

# BERICHTE UND URKUNDEN

## The Foreign Direct Investment Regime in China

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### *A. Introduction*

Since China opened its door to the outside world, more and more foreign direct investment (FDI) finds its location in the Chinese market due to the unique huge market potentials combined with the incentives which the Chinese government offers to investors.

The 1980s saw a steady rise in the inflow of FDI to China. When it came to the 1990s, China was among the leading recipient countries of FDI in the world. From 1992 on, China has continuously ranked top in the inflow of FDI in the developing world, with a record high of \$ US 38 billion in 1995.<sup>1</sup> In the meantime, however, many international investors have observed that China began to rescind or phase out some of the incentive policies. Typical of this is the abolition of the regulations concerning duty-free importation of capital goods, formerly generally applied to the foreign investment enterprises. The "Provisional Regulations on the Guidelines of Foreign Investment and Catalogue of Projects in Which Foreign Investment is Encouraged" (1995<sup>2</sup>) are among those regulations that have caused much worry about China's FDI policy. Does it signify

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<sup>1</sup> See United Nations Conference on Trade and Development, World Investment Reports, 1996, at 53.

<sup>2</sup> For the texts of the laws and regulations hereinafter, see, unless otherwise indicated, Guo Wu Yuan Gong Bao (Gazette of the State Council), Beijing. The marking of the year

that the Chinese government is beginning to retreat from the previous favourable attitude towards FDI? Is China proceeding to a less hospitable regime for FDI?

This article will examine the historical background of China's foreign investment regime and, in light of the social and economic situation, study the structure of the FDI framework and explore the characteristics of the FDI regime embodied in the framework, as well as its likely evolution in the future.

### *B. A Historical Account of the Foreign Direct Investment Regime in China*

#### I. The emergence of the FDI regime

China was among the developing countries that early recognised the important role of foreign direct investment in the economic development. This awareness coincided with the historical policy shift. Early in 1979, when China began shifting its emphasis from utopian ideology to pragmatic economic development<sup>3</sup>, the then Chinese leadership was determined to incorporate use of foreign investment as part of its reform and open-door policy. As a result, a new law was promulgated by the National People's Congress (hereinafter referred to as NPC), the Chinese legislative body. The unprecedented law, which was named "The Chinese-foreign Equity Joint Venture Law", thus initiated a process of using foreign direct investment and its regulation in China.

In this context, two points are worth noting. First, while most of the regulations that followed concerning FDI were to be adopted by the State Council or the Ministries<sup>4</sup>, the very first FDI law was enacted by the country's legislature. In China where administrative, rather than legislative power dominates the political life and most of the legal rules are thus in the form of regulations of the State Council or the Ministries, the formality difference showed the determination and commitment of the then

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following a law or regulations cited in this article is for the purpose of reference to its or their origin of publication.

<sup>3</sup> The convening of the third Plenary Session of the eleventh Central Committee of the Communist Party of China was a signal for the historical reformation.

<sup>4</sup> Under the Chinese legal system, the laws are adopted by the National People's Congress and its Standing Committee, and the administrative regulations approved by the State Council and its Ministries. These laws and regulations are considered to have binding force across the country. At the provincial level, the Provincial People's Congress and the Pro-

Chinese government to a policy of using FDI. Secondly, unlike the case in other developing countries, the new FDI law did not intend to cover all the FDI issues<sup>5</sup>. It is merely a law that governs one type of establishment of FDI, namely, equity joint venture. Given that foreign control of the economy of host country was among the very concerns of the developing host countries<sup>6</sup>, it is understandable why the law ensures, at least, part of control of the FDI establishment by the Chinese party. In other words, the Chinese government held, more or less, the same caution against the possible negative aspect of FDI. Judged from the perspective of law-making techniques, the new law was very simple: Instead of providing practically applicable rules, it gives principles governing the establishment of Chinese-foreign joint ventures and their operation after establishment. The fact reflected that the Chinese government was not accustomed to law-making for FDI. Considering no other laws could be cited as reference in terms of its implementation, much was left to be supplemented with the gaining of experience by appropriate authorities.

Due to the plural structure of law-making in China, failure to adopt a comprehensive FDI law would have a huge impact upon the shaping of the FDI framework, in that more laws dealing with certain specific FDI issues needed adopting, while any one of the laws, after its adoption by the NPC or its Standing Committee, might be supplemented by the State Council or the provincial government for the purpose of implementation. In the meantime, the regulations promulgated by the State Council might be supplemented by the relevant Ministries for the same purpose. The plural level making of rules for the same subject is often seen in the Chinese economic reformation and legislating process.

It is fair to say that, at that time when the using of FDI was still on a pilot basis, the enactment of the law was mainly to inform the outside world of China's policy change, in addition to regulating FDI issues. However, the mode of the first FDI law-making would have its impact upon the shaping of China's FDI framework: plural structural, complicated and potentially conflicting.

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vincial People's Government are empowered to adopt their own legislation which may have binding force within the province, on condition that the legislation is in conformity with the laws and administrative regulations. See the Constitution of the People's Republic of China, Art. 58, Art.89 (1), Art. 90 and Art. 100.

<sup>5</sup> See Meizheng Yao, *International Investment Law*, 1985, at 40.

<sup>6</sup> See M. Sornarajah, *The International Law on Foreign Investment*, 1994, 1-20.

## II. The shaping of FDI regime: historical background

It is too early to determine how far the reforms, which are still under way, have affected the shaping of the FDI framework in China. However, it is obvious that the former policies or measures have had their impact upon the latter. In this regard, several reformation policies or measures are chosen for the purpose of analysis<sup>7</sup>. The policy in relation to regional development strategy and urban economic restructuring, particularly, contributed to the shaping of the FDI framework at the earlier stage.

Almost hand in hand with the emergence of foreign investment policy, an overall economic restructuring and regional development strategy was formulated, by which, among other things, more economic policy-making power would be shifted from the Central Government to the local governments and enterprises and the coastal areas would be the priority economic development regions. In 1980, the State Council decided to establish four Special Economic Zones (SEZs), namely, Shenzhen, Zhuhai and Shantou in Guangdong Province, and Xiamen in Fujian Province, with a view to making these areas serve as comprehensive experimental sites for the country's economic restructuring and opening up to the outside world and a special channel for the country to use foreign investment. This strategy was heightened by later consecutive efforts in 1984 when fourteen coastal cities were opened to foreign investment, in 1988 when Hainan Province was announced to be a SEZ, in 1990 when a Shanghai Pudong New Development Area was created and in 1992 when a number of "coastal open areas" and "opening cities on rivers and borders" were announced. Special economic policies, which were mainly concerned with enlargement of local power and foreign investment promotion measures, were formulated exclusively for these areas to this end.<sup>8</sup> As will be explained later, most of these measures are tax-related. It is fair to say that this regional development strategy resulted in the prevalence of the evolving incentive-based FDI framework.

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<sup>7</sup> Economic reforms are too big a question to be discussed here in detail. For a detailed discussion, see Andrew Watson, *China's Economic Reforms, Growth and Cycles*, Asian-Pacific Economic Literature, Vol. 8, No. 1. Also see Guiguo Wang, *China's Investment Laws: New Directions*, 1988, 1-4.

