

FOREIGN TRADE,
INVESTMENT, AND THE
LAW IN THE
PEOPLE'S REPUBLIC OF CHINA

SECOND EDITION

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EDITOR : MICHAEL J. MOSER

FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA

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Beijing
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Introduction

MICHAEL J. MOSER

THE essays contained in this volume provide an introduction to the legal framework governing the conduct of business transactions with the People's Republic of China. Each chapter treats separately a specific topic relating to the legal aspects of trade, investment, and other commercial activities in China, surveys the relevant legislation in the field, and discusses some of the problems encountered in connection with their implementation. Unless otherwise noted, the essays address the status of legal developments as of January 1987.

This volume, like its predecessor first edition,¹ stems from a perceived need on the part of foreign business people, government policy-makers, and others with an interest in Chinese affairs for a greater knowledge of Chinese legal matters, particularly at a time when the People's Republic has begun dramatically to increase its economic contacts with the rest of the world. For the most part, the contributors to the volume are lawyers actively engaged in advising clients with commercial dealings in China. Despite this, their intention has not been to formulate a 'handbook' of China trade or to assemble a book of recipes for business success. Rather, the aim has been to provide an overview of the legal framework now being developed for the regulation of business activities involving Chinese and foreign companies and to shed some light on how this framework affects the conduct of business affairs in practice.

Before turning to the essays themselves, it will be useful to look briefly at the development of China's current legal system and the types of laws and regulations which affect business transactions with foreigners.

The emergence in China of a substantial body of laws and regulations applicable to business transactions with foreigners is a development which has occurred only very recently. Indeed, for much of the period since the establishment of the People's Republic in 1949, law and formal legal institutions have played a relatively minor role both domestically and in China's international economic relationships.²

Following the 'liberation' of the Chinese mainland in 1949, the Chinese Communist Party abolished the laws and judicial system established by the former Nationalist regime and proceeded to create a new legal system modelled generally on that of the Soviet Union. During the period up to 1957, a substantial number of laws were enacted, new judicial institutions were put into place, the legal profession was strengthened, and legal scholarship began to flourish. These promising developments ended, however, in the wake of the Party's anti-rightist campaign which followed the period of political liberalism encouraged by the 'Hundred Flowers' policy of 1957. Thereafter, the legal institutions earlier put into place began to atrophy and new legislative efforts were virtually halted

as the Party exerted near total control over the legal system and promoted the subservience of law to politics.

The downward spiral in China's legal development reached its nadir with the launching in 1966 of the 'Great Proletarian Cultural Revolution'. During the following decade China's radical leaders exhorted the Red Guards to 'smash the procuracies and the courts', mete out 'revolutionary justice' to 'counter-revolutionaries', and 'put politics in command'. As a consequence, during this period China's legal system and formal legal institutions were practically destroyed and the nation's economic contacts with the outside world came to a halt.

Following the death of Mao Zedong in 1976 and the purge of the infamous 'Gang of Four', the nightmare of the Cultural Revolution ended. China's new leadership proclaimed the goal of a thorough remaking of the People's Republic through the realization of the 'Four Modernizations': modern industry, agriculture, science and technology, and defence. At the same time, interest in law and legality was revived. As from 1979, new policies were implemented to restore the 'socialist legal system'. These policies marked the beginning of the restoration and strengthening of formal judicial institutions and the legal profession, and the promulgation of a large number of new laws, developments which have continued to the present.

An important aspect of the Four Modernizations programme has been the inauguration of an 'open-door' economic policy which since 1978 has led to a dramatic increase in foreign trade and other economic contacts. China's new economic policies have transformed the character and dimensions of its economic relationships with foreign countries. In particular, the permissible forms of business transactions have been expanded and have become more complex, encompassing not only simple commodity sales and purchases but also technology licensing, co-operative production arrangements, and direct equity investments in the form of Chinese-foreign joint ventures and the establishment of wholly-owned companies. With the aim of regulating the scope and content of China's increasing economic contacts with the outside world, literally hundreds of laws and regulations have been promulgated or reinstated since 1979 and scores of others are now being drafted.

