

A COMPARATIVE STUDY OF FOREIGN INVESTMENT LAWS IN TAIWAN AND CHINA

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Modern economic development is a long journey. Less developed countries usually lack¹ the capital and technology which are indispensable prerequisites for economic development.² The most effective method for starting a modernization plan without indigenous capital and technology is by attracting foreign investment.³ This short-cut to modernization has been followed by many of the less developed countries.⁴ Of the less developed countries which have substantially furthered their economic development by way of foreign investment, Taiwan is one of the most successful examples.

Although ideologically opposed to foreign investment, China too has increasingly recognized the advantages which foreign investment brings to domestic development. While both have foreign investment laws,⁵ Taiwan's laws are well established, whereas

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1. Landau, *Direct Foreign Investments in Developing Countries*, 4 J. LAW AND ECON. DEV. 182, 182-4 (1970).

2. Baranson, *Changes in the Investment Climate of Developing Nations*, 7 VAND. J. TRANS. L. 569, 569 (1974).

3. Landau, *supra* note 1, at 184-86.

4. *Id.*

5. Taiwan: Statute for Investment by Foreign Nationals, promulgated on July 14, 1954 (Amended July 27, 1979) [hereinafter cited as SIFN]; Statute for Investment by Overseas Chinese, promulgated November 19, 1955 (Amended August 9, 1979); Statute for Encouragement of Investment, promulgated on September 10, 1960 (Amended July 20, 1979) [hereinafter cited as SEI]; Statute for Technical Cooperation, promulgated August 9, 1962 (Amended May 29, 1964).

Communist China: Law on Joint Ventures Using Chinese & Foreign Investment, promulgated July 1, 1979. This coincided with the normalization of relations with the United States which spurred further trade enthusiasm. See Klingenberg & Patterson, *Joint Ventures in the People's Republic of China: The New Legal Environment*, 19 VA. J. INT'L L. 807, 807-08 (1979). The Regulations on Special Economic Zones in Guangdong Province, promulgated August 26, 1980; see Beijing Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, Aug. 28, 1980, at L9. Provisional Regulations on the Control of Resident Representative Offices of Foreign Enterprises in China, promulgated October 30, 1980; see Beijing Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, Nov. 25, 1980, at L36. Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Re-

China's are largely developing.⁶ Taiwan's laws provide a predictable, secure environment for foreign investment,⁷ while China's laws remain untested. However, with its one billion people — one-fourth of the world's population — its richness in natural resources and its willingness to invite foreign investment,⁸ China has great potential for increased foreign investment. Before reaching any decision for prospective projects in Asia, foreign investors should study both the legal framework and investment climates in Taiwan and China. Prior to that inquiry, a basic understanding of the historical and ideological backgrounds affecting foreign investment will illuminate the development of the attendant laws and policies of the countries.

This article examines and compares the foreign investment laws and investment climates of Taiwan and China within an historical and ideological context. It concludes that the future of both economies are likely to be bilaterally harmonious and beneficial to the interests of foreign investment.⁹ As an introduction, the pri-

public of China Concerning Joint Ventures With Chinese and Foreign Investment, promulgated December 14, 1980; see Beijing Xinhau, FOREIGN BROADCAST INFORMATION SERVICE, Dec. 19, 1980, L30. Individual Income Tax Law and its Detailed Rules for Implementation, promulgated December 14, 1980. Provisional Regulations for Foreign Exchange Control, promulgated December 18, 1980; see *Foreigners Remitting Profits From China Face New Rules*, Asian Wall Street Journal, Dec. 31, 1980.

6. Pursuant to the Compilation of Laws and Regulations (in Chinese, Liu-Fa-Chuan-Su) compiled by Lin Chi-tung, published by the Great China Book Company in June of 1979, 334 different laws and regulations of Taiwan not including rulings and administrative orders were collected. However, most of the legislation promulgated from 1949 to date in China dealt with criminal matters and organizational laws. According to Peng Zhen, Vice-Chairman of the Standing Committee of the National People's Congress, there are more than seventy laws and regulations in regard to economic and other fields which have either been drafted or promulgated since 1979. He conceded that China lacked legislative experience in the economic field, therefore, the legal framework should be established step by step on the basis of a cumulative experience. See Beijing Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, Sept. 2, 1980, at L34.

7. See notes 5 & 6 *supra*.

8. Deng Xiao-ping told an American Congressional delegation in April, 1979 that Communist China will do whatever is necessary to attract foreign investment. See Cohen & Nee, *Joint Venture: Behind the Headlines*, Asian Wall Street Journal, July 21, 1979, Part I, at 4. China's Finance Minister Zhang Jing-fu also stated that China would act in good faith with regard to foreign investment as he sought to assure investors and bankers at a luncheon given by the Chase Manhattan Bank in New York after the Law of Joint Ventures was promulgated. See *China Finance Minister Seeks to Reassure U.S. Investors*, Asian Wall Street Journal, July 17, 1979, at 11.

9. Assertions put forth in this article are largely based upon this author's experience of handling foreign investment projects while working for the law firm of Tsar & Tsai in Taiwan.

mary question of why foreign investment and foreign capital is attractive to developing countries will be examined.

I. FUNCTION OF FOREIGN INVESTMENT

A. *Contributions of Foreign Investment To The Capital Receiving Country*

United States contributions to the economic development of Taiwan began in 1948 and later became part of the United State's economic assistance program embodied in the Agency for International Development Program (AID).¹⁰ After AID's assistance stopped in 1964, foreign investment started flowing into Taiwan, accelerating capital formation and economic development.¹¹ Along with the influx of foreign capital came the advanced technology and efficient managerial skills associated with the foreign business operations.¹²

In order to meet the demands from overseas markets, foreign investment has had to keep pace with the development of new technology and equipment, thereby upgrading the industrial structure of Taiwan.¹³ In addition to the skilled local labor force which has developed, many foreign investment companies have coordinated their efforts with local professional schools to promote Construction-Education Cooperation (Chien-Chiao-Ho-Tso) programs which enable students to apply their academic knowledge to factory production.¹⁴ One factor which has bolstered development is

10. The original Chinese Assistance Act was found in Title IV of the Foreign Assistance Act of 1948, 22 U.S.C. § 1501 (1948) (repealed Aug. 24, 1951 c. 937 Title V § 542(a)(4), (6), (9)-(11) 68 Stat. 86). See Crawford, *United States Foreign Assistance Legislation 1947-1948*, 58 YALE L.J. 872 (1948). A.I.D. was established in 1961 to handle the nations foreign aid program. Foreign Assistance Act of 1961, 22 U.S.C. § 2151 *et seq.* (1961).

11. J. WANG, ENCOURAGEMENT AND PROTECTION OF FOREIGN PRIVATE INVESTMENT 15-18 (1975) (Chinese).

12. Foreign investors are encouraged to bring in advanced technology and efficient management by the incentives provided in Articles 3, 4 & 13 of the Statute for Technical Cooperation. By providing the advanced technical ability, patent right, and efficient management skills to the local subsidiary companies, foreign investors are entitled to repatriate the royalties fixed in the technical cooperation agreement with such subsidiaries. Local subsidiary companies can also deduct the royalties paid to foreign patent companies from gross income. Alternatively, foreign investors can ask to treat such advanced technology as capital of the investment. See SIFN, *supra* note 1, art. 3, para 1.

13. To effectively compete in the overseas market, foreign investors will demand that local support industries provide quality goods with lower prices. This demand will require foreign investors to provide necessary technology and training to the local support industries, resulting in an upgrading of the entire industrial structure.

14. The "Work-Study" program has been highly encouraged by the government of Taiwan because it serves the following purposes:

the investment incentives which Taiwan provides equally to foreign nationals and locals.¹⁵ Local businessmen were reluctant at first to take advantage of these incentives, but their doubts abated after they observed the profits foreign investors were earning.¹⁶

Although some of the incentives provide tax benefits, ultimately all foreign investors pay taxes, thereby greatly increasing the national income.¹⁷ Foreign investment also has generated the establishment of local support industries, which in turn have spawned additional industrial development.¹⁸

Between 1952 and 1979, Taiwan received 2.175 billion dollars from foreign investment projects.¹⁹ Not only was this influx of foreign capital extremely helpful to the balance of payments of Taiwan, but it also aided in establishing overseas markets for products bearing the "made in Taiwan" imprint.²⁰ Without foreign cap-

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- a) Factories can get a constant supply of skilled workers, part-time while student, and full-time after graduation;
 - b) Students are able to finish their education as they choose;
 - c) Schools can enroll students easier by having "Work-Study" programs with foreign investment factories.
 - d) Students are glad to have opportunity for practical training, while factories are happy to pay lower wages to students than they would to normal workers.

15. Most of incentives for investment are provided in the Statute for Encouragement of Investment. Any enterprises organized under the laws of the Nationalist China, no matter whether the capital is from local Chinese, overseas Chinese or foreign nationals, are all eligible to enjoy the investment incentives as long as they satisfy the requirements embodied in the SEI. In essence, the Statute for Investment by Foreign Nationals provides that foreign nationals shall have right to repatriate the earnings.

16. Capital formation is indispensable for economic development, however, it remains a common problem faced by the less developed countries. Taiwan solved this problem by setting a minimum amount of capital as a prerequisite to enjoying the investment incentives. While local investors are cautious, foreign investors with a strong financial background can proceed and take advantage of the investment incentives. The achievement and profit made by foreign investors creates a further incentive to local investors. Local investors begin collecting capital to form a company, satisfying the requirements for the incentives, domestic capital formation begins.

17. While foreign investors enjoy the tax holiday, local governments are suffering a loss of collectable revenues. Conversely, if local governments do not provide incentives such as tax holidays, foreign investors will not invest in the first place. During the tax holiday, the local government may still collect personal income taxes from employees of the foreign investment enterprises. Once the tax holiday is over, local government can collect taxes from the foreign investors on the same basis it does from domestic concerns.

18. See note 13 *supra*.

19. Y. WEI, BRIEF REPORT ON THE ROC'S ECONOMIC DEVELOPMENT, INDUSTRIAL INVESTMENT BRIEF CIRCULAR, INDUSTRIAL DEVELOPMENT & INVESTMENT CENTER No. 22 (Dec. 31, 1979) (Chinese).

20. Many tax incentives are closely linked to the requirement of export capability, especially in connection with the exemption, set-off, and refund of the customs duties. See notes 179-81 & 185 *infra* and accompanying text. On the other hand, foreign investors, especially multinational corporations, have better control of overseas markets. Therefore, foreign in-

ital, Taiwan's entry into the export markets would have been much more difficult.

Taiwan's government has allowed foreign investment companies to sell products locally which could not be produced by the domestic industry. This has reduced the level of imported goods, provided lower prices to local consumers, and allowed hard currency to remain in Taiwan.²¹ Foreign investment has also provided employment opportunities. Between 1966 and 1978, industrial employment increased from twenty-three to thirty-nine percent, paralleling the increased flow of foreign investment.²²

In an effort to create a more favorable investment climate, the government of Taiwan spent seven billion dollars to start the "Ten Major Construction Projects,"²³ seven of which related to basic industrial needs, such as highways, railroads, port facilities, and nuclear power plants.²⁴ Thus, foreign investment has induced the improvement of the basic infrastructure of Taiwan.

The demands placed on the local labor market by foreign investment and swift industrial expansion have caused a shortage of manpower. In order to hire enough skilled workers, foreign investors have had to offer various fringe benefits such as housing, medical care, continuing education, labor insurance, and retirement plans.²⁵

B. Benefits of Foreign Investment to the Capital-Providing Country

A number of benefits accrue to a country which provides investment capital. For example, access is gained both to the natural resources and to the typically open, unsaturated markets²⁶ of the developing nation. Manufacturing costs are lower than in developed countries,²⁷ and subsidiaries established in developing coun-

vestment has been extremely helpful in opening overseas market for the products manufactured in Taiwan.

21. F. Kuo, RESEARCH ON THE CURRENT POLICY OF INVESTMENT BY FOREIGN NATIONALS AND OVERSEAS CHINESE AND ITS PROBLEM 8 (1977) (Chinese).

22. See *supra* note 19, at 5.

23. INDUSTRIAL DEVELOPMENT & INVESTMENT CENTER, BRIEF INTRODUCTION TO THE INVESTMENT CLIMATE IN TAIWAN, THE REPUBLIC OF CHINA 5-6 (1979).

24. *Id.*

25. PRICE WATERHOUSE & CO., DOING BUSINESS IN TAIWAN 40 (1979).

26. Buldeley, *More U.S. Corporations Turn Overseas*, Asian Wall Street Journal, Dec. 12, 1979, at 1.

27. Meier, *Legal-Economic Problems of Private Foreign Investment In Developing Countries*, 33 U. CHI. L. REV. 463, 471-77 (1966).

tries bolster the profits of the foreign parent company. Ford Motor Company's overseas operations, for example, accounted for ninety-four percent of Ford's profits during the first nine months of 1979, offsetting domestic losses.²⁸

Capital-providing countries directly benefit from the incentive packages frequently offered by less developed countries to attract foreign investment.²⁹ These incentives, which tend to substantially increase profits, include exemption or reduction of income taxes, duty free imports, and deferred payment of import duties. Taiwan was one of the first nations to offer incentives packages by enacting, more than twenty-five years ago, the Statute of Investment for Foreign Nationals.³⁰ The People's Republic of China joined in this competition for foreign capital by adopting its first foreign investment law in 1979.³¹

II. THE ROLE OF FOREIGN BUSINESS IN CHINA BEFORE WORLD WAR II

At first glance it may seem curious that China had not invited foreign investment before 1979, especially in light of Taiwan's favorable experience.³² The former Chinese Communist policy of excluding foreign investment and limiting foreign trade, and the resulting effects upon the Chinese economy, can only be understood by considering the historic role of foreigners in China.³³

A. *Formation of the Anti-Foreign Attitude*

The role foreign business played in China before World War II caused "foreigners" to have an ugly image in the eyes of the

28. See note 26 *supra*, at 12.

29. The incentive packages consist mainly of "profitability," "safety," and "transferability" which are the primary considerations for foreign investors before investment decisions are made. "Profitability" is mainly reflected in the tax holidays. "Safety" is declared in the statement made by the host government not to expropriate the foreign investment. "Transferability" is represented in the degree of freedom to move the earning out of the host country in hard currency. C. CHEN, LEGAL PROBLEMS OF THE INTERNATIONAL PRIVATE INVESTMENT 70-71 (1976) (Chinese).

30. See note 5 *supra*.

31. *Id.*

32. Ronald C. Nairn, a noted author in this area, suggests, "The mainland's solution lies in 'Taiwanization,' its working for the Chinese on the island, it will work for the Chinese on the mainland." Nairn, *China: "Taiwanizing" the Mainland*, *Asian Wall Street Journal*, March 13, 1979, at 4.

33. CHINA'S MODERN ECONOMY IN HISTORICAL PERSPECTIVE I (D. Perkins, ed. 1975).

Chinese. An historical understanding of these anti-foreigner attitudes is helpful.

The literal translation of "China" is "Middle Kingdom" and the traditional Chinese viewpoint maintains that they are the center of the world. This viewpoint, along with the Chinese pride in their 5,000 year history and brilliant culture, accounts for the traditional idea that those living outside this middle kingdom are barbarians.³⁴

While China maintained an agricultural society, industrialization was occurring in the West. By the early 1800's European countries had built vast colonial empires reaching Far East Asia. In 1842, the Manchu ruler of China was forced to conclude the Treaty of Nanking³⁵ with the British government following the Chinese defeat in the Opium War, a war ignited by Chinese seizure of opium owned by British traders. The Treaty of Nanking required China to open five ports to British traders, to give the British Hong Kong as a colony, to grant extraterritoriality to the British, and to pay the British for the cost of fighting the war as well as the value of the opium seized.³⁶ This treaty was the first of what the Chinese called the "unequal treaties."³⁷ The Opium War fully exposed the weaknesses and backwardness of China. Other Western powers followed the British example and declared war against China for trivial reasons in order to gain exploitative economic advantages.³⁸ This culminated in China's concluding a series of unequal treaties with France, Germany, Portugal, Russia, and the United States.³⁹ The unequal treaties consisted mainly of clauses which granted exclusive rights known as "spheres of influence" within China. The treaty powers had the special privilege of leasing territory, establishing factories, mines, railroads, banking institutions, and navigating freely on inland rivers within these spheres.⁴⁰ The unequal treaties also deprived China of tariff autonomy.⁴¹ Thus, the initial

34. ALFORD, LAW AND CHINESE FOREIGN TRADE, PROBLEMS OF COMMUNISM 81 (1979).

35. Treaty between China and Great Britain signed at Nanking, 29 August 1842, 93 PARRY'S T.S. 465.

36. *Id.*

37. See generally R. GILBERT, THE UNEQUAL TREATIES, CHINA AND THE FOREIGNER (1976) [hereinafter cited as GILBERT].

38. CHINA, WORLD BOOK ENCYCLOPEDIA (1980 ed.).

39. *Id.*

40. Dernberger, *The Role of the Foreigner in China's Economic Development, 1840-1949*, reprinted in CHINA'S MODERN ECONOMY IN HISTORICAL PERSPECTIVE 43 (D. Perkins ed. 1975).

