEs are not a favorite foreign investment vehicle for Chinese regulators.54 As a result, the foreign investor interested in this form of investment vehicle must go through a stricter form of approval process, compared to vehicles like Equity Joint Ventures.55

There is a ninety-day approval process for WFOEs, for which application to at least two approving authorities is required.56 The initial step is for the foreign investor to apply to the local government authority (above the county level).57 The application should contain details such as: (1) "the purpose[,] . . . scope and scale of operations";58 (2) what is to be produced and/or manufactured and what types of technology and equipment are to be used;59 (3) the expected percentage of output overseas versus to domestic markets;60 (4) "area of land and land requirements";61 and (5) infrastructure prerequisites required for the enterprise to stay viable (i.e., water, fuel, public utility, electricity, coal, gas, etc., requirements).62 Upon receipt of the report, the local government agency is normally given thirty days to make a final determination regarding the feasibility of the proposed WFOE.63

If and when the local authority approves the proposed project (i.e., preliminary approval), the foreign investor is required to apply for final approval, depending on the situation, locality, and type of enterprise.64 Extensive documentation is necessary for the

54 See generally WANG, supra note 1, § 4.9.1, at 131.
55 See id. § 4.9.1, at 132.
56 See id.§ 4.9.2-4, at 132-33; see also FOLSOM ET AL., supra note 19, § 9, at 403.
57 See WANG, supra note 1, § 4.9.2, at 132.
58 Id.
59 See id.
60 See id.
61 Id.
62 See id.
63 Id.
final approval process:

Foreign companies are required to submit an application to the relevant authorities, together with the following documents: (1) a feasibility study; (2) articles of association of the enterprise; (3) a list of legal representatives or candidates for the board of directors; (4) evidence of the foreign investor's legal certification and credit standing; (5) the written response of the local government, at county level or above, in the locality of the proposed enterprise; (6) a detailed list of goods and materials needed to be imported; and (7) other necessary documents. All of these documents must either be written or translated in Mandarin Chinese.

The safest and most conducive way to be granted approval by MOFTEC is to specify in the formal application that the investment and/or project involves certain manifest aims which could include, among other things, aiding with the development of the Chinese economy, helping to create an ecologically sustainable development, using high technology and equipment, and/or exporting the majority of all the products produced in China to other countries.

Once the application has been approved and an approval certificate has been issued by MOFTEC, the applicant must file, within thirty days, a written request to register the enterprise and to receive a business license with the State Administration for Industry and Commerce (SAIC). When a business license has been issued by SAIC, thereby legitimizing the enterprise, the WFOE must register with the local tax authority "within 30 days of receiving the business license." The foreign investor should propose the general terms for which the enterprise will operate in the application to SAIC. These terms of operation will also be

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65 Id.; see also WANG, supra note 1, § 4.9.3, at 132.
66 See John S. Mo, International Foreign Investment Law, in INTRODUCTION TO CHINESE LAW 283 (Wang Chenguang & Zhang Xianchu eds., 1997); see also WANG, supra note 1, § 4.9.3, at 133.
67 WANG, supra note 1, § 4.9.5, at 133. Most interesting here is the precept of positive approval based on the guarantee that most of the products produced will be exported.
68 See Huang, supra note 64, at 479.
69 WANG, supra note 1, § 4.9.6, at 134.
70 See Huang, supra note 64, at 479.
subject to approval by the government. Finally, "[n]o minimum capital requirements will be imposed," and the sum of registered capital that the enterprise will use to start its operations must coincide with the scale and scope of operations.

It must be noted that there are certain sectors of industry in which WFOEs are either heavily discouraged or altogether barred. WFOEs are heavily discouraged from operating in the sectors of transport facilities, public utilities, real estate, leasing and trust investment. If a potential WFOE attempts to enter one of these sectors, MOFTEC will strictly scrutinize the application during the approval process. On the other hand, potential WFOEs are altogether prohibited from applying for investment approval in the sectors of newspapers, publishing, broadcasting, television or films; domestic commerce; foreign trade or

71 See id.
72 Id.
73 See id.
74 See WANG, supra note 1, § 4.10.2, at 135-36 (stating that FDI in various industrial sectors is generally divided up into four main sectors: encouraged, permitted, restricted, and prohibited).
75 See id.
76 See id.
77 Id. But see, e.g., Around the World Chairman Murdoch Strikes a Deal, 17 EARTH ISLAND J. 1, Spring 2002, at 14.

