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Equity Joint Ventures in the People’s Republic of China: Problems That Continue After More Than a Decade Under the Open Door Policy*

Margaret L.H. Png**

I. INTRODUCTION

In 1979, the People’s Republic of China (“China”) officially opened its doors to foreign investment. This “open door policy” was initiated by the enactment of the Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment (“Joint Venture Law”)¹ which provides for foreign investment in China through equity joint ventures between Chinese partners and foreign investors.²

However, it was obvious from the outset of China’s open door policy that the goals of the statutorily-mandated partners to a joint venture, the Chinese partner and the foreign investor, were diametrically opposed. On the one hand, the goal of China’s open door policy was to invigorate its domestic economy by increasing capital investment and raising the level of managerial skills and technology in China, with a view to increasing exports and earning foreign exchange.³ In other words, China hoped to develop export markets. Foreign investors, on the other hand, viewed China as the world’s largest potential consumer market and as a cheap source of labor and raw materials.⁴ Mainly, foreign investors hoped to develop domestic markets. From these conflicting goals, it was clear that problems in foreign investment were inevitable.

Other problems arose out of the differences between China’s centrally planned economy and the market economies of most foreign inves-

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* This article was written in early 1991 and does not reflect the most recent developments in the PRC to date.

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¹ The Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment (Promulgated by the People’s National Congress on July 8, 1979) (LEXIS, Asiapc library, Chinal file) [hereinafter Joint Venture Law].

² Id. art. 1.

³ See Andrew Quinn, China’s Top Economist Calls for Radical Reform, REUTERS, Mar. 24, 1992 (LEXIS, NEXIS library, Reuters file).

tors. For example, after thirty years of isolation and central government planning, China's workers, managers, planners, and government officials undoubtably carried their experience over into the new era of joint ventures. As a result, wide disparities in business concepts between a planned economy and a Western market economy soon emerged.

Despite the potential problems of investing in China, 3,248 direct foreign investment projects with an aggregate value of $8.990 billion\(^5\) were established in China from 1979 to 1984.\(^6\) The total number of projects rose to 21,734 in 1989, and the aggregate value rose to $32.356 billion.\(^7\)

Although there was no legislation governing cooperative joint ventures,\(^8\) this form of foreign investment was popular in China during the early 1980's because it offered greater flexibility than equity joint ventures.\(^9\) However, over time, it became clear that cooperative joint ventures were losing their attraction.\(^10\) One reason for this may be that foreign investors felt more comfortable with equity joint ventures because they were governed by a defined body of law and offered limited liability whereas cooperative joint ventures did not. In response to this, the Chinese government finally adopted a law for cooperative joint ventures in 1988.\(^11\) Even with this new law, limited liability was not accorded to cooperative joint ventures. This may be the reason why equity joint ventures have remained the favored vehicle for foreign investment in China in recent years.\(^12\)

This article will discuss the problems commonly encountered by foreign investors operating in China who are participants in equity joint ventures ("joint ventures").\(^13\) This discussion will center around the regulations that apply to these problems and will be made in the context of

\(^5\) All amounts recorded in "dollars" refer to U.S. dollars.
\(^7\) Id.
\(^8\) The first Chinese legislation on foreign investment only governs equity joint ventures. See generally Joint Venture Law, supra note 1.
\(^9\) *See A Breakdown of Foreign Investment in China, Contracted and Utilized*, supra note 6 (for example, from 1979 through 1984, 2,212 cooperative joint ventures were established compared to 931 equity joint ventures).
\(^10\) By 1989, there were 12,198 equity joint ventures compared to 7,994 cooperative joint ventures. *Id.*
\(^12\) For example, in 1989, 56% of foreign investment projects in China were equity joint ventures. *A Breakdown of Foreign Investment in China, Contracted and Utilized*, supra note 6.
\(^13\) A joint venture had a term of ten through thirty years. In 1986, the maximum term was extended to 50 years with the possibility of longer terms subject to the approval of the state council. In 1990, the fixed-term requirement was abolished. *Id.*
the experience of various joint ventures who have encountered these problems.

II. FOREIGN INVESTMENT PROBLEMS

In the mid-1980's, observers generally listed shortage of foreign exchange, difficulties in local sourcing, difficulties in labor management, inadequate infrastructure, and poor quality control as common problems encountered in the operation of joint ventures in China. According to one survey, the same problems continue to plague foreign investments in 1989 despite Chinese legislation enacted between 1985 and 1989. The continued prevalence of these problems suggests that legislation may not be the solution.

A. Shortage of Foreign Exchange

The Implementing Act for the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment ("Implementing Act") requires that joint ventures balance their foreign exchange receipts and expenditures. Because the Chinese currency renminbi is not freely convertible into foreign exchange, joint ventures must generate enough hard currency to pay for imported materials and the repatriation of profits belonging to the foreign partner. If they cannot, joint ventures must then find some means of converting their renminbi earnings into foreign exchange.

However, the task of balancing the foreign exchange account has proven to be a major problem for many foreign investment enterprises in China. For example, according to the National Council for U.S.-China

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15 Id. at 842.
16 Id. at 846; See also, Walter S. Surrey et al, Joint Ventures in China: The First Water Stop, 21 TEX. INT'L L. J. 222, 251 (1986).
17 Fenwick, supra note 14, at 842.
19 Id.
20 Id. at 9.
22 Id. art. 75.
23 NIGEL CAMPBELL, A STRATEGIC GUIDE TO EQUITY JOINT VENTURES IN CHINA 67 (1989).
24 Id.
25 On the other hand, hotel and tourist service joint ventures are spared from this plight because they provide accommodations and services to foreigners who pay in hard currency.
Trade, in 1988 only about 1,300 out of a total of 4,000 foreign investment enterprises were able to balance their foreign exchange income and expenditures.

The two major reasons for the imbalance in foreign exchange accounts are: (1) the heavy reliance on imported materials to produce the joint venture product (too much foreign currency going out of China); and (2) the inability to export in sufficient quantities to generate the requisite foreign exchange income (not enough foreign currency coming into China). For example, joint ventures often have to rely on imported materials because the materials are not available in China.\textsuperscript{26} If the materials are available, they are often not of adequate quality.\textsuperscript{27} Even if the materials are of sufficient quality, there is often not enough quantity to meet the needs of the joint venture.\textsuperscript{28} When exporting, joint ventures often have difficulty marketing their products because the products are either too expensive or fail to meet the standards of international markets.\textsuperscript{29}

AMC-Beijing, the first Sino-U.S. automotive joint venture, is a widely publicized example of a joint venture's foreign exchange dilemma.\textsuperscript{30} In the spring of 1986, AMC was caught in a Chinese government clampdown on foreign exchange.\textsuperscript{31} Ninety per cent of each Jeep Cherokee produced by AMC-Beijing was as built from imported $12,000 component kits.\textsuperscript{32} These kits had to be paid for in foreign currency.\textsuperscript{33} Since AMC-Beijing did not generate enough foreign exchange to pay for the imports, it purchased hard currency from the Chinese government.\textsuperscript{34} However, in 1986 the Chinese government restricted all foreign exchange purchases\textsuperscript{35} and specifically refused to sell foreign currency to the joint venture.\textsuperscript{36} The joint venture was therefore unable to pay for the imported components.\textsuperscript{37}

By the time the Chinese government decided to meet AMC's demands, it was clear that the confidence of foreign investors was damaged.

\textsuperscript{26} See infra section IIB(1).
\textsuperscript{27} See infra section IIB(2).
\textsuperscript{28} See infra section IIB(1).
\textsuperscript{29} See infra section IIE.
\textsuperscript{31} Burns, supra note 30.
\textsuperscript{32} Id.
\textsuperscript{33} Id.
\textsuperscript{34} Id.
\textsuperscript{35} Id. In 1985 China's foreign exchange reserves dropped by more than $5 billion, to just under $11 billion. This drop was due to overspending on imports and the government reacted by curtailing foreign exchange expenditure. Id.
\textsuperscript{36} Id.
\textsuperscript{37} Id.
For example, the AMC-Beijing venture, one of the largest American manufacturing joint ventures in China, was closely watched by other American investors as an indicator of how their own investments in China would fare. The Chinese government's handling of AMC-Beijing's foreign exchange purchases further eroded the confidence of foreign investors who were already plagued with similar foreign exchange problems. Many investors began to question whether their efforts to gain a foothold in China were worthwhile.

As early as 1983, the Chinese government recognized the foreign exchange problem. The Implementing Act permits the sale of foreign currency by the Chinese government to joint ventures in specified circumstances in order to solve a joint venture's foreign currency shortfall. However, the AMC-Beijing incident suggests that this solution is not adequate. In 1986, the State Council responded to investors' complaints by enacting the Regulations on Joint Ventures' Balancing of Foreign Exchange Revenue and Expenditure ("Foreign Exchange Regulations"). The regulations generally formalized methods which joint ventures were already using to rectify imbalances in their foreign exchange accounts. The Implementing Act and the Foreign Exchange Regulations recommended the following methods for generating foreign exchange to remedy a joint venture's shortfall in hard currency: (a) conversion of renminbi into foreign currency; (b) export sales of Chinese products to earn foreign currency; (c) sale in China for foreign currency; (d) import substitution; (e) swap arrangements; and (f) reinvestment of renminbi profits.

The regulations which theoretically provide solutions to hard currency shortages appeared to be generally welcomed by foreign investors because they represented the Chinese government's acknowledgement of the investors' problems and signified a willingness by the government to address the problems. In retrospect, however, it appears that the Chinese

38 Id. at D1.
39 Id.
40 Id. at D4.
41 Implementing Act, supra note 21, art. 75 ("When a joint venture whose products are mainly sold on domestic market [sic.] under its approved feasibility study report and contract has an unbalance of foreign exchange income and expenses, the unbalance shall be solved by the people's government . . . .").
42 The Regulations on Joint Ventures' Balancing of Foreign Exchange Revenue and Expenditure were promulgated by the State Council on Jan. 15, 1986 [hereinafter Foreign Exchange Regulations].
43 The regulations do not apply to banks, insurance companies, and other financial institutions. See Implementing Act, supra note 21, art. 11. (The authorities are not responsible for resolving the foreign exchange imbalance if a joint venture does not fulfill stipulated contractual obligations for exports and generation of foreign exchange); Foreign Exchange Regulations, supra note 42, art. 7.
44 See Foreign Exchange Regulations, supra note 42; Implementing Act, supra note 21.
government took a minimalist approach to investors' hard currency problems and merely did what it perceived was necessary to appease the disenchanted foreign investors. The Foreign Exchange Regulations were only intended to have a restricted application. This intention is evidenced by a leading Chinese official's statement that it is not possible "for a developing country like China to use its scarce foreign exchange reserves to subsidize joint ventures running a deficit in foreign exchange earnings."  

