

Output of Major Textile Materials in the Western Region (1999)

('000 tons)

	Cotton	Flax and Hemp	Silk Cocoon	Wool	Cashmere (ton)
Sichuan	76	13 (5)	81 (3)	4	41
Gansu	43	n.a	0.3	15	337
Xinjiang	1,354 (1)	n.a	3	65 (2)	849
Western Region Total	1,499	29	152	182	6,984
National Total	3,829	164	485	283	10,180

Note: Figures in () indicate ranking among all provinces in terms of output
 Source: China Statistical Yearbook 2000 & http://www.info.gov.hk/go_west/ebook

However, it has to be pointed out that similar to the production of minerals, processing agricultural products in the region is still underdeveloped. Although a large amount of fresh fruit and vegetables are ready for sale, about one-third of fresh fruits are either unable to make their way to market outside the region due to lack of highways and enough transportation vehicles or become rotten due to lack of proper packaging, storage and distributing facilities. Regarding textile industry, since processing industry is quite backward, good quality but raw textile materials produced by several provinces in the western region have to be transported to the eastern region for further processing.

In addition, animal husbandry in the western region is also under a low level of management. For example, not many villages have good housing and feeding facilities for livestock in winter. When natural hazards, especially the 'white hazard' (a snow cover is so thick that the livestock cannot feed on natural pastureland), as well as the 'black hazard' (too little snow, so that animals cannot get drinking water)¹², many animals die and the families that keep the animals in winter have to suffer a great loss.

Considering cheap manual labor, abundant natural resources, as well as favourable conditions offered by local governments in the western region, backward processing industry and animal husbandry in the region have in fact provided good opportunities for you to invest and make profit in the region.

1.2.3 Chinese Medicine Resources

China is a country with a long history of using medical herbs. People in China believe that proper diet and exercise, meditation and the careful

¹² Zhao Song-qiao "Geography of China" p. 259 John Wiley & Sons, Inc. 1994.

prescription of herbs can prevent disease, restore the body's proper balance and aid one in maintaining optimum health. In accordance with the report, Sichuan province has about 4,500 species of Chinese medicine materials, and medicinal plants found in Yunnan reach 6,559 species due to their unique climatic conditions. Yunnan Baiyao is one of the famous Chinese medicine.¹³ The total amount of medicine materials in these two provinces accounts for 51% of all the species found in China.¹⁴ There are also many famous medical herbs in other provinces in the western region. Among them Tianshan saussurea involucrata (snow lotus) and safflower (red flower) in Xinjiang, liquisticum, codonopsis pilosula and liquorice in Gansu province are the best. Other precious species that have excellent development potential include frillaria thunberga, cordyceps sinensis, Chinese lycium, rhizoma gastrodiae and eucommia ulmodies.¹⁵

Since the central government has started the campaign of 'going west', many large-scale pharmaceutical enterprises have been established in western China and various brands of Chinese medicine and health products have emerged in the local market. However, production scale of pharmaceutical enterprises in the western region is generally small with insufficient capital input. Moreover, the relatively weak economic foundation, limited export channels and the people's conservative attitude towards medicinal herbs have also weakened the research and development of traditional Chinese medicine in the region. For many years, Chinese medicinal herbs have been exported only to Southeast Asia in their raw form.

In order to improve production of Chinese medicinal herbs, local governments at all levels in the western region are currently placing great emphasis on them. For example, pharmaceutical parks in Shaanxi province are under construction in order to offer people more knowledge of Chinese medicine. Gansu provincial government has encouraged and offered preferential measures to local enterprises in producing Chinese medicine so that pharmaceutical industry in Guansu has now become pillar industry. In general, local pharmaceutical enterprises in western region are keen to seek foreign cooperation. A Hong Kong's Chinese medicine company has invested RMB 300 million to establish a research and production center for Chinese medicine at Chengdu's Longquan New and Hi Technology Zone, and a Macau company has made a commitment to develop a Chinese medicine park in Chengdu's Pixian.¹⁶

¹³ Baiyao is a kind of white medicinal powder for treating haemorrhages, wounds, bruises, etc.

¹⁴ For further information on 'Advantages of the Western Region' refer to http://www.info.gov.hk/go_west/ebook_3.htm

¹⁵ For further information on "Investment Opportunities in Western China" refer to <http://www.tdctrade.com/alert/chwest07c.htm>

¹⁶ For further information on 'Advantages of the Western Region' refer to http://www.info.gov.hk/go_west/ebook_3.htm

to help them solve problems in farming. Serious shortage of talented and experienced people in the western region in turn makes the economic development in the western region even worse, which eventually slow down the wheel of the whole country's economic development.

1.3.2 Local Protectionism

Furthermore, due to the difference between the eastern region and the western region in many areas, some local governments in the western region try hard to protect local enterprises by way of stopping products from the eastern region flooding into the western region. Local governments also refuse the enterprises from the eastern region to establish subsidiaries in the west in order to protect local enterprises from being defeated in market competition. This makes the confrontation between the enterprises in the eastern and western regions tense. Furthermore, under the shade of local governments' protection, the enterprises in the western region that are used to easy life without competition for a long time, prefer to continue the easy life. Therefore, they support the local governments' policies in local protectionism. This makes the gap between the enterprises in the eastern region and western region even wider.

1.3.3 Conflicts between Han and Minority Nationalities

China is a multi-nationality country with a total of 56 minority nationalities. Out of 1.3 billion people, most of them are Han nationality living in coastal and eastern areas and most of minorities are living in the central and western regions. About 20 minorities are living in the western border areas near to Afghanistan, Pakistan, Mongolia, Vietnam, Thailand and other countries. If the areas and regions where minorities are living are more backward than the eastern region, some separatists will take the opportunity to stir up the minorities against Han nationality. In recent years, some separatists encouraged the minorities in Xingjiang and Tibet to fight against the local governments and the central government in order to separate these two autonomous regions from the mainland China.

1.4 POLICIES OF DEVELOPING THE WESTERN REGION

In order to achieve balanced national economic growth and narrow the gap between the eastern and western regions, China has decided to focus on the

western region in its economic development. Several documents providing favourable measures to foreign investors have been published which include the Notice of "Several Policy Measures for Implementing Large-Scale Development of the Western Region"²¹ (hereafter referred to as "the Notice") made by the State Council on October 26th 2000. The following are the main points of these documents.

1.4.1 Key Tasks in the Immediate Future

The Notice states that large-scale development of the western region is a grand systematic program and a formidable historic mission. One of the key tasks in the immediate future is to spend five to ten years in development of infrastructure and the ecological environment of the western region. Considering the features of agriculture, industry and tourism in the western region, the Notice requires the local governments to adjust the development strategy among the above-mentioned three areas so as to consolidate the position of the agricultural base, make adjustments to the industrial structure and develop tourism with distinctive features. At the same time, the local governments in the western region are required to put effort in developing science and technology education and cultural and health undertakings.

1.4.2 Financial Support

In the following years, the central government plans to provide financial support to develop the western region. The financial support shall come from the state policy banks, preferential loans from international financial organizations and also from foreign governments. The loan provided by the governments shall be strictly used for projects in the western region with the condition that loans are made in accordance with lending principles. Major infrastructure projects newly arranged by the state shall be sponsored by the central government construction funds, other allocated construction funds, bank loans and also by foreign investment. The relevant departments at the central government level are required to provide full support to the western region when formulating industry development plans and policies and arranging for dedicated funds. In addition, both domestic and foreign enterprises are greatly encouraged to invest in major construction projects in the western region.

Banks are required to take priority in providing loans to large and medium-size energy resource projects such as power, petroleum, natural gas, railroad and main highway projects in the western region. Once the

²¹ For further information, refer to <http://www.chinalegalchange.com/subs/2001-01/devwest.htm>

materials and tools, engineering machinery, internal-combustion, industrial bearings, low-pressure electric equipment, precision optical instrument, industrial meter and instrument and precision machine tools for special use. Guiyang, capital of Guizhou province, is one of China's largest aluminum industrial bases, one of the five largest meter and instrument production bases, a major production base for grinding materials, grinding tools and cigarettes and one of the top ten electronic industrial cities in the western part of China.⁵³

Light and textile industries are also pillar industries in Guizhou, such as brand-named liquors, cigarettes and mineral waters, cotton, woolen, linen, silk, synthetic fiber, leather processing and paper making. Liquors and cigarettes produced in Guizhou are famous in national market.