News Corp. media mogul Rupert Murdoch has finally attained his long-sought goal of extending his communications empire to China. Murdock's Star TV has been granted permission to transmit to cable viewers in 'a restricted area in Guangdong province.' China asked only one thing in return: that Murdoch ensure that a China Central Television channel be widely available in the U.S. To accommodate China's rulers, Murdoch removed the BBC broadcast documentaries critical of the Chinese government. Star TV's pitch was doubtless enhanced when Murdoch's son... openly criticized the Falun Gong, an outlawed religious movement that has been brutally suppressed by Beijing.

Id.

78 See WANG, supra note 1, § 4.10.2, at 135. But see, e.g., supra note 30 and accompanying text (discussing Wal-Mart's decisive entry into the Chinese commercial market). Also, other foreign international commercial supermarket chains, such as Carrefour, a French conglomerate, have been acting within the Chinese domestic "scene" for some time now. See Kynge & Young, supra note 30, at 29. So there are exceptions to the rule. See id.; see also Mike Troy, Wal-Mart to Open Five in Beijing, DSN RETAILING TODAY, Nov. 19, 2001, at 2 (stating that because of China's admittance into the WTO, there will be fewer restrictions on foreign business ownership). And, in the
insurance; postal services and telecommunications; and "other industries that the Chinese [g]overnment prohibits a sole investment enterprise from establishing."

B. Equity Joint Ventures

Until recently, before the wholly owned foreign enterprise became the new "hot" investment vehicle for both foreign investors and their Chinese counterparts, equity joint ventures (EJVs), traditionally received the most attention. The first series of joint venture laws, Law of the People's Republic of China on Sino-Foreign Joint Equity Enterprises, was adopted on July 1, 1979, "at the 2nd Session of the 5th National People's Congress" and was later amended on April 4, 1990, "at the 3rd Session of the 7th National People's Congress." These laws came about by the advent of normalized trade relations between the United States and China in 1979 and were designed to attract foreign investment,

near future there will be "reduced import taxes, upgraded distribution infrastructure and more foreign investment . . . ." Id. (quoting Linda Kristiansen of UBS Warburg).


In February 2001, two foreign investors (along with two politically well-connected Chinese commercial banks . . .) made the first direct equity investment in China's still protected telecom sector. The two foreign investors splashed out $325 million for a combined 12% stake in China Netcom Corp. Ltd., a telecom upstart set to challenge State-owned monolith China Telecom. Id. While this is basically a joint venture, and not a WFOE, it still represents the fact that while the telecommunications sector is considered off limits to FDI, there are exceptions. See id.; see also infra Part II.B. (describing equity joint ventures in detail).

80 WANG, supra note 1, § 4.10.2, at 135.

81 See generally Moser, supra note 13, at 100; see also Foreign Investment Laws: Changes, May 2001, supra note 20 (stating that Joint Ventures are now considered the second most popular foreign investment vehicle in China, behind the Wholly Foreign Owned Enterprise).


83 WANG, supra note 1, § 3.2.1, at 94.

84 Id. § 3.2.1, at 94-95. A conclusive Chinese text of these sessions, with an English translation, can be found in CHINA'S FOREIGN ECONOMIC LEGISLATION 1-7 (Foreign Languages Press 1982).
capital, and expertise (i.e., know-how).\textsuperscript{85} Since that time, EJVs have been a major form of foreign investment. By 1987, over 3,210 EJVs were established in China.\textsuperscript{86} EJVs quickly became the main FDI tool for ventures between Chinese and foreign enterprises and as a result, the EJV laws are by far the most developed of all Chinese foreign investment laws.\textsuperscript{87} EJVs are now only second in popularity to WFOEs.\textsuperscript{88}

While there is no true definition of what an EJV should actually be, there are some criteria establishing its basic characteristics. These include such characteristics as: (1) both the foreign and Chinese parties (EJV partners) should share in the profits of the enterprise, along with bearing the risks of loss, in proportion to their contribution of registered capital;\textsuperscript{89} (2) the EJV should be "established within China's territory in accordance with relevant Chinese law and subject to the jurisdiction and protection of Chinese law",\textsuperscript{90} (3) the EJV should be registered as a Chinese legal person by taking the form of a limited liability enterprise;\textsuperscript{91} and (4) the foreign investor must have contributed not less than twenty-five percent of the venture's registered capital.\textsuperscript{92} Once an EJV has registered with the Chinese authorities, it cannot reduce its registered capital.\textsuperscript{93} Also, if an EJV wants to subsequently increase its registered capital, both the EJV's board of directors and the government authority who originally examined and approved the venture (i.e., the Registration and Administration Office for the Establishment of the EJV) must approve the increased capital.\textsuperscript{94} Nonetheless, to be economically feasible, an

