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Anyuan Yuan

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China's Entry into the WTO: Impact on China's Regulating Regime of Foreign Direct Investment

Anyuan Yuan*

I. Introduction

A. United States Grants China PNTR

On October 10, 2000, President Clinton signed into law legislation granting China Permanent Normal Trade Relations (PNTR) and ending the annual Congressional review of China's trade status, the culmination of fourteen years of negotiations, and a protracted struggle on Capitol Hill.¹ The U.S. Senate passed the legislation overwhelmingly on September 19, 2000, joining the approval by the House in May of the same year.² Both the U.S. and Chinese governments applauded the passage of the Senate bill in September.³ President Clinton said that the landmark U.S.-China Agreement will extend "economic prosperity at home and promote economic freedom in China, increasing the prospects for openness in China. . . ."⁴ The Chinese Foreign Ministry spokesman said that the "new relationship will give both countries a chance to start anew."⁵

⁴. Id.
⁵. Id.
Americans have reasons to be happy. In the November 1999 U.S.-China Agreement, all the trade concessions were on China's part, the price China paid to enter the World Trade Organization (WTO).\textsuperscript{6} The United States merely extended to China the terms of trade it offers to more than 130 countries.\textsuperscript{7} In the U.S.-China Agreement, China made numerous concessions ranging from the elimination and liberalization of trade barriers to the opening of major service markets.\textsuperscript{8} The bill cleared the way for American companies to take part in the open markets that China promised to deliver to part of the trade group, and many of the markets to be opened are ones in which American companies are world leaders.\textsuperscript{9} It is certainly a better deal for the United States than it is for China.\textsuperscript{10}

China, however, is more conservative in its greeting of the Senate bill. As China now shifts its focus to its future membership in the WTO, there is growing trepidation that China's business and industries are ill prepared for the global competition.\textsuperscript{11} This is especially true for state-owned enterprises in the farming, telecommunication, and banking industries that have long been sheltered by governmental protection.\textsuperscript{12} As a result, it is not a surprise that China has balked at several of the most politically sensitive concessions it made in negotiations with the United States just as President Clinton signed the law granting China's PNTR.\textsuperscript{13}

\textbf{B. CHINA'S PROLONGED ROAD TO THE WTO}

Although China was a founding member of the General Agreement on Tariffs and Trade (GATT), China's membership in GATT ended in 1950 when the Nationalist Taiwan Government withdrew from the agreement.\textsuperscript{14} More than thirty years passed before China demonstrated an interest in renewing this relationship. In 1982, China obtained observer status in the GATT.\textsuperscript{15} In July 1986, China formally notified the GATT's contracting parties of its desire to again participate in the trade agreement.\textsuperscript{16} In 1994, China commenced a massive campaign to join the GATT upon the conclusion of the Uruguay Round, an effort that culminated in China submitting a formal bid for accession to the WTO on December 7, 1995.\textsuperscript{17} China's failure to join the GATT in the Uruguay Round means that it has to join the WTO as a newly acceding government rather than as a GATT contracting party.\textsuperscript{18} The failure may be largely attributed to the fact that China has inherited from the pre-reform era a nonmarket legal regime that in most respects is incompatible with the market-

\begin{footnotesize}
\textsuperscript{7} See id.
\textsuperscript{9} See Schmitt, supra note 3, at A12.
\textsuperscript{10} See id.
\textsuperscript{11} See id. at A1, A12.
\textsuperscript{12} See id.
\textsuperscript{13} See Kahn & Sanger, supra note 1, at A1, A7.
\textsuperscript{16} See id.
\textsuperscript{17} See id.
\textsuperscript{18} See id.
\end{footnotesize}
based principles of the GATT. As a result, without seeing substantial changes in China’s current legal system, the current GATT members are very nervous about the potential for disruption.\(^\text{19}\)

Notwithstanding the disagreement on China’s joining status and terms, the United States led the effort to solidify China’s membership in the GATT principally aimed at encouraging China to adopt attitudes and laws consistent with the international norm.\(^\text{20}\) The U.S.-China trade agreement on November 15, 1999 certainly finalized the United States’ consent and support of China’s entry into the WTO.\(^\text{21}\) This landmark deal would also accelerate and simplify China’s bilateral negotiation with other member nations of the WTO. As of November 2000, China had completed bilateral negotiations with thirty-five out of thirty-seven countries whose consent is necessary for China’s accession.\(^\text{22}\)

C. CHINA’S CONCESSIONS

China’s biggest concessions to date are reflected in the November 1999 bilateral trade agreement with the United States. It is anticipated that such concessions would constitute the basis of China’s negotiation with other WTO Member States. This article uses the terms of the U.S.-China bilateral agreement as an example of China’s WTO concessions, a price China paid to enter the WTO. In terms of foreign direct investment (FDI), such concessions are mainly reflected in the alleviation of establishment restriction of FDI in services sectors, and the elimination of performance requirements.

1. Performance Requirements.

China will immediately eliminate all the performance requirements for FDIs, including but not limited to, export performance requirements, local content requirements, and requirements of mandatory transfer of technology.

2. Foreign Trade Rights

After China’s accession, restrictions on foreign trade rights and distribution services will be progressively phased out over three years.

3. Domestic Distribution and Related Services

China will liberalize wholesaling and related services within three years after accession. Restrictions on services auxiliary to distribution will also be phased out within four years.

4. Telecommunication

China will permit FDI in telecommunication services to own up to 49 percent after accession, and that percentage will increase to 50 percent after two years. Also, China will gradually phase out all geographic restrictions within six years.

5. Banking

China will allow 100 percent foreign ownership of banking entities starting five years after accession. Foreign banks will be allowed to conduct local currency business with Chi-
nese enterprises starting two years after accession, with Chinese individuals starting five years after accession.

6. Insurance

China will allow foreign companies to own up to 50 percent in life insurance companies after accession, and branching or wholly foreign-owned subsidiaries for non-life insurance within two years. Further, China will expand the scope of business for foreign investors to include group, health, and pension. All geographic limitation will be eliminated within three years.

7. Securities

China will permit minority foreign-owned joint ventures to engage in fund management on the same terms as Chinese firms. In addition, 33 percent of foreign-owned ventures will be allowed to underwrite domestic equity and debt issues.23

D. Scope of the Article

This article will first introduce the WTO agreements affecting foreign investments. Part III of the article will have a brief overview of FDIs in China, and China's regulating regime and restrictions of FDIs. Part IV and V will analyze whether and to what extent China's FDI regulating system and restrictions conform to the requirements of WTO agreements. Part VI of the article will introduce several obstacles that would potentially undermine China's effort to implement its commitments to WTO Member States.

The WTO Agreement on Trade Related Investment Measures (TRIM Agreement) and General Agreement on Trade in Services (GATS) requires the elimination of certain performance requirements from China's laws for Foreign Invested Enterprises (FIE), and alleviation of restrictions in the service area. However, it appears that, except in certain major service areas, China's separate regulating system for FDIs, additional approval procedures, higher incorporation requirements for FIEs, higher qualification requirements for foreign investors, and sectoral and ownership restrictions for FDIs, do not violate the mandate of the WTO.