<sup>8</sup> In fact, these measures were viewed as signs of the demonstration of the government's continuous commitment to an open-door policy and, particularly, to the policy of "using foreign investment".

The strategy was soon followed by an urban economic restructuring. The comprehensive urban economic restructuring started from 1984<sup>9</sup>, aiming at, among other things, the invigorating of state-owned enterprises and updating obsolete infrastructure in the old cities. In this context, foreign investment and its accompanying technology and management were deemed as a means to the end. Therefore, absorption of FDI began to become one of the priorities of the governments at different levels<sup>10</sup>. Governments, particularly, local governments with a mandate to regulate their own economic affairs, promulgated a quantity of FDI promotion policies, with a view to attracting foreign investment. As a consequence, foreign investment promotion and incentives, characteristic of fiscal incentives, whose application was not limited to the SEZs and coastal areas, were widely adopted by, firstly, the State Council and, subsequently, the local governments. Thus the incentive-based FDI regime was further strengthened by the new reform.

Since all these reformation measures were designed for different purposes and were implemented at different times, and since they usually varied from area to area, an extremely complicated picture of tax-break-based incentives occurred.

It is not difficult to find that, at this stage, the FDI framework evolved relatively independently of the shaping of the overall legal framework.

When it came to the 1990s, the economic situation called for the deepening of reforms, which finally led to the emergence of “socialist market economy” policy in 1992<sup>11</sup>. Ever larger parts of the socialist system have since been replaced by a market-oriented legal framework. Consequently, the 1990s saw a substantial development of new laws and regulations. The proliferation of market-oriented laws, with broad coverage and content applicable to domestic enterprises and foreign investment enterprises, makes it possible for the still evolving FDI framework to take in some elements from the overall legal framework. In other words, the reshaping of

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<sup>9</sup> The new reform was proclaimed in the “Decision on Reform of Economic Structure”, which was adopted at the third Plenary Session of the twelfth Central Committee of the Communist Party of China.

<sup>10</sup> For example, in the working reports made to the NPC and its counterparts at the local level by governments, the absorption of FDI was always mentioned as their task and achievement. For evidence see *The Working Reports of State Council*, made by Premier Li Peng at each sessions of the 7th, 8th NPCs, Beijing, 1988–1996.

<sup>11</sup> This drive was embodied in the “Decision on Establishment of Socialist Market Economy System with Chinese Characteristics”, which was adopted at the fourteenth Congress of the Communist Party of China.

the FDI framework, at this new stage roughly starting from 1992, was in combination with the shaping of the overall legal framework.

In the meantime, the same period witnessed a lot of changes of the FDI framework, particularly, the incentive-based FDI regimes. The change is characteristic of moving toward providing national treatment for foreign investment.<sup>12</sup>

At this new stage, the shift in the policy for the state enterprises and the formulation of a new regional development strategy have partly resulted in adjustment. From 1992 China began a new drive to invigorate the ill-performing state enterprises. In this regard, some state enterprises complained that the incentives for foreign investment enterprises put them in a disadvantageous position. Some incorporated a "phantom" foreign investment enterprise by knowingly undervaluing the state assets to induce dishonest foreign investors merely for the purpose of procuring incentives<sup>13</sup>. The perception that incentives for foreign investment enterprises might be unfair to state enterprises or contribute to the erosion of state assets reinforced the necessity of the adjustment of the incentive-based FDI policy.

Meanwhile, the issue of the economic development imbalance between the eastern coastal area and the middle and western interior area, which results partly from the majority of investments being made in the coastal area, has become ever prominent. Therefore, a new regional development strategy was promulgated in order to narrow the economic development gap. Pressure rose again to invoke the incentives granted to foreign investment enterprises in the coastal area.

When discussing the role of reformation measures in the shaping of a FDI framework, it is helpful to remember that the whole picture of this process lies in the interaction of these measures, each fuelling the other. For example, when China began to push the economic development of the coastal areas, it laid down the incentive-based policy for FDI to serve its objective, and this contributed, inversely, and partly, to the setting up of SEZs.

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<sup>12</sup> Despite that the national treatment standard, as the language "treatment no-less-favourable-than" indicates, is not intended to provide equality between foreign investors and nationals, a wrong perception often arises from the term of "national treatment". As a result, the effort to move toward national treatment has a twofold meaning in China. One is to alleviate the preferential treatment that had been exclusively accessible to foreign investment enterprises. The other is to make the treatment formerly available only to domestic enterprises accessible to foreign investors. The latter process usually takes place in the pre-establishment period, the former in the post-establishment period.

<sup>13</sup> See James Zhan, *Transnational Corporation*, 1995.

Finally, it is useful to notice that the FDI influx and investors' behaviour may have an impact upon the re-shaping of FDI framework. For instance, in order to reverse the trend of decline in the inflow of FDI after the Tianamen event in 1989, the Chinese government, and particularly the local governments, again, resorted to the incentive measures to attract foreign investment. When the influx of FDI to China reached a yearly record in 1993, 1994, and 1995, China began to adjust its FDI regime because it perceived that incentives should be used to orient FDI towards particular sectors rather than to attract FDI *per se*. It is also not difficult to see that some change in the FDI regime was, ironically, a result of the continuous appeal for national treatment on the part of foreign investors<sup>14</sup>. The unification of the tax system (since January 1994) and the elimination of the exemption from import duties (since April 1996) granted to foreign investment enterprises are two significant examples in this regard.

### *C. The Structure of Foreign Direct Investment Framework*

In 1982, the Constitution of the People's Republic of China was amended by the NPC to meet the needs of the reformation. Permission of foreign investment and, consequently, its protection were stipulated in the new text of the Constitution<sup>15</sup>. Foreign investment thus gained constitutional recognition and protection.

The adoption of the new provision concerning FDI was viewed as one of the indicators that China was sticking to the open-door policy. This policy declaration in the Constitution laid down the foundation for the FDI legal framework. From then on, more laws and regulations have been promulgated, either exclusively applicable to FDI issues or applicable to both domestic enterprises and foreign enterprises. They make up the legal framework for FDI. The constitutional provision concerning foreign investment is thus the first and fundamental part of the FDI framework.

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<sup>14</sup> See *supra* note 12.

<sup>15</sup> Constitution, Art. 18. "The People's Republic of China permits foreign enterprises, other foreign economic organisations and individual foreigners to invest in China and to enter into various forms of economic co-operation with Chinese enterprises and other Chinese economic organisations in accordance with the law of the People's Republic of China. All foreign enterprises, other foreign economic organisations as well as Chinese-foreign joint ventures within Chinese territory shall abide by the law of the People's Republic of China. Their lawful rights and interests are protected by the law of the People's Republic of China."

The second part of the FDI framework is made up of the FDI-related laws promulgated by the NPC or its Standing Committee, mainly, the “Chinese-Foreign Equity Joint Venture Law” (first adopted in 1979, amended in 1990), the “Chinese-Foreign Contractual Joint Venture Law” (1988), the “Wholly Foreign-funded Enterprise Law” (1986) and the “Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises” (1991)<sup>16</sup>.

