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China's Joint Venture Law: A Preliminary Analysis

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CHINA'S JOINT VENTURE LAW: A PRELIMINARY ANALYSIS*

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I. INTRODUCTION

The People's Republic of China has enacted a Joint Venture Law. It was passed by the Fifth National People's Congress on July 1, 1979, and took effect on July 8.[1] The Law is a further step in promoting China's new and growing economic contacts with the outside. The new Law establishes *inter alia* the procedure by which foreign firms may invest in China. The foreign joint venturer and his Chinese counterpart draft the agreement, contract and articles of incorporation of the joint venture and submit them to the Chinese Foreign Investment Control Commission. After the Commission has approved the investment, the joint venture company must register with the Chinese General Administration of Industry and Commerce and receive a business license.

The foreign joint venturer's investment may take the form of cash, equipment, industrial property, or other assets. There is no ceiling on the proportion of foreign capital, but foreign investment must constitute at least twenty-five percent of the value of the enterprise. The Chinese party may contribute a site as its capital in the enterprise. The Law provides for special tax privileges, such

1. Renmin ribao (The People's Daily), July 9, 1979, at 1, col. 1.

as exemptions or low tax rates for the first two or three profit-making years, for a joint venture equipped with advanced technology by world standards, and a rebate on part of the income taxes paid by foreign investors who reinvest their profits in China. A board of directors composed of a chairman appointed by the Chinese joint venturer and one or two vice chairmen appointed by the foreign participant manages the joint venture. The president and vice president will be chosen separately by different parties to the joint venture. The foreign joint venturer may remit its profits abroad. All joint ventures will have a definite term which may be extended upon approval by the Foreign Investment Control Commission.

The Joint Venture Law evidences a dramatic change in China's policies towards economic development. Yet an examination of the past experience of China and the more recent experience of other socialist countries reveals that the Joint Venture Law, for all its novelty, is not without precedents in China or in other socialist countries: the recent compensation trade contracts between Chinese organizations and foreign firms; the jointly managed state-private enterprises which existed in China during the 1950's and 1960's; and the current joint ventures between Western firms and socialist enterprises of Romania and Yugoslavia. These precedents provide a perspective from which to evaluate the Joint Venture Law itself and to identify certain potential problems in its implementation.

A comparative perspective, however, is not enough. Prospective joint venture participants also need to know about the institutional framework in which a joint venture will operate. The effect of current Chinese law on a joint venture company has acquired particular significance from the November 29, 1979 Decision of the Standing Committee of the National People's Congress. This decision provides that all laws and decrees passed or approved after October 1, 1949 continue in effect unless they conflict with the 1978 Constitution, laws or decrees passed by the Standing Committee of the Fifth National People's Congress.[2] In analyzing the Joint Venture Law, therefore, this article will also examine those areas in which current Chinese law and practice relating to industrial enterprises most affect a joint venture.

At present, however, no study can be definitive or comprehen-

2. Renmin ribao (The People's Daily), November 30, 1979, at 1, col. 1.

sive. China is in the process of reexamining the Joint Venture Law with a view to issuing implementing regulations as well as a company law, patent law, foreign exchange regulations and individual and corporate income tax laws. Yet a preliminary analysis may be of assistance to United States companies contemplating a joint venture and perhaps even to the Chinese draftsmen as they consider new legislation.

II. PRECEDENTS OF THE JOINT VENTURE LAW

A. *Compensation Trade*

In the last three years the system of compensation trade[3] involving mainly Hong Kong and Japanese firms has grown up principally in Guangdong and Fujian Provinces. Compensation trade constitutes an intermediary step between traditional foreign trade and conventional capital investment. As in traditional foreign trade, the primary benefit for the Chinese is the earning of foreign exchange. A secondary, but at times substantial, benefit to the Chinese is the introduction of foreign technology. Compensation trade consists of the importation of capital goods against payment through future product deliveries. There are three basic forms.[4] The first is called processing compensation trade. Under this form a Chinese enterprise either processes in China imported consigned materials, and re-exports them, or imports samples and produces goods in China identical to the samples for export. In both instances the foreign firm pays a fee to the Chinese to cover the cost of the processing or production and may also supply equipment. The second form, assembly compensation trade, involves the assembly by the Chinese of component parts supplied in whole or part by the foreign company. As in the case of processing compensation trade, the foreigner is charged a fee for assembly and may supply the equipment necessary for assembly operations. Under

3. The Chinese term for "compensation trade" (*buchang maoyi*) is generally narrower than Western usage, referring only to the purchase of capital equipment through repayment by products made with equipment. *See* JAPAN EXTERNAL TRADE ORGANIZATION, CHINA: A BUSINESS GUIDE 155-56 (1979). [hereinafter cited as CHINA BUSINESS GUIDE]. This is the definition adopted here.

4. This discussion of compensation trade, unless otherwise noted, is taken from the following two articles: Cohen & Nee, *China: All About Compensation Trade,* Parts I and II, the Asian Wall St. J., July 3, 1979, at 4, col. 3 and July 4, 1979, at 4, col. 3. For a more recent comprehensive article on compensation trade which appeared too late for use in this article see Fountain, *Countertrade in Selling Technology to China* at 35-76 (1979).

this arrangement, however, the Chinese party may share the profits earned from the sale of the product in foreign markets.

Pure compensation trade describes the traditional form of compensation trade: the repayment of the cost of importing capital equipment with the produce of the equipment itself alone or together with other products. Pure compensation trade contracts are often concluded for a period of three years, or in the case of Hong Kong parties, five years. After the expiration of the term, however, the Chinese have been willing to allow the foreign party to continue to act as distributor of the products in foreign markets. The Chinese thereby gain a distributor who is both experienced in the product and has international sales expertise. Such an arrangement can also be beneficial to the foreign party, if the sales price charged by the Chinese is reasonable. Although not specified in the contract, the Chinese recognize that in order to be reasonable the price must be lower than that charged for producing the same products in Hong Kong or Macau. It remains to be seen how long after repayment of the equipment the Chinese will continue to sell their products to the foreign party at a reasonable price.

An example of a typical compensation trade agreement is that signed in August 1978 between Itoman Co., Ltd., a Japanese trading firm, and the Shanghai Garments Branch of the China Textile Import and Export Corporation.[5] Itoman was disappointed with the uneven quality of pajamas it received from China due to the different levels of technical expertise, quality control and productivity of the different supplying factories. Itoman suggested that it select the best factory, install Japanese machinery and provide technical assistance. Under the resulting contract Itoman has supplied 100 sewing machines and fifteen technicians, while the Chinese partner has secured the raw materials locally. The Chinese sell to Itoman the products which bear the Japanese company's trademark. The pajamas have sold well on the Japanese market, and a new factory has been planned to produce one million pairs of pajamas for annual export to Japan.

Although China does not appear to have promulgated any laws or regulations detailing the procedures for handling such compensation trade contracts, the following operating instructions have been gleaned from discussions with Chinese officials.[6]

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5. CHINA BUSINESS GUIDE, *supra* note 3, at 157-58.
6. Cohen & Nee, *supra* note 4, at 4.

1. Contractual Authority

In general, all provinces, districts and independent municipalities seem to be authorized to negotiate compensation trade agreements without prior approval from superior authorities, provided that the value of any imported capital equipment does not exceed $3,000,000.[7] In processing and assembly agreements prior approval from the provincial branch of the appropriate foreign trade corporation or department must be obtained even though no capital equipment is imported. In other cases approval must come from the State Planning Commission, the Ministry of Foreign Trade and the Peking office of the appropriate foreign trade corporation.

2. Division of Responsibility

In addition to the geographically organized administrative agencies mentioned above, the producing enterprise may also negotiate and sometimes execute the contract jointly with the foreign trade corporation or other government departments. Under an understanding between the manufacturer and the foreign trade corporation, the former assumes responsibility for producing the goods according to the contract while the latter handles, for a fee, the import of materials and equipment.

3. Foreign Exchange

China has permitted the conversion of foreign exchange receipts for services performed under compensation trade agreements at rates favorable to the foreign party. A rate of U.S. $1.00 Renminbi (RMB) 3.00 (almost double the standard rate of U.S. $1.00 RMB 1.55) has been mentioned. The Chinese entities divide up the foreign exchange in the following manner: The manufacturer keeps fifteen percent for imports and business travel abroad; a certain portion is allocated to the local government (provincial or municipal) for other imports; any funds left over go to the central government.

4. Taxation and Duties

It appears that the manufacturers in a compensation trade agreement receive an exemption from the Industrial and Commercial Consolidated Tax for three years from the date of the con-

7. Interview with Nicholas Ludlow (Dec. 6, 1979). For further details see his forthcoming article in the China Business Review.

tract. No duties are charged on any items imported.

5. Inspection

The Chinese Commodities Inspection Bureau inspects the goods as a matter of course. Foreign parties, however, can conduct additional inspections in China with their own personnel. Since compensation trade agreements generally do not allow the return of non-conforming goods after they are exported, most foreign parties take advantage of this opportunity. It has been suggested that the contracts should set an allowable percentage of non-conforming goods in an effort to reduce the problem of rejects.

6. Financing

Most compensation trade agreements are on a sales credit basis, with products replacing currency as installments on a loan.[8] Japanese law, however, prohibits export transactions which are not settled within 180 days. Japanese companies, therefore, use a letter of credit format under which the Chinese open a letter of credit to settle accounts for the Japanese machinery and equipment. Later Japanese purchase of the finished goods insures that China does not lose foreign exchange.

Direct loans are another means of financing compensation trade. Foreign banks generally will not grant loans to Chinese enterprises due to uncertainties about enforcing any security rights under Chinese law. As a result, the foreign enterprise is responsible for securing financing of compensation trade. The Bank of China and associated banks seem to have established the China Development Finance Co. (Hong Kong) Limited in April 1979 to finance projects in a new Shum Chun free trade zone near Hong Kong. Prior to the establishment of this finance company, the Bank of China apparently extended loans to Hong Kong companies involved in compensation trade and may well continue to do

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8. CHINA BUSINESS GUIDE, *supra* note 3, at 157-90. One form of credit sales which has not yet been finalized, but which the Chinese have agreed to in principle would involve Chinese payment for "kits" on a unit basis against documents accepted. The Chinese would assemble the kits into finished products and resell them to the foreign party against documents presented. The initial sale would not actually involve a cash payment but would form the basis of credit against the payment required on the resale of the finished product to the foreign party. The Bank of China at the request of the foreign party would handle both transactions. The Chinese would assume the cost of any wastage. Memorandum of S. Steven Chu, attorney, Baker & McKenzie (January 16, 1980).

so in the future. The Bank of China also provides guarantees for important compensation trade agreements.

Specific problems encountered in compensation trade include quality control, inexperience, and deficient infrastructure services.[9] The most serious problem is quality control. Compensation trade projects have been mainly in the textile sector (because in this area China's technical knowledge is relatively high). The finished-product quality control is often good, but in-process quality control is often ineffective.[10] Defects are often not discovered until the product is put into use. A second difficulty is the Chinese managers' lack of practical experience. The situation is better in areas close to Hong Kong, particularly Guangdong Province. In other areas, however, incompetence appears to be common.[11] Third, China's infrastructure is not equipped to handle supplies and transportation of goods in an efficient manner.

The guidelines on compensation trade indicate that the Chinese have made efforts to overcome some of these difficulties.[12] They provide, for example, for delays in delivery of goods to compensate for any delays in China in transportation. In addition, more positive incentives are provided for factories that operate successfully and earn foreign exchange. For example, they can, with permission of higher authorities, offer their workers higher wages and better benefits. Factories that are not successful, however, are subject to penalties and their management to punishment. Further, factories are supposed to operate with the same number of workers (except for political and managerial personnel) as in foreign countries. It remains to be seen whether these and other measures will be fully successful in overcoming the relaxed work habits and ingrained prejudice against laboring for capitalists that seem to have caused difficulties in some compensation trade agreements.

Although compensation trade differs from a joint venture in that there is no capital investment and management participation by the foreign firm, compensation trade agreements, as the closest approximation of a joint venture, are certainly relevant to the op-

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9. CHINA BUSINESS GUIDE, *supra* note 3, at 159-60.

10. Richman, *Capitalists and Managers in Communist China*, 45 HARV. BUS. REV. 71 (1967) [hereinafter cited as *Capitalists and Managers*].

11. *See* Butterfield, *Aging Leadership is Worrying Peking*, N.Y. Times, Nov. 26, 1979, at 7, col. 1 (less than one third of officials in state operated enterprises are familiar with their professions' technology and management).

12. Cohen & Nee, *supra* note 4, at 4.

eration of joint ventures in China. The only substantial difference between the operations of a joint venture company and a supply factory under a compensation trade agreement is in the absence of foreign direct intervention in management. In fact, however, the demands of the export market appear to be enforcing a certain discipline on Chinese factories participating in compensation trade already. Furthermore, the Chinese government has taken the initiative to reform practices which do not directly affect marketability of the products in foreign markets (*e.g.* per capita worker productivity). In fact, it is puzzling why China finds a need for joint ventures, with their attendant problems, if it can use compensation trade to import foreign equipment and technology, earn foreign exchange and raise the productivity of its work force. The Chinese justification for joint ventures probably lies in the higher technology and management techniques that it can only acquire through them.

B. *Jointly Operated State-Private Enterprises*

Joint state capitalist enterprises are not new to China. During the early years of the People's Republic private enterprise existed. By 1952, however, it became clear that the transition from state capitalism to state ownership was to be rapid and compulsory. In September 1954, the government promulgated the Provisional Statute on Jointly Operated State-Private Industrial Enterprises to promote this transition. The Statute provided for the establishment of joint enterprises to be formed from previously wholly private companies. By 1956 it was announced that all remaining private industrial enterprises would be transformed into joint state-private enterprises by the end of the year.[13] Thus, from the beginning of 1957 until at least the Cultural Revolution in the mid-1960's joint state-private enterprises operated in China under the Provisional Statute.[14] The obvious differences between these enterprises and joint ventures as contemplated under the Joint Venture Law require no elaboration: the joint enterprises were unfortunate remnants of a bygone age, the joint ventures are to be harbingers of a new era. Nevertheless, the legal forms employed to

13. For a description of the transformation of private industry during the 1950's see B. RICHMAN, INDUSTRIAL SOCIETY IN COMMUNIST CHINA 897-98 (1969) [hereinafter cited as *Richman*].

14. 1 PRC CIVIL LAW REFERENCE MATERIALS 71-75 (Civil Law Study Office of Chinese People's University ed. 1956) (ZHONGHUA RENMIN GONGHEGUO MINFA CANKAO ZILIAO) [hereinafter cited as CIVIL LAW REFERENCE MATERIALS].

create and operate these joint enterprises are similar to those created by the new Joint Venture Law.

The Provisional Statute consists of six main sections: General Principles, Shares, Management, Distribution of Profits, Directors and Shareholders Meetings, and Leadership Relationship.[15] Article one declares that the general purpose of the Statute is to "encourage and lead" capitalist industry in its transformation into jointly operated state-private national capitalist industry and gradual completion of socialist reconstruction. Thus, as article three makes clear, the "socialist element" in a joint enterprise occupied a "leading position." A joint state-private enterprise was not an undertaking between two independent parties, each with equal bargaining power. Article three does mention that the "lawful interests of the shares of private persons shall receive protection," but this state protection of the private party's rights was subject to the leadership of the state party to the joint enterprise.[16]

The leading position of the socialist elements in the joint enterprise was independent of share ownership. The state, like any private party, invested in the private enterprises and received shares corresponding to the value of its investment, thus transforming the enterprises into joint state-private enterprises.[17] Nevertheless, a procedure had to be established for determining the value of the assets which would comprise the new joint enterprise. Article six of the Provisional Statute sets forth the general procedure: both the state and private parties should discuss and appraise the assets of the enterprise in accordance with the principles of fairness and reasonableness, with consideration of the remaining useful life of the assets and the degree of usefulness to the enterprise's production. Workers' representatives were also supposed to participate in estimating the value of the enterprise's assets, and, if necessary, a delegate from the government's industrial and commercial administrative organs would provide guidance. The rules for estimating the value of the assets of state enterprises merged

15. *An Explanation of the Provisional Statute on Jointly Operated State-Private Industrial Enterprises, id.* at 78, 82.

16. *Id.* at 79.

17. Regulation of the State Council Relating to Certain Important Questions on Estimating the Value of and Taking Inventory of Assets When Private Enterprises Implement State-Private Joint Operations, *reprinted in id.* at 88.

with private entities are not available; those relating, however, to estimating the value of a private enterprise's assets, particularly of land and buildings, are available. The Regulation of the State Council Relating to Certain Important Questions on Estimating the Value of and Taking Inventory of Assets When Private Enterprises Implement State-Private Joint Operation states that in regard to land and buildings, the estimation of the value should be arrived at "according to the degree of deterioration, with consideration of the Standards for Estimating Values of the Organs Managing Buildings and Land in such locality. . . ."[18] The precise nature of the standards used by the local organs managing buildings and land is not clear, but it is obvious that China has had experience in estimating the value of land and buildings in the context of contributions of capital to a joint enterprise and has established standards in this regard.

In regard to management, the Provisional Statute provides that representatives delegated by the government's principal business organ, and representatives of the private party, were responsible for management. In addition, the Provisional Statute requires joint enterprises to adopt appropriate forms for the participation in management by workers' representatives. Nevertheless, the representative of the private party was to be the person responsible for business administration of the enterprise.

The distribution of profits of a joint enterprise adopted an unusual form. The after-tax profits of the enterprise were, according to article seventeen of the Statute, to be divided into three funds: dividends and executive bonuses, the enterprise incentive fund, and the enterprise reserve fund. Of the total after-tax profits the portion allocated to executive bonuses and dividends could not exceed "approximately 25 percent."[19] The portion used for the incentive fund was to follow the practice of state enterprises, while the remainder of the profits were to be used for the reserve fund. The statute required the allocation of dividends according to the number of shares; the state's dividends were to be delivered to the appropriate state organ, the private party's dividends were to be disposed of as the private party desired. Management was to in-

18. *Id.* at 88.

