SINO-FOREIGN EQUITY JOINT VENTURES IN PRACTICE

by

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Foreign investment in China has expanded tremendously since China officially opened her doors to the West in 1978. The Chinese State Council and the various municipalities have published legislation and regulations concerning foreign direct investment. Though many foreign businesses have begun operations in China since 1978, there have been difficulties. Some of the difficulties are simply a result of the state of the Chinese economy and infrastructure. However, many of the obstacles are a direct result of culturally derived Chinese business practices. The aim of this paper is to point out potential problem areas, to discuss their possible origins and solutions, and to give a prospective investor insight into the Chinese way of conducting business.

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CHAPTER I

INTRODUCTION

OVERVIEW

Modern day business practices in China differ from those of the West. Because of this, it is important for a Westerner interested in doing business in China to understand the way the Chinese think. To a large extent the way the Chinese think is the result of historical shaping. Therefore, knowledge of Chinese history is an invaluable aid to the comprehension of today's Chinese business protocol. The first section of this paper is a brief overview of Chinese history since the founding of the People's Republic of China in 1949, and is intended to give the reader insight to the Chinese mind.

In addition to the insight provided by a historical background, a prospective investor needs to be aware of the relevant Chinese investment laws and their parameters. As the specific focus of this paper is equity joint ventures, the second section provides a legal analysis of China's national equity joint venture legislation. The purpose of this analysis is not only to point out the boundaries of what is acceptable (almost anything is negotiable), but also to indicate the necessary considerations an investor should entertain when establishing a Sino-foreign joint venture.

In order to attract foreign investment the Chinese government in the early 1980's began to allow particular geographic areas to offer preferential customs and tax treatment to potential investors. This decentralization of power led to local authorities publishing their own joint venture regulations. A competitive free-for-all ensued in which local authorities attempted to offer the most favorable investment terms hoping to attract foreign investors. As a result the incentives available to foreign investors differ among localities. An investor must be aware of these differences and choose the investment location according to which place offers the best incentive package.

The third section of this paper is a comparison between the national statutes and Shanghai's local regulations. Though the specific incentives differ from place to place, the type of incentives available are the same. This paper focuses on Shanghai as an example to illustrate the nature of available incentives. It is important to understand where incentives exist, and the nature of these incentives, in order to maximize potential profits.

Finally, there are a number of legal and cultural obstacles a foreign investor is likely to encounter. The experiences of existing joint ventures can be informative. If a prospective investor is aware of possible problem areas, much of the pain experienced by previous investors can be avoided. The last section of this paper discusses these legal and cultural problems and possible solutions.

Historical Background

In 1979, in the wake of the Cultural Revolution, China promulgated her first joint venture legislation. Foreign investment in the People's Republic of China (PRC) has expanded tremendously in the 15 years since the first laws on foreign direct investment were published. By 1989 over 20,000 Sino-foreign joint venture contracts had been signed and 8,000 joint ventures were in operation.[1] China's Open Door Policy was instituted in the late 1970's and was the campaign through which China officially invited foreign investment.[2]

In order to understand the reasons why Chinese operate the way they do, it is important to understand what they've been through. The establishment and reign of the Chinese Communist Party, the Great Leap Forward and the Cultural Revolution all serve as examples of Chinese politics and the manifestations of raw political power. The factional infighting of top level officials, and of the Red Guards born of the Cultural Revolution, is indicative of the Chinese willingness to use institutional power to serve personal ends. These patterns still dominate the way Chinese do business today.

The 1920's saw the founding of the Chinese Communist Party (CCP).[3] Though the CCP was driven underground in 1927, loyalists kept the party alive, and its strength grew in the following decades. During the Long March in the 1930's Mao Zedong became a prominent figure in the CCP.[4] By 1943 Mao formally had the power to make unilateral decisions within the Communist Party.[5] Under Mao's leadership, the CCP was successful in overthrowing the Nationalists who fled to Taiwan. On October 1, 1949, the CCP and its allies established the People's Republic of China.[6] The national unity achieved by the PRC was a major victory over decades of disunity.

Working closely with the Soviets, and with the Soviets as their model, the CCP attempted to turn China into an industrialized socialist state.[7] In the early 1950's the CCP implemented land reforms.[8] Initially the government planned to redistribute land from the rich landlords to the poor peasants. The next step was to gradually convert private landholdings to cooperatives, and finally to socialist ownership. The campaign to convert the land to socialist ownership was sped up under Mao's initiative, and by 1956 title to all Chinese land was held by the state.[9]

As the Chinese grew disillusioned with the viability of the Soviet model, they began to seek other more successful means to industrialize the nation. This search led the leadership into an extremely unsuccessful campaign known as the Great Leap Forward (GLF) beginning in 1958.[10] The GLF represented the first "fundamental break with the Soviet model."[11] It was presented as an alternative to the Soviet's slow process of industrialization. The Soviet model's success in China was limited due to China's relatively large population. The Soviet model depended on the sales of surplus agriculture to finance large industrial machinery, however due to her large population, China lacked an agricultural surplus, and therefore lacked financing with which to purchase the necessary machinery.[12] The idea behind the GLF was if China could somehow mobilize her vast resource, the population, the labor of the masses would more than equal that of the industrial machinery that China could not afford to purchase. The original goal was to modernize China and surpass Britain in the production of steel within 15 years.[13] Many backyard steel furnaces sprung up as a result of the campaign, and the masses were mobilized. As the people's labor was the key to the GLF's success there was little time for education. This emphasis on labor, and de-emphasis of expertise, resulted in the squandering of many resources and an overall low production rate.

The strategy of the GLF transferred power from the central government bureaucracy to local Party cadres.[14] By 1958 it was evident that the campaign was not successful, and that the national economy was suffering as a result. In 1959 when the information regarding "state grain procurement revealed that the situation was worse than was previously thought, and during that spring Mao led the effort to bring rationality and efficiency to the program."[15] However, because of the redistribution of power, the people who gained power, were resistent to any retreat from GLF policy.[16] These bureaucrats were serving selfish ends, and were unconcerned with the ramifications for the rest of the nation.

China's move away from the Soviet model at the beginning of the GLF, Mao's disillusion with the Soviet's apparent retreat from Stalinist policy, and the withdrawal of Soviet aid to China in 1960 caused a rift in Sino-Soviet relations.[17] The combination of the Soviet's withdrawal, unrealistic economic expectations and natural disasters resulting in poor harvests, brought the country to near collapse in the early 1960's.[18] The devastation of the Chinese economy brought the political campaign known as the GLF to an end.

Because of the deterioration of China's relationship with the Soviets, and the economic failure of the Great Leap Forward, China began to look to the West to develop trade relations. Learning from recent mistakes, China imported machinery and technology, and expertise was emphasized again.[19] However, the move toward modernization would soon be interrupted. In 1966, China plunged into chaos with the onset of the Cultural Revolution.[20]

As the GLF came to an end, two factions developed with differing notions of what caused the campaign to fail. One group believed the bureaucrats had been overzealous in implementing the policies of the campaign, the other believed the failure was proof that China must rely more on expertise and material incentives in developing her economy.[21] Mao Zedong feared the elitism which might develop as China reached out to the West. In 1966 Mao launched the Cultural Revolution in attempt to prevent such corruption. "The ultimate goal of the movement was to build a society without bureaucracy, elitism and inequalities, and the nation strived to isolate itself from the outside world."[22]

In order to counter the corruptions Mao feared most, he began the Cultural Revolution with four goals. Unofficially Mao's goal was to replace the people designated to succeed him, with leaders whose thoughts were more aligned with his own.[23] Another goal was to reform the CCP. Mao also hoped that through the Cultural Revolution the youth of China would gain a revolutionary experience. His final goal was to eradicate elitism from the educational, health care and cultural systems in China.[24]

In the beginning of the Cultural Revolution Mao mobilized China's youth to form revolutionary groups known as the Red Guards. "Mao ordered the Party and the army not to suppress the movement,"[25] and with no organized opposition these youths began their reign of destruction in China. The mission of the Red Guards was to help Mao combat the revisionists who had infiltrated the CCP. However, each Red Guard had his or her own reason for becoming a Red Guard, and their reasons were not necessarily aligned with Mao's goals.

Often it was not the Red Guards whose motives were unpure, but rather the people who affiliated themselves with the Red Guards. For some "this was the chance to re-create something of the experience of the Long March of 1935"[26] which satisfied to some extent Mao's goal for the Chinese youths to have a revolutionary experience. For others, however, being a Red Guard was a way to rebel against past oppressors who denied them of "a fair chance for education or advancement."[27] Every selfish reason imaginable served as the motivation for somebody's persection. Some youths became Red Guards to afford them an opportunity to return to their previous homes, while others were idealists hoping to change China for generations to come.[28] This is another example of Chinese willingness to use their positions of power to serve personal ends.

Liu Shaoqi, the man intended as Mao's successor and then head of state, his wife, Wang Guangmei, and Deng Xiaoping, then Party General Secretary, were all members of the faction who, after the Great Leap Forward, believed China needed to reach out to the West and rely on expertise more. Liu, his wife, and Deng were humiliated and removed from power early into the Red Guard Movement.[29] By mid-1968, it was apparent that the Red Guards were out of control, and they were encouraged to leave the ranks of the Red Guards.[30] The anarchy, terror, and paralysis that the Cultural Revolution resulted in a completely disrupted urban economy.[31] By the end of 1969 Mao called for the Red Guards to disband and sent them to the countryside where they would be out of the way.[32]

As the Cultural Revolution began, in attempt to combat elitism and bureaucratism schools were closed, and all contact with the world outside China was severed. Soon anyone who had an education or had any previous contact with the Western world was in danger of being labeled a rightist and publicly persecuted. As with the Red Guards, the accusers were of mixed motivation, not all of who were idealistic revolutionaries. Many people attacked others for selfish gain, sought revenge for past wrongs, or simply pointed their fingers in order to prevent others from pointing at them. What ensued was a complete destruction of even the pretense of societal order.

The upheaval which took place opened the door to massive societal and governmental corruption. Soon the Chinese society was exactly what Mao had sought to avoid when ushering in the Cultural Revolution; an elitist bureaucratic nightmare. There are countless stories of massive abuse and corruption by those in positions of power during the Cultural Revolution. China was essentially lawless. For example, Liu Shaoqi was deposed without action of the National People's Congress and imprisoned without a criminal charge or a trial.[33] In defense of this blatant denial of fair play, the persecutors defended their actions calling it "revolutionary legality."[34]

Two Chinese phrases are representative of the structural collapse and emergence of a system based solely on personal connections: "guanxi" and "hou men." Guanxi is the Chinese word for relation or relationship.[35] During the Cultural Revolution the only way a person could advance was if he had a relationship with someone who was willing to help him. Hou men means back door.[36] If a person had the right guanxi, then whatever the person was seeking, be it employment, coal or any other rationed commodity, could be attained through the back door (hou men), as opposed to through formal channels(i.e., the front door).[37]

China continued on her "revolutionary" path for ten years until 1976 when Mao Zedong died. The so-called Gang of Four, who included Mao's wife, and who had orchestrated the Cultural Revolution after Mao suffered a stroke in 1972, were purged shortly after Mao's death in 1976. The Eleventh Party Congress officially ended the Cultural Revolution in August of 1977.[38] Though the Cultural Revolution had ended, the disruption and lack of social order would take years to correct. During the Cultural Revolution the law was whatever the person above dictated, and this changed daily (as did the bureaucratic ranks). In November of 1979 it was finally announced that "the laws and decrees enacted since the founding of the PRC, despite their denunciation during the Cultural Revolution, remained in effect unless replaced by new laws."[39] Formal recognition of the laws of the PRC was an important step toward rebuilding the Chinese society, however, the tumultuous years since 1957 have taken their toll. The result of 22 years of not being able to count on the legal system is tremendous bureaucratic timidity, and a continued abuse and reliance on personal connections rather than laws. Much of the post-Cultural Revolution bureaucracy included people who rose to power during the Cultural Revolution, and remained in place afterwards.

At the end of the Cultural Revolution, the CCP blamed the years of turmoil and economic setbacks on the vilified Gang of Four. In July 1977 Deng Xiaoping was restored as vice-premier and party vice-chairman.[40] Upon his political restoration, Deng initiated the Four Modernizations campaign. The country was to focus on modernizing four sectors of the Chinese economy: industry, agriculture, science and technology and military affairs. In order to pursue modernization, China opened her doors once again to the Western world. "Drawing lessons from past experiences, the leaders realized that if China was to modernize it must engage in international exchange and import advanced technology, equipment, management expertise and foreign capital."[41]

CHAPTER II

NATIONAL JOINT VENTURE LEGISLATION

With an estimated population of 1.16 billion people (in 1991) China is the world's most populated country.[42] China also has vast natural resources. These resources include "the world's largest hydroelectric potential and coal reserves and...huge reserves of...iron, petroleum, mercury, tin, tungsten, antimony, manganese, molybdenum, vanadium, magnetite, aluminium, lead, zinc, and uranium."[43] Though China's natural resources and manpower are abundant, technology and financial resources are limited. In attempt to compensate for these deficiencies, China, under Deng Xiaoping, opened her doors and let in foreign investors.

Basic Legislation Concerning Joint Ventures

Since Deng announced the Four Modernizations campaign China has actively pursued foreign investment. On July 8, 1979 the "Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment(JVL)"* was promulgated and became effective immediately. The JVL was the fundamental legislation dealing with foreign investment

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* Appendix A.

in China. Article 1 of the JVL states China's purpose behind enacting the law: "With a view to expanding economic co-operation and technical exchange, the People's Republic of China permits foreign companies, enterprises, other economic organizations or individuals to join with Chinese companies...in establishing joint ventures...."[44] The JVL was ground-breaking legislation regarding foreign direct investment in China, however it only provided a skeletal framework. Four years later, in September of 1983, the "Regulations For the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (Implementing Act)"** was promulgated. This legislation was an elaboration of the 1979 JVL legislation. The Implementing Act covers a wide range of issues such as the possible types of contribution, how to set up the organizational structure of the joint venture, registration of the joint venture, taxation, labor termination, purchasing of and importation of materials, and dispute settlement. The Implementing Act is the most comprehensive piece of national legislation concerning equity joint ventures. Another important piece of legislation is the "Provisions of the State Council Encouraging Foreign Investment(22 articles),"*** which was promulgated and immediately effective October 1986. These provisions granted special privileges to technically-advanced and export-

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** Appendix B
*** Appendix C

oriented foreign-funded enterprises. The privileges are in the form of tax incentives, favorable production conditions, credit, and breaks on service charges and land use fees. The PRC also passed a new tax law in 1991 which unified tax rates for all foreign invested enterprises,[45] and introduced some new tax benefits which did not exist prior to this legislation. Finally, comprehensive patent and copyright laws were passed in 1984 and 1991 respectively.[46]

Three Types Of Foreign Direct Investment Enterprises In China

Since the promulgation of the JVL, China has witnessed a significant influx of foreign capital. "By the end of 1986 there were 7,738 enterprises involving foreign investment in the PRC including 3,210 equity joint ventures, 4,390 contractual joint ventures, and 138 wholly foreign-owned ventures."[47] By the end of 1988 the United States alone had invested $2.39 billion in China and was the second largest investor after Hongkong/Macau.[48]

There are three investment options for foreign direct investment in China; equity joint ventures, contractual joint ventures and wholly foreign-owned enterprises. Though this paper will be primarily concerned with equity joint ventures, it is important to understand the differences, and to evaluate which investment form will be the most profitable for any given investment.

Each of the three types of enterprise has similarities. Each has a foreign representative, each is subject to Chinese laws, and each must enter into contractual relations in China.[49] Though they share these similarities, their differences outweigh their similarities.