1.5.5.2 Foreign Investment

By the end of 2001, a total of 1483 FIEs had been established in Guizhou province. The amount of capital invested by foreigners was up to US\$431.2 million. FIEs from Hong Kong, Canada, the US and Malaysia have played more and more important role in various industries. The projects that attracted foreign investment are mainly in the industries of raw materials, construction, mechanical and electronics, etc.

In coming years, foreigners are welcomed to invest in the following fields: infrastructure (15 projects), foodstuff & light industry (13), medical & health (5), environmental protection (4), agriculture, forestry, husbandry and fishery (1), apparel & textile (4), building materials (3), tourism & recreation (5) mechanical & engineering industry (23), business on property right (1) electronics & information (9), petroleum & chemical industry (4) metallurgy & mining industry (7) and others (2).

1.5.5.3 Projects Waiting for Foreign Investment

1. *Nayong power plant 4x300 mw newly project.* This is one of the projects for 'Transfer power from Guizhou to Guangdong' and it will be approved by State Development & Planning Committee soon. This is also one of the coal-fired power project for 'Transfer power from western to eastern region'. The total investment needed is US\$5100 million. The investment can be in the form of joint venture or sole ownership. The site of the project is Yangchang town, Na Yong county, Guizhou Province. Coal mine reserve in that area is 52.2 billion ton with high quality and low sulfur content.⁵⁴

53 Ibid.

54 For further information refer to http://www.chinamarket.com.cn/cgi-bin/Mival=Xibu_invest_item&Item_id=1

2. *The production line of 6,000 plastic food package bottle a year.* The total investment required is US\$550 million. Since the factory produces 'Haohuahong' Brand chili sauce series and the products are sold in more than 30 cities in China and have been introduced to the U.S. market, the project will be prosperous. The estimated annual output value will be RMB40 million and the estimated annual profit will be RMB8 million. The project can be in the form of joint venture or technology transfer. The factory is supplied with sufficient water and electricity and the transportation and communication are convenient.⁵⁵
3. *Guizhou five-star hotel.* Guiyang is the center of Guizhou province in politics, economy, culture, trade, tourism, transportation and communication. There are 35 star hotels but no five-star hotel or international conference center in Guiyang or Guizhou. Therefore, it is expected that profit rate of the investment is 12.06%. Loan maturity is 3.52 years (not including construction cycle). Foreign investment will be paid back within 8 years.⁵⁶

*Foreign investors are also welcomed to invest the following projects:*⁵⁷

1. Storage, fresh-keeping and processing of grains, vegetables, fruits, aquatic products and animal husbandry products.
2. Afforestation and introduction of fine species of trees.
3. Comprehensive utilisation of bamboo reserves.
4. Rational development, utilisation and conservation of water resources.
5. Construction and operation of roads, bridges and tunnels.
6. Development of coal processing technology and production of related products.
7. Technological renovation of titanium smelting and processing enterprises.
8. Exploitation of low-grade and difficult-to-dress-and-smelt gold ore.
9. Technological renovation of barium salt production enterprises.
10. Exploitation of phosphorus reserves; production of high-concentration phosphorus compound fertilisers and phosphoric chemicals.
11. Development and production of new types of electronic components and parts.
12. Production of Chinese medicinal herbs and decoction.
13. Development, construction and operation of tourist spots and supporting facilities.

55 Ibid.

56 Ibid.

57 For further information refer to <http://www.gzfdi.org/news/xxxw/0221094136.htm>

the sole municipality directly under the central government in the western region of China. 85% of the Three Gorges reservoir area, which is famous worldwide, is within Chongqing's administration. Chongqing is rich in natural resources, 40 kinds of minerals have been discovered in the region including coal, natural gas, strontium, iron sulfate, rock salt, alumine, mercury, manganese, benzene, marble, limestone, barite and etc. Chongqing is also one of China's regions that are rich in biological species. There are more than 2,000 species of plants in Chongqing, among them, 30 species are famous trees. Particularly famous ones are in Jingshan Mountain, i.e. white China fir, giant azalea tree, broad leaf tea and square bamboo shoot. Chongqing is also one of China's important bases for crude Chinese medicine. Output of many medical herbs such as Chinese gall, honeysuckle flower, magnolia bark, yellow-corktree bark and eucommia bark ranks the first in China.⁶⁵

1.5.7.1 Industries

Chongqing is a city with early development of modern industry and one of China's old industrial bases. Chongqing is one of the four major automobiles bases and one of the main military production bases in China. In recent years, production of automobiles and motorcycles have gained rapid development. Changan Automotive Corp and China Jialing Industrial Corporation Group (中国嘉陵工业集团) a joint venture between Japan's Honda and Jialing Motorcycle take important roles in the industry. By 2001, Chongqing has become the 'Motorcycle Capital' in China. Chongqing is also one of the 9 biggest iron & steel production centres and one of the 3 major aluminium production bases in China. It produces more than 120 kinds of steel products and 13,000 kinds of aluminium products. It is also one of the most important chemical and pharmaceutical production bases in China. Other major industries include textiles, machinery, electronics, building materials and food processing.⁶⁶

1.5.7.2 Foreign Investment

By the end of 1999, over 2743 foreign-funded enterprises had been set up. The foreign capital actually used was up to US\$2.476 billion. Investors from 40 countries and regions, such as USA, Japan, Singapore, Hong Kong, Taiwan, etc. have invested in the industries of automobile, machinery, light industry, food, electronics, instruments and meters, and real estate.⁶⁷

65 For further information refer to <http://www.cq.gov.cn/text/chongqing/cqije.htm>

66 For further information refer to <http://www.tdctrade.com/mktprof/china/mpgux.htm>

67 For further information refer to http://202.98.36.244/cqgov/base/foreign_econo/General_Aspect.htm

In 2000, Chongqing approved 190 foreign invested projects (+12.4%) with contracted foreign investment of US\$357.2 million (-29.5%). About 85% of the city's cumulative foreign invested projects are involved in the manufacturing area.⁶⁸ Many multinationals have set up their business in Chongqing such as Nokia, Ericsson, American Standard, Rockwell, Hongda, Suzuki, Yamaha, Hutchison Whampao, China Bank Group, Samsung etc. Hong Kong is the largest source of investment. In 1999 alone, Hong Kong signed 59 investment contracts with US\$250 million. Other major investors are from Japan, the US, Taiwan, South Korea and Thailand.⁶⁹

Priority areas for foreign investment in the coming years will be on the modernization of old enterprises and hi-technology industries. The other areas that welcome foreign investment are infrastructure development, finance, tourism, education and land development.

1.5.7.3 Projects Waiting for Foreign Investment⁷⁰

1. *Infrastructure facilities* – Road, bridges, railways, power stations, water conservancy projects and such large infrastructure facilities. City construction, gas, water & heating supply real estate development, sewage treatment plants environmental protection, and such urban infrastructure facilities.
2. *Resource development projects* – Projects engaged in the mining and exploitation of coal, petroleum, natural gas, metal and nonmetal resources with their synthetical utilization, deep-processing projects, and the material production are encouraged.
3. *Agricultural projects* – The development of high quality grain, cotton, oil-bearing crops, vegetables, fruits, fresh-keeping & deep-processing projects. Spreading and adopting new technology projects shall be the subject of the foreign investment as well as the introduction of fine varieties of animals, poultry and fishes, the breeding and culture, the processing and other agricultural projects for export.
4. Industrial projects with foreign investment in the state-owned enterprises in the form of technological grafting and innovation to enhance technological level and production capacity and competence for export shall invite foreign investment particularly in the field of machinery, metallurgy, electronics, instrumentation, light industry, textiles, food-processing, chemical and building materials.
5. Foreign investment shall be invited for upgrading the tourist equipment and facilities, for development of tourist products and in the establishment of recreational facilities authorized by the State.

68 Ibid

69 Ibid.

70 For further information refer to http://202.98.36.244/cqgov/base/foreign_econo/Key_Proj.htm

1.5.10 Brief Introduction of Tibet Autonomous Region

Tibet is situated in the southwest of China. Its neighbour provinces are Xinjiang Uygur Autonomous region (新疆维吾尔自治区), the province of Qinghai (青海省) in the north, Sichuan (四川省) in the east, Yunnan (云南省) in the southeast. Its neighbour countries and regions are Myanmar, India, Burma, and Nepal in the south and west. Tibet has a long international border of nearly 4,000 km. The capital of Tibet is Lhasa (拉萨). Tibet is the largest resident place in China where 96% of Tibetan (藏族) live. Other groups are Han (汉族), Hui, (回族) Mongolian (蒙古族), Monga (门巴), Lhoba (珞巴), etc.