According to these laws, foreign investment enterprises in China fall under three categories: Chinese-foreign equity joint ventures, Chinese-foreign co-operative joint ventures and wholly foreign-owned enterprises. Foreign investment enterprises of the first category shall take the form of limited liability company and the proportion of investment contributed by the foreign partner to the registered capital of a venture shall be less than 25%. All parties to a joint venture shall share the profits, risks and losses of that venture in proportion to their contribution to the registered capital. Those that fall into the second category are more flexible than the equity joint ventures. They may take the form of either a limited liability company or an economic entity without having legal person status. Parties to a venture shall agree in their contract on the conditions for investment, the ratio of the distribution, the sharing of risks, the forms of operation and the ownership of the assets at the time of the termination of the venture. The third category of foreign investment enterprises are referred to as enterprises whose capital is solely contributed by foreign investors. The term “wholly foreign-owned enterprises does not cover branches of foreign enterprises within the Chinese territory. The establishment shall meet, in principle, one of the following criteria: using advanced technology and equipment, or a large proportion of the products being for export. The taxation law laid down a 33% of basic rate of income tax for foreign investment enterprises and foreign enterprises, which was lower than that applied to the domestic enterprises when it was promulgated.

The FDI-related administrative regulations form the third part of the framework. These regulations are promulgated either by the State Council or its subordinate Ministry of Foreign Trade and Economic Co-oper-

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<sup>16</sup> In principle, all the FDI-related administrative regulations derive from these laws. In 1984 the Standing Committee of NPC authorised the State Council in a decision to promulgate regulations concerning economic restructuring and opening up to the outside world. Thus the State Council is in a position to enact regulations whose effect is similar to that of laws.

ation (MOFTEC)<sup>17</sup>. In principle, the whole FDI framework shall be based upon the constitutional provision and these laws. But, while some FDI-related administrative regulations serve as interpretations for the laws, the others supplement the laws substantially. For instance, the FDI-related laws do not incorporate the incentives. It is the various regulations that provide for the quantities of incentives.

These FDI-related regulations include “Regulations on the Exploitation of Offshore Petroleum Resources in Co-operation with Foreign Enterprises” (1982), “Regulations on the Implementation of the Chinese-Foreign Equity Joint Venture Law” (promulgated in 1983), “Detailed Rules for Implementation of the Chinese-Foreign Contractual Joint Venture Law” (1995), “Detailed Rules for Implementation of the Wholly Foreign-funded Enterprises” (1991), “Regulations on the Encouragement of Foreign Investment” (1986), “Regulations on the Encouragement of Investment by Taiwanese Compatriots” (1987), “Regulations on the Encouragement of Investment by Overseas Chinese”, “Hong Kong and Macau Compatriots” (1990), “Provisions on the Labour Management in Foreign Investment Enterprises” (1988), “Provisional Regulations on the Guidelines of Foreign Investment” (1995) and “Catalogue of Projects in Which Foreign Investment is Encouraged” (1995), “Regulations Governing Foreign Financial Institutions” (1994), “Provisional Rules for Establishing Investing Corporation by Foreign Investors” (1995), and “Provisional Measures for Establishing Chinese-Foreign Joint Venture Trading Companies” (1996).

Apart from these laws and regulations, the fourth part comprises other laws and regulations, which may, if appropriate, apply to FDI issues, such as “Civil Law General Principles” (1986), “Law of Foreign Economic Contracts” (1985), “Regulations on Administration of Enterprise Legal Person Registration” (1988), “Regulations on Foreign Exchange Control” (first adopted in 1980, finally amended in 1996)<sup>18</sup>, “Law of Environment Protection” (1989), “Law of Patent” (promulgated in 1984, amended in 1992), “Law of Trademarks” (promulgated in 1983, amended in 1993), “Law of Foreign Trade” (1994), “Law of Customs Administration” (1987), “Law on Inspection of Imported and Exported Commodities” (1989), “Company Law” (1993), “Law of Urban Planning” (1985), “Law of Land Administration” (1986), “Labour Law” (1994), “Regulations on

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<sup>17</sup> The Ministry was formerly named the “Administration Commission of Foreign Investment” and “Ministry of Foreign Economic Relation and Trade”.

<sup>18</sup> Formerly it was the “Provisional Regulations on Foreign Exchange Control” (promulgated in 1980), see *infra* note 39.

Administration and Management of State Assets" (1993), "Regulations on Value-added Tax" (1994), "Regulations on Consumption Tax" (1994), "Regulations on Business Tax" (1994), "Law on Unfair Competition" (1993), "Law of Guarantee" (1994), "Law of Commercial Bank" (1995), "Law of Insurance" (1995), "Law of Urban Real Estate" (1995), etc.

When discussing the FDI framework of a country it is desirable to include mention of the participation of the country in international agreements, in this case, the bilateral investment treaties and multilateral investment agreements.<sup>19</sup> In accordance with the Chinese law, international agreements to which China is a party apply when the relevant Chinese law does not provide rules; the international agreement prevails over the Chinese law when the rules in the Chinese law are not in conformity with those in the international agreement<sup>20</sup>. Therefore, in this context, bilateral investment agreements and multilateral investment agreements are an integral part of the FDI regime in China.

#### *D. Assessment of the Present Foreign Direct Investment Regime*

##### I. The features of the FDI framework

An overview of the FDI laws and regulations may reveal some characteristics of the framework.

##### *1. Characteristics in forms*

Firstly, all the rules governing FDI in the laws and regulations are guided by some basic principles, such as the principles of sovereignty, of equality and mutual benefit, of reference to international practice and usage. As to be analysed, the rules are not complete *per se*; their interpretation shall be made by reference to the principles.

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<sup>19</sup> Up to 1995, China has signed with other countries 74 bilateral investment treaties and has acceded to two multilateral investment agreements, namely, the "Convention Establishing the Multilateral Investment Guarantee Agency" (ratified by China in 1988) and the "Convention on Settlement of Investment Disputes between States and Nationals of Other States" (acceded to in 1992).

<sup>20</sup> See "Civil Law General Principles", Art. 142 states with respect to civil relations with foreigners: "the law of the People's Republic of China shall apply. If the international treaties acceded to by the People's Republic of China contain provisions differing from those provided for in the law of the People's Republic of China, the provisions of the international treaties shall apply." See also "Law of Foreign Economic Contracts", Art. 6.

A typical FDI law is short; it is supplemented subsequently by an administrative regulation as to its interpretation or rules for implementation. The law typically lays down some principles while the implementing regulation gives out rules from the operational angle. In fact, as mentioned earlier, the administrative regulations form the main body of the FDI framework.

China's FDI regime is becoming more detailed and more comprehensive. The recent years witnessed many detailed FDI-related administrative regulations regularly published. In 1995, more than sixteen relevant administrative regulations, which would have served as *nei bu wen jian* or "internal directives" for reference to the relevant authorities, were promulgated. Among these regulations were the controversial "Provisional Regulations on the Guidelines of Foreign Investment and Catalogue of Projects in Which Foreign Investment is Encouraged". They provide for practically applicable rules from the operational point of view. The regulations specifically classify industries into four categories: encouraged, open, restricted and forbidden, and list in detail the industries that belong to each of the four categories. Moreover, their accompanying "Instructive Directory on Industries Restricting and Prohibiting Foreign Investment" encompasses a comprehensive list of sectors and industries that are restricted (15 sectors, 111 industries) or prohibited (18 sectors, 30 industries) to the entry of foreign investment. There is no denying that it is operational and realistic. Also, for instance, the regime of one of the three foreign investment enterprises, i.e. that of the contractual joint venture, remained general and vague until implementing rules were issued in 1995.

