DOES LAW MATTER IN CHINA:
AMENDMENT TO EQUITY JOINT VENTURE LAW 1990
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1. Introduction: Background of the Amendment

On 4th April 1990, the Third Session of the Seventh National People’s Congress of the People’s Republic of China (the PRC or China) approved a “Decision” on “the Revision of the Law on Joint Ventures Using Chinese and Foreign Inversment”. This legislative action of amending nine articles has, according to the view of the Chinese, borne out the PRC’s determination to continue its policy of opening up to the outside world, and “will help attract more advanced foreign technology and managerial expertise”, which will accordingly “promote the development of the national economy”.

However, some Western commentators have pointed out that the Amendment “will probably have little effect on the choice of investment form made by foreign firms interested in entering the Chinese market” and do “little to make direct investment in China more attractive, particularly after the tragedy of Tiananmen Square”. Thus, there arises a repeated argument on the development of Chinese law: Does law matter in the PRC, especially in its connection with international trade and investment within the post-1979 economic reforms? In other words, without any changes occurring to business practice, it is questionable if there is any meaning to the Amendment in facilitating the operation and the legal framework of those joint ventures in the PRC.

2. Law and Business Environment in China

The development of joint ventures since 1979 and the relationship between law and business circumstances today help one to understand and assess the general frameworks, including the legal, economic and social contexts, for foreign investment in China.

2.1 The Development of Joint Ventures Since 1979

Although there are different statistics on joint ventures, some 12,000 equity joint ventures, worth about US$12 billion, may be the number in the PRC today (see Table 1).
However, following the Tiananmen Square massacre in June 1989, foreign investment in China had slowed down from the following July and August, and consequently declined dramatically in the final three months of the year. The best example can be found through a comparison between two final quarters of 1988 and 1989. The number of new investment projects dropped 36.66 percent in the latter year of 1989, while the total contractual value of new foreign investment projects fell a whopping 42.76 percent as well. These figures indicate that foreign investors in China were not only investing in few projects, but also in smaller ones.

Furthermore, according to figures provided by the Ministry of Foreign Economic Relations and Trade (MOFERT) and the State Statistical Bureau (SSB) of the PRC, actual infusions of capital also dropped, but not as precipitately. This data cannot provide foreign investors with an optimistic climate for business. Even before June 1989 China was on the way to becoming Japan’s third largest overseas manufacturing base in Asia, after Thailand and Malaysia. However, to Japanese businessmen today, China’s economy is “still an inefficient and often an unprofitable place for foreigners to sink their money into”, although it is in some ways better than the Soviet Union.

2.2 Law and the Business Environment

Nevertheless, even long before the massacre in Beijing’s Tiananmen Square, joint ventures in China were struggling to survive. They suffered from acute shortages of foreign exchange, raw material and energy. In addition, there were labour problems, inflation, tight credit and arbitrary price controls. It is important to note that all these limitations remain today.

For instance, individual entrepreneurs, foreigners or Chinese, must devote concentrated attention and energy to managing the formal supply channels for materials. They have to link themselves informally into a network (in Chinese, guan- xi; or connection) with other entrepreneurs and administrative officials, that can effectively and dependably supply materials within the constraints of the centralized allocation system. This network is also very important for Chinese bureaucrats themselves. However, this difficulty and the flexibility of the legal wording open another problem for foreign investment in the PRC, that is, corruption and bureaucracy, discussed below.

Generally speaking, in 1989-1990 Chinese industry, both private and state-owned, was in danger of grinding to a halt. Figures for the first six months of 1990 show that profits of China’s state-owned enterprises were down 59% overall, and more than a third lost money. With regard to the PRC’s general business environment, foreign businessmen have been warned that China is printing money at an alarming rate and that enterprises are so short of working capital that many cannot pay their debts. Obviously, to foreign investors, the law and its amendment do not guarantee better circumstances in China’s macro-economy itself.

