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Cover Page Footnote

J.D., The Florida State University College of Law, 1996; B.A., Political Science, Boston College, 1982. This article is dedicated to my wife, Marietta, without whose steadfast suport I could have neither entered nor finished law school, and to my two youngest legal assistants, Whitney Marie Graham and James Jackson Graham.

FOREIGN INVESTMENT LAWS OF CHINA AND THE UNITED STATES: A COMPARATIVE STUDY

HENRY J. GRAHAM*

I. INTRODUCTION

The United States and China are two charter members of the nuclear club at very different stages of economic, political, legal and social development. Although their economic, political and social disparities are striking, the contrast in legal systems and in the role of law in society is probably the widest chasm between the two countries. While foreign investment in the United States is governed by numerous statutes and regulations some going back decades Chinese foreign investment laws are recent products of dynamic economic growth and are tailored to the specific Chinese province in question.[1] Moreover, to a greater extent than in most developing countries, knowledge of China's "operational code" (their system of unwritten laws) is critical to

* J.D., The Florida State University College of Law, 1996; B.A., Political Science, Boston College, 1982. This article is dedicated to my wife, Marietta, without whose steadfast suport I could have neither entered nor finished law school, and to my two youngest legal assistants, Whitney Marie Graham and James Jackson Graham.

1. FAR E. ECON. REV., Mar. 4, 1993, at 55 [hereinafter Guangdong]. Provincial officials in Guangdong province, the booming region neighboring and emulating Hong Kong, are now allowing more non-governmental people, including resident foreigners, to set up private businesses. Officials also have loosened foreign investment laws allowing private firms to establish joint ventures with foreign investors.

successfully investing in that enigmatic nation.[2] This knowledge also extends to "politically correct" descriptions of your interlocutors which, if not observed, can shatter business deals worth hundreds of millions of dollars in the space of several minutes.[3]

In China, "the rule of law is a tenuous concept."[4] Human rights violations abound; indefinite detention, often with no formal charges filed, is common, even for foreign citizens.[5] Personal connections, called *guanxi*, are paramount and critical to business success.[6] Indeed, this is illustrated by the fact that 80% of foreign investment in China comes from the so-called "overseas Chinese."[7] These expatriates funnel a tremendous amount of money back into the country through personal connections, mainly family relatives.[8] Without *guanxi*, doing business is problematic because it is difficult to get the Chinese to sign contracts and even more difficult to have them enforced.[9]

While American investors consult lawyers before and during business negotiations, the Chinese consider such consultation an insult because it infers a lack of trust.[10] Lawyers are brought in at the end of the negotiations to look over the contract.[11] If something eventually goes wrong, there is legal recourse which includes the increasingly preferable option of arbitration.[12] Arbitration eventuated, in part, from the Confucian ideal of social harmony and conciliation.[13] Historically, such self-regulation kept most "private law" disputes out of the state courts,

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2. RALPH H. FOLSOM, ET AL., INTERNATIONAL BUSINESS TRANSACTIONS: A PROBLEM-ORIENTED COURSEBOOK 762 (2d ed. 1991).

3. *See* Franklin L. Lavin, *When Toasting the Mayor, Don't Mention Democracy*, ASIAN WALL ST. J., June 16, 1994, at 8.

4. Kathy Chen, *China (A Special Report): Business Plan; The Extent of the Law*, ASIAN WALL ST. J., Dec. 13, 1993, at S10.

5. The case of James Peng is instructive. He is an "Overseas Chinese," now an Australian citizen. He built a business in Shenzhen Special Economic Zone, becoming, in 1990, the first foreign joint venture listed in China. He was the majority stockholder. Numerous bouts ensued with local officials; they wanted to take over his company. After more shenanigans, Chinese authorities, in cahoots with Macao's police, jailed Peng in October 1993. Nine months later, Chinese officials filed trumped-up charges which even a Shenzhen court found non-justiciable. Round two began in October 1994, when Peng's wife learned he was charged with embezzling money in 1989. *See* Lina Shen-Peng, *The Perils of Doing Business in China*, WALL ST. J., Nov. 11, 1994, at A14.

6. Bruce Gilley, *New Model*, FAR E. ECON. REV., Dec. 21, 1995, at 50.

7. Zongli Tang, *Is China Returning to Semi-Colonial Status?*, 45 MONTHLY REV. 77, 84 (1993).

8. *See id.*; Chen, *supra* note 4, at S10.

9. Chen, *supra* note 4, at S10.

10. *Id.*

11. *Id.*

12. *Id.* Parties to a dispute can seek arbitration through the China International Economic and Trade Arbitration Commission. The two sides help pick the panel which can include non-Chinese members. Although the process is slow, and the loser may still ignore the panel's decision, the alternative is a roll of the dice in the Chinese legal system before a Chinese judge. *Id.*

13. *See* KONRAD ZWEIGERT & HEIN KOTZ, AN INTRODUCTION TO COMPARATIVE LAW 320 (2d ed. 1987).

depending instead on local conciliation and the threat of social censure.[14] Arbitration and other forms of alternative dispute resolution represent the mainstream in China. Yet, litigation is the alternative, both for international and domestic disputes.[15] Furthermore, arbitration can serve the dual purposes of providing a "face-saving" approach to dispute resolution while preserving the underlying business relationship benefiting both sides.[16] The increasing prevalence of long-term contractual relationships in international business underscores the importance of conciliatory dispute resolution mechanisms.[17]

This Essay will analyze and compare foreign investment laws in China and the United States. The framework of analysis will include examining both nations' statutes and codes, China's Operational Code, and China's Aspirational Declarations.[18] The most successful foreign investors are those who, while understanding the written law, realize there are other important sources of law and custom which may have a considerable impact on their investment prospects, especially in an emerging market like China where the law is catching up to rapid economic development.[19]

II. NAVIGATING THE POLITICAL/LEGAL THICKET: INVESTING IN AMERICA

A foreign investor interested in investing in the United States confronts a multitude of antitrust and securities laws. Moreover, sensitive American technology is often subject to export controls.[20] Furthermore,

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14. *Id.* The conciliators of private disputes were usually the heads of families or other relatives or outsider who were so respected that there would be no "loss of face" in accepting one of their compromises. If one ignored a proposed compromise from such respected individuals, you would be subject to "social censure" from the tight-knit community to which you belonged.

15. FOLSOM, *supra* note 2, at 1060.

16. *Id.* at 1063.

17. *Id.*

18. *Id.* at 764. Aspirational Declarations are written pronouncements, not law. They are important because they create a "norm of expected conduct" and may eventually become customary international law or part of the country's Public Code or Operational Code regarding foreign investment. *Id.*

19. For purposes of this Essay, foreign investment or foreign direct investment ("FDI"), is "the ownership or control, directly or indirectly, by one foreign person of 10 per centum or more of the voting securities of an incorporated U.S. business enterprise or an equivalent in an unincorporated U.S. business enterprise, including a branch." Terry R. Spencer & Christian B. Green, *Foreign Direct Investment in the United States: An Analysis of Its Potential Costs and Benefits and a Review of Legislative Tools Available to Shape Its Future Course*, 6 TRANSNAT'L LAW 539, 541 n.3 (1993). FDI "is most often measured as the sum total, at book value, of intercompany equity inflows and reinvested corporate earnings . . . and calculated by the sum of the net stock existing in the United States and the annual gross flow of such investments." *Id.*

20. *See generally* Ruth L. Gana, *U.S. Science Policy and the International Transfer of Technology*, 3 J. TRANSNAT'L L. & POL'Y 205 (1994) (describing the economic and political issues surrounding technology transfer from the United States to foreign countries).