## 2. *Characteristics in substance*

All the FDI laws have one thing in common: the promotion of FDI in China. To this end various regulations provide for incentives to foreign investment enterprises, particularly those established in SEZs or other open areas. As a matter of fact, while most of the FDI regulations are either concerned with incentives or procedural aspects, no laws and regulations deal with the often debated issues such as treatment of foreign investors and foreign investment. The issues are either in blank or left to provisions in bilateral investment treaties. Therefore, the FDI framework is basically an incentive-based and regional-oriented regime, a supplement of procedures for the making of investment. This was particularly evident in the 1980s.

However, as indicative of the "Provisional Regulations on the Guidelines of Foreign Investment" and the "Catalogue of Projects in Which

Foreign Investment is Encouraged”, more attention has, since 1992, been paid to the guidance of foreign investment to targeted sectors or industries suited to the economic development strategy and objectives.

## II. A review of the FDI regime

A further look into the regime embodied in the FDI laws and regulations will help understand how the FDI framework works on the foreign investment.

### 1. Scope

In any FDI regime, the scope of the application needs to be determined. Definitions, whether of foreign investors, foreign investment or other key concepts, are important because they form part of the regime’s normative substance.

Under the present FDI framework in China, no definitions of foreign investors and foreign investment are given. According to Article 1 of the “Chinese-foreign Equity Joint Venture Law” and Article 1 of the “Wholly Foreign-funded Enterprise Law”, foreign companies, economic organisations or individuals may be a party to a joint venture or sole investing entity to a wholly foreign-funded enterprise. Therefore, foreign investors may be reasonably referred to as foreign companies, economic organisations or individuals. However, the laws leave much to further interpretation, which may, in effect, discourage foreign investment (e.g., for fear of arbitrary administrative measures).

With regard to foreign investment, Article 25 of the “Regulations for Implementation of Chinese-foreign Equity Joint Venture Law” provides a list defining assets that may act as contributed capital by foreign investors. This list of assets may be referred to as foreign investment protected by law. In this connection, the relevant provisions in the bilateral investment treaties to which China is a party may be treated as a reference<sup>21</sup>.

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<sup>21</sup> A typical bilateral investment treaty contains a broad, flexible concept of “investment”. It is viewed as a form of property and is usually defined through an open-ended (illustrative) list of assets, including movables and immovables, equity in companies, claims to money, industrial property rights, copyrights, concessions granted by host governments, etc. See, for instance, Article 1 (1) of the “Agreement on Mutual Protection of Investment” between China and Sweden (which took effect on 29 March 1982), *Zhong Hua Ren Min Gong He Guo Tiao Yue Ji* (Collections of the Treaties of the People’s Republic of China), Beijing, 1982: “... ‘investment’ shall comprise every kind of asset, of the investors of a Con-

## 2. Investment measures affecting the entry and operation of foreign investment

The present FDI framework imposes a great deal of measures concerning foreign investment. They are meant to maintain governmental freedom of action to enhance the country's economic development.

There is no provision in relation to right of entry or establishment on the part of foreign investors. Thus foreign investors are not entitled to unconditional entry or establishment. Measures relating to admission and establishment under the present FDI framework include screening, authorisation and registration requirements, closing certain sectors or industries to FDI, minimum capital requirements, quantitative restrictions on the number of areas open to foreign investment in specific sectors or industries, conditional entry upon investment meeting certain criteria, restrictive forms of establishment for foreign investment and security as well as public interest requirements.

Each foreign investment initiative shall be subject to the screening requirements stipulated in the FDI laws. The screening procedures, namely, reviewing and approval procedures, are administered by the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) and by provincial and municipal commissions of foreign trade and economic relations, while the environment protection administration, the land administration, urban planning administration and the state assets administration agencies participate separately in the screening process on their own authority. Noticeably, the approving authority is now under pressure from the planning agencies to strengthen the screening process in order to "restructure the foreign funded sectors where foreign businesses have already monopolised". A newly prepared report by the State Economic Commission suggested that a new appraisal and approval mechanism for new foreign investment projects be set up and that relevant laws and regulations be amended to this end<sup>22</sup>. The implications of the proposed policy remain to be seen.

tracting Party within the territory of the other Party, which may be used for investment under the latter's law, in particular, (a) movables, immovables and other rights in rem, such as mortgages, liens, pledges, right of use and other similar rights; (b) shares of companies and other kind of interests in companies; (c) claims to money and claims to any performance having an economic value; (d) copyrights, industrial property rights, technical process, trade-names and goodwill; (e) business concessions granted to the legitimate holder under public law or contract, including concessions to search for, extract and exploit natural resources".

<sup>22</sup> See China News Service, 21 July 1997. According to the news, the Report called on that, *inter alia*, new foreign investment projects in sectors that are of vital importance to the national economy and people's livelihood, "must be submitted to the State Council for approval via the department concerned".

As far as MOFTEC and its counterparts are concerned, they shall decide on approval or disapproval within three months upon submission of the establishment application by the foreign investor or its Chinese partner, in the case of joint ventures<sup>23</sup>.

In practice, however, most of the applications for foreign investment establishment were approved in the 1980s and early 1990s because the ratification authorities were usually under pressure to promote foreign investment while more applications were scrutinised in recent years.

In order for an application for investment establishment to be approved, the investment project, as explained later, must meet qualifications and avoid falling under the restrictions or prohibition scope, as stipulated in laws and regulations. According to the "Provisional Regulations on the Guidelines of Foreign Investment" and "Catalogue of Projects in Which Foreign Investment is Encouraged", foreign investments in the following areas are restricted:

- areas using technology that has already been developed in China or introduced into China, for which the existing production capacity in the relevant field can already satisfy domestic demands;
- areas falling under the experimenting industries of the State for absorption of foreign investment<sup>24</sup> or under the monopoly industries by the State;
- areas for exploring and exploiting rare or valuable mineral resources;
- areas falling under the industries subject to the overall arrangement and planning of the State; and
- areas falling under other items stipulated as restricted by the State laws and regulations.

Foreign investments are prohibited in the following circumstances:

- jeopardising national security or social and public interest<sup>25</sup>;
- polluting environment, destroying natural resources or causing harm to public health;
- occupying large amounts of farmland and being incompatible with the purpose of protecting and exploiting land resources in a reasonable way;

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<sup>23</sup> See "Regulations for Implementation of the Chinese-foreign Equity Joint Venture Law", Art. 10. See also "Wholly Foreign-funded Enterprise Law", Art. 6.

<sup>24</sup> For instance, foreign trading and domestic retailing are listed as the experimenting industries of the State of absorption of foreign investment.

<sup>25</sup> "National security" is a commonly cited restriction. However, in the Chinese context, "national security" lacks in clarity. For instance, it can be cited to ban investment in the management and operation of basic telecommunications, all aspects of value-added telecommunications as well as in the news media.