Equity and contractual joint ventures are different in three respects. Equity joint ventures are set up so that the amount each side contributes to the joint venture's registered capital directly determines the amount of the profits the parties are entitled to and the amount of the losses each is responsible for. In a contractual joint venture, a separate contract is negotiated, in which the proportion of profits and losses each party is entitled to is determined and set forth. Secondly, equity joint ventures are required to set up the ventures managerial staff as specifically outlined in the Implementing Act. Contractual joint venture parties are free to structure management as they see fit. And third, equity joint ventures are typically longer in duration than contractual joint ventures. Both forms of joint ventures can consist of as few as two investors; one foreign and one Chinese, or they can have more than one foreign or Chinese investor on either side. Joint ventures are separate entities from the investing partners, and therefore their liability is limited to the joint ventures registered capital.

Companies or individuals are also allowed to do business in China without having a Chinese partner.[50] In the case of a wholly foreign-owned enterprise, the foreign enterprise only needs to have a Chinese representative.[51] The duty of this representative is to explain the relevant Chinese policies, laws, acts, regulations, provisions and examination and approval procedures. The representative is also supposed to provide advice on commercial affairs, make transportation and travel arrangements for the foreign party, arrange the date and place for talks, and communicate with local tax, finance and service agencies and administrative authorities for comerce and industry. The management of a wholly foreign-owned enterprise may be entirely foreign if the enterprise so chooses, this is an advantage in that the company need not have Chinese managers. There is a shortage of well-trained Chinese managers, which often means the joint venturers have to pay for the required training, or pay salaries for and deal with unqualified managers. "A wholly foreign-owned enterprise conducts its economic activities in its own name and for its own interests."[52] Like an equity joint venture, a wholly foreign-owned enterprise is often a Chinese legal person, whereas a foreign party to a contractual joint venture does not always have the status of a Chinese legal person.[53] As a Chinese legal person, wholly foreign-owned companies and equity joint ventures have their legal domiciles where the companies are located, and the companies are subject to the local regulations of their domiciles and to the laws of the PRC.

On a practical level, contractual joint ventures are considerably more flexible than equity joint ventures. Because contractual joint ventures are not specificlly covered by the equity joint venture legislation, a contractual joint venture can be set up differently. The amount and percentage of capital contribution, the managerial make up, the wage rate for Chinese workers are all more easily negotiated. However, the downside is the legal parameters for a contractual joint venturer are less specifically delineated. Another attractive feature of an equity joint venture, relative to a wholly foreign-owned company, is its limited liability. An equity joint venture can only be held accountable for the amount of its registered capital. This is not the case with a wholly foreign-owned company.

It was not until April 1988 that the "basic legal framework for contractual joint ventures was drafted."[54] "Foreign investors increasingly seem to prefer equity over cooperative [contractual] joint ventures."[55] In 1988 nearly 50% of the total value of foreign direct investment in China was accounted for by equity joint ventures, while contractual and wholly foreign-owned enterprises accounted for the remaining 50%.[56] Because equity joint ventures have become the primary form of foreign direct investment in China, and the laws promulgated to date are specific with respect to equity joint ventures, equity joint ventures will be the focus of this paper. Though this paper will discuss equity joint ventures, many of the difficulties of dealing with China, and problems associated with equity joint ventures will be the same or similar for contractual joint ventures and wholly foreign-owned companies.

Establishing A Sino-Foreign Equity Joint Venture According to National Legislation

When considering the possibility of establishing a joint venture in China, a foreign investor must first be registered to do business in his own country, and must locate a Chinese partner who is capable of entering into the joint venture agreement. If the foreign investor does not already have or know of a suitable Chinese counterpart, the Implementing Act states that the foreign entity may "submit a preliminary plan for his joint venture projects and authorize the China International Trust and Investment Corporation (CITIC), or trust or investment corporations of a province...to introduce potential Chinese co-operators."[57] The Chinese party is essential to the joint venture agreement as "they are the only people [within the joint venture] who can provide a site where an economic entity can be established with investment."[58] Only economic organizations, who qualify as Chinese legal persons, can qualify as joint venture partners. China's governmental agencies and employees are not supposed to participate as joint venture partners. Though this may be true formally, often the relatives of governmental bureaucrats are appointed to management positions within a joint venture. Also, state-run enterprises are permitted to joint venture, and they are run by the government. Chinese businesses are limited by their official scope of business when engaging in joint ventures. They are only officially allowed to establish joint ventures in areas where they are already approved to do business,[59] as with everything in China, this is not strictly enforced and may be negotiable.

According to Articles 1 and 3 of the JVL, a joint venture is "subject to approval by the Chinese government,"[60] and must, once approved by the Ministry of Foreign Economic Relations and Trade (MOFERT), "register with the General Administration for Industry and Commerce"[61] and obtain a license to do business. Article 2 of the JVL guarantees protection of a joint venture by Chinese law. Furthermore, the joint venture has the status of a Chinese legal person.[62] As a Chinese legal person the joint venture is "subject to the jurisdiction and protection of Chinese law."[63]

Article 9 of the Implementing Act outlines the formal procedures one must follow when setting up a joint venture. First, a preliminary project proposal must be drafted by the parties and submitted by the Chinese party to the proper authority. If approved, it will be forwarded to the approval authority (MOFERT) for final approval.[64] "In practice, the project proposal is expected to give a broad outline of the joint operations..., the present market situation..., and the actual technical and financial positions of potential participants."[65] It is imperative that the foreign party is as exact and thorough as possible when drafting the project proposal, as often this proposal becomes the foundation of the joint venture contract. Article 3 of the Implementing Act lists the industries in which joint ventures are encouraged and allowed to participate. These include: Energy development; Machine manufacturing; Electronics and computers; Light industry, textile, foodstuffs, medical industry; Agriculture; and Tourism. If a joint venturer is looking to invest in an industry not covered by this list, approval will be potentially difficult.

Once the project proposal is approved, a much more in depth document known as the feasibility study must be produced by the parties to the joint venture. "What is required by the planning authorities and the department in charge of foreign investment at this stage is an in-depth report presenting accurate data for a technical and economic analysis of every key problem concerning the project."[66] If a foreign investor would like to invest in China, but has not located a suitable partner, he may do the feasibility study independently, submit it and settle on a partner later. In this case the project proposal would be executed after the feasibility study. Once the feasibility study is approved, the joint venturers must "negotiate and sign joint venture agreements, contracts and articles of association."[67]

Article 13 of the Implementing Act outlines the main principles regarding the establishment of a joint venture, and they must be covered in the joint venture agreement. Similarly, Article 14 outlines the required contents of the joint venture contract. The joint venture contract will be the primary legal document between the parties, and will be relied on in case of dispute, therefore close attention must be paid when drafting the contract. The Chinese government has designed a model contract which may be referred to when drafting a joint venture contract. It is necessary that the parties approach the drafting of the contract with a view to the future, keeping in mind worse case scenarios. They should endeavor to foresee problems and include contingencies regarding their solutions. "Joint venture negotiations are complex and require much time. Both parties should be cautious and patient."[68] Though it is imperative to draft carefully, even the most attentive drafting will not always prevent contractual abuse on the Chinese side. When the parties are ready to apply for approval, they will be required to submit:

> 1) an application in Chinese for the establishment of a joint venture; 2) the feasibility study...; 3) the joint venture contract and articles of association...; 4) a list of the board of directors and managers of the joint venture...; and 5) signed opinions of the department in charge of the autonomous, or municipal government organizations responsible for the joint venture business.[69]

When the joint venture receives official approval by MOFERT, it must, within one month, register with the appropriate State Administration for Industry and Commerce.[70]

The joint venture will be required to register its capital according to the "Provisional Regulations of the State Administration for Industry and Commerce Governing the Ratio of Registered Capital to Total Investment by Sino-Foreign Joint Ventures."[71] These regulations outline the amount of capital which must be registered as a proportion of total investment. For example, "if the total investment of a joint venture is up to $3 million dollars, then the registered capital must account for at least 70% of the total."[72] According to Article 4 of the JVL the foreign joint venturer should contribute at least 25% of the registered capital.[73] Though there is a lower limit, according to the JVL and the Implementing Act, there seems to be no upper limit on the percentage of registered capital the foreign party may contribute. In theory the foreign partner could contribute anywhere from 25-99% of the registered capital. Capital can be in the form of "cash or buildings, premises, equipment or other materials, industrial property or know-how, [or] right to the use of a site as investment."[74] All foreign exchange cash contributions must be converted into Renminbi (the People's money) and deposited into a Chinese bank account.[75] Article 74 of the Implementing Act allows the joint venture to open foreign exchange and Renminbi accounts once the venture has been issued its business license. These accounts must be established in order to do business in China, as joint ventures are required to deposit all foreign exchange income into a Chinese bank account. Finally, the joint venture "must register with the local tax bureau."[76]

The JVL at Article 6 states "a joint venture shall have a board of directors...."[77] This board of directors will be "the highest authority of the joint venture."[78] The Implementing Act specifies that the Chinese party is responsible for appointing the chairman of the board, while the foreign party appoints the vice-chairman.[79] The language in the Implementing Act does not require the chairman of the board to be Chinese, it only requires the Chinese side to appoint the chairman. In 1990 Article 6 of the JVL was amended to say "[t]he chairman and the vice-chairman or vice-chairmen shall be chosen through consultation by the parties to the venture...If the Chinese side or the foreign side assumes the office of the chairman, the other side shall assume the office(s) of the vice-chairman of vice-chairmen." The amendment is significant in that it clearly allows the chairman to be appointed by the foreign participant to the venture, and the chairman is the legal representative of the joint venture.[80] The directors are elected for four year terms, and the positions are renewable if desired.[81] The actual size of the board of directors is to be determined through negotiation. Article 34 of the Implementing Act states that the board of directors must have at least three members. It also states "the distribution of the number of directors shall be ascertained through consultation by the parties...with reference to the proportion of investment contributed."[82] The words "with reference to" are liberal and therefore do not require the parties to divide the number of seats exactly according to the amount each invested. Typically the venturers divide the seats equally for equal capital contributions, and adjust slightly if one party is clearly the majority investor.[83]

The Implementing Act also requires that a joint venture has a management team. This team is made up of a "general manager and several deputy general managers."[84] These positions may be filled by either Chinese or foreign citizens. The management is given control over personnel matters and other responsibilities the board of directors sees fit to relinquish to them.[85] If the board elects a foreign participant to the position of general manager, the foreign joint venturer is essentially given control of the venture.[86]

CHAPTER III

LOCAL REGULATIONS

In General

Though the 1979 JVL and the 1983 Implementing Act are both state legislation concerning foreign equity joint ventures, these laws are basically statements of foreign investment principles in the People's Republic of China. When pursuing the establishment of a joint venture in China, the actual location of the enterprise will significantly affect its success. The local regulations and laws concerning equity joint ventures will be the substantive statutes which will primarily govern the joint venture. A potential investor should carefully analyze the differing policies and select the location most suitable to the individual project.

As China opened her doors in the late 1970's five "Special Economic Zones (SEZ's)" and 14 coastal cities were opened up to foreign investors. The SEZ's which include: Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Island; and the fourteen coastal cities: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyunggang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai are all areas economically attractive to foreign investors.[87] The SEZ's economic policies differ from state policies regarding foreign investment, and were designed to offer more investment incentives to foreign investors. The characteristics of a SEZ are: a market-oriented economy; preferential taxation for foreign businesses; and, more autonomy from state authorities.[88]

Though the coastal cities do not always offer the same advantages as the SEZs, they do offer incentives compared with elsewhere in China. The coastal cities offer tax breaks, exemptions and concessions to foreign investors. Both the coastal cities and SEZ's offer an expedited approval processes for joint ventures. Local authorities in these zones and cities are empowered to approve foreign investment projects, which bypasses having to apply to MOFERT for approval.

Equity Joint Ventures in Shanghai Compared

Shanghai is China's largest city spanning 6,340.5 square kilometers and is home to thirteen million people.[89] It is on the eastern coast of China and hosts the busiest port in the country. "Shanghai is the most important industrial city in China, and is located "at the base of China's longest internal waterway."[90]

Shanghai's mayors have been progressive and aggressive in pursuing foreign investment in Shanghai.[91] Between 1979 and 1989 709 foreign investment enterprises were set up in Shanghai, totalling $2.5 billion U.S. dollars.[92] Aside from her size, abundant supply of skilled labor, and accessibility, the Shanghai Municipality has promulgated joint venture laws which offer advantages over the basic state legislation. With the decentralization of the Chinese economy, local agencies, such as the Shanghai Municipality, were given the authority to publish localized foreign investment regulations. These regulations must conform to the broader State Council promulgated joint venture legislation, and cannot be contrary to other National Chinese laws.

Though local regulations are supposed to defer to National laws, local authorities typically make all decisions regarding business within their locality. Local economies benefit largely from foreign investment in the way of greater tax revenues, more available jobs, etc.. When the local economy is prosperous, the local bureaucrats are happy (and fat). With the possibility of personal gain local authorities are less likely to defer to national regulations, or to send problematical issues up to the national authorities. This is an important consideration for an investor. With local officials calling the shots, having solid connections with the area's bureaucrats will stand a business in good stead.

Shanghai is divided into eastern and western sections by the Huangpu River. On April 18, 1990 it was officially announced that Shanghai intended to open the eastern half of the city to foreign investors. Historically, Puxi, the western section of Shanghai, has been the center of business, while the eastern section has remained largely undeveloped.[93] In an attempt to attract business on the eastern side of the River, new regulations were adopted. Though not officially a SEZ, the Shanghai Municipality promised SEZ-like regulations in Pudong (the eastern section). As a result Pudong has recently experienced an influx of foreign investment. Shanghai is now divided not only physically by the Huangpu River, but also legally with respect to foreign investment laws.

Appreciating the legal dichotomy, this section of this paper will focus on the comparison between foreign joint venture laws in Puxi and the state laws governing equity joint ventures in China. Again, an individual investor should complete a careful analysis of local investment laws in order to determine the appropriate venue for any given project.

July 1, 1984, the Shanghai Municipality issued the "Regulations of Shanghai Municipality on Discussion and Examination and Approval Procedures Concerning the Establishment of Sino-Foreign Joint Equity Ventures and the Acceptance of Self-Operated Enterprises Invested in and Established by Foreign Business (the Trial Implementation) (SMEAP)."[94] The same year the Shanghai Municipality issued other regulations concerning equity joint ventures:

1) October 8, 1984 - Implementing Measures for Labour Management for Sino-Foreign Joint Equity Ventures in Shanghai Municipality.[95]

2) October 18, 1984 - Implementing Measures for the Regulation of Shanghai Municipality on Discussions and Examination and Approval Procedures Concerning the Establishment of Sino-Foreign Joint Equity Ventures and the Acceptance of Self-Operated Enterprises Invested by Foreigners (IMRSM).[96]

3) December 5, 1984 - Regulations on Commodity Supply and Marketing and Price Control for Sino-Foreign Joint Equity Ventures in Shanghai Municipality.[97]

These laws were supplemented in 1986 with the "Measures Concerning Land Use Administration for Sino-Foreign Joint Equity Enterprises in Shanghai Municipality"[98] and the "Regulations of Shanghai Regarding Application and Approval of Sino-Foreign Equity and Contractual Joint Ventures and Wholly Foreign-Owned Enterprises."[99] Supplementing local legislation are the State laws, which must be consulted anytime local laws do not discuss an issue (i.e., intellectual property laws).[100]

The Shanghai Municipality developed its joint venture laws in order to "accelerate the development of economic construction, in accordance with actual circumstances in Shanghai."[101] The SMEAP outlines the basic process one must go through when attempting to establish a joint venture in Shanghai. The IMRSM develops this outline with specifics regarding what is expected of a prospective joint venturer. According to the SMEAP foreigners interested in setting up a joint venture in Shanghai must enter into discussions, which are not legally binding[102], and within two days submit "Discussion Details" to the department in charge of the Chinese party, and to the Shanghai Municipal Commission for Foreign Economic Relations and Trade (MCFERT).[103] If "uniform intentions" can be established, then the parties will begin a preliminary feasibility study. Based on this study, the parties will submit a project proposal to the appropriate district or county bureau.[104] Once approved three copies must be sent to MCFERT and two copies to the Municipal Planning Commission (MPC). These steps in the approval procedure parallel state guidelines.

