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The Capacity of Chinese Enterprises to Engage in Foreign Trade: Does Restriction Help or Hinder China's Trade Relations?

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Cover Page Footnote

An earlier version of this article first appeared in our book FOREIGN TRADE CONTRACT LAW IN CHINA (1998). However, for this article the original content has been substantially changed and the citations have been altered to conform with common U.S. standards. LL.B., University of Bristol; LL.M., University of London, King's College; Assistant Professor of Law, Department of Business Studies, Hong Kong Polytechnic University; Solicitor of the Supreme Court, England and Wales; Solicitor of the High Court of Hong Kong. Ph.D. candidate, University of Hong Kong; Master of Laws, Peking University; Associate Professor of Law, Yantai University School of Law, Shandong, China.

THE CAPACITY OF CHINESE ENTERPRISES TO ENGAGE IN FOREIGN TRADE: DOES RESTRICTION HELP OR HINDER CHINA'S TRADE RELATIONS?

MARK WILLIAMS** & ZHONG JIANHUA***

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I. INTRODUCTION

China's trade system is characterized by the unusually strict restrictions that Chinese law imposes on the capacity of Chinese enterprises¹ to engage in foreign trade. Only those enterprises that have permission from the government are qualified to import or export goods. Thus, in addition to the usual apparatus of external trade control (customs permissions, quota regimes, and international anti-dumping measures), the Chinese entity, whether as an exporter or an importer, must overcome another significant legal obstacle—that of the very capacity to enter into legally enforceable contracts of

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1. The term "enterprise" is an indefinite one in Chinese law and may have different meanings in different contexts. Here we use this term to include all economic organizations in China. Concerning business organizations in China, see Guanghua Yu, *The Emerging Framework of China's Business Organizations Law*, 10 *TRANSNAT'L LAW* 1, 39-69 (1997). See also Robert F. Dodds, Jr., *State Enterprises Reform in China: Managing the Transition to A Market Economy*, 27 *LAW & POL'Y INT'L BUS.* 695-754 (1996).

this type. While the methods of trade control at a macro level are common to all trading entities, the idea that the business' actual legal ability to enter into contracts is constrained only because it involves a foreign party or subject matter is to Western lawyers an unusual notion. The common law imposes restrictions on the validity of contracts for reasons of public policy, as the result of a statute involving enemy aliens in time of war, or as a result of United Nations sanctions. These are wholly exceptional and attack the validity of the contract, not the capacity of the parties. China, however, has quite different legal rules. The very ability to enter into foreign trade agreements is proscribed and a system of special administrative permissions is needed to enable Chinese businesses to legally contract with foreigners.

In the last twenty years China has adopted a policy of economic liberalization by gradually allowing the establishment of more types of business entities with different legal powers and constitutions, not all of which are state-owned. China, however, still retains excessively complicated procedures for granting licenses to enterprises that wish to engage in foreign trade. Although it is generally argued that China's licensing system is modelled on other socialist countries (in particular the former Soviet Union), China now continues to practice this system largely with its own particular situation in mind. The rationale justifying China's strict restraint on the ability of Chinese enterprises to engage in foreign trade is the necessity to maintain order in its foreign trade system. In response to demands by some Western countries during the negotiations on China's accession to the GATT, China has recently and repeatedly avowed that the licensing system regarding the capacity of Chinese enterprises is just a transitional measure and its ultimate goal is the introduction of a registration system.² For this purpose, China began to implement an experimental registration system in several Special Economic Zones (SEZs) in early 1997. However, the deep-rooted belief that strict control equals good order is still prevalent in China. The registration system, as the replacement of the licensing system, does not indicate

2. China presently views the licensing system as a transitional one that will be gradually cancelled in the future. See Song Yuanming, *jinyibu gaige waimao jingying zhidu, fangkai waimao jingying quan* [Toward a Better Foreign Trade System with Greater Decision-Making Power], 6 GUOJI MAOYI WENTI [INT'L TRADE J.] 2 (1995). During the negotiations concerning China's GATT membership conducted at the end of 1994, China stated that it would practice the registration system five years after it resumes its membership in the GATT. The China Working Group of the WTO unanimously approved China's proposals regarding the registration system on March 6, 1997. See Yao Sufeng, *xunxu jianjin de fangquan—zhongguo jiaru shimao zuzhi yu waimao jingying quan* [Deregulation on the Way: China's Membership in WTO vs. Foreign Trade Right], 11 GUOJI MAOYI WENTI [INT'L TRADE J.] 11 (1997).

that China's practice regarding the capacity of enterprises to contract will fully reflect the principle of free trade. China still seeks to achieve its aim of "orderly markets" through the use of the registration system. This will remain in place unless China's underlying policy considerations change.

This article argues that China's licensing system of the capacity of Chinese enterprises has not only failed to achieve its stated objective but in certain circumstances has become the major cause of distortion in China's foreign trade operations. The development of the licensing system is examined in Part Two; Part Three discusses the legal effects of foreign trade operation right (FTOR) on the validity of foreign trade contracts; Part Four analyzes the underlying policies behind the licensing system; and Part Five states our conclusions.

II. ESTABLISHMENT OF LICENSING SYSTEM REGARDING CAPACITY OF CHINESE ENTERPRISES TO ENGAGE IN FOREIGN TRADE

A. *Historical Development of Licensing System*

China modeled its trade practices on other socialist countries, in particular the former Soviet Union, and introduced a system of state control of foreign trade soon after the foundation of the People's Republic of China (PRC) in 1949.³ In the early 1950s, however, private and even foreign involvement in China's foreign trade was allowed⁴ through a registration requirement.⁵ After 1956, when China's socialist transformation⁶ was completed, all private traders in China's foreign trade were replaced by the state trading corporations that consequently monopolized China's foreign trade. This monopolization continued until the late 1970s when China introduced the "open-door policy." As an integral part of this comprehensive economic reform, China launched a far-reaching reform of its foreign trade system. This increased both the number of entities engaging in foreign trade and the diversification of foreign traders. However, the state trading corporations still controlled the majority

3. See RALPH H. FOLSOM, ET AL., *LAW AND POLITICS IN THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL* 25-26 (1992).

4. See *zhonghua renmin gongheguo duiwai maoyi guanli zanxing tiaoli* [1950 Provisional Regulations on Foreign Trade Administration of the PRC] (hereinafter PRFTA), art. 2.

5. See PRFTA, art. 3. "[A]ny national public or private-owned business establishment engaging in import and export activities or factory conducting export operations, shall apply for registration with the foreign trade administrative bureau of its location." See *id.*

6. The term "socialist transformation" refers to the gradual nationalization of Chinese private business occurring between 1954 and 1956. For detailed discussion of this issue, see CHEN YUAN, *EAST WEST TRADE: CHANGING PATTERNS IN CHINESE FOREIGN TRADE LAW AND INSTITUTIONS* 48-51 (1991). See also FOLSOM, *supra* note 3, at 27-28.

of business. By the end of 1996, the number of domestic entities permitted to conduct foreign trade activities amounted to more than 12,000 and foreign-invested enterprises (FIEs) to more than 140,000.⁷

The licensing system has undergone four distinct evolutionary stages and a brief history of each stage will help in understanding the nature of the system.

1. *From 1949 to 1956.*

After the founding of the PRC in 1949, China set up the Ministry of Trade (MOT) to regulate both domestic and foreign trade. In 1952, the Ministry of Foreign Trade (MFT) was established to replace the MOT and simultaneously reorganized foreign trade entities and formed and classified fifteen foreign trade corporations according to the commodities in which they dealt.⁸ During this period, subject to registration procedures, privately-owned and foreign-owned business establishments were allowed to conduct import or export activities.⁹ By 1950, as many as 4600 private business establishments (both Chinese and foreign) which engaged in foreign trade operated in China's major port cities employing approximately 35,000 people.¹⁰ The coexistence of state-owned and private-owned (including foreign-owned) trading companies was often regarded as the main feature of China's foreign trade system at this time.¹¹

2. *From 1956 to 1978.*

The socialist transformation of the capitalist economy carried out in China beginning in 1954 gradually excluded private traders from involvement in foreign trade. As a first step, private traders were required to join the public (state)-private joint operation entities.¹² By January 1956, private traders countrywide were no longer independent importers or exporters but had become partners of these entities.¹³ Although they had lost their autonomy to conduct import or export activities, they retained ownership and managerial rights in the joint entities.¹⁴ The next step deprived private partners in public-

7. See Zhao Yongqing, *jin nian lai woguo waimao tizhi gaige de xin jinzhan* [Recent Reforms in China's System Managing Foreign Trade], 10 GUOJI MAOYI WENTI [INT'L TRADE J.] 8 (1997).

8. LIN YUHUI, XINBIAN SHEWAI JINGJI FALU YU SHIWU [A NEW HANDBOOK OF FOREIGN ECONOMIC LAW AND PRACTICE] 50 (Lin Yuhui et al. eds, 1992).

9. See PRFTA, art. 3.

10. See YUAN, *supra* note 6, at 45.

11. See *id.* at 48-51.

12. See *id.* at 50.

13. See *id.* at 51.

14. See *id.*

private joint entities of both the ownership and managerial rights in the joint entities, being entitled to receive only a fixed dividend for a number of years as a return for their investment in the joint entities.¹⁵ The method and value of compensation was established unilaterally by the state.¹⁶ After 1956, the state-owned foreign trade corporations monopolized the import and export of all commodities.¹⁷ This continued until China inaugurated its "open-door" policy at the end of 1978.

3. From 1979 to September 1996

Following the comprehensive economic reform initiated at the end of 1978, China reformed its foreign trade system. The Report on Foreign Trade System Reform made by the Ministry of Foreign Economic Relations and Trade¹⁸ (MOFERT Report) in September 1984 was a landmark event signaling significant change. The MOFERT Report ended a 30-year monopoly over foreign trade by the state-owned foreign trade corporations. The MOFERT Report concluded that while the specialized foreign trade corporations¹⁹ would remain the principal force of foreign trade, they should not and could not enjoy a monopoly over foreign trade operations.²⁰ Accordingly, the MOFERT Report recommended that a limited number of small- and medium-sized enterprises be allowed to enter the market as complementary traders to revitalize China's foreign trade.²¹ To promote the link between the international market and industrial enterprises, the MOFERT Report stipulated that large production enterprises should be granted the FTOR if they satisfied certain requirements.²²

During the period between 1978 and 1996, the diversification continued as increasing numbers of production enterprises were

15. *See id.*

16. *See id.*

17. *See id.*

18. The Ministry of Foreign Economic Relations and Trade (MOFERT) was renamed the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) by the Plan for Reforming the Organizational Structure of the State Council approved by the National People's Congress of the PRC (NPC) on March 22, 1993. The MOFERT Report appeared in ZHONGHUA RENMIN GONGHEGUO FAGUI HUIBIAN [A COLLECTION OF LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA] 377-383 (Law Department of the General Office of the State Council of the PRC, ed., 1986) [hereinafter MOFERT].