The effectiveness of each method in generating foreign exchange will be analyzed below in the context of the applicable regulations. 

1. Conversion of Renminbi 

Joint ventures that have approval to sell their products in the domestic market may use their renminbi earnings to buy foreign currency from Chinese government authorities.  

The renminbi conversion solution, which appears simple in principle, has proved to be complicated in operation. A Chinese legal expert explained the process as follows: 

To convert the renminbi into foreign currency, a joint venture should submit its annual renminbi-foreign currency conversion plan to the department in charge of it and then obtain the foreign currency from the locally retained foreign exchange reserves of that department. If the amount converted from the local foreign exchange reserves is still insufficient, the department in charge shall then present a conversion plan to the Ministry of Foreign Economic Relations & Trade, and after the plan is examined and approved by the Ministry together with the State Planning Commission, the remaining amount to be converted into foreign currency should be included in the state foreign exchange plan and solved from the state foreign exchange reserves.

In order to effectuate the joint venture's conversion of renminbi into foreign exchange, a joint venture must be prepared to submit its currency conversion plan to two levels of authority, the local department and the

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46 Besides the six methods listed above, joint ventures have used or propose to use three other methods to obtain hard currency. The three methods are: (i) using the joint venture as a local marketing arm; (ii) obtaining hard currency loans; and (iii) maintaining evidence accounts as a means of determining the amount of foreign exchange a joint venture can purchase from the government authorities. These three methods will be discussed later.

47 See Implementing Act, supra note 21, art. 75.

48 Id.

49 EXTERNAL DEPARTMENT OF ECONOMIC DAILY, BEIJING, GUIDE TO EQUITY JOINT VENTURES 92 (1985).
This system creates at least three problems. First, the joint venture must submit its foreign exchange requirements yearly and in advance for inclusion in the annual currency conversion plan. This presumes that the venture can project its foreign exchange needs. The system does not provide for unforeseen requirements for foreign exchange during the subsequent year.

Second, there is no guarantee that the authorities will provide any or all of the foreign exchange requested in the joint venture’s annual currency conversion plan. The local government authorities are often reluctant to invade their own foreign exchange reserves to support a foreign investment project. They are also likely to provide foreign exchange only to high priority projects. For example, the joint venture Foxboro-Shanghai had to convince local authorities that the venture had exhausted all foreign exchange generating alternatives before it was allowed to convert its renminbi profits into foreign currency. Even then, the venture had to show that the foreign exchange was needed to keep the operation going.

This problem may be solved if the joint venture can bind the local authorities contractually to provide a minimum amount of foreign currency. It is not easy to extract such a commitment from the local authorities because foreign exchange is a precious and limited resource. However, it has been done. For example, the joint venture contract for Volkswagen-Shanghai requires the State Planning Commission to provide a specified amount of foreign exchange at the official exchange rate. The amount of foreign exchange was fixed at the value of parts imported by the venture for the manufacture of cars. Presumably, the quota of foreign exchange available to Volkswagen-Shanghai was adjusted periodically to correspond with the value of imported parts.

The third problem with renminbi conversion is that there is no legislative provision for determining the exchange rate. In practice this has not proved to be a problem, as the currency conversions have been made at the official exchange rate.

Finally, the renminbi conversion solution is only designed to assist

50 Implementing Act, supra note 21, art. 75.
51 Id.
52 Operating China JVs: How Shanghai-Foxboro Copes with Forex Woes, 14 BUS. CHINA 89, 90 (1988). [hereinafter Operating China JVs].
53 Id. at 90.
54 Id.
55 Id.
57 Id. at 41.
58 Id.
fledgling joint ventures during their initial years of operation. Therefore, authorizations for currency conversions must be obtained periodically. In Volkswagen-Shanghai, the State Planning Commission guarantee of foreign exchange to the joint venture was limited to the early phase of the venture. Foreign investors must also be wary of committing the venture to export quotas since government authorities are not responsible for providing foreign currency to a venture that fails to meet its export quota.

Despite the limitations of renminbi conversion, Foxboro-Shanghai, which was established in 1982, relied on this solution to fill 20% of its dollar requirements until 1988. At that point the government informed the venture that it could no longer use renminbi conversion as a solution to its foreign exchange shortages. Foxboro-Shanghai was probably so successful in converting renminbi because it was willing to put up with the inconvenience of the system.

2. Export Sales of Chinese Products

The Foreign Exchange Regulations permit joint ventures to purchase products made by Chinese enterprises and sell the products overseas for hard currency. Such purchases and sales must be approved by the Ministry of Foreign Economic Relations and Trade ("MOFERT"). The regulations for such domestic purchases and export-sales are embodied in the Provisions on the Purchase and Export of Domestic Products by Foreign-Investment Enterprises to Balance Foreign Exchange Accounts ("MOFERT Regulations"). Under the MOFERT regulations, an application must be made to the local provincial authorities. The application must specify the amount of foreign exchange needed and the corresponding sum of renminbi needed to buy the domes-
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The names, specifications, quantities, and export channels of the domestic product must also be specified in the application. Joint ventures are further encouraged to purchase from Chinese enterprises within their locality. If the domestic product has to be purchased from a different locality, the approval of the local provincial authority in that locality must be obtained.

There are two legal limitations to the domestic purchase and export-sale solution. First, this method can be used only to solve "temporary difficulties" experienced by joint ventures. Second, the quantity of domestic products that can be exported is limited to the amounts necessary to obtain the foreign exchange required to cover the shortfall in production, the repatriation of the foreign investor's profits, and the remittance of capital upon the liquidation of the joint venture. It is apparent that these two express limitations are required by China in order to protect the monopolies of its domestic trading companies by preventing competition from foreign trading operations.

In practice, there is a third limitation. Chinese producers of internationally marketable goods are often unwilling to sell their products to joint ventures for renminbi when they can sell the products overseas for hard currency. As a result, the range of Chinese goods available for export by joint ventures is often restricted to the least desirable ones which do not have an export market.

Some joint ventures have not been deterred by the limitations of the domestic purchase and export-sale method. This is especially true if the joint venture is able to sell to other subdivisions of the foreign partner and to show that it is creating new markets for China, rather than infringing on the "rice bowl" of the state trading companies. For example, the Hewlett-Packard joint venture in Beijing plans to generate foreign exchange by selling locally-sourced components and subassemblies that can be used by Hewlett-Packard in its operations around the world. UOP-Shanghai, a joint venture manufacturing molecular sieves, also intends to take advantage of this method by exporting raw materials sourced in China to UOP's plants in the U.S., Italy, and Japan.

A slight variation to the domestic purchase and export-sale method

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70 Id.
71 Id.
72 See infra note 144 and accompanying text.
73 MOFERT Regulations, supra note 67, art. 5.
74 Id. art. 2.
75 Id. art. 4.
has been successfully used by joint ventures. Instead of buying products made by Chinese enterprises and exporting them, a venture can manufacture additional products that can be used by the foreign parent company and its affiliates overseas. These additional products are then exported to earn foreign exchange. For example, Foxboro-Shanghai, which was established to manufacture electronic process controls, also manufactures electronic subassemblies for export to Foxboro affiliates around the world in order to earn hard currency. This method of generating hard currency is only available to joint ventures that have the capacity to manufacture products that can be used by their operations outside of China. It is unlikely that a venture will purposely embark on the production of new products just to sell them to its overseas affiliates for hard currency. A more likely scenario is that a joint venture that is already producing certain components for the venture's Chinese operations will increase its components production for sale to the venture's overseas operations to generate hard currency earnings.

3. Sale in China for Foreign Exchange

As a general rule, products sold by joint ventures on the Chinese domestic market must be paid for in renminbi.\(^{79}\) To assist joint ventures in increasing their foreign exchange income, the Foreign Exchange Regulations created three exceptions to this general rule.\(^{80}\)

First, foreign exchange may be used in the domestic market for sales of "sophisticated products."\(^{81}\) Foreign exchange may also be paid in sales of products of "high quality" that are competitive on the international market.\(^{82}\) Additionally, such products must be "urgently needed" by China and be "certified as up to standard" by local authorities.\(^{83}\) It is extremely onerous for a joint venture to utilize this exception to earn foreign exchange because of the host of conditions to be satisfied.\(^{84}\) Further, since the provision is couched in ambiguous terms, a joint venture cannot determine in advance of its application if its product is of sufficiently "high quality" or is "badly needed" by the state. To avoid ambiguities a foreign investor should attempt to include in the joint venture contract permission for domestic sales in hard currency.\(^{85}\)

\(^{79}\) Implementing Act, supra note 21, art. 66.

\(^{80}\) See Foreign Exchange Regulations, supra note 42, arts. 4, 5, 8.

\(^{81}\) Sophisticated products are those manufactured using advanced technology or lay technology provided by a foreign investor.

\(^{82}\) Foreign Exchange Regulations, supra note 42, art. 4.

\(^{83}\) Id.

\(^{84}\) See id.

\(^{85}\) Hewlett-Packard was careful to include in its contract such a provision, allowing the Beijing joint venture to sell locally for foreign exchange. China HP, Part I: Coping with Forex, Local Sourcing, supra note 77, at 18.
Second, a joint venture may obtain foreign exchange from domestic sales if its product is certified as an import substitute. Again certain conditions must be fulfilled and approval must be obtained before a joint venture may qualify its product as an import substitute.

Third, domestic sales may be made for foreign exchange if the customer is located outside the special economic zones and the economic and technological development zones of the open coastal cities. The approval of the foreign exchange control department must be obtained for such domestic sales. This exception appears easy to satisfy because a joint venture need only fulfill two conditions; the domestic sale must take place outside the specified zones and the authorities must approve the sale.

