

# China's Foreign Trade And Foreign Investment Law

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## **Introduction**

Law in the People's Republic of China, a topic that as recently as a decade ago attracted very little attention, is now attracting a good deal of it. Signs of interest in the subject are everywhere. For example, the March, 1995 issue of *China Quarterly*, the leading academic journal on Chinese affairs, was devoted entirely to the subject of Chinese law. In June the *Wall Street Journal* published a front-page article devoted entirely to recent legal developments in China and their impact on Chinese society as a whole. Commercial loose-leaf services now keep close track of Chinese legal developments publishing virtually all foreign-related laws and regulations as they issue from Beijing along with English translations. There is even a Chinese law discussion list on the Internet, where both broad policy issues and technical legal points are the subject of increasingly lively exchanges by specialists around the world.

There are good reasons for this growing interest in Chinese law. Most immediately, foreign businesses that are engaged in or considering doing business with China have an obvious need to acquire a greater understanding of the evolving legal environment within which they will have to operate. Foreign governments, in the face of China's growing importance in world trade and investment, are interested in protecting their nations' interests by ensuring the compatibility of China's legal system with that of the world economy.

For China itself, its "open door" policy of encouraging foreign trade and foreign investment has been the mainstay of its economic reform and a principal motive force behind its rapid economic growth since 1978. Change in foreign business law has spearheaded a widening reform of the entire legal system to meet the needs of a market economy. Both its people and their leaders are aware that continued progress in this area depends in part on continuing efforts to bring their legal system into conformity with world standards.

In its ongoing effort to promote greater understanding of major economic and social issues affecting China, The 1990 Institute sponsored two international conferences in 1995 on China's foreign trade and investment law. The first conference was held in San Francisco at the end of March and the other held in Beijing at the end of April. (See Appendices A and B for the agendas of the two conferences.) The topics discussed in these conferences closely followed the contents of a book published by the Institute on *Foreign Business Law in China*. The book was written by Professor Pitman Potter of the University of British Columbia Law School.

In this paper we attempt to summarize the findings of Professor Potter's book as well as discussions covered in the two conferences. The paper is divided into four parts. Following this introduction, Section I reviews the progress China has made since 1978 in developing a body of foreign trade and investment law, focusing on four areas: foreign trade, foreign investment, intellectual property protection, and dispute resolution. Section II discusses several issues and challenges confronting the Chinese legal system: its underlying philosophy (formalism and instrumentalism), law enforcement, transparency and accessibility, and the "two-track" approach to foreign trade and investment regulation. In Section III, we present our own assessment of China's legal system as it pertains to foreign trade and investment.

As to specific measures for the improvement of China's foreign business law, we defer to Professor Potter's book. On China's application for admission to the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), an issue on which extensive discussions were conducted but failed to reach consensus in the conferences, we report the various views to show the complexity of the topic and the difficulty in reaching agreement.

## **I. Legal Developments Since 1978: The Evolution of China's Foreign Trade Law Regime**

### **1. Background**

In December 1978 the Third Plenum of the Eleventh Central Committee of the Communist Party of China ended a long period of internal chaos and relative isolation from the outside world by announcing China's "opening" -- an opening to the outside world and an opening up of Chinese society as well. As part of this program, the Plenum announced China's intention to devote resources to the building after a period of prolonged and profound legal underdevelopment, of a society based on the rule of law.

It is no secret that China's "opening" was driven in some substantial measure by a desire to attract foreign investments and one of the first manifestations of its new openness was the passage by the National People's Congress (NPC), China's national legislature, in 1979 of an Equity Joint Venture Law, designed to offer foreign firms and individuals legal undergirding for direct investment projects. Following that China proceeded to enact during the decade of the 1980s what one conference speaker described as an "avalanche" of laws and implementing regulations on foreign trade and investment. As Professor Potter has observed: "In contrast to the relative dearth of regulatory enactments that greeted foreign business executives and their counselors in the early 1980s, a full array of laws and regulations is now in place." (Potter, p. 81.) Together these measures constitute a coherent framework for conducting foreign trade and investment.

It is a characteristic of legal frameworks that no sooner are they built than one discovers that they need to be rebuilt. And what emerged quite clearly from the two conferences was that the Chinese themselves fully understand this. The policymakers and Chinese legal academics who were the principal architects of China's foreign trade and investment regime are now spending a great deal of time on law revision. (One speaker suggested the only brake on change was the paucity of trained legal personnel to carry forward the task of law revision.) Indeed, the metaphor most often used by conference speakers to describe Chinese foreign trade and investment law was that of the moving target.

In its effort to build a comprehensive new legal order China decided to embark on what was in effect a dual-track strategy, making a distinction between laws applicable domestically and laws applicable to foreign matters. (In the view of several conference speakers that distinction may now be in the process of

breaking down.) Nonetheless certain domestic legislation has a direct bearing on foreign trade and investment.

## **2. Domestic Legislation Bearing on Foreign Trade and Investment**

China promulgated a new Constitution in 1982 and an amended version of the same in 1988. Both documents recognize the right of foreigners "to invest in China and to enter into various forms of economic cooperation with Chinese enterprises." Both also promise that foreign investors' rights and interests will be protected. (1982 Constitution, as amended 1988, Article 18). The General Principles of Civil Law, which corresponds to the first chapter or General Part of a European civil code and was a centerpiece of China's lawmaking efforts in the 1980s, specifies that joint ventures and wholly owned foreign enterprises may obtain the status of a Chinese legal person, with all the rights appertaining to that status, upon the appropriate registration and approval (Article 41). China's Civil Procedure Law (draft version, 1982; final version, 1991) explicitly recognizes the right of foreigners to sue in Chinese courts. The Administrative Litigation Law of 1989 allows foreigners the right to challenge administrative agency decisions in court. A final piece of "domestic" legislation bearing on foreign trade and investment is China's recently enacted Company Law (1993). This law, designed primarily to promote the reorganization of China's domestic enterprises, also by its terms makes new modes of direct investment available to foreign investors.

## **3. Foreign-Related Trade Laws**

While important for foreign traders and investors these laws are surpassed in importance by those addressed specifically to foreign trade and investment.