19. The term "specialized foreign trade corporations" here refers to state-owned foreign trade corporations.

20. MOFERT Report § 2, *supra* note 18.

21. *See id.*

22. *See id.*

accorded FTOR.²³ This diversification differed from the situation between 1949 and 1956 in that neither private enterprises nor FIEs could engage purely in China's foreign trade inside China.²⁴ FIEs are currently entitled only to import goods and technology they need and to export the products and technology they own.²⁵

4. Recent Developments

To facilitate China's trade with the outside world, the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), as the successor to MOFERT, promulgated the Provisional Procedures on the Establishment of Pilot Sino-Foreign-Investment Foreign Trade Corporations²⁶ (SFIFTC Procedures) on September 30, 1996, which ushered in a new stage in the development of China's foreign trade system. Under the SFIFTC Procedures, foreign corporations and enterprises as well as those in Hong Kong, Macao, and Taiwan may establish Sino-Foreign-Invested Foreign Trade Corporations (SFIFTCs) with Chinese companies and enterprises within mainland China.²⁷ SFIFTCs are different from general FIEs to the extent that SFIFTCs are entitled to specialize in import-export trade.²⁸

23. By 1995, more than 5,000 production enterprises had been granted FTOR. See Zhao Yongqing, *jin nian lai woguo waimao tizhi gaige de xin jinzhan* [Recent Reforms in China's System Managing Foreign Trade], 10 GUOJI MAOYI WENTI [INT'L TRADE J.] 8 (1997).

24. The MOFTEC issued the Provisional Decision on Issues Concerning Authorizing Private Productive Enterprises and Scientific Research Institutions the Right to Handle Import and Export (FTOR for Private Enterprises) on October 1, 1998. See *zhonghua renmin gongheguo duiwai maoyi jingji hezuo bu wengao* [Gazette of the Ministry of Foreign Trade and Economic Co-operation of the People's Republic of China] (hereinafter MOFTEC Gazette), Oct. 16, 1998, Issue No. 26, Serial No. 175. The FTOR for Private Enterprises became effective on January 1, 1999. It was only until then that private enterprises could be granted the right to import and export provided that they can satisfy the rigid requirements. For private enterprises to apply for the right to do so, they must have both registered capital and net assets of RMB 8.5 million, and annual sales income and the sale value for the purpose of exportation of RMB 50 million and \$1 million each respectively for two consecutive years. See FTOR for Private Enterprises art. 3. But private sector companies are still prevented from involvement in pure foreign trade to the extent that they can only import what they need for production and export what they have produced. See FTOR for Private Enterprises art. 7.

25. See *zhonghua renmin gongheguo zhongwai hezi jingying qiye fa* [Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures] (hereinafter SFEJV Law) art. 9; *zhonghua renmin gongheguo zhongwai hezuo jingying qiye fa* [Law of the People's Republic of China on Sino-Foreign Contractual Joint Ventures] (hereinafter SFCJV Law) art. 19.

26. *guanyu sheli zhongwai hezi duiwai maoyi gongsi shidian zanzheng banfa* [The Provisional Procedures on the Establishment of Pilot Sino-Foreign-Investment Foreign Trade Corporations] (hereinafter SFIFTC Procedures) The SFIFTC Procedures were promulgated by MOFTEC and became effective September 30, 1996. The SFIFTC Procedures consist of seventeen articles addressing: the formation and the requirements of SFIFTC, including examination procedures, forms of capital contribution, scope of business, administration of foreign exchange, quota, import and export licenses, finance, accounting, and statistics.

27. See SFIFTC Procedures art. 17, *supra* note 26.

28. See *id.* art. 2.

Compared to China's foreign trade system between 1949 and 1956, the SFIFTC procedures impose tighter restrictions on foreign involvement in China's import-export trade. First, the pilot regions are confined to the Shenzhen SEZ and the Shanghai Pudong New Area.²⁹ Second, the number of SFIFTCs is controlled by the State Council.³⁰ Third, only a few overseas companies can satisfy the exacting requirements imposed by MOFTEC's procedures,³¹ as will be explained later.

B. Categories of Foreign Trade Operations (FTOs)

Two decades of reform of China's foreign trade system has brought about great changes in the nature and number of FTOs. At present, all FTOs can be classified in the following types in terms of the nature and scope of their businesses.

1. Specialized Foreign Trade Corporations

The term "specialized foreign trade corporation" (SFTC) refers to state-owned and MOFTEC-controlled trade corporations specializing in foreign trade.³² SFTCs can be divided into three kinds. First are those SFTCs which engage in importing or exporting goods, such as China National Cereals, Oils and Foodstuffs Import and Export Corporation (CEROILFOOD).³³ Second are SFTCs which specialize in importing or exporting technology, such as China National Technical Import & Export Corporation (CNTIC).³⁴ Third are those SFTCs

29. *See id.* art. 16.

30. *See id.*

31. *See id.* art. 4.

32. ZHONG JIANHUA & MARK WILLIAMS, *FOREIGN TRADE CONTRACT LAW IN CHINA* 43 (1998).

33. CEROILFOOD ranked second in size among five hundred top import and export corporations in China in 1990. Its business scope covers such merchandise as cereals, beans and peas, animal fats, foodstuffs, salt, sugar, live poultry, livestock, frozen meat, meat products, eggs, fruits, dried and preserved fruits, vegetables, aquatic and marine products, canned goods, confectionery and biscuits, sugar products, wines and spirits, beverages, beer, dairy products, rice and flour products, peanuts products, and condiments. *See* 1990 ZHONGGUO JINCHUKOU ER ZUIDA DE 500 JIA QIYE [THE TOP 500 FOREIGN TRADE COMPANIES IN CHINA 1990] 2 (International Business ed., 1991).

34. CNTIC ranked fifth in size among five hundred top import and export corporations in China in 1990. It is a state-owned foreign trade corporation mainly dealing in the importation and exportation of technology and complete plants. Its business scope covers (1) importation for technology, complete plants, production lines, spare parts and components, mechanical and electrical products and instruments; (2) exportation of Chinese-patented technology, technical knowledge, complete plants, production lines, mechanical and electrical products and instruments, and new technical products; and (3) contracting in foreign countries, project engineering, providing technical services, and technical workforce. *See id.* at 5.

which carry out international economic co-operation,³⁵ such as China International Economic and Technical Co-operation Consultants, Inc. (ECOTECH).

Although SFTCs might have their own distinctive scope of operation, their main task is to engage in all import or export operations commissioned by enterprises and institutions in different regions of China.³⁶ Also, they have special permission to deal in those commodities that are either subject to competition in the international market or of vital importance to the nation's economy and the people's livelihood.³⁷ For instance, under Chinese law, only China National Textile Import and Export Corporation can deal in major commodities like cotton yarn and cotton grey cloth, enjoying a monopoly in these products.³⁸ In addition, SFTCs are responsible for those import or export activities consequent upon trade agreements entered into by China and foreign countries.³⁹

Apart from those SFTCs controlled by MOFTEC, SFTCs have been set up under various industrial ministries. These SFTCs are generally known as industrial and trading corporations.⁴⁰ China North Industries Corporation (NORINCO),⁴¹ established under the former Ministry of Ordnance Industry and China National Coal Import and Export Corporation (CNCIEC),⁴² is such a SFTC. The industrial and trading corporations are confined to imports and

35. The business scope of this type of SFTCs includes: (1) organizing and implementing various government-aided economic technological projects; (2) undertaking international contract business from preliminary feasibility studies, surveying, and designing to construction and installation; (3) providing technological services and labor cooperation in many fields; (4) handling the exportation and transit business of complete plants, equipment, and building materials needed in Chinese-aided projects. See MOFTEC, *GUIDEBOOK FOR CHINESE FOREIGN ECONOMIC AND TRADE INSTITUTIONS* 439 (1992).

36. See *supra* notes 35-37.

37. SHEN DAMING & FENG DATONG, *GUOJI MAOYI FA XINLUN* [REVISITING INTERNATIONAL TRADE LAW] 420 (1989).

38. ZHONG JIANHUA, *GUOJI HUOWU MAIMAI HETONG ZHONG DE FALU WENTI* [LEGAL ISSUES INVOLVING CONTRACTS FOR THE INTERNATIONAL SALES OF GOODS] 35 (1995).

39. See SHEN DAMING & FENG DATONG, *supra* note 39, at 420.

40. They are specialized trading corporations with the right to import and export business and are subordinate to the industrial ministries.

41. NORINCO is authorized to engage in international finance business, investment cooperation, import and export business for products and technologies, international transportation, joint venture and cooperation, labor cooperation, barter trade business, and compensation trade. The major industrial products offered by NORINCO include mechanical products, light industrial products, chemical products, opto-electronic products, civil blasting materials, and military products. See *GUIDEBOOK FOR CHINESE FOREIGN ECONOMIC AND TRADE INSTITUTIONS*, *supra* note 35, at 17.