After a joint venture qualifies under one of the exceptions to sell domestically for foreign exchange, the joint venture must next convince domestic purchasers to surrender their foreign currency. However, foreign currency is a scarce commodity in China and domestic purchasers are unwilling to easily part with it. As a result, inducements have to be offered to such purchasers. For example, the experience of Coca Cola-Hainan shows that domestic purchasers may be willing to pay in foreign exchange if they are given price incentives.

The best domestic customers are usually other foreign-related industries, since they are more likely to have a surplus foreign exchange income. For example, Coca Cola-Hainan sells its products domestically to hotels for foreign exchange.

Despite the practical problems of selling domestically for hard currency, at least one joint venture, Foxboro-Shanghai, has had great success. For Foxboro-Shanghai, domestic sales of its electronic process

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86 Foreign Exchange Regulations, supra note 42, art. 5.


88 Foreign Exchange Regulations, supra note 42 art. 8.

89 Id.

90 See id.

91 See U.S. Cites China, Others for Barriers to Free Trade, REUTERS, Mar. 29, 1991 (LEXIS, NEXIS library, Reuters File); China Will Tighten Price Controls on Foreign Trade, REUTERS, Mar. 22, 1991 (LEXIS, NEXIS library, Reuters file).

92 Coca-Cola's New Hainan Joint Venture, CHINA L. PRAc., Aug. 20, 1990, at 22, 26. See also Jerome A. Cohen & Stuart J. Valentine, Recent Chinese Legislation Assisting Foreign Investors to Solve their Hard Currency Problem: Import Substitution and Other Options, B.Y.U. L. REV., 1988, at 519, 530. Incentive is created by offering customers a choice of paying either an adjusted renminbi price or foreign exchange price. The renminbi price is adjusted to account for the cost of obtaining the foreign exchange required in the course of operating the joint venture.

93 Coca-Cola's New Hainan Joint Venture, supra note 92.
control instruments have been its most important source of foreign exchange.¹⁰⁴

4. Import Substitution

Import substitution, which refers to the manufacture and sale in China of products that China must otherwise import, has been encouraged since 1983. For example, the Implementing Act allows joint ventures in China to sell their products domestically for foreign currency if the products are those which “Chinese trading companies need to import.”¹⁰⁵

Through the enactment of the Implementing Act, China recognizes that import substitution is an ideal way to solve the foreign exchange problems of both foreign investors and China. These problems are solved because import substitution allows a joint venture to increase its foreign exchange income and at the same time it decreases China’s foreign exchange expenditure. Therefore, more foreign exchange remains in the country if a product is produced locally than if the same product is imported since only the foreign exchange attributable to the profit of the foreign investor is remitted abroad. On the other hand, if the product is imported, the full price in foreign currency flows out of China.¹⁰⁶

It has not always been clear which products created by joint ventures are import substitutes. Since the Implementing Act merely sets out general principles, regulations were enacted in 1986 and 1987 to clarify and set out the procedure to certify joint venture products as import substitutes.¹⁰⁷ In 1986, the Foreign Exchange Regulations also permitted joint venture products to be certified as import substitutes if the products were those that China needed to import on a long-term or urgent basis.¹⁰⁸ In the following year, the Measures Relating to the Import Substitution by Sino-Foreign Equity and Contractual Joint Ventures (“Import Substitution Regulations”) were enacted.¹⁰⁹ The Import Substitution Regulations were made expressly applicable to joint ventures that provide “advanced technology” needed by China and are involved in the “development and generation transition of existing products.”¹¹⁰ Presumably,

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¹⁰⁴ Operating China JVs, supra note 52, at 90.
¹⁰⁵ Implementing Act, supra note 21, art. 64.
¹⁰⁶ Another benefit of local production of import substitutes is that it creates jobs for the Chinese and stimulates the local economy by requiring that manufacturing facilities be set up. See generally China-Country Marketing Plan FY '93, 1992 NATIONAL TRADE DATA BANK MARKET REPORTS, Sept. 1, 1992, available in LEXIS, Asiapc library, Busan file.
¹⁰⁸ Id.
¹⁰⁹ Import Substitution Regulations, supra note 87.
¹¹⁰ Id. art. 2.
joint ventures that do not fall within the advanced technology category are still governed by the 1986 regulations as there is no preemptive clause in the Import Substitution Regulations.\textsuperscript{101}

Currently, a joint venture product must also satisfy stringent conditions to qualify as an import substitute under the Import Substitution Regulations: (1) the joint venture itself must be equipped with advanced technology needed by China; (2) the product must be one that the central and local authorities or departments are currently importing and will continue to import; and (3) the product must be tested by the state-level product quality inspection center and must be up to the standard of similar imported goods.\textsuperscript{102}

The experience of a foreign investor further suggests that elaborate distinctions\textsuperscript{103} are made between products that may be approved as import substitutes before production, during the joint venture negotiation, and products that must first be produced before substitution status may be granted.\textsuperscript{104} If the product is listed in the state import plan, application for import substitution approval may be made at the feasibility study stage of the joint venture negotiations.\textsuperscript{105} However, "in principle, no advance approval will be given for products" that are not included in the state import plan.\textsuperscript{106} According to Chinese sources, to obtain approval for non-planned imports, the joint venture must first find a Chinese customer for the products and persuade that customer to purchase the joint venture products rather than imports.\textsuperscript{107} To persuade that customer, the joint venture must first produce the product intended for import substitution.\textsuperscript{108} If the joint venture product is not within the state import plan, import substitution is a difficult mechanism to implement. In this case, foreign investors should not rely on import substitution as a long-term means of generating foreign exchange.\textsuperscript{109}

If the joint venture product is within the state import plan, import substitution can be an attractive option, as it alleviates both the joint venture's and China's foreign exchange problems. It is made more at-

\textsuperscript{101} Unlike article 12 of the Foreign Exchange Regulations which provides that the regulations will prevail over other prior promulgations in the event of discrepancies. See Foreign Exchange Regulations, supra note 42, art. 12.

\textsuperscript{102} Import Substitution Regulations, supra note 87, art. 3.

\textsuperscript{103} Apparently, the distinction is based on articles 6 and 7 of the of the Import Substitution Regulations. See Id. arts. 6, 7.

\textsuperscript{104} Import Substitution, CHINA L. PRAC., July 1988, at 31.

\textsuperscript{105} Measures Relating to the Import Substitution by Products Manufactured by Chinese-Foreign Equity Joint Ventures and Chinese-Foreign Cooperative Ventures (promulgated by the People's National Congress on October 1, 1987) (LEXIS, Aisapc Library, Chinal file).

\textsuperscript{106} Id.

\textsuperscript{107} Id.

\textsuperscript{108} Import Substitution, supra note 104, at 32.

\textsuperscript{109} Id.
tractive to joint ventures because domestic purchasers are required to use import substitution products in priority to other products, thereby granting foreign investors a monopoly on import substitution products, and because joint ventures are guaranteed the support of government departments in concluding purchase and sales contracts with domestic end-users. Unlike joint ventures that sell domestically for hard currency, joint ventures that sell import substitutes do not need to convince domestic purchasers to part with their foreign exchange. The challenge for joint ventures is to change the embedded Chinese attitude that all goods made in China, including those made by Sino-foreign joint ventures, are inferior to goods made abroad.

Evidence of the success of import substitution may be found in the Foxboro-Shanghai and Schindler Elevator joint ventures. These joint ventures already have products listed in the Mechanical and Electrical Import Substitutes Catalog.

5. Swap Arrangements

In February 1986, Chinese legislation granted foreign investors who have more than one investment in China permission to offset the deficit of one of their ventures against the surplus of another venture. Such adjustment must be approved by the foreign exchange control department.

The practical limitations of such an arrangement are apparent. The foreign investor must have more than one joint venture in China, and at least one of the joint ventures must be generating a surplus in its foreign exchange account. There are foreign investors with more than one venture in China. One example is Printronics, an Australian corporation, which has three joint ventures located in Shanghai, Guangzhou, and Tianjin. Another example is Carrier, a U.S. corporation, which has two joint ventures, both located in Shanghai. However, foreigners with more than one joint venture are few and far between. Therefore, few joint ventures are able use this method to balance their foreign exchange account.

The State Council probably realized the limitations of their February legislation. Eight months later, in October 1986, the State Council

110 Import Substitution Regulations, supra note 87, art. 8.
111 Foreign Exchange Regulations, supra note 42, art. 5.
112 CAMPBELL, supra note 23, at 68.
113 Foreign Exchange Regulations, supra note 42, art. 9.
114 Id.
promulgated the Provisions of the State Council on the Encouragement of Foreign Investment ("Twenty-two Articles").

Unrelated joint ventures are now allowed to mutually adjust their foreign exchange surpluses and deficiencies under the supervision of the foreign exchange control department. To facilitate the adjustments, currency swap centers have been established. Initially, the centers were segregated between those for Chinese enterprises and those for foreign investment enterprises. Presently, however, many cities allow foreign investment enterprises and domestic Chinese enterprises to participate in the same market.

On the other hand, there are two major shortcomings to the swap arrangement. The swap center can provide a joint venture with foreign exchange only to the extent that other joint ventures have a surplus in foreign exchange and are willing to convert the excess to renminbi. However, this drawback is probably offset by the relatively simple procedure it entails. The buyers and sellers of foreign exchange need only obtain the approval of the foreign exchange administration department before the swap. Once the approval is obtained, the parties are free to negotiate their own exchange rates; that is, these swap arrangements are governed by the open market forces of supply and demand. This leads to the next drawback of the arrangement. The purchaser of foreign exchange must pay a substantial premium over the official conversion rate to induce the sale of foreign exchange for renminbi. For example, Foxboro-Shanghai, which has often resorted to foreign exchange centers to swap renminbi for dollars, paid a premium of 25-30% in 1986, and a premium of 50% in 1988 because of higher demand by joint ventures and local firms.

The swap arrangement has proved to be a very popular solution among joint ventures. Beijing and Shanghai approved $71 million in swaps between November 1986 and early 1988, and 130 of Shanghai’s 220 foreign investment enterprises in operation have used the Shanghai currency swap center. OMI-Shenzhen, a joint venture established in 1984 to produce electroplating chemicals, has reported that it obtains

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118 Id. art. 14.