People call Tibet 'roof of the world' because it situates 4,000 meters above sea level and forms the main part of the Qinghai Plateau (青海高原). The Himalayas, ranging from east to west on the southern edge of the Tibet Plateau, run for 2,400 kilometers with an elevation of more than 6,000 meters. Moun Qomolangma is the world's highest peak with an elevation of 8848.13 meters. The Yarlungzangbo gorge at a depth of 5,382 meters, is the world's deepest gorge.⁸¹

Due to its unique geographic location, Tibet is rich in water, geothermal, solar and wind energy. It produces approximately 200 million kilowatts of natural hydro-energy annually, about 30% of the nation's total. It has 354.8 billion cubic meters of surface water resources, occupies 13.5 of the nation's total. Tibet also has 330 billion cubic meters of glacial water resources and 56.59 million kilowatts exploitable hydro-energy resources, which is about 15% of the nation's total. Tibet is also rich in geothermal energy. The Yangbajain geothermal field in Damxung County, Lhasa, is China's largest high temperature steam geothermal field, and also one of the largest geothermal fields in the world. Tibet is also rich in mineral resources such as chromium, borax, iron, lithium, gold, copper, gypsum, etc.⁸²

Tibet has more than 5,000 species of high-grade plants. It is also one of China's largest forest areas, preserving intact primeval forests. Almost all the main plant species from the tropical to the frigid zones of the northern hemisphere can be found in Tibet. There are 142 species of mammals in Tibet. The region's main crops include highland barley, wheat, broad beans, peas and rapeseed. Tibet is also famous for some Chinese medicine herbs such as fritillary bulb and fungus.⁸³

81 For further information refer to <http://www.china.org.cn/e-xibu/2JI/3JI/xizang/xizang-ban.htm>

82 Ibid.

83 Ibid.

1.5.10.1 Industries

In 2000, Tibet's industrial output reached RMB1.8 (+10%) billion and its industries are mainly located in Lhasa (拉萨), Nyingchi (林芝), Shannan (山南) and Xigaze (日喀则). Tibet has more than 500 industrial enterprises mainly producing foodstuffs, energy, timber processing, mineral, textiles and light industries. Famous products from Tibet are mineral water (西藏矿泉水), Lhasa Beers, Chinese and Tibetan medicinal herbs, carpet, etc.⁸⁴

Inconvenient transportation and communication once restricted Tibet's reform and opening. Over the last 20 years, the local government has improved road conditions through a focus on the Sichuan-Tibet highway, the Qinghai-Tibet Highway and China-Nepal Highway. Konggar Airport was expanded with domestic flights from Lhasa to Chengdu, Beijing, Xi'an and other cities, as well as international flights to Nepal.

1.5.10.2 Foreign Investment

At the end of 1998, 74 foreign-invested enterprises were established in Tibet. Foreign investors mainly came from the US, Japan, Germany, Malaysia, Nepal, Macao and Hong Kong. FIEs are mainly engaged in electrical & machinery, service industry, environmental protection, transportation and food processing. In recent years, Tibet has also gained some financial aid from international organizations. For example, UNDP has provided US\$4 million for the construction of the Yangbajain geothermal power plant. UN's WFP provided financial aid for comprehensive agricultural development projects in order to improve irrigation conditions in the four counties of the Lhasa River valley, all of which has already been used. The UNICEF provided US\$3.22 million in aid for ten projects including health centers for women and children.

In order to improve its infrastructure, in 2003, Tibet has earmarked more funds for communications and energy resources items. As a result, the total investment in this sector will reach RMB6 billion⁸⁵

1.5.10.3 Projects Waiting for Foreign Investment

The Tibet government has announced that except for the proclaimed prohibition in the laws and regulations, investors can not only invest freely and operate freely in Tibet, but also there is no limitation and restriction in terms of fields of investment, percentage of share holders and pattern of investment and business categories.

84 For further information refer to <http://www.tdctrade.com/mktprof/china/mpitib.htm>

85 For further information refer to http://www.tibetinfo.com.cn/english/market/status/sta_07.htm

government officers at the said level received and enjoyed. Therefore, administrative rank meant a great deal to SOEs. If an SOE was promoted to a level equivalent to an administrative department at provincial and ministry level, the central government would provide more support to the SOE in finance, raw material and manpower supply. The directors of the same SOE would also personally benefit from the privileges provided only to the government officers at the same level.⁸ That was one of the important reasons that all SOEs were keen to be upgraded their administrative ranks.

In accordance with 'Working Regulation on State Owned Enterprises'⁹, SOEs had to be responsible to the central or local government departments in five aspects under the centrally planned system. Firstly, SOEs were required to guarantee the products manufactured to reach the mandatory quality and quantity standard. Secondly, SOEs were required not to increase workers' salaries at their own wish, the total amount of the workers and staff's salaries in a SOE were controlled within the limit permitted by the central or local governments. Thirdly, SOEs were required to fulfil the production cost plan, which meant that the production cost should be controlled within the limit that the government permitted and SOEs were expected to further reduce the production cost. Fourthly, SOEs were required to reach the pre-fixed profit target and fifthly, SOEs should guarantee that their main equipment and machines to be maintained in good order within the use period.

On the other hand, the relevant government departments were also required to be responsible to SOEs in five aspects: Firstly, SOEs' production plan and scale should be designed and confirmed by the government in time. Secondly, total number of staff and workers in a SOE should be fixed on basis of the SOE's real situation and necessity. Thirdly, the main raw materials, fuel, energy, machines and tools that could directly affect SOEs' production should be allocated and guaranteed. Fourthly, SOEs' fixed capital and floating capital should be arranged and guaranteed. Fifthly, SOEs' coordinate enterprises should also be arranged.

8 If a large size SOE was upgraded to a provincial and ministry level, the director of the SOE was entitled to have an equivalent treatment as a government officer at the same level had such as a government- subsidised bigger house, better salary, cars and free medical treatment etc.

9 "Working Regulation on State Owned Industrial Enterprises" promulgated by the State Council in 1965 was the most important regulation governing SOEs before the economic reform. In the 'Working Regulation', more effort was put on the stipulation of the Party's absolute leadership [article 6-9] in SOEs. Regarding to discipline of cadres in SOEs, the 'Working Condition' emphasised the policy of criticism and self-criticism. It meant that directors in SOEs should and could restrain themselves against corruption and temptation. Principally, a cadre in SOE should be severely criticised but leniently punished. [article 59]. Li Dun (chief editor) "Working Regulation for State Owned Industrial Enterprises" [The Road to the Modern Enterprise System in China]. pp. 381-391 International Cultural Publishing Company 1996.

Since the central or local governments supported SOEs in every aspect, SOEs therefore should also share the responsibilities with the government in every possible way. For example, local SOEs were instructed to give priority to recruiting retired soldiers as a political task even if such a work force was not required.¹⁰ Local governments, as city administrators, were supposed to be responsible for management of the social welfare system in cities, for example, hospitals, schools, housing and allocation of pension fund for retired workers and staff. However, SOEs, especially the large ones in cities were required to set up these facilities¹¹ inside the enterprises in order to share the responsibilities with the local governments.

Furthermore, in order to ensure workers in SOEs have confidence in the centrally planned system, they were told that it was the socialist system that provided them all the welfare facilities inside the enterprises so that their working places were as comfortable as their homes. Therefore, they were expected to work hard as masters of the SOEs and masters of the whole country. The workers were brain-washed that only when the national economy had been greatly developed and the country became powerful because of their hard work, the workers in SOEs would be able to receive better salaries and enjoy better welfare facilities provided by the state.¹² Although the 'master' theory was designed beautifully, it was not practical. The workers eventually found out that their salaries did not reflect their hard work, which made them frustrated.

