

LEGAL ASPECTS OF TAIWANESE TRADE AND INVESTMENT  
IN THE PEOPLE'S REPUBLIC OF CHINA

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## ABSTRACT

Since the beginning of the 1980s, one of the most frequently debated issues concerning the Nationalist Republic of China on Taiwan (hereinafter, Taiwan) and the Communist People's Republic of China on the mainland (hereinafter, China or the PRC) has been investment and trade relationships between the two. Taiwan and the PRC, divided since 1949 and with a background of extreme hostility, both continue to claim to be the sole legitimate government of "China". However, they are *de facto* two exclusive entities with lawful international personalities which exist separately on either side of the Taiwan Straits.

Although the PRC has made continuous efforts to promote direct trade and investment with Taiwan, Taiwan still insists that all contacts should be indirect. According to the government of Taiwan's three-stage unification plan published in March 1991, direct business activities with the PRC can be conducted only if there is an equal, reciprocal relationship between the two regimes. While various scenarios are possible for future relationships, the most likely appears to be a compromise; a co-existence with economic and political co-operation coupled with legal *modus vivendi*.

The purpose of this study is first, to provide an academic analysis of the legal aspects of Taiwan-PRC trade and investment links which also promotes the cause of stronger Taiwan-PRC economic relations unilaterally; Secondly, in the broader context, to stimulate creative discussion of possible solutions for direct mutual exchange of economic activities between the two. The analysis of the legal aspects of Taiwanese trade and investment in the PRC includes an examination of the methods of legal settlement for handling business disputes.

This thesis employs the methodology of comparative analysis in approaching the topics it treats. Its theoretical standpoint is based on the argument that the model of former East-West trade and investment, arising from policies of mutual public non-recognition, reveals many close similarities to the characteristics of the Taiwan-PRC relationship where trade and investment are concerned. By undertaking a detailed examination of these similarities, it is hoped that this thesis provides not only a thorough account of the genesis and current state of the problem, but also that it offers realistic pointers to achieving an eventual satisfactory solution.

This thesis is made up of seven chapters. It begins with a chapter outlining comprehensively the recent history of China and Taiwan. This first chapter also outlines the goals, sources and framework of the study.

The second chapter tackles the main factors involved in the notion of a Greater China, embracing the present territories of the PRC, Taiwan, and Hong Kong. Consideration is given to the true extent and effect of PRC's economic reforms; to the political/economic background of the PRC-Taiwan trade and investment relationship; to prospects for enhancing the triangular economic tie which even now links these three territories; to the patterns of current trade and investment; and not least, to the two bodies deliberately set up to bridge the Taiwan-PRC ideological gap by dealing with practical issues. A conclusion is drawn.

The third chapter opens with a brief discussion of the prospects for a reunited country. It then restates in detail the background to Taiwan-PRC economic links, describing the emerging legal framework governing private business relations between the two regimes.

The fourth chapter deals with the legal issues in private business contracts for Taiwanese trade and investment in the PRC. These in-depth analyses include several issues arising in the context, and methods utilised in concluding business contracts.

The fifth chapter looks at the legal protection of Taiwanese trade and investment in the PRC. Discussion includes existing PRC laws and measures, their legal effectiveness and significance as they affect Taiwanese businesses.

The sixth chapter analyses the legal solutions for settling business conflicts of Taiwanese trade and investment in the PRC. It highlights the relative roles of arbitration and litigation in resolving such disputes.

The final chapter presents the conclusions that can be drawn from this study, and considers future prospects for Taiwan-PRC relations.

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## FOREWORD

As a Taiwanese law graduate studying abroad, I am glad to see that economic interaction and interdependence between Taiwan and the People's Republic of China (China, or the PRC) have developed as a result of the investment and trading activities which began during the late 1970s and have been on the increase ever since. The PRC is now widely recognised as one of the most promising opportunities in the coming decade for international business. Its phenomenal economic growth, its increased openness to foreign cooperation and its newly-welcoming legal environment have of late led to major reforms in the regulation of trade and investment.

Taiwan, with the common linguistic, cultural and ethnic background as well as geographic proximity, has been actively taking advantage of the PRC's modern economic boom. In doing business with the PRC, foreign companies should not underestimate the potential benefits of Taiwan-PRC economic and legal relationships. In undertaking research on the legal aspects of Taiwanese trade and investment in the PRC, I attempt to explore the interaction of PRC law and policy which are two of the most fascinating phenomena since 1979. This research also analyses the methods of legal settlement for handling Taiwan-PRC business disputes, using the model of East-West trade and examines the laws and policies of mutual public non-recognition which were in existence.

While carrying out this research, I have received financial support from the Sino-British Economic and Cultural Association (Taiwan), the Central Research Fund (University of London), the Sino-British Fellowship Fund (Britain), and incalculable help from my wife Yvonne Chen who has been working in London since 1989. Without their assistance it would have been impossible for me to complete this study.

With the paucity of legal scholarship in Taiwan-PRC business links, my study is, as far as I know, the most comprehensive and indeed pioneering research into the overall legal aspects of Taiwanese business transactions in the PRC. While various scenarios are possible for future Taiwan-PRC relationships, my study may, it is hoped, become a legal *modus vivendi* in coping with frequently-encountered business problems in the PRC, and contribute to further Taiwan-PRC economic cooperation.

In 1992 and 1994, I went to both China and Taiwan to conduct personal fieldwork. This was in order to obtain first-hand information of their legal background with regards to their trade and investment issues. Whilst in China, I consulted official Chinese documents, legal publications, periodicals and newspapers. I also interviewed many government officials, legal experts, economists, and Taiwanese businessmen based in the PRC. All of them have had much experience in dealing with the above issues. These interviews proved to be particularly valuable as they both confirmed and enriched the literatures I had obtained. Moreover, they have helped me gain a greater understanding of how the PRC's legal framework (for Taiwanese trade and investment) works in practice.

I owe a debt of gratitude to Michael Palmer, Director of East Asia Law Centre and concurrently the Head of the Law Department, the School of Oriental and African Studies (SOAS [University of London]). As my supervisor for this research work, his thoughtful instruction and great patience made this thesis become possible. My thanks are also due to Dr. Yuan Cheng and my tutor Dr. W.F. Menski who have offered very valuable advice and help to my research and writing.

I dedicate this thesis to my father who sadly passed away soon after I was enrolled as a first year Ph.D student at SOAS, and to my mother who, despite her loneliness and hard work in Taiwan, has continuously given help and encouragement to my studies in London.

Since the main body of this thesis was completed in 1994, I have been in employment with the Taiwan Cement Corporation Group. I owe many personal thanks to the Chairman Dr. C. F. Koo, currently Chairman of the Straits Exchange Foundation (the paramount semi-official channel of communication between Taiwan and the PRC). With his encouragement and assistance, I am now able to continue my research work in this field.

Last but not least, I feel very much indebted to my wife for her understanding and support over the past few years in London.

Finally, the laws and regulations cited in this thesis are as they stood on 1 July 1995.

## ABBREVIATIONS

ARATS	Association for Relations Across the Taiwan Straits
CCP	Chinese Communist Party
CCPIT	China Council for Promotion of International Trade
CITIC	China International Trust and Investment Corporation
CJV	Cooperative (contractual) Joint Venture
CJVL	Law of the PRC on Chinese-Foreign Cooperative Joint Ventures
CMAC	China Maritime Arbitration Commission
CMEA	Council for Mutual Economic Assistance
CPL	Civil Procedure Law of the PRC
DECL	Domestic Economic Contract Law of the PRC
ECL	Economic Contract Law of the PRC
EJV	Equity Joint Venture
EJVL	Law of the PRC on Chinese-Foreign Equity Joint Ventures
FDI	Foreign Direct Investment
FECL	Foreign Economic Contract Law of the PRC
FTC	Foreign Trade Corporation
FETAC	Foreign Economic and Trade Arbitration Commission
GATT	General Agreement on Tariffs and Trade
GPCL	General Principles of Civil Law of the PRC
KMT	Kuomintang (The Nationalist Party)
MAC	Mainland Affairs Commission
MFT	Ministry of Foreign Trade
MOFERT	Ministry of Foreign Economic Relations and Trade
PRC	People's Republic of China
ROC	Republic of China
SEF	Straits Exchange Foundation
SEZ	Special Economic Zones
TIP	Taiwan Investment Provisions

TIL            Taiwan Investment Law  
TMRS          Taiwan's Mainland Relations Statute  
USA            United States of America  
WFOE          Wholly Foreign-owned Enterprise  
WFOEL        Law of the PRC on Wholly Foreign-Owned  
Enterprises

TABLE OF CHINESE STATUTES AND REGULATIONS CITED

Administrative Litigation Law of the PRC (Zhonghua Renmin Gongheguo Xingzheng Susongfa), 4 April 1989.

Civil Procedure Law of the PRC (For Trial Implementation) (Zhonghua Remin Gongheguo Minshi Susongfa), 8 March 1982.

Civil Procedure Law of the PRC (Zhonghua Renmin Gongheguo Minshi Susongfa), 9 April 1991.

Detailed Rules for the Implementation of the Law of the PRC on Chinese-Foreign Equity Joint Ventures (Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiyefa Shishi Tiaoli), 20 September 1983.

Economic Contract Law of the PRC (Zhonghua Renmin Gongheguo Jingji Hetongfa), 13 December 1981 and amended on 2 September 1993.

Explanation of the Supreme People's Court on Several Issues Relating to the Application of the Law on Foreign Economic Contracts (Zuigao Renmin Fayuan Guanyu Shiyong Shewai Jingji Hetongfa Ruogan Wenti De Jieda), 19 October 1987.

General Principles of Civil Law of the PRC (Zhonghua Renmin Gongheguo Minfa Tongze), 12 April 1986.

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Provisions of the State Council on Encouraging Foreign Investment (Guowuyuan Guanyu Guli Waiguo Touzi de Guiding), 11 October 1986.

Provisions of the State Council on Encouraging Taiwan Compatriots' Investment (Guowuyuan Guanyu Guli Taiwan Tongbao Touzi de Guiding), 3 July 1988.

Provisions of the State Council on Encouraging Overseas Chinese, Hong Kong and Macao Compatriots' Investment (Guowuyuan Guanyu Guli Haiwai Huaqiao ji Gang'ao Tongbao Touzi de Guiding), 15 August 1990.

Regulations of the PRC on Arbitration of Economic Contracts (Zhonghua Renmin Gongheguo Jingji Hetong Zhongcai Tiaoli), 22 August 1983.

Rules of Arbitration of the China International Economic and Trade Arbitration Commission (Zhongguo Guoji Jingji Maoyi Zhongcai Waiyuanhui Zhongcai Guize), 12 September 1988.

Statute on Governing Relations Between People of the Areas of Taiwan and Mainland China (Taiwan Diqu yu Dalu Diqu Renmin Guanxi Tiaoli), 18 September 1992.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 General Survey of Recent History

China has the oldest continuous civilisation in the world and is also the oldest centralised state, having survived since 221 B.C. Taiwan, a semitropical island, is situated 100 miles east of China. Taiwan has been a major trade and shipping partner for China over many centuries.

After the Communist victory and the establishment of the People's Republic of China (China, or the PRC) in 1949, interaction between the Republic of China on Taiwan (Taiwan) and the PRC<sup>1</sup> came to a standstill. Taiwan and the PRC, with a background of extreme hostility, each continue to claim to be the sole legitimate government of "China". Driven by forces of economic expansion and nationalist sentiment, as well as by political and economic pragmatism starting in the 1980s, Taiwan and the PRC are now moving toward a closer informal relationship.

##### 1.1.1 Chinese Side

China's history goes back to the earliest times, about 5,000 years. But it was not until the third century BC that China was finally unified as one country under its first emperor. Successive dynasties followed,

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1. Throughout this thesis, I shall use the term Taiwan and China or the PRC as shorthand for their full names -- the Republic of China and the People's Republic of China, respectively, for reference only. The status between the two sides under international law and politics is not intended to be commented upon in any manner whether express or implied.

the Han and the Ming are perhaps best remembered by the rest of world, not forgetting the Tang which is best remembered for its cultural strength. Imperial rule lasted until 1911 when the Qing<sup>2</sup> Dynasty, which had ruled since 1644, was effectively overthrown by the Kuomintang (the Nationalist Party, or KMT) under Sun Yat-sen.