Through a series of laws passed in the 1980s, China sought to regulate in great detail trade in goods between Chinese and foreign business enterprises. These laws governed such things as the licensing of imports and exports, commodity inspection, and the content of import-export contracts. Chief among them is the so-called Foreign Economic Contract Law (FECL) of 1985.

The FECL applies to "foreign-related contracts," an admittedly vague term. But according to the experts, it refers to any contracts in which one of the parties is a foreigner. For example, the FECL would apply to a contract between an American automobile producer and a Chinese supplier of auto parts or to a Chinese-French joint venture auto parts maker and the same American auto producer. It would not, however, apply to a contract between the Chinese-French auto parts maker (joint ventures are considered to be Chinese legal persons) and a Chinese automobile producer. China has a separate Economic Contract Law governing contracts between domestic enterprises, including joint ventures.

The FECL regulates contractual terms and has other provisions affecting contractual validity. It has a provision that allows contracting parties to provide for the arbitration of disputes and to specify the applicable law the arbitrators shall apply. It should be noted that the FECL is itself subordinate to the United Nations Convention on the International Sale of Goods, an agreement governing contracts for the international sale of commercial goods to which China has acceded (see below).

In 1994 the NPC enacted a comprehensive Foreign Trade Law, which seeks to unify all the enactments concerning the organization and administration of foreign trade into a coherent whole. Implementing regulations are expected shortly.

There are several striking features of China's foreign trade law regime, the most important of which, stressed repeatedly at both conferences, is that engaging in foreign trade requires the official permission of the state. A corollary of this principle is that government authorities may review the terms of foreign trade contracts and may order any changes they deem appropriate before approval. Only Chinese parties (including Chinese/foreign joint ventures, purely private Chinese concerns, and state-owned enterprises) who have received official permission may engage in foreign trade. Foreigners who wish to contract with Chinese entities must first establish that these entities have received official authorization to engage in foreign trade. Any foreigner who enters into a contract with a nonauthorized entity, has entered into a contract that has no validity under Chinese law. He will likely find himself without legal recourse should the agreement be breached by the Chinese side.

Another serious hazard of which foreigners wishing to engage in trade with Chinese businesses must be aware of is the result of decentralization in China since 1978. In the past almost all of China's economic activity was in the hands of a relatively few large Chinese national companies, each with a headquarters and numerous branches. The headquarters and branches could be seen, and were seen legally, as constituting a single business entity. But that situation has now changed radically due to China's economic reforms. What were previously large conglomerates have now been broken up into numerous independent operating entities, each responsible for its own profits and losses. Whereas previously a national company might be held ultimately responsible for an export contract entered into by a provincial branch, now it might turn out that what looks like a provincial branch of a national company, though retaining the former national company's name, is in fact an independent legal entity with exclusive responsibility for its contractual commitments. Foreigners wishing to do business with Chinese firms need to be aware of this new economic and legal reality.

China's new foreign trade law regime raises several very significant issues. The principal one that came up for discussion at both conferences has to do with the accessibility of information on Chinese business concerns. Legal and business records in China are in such a state that foreigners often find it impossible to establish the exact legal status of a Chinese business entity with which they propose to deal, i.e., whether it is an independent entity or a branch, or to determine whether it has authorization to engage in foreign trade. This of course makes the task of negotiation a hazardous one. The consensus among observers is that this situation needs to be clarified if foreign trade contracts are to continue to grow.

A second issue that came up for some discussion was the Chinese commodity inspection system. An American lawyer at the Beijing conference with long experience in Chinese foreign trade, while acknowledging that China had made great progress in the area of commodity inspection, argued that there are further changes that need to be made. There is a need for foreigners and Chinese alike to know more about the exact standards applied by the Commodity Inspection Bureau. Furthermore, it was argued that there should be some relatively expeditious way of challenging bureau decisions. Finally, it was suggested that China consider letting foreigners designate some entity other than the bureau for the inspection of commodities.

## **4. Foreign Direct Investment Regulation**

China's legal regime for the encouragement and regulation of foreign direct investment was a main focus of discussion at both conferences. It is in this area that the National People's Congress has been most prolific in passing legislation, and it is in this area that the laws passed have had such significant consequences.

As noted above, China enacted its first law affecting foreign direct investment in 1979, the Equity Joint Venture Law. This measure sanctioned the creation, subject to state approval, of joint Sino-foreign business enterprises. Participants in these ventures are liable for the firm's debts and entitled to its profits to the extent of capital contributed. They are authorized to exist for up to thirty years or more and are recognized under Chinese law as legal persons. Equity joint

ventures are governed by their Boards of Directors and under the original law the Chair had to be Chinese. The law was amended in 1990 to permit foreigners to serve as Chairs. There is a minimum 25% equity requirement on the part of the foreign partner to the joint venture. Ownership interests in equity joint ventures are not transferable.

In the years since 1979 China has enacted laws sanctioning other types of foreign direct investment. In 1986 it authorized the establishment in China of wholly owned foreign enterprises. Two years later it passed a Cooperative Joint Venture Law, authorizing the creation of contractual joint ventures as opposed to equity joint ventures. These enterprises resemble general partnerships in structure and operation. Contractual joint ventures, like equity joint ventures, are subject to government approval and if approved are recognized as legal persons. They enjoy limited liability and may be of any duration the venturers choose. There are no minimum contributions on the part of foreigners, and the participants are free to decide on the distribution of profits and losses.

All laws affecting foreign direct investment have been followed by the promulgation of corresponding implementing regulations.

That China's laws have been successful in the promotion of foreign direct investment is witnessed by the fact that through 1994 China had approved some 206,000 foreign investment projects which together employ over 14 million people and account for approximately 29% of China's exports.

In 1993 the Chinese National People's Congress enacted a Company Law which applies potentially at least, to both domestic and foreign business entities. Under the Company Law, which makes new forms of business organization available to Chinese firms, potential new investment vehicles have become available to foreign investors in China as well. These are (1) the limited liability company, resembling in legal character a German limited liability company; and (2) the company limited by shares, similar to an American corporation. These new forms of business organization may give foreign investors more autonomy and managerial control than under the old investment vehicles, such as equity ventures and contractual joint ventures. In addition they open up the possibility of portfolio investment inasmuch as the law permits ownership interests in companies limited by shares to be listed and traded on exchanges.