As most of the essays in this volume are concerned with Chinese legal rules, it will be useful to consider briefly the types of rules used by China to regulate foreign business activities and their sources. In general, these fall into two different categories: published legislation, and internal (*neibu*) or restricted regulations.

Published legislation is issued in a variety of forms by Chinese legislative bodies and administrative agencies.³ Under China's Constitution,⁴ the power to enact and amend basic statutes (*falu*) in the civil area is granted to the National People's Congress (NPC). The NPC's Standing Committee may enact statutes in certain areas not specifically reserved to the NPC itself and may issue decrees (*faling*), decisions (*jueyi*), orders (*mingling*), and instructions (*zhishi*) based on existing laws when the NPC is not in session. In addition, China's State Council, designated by

the Constitution as 'the highest organ of state administration',⁵ as well as administrative organs directly responsible to the State Council, are authorized to issue administrative regulations (*guiding*) and measures (*banfa*) to implement existing legislation. Finally, local organs of state power such as local people's congresses and their standing committees at the provincial, municipal, and autonomous region levels are empowered to enact local laws and administrative regulations subject to the approval of the central government.

Access to published Chinese legislation has often proved to be a problem for foreigners. There is no officially published gazette or other compilation of Chinese laws and regulations that is updated on a regular basis. As a result, the student of Chinese law has had to rely on newspapers, magazines, and other publications which often print the texts of newly enacted legislation. These sources have not always proved to be entirely satisfactory, however. In many cases, legislation has not been made public until well after the date of promulgation even though the law has already been put into effect. Moreover, although 'unofficial' translations are sometimes circulated, all published laws are officially promulgated in Chinese. To meet the demands of foreigners for access to published rules and regulations, a number of commercial compilations of China's economic laws have recently begun to appear in English. However, the accuracy of the translations has varied and none of the compilations is entirely complete.⁶ Moreover, there is a lack of uniformity among the various translations not only with respect to the substantive content of the statutes but also as regards the names of the laws. To relieve the reader of the burden of familiarizing himself with the various forms of citation for the same law, I have asked the contributors to this volume to conform to a uniform system of citation at least as regards the formal name of the law, leaving the abbreviated citation form to each author's preference. The complete citation form for the most important and most commonly cited laws is set forth in the Appendix, together with the original title in Chinese characters (see pp. 581-99).

Published rules and regulations, even when they are accessible to foreigners, form only a part of the legal framework governing business transactions in China. In addition, Chinese units and officials are guided in their dealings with foreigners by internal rules, the content of which in most cases may not be directly revealed. Most of these internal rules consist of directives which must be followed by Chinese negotiators in interpreting and implementing statutory law. Some herald the introduction of new policies which may in time find their way into published law. Others are simply a formalization of practices which have developed as a product of experience gained in similar or related transactions. Whatever their source, internal rules complicate the elucidation and definition of China's legal system and as such pose constant pitfalls in the way of attempts to understand the nature and operation of the rules regulating commercial transactions.

The legal framework established by China for the conduct of business transactions is still in its infancy. As a result, it is hardly surprising that

significant problems—such as lack of uniformity in the implementation of existing laws, inconsistency of interpretation, and legislative lacunae—remain to be resolved. In this regard, it is important to remind ourselves that China's current law-making efforts cannot be viewed as an isolated phenomenon, but are only one aspect of a much more complex and infinitely more difficult task aimed at the transformation of an economically backward but culturally rich society. Seen from this perspective, the essays in this volume should be viewed as portraying the beginning rather than the end, and only a part rather than the whole, of a dynamic and evolutionary process.

Notes

1. M. Moser (ed.), *Foreign Trade, Investment and the Law in the People's Republic of China* (Hong Kong, Oxford University Press, 1984).

2. For a summary description of China's legal development, see S. Lubman, 'Emerging Functions of Formal Legal Institutions in China's Modernization', in *China Under the Four Modernizations, Part 2: Selected Papers Submitted to the Joint Economic Committee, Congress of the United States* (Washington, DC, United States Government Printing Office, 1982), p. 285. Also see T. T. Hsia and C. A. Johnson, *Law Making in the People's Republic of China: Terms, Procedures, Hierarchy and Interpretation* (Washington, DC, United States Library of Congress, 1986).