2.2.2 The Government and SOEs : Mother-in-Law and Daughters-in-Law

Under the centrally planned system, the relationship between SOEs and the government was very close. People used to say that the government acted like mother-in-law to SOEs and SOEs, daughters-in-law. SOEs had to work hard to please their mother-in-law in order to survive in markets. According to Chinese culture, a mother-in-law is different from a mother. A mother loves her children without any condition. While, a mother-in-law normally loves her daughter-in-law with condition as compared to a real mother. The condition is that a daughter-in-law must obey her mother-in-law.

10 Gao Shang-quan "Innovation of China's Economic System - From the Planning Economy to the Socialist Market Economy" p.6 People's Publisher 1993.

11 Most of large size SOEs had all kinds of welfare facilities. The chemical factory where the author of this book used to work, had a school, a kindergarten, several canteens, a library, dormitories, a hospital and a cinema. Once a director of a large size SOE described his job as important as the job of a major. He said that in the SOE, he had to manage not only the production but also all kinds of welfare facilities. The only job he was not required to do, he joked, was to manage a cemetery.

12 Zong Han "Analysis of China's Ownership Structure" pp. 84-85 Red Flag Publisher 1996.

late 1970s; at that time it urgently needed foreign currencies. Article five talks about the types of foreign investment. Each party of an equity joint venture may contribute cash, capital goods and industrial property rights as its investment in the venture. The details of foreign investment shall be discussed in Chapter Five.

Article six describes management structure of a joint venture. As the EJV Law was promulgated in 1979, the legislators at that time still held a quite conservative attitude towards a JV's management. The EJV Law requires the chairman of the board of directors to be a Chinese and a foreign partner could only be a vice chairman in a JV. The purpose of setting such arrangement is to ensure Chinese control of a joint venture. The amendment of the EJV Law in 2001 removed this rigid requirement and both Chinese and foreign partner can be the chairman of the board of directors as long as such an arrangement is suitable to a joint venture.

Article seven is about profit distribution. The net profit of an equity joint venture shall be distributed among the parties to the venture in accordance with the each party's contribution in the registered capital. Article eight is the requirement of foreign currency control. In early 1980s, it was preferable for all joint ventures to balance their own foreign exchange receipts and expenditure in order to remit profit abroad. If a JV had to import raw materials by using foreign currencies, it was better for the same JV to export its products for the sake of keeping balance of its foreign exchange. The Chinese government had no sufficient foreign currencies to support all joint ventures in early 1980s. With the further opening of China market, this requirement is becoming more and more relaxed. The amended EJV Law has changed this requirement, which shall be discussed later.

Article nine requires EJVs to give priority to Chinese sources when purchasing raw and semi-processed materials, fuels, auxiliary equipment, etc. The reason has been mentioned in the above. The Chinese government in late 1970s and early 1980s was not capable of providing sufficient foreign currency support to all joint ventures in importing raw materials. As this requirement is not compatible with TRIMs, one of WTO regulations, it was amended in 2001. Article ten and eleven are the requirement of remittance. Foreign investors are permitted to remit their profit as well as their wages, salaries or other legitimate income abroad after payment of the personal income tax in accordance with the foreign exchange regulations.

Article twelve regulates a joint venture's term. If a joint venture wants to extend its operation period, the venture may apply to the government examining and approving authority for permission six months before the expiration of the operation period. Article thirteen regulates a joint venture's termination. If a joint venture needs to be closed down due to certain reasons, the venture needs to apply to the government examining and approving authority for permission and also register the termination with the State's competent Department of Industry and Commerce Administration. Article fourteen guides joint ventures to settle their disputes.

3.4 THE AMENDMENT TO THE EJV LAW

3.4.1 Removal of Production and Operation Plan Filing Requirement

The EJV Law (1979) required all joint ventures to submit their production and operation plans to the department-in-charge for the record. The amended EJV Law removed this requirement for the reason that this provision was only compatible with the central planned economy system. Twenty years later, it is not necessary for the government to interfere with joint ventures' production or business operation. It is therefore not necessary for EJVs to submit their production and operation plans to the relevant governments for filing.

3.4.2 No More Priority for Domestic Products when Raw Materials are Purchased

Before the amendment, the EJV Law (1979) required all FIEs to give priority to the Chinese market when purchasing supplies for the purpose of balancing their foreign exchange receipts and expenditures. This requirement is made on the basis of circumstances at that time. As mentioned above, giving priority for domestic products is an effective method to keep the balance of foreign exchange expenditure and receipts. Now the situation is quite different from the time twenty years ago, it is therefore unnecessary to maintain the balance of foreign exchange, it is therefore not necessary to give priority for domestic products. Based on the amended EJV Law, FIEs shall enjoy autonomy in purchase and sale like other types of enterprises in China.

3.4.3 Protection of Workers' Interests in EJVs

Article 6(4) of the EJV Law (1979) requires that procedures concerning the employment and discharge of the workers and staff members of an EJV shall be stipulated according to the law in the agreement or contract concluded between the parties to the venture. The amended article 6(4) further emphasises that not only the matters relating to workers and staff members' employment and dismissal but also the matters relating to remuneration, welfare, labour protection, labour insurance and so on shall be stipulated in contract according to law. The amended EJV Law also adds one more article for the same purpose³. All EJVs are required to establish

³ Article 7 of the EJV Law (2001).

may not be converted into shares or calculated into the currency used for registered capital but shall be recorded in the joint venture contract. In a CJV, a foreign partner normally contributes cash, machines and equipment or advanced technology and a Chinese partner contributes other form of investment. Both parties shall clarify their rights and responsibilities based on the contract and share profits and losses also in accordance with the contract.

3.6.2.2 *Type of investment*

If both foreign and Chinese partners prefer to establish an EJV, their investment such as cash, materials, industrial properties and land use rights should be evaluated and converted into a certain currency and calculated into shares. Once the investment is converted, it belongs to a newly established company. While if a CJV is established, both parties may contribute not only cash and materials but also services, business reputation and technology consultancy. These contributions may not necessarily be converted into shares. As far as the ownership of these assets are concerned, they can belong to a newly established company if both parties agree, or the ownership of the assets may still remain in the hands of the two parties and the company only has the right to use these assets. Regarding withdrawal of investment in a CJV, normally both parties may pull out their investment when the company is wound up. It is also possible that a foreign party may withdraw its capital before termination of the CJV in accordance with the law and the settlement in the joint venture contract.

3.6.2.3 *Management structure*

If an EJV is set up, the EJV is a Chinese legal person. The board of directors of the EJV shall have the highest authority in management of the company and the general manager is responsible to execute decisions made by the board of directors. If a CJV is established, taking a form of Chinese legal person or not depends on both parties' decision. If a legal person CJV is set up, a board of directors or a joint management committee in the CJV should have the highest authority in management. While if a non-legal person CJV is established, a joint management committee is responsible for the CJV's management. The difference in management between an EJV and a CJV is discussed in Chapter Seven of this book, therefore will not be repeated here.

3.6.2.4 *Profit distribution*

As mentioned above, in an EJV, both parties share profit in accordance with their shareholding, while distribution of profit among parties in a CJV

is based on negotiation among the parties. Since foreign partner of a CJV normally contributes cash, in practice, the CJV prefers to pay back the foreign partner's investment as soon as possible. In certain areas, a foreign partner of a CJV receives 20% to 30% profit plus the percentage of its investment regularly.

For example, in 1992, More Company in Brazil, Shanghai Bingjiang Trading Company and Shanghai Jiahua Clothing Company joined together to establish a CJV. The total investment was RMB700,000. More Company from Brazil contributed machines which was equivalent to RMB400,000. Bingjiang invested RMB200,000 cash and Jiahua provided technology equivalent to RMB100,000. The profit distribution agreement among the three parties was that 10% profit was kept by the CJV as reserve. The rest 90% profit was distributed among the three partners. More Company from Brazil received 30% as return of its investment. The rest 60% profit was further divided into three parts; More Company received 35%, Bingjiang 45% and Jiahua 20%. The arrangement of responsibilities among the three partners was that More 45%, Bingjiang 45% and Jiahua 20%.¹³ From the above profit and liabilities arrangement, it is clear to see that one of the major reasons that foreign investors prefer to establish a CJV is because foreign investors may pull out their investment before the CJV is wound up. In other words, a foreign investor can make a quick profit by investing in a CJV.