After gaining approval of the proposal, the parties must begin the in depth feasibility study and negotiations.[105] Once agreement has been reached on all major issues, including; "production and operations objectives, the scale of the enterprise, the total investment..., technology transfer, [and] equipment prices" the feasibility study may be submitted for approval.

The final approval procedure in Shanghai differs somewhat from the state procedure. "[I]t seems that many foreign investors do not feel comfortable with the governmental approval process necessary for investment in

China."[106] As an effort to lessen the discomfort, Shanghai has implemented more favorable approval procedures. The Shanghai approval authorities have far greater discretion to approve joint ventures than other cities in China.[107] This can be advantageous to a foreign investor, as it means the approval procedure will take significantly less time, and therefore the enterprise will be up and running sooner. MCFERT is given the discretion to approve some projects with a total investment of up to $30 million U.S. dollars. If, however, total investment is too large, or requires special State assistance, the parties must submit their application to MCFERT, MOFERT and the MPC. Finally, as with the state regulations, the venture must "within a month of receiving a certificate of approval...go through registration procedures and obtain a business license from the Municipal Administration for Industry and Commerce."[108]

Labor and Land Use Policies can have a significant impact on the feasibility of a joint venture. Shanghai has promulgated specific regulations with respect to both issues: the "Implementing Measures for Labour Management for Sino-Foreign Joint Equity Ventures in Shanghai Municipality" and "Measures Concerning Land Use Administration for Sino-Foreign Joint Equity Enterprises in Shanghai Municipality." Though it is important for an investor to be aware of the provisions outlined in these regulations, he should also keep in mind that negotiation over land use fees is possible, and one's connections can make a tremendous difference.

Land use fees will always be a consideration when establishing a joint venture in China. In China urban land is owned by the state, while suburban and rural land is owned by collectives. Due to the socialist structure in China, individual are not supposed to own land, however people and businesses are given rights to use the land. Often the Chinese party to a joint venture contributes at least a portion of its share of the registered capital in the form of land use rights. "If the land use fee is not used as investment, the joint venture can obtain the right to the use of land by paying such a fee to the state."[109] This right to use the land is only the right to use, and is absolutely non-transferrable.[110]

According to State regulations the rates for land use are not to be adjusted within the first five years[111] and it is up to the local governmental authorities to establish applicable fees for land use.[112] In Shanghai the Shanghai Municipal Land Use Bureau is in charge of approving land use rights and setting the applicable rates.[113] An application must be submitted to the Shanghai Municipal Land Bureau within one month of receipt of approval of a joint venture.[114] The annual fees in Shanghai range from .5 - 100 yuan per square meter, or, in some circumstances, 5% of the enterprises turnover.[115] These fees only cover the right to use the land, and do not include "demolition, removal and reallocation expenses which result from its (the joint venture's) use of the land, infrastructure construction costs..., or construction costs for the proportion of public utilities and infrastructure facilities which are particular requirements...."[116]

Shanghai offers some breaks with respect to land use fees. In line with the Implementing Act, Shanghai assesses no fees for the first year if the joint venture occupies the land for less than six months, and otherwise only assesses half the annual fee.[117] Additionally, if the joint venture is considered technologically advanced, or export-oriented, it might be exempt from land use fees for the first three years, and then only be assessed "at half the lowest stipulated amount from the fourth year onward."[118] Article 16 of Shanghai's regulations provides for a reduction in or exemption from land use fees if the project involves "municipal infrastructure facilities, culture, education, health or scientific research, [and] profit-making is not the principal objective of the joint venture."[119] Any assessed fees must be paid twice annually, unless there are extenuating circumstances which entitle an exemption.[120] If the fees are not paid on time a 1% penalty will be charged on the balance daily.[121]

In addition to land use, labor regulations and responsibilities will be of major concern to prospective joint venturers, especially in the case of a labor intensive production projects. One feature that attracts foreign investors to Shanghai is the size of her labor force. Labor is cheaper in China compared with other parts of Asia.[122]

Though the average annual income in China is still quite low, there are other costs associated with employing Chinese workers that might significantly reduce the financial incentive.

In Shanghai, joint ventures may hire anyone who is over 16, qualified and not still in school, either local or from another region.[123] The Shanghai Municipalities willingness to allow foreign investors to recruit labor from outside Shanghai is evidence of their liberal attitude toward labor regulations. However, if the Chinese participant is from Shanghai already, its existing workers are to be given priority, and if they are not hired, the Chinese participant is responsible for relocating them.[124] The joint venture is responsible for training its employees as well.[125] After hiring an employee a labor contract must be signed between the joint venture and either the employee or his trade union.[126]

According to State regulations, local labor bureaus are free to set the wage between 120 and 150% of the average wage of a similar employee in a state-owned enterprise in Beijing.[127] Shanghai opted for the lower end and set the wage at 120% of the average wage.[128] Though this figure may be low compared with some regions in China, joint venture employers are required to take financial responsibility for their employees. Other expenses incurred by the joint venture on behalf of its employees include:

1) 30% monthly of employees actual wage to pension insurance fees;[129]
2) medical expenses for non-work-related illnesses as well as work related illnesses, including living expenses if the employee exceeds allowed sick leave;[130]
3) living expenses for those who become unable to work;[131]
4) "funeral expenses and pensions and medical expenses for the families of disabled or deceased employees;"[132]
5) 30 yuan per employee monthly for subsidies;[133]
6) welfare costs, i.e., "meals, kindergarten..., transport allowances, home leave expenses, etc.."[134]
7) 30 yuan monthly for housing, or the equivalent;[135]

According to the "Regulations of Shanghai Municipality for the Encouragement of Foreign Investment" joint ventures may choose not to pay the housing subsidy of 30 yuan a month, however, they must retain a like amount of money "as a fund to improve the housing conditions of their Chinese employees."[136] This provision can be beneficial to the joint venture, as improved living conditions for their employees can translate to higher productivity. In addition to the above requirements, a joint venture must set up an incentive award fund and welfare fund from its "after-tax profits." Chinese employees are to be given national holidays, sick leave, maternity leave and holidays for visiting relatives. These additional fees significantly increase the cost of hiring each employee, and can be a source of frustration for the employer. The frustration lies in the fact that the foreign partner pays these fees to the Chinese partner, or the employee's trade union, who is then supposed to disburse the benefits, which means the benefits are not always realized by the employee.

If a joint venture would like to dismiss an employee, it may do so, but there are restrictions. If the reason for termination is a labor dispute, the joint venture must first attempt resolution of the conflict with the aid of the employee's labor or trade union. If resolution is not forthcoming, the parties may seek arbitration.[137] If the joint venture needs to lay an employee off due to surplus labor, it may do so. First, however the employer must consult with the labor union, and the employee must be given a month's notice.[138] If an employee's contract is not renewed, and the employee is still of working age, he is entitled to severance pay. He is entitled to a month's pay for every year worked if he worked for the joint venture less than ten years. If his term of service exceeded ten years he is entitled to one and a half months pay for every year worked.[139] Finally, a woman who is pregnant or on maternity leave may not be dismissed.[140]

Employment of Chinese managers and board members is covered in the Implementing Act and applies to Shanghai.

Typically, Chinese managers are entitled to the same salary as their Western counterparts. Though the managers are supposed to earn the same salary, they don't always receive the monies they are entitled to. Even if the foreign investor makes the funds available, the Chinese partner doesn't always pay the managers their full salaries. The reality of the labor regulations is that a prospective investor will want to thoroughly research the applicable legislation and do a cost-benefit analysis. It is likely that relative to Western labor Chinese labor will still be inexpensive, however, not as inexpensive as it initially appears.

Success of any business endeavor is likely to be limited if raw materials and supplies are unavailable or are too expensive. One of China's primary goals in opening her doors to the West was to attract foreign exchange. Consequently, there are regulations limiting a joint venture's ability to either import materials, sell materials domestically, or bring materials (such as machinery) to the joint venture as part of its capital contribution. The Shanghai Municipality has issued the "Regulations on Commodity Supply and Marketing and Price Control for Sino-Foreign Joint Equity Ventures in Shanghai Municipality."[141] The Implementing Act states that materials may be bought from China or from abroad, but all things being equal, China should be given priority.[142] Domestically, joint ventures can buy materials under planned distribution, from commercial departments, on the free market, or from other foreign trade corporations.[143] The Shanghai Municipality also allows joint ventures to have fixed suppliers, to purchase materials at commodity trade fairs, and "establish bases for the production of raw materials to ensure supply."[144] If a joint venture needs to import materials, but does not require a sufficient amount to receive approval of the import license, it may apply to MCFERT to have materials supplied at a competitive price.[145] In cases where the venture needs an import license, Shanghai has set up offices which are to review the application within five days.

Shanghai also has more lenient regulations regarding sales of joint venture production items. According to state regulations, a joint venture may sell its products domestically via planned distribution channels; through materials and commercial departments; to other foreign trade companies; and may sell surplus production by itself or through entrusted sales organizations.[146] In Shanghai, if a joint venture is unable to export production due to insufficient quantity, MCFERT will arrange the sale with payment in foreign exchange.

According to the "Law Concerning the Income Tax of Foreign-funded Enterprises," all foreign-funded enterprises are taxed at a maximum rate of 33%, which is comprised of a 30% income tax and a 3% local tax. Sino-foreign joint ventures are exempted from taxes for two years and only pay 50% for the following three years.[147] Joint ventures established in one of the fourteen coastal cities, Shanghai included, are extended further tax benefits. The extent of the tax benefits depends on the type, and location within the city, of the joint venture. Shanghai, like the other 13 coastal cities, is divided into two areas: the economic and technological development zone (ETDZ), and the Old District.[148] If a joint venture is established in or primarily does business in the ETDZ, then it may only be subject to a flat rate of 15%.[149] Also, these enterprises may apply to the local authorities for a reduction of or exemption from local taxes. The tax rate in the Old District is 24% unless the joint venture qualifies for a reduction due to a technologically advanced or export-oriented classification in which case their taxes may be as low as 10% initially.[150]

CHAPTER IV

PROBLEMS FACED BY JOINT VENTURERS

Cultural and Legal Issues

Aside from the issues discussed regarding the establishment of an equity joint venture in Shanghai, there are a number of other cultural and legal aspects which foreign investors must be concerned with. Due to China's unique cultural and historical heritage, the way the Chinese do business often does not jive with the Western mind. Westerners rely on the contract and their presumption is that the words on paper and written law mean something, while the Chinese depend on relationships and trust or mistrust, and often ignore the written agreement. Throughout history the Chinese have emulated the Confucius model. The Confucian Analects say, "To rely on written law to enforce behavior was never as important as proper behavior itself."[151] When the Chinese resorted to relying on the laws, it was "evidence that people and their government had failed."[152] Adding to this predisposition, "Chinese rulers throughout history have consistently manipulated laws to benefit themselves, with the result that Chinese today are still less trustful of laws than of personal contacts."[153]

In the wake of the Cultural Revolution, the open door policy began. Since China opened her doors, foreigners doing business in China have had to face two realities which significantly affect business negotiations in China. As discussed above, the Chinese tradition was to rely on personal contacts. The guanxi system[154] experienced a new high during the Cultural Revolution, and still pervades China's business world. The residual effect is a distrust of the validity of written laws. It wasn't until 1979 that the laws which predated the Cultural Revolution were officially reinstated.[155] Two thousand-plus years of fabricating and bypassing laws to accomodate personal motivations is difficult to eradicate overnight. The second major influence from the semi-autarkic years between 1957 and 1979 is a distrust of foreigners. This distrust came to a head during the Cultural Revolution when anyone who even had prior connections with the West was persecuted. Foreigners were billed as imperialist aggressors and were not to be trusted.

It is imperative that foreign investors keep cultural differences and recent Chinese history in mind and adjust their behavior accordingly. From the outset the Chinese side will pay close attention to their perceived ability to trust (or fool) their foreign counterpart. The success of any joint venture will be directly proportional to the amount of trust developed between the two parties to the negotiation.

The working presumption for the Chinese will be that the foreign investor is simply interested in exploiting the Chinese partner. It will be an uphill battle for a foreign investor to convince the Chinese party that he is interested in mutual benefit of both parties, but the battle may be worth fighting.

In "Joint Venturing in China: A Negotiating Experience" Hans Fischer details his experience as a lawyer attempting to negotiate an equity joint venture contract in Heilongjiang Province.[156] The obstacles he faced when dealing with China are not atypical of those faced by many foreigners investing in China in the early 80's, and can be educational for future joint venturers. The primary problems Fischer encountered were: governmental involvement; bureaucratic inefficiencies; communication barriers; cultural difficulties; and a flexible approach to the law.

Establishing a joint venture in a state-run economy is always going to require the foreign party to pay close attention to governmental policy. If the joint venture's objectives don't parallel state objectives, it will be very difficult to get the project approved. In fact, Fischer felt the governmental intrusions (he counted over 39 different Chinese business cards representing 10 governmental organizations)[157] were beneficial to some extent. Though "the Chinese made it clear that final government approval of the negotiated agreement was not assured just because government representatives attended the negotiations,"[158] Fischer is convinced that governmental participation was beneficial in this respect. Another benefit of governmental participation is that it allows the foreign party to learn first hand the government's position on matters, thereby preventing the Chinese party from misstating a governmental position in pursuit of its own agenda.

A prevalent obstacle when dealing with China is bureaucratic inefficiency. With China's drive to decentralize her economy, many bureaus and ministries were set up on the local and provincial levels.[159] It is often the case that a given joint venture requires signatures from multiple bureaus and ministries. State Councillor Gu Mu said "that in some places officials either do not follow the law or simply regard their own word as law."[160] Though MOFERT is the state Ministry directly in charge of foreign investment, it cannot give approval of a project which lacks approval from another ministry or bureau. China lacks an ultimate authority which can give final approval of a joint venture.[161] The frustrating result can be that any given organization can refuse to give its signature, and the project will be denied approval. This is not always a problem objectively, but if one of the approving authorities has a personal problem with a project he might arbitrarily deny its approval. One China consultant said, "The best thing is to win your Chinese partners to your side. They can get you through the bureaucracy...."[162] When selecting a

Chinese partner, a major consideration should always be; what are its connections with local authorities?

The language barrier in China is often a difficult obstacle to overcome. For Fischer the problem was exaggerated due to the locality of their venture. As no one on Fischer's team spoke Chinese and no one on the Chinese side spoke English, they were forced to use a translator.[163] It can be difficult finding a translator familiar with technical and legal terminology. Using a translator had its attendant difficulties. The lack of precise, adequate translation often resulted in prolonged negotiations, because neither side could hear firsthand what the other side was saying. The upside to Fischer's experience was the translator's abilities improved with time, thereby increasing efficiency.

Cultural differences such as "work rules, plant cleanliness, environmental practices, and sometimes what seemed to Western eyes as a lack of common sense"[164] also caught Fischer's team off guard. The standard for cleanliness in China is low compared with the United States. Apart from affecting working conditions, this lack of cleanliness can affect a products quality. One of the national goals for foreign investment in China is to attract export-oriented projects. If the quality of products is low, the result is an inability to compete on an international market. The expected standards for quality control and cleanliness should be covered in detail when drafting the contract. Though this won't prevent aberrations, at least the Chinese side will know ahead of time what is expected. In a 1989 survey of Sino-American joint ventures, 60% of the joint ventures reported having problems with quality control.[165]

Aside from the issue of cleanliness, these joint venturers indicated that the idea of quality standards didn't exist in China.[166] Being a society which "has deliberately eschewed cosmetic factors as materialistic and bourgeois,"[167] it is somewhat understandable that quality control would be a problem. Somewhat encouraging is the fact that joint venturers have been successful in educating the Chinese with regard to quality control. Fischer felt their Chinese partners were willing to learn.[168]

What Fischer termed "a flexible approach to the law" can affect every aspect of the joint venture from labor, to sourcing materials, to contract negotiations. The manifestations of this flexibility are: Chinese parties citing laws and regulations that don't exist (or are not written down); interpreting laws literally or liberally depending on which interpretation is most beneficial (to the Chinese); and, not adhering to the terms of a contract when it is not convenient. This is such a significant problem that recent legislation has addressed it. In a Memorandum of Understanding (MOU) signed October 10, 1992 the Chinese government agreed to "publish on a regular basis all laws, regulations, rules decrees, administrative guidance and policies in the field of customs."[169] This MOU also states that only "published and readily available"[170] rules will be enforced. Though this MOU helps, it is not a solution to the problem. The Chinese have a history of ignoring written law, there is, therefore, no guarantee that these promises will be adhered. Additionally, it is impossible to change the business habits of a nation of a billion people simply by signing an MOU.