3. See F. H. Foster, 'Codification in Post Mao China', *American Journal of Comparative Law*, Vol. 30, 1982.

4. Promulgated on 4 December 1982.

5. Constitution of the People's Republic of China, Art. 85.

6. Among the most widely circulated compilations are: *China's Foreign Economic Legislation* (Beijing, Foreign Languages Press, 1982); P. Chan, *China: Modernization and its Economic Laws* (Hong Kong, The Economic Newspaper, 1982); *Laws and Regulations of the People's Republic of China*, Vols. I, II, and III (Hong Kong, Kingsway International Publications, Inc., 1982, 1983, and 1985); F. Chu, M. Moser, and O. Nee (eds.), *Commercial, Business and Trade Laws: People's Republic of China* (Dobbs Ferry, Oceana Publications, Inc., 1982). The most ambitious compilation is *China Laws for Foreign Business*, Vols. I, II, III, and IV (Sydney, CCH Australia Limited, 1985), a bilingual collection of laws and regulations periodically updated for subscribers.

1. The Regulation of China's Foreign Trade

JAMIE P. HORSLEY

I. Introduction

China's system for regulating foreign trade, traditionally highly centralized in view of the importance of controlling exports and imports in a planned economy, is in a state of nearly constant flux. As part of its current drive towards rapid modernization, the Chinese government has abandoned its insistence on self-reliance and has called for an unprecedented expansion of foreign trade, to obtain from abroad necessary raw materials, commodities, equipment, and technology, and to help pay for these foreign imports with increased export earnings. In order to realize this goal, China is seeking to stimulate and streamline foreign trade activity, in part by dispersing much direct trading authority to local governments and individual enterprises, rather than leaving it all in the hands of the national foreign trade corporations.

This decentralization of direct foreign trade control is being accompanied by a legislative effort to establish commercial laws and administrative rules to regulate the newly sanctioned foreign trade activity more indirectly, through such means as import and export licensing and inspection requirements and the imposition of, or exemption from, import and export tariffs and taxes. China's administrative goal in this area is to develop a system that efficiently balances increased local trading autonomy with overall central direction and control.

Since the adoption in late 1978 of an 'open-door policy' to welcome foreign investment in and trade with China, China's foreign trade has grown rapidly.¹ To date, the People's Republic of China has established trade relations with over 176 countries and regions and has signed trade agreements or protocols with some 94 countries.² Moreover, in addition to becoming increasingly active in international trade matters under the auspices of various United Nations bodies, China established relations with the General Agreement on Tariffs and Trade (GATT) in 1980, began to send official observers to GATT meetings in 1982, joined the GATT arrangement regarding international textile trade in late 1983, was granted formal observer status by GATT in late 1984, and formally applied to join the GATT in July 1986.

China's open-door foreign trade policy is closely interrelated with widespread political and economic reform that is intended to spur local enterprise and individual initiative, and increase and improve production through the easing of central administrative controls and greater reliance on 'market forces'. Just as economic decision-making and profit account-

ability in certain sectors are devolving to lower administrative and enterprise levels, so in the area of foreign trade the authority to negotiate, sign, and implement contracts is becoming more diversified.

The actual process of decentralizing the foreign trade system began in 1979,³ when authorities at the provincial, municipal, and autonomous regional level were first authorized gradually to take over control of the export of locally produced commodities and the import of locally required goods. These local authorities are now held accountable for their own foreign trade profits and losses, and are permitted to retain all or a portion of their foreign exchange trade earnings and pay taxes thereon, rather than turn all profits over to the central government as was previously required. Since 1979, certain provinces, especially Guangdong and Fujian, and the special municipalities of Beijing, Tianjin, and Shanghai, as well as other large coastal and inland cities, have been granted broad economic and trade autonomy,⁴ and the Chinese ministries have been encouraged to set up their own specialized trading corporations to export the products under their respective jurisdictions and to import the commodities and technology that they need. Moreover, selected key enterprises have been permitted to engage directly in import and export trade within a specified scope. Nearly 15 per cent of China's total imports in 1984 were made by local enterprises in the provinces, rather than by or through central government units.⁵

The decentralization of trading authority has been accompanied by the adoption of certain 'flexible' forms of trade, such as processing and assembly of imported materials and parts, compensation trade, the seeking of foreign trade financing, leasing, the expansion of overseas channels for trade, and the export of Chinese labour and engineering for construction projects abroad.