II. WTO Agreements Affecting FDI

The multilateral trading rules traditionally have focused on cross-border movement of goods and services. However, some GATT rules relating to the treatment of foreign investments developed as a result of the more integral relation between trade and investment. Currently, the WTO regime governing investment mainly consists of two agreements: the TRIM Agreement and the GATS.

A. TRIM Agreement: An Overview

The current WTO TRIM Agreement is a compromise between the developed countries and developing countries.24 The United States has been the chief proponent of a TRIM

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23. See Summary, supra note 8.
Agreement and has sought to achieve the free flow of investment and elimination of Trade-Related Investment Measures (TRIM) by expanding the principle of "National Treatment" to investment areas.25 Conversely, developing countries, led by India, Egypt, and the Philippines, opposed the TRIM Agreement as unnecessary and adverse to their development interests.26 The final TRIM Agreement reflected a middle ground between the above two positions (see infra discussions). Such a compromise not only preserved the existing GATT protection for investments, but also prevented future negotiations in this area from being adversely affected.27

The TRIM Agreement applies to investment measures related to TRIM only.28 The heart of the TRIM Agreement lies in article 2, which prohibits WTO members from applying any TRIM that is inconsistent with Article III and Article XI of the GATT 1994. An illustrative list of such TRIMs is contained in the Annex to the TRIM Agreement. Among those illustrated TRIMs are investment measures that require "the purchase or use by an enterprise of products of domestic origin or from any domestic source"29 (so-called "local content requirements"), and the "exportation or sale for export by an enterprise of products"30 (so-called "export performance requirements").

It is notable that such TRIMs not only "include those which are mandatory . . . under domestic law or administrative rulings," but also those "compliance with which is necessary to obtain an advantage."31 Moreover, the TRIM Agreement imposes the same transparency and notification obligations on member nations as Article X of the GATT Agreement 1994.32 Each member is obliged to notify the Secretariat of their publications in which TRIMs may be found, including those applied by regional and local governments within their territories.33

B. GATS AGREEMENT: AN OVERVIEW

Like the TRIM Agreement, the developed and developing countries also have different attitudes towards the regulation of trade in services by the WTO.34 The United States, together with the Organization for Economic Cooperation & Development (OECD) members outside of the European Union (EU), and Singapore, made the most liberal proposal.35 Under such proposal, most-favored-nation (MFN) treatment and national treatment obligations would generally apply to a broadly defined trade that includes investment.36 The EU proposed that national treatment should only apply to specific services sectors. On the other hand, many developing countries opposed the negotiation of an agreement covering

25. See id. at 447.
26. See id. at 450.
27. See id. at 451.
29. Id. Annex, para. 1.
30. Id. Annex, para. 2.
31. Id. Annex, para. 1, 2.
32. See id. art. 6.1.
33. See id. art. 6.2.
35. See id.
36. See id.
trade in service. The final GATS Agreement represents a compromise among the three initial offers (see infra discussions).

The GATS Agreement applies to measures affecting trade in services. The agreement covers four types of services: (1) services from one member state into the territory of another; (2) services from one member state for consumers of another; (3) services by an entity supplier of one member in the territory of another; and (4) services by a natural person of one member in the territory of another.

The GATS generally imposes an MFN treatment obligation on all trade in services with several exceptions. The Agreement also, in service sectors as scheduled by a member state, requires national treatment by such member nation for services and service suppliers of another member. Further, a member nation’s domestic regulation of general application affecting trade in services shall be “administered in a reasonable, objective and impartial manner” in sectors where specific commitments are undertaken by such member. As for market access, “each member shall accord services and service supplier of any other member treatment no less favorable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.” Moreover, the Agreement contains a transparency requirement similar to that of the TRIM Agreement.

C. LIMITATION OF THE TRIM AGREEMENT AND GATS

The protection for FDI under the TRIM Agreement, however, is very limited due to the Agreement’s limited coverage of “trade related investment measures only.” In this sense, the TRIM Agreement might be better characterized as a trade agreement, rather than an investment agreement. The TRIM Agreement contains no rights for investors, except as derived from protection accorded to trade in goods. Nor does the Agreement intend to address such major issues as barriers to establishment or operation of investment, restrictions on repatriation of profits, or the movement of personnel.

In terms of the breadth of covered protection for investors, the GATS does a better job than the TRIM Agreement. However, due to the structure of GATS and the nature of its obligations, the effects of GATS in liberalizing services traders is also, to some extent, limited. First, market access and national treatment under the GATS do not apply unconditionally, but only apply to those sectors that a member state has placed on its

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37. See id. at 332.
39. See id. art. I (2).
40. See id. art. II; see also Richard B. Self, General Agreement on Trade in Services, in THE WORLD TRADE ORGANIZATION, supra note 24, at 527.
41. See id. art. XVII.
42. Id. art. VI.
43. As observed by one scholar, the market-access article does not appear to add anything to the provisions of the national treatment article insofar as discrimination between foreign and domestic suppliers is concerned. Richard H. Snape, Reach Effective Agreement Covering Services, in THE WTO AS AN INTERNATIONAL ORGANIZATION 290 (Anne O. Krueger eds., 1998).
44. GATS, supra note 38, art. III.
45. See Price & Christy, supra note 24, at 453.
46. See id.
47. See Snape, supra note 43, at 287.
In other words, if a sector is not scheduled, there is no restriction on the terms or extent of the barriers to market access that can be imposed by one member on that sector. Second, MFN treatment is also less general and binding than that under the GATT. Various exceptions and exemptions for MFN exist under the GATS. Such exceptions can be taken, and have been taken, for measures applying to major services sectors, such as financial services and basic telecommunications. Third, the GATS also lacks many important protections found in modern investment agreements, for example, an absolute ban on performance requirements.

D. Future of Multilateral Investment Agreement Under the WTO Regime

The future of a real multilateral agreement on investment is uncertain because such an agreement, in large part, depends on the political will of member countries. First, governments of developing countries tend to react suspiciously to attempts to impose on them unnecessary regulatory requirements that might hinder their development. As discussed above, developing countries strongly opposed any limitations on TRIMs during the Uruguay round negotiation.

Second, lack of incentive in developing countries may be the most detrimental obstacle to reaching such an agreement. The desire to reach out to the developed countries' huge consumer market played a major role in prompting developing countries to participate in trade negotiations that led to the establishment of the WTO. However, such incentive does not exist with regard to an investment agreement. Quite the contrary, domestic industries in developing countries, such as China, have called for more investment protection rather than liberalization. Furthermore, the absence of an investment agreement, which does not seem to substantially affect the ability of some developing countries to attract foreign investments, further complicated the situation. For example, although China implements numerous restrictions on FDIs (see infra discussion), it is still the second largest importer of foreign direct investments according to 1996 statistics, after the United States, but ahead of the United Kingdom and Germany.

Third, the basic nature of the WTO as a forum for the liberalization of cross-border trade makes reaching such an investment agreement even more difficult. In fact, it is questionable that it would ever be successful to address investment issues in a framework designed to eliminate barriers to trade in goods. As a result, it is not a surprise that the OECD, not the WTO, first initiated the negotiation of a multilateral investment agreement.