- harming the security and effectiveness of military installations;
- manufacturing products with peculiar craft or technology which China owns; and
- other projects stipulated as prohibited by the State laws and regulations.

As a general rule, foreign investors shall contribute no less than 25 % of the registered capital of joint ventures. No upper limit is stipulated.<sup>26</sup> In regard to specific sectors, a specific minimum capital requirement is imposed upon the investors, whether Chinese or foreign. Article 4(3) of the “Provisional Measures on the Establishment of Chinese-foreign Joint Venture Trading Companies on a Pilot Basis” states the total registered capital of a Chinese-foreign joint venture trading company shall be no less than 100 million *yuan*. The “Regulations on Foreign Financial Institutions” provides a similar stipulation.<sup>27</sup>

While certain areas are opened to foreign investment in specific sectors or industries, other areas are left closed to the entry of foreign investment as far as the specific sectors or industries are concerned. A typical example is the “Provisional Measures on the Establishment of Chinese-foreign Joint Venture Trading Companies on a Pilot Basis”. Article 16 states:

“For the purpose of this administrative regulation, Shanghai Pudong New Development Area and Shenzhen SEZ are the places where the Chinese-foreign joint venture trading companies can be established on a pilot basis.”

According to Article 6 of the “Regulations Governing Foreign Financial Institutions”, for a subsidiary of a foreign financial institution to be established, the institution shall, among other things, have maintained its representative office in China for no less than two years. The “Provisional Measures on the Establishment of Chinese-foreign Joint venture Trading Companies on a Pilot Basis” has a similar provision.<sup>28</sup> Other criteria for entry can also be seen in the present FDI framework. Financial credibility is the most often adopted criterion<sup>29</sup>.

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<sup>26</sup> See “Chinese-Foreign Equity Joint Venture Law”, Art. 4.

<sup>27</sup> See “Regulations Governing Foreign Financial Institutions”, Art. 5.

<sup>28</sup> See “Provisional Measures on the Establishment of Chinese-foreign Joint venture Trading Companies on a Pilot Basis”, Art. 4 (1).

<sup>29</sup> See “Provisional Measures on the Establishment of Chinese-foreign Joint venture Trading Companies on a Pilot Basis”, Art. 4 (1) (b) states: “the foreign party to a Chinese-foreign joint venture trading company shall have a turnover of over US \$ 5 billion in the year prior to the application”.

The present FDI framework attaches importance to the forms of foreign investment establishment. While the forms of establishment for foreign investment enterprises are traditionally confined to Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, wholly foreign-funded enterprises and co-operative exploitation of petroleum resources, recently, more forms have been made available to foreign investors. The "Provisional Rules for Comprehensive Land Development with Foreign Investment" (1990) made it possible for foreign investors to become the developer of a *Kai Fa Qu*, i.e., development area, while this role had before been assumed by governments on the ground of sovereignty<sup>30</sup>. The "Company Law" provides for a status for Chinese branches of foreign companies, a foreign holding company status was officially created in 1995 for FDI. The "Provisional Rules for Establishing Investing Corporation by Foreign Investors" went even further, treating foreign investment companies limited by shares as a new category of foreign investment enterprises. In addition, BOT<sup>31</sup> and foreign-invested limited liability corporations have been introduced in 1995 as a result of the promulgations of the "Circular of the MOFTEC on the Relevant Matters Concerning Absorbing Foreign Investment by Means of BOT" (1995) and the "Provisional Rules for Relevant Issues in Establishing Foreign-invested Limited Liability Corporations".

### 3. Ownership and control

There are many different kinds of ownership-and-control restrictions, including, among other things, restrictions on foreign ownership, and restrictions on the nationality of a chairperson of the board of directors. It had long remained unclear whether whole foreign ownership was allowed. The promulgation of the "Wholly-foreign Funded Enterprises Law" in 1986 marked the beginning of liberalisation and transparency in

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<sup>30</sup> The Yangpu Economic Development Area in Hainan Province is the largest of this kind. It was, actually, leased to a Hong Kong-based company for 70 years. Its review and approval caused much controversy across the country in the late 1980s and early 1990s over whether the sovereignty would be undermined.

<sup>31</sup> Abbreviation for "Build-Operate-Transfer", which stands for a new type of involvement by foreign investment in local infrastructure and other public facility construction. The legal sense of this term varies from case to case, but it is basically referred to as the foreign investor's building an infrastructure at his own cost, operating it for a certain period of time when it is completed to get back his investment and profit and then transferring it to the local government.

this regard. Under the present FDI framework, ownership and control requirements can be found only in the provisions concerning specific sectors or industries. Article 3 of the “Provisional Measures on the Establishment of Chinese-Foreign Joint venture Trading Companies on a Pilot Basis” provides that the registered capital contribution to a joint venture trading company from the Chinese party shall be no less than 51 %, thus ensuring the control of the joint venture by China. In sectors which are of vital importance to the national economy and people’s livelihood, such as finished sedan cars, completed motorcycles, completed light-duty vehicles and automotive and motorcycle engines, a state dominant share or control is also required.<sup>32</sup>

In addition, for Chinese-foreign joint venture in certain sectors or industries, there are requirements relating to the nationality of the legal representatives or chairperson of the board of directors. For instance, Article 3 of the “Provisional Measures on the Establishment of Chinese-Foreign Joint venture Trading Companies on a Pilot Basis” requires that the legal representative of a Chinese-foreign joint venture trading company shall be appointed by the Chinese party.

#### 4. Operational measures

There are restrictions on foreign investment after its entry and establishment. These restrictive measures relating to operation include performance requirements, such as local content requirements, export requirements, trade-balance requirements, local procurements, restrictions on employment, restrictions on access to foreign exchange, special requirements on foreign investment enterprises in certain sectors or industries, linking incentives to performance requirements, operational requirements relating to security, public interest, etc.

##### a) Performance requirements

It is not clear whether there are some provisions in this regard. However, in practice, the local content requirements are imposed on certain industries, e.g. automobiles, and incorporated into a package of terms and conditions when a foreign investment project is open to negotiation with prospective foreign investors. The Shanghai FAG bearing

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<sup>32</sup> See “Catalogue of Projects in Which Foreign Investment is Encouraged”. See also *supra* note 22.

project was an example. The Chinese-German bearing joint venture was required by the government to use steel made in China instead of that imported from FAG's affiliates outside China<sup>33</sup>. In other words, local content requirements are imposed either on an industry-by-industry basis or on a project-by-project basis.

There is only a vague provision concerning export requirements. Article 14 (7) of the "Regulations for Implementation of the Chinese-Foreign Equity Joint Venture Law" provides that the parties to a joint venture shall incorporate a proportion of the output of products for export to that for sale in the domestic market. It does not make clear what the proportion shall be. In practice, it is open to negotiation by the prospective investors, but highly recommended by the government. Furthermore, the relevant regulations expressly link incentives with export requirements.<sup>34</sup>

As expounded later, foreign investment enterprises are required to keep their foreign exchange balance under the present FDI framework.<sup>35</sup>

#### b) Local procurement requirements

In this regard, provisions are laid down by which foreign investment enterprises shall purchase, under similar circumstances, raw materials and other production factors from the domestic market.<sup>36</sup>

#### c) Restrictions on employment

The present FDI framework requires that the employment of foreign managerial and technical personnel shall be subject to approval by the competent government agency,<sup>37</sup> while the employment of local staff and workers is in full power of the foreign investment enterprises.<sup>38</sup> However, for the foreign enterprises, their employment of local staff must be made through the state labour service company which collects monthly fees for each employee hired.