Moreover, in the PRC basic free-market concepts, such as profit, marketplace, and customer, are ill-
developed and not well understood. In the PRC's forty-one-year history, the last decade has been too short for most Chinese personnel who have lived their entire adult life in a lesser developed country with a centralized and planned communist economy.

3. The Major Issues in the Amendment

In practice, the Amendment to the Equity Joint Venture Law provides a good example for understanding the Chinese attitude towards furthering international co-operation and its economic legislation. At least three characteristics can be drawn out from the content of the Amendment: emphasis on negotiation under the facade of international practice; legitimation of business operation through legal experimentation; and rationalization of the state regulatory authorities.

3.1 Emphasis on Negotiation under the Facade of International Practice

To the Chinese government the Amendment is believed to be “very necessary” because several changes in the text conform “to international practice and the principles specified in agreements on investment protection signed by Chinese and foreign governments”. However, while keeping the amended text closer to those international practices Chinese legislators maintain a flexibility within the wording of the Amendment for further negotiation by both parties in order to reserve a leeway for the state regulatory authorities.

3.1.1 No Nationalization without Compensation

The issue of nationalization of joint ventures was not addressed in the original Joint Venture Law. The Amendment provides a pledge not to nationalize or expropriate equity joint ventures except where necessary for the “public interest”. However, according to some lawyers, a public interest can be easily found in practice. In cases where joint ventures must be expropriated the Amendment stipulates that appropriate compensation shall be paid. This guarantee conforms with the compensation rule applied in most Western countries for expropriation of foreign property. However, in addition to lacking reference to the term “appropriate compensation,” there is no provision that compensation will be paid in “hard currency”. Should a foreign investor whose joint venture is expropriated be compensated in Ren-min-bi (People’s Dollar) the investor could be faced with a foreign exchange problem. Thus, this provision opens the possibilities of further official interpretive comment, state practice, and parties’ bargaining.

Furthermore, the new provision, as criticized by western lawyers, obviously will not prevent the Chinese from reversing their policy in the future by simply repealing the statutory promise or enacting superseding legislation.

3.1.2 Chairmanship Open to Foreign Investors
The original article guaranteed the chairmanship to the Chinese side, with the foreign party taking one or two vice-chairmanships. Now the Amendment leaves the chairmanship of the enterprise open to both sides, eliminating one of the more conspicuous differences\textsuperscript{21} between the Equity Joint Venture Law and the Contractual Joint Venture Law\textsuperscript{22} (sometimes referred to as the "Cooperative" Joint Ventures Law).\textsuperscript{23} The new article 6, provided by paragraph 3 of the Amendment, allows foreigners to become the chairman of the board in equity joint ventures. Accordingly, the chairman may be elected by the board of directors or appointed through negotiation between both parties. The vice-chairman must come from "the side that does not take the chair".

However, in both law and practice, the power of the chairman is still not specified, except as authorized through negotiation by both parties to the equity joint venture.

3.1.3 Duration of Joint Venture may be Waived
Previously, under an amendment to article 100 of "the Implementing Rules of the Law of the People’s Republic of China on Using Chinese and Foreign Investment"\textsuperscript{24}, a blanket maximum of 50 years applied to "all" joint ventures. The Amendment changes article 12 to allow joint ventures in "certain industries" to operate without term limits. Without any detailed provision in the Amendment it is not clear whether enterprises already in operation under the fixed-period scheme will be able to renew their contracts without term limits. In addition, more official guidelines as to which "types" of joint ventures may be allowed to operate without term limits are still required.

Furthermore, Chinese policy on the term of the business was stated as: "different lines of business and circumstances shall be handled differently, a principally embodying the state’s industrial policies"\textsuperscript{25}. Thus, the wording of the Amendment does not actually differ much from the old text because, on the one hand, both provide that the term of the joint venture may be determined by the parties and because, on the other hand, any practical length more than the original 30-year limitation may still be repealed effectively by the administrative authorities.\textsuperscript{26} "In conformity with international practice" is only a covering phrase. Both negotiations and administrative approval are essentially important to Chinese state economic planning in order to control the operation and term of the business.