48. See Self, supra note 40, at 536.
50. See id. at 290.
51. GATS, supra note 38, art. II (3); see also Annex on article II exemptions.
52. See Snape, supra note 43, at 290.
53. See Price & Christy, supra note 24, at 454, 455.
54. See id. at 456.
55. See Schmitt, supra note 3.
57. See id. at 665.
58. See id. at 665, 666.
III. FDI and Its Regulating Regime in China

A. FDI in China: A Brief Overview

By the end of 1998, China approved the establishment of 324,620 foreign invested enterprises (FIE), with $572.495 billion under the contract and $267.109 billion in foreign funds actually utilized. The 150,000 FIEs currently in operation have employed about eighteen million people in China, which account for 11 percent of the non-agricultural labor force across the country. The amount of tax involving FIEs amounts to nearly RMB 120 billion (not including tariff and land use fees), accounting for 14.38 percent of the industry and commerce tax of China. In 1998 alone, 19,799 FIEs were set up with approval in the country and the amount of foreign investments in contracts amounted to $52,102.62

Historically, joint ventures (especially Equity Joint Ventures (EJV)) have been the major form of direct investment in China. In recent years, however, the role of Wholly Foreign-Owned Enterprise (WFOE) has increased significantly, as have the share of joint ventures with foreign equity participation relative to contractual joint ventures without foreign equity.

According to 1997 statistics, the primary sources of FDI in China were Hong Kong, with 35 percent; the United States with 10 percent; Japan with 7 percent; and Taiwan with 5 percent. The primary sectors receiving FDI from all countries, as actually utilized, were manufacturing, 62 percent; and real estate, 11 percent.

Approximately 70 percent of China’s inbound FDI is concentrated in the five coastal provinces of Guangdong, Jiangsu, Fujian, Shanghai, and Shandong. This is due partially to the location of Special Economic Zones (SEZ) and Economic and Technical Development Zones (ETDZ). China has set up five Special Economic Zones (Shenzhen, Xiamen, Zhuhai, Shantou, and Hainan) and steered foreign investments towards these zones by a variety of incentives. In addition to the SEZs, China also designated fourteen more coastal cities as well as Pudong New Zone as ETDZs. FIE Enterprises (as well as Chinese domestic enterprises) set up in the SEZs and ETDZs received more favorable income tax and other treatments than those established elsewhere in the country.

Direct investment represents the vast majority of foreign investments in China. A 1997 figure shows inflows of $44.2 billion in FDI and only $6.8 in portfolio investment. This

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59. China Council for the Promotion of International Trade, Information on China: Absorption of Foreign Investments in 1998, at http://www.ccpit.org/engVersion/cp_infor/cp_invest/cp_fvest.html (last visited Sept. 22, 2000) [hereinafter CCPIT]. In practice, there may be a lag of several years before the investment projects are fully executed, and therefore the amounts of contracted investments are always larger than those of actually utilized investments.

60. Id.

61. Id.

62. Id.


64. Id.

65. Id.

66. Id.

67. See id. at 2–14, 2–19, 2–23.

68. Id.

69. See id. at 2–23.

70. See id. at 2–19.
is due mostly to various encouragements to FDI in China's laws and regulations on one hand, and numerous restrictions on foreign portfolio investment on the other. The other possible reason is the relatively small size of China's stock market and limited choices for foreign investors.

B. CHINA'S REGULATING REGIME OF FDI

1. Separate Regulating System

In China, foreign investors may incorporate their investments under various laws, and therefore adopt different forms of enterprises. The collective concept of Foreign Investment Enterprises (FIE) in China encompasses three types of enterprises: Equity Joint Venture (EJV), Contractual Joint Venture (CJV), also translated as Cooperative Joint Venture and Wholly Foreign-Owned Enterprise (WFOE). Each type of enterprise is governed by its respective laws and implementing regulations. It is notable that FIE laws and regulations may be subject to change in the near future. A bill revising three laws on foreign investments in China was presented to the NPC recently.

In addition, cooperative exploitation is also an important form of investment adopted shortly after the initiation of China's open-door policy at the end of the 1970s. As China continues to open the country wider to the outside world, there has been a gradual increase in the forms of investment, including but not limited to Foreign Investment Companies,

71. See id.; see also GuoWuYuan GuangYu GuLi WaiShang TouZi De GuiDing (Provisions of the State Council for the Encouragement of Foreign Investments) (promulgated on Oct. 11, 1986) [hereinafter Provisions for the Encouragement].

72. See ITC Assessment, supra note 63, at 2–19.


75. The main framework applicable to CJVs are Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (ZhongHua RenMin GongHeGuo ZhongWai HeZuo JingYing QiYe Fa) (promulgated on April 16, 1988) [hereinafter CJV Law], and Detailed Rules for the Implementation of Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (promulgated on Sept. 4, 1995, by Ministry of Foreign Trade and Economic Cooperation, also called MOFTEC).


79. See generally GuanYu JuBan TouZiXing GongSi De TanXing GuiDing (Provisional Regulations of the PRC on Investment Companies Established by Foreign Investors) (promulgated on Apr. 4, 1995).
Foreign Invested Joint Stock Companies, and Foreign Invested Financial Institutions. Moreover, the form of Build-Operation-Transfer (BOT) investment was also introduced into China in recent years. Other forms of investment, including Compensation Trade, Processing and Assembling Operation, and International Lease, have been widely used by China since the beginning of its open-door policy.

a. Equity Joint Venture

An EJV is a limited liability company (LLC) between the Chinese and foreign investors in which the foreign investor's capital contribution should not be less than twenty-five percent of the total registered capital. All EJVs are enterprise legal persons of China. The EJV is the principal form adopted by foreign investors in China so far. An EJV may also possibly adopt the corporate form of Joint Stock Company Limited.

b. Contractual Joint Venture

A CJV is a company operated under a contract between Chinese and foreign enterprises. A CJV is not always a legal person, however, as only CJVs meeting the qualifications of a legal person under Chinese law may obtain such status. A CJV is distinctive from an EJV based on its (1) flexibility regarding requirements of incorporation, profit distribution, and the sharing of risk and losses; (2) a CJV need not meet the higher legal standard of legal person; (3) the forms of capital contribution in CJVs are generally more diversified, and the contributions of parties may not necessarily be converted into a ratio of investments; (4) the contract may agree that foreign parties may recoup their investments first; and (5) they may do so even before the income tax of the CJV is paid. The CJV form is most often utilized in situations where the value of the contributions from investing parties may not be easily or fairly appraised, such as land-use rights or usable equipments.