Congress recently enacted legislation that views proposed foreign acquisitions through the prism of American national security interests.[21]

A. *Exhibit A: National Security Concerns*

America is not as investor-friendly as it used to be. The current American legal framework can confuse and disadvantage foreign investors who may have difficulty identifying overlapping controls that may pertain to an investment. America adopted a laissez faire attitude toward foreign imports and investment during most of the Cold War, largely to jump start the prostrate economies of many of our allies in that epic struggle, notably Japan, South Korea, and West Germany.[22] Indeed, "[f]or nearly a decade after 1945 a 'Marshall Plan mentality' caused Washington to pursue economic foreign relations designed to make overseas allies self-sustaining participants in a thriving open international economy, *even at the expense of domestic American economic interests.*"[23] There was no great outcry in the late 1940's, 1950's, and early 1960's as America enjoyed unprecedented prosperity at home while resolutely confronting communism abroad through a network of alliances with its recovering allies.

President Lyndon Johnson's Great Society and the Vietnam War forever changed America's politics and economic order. President Johnson launched massive entitlement programs at home while simultaneously escalating the Vietnam War. His version of guns and butter had half a million American soldiers in Vietnam by 1968 and produced the beginnings of inflation at home. In 1969, America saw its last balanced budget for at least several decades.[24] Two years later, America suffered its first trade deficit since 1892.[25]

The emergence of Japan and West Germany as world-class economic powers in the 1970's coincided with America's continuing involvement in Vietnam (by then, an unbearable economic and moral drain) and domestic economic woes. The American standard of living eroded as the rate of inflation steadily increased and eventually reached 18% in 1980. Even after America finally exited Vietnam in 1975, the Cold War burden remained. America continued to provide extended deterrence for its allies through the nuclear umbrella and extensive forward deployment of conventional forces. This was very expensive.

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21. Dale C. Turza & Anthony F. Essaye, *New Foreign Investment Provision has Potential for Broad Restriction: The Exon-Florio Amendment*, 37 FED. BAR NEWS & J. 146 (1990).

22. *See* Alfred E. Eckes, *Trading American Interests*, 71 FOREIGN AFF. 135 (1992).

23. *Id.* at 136-37 (emphasis added).

24. Eckes, *supra* note 22, at 144.

25. *Id.*

It also allowed allies like Japan and West Germany to enjoy the luxury of spending little on defense while concentrating on building domestic industries and developing export markets, especially in the United States. This artificial situation could not continue forever. The one benefit of burgeoning trade deficits with its closest allies was to convince America that its allies could play a greater role in their own defense and would no longer require a "free ride" as they reconstructed their economies.[26]

During President Reagan's second term, Congress enacted legislation, against the wishes of the administration, designed to erect a national security "screen" for proposed foreign investment in the United States. Specifically, "[t]he President . . . [could] make an investigation to determine the effects on national security of mergers, acquisitions, and takeovers . . . by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States."[27] The Exon-Florio Amendment, enacted in 1988, gave the President broad powers to revise or bar sales of American companies to foreign investors. These powers were largely insulated from judicial review due to traditional deference to executive primacy in national security affairs.[28] Congress, through Exon-Florio, took an expansive view of national security by intentionally leaving the term undefined. Consequently, Exon-Florio gave the President considerable discretion in responding to what he deemed to be threats to national security.

Exon-Florio is enforced by an interagency group known as the Committee on Foreign Investment in the United States ("CFIUS").[29] Although first established in 1975, CFIUS lacked statutory authority to block foreign acquisitions prior to Exon-Florio.[30] CFIUS is composed of heavy hitters, including the Secretaries of State, Defense, Treasury, and Commerce, as well as other senior government officials.[31]

Exon-Florio is not universally acclaimed. One commentator characterizes it as "the primary and most controversial law governing foreign investment in the United States."[32] Recognizing the discretionary

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26. This was a constant bone of contention between America and its allies during Ronald Reagan's presidency. Progress was made, particularly in the late 1980's, when Japan finally exceeded its almost pathological 1% GNP ceiling on defense spending. Nevertheless, massive trade deficits remained, especially with the Japanese. High profile Japanese purchases of American landmarks (e.g., Rockefeller Center) made the situation all the more intolerable.

27. 50 U.S.C. app. § 2170(a) (1995).

28. 50 U.S.C. app. § 2170(e) & (f) (1995).

29. *See* Howard E. O'Leary & Judy Parker Jenkins, *"Exon-Florio": An Impediment To Foreign Investment in the United States?*, 69 MICH. B.J. 680, 681 (1990).

30. *Id.*

31. *Id.*

32. *See* Christopher F. Corr, *A Survey of United States Controls on Foreign Investment and Operations: How Much is Enough?*, 9 AM. U. J. INT'L L. & POL'Y 417, 420 (1994).

nature of Exon-Florio, the commentator notes that policy objectives of the incumbent administration will determine the law's actual influence.[33] Nevertheless, while the intent of Exon-Florio is laudable, the process can easily be abused by an American company facing a hostile takeover by a foreign company. In such situations, the "Exon-Florio temptation might seem irresistible . . . to exploit public fears relating to the perceived evils of foreign investment."[34] It is certainly ironic that this potentially restrictive law was adopted under the signature of one of the century's foremost free traders, Ronald Reagan. This law seems to clash with the traditional American policies of free enterprise and open markets.

Evidently, Congress intended Exon-Florio to create a barrier to foreign investment only when the investment threatens national security. Congress declared it is "the policy of the United States to encourage the efforts of other countries to increase the flow of international trade [and] to foster private initiative and competition . . . ."[35] This policy was evidenced by an "open-door" approach toward foreign investment, primarily in the form of over forty bilateral Treaties of Friendship, Commerce, and Navigation.[36] Furthermore, Alfred Eckes has convincingly demonstrated that America's postwar policy, continuing through at least the early 1990's, consists of trading access to its domestic market in exchange for cooperation on nontrade issues.[37] Therefore, "[i]t appears that the *intent* of Congress in passing the Exon-Florio Amendment was not to impose additional barriers to foreign direct investment flows unless there was *clear interference* with national security concerns."[38] In the same vein, regulations were developed by the Department of the Treasury to provide for voluntary notice by parties to a proposed transaction.[39]

The limited purpose of Exon-Florio may explain its minimal use. CFIUS examined over seven hundred cases by mid-1992, but only conducted fourteen in-depth investigations with its new Exon-Florio

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33. *Id.* at 421.

34. Jonathan A. Knee, *Limiting Abuse of Exon-Florio by Takeover Targets*, 23 GEO. WASH. J. INT'L L. & ECON. 475, 481 (1989). Knee feels this is a low-cost, low-risk option for American companies. This maneuver delays any further acquisition moves by at least 30 days and may convince the unwanted suitor that the price may be too high.

35. 22 U.S.C. § 2351(a) (1995).

36. THOMAS F. CLASEN, FOREIGN TRADE AND INVESTMENT: A LEGAL GUIDE 257 (1987).

37. Eckes, *supra* note 22, at 151.

38. Spencer & Green, *supra* note 19, at 570 (emphasis added). To come under Exon-Florio scrutiny, transactions must satisfy the control definition in the corresponding regulations. The element of control focuses on the power to formulate, determine, direct, or decide important matters relating to the entity. *See* 31 C.F.R. § 800.204(a) (1994).