42. CNCIEC is authorized to exclusively engage in the nationwide trade of coal, coal technologies, electrical and mechanical coal mining machinery, related equipment, and minerals. It also develops domestic coal mines through foreign investment and engages in foreign coal mine development and civil engineering projects by contracting and providing manpower sources for overseas projects. See *id.* at 12.

exports directly related to the relevant production enterprises under the ministries concerned.⁴³ Thus, the industrial and trading corporations generally do not deal in those commodities which might be imported for resale in China's domestic markets or which are within the scope of business of the SFTCs under MOFTEC.⁴⁴

With the decentralization of the administration of foreign trade in China beginning in 1979, local government was given more autonomy in the administration of locally-based foreign trade, including the establishment of local foreign trade corporations.⁴⁵ Against this background, local trade corporations mushroomed in the SEZs, provinces, autonomous regions, and open coastal cities.⁴⁶ The local foreign trading corporations are responsible for local imports or exports and are prohibited from conducting transregional operations.⁴⁷ They also may not set up branches outside their own local region.⁴⁸

To commence business an SFTC should fulfill the requirements imposed by Chinese law. An SFTC must possess legal person status which, as defined by the General Principles of Civil Law (GPCL),⁴⁹ is that of an organization with civil capacity, competence to perform civil acts, and civil rights and liabilities.⁵⁰ Under article 37 of the GPCL, an enterprise as a legal person should meet the following four requirements: (1) it must be established in accordance with law; (2) it must possess the necessary property or funds; (3) it must possess its own name, organizational structure, and premises; and (4) it must independently assume civil liability.⁵¹

Additionally, an SFTC must also satisfy the conditions of the Foreign Trade Law (FTL).⁵² Under the FTL, an FTO that engages in activities involving the trade of goods or technology must possess its own name and organizational structure; a specific foreign trade business objective; its own premises, funds, and professional

43. See YUAN, *supra* note 6, at 204.

44. See SHEN DAMING & FENG DATONG, *supra* note 39, at 420-21.

45. MOFERT Report § 2, *supra* note 18.

46. Among the top five hundred foreign trade companies of 1990 in China, 443 (or 88.6%) were local foreign trading corporations. See 1990 ZHONGGUO JINCHUKOU E ZUIDA DE 500 JIA QIYE [1990 TOP 500 FOREIGN TRADE COMPANIES IN CHINA] (Zheng Zhihai ed., 1991).

47. See SHEN DAMING & FENG DATONG, *supra* note 39, at 421.

48. See *id.*

49. GPCL was adopted at the Fourth Session of the Sixth National People's Congress, promulgated by Order Number 37 of the President of the People's Republic of China on April 12, 1986, and became effective on January 1, 1987.

50. See GPCL art. 36.

51. See *id.* art. 37.

52. The FTL was adopted at the Seventh Session of the Standing Committee of the Eighth National People's Republic of China and promulgated by Order No. 22 of the President of the People's Republic of China on May 12, 1994, and became effective as of July 1, 1994.

personnel necessary for its foreign trade operation; and should meet any other conditions specified by law or administrative regulation.⁵³

If an enterprise meets the above requirements, it may apply to the relevant government department in charge of foreign trade for permission to conduct foreign trade business. Different SFTCs must go through different procedures. All applications for the establishment of a national SFTC must be approved by MOFTEC. National SFTCs can be: (1) SFTCs controlled by various government ministries; (2) SFTCs established jointly by various provinces, autonomous regions and municipalities directly answerable to the central government; or (3) local SFTCs which deal in commodities from outside their own local region.⁵⁴ Those applications for establishing local SFTCs dealing in local commodities are generally approved by provincial departments in charge of foreign trade, which should report to MOFTEC for the record.⁵⁵

Examination and approval procedures for the establishment of SFTCs are as follows: The applicant should submit, via its administrative supervisory authority, a written application to the department in charge of examination and approval, a feasibility report for the establishment of the SFTC, a supporting opinion written by the applicant's administrative authority, articles of incorporation (including the scope/objectives of its business, catalogues of commodities it wants to deal in), and financial certificates by a bank or the financial department of the administrative authority.⁵⁶ The department in charge of examination and approval will then examine the application documents in light of relevant laws, regulations, and policies respecting foreign trade, and the need to promote foreign trade.⁵⁷ In addition, the department in charge of examination and approval is empowered to modify the articles of incorporation, the scope/objectives of the business, and the catalog of commodities it wishes to deal in before approval of any application for the establishment of an SFTC.⁵⁸ The SFTC shall, within the three months from the date of approval, register with the administrative departments for industry and commerce and open separate bank accounts.⁵⁹

53. See FTL art. 9.

54. Such local SFTCs refer to those that have obtained special permission to deal in commodities from outside their local region.

55. ZHONG JIANHUA & MARK WILLIAMS, *supra* note 32, at 48.

56. DANGDAI ZHONGGUO DUIWAI MAOYI [FOREIGN TRADE IN CHINA TODAY] 161 (Shen Jueren ed., 1992).

57. See *id.*

58. See *id.*

59. See *id.*

2. Production Enterprises with Foreign Trade Operation Right

Granting individual industrial enterprises FTOR was an important aspect of China's foreign trade system reform. For the purpose of this article, an industrial enterprise is a large- or medium-sized state-owned production enterprise.⁶⁰ Traditionally, Chinese production enterprises were separated from international markets by China's foreign trade control and monopoly system.⁶¹ Under this system, production enterprises could neither directly import what they needed for their production nor export what they produced. Their imports and exports were delegated to the SFTCs under MOFTEC.⁶² The separation of production enterprises from the international market weakened their competitive power vis-à-vis their foreign counterparts in the international market.⁶³ To revitalize production enterprises, China encouraged them to participate in international markets by granting them FTOR in the mid 1980s.⁶⁴ This measure was first piloted in the steel industry.⁶⁵ Large steel corporations in China's steel centers like Anshan, Beijing, Wuhan, and Ma'an Shan became the first production enterprises to be granted FTOR.⁶⁶

On July 23, 1992, the State Council promulgated the Regulations on Transformation of the Operating Mechanism of the State-owned Industrial Enterprises (Transformation Regulations).⁶⁷ For the first time, this listed FTOR as one of the 14 operating rights enjoyed by the state-owned production enterprises.⁶⁸ The Transformation

60. Production enterprises, distinct from commercial and material enterprises, are mainly involved in manufacturing rather than trading.

61. China's traditional foreign trade control and monopoly system allowed SFTCs to monopolize foreign trade activities to the effect that only these SFTCs were entitled to import or export goods.

62. It was not until the promulgation of the MOFERT Report in 1984 that production enterprises in China became qualified to import what they needed for their production and export what they produced. See MOFERT Report, § 2, *supra* note 18.

63. See ZHONG JIANHUA & MARK WILLIAMS, *supra* note 32, at 44.

64. MOFERT Report § 2, *supra* note 18.

65. See YUAN, *supra* note 6, at 207.

66. See *id.*

67. *quanmin suoyouzhi gongye qiye zhuanhuan jingying jizhi tiaoli* [The Regulations on Transformation of the Operating Mechanism of the State-owned Industrial Enterprises], *zhonghua renmin gongheguo guowuyuan gongbao* [Gazette of the State Council of the People's Republic of China], No. 22, Oct. 7, 1992, at 837-51 (hereinafter Transformation Regulations).

68. The fourteen managerial rights are the rights to: make decisions as to production and operation (art. 8); determine the price of their products and services (art. 9); sell their products (art. 10); purchase production materials (art. 11); import and export (art. 12); make investment decisions (art. 13); dispose of retained funds (art. 14); dispose of fixed assets (art. 15); make decisions as to joint operation or merger (art. 16); recruit and dismiss staff (art. 17); personnel administration (art. 18); decide salary and bonus (art. 19); establish internal organs (art. 20); and to refuse appointment of manpower, material, and finance from any department or entity (art. 21).

Regulations provided that any state-owned production enterprise could enjoy FTOR unless good cause could be shown for its denial.⁶⁹ Later that year, to implement the Transformation Regulations, the State Council approved the Opinions on Granting Production Enterprises FTOR (FTOR Opinion) by MOFTEC and the Production Office of the State Council which provided for requirements and procedures for granting production enterprises FTOR.⁷⁰ On January 30, 1997, MOFTEC and the State Economic and Trade Commission issued a Joint Circular on Further Promoting the Work of Granting the Production Enterprises FTOR (FPWGPE Circular).⁷¹ The FPWGPE Circular, apart from expanding permissible objects of production enterprises with FTOR, has relaxed the restrictions on granting production enterprises FTOR.⁷²

Under Chinese law, only large- or medium-sized state-owned production enterprises are qualified to apply for FTOR.⁷³ Subject to this restriction, the departments in charge of foreign trade shall consider applications for FTOR according to the following order of priority: (1) priority enterprises, which are technology intensive enterprises or enterprises which produce machinery and electrical equipment and need to provide after-sale services abroad, or enterprises that producing and export machinery and electrical equipment;⁷⁴ (2) strictly-controlled enterprises, which are enterprises mainly producing primary materials, products subject to quota control, or products with only a single market;⁷⁵ (3) flexibly-controlled enterprises, which are granted by evaluating the nature of demand and supply in both domestic and international markets if the enterprises do not produce machinery or electrical products but rather technology-intensive products or products with a short commercial life span (large state-owned pilot non-industrial enterprise groups might also be granted FTOR according to the characteristics of the industry concerned);⁷⁶ and (4) disqualified enterprises, which shall not be granted FTOR, including core enterprises in an enterprise group that has been granted FTOR, large state-owned

69. See Transformation Regulations art. 12.

70. The FTOR Opinion appeared in ZHONGGUO DUIWAI JINGJI MAOYI ZHENGCE SHOUCE [A MANUAL OF CHINA'S POLICIES ON FOREIGN ECONOMIC COOPERATION AND TRADE] 222-26 (Liu Xiangdong ed., 1994).