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80. See generally GuanYu SheLi WaiShang TouZi GuFen YouXian GongSi De ZanXing GuiDing (Provisional Regulations of the PRC on the Establishment of Foreign-Invested Joint Stock Companies) (promulgated on Jan. 10, 1995).
81. See generally WaiZi JinRong JiGou GuanLi TiaoLi (Regulation of the PRC on Financial Institutions with Foreign Capital) (promulgated on Feb. 25, 1994).
82. The BOT is used mainly for the construction of infrastructure facilities, such as toll-charged highways, power plants, and railways. See GuanYu Yi BOT FangShi XiShou WaiShang TouZi YouGuan WenTi De TongZhi (Circular on the Absorption of Foreign Investment by BOT Form) (promulgated on Jan. 16, 1995).
83. See EJV Law, supra note 74, art. 4. For a discussion of the concept of Registered Capital, see Yuan, supra note 73, at 487.
84. An "enterprise legal person" in China means a business entity that may independently undertake its civil liability. See ZhongHua RenMin GongHeGuo MinFa TongZe (General Principles of Civil Law of the PRC) art. 37 (promulgated on Apr. 12, 1986, and effective as of Jan. 1, 1987); ZhongHua RenMin GongHeGuo QiYe FaRen DengJi GuanLi TiaoLi (Regulation for the Registration and Administration of Enterprise Legal Persons of the PRC) art. 7 (promulgated by State Council on June 3, 1988).
85. See EJV Law, supra note 74, art. 2.
86. See Provisional Regulations of the PRC on the Establishment of Foreign-Invested Joint Stock Companies, arts. 1, 20(1).
87. See CJV Law, supra note 75, art. 2. Also translated as Cooperative Joint Venture.
88. See id.
89. See id. arts. 2, 8, 22.
c. Wholly Foreign-Owned Enterprise

A WFOE is a business entity wholly invested in by foreign investors. A WFOE may acquire the legal-person status if it meets the requisite conditions. However, the establishment of WFOEs requires one of the following to be met: that they will apply internationally advanced technology and equipment, or that all or most of their products will be export-oriented. In recent years, a WFOE may also possibly adopt the corporate form of Joint Stock Company Limited.

d. Foreign Invested Investment Company

A Foreign Invested Investment Company (FIIC) is a LLC engaging in direct investment in China. A FIIC may be solely established by a foreign investor in the form of a WFOE, or co-funded with Chinese investors in the form of an EJV. The incorporation of a FIIC, although as an EJV or WFOE, must go through separate application procedures that are different from those for normal EJVs, CJVs, or WFOEs. Therefore, impliedly, a normally approved and incorporated FIE may not engage in direct investment, or at least direct investments made in the name of such FIE may not exceed fifty percent of its net assets (equity).

e. Limited Liability Company Under Company Law

Arguably, foreign investors may also incorporate a Limited Liability Company (LLC) under the Company Law. Three types of major company forms are provided in the Company Law: Wholly State-Owned Company (Guo You Du Zi Gong Si), Limited Liability Company (You Xian Ze Ren Gong Si) (somewhat similar to a closely held corporation in the United States), and Joint Stock Company Limited (Gu Fen You Xian Gong Si) (also translated as Company Limited by Shares). Article 18 of the Company Law provides that the Company Law also applies to foreign-invested limited liability companies. But it is notable that the governing structure of a LLC incorporated under the Company Law may be dramatically different from those incorporated under FIE laws. This structural difference may lead to different outcomes in the protection of minority shareholders' interests (see infra discussions in Part III).

2. Restrictions and Prohibitions on FDI

Along with preferential treatments, Chinese laws and regulations also impose various restrictions and prohibitions on FDI. Such restrictions and prohibitions may be categorized

90. See WFOE Law, supra note 76, art. 2.
91. See id. art. 8.
92. See id. art. 3.
93. See Provisional Regulations of the PRC on the Establishment of Foreign-Invested Joint Stock Companies, arts. 1, 11.
94. See id. art. 1.
95. See id. arts. 1, 11.
96. This is the rule for LLCs and Joint Stock Companies Limited established under the Company Law. See ZhongHua RenMin GongHeGuo GongSiFa (Company Law of the People's Republic of China), passed on Dec. 29, 1993, and came into effect on July 1, 1994, art. 12 [hereinafter Company Law]. This fifty percent rule was sometimes applied to FIEs by government agencies. However, the author does not find any statutory provision supporting the application of such a rule to FIEs in general.
as the following. First, by enacting and enforcing a separate regulating system, FDIs in China are subject to special approval procedures and qualification requirements; second, by enforcing an investment guideline, Chinese law also restricts or prohibits FDIs' participation or percentage of ownership in certain industries (see infra discussions); third, Chinese law also imposes various performance requirements on FDIs, including but not limited to export performance requirements, local content requirements, or the balancing of foreign currency (see infra discussions).

IV. Impacts on China's FDI Regulating Regime

A. Separate Regulating Regime and Legality Under the WTO Regime

1. Separate Regulating System

In the United States, foreign investments are generally subject to the same law insofar as the establishment of companies is concerned. China, however, enacts and enforces a separate regulating system for FDIs that mainly consists of FIE laws and regulations. It is notable that those FIE laws and regulations only regulate the FDI, and do not govern the pure domestic investments of Chinese nationals. Domestic investments are regulated by a different regime mainly centered on the Company Law and the Law for Wholly State-Owned Industrial Enterprises. As a result of this separate regulating system, FDIs in China are treated differently from domestic investments in several aspects.

a. Governing Structure

The basic governing structures of FIEs established under FIE law are dramatically different from those established under the Company Law, which is the major corporate law governing domestic investments.

First, under article 37 of the Company Law, the shareholders meeting is the LLC's highest organ of authority. The shareholders' meeting is vested with broad powers to decide and approve the most important matters of a company such as the company's investment plan, the company's budget, as well as its profit distribution, the increase or decrease of a company's registered capital, the issuance of bonds, the amendment of articles of incorporation, and the merger, division, and dissolution of the company. Whereas under the EJV law, a board of directors is the highest organ of authority, the shareholders' meeting is not even

99. Regarding “balance of foreign currency requirements,” see generally WFOE Law, supra note 76, art. 18. See also CJV Law, supra note 75, art. 20.
100. For example, New York has eliminated requirements as to citizenship and residence of incorporators. N.Y. Bus. CORP. ACT, § 401, Legislative Studies and Report (McKinney 1986).
102. Although the Company Law also regulates business entities involving foreign investment, that is, foreign invested LLCs (art. 18), joint stock companies (art. 75), and branch or representative offices of foreign companies (art. 199), the major focus of the Company Law is domestic investments, as implied from the purpose of the Company Law, stating that the Company Law purports “to regulate and standardize the organization and conduct of companies, to protect the legitimate interests of companies' shareholders and creditors, and to stimulate the development of a socialist market economy.”
103. However, the Wholly State-Owned Company is an exception. See Company Law, supra note 97, art. 66.
104. See id. art. 38.
an organ of companies incorporated under the FIE laws. All of the above shareholder powers and functions are performed by the board of directors of FIEs under the FIE laws.

The second difference regarding the governing structure is the voting structure. Under the FIE laws, the directors vote by head (each director has a single vote) in the board of directors meeting. Whereas under the Company Law, the shareholders vote in the shareholders meeting by the number of shares they represent. This difference in voting structure may lead to dramatically different results in terms of the protection of minority shareholders' interest.