<sup>33</sup> See China News Service, 8 May 1997.

<sup>34</sup> See "Implementing Procedures for Confirmation and Assessment of Foreign Investment Product Exporting Enterprises and Advanced Technology Enterprises" (1987).

<sup>35</sup> See "Regulations of the Implementation of the Chinese-Foreign Equity Joint Venture Law", Art. 75. See, also "Wholly Foreign-funded Enterprises", Art. 18.

<sup>36</sup> See "Regulations of the Implementation of the Chinese-Foreign Equity Joint Venture Law", Art. 57. See, also "Wholly Foreign-funded Enterprises", Art. 15.

<sup>37</sup> See "Administrative Provisions on Foreigners' Employment in China" (1995).

<sup>38</sup> See "Provisions on Labour Management in Foreign Investment Enterprises".

## d) Restrictions on access to foreign exchange

In this regard, the general foreign exchange balancing requirements have the potential to distort the operation of foreign investment enterprises. Foreign investment enterprises, on the one hand, need special approval for obtaining foreign exchange,<sup>39</sup> and on the other hand are entitled to loans from foreign banks while domestic enterprises are not.<sup>40</sup> In addition, they are expected to have equal access to a unified interbank market<sup>41</sup>.

*5. Incentives*

Under the present FDI framework, incentives constitute a complicated picture<sup>42</sup>. They derive from different authorities, and vary from region to region (which compels competition in granting incentives among regions), and from sector to sector. In practice, fiscal incentives are commonly used while other measures such as financial incentives and subsidised infrastructure are sometimes employed by local governments. These incentives are often linked with performance requirements; they may be granted automatically to certain categories of foreign investment enterprises (e.g. in specific industries); or the administering authorities may exercise considerable discretion to decide on whether to grant or not. Moreover, for large

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<sup>39</sup> The Chinese government used to exercise very tight control over its foreign exchange. Formerly, the government-controlled exchange centres monopolised the business of foreign exchange transactions under the "Provisional Regulations on Foreign Exchange Control" (promulgated in 1980). Later sixteen more sets of rules governing management of foreign exchange were promulgated. See Guiguo Wang, *Business Law of China*, 1993, at 312–318. The government-controlled exchange centres now have been replaced with approved banks by virtue of the "Provisional Measures concerning Administration of Settlement, Sale and Payment of Foreign Exchange" (1994).

<sup>40</sup> See "Detailed Rules for Administration of Foreign Exchange in Enterprises Invested by Overseas Chinese, Foreign Enterprises and Chinese-Foreign Equity Joint Ventures", (1983), Art. 17.

<sup>41</sup> According to a foreign exchange reform, the Chinese currency, i.e., Renminbi, will be expected to be freely convertible before the year 2000 or earlier. At the same time, a unified interbank foreign market is in its nascent stage.

<sup>42</sup> At the national level, the regulations which provide for fiscal incentives include, among other things, "Provisional Rules of the State Council on Reduction and Exception of Enterprise Income Tax and Consolidated Business Tax in Special Economic Zones and the Fourteen Coastal Cities" (1984), "Provisional Procedures for Preferential Treatment for Chinese-Foreign Equity Joint Ventures for Port Construction" (1985), "Regulations on Encouragement of Foreign Investment" (1986), and "Provisions on Exempting and Reduction Income Tax and other Taxes in the Pudong New Development Area" (1990).

investment projects or targeted investors, *ad hoc*-incentives are often granted as part of the package of project negotiation.

Given the extreme complexity of the incentives, it is unlikely to give a complete illustration of the incentive system in this article. However, it will be useful and perhaps more desirable, to go into the intentions behind the system and their real impact. No doubt, the incentives were initially aimed at facilitating or precisely, attracting foreign investment. Actually, incentives were all that the governments could then offer when a poorly infrastructure and long-closed economy was to change itself into the locations of foreign investment. It is recognised that the surging influx of FDI in China was, on part, a result of the incentives, the granting of which showed the welcoming attitude on the part of the governments toward foreign investment.

It is important to bear in mind that, formerly, incentives were elaborated by the central authority and incline to some particular regions and foreign investment enterprises of particular economic natures. This soon resulted in a competition of national-wide promulgation and granting of incentives. The side effect arising therefrom was that some inexperienced local governments tended to rely solely on incentives for attracting foreign investments rather than the improving investment environment as a whole.

With widespread incentives granted, the role of incentives as a conduit for attracting foreign investment decreases. Evidence in this regard accumulated when a great many regions failed to become locations of most desired FDI. A shift of the fiscal incentives toward particular sectors or industries is emerging, which is expected to be more efficient than non-selective incentives.

Though the government has become aware of the ill effect of incentives, it is fair to say that, currently, incentives still form the basis of China's FDI regime. However, indicative of the unified income tax rate that applies to foreign investment enterprises as well as domestic enterprises, the move toward national treatment for foreign investment enterprises will reduce incentives to non-existence in the long run.

#### 6. *Investment-related trade measures*

These issues include tariffs and quantitative restrictions on import, export control, and export-processing zones. Their possible impact upon foreign investment differs, from inducing import-substituting foreign investment, to export-replacing foreign investment or to export-oriented

foreign investment. Given that quantitative restrictions on import and export control are two pillars of the present foreign trade system<sup>43</sup>, and SEZs are still treated as export-processing zones<sup>44</sup>, their impact needs some attention.

### *7. Treatment standards*

With respect to foreign investment, legal standards are distinguished by three categories, i.e. most-favoured-treatment, national treatment, and fair and equitable treatment. The former two are primarily intended to ensure non-discrimination: while national treatment is designed to make sure that foreign investors are treated in a manner no less favourable than that in which nationals are treated; and most-favoured-nation treatment is designed to make sure that foreign investors are treated in a manner no less favourable than that in which other alien investors are treated. The third standard, that of "fair and equitable treatment" is designed to provide foreign investors a basic standard detached from the host country's law which an investor may invoke.

#### *a) Most-favoured-nation (MFN) treatment*

No laws provide that foreign investment be granted MFN treatment. However, the bilateral investment treaties entered into between China and other countries provide such treatment for the investment by the contracting parties, thus securing non-discriminatory treatment for foreign investors. As a matter of fact, no discriminatory treatment takes place for investors from those countries that have not concluded bilateral investment treaties with China.

#### *b) National treatment*

In this regard, for the purpose of analysis, distinction shall be made between the pre-establishment phase and the post-establishment phase. In regard to the pre-establishment phase, no national treatment is granted by the present FDI framework. Some sectors, for instance, are not accessible

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<sup>43</sup> See Articles 16, 17 and 19 of "Foreign Trade Law".

<sup>44</sup> The Chinese leaders have, under various circumstances, reaffirmed that the special policy for SEZs will remain unchanged.

to foreign investment, some others are conditionally accessible to foreign investment.