The Chinese term for China, "Zhongguo", means middle kingdom. The Chinese word for foreign country, "Waiguo", literally means outside kingdom. For centuries, the Chinese emperors were quite ignorant and unaware of developments outside the Chinese borders. China became very self-centred, isolated and unconscious of the growth and progress being made in the Western world. This traditional Chinese perception of the world, the so-called "Sino-centricism"<sup>3</sup> was challenged only when Westerners began to penetrate into China.

During the mid-1800s, the two so-called "Opium Wars"<sup>4</sup> between China and Britain erupted over a trade dispute. China took exception to Britain's policy of paying for locally-produced goods and commodities with opium. The "Opium Wars" resulted in the signing of the Treaty of Nanjing in 1842. In addition to ceding Hong Kong to Britain, China was forced to open five ports to British trade, to establish official recognition and extend diplomatic relations on an equal basis, and to pay reparation.

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2. The Pinyin system of romanisation is used throughout, except for such widely recognised Chinese names as Sun Yat-sen, Chiang Kai-shek, Kuomintang, Mao Tse-tung, and so forth.

3. For more information on the traditional Chinese view, see Chiao Chiao Hsieh, *Strategy for Survival*, London: The Sherwood Press, 1985, p. 8.

4. For further studies, see Maurice Collis, *Foreign Mud: The Opium Imbroglia at Canton in the 1830s and the Anglo-Chinese War*, New York: W.W. Norton and Co., 1968.

The Treaty of Nanjing granted the privilege of extraterritoriality to British nationals. This Treaty was the first of a whole series of "unequal treaties"<sup>5</sup> by which Western powers extracted capitulations from China. Under the Treaty, the British Consul, acting as a judge, could extend and apply English law to British nationals in China. China was thus forced to open itself up to the outside world and make a series of political, commercial and territorial concessions to foreign countries. After the granting of privileges to Britain in China, other foreign countries made similar demands.

There were another seventeen powers such as France, Russia, Germany, Japan and so on followed the same suit as Britain imposed on China between this Treaty in 1842 and the Shimonoseki Treaty in 1895. The Chinese had looked upon such capitulations as a peculiarly odious stigma, of which they wanted to be rid as soon as possible. However, these extraterritorial rights were not relinquished until 1947 when China's full sovereign rights were recovered.<sup>6</sup>

Growing Western influence in China accelerated the internal decay of the Qing Dynasty. The dynastic system of government could not withstand the pressures of Western intrusion and social change.<sup>7</sup> After its overthrow in October 1911, the Republic of China (ROC)

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5. The Chinese imperial government, constrained by its internal weakness always responded to foreign demands by signing treaties which provided foreign countries with leased territories, or extraterritoriality, or foreign control of custom tariffs, or the exercise of foreign authority over Chinese territories. For further studies on foreign encroachments on the 19th century China, see J. K. Fairbank, *China: A New History*, Mass.: Harvard University Press, 1992.

6. See Cheng Yuan, *East-West Trade; Changing Patterns in Chinese Foreign Trade Law and Institutions*, New York: Oceana Publications, Inc., 1991, p. 37.

7. See J. F. Fairbank, *supra* note 5.

was proclaimed with the KMT as the central force in the administration. However, the Republic existed only in name and was unable to unify the country under a centralised political structure until 1928.<sup>8</sup>

The KMT government never in reality governed the whole of China. Portions remained under the control of regional war-lords, and a newly emerging Chinese Communist Party (CCP) movement led by Mao Zedong continually threatened the KMT's rule. Both the KMT and the CCP collaborated and competed with each other for final control of China. The KMT's obsession with ridding China of the CCP allowed the Japanese to attack the country. The KMT signed a peace treaty with the Japanese who subsequently annexed much of northeast China.

In 1937, Japan's full-scale invasion of China forced the KMT government to retreat inland to Chongqing in southern China. Both the KMT and the CCP cooperated in fighting the Japanese. But on Japan's defeat in 1945, the two sides were once again at odds and thus finally waged a bloody civil war. This war brought the CCP to power in October 1949 when it proclaimed the PRC, and forced the KMT to flee to Taiwan where it continued in government, ruling the ROC on that island.

The CCP's unification of the PRC under Mao Zedong's leadership, ended more than a century of internal division, social upheaval, and Western influence. However, all foreigners were expelled and a period of isolation followed that was not to end until Mao Zedong's death in 1976. Since then, the PRC has gradually opened itself up to foreign visitors and overseas investors in

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8. China lapsed into deeper internal turmoil as war-lords vied with each other for control and the Kuomintang under Generalissimo Chiang kai-shek was not able to unify the whole country. See Alvin Rabushka, *The New China*, Pacific Research Institute for Public Policy, USA: Westview Press, 1987, p. 15.

an effort to right the many economic wrongs of the earlier years of socialist rule. It has joined the world community, including the United Nations, where the ROC had held a seat, by maintaining its sole representation of China, until 1971.

### 1.1.2 Taiwanese Side

Taiwan, or Formosa in Portuguese<sup>9</sup>, is provincial home to the majority Han Chinese, who were the first to settle this island early in the 1700s.<sup>10</sup> Taiwan was ceded to Japan by China in 1895. In 1945, following Japan's defeat in the Second World War, the island was returned to China, then controlled by the KMT under the rule of Chiang Kai-shek. In 1949, the KMT forces were defeated by the CCP and up to one and a half million mainland Chinese, along with the KMT government fled to Taiwan for sanctuary and refuge on the island. A "temporary" provisional government was set up (which still presumes to represent all of China) dominated by politicians formerly in power on the mainland.<sup>11</sup>

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9. Formosa is a word of Portuguese origin, meaning "the beautiful island". Westerners in the past often used it to describe the island, although Taiwan, a word of unclear origin, is now much more popularly used. From time to time, attempts are made to attach political significance to one word or the other. For example, advocates of Taiwanese independence living in America and Japan usually use the term of Formosa in an attempt to deny even a linguistic affiliation with China. Independence advocates who live in Japan, however, are obliged to use the word Taiwan if they wish to be understood. In this study, the island will be called Taiwan with no intended implications.

10. A useful summary of the origin of Taiwan's population appears in Paul K. T. Sih, "Introduction", in Paul K. T. Sih, (ed.), *Taiwan in Modern Times*, New York: St. John's University Press, 1973, pp. vii-xix.

11. This section on Taiwan's political system draws from Richard L. Walker, "Taiwan's Movement into Political Modernity: 1945-1972", in *ibid*, pp. 359-396.

With the outbreak of hostilities in Korea in 1950 and the concomitant chill of a Cold War, the United States of America (USA) saw Taiwan as a vanguard essential in the defence of the Free World.<sup>12</sup> In 1954, a security treaty was signed between Taiwan and the USA, in which the USA, having refused to recognise the PRC, pledged to protect Taiwan in the event of a communist attack. The USA's support, including economic and military aid and advice, provided much of the initial investment that was to transform Taiwan's backward economy into one of the great economic stories of the post-war era. The USA then hoped for a democratic China, at least on Taiwan.<sup>13</sup>

As relations between the USA and the PRC improved, however, USA non-recognition became increasingly untenable. In 1971, having represented China up to that point, Taiwan was expelled from the United Nations<sup>14</sup> and replaced by the PRC. The USA recognised the PRC in 1979 and Taiwan entered a period of diplomatic isolation.

In 1973, Taiwan rejected an offer by the PRC to hold reunification talks and has since then consistently rebuffed any PRC proposal under the formula of "one country, two systems".<sup>15</sup> Taiwan at that time still dealt

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12. For further studies, see John F. Copper, *China Diplomacy, The Washington-Taipei-Beijing Triangle*, USA: Westview View Press, 1992, pp. 1-27.

13. Ibid., p. 2.

14. In 1971, the USA decided to improve relations with the PRC and ended its effort to sustain Taiwan's claim to be the sole legitimate government of China in the United Nations. See Steve Tsang, *In the Shadow of China, Political Developments in Taiwan since 1949*, UK: Hurst & Co., 1993, pp. 1, 176-177.

15. Under PRC's "one country, two systems" formula, Taiwan would be recognised as a special administrative region with its own government, with its own domestic laws, with an independent judicial system, and with an independent armed forces. In return, Taiwan government

with this political dilemma with "three no's": no contact, no negotiation and no compromise with the PRC.<sup>16</sup> However, after 1987, the lifting of martial law in Taiwan, contacts between the people of Taiwan and those of the PRC have become common.<sup>17</sup> The PRC has been one of Taiwan's major trading partners, albeit through third countries.

Nevertheless, in a White Paper published September 1993, the PRC repeated in the strongest possible terms that Taiwan is part of China and must not drift into independence.<sup>18</sup> Once again, as with Hong Kong in 1982, the PRC was making the veiled threat of using the force option if it did not get its way. Taiwan, for its part, closely regulates private contacts with the PRC pending proof of its goodwill. To date, Taiwan has rejected PRC offers for a direct relationship in large part because of PRC's refusal to compromise on political issues: recognising Taiwan as a comparable political entity, lessening diplomatic isolation, and reducing the military threat.<sup>19</sup>

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would be required to abandon its claim to authority over the mainland and to recognise the PRC as its sole international representative. For an account of such proposal, see Harrison, "Taiwan after Chiang Ching-Kuo", *Foreign Affairs* (1988), pp. 790, 798-99.

16. See Steve Tsang, *supra* note 14, p. 172.

17. Li Dahong, "Mainland-Taiwan Economic Relations on the Rise", *Beijing Review* (Beijing: 3-9 April 1989), p. 24.

18. See *The Taiwan Question and Re-unification of China* (English edition), issued by the Taiwan Affairs Office and Information Office, State Council, the People's Republic of China, August 1993.

19. See Steve Tsang, *supra* note 14, p. 202.

## 1.2 Goals for the Study

This study attempts to present a legal *modus operandi* which is most suitable for the present Taiwan-PRC economic cooperation. The sheer volume of trade and investment activities between the two sides has in effect resulted in the creation of a *de facto* economic relationship of interdependency. It seems possible that direct Taiwan-PRC investment and trade links could help bring about the peaceful and eventual reunification of China.<sup>20</sup> The full and complete economic integration of Taiwan and the PRC, if realised, could be viewed as a step in this direction.

The recent collapse of communism in Eastern Europe and the Soviet Union has made the reintegration of the two Germanies, for example, a reality. Many Chinese people across the Taiwan Straits see their reunification as inevitable, just as those in the two Germanies looked forward to the day when they were able to reunite. For some of the leaders of Taiwan and the PRC, re-unification may even take on the role of a sacred mission that must be accomplished to make China whole again and to demonstrate to the world the strength of the Chinese people.

However, people in Taiwan who have grown up under a market economy and a developing democracy would prefer to wait until socio-economic conditions and legal reform in the PRC have approached a comparable and stable stage. How soon can we envisage the PRC finally renouncing its Marxist ideology of socialism and proletarian

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20. The further economic integration such as direct trade and investment activities between Taiwan and the PRC could be seen as a step for eventual reunification. The author was informed of this in accordance with discussions with many Chinese and Taiwanese businessmen while carrying out interviews in 1992 and 1994 in the PRC.

dictatorship of the so-called "Four Cardinal Principles"?<sup>21</sup> How soon can we see a final success of legal reforms achieved by the PRC?

While carrying out interviews in the PRC both in 1992 and 1994, the author was informed by knowledgeable PRC scholars that a closer Taiwan-PRC economic relationship may play an important part in advancing democracy as well as a real market economy in the PRC. The present socialist market economy of the PRC is a market economy, but still operates within the context of the socialist system. The governmental functions and planning role of the State in the PRC have not yet been laid aside.<sup>22</sup>

Before the re-unification of Taiwan and the PRC, and before the PRC recognises Taiwan as a comparable political entity, can we also imagine a legal framework protecting Taiwanese trade and investment in the PRC? My purpose is first, to produce a work of high academic standing, while at the same time promoting the cause of stronger bilateral Taiwan-PRC economic and legal relations; secondly, in the broader context to stimulate creative discussion and encourage formulations of possible solutions for a direct mutual exchange in economic activities across the Taiwan Straits.

As a result of the different political and economic systems, Taiwan-PRC legal relations also mirror East-West trade issues.<sup>23</sup> In terms of this trade model, it came

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21. These four cardinal principles are: socialist road, Marxism-Leninism and Mao Zedong Thought, the leadership of the Chinese Communist Party, and the people's democratic dictatorship.