In addition to citing rules, regulations and laws that aren't published, or accessible, often the Chinese will re-negotiate a regulation. Fischer cites an example from his negotiations. A land use contract had been drawn up according to the negotiated annual price per square meter to be paid for rights to use the factory. At the last minute the municipal Land Use Authority said Fischer's company must also pay the same price for the surrounding property. Fischer's team was unwilling to agree to this, as it would would have doubled their annual land use fees. In the end the Chinese said the surrounding area must be paid for, but they would agree to a 50% reduction in the price per square meter. As this resulted in the initial price, Fischer's team agreed. In the end there seemed to be no apparent reason for the Chinese sides change in position, unless it was simply a power play.[171]

The Chinese ability to come up with laws and regulations that do not exist can affect any area of the joint venture. If the joint venture would like to dismiss a Chinese worker, the official in charge can impede the action by calling it illegal. If the joint venture needs supplies, the official in charge can say it is impossible. There are any number of situations which can be made problematic. There are two key points to keep in mind in dealing with this problem. First, it is important to pursue all avenues available. Because of the bureaucratic vagaries noted above, if one person cannot or will not help, another one might be willing to. Secondly, one must develop a trusting relationship with the Chinese parties involved. "Experts in international investment and experienced foreign investors are generally in agreement that the success of a joint venture can only be achieved through the mutual trust and respect of the parties involved,"[172] and both sides must stand to benefit. If the foreign party approaches the joint venture with a view toward the future and develops lasting trusting relationships with the Chinese, it will aid him when facing any of the obstacles mentioned above.[173]

Once established there are a number of legal problems that seem to be fairly universal for foreign invesors in China. Technology transfer is a problem that has historically been at issue, but seems to be improving somewhat. For example, a French switch manufacturing company faced blatant pirating of its product.[174] When the manager realized his product was reverse engineered by two factories in central China, he was outraged. Not only were they manufacturing and selling his switches, but the quality was poor. As the switches looked identical, the poor quality switches were easily mistaken for the French company's, thereby having a potential negative effect on the French Company's reputation. If the foreign participant or a third party is the transferor, the transfer regulations are set out in the Implementing Act.[175] According to Article 46, the transferor is entitled to reasonable compensation in the form of royalties. Generally the term of the agreement is not to exceed 10 years, and upon expiration of the agreement the transferee retains rights to the technology. Also, "no restrictive clause that is unreasonable and prohibited by Chinese laws and regulations may be included."[176] The regulations regarding technology transfer reflect China's modernization goals. Joint venture technology transfer is concurrently covered under more recent legislation: "Regulations on Administration of Technology Import Contracts of the People's Republic of China" apply.[177] Regardless of the source of the transfer, the technology transfer must be approved by the examining and approval authority.

Another common problem for investors is a shortage of foreign exchange. According to article 74 of the Implementing Act "all foreign exchange income of a joint venture must be deposited in the foreign exchange deposit account...."[178] All foreign exchange expenditures are to be paid for out of the same account.[179] Joint ventures are required to keep their foreign exchange income and output balanced. Many companies have difficulty meeting this requirement. The most common ways to deal with this problem are: increasing the ratio of products exported to those sold domestically; using government swap centers to change their Renminbi into foreign exchange-often paying high exchange fees; and, "trading in other products not produced by the joint venture overseas."[180] Related to, but not the same as the foreign exchange problem, is the shortage of cash. Domestic customers often have cash shortages themselves, as they can't pay their bills, joint venturers selling to them end up with high accounts receivable.[181] Joint venturers also report difficulties in obtaining business loans in China.[182]

Investors will always want to assess the tax situation and investigate applicable tax breaks. China has offered tax incentives to export-oriented and technologically advanced enterprises.[183] Objective criteria determine whether a joint venture is "export-oriented." The project: "must produce export products; the value of the products exported...in that year must exceed 50% of the value of production; and, foreign exchange revenue must exceed foreign exchange expenditure."[184] Unfortunately, the criteria to qualify as "technologically advanced" are not as objective, and are therefore subject to the whims of the approving authority. Basically the project must "employ internationally advanced and appropriate production technology; be a project in which the state encourages foreign investment; and, have a technology transfer agreement...."[185] In one sense this is beneficial to the foreign party, as they can bring in technology not considered advanced in the Western world, call it advanced technology and receive the favorable tax concessions. Both the export-oriented and the technologically advanced enterprises are offered a further 50% reduction (not to go below 10% tax) beyond the initial five years of tax breaks and the foreign party will not be required to pay a repatriation tax.[186] However, in order for the export-oriented enterprises to qualify for the 50% reduction the value of their exports must be 70% of total production.[187] Further incentives exist if the companies reinvest their profits. Aside from the difficulties of being classified in one of these two categories, the approved companies must continue to meet the classification standards through an annual review.[188] If an enterprise does not pass the annual review for three consecutive years it may have its status revoked.[189] These tax incentives are attractive, and will add to the joint venture's profit margin if taken advantage of.

In her survey of Sino-American joint ventures, Cecilia Wagner cites "the shortage of trained managers"[190] as the most prevalent problem joint venturers deal with. The basic problem seems to be a result of the Chinese system. Often Chinese managers are chosen from the ranks of the Chinese Communist Party (even though governmental employees are not allowed to be joint venturers). This means, not only are they chosen based on their titles, and not their abilities to manage, but also that their loyalties may well be to their ministries and not the joint venture.[191] The most common methods used to deal with this problem were education; recruitment of expatriate managers, and incentive programs.[192]

Though not a legal problem, China's infrastructure is outdated and overused. Problems ranging from reliable power sources to bottlenecked rail systems are irritating and inefficient.[193] As a result, many joint venture companies have difficulties getting supplies in on time and products out on schedule. Unfortunately, this is a reality one faces when dealing with a developing country. Investors should considerr this when doing the feasibility study. Aside from living with it, the only possible solution is to rely on the guanxi system to have shipments prioritized.[194]

As the possibility of conflict is quite large, joint venturers will need to concern themselves with methods of dispute resolution. Articles 109-112 of the Implementing Act outline the available methods of dispute resolution.

Initially the parties are to attempt to resolve their differences through "friendly consultation or mediation."[195] If they are not able to come to an agreement, then the dispute "may be settled through arbitration or courts of justice."[196] When drawing up a joint venture contract, a section covering dispute resolution must be included. Typically foreign investors specify arbitration as the formal method of dispute resolution.[197] The other option is the People's Court, "a series of local and provincial commercial courts."[198] Pursuing dispute resolution through the People's court system can be slow, inefficient and frustrating, and should be avoided if possible. The Stockholm Chamber of Commerce is the most commonly chosen arbitration organization.[199] In May, 1992 the American Arbitration Association Conciliation Center and Beijing Conciliation entered into a cooperation agreement. Foreign investors may now use this center for arbitration and specify New York or Beijing as the location for arbitration.[200]

The Future of Sino-Foreign Joint Ventures

Foreign investment has continued to grow, though not steadily, in China since the beginning of the Open Door Policy in 1979. The first three years of the Open Door campaign entailed developments in the legal structure and some cautious investing.[201] The following two years from 1983-1985 there was some decentralization of approval authority, and with the opening of the coastal cities the investment climate picked up.[202] Then in 1986 the domestic economy, with its rising inflation was not as strong, and the "government turned to a policy of retrenchment" causing a slowdown in foreign investment.[203] In 1988 optimism with regard to the investment climate was at a new high, and foreign direct investment increased.[204] This excitement was cut short in 1989 due to austerity measures and the Tiananmen incident.[205]

After the 1986 promulgation of the 22 articles encouraging foreign investment, China experienced a boom in investment, as foreign investors felt the investing environment promised a better tomorrow than today. However, many investors became extremely cautious after the Tiananmen incident in June of '89. Because of the Chinese government's retrenchment campaign the Chinese attitudes changed as well. Prior to 1989, with the decentralization of power regarding foreign investment, the Chinese were more willing to make decisions and to take action. After Tiananmen, the shift in the political climate created an atmosphere of caution and apprehension.[206] With the Cultural Revolution in the not too distant past, the Chinese remember the days when governmental policies changed with the wind. As a result, with the crackdown in Beijing the Chinese became less willing to make decisions on their own for fear of repercussions. Additionally, joint venturers began to fear the imposition of wage ceilings, thereby limiting the enterprises ability to attract workers. Due to problems such as these, foreign investment slowed down the fourth quarter of 1989, and was slow to recover.[207]

As the central government increased control, and the economy sagged, some investment projects were forced to consider dissolution. According to the Implementing Act there are six reasons a joint venture can legally dissolve.[208] Aside from "termination of duration" of the joint venture, the board of directors must unanimously approve the termination.[209] In the case of the Tianjin Simpson Household Appliance Company, who was forced to dissolve due to heavy losses following Tiananmen, official approval from MOFERT was obtained, but the Chinese chairman of the board refused to approve the dissolution.[210] The year long delay in obtaining his signature meant the joint venture was able to pay far fewer of its debts as much money was squandered trying to keep the joint venture operational during that year. The Implementing Act specifies how to carry out the dissolution, however, it offers no assistance for a company in Simpson's position. Investors should consider the worse case scenario and detail dissolution procedures when negotiating the joint venture contract.

Despite the economic retrenchment following the Tiananmen incident recent years have offered more hope again for foreign investors. Following Deng's trip to Southern China in 1992 credit loosened and reform was once again on the agenda.[211] In 1990 the JVL was amended to increase investor flexibility with respect to management and foreign exchange control. Some investments were also granted unlimited terms. The Income Tax Law of the People's Republic of China was amended in 1991 to provide a flat 33% tax rate to foreign investments in China. China's patent and trademark laws were both expanded in 1993 to provide more protection of intellectual property and trademarks. The results of the new legislation and increased emphasis on foreign investment have already been felt. In 1992 investments were five times higher than in 1991, which had been a record year.[212]

When considering establishing an equity joint venture in China, there are a number of legal and cultural issues which must be noted. With the uncertainty that exists in China, investors who focus on exports and the international market will more prepared to weather a political or economic storm. The most important things a prospective investor can do is think long term, research well, build lasting-trusting relationships, and proceed cautiously.

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41. Vepsalainen, p. 12.

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49. _Ibid_, p. 117.

50. _Ibid_.

51. _Ibid_, p. 118.

52. _Ibid_.

53. _Ibid_.

54. Vepsalainen p. 32.

55. Joseph Battat, "Foreign Investments in China in the 90's: Developing Trends," _East Asian Executive Reports_ 13(1991): p. 13.

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57. "Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese

and Foreign Investment [Implementing Act]," State Council of China (1983) art. 12. Appendix B.

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59. Vepsalainen, p. 45.

60. JVL art. 1. Appendix A, p. A-1.

61. JVL art. 3. Appendix A, p. A-1.

62. Implementing Act art. 2. Appendix B, p. B-1

63. Ibid.

64. Ibid art. 9. Appendix B, p. B-3.

65. Vepsalainen, p. 49.

66. Chu, p. 99.

67. Implementing Act art. 9(1). Appendix B, p. B-3.

68. Zhang, p. 69.

69. Ibid.

70. Implementing Act art. 11. Appendix B, B-4.

71. "Provisional Regulations of the State Administration for Industry and Commerce Governing the Ratio of Registered Capital to Total Investment by Sino-Foreign Joint Ventures," State Administration for Industry and Commerce (1988).

72. Ibid art. 3(i).

73. JVL art. 4. Appendix A, p. A-2.

74. Implementing Act art. 25. Appendix B, p. B-7.

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76. Zhang, 72.

77. JVL art. 6. Appendix A, p. A-6.

78. Implementing Act art. 33. Appendix B, p. B-8.

79. Ibid art. 34. Appendix B, p. B-8.

80. Ibid art. 37. Appendix B, p. B-9.

81. Ibid art. 34. Appendix B, p. B-8.

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84. Implementing Act art. 39. Appendix B, p. B-9.

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87. Bin Xuesang, "Pudong: Another Special Economic Zone in China? - An Analysis of the Special Regulations and Policy for Shanghai's Pudong New Area," Journal of International Law and Business 14(1993): p. 139.

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91. Norman Givant, "Investing in Shanghai," China Business Review March-April(1990): p. 28.

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94. "Regulations of Shanghai Municipality On Discussion and Examination and Approval Procedures Concerning the Establishment of Sino-Foreign Equity Ventures and the Acceptance of Self-Operated Enterprises Invested in and Established by Foreign Business [SMEAP]," (1984). Dialog LEXIS, Chinalaw No. 206.

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96. "Implementing Measures for the Regulations of Shanghai Municipality On Discussion and Examination and Approval Procedures Concerning the Establishment of Sino-Foreign Equity Ventures and the Acceptance of Self-Operated Enterprises Invested in and Established by Foreigners [IMRSM]," (1984). Dialog LEXIS, Chinalaw No. 222.

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100. Supra, p. 28.

101. SMEAP 1.

102. IMRSM art. I(1).

103. SMEAP art. 3.

104. IMRSM art. I(1).

105. Supra, p. 25.

106. Bin, p. 147.

107. Infra, p. 44.

108. IMRSM art. I(4).

109. Chu, p. 43.

110. Implementing Act art. 53. Appendix B, p. B-12.

111. Implementing Act art. 51. Appendix B, p. B-11.

112. Implementing Act art. 49. Appendix B, p. B-11.

113. MCLUA art. 2.

114. MCLUA art. 5.

115. MCLUA art. 8.

116. MCLUA art. 7.

117. MCLUA art. 10.

118. MCLUA art. 17.

119. MCLUA art. 16.

120. MCLUA art. 18.

121. MCLUA art. 11.

122. Battat, p. 13.

123. IMLM art. 3.

124. IMLM art. 6.

125. IMLM art. 7.

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127. "Regulations of the People's Republic of China on Labour Management in Joint Ventures Using Chinese and Foreign Investment [Labor Regulations]," (1980) art. 8. Dialog LEXIS, Chinalaw No. 64.

128. Labor Regulations art. 11.

129. Labor Regulations art. 12.

130. Labor Regulations art. 13.

131. Labor Regulations art. 13.

132. Labor Regulations art. 13.

133. Labor Regulations art. 15.

134. Labor Regulations art. 17.

135. Labor Regulations art. 15.

136. "Regulations of the Shanghai Municipality for the Encouragement of Foreign Investment [SMEFI]," (1986) art. 5. Dialog LEXIS, Chinalaw No. 381.

137. SMEFI art. 24.

138. SMEFI art. 9.

139. SMEFI art. 9.

140. SMEFI art. 9.

141. "Regulations on Commodity and Supply and Marketing for Sino-Foreign Joint Equity Ventures in Shanghai Municipality [Commodity Regulations]," (1984). Dialog LEXIS, Chinalaw No. 236.

142. Implementing Act art. 57. Appendix B, p. B-12.

143. Implementing Act art. 58. Appendix B, p. B-12.

144. Commodity Regulations art 1.

145. Commodity Regulations art 4.

146. Implementing Act art. 64.

147. "Investing: 14.3 Legislative Environment for Foreign Investment," (Economist Intelligence Unit, 1993). Dialog LEXIS.

148. Michael Moser and Winston Zee, China Tax Guide (New York, Oxford University Press, 1993), p. 143.

149. Ibid, p. 143.

150. Ibid, p. 163.

151. Roy F. Grow, "Resolving Commercial Disputes in China: Foreign Firms and the Role of Contract Law," Northwestern Journal of International Law and Business 14(1993): p. 163.