By law what were formerly equity joint ventures can be transformed into companies limited by shares. The Company Law also permits foreign companies to establish Chinese subsidiaries. The new law is seen by some observers as an attempt by China to create a single unified law of business organization, applying to domestic enterprises, joint ventures, and wholly owned foreign concerns alike. Whether it will have this effect is at the moment a topic about which there is considerable speculation but no firm consensus. The view of some is that foreigners may wish to retain the preferential treatment that is available to joint ventures and wholly foreign owned enterprises under existing legislation.

## **5. Intellectual Property Protection**

China's laws concerning the protection of intellectual property are not, strictly speaking, foreign trade or investment measures, but rather part of the country's domestic legislation. However, an argument can be made that these laws came into existence principally in order to encourage the transfer of foreign technology to China and only secondarily to provide protection to Chinese citizens. So in some sense they may be seen as belonging to China's foreign trade law regime.

A complete intellectual property law apparatus is now in place in China. China enacted its first modern intellectual property law, a Trademark Law in 1982. (It was amended in 1983 to permit the registration of service marks.) It enacted Patent and Copyright laws, respectively, in 1985 and 1990. An Unfair Competition Law, forbidding among other things unauthorized use of commercial names and false and misleading claims about a product, came into force in December, 1993. In addition to these laws China has entered into several Memoranda of Understanding with the United States concerning measures to be taken for the better protection of intellectual property.

Chinese intellectual property law resembles American intellectual property law in some respects but differs from it in others. Unlike American law, Chinese patent law does not protect new varieties of plants nor new breeds of animals, although it does protect new methods of making seeds. Furthermore, as in American law, one cannot patent computer software by itself in China but only in connection with new hardware. In seeking to protect computer software in China one is relegated exclusively to the regime of copyright law. As presented at both conferences, China plans to revise its copyright law to more fully cover the field of computer software or enact sui generis software protection legislation.

Discussion of China's intellectual property laws has centered more on the laws' enforcement or nonenforcement, rather than on their content. Actually, the content of these measures compare favorably with the intellectual property laws of most modern commercial nations. If there are deficiencies, the same exists in the intellectual property laws of virtually every nation in the world. In every country intellectual property law is struggling to keep up with the blistering pace of technological development especially in the computer field.

## **6. Dispute Resolution**

Provision for the resolution of disputes is a key feature of any legal system, and Chinese officials at both conferences acknowledged the importance of effective dispute resolution mechanism for confidence building in foreign business. As noted earlier, under Chinese law foreign businesses have the right to sue in Chinese courts. (See Civil Procedure Law, Article 185-7 ff.) Indeed the Intermediate People's Courts, the second-level courts from the bottom in the Chinese judicial hierarchy, have economic tribunals for the hearing of cases involving foreigners. Cases involving foreigners are heard with some regularity in China's Maritime Courts. These specialized courts exist in the coastal cities for the purpose of hearing maritime trade and maritime casualty cases. In general, however, the Chinese court system has rarely been resorted to by foreigners in foreign trade matters, and arbitration is the favored method of dispute resolution in this area.

Chinese law permits parties to a foreign trade contract to include provision for the arbitration of disputes that may arise under the agreement. The parties are free to choose which body of law shall be applied in resolving the dispute and to provide for arbitration outside China, in the International Chamber of Commerce, the Stockholm Chamber of Commerce or the London Court of International Arbitration, to name a few examples. In practice, however, most contracts call for the resolution of disputes in China and that is where the vast bulk of international trade arbitration takes place. A rather elaborate arbitration apparatus has grown up to meet this demand.

China has had some sort of system for the arbitration of international trade disputes for many years. One existed even during its period of autarky and relative isolation from international commerce. But China's current system for international trade arbitration dates to 1988 when the China International Economic and Trade Arbitration Commission (CIETAC) was established. This tribunal is authorized to handle all international trade disputes. (China has a separate system for domestic arbitration.) In recent years, the tribunal has been handling a great many disputes. In 1994, for example, it accepted 829 cases for arbitration, thus making it one of the busiest arbitration tribunals in the world. China recently enacted a new Arbitration Law. It and new arbitration rules are set to go into effect in September, 1995. The new law broadens the scope of disputes that may be submitted to arbitration. It sets tight time limits on the rendering of

awards. It also allows arbitration to continue even when the underlying contract is found to be invalid.

CIETAC, which is headquartered in Beijing but has subcommissions in Shenzhen and Shanghai, is an organization somewhat like the American Arbitration Association. Rather than hearing cases itself, it arranges for their hearing by individuals drawn from a list of arbitrators it has approved. And it supplies administrative support for the conduct of arbitration. There have been few complaints against CIETAC arbitration panels on the score of fairness or impartiality. The dispute resolution machinery has come under criticism on other scores, however.

CIETAC has apparently been unduly slow at times in processing cases. In the opinion of some it places undue emphasis on pressuring parties to compromise even when the relationship between them has completely broken down. CIETAC arbitrators, too, some argue, have a tendency to overlook clearly applicable law and decide disputes on rough intuitions of justice. The major area of controversy, however, concerns the enforcement of arbitral awards.

Considerable doubt exists among many foreign experts on Chinese law as to whether arbitral awards are readily enforceable in Chinese courts. Some contend that the record of enforcement is unclear at best, very spotty at worst. A leading scholar-practitioner who spoke at the San Francisco conference, expressed the view that one simply cannot say for certain whether arbitral awards will be enforced in Chinese courts--especially if they are adverse to local companies. Yet, he noted, a clear record of regular enforcement of arbitral awards is essential if foreigners are to have confidence in the system.<sup>2</sup> It should be noted that Chinese legal officials, including officials affiliated with CIETAC, vigorously disagreed with this view, contending that the dimensions of this problem have been exaggerated.