22. For further studies, see Tian Jun, "China's Gradual Reform: A Comparison With Eastern Europe and the Former Soviet Union", *The Chinese Economic Association (UK) Newsletter*, Vol. 5, No. 4, December 1993, pp. 11-15.

23. In the past, the term "East" was defined to cover the socialist countries, for the most part in Eastern Europe

about because of the political structure after World War Two, namely the East-West confrontation. In other words, this trade model was characterised by military confrontation between the "East", which refers to the socialist countries in Central and Eastern Europe as well as the former Soviet Union (The Warsaw Pact), and the "West", the capitalist countries within NATO. In the past, it was possible to identify a common framework for foreign trade within the socialist countries, for example, the state monopoly of trade. However, with the collapse of the socialist regimes and the failure of their planned economies, these countries have embraced market-oriented reforms and abandoned the mandatory central planning system, by which they were formerly constrained.

In seeking routes to economic reform, the PRC, being included in the "East", has asserted that it is making substantial progress towards converting its economy to a socialist market-oriented economy with "Chinese

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and Asia; "West" to include the industrialised capitalist countries, largely in Western Europe and North America. See *A Selective Bibliography of East-West Commercial Relations*, ed., by K. Grzybowski, New York: Oceana Publications, 1973, p. 293. At present, "East" is defined to cover all socialist countries and "West" all industrialised capitalist countries. The PRC should be categorised in the "East". See A. R. Dicks, *The People's Republic of China in East-West Business Transactions*, ed., by R. Starr, New York: Praeger Publications, 1974, p. 391. For further studies on PRC's establishment of the so-called socialist market economy in 1992, see Prof. Gao Shangquan, "China's Socialist Market Economy", and Zhu Rongji, "The Establishment of a Socialist Market in China", speech report printed on *The Chinese Economic Association (UK) Newsletter*, Vol. 4, No. 4, December 1992, pp. 11-16. Taiwan should be included in the "West" since it has developed into a modern industrial economy with a structure very similar to western industrialised nations. See Yuan-li Wu, *Becoming an Industrialised Nation - ROC's Development on Taiwan*, New York: Praeger Special Studies, 1985; and also *Taiwan Enterprises in Global Perspective*, (ed.), N. T. Wang, New York: M. E. Sharpe, 1992.

characteristics."<sup>24</sup> The extent of such development differs from that of European socialist countries, as it is dependent on factors such as political stability, proximity with the "West", historical and social background, and so on. It is now generally accepted that the PRC still maintains the validity of socialism emerging among the former socialist countries of the East European bloc.

To date, it seems that there is little up-to-date coverage of the literature with regard to this trade model. Unlike former Soviet and East European variants of market socialism, the PRC has not totally changed the nature of its trade (being in the "East") towards those of countries of the "West" including Taiwan. There remains a conflict between ideologies. Taiwan, to a considerable extent, is a capitalist system, while the PRC still firmly advocates socialism. The political confrontation between the two still exists, though they are more concerned with economic integration with each other.

Public ownership system still remains the mainstay of the PRC's economy.<sup>25</sup> And, to the extent that the PRC still relies on state planning, its economic activities are inherently discriminatory.<sup>26</sup> Despite significant

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24. For further discussion, see Cheng Yuan, *East-West Trade - Changing Patterns In Chinese Foreign Trade Law And Institutions*, New York: Oceana Publications, Inc., 1991), pp. 321-328. Also see, Long Yonglu, "China's Readmission to GATT - GATT & China's Socialist Market 93-138", FBIS-PRC, 21 July 1993, pp. 3-7; Decision of the CPC Central Committee on Issues Concerning the Establishment of a Socialist Market Structure (14 November 1993), *China Economic News*, 29 November 1993, p. 1.

25. See Chris Yeung, "Public Ownership Remains Mainstay", *South China Morning Post*, 26 November 1993, p. 1.

26. In a planned economy, the tariff and non-tariff that the GATT is designed to prevent are not the major impediments to free trade. Rather, the impediments are governmental control and direction over purchases and

economic reforms, the state enterprise system still produces ninety percent of the gross domestic product of the PRC.<sup>27</sup> The PRC's foreign trade system vis-a-vis Taiwan still follows the "East"/"West" divide. In this context, the "East" as used here is defined as meaning the socialist countries, and the "West" as meaning the capitalist countries. Taiwan is considered to be a country in the West and the PRC, of course, should be included in the East. Both parties, under the circumstances of mutual non-recognition, have experienced many legal problems in developing their trade and investment ties. Therefore, above all, this thesis analyses the legal aspects of Taiwanese trade and investment in the PRC and the methods of legal settlement for handling commercial conflicts.

Under the model of East-West trade between countries of mutual public non-recognition, the methodologies of comparative analysis and theoretical approach are the characteristics of this thesis. As the Taiwan-PRC situation is unique in looking forward to future reunification, the two regimes may look to foreign experience on both theoretical and practical levels to help rebuild, at the very least, a prosperous economic relationship.

It is hoped that, by using comparative analysis and theoretical approach of trade and investment, this thesis can show a capacity for critical analysis and a good grasp of the legal issues involved.

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prices. Thus, even the elimination of a trade barrier may not result in increased imports to the country, if the planning authorities decide against such imports or direct the price to below cost levels. Robert E. Herzstein, "China and the GATT: Legal and Policy Issues Raised by China's Participation in the General Agreement on Tariffs and Trade", 18 *Law and Policy of International Business* (1986), p. 375.

27. Chris Yeung, *supra* note 25.

### 1.3 Sources and Structure of the Study

In common with many other foreign businesses, Taiwanese trade and investment in the PRC has been hard pressed to stay on top of PRC's fast-changing rules, regulations, attitudes, and practices. Indeed, doing business with the PRC, especially in recent years, is perhaps more problem-ridden than formerly. The watchword in the PRC is reform, which translates into changes, experimentation, uncertainty, and often, grave risks. Seeking a fruitful source of reliable data and analysis has therefore been essential for my research work in this field.

In addition to studies in London, I have carried out several interviews and collected much legal material available in both Taiwan and the PRC on these issues from the following four sources: historical-background information about Taiwan-Chinese trade and investment activities as provided by both Taiwan and the PRC governments; legal problems of Taiwanese trade and investment in the PRC and other material published in official publications; literature on legal resolution affecting Taiwanese trade and investment in the PRC, published in both English and Chinese; and, finally, literature regarding East-West trade and foreign investment issues which are related to the PRC.

Since more detailed and up-to-date information in this field is not available in Britain, my field-work in Taiwan and the PRC respectively in 1992 and 1994 has enriched the contents of my discussions and substantially contributed to the quality of the whole research work.

This thesis contains seven chapters. The first chapter outlines evolution of the general environment across the Taiwan Straits. After it, this chapter goes on to outline the goals, sources and structure of the

study. Appendix I of this thesis gives a full contrast of major events affecting Taiwan-PRC economic relations since 1949.

The second chapter first considers factors bearing upon the possible formation of a Greater China, before proceeding to examine the reality of PRC's economic reforms. After an analysis of the political-economic aspects of Taiwan-PRC trade and investment links, attention turns to Taiwan-PRC trade and investment links, and Hong Kong's role, seen as an economic linkage triangular in form. Patterns of trade and investment are examined in detail, illustrated with examples of some investments which came to fruition and some which, in the end, did not. Lastly, the chapter deals with the role and achievements of bodies serving as channels to bridge the still substantial ideological gap separating Taiwan and the PRC, from which position a conclusion is drawn.

The third chapter sets out a brief discussion of a re-united country, and introduces the background to Taiwan-Chinese trade and investment links. It continues by describing the legal framework for private business relations between the two regimes. From these considerations, some conclusions are drawn. Appendix II of this thesis supplies useful referential figures of Taiwanese trade with and investment in the PRC since 1979.

In the fourth chapter, detailed consideration is given to the legal problems of Taiwan-PRC business contracts as these concern trade and investment. This in-depth examination includes reference to several problems which commonly arise in this context, and analyses the methods currently utilised in the conduct of such business.

In the fifth chapter, attention is turned to the problems of legal protection of trade and investment between the two regimes. Discussion includes existing PRC measures and laws, their legal effectiveness and significance as they affect Taiwanese businesses in the PRC. Appendix III of this thesis presents a full text of the new legislation of PRC's Law on Protecting Taiwanese Investment. Appendix IV looks at several important features of Taiwan's Mainland Relationship Statute relating to trade and investment activities.

The sixth chapter focuses on the ongoing issue of legal solutions presently available for settling business conflicts of trade and investment between Taiwan and the PRC. It highlights the relative roles of arbitration and litigation in resolving such disputes.

The final chapter begins with an examination of Taiwan's growing economic convergence with the PRC. It summarises the peculiar "shetai" (Taiwan related) economic relationship, and, arising from that relationship, the desirability of evolving a process for Taiwan-PRC Joint Mediation and Arbitration. It also looks at the feasibility of signing bilateral agreements covering judicial assistance in commercial matters. Finally, it suggests some implications for the future of this relationship.

## CHAPTER TWO

### A "GREATER CHINA" EMBRACING THE PRC, TAIWAN, AND HONG KONG

In the post-Colonial era, what is known to historians as "China proper" (the part of China that became the People's Republic in 1949) and the "China periphery" (Taiwan, the British colony of Hong Kong and the Portuguese colony of Macao) each survived and prospered, to varying degrees, as different sovereign, political, social and economic regimes. While different proposals and numerous efforts have been made to reunite China proper and the periphery, repeated political confrontations between the PRC and Taiwan have effectively prevented Chinese national reunification.

If one could make a general statement about the factors affecting Taiwan's reunification with China, or its separation or independence, it might be this: politically, Taiwan is going its own way; there is little or no convergence, so to speak, with the PRC. Economically, it is integrating with the PRC. These are two contradictory trends and it is difficult to say which will prevail. However, it may be relevant to note the following: if the new world order is based on economic power, and commercial or trade blocs come into being, the PRC and Taiwan are probably going to be in the same bloc -- either a Pacific Rim bloc led by Japan or a "Greater China". This is a global trend of great prominence, along with the demise of communism, a global economy, regionalism, and so on.<sup>1</sup>

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1. See David Shambough, "Introduction: The emergence of Greater China", *China Quarterly*, December 1993, p. 653.

## 2.1 The PRC's Economic Reform: Toward a Real Market Economy?

The PRC's economic reforms represent a process of transition from a planned economy to market economy, and essentially involve decentralisation efforts of the government. There existed doubts about a centrally planned economy in the PRC for thirty years since 1949.<sup>2</sup> Indeed, it was in response to the failure of such a system, that the PRC launched its reform programme in 1979. Though the PRC adopted a gradual approach and conducted its reforms in an experimental and fragmentary manner, it was a market-oriented reform from the outset.<sup>3</sup> The slogan of "crossing the river with the guidance of stones" (*mozhe shitou guohe*) provides a vivid illustration of the PRC's perception of the aims of its reforms.

In accordance with this approach, the PRC shaped its regional preferential policy by setting up four Special Economic Zones (SEZs) in Guangdong and Fujian to experiment with such reform. While some reforms were supported by laws and regulations, many policy statements were directly put into practice. In 1987, the PRC's economic reforms were given a further boost by the call for the establishment and strengthening of the role of the market in the entire economy. The principle employed was "the state regulates the market, while the market

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2. For further studies, generally, see Xue Muqiao, *China's Socialist Economy*, 1981; Gregory C. Chow, *The Chinese Economy*, 1985. Such an economic system sometimes is classified as "Non-market Economy".

3. Since 1979, the PRC has conducted agricultural and industrial reforms with several commercial, investment, and trade reforms. See Alvin Rabushka, *The New China - Comparative Economic Development in Mainland China, Taiwan and Hong Kong*, San Francisco: Westview Press, 1987, p. 85.

guides enterprises" (*guojia tiaojie shichang, shichang yindao qiye*).<sup>4</sup>

Having thus restated that the market was only an economic force, the adoption of a market economy as the PRC's ultimate goal in economic reform was viewed as the most appropriate way of achieving its aim of economic modernisation.<sup>5</sup> In October 1992, the PRC officially abandoned the idea of a planned economy, as well as limited-market reform, and declared its total commitment to a market economy. However, after fourteen years of reform, is there any real "market" in the PRC? As administrative manipulations are still existing, a "free market" in the strict Western understanding is therefore not yet truly in operation in the PRC.