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153. Min Chen, "Tricks of the China Trade," China Business Review March-April(1993): p. 12.

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155. Supra, p. 11.

156. Hans Fischer, "Joint Venturing in China: A Negotiating Experience," East Asian Executive Reports 15(1993): p 11.

157. Ibid, p. 11.

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159. Supra, p. 27.

160. Guigua Wang, China's Investment Laws: New Directions (Singapore, Butterworths & Co., 1988), p. 30.

161. Supra, p. 32.

162. Fischer, p. 12.

163. Ibid, p. 13.

164. Ibid, p. 13.

165. Cecilia Wagner, "A Survey of Sino-Foreign Joint Ventures: Problems and Outlook for Solutions," East Asian Executive Reports 12(1990): p. 7.

166. Ibid, p. 9.

167. Jeanne Chiang, "What Works and What Doesn't," China Business Review September-October(1990): p. 9.

168. Fischer, p. 15.

169. Ibid, p. 16.

170. Ibid.

171. Ibid, p. 17.

172. Wang, p. 25.

173. The problems experienced by a Sino-French joint venture are illustrative of the way guanxi works in China. The joint venture was in the business of producing electrical switches in Tianjin. Two Chinese factories in central China reverse engineered the switches and began selling them. The French company was outraged and approached a Mr. Li with an inquiry about its available courses of action. As the French company saw it, it was simply a matter of taking the Chinese factory to court. Mr. Li, however, was aware of the inefficiency and inability of the Chinese court system to handle these kinds of matters, and instead relied on his guanxi to come up with a solution. He put in a call to his old schoolmate in Shanghai. Mr. Li explained the problem, and they worked out an answer. The schoolmate worked in the Shanghai development zone, and had his own network of connections. He told Mr. Li that the "resin supplier would not be granted the necessary transit permits to ship his product south, [and] the pirate firm would be cited for violation of environmental regulations, including using potentially corrosive chemicals without the proper clearances." Within six weeks the pirate firm stopped production of the pirated switches. This is just one example out of hundreds of the way guanxi can and are used when doing business in China.

174. Supra, p. 10.

175. Implementing Act art. 43-46. Appendix B, p. B-10.

176. Implementing Act art. 46(7). Appendix B, p. B-11.

177. "Regulations on Administration of Technology Import Contracts of the People's Republic of China," (198?). Dialog LEXIS.

178. Implementing Act art. 74. Appendix B, p. B-15.

179. Implementing Act art. 74. Appendix B, p. B-15.

180. Wagner, p. 9.

181. Ibid.

182. Ibid, p. 10.

183. Supra, p. 27.

184. Pitman Potter, "Seeking Special Status," China Business Review March-April(1988): p. 36.

185. Ibid, p. 39.

186. Moser, p. 58.

187. Ibid, p. 59.

188. Potter, p. 39.

189. Ibid.

190. Wagner, p. 9.

191. Ibid.

192. Ibid.

193. Ibid.

194. Ibid.

195. Implementing Act art. 109. Appendix B, p. B-21.

196. Ibid.

197. Vepsalainen, p. 122.

198. Grow, p. 183.

199. Vepsalainen, p. 122.

200. American Arbitration Association Conciliation Center-Beijing Conciliation. Dialog LEXIS, BDIEL, File 86 (1993).

201. Battat, p. 13.

202. Ibid.

203. Ibid, p. 12.

204. Ibid.

205. Ibid.

206. Richard Brecher, "The End of Investment's Wonder Years," China Business Review January-February(1990): p. 27.

207. Ibid.

208. Implementing Act art. 102. Appendix B, p. B-B-19.

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210. John Frisbie and David Ben Kay, "Joint Venture Dissolution," China Business Review November-December(1990): p. 42.

211. See note 44.

212. Ibid.

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

(Adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 and Promulgated on and Effective as of July 8, 1979)

CHINALAW No. 41

SUBJECT: EQUITY JOINT VENTURES

ISSUING-DEPT: NATIONAL PEOPLE'S CONGRESS

ISSUE-DATE: 07/01/1979

IMPLEMENT-DATE: 07/08/1979

LENGTH: 1579 words

TEXT:

[Article 1] With a view to expanding international economic co-operation and technical exchange, the People's Republic of China permits foreign companies, enterprises, other economic organizations or individuals (hereafter referred to as "foreign joint venturers) to joint with Chinese companies, enterprises or other economic organizations (hereinafter referred to as "Chinese joint venturers") in establishing joint ventures in the People's Republic of China in accordance with the principle of equality and mutual benefit and subject to approval by the Chinese Government.

[Article 2] The Chinese Government protects, in accordance with the law,the investment of foreign joint venturers, the profits due them and their other lawful rights and intersts in a joint venture, pursuant to the agreement, contract and articles of association approved by the Chinese Government.

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

[Article 3] The joint venture agreement, contract and articles of association signed by the "parties to the venture shall be submitted to" Foreign Investment Commission of the People's Republic of China, and the Commission shall, within three months, decide whether to approve or disapprove them. After approval, the joint venture shall register with the General Administration for Industry and Commerce of the People's Republic of China, obtain a licence to do business and start operations.

[Article 4] A joint venture shall take the form of a limited liability company.
The proportion of the investment contributed by the foreign joint venturer(s) shall generally not be less than 25% of the registered capital of a joint venture.

The parties to the venture shall share the profits, risks and losses in proportion to their respective contributions to the registered capital.

assignment of the registered capital of a joint venturer shall be made without the consent of the other parties to the joint venture.

[Article 5] Each party to a joint venture may make its investment in cash, in kind or in industrial property rights, etc.

The technology and the equipment that serve as a foreign joint venturer's investment must be advanced technology and equipment that actually suit our country's needs. If the foreign joint venturer causes losses by deception through the intentional use of backward technology and equipment, it shall pay compensation for the losses.

The investment of a Chinese joint venturer may include the right to the use of a site provided for the joint venture during the period of operation. If the right to the use of the site does not constitute a part of a Chinese joint venturer's investment, the joint venture shall pay the Chinese Government a fee for its use.

The various investments referred to above shall be specified in the joint venture contract and articles of association, and the value of each (excluding that of the site) shall be jointly assessed by the parties to the venture.

[Article 6] A joint venture shall have a board of directors, which shall have its size and composition stipulated in the contract and the articles of association after consultation between the parties to the venture, and the directors shall be appointed and replaced by the parties to the venture. The board of directors shall have a chairman, whose office shall be assumed by the Chinese joint venturer(s), and one or two vice-chairmen, whose office(s) shall be assumed by the foreign joint venturer(s). In handling major problems, the board of directors shall reach a decision through consultation by the parties to the venture, in accordance with the principle of equality and mutual benefit.

The board of directors is empowered, pursuant to the provisions of the articles of association of the joint venture, to discuss and decide all major problems of the joint venture: expansion programmes, proposals for production and operating activities, the budget for revenues and expenditures, distribution of profits, plans concerning manpower and pay scales, the termination of business and the appointment of the president, the vice-president(s), the chief engineer, the treasurer and the auditors as well as their powers and terms of employment, etc.

The offices of president and vice-president(s) (or factory manager and deputy manager(s) shall be assumed by the respective parties to the venture.

The employment and dismissal of the staff and workers of a joint venture shall be provided for in accordance with the law in the agreement and contract of the parties to the venture.

[Article 7] After payment out of the gross profit earned by the joint venture of the joint venture income tax, pursuant to the provisions of the tax laws of the People's Republic of China, and after deduction from the gross profit of reserve fund, a bonus and welfare fund for staff and workers, and a venture expansion fund, as provided in the articles of the joint venture, the net profit shall be distributed to the parties to the joint venture in proportion to their respective contributions to the registered capital.

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

A foreign joint venturer that reinvest in China its share of the net profit may apply for refund of a part of the income taxes already paid.

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

The pertinent foreign exchange transactions of a joint venture shall be conducted in accordance with the regulations on foreign exchange control of the People's Republic of China.

In its operating activities a joint venture may directly raise funds from foreign banks.

The various kinds of insurance coverage of a joint venture shall be furnished by Chinese insurance companies.

[Article 9] The production and operating plans of a joint venture shall be filed with the departments in charge and shall be implemented through economic contracts.

In its purchase of required raw and processed materials, fuels, parts and auxiliary equipment, etc., a joint venture should give first priority to purcahses in China. It may also purchase them directly from the international market with foreign exchange raised by itself.

A joint venture is encouraged to market its products outside China. Export products may be distributed to foreign markets through the joint venture directly or through associated agencies,and they may also be distributed through China's foreign trade agencies. Products of the joint venture may also be distributed in the Chinese market.

Whenever necessary, a joint venture may establish branches outside China.

[Article 10] The net profit that a foreign joint venturer receives after fulfilling its obligations under the laws and the agreement and the contract, the funds it receives at the time of the joint venture's scheduled expiration or early termination, and its other funds may be remitted abroad through the Bank of China in accordance with the foreign exchange regulations and in the currency specified in the joint vneture contrct.

A foreign joint venturer shall be encouraged to deposit in the Bank of China foreign exchange that it is entitled to remit abroad.

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

[Article 12] The contract period of a joint vneture may be decided through consultation by the parties to the venture according to its particular line of business and circumstances. Upon the expiration of the joint venture contract period, if the parties have agreed, the period may be extended, subject to approval by the Foreign Investment Commission of the People's Republic of China. An application for extension of the contract shall be made six months before expiration of the contract.

[Article 13] Before the expiration of the joint venture contract period, in case of heavy losses, failure of party to fulfil the obligations prescribed by the contract and the articles of association, force majeure, etc., the contract may be terminated before the date of expiration through consultation and agreement by the parties to the venture, subject to approval by the Foreign Investment Commission of the People's Republic of China and to registration with the General Administration for Industry and Commerce. In cases of losses caused by a breach of contract, the financial responsibility shall be borne by the party that has violated the contract.

[Article 14] Disputes arising between the parties to a joint venture that the board of directors cannot settle through consultation may be settled through mediation or arbitration by a Chinese arbitration agency or through arbitration by another arbitration agency agreed upon by the parties to the venture.

[Article 15] This Law shall come into force on the day of its promulgation. The power to amend this Law is vested in the National People's Congress.

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

(Promulgated by the State Council on September 20, 1983)

CHINALAW No. 173

SUBJECT: EQUITY JOINT VENTURES

ISSUING-DEPT: STATE COUNCIL OF CHINA

ISSUE-DATE: 09/20/1983

IMPLEMENT-DATE: 09/20/1983

LENGTH: 11081 words

TEXT:

Chapter I General Provisions

[Article 1] The Regulations hereunder are formulated with a view to facilitating the implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (hereinafter referred to as the Law on Chinese-Foreign Joint Ventures).

[Article 2] Joint ventures using Chinese and foreign investment (hereinafter referred to as joint ventures) established within China's territory in accordance with the Law on Chinese-Foreign Joint Ventures are Chinese legal persons and are subject to the jurisdiction and protection of Chinese law.

[Article 3] Joint ventures established within China's territory shall be able to promote the development of China's economy and the raising of scientific and technological levels for the benefit of socialist modernization. Joint ventures permitted are mainly in the following industries:

(1) Energy development, the building material, chemical and metallurgical industries;

(2) Machine manufacturing, instrument and meter industries and offshore oil exploitation equipment manufacturing;

(3) Electronics and computer industries, and communication equipment manufacturing;

(4) Light, textile, foodstuffs, medicine, medical apparatus and packing industries;

(5) Agriculture, animal husbandry and fish breeding;

(6) Tourism and service trades.

[Article 4] Applicants to establish joint ventures shall lay stress on economic results and shall comply with one or several of the following requirements:

(1) They shall adopt advanced technical equipment and scientific management which enable the increase of the variety of products, the raising of quality and output and the saving of energy and materials;

(2) They shall provide benefits in terms of technical renovation of enterprises and result in less investment, quicker returns and bigger profits;

(3) They shall enable the expanded production of products for export and result in increasing income in foreign currency;

(4) They shall enable the training of technical and managerial personnel.

[Article 5] Applicants to establish joint ventures shall not be granted approval if the project involves any of the following conditions:

(1) Detriment to China's sovereignty;

(2) Violation of Chinese law;

(3) Nonconformity with the requirements of the development of China's national economy;

(4) Environmental pollution;

(5) Obvious inequity in the agreements, contracts and articles of association signed, impairing the rights and interests of one party.

[Article 6] Unless otherwise stipulated, the government department in charge of the Chinese participant in a joint venture shall be the department in charge of the joint venture (hereinafter referred to as the department in charge). In case of a joint venture having two or more Chinese participants which are under different departments or districts, the departments concerned shall consult the district to ascertain one department in charge.

Departments in charge are responsible for guidance and assistance and exercising supervision over the joint venture.

[Article 7] A joint venture has the right to do business independently within the scope of the provisions of Chinese laws, decrees, and the agreement, contract and articles of association of the joint venture. The departments concerned shall provide support and assistance.

Chapter II Establishment and Registration

[Article 8] The establishment of a joint venture in China is subject to examination and approval by the Ministry of Foreign Economic Relations and Trade of the People's Republic of China (hereinafter referred to as the Ministry of Foreign Economic Relations and Trade). Certificates of approval are granted by the Ministry of Foreign Economic Relations and Trade.

The Ministry of Foreign Economic Relations and Trade shall entrust the people's governments in the related provinces, autonomous regions, and municipalities directly under the central government or relevant ministries or bureaus under the State Council (hereinafter referred to as the entrusted office) with the power to examine and approve the establishment of joint ventures that comply with the following conditions:

(1) The total amount of investment is within the limit set by the State Council and the source of capital of the Chinese participants has been ascertained;

(2) No additional allocations of raw materials by the state are required and do not affect the national balance of fuel, power, transportation and foreign trade export quotas.

The entrusted office, after approving the establishment of a joint venture, shall report this to the Ministry of Foreign Economic Relations and Trade for the record. A certificate of approval shall be issued by the Ministry of Foreign Economic Relations and Trade. (The Ministry of Foreign Economic Relations and Trade and the entrusted office will hereinafter be referred to as a whole as the examination and approval authority.)

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

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

(2) When applying for the establishment of a joint venture, the Chinese participant is responsible for the submission of the following documents to the examination and approval authority;

(a) Application for the establishment of a joint venture;

(b) The feasibility study report jointly prepared by the parties to the venture;

(c) Joint venture agreement, contract and articles of association signed by representatives authorized by the parties to the venture;

(d) List of candidates for chairman, vice-chairman and directors appointed by the parties to the venture;

(e) Written opinions of the department in charge and the people's government of the province, autonomous region or municipality directly under the central government where the joint venture is located with regard to the establishment of the joint venture.

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

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

[Article 11] The applicant shall, within one month after receipt of the certificate of approval, register with the administrative bureau for industry and commerce of the province, autonomous region or municipality directly under the central government in accordance with the provisions of the Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures (hereinafter referred to as registration and administration office). The date on which it is issued its business license is regarded as the date of formal establishment of a joint venture.

[Article 12] Any foreign investor who intends to establish a joint venture in China but is unable to find a specific co-operator in China may submit a preliminary plan for his joint venture projects and authorize the China International Trust and Investment Corporation (CITIC) or trust and investment corporations of a province, autonomous region or municipality directly under the central government, or relevant government department or non-official organization, to introduce potential Chinese co-operators.

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

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

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

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

If the parties to the joint venture agree to sign only a contract and articles of association, the agreement can be omitted.