39. Spencer & Green, *supra* note 19, at 570.

powers.[40] Of these, the President blocked only one acquisition, that of MAMCO Manufacturing, a Seattle aircraft parts manufacturer, by the China National Aero-Technology Import and Export Corp.[41]

Nevertheless, Exon-Florio is essential to plugging the gaps left by other American laws dealing with foreign investment. For example, antitrust laws would not preclude foreign direct investment in *Intel*, the world's leading producer of microprocessors,[42] unless the investment would "substantially lessen" competition in the semiconductor industry."[43] As the U.S. military cannot go to war without the latest computer wizardry, foreign control of such high technology could constitute "clear interference" with American national security interests. Hence, Exon-Florio has a critical role.

B. Foreign Investment in America: The Public Code

In 1994, much of America's economy—the so-called "essential service industries"—remains off-limits to foreign direct investment. The prohibited sectors are mining and energy,[44] broadcasting and communications,[45] intercostal transportation,[46] banking,[47] investment companies,[48] domestic air transportation,[49] and military weapons technology.[50] In addition, numerous laws regulate foreign direct investment.

1. Antitrust & Unfair Competition

Antitrust laws may prohibit or eliminate foreign direct investment if free economic competition is hindered. The Sherman Act of 1890[51] criminalizes "restraint of trade" and bans monopolies or attempted

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40. *See* Karla D. Whalen, *Exon-Florio and Open Investment: Are They At Odds in a World Where National Security No Longer Revolves Solely Around Military Might?*, 17 SUFFOLK TRANSNAT'L L. J. 59, 70 (1994).

41. FOLSOM, *supra* note 2, 850-51. The exact reason for the disapproval remains unknown. Although MAMCO had no classified contracts with the U.S. government, the divestment was based on classified information regarding CATIC's prior operations. Patrick L. Schmidt, *The Exon-Florio Statute: How It Affects Foreign Investors and Lenders in the United States*, 27 INT'L LAW 795, 799-800 (1993).

42. Microprocessors are the "brains" of a computer.

43. 50 U.S.C. app. § 2170(e) & (f).

44. 42 U.S.C. § 2133(d) (1995).

45. 47 U.S.C. § 310(b) (1995).

46. 46 U.S.C. app. § 883 (1995).

47. 12 U.S.C. § 72 (1995).

48. 15 U.S.C. §§ 80a-7, a-8 (1995).

49. 49 U.S.C. app. § 1378(a)(4) (1995).

50. 22 U.S.C. § 2751 (1995).

51. Sherman Antitrust Act, ch. 647, §§ 1-8, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. §§ 1-7 (1988)).

monopolies.[52] The Sherman Act can be a potent weapon as "its prohibitions are almost unconstitutionally broad in their language and applications."[53] The Clayton Act of 1914[54] prohibits mergers, joint ventures, consolidations, and the like, where "the effect of such acquisition may be substantially to lessen competition."[55] The government "is required to define and substantiate the relevant product and geographic markets and then show that the particular foreign investment would likely substantially lessen competition in that particular market."[56]

The Federal Trade Commission Act[57] prohibits "unfair methods of competition." The United States Supreme Court, in *F.T.C. v. Brown Shoe Co.*,[58] interpreted this prohibition to embrace not only Sherman Act violations but also "restraints of trade contrary to the spirit of the antitrust laws."[59] Moreover, the Act bars "unfair or deceptive acts or practices" as well as misrepresentations as to the origin of products.[60] Thus, any prospective foreign investors would be well advised to familiarize themselves with American antitrust laws.

Securities laws also regulate foreign direct investment. The Securities Act of 1933 "requires all entities, foreign or domestic, issuing stock . . . to file a registration statement which includes the name of the issuer . . . and the names . . . of all persons owning more than ten percent of any stock class."[61] Non-compliance with the registration requirements can lead to a stop order by the Securities & Exchange Commission, halting the particular foreign direct investment activity.[62]

The Securities Exchange Act of 1934[63] also covers foreign direct investment. The Act "heavily regulates the proxy gathering process, which can be a method to prohibit foreign entities from secretly gaining control of both sensitive and non-sensitive business entities."[64] The Act

52. 15 U.S.C. § 2 (1995).

53. Spencer & Green *supra* note 19, at 558 n.119. "[T]he Act can be used by the U.S. government to prohibit any particular FDI if it would lead to further monopolization of a given market." For the required elements to demonstrate further monopolization, *see United States v. Grinnell Corp.*, 384 U.S. 563, 570-571 (1966).

54. Clayton Antitrust Act, 18 U.S.C. §§ 12-27 (1988 & Supp. V 1993).

55. 15 U.S.C. § 18 (1995).

56. Spencer & Green, *supra* note 19, at 558 n.120. There is no specific definition for "substantially lessen." However, a court can order divestiture if it is found. *See* RSR Corp. v. F.T.C., 602 F.2d 1317 (1979).

57. 15 U.S.C. § 45(a)(1) (1995).

58. 384 U.S. 316 (1966).

59. Spencer & Green, *supra* note 19, at 558 n.121.

60. *Id.*

61. 15 U.S.C. §§ 77a-77aa (1995).

62. 15 U.S.C. § 77h-1 (1995).

63. 15 U.S.C. §§ 77b-77kkk (1995).

64. 15 U.S.C. § 78n(d) (1995).

was amended in 1977 by the Domestic and Foreign Investment Improved Disclosure Act. The amended Act requires foreign investors holding greater than five percent of any class of stock to comply with increased disclosure requirements, including nationality and magnitude of the interest held.[65] With this enhanced power, American securities laws provide a mechanism for government scrutinization of foreign direct investment flows relating to securities.[66]

The Export Administration Act of 1979[67] provides another measure of control. It gives the President the power to curtail or eliminate current or prospective foreign direct investment. Factors that must be present for the President to act include threats to national security, resource drain, inflationary pressure, and achievement of foreign policy objectives.[68]

Finally, the International Emergency Economic Powers Act[69] gives the President the power to stop foreign acquisitions and to expropriate private property with just compensation. This Act is rarely invoked. The President must declare a national emergency in order to wield its powers.[70]

2. *Direct Controls on Foreign Direct Investment*

As a result of administration and congressional concern over possible foreign policy implications of uncontrolled foreign direct investment flows, CFIUS was established in 1975.[71] CFIUS is mandated to regulate "the impacts of foreign direct investment and foreign portfolio investments in the United States and coordinate the implementation of U.S. policy on these investments."[72] However, as mentioned above, CFIUS was very much a paper tiger prior to Exon-Florio.[73] Nevertheless, Congress passed the International Investment and Trade in Services Act of 1976 ("IITSA") to give CFIUS the requisite data from which to develop foreign direct investment policy. This authorized the president to collect limited amounts of foreign investment data on both foreign direct investment and portfolio investment. This data collection structure was enhanced by the Foreign Investment in Real Property Tax Act ("FIRPTA") in 1980, and the International Trade and Investment Act of 1984 ("ITIA"). FIRPTA requires any non-citizen whose "real

65. 15 U.S.C. §§ 78m (d), (e), (h) (1995).
66. *Id.*
67. 50 U.S.C. app. §§ 2401-20 (1995).
68. *Id.*
69. 50 U.S.C. §§ 1701-1706 (1995).
70. Spencer & Green, *supra* note 19, at 559.
71. *See supra* notes 29-31 and accompanying text.
72. *Id.* at 560.
73. *See supra* notes 40, 41 and accompanying text.

property interest" has a fair market value greater than $50,000 at any time during the year to file a return with their name, address, and a description of their property.[74] ITIA is a more active measure. It requires the U.S. Trade Representative "to identify and analyze trade barriers related to performance requirements and . . . impose import duties as a negotiation tactic."[75] The information collected under the authority of these various laws allows CFIUS, with its Exon-Florio powers, to make informed decisions regarding the suitability of foreign investment in the United States.[76]

III. CATCHING THE FEVER: FOREIGN DIRECT INVESTMENT IN CHINA

China has a long way to go before it establishes the stable capital markets essential for long-term growth.[77] China's two stock exchanges are bifurcated. A shares are available only to Chinese investors, while B shares can be purchased by foreigners.[78] The bifurcated exchange, coupled with large-scale speculation, deterred some potential major investors who remain "wary of China's political and economic stability as well as its *murky legal system*."[79] Bureaucratic foot-dragging, not uncommon in developed capitalist markets, also retards the evolution of China's financial marketplace. For example, Beijing has not yet enacted its National Securities Law after three years of discussion.[80] Swift passage of such uniform legislation would go a long way in arresting the fears of foreign investors that new issues will be quality controlled and that adjudicatory mechanisms will be available if disputes arise.