## **7. International Agreements**

A summary of Chinese foreign trade and investment lawmaking in the past sixteen years would be incomplete without mention of the important international treaties and agreements that China has entered into, all of which have a direct bearing on foreign trade and investment. The first of these was the Paris Convention for the Protection of Industrial Property, which China signed in 1984. In 1987 China acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and in 1991 to the United Nations Convention on Contracts for the International Sale of Goods (Vienna Convention). In that same year China joined the Hague Convention on the Service of Documents Abroad. (It has not however as of this writing acceded to the United Nations Convention on the Collection of Evidence Abroad.) In 1992, China joined the Berne Convention on Protection of Literary and Artistic Works. In addition it has entered into numerous bilateral trade agreements with other nations. It is worth mentioning --a point stressed by several Chinese speakers both at the San Francisco and at the Beijing Conference-- that under Chinese law if there is a conflict between Chinese domestic legislation and the provision of an international agreement, the international provision takes precedence unless China has specifically reserved the right to apply its own law. This is in contrast to American law, where just the reverse is true.

## **II. Systemic Issues and Challenges Ahead**

Notwithstanding the impressive record of lawmaking in the area of foreign trade and investment detailed above, virtually all observers agree that major deficiencies exist in China's foreign trade law regime and major improvements need to be made. This is frankly acknowledged by Chinese policymakers as well. As one of the lead speakers at the Beijing conference put it, rather than praising China's accomplishments it was more important to identify and move toward the solution of the formidable problems that yet remain if China is to develop a modern legal regime, without which a market economy could not develop to its full potential.

### **1. Formalism and Instrumentalism**

To many foreign observers the Chinese legal system is still characterized by "instrumentalism" and "formalism." Instrumentalism refers to the tendency to enact laws in pursuit of some short-term policy goal rather than recognize their long-term usefulness to the society. Formalism is the tendency to think that once a law has been enacted to deal with some perceived problem, nothing more needs to be done, i.e., that the law will implement itself without the need for monitoring and enforcement by officials. According to some, these attitudes exist and negatively affect the functioning of China's foreign trade law regime. Although the Chinese speakers at the conferences did not address these points systematically or in depth, they did discuss them and by implication seemed to accept these characterizations as endemic to the evolution of China's legal system, but not necessarily as permanent features of that system.

On instrumentalism they pointed out that law is a statement of the rules of the society and therefore must necessarily reflect a society's basic values and culture and the social thinking of the times. Thus, prior to 1979, when there was a centrally planned economy, there was little need for law, although there was some law on the books. It was only after economic reform began in 1978, that law began to be seen as having an important role to play. Then, institutions needed to be built, rules to be developed, social thinking to be adjusted, and personnel to be trained. To construct a legal system from the ground up, China has had to learn by doing and from increasing contacts with foreign countries. It has been a tentative process, but the Chinese speakers felt that China has accomplished a great deal in the relatively short span of sixteen years.

The symbiotic relationship between legal and social change and the tentative nature of the development of law in China can be illustrated by the extended process leading to the final adoption in April 1986 of the General Principles of Civil Law. The National People's Congress beginning of the economic reforms. Three years and four drafts later, the legislators decided to put off the task of completing a comprehensive civil code until major economic reforms had taken root and a clearer view had emerged of the new economic and social order in which it would apply. In the meantime, they decided to enact what corresponds to the General Part of a European Civil Code, i.e., a statement of foundational legal concepts and principles, and to defer until later the completion of the other provisions one would normally expect to find in a civil code. This task was completed in 1986.

There was little direct discussion of formalism on the part of the Chinese. But, here one needs to distinguish between an attitude of nonchalance toward law enforcement and a sense of frustration over ineffective enforcement combined with a determination to seek improvement. Undoubtedly in their negotiations with the United States over trade matters, Chinese officials have touted the laws and regulations they have promulgated in recent years as sufficient proof of China's rectitude in regulating international business activities. A fair amount of this emerged in the two conferences whenever the Chinese speakers felt defensive about their legal system. Mixed in with this attitude, however, was another side, perhaps more prevalent at the Beijing conference, which recognized the inadequacy of the enforcement of the law on the books.

### **2. Law Enforcement**

There was a consensus at both conferences that, notwithstanding the great strides China has made in passing foreign trade and investment legislation, the implementation of these laws remains a pressing problem.

Law enforcement requires an efficient and independent court system staffed by trained legal professionals. As was noted earlier, prior to China's economic reforms there was little need for law or courts or legally trained personnel and whatever had existed was destroyed during the ten chaotic years of the Cultural Revolution.

The task of reconstruction began in July 1979, when the National People's Congress passed a law on the organization of the courts. Four levels of courts were established: a Supreme People's Court at the top and under it twenty-nine Higher People's Courts, more than three hundred Intermediate People's Courts and more than three thousand Local or Basic People's Courts. Altogether, these courts employ more than 150,000 persons. It was a gigantic task to develop this administrative structure, to formulate its operational procedures, and to recruit and train its personnel. Law schools had to be restarted after being closed for more than a decade and graduates had to be channeled into judicial posts with great speed. Even now, after years of growth, law school graduates can fill only a fraction of the court system's needs, and a majority of judges have been recruited from the military or other government services, with less than one-half having completed more than a secondary education.

Beyond the issue of professional training is the issue of judicial independence. For decades the courts were under the Ministry of Justice, but in 1983 they gained independence from the executive branch of the government and put, nominally at least, under the authority of the Supreme People's Court, which now has the power to appoint lower court judges and review lower court decisions. This, however, does little to assure court independence. Interference by Party and local government officials in judicial decision-making remains formidable day-to-day problems.

The Party's pervasive influence in every branch of government is generally understood to be a sensitive subject for discussion in China, especially when foreigners are present. Yet, at the Beijing conference one highly placed Chinese speaker showed no hesitancy in bringing it up. He acknowledged that to this day the Chinese legal system still followed the Soviet model, in which the Party retains an overall right of control over the courts. At the same time, he stated, both the Chinese Constitution and the Party Charter guaranteed judicial independence, and an effort was afoot to prevent Party officials from interfering in court decisions. Such interference had once been the rule, he admitted, and still occurred on a wide scale, but it was no longer officially sanctioned.