19. *An Explanation of the Provisional Statute on Jointly Operated State-Private Industrial Enterprises, id.* at 84.

vest the reserve fund in the joint enterprise, in other joint enterprises or in a private enterprise implementing joint state-private operation. Management was to use the incentive fund for the collective welfare of the workers and for incentives for "progressive" workers. The president or plant manager and the trade union were to draft a budget for the use of the incentive fund subject to the approval of the trade union and the workers' representatives in management. At the time the Statute was adopted, however, some private parties had already received government permission to concede their role in managing a joint enterprise in return for a guaranteed dividend equal to a fixed percentage of the value of their shares.[20] By 1956 the Regulations of the State Council Relating to the Fixed Dividend Method Implemented in Jointly Operated State-Private Enterprises set forth the rules relating to such fixed dividends which applied to all private shareholders in joint enterprises.[21]

The Provisional Statute provided for directors and shareholders meetings. In small-scale joint enterprises no board of directors was necessary. Representatives of the state and private parties could handle the matters ordinarily dealt with by the board.[22] These representatives were to report to the government's principal business organ for approval of any "important decisions." In large-scale enterprises a board of directors was established. The parties were to agree upon the number of directors and designate each director either a public or private director. The government's principal business organ appointed the public directors, while the private party selected the private directors. The board had to report any important decisions or issues on which the public and private parties could not agree to the government's principal business organ for approval. The Statute also called for shareholders meetings, but they had only one function: to report to the private shareholders the work of the board and measures relating to the handling of the interests of the private shareholders. The shareholders meetings could not adopt resolutions.

The Chinese government apparently feared that these measures

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20. RICHMAN, *supra* note 13, at 897-98.

21. Regulation of the State Council Relating to the Fixed Dividend Method Implemented in Jointly Operated State-Private Enterprises, *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 86-87.

22. Provisional Statute on Jointly Operated State-Private Industrial Enterprises, art. 21, *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 74.

would not be sufficient to insure the necessary degree of state control over joint enterprises. The Provisional Statute therefore subordinated joint enterprises to the appropriate principal governmental business organ.[23] Such organ was responsible for handling industrial and commercial administrative matters relating to the enterprise. Finally, the Bank of Communications was to exercise supervision over the finances of the joint enterprise.

Certainly, the experience of these joint enterprises is, in some respects, not applicable to the joint ventures to be formed under the new Joint Venture Law. Private parties in joint enterprises were pressured to participate, while foreign firms must be persuaded to do so. Still, many similarities can be found. It is interesting to note, for example, that the new Joint Venture Law only allows foreign participation for a fixed term. Upon expiration of the term the joint venture company presumably will be converted into a full state enterprise. In this respect, a joint venture is very similar to a joint enterprise. Both are merely transitional stages allowing for capitalist participation in enterprises, but under state supervision, along the route to completely state-owned socialist enterprises. In fact, the similarities between the Provisional Statute and the Law raise the question of whether the absence of a certain provision in the Joint Venture Law means that the draftsmen were consciously departing from the Provisional Statute or whether they were simply assuming that provisions identical to, or similar to, those in the Provisional Statute should apply where appropriate.

C. *Joint Venture Laws of Other Socialist States*

The joint venture laws of other socialist countries are a third precedent for China's Joint Venture Law. In particular, the laws and experiences of two Eastern European countries, Romania and Yugoslavia, are relevant to China's new legislation. Prior to 1967, all Eastern European countries closely adhered to the socialist doctrine of state ownership of the means of production. In July 1967, however, Yugoslavia enacted a law permitting foreign equity participation in joint ventures.[24] In 1971, Romania became the

23. *Id.* art. 23.

24. The original Yugoslav Regulations permitting foreign equity participation appeared in two laws. The first, Law of July 10-11, 1967, Concerning Amending and Supplementing the Law on Funds of the Business Organizations, [1967] FED. OFFICIAL GAZETTE OF THE SOCIALIST FED. REPUBLIC OF YUGOSLAVIA, No. 31

first COMECON country to permit foreign private investment, through the adoption of its comprehensive foreign trade law.[25] In both these countries, the joint venture has been seen as a politically and ideologically acceptable means of developing the country's exports to hard currency markets and of obtaining and self-financing the latest technology and expertise. These means remain attractive despite the fact that they could be viewed as compromising the socialist doctrine of state ownership of the means of production[26] and the Yugoslav concept of worker self-management.[27]

1. Romania[28]

Romania's 1971 Foreign Trade Law provided a basic framework

(*cited in* Note, *The Legal Framework for American Direct Investment in Eastern Europe: Romania, Hungary and Yugoslavia,* 7 CORNELL INT'L L.J. 187, 191, n.20 (1974)), contained the basic provisions regarding foreign investments. An unofficial translation appears in AM. REV. EAST-WEST TRADE, Jan. 1968, at 43-48. The second law, Law of July 10-11, 1967, Concerning the Profit Tax Payable by the Foreign Persons Who Invest Funds in a Domestic Business Organization for Joint Business Operations, [1967] FED. OFFICIAL GAZETTE OF THE SOCIALIST FED. REPUBLIC OF YUGOSLAVIA, No. 31, *cited in* Note, 7 CORNELL INT'L L.J., at 91, n.20, regulated the payment of taxes on foreign investors' profits. An unofficial translation of the law appears in AM. REV. EAST-WEST TRADE, Feb. 1968, at 54-57. These laws have now been superseded by Law on Investment of Foreign Persons' Capital in Domestic Organizations of Associated Labor, published April 7, 1978 [hereinafter cited as 1978 Yugoslav Joint Venture Law]. An English translation of the Joint Venture Law appears in 1 BUSINESS INTERNATIONAL, DOING BUSINESS IN EASTERN EUROPE, YUGOSLAVIA, App. 10.1 (1977) [hereinafter cited as DOING BUSINESS IN YUGOSLAVIA].

25. Law No. 1 of March 17, 1971, Concerning the Foreign Trade, Economic, and Technico-Scientific Cooperative Activities of the Socialist Republic of Romania, 33 OFFICIAL BULL. OF THE SOCIALIST REPUBLIC OF ROMANIA (1971), *cited in* Note, 7 CORNELL INT'L L.J., *supra* note 24, at 192, n.24, [hereinafter cited as 1971 Romanian Investment Law]. A translation of the 1971 Romanian Investment Law appears at 11 INT'L LEGAL MATERIALS 161 (1972).

26. *See* Gordon, *The Developing Law of Joint Venture in Eastern Europe,* 9 TEXAS INT'L L.J. 281, 290-92 (1974).

27. *See* Glickman & Sukijasovic, *Yugoslav Worker Management and Effects on Foreign Investment,* 12 HARV. INT'L L.J. 260 (1971). *See also* Gordon, *supra* note 26, at 287-90; 1 DOING BUSINESS IN YUGOSLAVIA *supra* note 24, § 3.2 at III-17 to III-24.

28. For more information on Romanian joint venture law, *see generally* 1 BUSINESS INTERNATIONAL, DOING BUSINESS IN EASTERN EUROPE, ROMANIA; Donaghue, *Control Data's Joint Venture in Romania,* 10 INT'L LAW 55 (1976); Kuiper, *Socialist Republic of Romania; Organization Operation and Taxation of Joint Companies—Taxation of Income Obtained by Non-Resident Individuals and*

for foreign investment in joint ventures. The 1972 Decree on Joint Companies[29] provides for the formation of Romanian joint companies with foreign participation in various fields.[30] The Decree accords the joint venture parties great latitude in determining the details of the joint venture company in the contract and articles of incorporation. Under articles seventeen and eighteen of the Decree, the contract and articles of incorporation are approved by the Council of State and published in extract in Romania's Official Bulletin. Thus they acquire the legal effect of an ordinary statute.

The joint company may take the form of a joint stock company which issues formal stock certificates and provides for the establishment of a board of directors and for a general meeting of shareholders. Alternatively, it may take the form of a limited liability company, which specifies the capital shares of the participants and provides for a general assembly of partners and for the establishment of a joint management committee.[31]

The Decree both restricts and protects the foreign investment. The legally prescribed maximum foreign participation value is 49 percent.[32] There is no minimum. Contributions to capital by all parties may consist of cash, goods, industrial property or other rights.[33] The Joint Venture contract and statutes establish the parties' contributions. The Romanian party may also contribute the right to use a particular site.[34] The foreign partner's contributions are valued in a convertible currency agreed upon in the contract and statutes.[35] The parties must deposit cash contributions in a Romanian bank.[36] The Romanian government guarantees the

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Corporations, 16 EUROPEAN TAXATION 190 (1976); Morse and Goekjion, *Joint Investment Opportunities with the Socialist Republic of Romania*, 29 BUS. LAW. 133 (1973); Note, *Joint Venture in Eastern Europe*, 9 J. WORLD TRADE L. 427 (1975); Gordon, *supra* note 26.

29. Decree No. 424, on the Constitution, Organization and Operation of Joint Companies by the Council of State, Official Bulletin of the Socialist Republic of Romania, No. 121, Nov. 2, 1971 [hereinafter cited as Romanian Decree No. 424]. An English translation of the Decree appears at 12 INT'L LEGAL MATERIALS 651 (1972).

30. *Id.* art. 1.

31. *Id.* art. 9.

32. 1971 Romanian Investment Law, *supra* note 25, art. 59; Romanian Decree No. 424, *supra* note 29, art. 4.

33. *Id.* art. 14.

34. *Id.*

35. *Id.* art. 15.

36. *Id.*

financial contribution of the Romanian party as well as the transfer abroad to the foreign party of its redemption quota benefits and other amounts due after the payment of taxes and other obligations.[37]

The Decree further provides for foreign trade and foreign exchange. Joint ventures in Romania may buy or sell abroad directly without using Romanian foreign trade organizations.[38] The contract stipulations on foreign currency accounts take precedence over the Romanian foreign exchange control laws. The transfer of sums from foreign currency accounts to Romanian currency accounts and vice versa is considered on the basis of the rate of exchange established from non-commercial transactions.[39]

The Decree's labor provisions state that Romanian personnel enjoy the rights and obligations provided by the legislation regulating the personnel of state enterprises.[40] The rights of foreign personnel are established by the board of directors or managing committee.[41] Foreign personnel can transfer their wages abroad in accordance with management policy. The joint company may settle disputes either by litigation before Romanian courts or by arbitration if the parties previously consented.[42]

The 1972 Decree on the Taxation of Joint Ventures[43] provides for taxation of joint company net profits at an annual rate of 30 percent.[44] The Decree does not specify allowable deductions other than a reserve fund of five percent of annual taxable profits per year until the fund total reaches 25 percent of invested capital.[45] The Decree does not describe the methods for computing depreciation. The Romanian state guarantees the transfer abroad of the foreign partner's dividends. The Decree grants a tax exemption or reduction during the first three years.[46] Furthermore, profits rein-

37. 1971 Romanian Investment Law, *supra* note 25, art. 60; Romanian Decree No. 424, *supra* note 29, art. 28.

38. *Id.* art. 23.

39. *Id.* art. 28.

40. *Id.* art. 32.

41. *Id.* art. 33.

42. *Id.* art. 38.

43. Romanian Decree No. 425 on the Tax on Profits of Joint Companies Constituted in the Socialist Republic of Romania, Official Bulletin of the Socialist Republic of Romania, No. 121, Nov. 2, 1972 [hereinafter cited as Romanian Decree No. 425]. An English translation appears at 12 INT'L LEGAL MATERIALS 656 (1972).

44. *Id.* art. 1.

45. *Id.* art. 2.

46. *Id.* art. 3(1).

vested for a period of at least five years are taxed at 80 percent of the tax due,[47] for an effective tax rate of 24 percent. Post-tax profits transferred abroad are subject to a further tax of ten percent.[48]

2. Yugoslavia[49]

Yugoslavia has had a number of joint venture laws. The most recent legislation adopted in 1978 consolidates numerous earlier rules and regulations.[50] The present law permits foreign investment in all but three areas:[51] domestic and foreign trade, insurance and, except where waived by the government, public administration.[52] Investment may take the form of cash, capitalized know-how, licenses, patents, rights to technical documents and trademarks. The foreign partner also may contribute equipment, raw materials, and semi-finished goods, if the equipment or materials are not available in Yugoslavia in the required quantity or quality.[53] The value of capitalized equipment, licenses and materials must be established and approved by the government officials. Present law also requires the foreign joint venture partner to transfer all modifications and improvements of patents and know-how involved in the joint venture contract.[54] The Federal Secretariat for Foreign Trade may permit the import of capitalized equipment and raw materials, even if they are subject to import quotas, as long as such imports are intended solely for the use of the joint venture.[55]

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47. *Id.* art. 4.

48. *Id.* art. 13. The Income Tax Treaty, Dec. 4, 1973, United States-Romania art. 10, 27 U.S.T. 27, T.I.A.S. 8228, does not alter this withholding tax rate on dividend remittances.

49. For general articles on Yugoslav joint ventures, *see* 1 DOING BUSINESS IN YUGOSLAVIA, *supra* note 24, § 10; Gordon, *supra* note 26 at 283-84 app., 287-90 app., 301-11 app. For various Western companies' reactions to the latest Yugoslav Joint Venture Law, see BUSINESS INTERNATIONAL, DOING BUSINESS IN EASTERN EUROPE 356-57, 362-63, 371-73 (1978).

50. *See* note 24, *supra.*

51. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 10.

52. Public administration encompasses activities in such fields as culture, health care and education.

53. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 27.

54. The Law on Long-Term Cooperation in Production, Commercial Technical Cooperation and the Awarding and Acquiring of Technology between Organizations of Associated Labor and Foreign Persons (I aw on Transfer of Technology) arts. 18, 24(4), OFFICIAL GAZETTE OF THE SFRY, July 14, 1978, item 598.

55. 1 DOING BUSINESS IN YUGOSLAVIA, § 10.1 at X-4.

The 1978 law does not set limits on the proportion of capitalized equipment or technology that a foreign partner can invest.[56] Yugoslav officials, however, dislike joint venture proposals with proportionately large shares of capitalized equipment and know-how to invested cash.[57] The joint venture law does not specify the duration of the joint venture contract other than to indicate that the foreign partner's investment should be "of a long-term character,"[58] which in practice has meant typically ten to twenty years.[59] The law provides that a joint venture agreement may be cancelled before the time set in the agreement if: losses have occurred in the joint venture for "several years"; the mutual goals set under the joint venture agreement are not being attained; one of the partners fails to carry out the contractual obligations; or the circumstances existing at the time the agreement was concluded have changed substantially.[60] The joint venture law specifically provides that the rights of foreign persons with respect to their investment are governed by the legislation effective at the time the joint venture agreement becomes effective if such provisions are more favorable than subsequent changes in the law for the foreign partner, or if the partners do not resolve such questions otherwise.[61] The Yugoslav Constitution also includes this guarantee in general terms.[62] It does not apply, however, to tax obligations and certain other contributions and charges of the joint venture.[63]

The joint venture agreement must be approved and registered by the Federal Committee for Energy and Industry. The application for approval must contain the text of the agreement, an economic technical proposal justifying the investment, and the opinions of various government agencies and bodies.[64] The Federal Committee must decide on the joint venture application within 60 days of its receipt.[65] Since contract provisions may be sent back to

56. *Id.*
57. *Id.*
58. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 3.
59. Interview with James T. Hitch, III, attorney, Baker & McKenzie (Nov. 30, 1979).
60. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 12.
61. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 6.
62. Article 27 of the Yugoslav Constitution provides that the rights of foreign nationals to resources invested in an organization of associated labor in the country may not be curtailed by statute or other enactments after the formation of the contract.
63. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 6.
64. *Id.* art. 40.
65. *Id.* art. 45.

the negotiating partners for further clarification or explanation, it may take a year after the contract is signed for it to be approved.[66] An approved contract becomes effective retroactively to the day on which it was signed.[67] Should the application be rejected, the applicant can appeal the decision to the Federal Executive Council.[68]

The foreign partner may participate in the management of the joint venture through the joint business board, which is accountable to the workers' council.[69] The law provides that the number of foreign participants on the joint business board may not exceed the representatives from the Yugoslav partner.[70] In this way, the foreign partner may have a right to 50/50 management participation, despite the fact that its investment is only 49 percent of the total.[71] The joint venture contract must outline the specific powers of the joint business board, as well as its composition and its relationship with the workers' council and the general director of the joint venture. The joint venture's workers' council has the ultimate decision-making authority on issues of income distribution, allocation of personal earnings and salaries, labor policy, loans, enterprise planning and management of social property.[72] This apparently has not created substantial problems for foreign partners.[73]

Concerning profit transfer, Yugoslavia's current regulations distinguish between ventures in the developed Yugoslav republics and those in the less developed republics and autonomous regions. In the developed republics, a joint venture cannot transfer abroad more than 50 percent of the total foreign exchange realized through export earnings.[74] In the less developed republics, the joint venture may transfer the entire portion of the foreign partner's after tax profit abroad without currency limitations. The balance sheets of the joint venture in all republics are maintained in

66. 1 DOING BUSINESS IN YUGOSLAVIA, *supra* note 24, § 10 at X-11.
67. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 46.
68. *Id.* art. 42.
69. The workers' council is the primary organ of worker self-management. *See* note 27, *supra.*
70. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 15.
71. 1 DOING BUSINESS IN YUGOSLAVIA, *supra* note 24, at X-9.
72. *Id.*
73. *Id.*
74. *Id.* at X-6.