However, the difference between foreign investment enterprises and domestic enterprises is being lessened. More sectors and industries have been opened to FDI in this period, most notably services, such as advertising, general aviation, investing, retail trade, foreign trade, banking, insurance, accounting, auditing and legal services due to the promulgation of some regulations<sup>45</sup>. The gradual opening of sectors or industries to foreign investors can be seen from the number of foreign bank branches and representative offices.<sup>46</sup> Furthermore, there is a significant potential for FDI participation in infrastructure with the introduction of BOT.

On the other hand, in the post-establishment phase, while some foreign investors are still complaining that they are not treated as well as domestic enterprises, some others often assume more privileges than domestic enterprises in terms of, among other things, import and export of goods, purchase of raw materials and sale of products, procurement of land and foreign exchange, corporate governance, recruitment and dismissal of personnel, and taxation<sup>47</sup>. In fact, in order to appease the complaints from both foreign investors and domestic enterprises, the government has begun to remove any discriminatory treatment. For instance, the "Provisional Measures on the Establishment of Chinese-Foreign Joint venture Trading Companies on a Pilot Basis" provides that Chinese-foreign joint venture trading companies enjoy the same rights as the state-owned foreign trade companies in respect of payment, purchase and transfer of foreign exchange<sup>48</sup>.

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<sup>45</sup> These regulations include, among other things, "Provisional Rules for Establishment Offices by Foreign Law Firms" (1992), "Provisions on Retailing Establishment with Foreign Investment" (1992), "Regulations for Establishing Foreign Investment Advertising Enterprises" (1995), "Circular on Relevant Policy for Foreign Investment in Civil Aviation" (1994), "Provisional Rules for Establishing Investing Corporation by Foreign Investors" (1995), and "Measures for Approval and Administration of Foreign-invested International Freight Agent Enterprises" (1995).

<sup>46</sup> As of the end of 1995, a total of 137 foreign bank branches and 519 representative offices had been approved while 109 and 250 respectively as of September 1994.

<sup>47</sup> See, for instance, Article 54 of the "Regulations for the Implementation of the Chinese-Foreign Equity Joint Venture Law" which provides that "the authority shall make arrangement and secure implementation" with respect to the capital project construction of Chinese-foreign equity joint ventures.

<sup>48</sup> See the "Provisional Measures on the Establishment of Chinese-Foreign Joint venture Trading Companies on a Pilot Basis", Art. 10.

Some bilateral investment treaties provide that investment from the other party receive fair and equitable treatment; some provide that either MFN treatment or national treatment, the more favourable, applies, thus giving foreign investment more security and protection. But exceptions are usually provided. For instance, in the Protocol annexed to the “Mutual Promotion and Protection of Investment” between China and Switzerland, the contracting parties stated:

“... because of the difference between the two countries in economic and legal systems and the needs for the development of its national economy on the part of the People’s Republic of China, the Swiss investors are not supposed to claim, under all circumstances, the same treatment as Chinese investors ...”<sup>49</sup>.

### 8. *Investment protection*

#### a) *Expropriation and compensation*

The FDI laws in China declare that the government will not nationalise or take the property of foreign investors.<sup>50</sup> It is not difficult to observe that, instead of prohibiting such kind of conduct under law, the legislators only made a declaration. However, the difference in wording of law seems not to be a challenge against the notion that an expropriation, or other measures having equivalent effect, is only permitted if it is in the public interest and made according to legal procedures. In case of expropriation, compensation shall be made by virtue of the principles “adequate, prompt and effective”. This notion is observed by various bilateral investment treaties to which China is a party, as well as the FDI-related laws<sup>51</sup>.

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<sup>49</sup> See Protocol to the “Mutual Promotion and Protection of Investment” between China and Switzerland (which was signed on 12 November 1986), *Zhong Hua Ren Min Gong He Guo Tiao Yue Ji* (Collections of the Treaties of the People’s Republic of China), Beijing, 1986.

<sup>50</sup> See, for instance, Article 5 of the “Wholly Foreign-funded Enterprise Law”, which states that: “The State shall not nationalise or expropriate any wholly foreign-funded enterprises.” The other FDI-related laws also contain similar provisions.

<sup>51</sup> See, for instance, Article 3 of the “Agreement for Mutual Protection Investment” between China and Sweden, *Zhong Hua Ren Min Gong He Guo Tiao Yue Ji* (Collections of the Treaties of the People’s Republic of China), Beijing, 1982. For a discussion of China’s attitude towards compensation in case of expropriation of foreign investment, see M. Soranarajah, *Protection of Foreign Investment in Asia-Pacific Economic Co-operation Region*, *Journal of World Trade*, Vol. 29 No. 2, at 119–120.

## b) Transfers

Under the “Regulations on Foreign Exchange Control”, the government exercises centralised control and management of foreign exchange. The State Administration of Exchange Control and its branches is the authority in charge of foreign exchange administration of the State. Renminbi, the Chinese currency, may be convertible to foreign exchange on current account subject to certain conditions. Government review and approval is required for convertibility of currencies for overseas transfer of funds under certain circumstances.

In relation to foreign investment enterprises, generally speaking they are required to keep the balance of their foreign exchange income and expenditures by themselves under the “Regulations of the Implementation of the Chinese-foreign Joint Venture Law and Detailed Rules for the Implementation of the Wholly Foreign-funded Enterprises”. But remittance of profits, dividends and interests of foreign investors needs no approval as long as an investment agreement and related documents on profits distribution by the board of directors are presented.<sup>52</sup>

A limited convertibility for current account transactions of foreign investment enterprises was introduced as a result of foreign exchange reform in 1996.

In addition, it is worth mentioning that some bilateral investment treaties that China entered into with other countries, on the one hand made it possible for China to restrict transfers on account of balance of payments problems, and on the other hand, ensured partial transfer per year<sup>53</sup>.

## c) Protection from strife

This issue concerns the situation when foreign investors suffer losses in the host country due to war, any other armed conflict, state of emergency or similar events. Under the present FDI Framework, no provision is stipulated in this regard. However, it is addressed in the bilateral investment

<sup>52</sup> See “Detailed Rules for Administration of Foreign Exchange in Enterprises Invested by Overseas Chinese, Foreign Enterprises and Chinese-foreign Equity Joint Ventures” (1983), Art. 13.

<sup>53</sup> See, for instance, Article 6 (2) of the “Agreement for Mutual Protection Investment” between China and the United Kingdom, *Zhong Hua Ren Min Gong He Guo Tiao Yue Ji* (Collections of the Treaties of the People’s Republic of China), Beijing, 1986, which reads: “As regards investments and any other form of return, transfer of a minimum of 20 per cent a year is guaranteed.”

treaties to which China is a party. As a general rule, the parties shall not be obliged to pay compensation in such a case<sup>54</sup>. But, recent bilateral investment treaties stipulate that if the host country decides to pay compensation, then national treatment and MFN will apply.<sup>55</sup>

### *9. Dispute settlement*

Like other laws, China's FDI laws emphasise the settlement of disputes through amicable consultation between the parties to a dispute and mediation by a third party. This practice has long been used and proved a valuable means for dispute settlement. This practice is not only available to disputes between a Chinese investor and a foreign investor, but, theoretically, is available to disputes between the Chinese government and foreign investors. The present laws also make it possible for the parties to a dispute to choose arbitration and judicial settlement. For the disputes between investors, mediation or arbitration may be held in foreign tribunals.<sup>56</sup>

As far as disputes between the Chinese government and foreign investors are concerned, the only means available to the investors is local remedy, i.e. in this case, administrative remedy under the "Regulations on Administrative Reconsideration" (1990), and legal action under the "Administrative Litigation Law" (1989) in a Chinese court, unless the parties to a dispute make an arrangement of mediation or arbitration at the International Centre for Settlement of Investment Disputes under the "Convention on Settlement of Investment Disputes between States and Nationals of other States".