41. *Id.*

concept of "foreigner" was equated with unequal treaties until World War II, when the Japanese military occupation terminated the treaties.⁴²

Tremendously conflicting goals existed between foreign business and China. The goal of foreign business was to seek profits, while the Chinese sought to develop their own economic power. Foreign investment, having pursued profits without regard for the Chinese interests, seriously injured the traditional handicraft industries. The situation in China was worse than that in a colony,⁴³ as the Western powers made no efforts to foster indigenous economic development or strengthen the local economy. This was the basis for Dr. Sun Yat-sen's description of China at that time as a "hypo-colony."⁴⁴

Foreign business in China always has been larger and more powerful than Chinese industry. In fact, foreign business had had a preemptive effect on Chinese business. A learned scholar described the difficulty of the indigenous Chinese industries stating that "foreign enterprises in China were so effective in their competitive power or enjoyed so many advantages secured by their respective governments that Chinese owned modern enterprises were utterly and hopelessly oppressed and had little, if any, chance to grow."⁴⁵ One of the reasons for the foreign business advantage was that many foreign businesses incorporated during the "Concession," and operated under special privileges and immunities in China. As a result, China was unable to exercise effective control over foreign business.⁴⁶

42. During World War II, most of the "concession" and "sphere of influence" areas were occupied following the Japanese invasion of China. Gradually the treaty powers began to give up the "unequal treaties" with China. The United States and Britain were the last to abandon the unequal treaties in 1943. Cohen & Gelatt, *China: The Foreigner and the New Criminal Code*, Asian Wall Street Journal, Feb. 7, 1980, at 4.

43. See HSIAO-TUNG, CHINA'S GENTRY 116-17 (1953).

44. Dr. Sun Yat-sen believed that a colony only serves one master-nation. When natural disaster comes to the colony, the master-nation will always come to help, however, China served many master-nations under the "unequal treaties," and those master-nations exploited the wealth out of China without regard to the welfare of China. China under the bondage of the "unequal treaties" was worse than a "colony." A "semi-colony" is not the proper designation for China, China should be called a "hypo-colony." Y. SUN, SAN MING CHU I (The Three Principles of the People) 38-39 (F. Price trans., T. Chen ed. 1975).

45. C. HOU, FOREIGN INVESTMENT AND ECONOMIC DEVELOPMENT IN CHINA 1840-1937 1 (1965).

46. Chi-ming Hous further comments on the foreign business: "Foreign direct investment took place under very favorable conditions. A foreigner who wished to trade with the Chinese or establish business firms in the open ports in China had no reason to fear Chinese

Since most of the products made by the Chinese industries were hand-made, they could not compete with the machine-made products of foreign business. The money used in China at that time was silver coin, and foreign business were able to repatriate profits in specie without any loss by conversion to foreign exchange. Through these practices the wealth of China was drained into the Western countries.

Factories established by foreign businesses often employed mechanization, thereby decreasing the demand for labor. Most Chinese handicraft industries could not compete and were forced to shut down, resulting in a net loss of jobs and some serious social problems for China.⁴⁷ While the modern technology and management skill of foreign business amazed many Chinese intellectuals and officials who called for "Westernization,"⁴⁸ it also caused hostility toward Western civilization; the ensuing dichotomy caused political unrest in China.⁴⁹

B. Review of China's Failure in Modernization

It is unfair to say that before World War II foreign business had not made any positive contribution to the economic development of China. Foreign businesses brought technology appropriate to Chinese needs⁵⁰ and improved the basic infrastructure.⁵¹ The most important contribution, however, was in making the Chinese realize the urgent need for modernization.

While many scholars have imputed the failures of Chinese

laws or other Chinese control. . . In certain ways the open ports in China were not much different from the colonies of foreign powers, except that a colony usually served only one master whereas China had to serve them all." See note 45, *supra*, at 108-09. See also note 40 *supra*.

47. See note 45 *supra*.

48. Attempted Westernization gave rise to the "Self-Strengthening" movement in the late Ching Dynasty. See CHINA, 4 NEW ENCYCLOPEDIA BRITANICA, MACROPAEDIA 361 (1980).

49. Calls for the overall westernization resulted in the "Hundred Day's Reform" in the late Ching Dynasty which failed by the opposition from the conservatives. See *supra* note 48, at 363.

50. See *supra* note 40, at 42-43.

51. "Infrastructure (Social Overhead Capital) is 'the foundation underlying a nation's economy (transportation and communications systems, power facilities, and other public services upon which the degree of economic activity (industry, trade, etc.) depends. It may include such intangible assets as the population's education level and social attitudes, industrial skills and administrative experience . . . The building up of a country's infrastructure, which generally involves projects with a high initial cost and a very long payoff period, is frequently carried out by the government or with its aid.'" Meier, *supra* note 27, at 474.

modernization to the foreign business practices,⁵² a different perspective can be obtained by considering the economic development of Japan and the cultural discipline of China. When Japanese isolation ended in 1854, Japan was not a modernized nation; by the end of the 1800's, it was the strongest power in Asia. The success of Japan's modernization reveals that the crux of China's modernization problems was not the predominance of foreign business, but rather China's inability to effectively deal with and take advantage of foreign interests in terms of technological development.⁵³

Confucianism, which had been dominant for several thousand years,⁵⁴ encouraged the better governing of people.⁵⁵ Involvement with technology was generally despised and ridiculed by Chinese intellectuals.⁵⁶ This attitude had a negative effect on industrialization as did the persistence of the family⁵⁷ as the basis of Chinese society.⁵⁸ The accumulation of liquid capital necessary for modernization was stifled in a like manner by tradition; citizens preferred to keep their silver coins at home and trusted neither banks nor paper money.⁵⁹

Japan, in contrast, was subjected to Westernization by the Em-

52. See *supra* notes 45, 46 & 47.

53. See note 58 *infra*.

54. Han Wu Ti (140-87 B.C.), the founder of the Han Dynasty, established the "Imperial University" in 124 B.C. to educate future government officials with Confucius' "five classics." The examination for the government officials is also based upon the Confucius teaching. This measure has been followed by the subsequent dynasties. Therefore, Confucianism becomes popular philosophy in China. See THE ENCYCLOPEDIA AMERICANA 528 (1980).

55. Lee & Lai, *The Chinese Conception of Law: Confucian, Legalist, and Buddhist*, 29 HASTINGS L.J. 1307, 1308-12 (1978).

56. The traditional view of China among Chinese intellectuals is as the universal empire which deserves admiration and respect from "barbarians" outside the "Middle Kingdom." However, when the Chinese observe the superiority of the advanced technology owned by the "barbarians," such technology is referred to as the "clever, tricky yet insignificant contrivance." See ECKSTEIN, CHINA'S ECONOMIC DEVELOPMENT 143-44 (1975).

57. As M.J. Levy pointed out, the concept of the family together with other aspects of the Chinese social system became remarkably stable in the face of pressures for modernization; more importantly, they generated a defensive and anti-development behavior pattern which was not compatible with industrialization. Levy, *Contracting Factors in Modernization of China and Japan: Economic Development and Culture Change* (1953), cited in Dernberg, *The Role of the Foreigner in China's Economic Development 1840-1949*, in CHINA'S MODERN ECONOMY IN HISTORICAL PERSPECTIVE, 23 (D. Perkins ed. 1975).

58. Myers, *Cooperation in Traditional and Modern Agriculture*, in CHINA MODERN ECONOMY IN HISTORICAL PERSPECTIVE 271 (D. Perkins ed. 1975).

59. C.F. Remer says: "In 1914, China was one of the few countries in the world-the only of wide extent and great population-in which silver continued to be the means of payment in international trade." C. REMER, INTERNATIONAL TRADE BETWEEN GOLD AND SILVER COUNTRIES: CHINA 597 (R. Myers ed. 1980).

peror Meiji Mutsuhito (1852-1912) and, within thirty years, was transformed into a powerful industrialized nation.⁶⁰ This transformation included new criminal and civil codes⁶¹ which provided for fair treatment of foreigners. Following these legal developments, the Western powers gave up their claims of extraterritoriality in Japan.⁶²

Under the rule of the Manchu government China lacked an integrated legal system compatible with the West,⁶³ and even after adoption of the Law of Joint Venture in 1979, foreign investors have been reluctant to make large investments in China. Taiwan, in contrast, has successfully handled foreign investment with the aid of an integrated legal framework; the result is a standard of living exceeded in Asia by only Japan and Singapore.⁶⁴

III. THE IDEOLOGICAL BACKGROUND OF FOREIGN INVESTMENT POLICY

The Chinese tend to emphasize ideology. They believe that every action is a reflection of an ideology; an action is meaningless without its ideological background.⁶⁵ In order to understand the legal trend concerning foreign investment one should have a firm grasp of the ideological background for foreign investments.

A. Taiwan

Dr. Sun Yat-sen was the founder of the Kuomintang (Nationalist party) and led the revolution to overthrow the Manchu government. The revolution ended several thousand years of imperial rule and established the Republic of China in 1912.⁶⁶ Dr. Sun Yat-sen commanded that the new nation be guided by his "Three Principles of the People" (San-Ming Chu-I). According to these princi-

60. Mutsuhito began to rule Japan in 1867. His efforts to Westernize Japan resulted in defeating China in 1895. Since then, Japan became the strongest power in Asia. See JAPAN AND MUTSUHITO, WORLD BOOK ENCYCLOPEDIA (1979).

61. *Id.*

62. *Id.*

63. Carl, *Contemporary Law in the People's Republic of China*, 32 Sw. L.J. 1255, 1256-58. (1979).

64. In accordance with information published by the World Bank, Gross National Product (GNP) per capita for Asian countries in 1977, converted to value in United States dollars, are as follows: Japan \$6,510; Singapore: 2,820; Taiwan: 1,180; Korea: 980; Malaysia: 970; Philippines: 460; Thailand: 430. See WORLD BANK: WORLD TABLES (2nd ed. 1980).

65. Carl, *supra* note 63, at 1256-57.

66. See CHINA, WORLD BOOK ENCYCLOPEDIA (1979).

ples the Republic of China was to: (1) enforce nationalism to achieve political unity, resist imperialism, and cancel the “unequal treaties”; (2) create a centralized government in direct elections; (3) foster the people’s livelihood by increasing the standard of living and the people’s welfare.⁶⁷

In the Principles of Livelihood, Lecture 2, delivered on August 10, 1924, Dr. Sun Yat-sen maintained that foreign capital and foreign technology are indispensable to the economic development of China. He said:

The United States has developed capital in three ways: through railroads, through manufacturing, and through mining. We shall not be able to promote one of these three great industries by our own knowledge and experience with our own capital; we cannot but depend upon the already created capital of other countries. If we wait until we ourselves have enough capital before we start to promote industry, the process of development will be exceedingly slow. . . . So we shall certainly have to borrow foreign capital to develop our communication and transportation facilities, and foreign brains and experience to manage them.

As for our mines, we have not even begun to open them. . . . If we want to open our mines quickly, again we must borrow foreign capital. To construct steamships, to develop a merchant marine, and to build up all kinds of manufacturing industries on a large scale, it will be absolutely necessary for us to borrow foreign capital.⁶⁸

Dr. Sun Yat-sen died on March 12, 1925, while the Republic of China was still under the bondage of the “unequal treaties.” In his will Dr. Sun Yat-sen pleaded that: “Above all, my recent declarations in favor of . . . abolishing the unequal treaties should be carried into effect as soon as possible.”⁶⁹

Chiang Kai-shek who succeeded Dr. Sun Yat-sen as the leader of China also failed to bring foreign investments under effective control primarily because the unequal treaties limited the exercise of China’s sovereignty.⁷⁰ During World War II, however, one after another of the treaty countries cancelled the unequal treaties. In 1943, the United States and Great Britain abandoned all special privileges and immunities in China; they were the last two coun-

67. See note 44 *supra*.

68. *Id.* at 442-43.

69. Sun Yat-sen, *Last Testament*, CHINA YEAR BOOK iv (1977).

70. See note 46 *supra*.

tries to do so and thereby released China from the over one-hundred years bondage of unequal treaties. Immediately after World War II the Constitution of Taiwan (the Republic of China) was enacted.⁷¹ Article 1 provides that: "The Republic of China, founded on the Three Principles of the People, shall be a democratic republic of the people, to be governed by the people and for the people."⁷² General Chiang Kai-shek was elected President of the Republic of China.⁷³ At the same time, the Chinese communists focused their attention on leading the peasantry in the revolution against the nationalist government.⁷⁴ This resulted in the defeat of Chiang Kai-shek's Nationalist government and the founding of the People's Republic of China on October 1, 1949, with Mao Zedong elected head of state.

In 1949 Chiang Kai-shek moved the Nationalist government seat to Taipei, Taiwan, and began to implement Dr. Sun Yat-sen's Three Principles of People.⁷⁵ In accordance with Dr. Sun's lectures, the Statute of Investments by Foreign Nationals was promulgated in 1954.⁷⁶ By the time President Chiang Kai-shek died on April 5, 1975, Taiwan had greatly strengthened its economic power by channeling foreign investment in the desired directions.

Premier Chian Ching-kuo was elected President of Taiwan in 1978. His political philosophy is basically the same as that of his father, the late President Chiang Kai-shek.⁷⁷ Therefore no significant change of foreign investment policy is anticipated, and Taiwan is expected to continue attracting foreign investment by offering incentives and improving its investment climate.

B. China

During the past thirty years policies emphasizing self-sufficiency and self-reliance, which excluded foreign investment, often led people to believe that China would not accept foreign invest-

71. SEYMOUR, CONSTITUTION OF THE REPUBLIC OF CHINA, *reprinted in* III CONSTITUTION OF THE COUNTRIES OF THE WORLD (A. Blaustein & G. Flanz eds. 1974).

72. *Id.*

73. *Id.* at 11.

74. *See* note 48 *supra*.

75. Chiang Kai-shek, *Last Testament*, CHINA YEAR BOOK vi (1977). "I have since my formative years followed Dr. Sun Yat-sen, our Founding Father, in carrying out the National Revolution. I have at all times considered myself a disciple of Jesus Christ and a follower of Dr. Sun Yat-sen."

76. *See* note 5 *supra*.

77. *See* ENCYCLOPEDIA AMERICANA 41 (1979).

ment as a means of helping its economy.⁷⁸ However, a careful study of works written by Chinese communist leaders reveals that foreign investment was considered desirable.⁷⁹

The late Chairman Mao Zedong was aware of the fact that it was impossible to modernize the entire country without foreign assistance and technology.⁸⁰ However, his observations of foreign business in China prior to World War II, as well as his adherence to pure communism, resulted in his concluding that the Western countries were imperialists, and that foreign investment was nothing more than a weapon for imperialist economic invasion.⁸¹ The only alternative means of gaining access to advanced technology and capital was by seeking help from the Soviet Union. On June 30, 1949, Mao announced his famous "Lean to One Side" (i-pien-tao) policy:

[Some people say], "You lean to one side [i-pien tao]." This is correct . . . and we are convinced that in order to be victorious and secure the victory, we must lean to one side. . . . It will not do to sit on the fence, and there is no third road.⁸²

Immediately after Mao's announcement of the new policy, several agreements were concluded between China and the Soviet Union. The result was the joint management of the Changchun Railway,⁸³ the establishment of the Sino-Soviet Petroleum Company⁸⁴ and the Sino-Soviet Ferrous and Rare Metals Company,⁸⁵ as well as the founding of a joint civil-aviation company.⁸⁶ Their establishment represented the first Chinese joint ventures.⁸⁷

In 1957 Mao reiterated the importance of Soviet technology, but indicated that the Soviet Union was not the only acceptable source of such technology; capitalist countries could also be considered.

In order to turn our country into an industrial power, we must

78. D. RAY, CHINESE PERCEPTIONS OF SOCIAL IMPERIALISM AND ECONOMIC DEPENDENCY, THE IMPACT OF SOVIET AID, *reprinted in* CHINA CHANGING ROLE IN THE WORLD ECONOMY 59-64 (B. Grath ed. 1975).

79. Mao Tse-tung, *On the People's Democratic Dictatorship*, *quoted in* DOOLIN & NORTH, THE CHINESE PEOPLE'S REPUBLIC 33 (1966).

80. *Id.* at 33-34.

81. UNION RESEARCH INSTITUTE, WHO'S WHO IN COMMUNIST CHINA, MAO TSE-TUNG (1966).

82. *See* note 79 *supra*.

83. *See supra* note 79, at 33-34.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

learn conscientiously from the advanced experience of the Soviet Union. . . . It is perfectly true that we should learn from the good experience of all countries, socialist or capitalist, and there is no argument about this point. But the main thing is still to learn from the Soviet Union.⁸⁸

Aside from Mao Zedong, the late Premier Chou En-lai was the most influential figure in China.⁸⁹ Chou En-lai expressed his personal opinion of China's ever-present need of foreign technology in 1957:

It would be wrong to seek to construct socialism unaided, cut off from the world, China will, as in the past, need the aid of the USSR and the people's democracies for a long time to come. It is essential to expand at the same time economic, technical and cultural relations with other countries.