3.6.2.5 *Handling assets after termination of a joint venture*

If an EJV is going to be terminated, a liquidation committee is established to handle the remaining assets or debts of the venture. The parties to the EJV should receive the assets according to their shareholding. If a Chinese partner wants to take over the joint venture, a foreign partner is expected to be paid more since the foreign investor is entitled to pull out its investment when the venture is wound up. When a CJV is going to be terminated, as a foreign partner has already received his investment as well as his profit before the termination, the Chinese partner shall naturally keep all fixed assets after the termination without paying foreign partner extra capital.

¹³ Jin Qi, Tian Chuan 'A CJV Should Take Some Measures to Prevent Foreign Investors from Withdrawing Investment' pp. 313-319 *Case Study of Typical Foreign-Related Economy Cases* p. Legal Publishing House 1999.

of an approval certificate, joint venture registration. At each of these stages, there are laws and regulations you need to follow.

This chapter first acquaints you with the sources and channels for head hunting a suitable partner. Secondly, it lays out the Chinese policies regarding projects where foreign investments are encouraged as well as restricted. Next, it guides you into drafting your investment proposal and feasibility study report. Since a joint venture contract and articles of association are both very important documents, they may influence the government's examining and approving authority's decision, therefore, the relevant provisions in EJV Law, CJV Law and WFOE Law that guide you in drafting these two documents are introduced and discussed. This chapter also introduces the latest amendments to the relevant laws and regulations.

4.2 FINDING A CHINESE PARTNER

Finding a suitable Chinese partner is one of the most important steps for making profit in China. In the previous two chapters, Chinese state-owned enterprises [SOEs] and the companies transformed from SOEs have been introduced and discussed from the perspective of your potential Chinese partners. With reference to these chapters, you may have an idea how to choose a proper Chinese partner following the four available channels, in accordance with your requirements.

The first way to find your Chinese partner is through the government's channel. You may get information of the areas that need foreign investment and learn about potential Chinese partners through the News Bulletin released regularly by the central Chinese government. The Ministry of Foreign Economic Relations and Trade [MOFERT] regularly announce projects that are appropriate for foreign investment. Provincial and municipal governments also regularly broadcast projects that seek foreign investment. If you are interested in a particular project, you can contact the relevant government department for further information and ask to be introduced to a potential Chinese partner. You may also know your Chinese partner through different conferences or seminars organized by the central or local governments for the purpose of inviting foreign investment.

The second source is through an intermediary. If you want to contact a Chinese partner, you may contact the China's International Trust and Investment Company and also local trust and investment companies. These companies are organizations specialized in assisting foreign investment. One of their jobs is to provide a communication channel to introduce both foreign and Chinese companies interested in establishing a joint venture.

The third way to find your Chinese partner is to attend trade fairs. Twice a year, the Chinese government organizes national trade fairs in Guangzhou City, which is called 'Chinese Export Commodities Fair' (Canton

Fair).¹ In the fair, many Chinese companies exhibit their products and seek out potential interested parties; you can directly approach them for further information. For example, 'in the last five years, the Canton Fair has led to exports worth an average of US\$23 billion each year, representing one-third of mainland China's annual general trade'.² In addition, all provinces and major cities in China also organize different trade fairs regularly. Taking Zhejiang province as an example, in 2001, seven different trade fairs were organized by the local government. They are 'International Hotel Equipment Exhibition Zhejiang'; '2001 the Third China - Zhejiang Automotive Fair'; 'the 2nd China Hangzhou International Gifts & Toys Fair' etc.³

The fourth medium for obtaining necessary information to find a suitable Chinese partner is to approach local Chinese Embassies and Consulates. Foreign Chinese Missions are obliged to help foreign investors in finding a suitable Chinese partner in China.

4.3 ENCOURAGED, PERMITTED, RESTRICTED AND PROHIBITED FOREIGN INVESTMENT PROJECTS

Generally speaking, all foreign investment projects are divided into four categories namely, encouraged, permitted, restricted or prohibited projects in accordance with 'Interim Provisions on Guidance for Foreign Investment' (hereinafter referred to as "Guidance"), which is jointly promulgated by the State Planning Commission, the State Economic and Trade Commission (SPC) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in June 1995. The 'Guidance' was amended in 2002. The main change is that 'Permitted' foreign invested projects are no longer listed in

- 1 Canton Fair is China's largest international trade fair. It is organized by the Chinese government twice a year: Spring Fair is held in April 15-26 and Autumn Fair in October 15 - 26. The first Fair was staged in the former Sino-Soviet Friendship Building in the spring of 1957. Many Chinese enterprises go to the Fair armed with their novel products, crack items, etc. in order to squeeze their way into the world market via the Guangzhou Trade Fair. In the early days of the Guangzhou Fair, quests came from few countries and regions in Asia. As the Fair developed and as the country becomes more open, an increasing number of foreign business people from various countries and regions have secured business at the Guangzhou Trade Fair. In recent years, more than 80,000 foreign business people have visited each session of the Fair. Till the end of the 83rd Session, the Fair has seen an attendance of more than 2 million businessmen. 2002 Canton Fair Guangzhou China 4 July 2002 <http://www.chinadiscount.com/cantonfair/history.html>
- 2 <http://www.globalsources.com/tradeshw/cantonfairfall/showreview.htm> 2003-2-22
- 3 China Fair & Exhibitions 2001 11 July 2002 <http://www.ccpit.org/engVersion/cp_exhi/hangzhou.html>

partner's identity or an authorized document that describes a legal representative of a Chinese company and his ability to sign the contract. The reason for you to request for this kind of document from your Chinese partner is for the purpose of security. It is possible that some Chinese enterprises or companies are not real legal persons but branches of their parent companies. They may not be able to make an independent decision without asking permission from their parent companies. At the same time, you also need to show your identity and the authorization certificate to your Chinese partner before signing the contract. Mutual trust is the foundation of cooperation.

As mentioned above, once the government examining and approving authority approves a joint venture contract, amendment to the contract without approval from the original government authority is not permitted. Therefore, both you and your Chinese partner have to consider drafting a joint venture contract as a serious matter. Two case studies are attached. One case shows you the consequence of amending the contract without permission and the second case shows you the result of breaching a joint venture contract.

4.5.3.3 Case Study One

A joint venture's board of directors has no right to amend the joint venture contract.²⁴

Facts

On the 3rd of March 1992, a Chinese party (Party A) and a foreign party (Party B) signed an agreement to set up an equity joint venture enterprise. It was agreed that:

- (1) Both parties invest and establish a Sino-Japanese trading centre ('the centre'). The total capital input of 'the centre' is US\$12 million, and its registered capital is US\$6 million. Both Party A and Party B invest US\$3 million and both parties needed to subscribe its registered capital before 31st December 1993. If any party subscribes the capital after the deadline, the breaching party needs to pay 0.03% per day as penalty.
- (2) Party A is responsible for the construction and decoration work of 'the centre'. There are other matters concerning the joint venture enterprise prescribed in the contract.

After they signed the contract, there was a change in the exchange rate of US dollar to RMB. Both parties therefore signed an amendment contract in Shenzhen on 3rd October 1992. The amendment was regarding the

²⁴ Jin Qi & Tian Bin-chuang "Typical Foreign-related Economic Case Studies" pp. 283-288. Legal Publishing House 1996.

expansion of the building as a centre from comprising 14 floors to 20 floors. Party A should therefore invest capital by using the new exchange rate of US dollars instead of RMB. The deadline of capital subscription to Party B was postponed to 1st May 1993. At the time of making the amendment to the contract, both parties had orally agreed that Party A should be responsible for the confirmation of the loan of US\$6 million. On 20th November 1992, the relevant government department approved their equity joint venture contract as well as their amendment to the contract.

On 28th November 1992, the parties called their first Board meeting. In the meeting a resolution was passed which confirmed that if Party A could not find an enterprise or an organization to guarantee the loan of US\$6 million borrowed by Party A before 1st May 1993, Party B should not bear the liability of injecting the promised amount of capital before the deadline prescribed in the amendment to the contract.

After the government's approval of the contract as well as the amendment to the contract, Party A had injected US\$3 million as promised in accordance with the amendment to the contract on December 3rd 1992. Party A also obtained a loan guarantee and faxed a copy of the guarantee issued by the local government planning department to Party B on March 4th 1993. However, Party B claimed that the loan guarantee did not comply with "Provisional Administrative Measures on Securities Given to Foreign Parties by Domestic Institutions" promulgated in February 1987. They requested Party A to get a new guarantee and decided not to inject any additional capital at this stage.