119 See Zhao Zijian, U.S. - China Trade to Set Record This Year, XINHUA GENERAL OVERSEAS NEWS SERVICE, July 8, 1988, available in LEXIS, NEXIS library, Xinhua file.


121 Id.

122 Operating China JVs, supra note 52, at 90.

123 Cohen & Valentine, supra note 120, at 524.
most of its foreign exchange through the local swap center.\textsuperscript{124}

6. Reinvestment of Renminbi Profits

The reinvestment of profits from a joint venture has been sanctioned since 1979,\textsuperscript{125} but the Foreign Exchange Regulations have highlighted such reinvestment in China as a means to generate foreign exchange. \textit{Renminbi} profits may be reinvested in "enterprises in China . . . which are able to generate foreign exchange or to increase foreign exchange income."\textsuperscript{126} The approval of MOFERT and the foreign exchange control authorities must be obtained for such reinvestment.\textsuperscript{127} The foreign exchange generated from this reinvestment can also be used to repatriate the foreign investor’s profits from the original joint venture.

There appears to be no restriction on the type of enterprise in which the reinvestment may be made. Theoretically, it may even be possible for foreign investors to invest in Chinese enterprises. However, this is unlikely to happen since most Chinese enterprises are state-owned.\textsuperscript{128} In the immediate future, it is likely that reinvestments will be made in other Sino-foreign joint ventures.

It is hard to imagine a foreign investor resorting quickly to reinvestment in another venture as a means of generating foreign exchange. Investors would only consider this option if they already have problems with their original joint venture. They would, therefore, be wary of investing in a second joint venture in an attempt to solve the problems of the first venture.

Even if investment in Chinese enterprises becomes feasible in the future, it is unlikely to become a solution to the foreign investor’s hard currency problems. First, a Chinese enterprise would not be enthusiastic about a foreign investor investing in \textit{renminbi}. The enterprise would be better off accepting a local investor with whom they are familiar. Second, it is unlikely that the Chinese enterprise would pay hard currency dividends to the investor even if the enterprise earns hard currency profits. There is no legislation requiring payment of dividends in hard currency, and it is not likely that the Chinese enterprise would volunteer to do so.

7. Other Methods of Generating Foreign Exchange

a. Using the Joint Venture as a Marketing Arm

To increase their foreign exchange earnings, some joint ventures

\textsuperscript{125} Joint Venture Law, \textit{supra} note 1, art. 7.
\textsuperscript{126} Foreign Exchange Regulations, \textit{supra} note 42, art. 10.
\textsuperscript{127} \textit{Id}.
\textsuperscript{128} \textit{Id}.
have taken on the added role of marketing agent for the foreign investor's parent company. The joint venture then earns foreign exchange in the form of commissions paid by the foreign parent company. For example, Hewlett-Packard contractually provided that commissions earned by its joint venture from selling the parent company's products in China would be credited to the joint venture's foreign exchange account.\footnote{China HP, Part I: Coping with Forex. Local Sourcing, supra note 77, at 18.} The bulk of the venture's hard currency needs were met by these commission payments in 1987.\footnote{Id. at 17.} Stoody has also used its Shanghai joint venture as the local marketing arm to sell Stoody products, such as machinery used in welding and hardfacing operations.\footnote{The Stoody JV, Part I: Adapting to Change in the Foreign Parent, 13 Bus. China 177, 178 (1987).} The joint venture earns hard currency commissions for the sales.\footnote{Id. at 18.}

b. Loans

There is always the option of taking a hard currency loan from the Bank of China.\footnote{Implementing Act, supra note 21, art. 78.} Pursuant to the Bank of China Regulations on Providing Loans to Enterprises with Foreign Investment,\footnote{The Regulations of Bank of China on Providing Loans to Enterprises with Foreign Investment (Promulgated by the Bank of China on April 24, 1987) (LEXIS, Asiapc library, Chinal file) [hereinafter Bank Regulations].} three types of foreign exchange loans are available to joint ventures: (1) fixed assets loans to finance construction and installation costs, and to purchase technology and equipment; (2) working capital loans, to provide funds needed by a joint venture for normal operation, manufacturing, and marketing of products; and (3) stand-by credit.\footnote{Id. art. 5.}

Because of the disadvantages of these loans, it is likely that ventures will only resort to hard currency loans in emergencies. The disadvantages are that the venture has to provide security for the loan,\footnote{Id. arts. 7, 16.} the venture has to pay interest on the loan, presumably in hard currency,\footnote{Id. arts. 7, 18.} and the loan has to be repaid in hard currency.\footnote{Id. art. 18.} The last two factors may be the greatest deterrence to obtaining a hard currency loan.

c. Evidence Accounts

Foreign investors have proposed the use of evidence accounts as a means of determining the amount of foreign exchange they are entitled to

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129 China HP, Part I: Coping with Forex. Local Sourcing, supra note 77, at 18.  
130 Id. at 17.  
132 Id.  
133 Implementing Act, supra note 21, art. 78.  
134 The Regulations of Bank of China on Providing Loans to Enterprises with Foreign Investment (Promulgated by the Bank of China on April 24, 1987) (LEXIS, Asiapc library, Chinal file) [hereinafter Bank Regulations].  
135 Id. art. 5.  
136 Id. arts. 7, 16.  
137 Id. arts. 7, 18.  
138 Id. art. 18.
purchase from the local authorities.\textsuperscript{139} The general proposal is that an evidence account should keep track of the amount of foreign exchange the foreign investor spends in China. At a later date, if the venture needs to convert renminbi into foreign currency, the evidence account will be used to calculate the amount of foreign currency the venture is entitled to buy from the government at the official exchange rate. For example, if the foreign investor spent $20,000 in China, that venture should be entitled to buy $20,000 or a percentage thereof, from the government at the official exchange rate. The rationale of the evidence account is that the joint venture should at least be entitled to buy back a percentage of the foreign currency that the foreign investor brought into the Chinese economy. Apparently, Shanghai has already subscribed to this method of accounting on an ad hoc basis.\textsuperscript{140}

The potential advantages of the evidence account are threefold. First, foreign investors will be encouraged to source locally. The higher the level of local sourcing, the higher the amount of renminbi that can be converted into hard currency at the official exchange rate. This method has an advantage over the swap arrangement because the lower official exchange rate applies to the conversion. Second, in addition to inducing an increase in existing purchases from Chinese enterprises, the method will encourage foreign investors to switch from purchases currently made overseas to local sourcing.\textsuperscript{141} Third, this method offers some certainty in the amount of foreign exchange that will be available to the foreign investor. The amount can be calculated in proportion to previous hard currency expenditures in China.

It remains to be seen if the Chinese authorities will sanction the use of evidence accounts. As pointed out above, the evidence account offers advantages to foreign investors and China. At the same time, the Chinese authorities must be prepared to lose control over foreign exchange availability, since joint ventures may convert renminbi into hard currency in proportion to the foreign investor's hard currency expenditure in China.

\subsection*{B. Local Sourcing}

Local sourcing of raw materials and components has been cited as the second most pressing problem for joint ventures operating in China, next to balancing foreign exchange income and expenditure.\textsuperscript{142} There is no statutory requirement that joint ventures purchase domestic raw materials or components. Instead, the Joint Venture Law and the Imple-
menting Act merely require joint ventures to give "first priority to purchases in China" when "conditions are the same" between local purchasing and imports. Local sourcing is encouraged for the development of domestic industries in China.

The Implementing Act provides four official channels through which joint ventures may purchase materials in China:

1. under planned distribution of the state (the joint venture’s proposed purchase must be included in the supply plan of the department in charge of the joint venture),
2. from the state materials and commercial departments,
3. from production enterprises or through commission agencies,
4. from foreign trade corporations that handle export items.

In the experience of Thurmond-Shanghai, it is more efficient, if possible, to bypass all four official channels and purchase directly from anyone who is willing to sell the material. In 1987, the joint venture found itself with extra capacity, having met its quota for the year. It needed extra material to produce beyond the quota and pay the workers a bonus. The venture’s Chinese personnel located a willing supplier in Wuhan. Renminbi and material changed hands and the deal was completed. The foreign investor’s side had this to say about the transaction, “[t]hey don’t ask us why we want the material, we don’t ask them why they’re selling it. We don’t ask anyone for permission, and no one tells us no. What a system!”

Although local sourcing is not required, most joint ventures strive to increase the local content of their production in order to decrease their foreign exchange expenditure. The frustrations encountered by joint ventures in local sourcing are summarized up by Mr. Lowry, Director of American Motors Corporation, as follows:

The Chinese tell us they can provide virtually everything but it doesn’t work that way. When you find the supplier, it almost always turns out that he can’t guarantee the quantity or quality, or the prices are out of line, or they want to sell you 10,000 items when all you need is a few hundred.

Overall, the three problems most commonly encountered in local sourcing are:

1. Joint Venture Law, supra note 1, art. 9; Implementing Act, supra note 21, art. 57.
2. Implementing Act, supra note 21, art. 58.
3. Id.
4. Id.
5. Id.
6. Id.
7. Id.
8. Id.
9. Id.
sourcing are: (1) non-availability or shortage of material, (2) poor quality of materials, and (3) high prices of materials.

1. Non-availability or Shortage of Materials

The materials needed by joint ventures are sometimes simply not available in China. OMI's electroplating joint venture in Shenzhen has to import 50% of its product's value because the chemicals required for production are not found in China.\textsuperscript{152}

The problem is further exacerbated by the longstanding central planning system, which provides incentives for local managers to meet centrally mandated quotas.\textsuperscript{153} Meeting the quotas has become the definition of success, and managers have developed systems which are vertically integrated to ensure the supply of materials necessary for production to meet the quotas.\textsuperscript{154} Consequently, there are very few independent suppliers able or willing to supply materials.