71. The FPWGPE Circular appeared in *MOFTEC Gazette*, Mar. 18, 1997, Issue No. 6, Serial No. 123.

72. See FPWGPE Circular § 1(1).

73. See FTOR Opinion art. 1(1).

74. See *id.* art. 1(2).

75. See *id.* art. 1(4).

76. See *id.* art. 1(3).

pilot enterprise groups that have established a subsidiary specializing in import and export operations, or enterprises which have joined any export combine or joint export corporation.⁷⁷

An application for FTOR cannot be approved unless the enterprise: (1) is an independent economic entity which enjoys the autonomy to manage and has separated its business from administration by government; (2) has its own premises and facilities for operations, funds, and other materials necessary for import and export operations; (3) has personnel qualified for foreign trade operations; and (4) produces its own products for export and meets the set export value (SEV) requirement.⁷⁸ The SEV for a two-year period is \$500,000 for an enterprise producing technology-intensive machinery and electronic products, \$1 million for a general machinery enterprise, and \$2 million for a business making electrical or non-mechanical products.⁷⁹ However, as of January 1997, the SEV requirement no longer applies to large state-owned or state-controlled enterprises. Such enterprises may be granted FTOR without examination of their SEV if they satisfy the other conditions.⁸⁰

To apply for FTOR approval a production enterprise should prepare, among other documentation, a written application, a supporting certificate from the administrative department in charge of the enterprise, a legal person business certificate, and a catalog of the commodities for import and export in which the enterprise deal.⁸¹

Where the applicant is a local production enterprise, it should submit its application to the provincial foreign trade department and economic and trade commission, which shall jointly report the application to MOFTEC and SETC upon approval.⁸² Where the applicant is a production enterprise directly under an industrial ministry, the application should be approved by the concerned ministry, which shall submit it to MOFTEC and SETC.⁸³ A large pilot enterprise group separately listed in the state's plan may submit its application directly to MOFTEC and SETC.⁸⁴

Having solicited opinions from the administrative departments in charge of relevant industries, SETC will examine submitted applications and forward them to MOFTEC for approval.⁸⁵ MOFTEC will

77. See *id.* art. 1(5), (6).

78. See *id.* art. 2.

79. See FPWGPE Circular § 1(1).

80. See *id.* § 1(1)(a).

81. See FTOR Opinion art. 3.

82. See *id.* art. 4(1).

83. See *id.* art. 4(2).

84. See *id.* art. 4(3).

85. See *id.* art. 4(4).

review all applications, consider the observations of SETC, and officially reply to each application.⁸⁶

The production enterprises with FTOR are entitled to import the technology, equipment, spare parts, and raw materials necessary for their production and to export the goods and technology they produce or own.⁸⁷ The FPWGPE Circular expanded industrial enterprises' ability to import and export. Large production enterprises with FTOR that have exported RMB10 million of their own products a year may, subject to approval, establish a wholly-owned subsidiary limited liability import and export company to trade products associated with or similar to their own products.⁸⁸ Moreover, if they are qualified to design, manufacture, and export large complete sets of equipment, they may, subject to approval, contract for projects and send personnel abroad to design, install, test, and operate such plants and equipment.⁸⁹

3. Commercial and Material Enterprises with FTOR

The term "commercial and material enterprises" (CMEs) involves two types of domestic trade enterprises: commercial enterprises and material enterprises.⁹⁰ While the former trade in consumer goods, the latter deal in extractive products, petro-chemical products, and mechanical and electrical equipment.⁹¹ By 1995, there were 62 CMEs which had been granted FTOR.⁹² On November 4, 1993, the State Council approved the Opinions on Experimentally Granting Foreign Trade Right to CMEs (CMEs Opinion) jointly issued by SETC, MOFTEC, and the Ministry of Domestic Trade (MDT).⁹³ The CMEs Opinion provides similar requirements and procedures for granting FTOR to CMEs as those stipulated in other regulations for production enterprises.⁹⁴ However, CMEs are required to engage in both

86. *See id.*

87. *See id.* art 5(2). The FPWGPE Circular however has extended their scope of business to the extent that they may establish separate companies with limited liability to engage in importation and exportation of goods relevant or similar to their own products. *See* FPWGPE Circular § 2(1).

88. *See* FPWGPE Circular § 2(1).

89. *See id.* § 2(2).

90. ZHONG JIANHUA & MARK WILLIAMS, *supra* note 32, at 55.

91. *See id.*

92. *See* ZHONGGUO GUONEI MAOYI NIANJIAN [ALMANAC OF CHINA'S DOMESTIC TRADE] III-23 (1996).

93. *guanyu fuyu shangye wuzi qiye jinchukou jingying quan shidian yijian* [The Opinions on Experimentally Granting Foreign Trade Right to CMEs] (hereinafter CME Opinion) (reprinted in *MOFTEC Gazette*, Dec. 26, 1993, Issue No.20, Serial No. 20).

94. *See id.*

import and export activities.⁹⁵ Thus, CMEs wishing to obtain FTOR, must meet the following import-export performances: Material and commercial wholesale enterprises directly under ministries or in the coastal regions must have a total annual value of imports and exports of over RMB1 billion. Material and commercial wholesale enterprises in the inland regions must have a total annual value of imports and exports of over RMB300 million. Enterprises dealing mainly in machinery and electrical products in the coastal regions must have a total annual value of imports and exports of RMB600 million, while the same enterprises in the inland regions must have a total annual value of imports and exports of RMB200 million. Commercial retail enterprises must have a total annual value of imports and exports of over RMB300 million.⁹⁶ In addition, the export value must be not less than one-third of the total annual value of imports and exports.⁹⁷ However, in view of the practical difficulties faced by enterprises in the inland regions, the total annual value of imports and exports can have temporary weight in light of their total sales (including both domestic trade and foreign trade) during the pilot stage.⁹⁸

4. *Science Research Institutes with FTOR*

To promote scientific research, on October 5, 1993, MOFTEC and the State Science and Technology Commission promulgated the Provisional Procedures for Granting Science Research Institutes the Right to Import and Export Scientific and Technical Products (SRIs Procedures).⁹⁹ Under the SRIs Procedures, science research institutes are defined as independent science research institutes which are engaged in basic or applied research or technological development.¹⁰⁰ By January 1996, two hundred science research institutes had been granted the right to import and export scientific and technical products.¹⁰¹ Those institutes may, subject to approval and the nature of their work, import raw materials, subsidiary materials, technology, equipment, and spare parts necessary for their own research and production.¹⁰²

95. *See id.*

96. *See* CME Opinion art. 2.

97. *See id.*

98. *See id.* art. 2(7).

99. The SRIs Procedures appeared in *MOFTEC Gazette*, Oct. 28, 1993, Issue No. 5, Serial No. 5.

100. *See* SRIs Procedures art. 2.

101. *See Ta Kung Pao* (Hong Kong), Jan. 20, 1996, at A3.

102. *See* SRIs Procedures art. 8(1).

An SRI applying for FTOR must prepare application documents which include: (1) a feasibility report containing descriptions of scientific research, production capabilities, technical capacity, the names, business certificates, and list of enterprises controlled by the SRI, if any; and (2) a catalogue of technical commodities to be imported or exported and the nature of the technology to be exported.¹⁰³ The applicant SRI may then submit a written application in accordance with the following principles.¹⁰⁴ If the applicant is directly controlled by ministries of the State Council, it shall submit the application to the respective ministry which shall forward it to SSTC and MOFTEC.¹⁰⁵ Local SRIs shall submit their applications to the provincial foreign trade department and the provincial science and technology commission, which shall jointly report their findings to SSTC and MOFTEC.¹⁰⁶ SSTC shall examine the application and report to MOFTEC, which shall review the application again.¹⁰⁷

Article 3 of the SRI Procedures states that FTOR can be granted to SRIs if it: (1) possesses marketable technology and can conduct further research upon development and manufacture of technical products or development of internationally competitive technologies; (2) has achieved some element of commercialization and industrialization of its scientific output by annually exporting products or technologies worth \$500,000 or more for the two years prior to the application; and (3) has facilities, funds, and other equipment necessary for import and export operations.¹⁰⁸

FTOR shall be directly granted to the SRI. The SRI will not, however, be allowed to establish a new import and export corporation.¹⁰⁹ If it already has a legal person business certificate, it shall enjoy FTOR.¹¹⁰ If it does not, FTOR may be granted at the request of the applicant SRI to a state-owned enterprise designated by the applicant.¹¹¹ The application of the SRI will, however, be refused if it belongs to an enterprise group or another institution which has been granted FTOR.¹¹²

SRIs which have been granted FTOR enjoy and undertake the following rights and obligations: (1) they are entitled, within their

103. *See id.* art. 5.

104. *See id.* art. 6.

105. *See id.*

106. *See id.*

107. *See id.* art. 7.

108. *See id.* art. 3.

109. *See id.* art. 7.

110. *See id.*

111. *See id.*

112. *See id.* art. 4.

business scope, to export technologies developed and technical products produced by themselves and to import raw materials, subsidiary materials, technologies, equipment, and spare parts needed for their own research and production; (2) they shall enjoy all advantages offered under relevant import-export regulations; (3) they shall enjoy the same import and export rights as other FTOs; and (4) they shall abide by all policies, principles, laws, and regulations governing foreign trade and economic relations, and accept supervision, co-ordination, and management by foreign trade departments at national and provincial levels. They are also expected to accept co-ordination by relevant chambers of exporters and to only engage in operations within their scope of business. Furthermore, they must strictly observe government restrictions on the export of high technology products.¹¹³

5. Foreign Invested Enterprises

In Chinese law, "Foreign Invested Enterprises" (FIEs) refers to Sino-foreign equity joint ventures,¹¹⁴ Sino-foreign contractual joint ventures,¹¹⁵ and wholly foreign-owned enterprises.¹¹⁶ All FIEs enjoy FTOR to the extent that they can import production equipment, raw materials and other items necessary for their production and export

113. *See id.*

114. Sino-foreign equity joint ventures are regulated by the *zhonghua renmin gongheguo zhongwai hezi jingying qiye fa* [Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures] (SFEJV Law). This law was adopted at the Second Session of the Fifth National People's Congress on July 1, 1979, and revised in accordance with the Decisions of the National People's Congress regarding the Revision of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures adopted at the Third Session of the Seventh National People's Congress on April 4, 1990. The SFEJV Law is implemented by the Regulations for the Implementation of the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures (SFEJV Regulations) which was promulgated by the State Council in September of 1983.

115. Sino-foreign contractual joint ventures are regulated by the Law of the People's Republic of China on Sino-Foreign Contractual Joint Ventures (SFCJV Law) which was adopted at the First Session of the Seventh National People's Congress and promulgated by Order Number 4 of the President of the People's Republic of China on April 13, 1988, and effective as of the date of promulgation. The SFCJV Law is implemented by the Rules for the Implementation of the Law of the People's Republic of China on Sino-Foreign Contractual Joint Ventures (SFCJV Law Rules) which was approved by the State Council on August 7, 1995 and promulgated by Decree Number 6 of the Ministry of Foreign Trade and Economic Cooperation on September 4, 1995.