3.2 Legitimation of Business Operation through Legal Experimentation
The 1979 Joint Venture Law, the first of its kind in the PRC, has played an experimental role in the implementation of the open policy and attracting foreign investment. However, over the past ten years the business circumstance of joint ventures has changed beyond the scope of some of the Law’s original provisions. Although the basic principles of the 1979 Law remain applicable, some business practices, adopted by both joint ventures and administrative authorities, need legitimation from the Chinese government itself.
3.2.1 Banking Monopoly Relaxed

Originally, the Joint Venture Law provided for the Bank of China to handle all foreign currency deposits and remittances made by joint ventures. However, since 1979 many banks, including the CITIC Industrial Bank and foreign bank branches in Shenzhen Special Economic Zone, have received authorization to deal in foreign exchange. Joint ventures have gradually started dealing with such banks - first with approval granted on an ad hoc basis and now often without obtaining formal approval. The Amendment provides for a relaxation of the banking restrictions on foreign exchange of the equity joint ventures. This, in fact, only legitimizes a banking reform that has taken place over the last several years. Although this was criticized as "not an innovation", it still shows that a legal basis is necessary for foreign exchange operations.

The Amendment, on the one hand, extends greater banking freedoms to equity joint ventures, and on the other hand, places the informal business practice under the state control. Accordingly, the Amendment removes the requirement for joint ventures to seek approval to open foreign exchange accounts with "banks other than the Bank of China", or to use such banks to remit foreign exchange wages and profits outside the PRC.

Given the current pervasiveness of the PRC's restrictive foreign exchange controls, the Amendment is criticized as not making much difference to foreign investors. However, in order to eliminate foreign exchange dealings without formal approval, and to move the regulatory treatment of equity joint ventures closer to that of contractual joint ventures, Chinese legislators adopt a necessary legal basis which is the same as the banking rule found in the 1988 Contractual Joint Venture Law.

3.2.2 Tax Benefits Broadened

The original article 7 under the 1979 Joint Venture Law restricted the scope of tax types, time periods, and joint ventures to which tax concessions could be applied. The Amendment, providing no innovative tax concessions, widens the scope of tax breaks applicable which again conforms with current practice. Although this is criticized as simply reflecting "changes in the substance or administration of other laws applicable to equity joint ventures", a legitimation through the Amendment is deemed necessary by the PRC government. In this regard, the Amendment merely generalizes these items in deference to preferential tax laws promulgated since 1979.

3.3 Rationalization of the State Regulatory Authorities

In those fields mentioned, such as expropriation with compensation, approval on the term limit, and foreign exchange banking, the PRC government has re-assured itself of control over joint venture operations. In addition, as to the internal structures of administrative and legal frameworks under Chinese authority, the
Amendment provides certain improvements towards more rationalization of business regulation.

3.3.1 Applicability

Since 1979, the (Equity) Joint Venture Law itself clearly refers to joint ventures in which a separate entity is created using capital contributed by the foreign and Chinese parties.

On the other hand, cooperative joint ventures are the subject of a separate law, that is, the Contractual (Cooperative) Joint Ventures Law, adopted on 13 April, 1988. In practice, because the last Law was promulgated much later in time, its provisions and implementation provided the important references for the Amendment to the Equity Joint Venture Law. The Amendment is applicable only to Chinese-Foreign equity joint ventures. Thus, to a major degree, some lawyers have argued that the Amendment only eliminates several structural and functional differences between equity and contractual joint ventures, with little effect on attracting more investment into China. As a whole, these eliminations include provisions on chairmanship and banking.

3.3.2 Generalization of Regulatory Authorities

The Amendment, in paragraphs 2 and 7, generalizes the names of “the foreign economic and trade” and “the industry and commerce” administrative departments in articles 3 and 13. The names of both authorities have been changed since 1979. For some past years, the PRC government has been using the general term “administrative department” (xing-zheng guan-li zhu-guan bu-men) to refer to a department in charge of a particular function, rather than referring to the department by name. This part reflects de facto changes in the contract approval process that occurred when the PRC government had been attempting “to decentralize its administrative function” in the decade after the original Law was enacted. Similar to the legitimation of some business practices, the Amendment merely confirms that the Foreign Investment Commission in the original text is no longer the sole state agency that authorizes and governs the operation of equity joint ventures.