If a joint venture is fortunate enough to find the right material, it may encounter problems of inadequacy or unreliability of supply. For example, despite a contractual supply agreement, Hitachi-Fujian, which manufactures color televisions, was forced to halt operations for several months in 1986 because its supply of components was disrupted.\textsuperscript{155} Some ventures, such as Warner Lambert, which manufactures gelatin capsules in Jiangsu, offer inducements to their suppliers in order to ensure a steady source of materials.\textsuperscript{156} Warner Lambert offered its Guangdong supplier the possibility of exporting raw gelatin in Asia.\textsuperscript{157} If the factory supplied the gelatin on time and at a reasonable renminbi price, the supplier could sell to Warner Lambert's overseas operations for foreign exchange.\textsuperscript{158}

Other joint ventures have resorted to manufacturing the components required by the joint venture. This option is not always viable because the required quality may make the cost prohibitive. Also, the joint venture may not have the expertise to manufacture the components. Parker-Hubei has attempted unsuccessfully to persuade its overseas poly-

\textsuperscript{152} Electroplating Loses its Lustre at OMI's China Venture, supra note 124, at 187.

\textsuperscript{153} Economies in Transition: Guidelines for Doing Business in China and the U.S.S.R. EAST ASIAN EXEC. REPS., July 15, 1988, at 9 (in China, "[a] longstanding central planning system has for the last 40 years provided incentive for local managers to meet centrally mandated quotas").

\textsuperscript{154} Id.


\textsuperscript{156} Warner Lambert's JV Finishes First Year on Upbeat Note, 16 Bus. CHINA 27 (1990).

\textsuperscript{157} Id.

\textsuperscript{158} Id.
mer supplier to set up a plant in China.\textsuperscript{159}

2. Poor Quality of Materials

Even if a joint venture is fortunate enough to find local materials in sufficient quantities, the materials are often of poor quality.\textsuperscript{160} A common complaint is that locally sourced materials are below international standards.\textsuperscript{161} This quality problem is not limited to raw materials. For example, in the Beijing-Tokyo joint venture, an existing building was renovated to accommodate joint venture operations.\textsuperscript{162} Upon completion, it was found that much of the construction work was poor.\textsuperscript{163} The concrete used was of a lower grade than designated, and the walls began to crumble soon after the renovation was complete.\textsuperscript{164} The fuses often blew and the boiler did not operate properly as a result of poor circulation planning.\textsuperscript{165}

Sometimes, the quality problem is compounded by the Chinese bureaucracy. For example, in the Gillette-Shenyang joint venture, the top quality nuts and valves required were available, but since the project was classified under light industry, it was only entitled to low-quality bolts and valves.\textsuperscript{166} The matter was resolved only after a visit to the governor of Shenyang.\textsuperscript{167}

Even where the quality of the material is of an acceptable standard, there is the further problem of inconsistency of the standard of quality over time. For example, Parker-Hubei continues to rely on imported polymers to manufacture O-ring seals because local materials have proved to be inconsistent from batch to batch.\textsuperscript{168} Stoody-Shanghai has also reported "unsteady" quality in local materials.\textsuperscript{169} To minimize the impact of the inconsistent inputs, Stoody has modified its manufacturing process.\textsuperscript{170}

The problem of poor quality goods may be traced to the centrally-planned economy, which does not reward the production of quality prod-

\begin{thebibliography}{99}
\bibitem{161} See generally id. (the domestic materials are very poor).
\bibitem{162} Id.
\bibitem{163} Id.
\bibitem{164} Id.
\bibitem{165} Id.
\bibitem{166} SUSAN GOLDENBERG, HANDS ACROSS THE OCEAN: MANAGING JOINT VENTURES 132 (1988).
\bibitem{167} Id.
\bibitem{169} Id.
\bibitem{170} Id.
\end{thebibliography}
ucts. Instead, a central command system only focuses on producing the quota allocated, regardless of the quality of the products.\textsuperscript{171}

The quality problem is prevalent throughout all industries in China and the government has recently begun to deal with it.\textsuperscript{172} The Ministry of Light Industry and other government departments are jointly issuing production licenses to qualified enterprises in order to force enterprises producing low quality goods out of operation.\textsuperscript{173}

Joint ventures have adopted various techniques in dealing with quality setbacks. For example, Skipper-Nanjing, a joint venture which manufactures sounding equipment and other marine navigation aids, offers technical assistance to its local suppliers to achieve quality standards and to have better control over local supply standards.\textsuperscript{174} The foreign investor also sends, once a year, three Norwegian officers on short-term assignments to visit its local suppliers in Nanjing.\textsuperscript{175}

Foxboro-Shanghai has taken a different approach to accelerate the integration of local materials. The joint venture has built a quality-testing laboratory in its Shanghai factory to enabling it to test locally.\textsuperscript{176} Local testing avoids the delays associated with shipping the product overseas for testing.\textsuperscript{177} At the same time, it allows the Chinese supplier to participate in the evaluation and to learn the weakness of its products.\textsuperscript{178} In this manner, the joint venture can work with the supplier to correct the weakness of the product.

Finally, joint ventures such as Hewlett-Packard have simply relocated to a feasible site of supply. The joint venture was forced to move its manufacturing facilities from Peking to Shenzhen because it was very difficult to source locally in Peking.\textsuperscript{179}

3. High Prices of Materials

After getting past the hurdles of availability and quality, joint ven-

\textsuperscript{172} Several years ago, the new Minister for the Light Industry, Zheng Xianlin, did make an effort to eradicate the quality problem. He proposed holding an exhibition for shoddy goods. This idea met with strong resistance from various sources which feared that the exhibition could cause a number of enterprises to close down. The total output value under the state plan could not be achieved if enterprises closed down. Time to Get Rid of Shoddy Goods, CHINA ECON. NEWS, Nov. 12, 1990, at 2.
\textsuperscript{173} Id. at 1.
\textsuperscript{175} Id.
\textsuperscript{176} Operating China JVs, supra note 52, at 90.
\textsuperscript{177} Id.
\textsuperscript{178} Id.
\textsuperscript{179} Overcoming the Pitfalls of Sourcing in the PRC, Part 2, 15 Bus. CHINA 153 (1989).
tures often confront erratic pricing in China. Also, raw materials such as coal are priced at a fraction of world prices, but the cost of manufactured components can be much higher than comparable world prices. For example, Stoody-Shanghai, a joint venture which makes metal welding rods, electrodes, and wires, sources 70% of its materials locally, but must still import one key ingredient, cobalt, because the price of cobalt in China is twice the price on the world market.

Prices for locally sourced materials are determined as provided in the Implementing Act:

1. The price for raw materials, such as gold, silver, platinum, petroleum, coal, and timber which are used directly in export production are pegged to "international market prices." This international market price is determined by government authorities and may be paid in foreign currency or renminbi.

2. The price for materials handled by Chinese foreign trade companies is negotiated by the parties, again with reference to international market prices. Foreign currency must be paid in this case.

3. The price for materials not covered by (1) and (2) is pegged to prices paid by state-owned enterprises, and payment must be made in renminbi.

Before 1986, the pricing provisions offered little, if any, protection against price gouging by local Chinese suppliers. The provisions were too flexible as prices were determined by the Chinese seller. Joint ventures lacked local yardsticks against which to compare the prices and lacked legal recourse against the seller if the price was too high. Joint ventures were held to ransom because materials were needed for production, and they were usually scarce and hard to obtain.

The State Council recognized the price gouging problem and attempted to protect foreign investments in the Twenty-two Provisions. All government authorities are directed to curb indiscriminate pricing, and authorities at the provincial level are required to formulate specific methods to calculate prices. The provincial authorities are also required to strengthen supervision and administration to prevent price gouging. Further, the provisions give joint ventures redress against recalcitrant sellers. Joint ventures now have the right of appeal to local

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180 The Stoody JV, Part I: Adapting to Change in the Foreign Parent, supra note 131, at 178.
181 Implementing Act, supra note 21, art. 65.
182 Id. art. 65(1).
183 Id.
184 Id. art. 65(2)
185 Id.
186 Id. art. 65(3).
187 Twenty-two Articles, supra note 117, art. 16.
188 Id.
189 Id.
economic committees and to the State Economic Commission if the venture is a victim of price gouging.

C. Labor Management

Foreign investors have experienced problems in three main areas of labor management: (a) recruitment; (b) dismissal; and (c) bureaucratic interference.

In general, the five main legislations that govern labor management by joint ventures are:


This series of regulations, which were promulgated from 1980 through 1988, reflect a liberalizing trend of control over labor manage-

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192 Twenty-two Articles, supra note 118.

193 Regulations for the Autonomous Right of the Enterprises with Foreign Investment to Employ Personnel, the Wages and Salaries, and the Expenses for Insurance and Welfare Benefits for Staff Members and Workers (promulgated by the People's National Congress on Nov. 10, 1986) (LEXIS, Asiapc library, Chinal file) [hereinafter 1986 Labor Regulations].

ment by the Chinese government. The Chinese government probably realized that cheap labor is one of the primary reasons foreign investors are willing to locate their operations in China. If the government failed to address the investors' labor-management concerns, investment in China would have most likely lost much of its attraction.

1. Recruitment

Lack of autonomy and lack of skilled labor are the two major concerns of foreign investors when recruiting personnel in China.\(^\text{195}\)

a. Workers

Joint ventures did not always enjoy autonomy in recruiting workers, and this lack of autonomy in turn affected the quality of the workers hired. Under the 1980 Labor Regulations, joint ventures may either employ workers recommended by the local labor department, or may recruit workers on their own, subject to the consent of the labor department.\(^\text{196}\) In theory, joint ventures may recruit directly through newspaper advertisements, or from training courses, universities, and research institutes, so long as the approval of the labor department is obtained.

In practice, most joint ventures are staffed by personnel brought over by the Chinese partner from its own unit without regard for skills or qualifications. Joint ventures are pressured to accept the recommendation of the Chinese partner without instituting formal selection procedures. There is no legislative requirement that the foreign investor accept the Chinese partner's "recommendation" on recruitment. But the foreign partner is usually not inclined to go beyond initial protests against the "recommendation" for practical reasons. The foreign partner does not want the joint venture relationship to start at an acrimonious level, and the foreign partner must still rely on the Chinese partner for assistance in the future. For example, in Beijing-Tokyo, the joint venture was pressured into taking over 80 employees from the old photograph center when the venture only needed 40 workers.\(^\text{197}\) Since it is difficult for the foreign partner to resist the Chinese partner's pressures without jeopardizing the future operation of the venture, the only solution is for the Chinese government to pressure the Chinese counterparts to refrain from such acts. Indeed, the trend of Chinese legislation is toward liberalization of recruitment by the joint ventures.