Rampant speculation, so-called hot money, is fueled by "[a] pool of speculative capital that has grown to an estimated $30 billion or more—nearly a tenth the size of deposits in the state banking system—[which] is sloshing through China's financial markets in search of high, inflation-beating returns."[81] This destabilizing presence, paired with

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74. 26 U.S.C. § 6039C (1995).

75. Spencer & Green, *supra* note 19, at 562 n.147.

76. A noted Princeton economist, William Baumol, focuses on the *fact* of extensive FDI in the United States, rather than on suitability therein. He sees nothing frightening about FDI; indeed, he interprets it as a sign of America's continued vitality and strength. Comparing America to the great Dutch, Italian, and British empires of the past, he details how countries in decline not only lose FDI but, more tellingly, send their own capital abroad! Therefore, it certainly is no indication of decline "if the rest of the world is willing to send money to the United States." *See Notable & Quotable*, WALL ST. J., June 29, 1990, at A12.

77. Craig S. Smith, *China Markets, Hot for Now, May Turn Cool*, WALL ST. J., May 22, 1995, at B8A.

78. *Id.*

79. *Id.* (emphasis added).

80. *Id.*

81. Joseph Kahn, *Hot Money Stokes Chinese Stock Rally: State Companies Bend Rules in Search of Big Returns*, WALL ST. J., May 25, 1995, at A10.

the money managers' general lack of accountability for losses and bad investment decisions, produces regular surges in prices that are easily manipulated by a small number of investment bankers.[82] Such a "devil may care" attitude is further encouraged in that much of the gambled money comes from government-owned enterprises or even directly from government treasuries.[83] This unhealthy situation only increases the belief held by many prospective foreign investors that the Chinese market is not conducive to stable, predictable returns on capital investment.

Therefore, the investment climate in China's go-go 90's is no place for the timid. "China fever" is an epidemic that shows no signs of abating soon.[84] However, unique challenges await foreign investment managers: "to pick a deal from a field littered with bogus and unpromising choices; to ensure the target puts his capital to profitable use; and, finally, to find a way to sell out in order to realize the gain."[85] While China is certainly open to and desirous of outside capital, investors have fears of being taken as "dumb money" and working with companies with "dual mandates."[86] That is, investors fear raising money for China while producing returns for shareholders. The experience of the American Motors Company ("AMC") in China illustrates this challenge.

A. Chinese Foreign Investment Laws: The Public Code

Although China has been hailed as the next great investment market since Deng Xiaoping assumed power in the late 1970's, actual implementation of laws and treaties to facilitate investment lagged. Early pioneers, such as AMC, learned the danger of doing business in a country lacking legal protection for foreign investors when they were unable to repatriate their profits.[87] Eventually, AMC solved the problem and the enterprise, now controlled by Chrysler, remains an

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82. *Id.*

83. *Id.*

84. Henny Sender, *Maximum Bullish*, FAR E. ECON. REV., Dec. 16, 1993, at 50.

85. *Id.* at 51.

86. *Id.* at 53.

87. *See* Joseph Kahn, *China's Auto Industry Gains Momentum: Pioneering Investor Snaps Up Parts Plant as Beijing Sets Ambitious Goals*, ASIAN WALL ST. J., Nov. 2, 1994, at 1. Beijing Jeep was the West's first manufacturing venture in China. AMC produced the first Jeep after only 7 years of arduous negotiations. The enterprise almost failed when the Chinese authorities didn't make foreign currency available to purchase Jeep kits from the company's American base or to convert profits from the sale of "Beijing Jeeps." At the eleventh hour ("[w]e were about 20 minutes away from calling it quits"), the Chinese finally relented, granting a special waiver to convert Chinese yuan into hard currency. The result was large profits and uninterrupted production; 72,399 "Beijing Jeeps" were produced in 1993. *Id.*

investor in China today.[88] The AMC situation presented a negative model for an attractive foreign investment climate. Realizing this, China began to enact laws that would facilitate foreign investment in the mid-1980's.

1. Tax

In 1984, China took a critical first step to encourage widespread American investment. President Reagan and Premier Zhao Ziyang signed the *Agreement for the Avoidance of Double Taxation and the Prevention of Tax Evasion* ("Sino-U.S. Agreement") that was the first income tax treaty between China and America.[89] The Sino-U.S. Agreement aimed "to reduce double taxation of income earned by residents of either country from sources within the other country and to prevent avoidance of the income taxes imposed by the taxing authority of either country."[90] Under the Sino-U.S. Agreement, neither country would tax foreign business income unless the business activities in their country are "substantial enough to constitute a permanent establishment or fixed base."[91] While dividends, interest, and royalties received by a foreign investor *may* be taxed by both countries, they *will* be taxed by the source country[92] on a restricted basis.[93] The treaty provides for a maximum withholding rate of 10% and thereby provides tax relief when compared with the customary 20% Chinese rate and 30% American rate.[94]

Recent reforms of China's financial and tax systems produced mixed results. One of the reforms, effective January 1, 1994, clarifies which taxes are to be collected by the central government and which are the province of local administrations.[95] Another boost to foreign investor confidence was provided by the decision to "unify China's long-standing two-track foreign exchange system . . . while pegging the exchange rate to the international swaps rate and allowing it to float within fixed limits."[96] However, another permutation of the January

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88. In 1992, Beijing Jeep Corp. had the second highest sales volume among joint ventures in China. Its profit of 422 million yuan was also the second highest. *See* Sarah Lubman, *Round and Round: To Survive Your Business Negotiations, You'll Need Patience, Skill and Perhaps an Extra Coat*, ASIAN WALL ST. J., Dec. 13, 1993, at S4.

89. Michael Brent Nelson, *An Analysis of Foreign Investment in the People's Republic of China in the Aftermath of the Sino-U.S. Tax Agreement*, 1 TRANSNAT'L LAW 547, 548 (1988).

90. *Id.* at 548.

91. *Id.* at 549.