\textsuperscript{85} See generally FOLSOM ET AL., supra note 19, 403-04.
\textsuperscript{86} See id.
\textsuperscript{87} See Moser, supra note 13, at 101.
\textsuperscript{88} Id.
\textsuperscript{89} See WANG, supra note 1, § 3.2.2, at 95.
\textsuperscript{90} Id.
\textsuperscript{91} See id.
\textsuperscript{92} See Curley & Fortunato, supra note 22, at 534. Registered capital is the total amount of the contributed capital that has been registered at the Chinese government's Registration and Administration Office for the Establishment of the Equity Joint Venture and "is the total amount of capital subscribed by the parties." Id. at 534 n.9.
\textsuperscript{93} See id. at 535.
\textsuperscript{94} See id.
EJV is expected to assist with the development of China's economy and carry out at least one of a number of possible positive tasks, including: (1) "adopt[ing] advanced technical equipment and scientific management",\footnote{Huang, supra note 64, at 474-75; WANG, supra note 1, § 3.2.2, at 96.} (2) promot[ing] commercial and technological renovation,\footnote{See Huang, supra note 64, at 474-75; see also, e.g., WANG, supra note 1, § 3.2.2, at 96.} (3) "produc[ing] export oriented products",\footnote{See Huang, supra note 64, at 474-75; see also, e.g., WANG, supra note 1, § 3.2.2, at 96.} and/or (4) provid[ing] the means for organizing and training managerial and technical personnel.\footnote{See Huang, supra note 64, at 474-75; see also, e.g., WANG, supra note 1, § 3.2.2, at 96.} These tasks must not only be "advanced" in nature, but must also be in line with China's economic needs.\footnote{See WANG, supra note 1, § 3.2.2, at 96.}

1. Recent Equity Joint Venture Law Revisions Positively Affecting FDI

Until recently, foreign investors favored using the EJV vehicle.\footnote{See supra Part II.B.} EJVs were seen by the Chinese government as a way to prop up under-performing and ailing domestic enterprises.\footnote{See Foreign Investment Laws: Changes, May 2001, supra note 20.} In a nutshell, EJVs were a sort of "rescue package" handed to the enterprise by the government at the bequest of the foreign investor. In March 2001, the NPC made some minor revisions to the Law of the People's Republic of China on Sino-Foreign Joint Equity Enterprises.\footnote{See id.; see also supra notes 82-84 and accompanying text (discussing the amendments to the law).} While the changes were relatively minor in nature, the Chinese media characterized the revisions as "a milestone in the country's quest to provide a legal framework that will better serve the development of joint ventures in China."\footnote{Foreign Investment Laws: Changes, May 2001, supra note 20.} But this new EJV law has yet to be finalized or implemented.\footnote{See id.} Due to China's admittance into the WTO, it is soon expected that
more precise and sweeping amendments will be approved to provide healthier incentives to potential foreign investors.\textsuperscript{105}

To date, several positive and pragmatic revisions of the amended EJV law have been made. For instance, the requirement that EJVs “either procure raw materials, fuel and some capital goods from the domestic market or source from the international market using on-hand foreign currency” has been deleted.\textsuperscript{106} Instead, the amended law allows sourcing from the international market, but adds the provision that the procurement process must be done in a manner that effectuates “probity and impartiality.”\textsuperscript{107} In addition, the requirement that EJVs must “file production [and/or] business plans with government offices and implement plans through business contracts” has also been deleted.\textsuperscript{108} Finally, the provision that all insurance plans for an EJV must be provided by a Chinese insurance company has been changed to require that the insurance provider be located in the territory where the enterprise is operating.\textsuperscript{109}

2. The EJV Screening Process

The first and most basic step of an interested potential foreign investor is to locate an appropriate partner.\textsuperscript{110} Obviously, this first step is essential and absolutely crucial in developing a viable EJV. This first step is a relatively simple one, especially since China is in great need of foreign capital infusions and western technologies.\textsuperscript{111} The immense demand for these resources, by way

\textsuperscript{105} See State to Revise Related Laws for New FDI Model, ASIAINFO DAILY CHINA NEWS, Sept. 26, 2001, at 1. “China examined over 1,500 laws, regulations and documents... and found that over 500 of them should be eliminated, 200 should be revised according to... WTO rules, and over 20 new regulations should be laid down.” Id. China has worked to “revamp” the “laws concerning foreign-funded enterprises that did not adhered to WTO rules.” Id.