[Article 14] The joint venture contract shall include the following main items:

(1) The names, the countries of registration, the legal address of parties to the joint venture, and the names, professions and nationalities of the legal representatives thereof;

(2) Name of the joint venture, its legal address, purpose and the scope and scale of business;

(3) Total amount of investment and registered capital of the joint venture, investment contributed by the parties to the joint venture, each party's investment proportion, forms of investment, the time limit for contributing investment, stipulations concerning incomplete contributions, and assignment of investment;

(4) The ratio of profit distribution and losses to be borne by each party;

(5) The composition of the board of directors, the distribution of the number of directors, and the responsibilities, powers and means of employment of the general manager, deputy general manager and high-ranking management personnel;

(6) The main production equipment and technology to be adopted and their source of supply;

(7) The ways and means of purchasing raw materials and selling finished products, and the ratio of products sold within Chinese territory and outside China;

(8) Arrangements for income and expenditure of foreign currency;

(9) Principles governing the handling of finance, accounting and auditing;

(10) Stipulations concerning labor management, wages, welfare, and labor insurance;

(11) The duration of the joint venture, its dissolution and the procedure for liquidation;

(12) The liabilities for breach of contract;

(13) Ways and Procedures for settling disputes between the parties to the joint venture;

(14) The language used for the contract and the conditions for putting the contract into force.

The annex to the contract of a joint venture shall be equally authentic with the contract itself.

[Article 15] The formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by the Chinese law.

[Article 16] Articles of association shall include the following main items:

(1) The name of the joint venture and its legal address;

(2) The purpose, business scope and duration of the joint venture;

(3) The names, countries of registration and legal addresses of parties to the

joint venture, and the names, professions and nationalities of the legal representatives thereof;

(4) The total amount of investment, registered capital of the joint venture, each party's investment proportion, stipulations concerning the assignment of investment, the ratio of profit distribution and losses to be borne by parties to the joint venture;

(5) The composition of the board of directors, its responsibilities, powers and rules of procedure, the term of office of the directors, and the responsibilities of its chairman and vice-chairman;

(6) The setting up of management organizations, rules for handling routine affairs, the responsibilities of the general manager, deputy general manager and other high-ranking management personnel, and the method of their appointment and dismissal;

(7) Principles governing finance, accounting and auditing;

(8) Dissolution and liquidation;

(9) Procedures for amendment of the articles of association.

[Article 17] The agreement, contract and articles of association shall come into force after being approved by the examination and approval authority. The same applies in the event of amendments.

[Article 18] The examination and approval authority and the registration and administration office are responsible for supervising and inspecting the execution of the joint venture contracts and articles of association.

Chapter III Form of Organization and Registered Capital

[Article 19] A joint venture is a limited liability company.

Each party to the joint venture is liable to the joint venture within the limit of the capital subscribed by it.

[Article 20] The total amount of investment (including loans) of a joint venture refers to the sum of capital construction funds and the circulating funds needed for the joint venture's production scale as stipulated in the contract and the articles of association of the joint venture.

[Article 21] The registered capital shall generally be presented in total amount of investment registered at the registration and administration office for the establishment of the joint venture. It should be the total amount of investment subscribed by parties to the joint venture.

The registered capital shall generally be presented in Renminbi, or may be in a foreign currency agreed upon by the parties to the joint venture.

[Article 22] A joint venture shall not reduce its registered capital during the term of the joint venture.

[Article 23] If one party to the joint venture intends to assign all or part of his investment subscribed to a third party, consent shall be obtained from the other party to the joint venture, and approval from the examination and approval authority is required.

When one party assigns all or part of his investment to a third party, the other party has pre-emptive right.

When one party assigns his investment subscribed to a third party, the conditions given shall not be more favourable than those given to the other party to the joint venture.

No assignment shall be made effective should there be any violation of the above stipulations.

[Article 24] Any increase, assignment or other disposal of the registered capital of a joint venture shall be approved by a meeting of the board of directors and submitted to the original examination and approval authority for approval. Registration procedures for changes shall be dealt with at the original registration and administration office.

Chapter IV Ways of Contributing Investment

[Article 25] Each participant to a joint venture may contribute cash or buildings, premises, equipment or other materials, industrial property, know-how, right to the use of a site as investment, the value of which shall be ascertained. If the investment is in the form of buildings, premises, equipment or other materials, industrial property or known-how, the prices shall be ascertained through consultation by the parties to the joint venture on the basis of fairness and reasonableness, or evaluated by the third party agreed upon by parties to the joint venture.

[Article 26] The foreign currency contributed by the foreign participant shall be converted into Renminbi according to the exchange rate announced by the State General Administration of Foreign Exchange Control of the People's Republic of China (hereinafter referred to as the State General Administration of Foreign Exchange Control) on the day of its submission or be cross exchanged into a predetermined foreign currency.

Should the cash Renminbi contributed by the Chinese participant be converted into foreign currency, it shall be converted according to the exchange rate announced by the State General Administration of Foreign Exchange Control on the day of the submission of the funds.

[Article 27] The machinery equipment and other materials contributed as investment by the foreign participant shall meet the following conditions:

(1) They are indispensable to the production of the joint venture;

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

(3) The price fixed shall not be higher than the current international market

price for similar equipment or materials.

[Article 28] The industrial property or know-how contributed by the foreign participant as investment shall meet one of the following conditions:

(1) Capable of manufacturing new products urgently needed in China or products suitable for export;

(2) Capable of improving markedly the performance quality of existing products and raising productivity;

(3) Capable of notable savings in raw materials, fuel or power.

[Article 29] Foreign participants who contribute industrial property or know-how as investment shall present relevant documentation on the industrial property or know-how, including photocopies of the patent certificates or trademark registration certificates, statements of validity, their technical characteristics, practical value, the basis for calculating the price and the price agreement signed with the Chinese participants. All these shall serve as an annex to the contract.

[Article 30] The machinery, equipment or other materials, industrial property or know-how contributed by foreign participants as investment shall be examined and approved by the department in charge of Chinese participant and then submitted to the examination and approval authority for approval.

[Article 31] The parties to the joint venture shall pay in all the investment subscribed according to the time limit stipulated in the contract. Delay in payment or partial delay in payment will be subject to a payment of interest on arrears or a compensation for the loss as defined in the contract.

[Article 32] After the investment is paid by the parties to the joint venture, a Chinese registered accountant shall verify it and provide a certificate of verification, in accordance with which the joint venture shall issue an investment certificate, which includes the following items: name of the joint venture; date, month and year of the establishment of the joint venture; names of the participants and the investment contributed; date, month and year of the contribution of the investment; and date, month and year of issuance of the investment certificate.

Chapter V Board of Directors and Management Office

[Article 33] The highest authority of the joint venture shall be its board of directors. It shall decide all major issues concerning the joint venture.

[Article 34] The board of directors shall consist of no less than three members. The distribution of the number of directors shall be ascertained through consultation by the parties to the joint venture with reference to the proportion of investment contributed.

The directors shall be appointed by the parties to the joint venture. The chairman of the board shall be appointed by the Chinese participant and its vice-chairman by the foreign participant.

The term of office for the directors is four years. Their term of office may be renewed with the consent of the parties to the joint venture.

[Article 35] The board of directors shall convene at least one meeting every year. The meeting shall be called and presided over by the chairman of the board. Should the chairman be unable to call the meeting, he shall authorize the vice-chairman or other director to call and preside over the meeting. The chairman may convene an interim meeting based on a proposal made by more than one-third of the directors.

A board meeting requires a quorum of over two-thirds of the directors. Should the director be unable to attend, he shall present a proxy authorizing someone else to represent him and vote for him.

A board meeting shall generally be held at the location of the joint venture's legal address.

[Article 36] Decisions on the following items shall be made only after being unanimously agreed upon by the directors present at the board meeting:

(1) Amendment of the articles of association of the joint venture;

(2) Termination and dissolution of the joint venture;

(3) Increase or assignment of the registered capital of the joint venture;

(4) Merger of the joint venture with other economic organizations.

Decision on other items shall be made according to the rules of procedure stipulated in the articles of association.

[Article 37] The chairman of the board is the legal representative of the joint venture. Should the chairman be unable to exercise his responsibilities, he shall authorize the vice-chairman of the board or other director to represent the joint venture.

[Article 38] A joint venture shall establish a management office which shall be responsible for daily management. The management office shall have a general manager and several deputy general managers who shall assist the general manager in his work.

[Article 39] The general manager shall carry out the decisions of the board meeting and organize and conduct the daily management of the joint venture. The general manager shall, within the scope empowered him by the board, represent the joint venture in outside dealings, have the right to appoint and dismiss his subordinates, and exercise other responsibilities and rights as authorized by the board within the joint venture.

[Article 40] The general manager and deputy general managers shall be engaged by the board of directors of the joint venture. These positions may be held either by Chinese citizens or foreign citizens.

At the invitation of the board of directors, the chairman, vice-chairman or other directors of the board may concurrently be the general manager, deputy general managers or other high-ranking management personnel of the joint venture.

In handling major issues, the general manager shall consult with the deputy general managers.

The general manager or deputy general managers shall not hold posts concurrently as general manager or deputy general managers of other economic organizations. They shall not have any connections with other economic organizations in commercial competition with their own joint venture.

[Article 41] In case of graft or serious dereliction of duty on the part of the general manager, deputy general managers or other high-ranking management personnel, the board of directors shall have the power to dismiss them at any time.

[Article 42] Establishment of branch offices (including sales offices) outside of China or in Hongkong or Mocao is subject to approval by the Ministry of Foreign Economic Relations and Trade.

Chapter VI Acquisition of Technology

[Article 43] The acquisition of technology mentioned in this chapter refers to the necessary technology obtained by the joint venture by means of technology transfer from a third party or participants.

[Article 44] The technology acquired by the joint venture shall be appropriate and advanced and enable the venture's products to display conspicuous social economic results domestically or to be competitive on the international market.

[Article 45] The right of the joint venture to do business independently shall be maintained when making technology transfer agreements, and relevant documentation shall be provided by the technology exporting party in accordance with the provisions of Article 29 of the regulations.

[Article 46] The technology transfer agreements signed by a joint venture shall be examined and agreed to by the department in charge of the joint venture and then submitted for approval to the examination and approval authority.

Technology transfer agreements shall comply with the following stipulations:

(1) Expenses for the use of technology shall be fair and reasonable. Payments are generally made in royalties, and the royalty rate shall not be higher than the standard international rate, which shall be calculated on the basis of net sales of the products turned out with the relevant technology or other reasonable means agreed upon by both parties.

(2) Unless otherwise agreed upon by both parties, the technology exporting party shall not put any restrictions on the quantity, price or region of sale of the products that are to be exported by the technology importing party.

(3) The term for a technology transfer agreement is generally no longer than ten years.

(4) After the expiration of a technology transfer agreement, the technology importing party shall have the right to use the technology continuously.

(5) Conditions for mutual exchange of information on the improvement of technology by both parties of the technology transfer agreement shall be reciprocal.

(6) The technology importing party shall have the right to buy the equipment, parts and raw materials needed from sources they deem suitable.

(7) No irrational restrictive clauses prohibited by Chinese law and regulations shall be included.

Chapter VII Right to the Use of Site and Its Fee

[Article 47] Joint ventures shall practise economy in the use of land for their premises. Any joint venture requiring the use of a site shall file an application with local departments of the municipal (county) government in charge of land and obtain the right to use a site only after securing approval and signing a contract. The acreage, location, purpose and contract period and fee for the right to use a site (hereinafter referred to as site use fee), rights and obligations of the parties to a joint venture and fines for breach of contract should be stipulated in explicit terms in the contract.

[Article 48] If the Chinese participant already has the right to the use of site for the joint venture, the Chinese participant may use it as part of its investment. The monetary equivalent of this investment should be the same as the site use fee otherwise paid for acquiring such site.

[Article 49] The standard for site use fee shall be set by the people's governments of the province, autonomous region or municipality directly under the central government where the joint venture is located according to the purpose of use, geographic and environmental conditions, expenses for requisition, demolishing and resettlement and the joint venture's requirements with regard to infrastructure, and field with the Ministry of Foreign Economic Relations and Trade and the state department in charge of land.

[Article 50] Joint ventures engaged in agriculture and animal husbandry may, with consent of the people's government of the local province, autonomous region or municipality directly under the central government, pay a percentage of the joint venture's operating revenue as site use fees to the local department in charge of land.

Projects of a development nature in economically undeveloped areas shall receive special preferential treatment in respect of site use fees with consent of the local people's government.

[Article 51] The rates shall not be subject to adjustment in the first five years beginning from the day the land is used. After that the interval of adjustment shall not be less than three years according to the development and changes in geographic and environmental conditions.

Site use fee as part of the investment by the Chinese participant shall not be subject to adjustment during the contract period.

[Article 52] The fee for the right to the use of site obtained by a joint venture according to Article 47 of the regulations shall be paid annually from the day to use the land stipulated in the contract. For the first calendar year, the venture will pay a half-year fee if it has used the land for over six months; if less than six months, the site use fee shall be exempt. During the contract period, if the rates of site use fees are adjusted, the joint venture shall pay it according to the new rates from the year of adjustment.

[Article 53] Joint ventures that have permission to use a site shall only have the right to the use of it but no ownership. Assignment of the right to use land is forbidden.

Chapter VIII Planning, Purchasing and Selling

[Article 54] A joint venture shall work out a capital construction plan (including construction ability, building materials, water, power and gas supply) according to the approved feasibility study report, and the plan shall be included in the capital construction plan of the department in charge of the joint venture and shall be given priority in arranging supplies and be ensured to be carried out.

[Article 55] Funds earmarked for capital construction of a joint venture shall be put under unified management of the bank where the venture has opened an account.

[Article 56] A joint venture shall work out a production and operating plan in accordance with the scope of operation and scale of production stipulated in the contract. The plan shall be carried out with the approval of the board of directors and filed with the department in charge of the joint venture.

Departments in charge of the joint ventures and planning and administration departments at all levels shall not issue directive on production and operating plans to joint ventures.

[Article 57] In its purchase of required machinery, equipment, raw materials, fuel, parts, means of transport and things for office use, etc. (hereinafter referred to as materials), a joint venture has the right to decide whether it buys them in China or from abroad. However, where conditions are the same it should give first priority to purchase in China.

[Article 58] Joint ventures can purchase materials in China through the following channels:

(1) Those under planned distribution shall be brought into the supply plan of departments in charge of joint ventures and supplied by materials and commercial departments or production enterprises according to contract;

(2) Those handled by materials and commercial departments shall be purchased from these departments;

(3) Those freely circulating on the market shall be purchased from production enterprises or their sale or commission agencies;

(4) Those export items handled by foreign trade corporations shall be purchased

from the appropriate foreign trade corporations.

[Article 59] The amount of materials needed for office and daily life use for joint ventures purchased in China is not subject to restriction.

[Article 60] The Chinese Government encourages joint ventures to sell their products on the international market.

[Article 61] Products of joint ventures that China urgently needs or imports can be mainly sold on the Chinese market.

[Article 62] A joint venture has the right to export its products itself or entrust sale agencies of the foreign participant or Chinese foreign trade corporations with sales on a commission or distribution.

[Article 63] Within the scope of operation stipulated in the contract, a joint venture can import machinery, equipment, parts, raw materials and fuel needed for its production. A joint venture shall make a plan every year for items on which import licenses are required by the stipulation of the state, and apply for them every six months. For machines, equipment and other objects a foreign participant has contributed as part of his investment, the foreign participant can apply directly for import licenses with documents approved by examination and approval authority. For materials to be imported exceeding the stipulated scope of the contracts, separate application for import licenses according to state regulations is required.

A joint venture has the right to export its products by itself, for those export licenses are required by the stipulation of the State, the joint venture shall make an export plan every business year and apply for them every six months.

[Article 64] A joint venture may sell its products on the Chinese market in the following ways:

(1) For those items under planned distribution, departments in charge of joint ventures will bring them into the distribution plan of the materials administration departments, which sell them to designated users according to plan.

(2) For those items handled by materials and commercial departments, the materials and commercial departments, the materials and commercial departments will sign purchase contracts with the joint ventures.

(3) For excess portions other than those purchased by plan of the above two categories, and materials that do not belong to these two categories, the joint venture has the right to sell by itself or entrust sales to the organizations concerned.

(4) For products of a joint venture that Chinese foreign trade companies need to import, the joint venture may sell to Chinese foreign trade companies, and foreign currency shall be paid.

[Article 65] Materials purchased and services needed in China by joint ventures shall be priced according to the following stipulations:

(1) The six raw materials -- gold, silver, platinum, petroleum, coal and timber -- that are used directly in production for export shall be priced according to the international market prices provided by the State General Administration of Foreign Exchange Control or foreign trade departments, and paid in foreign currency or Renminbi.