At present, many economic reform measures in the PRC may not have yet taken root or been meaningfully implemented and accordingly have only symbolic meaning. Furthermore, such measures are initiated and implemented by those government officials and institutions which may still work under their old ways of "mandatory plans" and "guiding plans" which have been used since the 1950s. The gradualism approach for a real market economy increases the sense of uncertainty and makes predictability even less apparent. Such a transitional state of the PRC economy undoubtedly affects the making of laws and regulations and in particular their implementation.

According to a speech made by the PRC Vice-Premier Zhu Rongji in London in 1992, the PRC is still a socialist country and public ownership will remain the

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4. For the text, see *Beijing Review*, Vol.30, No. 45, 1987 pp. 1-XXVII.

5. For example, see Fang Sheng, "Opening Up and Making Use of Capitalism", *Beijing Review*, Vol. 35, No. 12, 1992, pp. 17-19.

mainstay of the PRC economy.<sup>6</sup> The most recent news of 1995 from Beijing reported that the PRC had decided to expand the role of old-style state planning to not just economic but social policy.<sup>7</sup> It is beyond doubt that a real "market" in the strict capitalist sense (the West) is therefore not yet truly in operation in a typical socialist country such as the PRC (the East).

## 2.2 Political-economic Aspects of Taiwan-PRC Relationships

Historically, the PRC and Taiwan have continued their hostility since the ending of the 1949 civil war. This civil war resulted in a divided China with the Communist regime remaining in the mainland and the Nationalist government moving to Taiwan. The intransigence of both states resulted in an almost complete breakdown of private and commercial relations for thirty years.

However, since the beginning of the 1980s, one of the most widely debated issues regarding Taiwan and the PRC, has been investment and trade relationships between the two. As both the PRC and Taiwan have existed almost entirely as mutually exclusive entities, they do not publicly recognise each other; each claims that there is only one China of which it is the sole legitimate government. There are *de facto* two entities with lawful international personalities which exist separately on either side of the Taiwan Straits.<sup>8</sup>

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6. See the text of speech (on file with the author) made by Zhu Rongji at the Royal Institute of International Affairs in London on 16 November 1992.

7. Willy Wo-Lap Lam, "Beijing to Increase State Planning Role", *South China Morning Post*, 14 September 1995, p. 1.

8. The Republic of China on Taiwan is a *de facto* entity with international personality: it carries out a full range of foreign relations, including entering into

In the 1950s, trade between the two sides was non-existent and was regarded as illegal in Taiwan. Each side viewed the other as a mortal enemy fighting to the death. Since 1949, the PRC has been striving to isolate Taiwan diplomatically from the international community. Diplomacy has been waged in all or nothing terms, with the international community recognising one or the other but never both. This has given rise to the situation of thirty nations recognizing Taiwan and more than 150 nations recognizing the PRC.<sup>9</sup>

After the PRC became more tolerant of foreign trade by adopting its "Open Policy"<sup>10</sup> in 1979, foreign companies were faced with the choice of doing business either in the PRC or in Taiwan. By convention, they could not operate in both. Otherwise, they risked being penalised by either of the two governments for trading with the enemy. However, the economic reforms flowing from a softening of policy eased the political tension between the two regimes. Private and commercial

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international agreements and sending and receiving official missions. For studies on this, see Hungdah Chiu and Robert Donnen (eds.), *Multi-System Nations and International Law*, Baltimore: University of Maryland, School of Law, Occasional Papers/Reprints Series in Contemporary Asian Studies; James Crawford, *The Creation of States in International Law*, London: Oxford University Press, 1979, p. 36.

9. At present (1995), Taiwan maintains diplomatic relations with thirty states, and has close economic and cultural relations with more than 120 countries. In addition, it has sixty four official or semi-official trade missions in forty two nations.

10. In 1978, The PRC adopted an "open-door" policy (duiwai kaifang zhengce), which represented a quest for economic development through the adaption and diffusion of foreign technology. Special economic zones and development zones were set up and coastal cities opened up to attract foreign investment. See Cheng Yuan, *East-West Trade, Changing Patterns in Chinese Foreign Trade Law and Institutions*, New York: Oceana Publications, Inc., 1991, p. 74.

relationships have been permitted and even encouraged by the authorities of Taiwan and the PRC.

In December 1988, the PRC even allowed Taiwan to use a formula of "Chinese Taipei" or "Taipei China" to return to the Asian Development Bank.<sup>11</sup> Co-existence with the PRC and allowing Taiwan room to establish its international presence is believed to be at the heart of developing links across the Taiwan Straits and laying the groundwork for negotiating re-unification of Taiwan and the PRC.<sup>12</sup>

Since the political relationship across the Taiwan Straits had developed from one of mutual enmity to one of peaceful co-existence, Taiwan further pronounced the end of "The Period of National Mobilisation for Suppression of the Communist Rebellion" on May 1991: the PRC is no longer "the enemy" as hitherto. Hostilities between the two regimes have gradually become ritualised in the form of diplomatic games which are played out every once in a while.<sup>13</sup>

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11. In December 1988, the PRC contended that the "Taipei China" formula, which was used in the Asian Development Bank, was a special arrangement that should not be universally applicable to other inter-governmental and international organizations. It opposed the establishment of official ties and contacts with Taiwan by countries enjoying diplomatic relations with the PRC, while tolerating economic, trade, and cultural exchanges of an entirely unofficial nature. See *China Daily* (Beijing), 20 December 1988, p. 1.

12. Chao Man-ke, "Elastic Diplomacy: A Blessing or a Plight to Reunification of China?" *Mingbao Yuekan* (Hong Kong: Ming-Pao Monthly), no. 3:22, 1989; Lin Cheng-i, "Taiwan's Tactics in the Asian Development Bank", *Guojia Zhengce* (Taipei: National Policy), no. 4, 15 December 1989, p. 34; Ramon H. Myers, "Taiwan Deserves to Join the World Community", *The Asian Wall Street Journal*, 21 December 1989, p. 6.

13. One such recent event was the 1993 policy paper on Taiwan issued by the PRC in which it reiterated its goal of peacefully unifying China under the "one country two systems" scheme, offering Taiwan terms even more favourable than those devised for the PRC's takeover of

According to Taiwan's Foreign Minister Mr. Frederick Chien, Taiwan must not consider the People's Republic of China to always be an adversary. In certain areas there may be compatibility.<sup>14</sup> One such area that the two regimes have in common is business only, which always means trade and investment activities across the Taiwan Straits.

"Once opened, the door of exchange can never be closed again" -- This is the generally accepted view of exchanges across the Taiwan Straits. However, evolution of these relations was hailed by the PRC as one of its three primary goals for reunification.<sup>15</sup> To be sure, both Taiwan and the PRC do share some common grounds: they agree that there is only one China, that Taiwan and the mainland are both parts of China, and they both seek peaceful unification and the promotion of positive developments across the Taiwan Straits.

For the moment, however, there seems to be no way to strike a balance for the achievement of these goals. For example, the PRC still insists on "one country, two systems"<sup>16</sup> as an orientation, while Taiwan advocates "one

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Hong Kong in 1997. However, trade and investment continued as usual.

14. "Taipei's Challenge: The China Question", in *The International Herald Tribune*, 23 August 1993, p. 9.

15. Zongda Yan, "Liang'an Jingmao Guanxi yu Woguo de Dalu Jingmao Zhengce" (Cross-Straits Commercial Relations and Our Mainland Commercial Policy), *Zhonghua Zhanlue Xuekan* (Taipei: China Strategic Studies Journal), 44 (Summer 1990).

16. Under PRC's "one country, two systems" formula, Taiwan would be recognised as a special administrative region with its own government, with its own domestic laws, with an independent judicial system, and with an independent armed forces. In return, Taiwan government would be required to abandon its claim to authority over the mainland and to recognise the PRC as its sole international representative. For an account of such

country, two governments"<sup>17</sup> (or "one country, two regions"). In the area of preset stances, the PRC supports the "santong siliu" (three links, four exchanges)<sup>18</sup> and the immediate initiation of negotiation, while Taiwan hopes for a more gradual approach divided into near-, medium- and long-term stages.<sup>19</sup>

Ever since 1987 when Taiwan relaxed its stance against the PRC by allowing its residents to visit their mainland Chinese relatives, the business activities of investing and trading with the PRC have been growing, if not actually bursting into bloom, at a phenomenal rate. Despite the government's policy of forbidding direct

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proposal, see Harrison, "Taiwan after Chiang Ching-Kuo", *Foreign Affairs* (1988).

17. Since 1987, Taiwan has opted for a more flexible and pragmatic foreign policy and countered PRC's "one country, two systems" with the "one country, two governments" concept. Under this formula, Taiwan and the PRC would be considered as equals, each with extensive authority over only their respective present areas of control and with joint international status. For further studies, see James Cotton, "Redefining Taiwan: 'one country, two governments'", *The World Today* (December 1989), pp. 213-16.

18. On 1 January 1979, the PRC called for establishing "three links" (mail, trade, and air and shipping services) and "four exchanges" (relatives and tourists, academic groups, cultural groups and sports representatives) with Taiwan, as a first step towards the ultimate goal of reunification. See "National People's Congress Standing Committee Messages to Compatriots in Taiwan", *Beijing Review*, vol. 22, no. 1, 5 January 1979, pp. 16-17.

19. In its work on advancing the reunification of China, Taiwan formulated the "Guidelines for National Reunification" on 5 March 1991. The Guidelines set the goal of China's reunification as a free, democratic, and equitably prosperous country, to be achieved through three phases under the principles of reason, peace, parity, and reciprocity. For further studies, see Ying-jeou Ma, "Policy Towards The Chinese Mainland: Taipei's View", *Issues and Studies* (Taipei), vol. 28, no. 6, June 1992.

trade and investment links, businessmen in Taiwan and the PRC have been conducting commerce through a third intermediary. The value of such indirect trading was US\$14,39 billion in 1993 placing Taiwan as the PRC's fourth largest trading partner.<sup>20</sup> From 1987 to 1993, total Taiwanese investment in the PRC amounted to US\$14.18 billion, second only to that of Hong Kong which was US\$111.53 billion.<sup>21</sup>

Although the PRC has made continuous efforts to promote direct trade and investment with Taiwan, Taiwan is still insistent that all contacts should be indirect.<sup>22</sup> Trade and investment must pass through an intermediary which is most often Hong Kong, or Singapore. It is only through such methods that Taiwan businesses can own and control enterprises in the PRC. However, Taiwan's rift with the PRC shows gradual signs of mending.

Until its repeal in May 1991, the Statute for Punishing Rebellion, which had been promulgated by Taiwan in June 1949, prohibited all commercial contact between citizens within its jurisdiction and those within areas controlled by the PRC. In practice, businesses from Taiwan had begun to trade with and invest in the PRC from about 1983, and since then this trend has developed into

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20. *Zhongguo Youbao* (Taipei:China Post), 20 January 1994, p. 10.

21. See Zhong Qin, "Liang'an Jingmao Jiaoliu" (Exchange of Trade and Investment Across the Taiwan Straits), *Jingji Chienzan* (Taipei: Economic Outlook), Vol. 33, p. 49, 10 January 1994. It is generally believed that a significant portion of the Hong Kong investment is in fact from Taiwan.

22. After the formal lifting of the ban on direct trade with North Korea and Cuba in September 1991, the PRC is the only country with which Taiwan bans direct trade. See *Asian Bulletin* (Taipei), vol. 16, no. 11, November 1991, p. 26.

a major structural shift in Taiwan's visible trade and investment.

Opening of direct trade and investment within the next few years is believed to be inevitable. It has been reported that the Taiwanese government will eventually be forced to lift the barriers on direct trade and direct investment with the PRC.<sup>23</sup> According to Taiwan government's three-stage unification plan<sup>24</sup> published in March 1991, direct business activities with the PRC can be conducted only if there is an equal, reciprocal relationship between the two governments.