4. National Interest, Foreign Interest, and Bureaucracy

Since the Amendment to the 1979 Joint Venture Law means little to the operation of investment, it is not likely to stimulate new foreign investment in China either. From the practical data, the violent suppression of the pro-democracy demonstration in June 1989 has significantly depressed foreign investment, especially tourist-related enterprises and joint venture hotels. Even one year after the Tiananmen Square massacre, it is reported if one takes off “the rosy spectacles”, the reality of the foreign investment in China looks less promising. Especially in relation to administration of foreign business:

China is burdened with a pervasive and corrupt bureaucracy. As state-owned companies scramble
and scheme for credit and foreign exchange in today's climate of economic austerity, the problem is growing worse...38

Indeed for over two thousand years, the Chinese have been administering their affairs through a professional civil bureaucracy which plays a more important and impregnable role in post-1979 Chinese-foreign economic co-operation.

Also, the PRC state-planning economy, based on unpredictable bureaucratic proposals, is another serious problem for business. For instance, for the past ten years, foreign investors have been told that Shanghai was expanding westwards around the airport and they invested accordingly. Now the industrial centre is to be on swampy land to the east, the famous Pudong New Area. Foreign investors then ask, “If the rules change once, why not twice” ?39

In addition to those corrupt and conservative weaknesses mentioned, Chinese administration has been facing another difficulty in the post-1979 reforms, that is the counter-reform from the bureaucracy itself. Although government has always been a fortress for pedantry and inflexibility, it has always been a constant part of Chinese life. Since 1979 Chinese policies have been reflecting the beliefs of those in power in Beijing that continued development of the PRC depends on a unified nation and that unity depends on a strong central government and a strong army. It is a deep question for Chinese bureaucrats themselves how far the distance from their reform “mind” to the “reality” is. It is noted:

For the past four years, reform-minded authorities have drawn a clear distinction between the need for economic reform and any “misguided” experimentation with political reform. Although Tiananmen Square may well represent a change in degree, it certainly represents no change in policy.40

Indeed, to Chinese leadership today western-style democracy is irrelevant to Chinese economic reform; what matters is the group interest of the bureaucracy under the sham of “national interest” or “Party interest”. This author is convinced that the massacre in Tiananmen Square clearly distinguished “national interest” from the “social interest", distinguished the “state” from “society", distinguished the “Republic” from the “People”. The post-1979 economic reforms and their results are not commonly shared by all the people of China. At least, inflation, corruption, wages and achieving western democracy are the different concerns between the people and those party and state bureaucrats. The difficulties of the PRC economy and foreign business in China after the Tiananmen killing in fact come out from the counter-reforms of the bureaucracy, which maintain the group interests of the administrative officials at different levels in the past years and in the violence of June 1989 itself.

Then, what is the relationship between this group interest of the bureaucracy and that of the foreign investors? The future of any foreign business in China lies in the practical negotiations and the personal connections with the PRC officials and managers at different levels. Because, on the one hand, the flexibilities of the wording within Chinese economic legislation and its implementation and because, on the other
hand, the PRC state-agency always maintains administrative approvals as the final tools for the regulation of foreign investment and trade, the bureaucracy plays gateguard on every international economic activity in China, in order to protect its own group interest under the sham of the national interest. On the table, the national interest provides the reasons for the administrative interference on foreign business: the Chinese intend to share profitability with foreign investors in overseas markets supplied by Chinese-made goods - not simply to subsidize domestic profits for foreigners by low-cost Chinese labour. Under the table, however, the group interest of the administrative officials in power can be achieved: project setting; allocation of raw materials, foreign exchange, and energy; production; marketing; and profit repatriation are all based on case-by-case approvals within a centralized secretive system.