Moreover, even in the future, once our country has become a socialist and industrial economy, it is difficult to imagine that we can coop ourselves up and do without aid.⁹⁰

Deng Xiao-ping is a legendary figure in China. His outspoken nature caused him to be purged twice, but miraculously he staged successful comebacks. A close friendship between Chou En-lai and Deng Xiao-ping began in 1920 when they studied together in France.⁹¹ While in France, they obtained a better understanding of Western culture, making them amenable to westernizing mainland China.⁹² Chou's plan to modernize the whole country was interrupted by the "Cultural Revolution."⁹³ After Chou's death, Deng was labeled an "irrepentant revisionist roader" and purged again.⁹⁴ Returning to power in 1977, Deng advocated the "Four Modernizations," encompassing industry, agriculture, national defense, and

88. MAO ZEDONG, *FOUR ESSAYS ON PHILOSOPHY* 131.

89. Chou En-lai called for the "Four Modernizations." in his last major speech in 1975. In that speech Chou En-lai set forth the guidelines for China's modernization. He said, "China would accomplish the comprehensive of agriculture, industry, national defense, and science and technology modernization before the end of the century." *See* note 48 *supra*, at 400.

90. CHOU EN-LAI, DELEYNE, *THE CHINESE ECONOMY* 149 (R. Leriche trans.).

91. UNION RESEARCH INSTITUTE, *WHO'S WHO IN COMMUNIST CHINA* 138 & 546 (1966).

92. *Id.*

93. *See supra* note 38, at 390.

94. Mao's wife, Chiang Ching, in her speech "Down With Teng Hsiao-ping! Teng's Ten Major Crimes" at a Red Guard rally during the Culture Revolution, said at the outset: "Teng Hsiao-ping is China's number two revisionalist, the second person in power in the Party taking the capitalist road! He is the chief culprit for the counter-revolutionary capitalist line!" Her speech was originally published in the Peking Red Guard News on April 10, 1967, TENG HSIAO-PING—A POLITICAL BIOGRAPHY 49 (C. Hsin ed. 1978).

scientific technology.⁹⁵ Deng's view of foreign investment is summed up by his well-known remark: "No matter whether a cat is black or white, as long as it can catch rats, that is the good cat."⁹⁶ As long as foreign investment can help China achieve the goal of the "Four Modernizations,"⁹⁷ that approach is a good one. The law of joint ventures,⁹⁸ the first foreign investment law in 30 years, reflects his ideology. As Deng's position becomes more secure subsequent to the personnel shuffle in the Politburo which occurred in early 1980, China's policy toward foreign investment should become more lenient, and its investment climate should improve substantially.

IV. THE FRAMEWORK OF FOREIGN INVESTMENT LAWS IN TAIWAN

Many factors can be attributed to the positive development of Taiwan since 1949. One of the most important has been the contribution of foreign investment.⁹⁹

The Statute for Investment by Foreign Nationals (SIFN) was promulgated by the Taiwan (Nationalist) government on July 14, 1954, and became effective immediately.¹⁰⁰ Concurrently, local capital also began to form as land reform was successfully carried out and the people of Taiwan prospered.¹⁰¹ The Taiwan (Nationalist) government, as a means of encouraging investment in Taiwan's export industries, enacted and implemented the Statute for Encouragement of Investment (SEI) on September 10, 1960.¹⁰² The incentives provided by the SEI have been available to both domestic and foreign interests as long as the investment projects conform with the requirements of the SEI.¹⁰³ This has enabled the government to efficiently channel investment towards national development. In order to encourage foreign investment to bring advanced technology to Taiwan, the government has allowed technical expertise and

95. Carl, *supra* note 63, at 1259.

96. This statement was made at a meeting of the Central Committee of the Communist Youth League in 1962. Deng openly encouraged the restoration of individual farming and went so far as to say that, "It doesn't matter if it's a white cat or black cat, as long as it can catch rats, it's a good cat." See *supra* note 94, at 45.

97. Carl, *supra* note 63, at 1259.

98. See note 5 *supra*.

99. See *id.* § I(A).

100. See *id.*

101. See note 32 *supra*.

102. See note 5 *supra*.

103. See note 15 *supra*.

patent rights to be considered as protected capital through enactment and implementation of the Regulations for Furnishing Patent Rights and Technical Expertise as Capital Stock.¹⁰⁴

The SIFN,¹⁰⁵ the SEI,¹⁰⁶ the Statute for Technical Cooperation,¹⁰⁷ the Law of Custom Duty,¹⁰⁸ and the Company Law¹⁰⁹ combine with other pertinent laws and regulations to form the legal framework for foreign investment in Taiwan. The resulting advantages to Taiwan and foreign investors can be seen through the restrictions, controls, and incentives applicable to foreign investment under this framework.

A. *Restricted Legal Definition of Foreign Investment*

Foreign investment is generally considered to be of two kinds. Direct foreign investment is aimed at establishing effective control over permanent establishments such as factories, mines, or hotels.¹¹⁰ On the other hand, portfolio investment refers to debt securities, such as bonds, debentures, and equities, where the amount is not sufficient to control the enterprise.¹¹¹ Both direct and portfolio investments occur in Taiwan, however, under Taiwan law their scope is restricted by statutory definition.¹¹² According to Article 5 of the SIFN only the following specific types of investment are allowed as foreign investment:

1. Investments in productive or manufacturing enterprises which are needed domestically;
2. Investments in enterprises which have an export market;
3. Investments which are conducive to important industrial, mining, or communications enterprises;

104. Regulations for Furnishing Patent Rights and Technical Know-how as Capital Stock was promulgated on June 3, 1968.

105. See note 5 *supra*.

106. *Id.*

107. *Id.*; see also note 12 *supra*.

108. The Law of Custom Duty was promulgated on August 8, 1969 and amended on December 8, 1978.

109. The Company Law was promulgated on December 30, 1929 and amended on September 4, 1970.

110. According to the definition given by the Foreign Direct Investment Regulations, direct investment refers to an investment, directly or indirectly, in which one owns or acquires a ten percent interest in a corporation or partnership, or business venture. Foreign Direct Investment Regulations, Title 15, § 1000.305, (Amended July 1, 1972).

111. Investment is considered a "portfolio investment," if the holder owes less than ten percent of the voting stock in the issuing corporation and less than ten percent of the capital or profits interest of a partnership. A. WEINBERG, S. HUTTON, U.S. FEDERAL INCOME TAXATION OF PORTFOLIO INVESTMENT BY FOREIGN PERSONS 75-76 (Singer & Weiss, eds. 1980).

112. SIFN, *supra* note 5, at art. 5.

4. Investments in enterprises which are engaged in scientific and technical research and development;
5. Investments in other enterprises which are conducive to the economic and social development of China.¹¹³

These threshold restrictions have allowed foreign investment to be channeled toward fixed national economic goals.¹¹⁴ National security interests are protected through laws concerning percentage of ownership and these laws have an attractive side for foreign investment as well.

B. Percentage of Ownership Requirements and Consequences

Taiwan does not require minimum foreign ownership of joint ventures between foreign investors and local nationals, or the host government or both.¹¹⁵ However, when foreign investment in a joint venture is less than forty-five percent, such enterprises may be expropriated for reasonable compensation, but only if it fulfills a need of national defense.¹¹⁶ If foreign investment accounts for more than forty-five percent of a joint venture, it will not be expropriated for at least twenty years.¹¹⁷ Although Taiwan allows foreign investors to have total ownership,¹¹⁸ domestic participation is required in certain industries.¹¹⁹ For example, sixty percent domestic participation is required in basic metals manufacturing, (unless a waiver is granted by the Investment Screening Committee),¹²⁰ fifty percent in the pork processing industry,¹²¹ sixty percent in the investment and trust company (no individual investor may own more than twenty percent of the registered capital) and a relative percentage in electronics industries (except where production is

113. See note 5 *supra*.

114. By selecting the foreign investment it desires, the host government is able to avoid the preemptive effect foreign investment may pose to domestic investment. As a result, local industry may also be encouraged.

115. SIFN, *supra* note 5, at art. 4, para. 1.

116. *Id.* at art. 15, para. 1.

117. *Id.* at art. 16.

118. *Id.* at art. 4, para. 1.

119. Domestic participation is mostly a contingent policy consideration. There are no laws or regulations governing the percentage of foreign ownership in the joint venture. Therefore, percentage limits and the nature of industry which requires domestic participation may vary from time to time. Hsu, *Legal Consideration and Business Strategy For U.S. Firms to do Business in Taiwan*, 8 NAT'L TAIWAN U.L.J. 149-50 (1978).

120. Chun Li, *How to Structure Investment and Trade Operation for American in the Republic of China: A Lawyer's View*, 2 SOOCHOW L. REV. 82 (1978).

121. *Id.*

wholly exported).¹²² The decisions concerning ownership percentages and consequences thereof, as well as all matters of foreign investment, are centralized.

C. Regulation of Foreign Investment

Foreign investment is under the jurisdiction of the Ministry of Economic Affairs (MOEA).¹²³ An investment Screening Committee has been established within the MOEA to review investments made by foreign nationals under the SIFN.¹²⁴ The Investment Screening Committee consists of officials from the ministries of Economic Affairs, Finance, and Interior Affairs, along with the Foreign Trade Bureau, the Foreign Exchange Bureau of the Central Bank, and the Construction Department of the Taipei Municipal Government. The purpose of broad participation on this committee is to expedite the processing of foreign investment applications.¹²⁵ The guiding principle of foreign investment regulation can be simply stated: *foreign investment establishments shall be accorded the same treatment as that accorded to the same type of establishments operated by local nationals*.¹²⁶ For example, any incentives provided to local enterprises will also be extended to foreign enterprises.¹²⁷ Furthermore, some incentives are provided only to foreign investment.

D. Non-Tax Incentives

As mentioned above, the Taiwan (Nationalist) government will not expropriate enterprises operated by foreign investors within twenty years from the date of commencement of business as long as foreign investors maintain forty-five percent ownership of the total registered capital.¹²⁸ In addition to this protection, foreign investors have special privileges such as a right to repatriate net profits, interest earnings, and invested capital.

The privilege to repatriate net profits and interest earnings is not enjoyed by domestic enterprises.¹²⁹ Only foreign investments

122. See *supra* note 25, at 17.

123. SIFN, *supra* note 5, art. 7, para. 1.

124. *Id.* at para. 2.

125. See F. KUO, RESEARCH ON THE CURRENT POLICY OF INVESTMENT BY FOREIGN NATIONALS AND OVERSEAS CHINESE AND ITS PROBLEMS 49 (in Chinese).

126. SIFN, *supra* note 5, at art. 20 (emphasis added).

127. *Id.*

128. *Id.* at art. 16.

129. *Id.* at art. 13, para. 1.

approved by the Investment Screening Committee can apply for the unlimited privilege of repatriating net profits and interest earnings.¹³⁰ Furthermore, with special approval foreign investors may postpone repatriation for one year so that profits can be used as working capital. Beyond a one year extension, this privilege is considered waived.¹³¹

Repatriation of invested capital is allowed in two situations. First, two years after the date of drawing the first invoice, foreign investors are allowed to repatriate fifteen percent of the total investment capital.¹³² This percentage may be raised with special approval of the Executive Yuan (cabinet) and depends upon the status of the government's foreign currency reserve.¹³³ The second situation is where foreign investors transfer a part of their invested equity to local nationals in accordance with agreed conditions as approved under the investment case. All the proceeds from such transfers can be repatriated, but only once.¹³⁴ This privilege to repatriate capital can only be extended for one year with special approval.¹³⁵

Lastly, as a non-tax incentive to export trade, the Taiwan government provides a non-profit export insurance program which is available to both foreign and domestic investment enterprises.¹³⁶

E. Tax Incentives

A newly established "productive enterprise" may select either a five-year income tax holiday from the date on which it began to market its products or to render service, or an accelerated depreciation of fixed assets.¹³⁷ In the latter if the service life is over ten years, depreciation may be accelerated to five years;¹³⁸ if the service life is less than ten years, depreciation may be cut by half.¹³⁹ Where the service life of buildings and equipment for transportation or communication are concerned, depreciation may be accelerated by one-third.¹⁴⁰

130. *Id.*

131. *Id.* at art. 14, para. 4.

132. *Id.* at art. 13, para. 2.

133. *Id.* at art. 13, para. 3.

134. *Id.* at art. 13, para. 4.

135. *Id.* at art. 14, para. 4.

136. SEI, *supra* note 5, at art. 24.

137. *Id.* at art. 6, para. 1.

138. *Id.* at item 2(1).

139. *Id.*

140. *Id.*

In order to qualify as a “productive enterprise,” a venture must be organized as a “company limited by shares,” similar to a corporation in the United States. The venture must produce goods or render services or both, in one of the following fields: manufacturing, handicraft, mining, agriculture, forestry, fishery, animal husbandry, transportation, warehousing, public utility, public housing construction, technical services, international tourist hotel, and heavy machinery construction.¹⁴¹ In order to enjoy this incentive, such productive enterprises must also meet the general criteria or special criteria specified in the “Categories and Criteria of Productive Enterprises Eligible for Encouragement.”¹⁴²

In general, enterprises organized as companies limited by shares sold publicly in the form of registered certificates are entitled to a ten percent reduction on the income tax for three consecutive years from the year in which shares are listed on the stock market.¹⁴³ This incentive is aimed at inducing foreign investors to allow local participation.¹⁴⁴

Other tax breaks available to “production enterprises” include a reduction of the Deed Tax by fifty percent when the land and buildings used for productive purposes are purchased by a productive enterprise.¹⁴⁵ The House Tax also is reduced by fifty percent for buildings owned by a productive enterprise which are put to productive use.¹⁴⁶ In addition, when a productive enterprise has a contract with the national defense unit of the government to produce weapons, or any items related to warfare, the business tax and the stamp tax on the amount of the said transaction are exempted.¹⁴⁷

To cope with the emerging economic threat from China, Taiwan has attempted to upgrade its own industrial structure to avoid direct competition with China, which has the cheapest labor

141. *Id.* at art. 3, para. 1, items 1-14.

142. Categories and Criteria of Productive Enterprises eligible for Encouragement was enacted under SEI, art. 3, para. 2, (Amended Nov. 14, 1979).

143. *Id.* at art. 11.

144. The newly proposed revision, which is subject to final approval by the Legislative Yuan (Senate in Taiwan), boosts the three-year tax reduction from the current ten percent to fifteen percent for the company which offers its stock publicly. Ying, *Taiwan Proposes Investment Law Revisions as Part of Effort to Upgrade Industries*, Asian Wall Street Journal, Nov. 4, 1980, at 1.

145. SEI, *supra* note 5, at art. 31.

146. Statute for House Tax, promulgated on March 11, 1943 (Amended Nov. 30, 1974) at art. 15, para. 2 (2).

147. SEI, *supra* note 5, at art. 22-2.

in the world.¹⁴⁸ On July 26, 1977, Taiwan made an addition to the income tax holiday whereby a “productive enterprise” which is an important capital or technology intensive industry or both, may defer the running of the five year income tax holiday for up to four years from the date on which it begins to market its products or render services.¹⁴⁹ Thus, newly established “productive enterprises” can operate for up to nine years without paying any income tax in Taiwan.

Whereas any enterprise may retain undistributed profits not exceeding one-half of its paid-in capital, capital or technology intensive enterprises or both, as specified in the Categories and Criteria for Special Encouragement of Important Productive Enterprises, may retain undistributed profits not exceeding 100 percent of total paid-in capital.¹⁵⁰ The higher the amount of undistributed profit the company can retain, the less the amount of income tax the company has to pay. Income tax holidays or accelerated depreciation are also offered to the expansion programs of existing “productive enterprises.”¹⁵¹ “Productive enterprises” also are provided with a special income tax ceiling rate.

The ordinary ceiling rate of a business is thirty-five percent of the amount over NT \$500,000 (approximately equal to \$13,900 United States dollars).¹⁵² The income tax and surtaxes imposed upon “productive enterprises” do not exceed twenty-five percent of their annual income.¹⁵³ Furthermore, in order to particularly encourage basic metal production, heavy machinery, petrochemical industries, and other important “productive enterprises” which may be designated as such by the Executive Yuan, the ceiling tax rate is twenty-two percent.¹⁵⁴ The “productive enterprise” whose income tax holiday is finished can still enjoy this ceiling rate.¹⁵⁵

As an incentive to domestic technical development, a “productive enterprise” may deduct the cost of research and development

148. Ying, *Chinese Competition for U.S. Trade Alarms Taiwan*, Asian Wall Street Journal, Feb. 1, 1980, at 1 & 3.

149. SEI, *supra* note 5, at art. 6-1.

150. *Id.* at art. 12-1.

151. *Id.* at art. 6 & art. 6-1.