The Taiwan Legislature passed a statute<sup>25</sup> in July 1992 aimed at regulating Taiwan-PRC economic and social relations. However, attempts to curb the tide of investment (i.e., by limiting commercial activities to indirect trade conducted via an intermediary) were overtaken by market forces. The two sides of both Taiwan and the PRC have been holding a series of semi-official

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23. *Jingji Ribao* (Taipei: Economic Daily News), 18 March 1991, p. 1. It was reported that Taiwan government would allow direct trade links with the PRC in one to six years. Furthermore, in September 1992, Taiwan's Legislative Yuan issued a document entitled "The Issue and Outlook for Direct Air and Sea Links Across the Straits" which set down several conditions for direct links with the PRC. See *McKenna China Newsletter* (Hong Kong: February 1993), no. 85, p. 23.

24. *Supra* note 18. See the full text of Taiwan's Guidelines for National Unification, reprinted in *Zhongyang Ribao* (Taipei: Central Daily News, Overseas Edition), 7 March 1991, p. 1.

25. *Taiwan Diqu yu Dalu Diqu Renmin Guanxi Tiaoli* (Statute Governing Relationship between People of the Areas of Taiwan and the Mainland) (hereinafter, Taiwan's Mainland Relationship Statute, or TMRS) (1992). An English translation text is seen Ada Koon Hang Tse, "The Emerging Legal Framework for Regulating Economic Relations Between Taiwan and Mainland China", *Journal of Chinese Law* (1992), Vol. 6, No. 2, pp. 179-210.

meetings on handling the fast growing commercial, social, and tourism interactions.<sup>26</sup>

While Taiwan and the PRC have entered a state of détente, neither side is willing to recognise the other as a legitimate government, and deep mistrust still exists between the two regimes. There are certain major political obstacles standing in the way of progress on other fronts. The most important of these are the issues of Taiwan independence, Taiwan's desired recognition as a comparable political entity under the "One China" premise, and the PRC's threat to use force for reunification. If these key points are not resolved, the growth of political ties, or the further normalisation of relations required for coordinated economic cooperation will not be possible.

These political obstacles notwithstanding, economic interaction and a degree of economic interdependence between Taiwan and the PRC have developed as a result of indirect investment and trading activities between the two which began in the late 1970s, and which have continued even since at an increasing rate. The PRC can make use of Taiwan's capital, management, marketing, and production techniques while Taiwan can make use of PRC's cheap labour, raw materials and potential market.

True, the momentum for this lively economic activity may well have owed its origin to self-interest, but it has also been fuelled by the common linguistic, cultural and ethnic background shared by the people on both sides of the Taiwan Straits, influences stronger than mere

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26. Prior to 30 March 1994, there were four rounds of Taiwan-PRC talks in order to settle technical issues between the two regimes. The talks were organised by Taiwan's semi-official Straits Exchange Foundation (SEF) and its PRC counterpart Association for Relations Across the Taiwan Straits (ARATS). See George T. Crane, "China and Taiwan: Not yet 'Greater China'", *International Affairs* 69, April 1993, p. 713.

geographic proximity. While it is entirely possible to envisage several different scenarios for the future Taiwan-PRC relationship, the most likely one, at least in the light of the foregoing, appears to be co-existence based on economic cooperation, coupled with political and legal *modus vivendi*.

### 2.3 Intensifying a Triangular Economic Linkage

In 1979, the PRC spearheaded its "open policy" by creating "Special Economic Zones" (SEZs) in four coastal cities of Guangdong and Fujian provinces. It became obvious that the choice of Shenzhen, Zhuhai, Shantou (all in Guangdong) and Xiamen (in Fujian) as the pilot sites for SEZs was meant to target ethnic Chinese business communities in Hong Kong, Macao, Taiwan, and elsewhere in the world. The PRC not only encouraged traditional Confucian values of kinship and ancestral ties but also offered special tax breaks to those so-called compatriot (*tongbao*) or overseas Chinese (*huaqiao*) investing in the SEZs.<sup>27</sup> As the "open policy" has achieved a high level of success, these investments have spurred an economic boom in the two provinces where various political and economic incentives were utilised.<sup>28</sup>

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27. Chinese nationals living in Hong Kong, Macao and Taiwan are in Chinese law referred to as "Hong Kong, Macao and Taiwan compatriots" (*gang-ao-tai-tongbao*), who are occasionally treated as "overseas Chinese" (*huaqiao*). For further studies, see Yuan Cheng, "Law and Policy of the People's Republic of China on Nationality", *Immigration And Nationality Law & Practice*, October 1990, pp. 136-144.

28. For a detailed account of the PRC's utilisation of *huaqiao* "patriotism", see Hsin-Huang Michael Hsiao and Alvin Y. So, "Ascent through National Integration: The Chinese Triangle of Mainland-Taiwan-Hong Kong", in Ravi Arvind Palat, ed., *Pacific-Asia and the Future of the World System* (Westport, Connecticut: Greenwood Press, 1993), pp. 133-147.

Since the founding of the PRC in 1949, Hong Kong has served as the single, most crucial linkage between the PRC economy and the world capitalist economic system. In spite of the early PRC economic policy of "leaning to one side" (toward the Soviet Union and its communist bloc) and the Sino-U.S. military clash over Korea, the PRC imported most of its strategic supplies through Hong Kong. The U.S.-led United Nations embargo against the PRC did not prevent "significant quantities of strategic supplies" from being smuggled into the mainland.<sup>29</sup> However, steady trade and investment between Hong Kong and the PRC was not established until the PRC's economic reform of implementing the SEZ policies in 1979.

As Yun-wing Sung's study illustrates, since the inception of Beijing's "open policy", Hong Kong has played a multiplicity of roles in the PRC's economy: as financier, trading partner, middleman, facilitator, and so on.<sup>30</sup> It can be said that, without Hong Kong's consistent participation, the success of the PRC's economic reform programmes would have been limited. Further, without Hong Kong acting as a buffer zone against a possible ending of the PRC's "open policy", foreign participation including that of Taiwan in the PRC economy would not have been as substained, particularly in the immediate aftermath of the 1989 Tiananmen Square incident.

Officially, trade between the PRC and Taiwan did not exist before 1988, the year after Taiwan lifted its ban on private visits among Chinese families living on both sides of the Taiwan Straits. In reality, 1988 was merely the year underground trading activities between the two

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29. Yun-wing Sung, *The China-Hong Kong Connection: The Key to China's Open-Door Policy*, Cambridge: Cambridge University Press, 1991, p. 5.

30. Sung, *ibid.*, "The Pivotal Role of Hong Kong", pp. 15-43.

came out in the open. Since then, in spite of obvious political uncertainties, Taiwanese trade and investment in the PRC has increased steadily and has reached a very significant level. For example, officially approved Taiwanese investment in the PRC has reached eighteen provinces, covering nineteen major industries in 1993<sup>31</sup> and since 1994, the PRC has become Taiwan's largest trading partner.<sup>32</sup> A decade ago, one could not have imagined this. The growing, integrated economic ties across the Taiwan Straits will continue to lead, unless political difficulties arise, to the removal of barriers, and to the building of better relations between the two regimes.

The PRC has also played a prominent role in Hong Kong's economy. In monetary terms, it is Hong Kong's largest outside investor, followed by Japan and the United States. Since PRC investment is concentrated in Hong Kong's strategically important industries such as banking, real estate, air and water transportation, the former is poised to play a long-term role in the latter unless political instability within the PRC or Sino-British difficulties over the future of Hong Kong are so great, that the PRC has to withdraw from its role to a significant extent. Moreover, were it not for Taiwan's opposition to two-way trade and investment, the PRC would have already played a part in Taiwan's economy.

However, to suggest that economic interaction and mutual interdependence (which have been created by trade and investment) will continue to increase, one must make certain assumptions. Increased economic ties will

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31. See the report of Taiwan's Investment Commission, Ministry of Economic Affairs, *Statistics on Approved Indirect Mainland Investment by Area and by Industry*, May 1993, pp. 68-73.

32. See "Trade With Mainland Grows", *Free China Journal* (Taipei), 2 September 1994, p. 3.

certainly be contingent upon the PRC continuing its drive toward free market capitalism. Leaving Hong Kong aside, could the PRC easily merge Taiwan's capitalist style economy with its own socialist economy? In her speech in Taipei in August 1992, Lady Thatcher (the former British Prime Minister) pointed out several conditions for increasing meaningful ties across the Taiwan Straits. As she observed:

"Still the PRC must continue privatising state-owned industries while making its economic links with Taiwan. It must resolve the contradiction of a capitalist economic system and a communist political system. It must continue to allow foreign influence in the PRC, including Western and Overseas Chinese as well as Taiwanese influence. It must develop a legal system that is conducive to the further development of a market economy."<sup>33</sup>

Therefore, what political significance can be drawn from the situation described above? Chinese intellectuals are among the most energetic in analysing the political implications that such economic linkages may have for the future of Chinese national reunification of the PRC, Taiwan, and Hong Kong. They express much optimism in deeper economic interaction among the three territories to the extent that some see as feasible the formation of a pan-Chinese economic bloc or an economic "Greater China" as the first step towards Chinese national reunification. Such optimism may well be ill-founded because the proposition that existing economic linkages will lead to political reconciliation between the PRC and Taiwan is very problematic.

#### 2.4 Patterns of Trade and Investment

By the end of 1994, the PRC's proposals for direct trade and investment between itself and Taiwan had not

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33. See "The Future Has No Borders", *Free China Review* (Taipei), Vol. 42, No. 9, September 1992, p. 35.

become reality, but indirect trade and investment had grown explosively. The unwillingness of the Taiwan authorities to negotiate with PRC officials continued to impose limitations even on indirect intercourse, but in 1993 two-way trade jumped to US\$8.68 billion from US\$77 million in 1979 (See Appendix II). The PRC's imports from Taiwan includes textile machinery, telecommunications equipment, petrochemicals, television sets, motorcycles, and so on. For its part, Taiwan buys textile items, raw materials, Chinese herbal medicines and so on from the PRC.

In order to attract Taiwan's businessmen, the PRC announced in April 1980 that Taiwan's products would be duty-free as "inter-provincial material exchanges"; in addition, Taiwan's ships which are "nationality ships" would not be charged tonnage-tax.<sup>34</sup> This most-favoured-status policy toward Taiwan had shortcomings in that some other countries, through false labelling and other means, took unfair advantage of this tariff relaxation. As a result, the PRC cancelled this duty-free policy.<sup>35</sup> However, at the same time, the PRC announced another approach to woo its antagonist: "Taiwan imports, by whatever channel, are still considered domestic products and thus exempt from customs tariffs. Instead, they are charged a lower adjustment tax which the PRC uses to regulate inter-provincial trade".<sup>36</sup>

It is evident that the PRC's huge potential market and the economic incentives offered are tempting bait, attractive to Taiwanese businesspeople. As a result, some private and indirect trade has gone on since 1979. The PRC's ultimate goal is direct rather than indirect

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34. See *Renmin Ribao*, 5 April 1980, p. 1.

35. The policy was abolished in May 1981. *Remin Ribao*, 12 May 1981, p. 1.

36. *Ibid.*

trade. The significance of the former will be greater than the latter both politically and economically. In May 1985, the PRC even announced that Taiwan's products would be completely duty-free if they were genuinely imported from Taiwan, and if the businesspeople were truly Taiwanese compatriots.<sup>37</sup>

In response to such an overt political deal, Taiwan was placed in a dilemma about how to handle this issue. Then, in July 1985, Taiwan announced three principles governing trade with the PRC: no direct trade would be permitted; businesspeople were prohibited from contacting PRC parties; and entrepôt trade was allowed.<sup>38</sup> Thus, entrepôt trade with the PRC has been officially permissible since 1985. It should be noted, however, that Taiwan could only then export to, but not import from, the PRC. In July 1988, Taiwan started to allow the indirect import of raw materials from the PRC through a third country as part of its new liberal policies.<sup>39</sup> In June 1989, in order to prevent the export of sophisticated products to the PRC, Taiwan formally relaxed its trade policy of permitting only entrepôt trade, to allowing also indirect trade with the PRC.<sup>40</sup>

In a nutshell, Taiwan's trade policy toward the PRC thus far can be summarised by three points: prohibition of direct trade; no interference with entrepôt or indirect trade; and gradual relaxation of the regulations governing imports of PRC's raw materials. These points

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37. Liang Mien-kuan, "The Golden Route Between Taiwan-Hong Kong-China", *Jiuling Niandai* (Hong KONG: The Nineties), May 1985, p. 11.