The main focus of the labor regulations enacted from 1983 through

\(^{195}\) 1980 Labor Regulations, supra note 190, art. 3.

\(^{196}\) Id.

\(^{197}\) Beijing Tokyo Photographic Art Co., Ltd., supra note 160, at 12 (while eighty employees were originally hired, fifty employees were ultimately fired after negotiations).
1988 was to liberalize the recruitment of workers from other localities.\textsuperscript{198} The 1983 regulations sanctioned the recruitment of engineers, technicians, and managing personnel from other localities provided such workers could not be found in the venture's own locality.\textsuperscript{199} However, such recruitment is subject to the approval of labor authorities in the venture's locality and in the locality where each prospective worker is located.\textsuperscript{200} The 1986 Labor Regulations further enhanced outside hiring of workers by requiring the original work units to "give their support and permit the transfer."\textsuperscript{201} If the original work unit refuses an employee transfer, or some other dispute arises, the foreign investor may submit the dispute for adjudication.\textsuperscript{202} Finally, the 1988 Labor Decisions went even further, prohibiting the original work unit from using "such means as unreasonable charges and withdrawal of living stipend of employee so as to block the transfer."\textsuperscript{203}

Otsuka Pharmaceutical Company which was established in 1980 has experienced the Chinese government's liberalization policy over the years. In 1983 and 1984, the joint venture had to file many reports to recruit workers, and was required to maintain a balance between the number of female and male workers.\textsuperscript{204} In 1987, the report requirements were relaxed, and the joint venture was only required to report the number of workers recruited.\textsuperscript{205} Currently, the joint venture recruits its own workforce based on a written exam with the assistance of the Labor Services Bureau.\textsuperscript{206} By recruiting in September, just after the results of the university entrance examinations are announced, Otsuka has managed to attract young candidates who are mostly senior high school graduates.\textsuperscript{207} Recruiting recent graduates is advantageous because they do not bring bad management practices into the joint venture since they have not had an opportunity to work in local enterprises.\textsuperscript{208}

Joint ventures now have greater latitude under the liberalized regulations to search for skilled labor in their localities and in other localities. This increased search area creates a larger labor pool from which they may select workers.

\textsuperscript{199} See 1983 Labor Regulations, supra note 191; see also Beijing Tokyo Photographic Art Co., Ltd., supra note 160, at 12.
\textsuperscript{200} See 1983 Labor Regulations, supra note 191.
\textsuperscript{201} 1986 Labor Regulations, supra note 193, art. (1)(b).
\textsuperscript{202} Id.
\textsuperscript{203} 1988 Labor Decisions, supra note 194, art. 3.
\textsuperscript{204} CAMPBELL, supra note 23, at 94.
\textsuperscript{205} Id.
\textsuperscript{206} Id.
\textsuperscript{207} Id.
\textsuperscript{208} Id.
Some Chinese authorities have also taken the initiative to alleviate the shortage of skilled labor. According to one report, the Beijing Foreign Enterprise Service Corporation has made available a reserve of more than 10,000 qualified workers from various professions to meet the needs of resident offices of foreign firms in the capital, Beijing. In selecting candidates, the Corporation claims to have paid attention not only to foreign language abilities and technical skills, but also to the candidates' moral character.

Recruiting skilled labor should now be a lesser problem under the law, and joint ventures, such as Otsuka Pharmaceutical Company, appear to have benefitted from the liberalized recruitment law. However, there is still some skepticism about the uniform implementation of the law by government authorities. Some observers believe that the labor regulations will be largely ignored by authorities, and recruitment of skilled labor will continue to pose a problem. Further, Chinese law still does not prohibit a venture's Chinese partner from pressuring the foreign partner to accept its staffing "recommendations." The foreign partner can minimize this problem and avoid having to confront its Chinese counterpart by providing in the joint venture contract that all workers must be recruited through a specified selection process, such as an examination. Where there are specific provisions on the selection process, it is less likely that the Chinese partner will breach its contractual obligations under the venture contract.

b. Senior Management

The recruitment of high-level personnel, such as general managers and deputy general managers, is different from the recruitment of lesser qualified workers. Recruitment of high level personnel is governed by the Implementing Act which empowers the board of directors of a joint venture to select senior management personnel.

The qualifications and experience of senior management personnel are the main concerns of foreign partners in a joint venture. For example, according to one survey, "Chinese managers assigned to a joint venture traditionally come from the Communist Party, where title and rank are more important than management skills." This selection process places low priority on merit and qualifications. For example, McDonnell Douglas, a cooperative joint venture with the Chinese, found that their...
Chinese partner had to struggle to separate party and factory management. The most qualified managers were not given authority simply because they did not have party credentials. McDonnell Douglas finally threatened to halt production forcing senior management changes. The process took more than six months, and the decision to change senior management had to be approved by the Party Central Committee.

A solution to this problem is for the foreign partner to attempt to incorporate a fixed selection procedure for high-level management personnel into its joint venture contract. Such a provision would avoid a joint venture having to accept an incompetent general manager or deputy general manager.

The transfer of high-level Chinese administrative staff has also been a source of frustration to foreign investors. For example, after investing time and effort in training administrative personnel, a joint venture may be forced by the authorities to release them. The 1986 Labor Regulations specifically addressed this issue by prohibiting government departments from transferring Chinese senior management personnel to other jobs during their terms in office at the joint venture. If the personnel must be transferred, the consent of the board of directors of the venture must be obtained. The 1988 Labor Decisions required that, in addition to the consent of the board of directors, the consent of the general manager be obtained for such transfers.

2. Dismissal

Experience suggests that dismissing joint venture employees is very difficult, especially dismissing employees provided by the Chinese partner. Pursuant to the 1980 Labor Regulations, joint venture workers may be dismissed in two situations. First, if a worker has become “superfluous as a result of changes in production and technical conditions,” he or she may be dismissed. The dismissal can be made if the worker cannot meet requirements after training, and is not suitable for other work. The joint venture must compensate the dismissed worker ac-

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215 Id.
216 Id.
217 Id.
218 1986 Labor Regulations, supra note 193, art. (1)(c).
219 Id.
220 1988 Labor Decisions, supra note 194, art. 7.
221 1980 Labor Regulations, supra note 190, art. 4.
222 Id.
223 Id.
cording to the labor contract provisions. Second, a worker who violates the rules and regulations of a joint venture may be dismissed if the violation is serious. The dismissal must be approved by the department in charge of the joint venture and the labor management department.

In both cases, the labor union can file an objection to the dismissal with the board of directors, and if the dispute cannot be resolved through consultation, either party may request arbitration before the labor authorities. If either party refuses to accept the arbitration award, that party may file suit in a Chinese court. Because of the host of provisions for approval and redress, foreign investors find that the dismissal of a joint venture employee is extremely difficult to enforce without the agreement of the Chinese partner.

In 1983, labor regulations were both liberalized and tightened in different respects. The procedure for dismissal was tightened so that the joint venture must now simultaneously give one month’s prior notice of dismissal to the labor union and the worker. The procedure appears to be liberalized in that the dismissal decision need only be submitted to the department in charge of the venture, and to the local labor personnel department. No approval is expressly required. But limitations to dismissals were also added. Workers cannot be dismissed during the period of their treatment or recuperation from injury or illness, and women cannot be dismissed during pregnancy or maternity leave.

To further encourage foreign investments, the Twenty-two Articles sanctioned the dismissal of workers who have become “redundant.” No prior notice is required. Filing a report with the local labor and personnel department is sufficient. The 1986 Labor Regulations contained similar provisions, except that filing of the dismissal was not required. The trend toward liberalization of labor dismissal

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224 Id.
225 Id. art. 5.
226 Id.
227 Id. art. 6.
228 Id. arts. 6, 14.
229 Id. art. 14.
231 Id. arts. 7, 10.
232 Id.
233 Id.
234 Id. art. 7.
235 Twenty-two Articles, supra note 117.
236 Id. Prior to this, a report also had to be filed with the department in charge of the joint venture.
237 1986 Labor Regulations, supra note 193, art. (1)(d).
culminated in the 1988 Labor Decisions. These decisions prohibited government agencies, local enterprises, or individuals from interfering with the decision of a joint venture to fire its Chinese employees so long as such decisions were made according to the terms of the employment contract and relevant regulations.

Notwithstanding legislative safeguards, the Warner Lambert joint venture has come up with its own way to circumvent resistance to firing workers. Each worker is required to read and sign a list of work regulations approved by the trade union before working for the joint venture. When a worker is subsequently fired for breaking the rules, neither the worker nor the trade union can complain. This agreement has been successfully invoked at least four times by the joint venture. It would be beneficial for other foreign investors to also adopt such a procedure.

3. Interference by the Bureaucracy

The Chinese bureaucracy has been known to interfere in the labor management of joint ventures. The interference is usually carried out by the department in charge of the Chinese partner ("Department"). Since Departments have power over the recruitment and dismissal of workers in Chinese enterprises, Departments often misconstrue this power to extend to joint ventures in which Chinese enterprises have an interest.

Joint ventures have self-governing power under the Implementing Act, and the role of the Department is limited to providing "support and assistance" to the ventures. However, some Departments have given a wide interpretation to the provision of "support and assistance" to joint ventures, and some Departments simply ignore the autonomy of joint ventures or are ignorant of the self-governing power of joint ventures.