The revitalization of foreign trade as a significant factor in the development of China's planned economy has been neither a smooth nor a straightforward process. The lack of an efficient foreign trade infrastructure and a comprehensive set of regulations or guidelines for trading activity, combined with local inexperience with respect to foreign trade matters, gave rise initially to unforeseen consequences. In the words of one Chinese official:

[Following the structural reform of China's foreign trade] more departments and enterprises began to engage in foreign trade. This in turn stimulated the central departments, local authorities and enterprises to create additional channels to do business abroad. However, some problems cropped up, such as indiscriminate importation of consumer goods, which had an adverse impact on the domestic market and production. Left unchecked, this would have impaired the development of China's industry and inflicted losses on the national economy. Expansion of some exports which were in short supply domestically also upset the state plan, and at that point enterprises even began to compete with each other to sell goods at lower prices on the world market. This was detrimental to the normal development of China's export trade, affected economic results and had a negative impact on normal profits earned by foreign firms handling Chinese goods regularly.⁶

The year 1980 witnessed the ascension of Premier Zhao Ziyang and a general movement to tighten central management of the economy, including foreign trade. This harnessing of the decentralization process did not represent a policy reversal, since an increasing number of provinces, municipalities, departments, and enterprises continued to be given expanded foreign trade autonomy. Rather, it signalled a realization that decentralization should evolve in a more planned and co-ordinated manner.

Since 1980, policy regarding foreign trade management has fluctuated between decentralization and recentralization. As of late 1984, the Ministry of Foreign Economic Relations and Trade (MOFERT) adopted a policy of separating government administration from decentralizing enterprise management and centralizing administrative control over import and export activity.⁷

In the administrative area, export and import licensing regulations have been issued and revised to improve control over the types, quantity, and prices of commodities being traded, as well as to ensure that only authorized Chinese units engage directly in foreign trade business. The watchdog Customs Administration has been separated from the foreign trade ministry and directly subordinated to the State Council, presumably to make it a more independent check on foreign trade activity, and the commodity inspection apparatus has been reorganized and strengthened to increase quality control over both exports and imports. In an exercise of more indirect control, import duties on over 100 commodities were adjusted upward or downward in late 1982 and export duties were imposed on more than 30 goods to inhibit trading in certain strategic items. Duty rates continue to be adjusted, and new regulations on import and export duties were promulgated by the State Council in March 1985.⁸ As of 1986, the licensing system is in the process of being streamlined and extended, and the customs laws updated.

II. China's Foreign Trade Apparatus

In recent times, China's foreign trade management structure has been undergoing virtually continual readjustment. The basic decentralization of trading authority has been accompanied by occasional drives to recentralize a certain amount of administrative control and to define more clearly the division of authority and work between the central and local trade levels, and between governmental trade bodies and local enterprises, within the general framework of a unified plan and policy.

The more recent institutional developments in China's search for a foreign trade system under which the necessary control and coordination can be exercised without unduly dampening local trading initiative are (a) the establishment of special trade commissioner offices directly under MOFERT, and (b) reform of the national foreign trade corporation system.