(2) When purchasing export or import commodities handled by Chinese foreign trade companies, the suppliers and buyers shall negotiate the price, with reference to the prices on the international market, and foreign currency shall be paid.

(3) The prices for purchasing coal used as fuel and oil for motor vehicles, which are needed for manufacturing products to be sold domestically, as well as materials other than those listed in (1) and (2) of this article, and the fees charged for water, electricity, gas, heat, goods transportation, service, engineering, consultation service and advertisement etc, provided to joint venture, shall be treated equally with state-owned enterprises and paid in Renminbi.

[Article 66] Prices of products of a joint venture for sale on the Chinese domestic market, except those items approved by the price control department for valuation with reference to the international market, shall correspond with state-set prices, be rated according to quality and paid for in Renminbi. Prices fixed by a joint venture for its products shall be filed with departments in charge of joint ventures and of prices control.

Prices of export products of a joint venture will be fixed by the joint venture itself and shall be filed with departments in charge of joint ventures and of prices control.

[Article 67] A joint venture and other Chinese economic organizations shall, in their economic exchanges, undertake economic responsibilities and settle disputes over contracts in accordance with relevant law and the contract concluded between both parties.

[Article 68] A joint venture shall fill statistical forms on production, supply and marketing in accordance with relevant regulations, and file them with departments in charge, statistics departments and other departments concerned.

Chapter IX Taxes

[Article 69] Joint ventures shall pay taxes according to the stipulations of relevant laws of the People's Republic of China.

[Article 70] Staff members and workers employed by joint ventures shall pay individual income tax according to the Individual Income Tax Law of the People's Republic of China.

[Article 71] Joint ventures shall be exempt from customs duty and industrial and commercial consolidated tax for the following imported materials:

(1) Machinery, equipment, parts and other materials (materials here and hereinafter mean required materials for the joint venture's construction on the factory site and for installation and reinforcement of machines,) which are part

of the foreign participant's share of investment according to the provisions of contract.

(2) Machinery, equipment, parts and other materials imported with funds which are part of the joint venture's total investment.

(3) Machinery, equipment, parts and other materials imported by the joint venture with the additional capital under the approval of examination and approval authority on which China cannot guarantee production and supply.

(4) Raw materials, auxiliary materials, components, parts and packing materials imported by the joint venture for production of export goods.

Taxes shall be pursued and payable according to regulations when the above-mentioned duty-free materials are approved for sale inside China or switched to the production of items to be sold on the Chinese domestic market.

[Article 72] Except for those export items restricted by the state, products of a joint venture for export will be exempt from industrial and commercial consolidated tax, subject to the approval by the Ministry of Finance of the People's Republic of China.

A joint venture can apply for reduction or exemption of industrial and commercial consolidated tax for a certain period of time for products that are sold on the domestic market when it has difficulty to pay such tax in its initial period of production.

Chapter X Foreign Exchange Control

[Article 73] All matters concerning foreign exchange for joint ventures shall be handled according to the Interim Regulations on Foreign Exchange Control of the People's Republic of China and relevant regulations.

[Article 74] With the business license issued by the General Administration for Industry and Commerce of the People's Republic of China, a joint venture can open foreign exchange deposit accounts and Renminbi deposit accounts with the Bank of China, or some other banks designated. The bank handling the account of the joint venture exercises supervision of receipts and expenditures.

All foreign exchange income of a joint venture must be deposited in the foreign exchange deposit account in the bank where an account has been opened; all payments by the joint venture in foreign exchange are to be made from its foreign exchange deposit account. The deposit interest rate shall be set as announced by the Bank of China.

[Article 75] A joint venture shall in general keep balance between its foreign exchange income and expenses. When a joint venture whose products are mainly sold on domestic market under its approved feasibility study report and contract has an unbalance of foreign exchange income and expenses, the unbalance shall be solved by the people's government of a relevant province, an autonomous region or a municipality directly under the central government or the department in charge under the State Council from their own foreign exchange reserves, if unable to be solved, it shall be solved through inclusion into plan after the examination and approval by the Ministry of Foreign Economic Relations and Trade together with the State Planning Commission of the People's Republic of China.

[Article 76] A joint venture shall get permission from the General Administration of Foreign Exchange Control or one of its branches to open a foreign exchange deposit account with an overseas bank or one in Hongkong or Mocao, and report to the State General Administration of Foreign Exchange Control or one of its branches its foreign exchange receipts and expenditures, and provide account sheets.

[Article 77] Sub-divisions set up by a joint venture in foreign countries or in Xianggang or Aomen shall open an account with the Bank of China wherever there is a branch. The sub-division shall submit its annual statement of assets and liabilities and annual profit report to the State General Administration of Foreign Exchange Control or one of its branches through the joint venture.

[Article 78] A joint venture can apply to the Bank of China for foreign loans and Renminbi loans according to business needs and following the Provisional Regulations for Providing Loans to Joint Ventures Using Chinese and Foreign Investment by the Bank of China. Interest rates on loans to joint ventures are as announced by the Bank of China. A joint venture can also borrow foreign exchange as capital from banks abroad or in Hongkong or Mocao, but shall file a report with the State General Administration of Foreign Exchange Control or one of its branches.

[Article 79] After foreign staff and workers and staff and workers from Hongkong or Mocao have paid income tax on their salaries and other legitimate incomes according to the law, they can apply to the Bank of China for permission to remit outside China all the remaining foreign exchange after deduction of their living expenses in China.

Chapter XI Financial Affairs and Accounting

[Article 80] Procedures for handling financial affairs and accounting of a joint venture shall be formulated in accordance with China's relevant laws and procedures on financial affairs and accounting, and in consideration of the conditions of the joint venture, and then being filed with local financial departments and tax authorities.

[Article 81] A joint venture shall employ a treasurer to assist the general manager in handling the financial affairs of the enterprise. If necessary a deputy treasurer can be appointed.

[Article 82] A joint venture shall (small venture may not) appoint an auditor to be responsible for checking financial receipts, payments and accounts, and to submit reports to the board of directors and the general manager.

[Article 83] The fiscal year of a joint venture shall coincide with the calendar year, i.e. from January 1 to December 31 on the Gregorian calendar.

[Article 84] The accounting of a joint venture shall adopt the internationally used accrual basis and debit and credit accounting system in their work. All vouchers, account books, statistic statements and reports prepared by the enterprise shall be written in Chinese. A foreign language can be used concurrently with mutual consent.

[Article 85] Principally joint ventures shall adopt Renminbi as the standard currency. In keeping accounts, however, another currency can be used through consultation by the parties concerned.

[Article 86] In addition to the use of standard currency to record accounts, joint ventures shall record accounts in currencies actually used in payments and receipts, if such currencies in cash, bank deposits, funds of other currencies, creditor's right, debts, gains, expenses, etc. are inconsistent with the standard currency in recording accounts.

Joint ventures using a foreign currency in accounting shall work out a statement of accounts in Renminbi equivalents in addition to those in the foreign currency.

The actual amounts of losses and gains caused by differences in exchange rates in the course of remittances shall be recorded in the year's losses and gains accounts. No adjustments shall be made for recorded changes in exchange rates and remaining sum on the book of related foreign exchange accounts.

[Article 87] Principles of profit distribution after payment of taxes in accordance with the Income Tax Law of the People's Republic of China concerning Joint Ventures with Chinese and Foreign Investment are as follows:

(1) Allocations for reserve funds, bonuses and welfare funds for staff and workers and expansion funds of the joint venture. Proportion of allocations is decided by the board of directors.

(2) Reserve funds can be used to make up the losses of the joint venture, and with the consent of examination and approval authority, to increase the joint venture's capital for production expansion.

(3) After the funds described in (1) of this article have been deducted and if the board of directors decides to distribute the remaining profit, it should be distributed according to the proportion of each participant's investment.

[Article 88] Profits cannot be distributed unless the losses of previous year's have been made up. Remaining profits from previous year (or years) can be distributed together with that of the current year.

[Article 89] A joint venture shall submit quarterly and annual fiscal reports to parties to the joint venture, the local tax authority, department in charge of the joint venture and financial department at the same level to those departments.

A copy of the annual fiscal reports shall be submitted to the original examination and approval authority.

[Article 90] Only after being examined and certified by an accountant registered in China can the following documents, certificates and reports be considered valid.

(1) Certificates of investment from all parties to a joint venture (lists of assessed value shall be attached to documents on investments involving

materials, site use rights, industrial property and know-how);

(2) Annual fiscal reports of the joint venture;

(3) Fiscal reports on liquidation of the joint venture.

Chapter XII Staff and Workers

[Article 91] The employment, recruitment, dismissal and resignation of staff and workers of joint ventures, and their salary, welfare benefits, labour insurance, labour protection, labour discipline and other matters shall be handled according to the Regulations of the People's Republic of China on Labour Management in Joint Ventures Using Chinese and Foreign Investment.

[Article 92] Joint ventures shall make efforts to conduct professional and technical training of their staff and workers and establish a strict examination system so that they can meet the requirements of production and managerial skills in a modernized enterprise.

[Article 93] The salary and bonus systems of joint ventures shall be in accordance with the principle of distribution to each according to his work, and more pay for more works.

[Article 94] Salaries and remuneration of the general manager, deputy general manager(s), chief engineer and deputy chief engineer(s), treasurer and deputy treasurer(s), auditor and other high-ranking officials shall be decided upon by the board of directors.

Chapter XIII Trade Union

[Article 95] Staff and workers of a joint venture have the right to set up grass-roots trade unions and carry on trade union activities in accordance with the Trade Union Law of the People's Republic of China (hereinafter referred to as Chinese Trade Union Law) and the Articles of Association of Chinese Trade Union.

[Article 96] Trade unions in joint ventures are representatives of the interests of the staff and workers. They have the power to represent the staff and workers to sign labour contracts with joint ventures and supervise the execution of these contracts.

[Article 97] The basic tasks of the trade unions in joint ventures are: to protect the democratic rights and material interests of the staff and workers pursuant to the law; to help the joint ventures with the arrangement and rational use of welfare and bonus funds; to organize political, professional, scientific and technical studies, carry out literary, art and sports activities; and to educate staff and workers to observe labour discipline and strive to fulfill the economic tasks of the enterprises.

[Article 98] Trade union representatives have the right to attend as nonvoting members and to report the opinions and demands of staff and workers to meetings of the board of directors held to discuss important issues such as development plans, production and operational activities of joint ventures.

Trade union representatives have the right to attend as nonvoting members of meetings of the board of directors held to discuss and decide on awards and penalties to staff and workers, salary systems, welfare benefits, labour protection and labour insurance, etc. The board of directors shall heed the opinions of the trade unions and win its cooperation.

[Article 99] A joint venture shall actively support the work of the trade union, and, in accordance with stipulations of the Chinese Trade Union Law, provide housing and facilities for the trade union's office work, meetings, and welfare, cultural and sports activities. The joint venture shall allot an amount of money totalling 2 percent of all the salaries of the joint venture's staff and workers as trade union's funds, which the trade union of the joint venture shall use according to the relevant managerial rules for trade union funds formulated by the All China Federation of Trade Unions.

Chapter XIV Duration, Dissolution and Liquidation

[Article 100] The duration of a joint venture shall be decided upon through consultation or all parties to the joint venture according to actual conditions of the particular lines of business and projects. The duration of a joint venture engaged in an ordinary project requiring large amount of investment, long construction periods and low interest rates on funds can be extended to more than 30 years.

[Article 101] The duration of a joint venture shall be stipulated by all parties to the joint venture in the agreement, contract and articles of association. The duration begins from the day when the joint venture is issued a business license.

When all parties to a joint venture agree to extend the duration, the joint venture shall file an application for extending the duration signed by representatives authorized by the parties with the examination and approval authority six months before the date of expiration of the duration. The examination and approval authority shall give an official written reply to the applicant within one month beginning from the day it receives the application.

Upon approval of the extension of the duration, the joint venture concerned shall go through registration formalities for the alteration in accordance with the Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures.

[Article 102] A joint venture may be dissolved in the following situations:

(1) Termination of duration;

(2) Inability to continue operations due to heavy losses;

(3) Inability to continue operations due to the failure of one of the contracting parties to fulfill the obligations prescribed by the agreement, contract and articles of association;

(4) Inability to continue operations due to heavy losses caused by force majeure such as natural calamities and wars, etc.;

(5) Inability to obtain the desired objectives of the operation and at the same time to see a future for development;

(6) Occurrence of other reasons for dissolution prescribed by the contract and articles of association.

In cases described in (2), (3), (4), (5) and (6) of this article, the board of directors shall make an application for dissolution to the examination and approval authority.

In the situation described in (3) of this article, the party failed to fulfill the obligations prescribed by the agreement, contract and articles of association shall be liable to the losses thus caused.

[Article 103] Upon announcement of the dissolution of a joint venture, its board of directors shall work out procedures and principles for the liquidation and nominate candidates for the liquidation committee. It shall report to the department in charge of the joint venture for examination, verification and supervision of the liquidation.

[Article 104] Members of a liquidation committee are usually selected among directors of a joint venture. In case the directors cannot serve or are unsuitable to be members of the liquidation committee, the joint venture may invite accountants and lawyers registered in China to do the job. When the examination and approval authority deems necessary, it may send personnel to supervise the process.

The liquidation expenses and remuneration to members of the liquidation committee shall be paid in priority from the existing assets of the joint venture.

[Article 105] The tasks of the liquidation committee are: to conduct thorough check of the property of the joint venture concerned, its creditors' rights and liabilities; to work out the statement of assets and liabilities and 105 list of property; to put forward a basis on which property is to be evaluated and calculated: and to formulate a liquidation plan. All these shall be carried out upon approval of the board of directors.

During the process of liquidation, the liquidation committee shall represent the joint venture concerned to sue and be sued.

[Article 106] Joint venture shall be liable to its debts with all of its assets. The remaining property after the clearance of debts shall be distributed among parties to the joint venture according to the proportion of each party's investment unless otherwise provided by agreement, contract and articles of association of the joint venture.

At the time when a joint venture is being dissolved the value added to its net assets or remaining property that exceeds the registered capital is regarded as profit on which income taxes shall be levied according to law. The foreign participant shall pay income taxes according to law for the portion of the net assets or remaining property that exceeds his investment when he remits it abroad.

[Article 107] On completion of the liquidation of a dissolved joint venture, the liquidation committee shall submit a liquidation report approved by a meeting of the board of directors to the original examination and approval authority, go through formalities for nullifying its registration and hand in its business license to the original registration authority.

[Article 108] After dissolution of a joint venture, its account books and documents shall be left in the care of the Chinese participant.

Chapter XV Settlement of Disputes

[Article 109] Disputes arising over the interpretation of execution of the agreement, contract or articles of association between the parties to the joint venture shall, if possible, be settled through friendly consultation or mediation. Disputes that cannot be settled through these means may be settled through arbitration or courts of justice.

[Article 110] Parties to a joint venture shall apply for arbitration in accordance with the relevant written agreement. They may submit the dispute to the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade in accordance with its arbitration rules. With mutual consent of the parties concerned, arbitration can also be carried out through an arbitration agency in the country where the sued party is located or through one in a third country in accordance with the arbitration agency's procedures.

[Article 111] If there is no written arbitration agreement between the parties to a joint venture, each side can file a suit with the Chinese People's Court.

[Article 112] In the process of solving disputes, except for matters in dispute, parties to a joint venture shall continue to carry out other provisions stipulated by the agreement, contract and articles of association of the joint venture.

Chapter XVI Supplementary Articles

[Article 113] The Chinese office in charge of visas shall give convenient service by simplifying procedures for staff and workers from foreign countries or from Xianggang and Aomen (including their family members) who frequently cross Chinese borders.

[Article 114] Departments in charge of joint ventures are responsible for handling applications and procedures for Chinese staff and workers going abroad for study tours, business negotiations or training.