The third major structural difference is the minority shareholders' veto rights with regards to certain important matters. According to article 36 of EJV Implementation, the following matters require the unanimous consent of all attending directors (provided that the meeting meets the two-thirds quorum requirement): (1) modification of an EJV's articles of incorporation; (2) termination or dissolution of an EJV; (3) the increase or transfer of an EJV's registered capital; and (4) the EJV's merger with other business organizations. This veto power is very crucial for minority shareholders of an EJV to protect their interests in the joint venture, and to retain a voice in the most important matters of an EJV. By contrast, the Company Law's structure gives no say at all to minority shareholders. As discussed above, under the Company Law, shareholder meetings are the organ of authority for a company and determine all of its most important matters. Because in shareholder meetings shareholders vote by the number of shares they own, the controlling shareholders or their representative group would presumably control the voting process and ultimately the outcome of all important matters, including those matters in which the minority shareholders of an EJV may have veto rights.

On the face of the law, however, it is difficult to conclude that foreign investors in FIEs, as a whole, are disadvantaged by the above governing structures. In other words, it is hard to say that national treatment in this regard (i.e., applying the Company Law to FIEs) would grant additional benefits to FDIs. But, the majority shareholders in FIEs might have an argument that they are discriminated against because, by the minority-friendly voting structure and minority's veto power, the majority shareholders in FIEs apparently exercise less control over the company than their counterparts in domestic enterprises. However, assuming that FDIs as a whole are discriminated against in this regard, as discussed below, such discrimination might not violate the TRIM Agreement or GATS at all.

b. Approval Procedures

In the United States, there is no special approval or registration requirement for foreign investment. However in China, FIEs are subject to special approval procedures that are not, or at least not evenly, applied to domestic investments. For example, in addition to the Registration of SAIC, the formation of an FIE in China requires the approval of MOFTEC.

In contrast, domestic companies without the involvement of foreign funds do not require such approval or any other equivalent process.

105. See EJV Law, supra note 74, art. 6; see also EJV Implementation, supra note 74, art. 33.
106. EJV Law, supra note 74, art. 6; see also CJV Law, supra note 75, art. 12.
107. Company Law, supra note 97, arts. 41, 106.
108. Id. arts. 37, 38, 102, 103.
110. See EJV Law, supra note 74, art. 3; CJV Law, supra note 75, art. 5; WFOE Law, supra note 76, art. 6.
111. ZhongHua RenMin GongHeGuo GongSi DengJi GuanLi TiaoLi (Regulation of the People's Republic of China on Administration of Registration of Companies) (promulgated on June 24, 1994), art. 3.
c. Qualification Requirements

With regard to the qualification requirements for the establishment of an FIE, Chinese law very often imposes higher standards on foreign investors and FIEs, and much lower or no requirements on Chinese investors or companies. Such qualification requirements may be characterized in two categories. First, foreign investors are sometimes subject to higher qualification requirements than their Chinese partners when forming an FIE. For example, to establish a Chinese-foreign joint venture trading company, the foreign party must, besides other requirements, have a turnover of over $5 billion in the year prior to the application, and enjoy an average annual trading volume of over $30 million in the previous three years prior to the application. In contrast, the requirements for their Chinese partners are much more flexible. The Chinese party only needs, besides other requirements, an average annual foreign trade volume of over $200 million in the previous three years (of which no less than half shall be export), and enjoy an average annual turnover of over $10 million in the previous three years. Moreover, for the establishment of a joint venture investments company, the total assets of the foreign investor one year before the application shall be no less than $400 million. The same requirements for the Chinese partner are merely RMB 100 million.

Second, FIEs in China are subject to higher establishment standards compared with domestic companies without the involvement of foreign investments. Such higher standards include (but are not limited to) the use of advanced technology, promotion of overseas market, or higher registered capital requirements. For example, article 3 of the WFOE Law and article 3 of its implementing rule provide that WFOEs must either transfer advanced technology to their Chinese operation, or export more than fifty percent of their output value of all products every year. Article 9 of EJV Law and article 4 of the CJV Law provide that the state encourages the establishment of joint ventures that are either export-oriented or utilizing advanced technology. The joint venture commercial companies may best illustrate the example of higher registered capital requirements. Investors shall contribute at least a registered capital of no less than RMB 50 million for a joint venture commercial company engaging in retail business, and RMB 80 million for a joint venture engaging in wholesale business. However, for the incorporation of a trading company with all incorporators as Chinese nationals, only an RMB 300,000 is required for a retail company, and RMB 500,000 for a wholesale company.

2. Legality Under the TRIM and GATS Agreements

The foregoing discussions demonstrate that along with certain preferential treatments, China also discriminates against FDIs in some aspects by enacting a separate regulating

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112. GuanYu SheLi ZhongWai HeZi DuiWai MaoYi GongSi ZanXing BanFa (Provisional Measures on the Establishment of Chinese-Foreign Joint Venture Trading Companies on a Trial Basis) (promulgated on Sept. 30, 1996) [hereinafter Provisional Measures of JV Trading Companies], art. 4, para. 1.
113. See id. art. 4, para. 2. RMB 100 million is the equivalent of approximately $12 million.
114. See id. art. 2.
115. See id.
117. See Company Law, supra note 97, art. 23.
system and setting forth higher establishment standards for FIEs or FDIs in general. The question is whether such a separate regulating regime for FDIs is permissible under the WTO regime. This part of the paper will discuss the effects of both the TRIM Agreement and the GATS.

a. Effect of the TRIM Agreement

As discussed in Part I, the TRIM Agreement only applies to trade-related investment measures that could cause trade-restricting or distorting effects but does not apply to barriers to the establishment and operation of investments in general. The narrow scope of the TRIM Agreement is corroborated by the history of the TRIM Agreement and Uruguay Round negotiations. The investment discussion in the Uruguay Round is limited to investment measures with “adverse effects on trade,” rather than the broad relationship between investment, production, and trade. As a result, the TRIM Agreement prohibits those investment measures with direct and adverse effects on trade, such as local content requirements and export performance requirements, but does not mandate the national treatment to the establishment and operation of international investment in general.

China's separate regulating system for FDIs appears to be outside the scope of the TRIM Agreement. The different treatments of FDIs in China (different corporate structure, special approval procedure, and higher qualification requirements), even assumed to be unfair discrimination, are not directly related to trade in goods, nor are they similar to any illustration to the TRIM Agreement (i.e., various performance requirements). Rather, those discrimination measures concern the national treatment of foreign investments in general, which is not mandated by the WTO regime to date. Therefore, China's separate regulating system would probably pass the test of the TRIM Agreement.

b. Effects of the GATS Agreement

As discussed in Part I, the GATS Agreement has a much broader coverage than the TRIM Agreement insofar as the effects on FDI are concerned. However, China's separate regulating regime for FDIs does not appear to violate the GATS.

First, the GATS only covers trade in services not the foreign investments in general; second, even though in the services area, the national treatment and market access obligations under the GATS Agreement only applies to those sectors that a member nation has placed on its Schedule. Therefore, the national treatment and market obligation of the GATS would only apply to those sectors where China had made specific commitments, such as banking, distribution, insurance, telecommunications, and securities. So far China has promised, after the accession, to gradually phase out most of the restrictions in major service areas listed above. As a result, the above-mentioned qualification requirements

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118. TRIM Agreement, supra note 28, at Preface and art. 1.
119. See Price & Christy, supra note 24, at 453.
120. See id. at 447.
121. TRIM Agreement, supra note 28, at Annex.
122. GATS, supra note 38, art. I(l).
123. See Self, supra note 40, at 536; see also GATS, supra note 38, art. XX. Unlike this positive list for coverage of services under GATS, the North American Free Trade Agreement (NAFTA) took a negative list approach, which means all service areas are covered by NAFTA unless specially excluded. North American Free Trade Agreement (1994), art. 1206, reprinted in Ralph H. Folsom, NAFTA in a Nutshell (1999).
124. See Summary, supra note 8.
125. See id.
would probably fall within China's commitments and thus would be amended in the near future. However, the majority of the regulating regime, such as the basic structure of a dual regulating system, special approval procedure for FDIs, higher incorporation requirements for FIEs of a manufacturing nature, and higher qualification requirements for foreign investors in those FIEs, would probably survive China's entry into the WTO.