The problem of interference by local government officials in court decision-making ("local protectionism") was repeatedly brought up at both the San Francisco and Beijing conferences. The Basic or Local Courts may theoretically be under the supervision of the higher-level courts, but they also have close connections with local governments in China. Most local judges are former local government officials and maintain close ties with their former colleagues. Furthermore local judges are paid by local governments, rather than by the central government in Beijing. These relationships have inevitably compromised judicial independence and impeded the execution of justice at times. It is very difficult to win cases brought against local government officials, and even when litigants win, they often find it impossible to enforce the judgments.

Another aspect of local protectionism that came up for discussion is the nonenforcement of central government commands by local officials. Several speakers expressed doubts whether laws and regulations passed at the national level were being routinely enforced at the local level if officials at the local level felt these enactments ran contrary to local interests. As one speaker rather colorfully put it, there is a real question as to whether the central government can make its writ run in the provinces. In the experience of some there was often a wide divergence between central government policy and local government practice. Such inconsistency in applying the law makes it difficult for foreign businesspersons to operate.

The Chinese speakers at the Beijing conference readily conceded these points. They stated judicial independence from political control and the uniform enforcement of national law were primary goals of legal reform in China, but, given the magnitude of the task, they predicted it would take a long time to achieve.

### **3. Transparency and Accessibility**

Another issue discussed at great length at both conferences was the transparency and accessibility of the laws and regulations that affect foreign business operations in China. As a speaker at the San Francisco conference put it, foreign investment, like other kinds of investment, involves risk management. Risk management demands access to information, which means transparency in lawmaking and law implementation. China has exhibited some notable deficiencies on this front.

Lawyers working with foreign clients pointed out that it is often difficult to get access to the content of the laws and regulations that apply to business operations. The dissemination of legal information in China is so underdeveloped, so unsystematic that it is often difficult simply to find the applicable law. Even when the relevant rule can be found, provisions are often so broad and sketchy that it is difficult to be certain of correct interpretation. There is also no systematic compilation of case-law precedents that would aid in the interpretation of statutes and regulations.<sup>3</sup> There is also the vexing problem of the so-called "neibu" or internal agency rules.

In China, as in developed industrial countries, the task of implementing law is often given to a designated government agency. Implementation includes the promulgation of rules and regulations that fill in the details left vague by the often general terms of a statute. These regulations, once promulgated, have the force and effect of law and may then be applied by agencies to individuals and firms. (It is presumed that the regulations are in harmony with the statute's purposes.) Under the Administrative Litigation Law, foreigners who are adversely affected by an agency decision applying its regulations may challenge that decision in the courts, though they may not challenge the lawfulness of the regulations themselves, i.e., on the grounds that they conflict with the underlying statute.

The problem in China is that besides published regulations agencies often issue internal (neibu) unpublished rules, which are inaccessible to outsiders and which at times are the real rules under which the agency operates. To find out the content of these rules would require many visits to an agency and even then would often not result in disclosure. To many conference participants this practice leaves too much power in the hands of agency bureaucrats, breeds corruption, makes it impossible for foreign businesses to know what actions they are and are not permitted to take and in general makes it difficult for foreigners to do business in China.

By and large, the Chinese speakers accepted these as valid criticisms and agreed that greater effort must be made to correct these problems. On the positive side, they pointed out that China has published most of its major laws and regulations as well as selected major court decisions. Because the law has been changing so rapidly and because of the increasing volume of court decisions, they declared, it has been difficult to keep up with developments. Nevertheless, the government has started a new, systematic compilation of all major laws, regulations, and selected court decisions and plans to publish this compilation in the future. In the meantime they advised "due diligence" on the part of foreign businesses and their lawyers. On the subject of neibu they acknowledged that the practice existed but claimed it was diminishing.

### **4. The Two-Track Strategy**

The two-track system is a feature in Chinese law that treats foreign business concerns differently from domestic enterprises. In most aspects, such as taxation, foreign exchange, access to scarce resources (energy, transportation, raw materials, etc.), and dispute settlement, foreign business firms, as an incentive to investment in China, are accorded different, and in general more favorable, treatment than that accorded domestic firms. Hence, this is a lesser issue for foreigners than for China itself.

From China's point of view, a two-track system appears to be a necessary stop-gap measure in the evolution of its economic and social reforms. It was obvious, when the process got underway, that the general reform of the Chinese legal system would take time. But the special need for foreign trade and foreign investment law could not wait. China had to start with the latter first, while at the same time beginning to build a body of domestic law.

Thus in 1979 China passed a Foreign Joint Venture Law and in 1983 added implementing regulations, conferring tax concessions, access to scarce energy and raw material supplies on enterprises with significant foreign participation. In 1985 it enacted a Foreign Economic Contract Law, running parallel to, but differing in important ways from, the Economic Contract Law governing purely domestic contracts. Under the FECL the contracting parties could select the law of a foreign nation as the applicable law to apply when contract disputes arose. Or, in the absence of specific contract provisions, a court was empowered to select the law of the country with the closest relation to the contract. Under the Economic Contract Law, in contrast, only Chinese law could apply.

The dispute settlement mechanism provided for foreign entities also illustrates the dual-track approach -- and points to a possible model for the system's future reform. As described above, the principal institution provided by law for the resolution of disputes involving foreign firms is the China International Economic and Trade Arbitration Commission. It serves in all arbitration cases, in which a foreign person, legal or natural, is involved; or even where no foreign person is involved, when the case has to do with China's foreign trade or other kinds of international economic activities.

The Commission is prominent in China's legal system because of its recognized independence from political control, its adherence to transparent and internationally endorsed arbitration procedures, and its reputation for fairness. In contrast, Chinese domestic arbitration cases are handled by the Industrial and Commercial Arbitration Commission (ICAC), under the Bureau of Industry and Commerce, which is itself under the supervision of the General Administration of Industry and Commerce. Its place at the bottom of this bureaucratic hierarchy may bespeak its lowly status. Although the ICAC was not explicitly discussed at the conferences, one had the impression that it enjoys neither the independence nor the stature of CIETAC.