152. Statute of Income Tax Rate in 1979, art. 5.

153. SEI, *supra* note 5, at art. 10.

154. *Id.* Also the other important “productive enterprises” must meet the requirements set forth in the Categories and Criteria for Special Encouragement of Important Productive Enterprises (Amended on Oct. 2, 1978).

155. *See supra* note 11, at 46-63.

programs from taxable income of the current year.¹⁵⁶ If the service life of the apparatus and equipment furnished for research and experimental purpose exceeds two years, an incentive of accelerated depreciation is provided.¹⁵⁷ Export businesses are exempt from a business tax as verified by their invoices,¹⁵⁸ and also enjoy reduced Stamp Tax for their activities.¹⁵⁹

These tax savings are further supplemented by import duty exemptions and installment or deferred payment plans. Import duties including harbor dues for machinery, instruments, and equipment may be exempted for certain industries. The iron and steel industry, electrical machinery, aluminum, copper, zinc, lead, electronics, machinery manufacturing and machinery parts manufacturing, ship-building, chemical, textile dyeing and finishing, coal mining, and organic fertilizer industries which meet the "Criteria for Encouragement of Establishment or Expansion of Industrial and Mining Enterprises,"¹⁶⁰ may be exempted from the payment of import duties on their machinery and equipment brought in for their own use under a newly established investment project or subsequent expansion of a project approved by the Investment Screening Committee.¹⁶¹ The eligible imported machinery and equipment, however, must be those which have not been produced locally.¹⁶²

An exemption of import duties on instruments and equipment not produced locally and brought in for research and development programs may be granted to "productive enterprises" for use in development of new products, improvement of quality, conservation of energy, prevention of public pollution, promotion of waste utilization, or improvement of manufacturing methods.¹⁶³ In addition, such an exemption is even available to a "productive enterprise" which does not fall within the Categories and Criteria of Productive Enterprises Eligible for Encouragement¹⁶⁴ because that law is ap-

156. SEI, *supra* note 5, at art. 23-1. In order to accelerate the pace of upgrading the industrial structure in Taiwan, a revision has been proposed making it mandatory that productive enterprises allocate undistributed profits to research and development programs in order to enjoy tax incentives. See note 144 *supra*.

157. SEI, *supra* note 5, at art. 23-1.

158. *Id.* at art. 22.

159. *Id.* at art. 29(4).

160. Criteria for Encouragement of Establishment or Expansion of Industrial and Mining Enterprises (Amended August 23, 1979).

161. SEI, *supra* note 5, at art. 27, para. 2.

162. *Id.*

163. *Id.* at art. 27, para. 3.

164. See note 142 *supra*.

plicable to determining eligibility for income tax holidays or accelerated depreciation.¹⁶⁵

“Productive enterprises” which are not eligible for exemption of import duties may apply for payment of these duties in six to thirty equal monthly installments beginning one year after the date on which such machinery or equipment begins to produce goods or render services. Extension of the installment periods will be given for amounts over NT \$30 million (approximately US \$833,000).¹⁶⁶ However, only machinery and equipment not produced locally are eligible for this incentive.¹⁶⁷ In addition, “productive enterprises” must furnish a guarantee to the custom house of the Ministry of Finance.¹⁶⁸ This guarantee may be in writing from a bonding agency, a letter of credit in favor of the custom house, a promissory note endorsed by two factories, or a chattel mortgage on the imported machinery and equipment for the benefit of the custom house.¹⁶⁹

In accordance with Article 27 of the Custom Duty Law,¹⁷⁰ wholly export oriented “productive enterprises” which contribute to national economic development or employ advanced technology are entitled to a five year deferred payment of import duties levied on machinery and equipment used for their plans under an approved project. These deferred payments are subject to a satisfactory guarantee furnished to the custom house.¹⁷¹ It is important to note that, under this Article, machinery and equipment are not limited to those which are not produced locally.¹⁷² This incentive is, in effect, a five year loan from the government without interest. Eligible industries under this Article include: steel, aluminum and copper, electrical engineering, electronics, machine manufacturing, automobile and parts, shipbuilding, chemical, petroleum, mining, precision instruments, metal processing, lumber processing, rubber,

165. SEI, *supra* note 5, at art. 6.

166. *Id.* at art. 27, para. 1. *See also infra* note 169, art. 5, para. 1.

167. *Id.*

168. *Id.*

169. Industrial Development and Investment Center of the Republic of China Enforcement Rules Governing the Payment in Installments and Exemption from Duties and Dues Leviable on Machinery and Equipment Imported by Productive Enterprises, promulgated November 5, 1971, (Amended on May 12, 1976) art. 7.

170. The Custom Duty Law was promulgated on August 8, 1967, (Amended on December 8, 1978).

171. *Id.* at art. 27, para. 1.

172. *Id.*

and food.¹⁷³ The five year deferred payment of import duties begins on the date the first shipment is released from the customhouse.¹⁷⁴ In order to streamline the procedure, applications for exemption, installment payment, and the five year deferred payment of import duties are only filed with the Investment Screening Committee. Since August, 1979, approved applications have been forwarded directly to the customhouse by the Investment Screening Committee.¹⁷⁵

Under the Custom Duty Law,¹⁷⁶ raw materials used in export enterprises are effectively exempt from import duties and other taxes. At the time of export, import duties, harbor dues, and commodity taxes on raw materials used in export products may be refunded upon request.¹⁷⁷ The Regulations Governing the Offset and the Refund of Taxes on Raw Materials Used for Export Products¹⁷⁸ provide detailed procedures to follow in applying for tax refunds as well as a tax offset, whereby duties, surtaxes, and harbor dues may be owed on credit, to be offset against the raw material content of processed products exported within a prescribed time.¹⁷⁹ Also, imported raw materials may be stored in bonded warehouses inside an importer's factory,¹⁸⁰ or in an importer's bonded factory under the supervision of either a designated bonding agency or the custom authorities.¹⁸¹ Beyond the foregoing legal incentives for export and research and development enterprises, there are special incentives applicable to such enterprises located in designated areas of Taiwan.

According to the Statute for the Establishment and the Management of the Export Processing Zone,¹⁸² three export processing zones have been established in Taiwan at Kaohsiung, Nantze, and Taiching. The manufacturers in the export processing zones can

173. See note 120 *supra*.

174. Rules Governing the Implementation of the Custom Duty Law (Amended on Feb. 27, 1979) at art. 38.

175. Y. WEI, BRIEF REPORT ON THE ROC'S ECONOMIC DEVELOPMENT 7 (1979) (in Chinese).

176. See note 170 *supra*.

177. Custom Duty Law, *supra* note 170, at art. 36.

178. Regulations Governing the Offset and Refund of Taxes on Raw Materials Used for Export Products, promulgated on July 26, 1977.

179. Custom Duty Law, *supra* note 170, at art. 37.

180. *Id.* at art. 35.

181. *Id.* at art. 35-1. See also Regulations Governing the Custom House Management of Bonded Factories, promulgated on Nov. 3, 1978.

182. Statute for the Establishment and the Management of the Export Processing Zone, promulgated on Jan. 31, 1965 (Amended on December 24, 1979).

import machinery, equipment, and raw materials free of import duties, commodity tax, and business tax.¹⁸³ Furthermore, procedures concerning import and export, remittance of foreign exchange, and custom inspection investment application can be handled with maximum efficiency. Investors may purchase a factory outright or rent land and build a plant.¹⁸⁴ The manufacturer may then apply for a factory loan from the host government which is repayable in installments spread over ten years. Title to such factories can only be transferred to other export manufacturers.¹⁸⁵

Similar to export processing zones is the Hsin Chu Science Industrial Park which was completed at the end of 1980. This industrial park follows the models of the science industry parks in Massachusetts and California which are used to accommodate research institutes.¹⁸⁶ In addition to the exemption of import duties on machinery, equipment, and raw materials as well as tax holidays, the regulations governing the Hsin Chu Science Industrial Park also provide an income tax ceiling rate of 22 percent, and a reduction or exemption of land rentals for up to five years for desirable industries.¹⁸⁷

V. EMERGING FRAMEWORK OF FOREIGN INVESTMENT LAWS IN CHINA

After Deng Xiao-ping regained power and was restored to his former posts in 1977, he took the initiative in promoting the "Four Modernizations," setting a goal of modernizing China by the turn of the century. In order to facilitate this ambitious plan many measures of reform have been taken. The most notable measure was the adoption on July 1, 1979, of the Law of the People's Republic of China on Joint Ventures Using Chinese & Foreign Investment (hereinafter referred to as the Law of Joint Ventures).

However, many foreign investors who had been awaiting such a law expressed their disappointment over the briefness and vagueness of the new law.¹⁸⁸ The Law of Joint Ventures demonstrated China's determination to modernize the country as well as its desire

183. SGV-SOONG & CO., *DOING BUSINESS IN TAIWAN, THE REPUBLIC OF CHINA*, at 60 (1979).

184. *Id.* at 61.

185. *See* INDUSTRIAL DEVELOPMENT AND INVESTMENT CENTER, *A BRIEF INTRODUCTION TO THE INDUSTRIAL ESTATE IN TAIWAN*, 3 (1979).

186. *See supra* note 125, at 152.

187. CHINA NEWS, *DIRECTORY OF TAIWAN* 283 (1980).

188. *China Disappointed by Response to Offer for Joint Ventures*, *Asian Wall Street Jour-*

to invite foreign investment, but many measures are needed to complete implementation.¹⁸⁹

Professor Jerome Alan Cohen commented:

[The Law of Joint Ventures] can only be understood by examining the environment that spawned it. To ignore the fact that this invitation to foreign businessmen was extended as part of the continuing work of the Chinese government to ensure domestic tranquility, to promote the rule of law and to implement a socialist democracy would be to miss entirely the new law's meaning.¹⁹⁰

The Law of Joint Ventures, consisting of fifteen articles totaling less than 2000 words in its unofficial English translation,¹⁹¹ is so brief that supplemental laws and regulations as well as official interpretations are imperative. Nevertheless, the legal framework for foreign investment has already emerged from both the Law of Joint Ventures and the Regulations on Special Economic Zones in Guantung Province, together with the Regulations on the Control of Resident Representatives Offices of Foreign Enterprises in China, Income Tax Law Concerning Joint Ventures with Chinese and Foreign Investment, Individual Income Tax Law, and Provisional Regulations for Foreign Exchange Control.¹⁹² The legal framework of foreign investment will be examined within this context.

A. *Legal Framework Under the Law of Joint Ventures*

1. *Recognition of private property rights of the foreign investment.* Article 1 permits foreign companies, enterprises, and other economic entities or individuals to participate in joint ventures with Chinese companies, enterprises, and other economic entities. Article 2 states that the Chinese will protect the resources of and profits due to the foreign investor "as well as his other lawful rights and interests."¹⁹³ When read together, these two articles "create private

nal, March 11, 1980; see also Lambert, *Further Delays are Seen in China's Joint Venture Law*, *Asian Wall Street Journal*, April 17, 1980, at 3, col. 1.

189. *Id.*

190. Cohen & Nee, *Joint Ventures: Behind the Headline*, *The Asian Wall Street Journal*, July 21, 1979 ed., Part 1 at 4, col. 3 [hereinafter cited as Cohen & Nee].

191. LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON JOINT VENTURES USING CHINESE AND FOREIGN INVESTMENT 25 (Wen Wei Po ed. 1979) [hereinafter cited as LAW OF JOINT VENTURES].

192. See note 5 *supra*.

193. Law of Joint Ventures, *supra* note 5, at art. 2, para. 1.

property rights for the foreign investor in China.”¹⁹⁴

2. *Legal status of the joint ventures.* Whether joint ventures established under the Law of Joint Ventures are independent legal entities has been an open question. Mr. Tsuneo Kawasakiya, general manager of the China Department of Mitsui & Co., Ltd., stated that:

The Chinese government’s concept of joint ventures with foreign partners is fundamentally different from the accepted practice of capitalist nations. Under the socialist system of China, *a concept that a joint venture company established with foreign partners will be an independent legal entity does not hold water.* The plant and equipment of joint ventures are national assets and the foreign partner should be allowed only partial management control. The investment in China can be regarded as a sort of financing or like buying preferential stocks.¹⁹⁵

Professor Cohen disagrees.¹⁹⁶ He maintains that the joint venture is an independent legal entity, separate from the Chinese state. He supports this on the following grounds:

(a) Reference made in Article 1 to the venture as an “enterprise” is the same term that the Chinese have used for state enterprise and public-private joint venture enterprises, both of which have been independent legal entities in Chinese law.¹⁹⁷

(b) Article 4 provides: “A joint venture shall take the form of a limited liability company.”¹⁹⁸

(c) Although the joint venture is likely to be subject to closer regulation than in a capitalist state and enjoy less autonomy concerning important matters, this does not necessarily destroy the venture’s identity as a legal entity.¹⁹⁹

It is possible that this confusion was caused by China’s policy of “proletarian dictatorship” which is rooted in their constitution.²⁰⁰ Article 5, enacted on March 5, 1978, provides that owner-

194. Cohen & Nee, *supra* note 190, at col. 5.

195. McCue, *Japanese Executive Warns That Concept of Joint Ventures Is ‘Different’ in China*, The Asian Wall Street Journal, Oct. 16, 1979, at 13.

196. Cohen, *Beyond China’s Joint Venture Law: Filling in Some Gaps*, Asian Wall Street Journal, Dec. 1, 1979, at 4, col. 5.

197. *Id.* at col. 4.

198. *Id.*

199. *Id.* at col. 5.

200. The Constitution of the People’s Republic of China was adopted on March 5, 1978 by the Fifth National People’s Congress, at its First Session. Article 1 states, “The People’s Republic of China is a socialist state of *the dictatorship of the proletariat* led by the working

ship of the means of production belongs to all people through the state. The joint venture, as well as the state enterprise, and the public-private joint venture, is considered a means of production. Furthermore, there are only two kinds of ownership of means of production in China; social ownership by the whole people, and socialist collective ownership by the working people.²⁰¹ Apparently, joint venture fits neither of them. Unless the joint venture is interpreted as a national asset, the Law of Joint Ventures contradicts the Chinese Constitution. If a Joint Venture is a national asset, it is difficult for the Joint Venture to possess an independent character, one of the fundamental requirements of a legal entity. Even though the joint venture is presumed as a legal entity, its degree of independence needs clarification. Another alternative is to amend the Constitution so that the joint venture has the unquestioned legal status of an independent legal entity. Professor Cohen urged that the new regulation should leave no doubt on this score. Otherwise, "foreign investment in China is very much at risk" and "many potential investors will be frightened away."²⁰²

3. *Protection of laws.* One of the basic tenets of the Law of Joint Ventures is to provide legal protection for foreign investment. Peng Zhen, Director of the Legislative Affairs Commission, pointed out the importance of legal protection at the Second Plenary Session of the Fifth National People's Congress on June 26, 1979. He said it was imperative that "the resources invested by a foreign participant in a joint venture pursuant to the agreements and contracts authorized by the Chinese government as well as their other lawful rights and interests . . . be protected by the legislation in force."²⁰³

Article 2 of the Law of Joint Ventures provides legal protection of foreign rights and interests. Unfortunately, the unofficial English translation of the law used by China's official newspaper

class and based on the alliance of workers and peasants." See III CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (A. Blaustein & G. Flanz eds. 1980).

201. Article 5. states: "There are mainly *two kinds of ownership of the means of production* in the People's Republic of China at the present stage: socialist ownership by the whole people and socialist collective ownership by the working people. The State allows non-agricultural individual laborers to engage in work involving no exploitation of others, within the limits permitted by law and under unified arrangements and management by organizations at the basic level in cities and towns or in rural areas. At the same time, it guides these individual labourers step by step onto the road of socialist collectivization." See note 200 *supra*.

202. Cohen, *supra* note 196, at col. 5.

203. *Id.*

diminished some of the assurances that the original Chinese version provided for foreign investors.²⁰⁴ Professor Cohen pointed out this discrepancy between the Chinese version and its unofficial English translation stating:

The English translation of Article 2 unduly narrows the protection afforded to the foreigner's investment, his profits and his other rights. It states that the government protects these 'by the legislation in force.' Since there is little relevant legislation currently in force, this hardly enhances the foreigner's sense of security. The Chinese text actually states that the protection shall be 'according to the law,' a broader phrase that allows investors to be protected by forthcoming legislation as well as that currently in force and that also includes legal principles, practice and precedents in addition to legislation.²⁰⁵

Since Article 2 requires that all activities of a joint venture shall be governed by the laws, decrees, and pertinent rules and regulations of China, such laws become important, not only because they provide standards for the operation of a joint venture, but also because they facilitate government agencies in screening and regulating the foreign investment program. The Law of Joint Ventures relates those laws concerning corporate tax, foreign exchange, and industrial private and joint venture property which should be enacted as soon as possible.²⁰⁶ Before such laws are promulgated, problems arising from joint venture operation must be resolved by reference to the terms of an agreement. If a problem is not covered in a joint venture agreement, settlement may be obtained through either conciliation or arbitration.²⁰⁷ As a result, special care must be taken in drafting any joint venture agreement, with care being taken to anticipate all potential problems.