92. The country where the investment is located.

93. Nelson, *supra* note 89, at 549.

94. *Id.*

95. Xiong Lei, *New System Outweighs the Risks Involved*, S. CHINA MORNING POST, Sept. 24, 1994, Supp. at 1.

96. *Id.*

value-added tax ("VAT") law has recently surfaced in a two-page circular from the Ministry of Finance and State Tax Bureau.[97] The law, published in January and hailed by the Chinese as exemplifying the international trade principle of national treatment,[98] charged *all* manufacturers a 17% tax on purchases of local raw materials.[99] That money is then refunded to companies making goods for export. However, China later retracted that promise by asserting that exporters with foreign investment will not get the promised refunds.[100] Although one expert believes the Chinese simply cannot afford to refund the money, another posits the "change will hurt China's attractiveness as a place to have a factory because other countries, such as Thailand, Malaysia and Indonesia, offer exporters a VAT refund."[101] Time will tell whether the Chinese have shot themselves in the foot or if investors adapt to another price of doing business in a vast, burgeoning market.

More foreign investment laws followed in quick succession after the 1984 tax treaty. Detailed laws and regulations from central government ministries and municipal governments began appearing in 1986, an example of which is the *Regulations of Shanghai Municipality for the Encouragement of Foreign Investment*.[102] Investment incentives abound; Article V decrees that "enterprises with foreign investment will be exempt from the housing subsidies" normally paid to the State.[103] Those enterprises will be given priority in obtaining water, power, gas, communication facilities, transportation, short-term working capital loans and other credit funds.[104] Article XII mandates that economic and technological development zones "will be given greater autonomy and *enterprises with foreign investment established there will be given even greater preferential treatment*."[105]

2. *Customs Laws*

National customs laws, always a concern of foreign investors, were likewise revised.[106] Specifically, joint ventures "shall . . . enjoy

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97. Leslie Chang, *China Retracts Promised Tax Refund, Bewildering Foreign Manufacturers*, WALL ST. J., Oct. 19, 1994, at A16.

98. The principle of national treatment requires that foreign and domestic products be treated equally.

99. Chang, *supra* note 97, at A16.

100. *Id.*

101. *Id.*

102. 1986 WL 84083, ChinaLaw File # 0384, November 1, 1986.

103. *Id.*

104. *Id.*

105. *Id.* (emphasis added).

106. 1986 WL 84053, CHINALAW FILE # 0237, *Provisions of the Customs Governing the Import of Materials and Parts Needed By Enterprises With Foreign Investment to Perform Product Export Contracts*, Dec. 1, 1986 [hereinafter *Provisions*].

preferential treatment . . . in customs clearance and the paying of taxes."[107] Not only will "[t]he goods imported and exported by them . . . be declared to the Customs strictly according to the facts," but more importantly, "[t]he imported machinery, equipment, vehicles, materials, and parts . . . shall be exempted from the requirement of obtaining import licenses."[108] The re-exportation of imported materials generates money for China, and this explains why China offers the incentives. However, Article III also provides if the materials are used "in products to be sold domestically, the enterprise . . . shall have to go through the import procedures retroactively *in accordance with the relevant provisions of the State.*"[109] Therefore, as long as an enterprise is making money *for China* and not making money *off China,* customs procedures will be waived or simplified.[110]

3. *Foreign Capital Requirement*

China has very specific "registered capital"[111] requirements for all Chinese-foreign equity joint ventures.[112] The Chinese have a vested interest in such specificity because, according to official figures, they currently have more than 170,000 foreign-funded ventures with a gross investment of approximately $60 billion.[113] For example, if the total investment of a joint venture is less than $3 million, its registered capital shall be at least 70% of the total investment. Article II of the law states that "[t]he parties to the joint venture shall share profits and bear risks and losses according to the *proportion of registered capital.*"[114] This issue arose earlier when China introduced new regulations targeting foreign companies that allegedly inflate the value of their assets to cheat their Chinese partners.[115] An official Chinese report stated, "[b]y overvaluing their assets, some foreign investors have been claiming a disproportionately large share of profits, which are nailed down according to each side's *stated investment.*"[116] The new regulations include an

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107. *Id.*

108. *Id.*

109. *Id.* (emphasis added).

110. This is a recurrent theme which will be examined closely in section III (E), *infra,* regarding China's Operational Code.

111. An exact accounting of the amount of foreign capital investment.

112. 1987 WL 124775, CHINALAW FILE # 0438, *Provisional Regulations for the Proportion of Registered Capital to Total Amount of Investment of Joint Ventures Using Chinese and Foreign Investment,* March 1, 1987 [hereinafter *Capital*].

113. *Chinese Rules Target Joint-Venture Fraud,* ASIAN WALL ST. J., April 5, 1994, at 3 [hereinafter *Fraud*].

114. *Capital, supra* note 112, at 2 (emphasis added).

115. *Fraud, supra* note 113, at 3.

116. *Id.* (emphasis added).

evaluation procedure which will aid officials in ascertaining the real value of a foreign investment.[117]

4. Securities Laws

China, lacking an overall securities law and anticipating numerous foreign listings, issued stopgap regulations in 1993.[118] In addition to foreign capital investment, China desires portfolio investment, especially as it emphasizes development of a major financial market in Shahghai. Government officials realize the potential for abuse and insider trading, and therefore they are trying to keep a tight rein on China's burgeoning financial market. Accordingly, lawyers handling offshore flotations of Chinese shares now require government approval.[119] Nevertheless, foreign investors do worry about "the China risk" and the absence of a comprehensive securities law.[120] An expert on Chinese securities believes it's an enforcement risk, a practical problem of legal and commercial uncertainty that will abate "as the appreciation of the need to consistently and rapidly enforce available law grows."[121] Moreover, individual Chinese listings in Hong Kong and New York must conform to a detailed set of requirements. Therefore, "on an issue-by-issue basis, there will be individual mechanisms in place."[122]

B. Contract Law

China's contract law also raises concern. Heretofore, "[c]ontracts in China have more of a sense of moral obligation than absolute rights."[123] According to a Beijing-based American lawyer, "[t]here is no concept that [they are] binding."[124] Contracts can always be renegotiated; indeed, as discussed below, negotiations never really end. The Chinese are very patient. They will try to outlast foreign negotiators and will repeatedly re-visit items agreed upon months before.

Local protectionism, bolstered by courts' parochial verdicts against foreign investors in disputes, has been the most significant problem. Foreigners have found out the hard way that "the outcome of contract

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117. *Id.*

118. Guangdong, *supra* note 1, at 55.

119. *Id.*

120. *Dealing with China: Lawyer Discusses Investor Protection*, ASIAN WALL ST. J., April 25, 1994, at 3.

121. *Id.*

122. *Id.*

123. Henny Sender, *Party of the First Part: China Tries to Improve Contract Law*, FAR E. ECON. REV., Feb. 11, 1993, at 42.

124. *Id.*

disputes—and indeed the whole emphasis of law in China—is more a *question of agreement* than the application of principles."[125] Therefore, if "there's a change made in the contract, put it in writing *on the spot*, so there's no misunderstanding later."[126]

Nevertheless, progress has been made. The president of the Supreme People's Court has admonished lower courts to be more consistent and equitable.[127] Seminars are being held where sample contracts and handbooks are being distributed. More importantly, courts are actually beginning to follow the many new laws accompanying China's economic liberalization.[128]

Furthermore, despite foreign investors' preference for arbitration of disputes, multinational corporations such as Walt Disney Co. have successfully litigated intellectual property suits in Chinese courts.[129] This legal evolution has encouraged foreign law firms to open Chinese offices.[130] Foreign lawyers remain barred from practicing local law.[131]

However, reciprocity is a major issue which remains to be resolved before critics will believe in China's sincerity in reforming its contract law.[132] Until Chinese courts enforce foreign legal decisions, the comfort level of foreign investors will remain low.