Yugoslav *dinars*.[75] While joint ventures in the developed republics are expected to earn sufficient hard currency from exports or import substitutes to insure profit transfer, the less developed republic ventures may obtain convertible currency for this purpose from several other sources. These sources include the pooling of hard currency earnings among several enterprises and the purchase of foreign exchange for *dinars* on the Belgrade foreign exchange market.[76]

Regardless of the location of the venture, the law requires the partners to specify in the agreement a maximum annual rate of return on invested assets.[77] The profits that exceed the annual ceiling are not forfeited. The parties may treat them as advanced repatriation of the foreign partner's original investment. Alternatively, the parties may reinvest the excess in the joint venture, thereby increasing the foreign partner's capital contribution and profit share up to the 49 percent allowed by law, or they may invest in another Yugoslav joint venture.[78] Since profits exceeding the annual ceiling may be treated as advance repatriation of the foreign partner's original investment and could result in early termination of the joint venture agreement, it is important that the accounting mechanism for such transactions be clearly outlined in the joint venture contract.[79] The foreign partner's capital investment may be repatriated following expiration of the joint venture contract as specified therein.[80] The joint venture may secure foreign exchange for repatriation from its foreign exchange export earnings or from the purchase of convertible currency on the Belgrade foreign exchange market.[81]

Yugoslavia does not tax corporate profits as such. It does tax, however, the foreign partner's share of the joint venture's profit. In order to determine the amount of the foreign partner's share, a number of deductions must be made from the total revenue of the joint venture.[82] The tax rate on the foreign partner's gross profit varies depending upon the republic in which the joint venture op-

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75. *Id.*
76. *Id.* at X-6 to X-7.
77. 1978 Yugoslav Joint Venture Law, *supra* note 26, art. 19.
78. *Id.* arts. 19, 23.
79. *See* BUSINESS INTERNATIONAL, DOING BUSINESS IN EASTERN EUROPE, *supra* note 49, at 262, 263 (1978).
80. 1978 Yugoslav Joint Venture Law, *supra* note 26, arts. 31-37.
81. 1 DOING BUSINESS IN YUGOSLAVIA, *supra* note 24 at X-9.
82. *Id.* at X-5.

erates. Furthermore, the government taxes profits reinvested in the same or another Yugoslav entity at reduced tax rates depending upon the share of the foreign partner's profit that is reinvested.[83]

The accumulated experience of these other socialist countries regarding joint ventures has been a valuable source of inspiration for China as it takes its first step along the same path. The Chinese Joint Venture Law undoubtedly owes many of its provisions to precedents provided by these other socialist countries. More importantly, as China implements, interprets and adds to its one General Joint Venture Law, it will again refer to this European experience. Detailed provisions of the more mature joint venture legislation in these jurisdictions, like the compensation trade contracts and joint state-private enterprises, provide the means for understanding the context and direction, perhaps even some details, of the future evolution of China's joint venture legislation.

III. Analysis of the Law

A. *The Translation of the Law*

Shortly after the Joint Venture Law was passed, the New China News Agency distributed an unofficial English translation and no other translation has appeared. The Chinese authorities, however, have never designated it as the official translation. Although for the most part the unofficial translation appears accurate, there exist several difficulties. Certain problems arise from the lack of clarity in the original Chinese text. Our major criticism of the unofficial translation, however, relates to its lack of internal consistency. The translators in a number of instances have used different English words to translate the same Chinese word. The result has been to draw distinctions in meaning that were not intended by the Chinese draftsmen of the Joint Venture Law.[84] Consequently, appended to this article is a translation of the Joint Venture Law which attempts to resolve these general problems of the unofficial translation.

B. *Article 1: Establishment of a Joint Venture*

Article one begins with a general, understated description of the purpose of the Joint Venture Law. The aim of the Law is to

83. *Id.* at 10X-5 to 10X-6.

84. For a fuller discussion of the unofficial translation, see Appendix II.

increase international economic cooperation and technical exchange. This, however, appears to be secondary to the Chinese need to facilitate imports of advanced foreign equipment, technology and managerial skills to modernize the Chinese economy. The Chinese government has acknowledged this motivation[85] and the joint venture legislation of other socialist countries states it expressly.[86] The lack of direct reference to it here is surprising.

The reference to the "principles of equality and mutual benefit" may be another example of unclear diplomatic language, but it also could be a legal standard which every joint venture would have to satisfy before being licensed. Presumably, if it is intended that the Foreign Investment Control Commission refuse to approve all joint ventures which do not comply with these principles, it would be more appropriate to place the discussion of such principles in article three which treats the approval procedure for joint venture proposals. If, on the other hand, the Commission is not to enforce these standards, then it is unclear what organization other than the State Council, which is authorized by Article 30 of the Constitution to implement laws, would perform this function.[87]

Regardless of which organ is to enforce such standards, the precise meaning of "equality and mutual benefit" remains unclear. This phrase, originating in the 1949 Common Program of the Chinese People's Political Consultative Congress,[88] has never been authoritatively interpreted by a Chinese court or other Chinese government organ. Indeed, "the principles of equality and mutual benefit" are not so much legal as political terms. Although Chinese officials have mentioned these principles in the context of foreign policy for many years, they are not enshrined in the Con-

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85. *See, e.g.*, Los Angeles Times, Sept. 4, 1977, at 1, col. 2; Financial Times, Sept. 24, 1977, at 19, col. 1; Wall St. J., Oct. 12, 1978, at 35, col. 2.

86. *E.g.*, Romanian Decree No. 424, *supra* note 29, art. 2 (Romanian joint ventures may be established for the following purposes: introduction of modern technologies and modern methods of management and production; raising technical quality and labor productivity; the promotion of exports; the development of collaboration activities in third markets; training of management).

87. THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, art. 30 (ZHONGHUA RENMIN GONGHEGUO XIANFA). Adopted on March 5, 1978, by the Fifth National People's Congress of The People's Republic of China at its First Session, the Constitution was published in 1978 by The People's Publishing House, Peking.

88. The Common Program of Chinese People's Political Consultative Congress, art. 57, *reprinted in* [1949-1050] COMPILATION OF LAWS AND DECREES OF THE CENTRAL PEOPLE'S GOVERNMENT (ZHONGYANG RENMIN ZHENGFU FALING HUIBIAN) [hereinafter cited as CENTRAL PEOPLE'S COMPILATION].

stitution. They constitute, therefore, a time-tested political policy—perhaps China's version of a "common law,"—rather than a constitutional requirement. Accordingly, as a matter of legal draftsmanship it might be advisable to omit them.

The words "companies, enterprises and/or other economic organizations" seem to be designed to encompass a wide range of entities. When applied to the foreign entities eligible to act as joint venture parties, however, these terms are not mutually exclusive. When applied to Chinese entities eligible to act as joint venture parties, it is not clear precisely what the terms mean. In the early years of the People's Republic the term "company" (*gongsi*), was generally used to describe a legal person established in accordance with the earlier Republican Company Law or the Implementing Regulations of the Provisional Statute on Private Enterprises[89] and taking the form of a limited company, or company limited by shares. In recent usage, however, the term refers to companies or corporations subordinate to local bureaus of industry and controlling a group of factories or "enterprises" *(qiye).*[90] China's foreign trading corporations, for example, are in fact "companies" *(gongsi)* and would be eligible to act as joint venture partners.

In general, the term "enterprise" seems to apply more often to the entity which is in fact producing the goods, and seems to take the place of the term "company" as previously used.[91] This is per-

89. Implementing Regulations of the Provisional Statute on Private Enterprises, *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14 at 114-36.

90. A. DONNITHORNE, CHINA'S ECONOMIC SYSTEM 25 (1969).

91. BASIC QUESTIONS IN THE CIVIL LAW OF THE PEOPLE'S REPUBLIC OF CHINA 68-69 (ZHONGHUA RENMIN GONGHEGUO MINFA JIBEN WENTI) (Civil Law Study Office of the Central Political and Legal Cadre School ed. 1958) [hereinafter cited as BASIC QUESTIONS].

The term "enterprises" refers to the two types of economic entities in China: state and collective. The state enterprises occupy the preferred position in the economy. They are often large in scale and managed by the government, which supplies capital, equipment, labor, raw materials and financing according to numerous central regulations. State enterprises offer their workers greater work stability, higher wages and more generous benefits. Collective enterprises, by contrast, are set up under provincially promulgated regulations, are generally small in scale and run by rural communes or urban street affairs offices which provide little or no capital and equipment. They offer low salaries and benefits to their employees, often women, older men and young people "awaiting assignment" (i.e. unemployed). They often perform functions, such as consumer services, which the state enterprises have ignored, but some of them have engaged in handicraft manufacture for export. These collective enterprises have the advantage of being able to operate free from the restrictions of the state economic plan

haps due to the influence of Soviet usage of the term "enterprise." It appears, therefore, that the draftsmen used the terms "companies" and "enterprises" to mean that the higher level companies and foreign trading corporations are allowed to participate in joint ventures as well as the factories subordinate to them. The addition of the term "economic organizations" emphasizes that the scope of entities eligible to participate in a joint venture is very broad.

It appears that all Chinese participants in a joint venture will probably be legal persons. According to general principles of Chinese civil law, state enterprises, state budget organs, cooperatives, and social organizations are legal persons. Other entities which have the following characteristics would also seem to be legal persons: Recognition by the state; independent control of property; ability to bear independently civil financial obligations; and ability to act in their own name.[92]

C. *Article 2: Protection of a Joint Venture*

The assertion that the Chinese government will protect the capital invested in the joint venture by the foreign joint venturer, its share of the profits and its other lawful rights and interests may strike foreigners as somewhat unusual. Presumably any foreign company considering a joint venture in China would assume that the Chinese government would welcome and try to facilitate its investment. Ideally, the foreign party's rights under the Joint Venture Law and other legislation would be sufficient protection by themselves. Access to independent courts would protect the foreign party's interest in the joint venture not only against third parties, but also against arbitrary actions by the Chinese government itself. United States businessmen—or at least their lawyers—would prefer protection by law to protection by the govern-

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and the many regulations which apply to state enterprises. Some potential investors might consider a joint venture with a collective enterprise, since it would have sourcing not dependent on the plan and might be able to assist the joint venture in this regard. Whether the joint venture company itself could operate as a collective enterprise seems open to question in view of the reference to "economic contracts" in Article 9 of the Joint Venture Law. *See* BEIJING REVIEW, June 8, 1979, at 5; *id.*, September 21, 1979, at 9; *id.*, August 31, 1979, at 10; Gelatt, *Signs of China's New Economic Order,* Asian Wall St. J., Nov. 6, 1979, at 6, col. 3.

92. BASIC QUESTIONS, *supra* note 91, at 68-71.

ment. The concept of government protection, however, is common in China. Article nine of the Constitution, for example, provides that the state shall "protect the citizen's lawful rights of ownership in income, savings, real estate and other means of livelihood"[93] and as noted above, article three of the Provisional Statute on Jointly Operated State-Private Enterprises provided for the "protection" of the lawful "interests" of the private shareholders by the state.

It is interesting to note, however, that in these prior cases, the institution granting the protection has been the state. In the Joint Venture Law, however, it is the government which protects the rights and interests of the foreign joint venture party. Chinese usage allows the use of the term "government" to refer not only to the present national leadership, but to the nation or state. The discrepancy in language, however, is unfortunate because it raises the question of whether the protection afforded to foreign joint venture parties is intended to be more limited than that afforded to Chinese citizens under the present Constitution or the Provisional Statute.

The term "according to law" is not altogether clear. Chinese law distinguishes between "laws," "decrees," and "regulations," but the term "law" *(fa)* can refer, as in English, to all of these enactments as well as legal principles. This is presumably the sense in which it is used here. But if the term "according to law" refers to other laws, decrees, regulations and legal principles besides the Joint Venture Law, it is unnecessary. If it refers only to the Joint Venture Law, then the nature of this protection remains unspecified.

Granting that the Chinese government desires to protect foreign investors' rights, two questions arise: First, what is the nature of the foreign joint venture party's rights; Second, has the Chinese government fulfilled commitments to protect such rights of private persons in the past? Interestingly, article two does not clearly specify the legal nature of the foreign participant's "lawful rights and interests." Nor does the Constitution provide any direct support for rights of foreigners.[94] Under general principles of Chinese civil law the question is whether or not the foreign party

93. The third section of the Constitution deals with the basic rights and obligations of "citizens." Thus, foreign companies, enterprises, economic organizations or individuals could not enjoy the rights enumerated there. The Constitution makes no mention of the rights of foreigners. PRC CONSTITUTION, arts. 44-59.

94. *See id.* art. 5.

to a joint venture has an "ownership" right. If he possesses an ownership right, he arguably would own the "means of production." This would be constitutionally acceptable, since article five of the Constitution provides only that ownership in China is "mainly" of two types, state and collective. Still, this would be a significant ideological concession as well as a substantial benefit to a joint venture party.[95]

General principles of Chinese civil law protect two types of legal interests of private parties. The first is ownership. The protection guaranteed to rights of ownership of Chinese citizens by article nine of the Constitution is fulfilled by specific legal means of protection available to the individual owner of the right. These include the right of the owner of a property right to a legal determination of his right to ownership, the right to return of the property, the right to prevent harm to the property, the right to compensation for damages, and the right of the return of unjust enrichment of another person relating to the property.[96] The second right of private persons is the right of a capitalist to receive fixed interest from companies which were converted into joint state-private enterprises during socialist reconstruction. Chinese legal authorities made it clear that this right was not one of ownership or a creditor's right, but a special, more limited statutory right granted by the 1956 Regulations of the State Council Relating to the Fixed Dividend Method Implemented in Jointly Operated State-Private Enterprises, mentioned above.[97] In contrast to the right of ownership, the right to fixed interest entitled the holder merely to a demand for payment. Whether this right was

95. One Japanese commentator has stated that the Joint Venture Law grants to foreign investors, "a right of ownership, but the concrete content has not yet been determined." Suzuki, *The Meaning and Problem Areas in China's Joint Venture Law*, 9 NITCHŪ KEIZAI KYOKAI KAIHŌ 12 (September, 1979) (THE JOURNAL OF THE CHINA-JAPAN ASSOCIATION OF ECONOMY AND TRADE).

96. BASIC QUESTIONS, *supra* note 91, at 129-33.

97. *Id.* at 169-72; Rui Mu & Hu Zhou, *A Discussion of the Capitalists' Right of Ownership in the Means of Subsistence After the Conversion of an Entire Trade or Industry to Joint State-Private Operation*, ZHENGFA YANJIU, April 1957, at 45-48 (RESEARCH IN POLITICS AND LAW). *See also* Ding Yi-zhi & Zhuo Ping, *Discussion of the Problem of Ownership of the Means of Production by the Capitalists After an Entire Profession or Industry is Converted to Public-Private Joint Operation*, ZHENGFA YANJIU, April 1956, at 37; Cao Jie, *Some Opinions on the Problem of the Nature of Fixed Interests in Law*, ZHENGFA YANJIU, August 1957, at 37; Wan Shan, *Regarding the Problem of the Ownership of the Means of Production by Capitalists After an Entire Profession or Industry has been Converted to State-Private Joint Operation*, ZHENGFA YANJIU, April 1956, at 35.

to be protected through the same mechanisms as the right to ownership is unclear, but appears doubtful. In socialist China as in other societies, the right of ownership appears to endow its holders with certain special privileges. For these reasons subsequent legislation should clarify whether foreign investors do indeed have an ownership right. Amendment of article two of the Law to include the word "ownership," as in article nine of the Constitution, would perhaps be the most effective means of accomplishing this.

Although the legal recourse available to the possessor of a fixed interest right does not seem to have been as great as that of a person who actually owned property, the Chinese government in general honored its commitment to pay the interest to these former capitalists. Although the Regulations do not mention the term over which such payments were to be made, other sources indicate that the original term was seven years, but was extended upon expiration for another three years.[98] Interest generally seems to have been paid over this period, although in some cases the interest rate was cut, the private investment upon which the interest payments were computed was reassessed downward and some capitalists even received non-redeemable government bonds in lieu of interest.[99]

References to the "agreement, contract and articles of incorporation" of the joint venture seem to imply a three step drafting-implementation procedure. The prospective parties to the joint venture first reach a consensus on the general nature of the joint venture which will be incorporated into an agreement. This agreement is not necessarily binding upon the parties, particularly if the later joint venture contract excludes all prior or contemporaneous oral or written evidence as to the nature of the joint venture agreement. After more detailed discussions, the parties to the joint venture draw up the joint venture contract, the legally binding document which details all aspects of the joint venture which the parties wish to determine for themselves. The final step in the process is the drafting of the articles of incorporation, which could be a legally independent document regulating those aspects of the joint venture not covered in the joint venture contract itself or simply an appendix to the joint venture contract.

The first sentence of article two, when read together with the second sentence, raises the most interesting question of the Joint

98. RICHMAN, *supra* note 13, at 398.
99. *Id.* at 897-98.

Venture Law—the relationship between the provisions of the agreement, contract and articles of incorporation of the joint venture and other Chinese legislation. The first sentence of article two states that the Chinese government will protect the investment, profits and other lawful interests and rights of the foreign joint venture party, while the second sentence of article two requires that all the joint venture's activities accord with Chinese laws, decrees and relevant regulations. By itself, the first sentence would seem to refer merely to the protection of the foreign party's interest in the joint venture and not to the operations of the joint venture itself. The intent of this sentence does not seem so much to proclaim a general protection of all aspects of a joint venture as to reassure prospective foreign participants that their interests will be safeguarded. Examination of the language of this sentence, particularly the reference to "other lawful interests," reveals that its meaning is that the Chinese government will grant protection to those provisions of a joint venture agreement, contract and articles of incorporation which are in accord with other Chinese legislation and are thus "lawful." This first sentence seems not to grant a carte blanche to the joint venture parties and offer Chinese government protection of whatever they draft into the joint venture documents approved by the Foreign Investment Control Commission. On the contrary, its language appears to restrict the rights and interests subject to protection to those which are granted by article two of the Law (right to investment and to profits) and in other Chinese legislation. Rather than giving precedence to the joint venture agreement, contract and articles of incorporation, this sentence seems to subject their provisions to prior Chinese legislation.

If there were any doubt as to this meaning, the second sentence of article two would seem to dispel it. In contrast to the first sentence, this sentence does not refer merely to the interests of one party to the joint venture, but to all the activities of the joint venture itself. It declares that all these activities shall be in accordance with applicable Chinese laws, decrees and regulations. This could mean that if the management of a joint venture acts in accordance with the joint venture contract, but in violation of a conflicting Chinese law, it would violate this provision. Thus, these two sentences of article two would seem to subject a joint venture's operations to all existing Chinese legislation, since this legislation could take precedence in case of a conflict with the joint venture agreement, contract or articles of incorporation.

It is true that Chinese official spokesmen, such as Rong Yiren,

have addressed this question at least indirectly. They have stated that the parties to a joint venture will be given wide latitude to determine the legal framework of a joint venture.[100] If they mean that the joint venture contract will take precedence over prior conflicting legislation the legal basis in the Joint Venture Law for such assertions is unclear.

Under these circumstances it would be in the interest of the foreign party to a joint venture to include in the joint venture contract a statement to the effect that it would take precedence over any other prior conflicting legislation. If this provision were accepted by the Foreign Investment Control Commission, it might be persuasive when the joint venture has to argue with Chinese officials that certain Chinese legislation should not apply to the joint venture.