B. PERFORMANCE REQUIREMENTS

Chinese law imposes on FIEs broad performance requirements that mainly consist of local content requirements, export performance requirements, and balance of foreign currency.126

1. Export Performance Requirements

FIE laws in China, to a different extent, impose or compel export performance requirements on FIEs. Under article 3 of the WFOE Law and article 3 of its Rule, WFOEs must either transfer advance technology to their Chinese operation, or export more than 50 percent of their output value of all products every year. Although the EJV and CJV Law do not impose such mandatory requirements, article 9 of EJV Law and article 4 of the CJV Law provide that the state encourages the establishment of joint ventures that are either export-oriented or utilizing advanced technology. The encouraging measures include broad categories ranging from the preferential terms of land use fees,27 to the refund of income tax,28 and to preferential approval procedures for imported manufacturing facilities and materials.29 By implementing the preferential encouraging measures, Chinese law compels or induces the FIEs to engage in export-oriented operations.

As discussed above, the TRIM Agreement prohibits Member States from applying any trade-related investment measures that are inconsistent with the basic principle of national treatment.30 Such TRIMs include both the local content requirements and the export performance requirements.31 Further, the impermissible TRIMs not only "include those which are mandatory under domestic law or administrative rules," but also those "compliance with which is necessary to obtain an advantage."32 Applying the TRIM Agreement to China's FIEs, first, the mandatory export performance requirements under the WFOE Law apparently do not conform to the TRIM Agreement since they squarely fall within the illustrated TRIMs. Second, the provisions of EJV and CJV Law that encourage the export performance are also inconsistent with the WTO regime. Although EJV and CJV Law do not require mandatory export performance, however, complying with those provisions is "necessary to obtain an advantage," for example, tax reductions.33 Thus, these provisions of EJV and CJV Law also violate the TRIM Agreement.

126. For balance of foreign currency, see CJV Law, supra note 75, art. 20. See also WFOE Law, supra note 76, art. 18.
127. See Provisional Regulation for the Encouragement, art. 4.
128. See id. arts. 7, 8, 9.
129. See id. arts. 12, 13.
130. See TRIM Agreement, supra note 28, art. 2(1).
131. Id.
132. Id.
133. Id.

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Moreover, China's encouraging measures for export performance might also violate the WTO Agreement on Subsidiary and Countervailing Measures (SCM Agreement). The SCM Agreement prohibits any subsidy such as tax credit that is contingent upon export performance. China's major encouraging measure, an income tax refund, would certainly constitute such impermissible subsidy under the SCM Agreement.

The problem regarding performance requirements, however, might become moot upon China's entry to WTO, if China fulfills its commitments. In the U.S.-China Agreement, China had promised to eliminate all performance requirements (including local content requirement, export performance requirements, and requirements of balance of foreign currency) immediately after the accession. Thus, relevant provisions of China's FIE laws requiring export performance requirements would be eliminated from the FIE laws in the near future.

2. Local Content Requirements

"Local content requirement" is an import substitution practice obligating foreign investors to purchase or use domestic products or services rather than importing those products or services. Local content requirements are prevalent throughout China's FIE laws. Article 9 of the EJV Law and article 15 of the WFOE Law provide that EJV or WFOE may purchase its materials and fuels on the Chinese domestic markets or international markets; however, under the same conditions, China's domestic market should be given priority. Article 18 of the CJV Law and article 16 of the WFOE Law require that CJVs or WFOEs shall purchase insurance from insurance companies within the territory of China. Pursuant to the above provisions, various governmental agencies in China promulgated a number of detailed local content requirements in various industries. For example, a 1994 automobile industrial policy imposed local content requirements for passenger vehicles of 40 percent at start-up, 60 percent by the second year, and 80 percent by the third year. A 1998 Circular of Ministry of Information Industries required telecommunication enterprises to purchase components from domestic suppliers.

As discussed above, the local content requirements, if mandatorily required or if compliance is necessary to obtain certain advantages, violate the TRIM Agreements. The above mandatory local content requirements under China's FIE laws certainly fall within these impermissible categories, and therefore would constitute illegal non-tariff trade barriers after China's accession.

China has promised to eliminate all the local content requirements upon its entry into the WTO. Thus, it is also anticipated that relevant provisions of FIE laws will be amended accordingly in the near future.

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134. WTO Agreement on Subsidies and Countervailing Measures, arts. 1.1, 3.1, reprinted in Raworth, supra note 28.
135. See Summary, supra note 8.
136. A bill revising three FIE laws had been presented to the NPC. See Yuan, supra note 73.
137. See Bacon, supra note 15, at 406.
138. See id.
140. See Summary, supra note 8. However, due to various domestic pressures in developing countries, the complete elimination of local content requirements might not be so easy. For example, after the establishment of WTO, Brazil and Indonesia still maintain various local content requirement in the auto sector, and the United States and Japan had initiated complaints against the above two countries regarding the TRIM violation in the auto sector. See Robert H. Edwards, Jr. & Simon N. Lester, Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures, 33 Stan. J. Int'l L. 169, 181, 184, 197 (1999).
V. Impacts on Sectoral Restrictions

A. China's Foreign Investment Guideline

1. An Overview

China regulates the direction of FDIs in China by enacting and enforcing a so-called Investment Guideline (Guideline). The purpose of this Guideline is to "guide foreign investment, adapt foreign investments to China's national economic and social development plan." All foreign investments in China are governed by the Guideline.

Under the Guideline, projects involving foreign investments in China would be divided into four categories: encouraged, permitted, restricted, and prohibited. The encouraged categories are those involving advanced technology, or the expansion of overseas markets. The restricted and prohibited categories reflect several common themes that include the protection of national security, the prevention of environmental pollution, the restriction of consumer luxuries, or the avoidance of overdevelopment in certain areas. The restricted and prohibited categories involve a number of sectors in a variety of industries, including, but not limited to, those in the textile industry, petroleum industry, electronic industry, machine-building industry, and various service sectors. Such service sectors range from domestic and foreign trade, to telecommunication, finance, and journalism.

Moreover, the Guideline imposes ownership restrictions on those restricted categories that are open to FDI on a trial basis. For example, in all domestic and foreign trade sectors, the Chinese party must have a controlling stake, including the motor vehicles industry, and the construction and operation of main railway lines. In some sectors, wholly foreign-owned operations are not allowed, including auto transportation.