In November 1993, the construction work of the centre was completed. Party B had not injected a single penny. The delay of capital injection from Party B caused Party A to suffer substantial loss in December 1993.

On the 4th of February 1994, in accordance with the arbitration clause in the joint venture contract, Party A submitted an application to the Branch of China Trade Promotion Committee for Arbitration.

The applicant (Party A) claimed that they had carried out all the responsibilities prescribed in the contract. However, they suffered great loss because of the delay in capital injection from Party B, which amounted to US\$12 million. Party A requested for compensation from Party B.

Party B however claimed that it was Party A, that failed to find an enterprise or an organization to guarantee a loan of US\$6 million in accordance with the resolution passed in the Board meeting. Party B did not inject any capital because Party A breached the contract first. Party A should therefore bear any resulting liability.

The decision made by the arbitration tribunal

- (1) The joint venture contract and the amendment to the contract are signed in accordance with the law in China, and thus they are valid and legal.
- (2) The resolution passed in the first Board meeting of the Centre is null and void. Since the resolution is actually an amendment to the joint

you plan to assign all or part of your investment to a third party, your partner has pre-emptive rights. In addition, when assigning your shares in the joint venture to a third party, the terms of assignment shall not be more favourable than the terms you offer to your partner. If you violate the above stipulation when transferring your investment, the assignment shall be ineffective.

You may ask, what if you plan to assign your assets rather than your capital in a JV to a third person, and whether the procedure will be similar to that of assigning capital. In fact, so far the three important laws regulating FIEs such as the EJV Law, CJV Law and WFOE Law has no clear instructions for transferring property ownership or the right to use of property as a non-monetary investment contributed to FIEs. However, China's Company Law has clear requirements in this respect. 'Where a shareholder makes its capital contribution in the form of material objects, industrial property rights, non-patented technology or land-use right, the transfer procedures for the property rights shall be handled in accordance with the law.'²⁷ The reason for mentioning this is because sometimes, investors contribute material objects to a joint venture but ignore the procedure of transferring the property ownership to the joint venture. When disputes arise among joint venture partners, the party that has not transferred the property ownership is normally in an unfortunate position.

For example, a company in Hong Kong signed a joint venture contract with two companies in Mainland China for business of producing packaging. In accordance with the contract, the company from Hong Kong invested US\$800,000 and one of the two companies from China contributed RMB1.6 million and the other offered workshop buildings, machines and equipment as its investment. Afterwards, a dispute broke out among the three and they failed to solve their dispute among themselves. Eventually they applied to an arbitration commission for a settlement. After investigation, the arbitration commission found out that although one of the two Chinese companies delivered the relevant workshop buildings, machines and equipment as investment to the EJV, the company did not transfer the ownership of these assets to the EJV in line with relevant regulations. As the ownership of these assets had not been transferred, the company could not be regarded as having fulfilled its obligations of making investment according to the arbitration commission.²⁸

It can be clearly seen from the above case that although the company from mainland China had contributed workshop buildings, machines, equipment as investment, it does not necessarily mean that the company have completed its investment. The proper procedure is that when you deliver machines and equipment or other assets as investment to a joint

27 Art. 25 of China's Company Law.

28 Yao Xiao-ming 'Legal Issues Notable by Chinese, Foreign Investors in Making Investment with Contribution in Kind, Industrial Property Rights, Technological Know-How or Land-Use Right' p. 93 China Law, August 2000.

venture, you need to go through the formalities of re-registering and changing the ownership of the property. Only when you have gone through all these formalities, you are considered as having completed your investment.

5.6.3 Case Study Two²⁹

One party assigns shares, the other party to the JV has the pre-emptive right.

Facts

A Chinese company (Party A) in Fujian province and a Hong Kong company (Party B) joined together to build a restaurant in 1980. The total investment capital is RMB1.5 million. Party B had 50% controlling shares. At the end of 1981, Party B (Hong Kong company) was bankrupted. In order to pay its debts in Hong Kong, Party B intended to transfer its shares to Party A. Party B offered its 50% shares for the price of RMB1 million. Party A rejected its offer considering the price was too high. Later, Party B approached another Chinese company offering its 50% shares. After several rounds of bargain, the two parties reached an agreement that the price of the 50% controlling shares would be RMB750,000.00. No additional conditions were affixed. The two parties then drafted a share transfer agreement and submitted it to the relevant government department.

When Party A found out about the share transfer, they thought that Party B had no right to transfer its shares to a third party for such a low price. Party A therefore contacted Party B and the third party, requesting Party B to cancel the share transfer agreement and transfer the 50% shares back to Party A with the same price that Party B had offered to the third party.

Party B explained that before Party B decided to transfer the shares to a third party, it had offered the same amount of shares to Party A. Only after Party A had rejected the offer, Party B started looking for a third party. Therefore, what Party A requested was unreasonable and could not be accepted.

Analysis

This case reveals a dispute of share transfer within a limited liability company. It involved a number of legal issues.

Firstly, according to China's Company Law, a limited liability company can reduce its registered capital but shareholders cannot withdraw their

29 "One Party Transfers Its Property, the Other Existing Party in the Company Should Be Offered First" pp. 59-60 *Case Study of Company Law* Hunan People's Publisher 1997.

assets assessment institution in the form of joint venture, the procedure of applying for setting up such an institution as well as relevant information of a foreign asset assessment.

6.2 CASH INVESTMENT

One of the popular ways to invest in a company is to contribute cash, either RMB or foreign currencies. Normally the amount of RMB or foreign currencies you and your Chinese partner plan to contribute shall be written in a joint venture contract. Some clauses relating to cash investment are put in the contract for example, total amount of investment and registered capital, the deadline of the capital injection and also the punishment imposed on a party in breach of contract.

It is suggested that you pay attention to the two things when you decide to contribute cash as your investment. One is currency exchange. If you plan to contribute a foreign currency, the said currency shall be converted into RMB or cross-converted into agreed foreign currency according to the Base Exchange rate as published by the People's Bank of China on the date of payment.¹ This article has in fact been amended. Previous *'Implementing Regulation for the EJV Law'* required a JV to convert RMB or vice versa according to the exchange rate quoted by the State Administration of Foreign Exchange Control of the PRC on the day of its submission. In accordance with the amended *'Implementing Regulations for the EJV Law'* a JV is now required to follow the exchange rate quoted by the People's Bank of China.

Second thing is ownership of cash investment. The capital invested by you or your Chinese partner must be your own capital, which has been discussed in Chapter Five. It is strictly forbidden for any partner to a joint venture to use a loan obtained in the name of the joint venture as its investment or use a joint venture's interest and property to guarantee one party's investment.

6.3 MATERIAL INVESTMENT

Material investment refers to investment of buildings, factory premises, equipment and machines or other materials. Normally, a foreign partner prefers to contribute cash, machines, equipment and advanced technology. A Chinese partner can also contribute land use right other than what a foreign investor contributes. The important thing is to prepare the relevant

1 Art. 23 of *'Implementing Regulations for EJV Law'* amended in 2001.

documents of the materials you are willing to contribute such as the mode and technology data and detailed description of the machine's advanced features.

In accordance with 1979's *'EJV Law'*, the technology or equipment contributed by a foreign party must be truly advanced and appropriate to China's needs.² It means that the machines and equipment contributed by a foreigner should be advanced to a certain degree that Chinese factory is incapable of producing, or even if the Chinese has the ability to produce, the cost will be higher than that in an international market or the quality of the machine is not up to the standard. Therefore, the Chinese partner welcomes its foreign partner contributing such kind of advanced machines. In addition, the price of the machines contributed by foreign partner should not be higher than the price of the same machine in an international market.

The *'Implementing Regulations for the EJV Law'* amended in 2001 has cancelled the following two requirements. One is 'they are indispensable to the production of the joint venture'. The other is 'China is unable to manufacture them or can manufacture them only at too high a price or their technical performance and time of availability cannot meet the requirement'. The reason for the cancellation is that it is not consistent with the WTO rules. Based on one of the WTO rules *'Agreement on Trade-Related Investment Measures'* (TRIMs), FIEs should be treated the same as local enterprises. They should not be required to manufacture products that are specially needed in Chinese market or products that must be exported³. Therefore, based on the new requirement, as long as the machines and equipment provided by you are those truly advanced and required by Chinese companies, you may invest these machines and equipment without any trouble. The important thing is to explain clearly in the contract signed with your Chinese partner the kind of machine, equipment or technology you contribute and the price of the materials or technology agreed by both parties based on the principle of fairness. Another alternative is to invite a third party agreed by the both parties to the joint venture to evaluate and decide the materials or the technology.