38. See *Zhungyang Ribao*, (Taipei: Central Daily Nwvs), 5 July 1986, p. 1.

39. See *Free China Journal* (Taipei), 18 July 1988, p. 8.

40. Taiwan said that this policy would make it easier to control the export destination. See *Zhungyang Ribao* (Taipei), 26 June 1989, p. 2.

do not mean that Taiwan is forever to bar direct trade with the PRC. Direct trade between the two is possible only if Taiwan can be recognised and treated as having equal political status.<sup>41</sup>

As for indirect investment, Taiwan began this process on a small scale in the mid-1980s and investment apace after travel to the PRC was authorised in 1987. Because investment is indirect, generally through companies in Hong Kong, accurate figures for amounts actually invested are not available. However, according to relevant sources, the PRC absorbed Taiwan investment totalling at least US\$14 billion between 1979 and 1993 (See Appendix II). One obvious reason for this amount is that the PRC offered special incentives to Taiwan investors both within its SEZs and elsewhere.

Initially, individual investments to the PRC were small, mostly under US\$ 1 million, and frequently involved the shipment of used machinery from factories that were no longer profitable to operate in Taiwan. Many plants involved simple operations - processing, finishing, or assembling materials and components shipped from Taiwan. Uncertainties about future economic and political conditions in the PRC caused investors to take a short-term view, investing in projects that had good prospects for allowing recovery of their investment within two or three years.<sup>42</sup>

A typical example of such investment was a shoe factory set up in Fujian province with machinery shipped from Taiwan. At first, it had only a single assembly line with several hundred workers recruited locally,

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41. See art. 35 of Taiwan's Mainland Relationship Statute (TMRS) of 1992.

42. The author was informed of this by the Taiwanese investors based in the PRC while carrying out interviews in the PRC in 1992 and 1994.

where labour was cheap. Materials were sent from Taiwan to be assembled into finished shoes, which were then exported to the United States or other countries. This type of operation did not bring in high technology, but it was advantageous to the PRC as it absorbed surplus labour and earned foreign exchange. The Taiwanese owner supplied a small amount of capital, plus management skills, marketing expertise, and connections.<sup>43</sup>

Like that of other foreign investors in the PRC, Taiwanese investors were often beset by problems. In particular, because no official relations existed between the two governments, these investors could not seek governmental assistance when trade disputes arose. Electric power was frequently unreliable, requiring investors to supply their own generators to assure quality and meet deadlines.<sup>44</sup> The need to import materials and components from abroad led to delays caused by inefficiencies in the PRC customs service. The need to operate through a dummy paper company in a third country, usually located in Hong Kong, and to travel and ship goods through it added to costs. Moreover, it took between two and six weeks for a Taiwan passport holder to obtain a visa for Hong Kong.<sup>45</sup>

A classic example of a frustrated Taiwanese investment project in the PRC is the case of the Formosa Plastics Group. This Group, the largest private industrial company in Taiwan, announced in 1990 the possibility of investing up to US\$7 billion in a petrochemical facility in Fujian province of the PRC. The proposed project, which would include an oil refinery and two naphtha crackers capable of producing over one

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43. The author interviewed a Taiwanese shoe manufacturer based in Fujian province in 1992.

44. Ibid.

45. Ibid.

billion metric tons of ethylene per year, was expected to lead in addition to many "downstream" petrochemical industries in the PRC.<sup>46</sup>

The Taiwan government feared that this investment project would lead others to overestimate the safety and potential profitability of investment in the PRC. Theoretically, the Taiwan government could not prevent an investment project by this Group, since the Group could invest indirectly either through its US subsidiary or via a 'paper' company in Hong Kong. The Taiwan government, however, did exert pressure on the Group by denying bank loans from Taiwan and preventing the transfer of capital abroad. This investment project highlights some of the complicated and challenging issues presented by the growing economic interaction between Taiwan and the PRC.

## 2.5 Bodies Bridging the Taiwan Straits

With the establishment of the Straits Exchange Foundation (SEF)<sup>47</sup> in November 1990, Taiwan created an authoritative, "unofficial" channel for dealing with the PRC authorities, matched a year later by PRC establishing a counterpart: the Association for Relations Across the Taiwan Straits (ARATS). These two quasi-official bodies handle a broad range of problems arising between Taiwan and the PRC, including the issues of trade and investment.

The SEF is a nonprofit corporate entity funded primarily by the Taiwan government, but also with contributions from private sources. Dr. Koo Chen-fu, a prominent Taiwan businessmen, was appointed chairman. It

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46. See *Zhongyang Ribao* (Taipei: Central Daily News), 22 July 1990, p. 3.

47. See *Free China Journal* (Taipei), 25 February 1991, p. 1.



has a board of directors of forty-three persons, twenty of them from business circles, the remainder from the Central Standing Committee of the KMT, the National Assembly, academic and political circles, and the news media. It is an intermediary agency commissioned by the government to negotiate with the PRC officials on technical and non-official issues such as tourism, trade, investment, legal affairs, general affairs, and so on.

In response to SEF's request for non-official exchanges between the two regimes, the PRC established the ARATS in 1992 as an "unofficial" body in charge of promoting relations with Taiwan. Nominally, the ARATS is non-official; in fact, it is directed and administered by the State Council's Taiwan Affairs Office. Although the announcement stressed the non-governmental nature, the body's sixty-five-member board of directors included a substantial number of government officials.<sup>48</sup> Wang Daohan, the former mayor of Shanghai, is in charge of this body. According to Wang, the body strives to promote the direct "three links" (*santong*) between Taiwan and the PRC which are: exchanges of postal services, transportation, and trade.<sup>49</sup>

Through the SEF and the ARATS, the two regimes have contacted each other under the guise of non-official communication. The meeting known as the "Koo-Wang Talks"<sup>50</sup> in April 1993, held in Singapore, marked the

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48. The author was informed of this while carrying out interviews with officials of the ARATS in the PRC in 1992.

49. See *Foreign Broadcast Information Service: China*, 19 July 1991, pp. 69-70. The mission of the ARATS is under the orders of the State Council and the Communist Party to realise the peaceful reunification task on the basis of "one country, two systems".

50. The term Koo-Wang refers to Dr, Koo Chen-fu and Mr. Wang Daohan. The former is the chairman of Taiwan's SEF and the latter is the Chairman of the PRC's ARATS. Both of the are very important political personalities.

highest level of such non-official contact between the two regimes since 1949. Although discussion of political issues was banned, the talks at the very least indicated an improvement towards an equal relationship. As a recent example, in early 1995, the two bodies exchanged drafts of a proposed agreement on repatriation of hijackers. The two have also worked out the framework of an agreement on sending back nationals who enter each other's territory illegally, and an agreement on ways of dealing with fishing disputes.<sup>51</sup>

## 2.6 Conclusion

While international business circles are correct to point out the regional or even international implications of what they see as Chinese economic integration, caution should be exercised in using the term "Greater China".<sup>52</sup> Officials in both the PRC and Taiwan have observed with some apprehension the global trend toward closer regional economic cooperation, as exemplified by the European Community and the North American Free Trade Area, fearing that regional organisations would become too protectionist. Hence, there is a strong motivation on the part of both governments in encouraging economic cooperation among the PRC, Hong Kong, and Taiwan so as to create a strong regional bloc, capable of holding its own against challenges from other regions.

We have reason to be optimistic about future political-economic developments moving in the direction of "Greater China" economic interdependence. The PRC

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51. See *Asian Bulletin* (Taipei), Vol. 20, No. 3, March 1995, p. 21.

52. Stephen Whalley, "'Greater China': What's in a Name?", Paper delivered to Contemporary China Seminar, Centre for Chinese Studies, University of Hawaii, 27 February 1993.

scholar, Fang Sheng, proposed the establishment of a "China Economic Conglomerate " to include the PRC, Hong Kong, and Taiwan which would be at first simply a loosely organised, unofficial organisation, but which would develop step-by-step towards quasi-governmental and finally even full governmental cooperation.<sup>53</sup> Thus, the growing economic integration of these three economies is driven not only by the profit-making activities of individual business, but also by the vision, shared on both sides of the Taiwan Straits, of a future when full advantage could be taken of the complementary nature of the three economies.

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53. See *Beijing Review*, Vol. 34, No. 48, 1991, pp. 28-30.

## CHAPTER THREE

### BACKGROUND TO, AND LEGAL FRAMEWORK FOR, PRIVATE TAIWAN-PRC LINKS

After the Communist victory and the establishment of the PRC in 1949, interaction between the people of Taiwan and the people of the PRC came to a virtual standstill. The defeated KMT, while retaining control only over Taiwan and nearby smaller islands, continued to assert the existence of the ROC whose purported territories included all the provinces and regions of Mainland China. The PRC likewise claimed that its territories included all areas of Mainland China and Taiwan. Thus, the persistent position of each regime has been that there is only one "China" of which it is the sole legitimate government.

#### 3.1 A Re-unified China: A Future or a Futility?

China became a divided country after the end of the civil war in 1949. Since then, the ROC on Taiwan and the PRC on the mainland have existed almost entirely as mutually exclusive entities. The main difference between the two in their political and economic ideology is that Taiwan pursues a capitalist system but the PRC is run on predominantly communist lines.

Since 1949, both Taiwan and the PRC each pursued economic policies that have ranged from attempts at comprehensive central planning to almost complete laissez-faire. In Taiwan, the KMT government initially undertook policies of land reform and import-substitution-based industrial development, which entailed substantial government participation in the economy. In the 1960s, the government switched direction to a private-enterprises-based, export-oriented strategy of

industrialisation. To date, however, the government has continued to undertake major industrial development projects.

In short, Taiwan has combined some state ownership of heavy industry, the banking system, and provision of infrastructure with a largely free-enterprise, export-oriented economy. Taiwan has now firmly established itself as one of the post-war economic power houses of Asia. Rapid economic expansion has transformed the Taiwanese economy from a poor agricultural base into a sophisticated industrial one and most recently, to a service sector economy.<sup>1</sup> In decades, Taiwan has achieved what has been recognized world-wide as an "economic miracle", and has consistently been rated one of the world's top economic performers in terms of both growth and equity.<sup>2</sup>

Since 1987, the outward foreign direct investment (FDI)<sup>3</sup> of Taiwan has expanded spectacularly. There are three main reasons for this development. First, there has been a rapid rise in land and labour costs in Taiwan. Secondly, the marked appreciation of Taiwan's currency (the New Taiwan Dollar) further diminishes the

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1. In recent years, Taiwan's services sectors -- the financial sector in particular -- have gained increasing importance. Substantial financial liberalisation has been taking place in Taiwan. The objective is to promote Taiwan as an international financial centre that can compete with Hong Kong and Singapore. For further studies, see Prabhu Ghatge et al., *Informal Finance: Some Findings from Asia*, Hong Kong: Asian Development Bank and Oxford University Press, 1992.

2. "The Other China is Starting to Soar", *Business Week* (6 November 1989), p. 60.

3. Foreign direct investment (FDI) has played an important role in the economic development of the Asia-Pacific region. For further studies, see Eric D. Ramstetter, (ed.), *Direct Foreign Investment in Asia's Developing Economics and Structural Change in the Asia-Pacific Region*, Boulder, Colorado: Westview Press, 1991.

competitiveness of its exports. Lastly, and most importantly, the significant relaxation of regulations on outward investment (including the simplification of application procedure and relaxation of foreign exchange control) encourages investment overseas, including the PRC.

Many Asian countries are recipients of Taiwan's outward FDI. Hong Kong, with its close PRC connection and excellent infrastructure, acts as an important base for Taiwan investors to invest in the PRC. Its role as an intermediary has been strengthened further since 1990 when FDI to the PRC (FDI via a third country) was permitted by the Taiwanese government.

In contrast to Taiwan, the PRC from the 1950s to 1970s, adhered more or less rigidly to a Marxist model of economic development in almost complete isolation, by a programme emphasising heavy industry coupled with its own radical version of rural collectivisation. Government planners controlled all factories, farms, and enterprises, set prices for all goods and services, assigned production inputs and specified output targets, allocated labour, rationed goods in short supply, determined individual incomes, and chose the mix between consumption and investment.

The PRC economy was in ruins at the end of the Cultural Revolution in 1976. Since 1979, the PRC has reduced its emphasis on Soviet-style central planning in favour of greater reliance on market forces. However, political considerations, rather than market forces alone, often dictate economic measures. In 1979 Deng Xiaoping assumed control from the Maoist leaders and instituted a bold new "Open Policy" designed rapidly to develop the PRC economy. According to this Policy, in the 1980s four special economic zones were established,

followed by the opening up of fourteen coastal cities and the setting up of economic development zones.