According to the Chinese speakers at the Beijing conference, the Chinese government is aware of the need for a single law applicable to both Chinese and foreign firms alike. Meanwhile, in the interest of attracting foreign investment, China is bending over backwards to accommodate foreign business interests. In time, they claim, the present two-track system will be replaced.

### **III. Assessment and Recommendations**

What has been learned from The 1990 Institute's efforts at promoting understanding of the role of law in China's foreign trade and investment? What concrete recommendations can be made --to the foreign business community, to China, and to the United States-- on the basis of the conference findings?

First there was general consensus that Pitman Potter's study, which was provided to all conference speakers in advance (a Chinese translation was published in time for the Beijing conference) formed a useful starting point for conference discussions.<sup>4</sup> All agreed that it framed the issues well and suggested useful tracks along which discussion could proceed.

Since the speakers at the two conferences came from different backgrounds and represented different viewpoints and since most of the salient topics discussed were controversial, divergent views were to be heard. Yet, surprisingly, there was broad consensus on some points.

Starting from a base near zero in 1978, China has achieved impressive progress in sixteen years in building up a legal framework for the conduct of foreign business in China and in constructing a domestic legal order as well. The pace has accelerated in the last ten years, as the nation has become increasingly aware of the importance of law for developing an orderly domestic market economy and of the critical need for adaptation to international legal standards if China is to truly integrate itself into the world economy.

The construction of a legal system that meets accepted world standards is a tremendous task in a nation of 1.2 billion people with four thousand years' tradition of personal rule. Completion of the task will be a long process. Professor Potter's description of China's foreign business law as characterized by "instrumentalism" and "formalism" was considered as both apt and inevitable at this early stage of China's legal development.

Far from being defensive about the existing system, most Chinese speakers at the Beijing conference accepted the criticisms that emerged in the earlier San Francisco conference concerning the system's deficiencies and the need for remedies. Among the Chinese speakers were some of the principal architects of China's new foreign business law. On their shoulders is the task of building a modern functioning legal order. We found them to be well informed, articulate, open to new ideas, and well qualified for the difficult task.

What lessons should the foreign business community draw from the conference discussions? Obviously China is a huge, rapidly expanding, and as yet under-explored market. Opportunities are nearly unlimited. Yet at the same time it is still a developing country with an underdeveloped infrastructure and institutions still not quite up to the standards in the developed countries. This is especially true in the area of law. The impressive progress of the past sixteen years has laid down and clarified the rules for doing business in China, but enforcement is still unreliable. Personal relationships still count more than written contracts sometimes; conciliation may have to be resorted to rather than going to arbitration or to court even though it may seem the less satisfactory way of resolving a dispute. Due diligence and a sensitivity to the cultural environment in which one operates are absolutely essential for doing business in China. In this respect, of course, China is similar to other developing countries in the world.

So far as recommendations to China are concerned, we endorse what Professor Potter has to say in the concluding chapter of his book. There is a need to change underlying attitudes toward law in China, to move away from formalism and instrumentalism in lawmaking and law implementation. Specific, concrete reforms are needed in the areas of foreign trade law, foreign investment law, intellectual property law and dispute settlement. The body of law governing foreign trade and investment needs to be made more transparent and more accessible. The practice of issuing internal neibu rules should be abolished. Judicial independence needs to be encouraged. These themes were echoed again and again at both the San Francisco and Beijing conferences.

For other countries, including the United States, the promotion of increased trade with and investment in China is a worthwhile objective. Where business practices in China are in serious contravention of accepted international standards -- such as blatant government interference to protect local business interests, large-scale violation of intellectual property rights -- firm, steady pressure on China to bring its law and practices into conformity with those of the international community is called for.

One specific issue deserving of special discussion is China's application for admission to the General Agreement on Tariffs and Trade and the World Trade Organization. The topic came up for vigorous discussion both in San Francisco and Beijing and is still a subject of live controversy. Rather than making a recommendation, we limit ourselves to reporting the views that were expressed.

On the question of the GATT and the WTO, the Chinese speakers argued strongly for China's admission. Among the non-Chinese speakers who addressed the topic there was considerable ambivalence. At most they favored making China's admission contingent on its first fulfilling certain specific conditions and resolving certain still unresolved problems. While acknowledging China's progress in lawmaking in the area of trade in foreign goods and services and intellectual property protection, they pointed to the continuing problems of lack of legal transparency and nonenforcement. Some pointed to what they see as a continuing fundamental incompatibility between certain characteristics of the Chinese economy and the GATT/WTO principles, to wit the large role that state enterprises, which do not operate according to market principles, still play in the Chinese economy. There is also the problem of interference by local governments in the interregional movement of goods and commodities. The central government has been notably unsuccessful, they contended, in putting a stop to this trade-obstructing local practice.

The Chinese speakers argued that it is unfair to single out China for exclusion from the GATT/WTO when in fact many long-standing GATT-signatory countries have practices that are out of conformity with the GATT principles. State enterprises are quite common among the GATT countries, they argued, and many, if not most, of these receive government subsidies. Trade barriers are not restricted to the developing countries. The United States, for instance, with its various import quotas on agricultural products (e.g., sugar, cheese, peanuts) and the so-called "voluntary export restraints," has been among the largest offenders in this regard, they noted.

Apart from the general question of China's admission to the GATT/WTO, there is the specific question of what status China should have if it is admitted, that of a developing or a partially developed country. The Chinese speakers argued that China is unquestionably a developing country and contended that it should be accorded the same treatment, i.e. given more time to bring its trade practices into conformity with the GATT practices, as is accorded other developing countries. To disallow China's claim of developing country status because of its success in export expansion would be contrary to the very purpose of the GATT. That might all be true, countered one non-Chinese speaker, but the political and economic reality is that no "developing country" ever had China's ability to disrupt world trade.

To sum up, on the issue of China's admission to the GATT/WTO the participants in the two conferences agreed to disagree. This is hardly surprising in view of the highly complex and politically sensitive nature of the issue. Nevertheless, the conferences provided an opportunity for the participants to systematically examine the major elements of the issue and consider different viewpoints in an open and scholarly manner.