The Chinese authorities might consider resolving this problem through amendment of the Joint Venture Law. In doing so they might refer to the joint venture laws of Romania and Yugoslavia which provide clear examples of how to deal with the issue of the compatability of joint venture documents and domestic legislation. As noted above, the Romanian law provides that the joint venture contract is to be approved by the State Council and thus acquire the same legal effect as any other statute. The provisions of the joint venture contract would thus take precedence over prior conflicting legislation. In Yugoslavia the constitution and the joint venture legislation provide that a foreign joint venture party's rights cannot be lessened by subsequent laws or regulations.[101]

Even subsequent legislation of this type, however, can not fully resolve the issue. Clearly the joint venture documents can not provide for the activities of an enterprise in the same detail as existing Chinese legislation. For those aspects of the joint venture's activities on which the joint venture documents are silent, current Chinese legislation will apply. This is true not merely as a matter of legal theory, but of common sense as well. The Chinese joint venture party, the joint venture's staff and workers as well as government offices and enterprises which deal with the joint venture will surely insist, unless convinced otherwise by the foreign joint venture party, that the joint venture follow provisions of Chinese legislation familiar to them in the absence of specific provisions in

100. Comments by Rong Yiren at Hong Kong Hilton Hotel (Nov. 9, 1979).
101. *See* text accompanying notes 62-63, *supra.*

the joint venture documents. Accordingly, prospective foreign joint venture parties will want to try to gain some understanding of the legal framework in which Chinese enterprises operate.

Finally, the requirement in the second sentence of article two that the activities of the joint venture comply with all applicable "laws, decrees and regulations" raises a number of questions. First, what is meant by the terms "laws, decrees and regulations?" Apparently the draftsmen intended these terms to encompass the whole range of legal enactments. In China laws (*falü*) are based on the Constitution and are passed by the National People's Congress.[102] Decrees (*faling*) (including decisions (*jueyi*), instructions (*zhishi*) and orders (*mingling*)) are passed by the Standing Committee of the National People's Congress on the basis of laws. Administrative regulations (*banfa, guiding*) are the only binding rules which can be passed or approved by state administrative organs.

Second, this requirement of legality raises the question of the necessity of such a provision. Any company operating in any jurisdiction realizes that it must comply with the laws, decrees and applicable regulations of that jurisdiction. Surely the Chinese authorities would not have waived their right to apply and enforce Chinese laws, decrees and regulations against a joint venture if they had not included this provision in the law. It appears, therefore, that this provision is probably unnecessary, but serves a certain publicity function. While the Chinese authorities are ready to welcome foreign participation in Chinese industry, they may well have certain doubts about their methods of operation and wish to express their concern that the foreign presence not lead to illegal activities. Given the bad repute in which capitalists have stood in China for the last thirty years, such a concern is understandable. This might explain the emphasis on the full gamut of legal enactments here rather than the simple reference to "law" as earlier in article two when mentioning the protection by the government of the foreign party's rights and interests.

The third question is whether the Chinese authorities could use this provision to exert pressure over a joint venture acting in substantial compliance with applicable laws, decrees and regulations. The point is that the foreign participant to a joint venture will

102. FALÜ ZHISHI WENDA 10 (QUESTIONS AND ANSWERS ON LEGAL KNOWLEDGE) (Chen Chun-long ed. 1979).

never know whether the joint venture is in compliance with all applicable laws, decrees and regulations of China. In fact, it is possible that the Chinese partners will not know either. The reason is that the Chinese government has not made available much of the legislation of the last thirty years. The lack of access to these laws, decrees and regulations, combined with the difficulty of reading the originals in the Chinese language, will probably prevent foreign parties from verifying that a joint venture is in compliance with Chinese laws. These difficulties will also enable officials to take measures against the joint venture on the pretext that it has violated some regulation. This, however, is not the only, or most injurious, aspect of this failure to know the laws. The foreign party's ignorance of the applicable laws and regulations will also make him a captive to any Chinese who claims without justification that the course of action which the foreigner wishes to take is in violation of some Chinese law, decree or regulation.[103] When the foreign party asks for a copy of the law or regulation, the other party could tell him that it is impossible to find it. Even if he had a copy, however, he would not be able to read or interpret it. Unfortunately, it appears that in China at present there are no independent lawyers versed in business affairs to whom a foreign joint venture party could turn. The Legal Department of the China Council for the Promotion of International Trade is establishing a Legal Advisors Office to serve as legal consultants to Chinese and foreigners.[104] This measure will certainly ameliorate the situation, but by no means completely solve the problem.

The final question posed by this section is whether an enterprise in China can be operated profitably and still comply with all applicable laws, decrees and regulations. This would apply particularly to a joint venture that was subject to the central plan's allocation of raw materials and all of the regulations applying to state enterprises.[105] No generally applicable answer to this problem is available.

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103. In the past certain local officials have taken advantage of enterprises, commonly collective enterprises which have accumulated substantial funds, to exact from them, in addition to 55% of their profits in accordance with income tax provisions, other illegal sums, such as 5% of their profits for "civil defense dues," another 5% as "urban construction dues" and still another 5% as "environmental maintenance dues." *See* 1 Foreign Broadcast Information Service, No. 179, September 13, 1979, at L-13.

104. Interview with Jen Tsien-hsin, Head of the Legal Division, in Beijing (Nov. 6, 1979).

105. *See* text accompanying notes 224-45 *infra*.

D. *Article 3: Approval of the Joint Venture*

This article sets out the procedures for the approval and registration of a joint venture in brief terms. The stipulation that the Foreign Investment Control Commission must approve any joint venture within three months is a positive measure. Still, as in Yugoslavia, it may take longer than three months to get approval on any particular joint venture, depending on the circumstances. If the foreign and Chinese parties to the joint venture are willing to submit for approval only a joint venture proposal which is likely to be approved, then the three month deadline probably will be met. If, however, the joint venture parties are willing to submit joint venture contracts containing provisions which may not necessarily meet with the approval of the Commission, or after submission they want to make amendments, the approval process could take much longer. It is unclear whether the commission will be willing to advise prospective joint venture partners of which specific portions of the contract are unacceptable and could be amended. If the commission is helpful to the parties and is willing to suggest changes, then there is a question whether the three month period begins to run again after the submission of each changed portion of the contract. The commission will probably take the view that the three month term begins again upon each resubmission. Despite this, the three month deadline is better than none.

The Foreign Investment Control Commission and the General Administration for Industry and Commerce are two of several organizations established to facilitate joint ventures. The Standing Committee of the National People's Congress established the Commission several weeks after the promulgation of the Joint Venture Law. Vice Premier Gu Mu was appointed as Chairman.[106] The General Administration for Industry and Commerce dates back to at least 1950. In that year the Central Administration for Private Enterprises undertook administration of the Provisional Act for Registration of Trademarks.[107] The General Administration for Industry and Commerce superseded this organization and

106. Renmin ribao (The People's Daily), July 31, 1979, at 1, col. 3. *China Establishing Organizations to Prepare for Joint Ventures*, Asian Wall St. J., Aug. 2, 1979, at 1, col. 1; Wen Hui Pao (Hong Kong), Oct. 5, 1979, at 2, col. 1.

107. A. DONNITHORNE, CHINA'S ECONOMIC SYSTEM 147, 275 (1968); G. HSIAO, THE FOREIGN TRADE OF CHINA 132, 219 (1977); The Provisional Statute on Jointly Operated State-Private Enterprises (adopted September 2, 1954), *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 74.

took control over the joint state-private enterprises in the mid-1950's.

The Government has established other organizations to help administer the work relating to joint ventures since the promulgation of the Law. These include the China International Trust and Investment Corporation (CITIC), the Financial and Economic Commission, the Import-Export Control Commission, and the State General Administration of Exchange Control.[108] Perhaps the most important institution for the prospective foreign investor in the first instance is CITIC which was established on July 8, 1979.[109] The Chairman of the Board of the Corporation, Rong Yiren, is a former capitalist from Shanghai. The purpose of CITIC, according to its articles of incorporation, is to introduce, absorb and apply foreign investment, advanced technology and advanced equipment for the purposes of China's national construction and the promotion of socialist modernization.[110] More specifically, the Corporation is to act as an intermediary between Chinese and Western enterprises interested in joint ventures. The Corporation has already signed an agreement with the First National Bank of Chicago enlisting the Bank's assistance in matching foreign and Chinese joint venture parties.[111]

The procedures for the registration of the joint venture and the receipt of its business license are not explained in detail in article three. It appears that the provisions of the Experimental Regulations on the Handling of Registration of Industrial and Commercial Enterprises generally apply to the registration of a joint venture.[112] These regulations outline a three step procedure for the registration of enterprises in China: First, the prospective enterprise must secure the consent of its superior organ in the bureaucracy. Second, it must gain approval and register with the principal registration organ of its county or municipality.[113] Finally, it

108. D.J., *China's New Financial, Economic Organizations,* 6 THE CHINA BUSINESS REVIEW, No. 5, at 9 (1979).

109. Renmin Ribao (The People's Daily), Jul. 9, 1979, at 1, col. 1.

110. *Id. See also* Wen Hui Pao (Hong Kong), Oct. 5, 1979, at 2, col. 1.

111. Chicago Tribune, Oct. 30, 1979, § 4, at 7, col. 1.

112. Experimental Regulations on the Handling of the Registration of Industrial and Commercial Enterprises, *reprinted in* [1963] COLLECTION OF LAWS AND DECREES OF THE PEOPLE'S REPUBLIC OF CHINA 159-61 (ZHONGYANG RENMIN GONGHEGUO FALING HUIBIAN) [hereinafter cited as COLLECTION].

113. This procedure seems to differ from the earlier procedures for approval and registration applied to private companies, under which a strict division of labor existed between approval and registration. *See* Provisional Statute on Pri-

must secure a license from the county or municipal people's committee or the principal registration organ. An enterprise may not conduct business before it has been approved and registered.[114] In the case of joint ventures, the reporting to the Foreign Investment Control Commission and the securing of its approval seems to be similar to the first step noted above. The Foreign Investment Control Commission acts in the same role as the superior organs act for Chinese enterprises. The registration of the joint venture with the General Administration for Industry and Commerce seems to be the equivalent of approval and registration by the county or municipal registration organs for Chinese enterprises. Like the Experimental Regulations, the Joint Venture Law does not make clear who issues the license. Perhaps it is the General Administration for Industry and Commerce, perhaps the county or municipal people's committee. It seems that the joint venture would be able to conduct business after registration and before issuance of the business license, although the application for the business license may be due within a short period after registration.[115]

E. *Article 4: Corporate Form of the Joint Venture*

The designation of the joint venture company as a limited liability company is significant. It appears that the particular form of company most appropriate for a joint venture would be a "limited company" (*youxian gongsi*). Prior Republican legislation, the present Company Law in Taiwan, the Provisional Statute on Private Enterprises and the related Implementing Regulations of the People's Republic all have specific provisions relating to a type of company called a "limited company."[116] The Provisional Statute on Private Enterprises, which together with the Implementing Regulations, are probably the most accurate forecast of China's

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vate Enterprises, arts. 11-16, *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 99-100; An Explanation and the Process of the Drafting of the "Provisional Statute on Private Enterprises," *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 108 (report delivered on December 29, 1950).

114. Experimental Regulations on the Handling of the Registration of Industrial and Commercial Enterprises, *supra* note 112, arts. 5, 6.

115. Article 6 of the Experimental Regulations states that "an industrial or commercial enterprise which has not been approved and registered shall as a rule not be allowed to begin operations." *Id.* art. 6.

116. *See* The Company Law, arts. 98-113 (1929), *reprinted in* A COMPILATION OF LAWS AND REGULATIONS (ZUIXIN LIUFA QUANSHU) (Z. B. Zhang & J. D. Lin ed. 1978).

future company law, provide in article three that a limited company is organized by two or more shareholders who are liable for the company's liabilities to the extent of their capital contribution.[117] This provision dovetails with paragraph three of article four of the Joint Venture Law, which states that the joint venture parties will share the profits and losses in accordance with their proportion of capital.

The provision in article four relating to the minimum percentage of registered capital invested by the foreign party is an interesting variation from other socialist joint venture laws. These laws generally provide for a maximum rather than a minimum percentage of foreign investment in any joint venture.[118] The Chinese Law, however, does not contain a ceiling on the percentage of the foreign party's investment in a joint venture. There has been much speculation on whether a 100 percent foreign investment would be permissible, and Rong Yiren, among others, has hinted that this would be possible.[119] Such a situation seems unlikely under present law. A 100 percent foreign investment would not fit the definition of a joint venture and would not be subject to the Joint Venture Law.

The provision requiring the approval of the other joint venture parties for the transfer of the joint venture's registered capital raises the question of whether an approval for transfer executed in advance with the name of the transferee and the date left blank would be an acceptable procedure. Available materials on Chinese law do not answer this question. A further question is the legality of other arrangements between the joint venture parties which they may not include in their joint venture contract, such as restrictions on export sales in a licensing agreement.

F. *Article 5: Form of the Investments*

Allowing investment in different forms creates problems of valuations. In the case of equipment, China may follow the practice in compensation trade agreements-supplying an original supplier's certificate. The value of goods should not be difficult to establish,

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117. [1963] COLLECTION *supra* note 112, at 159-61.

118. The laws of Romania and Yugoslavia provide for a maximum percentage of foreign capital of 49 percent.

119. Comments by Rong Yiren at Washington Hilton Hotel (October 9, 1979). *See also* Mainichi Shimbun, July 16, 1979, at 3, col. 3 (quoting Vice Minister Li Xiannian).

but it may not be easy to evaluate industrial property rights relating to the most advanced technology, since such technology may not yet have an established market value.

The second section of article five raises the related issue of the nature of the technology used as the investment by the foreign joint party. This section states that the technology and equipment must be truly advanced, but must also suit China's needs. Unfortunately, these two requirements may be contradictory, since a backward economy cannot always use the most advanced technology. Prospective foreign investors need not worry about this in the first instance, however, for it is the Foreign Investment Control Commission, and not foreign experts, which will determine what suits China's needs.

Perhaps of more importance is the question of what constitutes advanced technology. In sales of technology to Eastern Europe, the insistence of the purchaser that the equipment incorporate the most up-to-date technology has caused problems, since a lag time of one or two years between first discussions and final delivery mean that the technology by definition is not up-to-date when it is acutally transferred. Accordingly, the question arises whether the foreign firm can in good faith certify, as the contract requires, that the equipment is the most up-to-date at the time of delivery. A similar dilemma may confront foreign firms contemplating investments in China. It may be that Foreign Investment Control Commission approval of a joint venture will prevent further questioning of whether the technology and equipment supplied by the foreign joint venture party is truly advanced. The provision requiring the foreign joint venture to compensate for losses caused by the supplying of outdated technology and equipment, however, indicates that the approval of the Foreign Investment Control Commission itself may not be determinative. It is unclear what organizations other than the Commission might participate in the reassessment of the advanced nature of any particular technology, and what standards they would employ in making their determination. The Joint Venture Law specifically states that the foreign joint venture party must have intended to deceive before civil liability will be imposed on him. Presumably, the provisions of the newly enacted Chinese Criminal Code apply by analogy to determine whether such intent existed. Article eleven of the Criminal Code states that "knowing that one's actions will result in injury to society and desiring or allowing such result, thus constituting

an offense, is an intentional offense."[120] Until a substantial amount of case law has accumulated under the new Criminal Law, it will be difficult to determine how this standard will be applied.

The Joint Venture Law's reference in the third paragraph of article five to the "site" seems to apply only to land and not buildings. Certain evidence, however, contradicts this interpretation.[121] The interpretation of the term "site" as including only the land, may imply that the joint venture must establish the factory building. This could be a considerable burden, since the State Construction Bureau is reputed to be very slow in completing construction projects. Accordingly, many Chinese enterprises have had to build their own buildings and apartments for workers with their own resources.

The provision allowing the Chinese joint venture party to employ the right to use a site as its investment does not address the question of the nature of this right. The foreign joint venture party should see a copy of the contract or order which allows the Chinese joint venture party or the joint venture to use the site.[122] Although it seems fair for the Chinese joint venture party to be able to use the right to the site as its investment, the requirement that the joint venture pay rent to the Chinese government if the site is not used as investment is interesting in view of the practice of state enterprises.[123] Although payment for the use of a site is not unusual in capitalist countries, Chinese state enterprises do not pay for or include the value of a site or its rental value as an expense on their books.[124]

120. THE CRIMINAL CODE OF THE PEOPLE'S REPUBLIC OF CHINA, THE CODE OF CRIMINAL PROCEDURE OF THE PEOPLE'S REPUBLIC OF CHINA art. 11 (ZHONGHUA RENMIN GONGHEGUO XINGFA, ZHONGHUA RENMIN GONGHEGUO XINGSHI SUSONGFA) (1979).

121. Mr. Suzuki mentions a project in which a building was included with the land as the contribution by the Chinese joint venture party. Suzuki, *The Meaning and Problem Areas of The Chinese Joint Venture Law, supra* note 95, at 17.

122. Note the difficulties concerning the rights to use of land which occurred during the negotiations on several hotel projects in China in 1979. The central government authorities told the prospective hotel builders there was no problem about sites, but in fact, it turned out that the site locations were subject to disposition by municipal authorities who were not in agreement with the central government authorities. Asian Wall St. J., May 4, 1979, at 1, col. 4.

123. Romanian Decree No. 424, *supra* note 29, art. 14 similarly provides: [i]f the equivalent of the right of use of the ground has not been included in the contribution of the Romanian party, the Joint Company shall pay a rent to the State to be established for this use.

124. Kwang, *Economic Accounting in Mainland China,* INT'L J. ACCOUNTING

The final section of article five stipulates that joint venture parties will not determine the value of the site included as an investment by the Chinese joint venture party or as a site rented from the Chinese government. Presumably, this means that the Chinese government will determine the value of the site at its discretion. This has posed a problem in other socialist countries allowing joint ventures, principally Romania, where prospective joint ventures have failed because of the high valuation of the land site by government experts.[125] Since a free real estate market may not exist in China, it is difficult for the foreign party to know which land values are reasonable. A possible procedure would be to ask the Chinese for the Standards for Estimating Values of the Organs Managing Buildings and Land in local areas. Another procedure would be to try to determine the value of the adjacent land and compare it with the government determinations of the value of the site of the joint venture. Finally, if the joint venture site is in land being developed, it might be possible to make discreet inquiries of local peasants who had recently sold their land for other government projects.