Deng's plan was to introduce Western technology and capital, and elements of a market economy. However, ten years of rapid economic growth have led to the development of two distinct economies in the PRC, one inside and the other outside the state plan.<sup>4</sup> Although little of the economic progress in recent years is attributable to the economy within the state plan, the PRC still relies upon its socialist system to assert firm authority over state enterprises.<sup>5</sup>

Although the PRC established a socialist market economy in 1992, however, foreign trade and investment are still driven by needs identified in central planning.<sup>6</sup> At present, the PRC government itself still plays an important role in guiding the new economic system, with public ownership remaining the backbone of the economy.<sup>7</sup> With PRC central planning offering

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4. *The Wall Street Journal*, 30 August 1989, p. A-13. This emergence of two economies was called in the PRC the "Jihua nei/wai" phenomenon, i.e. economic activity which is within the state plan, and economic activity which is outside it, undertaken "privately".

5. The PRC's remarkable economy growth is driven by non-state industries, yet state-owned enterprises still account for half of industrial output and seventy per cent of urban workforce. For further studies, see David Brown and Mark Easterby-Smith, *Research Report on China's Market-Oriented Management*, England: Lancaster University Management School, 1993.

6. In early 1992, Deng Xiaoping initiated a new era of economic reforms in which the market economy is described as compatible with either socialist or capitalist economies. However, Deng's emerging market economy policy seems to contradict the PRC Constitution which calls for official state economic domination of central planning. See Art. 15 of the 1982 PRC Constitution.

7. See Prof. Gao Shangquan, "China's Socialist Market Economy", *The Chinese Economic Association (UK) Newsletter*, London: The Chinese Economic Association in the U. K., Vol. 5, No. 1, March 1993, pp. 4-5.

preferential treatment, Taiwanese trade and investment in the PRC has increased significantly in the late 1980s, particularly in Fujian and Guangdong provinces.<sup>8</sup>

In recent years, the proliferation of informal contacts and a boom in indirect commercial relations may represent the beginnings of a possible future re-unification of the two.<sup>9</sup> The gradually increased reliance on Taiwanese trade and investment in the PRC could allow PRC to obtain control over Taiwan's economy, in such a way that re-unification efforts could be accelerated.<sup>10</sup> In fact, both Taiwan and the PRC agree that "there is only one China"; however, each side has its own version of "one China". The PRC wants Taiwan to be a part of "communist China" with its "Chinese-style" socialism, while Taiwan demands the mainland be a part of "free China" under conditions of democracy and a full capitalist market economy.

Recently, Taiwan's rapid industrialisation, as well as the PRC's economic reforms have significantly complicated the "theological" debate about who are the rightful rulers of all China. Taiwan, with its new-found wealth and democratic liberties is anxious to achieve western recognition and play a fuller role in the world community. Yet movement on this front is largely dependent upon Taiwan's status in relation to the PRC. The simplicity of the past has been replaced by confusion in Taiwan about how to deal with the "China Question".

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8. Edward K. Y. Chen, "Foreign Direct Investment in East Asia", *Asian Development Review*, Manila: Asian Development Bank Press, 1993, p. 50.

9. The PRC indicated that various investment and trade incentives were targeted at Taiwanese businesses to induce industrial and commercial circles in Taiwan to establish the conditions for re-unification. See *Jingji Ribao* (Beijing: Economic Daily, 9 September 1990), p. 1. Also see note 39 of Chapter 1.

10. Ibid.

Taiwan has long asked itself at what pace contacts with the PRC should proceed, and what will be the ultimate result of increasing contacts. The current KMT leadership says it wants a "re-united China, but not now".<sup>11</sup> There are indications which suggest that Taiwan really seeks to return to the United Nations from which it was ejected in 1971 when the PRC government replaced it as the representative of "China". Re-entry into the United Nations represents Taiwan's ambition for achieving broad international recognition of its sovereignty.

In the event, the PRC voiced strong objections, saying that admitting Taiwan to the United Nations would set an "abominable precedent" and would interfere in PRC internal affairs.<sup>12</sup> There are only thirty countries in the world still according Taiwan full diplomatic recognition. Most western countries have only *de facto* relations with Taiwan, stationing officials in Taipei at quasi-embassies called trade offices and limiting official diplomatic contacts. However, Taiwan is very much a reality that international society cannot afford to ignore.

In the context of international law, it is clear that Taiwan is a State. According to Article 1 of the 1933 Montevideo Convention of the Rights and Duties of States, "the State as a person of international law should possess the following qualification: (i) a permanent population; (ii) a defined territory; (iii) a Government; and (iv) a capacity to enter into relations

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11. Jason Hu, "President Lee's Pragmatic Diplomacy and China's Re-unification", *The Daily Telegraph*, a special report on the Republic of China, (London: *The Daily Telegraph*, 21 May 1990), p. 2.

12. See *The Taiwan Question and Re-unification of China*, issued by the State Council of the PRC, Beijing: Taiwan Affairs Office & Information Office, (English Edition), August 1993.

with other states." According to the former President of the United Nations Court of Administration, Madame Bastid, the ROC on Taiwan, with its constant existence, its territory, its people, its public service, its national flag, and its sovereignty, is definitely a State in the international community.<sup>13</sup>

Is a re-unified "China" a future or a futility? No one knows the answer. The nature of China's division is unique in world affairs. Both governments of Taiwan and the PRC agree that "there is but one China, and Taiwan is a part of it". According to Taiwan's Guide-lines for National Unification in 1991, Taiwan's current "one China, not-now-but-later policy," is proof of its genuine desire to expand its international reach and responsibility, and to compete peacefully with the PRC for future re-unification.<sup>14</sup>

In contrast, the PRC has its own re-unification goal of "one country, two systems" in respect of Taiwan.<sup>15</sup> Under this model, the PRC would recognise Taiwan as a special administrative region<sup>16</sup> with its own government, with its own domestic laws, with an independent judicial system, and with independent armed forces. In return,

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13. See Kuen-chen Fu, *Law and National Affairs*, Taipei: Times Publishing Co., 1982, pp. 163-164.

14. *Supra* note 11.

15. This proposal was first made in 1983, offering Taiwan terms even more favourable than those devised for the PRC's takeover of Hong Kong in 1997. It became known through a discussion between Deng Xiaoping and Professor Yang Liyu of Seton Hall University of the United States. For an account of the discussion and for a summary of the proposal, see Deng Xiaoping, "An Idea for the Peaceful Reunification of the Chinese Mainland and Taiwan", in *Fundamental Issues in Present-Day China* (1987), p. 19.

16. The PRC Constitution allows the government to establish special administrative regions as necessary. For further studies, see Hungdah Chiu, "The 1982 Chinese Constitution and the Rule of Law", *Review of Socialist Law*, Vol. 11 (1985).

the government of Taiwan would be required to recognise the PRC as its sole international representative and to abandon its claim to authority over the mainland.<sup>17</sup> This proposal would result in a predominantly communist system, coupled with a subordinate capitalist system. Since the Hong Kong people have already voiced their doubts over this model, it would be impossible to see Taiwan accepting a similar scheme.

Most probably, people in Taiwan who have been enjoying a market economy and a developing democracy would prefer to wait until socio-economic conditions in the PRC have become more stable and approach comparable stage to these of Taiwan. It was Mao Zedong himself who said that while he was sure Taiwan and the mainland would inevitably be reunified one day, it wouldn't necessarily be within his lifetime; perhaps one hundred years after his death might be needed. Now, with Maoism being phased out, the gap between the living standards of Taiwan and the PRC is gradually narrowing. But there still remain fundamental differences in the social and economic systems of the two territories.<sup>18</sup>

Nevertheless, the development of a strong economic relationship between Taiwan and the PRC may lead to a change in their relative bargaining powers in any future

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17. The proposal is similar in most respects to the plan under which the PRC shall regain sovereignty over Hong Kong in 1997, see "The Draft Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China for Solicitation of Opinions", *Beijing Review*, 9-15 May 1988, p. 23.

18. The author was informed of this while carrying out interviews with many PRC governmental officials in 1994. Those governmental officials all quoted Jiang Zemin, Secretary General of the Chinese Communist Party, as saying "private ownership of property: not in my life time". It seems the PRC is still vowing to uphold its Socialist/Communist ideology. However, not one of these governmental officials commented as to how things will be after the Party leader and his contemporaries pass away.

negotiations over the terms and conditions for re-unification.<sup>19</sup> But with mutual non-recognition and hostility, each side has firmly rejected the proposal of the other for future re-unification. Under such circumstances, re-unification of "China" seems a long way off.

### 3.2 Background to Taiwan-Chinese Economic Links

Taiwan and China are geographically close. Taiwan has a long history of world trade. It was a major trade and shipping port during the Dutch and Spanish occupations in the seventeenth century, and again when China's ports were opened by the Treaty of Tientsin in the mid-nineteenth century.<sup>20</sup> For centuries, economic relations between Taiwan and China included everything from piracy and smuggling to transshipping and trade.

Historians and archaeologists have yet to agree on exactly when economic exchanges first began between residents of China and residents of Taiwan, but there is a consensus that Taiwan-Chinese economic contacts long predate the first decades of the seventeenth century, when large numbers of Han Chinese from China first settled on Taiwan. Military expeditions to Taiwan in A.D. 230 and 610 are mentioned in early Chinese records. It was probably over a thousand years ago that Chinese

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19. See Chu-yuan Cheng, "Haixia Liangan Jingmao Guanxi Xianshi ji Qianjing" (The Reality and Prospects for Economic and Trade Relationship across the Taiwan Straits), *Zhongyang Ribao*, Taipei: Central Daily News, 22 July 1990, p. 3.

20. For further studies on foreign encroachments on China in the nineteenth century, see J. F. Fairbank, *China: A New History*, Mass.: Harvard University Press, 1992, p. 202.

fishermen began coming regularly to Taiwan from the Chinese coastal provinces of Fujian and Guangdong.<sup>21</sup>

### 3.2.1 History to 1949

China has maintained contact with Taiwan since the earliest times. During the sixteenth century, permanent settlements were established by immigrants who came largely from southern Fujian. Subsequently, these began a major expansion in cross-straits commercial ties between China and Taiwan. For this reason, the Taiwanese dialect is closely related to the local dialect of Amoy (Min'an Hua) in southern Fujian.<sup>22</sup>

The immigrants used Taiwan as a staging post to Japan, a stepping stone in the then expanding trade between Japan and South East Asia. The settlements generated a worthwhile trade in their own right, creating a barter business of Chinese jewellery and cloth for Taiwan's prized deer products.<sup>23</sup>

As they were interested in establishing trading posts, the last part of the sixteenth century also brought Europeans to Taiwan: first the Portuguese, then the Spanish and the Dutch. When the Portuguese sailors first gazed at Taiwan, they called it "Ilha Formosa" which means the "beautiful island."<sup>24</sup> In 1624, the Dutch

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21. See Lih-wu Han, *Taiwan Today*, Taipei: Cheng Chung Book Co., 1988, p. 1.

22. Id.

23. During the seventeenth century, many Chinese fishermen visited Taiwan to purchase deer skins, which brought substantial profits in Japan, where they were used for making armour. See Simon Long, *Taiwan to 1993*, Special Report No. 1159, London: The Economist Intelligence Unit, June 1989, p. 4.

24. "Ilha Formosa" is a word of Portuguese origin, meaning literally "beautiful island". It was first so named by the Portuguese seafarers to describe Taiwan as a

occupied Taiwan and held it for thirty eight years until 1661 when it was again liberated by a Ming Dynasty loyalist named Cheng Cheng-kung. In 1626, the Spanish invaded and occupied several coastal cities in northern Taiwan. Fifteen years later, the Spanish were driven out by the Dutch.

During the period of occupation, the Dutch and the Spanish both set up trading companies branches in Taiwan, giving them additional trade bases in the rest of the world. In 1661, Cheng Cheng-kung, the famous Ming loyalist known in the West as "*Koxinga*" fled to Taiwan from China, defeating the Dutch with several thousand Chinese, and made the island his personal kingdom. Many followed him to escape Manchu rule and these new immigrants greatly facilitated the transfer of Chinese culture to the island.