#### **ENDNOTES:**

\* Charles McClain is Vice Chairman, Jurisprudence and Social Policy Program, School of Law, University of California, Berkeley; Hang-Sheng Cheng is President, The 1990 Institute. They wish to thank Jack H. Beebe, Chen Zhensheng, James V. Feinerman, and Pitman B. Potter for their helpful comments on an earlier draft of this paper. Responsibility for any remaining errors rests with the authors only.

1. A point often forgotten is that China's modern legal culture, to the extent it has one, derives like Japan's almost entirely from the continental civil law rather than the Anglo-American common law tradition.

2. For an account of the difficulty experienced by one American company in getting enforcement of an award rendered by the Stockholm Chamber of Commerce, see *China Joint Venturer*, October 1995, pp. 12-13. Legislation has been introduced in the U.S. Congress conditioning the future extension of MFN trade status to China on its willingness to abide by the provisions of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to which it is a party.

3. It seems unrealistic to expect that case law will ever play as great a role in China, a country with legal roots in the continental civil law tradition, as it does in the United States or any other common law nation.

Recently, China took a major step forward in announcing on January 16, 1996 the launching of the first loose-leaf edition of the complete set of its laws and regulations currently in force. In six volumes, the publication contains 1,435 laws and regulations promulgated by the National People's Congress (NPC) and the State Council between 1949 and 1995. It will be updated six times a year, normally within 15 days of the adjournment of the NPC or its Standing Committee sessions. The compilation was done by the Editorial Board of the Legal Affairs Committee of the NPC's Standing Committee and published by the Legal Publications Department of the Ministry of Justice. The sole agent for overseas distribution is Joint Publishing (Hong Kong) Ltd.

4. We might note that the book has been enthusiastically received by the scholarly community. It is seen as a highly significant contribution to the subject of foreign business law in China.

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## **Appendix A:**

San Francisco Conference Agenda

March 24-25, 1995

At The Federal Reserve Bank of San Francisco

### **CHINA'S FOREIGN TRADE AND INVESTMENT LAW**

- The evolving role of law in China's foreign economic relations
- Current trends in foreign direct investment law
- The latest update on foreign exchange and taxation regulations
- Recent developments in technology transfer and intellectual property protection
- Effective tactics for dispute resolution
- The impact of GATT and the World Trade Organization on China's foreign business law

This conference was co-sponsored by: The 1990 Institute (U.S.) - Vision 2047 Foundation (Hong Kong) - Bank of America (U.S.)

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## Day 1: Friday, March 24, 1995

Day Chair: **Alexander Calhoun** (U.S.), *Graham & James, San Francisco*

8:45 am Opening Remarks

**Robert A. Parry** (U.S.), *President, Federal Reserve Bank of San Francisco*

**Hang-Sheng Cheng** (U.S.), *President, The 1990 Institute*

9:00 am Keynote Address "**China's Law and the Demands of the World Economy**"

Speaker: **Jerome A. Cohen** (U.S.), *Partner, Paul, Weiss, Rifking, Wharton & Garrison, and Professor, New York University Law School*

9:30 am Opening Presentation "**Formalism, Instrumentalism and Beyond: Past and Future of Chinese Foreign Business Law**"

Speaker: **Pitman B. Potter** (Canada), *Associate Professor of Law and Director, Chinese Legal Studies, University of British Columbia, Vancouver*

10:15 am Session I: Trade Regulation and Administrative Structure

Chair: **Stanley B. Lubman**, *Esq. (U.S.) in association with Allen & Overy, New York*

Speakers: **Samuel X. Zhang**, *Esq. (Hong Kong), Deacons in association with Graham & James, Hong Kong*

**Zhang Yuejiao** (China), *Deputy Director General, Department of Treaty and Law, Ministry of Foreign Trade and External Cooperation, Beijing*

1:30 pm Session II: Technology Transfer and Intellectual Property Protection

Chair: **Richard M. Buxbaum** (U.S.), *Professor of Law and Dean, International and Area Studies, University of California at Berkeley*

Speakers: **Robert C. Berring** (U.S.), *Professor of Law and Director, Law Library, University of California at Berkeley*

**Zheng Chengsi** (China), *Deputy Director, Institute of Law and Director, Center on Intellectual Property, Chinese Academy of Social Sciences, Beijing*

3:15 pm Session III: Dispute Resolution Mechanisms

Chair: **Charles J. McClain** (U.S.), *Vice Chair, Jurisprudence and Social Policy Program, School of Law, University of California at Berkeley*

Speakers: **Stanley B. Lubman**, *Esq. (U.S.) in association with Allen & Overy, NY*

**Tang Houzhi** (China), *Vice Chairman, Chinese Council for the Promotion of Foreign Trade and Economic Cooperation, Beijing*

4:45 pm First Day Adjournment

7:00 pm Dinner Presentation "**China's Leap Into The 21st Century**"

Speaker: **Victor Hao Li** (U.S.), *Co-Chairman, Asia Pacific Consulting Group, Past President, East West Center, Honolulu*

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## Day 2: Saturday, March 25, 1995

Day Chair: **C.B. Sung** (U.S.), *Chairman, The 1990 Institute and Unison Group*

8:45 am Session IV: Regulation of Foreign Direct Investment - Foreign Exchange Controls

and Taxation

Chair: **Richard H. Holton** (U.S.), *Professor Emeritus, Walter A. Haas School of Business, University of California at Berkeley*

Speakers: **James V. Feinerman** (U.S.), *Executive Director, U.S. Committee of Scholarly Exchange with China, and Adjunct Professor of Law, Georgetown University, Washington, DC*

**Anna M. Han** (U.S.), *Associate Professor of Law, University of Santa Clara*

**Li Ling** (China), *Director, Foreign Investment Division, Department of Treaty and Law, Ministry of Foreign Trade and External Cooperation, Beijing*

10:45 am Session V: Chinese Foreign Business Law and the GATT

Chair: **Pitman B. Potter** (Canada), *Associate Professor of Law and Director, Chinese Legal Studies, University of British Columbia, Vancouver*