4. *Authorities in charge of the foreign investment.* Article 3 of the Law of Joint Ventures required joint venture participants to file the joint venture application agreement and by-laws for approval by the Foreign Investment Control Commission.²⁰⁸ The Commission then has three months to either approve or disapprove the application.²⁰⁹ If the project is approved, the joint venture should register with the General Administration for Industry and Com-

204. LAW OF JOINT VENTURES *supra* note 191, at 25.

205. Cohen, *supra* note 196, at col. 2.

206. *Id.* at col. 4.

207. *Id.* at col. 2.

208. LAW OF JOINT VENTURES, *supra* note 191, at art. 3.

209. *Id.*

merce and obtain a business license before commencing operation. In connection with joint ventures, the following official agencies have been established:²¹⁰

(a) The Foreign Investment Control Commission, the most powerful agency dealing with joint ventures, is headed by Vice Premier Gu Mu.²¹¹ Placing a Vice Premier in charge of foreign investment reflects the importance China places on foreign investment as a means for economic development;

(b) The General Administration for Industry and Commerce is designed to deal with the incorporation and issuance of business licenses;²¹²

(c) The Import-Export Control Commission, also headed by Vice Premier Gu Mu, coordinates the importation of machinery and equipment used by joint venture projects;²¹³

(d) The China International Trust Investment Corporation,²¹⁴ coordinates the use of foreign investment and technology,²¹⁵

(e) The State General Administration of Exchange Control (SGAEC) is responsible for the remittance of profits and other lawful interests earned under the joint venture program. The Bank of China is the only bank authorized to engage in foreign exchange under supervision of the SGAEC.²¹⁶

5. *Structure of company for the joint venture.* Since enterprises in China are virtually state owned, and since state enterprises are aimed at achieving a planned economy, all profits and losses are absorbed by the state. However, the joint venture is established on the basis of mutual benefit,²¹⁷ and therefore cannot be treated solely as a tool for attaining a planned economy. Article 4 provides that joint ventures shall take the form of a limited liability company.²¹⁸ To date, the limited liability company law has not been enacted. Because there is no way of knowing the rights, obliga-

210. Ching, *China Establishing Organizations to Prepare for Joint Ventures*, Asian Wall Street Journal, Aug. 2, 1979, at 3, cols. 1-2.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.*

216. Provisional Regulations for Foreign Exchange Control, *supra* note 5, at art. 3, paras. 2 & 3.

217. LAW OF JOINT VENTURES, *supra* note 191, at art. 1.

218. *Id.* at art. 4, para. 1.

tions, and structure of such a forthcoming company law, it is therefore advisable to set forth in detail all rights, obligations, methods of resolution, and other matters which are usually governed by the company laws of free enterprise countries.

China requires the establishment of a board of directors for limited liability companies and provides that the chairman of the Board be appointed by the Chinese participant.²¹⁹ This requirement provides the Chinese participant in a joint venture an effective means of controlling the operation, even where the Chinese hold only a minority interest.

One way of diminishing the influential power of the chairman of the board of directors is by establishing a standing chairman of the assembly of shareholders (if the foreign participant owns the majority of shares) to supervise the action taken by the Chinese chairman.²²⁰ Detailed provisions concerning the authority and decision making process of the assembly of shareholders should be incorporated into the by-laws of joint ventures. The establishment of an assembly of shareholders should be acceptable to the Chinese government because it conforms with the Chinese political principle of majority rule.

The requirement of a Chinese chairman of the board of directors (considered the head of the joint venture) may be a by-product of both the concept of "face"²²¹ and the bad image of foreign business before World War II. As long as China can have "face," it may not insist on total controls of joint venture operations.

6. *Structure of capital in the joint venture.* It has been noted that a minimum of twenty-five percent of the total capital in a joint venture must be contributed by the foreign participant,²²² however, no maximum amounts of foreign ownership is mentioned in the text. This omission has created speculation. It appears that the foreign proportion of ownership may exceed fifty-one percent because

219. *Id.* at art. 6, para. 1.

220. As a general principle of law, the board of directors is supposed to carry out the decision made by the shareholders. For example, the Company Law of Taiwan provides: "The business conducted by the board of directors shall comply with laws and regulations, by-laws of the company, and the decision made by the assembly of shareholders." Taiwan's Company Law, *supra* note 6, at art. 193, para. 1.

221. The concept of "face" plays an important role in Chinese social life as well as political life. Chinese always disguise "face" underneath "friendship." See Yao, *How to Succeed in Business with China? U.S. Firms Find Friendship is the Key*, Asian Wall Street Journal, April 9, 1980, at 3, col. 2; see ECKSTEIN, *supra* note 56.

222. LAW OF JOINT VENTURES, *supra* note 191, at art., 4, para. 2.

Vice Premier Li Xiannian pointed out that "China does not confine herself to the established international practice of fifty-one percent and forty-nine percent. The proportion of investment by foreign companies can be higher than fifty percent, and the duration may be ten years, twenty years or even longer."²²³ Professor Cohen indicated that it is not in China's best interest to limit foreign investors to forty-nine percent ownership since China presently suffers from a lack of capital.²²⁴ Speculations concerning the limits of foreign ownership in joint ventures are varied:

(a) Some have maintained that 100 percent foreign ownership is possible. This view is based on statements made by China's senior official to a thirteen member chamber delegation in July, 1979, in which it was stated that in certain cases China might accept up to one hundred percent foreign equity in a joint venture;²²⁵

(b) It has been asserted that a wholly-owned foreign subsidiary contradicts the basic nature of the Law of Joint Ventures. In other words, a joint venture which is wholly-owned by foreigners is not a "joint venture;"²²⁶

(c) According to sources with access to Chinese trade and finance officials, the maximum ownership for a foreign participant in a joint venture may be seventy-five percent, with the Chinese maintaining a substantial interest in all joint ventures.²²⁷ This theory has been substantiated by an arrangement of a joint venture agreement between Sanyo Electric Co., a Japanese electric appliance maker, and the city of Shanghai, to produce refrigerator compressors in China. Seventy-five percent of the joint venture capital shall be owned by Sanyo, and twenty-five percent will be held by the Shanghai municipality.²²⁸

(d) Some have reported that the Chinese leaders have indicated in press interviews that the proportion of the foreign investment could go as high as ninety percent of the total capital in the joint venture.²²⁹

223. See Ching, *supra* note 210.

224. See Cohen & Nee, *supra* note 190, at 4.

225. Lederer, *China Said to Bar Control of Industries by Foreigners, Even with Full Ownership*, Asian Wall Street Journal, July 26, 1979, at 3.

226. Huang, *The Course of the PRC's Learning the Economy of Taiwan*, World Daily News, January 19, 1980, at 9 (Chinese).

227. Ching, *supra* note 210, at 3.

228. Sanyo, *Chinese Set Up Venture to Produce Refrigerator Parts*, Asian Wall Street Journal, Jan. 12, 1980, at 3.

229. *China-Traders Awaits Details on Ventures Law*, Christian Science Monitor, August 6, 1979, at 13.

(e) Since China established the Foreign Investment Control Commission instead of a "Joint Venture Control Commission," it appears as if it is possible to have an establishment wholly-owned by foreign investors in China. However, such an establishment would only be permitted in "special economic zones" and not subject to the Law of Joint Ventures. For example, wholly foreign-owned enterprises are allowed to be established within the "special economic zones" of Guangdong Province in accordance with the Regulations on Special Economic Zones in Guangdong Province.²³⁰

7. *Forms of the capital contribution in the joint venture.* Paragraph 3 of Article 4 provides that the profits, risks, and losses of a joint venture shall be shared by the parties to the venture in proportion to their contribution of capital. The capital contribution may take the form of cash, capital goods, industrial property, or the use of the site provided for the joint venture.²³¹ The value of capital contributions other than cash shall be subject to the joint assessment of both parties.²³² Different forms of capital contribution have given rise to two kinds of joint ventures: equity joint ventures and contractual joint ventures.²³³ The former relates to agreements under which the Chinese and foreign partners provide capital and management, sharing risks as well as profits and losses. Examples of this are the Beijing Air Catering Company Ltd., the Shanghai Elevator Works of China, and the Schindler Elevator Company, Ltd.. Contractual joint ventures are agreements under which foreign firms provide funds and equipment, and the Chinese furnish land, factory premises, labor, and management. Profits are shared at an agreed percentage and all assets revert to the Chinese when the contract expires. Where the capital contribution consists of land or site use, problems in valuation exist. In China the state has title to all the land, and the market value is often difficult to ascertain. Unilateral determination by the Chinese government would violate the principle of equality announced in Article 1. Furthermore, the market value in the foreign participant's home country would not be a fair measurement. A Chinese official has

230. Regulations on Special Economic Zones in Guangdong, *supra* note 5, at art. 1, para. 2.

231. LAW OF JOINT VENTURES, *supra* note 191, at art. 5, para. 1.

232. *Id.* at art. 5, para. 4.

233. Xinhua, *Joint Enterprise Development with Foreign Firms*, FOREIGN BROADCAST INFORMATION SERVICE, December 12, 1980, at L9 (Chinese).

suggested that in determining the fair market value, the standard of a third country should be used.²³⁴ In the first press conference held by the newly established Foreign Investment Control Commission, Mr. Liu Chu, was asked about the problem of valuation of site use for a joint venture. Recognizing that there is not real estate market in China, he answered:

The predominant thinking within the government thinking is to let each locality set its own land values. For some cities, such as Peking, we can compare it with land prices in cities such as London, Tokyo, Paris and Hong Kong. We think the land prices we decide on will be lower.²³⁵

In the same press conference, Mr. Liu Chu made it clear that land would not be sold.²³⁶ However, he did suggest a way of getting around the problem of land valuation, by setting aside a percentage of income as compensation for use of the land.²³⁷ Such a method was incorporated in a joint venture agreement to build and operate the seventeen story, 1,008 room "Great Wall Hotel" in Peking.²³⁸

In addition to the problem of valuation, another problem centers around protection of industrial property rights, as there is no patent law in China. The laws pertaining to patents, corporations, wages, and civil law and procedure are being drafted.²³⁹ Until the laws become operational, the only protection available to the foreign participant is by incorporating detailed provisions for the protection of the company into the joint venture agreement and by-laws. Because contract principles only apply to the parties of the contract, it is suggested that a separate agreement be signed with the Chinese government, thus avoiding possible infringement by a third party not governed by the joint venture agreement.²⁴⁰

8. *Desired technology and equipment for the joint venture.* There is a substantial discrepancy between the Chinese text of Article 5, paragraph 2 of the Law of Joint Ventures and its unofficial

234. Ching, *China Nears Approval of Joint Ventures, Including Hotel Backed by U.S. Investors*, *Asian Wall Street Journal*, December 14, 1979, at 1.

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.*

239. See note 188 *supra*.

240. Even if an agreement is reached with the government of Communist China to protect patent rights against infringement, enforcement problems will still arise unless rules or regulations are issued so that third parties will be aware such patent rights are protected. Therefore, before the promulgation of a patent law, foreign patent rights will not have proper protection.

English translation. The precise English translation should read "The technology or equipment contributed by any foreign participant as investment shall be *advanced and truly appropriate to China's needs*."²⁴¹ However, the unofficial English translation reads "The technology or equipment contributed by any foreign participant as the investment shall be *truly advanced and appropriate to China's needs*."²⁴² There is meaningful difference between "advanced and truly appropriate to China's needs" and "truly advanced and appropriate to China's needs." The former means that the technology is advanced in comparison with the existing standard in China and is truly appropriate to Chinese needs. The latter means that the technology must be truly advanced by world standards and appropriate to China's needs. This interpretation is supported by the rules of Chinese grammar.²⁴³ From this observation, the technology mentioned in the Law of Joint Ventures can be classified into the following categories:

(a) *Advanced technology by world standards*. "A joint venture that is equipped with up-to-date technology by world standards may apply for a reduction of or exemption from income tax for the first two to three profit-making years."²⁴⁴ It should be noted that "up-to-date technology" should be translated as "advanced technology" in order to obtain uniformity with "advanced technology" in Article 5, paragraph 2 because both come from the phrase "Hsien-Ching-Chi-Su."²⁴⁵ Only if the technology is advanced by world standards can it be called "truly advanced technology." If China accepts only truly advanced technology by world standards, then the provision in Article 5, paragraph 2 will not only be meaningless as a duplication of Article 7, paragraph 2, but it will also be unrealistic.²⁴⁶

(b) *Advanced technology which is appropriate to China's needs*.

241. Cf. the Chinese version in *supra* note 191, at art. 5, para. 2.

242. Cf. the English version in *supra* note 191, at art. 5, para. 2.

243. According to Chinese grammar, an adverb usually closely precedes its adjective. The word "truly" is an adverb, while the word "appropriate" is its adjective. In the Chinese version of the Law of Joint Ventures, "appropriate" is immediately preceded by "truly." Therefore, a precise English translation should read as "truly appropriate," not "truly advanced."

244. LAW OF JOINT VENTURES, *supra* note 191, at art. 7, para. 2.

245. See *supra* note 193, in the Chinese version.

246. Cohen & Nee, *Joint Ventures: Behind the Headlines*, Asian Wall Street Journal, July 24, 1979, Part II, at 4.

China will only accept advanced technology and equipment which is truly appropriate to their needs.²⁴⁷ The technology and equipment under this category may not necessarily enjoy the reduction or exemption from income tax as provided in Article 7, paragraph 2, since advanced technology which is truly appropriate to China's needs is not necessarily advanced technology by world standards. Professor Cohen felt:

It would be sensible for them [China] to recognize that in some circumstances it may be appropriate to China's needs not to have up-to-date technology by world standards so long as the technology is sufficiently advanced to be suitable for the joint venture and is acquired with open eyes and at a proper valuation. In these circumstances there is no deception but only mutual benefit.²⁴⁸

It seems that China would have noticed that the criterion for "advanced technology which is truly appropriate to China's needs" should be different to that of "advanced technology by world standards." Had Professor Cohen known the translation discrepancy in the paragraph, he would not have worried about the implementation of Article 5, paragraph 2.

(c) *Outdated technology and equipment.* "In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation shall be paid for the losses."²⁴⁹ Thus, the foreign participant is held responsible only for compensation when he conforms to the two requirements simultaneously. First, the foreign participant must possess malicious intention to deceive; and second, the technology or equipment must be outdated from the viewpoint of the standard of existing Chinese technology.²⁵⁰

Since the paragraph is aimed at protecting the interests of China,²⁵¹ the compensation clause appears designed to protect against a breach by the foreign participant. It is not clear whether this compensation provision applies to the Chinese participant when the technology and equipment provided by the Chinese participant is outdated and full disclosure is not made. A similar compensation clause should be inserted against the Chinese participant

247. LAW OF JOINT VENTURES, *supra* note 191, at art. 5, para. 1 (in the Chinese version).

248. Cohen & Nee, *supra* note 246.

249. LAW OF JOINT VENTURES, *supra* note 191, at art. 5, para. 2.

250. *Id.*

251. *Id.*

to insure the principle of equality as provided in the Law of Joint Ventures.²⁵²

9. *Personnel management of the joint venture.* According to the Law of Joint Ventures, the chairman of the board of directors shall be appointed by the Chinese participant.²⁵³ Since China's corporation law has not yet been promulgated, the authority of the chairman of the board of directors is not clear. Because the chairman may only be removed by the Chinese participant,²⁵⁴ it is of vital importance to define the scope of the chairman's authority in order to protect the interests of the foreign participant.

Chinese officials indicated that "the Chinese partner will retain the overall veto right through the chairmanship of every board of directors."²⁵⁵ This may frighten away many foreign investors. China will not want this to happen as they are short of investment funds and need foreign investment.²⁵⁶ Furthermore, Vice Premier Deng Xiao-ping told an American congressional delegation in April, 1979, that China will do whatever is necessary to attract foreign investment.²⁵⁷ The granting of an overall veto right to the chairman of the board of directors is impractical, and violates the basic principles of equality and mutual benefit of the Law of Joint Ventures.²⁵⁸

The foreign participant is allowed to appoint one or two vice-chairmen to the board of directors.²⁵⁹ Since the vice-chairman is considered the highest ranking official of the foreign participant, his function, duty, and relationship with the Chinese chairman will be a crucial item during the negotiation of the joint venture agreement.

The president, vice president, chief engineer, treasurer, and auditor shall be appointed or hired by the board of directors.²⁶⁰ Paragraph 3 of Article 6 reads: "The president and the vice-president shall be chosen from various parties to the joint venture, respec-

252. LAW OF JOINT VENTURES, *supra* note 191, at art. 1.

253. *Id.* at art. 6, para. 1.

254. *Id.*

255. Lederer, *supra* note 225, at 3.

256. Pura, *China May Allow Foreign Ventures Freedom to Tap Domestic Market*, Asian Wall Street Journal, Oct. 29, 1980, 1 & 4, col. 1.