The Joint Venture Law makes no mention of licensing agreements for patents, technology, or trademarks. This may be because a separate statute on licensing of technology may be drafted in the future. Since China is not a party to the Paris Convention for the Protection of Industrial Property[126] or any other international union for the protection of industrial property rights, foreign joint venture parties will have to rely on Chinese domestic legislation. Present domestic Chinese legislation relating to patents consists of two statutes.[127] These are not designed to protect

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98 (1976). Proposals for changing this situation have been made recently. *See* Liang & Tian, *A Discussion of the System of Compensation for the Use of Fixed Assets*, JINGJI YANJIU, No. 4 at 16-24 (1979) (RESEARCH IN ECONOMICS).

125. Suzuki, *The Meaning and Problem Areas of the Chinese Joint Venture Law*, *supra* note 95, at 16.

126. Paris Convention for the Protection of Industrial Property, March 20, 1883, 25 Stat. 1379, T.S. No. 379 (latest revision July 14, 1967, 21 U.S.T. 1583, T.I.A.S. No. 6923).

127. *See* Statute on Awards for Inventions, and Statute on Awards for Technical Improvements, *reprinted in* [1962] COLLECTION, *supra* note 112 at 241-46; China's New Invention Law, 6 THE CHINA BUSINESS REVIEW, No. 1, at 60 (1979). Theroux, *Licensing Operations in The People's Republic of China*, 74 PATENT & TRADEMARK REV. 37-39 (1976). *See also* the forthcoming article by Eugene A. Theroux in the George Washington University JOURNAL OF INTERNATIONAL LAW AND ECONOMICS.

foreign parties, but to encourage invention and technical improvements. Until China promulgates a new patent law, the United States joint venture parties may take some consolation from article six of the United States-China Trade Agreement under which China agrees "with due regard to international practice" to insure protection of patents and trademarks equivalent to the patent and trademark protection correspondingly accorded by the United States to Chinese corporations. Furthermore, China will facilitate enforcement of provisions concerning protection of industrial property in contracts and will provide means to restrict unfair competition involving unauthorized use of such rights.[128] Foreign joint venture parties should draft their patent and technology agreements to provide for the protection granted through legislation or international convention in other jurisdictions.

As for trademarks, China is not a member of the Universal Copyright Convention[129] or the Paris Convention for the Protection of Industrial Property.[130] China does, however, have legislation providing for the regulation of trademarks. The Statute for the Control of Trademarks provides in article twelve for a bilateral agreement on trademark registration between China and the country of the potential registrant before registration will be allowed.[131] On March 4, 1978, however, the China Council for the Promotion of International Trade informed the United States National Council for United States-China Trade that China would allow trademark registrations by United States businessmen as of January 1, 1978.[132] The Chinese government interpreted the requirement of a bilateral agreement as one of reciprocity. This requirement was fulfilled by United States permission to Chinese foreign trade corporations to register trademarks in the United States.

G. *Article 6: Management of a Joint Venture*

The provisions of this article relating to the Board of Directors

128. Agreement on Trade Relations Between the United States of America and the People's Republic of China, *reprinted in* INT'L LEGAL MATERIALS at 1048 (1979).

129. Universal Copyright Convention, Sept. 6, 1952, 6 U.S.T. 2731, T.I.A.S. 3324.

130. *Supra* note 126.

131. Statute for Control of Trademarks, *reprinted in* [1963] COLLECTION, *supra* note 112, at 243.

132. Letter from the China Council for the Promotion of International Trade to the National Council for US-China Trade (March 4, 1978) *reprinted in* TRADEMARK REGISTRATION IN THE PRC at 8-9 (N. Ludlow ed. 1979).

differ from those in the Provisional Statute on Private Enterprises and the related Provisional Regulations. The principle difference lies in the choice of a structure which includes a board of directors, but no shareholders meetings. The Provisional Statute provides for two forms of limited companies: one with a board of directors and stockholders meetings, and the second with executive shareholders who manage the affairs of the company without a board of directors. Since this latter structure does not allow control by persons not directly involved in the daily management of the company, it is inappropriate for a joint venture. The Joint Venture Law has thus adopted the latter arrangement for a board of directors but has dropped the provision for shareholders meetings. The reason for this is clear. The Provisional Statute on Jointly Operated State-Private Enterprises encouraged unanimity for board decisions in joint enterprises and pro forma shareholders meetings were held merely to allow reports by directors to shareholders.[133] Similarly, the Joint Venture Law provides that the board of directors of a joint venture will function on the basis of "equality and mutual benefit" for the foreign and Chinese partners. This provision makes shareholders meetings unnecessary since both investors will enjoy equal power on the board. All board decisions will be unanimous, stock ownership will not determine voting rights and each side will have a veto power.[134] Under these circumstances the stockholders meetings serve no useful function and may be dispensed with.

The question of which directors or officers of the joint venture will be the joint venturer's authorized representatives in dealing with third parties may be an item that can be determined in the joint venture contract. It is of interest to note that the Provisional Regulations on Private Enterprises provided that in a limited company, the members of the board would be the responsible persons of the enterprise. If the enterprise established a manager and a plant manager, the Provisional Regulations required them to handle the business of the company in accordance with the instructions of the responsible persons. In the execution of the enterprise's business, the responsible person or their representatives would bear legal responsibility for actions which violated a government decree, the articles of incorporation or a shareholders resolution and which caused damage to a third party, the bank-

133. Provisional Statute on Jointly Managed State-Private Enterprises art. 20, *reprinted in* 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 74.

134. Comments by Rong Yiren at Washington Hilton Hotel (Oct. 9, 1979).

ruptcy of the enterprise or, without reporting such fact to the shareholders, caused losses to the enterprise amounting to one-third of its capital. The responsible persons or their representatives had the right to refuse to implement any action which violated current law, the articles of incorporation or a shareholders' resolution.[135]

If the articles of incorporation of a joint venture follow these principles in determining the responsible persons of the joint venture company, then the fact that the chairman of the board is Chinese will not necessarily be unduly prejudicial to the foreign joint venture party.[136] The parties could still determine the other responsible persons of the company in its relations with third parties. Practical concerns probably would force the selection of a Chinese director or general manager as the responsible person or persons, but this would not necessarily bar a foreigner from also serving in that capacity. All contracts or other legal commitments of the joint venture could require the affixation of the seals of both the Chinese and the foreign responsible persons.

The duties to be performed by the personnel in the various positions mentioned in article six are generally clear. With regard to the accounting personnel, however, some questions remain. China has no independent certified public accountants; enterprises, organizations, banks, and schools are all required to establish internal accounting departments.[137] Regulations relating to accounting personnel refer to accountants *(kuaijiyuan),* and several other accounting functionaries but make no mention of an auditor *(shenjishi).* The duties of the chief accountant are clearly detailed in the Statute on the Authority of Accounting Personnel. It is unclear, however, whether such provisions apply to chief accountants in joint ventures. Presumably, the requirement in article fifteen of the Statute that an enterprise's directly superior organs approve its chief accountant will not apply to joint ventures. The description of their authority stipulated in article thirteen,

135. Provisional Statute on Jointly Managed State-Private Enterprises, *supra* note 133, arts. 19, 23.

136. In Taiwan, by contrast, the Chairman is a statutorily designated responsible person of a limited company. Zuixin liufa quanshu. Company Law, *supra* note 133, arts. 108, 208.

137. The Statute on the Authority of Accounting Personnel art. 2, at 3 (1978).

however, may be applicable.[138]

Since there are no independent public accountants in China, the accountant's responsibility is not to his profession but to the state. Accordingly, the Statute on the Authority of Accounting Personnel provides that in cases where an accountant is asked to perform acts that are false, corrupt, or deceptive, the accountant must refuse to enforce such activities and report them to the leader of his unit or to the superior organ.[139]

The last paragraph of article six raises in regard to the employment and discharge of staff and workers the same questions as article two does in regard to the joint venture as a whole. It appears that the term "according to law" means that the employment and discharge must be in accordance with current Chinese laws and regulations relating to employment and discharge. Rong Yiren has stated that employees of a joint venture will undergo special testing, can receive higher wages than ordinary Chinese workers, and can be dismissed for good cause.[140] The relationship between the joint venture, its staff, workers, and current Chinese labor laws and regulations is unclear, but it appears that failure to provide otherwise in the joint venture documentation will result in the application of current Chinese legislation. For purposes of reference and discussion, it may be helpful to consider a few provisions of current Chinese labor legislation and the extent to which they would be acceptable to a foreign joint venture party.

In China the local labor bureau exercises authority over the employment and work conditions of workers in all state enterprises pursuant to a State Council decision of 1950. Since 1958 the local labor bureau has implemented an administrative system of labor allocation which has developed to control undesirable migration to the cities.[141]

Relevant legislation has classified employment in industrial en-

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138. *Id.* Art. 13. *See also* Draft Regulations of the State Economic Committee and the Ministry of Finance on Chief Accountants Established in State Operated Industrial and Transportation Enterprises, *reprinted in* [1963] COLLECTION, *supra* note 112, at 134.

139. Statute on the Authority of Accounting Personnel art. 9, *supra* note 137 at 5.

140. Comments by Rong Yiren, at Washington Hilton Hotel (Oct. 9, 1979).

141. Decision of the Finance and Economic Committee of the State Council on the Working Relationships between the Provincial and Municipal People's Government's Labor Bureaus and Local State Operated Enterprises, *reprinted in* [1949-1950] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 490.

terprises into three different types: temporary employment, contract employment, and regular employment. Temporary workers include a broad range of peasants from the countryside and delinquents.[142] Some factories have used temporary workers to construct buildings and other construction work. The Provisional Regulations of the State Council Relating to the Use of Temporary Workers by State Enterprises provides, in article three that, except for emergencies, the local labor bureau must approve and implement any request for the use of temporary workers.[143] The hiring enterprise must execute a labor contract with the temporary workers themselves or their organization (such as a rural commune) and send a copy of it to the local labor bureau which bears responsibility for seeing that both sides fulfill it.[144] The advantage of temporary workers is that they are not eligible for the bonuses, welfare payments, and other labor law benefits to which regular workers are entitled. Therefore, temporary laborers are generally cheaper. They can also be dismissed when their work is completed pursuant to article one of the Provisional Regulations.[145] In fact, during the 1950's planners valued the flexibility and cheapness of temporary workers and encouraged enterprises to hire them instead of permanent workers.[146]

Contract employment is a system under which workers from other economic units are assigned as a group to work on a specific assignment and return to their original economic unit upon completion of the assignment. The contract between the employing enterprise and the supplying economic unit stipulates the specific tasks to be performed, the payments to the commune and individual laborers, and the preservation of the worker's work-point

142. C. HOFFMAN, THE CHINESE WORKER 66 (1974) [hereinafter cited as HOFFMAN].

143. The Provisional Regulations of the State Council on the Use of Temporary Workers by State Enterprises, *reprinted in* [1962-63] COLLECTION, *supra* note 112, at 221.

144. *Id.* art. 7.

145. The Provisional Regulations of the State Council on the Use of Temporary Workers by State Enterprises, art. 1, *reprinted in* [1962-63] COLLECTION, *supra* note 112, at 221.

146. *See* Provisional Regulations of the State Council Concerning the Hiring of Temporary Workers from the Countryside by Unit, *reprinted in* [1957] COLLECTION, *supra* note 112, at 481; Provisional Regulations of the State Council on the Use by State Enterprises of Temporary Workers, *reprinted in* [1962] *Id.* at 220.

rights in their commune.[147]

Regular workers are employed full time in one enterprise for a long period. They are divided into apprentices and masters.[148] In accordance with the Provisional Regulations of the State Council concerning the Periods of Apprenticeship and the Living Allowances of Apprentices in State Operated, State-Private Jointly Operated, Cooperatively Operated and Individually Operated Enterprises and Businesses, apprentices train at least two and generally three years, under the supervision of a master with whom they execute an apprenticeship contract. When their term of apprenticeship expires, they take a qualifying test for permanent employment.[149] The apprenticeship contracts seem to provide that if the apprentice does not pass the test, the enterprise will retain him for another six months to pass it. If he fails a second time he may remain on the job another six months. At the end of four years the enterprise may fire him.[150]

The control mechanism for preserving the distinctions between these three types of workers is the residence card. An enterprise may only hire as a regular worker a job applicant whose residence card is validated for the location of the enterprise. Thus, the manager of a plant must check whether a job seeker's residence card has been validated for the area in which the plant is located. If it has not been, the manager of the plant will know that it is illegal to give him a regular position.[151]

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147. HOFFMAN, *supra* note 144, at 69.

148. This discussion on apprenticeships is in part based on information derived from a series of transcripts of interviews with Chinese refugees conducted by Professors William Parish and Martin Whyte in Hong Kong, 1977-78. These transcripts are referred to periodically throughout the remainder of this article. The transcripts are located in Professor Parish's office at the University of Chicago. Hereinafter this source will be identified by the word "Transcript" followed by the Reporter's designation and page number. For example, the apprenticeship information may be found at Transcript KSP-6 at 5. *See also* Provisional Regulations of the State Council concerning the Periods of Apprenticeship and the Living Allowances of Apprentices in State-Private Jointly Operated, Cooperatively Operated, Individually Operated Enterprises and Businesses, *reprinted in* [1958] COLLECTION, *supra* note 112, at 398.

149. Provisional Regulations Concerning Periods of Apprenticeship and Living Allowances of Apprentices, *supra* note 148, arts. 1, 7.

150. *Id.* art. 7; *Resurrect the System of Signing Contracts Between Masters and Apprentices*, Renmin Ribao (The People's Daily), Mar. 14, 1978, at 7.

151. HOFFMAN, *supra* note 144, at 90. For additional documentation, see Outline of the Internal Labor Regulations of State Enterprises, *reprinted in* [1954] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 152.

A foreign firm entering into a joint venture should consider which types of employees would be most beneficial to a joint venture. Regular workers would probably be the most skilled and disciplined, but the benefits and allowances to which they are entitled would make them relatively expensive. Chinese factories are expected to provide many of the welfare services and facilities that in the West are often provided by the state. As one observer has noted, "Truly, large Chinese factories do provide cradle-to-grave protection, and blessed is he or she who happens to work for a really wealthy and munificient one."[152] A partial list of the benefits which Chinese workers receive would include work clothes, medical care, grain differential, supplemental salary, transportation fee, traffic allowance, cold drink fee, livelihood supplement for the poor, and winter fuel supplement fee. In addition, Chinese factories often build housing for their workers. Such factories may charge their workers rent, but often only enough to cover upkeep expenses rather than construction costs.[153] Still, the percentage of the total wage package which is devoted to welfare benefits may not seem high to some Western firms. Although a recent source has suggested that such welfare payments may amount to 36 percent of total compensation, the typical figure is probably around thirteen percent.[154]

Another drawback of regular workers is the problem of job permanency. Although Chinese law allows for the dismissal of a worker through certain procedures, in practice, Chinese workers enjoy an "iron rice bowl," that is, a permanent position from which they will be dismissed only for political offenses.[155] While a joint venture could provide in its articles of incorporation for exceptions to certain procedures relating to discharge, it would also be wise to try to prepare the Chinese workers psychologically for dismissal. One possible means of doing this would be to adapt the apprenticeship system to a joint venture. The joint venture could classify as apprentices all newly hired workers, and thereby subject them to preliminary screening exams before hiring and to a technical exam after a reasonable period. The joint venture could release those who could not pass the exam on the second try. The

152. W. Parish, *The View from the Factory,* in THE CHINA DIFFERENCE 196 (R. Terrill ed, 1979).

153. Transcripts KSP-11, *supra* note 148, at 1; *Id.* CHS-4 at 3; *Id.* CRD-1 at 4; *Id.* HNH-1 at 10.

154. *See* Howe, *infra* note 203, at 252.

155. Transcript CCSN, *supra* note 148, at 10.

hiring of temporary workers would avoid the problems of high welfare benefit costs and of expectations of permanent employment, but might involve unacceptable sacrifices in skills and discipline. The hiring of contract workers seems to involve the same type of trade-off.

Whatever the type of workers employed, the legal framework for employment will be similar: recruitment through a local labor bureau and execution of a collective contract covering the working conditions and other aspects of employment between the enterprise and the labor union as collective representative of the workers and staff members as provided for in article five of the Trade Union Law of the People's Republic of China.[156] Since these collective agreements contain the provisions relating to working conditions at the enterprise, and since the joint venture contract is not necessarily binding on the workers, it is important that the foreign joint venture party incorporate its suggested labor policies in the collective contract as well as in the joint venture contract.[157] This would also serve to prepare the workers for the joint venture's employment policies.

The question of discharging an employee is covered by articles eleven and twenty-two of the Trade Union Law. The most difficult person to dismiss is a union committee member. Article eleven requires the approval of a superior trade union committee before a committee member at a factory may be dismissed. A foreign joint venture party may want an exception to this article, or it may want to reach assurances with the workers and party members in the factory as to the election of the trade union committee members.

Article twenty-two is a more generally applicable provision that states that the management must inform the trade union commit-

156. *Reprinted in* COMPILATION OF CENTRAL LABOR LAWS AND DECREES at 2 (Labor Policy Study Office of the Ministry of Labor ed. 1953) (ZHONGYANG LAODONG FALING HUIBIAN).

157. Foreign joint venture parties should realize, however, that personnel and labor policies are a particularly sensitive area. For example, in the joint state-private enterprises in which former capitalists continued to play a management role, they were given more leeway in making technical decisions than in matters directly involving personnel matters. It seems likely that the Chinese officials and joint venture parties will take the same view toward foreign capitalists. *Capitalists and Managers, supra* note 10, at 59. For a copy of what a standard collective agreement should contain relating to labor relations, see Outline of the Internal Labor Regulations of State Enterprises, *reprinted in* [1954] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 152-56.

tee at the factory of the name of the employee and the reasons for the proposed discharge ten days in advance of the dismissal of an employee. If the trade union committee finds that the dismissal violates any law or decree or the provisions of the collective agreement, it may then protest and the case will be handled in accordance with the procedures for settling labor disputes. The Regulations of the Ministry of Labor Concerning the Procedures for the Resolution of Labor Disputes of 1950 specify these procedures.[158] Article five of these Regulations provides that when both parties to a dispute cannot agree they must refer the matter, in the case of a state enterprise or a jointly operated state-private enterprise, to the organization in charge of the enterprise for resolution, or in the case of a private enterprise, to the labor union and the guild organization of the enterprise for resolution. If these procedures do not lead to the resolution of the dispute, the parties may refer it to a local administrative organ for mediation. If this is unsuccessful they may refer the matter to a Committee on Labor Disputes for arbitration.[159] If one of the parties is dissatisfied with the arbitration award, it may appeal to court. Foreign joint venture parties should avoid this lengthy and time-consuming procedure. If possible, they should include in their joint venture agreement and in the collective contract they sign with the union, provisions for more streamlined handling of dismissals.