[Article 115] Staff and workers from foreign countries or from Xianggang and Aomen working for a joint venture can bring in needed means of transport and items for office use, paying regular customs duty and industrial and commercial consolidated tax on them.

[Article 116] Joint ventures set up in the special economic zones shall abide by the provisions, if any, provided otherwise in the laws and regulations adopted by the National People's Congress, its Standing Committee or the State Council.

[Article 117] The power to explain the Regulations is vested in the Ministry of Foreign Economic Relations and Trade.

[Article 118] The regulations shall come into force on the day of promulgation.

Appendix: Some Key Terms Used in the "Regulations for the Implementation of the Law on Joint Ventures Using Chinese and Foreign Investment"

Total amount of investment: The total amount of investment of a joint venture refers to the sum (total) of the capital construction funds needed for the production scale specified in the contract and the articles of association of joint venture and the circulating funds for production. If the funds contributed by the parties to the venture fall short of the total amount of investment, the joint venture may, in its own name, obtain loans from the banks as its investment. Therefore, the total amount of investment of a joint venture may generally consist of two categories, funds provided by the parties to the venture themselves and loans obtained in the name of the venture.

Registered capital: The registered capital of a joint venture refers to the total amount of investment registered at the administrative departments for industry and commerce for the establishment of the joint venture, and it should be the sum of investment subscribed by the parties to the joint venture. The parties to the joint venture may, in accordance with the provisions of the joint venture contract, put in their subscribed investments to the venture in a lump sum or by installments.

Investment subscribed: This refers to the amount of capital the parties to a joint venture agreed to put in for the establishment of the venture. The contribution to the joint venture by the parties is to be judged by the amount of investment subscribed and the responsibility of each party for the joint venture is limited to their respective investment subscribed.

The right to the use of site: The right to the use of site of a joint venture is the right to the use of a site obtained by the joint venture in accordance with the needs of its operation. The right may be obtained by the joint venture by concluding a leasing contract with the land department concerned of the local government or it may be contributed by the Chinese participant as its investment by evaluating the right. Whichever way did the joint venture obtain the right to the use of site, it should only have the right to use, but not the ownership. And transfer of the right to the use of site is not permitted.

Investment certificates: Investment certificates are the certificates issued by a joint venture to testify the amount of investment subscribed by the parties to the joint venture. They are issued to the joint ventures after the parties to the venture have put in their respective subscribed investment and after the Chinese-registered accountant has verified the amount and issued the verification report. Without the consent of the other parties and the approval of the examination and approval authority of the joint venture, no party to the joint venture is allowed to dispose of the certificate by transfer, mortgage or other ways.

Reserve fund: The reserve fund of a joint venture is a special fund withheld from its profits to make up for the losses the venture may be subjected to and to guard against accidents. The proportion of the fund is to be decided upon by the board of directors, but it is not to exceed a certain amount. The reserve fund is in general not to be used for other purposes, but, with the approval of the joint venture's examination and approval authority, may be used by the joint venture for increasing its capital or expanding production.

Bonus and welfare fund for staff and workers: The bonus and welfare fund for the staff and workers of a joint venture is a special fund withheld from the venture's profits to improve the welfare of the staff and workers and encourage individuals or groups who have made comparatively great contributions to the production and work. It can be used only for commending those who have made comparatively great contributions and providing collective welfare facilities for the staff and workers, medical and health service and financial aids.

Enterprise expansion fund: The expansion fund of a joint venture is a special fund withheld from the joint venture's profits to expand its production. It can be used for purchasing fixed assets, increasing circulating funds and expanding operation. It can also be used for the trial manufacture of new products, undertaking scientific research and running technical training for the staff and workers.

Industrial property: The industrial property is the proprietary right acquired in accordance with the law for patented inventions, new designs and trade marks. It is to be protected according to the law, although such protection is strictly regional. Exclusive in character, the industrial property shall not be encroached upon by others. Use of such a right by others must have the consent of the owner of the right and a fixed amount of reward for him. The Law on Joint Ventures Using Chinese and Foreign Investment stipulates that a joint venture may make its investment in industrial property, to which provision rules have been added in the Regulations for the Implementation of the Law on Joint Ventures Using Chinese and Foreign Investments.

Knowhow: Knowhow, also called technical secret, is technical knowledge which can be transferred or imparted and which not known to the public and not patented. Unlike the patent right whose effective period is limited, knowhow is monopolized by means of secrecy.

Accrual basis: This is an accounting method of ascertaining the income and costs of a venture in a fiscal period (a month, a season or a year). In other words, the income and costs of a current period should be dealt with as such, no matter if the sum is received or paid in that particular period. Conversely, the income and costs not of the current period shall not be dealt with as such, even if the sum is received or paid in that particular period. For instance, the rent of September should still be entered into the account book as the costs of that month, even if it was paid in August or October. The adoption of accrual basis makes it possible to accurately calculate a venture's income, costs and profit or loss in various fiscal periods.

Debit-credit bookkeeping method: In accounting, the words "debit" and "credit" are used to record the increase and decrease of a venture's application of funds (assets or costs) and its sources of funds (liabilities, capital or income). "Debit" signifies the increase in the application of funds or the decrease in the source of funds and "credit" denotes the decrease in the application of funds or the increase in the source of funds. In accordance with the principle that a venture's application of funds must equal its sources of funds, each item of the economic activity that should be entered into the account book should be thus entered in accordance with the principle that "with debiting, there must be crediting and debiting and crediting must balance". In other words, the equivalent sums should be entered on both the debit side of one or several accounts and the credit side of one of several accounts. The sum total entered on the debit side of all accounts, and the total balance of the debit side of all accounts at the end of a period should equal that of the credit side of all accounts at the end of the same period. The account with debit balance is the account of the application of funds and the account with credit balance is the account of the source of funds.

Statement of assets and liabilities: This is also called "balance sheet". In Chinese-foreign joint ventures, it is an accounting report presenting in a summerized form the venture's financial situation on a certain date (for instance, at the end of a month, season or year). There are usually two sides in the form, the left side listing the item of assets (including property, materials, receivables and rights, etc.) and the right side listing the item of liabilities (including short-term and long-term debts of different types) and the item of the investor's equity (including capital and retained earnings). The sum total of the items on the left side should equal that on the right side.

Standard currency in bookkeeping: The standard currency, or standard money, is the legal tender of a country. For example, the Renminbi (RMB) is the standard currency of China, the American dollar of the United States, the pound sterling of Britain, and the French franc of France. The standard currency used in accounting is called standard currency in bookkeeping.

Provisions of the State Council Encouraging Foreign Investment

Attracting foreign investment is an important part of China's opening to the outside world. As China wishes to attract more investment, import more advanced technology and equipment and expand Chinese exports, the State Council on October 11 promulgated the Provisions for the Encouragement of Foreign Investment which came into force the same day.

Article 1. These provisions are hereby formulated in order to improve the investment environment, facilitate the absorption of foreign investment, introduce advanced technology, improve product quality, expand exports in order to generate foreign exchange and develop the national economy.

Article 2. The state encourages foreign companies, enterprises and other economic entities or individuals (hereinafter referred to as "foreign investors") to establish Chinese-foreign equity joint ventures, Chinese-foreign co-operative ventures and wholly foreign-owned enterprises (hereinafter referred to as "enterprises with foreign investment") within the territory of China.

The state grants special preferences to the enterprises with foreign investment listed below:

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

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

Article 3. Export enterprises and technologically advanced enterprises shall be exempt from payment to the state of all subsidies to staff and workers, except for the payment of or allocation of funds for labour insurance, welfare costs and housing subsidies for Chinese staff and workers in accordance with the provisions of the state.

Article 4. The site use fees for export enterprises and technologically advanced enterprises, excep for those located in busy urban sectors of larg cities, shall be computed and charged according t the following standards:

(1) Five to 20 RMB yuan per square metre pe year in areas where the development fee and the sit use fee are computed and charged together;

(2) Not more than three RMB yuan per squar meter per year in site areas where the developmen fee is computed and charged on a one-time basis o areas which are developed by the above-mentione enterprises themselves.

Exemptions for specified periods of time from the fees provided in the foregoing provision may be granted at the discretion of local people's governments.

Article 5. Export enterprises and technologically advanced enterprises shall be given priority in obtaining water, electricity and transportation services, and communication facilities needed for their production and operation. Fees shall be computed and charged in accordance with the standards for local state enterprises.

Article 6. Export enterprises and technologically advanced enterprises, after examination by the Bank of China, shall be given priority in receiving loans for short-term revolving funds needed for production and distribution, as well as for other needed credit.

Article 7. When foreign investors in export enterprises and technologically advanced enterprises remit abroad profits distributed to them by such enterprises, the amount remitted shall be exempt from income tax.

Article 8. After the expiration of the period for the reduction or exemption of enterprise income tax in accordance with the provisions of the state, export enterprises whose value of export products in that year amounts to 70 percent or more of the value of their products for that year, may pay enterprise income tax at one-half the rate of the present tax.

Export enterprises in the special economic zones and in the economic and technological development zones and other export enterprises that already pay enterprise income tax at a tax rate of 15 percent and that comply with the foregoing conditions, shall pay enterprise income tax at a rate of 10 percent.

Article 9. After the expiration of the period of reduction or exemption of enterprise income tax in accordance with the provisions of the state, technologically advanced enterprises may extend for three years the payment of enterprise income tax at a rate reduced by one half.

Article 10. Foreign investors who reinvest the profits distributed to them by their enterprises in order to establish or expand export enterprises or technologically advanced enterprises for a period of operation of not less than five years, after application to and approval by the tax authorities, shall be refunded the total amount of enterprise income tax already paid on the reinvested portion. If the investment is withdrawn before the period of operation reaches five years, the amount of enterprise income tax refunded shall be repaid.

Article 11. Export products of enterprises with foreign investment, except crude oil, finished oil and other products subject to special state provisions, shall be exempt from the consolidated industrial and commercial tax.

Article 12. Enterprises with foreign investment may arrange the export of their products directly or may also export by consignment to agents in accordance with state provisions. For products that require an export license, in accordance with the annual export plan of the enterprise, an application for an export license may be made every six months.

Article 13. Machinery and equipment, vehicles used in production, raw materials, fuel, bulk parts, spare parts, machine component parts and fittings, (including imports restricted by the state) which enterprises with foreign investment need to import in order to carry out their export contracts do not require further applications for examination and approval and are exempt from the requirement for import licenses. The customs department shall exercise supervision and control, and shall inspect and release such imports on the basis of the enterprise contract or the export contract.

The imported materials and items mentioned above are restricted to use by the enterprise and may not be sold on the domestic market. If they are used in products to be sold domestically, import procedures shall be handled in accordance with provisions and the taxes shall be made up according to the governing sections.

Article 14. Under the supervision of the foreign exchange control departments, enterprises with foreign investment may mutually adjust their foreign exchange surpluses and defficiencies among each other.

The Bank of China and other banks designated by the People's Bank of China may provide cash security services and may grant loans in Renminbi to enterprises with foreign investment.

Article 15. The people's governments at all levels and relevant departments in charge shall guarantee the right of autonomy of enterprises with foreign investment and shall support enterprises with foreign investment in managing themselves in accordance with international scientific advanced methods.

Within the scope of their approved contracts, enterprises with foreign investment have the right by themselves to determine production and operation plans, to raise funds, to use funds, to purchase production materials and to sell products; and to determine by themselves the wage levels, the forms of wages and bonuses and the allowance system.

Enterprises with foreign investment may, in accordance with their production and operation requirements, determine by themselves their organizational structure and personnel system, employ or dismiss senior management personnel, increase or dismiss staff and workers. They may recruit and employ techical personnel, managerial personnel and workers in their locality. The unit to which such employed personnel belong shall provide its support and shall permit their transfer. Staff and workers who violate the rules and regulations, and thereby cause certain bad consequences may, in accordance with the seriousness of the case, be given differing sanctions, up to that of discharge. Enterprises with foreign investment that recruit, employ, dismiss or discharge staff and workers, shall file a report with the local labour and personnel department.

Article 16. All districts and departments must implement the Circular of the State Council Concerning Firmly Curbing the Indiscriminate Levy of Charges on Enterprises. The people's governments at the provincial level shall formulate specific methods and strengthen supervision and administration.

Enterprises with foreign investment that encounter unreasonable charges may refuse to pay and may also appeal to the local economic committees up to the State Economic Commission.

Article 17. The people's governments at all levels and relevant departments in charge shall strengthen the co-ordination of their work, improve efficiency in handling matters and shall promptly examine and approve matters reported by enterprises with foreign investment that require response and resolution. The agreement, contract and articles of association of an enterprise with foreign investment shall be examined and approved by the departments in charge under the State Council. The examination and approval authority must within three months from the date of receipt of all documents decide to approve or not to approve them.

Article 18. Export enterprises and technologically advanced enterprises mentioned in these provisions shall be confirmed jointly as such by the foreign economic relations and trade departments where such enterprises are located and the relevant departments in accordance with the enterprise contract, and certification shall be issued.

If the actual results of the annual exports of an export enterprise are unable to realize the goal of the surplus in the foreign exchange balance that is stipulated in the enterprise contract, the taxes and fees which have already been reduced or exempted in the previous year shall be made up in the following year.

Article 19. Except where these provisions expressly provide that they are to be applicable to export enterprises or technologically advanced enterprises, other articles shall be applicable to all enterprises with foreign investment.

These provisions apply from the date of implementation to those enterprises with foreign investment that have obtained approval for establishment before the date of implementation of these provisions and that qualify for the preferential terms of these provisions.

Article 20. For enterprises invested in and established by companies, enterprises and other economic organizations or individuals from Hong Kong, Macao, or Taiwan, matters shall be handled by reference to these provisions.

Article 21. The Ministry of Foreign Economic Relations and Trade shall be responsible for interpreting these provisions.

Article 22. These provisions shall go into effect on the date of issue. ■

(Issued on October 11, 1986)

State Council Official Answers Questions

An official from the Investment Working Group of the State Council recently answered *Renmin Ribao* (People's Daily) and Xinhua News Agency correspondents' questions on the Provisions for the Encouragement of Foreign Investment promulgated by the State Council on October 11 this year.

Question: What is the spirit of the provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment?

Answer: Briefly, it is a determined, down-to-earth effort to improve China's investment environment in order to make a better job of foreign investment in China. Opening to the outside world is the basic state policy of China and attracting and absorbing foreign capital is a major element in the open policy. In recent years, especially after 1984, China made great progress in attracting foreign investment, but there are still some problems which must be solved immediately. Some ventures involving foreign investment have experienced difficulties. These were due partly to our lack of experience, our failure to make certain arrangements for absorption and utilization of foreign investment, deficiencies in our management system and bureaucratic wrangling. This has been the subject of much talk outside China. We do not deny these problems and realize that we need to study them seriously and make efforts to solve them. Our State Council organized special departments to investigate, and on the basis of lengthy discussions and pooling of experience, it has formulated the Provisions. This marks an important step by the Chinese government in promoting the absorption of foreign capital.

Q: Why do the Provisions emphasize that "export enterprises and technologically advanced enterprises" be given "special preferences"?

A: This is meant to direct foreign investment so as best to serve China's economic construction. China's industrial and agricultural production has developed to some extent; many products could be made in China. The problem is that the products are not competitive. This could be because they are made with low-level technology, are of poor quality, or dull in variety and design. One of the important points of encouraging foreign investment is to import advanced technology and managerial expertise to promote technical progress and upgrade China's products. The financial success of enterprises operated with foreign investment contributes to a favourable balance of payments for China and provides the surest guarantee that foreign investors can remit their legal profit dividends abroad. This is why China encourages foreign investment in export-oriented production, and in enterprises which import the advanced technology needed by China.

Q: What new special privileges have the Provisions granted the "export-oriented and technologically advanced enterprises" then?

A: They include reduced fees for labour, and for land use, reduction or exemption from taxes, incentives to use profit to reinvest in China, and guarantees for the external conditions required by these enterprises for production and management (including import and export of material). All these are designed to allow China's advantages full range while minimizing production costs for foreign investors and making products more

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