\textsuperscript{106} Foreign Investment Laws: Changes, May 2001, supra note 20.

\textsuperscript{107} See id.

\textsuperscript{108} Id. This is a remarkable and rather progressive amendment showing the government’s willingness to allow some form of foreign investment autonomy. See id. It is also more of a counter-strike against what the WTO will soon be demanding.

\textsuperscript{109} See State to Revise Related Laws for New FDI Model, supra note 105.


\textsuperscript{111} See generally supra Part II (explaining how FDI is steadily increasing and describing the vastness of the Chinese FDI market).
of FDI, is far greater than the present supply.\textsuperscript{112} Thus, as the government hastily opens the doors at China's gates, most of the domestic Chinese companies are lying in wait for opportunities to establish EJVs with foreign enterprises so they too can enjoy the potential profits and derivative benefits of such an undertaking.\textsuperscript{113}

For example:

China is likely to have a domestic television industry strong enough to be a big export [sic] of cheap sets. Japanese firms will have a stake in that... : they are providing the technology now. Toshiba, Japan Victor Company Matsushita, Sanyo and Sony are all starting joint ventures with Chinese partners. Of the 2.8m sets sold last year, 1.5m were supplied by domestic joint ventures, the biggest of which is Hitachi's at Fujian.\textsuperscript{114}

An EJV must be approved by MOFTEC or local authorities before it can be established.\textsuperscript{115} In order for an EJV to be preliminarily approved, certain procedures must be followed and materials provided by the Chinese partner, including: (1) an application for the establishment of the EJV; (2) an EJV agreement and articles of association signed by agents (authorized representatives) of the proposed venture; (3) a joint feasibility study report; (4) a project proposal; (5) a letter of intent or memorandum of understanding providing not that there exists a binding agreement, but simply evidencing the parties' intent; (6) a list of candidates for board of directors and highest executive positions; and (7) various written opinions by local government agencies for the jurisdiction where the proposed EJV is to be established.\textsuperscript{116} All of these documents must be written in

\textsuperscript{112} See generally Mo, supra note 66, at 275 (discussing the relatively large currency reserve China has established).

\textsuperscript{113} See WANG, supra note 1, § 3.3.1.1, at 98.

\textsuperscript{114} Tai, supra note 4, § 2, at 29 (citing a relatively old, yet very relevant quote from ECONOMIST, Apr. 6, 1985); see also Karby Leggett & Paul Becket, A Global Journal Report: Citigroup Inc. Deal With Chinese Bank Would Be Milestone, WALL ST. J., Aug. 21, 2002, at C1 (highlighting the fact that even major investment banks, such as Citigroup, Inc., are partnering-up with local Chinese banks and financial institutions in creating joint ventures).

\textsuperscript{115} See Huang, supra note 64, at 475. Authorized local authorities can mean provincial, county, township, etc. Id. Each level of government may approve foreign investments, depending on the size. Id.

\textsuperscript{116} Id.
Mandarin Chinese. After the application has been reviewed and approved by authorized local authorities, it must then be submitted to MOFTEC for final approval. MOFTEC has three months to make a final determination. However, the time for approval can be extended if the Chinese authorities find something needing further investigation. Finally, if approved, the parties to the EJV must conduct work relevant to the feasibility study, negotiate and sign an EJV agreement and other related contracts, and posit the articles of incorporation.

There are a number of principal causes why projects are generally denied. The main reasons for denial of an EJV are: (1) "detriment[] to China's sovereignty", (2) violation of Chinese law; (3) "non-conformity with the requirements for the development of China's economy"; (4) potential propagation of environmental pollution; and/or (5) unconscionability in the agreement between the Chinese and foreign enterprise.