Perhaps one of the most important questions relating to the workers in a joint venture factory will be the question of wages. Rong Yiren and other Chinese officials have noted that joint ventures will be able to pay workers more than do regular Chinese state enterprises.[160] It seems likely that a joint venture would be able to set its own wage system. In practice, the issue of wages may not concern whether the foreign joint venture party wishes to pay higher wages than the Chinese authorities believe is useful, but that the Chinese authorities will demand higher wages than the foreign party believes are warranted. According to reports, the Chinese officials discussing joint ventures have placed a value on the labor of Chinese workers equivalent to two thirds or the entire

158. *Reprinted in* [1950] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 476.

159. The Committees on Arbitration on Labor Disputes were established under the Regulations on the Work and Organization of Municipal Committees for Labor Disputes, *reprinted in id.*

160. Comments by Rong Yiren at Washington Hilton Hotel (Oct. 9, 1979).

hourly wages in Hong Kong.[161] If this is true, such high wages coupled with welfare benefits and low per capita productivity may well price Chinese labor out of the market. If, as seems more likely, the Chinese follow the example of compensation trade agreements in which the enterprise deliberately sets the net price to the foreign purchaser of products below production costs of comparable products in Taiwan and Hong Kong, this problem should be alleviated.[162]

A foreign joint venture party should be aware that the party committee chairman and not the chairman or general manager may receive the highest salary in a Chinese enterprise.[163] Foreign observers generally agree that it is the party members who in fact run Chinese factories, regardless of what otherwise appears to be the case. The widely touted three-in-one technical groups (including managers, technicians and workers) appear to be formalistic.[164] Typically, party members play key roles in personnel matters, overall direction, leadership, selection, training and appraisal. Managers and experts have a voice in planning, technical decision making, control, organizing activities, technical training and some personnel appraisal work.[165] A foreign investor should keep these facts in mind in drafting the articles of incorporation and in hiring management personnel.

China has many statutes dealing with various aspects of work, such as hours, wages and supplemental benefits. Even assuming that some of these matters can be provided for in the joint venture contract, many areas will remain in which the foreign joint venture party, in particular, will be unaware of applicable Chinese regulations. As might be expected, much of this legislation is

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161. Ludlow, *China Wire* 6 CHINA BUS. REV., No. 6 at 15 (1979).

162. In considering other non-monetary incentives, foreign joint venture parties should be aware of some of the means by which an enterprise is able to affect the lives of its workers. In a Chinese enterprise, the work unit exercises the following control over an individual worker: a worker must receive permission from his work unit to marry; a worker must go to his work unit for the best sources of housing, which are extremely scarce for young couples; the worker's unit enforces a limit of two children per couple; a worker's unit must approve any divorce. Parish, *The View from the Factory, supra* note 152, at 196.

163. Howe, *Labor Organization and Incentive in Industry, Before and After the Cultural Revolution,* in AUTHORITY, PARTICIPATION AND CULTURAL CHANGE IN CHINA at 234 (S. Schram ed. 1973).

164. Parish, *The View from the Factory, supra* note 152, at 193.

165. *Capitalists and Managers, supra* note 10, at 70.

general in character. For example, article nine of the Regulations on Factory Safety and Sanitation requires that a work site be kept neat and clean.[166] Whether this requirement will cause a problem depends on how it is administered. In most cases, no difficulties should arise.

There may be instances, however, where foreign practices will conflict with Chinese requirements. One example of a potential problem which could arise relates to exports of the joint venture's products. According to article seven of the Provisional Regulations on the Inspection of Exported and Imported Goods, the China Commodities Inspection Bureau inspects all goods on its current inspection list according to meticulous standards set by the Ministry of Foreign Trade.[167] United States labor-saving techniques call for packaging of small items, such as bolts, by weight assuming, for example, that 1,200 bolts equal eight pounds.[168] The Inspection Bureau, however, counts out the items by hand and rejects a shipment if it discovers discrepancies. Accordingly, by the rigorous application of these regulations, the Chinese authorities could prevent a joint venture from using labor-saving techniques which are common in the United States.

H. *Article 7: Taxation*

The present Chinese tax system has two taxes of interest to prospective joint venture parties: a turn-over tax and an income tax. The turn-over tax is imposed at graduated rates at each stage of production or distribution upon transfer of the goods from one entity to another and at the retail level when the goods are sold.[169] The turn-over taxes are calculated according to different rates for

166. Regulations on Factory Safety and Sanitation, *reprinted in* [1956] COLLECTION, *supra* note 112, at 399.

167. Provisional Regulations on the Inspection of Exported and Imported Goods, *reprinted in* [1953] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 72.

168. *See* Torbert, *The American Lawyer's Role in Trade with China*, 63 AM. B. A. J. 1117, 1120 (1977).

169. *Taxation in the People's Republic of China*, [79-18] INT'L TAX REPORT 1, 2. *See also* Draft Statute on the People's Republic of China Industrial and Commercial Consolidated Tax, *reprinted in* [1958] COLLECTION, *supra* note 112, at 126-44; Fujimoto, *On the Unified Industrial and Commercial Tax of China*, 115 KOKUMIN KEIZAI ZASSHI 96, 96-108 (JOURNAL OF ECONOMICS AND BUSINESS ADMINISTRATION).

different products (e.g. 1.5 percent for coarse cloth, five percent for steel, sixty-nine percent for cigarettes). The income tax is imposed on industrial and commercial enterprises at a progressive rate on the amount of gross receipts. An additional surtax raises the maximum to 55 percent. Costs, expenses and losses, however, are deductible.[170]

The other provisions of article seven relating to tax holidays and rebates are common in developing countries and in Eastern Europe. There are, however, several other tax aspects of which a prospective joint venture should take notice. A prospective joint venture party might want to negotiate with the Foreign Investment Commission for tax benefits other than those provided by article seven or in future Chinese tax legislation. Article nine of the Provisional Statute on Private Enterprises provides that an enterprise may enjoy special tax benefits if its activities are in response to the country's needs or if the enterprise develops a significant new invention.[171]

Currently, there is no income tax treaty for the prevention of double taxation between the United States and the People's Republic of China. Such a treaty would reduce the tax rate imposed by China on income received by the United States joint venture party. The United States Federal Income Tax Law, however, does provide credits or deductions of certain foreign taxes paid or accrued by United States taxpayers.[172]

In structuring the Chinese joint venture, the United States joint venture party will have to be aware of various United States Income Tax Law provisions. Among the provisions that may relate to a joint venture transaction are those concerning the tax-free treatment of contributions of technology to the joint venture.[173] Another area, principally of interest if the contracting joint venture party is a foreign subsidiary of a United States corporation, is that concerning current recognition of undistributed income of the subsidiary received from the joint venture.[174]

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170. Cohen & Stevens, *China's Emerging Tax Policy,* Asian Wall St. J., Feb. 28, 1979, at 4, col. 3. *See also* Provisional Statute on the Industrial and Commercial Tax, [1949-50] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 236-47; The Experimental Regulations of the Ministry of Finance Ending the Industrial and Commercial Tax System, *reprinted in* [1958] COLLECTION, *supra* note 112, at 274-78.

171. The Provisional Statute on Private Enterprises, art. 9. 1 CIVIL LAW REFERENCE MATERIALS, *supra* note 14 at 99.

172. I.R.C. §§ 901-04, 960.

173. *See,* I.R.C. §§ 351, 721.

174. *See,* I.R.C. §§ 951-64.

Another aspect of taxation about which article seven is silent is that of customs duties. Other jurisdictions which wish to encourage foreign investment have allowed exemptions from or deferral of customs taxes on imported items.[175] The requirement of giving priority to Chinese purchases, as stated in article nine, may imply, however, that the Chinese do not wish to encourage the use of imported raw materials or components by lowering the import duties or giving exemptions or rebates to joint ventures. The practice in compensation trade, however, would indicate the contrary. This is a point which should be clarified by the Chinese authorities.

I. *Article 8: Banking*

It is interesting to note that this article requires the joint venture to open a bank account with the Bank of China or a bank approved by it. This grants primary authority over the joint venture's banking activities to the Bank of China, rather than its parent corporation the People's Bank of China which functions as the central bank and the primary domestic bank.[176] The authorization of the Bank of China to handle a joint venture's banking account may be due to the fact that the Bank of China, which acts as the foreign arm of the People's Bank, is more experienced in dealing with the foreign transactions in which the joint venture will be involved.

The joint venture will certainly need the services of a bank, but the foreign joint venture party may well want to consider whether it wants the same relationship with its bank as Chinese enterprises have. In general, enterprises in China must use the services of the People's Bank which closely supervises the enterprise's financial activities.[177] Enterprises must submit a copy of every

175. *See, e.g.*, Taiwan's Statute for Encouragement of Investment art. 27, *reprinted in* ZUIXIN LIUFA QUANSHU, *supra* note 116, at 773. *See also* text accompanying note 116 *supra*.

176. B. SZUPROWICZ & M. SZUPROWICZ, DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, 76-78 (1978).

177. *See, e.g.*, Regulations of the Ministry of Commerce and the People's Bank of China Concerning the Abolition of Commercial Credit Within State Operated Commercial Enterprise Systems and Their Subdivisions, *reprinted in* [1954-55] CENTRAL PEOPLE'S COMPILATION, *supra* note 88, at 278-86; Supplemental Notification from the State Council to the Ministry of Finance and the People's Bank of China Concerning the Change in the Liquid Assets of State Enterprises to Unified Handling by the People's Bank, *reprinted in* [1959] COLLECTION, *supra*

contract they execute to the Bank. Further, in China, government agencies and enterprises may not extend credit to one another, nor may they keep on hand significant balances of cash. Holders of excess cash must deposit it in the Bank. Since all such units engaged in business must open clearing or settling accounts with the Bank, the Bank clears and settles all claims among government agencies and enterprises. Except for certain transactions specifically authorized to be settled in cash, government units must settle transactions through the clearing system of the Bank. A foreign joint venture party should discuss with the Foreign Investment Control Commission and the Bank of China the relationship between the Bank and a joint venture.

In regard to foreign exchange, it appears that China at present has no generally applicable foreign exchange regulations. Foreign exchange regulations relating to the early period of the People's Republic are available. These are the Provisional Regulations on Foreign Exchange Control in East China, which were promulgated June 3, 1949, and the related Implementing Regulations, which were promulgated June 9, 1949.[178] Future exchange control regulations to be promulgated by the People's Republic may be similar in structure. Almost certainly they will be similar in content. The Chinese authorities will decide the remittance of foreign exchange on a discretionary case-by-case basis. The Chinese authorities may provide in future legislation certain guarantees relating to the remittance of foreign exchange. Japanese commentators have suggested that China should guarantee the remittance of compensation for the transfer of ownership of shares in a joint venture by a foreign participant, the capital and assets returned to a foreign participant following dissolution, as well as dividends, principal and interest on funds borrowed from a foreign country, and the remuneration of foreign employees.[179] Such guar-

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note 112, at 121-23. *See also* Provisional Regulations Promulgated by the Finance and Economic Committee of the State Council of the Central People's Government on the Signing of Contracts by Organs, State Managed Enterprises and Cooperatives arts. 2, 3, *reprinted in* 2 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 204.

178. HUADONGQU WAIHUI GOANLI FAGUI HUIBIAN 1, 4 (Chinese Economic Investigation Office ed. 1949). These Regulations provide in articles 7 and 12 that only the Bank of China and its appointed banks may sell foreign exchange and only to persons who have received prior approval of the Bank or other government authorities.

179. China's Foreign Investment Law and Problems Involved, CHINA NEWSLETTER, October 1979, at 22.

antees of remittance would certainly give a greater sense of security to foreign investors.

As a legal matter, however, they would probably not guarantee remittability of any particular sum at any particular time in the future. Guarantees generally only grant the recipient the right to apply to purchase foreign exchange from the appropriate banking authorities when such authorities are selling foreign exchange.[180] Should they refuse to sell foreign exchange at any time in the future, the beneficiary of a government guarantee cannot obtain a court judgment ordering the foreign exchange authorities to sell the claimant foreign exchange. As a matter of substantive legal rights, therefore, such a guarantee would grant the beneficiary a priority position, not an enforceable right to foreign exchange. China would probably honor such guarantees, as it would requests for foreign exchange without such guarantees, not because it is legally obligated to do so, but to maintain its good name among foreign investors.

Article five paragraph one of the Trade Agreement between the United States and China would not seem to provide any assistance to United States joint venture parties in the remittance of their earnings from China. The article is restricted to "payments for transactions between the United States of America and the People's Republic of China."[181] This is disappointing because the second sentence in the article which limits restrictions on such payments to time of national emergency could be of some help.

Foreign exchange regulations of the type noted above should be familiar and acceptable to foreign investors and their bankers. A more substantial problem for the joint venture party and foreign banks will be the uncertainties under Chinese law relating to the obtaining and enforcing of security. This may mean that the Chinese party may call upon the foreign joint venture party to provide security, perhaps a guarantee, to a foreign bank extending credit to a joint venture. The financing arrangements in compensation trade indicate that foreign banks connected with the Bank of

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180. Such is the situation in Taiwan, for example. Torbert, *The Legal Status of United States Corporations and Individuals in Taiwan if United States—Republic of China Diplomatic Relations Were Severed*, 1 HASTINGS INT'L & COMP. L. REV. 295 (1978).

181. Agreement on Trade Relations Between the United States of America and the People's Republic of China, July 7, 1979, art. 5(1), *reprinted in* 18 INT'L LEGAL MATERIALS at 1046 (1979).

China may be willing to help finance joint ventures, perhaps without guarantees by the foreign joint venture party.

In regard to insurance, the foreign joint venture party might suggest that if the Chinese joint venture party provides the site and the building, the Chinese party should also insure the building as well. Insurance of the building by the Chinese party would be an incentive for it for a lower, rather than higher, assessed value for the building.

J. *Article 9: Purchasing and Selling*

Aside from the question of labor and its regulation, the most important problem area in a joint venture may well be that of purchasing and selling. The principal question here is whether China will integrate a joint venture into the national economic plan and subject it to the plan's restraints. The term "economic contracts" in the first paragraph of article nine indicates that it will. In China the term "economic contracts" (*jingji hetong*) refers to different types of contracts, such as contracts for the supply of materials, production cooperation contracts or services contracts, but all of them play the role of implementing the state plan.[182] Since the plan is not self-executing, it uses economic contracts to translate its general principles into specific terms. Generally, the superior authorities who sign general contracts relating to fulfullment of the plan objectives set the requirements of the plan. More specific contracts between enterprises prescribe the particular transactions which will implement the general contracts.[183] These specific contracts have a dual nature. Some terms are primarily administrative, having been set by the distribution plan or legislation. These include the parties to the contract, the price, the assortment and the amount of the product.[184] Other

182. Song Jishan, *A Brief Discussion of the Nature and Use of Industrial Economics Contracts in Our Country*, JINGJI YANJIU 1, 3-4 (1965) (ECONOMIC STUDIES). Recent reforms introduced on an experimental basis in selected factories may grant enterprises more autonomy, but should not alter the fundamental attributes of the system of economic contracts described here. *See* Renmin Ribao (The People's Daily), July 29, 1979, at 1, col. 1-2.

183. R. PFEFFER, THE ROLE OF CONTRACTS IN CHINA 28 (1970); Hsiao, *The Role of Economic Contracts in Communist China*, 53 CALIF. L. REV. 1029 (1965) [hereinafter cited as Hsiao, *Economic Contracts*].

184. Hsiao, *Economic Contracts, supra* note 185, at 104-7. To a United States lawyer the stipulation of the terms by other than the parties to the contract raises the question whether these contracts are freely entered into and constitute contracts at all. *See* PFEFFER, *supra* note 183, at 30-48.

terms are contractual, having been agreed upon by the parties. These may include the packaging, the procedure of delivery and inspection and the fine for breach.

The administrative nature of Chinese contracts has two important consequences. First, once formed, the contract must be executed in accordance with its terms and cannot be altered or rescinded unless there is a change in the plan or the proper administrative unit authorizes such alteration or recission. Thus, specific performance of obligations is emphasized, since only by specific performance can the plan be fulfilled.[185] Second, an executed contract is still vulnerable to outside interference. Administrative organs in charge of supervising the plan can amend the contract at their discretion just as they prohibit the parties to the contract from doing so.

Legislation prescribes certain terms of the economic contracts executed between enterprises. For example, the Provisional Regulations Promulgated by the Finance and Economic Committee of the State Council of the Central People's Government on the Signing of Contracts by Organs, State Managed Enterprises and Cooperatives and the Provisional Basic Provisions of Supply Contract for Products of the Ministry of Heavy Industry of the People's Republic of China provide for a number of obligatory contract provisions. These relate to such matters as quality, packing, transportation, delivery, inspection upon delivery, price and payment, penalties and dispute settlement.[186] When a breach of contract occurs, the contract terms demand not only specific performance, but a penalty as well. For example, the obligatory contract terms in heavy industry call for a penalty of 5/10,000 of the total price of the contract for each day's delay in delivery of the goods.[187] Such penalty clauses apply in cases of default, regardless of damage, but only if the guilty party was at fault.[188] In the case of force majeure the enterprise breaching a contract is not liable. A change of the economic plan by superior planning organs seems to constitute force majeure, but whether force majeure also applies to the breach of an obligation to the obligor by a third person if it should cause the obligor's default is unclear. One specific case seems to indicate that it would.[189] Contract

185. *See* PFEFFER, *supra* note 185, at 37-38.
186. 2 CIVIL LAW REFERENCE MATERIALS, *supra* note 14, at 205, 243.
187. *Id.* at 243.
188. PFEFFER, *supra* note 185, at 39.
189. *Id.* at 54-55. Note, however, that the Chinese do not regard acts of gov-

breaches in China have not been uncommon and in some cases the fines have been considerable.[190] For example, a machine tool factory in Shanghai was liable for a total of 150,000 *yuan* for failure to perform contract obligations. Interestingly, the factory was not ordered to make payment, since this would have disrupted its operations.[191]

The nature of the Chinese state enterprises probably makes such a result inevitable. Chinese enterprises enjoy state-provided fixed and liquid assets. The plan allocates the former while bank credit supplies the latter. Chinese law prohibits an enterprise from disposing of its fixed assets, which are state property.[192] A state enterprise can satisfy obligations, therefore, only from its liquid assets. The state banks and other financial supervisory organs, however, as part of their duties of supervision over state enterprises, restrict a state enterprise's liquid assets to the minimum necessary for daily operations. It is clear, therefore, that a state enterprise can only satisfy its debts out of a very small amount of liquid assets allowed to it by the state. This may be why all contracts executed by enterprises have had to be guaranteed by the superior organ, although it seems that this may not be required at present.[193] In view of the limited effectiveness of fines in inducing contract fulfillment, the Chinese generally employ the usual party and governmental disciplinary sanctions to promote contract performance. Officials have been warned that nonperformance will incur "political" as well as economic responsibilities.[194]

China does have, nevertheless, a formal mechanism for the set-

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ernment as force majeure in foreign trade contracts. G. HSIAO, THE FOREIGN TRADE OF CHINA, *infra* note 215, at 153.