116. Wholly foreign-owned enterprises are regulated by the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (WFOE Law), adopted at the Fourth Session of the Sixth National People's Congress, promulgated by Order No. 39 of the President of the People's Republic of China, and effective upon April 12, 1986. The WFOE Law is implemented by Rules for the Implementation of the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (WFOE Rules) which was approved by the State Council on October 28 1990 and promulgated by Decree Number 1 of the Ministry of Foreign Economic Relations and Trade on December 12, 1990.

the products they produce.¹¹⁷ The privilege enjoyed by FIEs has been confirmed by the FTL which has exempted FIEs from the need to obtain permission with respect to the FTOs when importing non-production goods for their own use, equipment, raw materials, and other goods necessary for manufacturing and exporting their own products.¹¹⁸

6. Sino-Foreign Investment Foreign Trade Corporations

Sino-foreign investment foreign trade corporations (SFIFTCs), the newest type of FTO, are economic entities established between foreign and Chinese companies, located in China, specializing in import and export operations.¹¹⁹ Because Hong Kong, Macao, and Taiwan are viewed as integral parts of China by the central government, companies based there can also establish SFIFTCs in mainland China.¹²⁰ Under the SFIFTC Procedures, all SFIFTCs are limited liability companies in which the proportion of the registered capital contributed by the Chinese party must be no less than fifty-one percent and the proportion contributed by the foreign party shall be at least twenty-five percent.¹²¹ In addition, the legal representative¹²² must be appointed by the Chinese partners.¹²³ The capital

117. Article 9 of the SFEJV Law stipulates that:

its purchase of required raw and semi-processed materials, fuels, auxiliary equipment, etc., and equity joint venture should give first priority the purchases in China. It may also make such purchases directly on the world market with foreign exchange raised by itself. An equity joint venture shall be encouraged to market its products outside China. It may sell its export products on foreign markets directly or through associated agencies or China's foreign trade agencies.

SFEJV Law art. 9 (emphasis added). For detailed provisions regarding the right of Sino-foreign equity joint ventures to import and export, see SFEJV Regulations, arts. 57, 60, 62 and 63. Article 19 of the SFCJV Law provides that "a contractual joint venture may, within its approved scope of operation, import materials it needs and export products it produces. A contractual joint venture may purchase, on both the domestic market and world market, the raw and processed materials, fuels, etc. within its approved scope of operation." (emphasis added) See also SFCJV Rules, arts. 37-41. Article 15 of the SFEJV Law states that "within the scope of business approved, wholly foreign-owned enterprises may purchase, either in China or from the world market, raw and semi-processed materials, fuels and other materials they need." (emphasis added). See also SFEJV Rules arts. 44, 46-48.

118. See FTL, art. 9.

119. See SFIFTC Procedures art. 2, *supra* note 26.

120. See *id.* art. 15.

121. See *id.* art. 3.

122. The term "legal representative [*fading daibiaoren*]" comes from article 38 of the GPCL: "the person in a responsible position [*fuzeren*] of a legal person who, in accordance with the law or the provisions of its charter, exercises his functions and powers on behalf of the legal person." For the purpose of this provision, the person in a responsible position refers to the head of an entity. For instance, in the case of a university, the president is the head and accordingly falls into the meaning of the person in responsible position. Thus, under Chinese law, the president of a university is also the legal representative of the university. In the case of a company, however, the chairman of the board of directors shall be the company's legal

contribution of the foreign party must be in hard currency.¹²⁴ The Chinese party may use *renminbi*, goods, intangible assets, or other property rights as its capital contribution.¹²⁵ Furthermore, each party to the SFIFTC must contribute its respective capital amount within one month of the signing and issuance of the business license.¹²⁶

When they have received approval certificates from MOFTEC, the SFIFTCs may conduct import or export activities on their own behalf or as agents of other enterprises.¹²⁷ However, an SFIFTC's foreign trade activities are limited to the designated scope of business, and they may not conduct other activities without special permission.¹²⁸ If the commodities they import or export are subject to quotas or license controls, the SFIFTCs must first apply for the quotas or licenses necessary for such imports and exports.¹²⁹

Under the SFIFTC Procedures, both the Chinese and foreign party to an SFIFTC must fulfill the requirements imposed by Chinese law. The foreign party must satisfy the following conditions: (1) its turnover in the year prior to application must amount to \$5 billion; (2) its average annual trade volume with China over the previous three years must be over \$30 million; and (3) it must have a representative office established in China for at least three years prior to application, or have invested over \$30 million in China.¹³⁰ These conditions are often viewed as so rigid that only a few corporations in the world qualify to enter China's foreign trade business. Corporations having a trading turnover of \$5 billion are rare,¹³¹ and are therefore more likely to include corporations with a diversified structure including manufacture, retail, and wholesale operations. The SFIFTC Procedures, however, do not clarify the type of the turnover.¹³² The number of qualified foreign companies would be considerably reduced if the turnover is construed to be only that relating to pure trading business. In contrast, the

representative. See Company Law of the PRC arts. 45, 68, 113. The functions and powers of the legal representative include: (1) control of daily business operations; (2) enjoyment of civil rights and bearing of civil liability; (3) bringing or defending a suit at court; and (4) entrusting an agent to engage in civil activities in the name of the legal person.

123. See SFIFTC Procedures art. 3, *supra* note 26.

124. See *id.* art. 7.

125. See *id.*

126. See *id.*

127. See *id.* art. 8.

128. See *id.* art. 8.

129. See *id.* art. 9.

130. See *id.* art. 4(1).

131. See HONG KONG ECON. TIMES, Oct. 1, 1996, at 2.

132. See SFIFTC Procedures, *supra* note 26.

requirements for the Chinese party are much more flexible. The SFIFTC Procedures only require the Chinese party to (1) enjoy FTOR; (2) have an average annual import and export volume over the previous three years of over \$200 million, of which the export volume must be no less than \$100 million; and (3) establish more than three branches, subsidiaries, or joint ventures outside China having an average annual turnover of more than \$10 million over the three years prior to application.¹³³

Apart from the above requirements, the SFIFTC Procedures provide that the SFIFTC cannot be established until the SFIFTC itself fulfills the following conditions: it must have (1) registered capital of at least *Yuan* 100 million; (2) its own name and organizational structure; and (3) business premises, specialized personnel, and other necessary material conditions appropriate to its foreign trade business.¹³⁴

The Chinese party to an SFIFTC seeking establishment must submit its application and necessary documents to MOFTEC through the local foreign trade department.¹³⁵ Having examined the application for the establishment of the SFIFTC, MOFTEC shall report to the State Council and, with the approval of the State Council, issue an approval certificate.¹³⁶ Within one month of the date of approval the Chinese party should satisfy the registration procedures with the administrative authorities for industry and commerce and complete the business registration procedures with the relevant financial authority.¹³⁷

Thus, Chinese bureaucratic procedures for the classification and approval of entities entitled to conduct foreign trade are of Byzantine complexity. The sheer variety of potential routes for approval and the number of entities potentially capable of applying for the right to deal with foreign trade are minefields for the unwary foreigner

133. See *id.* art. 4(2).

134. See *id.* art. 4(3).

135. The following documents must be attached to support the application: the project proposal with a feasibility report; SFIFTC contract and articles of association signed by both the Chinese party and the foreign party; documents verifying the registration, credit worthiness, and the legal representatives of the Chinese party and the foreign party; the approval certificate of the enterprise(s) in which the foreign party has invested in China or the approval certificate of the representative office(s) which the foreign party has established in China and the capital verification report made by the registered Chinese auditor; the documents concerning registration of branches, subsidiaries, or joint ventures which the Chinese party has established abroad; a balance sheet and confirmation certificate issued by the auditor, for the past three years, of the Chinese and foreign parties; the proposed nature of business and the commodities to be dealt in by the prospective SFIFTC; and other documents required by MOFTEC. See *id.* art. 5.

136. See *id.*

137. See *id.* art. 6.

wanting to deal with a Chinese enterprise. Fortunately, the internal procedures explained above are primarily of concern to the Chinese entity, except for the courageous trader that wishes to set up a SFIFTC. This bureaucratic jungle is the legacy of the command economy, which is still all too evident and could easily strangle the efforts of the business that wants the right to trade with foreigners.

III. LEGAL EFFECTS OF CAPACITY OF CHINESE ENTERPRISES ON VALIDITY OF FOREIGN TRADE CONTRACTS

A. Nature of Foreign Trade Operators

It is next necessary to discuss the nature of FTOs before addressing the legal effects of the capacity of Chinese enterprises on the validity of foreign trade contracts. The fundamental civil law of China is the GPCL¹³⁸ which became effective in 1987. It is classified as a basic law in constitutional law and postulates the basic civil law norms of the legislative hierarchy.¹³⁹ Article 36 defines a "legal person" as an organization with the capacity for civil rights and conduct and the ability to independently assume civil obligations including, *inter alia*, contractual duties.¹⁴⁰ Contracting parties are obliged to fully perform their resultant obligations¹⁴¹ and legal persons who breach their contracts bear civil liability.¹⁴² The court may force the breaching party to render performance¹⁴³ or pay compensatory damages.¹⁴⁴

There is no limitation on the capacity of a legal person to enter general economic contracts, save that it should be established in accordance with the law.¹⁴⁵ An enterprise legal person should only conduct operations within the scope of business duly approved and registered.¹⁴⁶ However, not all legal persons are competent to enter foreign trade contracts as capacity to do so is restricted to those enterprise legal persons¹⁴⁷ granted FTOR.

138. *See generally* GPCL.

139. *See id.*

140. *See id.* art. 85.

141. *See id.* art. 88.

142. *See id.* art. 106.

143. *See id.* art. 111.

144. *See id.* art. 112.

145. *See id.* art. 37(1).

146. *See id.* art. 42.

147. The GCPL classifies legal persons into three types—either enterprise legal persons, government agencies, or public institutions that enjoy the status of a legal person. *See id.* arts. 41-50.

Consequently, in the context of foreign trade contracts, most legal persons have no capacity to so contract. The Chinese approach to the capacity of enterprises is distinct from that of common law countries. In medieval common law a corporation possessed full contractual capacity, though normally it would make all important contracts under its common seal so signifying formality and proper consent of the corporation; natural persons also made contracts in this way.¹⁴⁸ English law allows full freedom to contract with foreign entities, subject to the general law, save in respect to contracts between British citizens and enemy aliens.¹⁴⁹ Such contracts are contrary to public policy at common law except insofar as they are allowed by royal license.¹⁵⁰ This prohibition is clearly exceptional and limited to times of war.¹⁵¹ In ordinary circumstances English law does not seek to control or inhibit the freedom of English contractors to deal with foreign entities.