Once a certificate of approval to establish an EJV has been received, an EJV is required to register with the local bureau of the State Administration for Industry and Commerce (SAIC). This must be done within one month of receipt of the certificate of approval. When applying for registration, the parties to the EJV should provide:

(1) the document of approval; (2) copies of the Chinese and

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117 See id.
118 See WANG, supra note 1, § 3.3.1.2, at 99.
119 See id. § 3.3.1.2, at 100.
120 See Guo & Tao, supra note 110, at 320. Due to the slow bureaucratic machinery at work, this could take some time. See id.
121 See id.
122 WANG, supra note 1, § 3.5.2.2, at 108-09.
123 See id.
124 Id.
125 See id. Environmental pollution is an especially "hot" item on the list due to the fact that Beijing is trying extremely hard to clean up the environment and strengthen environmental regulations before the 2008 Olympics in China. See Angela Leary, Ready, Set, Go, ASIAN BUS., Oct. 2001, at 60.
126 WANG, supra note 1, § 3.5.2.2, at 108-09.
127 See Huang, supra note 64, at 475.
128 See id.
foreign language [EJV] texts of the joint venture agreement, the joint venture contract, and the company charter; (3) a copy of the foreign party's business license or other similar documents . . . ; and (4) a complete registration form, in triplicate . . . 129

The day when the business license for operation has been issued is the day that the investment becomes a legal entity with protection under the Chinese laws. 130 Generally speaking, it takes anywhere from six to twelve months, from beginning to end, for this process to transpire. 131

While not going into detail regarding percentages of capital contributions as to the value of the investment or standards of registration fees, it is important to note a few important fine points on EJV capital contribution regulations. It is essential that the parties applying for the EJV pledge their own capital for the venture. 132 This means that the capital pledged should be free of all encumbrances – not mortgaged, have a lien placed against it, or be secured by a creditor. 133 Capital contributions can be in the form of cash, equipment, buildings, and/or intangible property such as expertise and know-how, intellectual property, and land use rights. 134 If a form of investment other than cash is proposed, both parties must agree on the form and the authorized examination and approval authority must approve it. 135

C. Wholly Foreign-Owned Enterprises Versus Equity Joint Ventures

There are many advantages and disadvantages to choosing an EJV over a WFOE. The most obvious advantage is that having a Chinese party involved in the EJV is very helpful in obtaining the necessary government approvals to necessitate the project/investment. This results from the Chinese partner’s

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129 Id.
130 See Guo & Tao, supra note 110, at 320.
131 See generally Huang, supra note 64, at 475.
132 See Guo & Tao, supra note 110, at 320.
133 See id.
134 See generally WANG, supra note 1, § 3.4.3, at 106-07.
135 See id. § 3.4.3, at 107.
guanxi and familiarity with the complex procedures inherent in dealing with the multi-layered Chinese bureaucracy. On the other hand, there are also some major disadvantages to developing an EJV (compared to a WFOE). The most obvious disadvantage is that the foreign investor has to “transfer” technology and know-how over to the Chinese party (essentially a sharing of assets, including, e.g., research and development activities) at the behest of the foreign investor. Foreign investors also have to consult with the Chinese partner when dealing with management, facility, and production issues. Lastly, the Chinese government has significantly more oversight and control over an EJV than it does a WFOE.

D. “Special Areas” – Special Economic Zones and Coastal Economic Open Areas

A major by-product of China’s “open door policy” is the highly publicized development of “special areas” including “Special Economic Zones” (SEZs) and “Coastal Economic Open Areas [(CEOAs)].” SEZs are clever tools used by the Chinese government with the main purpose of acting “as ‘windows’ to the outside world.” They exist, for the most part, to create domestic

136 Telephone Interview with Dr. Ronald R. Robel, Director, Critical Languages Center; Director, International Honors Program; Director, Asian Studies Program, University of Alabama, Tuscaloosa, Ala. (Feb. 27, 2003) (stating that guanxi are connections fostered via friendships – in China these take considerable time and skill in developing, especially at high levels); see also Bee Chen Goh, Trade and Investment Negotiation with the Chinese, in CHINA’S INTERNATIONAL TRANSACTIONS: TRADE AND INVESTMENT § 3, at 39 (K. C. D. M. Wilde ed., 2000) (explaining that many businesses start off business relations by way of relying on guanxi).