190. Hsiao, *Economic Contracts*, *supra* note 185, at 1047.

191. *Id.* at 1048.

192. BASIC QUESTIONS, *supra* note 91, at 138.

193. *See* The Provisional Regulation Promulgated by the Financial and Economic Committee of the State Council of the People's Government on the Signing of Contracts by Organs, State Enterprises and Cooperatives arts. 5, 6, *reprinted in* 2 CIVIL LAW REFERENCE MATERIALS, *supra* note 14 at 205. *See also* Reply of the State Council on an Inquiry by the Tientsin People's Committee Stating That Guarantees Are Not Necessary for Contracts Executed by State Enterprises, Local State Enterprises and Jointly Operated State Private Enterprises, *reprinted in id.* at 214.

194. Hsiao, *Economic Contracts*, *supra* note 185, at 1048; Song Jishan, *Brief Discussion*, *supra* note 184, at 38.

tling of contract disputes between state enterprises. The Provisional Regulations on Signing Contracts provide in article ten that if one party to a contract, without the consent of the other party, does not fulfill it or frustrates it, then the directly superior financial committee handles the dispute if the parties are from the same administrative area. If they are from different administrative areas, they must ask the Finance and Economic Committee of the State Council to handle their dispute. Only if the handling of the dispute by these bodies is unsuccessful, may the parties resort to court.[195] Recent reports, however, indicate that China may be considering easier access to courts to settle contractual disputes. The government recently has set up special economic divisions in intermediate People's Courts in Peking and other cities to handle cases involving heavy political or economic losses from breach of contract. Previously mediation by the superior organs could not solve many economic disputes.[196]

Integration of the joint venture into the economic plan through the use of economic contracts not only binds the joint venture in the ways described above, but also severely restricts the freedom of the joint venture and may, in fact, prohibit it from purchasing independently. Of course, the allocations of scarce materials to the joint venture through the plan may be to the joint venture's advantage.[197] On the other hand, if the suppliers do not perform, the joint venture may be unable to operate for extended periods. In the past the Chinese have not regarded factories as purely economic units where economic performance takes priority over all. Enterprises have also pursued political, educational, and welfare objectives during work stoppages caused by lack of supplies or spare parts.[198] For foreign firms contemplating joint ventures,

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195. *See* Provisional Regulation on the Signing of Contracts, *supra* note 193.

196. *See, e.g.,* BEIJING REV., Aug. 10, 1979, at 5; Renmin Ribao (The People's Daily), Aug. 11, 1979, at 4, col. 1.

197. The experience of Renk AG, a West German company participating in a Romanian Joint Venture, demonstrates that operating outside of the domestic economic plan makes it difficult to procure domestic raw materials and semi-finished products since enterprises under the plan had first call on domestic production. DOING BUSINESS IN ROMANIA, *supra* note 28 § 10.2 at X-11.

198. Thus, free time caused by delays in supplies could be put to good use: illiterate workers can learn to read and write; employees can improve their work skills and develop new ones; housing, schools, and offices can be constructed by factory employees; and workers can go into the fields to help the peasants with the harvest. *Capitalists and Managers, supra* note 10, at 61.

however, the economic goals of the factory will certainly take priority.

Another possible disadvantage of being integrated into the state plan is that the plan may allocate resources to the joint venture not on the basis of quality and price, but on the basis of convenience to state planners. The price for a product, such as cement, may differ depending upon the supplier. It may cost sixty *yuan* per ton from a provincial level factory, but eighty *yuan* per ton from a county factory. Both of these prices are state-fixed prices, but the local factory is less efficient and has higher costs and, thus, higher prices.[199] Certainly, no joint venture wants to be assigned purchases from less efficient and more costly producers. But, if the joint venture is integrated into the plan, it may not be able to avoid this. For these reasons prospective joint venturers may be interested in the possibilities of obtaining supplies or scarce materials in other ways.

Aside from the state plan, three sources of supply exist: the "backdoor" of state enterprises which are willing to give up some of their quota of scarce supplies (sometimes only for a bribe); waste materials from state enterprises; and materials exchanged or bartered with other enterprises on the basis of mutual needs. The first method appears to be illegal. The second appears to be legal, but is rarely used because strict controls limit the amounts of waste materials in state enterprises. The third can be legal or illegal. In all three cases the line between legality and illegality is unclear.

Enterprises can exchange in a formal or informal manner. Formal exchanges occur at exchange conferences, held at regular intervals, where enterprises can exchange any surplus for needed supplies. In the Canton area, for example, official exchange conferences are held several times a year in the city and more often in the countryside. At these conferences the Socialist Economic Cooperation Office or the Revolutionary Committee has to approve purchases or barter transactions.[200] Informal exchanges take place in teahouses or other surroundings free from official supervision. For example, the meeting place for those needing electrical machinery in Canton is a teahouse in the Taiping House, directly across from the Love the Masses Skyscraper.[201] As a pre-

199. Transcripts KSP-9, *supra* note 148, at 4.
200. *Id.* KSN-16 at 4; *id.* KSP-9 at 3; *id.* KSP-9 at 4.
201. *Id.* KSP-9 at 4.

caution, in informal exchanges those entering the teahouse carry only their residence or work card, but no evidence that they are exchanging goods. The parties work out concrete details of a swap not in the teahouse but outside.[202]

In a Chinese enterprise it is the purchaser or expediter who carries out these formal and informal exchanges. His activities are often the crucial aspect of operating a factory. If an enterprise has a good purchaser, there will be a steady flow of work and supplies. If not, work is less steady and profits are lower. The activities of purchasers or expediters, however, are necessarily on the edge of the law. Chinese officials are aware that illegal means are used to obtain materials, but are not generally concerned. They realize that state planners cannot arrange for the supply of everything that enterprises need, so they allow enterprises to solve their problems on their own.[203] In view of the requirement of article two of the Joint Venture Law that all activities of the joint venture comply with all laws, decrees, and regulations, it is possible that joint ventures may have to restrain their expediters from all informal exchanges. A foreign joint venture party will want to inquire of the Chinese authorities the extent to which the execution of economic contracts by the joint venture will restrict its freedom to purchase supplies independently.

The requirement that priority in purchasing should be given to Chinese raw materials accentuates the problems relating to economic contracts. The nature of the requirement of priority, however, is not clear. If priority means that all other conditions being equal the source should be domestic, then the requirement will probably not have much effect on the purchases of a joint venture. If, on the other hand, the requirement means that the preference for Chinese purchases should outweigh other considerations, such as quality or cost, it could have a substantial adverse effect on a joint venture's operations. If the joint venture may purchase materials from abroad only with self-provided foreign exchange, it is difficult to see how the joint venture can make its initial purchases of raw materials. Presumably, the foreign joint venture party will be called upon to provide the exchange.

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202. *Id.* KSM-16 at 5.

203. The activities of the expediters, even if condoned by the authorities, can lead to problems for the enterprise: for example, the expediter might buy more of a commodity than he reports and sell the excess for his own profit. Butler, *China's Host of Buying Agents Patch Up Oversights of Planning,* Asian Wall St. J., July 25, 1978, at 8, col. 2.

The encouragement of exports by a joint venture appears to be an understatement. The earning of foreign exchange seems to be one of the major purposes of the Joint Venture Law, and enterprises which do not earn foreign exchange may not be approved by the Foreign Investment Control Commission. The Trade Agreement between China and the United States will promote the earning of foreign exchange by joint ventures by allowing their products into the United States under the lower tariffs applied to products from a most favored nation.[204]

The language of the third paragraph of article nine may indicate that the joint venture will export its products either directly to the foreign customer[205] or through Chinese government agencies. This would seem to preclude a foreign company, particularly the foreign joint venture party, from acting as distributor of the joint venture's products. To our knowledge, however, no Chinese official has interpreted this provision in this manner. The experience in compensation trade indicates that the Chinese may well want to take advantage of the marketing skills of foreign companies. Future implementing regulations of the Joint Venture Law may answer this question.

The joint venture may also sell its products on the Chinese market, but there may be a question of pricing. Since the joint venture will be subject to the state plan, the state planning authorities will probably set the price. Whether or not this price reflects the true value of the product will not be in the control of the joint venture parties. Therefore, prospective foreign joint venture parties should receive assurances from the Chinese state planning authorities about the marketing and pricing of the joint venture's output sold in China. If the joint venture makes sales abroad, it may wish to establish its own servicing network abroad. The term "related organizations" seems to indicate that these related entities could be subsidiaries, branches or representative offices.

K. *Article 10: Foreign Exchange Remittance*

This provision on the remittance of funds by the foreign joint venture party in foreign currency contrasts with the provisions of

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204. Agreement on Trade Relations Between the United States of America and the People's Republic of China, July 7, 1979, *reprinted in* 18 INT'L LEGAL MATERIALS, at 1041-51 (1979).

205. This is another example of a breach in the foreign trade monopoly once enjoyed by China's Foreign Trade Corporations. This follows the Romanian pre-

investment legislation in other countries; no limitation is placed on the amount of dividends or capital which a foreign joint venture party may remit.[206] In fact, there is no mention at all of the remittance of capital, although the term "other funds" may refer to this. A foreign joint venture party may wish to seek reassurances from the Chinese authorities on this point.

The encouragement of the foreign joint venture party to deposit its foreign exchange in the Bank of China will have to be substantial. Higher interest rates than banks offer abroad are an obvious means of encouragement. Whether the Law intends this concrete form of encouragement or other less concrete and perhaps less effective measures is not clear. Ordinarily, the interest rates which China pays on deposits are not high. On overseas Chinese accounts, for example, the highest rate for five year new accounts is 5.4 percent per annum.[207] The Chinese authorities might clarify what the interest rates will be and what other forms of encouragement they have in mind.

Article ten is perhaps most notable for its omission of any provision for the currency in which the accounting of the joint venture will be conducted. In joint ventures in Eastern Europe this question has been a problem. Since the joint venture will conduct both domestic and foreign transactions, no one currency is appropriate for all transactions. The joint venture will have to make conversions for many transactions. The issue is how the conversions are to be made, the applicable rate of exchange, and how these rates of exchange will affect the costs and the profitability of the joint venture company.[208] Chinese authorities might clarify this point.

L. *Article 11: Individual Income Tax*

At present the People's Republic has no individual income tax. This article, therefore, refers to the future income tax which is to be promulgated in the near future. It is difficult to predict exactly what this individual income tax will provide, but this article seems to imply that foreign workers will receive their income in

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cedent. *See* text accompanying note 38 *supra.*

206. Taiwan, for example, limits remittances of capital to 15 percent per year. The Statute for Investment by Foreign Nationals art. 12 *reprinted in* ZUIXIN LIUFA QUANSHU, *supra* note 116, at 714.

207. CHINA BUSINESS GUIDE, *supra* note 3, at 10.

208. *See generally* Comment, *Joint Ventures in the Soviet Union: A Legal and Economic Perspective,* 16 HARV. INT'L L.J. 390, 424-30 (1975).

Chinese currency. This may raise some questions. One of the issues arising in joint ventures in Eastern Europe has been the fact that foreign personnel will not work for the same wages as the local personnel. Understandably, the local personnel and the local authorities, as a matter of principle, insist that the local and foreign personnel of equal qualifications receive equal pay. Joint ventures have overcome this problem in Eastern Europe by paying an extra supplement to the foreign personnel abroad. In this way the joint venture's books reflects equal salaries to foreign and domestic personnel of similar qualifications, but the foreign personnel have the satisfaction of receiving larger salaries and having foreign exchange which they can employ for certain fixed expenses they may have abroad. This would seem to be a precedent which could be used in China, but this article seems to imply that all of the foreign personnel's salary must be paid in China in Chinese currency.

If, as seems likely, the future Chinese tax code will provide that all income derived from services performed in China will be taxable in China, then this provision may assist the Chinese tax authorities in monitoring foreigners' compliance with the income tax law. Foreign personnel, however, may resist this for two reasons. First, many foreigners have fixed expenses abroad which they must pay for in foreign currency. They may not want to suffer the delays and inconvenience of having to remit money from China to pay these expenses. Second, some foreign personnel may want to take advantage of the opportunity to avoid taxes. If the foreign personnel are from the United States they will be subject to taxation both in China and the United States for services rendered in China.[209] Since Congress has abolished the prior deductions under section 911 of the United States Internal Revenue Code,[210] United States personnel may have little incentive to avoid Chinese income taxation, assuming that the Chinese rates are not in excess of those in the United States. Non-United States foreign personnel, however, will generally not be taxed in their home jurisdiction for services rendered in China, and therefore would have more to gain by persuading the foreign joint venture party to pay part of their income abroad. Whether such an arrangement between a foreign joint venture party and its employees would taint the operations of the joint venture so that its activities would not

209. I.R.C. § 862.
210. *Id.* § 911.

be in compliance with all applicable regulations of the People's Republic of China is a debatable question.

M. *Article 12: Term of the Joint Venture*

The joint venture parties determine the term of the joint venture contract, but, in fact, it will be the Foreign Investment Control Commission which makes the final decision. Statements by Chinese officials indicate that they are contemplating terms for joint ventures similar to those in Eastern Europe, which often run for five to twenty years.[211]

N. *Article 13: Expiration or Breach of the Joint Venture Contract*

This article presumes that the joint venture parties will be able to agree on the termination of the joint venture. Thus, if one party violates the contract or articles of incorporation, the other party may not terminate the joint venture without the breaching party's consent. This could be unfair to the foreign joint venture party. It would not be unreasonable for China to grant the foreign joint venture party a guarantee that it could retreat from the joint venture at any time and that the Chinese side, and perhaps the Bank of China, would repay to the foreign joint venture party the amount of its investment or return its equipment. The provision concerning the assumption of financial liability seems to mean that China will attach the capital and equipment upon the expiration of the joint venture if the foreign party's violation of the joint venture contract causes damages. The scope of liability for damages, however, is unclear. Implementing regulations could clarify this point.

O. *Article 14: Dispute Resolution*

This article creates a three-step procedure for settling disputes within the joint venture that is similar to that employed by China in foreign trade: discussion, mediation, and arbitration. The meaning of discussion is self-evident. The term is also used in articles six and thirteen of the Joint Venture Law. Mediation in

211. *E.g.*, Comments by Mr. Rong Yiren at Washington Hilton Hotel (October 9, 1979).

China has a long history.[212] In regard to international trade, it has generally meant the intervention of the Foreign Trade Arbitration Commission or the Maritime Arbitration Commission in the dispute. The Commission involved drafts a written suggestion, but it is not binding on the parties.[213] If the dispute is not resolved by mediation, the parties seek arbitration.

The references to Chinese arbitration organs might point to the Foreign Trade Arbitration Commission, since this is the organization most experienced in dealing with foreign companies. Still, disputes between the joint venture parties would not be trade disputes, but corporate disputes. The technical issues involved might be novel to arbitrators accustomed to dealing with foreign trade issues. Further, the charter of the Foreign Trade Arbitration Commission seems to limit its handling of disputes to those relating to "foreign trade."[214] A possible interpretation is that the Commission is not authorized to accept a dispute between two joint venture parties relating to the operations of a joint venture.

The problem of whether a dispute between two joint venture parties would constitute a trade dispute would also occur if a United States party to a joint venture invoked the Trade Agreement between China and the United States to bolster an argument for arbitration in a third country. The Trade Agreement does not specifically refer to other than trade transactions. References in the Preamble and article one, however, might indicate the intention of the two countries to extend the reach of the Treaty to joint ventures. If this is so, the Trade Agreement might aid United States joint venture parties in arguing for the application of arbitration in a third country under foreign rules of procedure and for prompt enforcement of arbitral awards.[215]

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212. Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CALIF. L. REV. 1284 (1967).

213. G. HSIAO, THE FOREIGN TRADE OF CHINA, *supra* note 107 at 155.

214. *See* Decision of the Government Administration Council of the Central People's Government Concerning the Establishment of a Foreign Trade Arbitration Commission Within the China Council for the Promotion of International Trade, *reprinted in* ARBITRATION AND DISPUTE SETTLEMENT IN TRADE WITH CHINA, SPECIAL REPORT No. 4 at 49 (1974).

215. *See* Agreement on Trade Relations Between the United States of America and the People's Republic of China art. 7, *reprinted in* 18 INT'L LEGAL MATERIALS at 1049 (1979); Surrey & Soble, *Joint Venture Law and Dispute Resolution in China: A Framework for International Trade*, 1 E. ASIAN EXEC. REP. 16 (1979).

P. *Article 15: Effective Date and Amendment*

Since the Joint Venture Law is a statute, it was passed by the National People's Congress and must be amended by the National People's Congress according to article 22 of the Constitution.[216] Since the National People's Congress has generally met infrequently, however, it is interesting to inquire whether the Standing Committee of the National People's Congress could amend the Joint Venture Law. The Standing Committee, pursuant to article 25(3) of the Constitution may "interpret the Constitution and laws and establish decrees." Absent other legislation, therefore, the Standing Committee could only interpret the Joint Venture Law or issue decrees relating to it. Article 25(13) of the Constitution indicates that the National People's Congress can authorize the Standing Committee to perform other functions. This would include the amending of statutes. In fact, the National People's Congress has authorized the Standing Committee to issue laws in the past, as in a statute relating to increased legislative activity after the promulgation of the prior 1955 Constitution.[217] There seems to be no analogous statute passed after the adoption of the 1978 Constitution. Accordingly, amendment to the law will have to wait for another meeting of the National People's Congress.