In February 1983 MOFERT announced that chief trade commissioners

and deputy trade commissioners had been dispatched to the four major port cities of Shanghai, Tianjin, Dalian, and Guangzhou.⁹ Although the precise role of these special trade offices is not yet entirely clear, the chief trade commissioners are reported to have the equivalent of vice-ministerial status and are responsible for (a) supervising and coordinating foreign trade activities around the port cities where they are located, under a unified policy and plan determined by the central authorities; (b) strengthening administrative control over the export and import licensing system and issuing some export and import licences within a scope approved by MOFERT; (c) assisting the head offices of the national import and export corporations gradually to reach unified management over major export commodities; (d) convening trade-related joint conferences between economic and trade departments in the ports and inland areas; (e) setting up joint enterprises around the ports, specializing in different lines of trade; and (f) generally advising MOFERT on trade policy and reform of the foreign economic and trade structure.¹⁰ Although the State Council is reported to have approved relevant provisional regulations governing these commissioners and their offices, no such regulations have been made public.¹¹

The establishment of the special trade commissioner offices appears to be a move to reconcentrate below the centre some of the administrative authority that had been exercised by the local foreign trade departments and bureaux in the wake of decentralization. Each trade office has been assigned the task of strengthening 'traditional economic relations' between the port cities and China's hinterland by co-ordinating trade activities within designated parts of China. Shanghai is to supervise the East and South-west, including trade in Fujian province and its special economic zone at Xiamen; Tianjin, the North and North-west; Dalian, the North-east; and Guangzhou, the Central-South region, including Guangdong province and the three special economic zones there.¹² It remains to be seen what the role of the special trade offices will be with respect to areas such as Fujian and Guangdong provinces and their special economic zones, which have been given a great deal of independence in connection with economic and trade matters.

The second major institutional reform, that of changing the traditional role of the national foreign trade corporations, is discussed below in the context of describing the major foreign trade institutions.

The major institutions involved in China's foreign trade system are MOFERT, the national foreign trade corporations directly under MOFERT and their local branches, other import and export corporations specializing in particular commodities established by the State Council or ministries other than MOFERT, and the local foreign trade departments or bureaux and corporations administered by the provinces, special municipalities, other large cities, and autonomous regions, as well as official Chinese commercial offices located abroad.¹³ Apart from the institutional participants, an increasing number of individual enterprises are being granted the authority to engage directly in export and import trade.

A. MOFERT

China's foreign trade apparatus is headed by MOFERT, which was established in March 1982 as an amalgamation of two former ministries and two commissions: the Ministry of Foreign Trade, the Ministry of Foreign Economic Relations, the Foreign Investment Commission, and the State Import-Export Commission. MOFERT is responsible for helping to formulate the national foreign trade plans in consultation with the State Planning Commission, managing the foreign trade system, approving export quotas and import and export licences, authorizing enterprises to conduct foreign trade, supervising technology transfers to Chinese enterprises, negotiating international trade agreements, and participating in relevant international trade organizations. In addition, MOFERT supervises the local foreign trade bureaux in each province, major city, and autonomous region, and some 15 specialized national foreign trade corporations that are primarily responsible for conducting foreign trade on behalf of China. MOFERT also controls several trade-related service companies, including the China Resources Company, the Foreign Trade Consultancy and Technical Services Corporation (CONSULTECH), and the Foreign Trade Science and Technology Service Corporation. The Customs Administration and the commodity inspection apparatus work closely on foreign trade management with MOFERT, but they are constituted as specialized agencies directly under the leadership of the State Council.

MOFERT is organized into 7 administrative and 13 functional or regional departments, including departments for general planning, foreign trade administration, treaties and law, import-export administration, and technology transfers.¹⁴

B. *The National Foreign Trade Corporations*

As part of the movement towards the decentralization of trade management and contracting authority, the monopolistic role played by the national foreign trade corporations (NFTCs) under MOFERT, headquartered in Beijing, and their local branches is gradually being reduced. Once primarily responsible for negotiating and conducting a major portion of China's foreign trade for their own account, they are now to operate independently from their administrative organs as agents on a commission basis.¹⁵

The NFTCs are constituted as independent legal entities, like subsidiaries of MOFERT. Each NFTC handles a separate category of trade commodities or services, such as chemicals, metals and minerals, textiles, arts and crafts, cereals, oil and foodstuffs, light industrial products, native produce and animal by-products, packing materials, the purchase of whole plants, and the licensing of technology.¹⁶ The NFTCs have local branches in various cities that are supervised by the local authorities, with respect to administrative matters, as well as by the head office in Beijing,¹⁷ and that are establishing specialized trading subsidiaries of their own.¹⁸