257. Deng, Xiao-ping, *quoted in* Cohen & Nee, *supra* note 246, Asian Wall Street Journal, July 21, 1979, Part I, at 4.

258. LAW OF JOINT VENTURES, *supra* note 191, at art. 1.

259. *Id.* at art. 6, para. 1.

260. *Id.* at para. 2.

tively.”²⁶¹ This means that if the president is appointed by the foreign participant, the vice-president will be appointed by the Chinese participant, and vice-versa.

Workers and staff members of the joint venture can be hired and discharged by the personnel office of the joint venture in accordance with the procedures agreed to in the joint venture agreement and the Chinese laws concerning labor matters.²⁶²

10. *Formula to determine net profit; income tax determination.* Article 4 provides that the profits, risks, and losses of a joint venture shall be shared by the parties in proportion to their contribution of registered capital.²⁶³ The formula for determining the net profit is clearly stated in the Chinese text,²⁶⁴ however, the unofficial English translation makes two interpretations possible. With regard to the formula for determining net profits, Kevin Maher has proposed the following possible formulas:

- (a) Gross profit-(Gross profit × tax rate)-deductions=Net profit;
- (b) Gross profit-(gross profit-deductions) × tax rate-deductions=Net profit.²⁶⁵

For the foreign participant, the latter formula is more favorable.²⁶⁶ Professor Cohen was led to believe that China had adopted the latter formula which was considered an incentive to include expansion funds as a tax deductible item which must come out of after-tax retained earnings in the normal procedures of the West.²⁶⁷ However, the Chinese language text has clearly chosen the first formula. The preciseness of the unofficial English translation would be greatly improved if the wording “. . . and after the deductions therefrom . . .” were changed to “. . . and then the deductions therefrom . . .”²⁶⁸ A more detailed formula for calculating taxable income has been designed for industry, commerce, services, and other sectors.²⁶⁹ Many predictions have been

261. *Id.* at para. 3.

262. *Id.* at para. 4.

263. *Id.* at art. 4, para. 3.

264. *Id.* at art. 7, para. 1.

265. MAHER, COMMERCIAL TRANSACTIONS AND INVESTMENT IN THE PEOPLE'S REPUBLIC OF CHINA: A GUIDE TO THE CURRENT LEGAL ENVIRONMENT 21 (1979).

266. See Cohen & Nee, *supra* note 246, at 4.

267. *Id.*

268. LAW OF JOINT VENTURES, *supra* note 191 at art 7, para. 1 (in Chinese).

269. Detailed Rules and Regulations for the Implementation of the Income Tax Law Concerning Joint Ventures with Chinese and Foreign Investment, *supra* note 5, at art. 8.

made as to the possible income tax rate, ranging from thirty to forty percent.²⁷⁰ However, in accordance with the tax laws unveiled at China's National People's Congress profits will be taxed at thirty-three percent a year, including ten percent levied by state and local authorities. An additional ten percent tax will be imposed upon the profit amount to be remitted outside China.²⁷¹

A joint venture equipped with up-to-date or advanced technology by world standards is entitled to apply for a reduction or exemption of income tax for the first two to three profit-making years.²⁷² This incentive is very practical for the foreign participant. The newly drafted tax laws provide more incentive to joint ventures. A joint venture scheduled to operate for ten or more years may enjoy a tax holiday in the first profit-making year and may be given a fifty percent reduction in the second and third years.²⁷³ Furthermore, joint ventures engaged in farming and forestry or in remote areas may be allowed a fifteen to thirty percent tax reduction for an added ten years.²⁷⁴ Ten percent of the local surtax may be exempted or reduced by the local authorities.²⁷⁵ It is not unusual for less developed countries to offer a tax holiday for longer than three years. However, most income tax holidays start on the date of first sale, such as the five-year income holiday offered by Taiwan to noncapital-intensive and nontechnology-intensive foreign investments.²⁷⁶ Taiwan's five-year income holidays from the date of first sale may turn out to be much shorter than China's two or three-year income tax holidays which start from the first profit-making year. Article 7 allows the foreign participant who has reinvested profits in China for at least five years to apply for forty percent rebates on income tax paid on profits.²⁷⁷

11. *Insurance Requirements.* The joint venture is required to purchase insurance programs from local insurance companies.²⁷⁸ In November, 1979, a precedent-setting event was successfully car-

270. Lederer, *supra* note 225, at 3.

271. Ching, *China Unveils Legislation Requiring Tax Rate of 33% on Joint Ventures*, Asian Wall Street Journal, September 4, 1980, at 1, col. 3. See also Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, September 3, 1980, at L5.

272. LAW OF JOINT VENTURES, *supra* note 191, at art 7, para. 2.

273. Ching, *supra* note 271.

274. *Id.*

275. *Supra* note 269, at art. 3, para. 2.

276. SEI, *supra* note 5, at art. 6.

277. See *supra* note 269, at art. 6.

278. LAW OF JOINT VENTURES, *supra* note 191, at art. 8, para. 4.

ried out by the People's Insurance Company of China. The company provided insurance against political incidents threatening the joint venture between the Chrysoberyl River Development, Ltd., a newly formed Hong Kong real estate firm, and the Dong Shan housing authority of Canton. The joint venture was formed to build a huge residential complex in the Dong Shan suburb. Under the insurance policy, Chrysoberyl would be compensated for delays caused by war, riots, political demonstrations, or other disruptive events such as labor strife that could disrupt construction.²⁷⁹

12. *Foreign Loan Privileges.* The joint venture is authorized to obtain funds from foreign banks directly for its business operations.²⁸⁰ The Foreign Exchange Regulations authorize provinces and municipalities to borrow foreign funds subject to the approval of the State Council.²⁸¹ The joint venture can, like the Bank of China, borrow from foreign banks. However, since funds from foreign banks are considered foreign exchange, compliance with the procedures established by the Foreign Exchange Regulations will be required.²⁸²

The following earnings and funds may be repatriated out of China according to the provisions of Articles 10 and 11.²⁸³

(1) The foreign participant's net profit after fulfilling all obligations under the pertinent laws and the agreement;

(2) The foreign participant's contribution and other funds derived at the expiration of the joint venture's tenure, or the termination of the joint venture project;

(3) A foreign worker or staff member's after-tax earnings such as wages, salaries or other legitimate income which may include the funds from disposition of his personal property in the local market before leaving China. This allowance will give added convenience to personnel of the joint venture. Imported goods, however, can be sold only to designated stores.²⁸⁴ Repatriation must be conducted through the Bank of China in accordance with

279. Kulkarni, *China Firms Safeguards for Foreign Ventures*, Christian Science Monitor, Nov. 28, 1979, at 15.

280. LAW OF JOINT VENTURES, *supra* note 191, at art. 8, para. 3.

281. Provisional Regulations for Foreign Exchange Control, *supra* note 5, at art. 8.

282. LAW OF JOINT VENTURES, *supra* note 191, at art. 8, para. 2.

283. *Id.* at arts. 10-11.

284. Provisional Regulations on the Control of Resident Presentative Offices of Foreign Enterprises in China, promulgated on Oct. 3, 1980, at art. 10.

the foreign exchange regulations.²⁸⁵

The foreign exchange to be repatriated by the foreign participant must be the same currency as mentioned in the joint venture agreement.²⁸⁶ However, foreign currency to be repatriated by the foreign worker or staff member may be any form of foreign currency. Due to the lack of foreign currency in China, the Regulations of Foreign Exchange provide that Foreign investors may repatriate net profits or foreign exchange capital by debiting their foreign exchange account with the Bank of China.²⁸⁷ The same regulations are silent in regards to foreign partners repatriating profits when their foreign exchange accounts lack sufficient foreign currency. In order to have enough foreign currency to repatriate profits, foreign investors have to aim at overseas markets. Moreover, to discourage repatriation of profit by the foreign participant, China has instituted a ten percent tax on any after-tax profits repatriated.²⁸⁸ In addition, foreigners employed by joint ventures may not repatriate more than fifty percent of their after-tax net wages and other legitimate earnings in foreign currency.²⁸⁹

Article 9, paragraph 3 permits a joint venture to distribute its products in China, thus providing foreign investors with access to a market of one billion people. This should allow China to retain foreign currency that would otherwise be spent on importation of the foreign goods. In the meantime, China encourages joint ventures to export goods in order to earn foreign currency²⁹⁰ and establish an outlet for its products through foreign trade establishments or affiliated agencies.

13. *Conversion of the joint venture into a state enterprise.* The ultimate goal of the Law of Joint Ventures is to foster domestic industry and develop local technology.²⁹¹ Consistent with this goal, China might eventually convert joint ventures into state enterprises. There are several methods available to achieve this conversion.

First, since the joint venture agreement automatically ceases at

285. LAW OF JOINT VENTURES, *supra* note 191, at art. 10, para. 1.

286. *Id.*

287. Provisional Regulations of Foreign Exchange Control, *supra* note 5, at art. 24.

288. Detailed Rules and Regulations for the Implementation of the Income Tax Law Concerning Joint Ventures, *supra* note 5, at art. 4.

289. Provisional Regulations of Foreign Exchange Control, *supra* note 5, at art. 25.

290. Law of Joint Ventures, *supra* note 5, at art. 9, para. 3.

291. See the explanation given by Peng Zhen on June 26, 1979, at the Second Plenary Session of the Fifth National People's Congress on the Law of Joint Ventures, *supra* note 191, at 1.

the expiration of tenure,²⁹² it would be possible to return the foreign participant's capital allowing the state to assume ownership. This could also be accomplished by transferring the foreign participant's share to the Chinese participant.²⁹³ In addition, Article 13 provides that in the event of heavy losses, the failure of any party to fulfill their obligations under the joint venture agreement or *force majeure* may be the basis for termination of the agreement before its expiration date by agreement of both parties together with the approval of the Foreign Investment Control Commission. This will result in the joint venture becoming a state enterprise. However, if a party is found at fault for this termination it will be held liable for damages.

14. *Settlement of disputes within the joint venture.* Article 14 provides for conciliation and arbitration as a means of dispute settlement. If there isn't an agreement between the parties concerning the selection of an arbitral body, China's arbitral body will preside over the case.²⁹⁴ Thus, it is wise to incorporate a clause into the joint venture agreement establishing an arbitral body in a third country.

It is not clear whether a party can seek legal remedies other than settlement through conciliation or arbitration. However, a joint venture agreement signed in March of 1980, between the China Construction Machinery Corp., the Schindler Holdings A.G., a Swiss firm and the Jardine Schindler (Far East) Holdings, S.A., incorporated a special clause providing that in the event of litigation between the participants, the defendant would have a right to seek hearings in its country of incorporation.²⁹⁵

15. *Effective date of the Law of Joint Ventures.* Article 15 provides that the Law of Joint Ventures became effective on the date of promulgation.²⁹⁶ Any joint venture agreement signed before that date will be governed by the provisions of that joint venture agreement.²⁹⁷ Any joint venture agreement signed before

292. Law of Joint Ventures, *supra* note 5, at art. 12.

293. *Id.* at art. 4, para. 4.

294. *Id.* at art. 14.

295. Leung, *China Venture With Swiss, Jardine Suggests Terms of Deals to Come*, Asian Wall Street Journal, March 28, 1980, at 3.

296. The Law of Joint Ventures was promulgated on July 8, 1979, and became effective as of July 8, 1979 according to article 15.

297. A Foreign Investment Control Commission official stated that the joint venture agreement approved by the Foreign Investment Control Commission would have the force

July 8, 1979, may be modified by mutual consent of the parties in order to obtain the benefits of the Law of Joint Ventures.²⁹⁸

B. Legal Structure Embodied in the Regulations on Special Economic Zones in Guangdong Province

One of the primary ways less developed countries attract foreign investment, acquire foreign currency from exports, and develop a skilled labor force is through the establishment of a "free zone."²⁹⁹ The Law of Joint Ventures did not include a provision for a "free zone." However, after passage of the Law of Joint Ventures, China enacted the Regulations on Special Economic Zones in Guangdong Province³⁰⁰ governing the "special economic zones" in areas of Shenzhen, Zhuhai, and Shantou. Since these three areas are close to Hong Kong across the South China Sea, it was felt that favorable and comprehensive rules similar to a "free zone" were necessary to compete with Hong Kong. Though these regulations only apply to the areas mentioned, they are indicative of China's future policy decisions concerning foreign investment.

The regulations governing the enterprises in the "special economic zones" have some key elements that merit attention. First, unlike the Law of Joint Ventures, foreign investors are free to establish a wholly owned enterprise or form a joint venture with the Chinese side.³⁰¹ Second, consistent with free zone concepts, all raw material, machinery equipment, spare parts, transport vehicles, and other items needed by the enterprises for production can be imported duty free.³⁰² Third, foreign investors are free to engage in any kind of business which is of interest to both sides, although they are encouraged to invest in the fields of industry, agriculture, animal husbandry, breeding, tourism, housing and other construc-

of law, even if its provisions conflicted with subsequent legislation. See Lambert, *supra* note 188, at col. 3.

298. This follows from the general principle that a law does not have retroactive effect if the application of the law would adversely affect a prior transaction. If the subsequent law benefits the previous transaction, and both parties agree to apply the subsequent law, then the parties should be allowed to modify the contract, subject to the approval of the Foreign Investment Control Commission.

299. For example, Taiwan has established four "free zones" including the Kaohsiung Export Processing Zone, the Nantze Export Processing Zone, the Taichung Export Processing Zone, and the Hsin Chu Industrial Park. See notes 182-87 *supra*.

300. Regulations on Special Economic Zones in Guangdong, *supra* note 5, at L10.

301. *Id.* at art. 1, para. 2.

302. *Id.* at art. 13.

tion work, advanced technological research, and manufacturing.³⁰³

In addition to establishing general provisions for registration of business entities,³⁰⁴ the regulations allow foreign investors a good deal of autonomy in personnel management. For instance, the enterprises are free to hire foreign employees for technical and management work.³⁰⁵ The enterprises are also allowed to hire local employees directly from the labor market with the permission from the local authority concerned, or through the introduction of labor service companies after testing and evaluation by the enterprises.³⁰⁶ Local employees working in the enterprises are not entitled to the benefits provided in state enterprises. To remedy this, the regulations require that employment contracts be signed between the enterprises and local employees stipulating wage level and structure, methods of reward, insurance, and state subsidies in accordance with the regulations prescribed by the authority-in-charge.³⁰⁷ It is said that a ten percent addition to the wage bill of individuals will be required for welfare funds and medical benefits.³⁰⁸

Further benefits include a guarantee of low overhead. The government will provide the land, water supply, drainage, electric power, roads, docks, communications, warehouses, and other public facilities in the special economic zones with reasonable charges.³⁰⁹ It is reported that the charge for water in China is twenty percent less than Hong Kong.³¹⁰ The enterprises are also allowed to maintain a foreign currency account in banks established in the special economic zones. This will insure the unrestricted inflow of currency and expedite repatriation of money in accordance with the newly published Regulations of Foreign Exchange Control.³¹¹ The regulations also provide simplified exit and entry procedures to foreign employees working for the enterprises.³¹²

Perhaps the most important provision in the Regulations of Special Economic Zones is the income tax incentive provision. The

303. *Id.* at art. 4.

304. *Id.* at art. 7.

305. *Id.* at L10, art. 10.

306. *Id.* at L11, art. 19.

307. *Id.* at art. 21.

308. Cohen, *A Year of High Adventure in Coming Joint Venture*, FAR EAST. ECON REV., at 44 (March 7, 1980).

309. *Supra* note 300, at L10, arts. 5 & 12.

310. Cohen, *supra* note 308, at 45.

311. *Supra* note 300, at L10 & 11, arts. 8 & 15.

312. *Id.* at art. 18.

enterprises in the special economic zones enjoy a low income tax rate of fifteen percent levied on profits.³¹³ This stands in contrast to the thirty-three percent income tax rate for the joint ventures outside the special economic zones.³¹⁴ However, preferential income tax treatment will be given only to enterprises established within two years after the date of the regulations' enactment, or enterprises with an investment of at least five million United States dollars, or enterprises involving higher technologies, or having a longer cycle of capital turnover.³¹⁵ Additionally, enterprises which reinvest their profits in the special economic zones for a period of not less than five years may request a reduction or an exemption on profits thus reinvested.³¹⁶

By analogy, questions raised by the Law of Joint Ventures may be answered by reference to the Regulations on Special Economic Zones in Guangdong Province.³¹⁷ However, one should bear in mind that these regulations are experimental and subject to future evaluation. Nevertheless, the emerging legal framework of foreign investment has gained more definition following the adoption of the Regulations on Special Economic Zones in Guangdong Province and other pertinent regulations.³¹⁸

VI. COMPARATIVE EVALUATIONS OF FOREIGN INVESTMENT CLIMATES IN TAIWAN AND CHINA

Before deciding where to invest, foreign investors usually conduct an investigation into the foreign investment climate of the host country.³¹⁹ To determine whether the foreign investment climate of a host country is favorable or unfavorable, the establishment of a legal framework for foreign investment is crucial. However, even more important than the legal framework are other factors which affect the successful operation of the foreign investment projects.³²⁰

313. *Id.* at art. 14.