2. Permissibility in General Under WTO Regime

The question is whether China's sectoral restrictions, prohibitions, or ownership restrictions are permissible under the WTO regime. The problem did not become moot after China's entry into the WTO because China only promised to lift certain bans in several service industries. The majority of the restrictions and prohibitions in the Guideline,
are concerned with industries with a manufacturing nature, and thus would remain untouched.  

a. Effect of the TRIM Agreement

As discussed in Part I, the TRIM Agreement only applies to trade-related investment measures that could cause trade-restricting or distorting effects, but it does not apply to barriers against the establishment and operation of investments in general. As a result, all the illustrations in the TRIM Agreement Annex focus on those investment measures with direct and adverse effect on trade, such as local content requirements and export performance requirements.

China's general scheme of sectoral restrictions and prohibitions on FDIs under the Guideline do not quite fit into the limited scope of the TRIM Agreement. The same is true for China's separate regulating system on foreign direct investment; these sectoral restrictions are more related to the establishment of foreign investment in general. Although these sectoral restrictions might have some distorting effect on trade, they are not directly related to trade in goods, nor are they similar with any of the illustrations contained in the TRIM Agreement. Therefore, technologically speaking, the Guideline would probably survive the mandate of the TRIM Agreement.

b. Effects of the GATS Agreement

As discussed in Part I, the GATS Agreement has a broader coverage than the TRIM Agreement insofar as the effects on FDI are concerned. However, China's Investment Guideline, in large part, would probably pass the GATS examinations.

First, as discussed above, the national treatment and market access obligations under the GATS Agreement only apply to those sectors that a member nation has placed on its Schedule. Therefore, the national treatment and market obligation of the GATS would only apply to those sectors where China has made specific commitments, such as banking, distribution, and telecommunications. The GATS does not cover any of the service sectors that China does not place in its GATS Schedule but still remain in the Investment Guideline.

Second, the GATS applies to trade in services only, not those industries of a manufacturing nature. Although restrictions and prohibitions of FDI in service industries is one of the major focuses, China's Investment Guideline, in a larger part, covers the manufacturing industries. Those restrictions and prohibitions in manufacturing industries would survive China's entry into the WTO.

Furthermore, even though China decided or promised to place certain sectors into the Schedule, it still has the right under the GATS to specify the terms, conditions, and qualifications on market access and national treatments in those sectors. For example, although China made promises in the telecommunication sector, it will only open the telecommunication service market progressively within six years after accession, and the

153. See Summary, supra note 8.
154. TRIM Agreement, supra note 28, at Preface and art. 1.
155. See Price & Christy, supra note 24, at 453.
156. See Self, supra note 43, at 536; see also GATS, supra note 41, art. XX.
157. See Summary, supra note 8.
158. GATS, supra note 38, art. 1.
159. See id. art. XX.
ownership restriction (Chinese part must have a controlling stake) would still be perfectly permissible after six years. In fact, the numbers of sectoral commitments made by member nations are historically low. Within a maximum of around 150 service sectors, most developed countries have made commitments in more than seventy sectors; transition economies made commitments in about half of all sectors, and developing countries did so in only 16 percent.

In sum, a large part, if not most of the restrictions and prohibitions in service industries listed in China's Investment Guideline, will continue to exist, at least for a certain period of time, after China acquires the WTO membership.

3. Protectionism v. Reasonable Restriction

The total elimination of sectoral or ownership restrictions is unrealistic for China as a developing country. In fact, sectoral restrictions on FDIs also exist in developed countries. For example, in the United States, there are several degrees of restrictions on FDIs. There may be total prohibition from FDIs in certain sectors (nuclear power, maritime activities), or strict regulation (airlines, financial services, communications), or limits on equity ownership (limited to minority shares). However, the difference is whether the restrictions are narrowly tailored for some specific purposes (e.g., national security), or so broad that they become the cloak of general protectionism for domestic industries. Although China's broad sectoral restrictions, in large part, do not technically violate the WTO mandates, they apparently exceed the scope necessary and reasonable for the protection of certain specific interests (e.g., national security).

B. An Example: Foreign Trade Rights

Historically, China modeled its foreign trade practices on other socialist countries, and adopted a system of state control of foreign trade soon after the foundation of the PRC in 1949. After the introduction of the open-door policy in the late 1970s, China launched a far-reaching reform of its foreign-trade system and ended the thirty-year monopoly over foreign trade by the state-owned foreign trade companies. Such reform increased both the number of entities engaging in foreign trade and the diversification of foreign traders.

1. Foreign Trade Rights For Chinese Domestic Enterprises

For companies owned by Chinese nationals and enterprise legal persons, the foreign trade rights were mainly administered by a licensing system. A would-be foreign trade dealer in

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160. See Investment Guideline, supra note 141.
161. See Summary, supra note 8.
162. See Snape, supra note 43, at 287 (the data predated the conclusions of the telecommunication and financial services agreements).
163. China is generally deemed as a developing country, although it is unclear whether China might be able to accede into the WTO as a developing country.
164. See Folsom, supra note 109, at 195.
166. See id.
168. See id.
169. See id.
China who intends to engage in the import and export of goods and technologies shall acquire a permit from the responsible authority after meeting certain requirements.170

2. Foreign Trade Rights for Foreigners

Under current China law, wholly foreign-owned operations are not allowed to engage in foreign trade in China.171 A foreign investor may only engage in foreign trade practice in China indirectly by one of the following two ways.

a. Joint Venture Trading Companies

A joint venture trading company is a business entity between foreign and Chinese companies specializing in the import and export trade.172 All joint trading companies are limited liability companies in which the shares of the Chinese party in the registered capital must be no less than 51 percent, and the legal representative173 of which shall be appointed by the Chinese party.174 Also, the joint venture trading company shall have a registered capital of no less than RMB 100 million.175

Apart from the above requirements regarding the joint venture companies, both the Chinese and foreign party to a joint venture company must also fulfill certain qualification requirements. The foreign party must (1) have a turnover of over $5 billion in the year before the application; and (2) enjoy an average annual trading volume of over $30 million in the three years before the application investment of over $30 million in China.176 In contrast, the requirements for the Chinese party are more flexible. The Chinese party must (1) have foreign trade rights; (2) have an average annual foreign trade volume of over $200 million in the previous three years, of which no less than half shall be export; and (3) establish more than three branches outside China having an average annual turnover of over $10 million in the previous three years.177

b. FIEs in General

All FIEs in China automatically enjoy the foreign trade privilege, without the need for obtaining the license or permit, to the extent that they import non-production goods for their own use, equipment, raw materials, and other goods necessary for the manufacturing and exporting of their own products.178

3. Effects of China's Entry into the WTO on Foreign Trade Rights

The above discussions reveal that current China law treats Chinese nationals differently from foreigners in terms of the grant and exercise of foreign trade rights. The differences

170. See ZhongHua RenMin GongHeGuo DuiWai MaoYi Fa (Foreign Trade Law of the PRC), art. 9 (May 12, 1994) [hereinafter Foreign Trade Law].
171. See Investment Guideline, supra note 141.
172. See Provisional Measures in the Establishment of Sino-Foreign Joint Venture Trading Companies on a Pilot Basis, art. 2 (Sept. 30, 1996) [hereinafter Provisional Measures of JV Trading Companies].
173. For a detailed discussion of the concept of Legal Representative in China, see Yuan, supra note 73, at 490.
174. See Provisional Measures of JV Trading Companies, supra note 174, art. 3.
175. See id. art 4, para. 3.
176. See id. art. 4, para. 1.
177. See id. art. 4, para. 2.
178. See Foreign Trade Law, supra note 170, art. 9; EJV Law, supra note 74, art. 9; EJV Implementation, supra note 74, arts. 57, 60, 62, 63; CJV Law, supra note 75, art. 19; WFOE Law, supra note 76, art. 15; WFOE Rule, supra note 76, arts. 44, 46–48.
are not only manifested as a general prohibition on foreign companies to engage in import and export trade in China (except by joint ventures), but also the more stringent qualification requirements on foreign investors when participating in a joint venture trading company, and the ownership restriction (no more than 49 percent) on such foreign investors.