137 See WANG, supra note 1, § 3.2.5, at 97-98.

138 See supra Part II.A.

139 See WANG, supra note 1, § 3.2.5, at 97-98.

140 See id.


employment opportunities and to draw in much needed know-how and technology by way of FDI.\textsuperscript{143} SEZs are essentially defined areas existing throughout China that offer numerous and rather large forms of special incentives and preferential treatment to foreign investors located within the specified area. Two broad principles guide SEZ operation: (1) "foreign investors and enterprises located in the special areas are to enjoy preferential treatment in the form of lower tax rates and easier entry and exit procedures"\textsuperscript{144} and (2) "local government authorities are to have greater decision-making power than as previously available to them in China."\textsuperscript{145}

To date, several "special areas" have been administered. All of these areas benefit from special regulations and policies that highlight each particular area's comparative advantage.\textsuperscript{146} They include the five SEZs (Shenzhen – the first, largest, and most successful of the SEZs – Shantou, Zhuhai, Xiamen, and Hainan Island),\textsuperscript{147} and fourteen CEOAs\textsuperscript{148} that were opened as part of the

\textsuperscript{143} See Lau, supra note 142, at 128-30.

\textsuperscript{144} Id.; see also Curley & Fortunato, supra note 22, at 551. "The income tax rate on a Foreign Investment Enterprise and a Foreign Enterprise with an establishment or site in China engaged in production or business operations . . . may be entitled to various tax rate reductions and/or holidays depending on the requirements of the region in which they are established." Id.

\textsuperscript{145} Id.

\textsuperscript{146} See Bin Xue Sang, Another Special Economic Zone in China? – An Analysis of the Special Regulations and Policy for Shanghai's Pudong New Area, 14 J. INTL. L. BUS. 130 n.3 (1993). A comparative advantage is:

when a particular country, while maybe not as efficient as other countries, focuses on what it does best – and invests in what it does best – even though it may still produce a product less efficiently than another country. What then happens is other countries will then shift production to other areas where their expertise and skills will be of better use maximizing efficiencies in a less competitive environment.


\textsuperscript{147} See Tai, supra note 4, § 2, at 20 (explaining that Shenzhen was the first of the SEZs, established in 1980; the rest were established and then all elevated to provincial status in 1988).

\textsuperscript{148} These are also known as “Coastal Cities.” See id. CEOAs have spread to twenty-seven provinces and cities throughout the PRC. See Guo & Tao, supra note 110, at 320.
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"open door policy" to foster trade and investment in 1984.  

There are a few important differences between SEZs and CEOAs. SEZs were primarily formed for the purpose of "general development." With this in mind, foreign capital can be invested in many activities, such as "industry, agriculture, animal husbandry, aquaculture, tourism, housing, the building industry, [and] high-grade technology development," among others. Almost all imported capital and consumer goods are exempt from customs duties. Presently, in SEZs, investors pay a modest fifteen percent income tax rate. Also, the Unified Foreign Tax Law implies that local taxes on foreign investors can be waived or reduced by the local governments of the provinces and municipalities where the SEZ exists. But, in order to comply with WTO policies, government ministry officials are contemplating phasing out the preferential tax rate in order to harmonize domestic tax rates. Ultimately, this will work to the disadvantage of foreign companies already invested in SEZs and create a less attractive opportunity for future foreign investors.

149 See Tai, supra note 4, § 2, at 20. The fourteen coastal cities are Dalian, Beihai, Qinhuangdao, Tianjin, Zhanjiang, Yantai, Qingdao, Lianyangang, Nantong, Shanghai, Nihbo, Wenzhou, Fuzhou, and Guangzhou. Id.

150 See id.

151 Id. For example, China's Silicon Valley or Shanghai which are considered "the" places for future high-tech development in China, and most of Asia. See Mike Clendenin, China's Silicon Road, ELEC. ENG'TIMES, Oct. 15, 2001, at 1.

152 Except for such things as alcohol and cigarettes, and other "luxury" goods. See generally Tai, supra note 4, § 2, at 20.


155 See Curley & Fortunato, supra note 22, at 551-55 (stating that for practical purposes, to continue to compete against other SEZs & encourage local investment, the local authorities usually always waive or reduce taxes on FDI in these areas).

156 See James Kynge, China Ready to Scrap Tax Breaks for Foreign Companies, FIN. TIMES, Nov. 13, 2001, at 15 (stating that "the five SEZs -- the booming southern cities of Shenzhen, Zhuhai, Xiamen, Shantou and the island of Hainan -- may find it more difficult to attract foreign investment after they are stripped of their power to award tax perks").