In China, however, only those legal persons, which have been granted FTOR, are qualified parties to foreign trade contracts.¹⁵² There were several categories identifying those enterprises granted the right to engage in foreign trade, such as foreign trade corporations, foreign trade enterprises, and import and export corporations.¹⁵³ Not until the promulgation of the Foreign Trade Law of the PRC (FTL) on May 22, 1994¹⁵⁴ did the FTL describe these enterprises as foreign trade operators in a unified way. Article 8 of the FTL stipulates that "[f]oreign trade operators as used in this Law refer to the legal persons or other organizations engaged in operations of foreign trade in accordance with the provisions of this Law."¹⁵⁵ This definition of the FTOs demonstrates that they are in nature enterprise legal persons that have obtained permission from government and therefore have the right to conduct foreign trade. As enterprise legal persons, FTOs should run their businesses autonomously, bear sole responsibility for their own profits and losses, and shoulder civil

148. CHITTY ON CONTRACTS ch. 1 (A.G. Guest ed., 27th ed. 1994).

149. See Trading with the Enemy Act, 1939, 2 & 3 Geo. 6, ch. 89, §§ 1, 2(1) (creating a criminal offense and defining the "enemy").

150. *Ertel Bieber & Co. v. Rio Tinto Co.*, [1918] App. Cas. 260.

151. See *id.*

152. See FTL art 9.

153. ZHONG JIANHUA, ZHONGGUO DUIWAI MAOYI GUANLI FA DAOLUN [AN INTRODUCTION TO LAW OF ADMINISTRATION OF FOREIGN TRADE IN CHINA] 39 (1998).

154. See FTL. The FTL consists of eight chapters. Chapter I deals with general principles covering China's major foreign trade policies. Chapter II specifies the FTOs. Chapter III address administration of import and export of goods and technology. Chapter IV prescribes international service trade. Chapter V deals with maintenance of order of foreign trade. Chapter VI lists measures for promotion of foreign trade. Chapter VII imposes legal liability and Chapter VIII provides some supplementary provisions.

155. FTL art. 8.

liability to the extent of their own property or state-owned property which they are entrusted to manage and operate.¹⁵⁶ It is vitally important that FTOs are legally independent economic entities. For some time, western traders did not understand the status of the FTOs; they would often bring actions against the Chinese government rather than the FTO when disputes arose.¹⁵⁷

Under Chinese law, FTOs have the following legal characteristics which distinguish them from other economic entities: First, FTOs are Chinese legal persons.¹⁵⁸ Therefore, natural persons, individual industrial and commercial households,¹⁵⁹ rural contract-operation households,¹⁶⁰ individual partnerships,¹⁶¹ and joint operations¹⁶² do not enjoy the status of legal person and, therefore, are not entitled to conduct foreign trade activities.¹⁶³ Second, the FTOs are enterprise legal persons that run their business autonomously and assume sole responsibility for their own profits and losses.¹⁶⁴ This feature of the FTOs has been confirmed by the FTL. Article 11 stipulates that "foreign trade operators shall run their operations autonomously in accordance with the law and shall bear sole responsibility for their own profits and losses."¹⁶⁵ Thus, this requirement excludes government organs, public institutions, and social organizations from carrying foreign trade operations even though they enjoy the status of a legal person. They can only commission FTOs within China, subject to their business objects,¹⁶⁶ to conduct foreign trade business on their behalf.¹⁶⁷ Third, the FTOs are not general enterprise legal persons but those enterprise legal persons which have been granted FTOR.

156. See FTL art. 11.

157. For detailed discussion on this issue, see ZHONG JIANHUA, ZHONGGUO DUIWAI MAOYI GUANLI FA DAOLUN [AN INTRODUCTION TO LAW OF FOREIGN TRADE ADMINISTRATION IN CHINA] 39 (1998).

158. See FTL art. 8.

159. Individual industrial and commercial household is defined by the GPCL as citizens who, upon approval and registration in accordance with law, conduct industrial or commercial business within the scope permitted by law. See GPCL art. 26.

160. Rural contract-operation household refers, as identified by the GPCL, to members of rural collective economic organizations who in accordance with provisions of a contract conduct business with respect to goods within the scope permitted by law. See GPCL art. 27.

161. The term "individual partnership" means two or more citizens who by agreement contribute funds, property, skills, and the like and operate in partnership and work jointly.

162. Joint operations can be divided into three categories: (1) those which independently bear civil liability and can be qualified as a legal person; (2) those which bear civil liability only with respect to the property that each party owns and cannot be qualified as a legal person; (3) those which are bound by contract to conduct operations independently and cannot be qualified as a legal person. See GPCL, arts. 51-53.

163. See ZHONG JIANHUA & MARK WILLIAMS, *supra* note 32, at 39.

164. See FTL art. 11.

165. *Id.*

166. We define this term as meaning objects of the business as well as scope of business.

167. See FTL art. 13.

The term "foreign trade operation right" is also characterized as "import and export right" or "foreign operation right."¹⁶⁸ The so-called foreign trade operation right refers to the legal capacity to conduct foreign trade activities. Only those enterprises which have FTOR can be a party to a foreign trade contract; not all enterprise legal persons can enter into a foreign trade contract.¹⁶⁹ Under Article 9 of the FTL, any enterprise wishing to import or export goods or technology must meet the conditions required by the law and obtain permission from the State Council's department in charge of foreign trade and economic relations.¹⁷⁰

B. Validity of Contracts Concluded by Chinese Enterprises Without FTOR

Under Chinese law, the holding of FTOR allows Chinese enterprises to enter into foreign trade contracts; without it, enterprises lack such capacity and foreign trade contracts entered into by them are void.¹⁷¹

It is interesting to contrast the Chinese view of capacity with the common law capacity rules. In other countries (particularly in common law ones), lack of capacity does not necessarily result in the denial of the validity of a contract. The common law distinguishes between corporations created by royal charter (which have the attributes of a natural person) and those incorporated by statute.¹⁷² The latter only had that contractual capacity granted by the statute under which they were formed or by the constitutional documents required to be registered by the general companies acts, under which most ordinary trading entities with limited liability are formed.¹⁷³ This *ultra vires* rule meant that any act or contract entered into by the company that was not specifically authorized in its Memorandum of

168. The term foreign trade operation right is often used in scholarly discussions, see SHEN DAMING & FENG DATONG, *supra* note 39, at 417-21. The other two terms are usually found in legal documents. For instance, the term "import and export right" is used in the SRIs Procedures (art. 3) while the terms "foreign operation right" is employed in *zuigao renmin fayuan guanyu shiyong shewai jingji hetong fa ruogan wenti de yida* [Response of the Supreme People's Court to Several Questions Concerning the Application of the Foreign Economic Contract Law] (hereinafter FECL Response) issued by the Supreme People's Court on October 19, 1987 and published in *zhonghua renmin gongheguo quanguo zuigao renmin fayuan gongbao* [Gazette of the Supreme People's Court of the PRC] 3-7, Issue 4, 1987.

169. The FECL Response declares any contracts entered into by Chinese entities that have no FTOR to be void. See FECL Response, art. 3(2).

170. See FTL art. 9.

171. See FECL Response § 3(i). The FECL Response is a judicial interpretation of the Foreign Economic Contract Law of the PRC (FECL), handed down by the Supreme People's Court of the PRC on October 19, 1987, more than two years after the FECL came into effect.

172. See *The Case of Sutton's Hospital*, 77 Eng. Rep. 936, 960 (K.B. 1612).

173. See *Joint Stock Companies Act, 1844*, 7 & 8 Vict., ch. 110 (Eng.); *Companies Act, 1862*, 25 & 26 Vict., ch. 89 (Eng.).

Association was beyond its powers or capacity to contract and was consequently void and unenforceable,¹⁷⁴ even if the contract or act was ratified by all the members of the company.¹⁷⁵ Knowledge of the content of the Memorandum was presumed as it was a public document available for inspection by any member of the public. This harsh rule in the common law had no specific ramifications in relation to contracts between corporations and foreigners.¹⁷⁶

The *ultra vires* rule was first modified in 1972 by section 9(1) of the European Communities Act¹⁷⁷ and later by the Companies Act of 1989.¹⁷⁸ This gave greater security to third parties who deal with companies. It also retained some safeguards for shareholders against potential misuse of company funds for purposes that were not envisioned when the shareholders invested their money in the enterprise.¹⁷⁹

The common law also denies validity to contracts that involve the commission of a legal wrong or are contrary to public policy.¹⁸⁰ The distinction between the two is complex and a general classification of this area of law is not accepted by academic writers.¹⁸¹ Using public policy considerations to deny contractual validity is a complex and difficult area of law which has had its detractors: "[I]t is a very unruly horse, and when once you get astride it you never know where it will carry you."¹⁸² However, it has also had its proponents: "with a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles," in the words of Lord Denning in *Enderby Town Football Club v. Football Association Ltd.*¹⁸³

In consequence of its unpredictability and the need to minimize the drastic sanction of invalidity, the courts are generally mindful of the fundamental tenets of contract law and minimize the situations when they expand the boundaries of public policy to invalidate contracts. The traditionalist view was exemplified by Jessel, M.R., in *Printing & Numerical Numbering Co. v. Sampson*:

174. See *Ashbury Ry. Carriage & Iron Co. v. Riche*, 7 L.R.-E. & I. App. 653 (1875).

175. See *id.*

176. L.C.B. GOWER, *PRINCIPLES OF MODERN CONTRACT LAW* ch. 8 (5th ed. 1992).

177. European Communities Act, 1972, ch. 68 (Eng.).

178. Companies Act, 1989, ch. 40 (Eng.).

179. See *id.* § 108-112.

180. See CHITTY, *supra* note 148, ch. 16.

181. See G.H. TREITEL, *THE LAW OF CONTRACT* 377-78 (8th ed. 1991); G.H.L. FRIDMAN, *THE LAW OF CONTRACT IN CANADA* 344 (3d ed. 1994); G.C. CHESHIRE ET AL., *LAW OF CONTRACT* chs. 10-12 (12th ed. 1986); CHITTY, *supra* note 148, ch. 16.

182. *Richardson v. Mellish*, 2 Bing. 229, 252 (1824).