2 Art. 5 of "Equity Sino-foreign Joint Venture Law" promulgated in July 1979.

3 In accordance with article one of 'ANNEX Illustrative List' 'TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require: (a) the purchase or use by an enterprise of products of domestic origin from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.'

6.5.2 Chinese Partner Contributes Granted Land Use Rights as Investment

There are in total four methods of obtaining land-use right in China. You can obtain the land-use right through establishment of an EJV or a CJV and your Chinese partner may contribute its land use right either by allocation or by grant. A FIE can also obtain the land use right from the government directly by themselves. The last method of obtaining land-use right is through lease. It means that an FIE may lease land directly from the State and so obtain the right to occupy and use land.

To foreign investors, establishing an EJV or a CJV in China is the easiest way to obtain land-use right. However, you need to know what kind of land use right your Chinese partner is holding. As mentioned above, a Chinese company can obtain land use right by allocation or by grant. What is the difference between the two? Will the difference influence you as a foreign partner? All these questions will be explained one by one.

When you invite a Chinese enterprise to be your partner in a joint venture, your partner may have already obtained the land-use right and converted the said right into investment. The important thing is to evaluate and determine the value of the converted land-use right regardless whether your partner obtained the land-use right by allocation or by grant. Normally the value should be determined by the parties to the venture, based on the total amount of the site use fees that the joint venture needs to pay to the government during its term of operation. The site use fees must also be reported to the land administration department for the record. The Chinese partner, after contributing its land use right to the joint venture, needs to pay the site use fees to the government in accordance with the relevant regulations.

Before you decide to sign a contract of using the land for the joint venture, you need to check carefully all the documents that your Chinese partner presents in order to make sure that the documents have been approved by the relevant government department. The documents include the originals of the state-owned land-use rights certificate; the property ownership certificate for the buildings, structures and other attachments to the land and the documentary evidence of ancillary land rights. Most important thing is to check whether your Chinese partner has completed the registration procedures with the government for the land-use rights and also the property ownership rights for the buildings, structures and other attachments to the land.²⁴

24 Chapter Three 'Methods by Which FIEs May Obtain Land-Use Rights' in *A Professional's Guide to PRC Land Legislation* Release 1 – December 1999 p. 605 Sweet & Maxwell Asia 2000.

6.5.2.1 Contributing Land Use Right by Allocation

There is a huge difference between your Chinese partner's contribution of its land use right and its granted land to a joint venture. If your partner contributes only the land use right, its contribution is smaller than your partner's contribution of a piece of granted land. What kind of enterprises can obtain land use right by allocation? In accordance with 'Law of the PRC on Land Management',²⁵ only those enterprises that need land for special purpose may obtain the privilege of being given land through the government's allocation. The special purpose of using land includes 'land used by state organs and land used for military affairs; land used for urban infrastructure facilities and public welfare undertakings; land used for state-supported key infrastructure facilities in the areas of energy resources, communications, water conservancy, etc. The special purpose of using land also includes the land uses as stipulated by the laws and administrative statutes.²⁶ If an enterprise has been given the land by allocation, the enterprise shall be exempted from paying a certain amount of money for using the land and the enterprise can use the land permanently. If an enterprise obtains a piece of land from the government by grant or other means of compensatory use, the enterprise needs to pay a good amount of capital (the land grant premium) and the term of using that piece of land is limited.

Due to the nature of land use right by allocation, if your Chinese partner has a piece of land given by the government by allocation and later the partner contributes the same land-use right to a joint venture, the venture can only utilize the land but cannot assign, lease or mortgage the land. However, if your partner obtains a piece of land from the government by grant or other means of compensatory use, it needs to pay the grant premium. Due to the money paid to the government, later, when your partner contributes the same granted land-use rights as its capital investment, the joint venture may not only use the land but also can choose to assign, mortgage or lease the land.

Because of the huge difference in payment of capital, in practice, your partner seldom contributes granted land as part of its investment. Instead, it prefers to contribute land-use rights for the simple reason that it is cheaper and also easier to complete the procedure. If the Chinese partner only transfers its allocated land-use right, it is required to complete only the procedures that legally convey the land-use rights to the joint venture.

Furthermore, if you obtain allocated land use rights from your Chinese partner, the joint venture should be responsible for carrying out the assignment procedures with the relevant government department and also paying the land grant fee. The Chinese partner is therefore responsible for carrying out the land grant procedures and paying the land grant premium

25 'Law of the PRC on Land Management' was promulgated in 1986 and was amended in 1988 and 1998.

26 Ibid., Art. 54.

pointed out to the general manager that the general manager had no power to make any decision relating to the company's property without permission of the board of directors. The general manager explained that he had the power to make decisions even relating to the company's property if it was urgent. The chairman of the board suggested removing the general manager. The board of directors therefore had to arrange a meeting to solve the problem.¹

One of the reasons that caused the problem between the chairman and the general manager is that the general manager was a foreigner. His way of managing a company is western style. He believed that as long as he was exercising the management power given to him and he was responsible for what he was doing, nobody should interfere including the chairman of the board of directors. On the other hand, the chairman of the board of directors used to be a director of a SOE and was trained under the socialist central planned economic system. Therefore, he was familiar with the working style of reporting everything to his superior. He believed that important decisions should be made collectively. When the Chinese chairman and the foreign manager worked together, conflicts were unavoidable. If the articles of association of the joint venture could clearly describe the rights and responsibilities of the chairman of the Board and the general manager, the conflict mentioned above could possibly be avoided.

When you plan to establish a joint venture in China with a Chinese partner, it is suggested that you know a bit of Chinese culture and the Chinese people's working style such as teamwork, obedience and respect of superior. In order to avoid unnecessary conflicts, it is better to know and understand Chinese laws and regulations governing management of FIEs, and draft a company's articles of association carefully based on the relevant laws.

This chapter mainly discusses management structure of FIEs in the form of limited liability companies, joint stock companies, CJVs and WFOEs. Amendments to the relevant laws are also discussed. When each form of FIEs is discussed, in addition to discussion of ordinary management structure such as formation of the board of directors, its power, meeting and selection of the Board chairman, some potential problems in different areas are also discussed, suggestions are given and case studies are attached.

¹ Yie Zhu 'Case Studies of the Company Law' pp.50-51 Hunan People's Publishing House 1997.

7.2 FIEs IN THE FORM OF LIMITED LIABILITY COMPANIES

7.2.1 China's Company Law and FIE Law

The 'EJV Law' and 'Implementing Regulations for the EJV Law' have described clearly the internal organizational structure of EJVs. As EJVs are normally in the form of limited liability companies, theoretically speaking, *China's Company Law*, therefore, should also apply to EJVs. Many foreign investors may wonder which law they should follow, the Company Law or the laws regulating FIEs. As mentioned in Chapter Three of this book, article 18 of the Company Law has described clearly that the 'Where laws concerning Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and foreign-funded enterprises provide otherwise, such provisions shall prevail.' Since both the *EJV Law* and the *Implementing Regulations for the EJV Law* have detailed stipulation of EJVs' management structure, foreign investors are therefore suggested to follow the *EJV Law* and its *Regulations* instead of the Company Law when operating a limited liability company.

7.2.1.1 Case Study One

A FIE Should Apply the FIE Laws instead of the Company Law²

Facts

In January 1995, a Chinese SOE and a Japanese company joined together to establish a Sino-foreign CJV (the enterprise) in Shanghai China, which was in the form of a limited liability company. This enterprise has obtained the legal person business license. The relevant government authorities had approved its articles of association. Some of the terms are as follows:

- (1) The total investment amount of the enterprise was RMB5 million. The registered capital was RMB4 million. The Chinese party obtained 55% share of the enterprise and the Japanese party obtained the balance 45%.
- (2) The Chinese and Japanese parties share the profit and risk at ratio of 40% and 60% respectively.
- (3) The enterprise sets up a board of directors, which decides all the important matters. No Shareholders Meeting and Supervising Board shall be established.