314. Ching, *supra* note 271.

315. *Supra* note 300, at L10, art. 14.

316. *Id.* at art. 16.

317. *See generally* note 300 *supra*.

318. *See generally* note 5 *supra*.

319. Investment climate denotes all the factors which may affect the proposed investment. Those factors include, but are not limited to, the legal framework, foreign currency reserve, quality of manpower, basic infrastructure, and the general attitude of the host government. *See* CHEN, *supra* note 29 at 19; *see also* A. FATOUROS, GOVERNMENT GUARANTEES TO FOREIGN INVESTORS 34 (1962).

320. The legal framework can be completed within a rather short period of time by adopting the laws and regulations from other countries. In the case of China, they can adopt

The following comparison examines the foreign investment climates of China and Taiwan.

A. Legal Framework

Taiwan has been open to foreign investment for over twenty-five years. During that time the government has tried its best to guide foreign investment by enacting laws and regulations that both government administrative agencies and foreign investors can mold into a well established legal framework for foreign investment.³²¹ Similarly, China, in addition to the promulgation of the Law of Joint Ventures, has shown a determination to encourage joint ventures by enacting a series of new laws on corporate and personal income taxes,³²² regulations on special economic zones,³²³ and regulations regarding foreign currency control.³²⁴ These enactments have removed one of the major obstacles to foreign investment in China.³²⁵ However, potential foreign investors are still waiting for more laws and regulations. Peng Zhen, Vice-Chairman of the Standing Committee of the National People's Congress, stated that China lacks experience in economics; the formulation of economic laws and regulations requires time and should be done on the basis of experience.³²⁶ There is every indication that the Chinese government is still working hard on clarifying investment policies. It is estimated that more than seventy laws and regulations concerning economics and other areas have been drafted or enacted since 1979.³²⁷

B. Foreign Currency Reserve

It is very important for foreign investors to be able to repatriate their profits and other interests in hard currency.³²⁸ However,

the laws and regulations of Taiwan without encountering too much difficulty because both share the same history, philosophy and language. However, factors of investment climate other than the legal framework will usually take a long time to improve.

321. A mutual confidence has been established between foreign investors and the host government through the legal framework in the course of time.

322. Law of Joint Ventures, *supra* note 5.

323. *Id.*

324. *Id.*

325. Pura, *supra* note 256, at 1, col. 3.

326. Xinhua, *Economic Legislation*, FOREIGN BROADCAST INFORMATION SERVICE, Sept. 2, 1980, at L34.

327. *Id.*

328. The ability to repatriate is the "transferability" embodied in the basic elements of the incentive packages, *see* CHEN, *supra* note 29. The International Monetary Fund (IMF)

host countries are not able to satisfy this need when there is a shortage of hard currency. This problem does not exist for the foreign investor in Taiwan because the government has a seven billion dollar foreign exchange cushion.³²⁹

Unlike Taiwan, China has consistently suffered serious problems with their balance of payments.³³⁰ This situation should grow worse as China starts importing foreign equipment and technology on a large scale. Lord Shawcross, an advisor to Morgan Guaranty Trust Co., New York, stated that "China's policy of paying for imports with hard currency is no longer possible."³³¹ Legal experts also anticipated this problem and suggested that "foreign participants may agree to accept its equivalent in Chinese raw materials or other items that can be sold abroad."³³² Due to a lack of foreign exchange, China is conducting its foreign trade by the following methods:

1. *Compensation trade*. Under compensation trade, China's purchase of capital equipment is offset by the exchange of a specific product, not by cash.³³³ This is accomplished in one of three ways:

a. Direct product compensation, which refers to paying for the imported equipment with products manufactured directly with the equipment;³³⁴

b. Indirect or mixed product compensation, which refers to paying with goods or commodities wholly or partially produced with equipment other than the imported equipment,³³⁵

c. Raw materials and other natural compensation which refers to paying with raw materials or other natural resources such as coal, crude oil, and nonferrous metals.³³⁶

allows its members to impose restrictions upon the transfer of the invested capital, but requires its members to avoid imposing restrictions on the transfer of profits. Aufricht, *Exchange Restrictions Under the Fund Agreement*, 2 J. WORLD TRADE L. 297 (1968).

329. Rowan, *Taiwan Gears Up to Go It Alone*, FORTUNE, Feb. 12, 1979, at 72.

330. Ching, *China Posts \$11 Billion Deficit for 1979*, Asian Wall Street Journal, Sept. 2, 1980, at 1, col. 2.

331. Fungi, *China Aide Stresses Joint Venture Safety*, Asian Wall Street Journal, Dec. 4, 1979, at 4.

332. Cohen & Nee, *supra* note 190, at 4.

333. Cohen & Nee, *China: All About Compensation Trade*, Asian Wall Street Journal, July 4, 1979, at 4, col. 1.

334. *Id.*

335. *Id.*

336. Zhang, *Sketches Rules for Doing Business with China*, Christian Science Monitor, July 16, 1979, at 13.

2. *Processing operations.* This involves the importation of raw materials and packaging which the Chinese workers process for a fee. If any equipment is supplied by foreign partners, it will be paid for by subtracting its cost from the processing fees.³³⁷

3. *Assembly operations.* If a foreign businessman supplies all component parts for assembly in China, he may deduct its cost from the processing fee.³³⁸

4. *Cooperative production.* This refers to products manufactured from parts supplied by both Chinese factories and foreign businessmen. If any equipment is supplied by foreign businessmen, it will be paid for by products, deducting the cost of labor and the parts.³³⁹

5. *Installment payments.* Chinese purchase of equipment will be paid by installment because "payment at one time would be difficult."³⁴⁰

Since China has a problem with hard currency, the foreign participant in the joint venture may be asked to change his repatriable profits into one of the aforesaid methods of repayment.³⁴¹ Also, in order to discourage the repatriation of the after-tax profit, China's recent income tax law on joint ventures adopted a ten percent tax on repatriated funds.³⁴² This charge constitutes a double tax on the repatriated profits.³⁴³

C. *Quality of Manpower*

Labor in Taiwan is no longer inexpensive as evidenced by the fact the the per capita Gross National Product (GNP) in 1978 was \$1,304.³⁴⁴ It is expected that the per capita GNP will jump to \$2,126 in 1980.³⁴⁵ Compulsory education has been extended from

337. MAHER, *supra* note 265, at 6.

338. *Id.*

339. Zhang, *supra* note 336, at 13.

340. *Id.*

341. See note 332 *supra* and accompanying text.

342. See note 288 *supra*.

343. Leung, *supra* note 295, at 3.

344. Wei, *Brief Report on the ROC's Economic Development*, THE INDUSTRIAL INVESTMENT BRIEF CIRCULAR, INDUSTRIAL DEVELOPMENT AND INVESTMENT CENTER, at 5 (December 31, 1979) (in Chinese).

345. *Taiwan Industrial Panorama*, INDUSTRIAL DEVELOPMENT AND INVESTMENT CENTER, at 1 (February 1, 1980).

six to nine years since 1968, and the school attendance rate for children ranging from six to twelve years old reached 99.6 percent. There is virtually no illiteracy among the nation's youth.³⁴⁶ Seven percent of all former students have completed a college education, and one-third of all college students major in science or engineering.³⁴⁷ About 4,000 college graduates continue their advanced education abroad each year.³⁴⁸ Foreign investors will discover that laborers can be easily trained to become skilled workers.

Undeniably, China has one of the cheapest labor forces in the world. Among more than one hundred fifty nations and territories, the per capita GNP in China ranks forty-ninth from the bottom.³⁴⁹ China's per capita GNP was around \$240 in US currency 1979.³⁵⁰ Generally speaking, communist countries pay special attention to education. However, China had endured the "Cultural Revolution" for as long as ten years, from 1966 to 1976, during which time all schools were closed.³⁵¹ This ten year gap in education will definitely affect the short term quality of the manpower in China.

China still remains attractive to labor-intensive industries because of its cheap labor and endless supply of manpower.³⁵² Although China has inexpensive labor, foreign investors will be limited in their ability to take advantage of it because China may fix the wages of workers in joint ventures and foreign-owned enterprises.³⁵³ For instance, the joint venture agreement recently signed between the China Construction Machinery Corp., Schindler Holdings A.G. and Jardine Schindler (Far East) Holdings S.A. provided that several thousand workers would be paid at about fifteen percent less than those of their counterparts in Hong Kong.³⁵⁴ Since the wage rate in Hong Kong is considered very high in Asia, eighty-five percent of the Hong Kong wage is considerably higher than

346. *Supra* note 344, at 5.

347. *Id.*

348. *Id.*

349. Beijing Ribao, *How Should We Understand the Concept of an Average of \$1,000 per capita GNP by the End of Century?*, FOREIGN BROADCAST INFORMATION SERVICE, Nov. 17, 1980, at L24.

350. *Id.*; Per Capita GNP in China was \$155 in 1975, \$152 in 1976, \$171 in 1977, \$208 in 1978, and approximately \$240 in 1979.

351. *See* note 38 *supra*.

352. Xinhua, *Growth Experienced in Labor-Intensive Industries*, FOREIGN BROADCAST INFORMATION SERVICE, Nov. 14, 1980, at L23-L24.

353. *See* Regulations on Special Economic Zones in Guangdong, *supra* note 5, at L11, art. 21; and Leung, *supra* note 295, at 3.

354. *Id.*

many Asian countries.³⁵⁵

D. Basic Infrastructure

During the "Energy Crisis," private industries and businesses in Taiwan were seriously damaged and unemployment soared.³⁵⁶ Then, in 1974, the Taiwan government decided to spend seven billion dollars to start the "Ten Major Construction Projects,"³⁵⁷ with the goal of creating jobs and providing business opportunities for the seriously damaged local industries. By the end of 1979, all ten projects had been completed. Seven of the Ten Major Construction Projects are related to the basic infrastructure, including the construction of Taichung Harbor and Shao Harbor which were completed in April, 1979; the construction of the North-South Freeway which was completed in October of 1978; the construction of Chiang Kai-shek International Airport which was completed in February of 1979; the construction of two nuclear power plants which started operation in 1977 and 1978, respectively; the electrification of the railway and the construction of the North Ring Railway completed in the end of 1979.³⁵⁸ An ample supply of power, a sufficient supply of water, free access to highways and railways, modern port facilities, efficient air cargo and passenger service together with the development of many industrial zones in every county, including the Hsin Chu Science Industrial Park, have greatly improved the investment climate in Taiwan, insuring the successful operation of the foreign investment project.³⁵⁹

The pace of the construction of the basic infrastructure in China was hampered by the "Great Jump Forward"³⁶⁰ in 1958-60 and the "Cultural Revolution"³⁶¹ in 1966-76. An expert in Chinese trade pointed out: "Inadequate port facilities and inland transportation will lead to delays." These delays, in turn, might well cause trade financing problems.³⁶² Another scholar spoke of the insufficient supply of electrical power, stating: "It also should be pointed

355. Hong Kong's per capita GNP was \$2,620 in 1977. It ranks third in all countries and areas in Asia, *see supra* note 64, at 100.

356. Sun, *Looking Back the Achievement made on Taiwan's Economy*, 9 CHINA TRIBUNAL (1979) (in Chinese).

357. *See supra* notes 23 & 24.

358. *Id.*

359. *Id.*

360. BRETH, MAO'S CHINA: A STUDY OF SOCIALIST ECONOMIC DEVELOPMENT 45-67 (1977).

361. *Supra* note 38.

362. McCue, *supra* note 195, at 3.

out that China's conspicuous backwardness in securing electric power has been a major bottleneck in propelling various industrial projects."³⁶³ To improve the investment climate, China must place more emphasis on the basic infrastructure in order to attract foreign investors and further the goal of modernization.

E. Government Policy Toward Foreign Investment

The Taiwan government has encountered numerous diplomatic setbacks since it withdrew from the United Nations.³⁶⁴ In December, 1978, the United States accepted the "three conditions of the normalization" requested by the Chinese; first, withdrawal of United States troops stationed in Taiwan; second, severance of its diplomatic relationship with Taiwan; and third, termination of its mutual defense treaty with Taiwan.³⁶⁵ Since the severing of diplomatic relations with the United States, Taiwan has concentrated its efforts on developing economic relations with countries with which it has not had diplomatic relations. Foreign investment is one of the best means of developing this kind of relationship. Due to this motivation, Taiwan has become more lenient toward foreign investment. At the same time, positive efforts have been made to attract potential investors by educating them as to the investment climate in Taiwan.³⁶⁶ Taiwan's friendly attitude toward foreign investment will most likely remain unchanged for years to come.³⁶⁷ However, since labor in Taiwan is no longer inexpensive when compared with neighboring areas, Taiwan is currently offering special incentives to foreign investors for their technology and capital-

363. Uchiyama, *The Present and Future of Economic Cooperation between Japan and the PRC*, Asian Wall Street Journal, March 21, 1980, at 10.

364. Taiwan was the one of the founding members of the United Nations, and one of the permanent members of the Security Council. Due to the entry of China, Taiwan withdrew from the United Nations in 1971.

365. Ying, *U. S. and China Usher in a New Political Era, Leaving Clouds of Uncertainty Over Taiwan*, Asian Wall Street Journal, Dec. 18, 1978, at 12, col. 1.

366. The Industrial Development & Investment Center (IDIC), established in December, 1959, has served as a bridge between prospective foreign investors and local government agencies by rendering prompt and free services such as providing information on the investment climate, assistance in finding joint venture partners, assistance in filing applications, improvement of business operation and plant expansion. IDIC's address is 6th Floor, 66 Sungchiang Road, Taipei, Taiwan, Republic of China, cable: INVEST, tel: 5717121/8. See *IDIC Stands for Services to Investors in Taiwan*, ROC, (June 1979).

367. Clark, *Interview with Taiwan's President*, TIME, May 28, 1979, at 24; see also Keatley & Ying, *Premier Sun: Defining a Role for Taiwan in the 1980's*, Asian Wall Street Journal, April 25, 1980, at 4, col. 1.

intensive industry projects.³⁶⁸

Since China needs considerable amounts of hard currency to complete its plan of "four modernizations,"³⁶⁹ foreign investment appears necessary. China is therefore expected to act favorably toward foreign investment. Due to a lack of experience in handling foreign investment, it will take some time before China learns to deal with foreign investors.

F. *Most Favored Nation Status*

Taiwan is party to a trade agreement with the United States.³⁷⁰ As a result of this agreement, investment by United States citizens in Taiwan can be insured by the United States Overseas Private Investment Corporation (OPIC).³⁷¹ Taiwan is also the beneficiary of a most-favored-nation status,³⁷² which provides that products manufactured in Taiwan may enjoy favorable tariff treatment. Further, United States companies may apply to the Export-Import Bank to extend credit and loan guarantees to Taiwan to finance purchases from the United States.³⁷³ As a result of this trade agree-

368. *Id.*; see also SEI, *supra* note 5.

369. Kramer, *China Hints at Lowering Tax on Foreign Investment Profit*, Asian Wall Street Journal, Oct. 10, 1980, at 3, col. 2.

370. The Treaty of Friendship, Commerce and Navigation between the United States and the Republic of China (Taiwan) was entered into November 4, 1946. This treaty grants the most-favored-nation treatment to the nationals of both countries in trade and commerce, see articles 2 and 16 of the treaty, 63 Stat. 1301, 81st Cong. 1st Sess. (1949). After the United States recognized Communist China in 1978, the Taiwan Relations Act, 22 U.S.C.A. §§ 3301 — 3316 (West Supp. 1980), was promulgated and became effective as of January 1, 1979. According to Section 3303 (c), for all purposes the United States approved the continuation in force of all treaties and other international agreements entered into between two countries prior to January 1, 1979, unless and until terminated. Since the treaty has not been terminated, nationals of both countries still enjoy the most-favored-nation treatment in the field of trade and commerce.

371. The Overseas Private Investment Corporation (OPIC) was established under 22 U.S.C. § 1933 (1958). Taiwan signed an agreement of investment guarantees with the United States on June 25, 1952, as amended on December 30, 1963, in which investment guarantees may be given by the United States for investments in Taiwan, 14 U.S.C. § 2222 (1978). The Taiwan Relations Act, *supra* § 3304 further provides that though per capita income in Taiwan is only slightly over \$1000 in United States currency shall not affect the activities of the Overseas Private Investment Corporation in determining whether to provide any insurance, reinsurance, loans or guarantees with respect to investment projects in Taiwan.

372. Treaty of Friendship, Commerce and Navigation, see *supra* note 370, at § 1311, art. 16, para. 1.

373. The Export-Import Bank of the United States was established in accordance with the 12 U.S.C. § 635 (West Supp. 1980) for the purpose of expanding exports of goods and related service by way of export financing. However, such export financing is subject to restrictions imposed by the Export-Import Bank Act. The Act prohibits Exim bank from participating in any transaction such as providing insurance or guaranty, or extending credit

ment, Taiwan has been able to attract United States investment, even though diplomatic relations have been severed between the nations.