C. *A Success Story*

One bright shining example for the world and the rest of China to behold is Guangdong province, the mainland alter ego of its vibrant neighbor, Hong Kong. Guangdong is blazing the path for the rest of China, providing the regulations governing stock trading, joint ventures, the transfer of land-use rights and the licensing of technology that assures prospective investors of a stable business environment.[133] National leaders acknowledge that an uncertain legal system stifles growth and deters investment. Accordingly, the National People's Congress granted Shenzhen, Guangdong's thriving special economic zone adjoining Hong Kong, independent legislative powers in 1992.[134] Western legal concepts have taken hold in Shenzhen, courtesy of Hong

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125. *Id.* (emphasis added).

126. Chen, *supra* note 4, at S10 (emphasis added).

127. *Id.*

128. Marcus W. Brauchli, *China's New Economy Spurs Legal Reforms, Hopes for Democracy*, WALL ST. J., June 20, 1995, at A1.

129. *Id.* at A8.

130. Previously, over forty firms advised clients on international business and enlisted Chinese firms as local counsel when needed. *Id.*

131. *Id.*

132. *Id.*

133. *See* Carl Goldstein, *Legal Aid: China Develops Business Law By Looking to Guangdong*, FAR E. ECON. REV., Nov. 4, 1993, at 71.

134. *Id.* at 73.

Kong.[135] China takes notice, considering provinces like Guangdong the "nation's experimental plot."[136] Whether China can emulate Guangdong's success and adaptability remains to be seen.

Guangdong recently attracted one of the big wheels of American retailing, *Wal-Mart Stores Inc.*[137] The giant chain will open discount stores and Sam's Club membership warehouses in Shenzhen and Shanghai sometime in the near future.[138] The move surprised many analysts who note that the "lack of infrastructure remains a problem for retailers."[139] The fact they must operate in joint ventures, and then only in eleven major cities, has also slowed movement into the vast Chinese market. Interestingly, Chinese regulations currently bar foreign operators from wholesale sales, and wholesale sales is what Sam's Club is all about.[140] Wal-Mart must deal with that issue while also adhering to the government's decree that "foreign operators . . . generate at least half their sales volume from Chinese-made goods."[141]

D. Analysis

Is China's legal system adequate to sustain growth and bolster the confidence of its most precious suitors, foreign investors? The near consensus answer of China-watchers is an unqualified "no." Indeed, investment banker Marc Faber is very pessimistic about how long it will take to develop the necessary legal and commercial infrastructure because of high-level opposition to codification of contract and business law.[142] He maintains chaos has brought the Chinese government riches.[143] However, this systemic problem of legal uncertainty cannot be addressed until the pervasive influence of corruption is thwarted.[144] As local governments have increasing power to allocate resources, they have become the arbiters of success. The small entrepreneur must buy off the local government leaders in order to set up a business. Either the central government has to step in to control corruption or it must allow private companies to grow larger in order to be in a stronger position to deal with local government.[145] This, of course, would

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135. *Id.*
136. *Id.* at 71.
137. Bob Ortega, *Wal-Mart Plans to Open Stores in Hong Kong*, WALL ST. J., Aug. 22, 1994, at B5.
138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.*
142. Carl Goldstein, *China's Challenge: Experts Assess Economic Reforms and Prospects*, FAR E. ECON. REV., April 21, 1994, at 76.
143. *Id.*
144. *Id.* at 77.
145. *Id.*

rebound to the benefit of foreign investors, upon whom much of China's future success depends.[146]

E. Foreign Investment in China: The Operational Code

In business as in war, the unknown kills. For American businessmen/investors, China *is* the great unknown. Negotiating the business and cultural intricacies of China can be a treacherous journey. Some have failed when they thought they had already completed a successful voyage. China's unwritten laws, its Operational Code, define China itself. Form often prevails over substance and things are not always as they appear. The cost of not knowing China's Operational Code can be high. Such ignorance cost an American businessman a $300 million dinner, including tip![147] To prevent such folly in the future, the four tenets of China's Operational Code follow.

1. Tenet One: Project Desirability Trumps Acceptability

Whereas American investors look for a joint venture to meet criteria of acceptability such as whether it conforms with China's laws, tax code, and labor regulations, "Chinese officials want to evaluate the project's *desirability*, by looking at what benefits" China may derive from the project.[148] Will the project bring new investment, foreign exchange, employment, or—most desirably—technology transfer or will it simply "separate Chinese buyers from their money" and pad the wallets of foreign investors?[149] The Chinese feel they have been victimized by some foreign investors, and this paranoia prompted the new securities law described above.[150] Investment that produces exports or capital goods, such as machine tools for the domestic market, is viewed as beneficial to China because it develops China's industrial capacity and increase its wealth. Therefore, a toy store probably will not contribute to China's economic growth and therefore is not a preferred foreign investment venture.[151] However, the ultimate desirable

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146. A recent United Nations report on world investment underscores this point. China attracted $26 billion in foreign investment in 1993, by far the favorite developing country and second overall to the United States! Only two years earlier, China was 13th overall and only third among developing nations. American companies had $50 billion in FDI in 1993, almost twice as much as the next country, Great Britain, with $26 billion. *See* Fred R. Bleakley, *Foreign Investment by Multinationals Rebounds, Benefiting China, U.N. Says*, WALL ST. J., Aug. 31, 1994, at A2.

147. Lavin, *supra* note 3, at 8.

148. *Id.* (emphasis added).

149. *Id.*; *cf.* Eckes, *supra* note 22, at 135-37 (stating that after World War II economic foreign policy of the United States has been designed to make foreign allies self-sustaining economic partners, even at the expense of American economic interests.)

150. *See supra* part III.A.4.

151. Lavin, *supra* note 3, at 8.

good is maintaining political control.[152] The political fiction of "democratic centralism" and the superiority of planned economies have few adherents in China today. The *raison d'etre*[153] of the Chinese Communist Party is to remain in power. To this end, China will sacrifice economic growth every time, as vividly seen in June of 1989.

Moreover, "[t]his is why Chinese law requires almost without exception that foreign investment be put in a joint venture . . . with the indigenous firm gaining majority control at some point."[154] Whether a legacy of its long colonial past or not, the Chinese are still extremely wary of foreigners. They seek capital and know-how, not friendships. Every business negotiation is an adversarial encounter. Likewise, the Chinese believe every deal has a winner and a loser. This must be recognized when dealing with the Chinese. In the final analysis, the Chinese will develop on their own terms.

2. *Tenet Two: Decision Making is a Riddle*

Who is in charge? The people with whom you negotiate a deal are usually not those who can give the thumbs up or thumbs down.[155] Rather, your negotiating partner is probably one of the thousands of young Chinese who have studied in the West and speak English.[156] More often than not, your partner reports to "the guy with the bad haircut sitting behind a grey metal desk who makes the decisions."[157] To further confuse Western investors, the Chinese may try to bluff their way to a concession by switching negotiators.[158] However, the Chinese will usually back down if their hardball tactics are challenged.[159] Furthermore, "China is heavily bureaucratic, and . . . your [former negotiating partner] may not want the new negotiator at the table any more than you do."[160]

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152. Jack A. Goldstone, *The Coming Chinese Collapse*, 99 FOREIGN POLICY 41 (1995).

153. Reason for being.

154. Lubman, *supra* note 84, at S4.

155. Lavin, *supra* note 3, at 8.

156. *Id.* Moreover, as "[o]nly senior officials have the authority to spend money, your negotiating "partner" is really only an intermediary to the decision-makers. *See* Lubman, *supra* note 84, at S4.