IV. CONCLUSION

China's Joint Venture Law is an impressive step towards modernizing the Chinese economy with the help of Western managerial and technical help. It is, however, unclear and incomplete in several respects. In assessing the nature of the Joint Venture Law as it presently stands and in forecasting the changes that will be made, it is helpful to look both to the experiences of Romania and Yugoslavia as well as to China's own experience with compensation trade and joint state-private enterprises. Not only are these prior experiences valuable from an analytical point of view, but they are also useful as practical tools available to prospective joint venture participants in their negotiations with the Chinese joint venture party or the Chinese authorities. Prospective joint participants can use these precedents to argue for greater bene-

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216. PRC CONST. art. 22.

217. *See* Decision of the Second Meeting of the First Session of the National People's Republic of China Concerning the Authorizing of the Standing Committee to Establish Separate Laws and Regulations, *reprinted in* [1955] COLLECTION, *supra* note 112, at 65.

fits and greater clarity in the joint venture contract and legislation. There is no reason why prospective joint venture parties should passively await the promulgation of regulations or new legislation by the Chinese authorities without expressing their own views in an effort to influence the nature of these regulations or legislation. It seems clear that suggestions couched in terms of the Chinese experience familiar to the Chinese authorities will be most effective. The prior Chinese experience with compensation trade and joint state-private enterprises, as well as the experience of Romania and Yugoslavia with joint ventures, therefore constitute a valuable reference source which prospective joint venture parties should exploit to the maximum.

This is not to say, of course, that the Chinese authorities will not rely on their earlier experience without prompting by foreigners. The recent decision of the State Council reaffirming all legislation promulgated by the People's Republic since 1949 not specifically overruled by subsequent legislation underlines the fact that the Chinese authorities are not ignoring their prior experience. In fact, this emphasis on continuity as well as innovation has created the major legal question of the Joint Venture Law. From a legal point of view, the problem is the relationship between the Joint Venture Law and other Chinese legislation. The Law itself does not expressly state that it authorizes the drafting of joint venture contracts and articles of incorporation establishing companies in China which are free from all restraints imposed on Chinese enterprises generally by current or prior Chinese domestic legislation. The brief references to government protection according to law and the conduct of the joint venture's activities in accordance with law do not seem to provide sufficient basis for assuming that the joint venture contract and articles of incorporation will take precedence over such legislation. This is particularly true when one considers the explicit measures taken by Yugoslavia and in Romania in regard to the relationship of the joint venture to domestic legislation.

As the Chinese authorities interpret and develop China's joint venture legislation, they may amend the Joint Venture Law or issue another statute clarifying this question. This would be particularly helpful in regard to the applicability of labor law and the state economic plan to a joint venture. General legal principles seem to preclude the possibility of using implementing regulations to resolve this issue. If the joint venture contract and articles of incorporation are to take precedence over prior and contemporaneous legislation, this can probably only be accomplished by a legal enactment which has the same or greater legal

effect as the laws which are to be superseded. This would seem to preclude the use of implementing regulations or a decree by the Standing Committee of the National People's Congress to resolve this issue. It appears that only a statute would be sufficient. Furthermore, article fifteen of the Joint Venture Law states that the power of revision resides with the National People's Congress. Accordingly, in the absence of specific legislation authorizing the Standing Committee to assume the legislative role normally carried out by the National People's Congress, amendment of the Joint Venture Law itself or other legislation of equal effect will have to wait until the next meeting of the National People's Congress.

Other aspects of the Joint Venture Law could also be changed by amendment of the Law or the promulgation of legislation of equal effect. These would include the determination of the right which a foreign joint venture party acquires in a joint venture, an exemption from customs duties for imports by a joint venture, the promulgation of a tax code, foreign exchange regulations and a patent law. None of these aspects of the Law are sufficiently clear to allow the inference that the National People's Congress conferred authority on the joint venture parties to make their own arrangements in these regards or that the National People's Congress authorized the appropriate Chinese administrative organs to promulgate their own regulations in regard to these areas. The Chinese authorities have stated that new legislation relating to taxes, foreign exchange and patents will be forthcoming soon. It appears likely, therefore, that amendments to the Joint Venture Law itself or new legislation could be promulgated at the same time as these other statutes.

Presumably the forthcoming Joint Venture Law implementing regulations will deal with other issues. These regulations could provide for the procedural or administrative aspects of a joint venture. They could resolve, among others, the following problems: Whether the approval of a joint venture contract and articles of incorporation by the Foreign Investment Control Commission is binding on the Chinese government as a whole; which organization issues the joint venture's business license; the standards for the evaluation of the contribution of the Chinese venture party; the definition of advanced technology; the nature of the intent in establishing the intentional provision of outdated technology by a foreign joint venture party; the amount of the welfare and incentive fund; the relationship of a joint venture company to its bank; the extent to which the joint venture company will enjoy freedom

of contract in executing economic contracts; the precise nature of the priority a joint venture company must give to Chinese sourcing raw materials and parts; whether a foreign joint venture party can play the role of distributor for the joint venture's products abroad; the pricing of the joint venture's products sold in China; whether for the purposes of foreign exchange remittance "other funds" include capital; the interest rates granted to foreign joint venture parties on deposits of exchange in China; the currency of account for the joint venture's books; the legal effect of agreements between the joint venture parties which are not reported to the Foreign Investment Control Commission; the scope of liability of a foreign joint venture party for damages to the Chinese joint venture party; and, if arbitration is to take place in China, the identity of the Chinese arbitration organs that will handle disputes between joint venture parties.

Still other questions which arise under the Joint Venture Law may be resolved by informal consultation between foreign joint venture parties and the relevant Chinese authorities. If a joint venture is subject to the state plan, then the foreign joint venture party may want to receive informal assurances from the Chinese authorities that the arranging of supplies by the joint venture's expediter through informal exhanges will not be cause for prosecution of the joint venture for violation of Chinese law. Similarly, the Chinese authorities might assure foreign companies that the avoidance of income taxation by foreign employees of the joint venture will not be a matter of grave concern to the Chinese authorities. Alternatively, the Chinese authorities could simply choose to ignore this potential problem, or they might enforce the law strictly.

Finally, a few questions raised by the Joint Venture Law may not find a suitable explanation by the Chinese authorities. One wonders, for example, whether they would clearly explain the phrase "equality and mutual benefit" when this term's vague generality has served Chinese spokesmen in foreign and commercial affairs so well for so many years. As long as the reference to these principles does not interfere with the establishment or conduct of joint ventures, prospective joint venture parties need not worry about their precise content.

China's Joint Venture Law constitutes a great stride forward in the effort to modernize the Chinese economy, particularly when viewed in contrast to Chinese economic policy during the Cultural Revolution. The Law establishes a legal basis for foreign participation in Chinese enterprises. Yet from a lawyer's point

of view it leaves many questions unanswered. Accordingly, it appears that some time will have to pass before foreign companies can invest in Chinese joint ventures with the same degree of assurance concerning the legal background as in other underdeveloped countries. Still, foreign corporations may well decide that the risks inherent in investing in the People's Republic now are not significantly greater than those in other underdeveloped jurisdictions. In certain cases they may decide that even before the amendment of the Law and the promulgation of other legislation the potential benefits outweigh any greater risks of investing in China.

Appendix I

THE JOINT VENTURE LAW OF THE PEOPLE'S REPUBLIC OF CHINA[218]

Article 1

The People's Republic of China, in order to expand international economic cooperation and technological exchange shall permit foreign companies, enterprises and other economic organizations and/or individuals (hereinafter referred to as "foreign joint venturers"), in accordance with the principles of equality and mutual benefit, and after approval by the Chinese government, to establish joint ventures in the People's Republic of China jointly together with Chinese companies, enterprises and/or economic organizations (hereinafter referred to as "Chinese joint venturers").

Article 2

The Chinese government shall protect according to law the investment in the joint venture by the foreign joint venturer, its share of the profits and its other lawful rights and interests in accordance with the agreement, contract and articles of incorporation approved by the Chinese government.

All of the activities of the joint venture should comply with the provisions of the laws, decrees and applicable regulations of the People's Republic of China.

Article 3

The agreement, contract and articles of incorporation of the joint venture signed by the joint venture parties should be reported to the Foreign Investment Control Commission of the People's Republic of China and such Commission should within three months decide whether to approve or disapprove [the joint venture]. After the joint venture has been approved, it shall be registered with the General Administration for Industry and Commerce of the People's Republic of China, shall receive a business license and shall begin to conduct business.

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218. Literally, "THE LAW ON CHINESE-FOREIGN JOINTLY INVESTED AND OPERATED ENTERPRISES OF THE PEOPLE'S REPUBLIC OF CHINA". Passed by the Second Session of the Fifth National People's Congress on July 1, 1979, and promulgated July 8, 1979. Translation by Preston M. Torbert.

Article 4

The form of a joint venture shall be a limited liability company.

Of the registered capital of a joint venture, the proportion of the foreign joint venturer's investment shall not, in general, be less than twenty-five percent.

The joint venture parties shall share the profits and assume the risks and losses in accordance with their proportions of registered capital.

The transfer of a joint venturer's registered capital must have the [prior] approval of the joint venture parties.

Article 5

The joint venture parties may make their investments in cash, goods, industrial property rights, etc.

The technology and equipment which the foreign joint venturer uses as his investment must truly be advanced technology and equipment which suits China's needs. If [the foreign joint venturer] intentionally engages in deceit by supplying outdated technology and equipment and a loss is thereby caused, he should compensate the loss.

The Chinese joint venturer's investment may include the right to use a site which is provided to the joint venture during the term of the joint venture. If the right to use a site is not used as a part of the investment by the Chinese joint venturer, the joint venture should pay to the Chinese government a fee for its use.

The investments mentioned above should be provided for in the contract and articles of incorporation of the joint venture and their value (not including the site) shall be determined by discussion among the joint venture parties.

Article 6

The joint venture shall establish a board of directors, the size and composition of which shall be discussed by the joint venture parties and stipulated in the contract and articles of incorporation and [the members of the board] shall be appointed and removed by the joint venture parties. The board of directors shall establish one chairman [a position] which shall be filled by the Chinese joint venturer; one or two vice-chairman, [position(s)] which shall be filled by the foreign joint venturer. The board of directors shall handle important questions which shall be discussed and decided by the joint venture parties based on the principles of equality and mutual benefit.

The authority of the board of directors shall be in accordance with the provisions of the articles of incorporation of the joint venture; it shall debate and decide all important questions of the joint venture: enterprise development plans, production and operations activities program, the budget, the distribution of profits, plans relating to labor and wages, and termination of business and the appointment or hiring of the general manager, manager, chief engineer, chief accountant, auditor, and their authority and remuneration, etc.

The [positions of] general manager and manager (or plant manager and vice plant manager) shall be filled by different joint venture parties.

The employment and discharge of the staff and workers of the joint venture shall be provided for by the agreement and contract of the joint venture parties according to law.

Article 7

From the gross profits earned by the joint venture, after payment of the joint venture income tax in accordance with the provisions of the tax law of the People's Republic of China, there shall be deducted a reserve fund, a staff and workers' incentive and welfare fund and an enterprise development fund provided for in the articles of incorporation of the joint venture. The net profit shall be distributed based on the proportion of each joint venture party's registered capital.

A joint venture which possesses advanced technology by world standards may apply for reduction of income tax for the first two or three years in which it begins to make a profit.

If the foreign joint venturer uses its net profits for reinvestment in China, it may apply for a rebate of part of the income tax already paid.

Article 8

The joint venture should open an account with the Bank of China or a bank approved by the Bank of China.

The joint venture's arrangements relating to foreign exchange should be handled with the observance of the foreign exchange regulations of the People's Republic of China.

In the conduct of its activities the joint venture may raise funds directly from foreign banks.

All the joint venture's insurance should be taken out with Chinese insurance companies.

Article 9

The production and operations plans of the joint venture should be reported for registration to the department in charge and implemented in the form of economic contracts.

The joint venture should give priority to purchasing in China raw materials, fuel, accessories, etc. required by it, but it may also purchase directly on the international market with its self-provided foreign exchange.

The joint venture shall be encouraged to sell its products outside China. Export products may be sold to export markets by the joint venture directly or given to its competent agencies for sale to export markets or sold through Chinese foreign trade organs. The products of the joint venture may also be sold on the Chinese market.

The joint venture may, when necessary, establish related organizations outside of China.

Article 10

The foreign joint venturer, after fulfilling the obligations provived for in law, the agreement and the contract, may remit abroad in the currency provided for in accordance with the joint venture contract and through the Bank of China in accordance with the foreign exchange regulations its portion of the net profits, its portion of the funds in the case of expiration or termination of the joint venture's term, and other funds.

The foreign joint venturer shall be encouraged to deposit in the Bank of China the foreign exchange which it may remit out.

Article 11

After payment of individual income tax in accordance with the tax laws of the People's Republic of China, the income from wages and other proper income of the foreign staff and workers of the joint venture may be remitted abroad through the Bank of China in accordance with the foreign exchange regulations.

Article 12

The term of the joint venture contract shall be determined by the joint venture parties with consideration of the particular industry and particular conditions. After the expiration of the term of the joint venture contract, if the parties agree and request the approval of the Foreign Investment Control Commission of the

People's Republic of China, the term may be extended. An application for the extension of the contract term should be submitted six months prior to the expiration of the term.

Article 13

If before the term of the joint venture contract expires, serious losses occur, one party fails to fulfill the obligations provided for in the contract and articles of incorporation, a [case of] force majeure occurs, etc., the joint venture parties, after discussion and agreement, shall request the approval of the Foreign Investment Control Commission of the People's Republic of China, shall also register with the General Administration for Industry and Commerce and may terminate the contract prior to its expiration. If a loss is caused by a violation of the contract, the party violating the contract should assume financial liability.

Article 14

If a dispute occurs among the joint venture parties and the board of directors is unable to settle it by discussion, [the parties] shall enter into mediation or arbitration by Chinese arbitration organs or they may arbitrate in other arbitration organs agreed upon by the joint venture parties.

Article 15

The present law shall take effect on the date of promulgation. The power of amendment of the present law shall reside in the National People's Congress.

Appendix II

Analysis of the Unofficial Translation

The unofficial translation, although good, does contain some undesirable inconsistencies and other defects. Some of these are discussed below.

In article two the unofficial translation talks of the "resources" invested by a foreign participant as being protected by the Chinese government. Other articles, however, only mention an investment of "capital" by the foreign participant. To a lawyer this raises the question of whether the term "resources" was intentionally used to imply something more than just invested capital, perhaps to include the human resources contributed by a foreign participant to a joint venture. In fact, however, this reference to protection of "resources" does not imply that the Chinese government is legally obligated by it to take special measures to protect the foreign personnel. The Chinese word *ziben* (capital) in article two has simply been liberally translated by the translators as "resources," while in other articles they have used the standard translation "capital." The Chinese text is consistent, but the unofficial translation is not.

Another example of lack of consistency is the mood of the verbs. The unofficial translation uses only the indicative mood (e.g. "is") and the suggestive (e.g. "shall") and their use is not consistent with the Chinese version. In article three for example, the Chinese word "should" is translated as "shall," while in article four the Chinese word "is" is translated "shall be." Further, the Chinese word "must" in articles four and five is also translated "shall." Clearly, the unofficial translation fails to convey the differences in emphasis of the three Chinese terms. In the translation attached at Appendix I hereto an effort has been made to preserve these levels in the English in the following manner: the simple indicative in the Chinese was translated into English "shall" in accordance with the general practice in American legal documents. The more forceful Chinese word *ying* was translated as "should," while the most emphatic Chinese term *bixu* was translated as "must." Looking at the Chinese version of the Law, it is clear that the draftsmen used this most emphatic term "must" only in articles four and five where they wished to emphasize that the technology contributed *must* be advanced and that transfer of capital in a joint venture *must* have the approval of the other joint venture parties. The less forceful "should" was used in articles two, three, five, eight, nine, and twelve to apply to acts which are

somewhat less compulsory than those mentioned in articles four and five, but more so than those mentioned in other articles of the Law. The attached translation follows the Chinese consistently so that an American lawyer can try to draw the same implications from these differences that a Chinese lawyer could.

Another inconsistency appears in article six relating to the appointment of directors and other personnel. The Chinese text uses the same word, *danren*, in referring to the appointment of directors and of general manager and manager. The unofficial translation, however, talks of the chairman of the board as being "appointed by the Chinese participant" and of the general manager as being "chosen from among the various parties to the joint venture." The unofficial translation thus raises the unfounded inference that the chairman of the board need not be an employee of the Chinese joint venture party, but the general manager (or manager) must be an employee of a joint venture party. The Chinese term *danren* does not imply that the person appointed must be an employee of a joint venture party.

There are other minor inconsistencies, but suffice it to mention simply two others. First, article six of the unofficial translation mentions the board of directors as handling "important problem[s]," but also says that the board is empowered only to take action on "fundamental issues." The Chinese text, however, uses the same words *zhongda wenti* for both these terms. Accordingly, we have translated this phrase in both instances as "important questions." Second, the unofficial translation alternates between the use of the singular and the plural form of certain nouns. The Chinese text is ambiguous as to whether the singular or plural is meant, and in most cases it probably does not matter whether the singular or plural is used. Consistent use of one or the other would help to avoid possible misunderstandings. For example, the Chinese text does not make clear whether the joint venture agreement (and contract) is singular or plural. The unofficial translation has chosen to translate it in the plural, except that in the last clause of article six, it uses the singular. There seems no good reason for this discrepancy.

There are in addition to the problems mentioned above, still others which stem from the lack of clarity in the original Chinese text. For example, the term *heying gefang* is generally used to mean "the joint venture parties," but it can also have the sense of "each joint venture party." The question arises, therefore, whether in the first paragraph of article six the draftsmen meant that each director would be appointed and removed only by one

party to the joint venture or whether each director would be appointed and removed by the joint venture parties together. It appears that when the draftsmen meant to convey the meaning that each joint venture party would separately appoint personnel they could do so with other clearer language. In the penultimate paragraph of article six, for example, they used the words *heying gefang* with the additional term *fenbie* (literally "separately") to mean each joint venture party would appoint either the general manager or managers. Based on this textual interpretation, we have translated the relevant part of the first paragraph of article six as follows: "[members of the board] shall be appointed and removed by the joint venture parties." The unofficial translation follows a reasonable, but more liberal reading: "each director shall be appointed or removed by his own side." We would agree that the unofficial translation could be closer to what the draftsmen had in mind, but we do not believe that one can infer this from the Chinese text of the Law.