Speakers: **Donald C. Clarke** (U.S.), *Professor of Law, University of Washington, Seattle*

**James V. Feinerman** (U.S.), Executive Director, U. S. Committee of Scholarly Exchange with China and Adjunct Professor of Law, Georgetown University, Washington, DC

2:00 pm Roundtable Discussion: Past Progress and Future Challenges

Chair: **Jack H. Beebe** (U.S.), Senior Vice President and Director of Research, Federal Reserve Bank of San Francisco

Speakers: **Jerome A. Cohen** (U.S.), Partner, Paul, Weiss, Rifkind and Professor, New York University Law School

**Pitman B. Potter** (Canada), Associate Professor and Director, Chinese Legal Studies Program, University of British Columbia, Vancouver

**Samuel X. Zhang, Esq.** (Hong Kong), Deacons, in association with Graham & James

**Zhang Yuejiao** (China), Deputy Director General, Department of Treaty and Law, Ministry of Foreign Trade and External Cooperation

3:30 pm Conference Adjournment

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## **Appendix B:**

Beijing Conference Agenda

April 24-25, 1995

At The Western Return Scholars Association, Beijing

### **AN INTERNATIONAL CONFERENCE ON LAW AND CHINA'S EXTERNAL ECONOMIC RELATIONS**

- Trade Regulation and Administrative Structure
- Technology Transfer and Intellectual Property Protection
- Dispute Resolution Mechanism
- Financial Regulation of Foreign Direct Investment: Exchange Control and Taxation
- China's Foreign Business Law and the GATT and WTO

*This conference was co-sponsored by: The 1990 Institute (U.S.) - Western Returned Scholars Association (China) - Vision 2047 (Hong Kong)*

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#### **Day 1: Monday, April 24, 1995**

8:30 am Opening Remarks

**Lung Yungtu** (China), Assistant Minister, Ministry of Foreign Trade and External Cooperation

**Zhang Wei** (China), Vice President, Western Returned Scholars Association

**C. B. Sung** (U.S.), Chairman, The 1990 Institute

**Camille Tang Yeh**, Director, Vision 2047 (Hong Kong)

9:00 am Summary Presentation of The 1990 Institute Study

Speaker: **Pitman B. Potter** (Canada), Associate Professor of Law and Director, Chinese Legal Studies, University of British Columbia

9:30 am Report on the Results of the San Francisco Conference

Speaker: **Charles J. McClain** (U.S.), Professor of Law and Vice Chairman, Jurisprudence and Social Policy Program, Law School, University of California at Berkeley

10:15 am **Session I: Trade Regulation and Administrative Structure**

Chair: **Li Ling** (China), Director, Foreign Investment Division, Department of Treaty and Law, Ministry of Foreign Trade and External Cooperation

Speakers: **Sally A. Harpole** (Hong Kong), Deacon's

**Fung Datong** (China), Professor of International Economic Law, University of Economics and Trade, Beijing

**Wang Zuanli** (China), Chairman and Professor, Department of Law, University of Political Science and Law

2:00 pm **Session II: Technology Transfer and Intellectual Property Protection**

Chair: **Zheng Chengsi** (China), Deputy Director, Institute of Law, and Director, Center on Intellectual Property, Chinese Academy of Social Sciences, Beijing

Speakers: **Donald J. Lewis** (Hong Kong), Lecturer, Law Faculty, University of Hong Kong

**Shen Rengan** (China), Deputy Director, State Patent Bureau, Beijing

**Wu Zhengquan** (China), Deputy Director General, Department of Science and Technology, Ministry of Foreign Trade and External Cooperation, Beijing

3:30 pm **Session III: Dispute Resolution Mechanism**

Chair: **Zheng Dejun**, Secretary General, China International Economic and Trade Arbitration Commission (China)

Speakers: **Pitman B. Potter** (Canada), Associate Professor of Law and Director, Chinese Legal Studies, University of British Columbia, Vancouver

**Yao Zhuan**, Commissioner and Professor, China International Economic and Trade Arbitration Commission, Beijing

**Fei Zhongyi** (China), Member and Professor, Advisory Council, Supreme People's Court, Beijing

5:00 pm First Day Adjournment

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**Day 2: Tuesday, April 25, 1995**

8:30 am **Session IV: Financial Regulation of Foreign Direct Investment: Exchange Control and Taxation**

Chair: **Zhu Yixing** (China), Advisor, State Administration of Exchange Control, Beijing

Speakers: **James V. Feinerman** (U.S.), Executive Director, U.S. Committee of Scholarly Exchange with China, and Adjunct Professor of Law, Georgetown University, Washington, DC

**Donald J. Lewis** (Hong Kong), Lecturer, Law Faculty, University of Hong Kong

**Xu Bing** (China), Vice Chairman, State Administration of Exchange Control, Beijing

**Xu Shanda** (China), Director General, Department of Taxation Reform and Law, State Tax Bureau, Beijing

10:30 am **Session V: China's Foreign Business Law and the GATT/WTO**

Chair: **Zhu Lanye** (China), Vice Chairman, Department of International Law, Hua Dong College of Political Science and Law, Beijing

Speakers: **James V. Feinerman** (U.S.), Executive Director, U.S. Committee of Scholarly Exchange with China, and Adjunct Professor of Law, Georgetown University, Washington, DC

**Zhang Yuejiao** (China), Director General, Department of Treaty and Law, Ministry of Foreign Trade and External Cooperation, Beijing

**Li Zhongzhou** (China), Director General, Department of International Trade and Economic Affairs, Ministry of Foreign Trade and External Cooperation, Beijing

2:00 pm **Summary Conclusion: Past Progress and Future Challenge**

Chair: **Hang-Sheng Cheng** (U.S.), President, The 1990 Institute

Speakers: **Pitman B. Potter** (Canada), Associate Professor of Law and Director, Chinese Legal Studies, University of British Columbia, Vancouver

**Moses M. C. Cheng** (Hong Kong), P.C. Woo & Co, Hong Kong.

**Fei Zhongyi** (China), Member and Professor, Advisory Council, Supreme People's Court, Beijing

4:00 pm Conference Adjournment

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