157. Lavin, *supra* note 3, at 8.

158. *See id.*

159. *Id.* These tactics may be exemplified by a recent episode in negotiations between an Australian company and Chinese officials. After four painful years of negotiations, the Chinese brought a new negotiator and new contract to their Australian counterparts. The Australians were understandably furious; they canceled the deal. Within a week of their bluff being called, the Chinese reinstated the original contract's terms. *Id.*

160. *Id.*

3. *Tenet Three: Different Risk v. Reward Equation*

"Return on investment isn't the goal in China; stability is."[161] The apparatchiks[162] that examine investment proposals evaluate them against their own personal and bureaucratic self-interests.[163] This is especially true of the older functionaries who came of age under Mao.[164] Capitalism and free enterprise are still a relatively new phenomenon. Their view of the world is still colored by forty stifling years of central planning. While an American manager will get rewarded for streamlining production and for revitalizing a manufacturing facility by reducing unneeded staff, a Chinese manager would be fired and perhaps physically attacked for inflicting hardship on his workers.[165] As stability is paramount, efficiency will be achieved by attrition and employee buy-outs and only then in lockstep with your Chinese partners![166]

4. *Tenet Four: Dollars Don't Drive the Decision*

As with the second tenet,[167] where your interlocutor is not the decision-maker, he will probably receive "virtually no benefit from a decision to do business with you, even if the venture proves to be fabulously successful."[168] The negotiator's chances of receiving a "bonus" for landing a huge foreign investment are rather slim (this is still a country where much of the money is skimmed off at the top, especially by Deng's son and daughter). This is more a social decision. Bonds are built at dinners and banquets; simple gestures, such as offering your counterpart a lift after negotiating all day, can cement a deal.[169] Small gifts and favors fortify key relationships. For example, a Coke bottler periodically sends cases of the soft drink to important local bureaucrats in order to keep them in his corner.[170] Whatever the business merits of the proposal, if the decision-maker is not comfortable toasting Mao's memory with you over a dinner of Mandarin duck, then

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161. Lavin, *supra* note 3, at 8.
162. Bureaucrats
163. *Id.*
164. LESTER THUROW, HEAD TO HEAD: THE COMING ECONOMIC BATTLE AMONG JAPAN, EUROPE, AND AMERICA 210 (1992).
165. Lavin, *supra* note 3, at 8.
166. *Id.*
167. *See supra* part III.E.2.
168. *Id.*
169. Chen, *supra* note 4, at S10.
170. *See* John Bussey & James McGregor, *What, Why and How: For the Host of Questions That Will No Doubt Spring to Mind, Some Considered Answers*, ASIAN WALL ST. J., Dec. 13, 1993, at S27.

your goose is cooked. If you are invited to dinner, you are invited to invest.[171]

F. Foreign Investment in China: Aspirational Declarations

Like many nations, China often previews impending policy shifts via news leaks and "official" publications. On the contrary, such communications may also just be trial balloons that can be plausibly denied if there is a vehement reaction. China's aspirational declarations usually appear in official newspapers like the *China Daily* or *The People's Daily*.[172]

Recently, an official Chinese newspaper telegraphed a message to foreign investors by reporting that in 1994, "China's government-run labor federation wants to double its membership in foreign-[operated] factories and joint ventures."[173] Official media previewed this drive by reporting "a storm of criticism of alleged labor abuses by foreign [managers], especially those from Hong Kong, Taiwan, and South Korea."[174]

The government's end game is not lost on foreign investors. Currently, 25-30% of companies with foreign investment have unions; the labor federation wants to boost that to 50% by the end of 1994.[175] This is ominous to foreign investors because they see the federation as a tool of the communist government rather than a representative of the workers.[176] Moreover, "China's trade law . . . gives official unions a seat on a company's board of directors," a prerogative denied independent unions.[177] This creeping unionization and attendant government influence on foreign business enterprises is a trend to watch in China.

IV. COMPARING THE TWO SYSTEMS

This paper compares two countries at vastly different stages of development. The economic disparity is compounded by a cultural gap as wide as the Pacific and historical experiences that could not be more diametrically opposed. Furthermore, there is little or no precedent for what China is trying to accomplish because China's goal is to achieve in fifteen years what the United States did in 200 years! China's breathtaking rush to development is not even a generation old.[178]

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171. Lavin, *supra* note 3, at 8.
172. Yasheng Huang, *Why China Will Not Collapse*, 99 FOREIGN POLICY 65 (1995).
173. *Chinese Unionization Targets Foreign Firms*, ASIAN WALL ST. J., Feb. 22, 1994, at 3.
174. *Id.*
175. *Id.*
176. *Id.*
177. *Id.*
178. Goldstone, *supra* note 152, at 40 (noting that Deng's reforms began in 1980).

A. The Difference in Perspective

From that point of departure, the two countries view foreign investment through completely different lenses. The Chinese are a regional military power. Thus, they leveraged political power from the U.S.-Soviet great game by playing the "China card" to *their* advantage. They had no great standing in international politics other than in that triangular relationship. They were economic pygmies, a humiliating reality as their smaller neighbors became the "economic tigers" of North and Southeast Asia in the 1960's, 1970's, and 1980's. The death of Mao in 1976 and the final demise of the "Gang of Four" shortly thereafter paved the way for Deng's third "rehabilitation" and his assumption of pre-eminent power.[179] What initially began as a de facto alliance with the United States against Soviet "hegemony" slowly evolved from a geostrategic relationship into a political and economic association. Accordingly, China opened its doors to outside investors, especially American multinational corporations. AMC arrived in the early 1980's.[180] McDonalds and others followed later.

B. Growth Above All

Although the pace of Chinese growth has been uneven, mainly due to periodic political upheavals like the Tiananmen Square massacre of 1989, Deng has remained fairly focused on the imperative of the "Four Modernizations" in agriculture, industry, national defense, and science and technology.[181] Industry is accorded the highest priority of the modernizations. National defense gets the lowest. Whichever of the modernizations is concerned, the central goal has always been to grow and modernize. China is concerned with growth, especially in its industrial and commercial infrastructure.[182] To fuel that growth and become a developed country, China needs capital.[183] Whatever achieves

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179. HARRY HARDING, CHINA'S SECOND REVOLUTION: REFORM AFTER MAO 48-66 (1987).

180. *See supra* part III.A.

181. Nelson, *supra* note 89, at 548.

182. According to Bank of China senior economist, China is actively seeking foreign investment in high-technology sectors. Magdalen Chow, *Door Closes on Low-Tech Deals*, S. CHINA MORNING POST, Oct. 21, 1994, at 4. Thus, China is granting incentives to companies investing in agriculture, machinery, electronics, car-making, construction, and the petrochemical sector. *Id.* Their reward will be Chinese permission to sell their products on the mainland market. *Id.*

183. Citicorp Chairman John Reed estimates the price tag to be an eyepopping $55 *trillion*! The road to development is currently paved by foreign investment. However, Chinese officials recognize they must develop indigenous financial markets to truly become a developed nation. This recognition explains their drive to make Shanghai, once more, a major international financial center. Shanghai, the wealthiest city in Asia prior to the communist takeover, again has stock, bond, currency and commodities markets. Shanghai's re-emergence will also serve the political goal of avoiding financial overdependence on politically suspect Hong Kong. *See* Joseph Kahn, *A Tale of 3*

that end within the bounds of political control and the primacy of the Chinese Communist Party is good. China views foreign investment as a means to improve the "Four Modernizations" and this explains the preference for modern equipment and technology transfer as opposed to toy stores for the kids.[184] Again, technology transfer allows *China* to progress, to export, and to put money in its own pocket. Allowing foreigners to sell consumer goods in China puts money in *foreign* pockets and contributes nothing to China's growth. The Chinese structure their foreign investment laws accordingly.