One example of this interference is found with Parker-Hubei. In this situation, the Hubei Provincial Bureau of Machine Building Industry "retired" two Chinese managers appointed by the joint venture without the consent of the board of directors or knowledge of the American partner. The Bureau completely disregarded the self-governing

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239 Warner Lambert's JV Finishes First Year On Upbeat Note, supra note 156, at 28.
240 Id.
241 Id.
242 Id.
243 Implementing Act, supra note 21, art. 7.
244 See Joint Venture Law, supra note 1, art. 33.
245 The department in charge of the joint venture.
246 Parker-Hubei: Open Policy Defeats Bureaucracy, BEIJING REV., Apr. 4-10, 1988, at 35-36.
power of the joint venture and article 33 of the Joint Venture Law.\textsuperscript{247} Article 33 provides that the board of directors is the “highest authority” in a joint venture and is vested with the power to decide all major issues.\textsuperscript{248} The American partner protested the dismissal and threatened to cancel transfers of technology from the parent company to the joint venture if the managers were not reinstated.\textsuperscript{249} Finally, the Bureau admitted that it was ignorant of the law regarding joint ventures, and after pressure from the Standing Committee of the National People’s Congress and MOFERT, rescinded their dismissal of the two managers.\textsuperscript{250} The Parker-Hubei joint venture, however, still suffered losses as a result of this incident.\textsuperscript{251}

Similarly, in Salinan-Automotive Technical Service, a car maintenance joint venture, China National Automotive Industry Corporation, dismissed the chairman and all the directors of the joint venture without notice to the foreign partners.\textsuperscript{252} The foreign partners had to go to China’s top authorities before the chairman and directors were reinstated.\textsuperscript{253} The dispute lasted over a year.\textsuperscript{254}

After many complaints and incidents, the State Council approved an 8-point opinion issued jointly by the Ministry of Labor and the Ministry of Personnel.\textsuperscript{255} The opinion in part sought to alleviate bureaucratic interference in joint ventures.\textsuperscript{256} The opinion, which is now embodied in the 1988 Labor Decisions, places special emphasis on the autonomy of foreign investment enterprises in the hiring and firing of Chinese personnel.\textsuperscript{257} Local governments and departments were directed to educate all levels of leaders, workers, and staff members of the high degree of autonomy in personnel management accorded to joint ventures.\textsuperscript{258}

The 1988 legislation is designed to deter future interference by the bureaucracy, with administrative liability ensuing for those who breach their obligations.\textsuperscript{259} The reality is that earlier legislation already afforded some protection against such interference, but that did not prevent the

\textsuperscript{247} Id.
\textsuperscript{248} Id. See also Joint Venture Law, supra note 1, art. 33.
\textsuperscript{249} Parker-Hubei: Open Policy Defeats Bureaucracy, supra note 246.
\textsuperscript{250} Id.
\textsuperscript{251} Id.
\textsuperscript{252} Jardine Gets More than it Bargained for at Peking Car Service JV, 23 Bus. China 177, 177.
\textsuperscript{253} Id.
\textsuperscript{254} Id. at 178.
\textsuperscript{256} Id.
\textsuperscript{257} 1988 Labor Decisions, supra note 194, art. 1.
\textsuperscript{258} Id. art. 9.
\textsuperscript{259} Id.
bureaucracy from firing Chinese staff and workers employed by joint ventures.\textsuperscript{260} As such, the 1988 legislation may be just another addition to a host of ineffective laws which supposedly protect the autonomy of joint ventures.

\textbf{D. Inadequate Infrastructure}

Foreign investment in China is also hampered by the country's inadequate infrastructure. This poor infrastructure is exemplified by power shortages, a poor transportation system, and a poor communications system.

The Chinese authorities are aware of the country's over-burdened and inadequate infrastructure, and have attempted to address these problems. For example, the Twenty-two Articles give priority to export enterprises and technologically-advanced enterprises in obtaining water and power service, and transportation and communication facilities needed for production and distribution.\textsuperscript{261}

1. Power Shortages

The power supply in China is notorious for being inadequate and unreliable. Sino-foreign joint ventures have experienced varying degrees of inconvenience caused by the inadequate supply and have adapted. For example, Stoody-Shanghai is not able to run its plant at full capacity because the amount of power allocated to the joint venture is inadequate.\textsuperscript{262} To compound the problem, the power supply is also erratic, and the plants have to close down parts of their operation periodically.\textsuperscript{263} Parker-Hubei is more fortunate, as power is available six days a week to the joint venture for most of the year.\textsuperscript{264} But power supply is curtailed in summers, when floods and droughts reduce the electricity supply.\textsuperscript{265} Municipal needs are given priority over the needs of Parker-Hubei, and the plant can only operate four days a week during the summer.\textsuperscript{266} Apparently, the joint venture either does not qualify as a priority venture under the Twenty-two Articles, or the local authorities are simply ignoring the law.

Fu-Wan Toy Company, a Sino-Japanese joint venture, accommo-
dates the vagaries of power supply by closing its plants on Wednesdays. However, there have been instances where authorities also cut off power supply on Thursdays, informing the company of the power cut only on the same morning. Beijing-Tokyo, on the other hand, has not allowed its operations to be hampered by power shortages. Initially, it continued to operate its photo processing laboratory and photographic shop by candlelight when power was cut. When the authorities prohibited business by candlelight, the venture used pocket flashlights or got by with window light.

To minimize the inconvenience of power curtailments, foreign investors should attempt, during venture negotiations, to obtain a contractual commitment by the relevant authorities to provide the requisite power to the venture. This commitment may be hard to extract, as local authorities may be inexperienced and unable to appreciate the needs of joint ventures. For example, the Hainan authorities required Coca Cola-Hainan to pre-pay 1.2 million renminbi for the establishment of a power line and substation, but refused to contract or guarantee to supply the power needed.

If it is any comfort to foreign investors, the power-supply problem extends beyond joint venture operations. In October 1984 the Government reported that 20% of the country's machinery stood idle because of energy shortages. The shortages were most serious in Shanghai, China's biggest industrial center, and in nine eastern provinces, including many special economic zone port cities.

2. Poor Transportation System

China is also plagued by a poor transportation system both on land and sea. The waterways are used as the primary mode to transport goods, but the major ports are relatively shallow and extremely congested. Ships must often wait weeks or months for loading berths. Many of China's roads are unpaved, making road transportation a nightmare. At Thurmond-Shanghai, foreign personnel reported having to drive through streams to get to Wuhan to collect materials.

Printronic-Guangzhou has also complained about air transporta-

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267 China Fu-Wan Toy Company, Ltd., CHINA NEWSL., no. 75, at 18.
268 Id.
270 Id.
271 Id.
272 Coca-Cola's New Hainan Venture, supra note 92, at 27.
274 Webber, supra note 146, at 24.
tion in China. The joint venture sells its printed circuit boards mainly to end-users in Europe, the U.S., and Singapore. Most of the product is air freighted. In one case, the venture suffered a costly delay of 3 days to a week because it used the busy Shanghai-Hong Kong air freight route.

3. Poor Communications System

Telephones are scarce and expensive in China, and the telecommunications infrastructure is ill-equipped to serve the vast country. For example, Stoody-Shanghai has reported that it takes hours to get through to the country’s national operator to make overseas calls, despite the joint venture’s location in Jianding, the satellite “science city” in Shanghai.

E. Poor Quality Control

Joint ventures cannot sell their products overseas if the products do not meet international quality standards. Many ventures have problems exporting their products because of poor quality. This is especially true in the initial years of a venture’s operation. Poor quality is usually the result of poor-quality inputs and/or indifference of the joint venture workers and the input production workers to quality control.

As discussed above, Chinese workers have no regard for the production of high-quality products, largely because of China’s centrally-planned quota system, which only rewards the ability to produce the allocated quota. Quality of the product is irrelevant so long as the quota is met. Chinese workers naturally carry over their poor work habits from the quota system to the joint venture.

Joint ventures use different methods to rectify the problem. Printronics-Guangzhou tries to improve the quality of its multi-layered printed circuit boards by making quality checks at three different places along the production line. Twenty-two technicians have also been sent for four months of training at the parent company’s plant in Australia, and these technicians in turn have trained other workers on their return to China. Workers are also required to attend classes at the plant every day.

Volkswagen-Shanghai has a different approach to improving qual-

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275 *Australia Firm Uses PRC Venture as Lesson for Other Asian Projects*, supra note 115, at 10.
276 Id.
277 Id.
280 Id.
281 Id.
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ity. The workers at the joint venture were divided into small groups of five to six people and are supervised by a foreman. Each group is responsible for the quality of the products it manufactures, and a worker may be removed from his group as punishment if he fails to comply with quality standards.

An arms-length approach has been adopted by McDonnell Douglas to solve the problem. This approach is possible here because McDonnell Douglas has a licensing agreement, and not a joint venture, with Shanghai Aviation Industrial Corporation. First, the contract provides that the Federal Aviation Authority ("FAA") is the final authority on quality inspection; that is, the FAA certifies or rejects all planes made in China. Second, the FAA designees work in China to assure compliance with the U.S. regulations.

However, the appointment of an independent third party as the final authority on quality may not be acceptable or feasible in most joint venture situations. It entails additional costs and time to meet the inspection requirements, and the Chinese partner may not be open to leaving the final decision to a third party.

Whatever the approach that foreign investors decide to adopt for quality control, the system should be devised early in the joint venture negotiations, and be included in the joint venture contract to prevent resistance at the operation stage.

F. Termination

The relationship between the Chinese partner and the foreign partner in a joint venture may be terminated in two ways: the transfer of one partner's interest in the venture to a third party or to the remaining partner; or the dissolution of the joint venture.

Chinese law covers the second situation, but only partially provides for the first situation. The Joint Venture Law and the Implementing Act provide for the assignment of one partner's interest to a third party. The law is silent on the more obvious alternative of the remaining partner buying out the outgoing partner's interest in the joint venture.

1. Buy-outs

There are three possible scenarios for a joint venture buy-out: (a) the Chinese partner buys the foreign partner's interest; (b) the foreign

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282 Joint Venture Report - Shanghai Volkswagen, supra note 56, at 37-38.
283 Id.
285 Id. at 27-28.
286 Id. at 28.
287 See Joint Venture Law, supra note 1, art. 4; Implementing Act, supra note 21, art. 23.
partner buys the Chinese partner’s interest; or (c) a third partner buys either the Chinese or foreign partner’s or both partners’ interest in the venture.

There is generally no specific provision for a straight buy-out of one partner’s interest in a joint venture by the remaining partner. However, there is a buy-out provision that can be invoked when one partner attempts to assign its interest in the venture to a third party.\textsuperscript{288} Here, the remaining partner to the joint venture has the preemptive right to purchase the divesting partner’s share.\textsuperscript{289} The consent of the examination and approval authority is required for such purchase.\textsuperscript{290}

The issue remains whether one partner may directly buy out the other partner’s interest in a joint venture. It would be anomalous for the Chinese authorities to object to a straight buy-out of the remaining partner’s interest on the ground that there is no express provision for such a buy-out. The objection can easily be circumvented by first offering to assign the interest to a third party, thereby triggering the right of pre-emption vested in the remaining partner. In this circuitous manner, a buy-out by the remaining partner may be achieved. It is likely that if the Chinese authorities do object to a direct buy-out of a venture partner’s interest, it will probably be for reasons other than the absence of legislative provision for such a buy-out.