183. [1971] Ch. 591, 606

It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract.¹⁸⁴

Subsequent statutory intervention for protection¹⁸⁵ or the standardization of implied terms¹⁸⁶ has at least the merit of public debate prior to enactment and is prospective in effect. Arguably, the essential elements of freedom to contract have been maintained. As this outline of common law capacity elucidates, the right of dealing with foreigners has no real limitation. For reasons of history and ideology, China's approach is very different. Rooted in a socialist control model and with a long history of bureaucratic control, China's rules are still very restrictive. This comparative outline only serves to reinforce these observations.

However, an interesting issue is whether a foreign court would enforce a contract entered into by a Chinese entity that lacked FTOR, and a foreign entity (English or otherwise). Here Chinese law would deny validity to the contract on the basis of lack of capacity by the Chinese contractor. But if English law had been chosen as the proper law of the contract, as is allowed by Chinese law,¹⁸⁷ would the English court decide the capacity issue in accordance with Chinese or English principles?

In the case of *Bodley Head Ltd. v Flegon* an English publisher sought to restrain the unauthorized publication in England of a book written by Alexander Solzhenitsyn.¹⁸⁸ The author had appointed a Swiss national as his literary attorney to deal with matters on the author's behalf outside Russia.¹⁸⁹ The power of attorney was explicitly stated to be subject to Swiss law.¹⁹⁰ The publisher acquired the English copyright via the attorney and sued the defendant who sought to publish a unauthorized edition of the book.¹⁹¹ The

184. *Printing & Numerical Numbering Co. v. Sampson*, 19 L.R. 462, 465 (1875).

185. *Unfair Contract Terms Act, 1977*, Ch. 50 (Eng.)

186. *Sale of Goods Act, 1979*, Ch. 54 (Eng.), *Supply of Goods and Services Act, 1982*, Ch. 29 (Eng.)

187. FECL art. 5 (1985).

188. *Bodley Head Ltd. v. Flegon*, 1 W.L.R. 680 (1972).

189. *See id.* at 683.

190. *See id.*

191. *See id.* at 683-84.

defendant argued in part that the author's capacity to make a valid power of attorney was regulated by Soviet law as the author was domiciled in Russia and the power of the attorney was executed in Moscow.¹⁹² At the time, Soviet law denied a Russian citizen capacity to appoint an agent to enter into contracts on his behalf outside of the Soviet Union.¹⁹³ Consequently, the defendant argued that the power of attorney was void, thereby making any acts of the agent nullities.¹⁹⁴ Judge Brightman held that as no acts were contemplated to be carried out by the agent in Russia, and the power of attorney was stated to be governed by Swiss law, the agency had no relevant connection with Russia and, therefore, the author's capacity was governed by Swiss, not Soviet, law.¹⁹⁵

This decision seems to indicate that even when a foreign trade contract is made in China, between a foreign entity and a Chinese entity, and the contract is stated to be subject to English law, an English court will likely hold the contract enforceable and the Chinese entity to have capacity. However, if the contract is to be performed in China, *Bodley Head Ltd. v. Flegon* may be distinguished because the FECL provides for different provisions when a contract is to be performed within the PRC.¹⁹⁶

The above discussion clarifies that to make an enforceable foreign trade contract the Chinese party to the contract must have been granted the right to conduct foreign trade. Where it lacks such right, the contract is invalid under Chinese law.¹⁹⁷ Given that only FTOs can conduct foreign trade activities, it is extremely important for foreign corporations engaged in the China trade to find a legally competent Chinese partner. Thus, knowledge of the system and the right connections are still invaluable in cutting a swathe through the forest of regulation. The foreign business wishing to deal with a Chinese entity must ensure that it holds a valid FTOR, for if it does not, any entered contract will be void under Chinese law.¹⁹⁸

A possible safeguard is the insistence upon the application of a foreign law as the law of the contract, thereby potentially subverting the effect of the Chinese capacity provisions, if a foreign court accepted jurisdiction over the contract and agreed to apply the non-Chinese rules on capacity to the contracting parties. Clearly, a

192. *See id.* at 688.

193. *See id.*

194. *See id.*

195. *See id.* at 688-89.

196. *See* FECL art. 5 (1985).

197. *See* FECL Response § 3(ii).

198. *See* FECL art. 5 (1985).

Chinese court would regard the capacity issue as a mandatory one governing the contract and its parties and would not allow foreign capacity rules to subvert the Chinese system. Due diligence exercises to prove the Chinese entity has capacity are still the best way for a potential foreign contractor to reduce the risk of invalidity.

IV. ANALYSIS OF THE UNDERLYING POLICIES OF THE LICENSING SYSTEM

The preceding has established that in the past twenty years China has gradually released its tight hold on the capacity of Chinese enterprises to engage in foreign trade, making possible the more active involvement of a wider spectrum of Chinese enterprises in international competition. The recent diversification of FTOs, however, does not indicate that China will soon remove all restrictions on enterprises to conduct foreign trade. The argument for China's licensing system is the necessity to maintain order in China's foreign trade relations.¹⁹⁹ In the view of the Chinese government and some Chinese scholars, to allow all enterprises to conduct foreign trade would disrupt China's foreign trade system.²⁰⁰ This argument is based on the following considerations. China is a large and underdeveloped country with a population of more than 1.2 billion.²⁰¹ Trade in certain commodities, such as rice, is strictly controlled for strategic reasons, and liberalization allowing free trade in such goods is politically impossible, mainly because the Chinese government finds the supply of such strategic goods to be related to social stability.²⁰² Also, the supply of educated personnel experienced in foreign trade operations is limited and does not meet the demand from enterprises wishing to engage in foreign trade.²⁰³ Additionally, the government was previously very keen to ration the use of scarce foreign exchange.²⁰⁴ This is now of less importance given China's current trade surplus and large reserves of foreign exchange.²⁰⁵

199. See FENG DATONG, GUOJI MAOYI FA [INT'L TRADE LAW] 288-89 (1995).

200. For official opinions, see Liu Xiangdong, *duiwai maoyi tizhi gaige redian wenti jixi* [Explanation of the Hot Points in Foreign Trade System Reform], *zhongguo gaige* [China Reform] 41, May 1994. Mr. Liu was then a MOFTEC official. For scholarly arguments, see FENG DATONG, *supra* note 199, at 288-89.

201. By the end of 1996, China had the population of 1,238,900,000 persons, excluding that of Hong Kong, Macao, and Taiwan. See CHINA STATISTICAL YEARBOOK 69 (State Statistical Bureau of the PRC ed., 1997).

202. See ZHONG JIANHUA & MARK WILLIAMS, *supra* note 32, at 38.

203. See SHENG JIEMIN & LI YAN, *ZHONGGUO SHEWAI JINGJI FALU ZHIDU* [FOREIGN ECONOMIC LAW IN CHINA] 187 (Beijing: Modern Publishing House, 1992).

204. See *id.*

205. China has become one of the major countries which has the largest foreign exchange reserves. In 1996, China's foreign exchange reserve was \$105.029 billion while in 1979 \$8.4 billion. See CHINA STATISTICAL YEARBOOK, *supra* note 201, at 624.

These arguments for China's licensing system are justified by certain recent negative experiences observed by the Chinese government. China attempted to loosen constraints on enterprises by decentralizing the power to examine and approve applications for foreign trade permissions in the second half of 1988.²⁰⁶ The number of the FTOs resultingly increased by two-thirds in just three months.²⁰⁷ The dramatic increase in the number of new participants in the foreign trade business inevitably disturbed the foreign trade order as many of the newly established FTOs lacked experienced personnel and the facilities necessary for foreign trade operations.²⁰⁸ Some FTOs gained tax refunds from the government by illegal methods such as using false foreign trade contracts.²⁰⁹ Others did not have sufficient professional personnel resources and were often disadvantaged in foreign trade transactions due to their ignorance of international trade law and practice, resulting in a great financial losses to the enterprises concerned.²¹⁰ This keen price competition between FTOs caused many products to be exported at prices significantly lower than the cost of production.²¹¹ This occurs as most FTOs are state-owned but are responsible to different government entities who directly compete for the most foreign exchange earnings.

Also, the rapid increase in the number of new players in China's foreign trade caused a series of "product wars" to recently break out.²¹² Some FTOs purchased products at a high price from China's domestic producers and then exported them abroad at a lower price. The price competition between FTOs consequently meant that Chinese exports were more vulnerable to anti-dumping investigations.²¹³ In recent years, Chinese exports have become the major target of anti-dumping laws in the United States and European Union. Anti-dumping lawsuits initiated in these countries have thus

206. See Liu Xiangdong, *supra* note 200, at 41.

207. See *id.*

208. See *id.*

209. See DATONG, *supra* note 199, at 289.

210. See *id.*

211. Statistics show that among 160 merchandise items exported from mainland China to Hong Kong more than 120 merchandise items have been exported at a price lower than the normal one. See Dai Qingmin, *daodi shi yi chuanghai wei zhongxin, haishi yi xiaoyi wei zhongxin—zhongguo waimao: ni zou na tiao dao* [China's Foreign Trade at a Crossroad: Foreign Exchange Oriented or Economic Benefit Oriented?], 14 ECON. FOREIGN & INT'L TRADE 31 (1997).

212. The term "product wars" here refers to unfair competition between FTOs. For instance, some FTOs attempted to defeat their rivals by purchasing products for which there might be good markets in foreign countries from domestic producers with high price and then exported abroad at an unreasonably lower price.

213. See DATONG, *supra* note 199, at 289.

been deemed the greatest obstacle to China's export trade.²¹⁴ By mid-1996, as many as two hundred types of Chinese products had been subject to anti-dumping investigations, among them fifty-seven cases investigated by the United States and sixty-four by the European Union.²¹⁵ These investigations have covered a wide spectrum of Chinese products including manganese, rare-earth metals, shoes, toys, garments, and color TV sets.²¹⁶

This negative experience has always been strong evidence of a connection between disorder in the foreign trade regime and the relaxation of strict controls on the capacity of enterprises to engage in foreign trade. However, although Chinese foreign trade has had recent problems, the major cause of these problems is not, as the Chinese government argues, the loosening of the control of enterprises in conducting foreign trade and the resultant diversification of FTOs. Instead, strict control by the Chinese government on enterprises is responsible for the disruption of foreign trade in recent years.