157 See id. The harmonization of local (Chinese) rules with national laws to conform to WTO standards is a perplexing and extremely time consuming task being
Nevertheless, it is clear that the tax policies will soon be revised to reflect China's determination to be a major player within the WTO. By not having added tax perks to draw in foreign investment, the impact on SEZ local economies may be immense.158

On the other hand, within CEOAs, investment must be "directed towards production and research, and therefore [is] most specifically aimed at the development of new technology and new products and industries."159 Correspondingly, only imported capital goods are considered exempt from customs duties in CEOAs.160 Also, only approved enterprises in CEOAs, strictly in the areas of economic and technological development, can take advantage of the preferential tax treatment granted SEZs.161 All other enterprises not approved for the lower tax rate must pay a higher rate of twenty-four percent.162 Nonetheless, CEOAs will also be hit by the same tax law revisions as the SEZs.163 Furthermore, the pending ratification of new tax revisions fostering harmonization of domestic tax laws, thereby complying with WTO policies and creating a level playing field, could mildly chill foreign investor interest in CEOAs.164

All of these areas deal with the government's theme of "spacial placement" and planning activities centered on the unique qualities of each specific "Special Area."165

See id. One very interesting twist here is that the inevitable tax revisions could also sack the prevalent abuse of what is called "round-tripping." "[R]ound-tripping" [is when] Chinese groups set up shelf companies in Hong Kong, which they then use as mainland investment vehicles in order to qualify for 'foreign' rates of tax." Id.

158 See id. One very interesting twist here is that the inevitable tax revisions could also sack the prevalent abuse of what is called "round-tripping." Id. "[R]ound-tripping" [is when] Chinese groups set up shelf companies in Hong Kong, which they then use as mainland investment vehicles in order to qualify for 'foreign' rates of tax." Id.

159 Tai, supra note 4, § 2, at 21.

160 Id.

161 See ZHENG, supra note 153, at 81.

162 See Huang, supra note 64, at 483.

163 See Kynge & Young, supra note 30, at 15.

164 See id. It must be noted that the new WTO sanctioned FDI tax policies would most severely hurt the Chinese government's foreign investment push toward new development zones in the West such as Lhasa & Lanzhou. See id.

165 See Lau, supra note 142, at 128; see also China Wooing FDI for Neglected Areas, BUSINESSLINE, Oct. 6, 2001, at 1 (describing that the ambitious Great Western
placement... refers to active state initiatives in site selection...." The whole idea of "spacial placement" is to look at economic, geographical, political, and cultural proximity. A good example of how this idea works in fostering FDI growth is the example of Shenzhen. A SEZ was established in Shenzhen by the Chinese government and put under the newly created Administrative Committee of the Special Economic Zones of Guangdong Province. Because Shenzhen was within close proximity to Hong Kong, many foreign enterprises in Hong Kong slowly relocated their "low-tech, labour-intensive industries across the border ... stock and barrel ... [so that by the early 1990s,] 96% of Shenzhen’s textiles and dyeing [and] 95% of garment joint ventures were financed by Hong Kong investors." Shenzhen’s incredible success comes from its geographical and economic proximity to Hong Kong. Because of these factors, Shenzhen has facilitated ties to a highly leveraged and developed foreign investment pool (Hong Kong), thereby maximizing its comparative advantages (e.g., much lower wages, relatively modest tax rates, and vast supply of raw materials and manpower) while taking advantage of a positively regulated investment area (the Shenzhen SEZ). This is exactly why the SEZs and CEOAs were contrived and developed by the Chinese government — regulatory efficiency that creates an investment friendly environment.

III. Conclusion

China’s investment climate has changed significantly over the past twenty years. With its recent accession into the WTO, China

Development or "Go West" project started by the Chinese government to steer foreign investment may be in jeopardy once domestic laws are harmonized to comply with WTO regulations).

166 Lau, supra note 142, at 128.
167 See id.
168 See generally note 147 and accompanying text (briefly discussing Shenzhen).
169 See Pow & Moser, supra note 141, at 200. Prior to being named a SEZ, Shenzhen was considered a "trade and investment zone." Id.
170 See Lau, supra note 142, at 129.
171 See id.
172 See id.
has revolutionized its global image. During this same period, the Chinese government has established several laws and regulations concerning foreign direct investment and international commercial activities. Most foreign investors still perceive China as having difficulties changing its relatively opaque, inefficient legal system and harsh business climate. But China is pressing on with much needed economic and legal reforms which are establishing a more hospitable investment climate for foreign enterprises wishing to develop projects within its borders. China’s WTO membership will only serve to accelerate this process.