Outside of their trade agreement with the United States, Taiwan has been relatively unsuccessful in negotiating further agreements.³⁷⁴ For example, no trade agreement exists between Taiwan and either the European Economic Community or Japan, although negotiations are under way.³⁷⁵ It is reported that Japan has offered to grant tariff benefits to products from Taiwan.³⁷⁶

China too has a trade agreement with the United States. This agreement was entered into on July 7, 1979, in Peking, and ratified by the United States Congress in January, 1980.³⁷⁷ In April, 1980, the Export-Import Bank was authorized to begin financing business in China.³⁷⁸ The OPIC provisions protecting investment from loss caused by war, insurrection, inconvertibility, or expropriation are also in effect.³⁷⁹ It thus becomes clear that China and Taiwan are in direct competition for United States investment.

China has had considerably more success in negotiating trade agreements with other nations than has Taiwan.³⁸⁰ For example, China signed a trade agreement with Japan on January 5, 1974, which granted China most-favored-nation status.³⁸¹ On February 16, 1978, China signed a "Long Term Trade Agreement" with Japan which is to last for eight years.³⁸² According to the terms of the agreement, during the first five years Japan will export seven to eight billion dollars worth of industrial plants and technology to

to any Communist country as defined in the Foreign Assistance Act 22 U.S.C. § 2370(f) (1978), or any country if the product to be financed is principally for use in a Communist country so defined. See 12 U.S.C. § 635(b-2), see also A HANDBOOK ON FINANCING U. S. EXPORTS, MACHINERY AND ALLIED PRODUCTS INSTITUTE (1978). Since Taiwan still enjoys the most-favored-nations treatment, exports to Taiwan are eligible for the programs provided by the Exim Bank.

374. Y. WEI, *supra* note 175, at 6.

375. *Id.*

376. *Id.*

377. *China Given Special Trade Status That U. S. Denies to Soviet Union*, Asian Wall Street Journal, Jan. 26, 1980 at 2.

378. McCue, *First U. S. Ex-Im Bank Financing for a China Project in Offer*, Asian Wall Street Journal, May 24, 1980, at 5.

379. *Business Insurance in China*, Asian Wall Street Journal, August 12, 1980, at 2. See also Ching, *U.S. Agency to Insure Investors In China Against Political Risks*, Asian Wall Street Journal, Oct. 9, 1980, at 1, col. 1.

380. Huang, *Ching-yuan, The Course of the PRC's Learning from the Economy of Taiwan* (in Chinese), World Daily News, Jan. 19, 1980, at 9.

381. *Id.*

382. *Id.*

China, with payment to be made in coal, crude oil, or by installment.³⁸³ Similarly a trade agreement was signed between China and the EEC in 1978 which granted most-favored-nation status and required the EEC to increase the items and quotas of products imported from China.³⁸⁴

Thus, China has created more favorable foreign trade opportunities than Taiwan. Taiwan has watched this development closely and urged its private traders and businessmen to take a serious attitude in dealing with potential economic competition from China.³⁸⁵

VII. CONCLUSION

In observing China's history before the death of Mao, it is apparent that China's economic development was fundamentally hindered by its lack of Western oriented law.³⁸⁶ Japan's ascension as the strongest power in Asia during the mid-nineteenth century took only thirty years and was greatly facilitated by the adoption of modern law.³⁸⁷ In that same period China languished under the Manchu dynasty as a "hypo-colony," largely due to the inability of its antiquated legal system to regulate foreign interests. Moreover, Taiwan's rapid economic development after World War II further demonstrates the utility of a modern system of law.

Eastern history has shown that the modernization of a country must include the modernization of its legal system, and China's recent practice evidences a recognition of this developmental concept. The new leaders in China have established its first criminal law and procedure codes.³⁸⁸ In addition, China is emphasizing the role of law in the plan of the "four modernizations."³⁸⁹ Those measures

383. *Id.*

384. *Id.*

385. See SEI, *supra* note 5 and accompanying text.

386. Li, *Reflections on the Current Drive Toward Greater Legalization in China*, reprinted in PRACTICING LAW INSTITUTE, A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 92-93 (Holtzmann & Surrey, eds. 1979).

387. See notes 60-63 *supra*.

388. Cohen & Gelatt, *supra* note 42 at 4.

389. For instance, the Provisional Regulations on Lawyers was adopted on August 26, 1980 and becomes effective on January 1, 1982. See Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, August 28, 1980, at L6-19. This regulation consists of twenty-one articles. Article 2 authorizes lawyers to defend criminal or civil cases, or engage in non-litigation business, such as providing legal assistance to the joint venture enterprises or the wholly foreign-owned enterprises. See also Gelatt, *Legal Profession and Lawyers Start to Reemerge in China*, Asian Wall Street Journal, Sept. 25, 1980, at 4, col. 2. In addition, there are 501 articles in the initial draft of the civil law and 167 articles in the initial draft of the civil

include reopening law schools, publishing law journals, popular dissemination of legal knowledge, law seminars, and enacting new laws.³⁹⁰ Therefore, the resort to negotiation to cope with problems encountered by joint ventures should be considered only as an expedient or transitional measure.

Although more than a year has passed since the Law of Joint Ventures was enacted, implementation rules and regulations still are not completed. The delay, however, may be nothing more than a reflection of careful, prudent drafting. The enactment of those rules and regulations will surely result in broad invitations to foreign investors.

Across a narrow sea, Taiwan continues to upgrade its industrial structure. As Taiwan develops a capital and technology intensive economy, there should not be any direct trade conflicts with China's developing a labor intensive economy.³⁹¹ If Taiwan and China are united into one nation, the prophesy that the twenty-first century will be for China may come true.

procedure law separately prepared by two groups set up in 1979. Furthermore, the nationality law, marriage law as well as the corporate law for stock owned companies are being drafted. *See* Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, Sept. 2, 1980, at L34-L36; *and* FOREIGN BROADCAST INFORMATION SERVICE, Nov. 13, 1980, at L5.

390. Gelatt, *China's Propaganda Machine Turns Attention to 'Legal Education,'* March 4, 1980, Asian Wall Street Journal, at 6, col. 1. *See also supra* note 34, at 83-84.

391. According to Xinhua, Communist China currently aims at developing labor-intensive industries which consume less raw materials and energy than capital-intensive or technology-intensive industries but employ more hands. *See supra* note 352, at L24.

APPENDIX A

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

Editor's Note: The following is an unofficial translation of the full text of the Law of the People's Republic of China on Joint Ventures using Chinese and Foreign Investment, which was adopted on July 1, 1979, at the second session of the Fifth National People's Congress and became effective on July 8, 1979 by the order of Ye Jianying, Chairman of the Standing Committee of the National People's Congress.

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

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

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

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

Article 4. A joint venture shall take the form of a Limited Liability Company.

* Reprinted from LAW OF PRC ON JOINT VENTURES USING CHINESE & FOREIGN INVESTMENT 18 (Wen Wei Po ed. 1979) [in Chinese and English].

In the registered capital of a joint venture, the proportion of the investment contributed by the Foreign Participant(s) shall in general not be less than 25 per cent.

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

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

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

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

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

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

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

The Board of Directors is empowered to discuss and take action on, pursuant to the provisions of the articles of association of the joint venture, all fundamental issues concerning the venture, namely, expansion projects, production and business programmes, the budget, distribution of profits, plans concerning manpower and

pay scales, the termination of business, the appointment or hiring of the President, the Vice-President(s), the Chief Engineer, the Treasurer and the Auditors as well as their functions and powers and their remuneration, etc..

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

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

Article 7. The net profit of a joint venture shall be distributed between the parties to the venture in proportion to their respective shares in the registered capital after the payment of a joint venture income tax on its gross profit pursuant to the tax laws of the People's Republic of China and after the deductions therefrom as stipulated in the articles of association of the venture for the reserve funds, the bonus and welfare funds for the workers and staff members and the expansion funds of the venture.

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

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

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

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

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

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

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

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

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

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

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

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

Article 11. The wages, salaries or other legitimate income earned by a foreign worker or staff member of a joint venture, after payment of the personal income tax under the tax laws of the People's Republic of China, may be remitted abroad through the Bank of China in accordance with the foreign exchange regulations.

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

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

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

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

EXPLANATION OF CHINA'S LAW ON JOINT VENTURES**

Editor's Note:

Peng Zhen, Director of the Legislative Affairs Commission, explained the seven drafts of laws proposed for examination on June 26th, 1979 at the Second Plenary Session of the Fifth National People's Congress. Excerpts explaining the draft of the "Law of the People's Republic of China on Joint Ventures using Chinese and Foreign Investment" are given below. The National People's Congress enacted the law on July 1, 1979.

For the purpose of absorbing foreign investments and expanding international economic co-operation and technological exchange on the basis of equality and mutual benefit, the State Council has decided to authorize certain joint ventures with foreign investment which are deemed by all participants as conducive to their interests. An appropriate law is therefore needed for this purpose. I shall point to the following three provisions in the draft of the law that is now proposed:

- (1) The resources invested by a foreign participant in a joint venture pursuant to the agreements and contracts authorized by the Chinese government as well as their other lawful rights and interests shall be protected by the legislation in force.
- (2) The technology of [sic] equipment contributed by any foreign participant as investment shall be truly up to advanced world standards and appropriate to China's needs.
- (3) The activities of a joint venture shall be governed by the laws, decrees and pertinent regulations of the People's Republic of China.

To facilitate the successful implementation of this law, specific regulations for its application will be worked out, and other related economic legislation will be enacted and enforced from time to time.

** Reprinted from 'LAW OF PRC ON JOINT VENTURES USING CHINESE & FOREIGN INVESTMENT 24 (Wen Wei Po ed. 1979) [in Chinese and English].

APPENDIX B

THE REGULATIONS ON SPECIAL ECONOMIC ZONES IN GUANGDONG PROVINCE*

CHAPTER ONE: GENERAL PRINCIPLES

Article 1: In order to develop economic cooperation and technical exchange with foreign countries and promote socialist modernization, specific areas in Shenzhen, Zhuhai and Shantou Municipalities of Guangdong Province will be designated as special economic zones (to be called "special zones" in subsequent paragraphs for brevity). Citizens of foreign countries, Chinese residing abroad and Chinese compatriots in Hong Kong and Macao and their companies and enterprises (to be called "traders" in subsequent paragraphs for brevity) will be encouraged to set up plants, enterprises or other business undertakings *with their own investment* or to run joint ventures with China. Their assets, profits and other legitimate rights and interests will be protected under law.

Article 2: The enterprises and individuals operating in the special zones must observe the laws, decrees and related regulations of the People's Republic of China, with the exception of special provisions as stipulated in these regulations.

Article 3: The Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones will be set up to exercise the power of unified management over all special zones on behalf of the Guangdong Provincial People's Government.

Article 4: The special zones will provide a wide scope of business operation for traders, create favorable conditions for their business operations and guarantee the stability of their operational sites. The traders may invest, or run joint ventures with China, in all undertakings which have a positive meaning in international economic cooperation and technical exchange, including the fields of industry, agriculture, animal husbandry, breeding, tourism, housing and other construction work and advances technological research and manufacturing work. They may also engage in other business which is of interest to both sides.

Article 5: The Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones will be responsible for the leveling and other land preparation work and construction.

* Reprinted from Beijing Xinhua, FOREIGN BROADCAST INFORMATION SERVICE, August 28, 1980, at L9.

work for water supply, drainage, electric power, roads, docks, communications, warehouses and other public facilities. If necessary, foreign capital may be used in the above-mentioned construction work.

Article 6: Chinese and foreign experts and people who are enthusiastic in promoting modernization in our country will be invited by various special zones to form advisory committees and give advice to the respective special zones.

CHAPTER TWO: REGISTRATION AND OPERATION

Article 7: The traders should submit applications to the Guangdong Provincial Administration Committee in Charge of the Special Economic Zones for their investment in setting up plants or other economic undertakings. After review and approval by the committee, the traders will be given registration certificates and land use certificates.

Article 8: The traders may open up accounts and deal with foreign exchange matters at Bank of China branches set up in the special zones or at other banks set up in the special zones with the approval of our government. The traders may purchase insurance for various matters at the Chinese People's Insurance Company or other insurance companies set up in the special zones with the approval of our government.

Article 9: The commodities produced by enterprises in the special zones are to be sold on the international market. If an enterprise wants to sell its products on the Chinese market, it must obtain approval from the Guangdong Provincial Administrative Committee in charge of the Special Economic Zones and pay customs duty.

Article 10: The traders may independently operate their own enterprises and hire foreign personnel for technical and management work.

Article 11: If the traders want to cease operating their enterprise, they should give their reasons to the Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones, carry out procedures for the closure of business and clean up loans and debts. After close of business, traders may transfer their assets to other parties and may remit their investment money out of China.

CHAPTER THREE: PREFERENTIAL TREATMENT

Article 12: The land in the special zones remains the property of the People's Republic of China. Land will be furnished to traders according to their actual needs. Favorable consideration will be given to traders in such matters as length of tenure, land rent and method of payment according to their trade and purpose. Specific regulations governing the use of land will be published separately.

Article 13: Machinery equipment, spare parts, raw materials, transport vehicles and other items needed by the enterprises in the special zones for production will be exempted from import duty. Consumer goods needed by traders shall be subject to full or lower import duties, or exempted, depending on the merits of each case. The import of the above-mentioned items and the export of commodities from the special zones should go through the customs declaration procedures.

Article 14: The rate of income tax to be paid by enterprises in the special zones is to be 15 percent. Preferential treatment will be given to enterprises established within 2 years of the promulgation of the regulations, enterprises with an investment of at least 5 million U.S. dollars and enterprises involving higher technologies or having a longer cycle of capital turnover.

Article 15: After paying income tax, traders' legitimate profits and wages and other normal income of foreign employees, Overseas Chinese employees and employees hired from Hong Kong and Macao may be remitted out of China through the Bank of China or other banks in the special zones in accordance with the regulations governing foreign exchange control in the special zones.

Article 16: If the traders use their profits for reinvestment in the special zones for a period of at least 5 years, they may request the authorities concerned to reduce or exempt income tax on profits thus reinvested.

Article 17: Enterprises in the special zones will be encouraged to use machinery, equipment, raw materials and other supplies produced in China. They will be given favorable treatment, paying export prices for the same kind of commodities at the time of purchase. The prices will be paid in foreign exchange. The commodities and supplies may be shipped to the special zones directly from the selling units, based on vouchers.

Article 18: Entry and exit procedures will be simplified for foreigners, Chinese residing abroad and Chinese compatriots from Hong Kong and Macao coming into and leaving the special zones.

Article 19: Labor service companies will be established in various special zones. The enterprises in the special zone may hire Chinese staff members and workers through the introduction of the local labor service companies or hire them directly with the concurrence of the Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones. They will be tested or evaluated for employment by the enterprises. Employment contracts will be signed by the enterprises and the Chinese staff members and workers.

Article 20: The staff members and workers hired by the enterprises in the special zones will be administered by the enterprises according to their operational requirements. If necessary, they may be dismissed according to the stipulations of the employment contract. Staff members and workers hired by enterprises in the special zones may also resign according to the stipulations of the employment contracts.

Article 21: The wage level, wage structure and methods of reward for Chinese staff members and workers employed by the enterprises in the special zones, as well as labor insurance and state subsidies to staff members and workers are all to be included in contracts signed by the enterprises and staff members and workers in accordance with the regulations prescribed by the Guangdong Provincial Administrative Committee in Charge of Special Economic Zones.

Article 22: Enterprises in the special zones should adopt necessary labor protection measures to insure that staff members and workers work under safe and sanitary conditions.

CHAPTER FIVE: ORGANIZATION AND MANAGEMENT

Article 23: The Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones undertakes the following duties:

1. It is to draft, organize and implement development projects in the special zones.
2. It is to review and approve the traders' investment projects in the special zones.
3. It is to handle industrial and commercial registration work and land allocation in the special zones.
4. It is to coordinate working relations for banks, insurance companies, tax units, customs, border inspection units and posts and telecommunications in the special zones.
5. It is to find sources of staff members and workers for the

enterprises in the special zones and to safeguard the just rights of staff members and workers.

6. It is to run educational, cultural, public health and other public welfare work in the special zones.

7. It is to safeguard security in the special zones and protect the inviolability of person and property.

Article 24: The Shenzhen Special Economic Zone will be directly operated and administered by the Guangdong Provincial Administrative Committee in Charge of the Special Economic Zones. Necessary organizations will be established in the Zhuhai and Shantou Special Economic Zones to handle matters there.

Article 25: To meet the need of developing economic activities in the special economic zones, the Guangdong Provincial Special Economic Zones Development Company will be established. The scope of operation of the company is as follows: It is to handle the accumulation of funds and trust and investment work, operate enterprises or cooperate with traders in the special zones in setting up joint ventures, act as an agent for traders in the special zones in dealing with procurement and marketing work with units in China, and offer consultative services.

CHAPTER SIX: SUPPLEMENTARY ARTICLE

Article 26: The regulations will be put into practice after being adopted by the Guangdong Provincial People's Congress and approved by the Standing Committee of the National People's Congress of the People's Republic of China.