### *10. Special issues*

#### a) Restrictive business practices

Restrictive business practices are anti-competitive practices by enterprises, that aim at monopolising markets, creating or abusing a dominant

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<sup>54</sup> See, Robin Morgan, Treatment and Protection of Investors and Investment, report presented at the Symposium on the MAI, 3-4 April, 1997, Seoul.

<sup>55</sup> See, for instance, Article 4 of the "Agreement for Promotion and Mutual Protection Investment" between China and the United Kingdom (which was signed on 15 May 1986), Zhong Hua Ren Min Gong He Guo Tiao Yue Ji (Collections of the Treaties of the People's Republic of China), Beijing, 1986.

<sup>56</sup> See "Foreign Economic Contract Law", Art. 37.

position of market power. The “Law on Unfair Competition” was adopted to this end; it prohibits and provides for the punishment of anti-competitive practices.

b) Transfer pricing

Transfer pricing refers to the pricing of intra-enterprise transactions between units of the same multinational corporation. In this regard, the “Provisional Rules for Administration of Taxation on Transaction between Foreign Investment Enterprises and their Affiliated Companies” (1990) were promulgated. To this end “affiliated companies of foreign investment enterprise” are defined as either companies which control the foreign investment enterprise in China or companies which are controlled by the foreign investment company<sup>57</sup>. According to these provisions, transactions between the foreign investment companies and their affiliated companies, such as sales, the provision of materials and other assets, financing, the assignment or leasing of property or assets, and the provision of personal service, fall within the scope of application<sup>58</sup>. Noticeably, the burden of proof that a foreign investment company is dealing with its affiliates at a market price is placed on the enterprise itself<sup>59</sup>.

c) Transfer of technology

Under the present FDI framework, provisions concerning transfer of technology in the foreign investment context can be found in “Regulations for Implementation of the Chinese-foreign Equity Joint Venture Law”<sup>60</sup>. These provisions are more concerned with the terms and conditions of transfer of technology. Under these terms and conditions, while the technology in question shall be “appropriate or advanced, enabling the products manufactured with the technology to yield good social or economic result or be competitive in the international market”<sup>61</sup>, the trans-

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<sup>57</sup> See “Provisional Rules for Administration of Taxation on Transaction between Foreign Investment Enterprises and their Affiliated Companies”, Art. 2.

<sup>58</sup> See *ibid.*, Art. 3.

<sup>59</sup> See *ibid.*, Art. 5.

<sup>60</sup> See “Regulations for Implementation of the Chinese-Foreign Equity Joint Venture Law”, Chapter 6. The regulations dealing with import of technology excludes from the scope of application the transferring by foreign investors of technology as part of investment in the context of foreign investment enterprises.

<sup>61</sup> See *ibid.*, Art. 44.

feror is not allowed to prohibit the transferee from continuing using the technology concerned after the license expires or restrict the transferee from exporting products manufactured with the technology to certain countries or regions or restrict the quantity of the product to be exported<sup>62</sup>.

#### d) Employment

Employment and related issues are of great importance in the context of foreign investment. Most of these issues are about labour standards, either for host government or for foreign investors, such as forced labour, child labour, discrimination and freedom of association.

As far as foreign investors are concerned, employment of personnel and, accordingly, the right of entry and sojourn of alien personnel in the host country is of particular importance. According to the "Law on the Administration of Foreigners' Entry and Departure", foreigners must gain approval by the competent authority so as to enter into and reside in China. As explained earlier, their employment also needs approval. However, the Chinese government has committed itself to give favourable consideration to investors and their employees in connection with such applications<sup>63</sup>.

#### e) Environmental issues

Environmental protection is an area of critical concern. The question of environmental protection is increasingly seen as part of the FDI framework that seeks to promote the orderly operation of economic activity. It has become an internationally accepted practice to use environmental standards to discipline foreign investors.

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<sup>62</sup> See *ibid.*, Art. 46.

<sup>63</sup> For example, the "Mutual Encouragement and Protection of Investment" between the People's Republic of China and the Federal Republic of Germany, Protocol, Article 3(d), states: "The Contracting Parties will favourably consider, within the bounds of their national laws, entry and residence applications by persons of one Contracting Party in connection with undertaking and carrying through an investment; the same shall apply to employed persons who are nationals of One Contracting Party and wish to stay and reside in the territory of the other Contracting Party in connection with an investment in order to work as an employed person. Requests for work permits will also be favourably considered." See *Zhong Hua Ren Min Gong He Guo Tiao Yue Ji* (Collections of the Treaties of the People's Republic of China), 1983.

Under the present FDI framework, environment-related provisions are compulsory. Failure to comply with them may generate serious results, e.g. disapproval of investment contract<sup>64</sup> or contract for transfer of technology<sup>65</sup>, or revocation of business license<sup>66</sup>.

### *E. Concluding Remarks*

It is not difficult to perceive the architectural shortcomings of China's FDI regime: lack of definitional clarity, failing to generate adequate transparency, not inherently liberalising. It is basically an incentive-based regime, made up of complicated fiscal incentives and other incentives which are designed for different areas and different purposes.

However, it is too much to expect China to perfect its FDI regime by the standard of developed countries. Important is the emerging trend towards the evolution of its FDI regime. The trend is characterised by a number of far-reaching changes in rule-making with respect to foreign investment. Among such changes are:

- the gradual removal of incentives;
- moving towards national treatment
- an effort to level the playing field for domestic enterprises and foreign investment enterprises;
- more transparency.

These changes are all translating into liberalisation of China's FDI regime.

However, these trends may, from time to time, be counterbalanced by China's intentions to keep FDI in compliance with its economic development objectives, which are subject to change.

It is important to bear in mind that the current adjustment of the FDI regime is not only for the sake of the FDI regime *per se*, but because the whole economic environment upon which FDI policy rests is changing. As long as China continues to compete with other countries for FDI, given that it is unlikely that China will reverse its drive towards a market-oriented economy, China's FDI regime will continue to evolve together

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<sup>64</sup> See "Regulations of the Implementation of the Chinese-foreign Equity Joint Venture Law", Art. 5 (4).

<sup>65</sup> See "Implementing Rules for the Regulations on Contracts for Import of Technology".

<sup>66</sup> See "Law of Environment Protection".

with the shaping of the overall legal framework, characterised by the process of liberalisation.

China's effort to join the World Trade Organization (WTO)<sup>67</sup>, together with its participation in bilateral negotiations, mainly with the United States, will contribute to these trends.

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<sup>67</sup> In October 1996, China announced the implementation of a standstill, a commitment not to introduce new WTO-inconsistent policies during the course of the accession negotiations.