In other words, the reality of the emphasis on negotiation and administrative measures, means that law and its implementation merely act as the milestones within which both foreign and Chinese parties can carry out their business bargainings.

5. Concluding Remarks

Is it imperative that some provisions of the 1979 Joint Venture Law be amended and implemented? The answer is positive - yes - for the Chinese state authorities with emphasis on negotiation under the facade of international practice, legitimization of business operation through legal experimentation, and rationalization of the state regulatory authorities (analysed above).

In the final analysis law does matter in the PRC as it is the instrument which stimulates foreign investment and trade and secondly it is the tool for administrative regulation and bargaining. However, at the moment, the business environment lacks any other positive conditions. Without additional positive conditions the political economy of China cannot develop as law is not sufficient on its own. Both the Amendment to the 1979 Joint Venture Law and the business trend after the Tiananmen massacre also prove that the PRC government only deems law as a corresponding tool for legitimization and regulation of the current business practice, not a more positive mechanism to improve economic circumstances. In summary, in addition to simply changing a law text, more far-reaching economic reforms are needed for the PRC government to stimulate new foreign investment.*

Table 1. Foreign Investment in the PRC, 1979-89

<table>
<thead>
<tr>
<th>Resources</th>
<th>Beijing Review</th>
<th>China Economic News</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period</td>
<td>1979-89</td>
<td>April 1979-Sept. 1989</td>
</tr>
<tr>
<td>Foreign-funded Projects</td>
<td>21,739</td>
<td>20,278</td>
</tr>
<tr>
<td>Commitment Value</td>
<td>US$ 33.801 billion</td>
<td>US$ 32.17 billion</td>
</tr>
<tr>
<td>Joint Ventures</td>
<td>Unknown</td>
<td>18,999</td>
</tr>
</tbody>
</table>
Commitment Value

Equity: 12,195

Equity:
US$ 12.55 billion

Equity: 11,286

Contractual: 7,713

Equity:
US$ 11.80 billion

Contractual:
US$ 14.70 billion

{FOOTNOTES}

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6. Ibid.

7. Ibid.

8. Ibid.


10. Ibid.


12. Ibid., 25.


15. Ibid.


17. Li, op.cit. note 3.

18. Robertson and Chen, op.cit. note 4, 11.


21. Ibid. See also CLP Editor’s Notes op.cit. note 19, 39.


23. The “contractual” joint ventures in the PRC are frequently referred to as “co-operative” joint ventures or “co-operative arrangements”. Both these labels refer to joint enterprises between Chinese and foreign concerns which are not governed by the Equity Joint Venture Law. See X. Wang, “Taxation and Investment in China”, 17 International Business Lawyer, June 1989, 267-268, cited in Robertson and Chen, op.cit. note 3, 25. The document was “Amendment to Article 100 of the Regulations for the Implementation of the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment” adopted on 15 January 1986.

25. Li, op. cit. note 3, 25.


27. Ibid.

28. CLP Editor’s Notes, op.cit. note 19, 39.

29. Robertson and Chen, op.cit. note 4, 11.

30. The contractual joint ventures are permitted, under article 16 of the Contractual Joint Venture Law, to open a foreign exchange account at any “bank or other financial institution” which is authorized by the PRC government to conduct foreign exchange transactions. Supra note 10.

31. Robertson and Chen, op.cit. note 4, 12.

32. CLP Editor’s Notes, op.cit. note 19, 39.

33. Supra note 22.

34. The Amendment, argued by Robertson and Chen, is “not likely to give the parties to an equity joint venture significantly greater control over the management of their joint business”. For the most part, it simply incorporates into Equity Joint Venture Law “changes in other laws applicable to foreign-funded enterprises in China”. Robertson and Chen, op.cit. note 4, 10.

35. CLP Editor’s Notes, op.cit. note 19, 39.

36. Robertson and Chen, op.cit. note 4, 11.
37. Ibid., 12.
39. Ibid.
40. Foster and Tosi, op.cit. note 11, 26.

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