First, the government requires all FTOs, as a condition for granting FTOR, to attain targets for foreign exchange earnings through export.²¹⁷ Thus, to earn foreign exchange through export is one of the major obligations of FTOs. As one MOFTEC official pointed out, once an enterprise has obtained FTOR it must meet this obligation.²¹⁸ Further, to preserve FTOR, FTOs must not only maintain foreign exchange earnings but increase them annually.²¹⁹ Any failure to reach the target will result in cancellation of FTOR.²²⁰ Although this foreign exchange oriented policy has contributed considerably to China's current trade surplus and large reserves of foreign trade exchange, it has also resulted in export operations without consideration for economic returns and even promotes exports at less than the cost of production or purchase.²²¹ This practice has not only lead to anti-dumping investigations but also to

214. Chen Zhidong & Feng Jun, *woguo chukou chapin pinfan zao fang qingxiao susong de guonei yuanyin chutan* [An Initial Exploration into Domestic Reasons for Frequent Anti-dumping Lawsuits Against Our Exports], GUOJI JINGJI FA YANJIU WENJI [A COLLECTION OF PAPERS ON INT'L ECON. LAW] 90 (Dep't of Educ. of the Ministry of Justice of the PRC ed., 1996).

215. ZHANG YUEJIAO, GUOJI JINGMAO FALU PINGXI YU YUNYONG [ANALYSIS AND APPLICATION OF INT'L TRADE AND ECON. LAWS] 103 (1997).

216. *See id.* at 102.

217. Zhang Nan & Qing Li, *dui waimao kaifang jingyingde sikao* [Some Considerations on Opening Foreign Trade Operations], 1 GUOJI MAOYI [INT'L TRADE] 19 (1994).

218. *See* Xiangdong, *supra* note 200, at 41.

219. *See* Zhang Nan & Qing Li, *supra* note 217, at 19.

220. *See id.*

221. *See id.*

losses to the enterprises concerned and to the state.²²² The outcome then is that the more an FTO has exported, the greater its actual loss.²²³ The deficit is made up by state promoted loans from state controlled banks.²²⁴

Another problem associated with this foreign exchange earnings quota requirement for FTOs is price wars between competing FTOs.²²⁵ On one hand, these competing FTOs have often paid exorbitant prices for goods which they believe are in great demand abroad, resulting in significant domestic price rises of the relevant goods.²²⁶ Although the domestic producers are content with this state of affairs, it has seriously disrupted the order in foreign trade (at least in the eyes of the Chinese government).²²⁷ On the other hand, to attract overseas customers these competing FTOs often must sell the goods abroad for much less than their purchase price.²²⁸ Again, the root of this evil is the FTOs' need to fulfill the foreign exchange earnings quota. These frequent price wars between FTOs have eventually not only disturbed the foreign trade order but also resulted in export at a lower price which again provides the basis for anti-dumping investigations initiated by foreign countries.²²⁹

A further reason for the disorder of foreign trade patterns is the multiplicity of authorities that administer FTOs. As the foregoing description indicated, FTOs can be classified as specialized foreign trade corporations, production enterprises with FTOR, commercial and material enterprises with FTOR, science research institutes with FTOR, foreign invested enterprises, and Sino-foreign investment foreign trade corporations. They are respectively controlled by various authorities including the central government, local governments, and different administrative departments of both central government and local governments. For reasons of departmental interests, the authorities usually pressure FTOs under their control to expand their exports, resulting in departmental competition in price, products,

222. Due to price competition between FTOs, China has lost more than \$10 billion annually. See Tong Shuxing & Zhao Jingxia, *zhuyue woguo waimao tizhi shengru fazhan de zhengjie Suozai* [Bottle-necks to Restrict China's Foreign Trade Reform], 2 GUOJI MAOYI [INT'L TRADE] 8 (1995).

223. See Qingmin, *supra* note 211, at 31.

224. See *id.*

225. See Tong Shuxing & Zhao Jingxia, *supra* note 222, at 8.

226. See Sufeng, *supra* note 2, at 13.

227. According to a report made by the Research Center to Advise on Economic, Technological and Social Development, a research institute under the State Council of the PRC, China suffered an annual loss of as much as SU \$ 10 billion as a result of price wars between FTOs. See Tong Shuxing & Zhao Jingxia, *supra* note 222, at 8.

228. More than 120 of the 160 categories of goods exported from the Chinese mainland to Hong Kong were sold at a price 20% less than normal price. See Dai Qingmin, *supra* note 211, at 31.

229. See *id.*

and customers, and leading to politically motivated exports rather than ones based on economic logic.²³⁰

The strict control on the capacity of enterprises to engage in foreign trade has also led to the separation of the majority of Chinese enterprises from international markets and, consequently, their ignorance of international practices and rules.²³¹ Due in large part to their ignorance, these long-isolated enterprises sometimes do not conduct their business in accordance with the law and rules of international trade.²³² Also, their bargaining positions are often weakened.²³³ This will continue if China continues to isolate them from the outside world through its licensing system.

In fact, China has realized the negative impact of the licensing system on China's foreign trade. The central government has expressed its intention to move from a licensing system to a registration system.²³⁴ As an experimental measure, on January 30, 1997, MOFTEC promulgated the Provisional Measures for Automatic Registration of FTOR for Production Enterprises in the SEZs (FTOR Registration Measures).²³⁵ For the purposes of the FTOR Registration Measures, the businesses concerned are production enterprises exclusive of FIEs registered in accordance with Chinese law in the five SEZs (Shenzhen, Zhuhai, Shantou, Xiamen, and Hainan).²³⁶ Although the registration system introduced by the FTOR Registration Measures indicates a significant step forward toward the principle of free trade, it still imposes requirements upon those enterprises wishing to obtain FTOR.²³⁷ Furthermore, such requirements are not clearly stated in the FTOR Registration Measures.²³⁸

230. See Tong Shuxing & Zhao Jingxia, *supra* note 222, at 8.

231. See DATONG, *supra* note 199, at 289.

232. See *id.*

233. See *id.*

234. China has undertaken to implement the registration system five years after China's accession to the WTO. See WANG CHUANLI, GUOJI MAOYI FA [INT'L TRADE LAW] 317 (1998).

235. *jingji tequ shengcha qiye ziying jinchukou quan zidong deji zanxing* [The Provisional Measures for Automatic Registration of FTOR for Production Enterprises in the SEZs] (hereinafter FTOR Registration Measures) (reprinted in *MOFTEC Gazette*, Mar. 18 1997, Issue No. 6, Ser. No. 123).

236. See FTOR Registration Measures art. 2.

237. Under article 4 of the FTOR Registration Measures, any qualifying business based in the SEZs which have fulfilled the following conditions may apply for the FTOR:

- (1) It must have registered with the administrative department in charge of industry and commerce in the SEZs and obtained legal person status;
- (2) It has production premises, equipment and is a going concern;
- (3) It has its premises necessary for its operations, in addition to funds and personnel to carry out foreign trade operations; and
- (4) It satisfies any other conditions imposed by both laws and regulations.

238. Article 4(4) of the FTOR Registration Measures requires the applicant enterprise to meet "any other conditions imposed by both laws and regulations."

The FTOR Registration Measures have considerably simplified the application procedures. Production enterprises that wish to obtain FTOR may apply to the foreign trade departments in the SEZs which shall record the applications and issue registration certificates within fifteen working days.²³⁹ The departments concerned may also reject applications within fifteen working day limit if the enterprises do not meet those requirements.²⁴⁰ However, the complicated documentation might be still a significant burden for applicant enterprises.²⁴¹

Further, even if an enterprise has fortunately obtained FTOR by registration, its scope of business is strictly restricted.²⁴² The remit of a production enterprise in respect of foreign trade operations is confined to the exports which they produce themselves and the imports (including machines, equipment, spare parts, and raw and subsidiary materials) necessary for their own production.²⁴³ They may only deal in sixteen types of special export commodities²⁴⁴ and fourteen types of special import commodities that must be approved by the SFTCs designated by the government.²⁴⁵

239. See FTOR Registration Measures art. 5.

240. See *id.*

241. The application process requires the completion of a form supported by the following documents:

- (1) Basic data on the production enterprise (including its own assets, the dimensions of the production premises, number of employees, products, and annual output);
- (2) A copy of its business certificate (the original of the document should be produced for verification);
- (3) A capital verification report drawn up by a qualified auditor;
- (4) A catalogue of the enterprise's imports and/or exports; and
- (5) An official certificate confirming its legal representative and the legal representative's identity card information, residential address, and telephone number.

See FTOR Registration Measures art. 7.

242. See FTOR Registration Measures art. 8.

243. See *id.*

244. Under *guanyu chukou shangpin jihua pei'e guanli de shishi xize* [Rules for the Implementation of the Administration of Planned Quota for Export Commodities] (PQEC) promulgated by MOFTEC in the *MOFTEC Gazette* on October 18, 1993, Issue No. 3, Serial No. 3, the sixteen special export commodities include rice, soybean, corn, tea leaves, coal, tungsten, antimony, crude oil, oil products, and cotton.

245. The FTOR Registration Measures do not identify the fourteen special import commodities. However, *jinkou shangpin jingying guanli zanxing banfa* [Interim Measures for Administration of Trading in Import Commodities], promulgated by MOFTEC lists only twelve types of special import commodities in which authorized SFTCs must deal, including wheat, crude oil, oil products (gasoline, diesel oil, and kerosene), chemical fertilizers (nitrogenous fertilizer, phosphate fertilizer, potash fertilizer, and compound fertilizer), natural rubber, steel products, plywood, wool, polyacrylic fibers, raw cotton, and leaf tobacco and tobacco products. *MOFTEC Gazette*, Aug. 24, 1994, Issue No. 20, Serial No. 40.

V. CONCLUSION

The best cure for the imperfections in China's foreign trade system is not a tightening but rather a relaxation of control on the capacity of enterprises to conduct foreign trade. The Chinese government may in fact be prepared to accept this prescription. During a meeting of China Working Group of the WTO held in early March of 1997, Mr. Long Yongtu, the deputy minister of MOFTEC, outlined China's proposals for relaxing control on the capacity of enterprises to conduct foreign trade. The most revolutionary step proposed is that China will recognize that all enterprises shall enjoy FTOR. This new system will also be applicable to foreign companies through the principle of national treatment.²⁴⁶ Thus, due to both internal and external factors, China will eventually step forward to embrace a system of free trade, although it is difficult to estimate when this major reform will actually be implemented.

246. See Sufeng, *supra* note 2, at 11-12.