² Huang Xue-hai & Wong Shao-chun & Ma-hua "Enterprise Law & Company Law Case Studies" pp. 146-150. Legal Publisher 1999.

The Respondent's Reply:

The sales department of the Company was an illegal organization established by the director as well as the general manager appointed by the applicant. Establishment of the sales department does not just violate the joint venture contract and the articles of association, it also violates the State's administrative regulation governing industry and commerce. What the managing director did on 15 October 1992 and on the following days was not his personal decision but the decision made by the five directors under the request of not less than 1/3 of directors of the joint venture. The reason for the five directors to make such decision was that the director, who was also the general manager, accepted bribes and was busy seeking his personal gain. His action had already made the joint venture suffer a great loss. The board of directors of the Company ratified the action on 21 October 1992 and on the following days.

The Arbitration award:

China International Economic & Trade Arbitration Committee (Shanghai Branch) set up an arbitration tribunal, examined the case and made the following award:

- (1) The Applicant request the respondent to compensate the loss of RMB144,000 but there are no substantial reasons to support the applicant's request, therefore, the request is rejected.
- (2) The respondent has to pay 65% of the arbitration cost and the applicant should pay the remaining 35% of the cost.
- (3) The applicant's request of asking the respondent to pay for the lawyers' fees was also declined.

The Analysis of the Case

It is a case regarding internal management disputes in an EJV. The main legal issues are:

- (1) the majority rule, rights and obligations of directors and the managing director in an EJV;
- (2) the compensation due to the dispute in an equity joint venture.

Normally the board of directors of a FIE has the highest authority to make decisions in management of the FIE. In practice, a FIE's articles of association and the joint venture contract should clearly describe the rights and responsibilities of internal management organizations, the rights and obligations of a legal person, the general manager; the chief engineer and the chief accountant.

In this case, all the members in the Board meeting did not approve what the managing director, who was appointed by the respondent, did on 15 Oct 1992 and on the following days, although he did this based on several reasons. In addition, the respondent did not inform the relevant parties in the joint venture after the incident. The director simply did it by

the request of more than 1/3 of directors in the Board and was based on the decision made by the five directors. Although the board of directors later rectified the director's action on 21 October, only a few directors attended that meeting on that day. There was no full consent from the members of the Board. As a result, the actions are not in line with the joint venture contract and its articles of association.

As far as the details of the Board meeting is concerned, Chinese laws regulating FIEs have not clearly described the relevant requirements such as the obligations of informing directors, forms and time schedule of the Board meetings. If the joint venture contract and its articles of association have not described clearly the details of the Board meeting, it may cause a lot of disputes. The government should amend the laws to deal with this issue. The question about the number of directors who should attend the meeting is governed by article 32(2) of the 'Implementing Regulations for the EJV Law'. It says that the Board meeting should only be held when there are more than 2/3 of total numbers of directors attending the meeting. However, the question is how to identify the 'quorum'. Does the 'quorum' mean the number of directors present at the beginning of the Board meeting or the numbers of directors who are present throughout the Board meeting? There is no clear answer for this yet. Therefore, joint ventures are suggested to put down the details of the Board meeting in their articles of association and/or in internal regulations in order to avoid disputes.

There are three kinds of majority rules in the Board meeting; they are unanimous approval, special resolution and simple majority. As mentioned above, normally the Board meeting requires a unanimous approval of the directors when discussing the matters relating to existence and development of the company. The requirement of unanimous approval also protects the rights of minority shareholders. Unanimous approval can also be interpreted in two ways; an approval made by all shareholders and an approval made by all shareholders who attend the meeting. In China, the latter is preferred. It is governed by article 33 of the 'Implementing Regulations for the EJV law'.

According to the 'EJV Law' and its 'Implementing Regulation', if the numbers of directors who were appointed by one party was equal to or less than one third of the total number of the directors in an EJV and they cannot attend the meetings due to certain reasons, the other party can still make decisions by "unanimous approval", without consent of those minority directors and execute the decision. If so, the minority shareholders' right cannot be properly protected. To deal with this problem, all the parties to a joint venture should clarify in the joint venture contract that the number of quorum is the number of all shareholders. On the other hand, the problem can be dealt with by way of amendment of the relevant laws. Nevertheless, if the former is used, a deadlock may occur in the Board meeting, which may cause the inefficiency. Therefore, the interpretation of 'quorum' referring to all shareholders should be restricted.

In this case, the sales department is an internal department, not a branch of the joint venture. Therefore, its establishment does not need any approval from the government and the sales department is not required to

party or the 'defendant' for the labour disputes arising before the merger. If an employee takes legal action against his employer company but the company later is divided into several companies, the 'actual' employer after the division should be the 'defendant' or the other party to the labour dispute arising before the division. If it is not clear which company should assume the labour rights and obligations after division, all the companies existing after division shall be the parties to the dispute.

8.10.3.5 Burden of Proof

If an employee is not happy with the decision made by an employer company such as a decision to dismiss the employee, to rescind the employment contract, to reduce the employee's remuneration, or a decision on calculation of the employee's working years, the employee may apply to a labour arbitration committee for a review. In such a situation, the employee is not obliged to provide the relevant evidence. Instead, the employer company shall bear the burden of proof.

8.10.3.6 Arbitral Awards Suspended

If an arbitral award for a labour dispute issued by an arbitration committee involves more than one employee and some employees are happy with the award but some are not happy, the award shall become legally binding only on those employees who are willing to be bound by the award. If the employees are not happy with the award, and have brought legal proceedings in a people's court, the award shall not be legally binding on them.

8.10.3.7 The Courts Refuses to Enforce Arbitral Awards

Normally, if when an arbitral award is issued, one of the parties is not satisfied with the award but does not file a suit in a people's court and at the same time, refuses to implement the award within the time limit, the other party may apply to the court for enforcement. However, it is also possible that when one party applies to a people's court for enforcement of the arbitral award or a mediation document that has become legally binding, the people's court may later rule not to enforce the award or the mediation document after review and have found out that one of the following situations applies:

- "Matters decided in the award fall outside the scope of labour dispute arbitration or exceed the authority of the labour dispute arbitration commission;
- The law was applied incorrectly;

- One or more of the arbitrators practiced favouritism or made an award that perverted the law when conducting the arbitration; or
- The people's court determines that enforcement of the labour dispute arbitration award would be against the public interest".⁷⁷

If one of the above-mentioned situations happens, the people's court shall give a written notice to the parties involved, and rule that enforcement of the award shall be denied and the parties may bring proceedings in a people's court concerning the labour dispute matters within 30 days after they have received the written ruling.

8.10.3.8 Case Study Five⁷⁸

Mr. Feng was an interpreter working in a representative office of a company in Hong Kong. The representative office is located in Beijing. Since Mr. Feng was quite confident of his talent, ability and working attitude, he could never figure out why his boss did not like him and eventually dismissed him. He sued the company in Hong Kong in the Labour Dispute Committee in Beijing, requesting the company to reimburse his wages and allow him to resume his work in the same office.

The company in Hong Kong defended that the company was registered in Hong Kong. In accordance with *Hong Kong Basic Law* and the principle of one country, two systems, the dispute between Mr. Feng and the company in Hong Kong shall be dealt in accordance with Hong Kong Law instead of *China's Labour Law*. The Labour Dispute Committee therefore turned down Mr. Feng's request. Mr. Feng filed his case in the People's Court in Beijing to re-examine the case and cancel the award made by the Labour Dispute Committee.

After a careful study of the case, the judge in the People's Court in Beijing considered it necessary to clarify two points in this case. One point is the subject of the case. Mr. Feng signed the employment contract not directly with the company in Hong Kong but with a foreign affairs service company (FASC) in Beijing. In fact, it was the FASC that introduced Feng to work in the representative office of the company. Therefore, the defendant in this case should be the FASC, and the company in Hong Kong should be treated as a third party in this case.

Second point is implementation of law. Since the FASC was a legal person registered and located in China, in accordance with the relevant laws, if disputes happened between the employee and the FASC relating to the employment contract, the court in China shall implement China's Labour Law instead of Hong Kong laws to solve the dispute. Furthermore,

⁷⁷ The "Interpretation of the Supreme People's Court on Several Issues Concerning the Applicable Law for the Trial of Labor Dispute Cases.

⁷⁸ See, <http://www.bjgf.gov.cn/talklaw> on September 12 2001.