Although as discussed in Part III, such discrimination did not necessarily run afoul of China’s obligations under the GATS Agreement; China has promised, after the entry of WTO, to progressively eliminate all restrictions in the foreign trade area within three years. Thus, three years after China acquired the WTO membership, foreign investments would presumably enjoy the national treatment and MFN in obtaining foreign trade rights in China.

VI. Challenges and Obstacles for China

The above discussion was based on an assumption that China would successfully and smoothly implement its commitments and obligations to the WTO. However, several potential obstacles exist that may substantially undermine China’s efforts to carry out its commitments. These obstacles range from the reform of China’s state-owned enterprises (SOE), to the transparency of laws and regulations, to the elimination of local protections.

A. China’s Reform of SOEs

The success of China’s reformation of its SOEs is crucial to the implementation of China’s obligations under the GATT and WTO agreements. The failure of such reforms may cause the excessive bankruptcy of SOEs, and expose some seventy million Chinese to unemployment and loss of post-retirement pension.

Under the GATT, SOEs are required to make purchases or sales solely in accordance with commercial consideration, such as price, quality, availability, and marketability. In other words, SOEs are supposed to be on equal footing in commercial transactions and competitions with private business sectors.

SOEs in China, however, have heavily relied on governmental protection. There always exist significant political and economic pressure in China to retain some form of protection for SOEs after China’s entry into the WTO. The governmental protection of SOEs in China may not necessarily involve direct subsidies, which the Chinese government has tried to eliminate in the past two decades. Rather, it normally takes the form of favorable policy treatments, examples of which include the uneven giving of certain quotas or licenses, the grant of certain monopolies in certain business sectors within a certain geographical area, and the guaranty of government procurement contracts. In addition, the non-economic

179. Part of this title is based on the author’s personal observations and opinions, and may not necessarily reflect or be supported by generally-accepted views.

180. More than forty-four percent of China’s SOEs are losing money according to the World Bank, and SOEs in China face U.S.$200 billion in bad debts, which constitute more than twenty percent of China’s bank loans. See Bacon, supra note 15, at 430, 431.

181. See Burke, supra note 34, at 325.

182. General Agreement on Tariffs and Trade (1947), art. XVII(1), reprinted in Raworth, supra note 134 [hereinafter GATT 1947].

183. There are general perceptions in China that SOEs are not yet ready for the anticipated post-WTO competitions. See Smith, supra note 2, at A1.
policy loans from the state-owned financial institutions, which were generally not justified by the SOEs' financial conditions and would not be contracted but for the government's interference, may also arguably constitute a kind of indirect subsidy.\footnote{184}

The Chinese government has tried various ways to reform SOEs in the past two decades. The continuing efforts include (1) improving the efficiency, competition consciousness, and risk-taking ideas in most of the SOEs by decentralizing the decision-making process; (2) while retaining control, privatizing some of the SOEs by publicly issuing stocks and debt instruments; (3) encouraging the participating of foreign investments in most of sectors; and (4) leasing or selling small-scale SOEs to private sectors.

Notwithstanding the Chinese government's well-intended efforts, the longtime problems might not be easily resolved within one night. Moreover, the SOEs' role as service providers of certain social functions such as post-retirement pensions, education, and health care, certainly exacerbate the difficulty and bitterness of the reform. In fact, SOEs themselves in China have been crying that they are not ready for the coming of the wolf—WTO.

B. Transparency of Law

Article X (1) of the \textit{GATT} provides that all "trade-related laws, regulations, judicial decisions and administrative rulings of general application . . . shall be published promptly in such a manner as to enable trades to become acquainted with them." The purpose is to ensure "WTO members . . . administer published laws in a uniform, impartial and reasonable manner."\footnote{185}

China's current legal system, however, still manifests an overall lack of transparency. First, China's laws and regulations are highly generalized and replete with ambiguities. The implementation of such laws and regulations to a large degree relies on the discretion of bureaucrats. To make this situation worse, interpretations by judicial tribunes of these skeletal laws and regulations do not have any legal precedent effects on later transactions or litigations. Second, China does not have an official compilation system for laws and regulations. Although the State Council, the MOFTEC, and the People's Supreme Court issue periodical publications (called \textit{Gazette}) containing laws and regulations, these publications are not always complete or updated. So are the situations of various commercial compilations in China. Third, similarly, there is no official compilation for local rules and regulations. As a result, it is sometimes very difficult to retrieve a law or regulation in China, even for a native professional practitioner.

Although China is moving toward a more transparent, rule-based legal system, Rome was not built in a day. In the short term, the transparency of law problem will constitute a big challenge to China's implementation of its obligations under the WTO agreements.

C. Local Protectionism

China also has to address its local protectionism, which is to some extent prevalent and notorious. The cost of failure to do so may be very high because the WTO disciplines impose responsibility for local government action on central government.\footnote{186} Thus the Bei-
jing central government would be responsible for any illegal protectionism action of any local government within the territory of China.

The local protectionism impedes the free movement of goods and services, which is a basic goal of the WTO. Due to difficult local interest, many local governments in China try various means to protect their locally-owned business from competing with other localities, or to protect their local interest to the detriment of other localities. Such local protectionism may take various forms, including (1) at the legislative level, enacting local rules aiming to protect local interests; (2) at the judicial level, refusing to enforce other courts' judgments against local interests or distorting the law to render favorable judgments for local interests; and (3) at the administrative level, setting up physical check points blocking the inflow of goods from other localities.

Although the central governmental has repeatedly demanded the removal of local protections, its orders are often ignored with impunity by local authorities. A completely independent legal system would be the ideal solution for this problem. However, the establishment of such a system is impossible under China's current one-party political structure. Therefore, local protectionism would probably continue to threaten the central government's effort to insure the free flow of goods in China.

VII. Conclusion

China's entry into the WTO necessitates the elimination of local content and export performance requirements from China's laws for FIEs, and the alleviation of restrictions in major service areas. However, it appears that except in certain major service areas, China's separate regulating system for FDIs, additional approval procedures, higher incorporation requirements for FIEs, higher qualification requirements for foreign investors, and sectoral and ownership restrictions for FDIs, do not run afoul of the WTO's mandate. At the same time, several obstacles might potentially threaten China's effort to implement its commitments to the WTO. National treatment of FDIs in China, with only limited and reasonable exceptions, probably have a long way to go.

187. See Clarke, supra note 19, at 527.