C. *The American Mission*

On the contrary, the United States has a different mission in the world, what Stanley Hoffman calls "exceptionalism." It is *the* superpower, a military, political, *and* economic giant. Accordingly, America must assume an "exceptional" world role, leading in all spheres of international affairs as no other nation can. America's responsibility has burdens and benefits. America is burdened by expensive commitments yet benefitted economically by its global reach. The United States is not nearly so single-minded as China because America cannot afford to be. American actions are based on global considerations. Its alliance structure and military presence around the world surpass even those of the old British Empire. Consequently, America has pursued a liberal trade and foreign investment policy in order to spark and solidify the economies of war-ravaged allies in return for their support in the global contest with the old Soviet Union.[185]

American foreign policy slowly changed as the Cold War receded and America's economic problems became paramount to leaders and citizens alike. As the Soviets collapsed under the dead weight of corruption and monumental mismanagement, traditional allies like the Japanese became the new villains. The Japanese had recovered and prospered due to a situation Americans created and encouraged. That reality was lost amid massive trade deficits and Japanese taunts of American manufacturing inferiority. The United States, long a paragon of free trade and one of the leading supporters of the General

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Cities: Beijing Warily Pushes Shanghai to Resume Role in Global Finance, WALL ST. J., Nov. 25, 1994, at A1.

184. *See supra* note 151. The centrality of foreign investment to China's modernization is confirmed by the numbers. "Chinese companies with foreign investment generated $35.79 billion in foreign trade during the first half of 1994, a 45% increase from [the same period in 1993]." *See* Richard L. Holman, *Foreign-Invested Chinese Firms*, WALL ST. J., July 28, 1994, at A8. These exports account for 36% of China's total trade. *Id.*

185. *See* Eckes, *supra* note 22, at 137.

Agreement on Tariffs and Trade ("GATT"),[186] began to consider retaliation against perceived unfair trading and investment practices of its allies. The pendulum had swung in the opposite direction.

The United States now wants reciprocal trade agreements—something it rejected during the Cold War. American firms are interested in investing in all types of markets to the benefit of both sides and attracting all kinds of foreign investment to its shores. If a domestic consumer goods market can develop, and a foreign investor is interested, the project will go forward to the benefit of the local economy and consumers in addition to benefiting the foreign investor. Even the recent Exon-Florio provision, actually barring foreign investment in certain instances, is almost never invoked. There is no consumer goods "screen" because the United States is at a drastically different stage of industrial development. Maybe America has the luxury of fueling consumption while still supporting the development of industry and high technology.

V. THE OUTLOOK

In summary, the United States and China approach foreign investment in their economies from divergent points of view. American firms seek to develop markets here and abroad through mutually beneficial development, realizing that huge trade deficits wind up hurting both partners in the end. Both countries benefit when a new market opens for American investors and a foreign economy matures and develops, eventually providing another reliable economic partner, and possible military/political ally, for America. These are ties that bind; countries with extensive commercial ties rarely go to war with each other. Foreign investment provides a strong foundation for an enduring relationship.

China, on the other hand, is on a singular crusade to bring its commercial and industrial infrastructure into the 20th century. Notwithstanding American altruism, the Chinese will derive technological benefits from American foreign investment even if that is not the foremost goal of American investors. Clearly, the Chinese will not allow anyone to exploit their markets without quid pro quos. China's colonial legacy weighs heavily on their current philosophy.

Technological growth and development is critical if China is to compete successfully on the world stage while trying to support an exploding population in excess of 1 billion people. However, China often shoots itself in the foot, forcing some investors to seek other developing markets.

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186. Oct. 30, 1947, 61 Stat. pts. 5 & 6, 55 U.N.T.S. 194.

In addition to capital, China's astounding growth requires electric power. Therefore, foreign investors have been encouraged to build power plants in China.[187] However, until recently, they were held to a 12% to 15% annual return by government officials, rather than the customary 20% or better.[188] This infuriated large investors, especially power producers from Hong Kong.[189] Consequently, they moved to other more profitable markets, namely Pakistan and India.[190] In response, Beijing quietly relaxed the profit restriction in November 1994.[191] Now, if a plant operates at 90% efficiency, investors will receive a 22% return.[192] Once again, China's Operational Code intrudes. Negotiations will never end, but investors can call the Chinese bluffs.

In stark contrast to that accommodation to foreign investors, Beijing recently ordered McDonald's to vacate its prize location in a shopping district near Tiananmen Square.[193] The American fast-food chain not only has its largest restaurant on the site, as a commitment to the Chinese market, but also signed a twenty-year lease only last year.[194] They have been ordered off the property to make way for a development project. Demolition of surrounding buildings commenced in November 1994.[195] As a result, McDonald's, one of China's earliest investors, is reviewing its China investment strategy.[196] Other possible investors, like Ford Motor Company, remain on the sidelines.[197] Such possible business disenchantment may be growing pains from earlier exuberance about the Chinese market, or may reflect the reality that China will develop on its own terms. However, such uncertainty may not augur well for a stable, long-term investment environment.

Despite the differences, the countries' destinies are linked to a degree.[198] One of China's leading industrialists is basing his company's

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187. Erik Guyot, *China Eases Limits on Power Plant Investment Returns*, WALL ST. J., Nov. 15, 1994, at A18.

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. Marcus W. Brauchli et. al., *Honeymoon's Over: After the Initial Ardor, China and Foreigners Argue About Money*, WALL ST. J., Dec.2, 1994, at A1.

194. *Id.*

195. *Id.*

196. *Id.*

197. Ford "is ready to invest as much as $1 billion in China." *Id.* However, Chinese approval of investment projects remains elusive. *Id.* One Ford executive laments, "China is large enough to write its own rules." *Id.*

198. A recent survey of 230 global companies found they "overwhelmingly viewed China as the most attractive of the world's emerging markets." Tim Carrington, *U.S. Companies See Greater Investment In Emerging Markets, Especially in Asia*, WALL ST. J., Oct. 21, 1994, at A16. In particular,

future on trade and investment with the United States.[199] Although his primary export market is Asia, he acknowledges that the country that really matters outside Asia is the United States.[200] Therefore, the industrialist's company plans to build a factory in Florida, and engage in a joint research venture in California, in addition to listing its shares on the New York Stock Exchange.[201] Such a commitment mirrors the long-term determination of many American companies to assist in China's development while opening new markets for investment. However, American investors may awake a "sleeping dragon" in the process.[202]

Investment is a *quid pro quo* transaction. America's liberalizing influence and China's dynamism will make for an interesting economic relationship for years to come. We should all be the richer for it.

American companies named China most often as a market where they intend to substantially increase their investments over the next five years. *Id.* Of note, 32% of the companies said the host country legal system could be a major barrier to investment. *Id.* This concern was only exceeded by worries about political instability, cited by 53% of the respondents. *Id.*

199. E.S. Browning, *China Drug Company With Ties To Military Is Expanding to U.S.*, WALL ST. J., Sept. 7, 1994, at A10.

200. *Id.*

201. *Id.*

202. JIM ROGERS, ON THE ROAD WITH JIM ROGERS: INVESTMENT BIKER 55 (1994). Rogers, who made millions on international stocks twenty years before such investing was in vogue, believes the Chinese will be some of the world's best capitalists in two decades. Indeed, he believes they "will run circles around most of us." *Id.*