In practice, the absence of express legislative provisions has not proved to be an obstacle to direct buy-outs by the Chinese partner.\textsuperscript{291} Last December, UNISOL, the foreign partner, was reported as negotiating with its Chinese partner to sell out the former’s share in the UNISOL-Guangdong joint venture to the Chinese partner.\textsuperscript{292} On the other hand, the buy-out of a Chinese partner’s interest by the foreign partner would have been impossible before 1986, since there was no provision for wholly foreign-owned enterprises before 1986. With the passage of the Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises on April 12, 1986, this obstacle was removed.\textsuperscript{293}

According to one report, despite the dearth of legislation on buy-outs, joint venture parties have included:

- clauses in their joint venture contracts [providing] for . . . voluntary, negotiated, buy-out[s] by either party, or for mandatory buy-outs but

\textsuperscript{288} Joint Venture Law, supra note 1, art. 4; Implementing Act, supra note 21, art. 23.
\textsuperscript{289} Joint Venture Law, supra note 1, art. 4; Implementing Act, supra note 21, art. 23.
\textsuperscript{290} Joint Venture Law, supra note 1, art. 4; Implementing Act, supra note 21, art. 23.
\textsuperscript{292} United Aerosol and Home Products Company, supra note 291, at 20.
\textsuperscript{293} The Law of the People’s Republic of China on Whole Foreign Owned Enterprises (promulgated by the State Council on Apr. 12, 1986) (WESTLAW, Intlaw library, Chinalaw file).
the latter type of buy-out is rarely included as a provision. In either case, a buy-out ... must be approved by the [Chinese] government authority which approved the original joint venture contract. The same report mentions that in the early 1980's, voluntary buy-out provisions were approved within joint venture contracts on an irregular basis. More recently, however, buy-outs appear to have gained the grudging acceptance of MOFERT.

It is in a joint venture's interest to provide for buy-outs in case the partners do not get along but the termination of the joint venture's operation is not economically feasible at that stage. This is true especially when one partner is very interested in carrying on with the venture alone. The buy-out clauses should provide for: (1) the valuation of assets; (2) the inclusion of goodwill as an asset; (3) the payment for the foreign party's interest in foreign currency; (4) the inclusion of foreign lawyers or accountants in the valuation process; and (5) the submission of the matter to an independent third party for determination in case of disagreement.

2. Dissolution

The law permits a joint venture to be terminated prior to its natural expiration date in the following circumstances:

(1) The joint venture is unable to continue operations because of: heavy losses; the failure of one party to fulfil its obligations; or heavy losses caused by force majeure.

(2) The joint venture is unable to achieve the objects of the venture and the plans for future development;

(3) Other reasons for termination, as provided for in the joint venture contract have occurred.

The termination must be agreed upon by all parties to the joint venture, and sanctioned by the original approving authority for the joint venture. The termination must also be registered with the relevant authorities.


295 Simone, supra note 294, at 23.

296 Some approved clauses are vague, providing only that parties negotiate the purchase price in good faith. Other clauses provide for payment in addition to the book value of the joint venture at some fixed percentage of the book value. Still others are more complex, setting out a formula based on the net worth of the joint venture. See Kolenda, supra note 291, at 103.

297 Joint Venture Law, supra note 1, art. 13; Implementing Act, supra note 21, art. 102. The Joint Venture Law uses the word “terminate” while the Implementing Act uses the word “dissolve.” Both words read in context are synonymous.

298 The party in breach of its obligations bears the losses ensuing from such breach. Joint Venture Law, supra note 1, art. 13; Implementing Act, supra note 21, art. 102.

299 Joint Venture Law, supra note 1, art. 13.

300 Implementing Act, supra note 21, art. 102.
It is apparent from the agreement and approval requirements that there can be no unilateral termination of a joint venture.

Despite the legislative provisions on joint venture termination, it is in the interest of the parties to reiterate the law in the joint venture contract and articles of association. The circumstances under which a venture may be dissolved should be clarified to minimize dispute over their interpretation. For example, heavy losses, inability of the joint venture to achieve its objectives, and force majeure should be defined, or a third party should be nominated to determine whether the specified events have occurred.

After the parties have agreed to terminate the joint venture and the requisite approvals have been obtained, the parties must go through a series of steps to liquidate the venture. First, the parties must execute an agreement for the termination of the joint venture. The reasons for termination must be set forth in the agreement, and must be approved by the original authority that approved the joint venture contract.

Second, after the termination agreement has been approved, the board of directors must announce the dissolution of the venture. The board works out the procedures and principles for the liquidation, and establishes a liquidation committee. The members of the committee consist of directors of the joint venture, lawyers, and accountants. The lawyers and accountants must be registered in China. The committee represents the joint venture during the liquidation process and can sue and be sued.

The committee is entrusted with the tasks of compiling an inventory of the joint venture's assets and liabilities, and of formulating a plan for liquidation. The plan must be ratified by the board of directors and implemented under the supervision of the local Administration for Industry and Commerce. "The Administration enjoys the power to overrule the decisions of the liquidation committee regarding the sale of assets and the distribution of proceeds where the result of such commit-
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tee decisions would be unfair."313

Finally, after the venture's debts are cleared, the remaining property, if any, may be distributed to the parties according to the proportion of each party's contributions, or by some other method agreed upon between the parties.314 When the affairs of the venture have been wound up, the venture must be de-registered, and the business license must be cancelled.315 To give the public notice of the termination and liquidation of the joint venture, advertisements must placed in newspapers within the locality where the venture carried on business.316

III. CONCLUSION

More than a decade has passed since the initial Sino-foreign joint ventures were established in China under the Joint Venture Law. Many problems were encountered by foreign investors in the early 1980's, and most of the same problems are still being experienced today. To be fair, many laws have been promulgated to address foreign investors' concerns, the latest being the Twenty-two Articles.317 But it is apparent that legislation alone cannot eradicate foreign investors' problems in China. Instead, government policy, the bureaucracy, and the business culture and attitude of the Chinese people play an equal, if not more important, part in eradicating foreign investment problems.

Government policy sometimes plays a more important role in the area of foreign exchange availability. For example, joint ventures have to generate the hard currency they need because of the inconvertibility of the renminbi, and the hard currency shortage in China. The solution to the foreign exchange problem does not rest in legislation alone. Instead, the solution is inextricably tied to the policies of the Chinese government at any given time. For example, in AMC-Beijing, the Chinese government had agreed to sell foreign exchange to the venture, presumably pursuant to the Implementing Act.318 This permits ventures to purchase hard currency from Chinese government authorities. Because of an import growth, China's foreign exchange reserves plunged by more than $11 billion in 1985, causing the government to drastically restrict hard currency expenditure. As a result of the belt-tightening policy, the government in 1986 refused to provide the hard currency which it had previously agreed to sell to the venture. This incident indicates that

314 Implementing Act, supra note 21, art. 106.
315 Id. art. 107.
316 Practice Notes: Liquidation of Joint Ventures, supra note 313, at 27.
317 See Twenty-two Articles, supra note 117 (the promulgation date was Oct. 11, 1986).
318 Implementing Act, supra note 21, art. 75.
government policies play a more important role than existing legislation or commitments.

The bureaucracy, on the other hand, plays an important role in labor management problems. Despite a host of legislation granting autonomy in the management of joint ventures, local bureaucrats are either ignorant of the existence of the legislation, or they simply ignore the legislation. Instead, they take matters into their own hands. For example, in Parker-Hubei, the bureaucrats in charge of the Chinese partner in the venture were generally suspicious of foreign investors, and regarded the venture as a "colonial enterprise." This general suspicion spilled over to the Chinese managers who were running the venture. The managers were accused of "championing foreigners." As a result of the ill-feelings harbored by the bureaucrats, the bureaucrats removed the Chinese managers from office in the joint venture without notification or consent of the foreign partners. The removal of Chinese personnel took place despite the existence of legislation granting autonomy to joint venture operations. The bureaucrats later pleaded ignorance to legislation granting autonomy in joint venture management.

It is, therefore, not surprising that there is great skepticism about the effectiveness of the 1988 Labor Decisions in preventing future bureaucratic "meddling" in joint ventures. Although the 1988 Labor Decisions emphasize the autonomy of joint ventures and the education of local leaders on the existence of such autonomy, there is a general perception that Chinese bureaucrats' predisposition to ignore the law and their general suspicion of foreign investments may prevail over the legislation.

Finally, in the areas of local sourcing and poor quality control of the venture's products, the central command system of the Chinese government economy is responsible for the foreign investors' problems, not the dearth in regulations. Most of China's existing workforce is accustomed to the quota system under which quantity and not quality is the indicator of success. Under the central planning system, as long as Chinese enterprises produce the quota assigned under the state plan, they have discharged their obligation. No reward is given for quality products and no penalties are imposed for shoddy quality. It is, therefore almost impossible for joint ventures to source quality materials locally and to produce quality products in China without re-educating the workforce about the virtues of quality products. Perhaps the greatest obstacle to educating the workforce is the continued existence of the central planning system in China today. The workers have to be quality-oriented at the joint venture where they work, but outside their workplace they have to comply with the nation's central planning system which governs all other aspects of their lives. The workers have to learn to adapt to the dual system that exists side by side in China.
Despite the existence and recurrence of the same problems in foreign investment in China after more than one decade, investors seem to have endless faith in the Chinese economy. According to a survey, more than 50% of the joint ventures examined still have hopes that their venture problems will be solved in the next two to three years.\textsuperscript{319} It is hard to imagine the source of their hopes since the Chinese government has tried over ten years and still has not succeeded in solving the investors' problems. Perhaps, these investors view the Chinese government's attempts to solve their problems as a light at the end of the tunnel. At least the government is aware of their problems and is willing to address them, albeit unsuccessfully. Or perhaps, the foreign investors are just blinded by their dreams to capture the world's largest potential consumer market in China.

\textsuperscript{319} Wagner, supra note 18, at 11.