To negate Cheng and his descendants' claims to sovereignty over Taiwan, the Manchu regime sought to gain control over the island. They eventually succeeded, making Taiwan a part of Fujian province in 1683. Prior to this, Taiwan-Chinese trade had dwindled seriously, leaving only piracy and smuggling activities across the straits. However, Taiwan kept a broad range of trade contacts with the rest of world.

During the period 1624 to 1683, both Chinese and foreigners used Taiwan as a centre for transshipping China's commodities to the rest of the world. As a result, business links between Taiwan and China became close. For the next two centuries Taiwan remained a relatively obscure off-shore possession of the Chinese Empire, until it was made a province in its own right in

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beautiful island during the sixteenth century and remained known by this name in the Western world for four hundred years.

1886. Life in Taiwan began to resemble life in China and conditions in the two became almost identical.

From 1683 to 1860, Taiwan's economy developed into something more than a self-sufficient agricultural sector supporting entrepôt, barter and private trade.<sup>25</sup> At the same time, immigration from China was actively encouraged. These Chinese immigrants maintained close trade relations with their motherland. Taiwan had no real manufacturing facilities and thus almost exclusively imported finished goods rather than raw materials. Chinese traders operating junks across the Taiwan Straits supplemented the trade conducted by Western traders.

An estimated 100,000 Chinese settled in Taiwan between 1624 and 1661. The number doubled during the time when Cheng and his descendants ruled Taiwan (1661 - 1683). By 1860, Chinese residents in Taiwan totalled two million. By 1905, the Chinese population on Taiwan had increased to nearly three million.<sup>26</sup>

According to the Treaty of Tientsin, signed in 1858 by China with Britain, France, the United States and Russia, China opened a number of treaty ports to trade. Four ports were opened in Taiwan for the four foreign countries before 1862.<sup>27</sup> Subsequently, several other countries also signed trade pacts with China. Between 1860 and 1895, Taiwan established many trade links with the world and functioned as an entrepôt.<sup>28</sup>

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25. Simon Long, *supra* note 23, p. 5.

26. See Man-houng Lin, "New Concept, Old Reality", *Free China Review*, Taipei: Kwang Hwa Publishing Co., Vol. 44, No. 1, 1994, p. 43.

27. *Supra* note 19.

28. For example, Xiamen (Amoy) and Hong Kong became the transshipping ports for Taiwan's agricultural products en route to the West. The Western products were sold to Taiwan through Shanghai and Hong Kong. See Man-houng Lin, *supra* note 26, p. 44.

In 1894, China and Japan went to war. Under the Treaty of Shimonoseki, which followed the war, Manchuria, Taiwan, and the Pescadores, a group of islands lying off the west coast of Taiwan were 'seized' by the Japanese in 1895.<sup>29</sup> Under Japanese rule, Taiwan and China initially maintained close trade relations. However, Japan first started by creating a thriving plantation economy in Taiwan, and then also introduced a certain measure of industrialisation, including the island's first railway, and a hydroelectric power plant. After 1902, China was replaced by Japan as Taiwan's chief trading partner.

By the end of the Second World War, five decades of Japanese rule had made Taiwan the longest-established and wealthiest Japanese colony. However, since 1895 successive Chinese governments understandably took the view that Taiwan had been snatched from China during a moment of weakness. Upon Japan's surrender in August 1945, Taiwan was swiftly reunited with China as a province.<sup>30</sup>

When the Second World War ended, the Supreme Commander of the Allied Powers gave the Nationalist Chinese government of Chiang Kai-shek authority to accept

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29. The term "stolen territory" was used in the Cairo Declaration of 26 November 1943. It refers to the areas taken from the Chinese by Japan (between 1895 and 1945), such as Manchuria, Taiwan, and the Pescadores.

30. The decision was made at the Cairo Conference, which issued the Cairo Declaration (1 December 1943) dealing with the post-war situation in the Far East. See Documents 11 and 12: "The Cairo Conference: The Chinese record of the November 26, 1943 Meeting" and "The Cairo Declaration, November 26, 1943", in Hungdah Chiu (ed.), *China and the Question of Taiwan: Documents and Analysis*, New York: Praeger, 1973, pp. 205-6. The complete text of the Cairo Declaration can be found in *Foreign Relations of the United States, Diplomatic Papers: The Conferences at Cairo and Tehran, 1943*, Washington, D.C.: U.S. Government Printing Office, 1961, pp. 448-449.

the Japanese surrender and administer the island. Although most Taiwanese undoubtedly welcomed their reabsorption by China, the process was not without its strains. Leadership positions were largely transferred from the former Japanese to the mainland Chinese coming to administer Taiwan on the central government's behalf. The Taiwanese naturally resented this fact and sporadic protest riots spread across the island. These were brutally repressed at the cost of several thousand lives.<sup>31</sup>

Although the government at that time laboured to repair the damage, this incident and related events laid a foundation for the later ill-feeling between the native Taiwanese (numbering about six million) and the mainland Chinese people (numbering about one and a half million) who began arriving in 1949. As a result, a Taiwan Independence Movement developed and this constituted a potential threat to Nationalist China's rule of the island.<sup>32</sup> Trade between Taiwan and China, resumed in 1945, was banned in 1949.

### 3.2.2 Military Confrontation, 1949-78

While postwar reconstruction was taking place in Taiwan, the CCP resumed its attacks on the KMT in China. The KMT began to lose control of the country. In late 1949, the KMT moved its seat of government from the mainland to the island of Taiwan, while the CCP founded

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31. For further studies on this anti-Chinese riot, see *The Truth About the February 28, 1947 Incident in Taiwan*, Taichung: Historical Research Commission of Taiwan Province (comp.), 1967.

32. The Taiwan Independence Movement advocates an independent state of Taiwan, governed by Taiwanese only, and appeals to the memory of the uprising to stimulate Taiwanese antipathy to the nationalist Chinese rule. It is active in Japan, United States and some European countries. For an official Nationalist report, see id.

the PRC on the mainland. Since 1949, Taiwan has been governed by the KMT directly. Despite its comprehensive defeat in the civil war, Taiwan regarded the 1949 retreat as temporary and determined to return to the mainland, to re-unite the country under Nationalist leadership. At the same time, the PRC proclaimed that Taiwan was going to be "liberated through military means." From 1949 to 1978, links between the PRC and Taiwan were characterized by confrontation and hostility.

In the 1970s, when the PRC was admitted to the United Nations and established diplomatic relations with the United States, a different strategy evolved on the part of the mainland authorities. Instead of "liberating" Taiwan, the PRC sought to "unify China through peaceful means," while reserving the right to "solve the Taiwan problem through military means."<sup>33</sup> In the early 1980s, the PRC made an assortment of offers in an attempt to lure Taiwan into re-unification negotiations.<sup>34</sup> Although direct contact was non-

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33. On 1 October 1979, the PRC National People's Congress recommended the resumption of postal services between the two sides or opening some other channel for communication. At the same time, the Congress made a gesture of its intention to abandon the threat of "liberating" Taiwan by ordering a cease-fire on Quemoy and Matsu, Taiwan's mainland defense frontiers, while reserving the right to use force for solving Taiwan problem.. See *Zili Wanbao* (Taipei: Independence Evening Post), 29th August 1987, p. 2. Also see *Yearbook of the Republic of China*, Taipei: Kwang Hwa Publishing Company, 1991, p. 197.

34. On 30 September 1981, the PRC made a "nine-point proposal" for the peaceful reunification of China, calling for direct "ruling party-to-party" negotiations and offering to create a "Taiwan Special Administrative Region" which would be able to retain its own armed forces and its current socio-economic system. For the text, see *Renmin Ribao* (Beijing: The People's Daily), 1 October 1981, p. 2. Also, in 1983, the PRC proposed a plan for the peaceful reunification of Taiwan and Mainland China under the "one country, two systems" formula, offering Taiwan terms even more favourable than those devised for the PRC's takeover of Hong Kong in 1997. See Deng Xiaoping, "An Idea for the Peaceful Reunification of the Chinese Mainland and Taiwan",

existent, some economic ties of a limited indirect nature did exist between the two even at this stage. Some indirect trade, for instance, was carried out, but only in a clandestine manner and at a minimal volume of US\$ 50 million annually.<sup>35</sup> Most of the indirect trade transactions were conducted by certain Taiwanese government agencies which were authorised to make purchases from the PRC, either via Hong Kong or on the international market. The PRC also imported limited quantities of consumer goods indirectly from Taiwan. Their value never exceeded US\$50,000 per year. The balance of trade at this time was very much in the PRC's favour.<sup>36</sup>

### 3.2.3 Illegal Indirect Trade and Investment, 1978-84

In 1979, the PRC urged Taiwan to establish direct trade, telecommunication, and traffic connections (known as the "three links"), as well as academic, cultural, sports, and technological exchanges (known as the "four exchanges"). Meanwhile, it ceased its shelling of the Taiwan-controlled off-shore islands.<sup>37</sup> The PRC initially made large purchases of Taiwanese consumer goods through intermediaries in Hong Kong. In 1980, the PRC even went

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*Fundamental Issues in Present-Day China* (1987), p. 19. For further relevant PRC documents, see *Tongyi Zhongguo Renren Youze* (Reunification of China is everybody's business), (Beijing: Beijing Publishing House, 1985).

35. For years, Taiwanese customers clandestinely purchased PRC medicinal herbs, tea, and other native products of foodstuffs, the value totalling a mere US\$50 million per year. See Li Dahong, "Mainland-Taiwan Economic Relations on the Rise", *Beijing Review*, (Beijing), 3-9 April 1989, p. 24.

36. See Jan S. Prybyla, "The Economic Relations Across the Taiwan Straits", (Paper presented in Asia & World Institute, Taipei, Taiwan, 1 June 1989), *Asia & World Institute Digest*, Vol. 11, No. 1, July 1989, p. 58.

37. See *Beijing Review*, 5-11 January 1979, pp. 16-17.

so far as to remove duties on Taiwanese goods, henceforth regarding indirect PRC-Taiwan trade, which was still considered illegal in Taiwan, as domestic trade. However, this preferential measure discriminated against Hong Kong-made goods and inevitably gave rise to speculation, and to uncertainty among Hong Kong re-exporters. It was abolished in May 1981.<sup>38</sup>

During the period 1978 to 1984, the Taiwan authorities maintained that trade and investment with the PRC, direct and indirect, was illegal. Even though trading had been in fact conducted discreetly for quite some time, it had been on a small scale, mainly due to fear of penalties in the event of being discovered. Despite the peace rhetoric, no substantial ties, official or unofficial, were built up between Taiwan and the PRC during the period 1980-84. Yet there was a noticeable increase in indirect trade, which grew annually by as much as 157 per cent. In the post 1980 period, Taiwan became the leading source of Hong Kong's re-exported goods to the PRC. Moreover, despite official prohibition, Taiwanese entrepreneurs had been investing in the Guangdong and Fujian provinces of the PRC since 1979.<sup>39</sup>

#### 3.2.4 Non-interference in One-way Indirect Trade and Investment, 1985-87

One important dimension of Taiwan-PRC economic relations which emerged in the mid-1980s was that more and more Taiwanese businessmen were encouraged by the market potential of the PRC's ongoing economic reforms.

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38. Ricky Tung, "Mainland China in Taiwan's Economic Future", *Issues & Studies*, Vol. 11, No.1, July 1989, p. 58.

39. Bill Kazer, "Taiwan breaks a taboo", *Far Eastern Economic Review*, 27 July 1979, pp. 44-45; Andrew Tanzer, "Taiwan's China links", *Far Eastern Economic Review*, 5 June 1981, p. 53-54.

They set aside the political and ideological restrictions and went searching for commercial opportunities through indirect channels. They then provided technology and capital in their trade and investment activities on the PRC's southeast coast.<sup>40</sup> Taiwan, under pressure of public opinion, announced in July 1985 that the government would adhere to a principle of "non-interference" and "non-encouragement" when dealing with such business activities.<sup>41</sup>

According to Taiwan law, punishment of sedition for financially assisting the "communist rebels" by engaging in direct trade and investment with the PRC could range from ten years' imprisonment to the death penalty.<sup>42</sup> However, the lifting of martial law in Taiwan in November 1987 has legalised commercial activities of indirect trade and unilateral investment from Taiwan to the PRC. The Taiwan authorities began to assume that commercial activities of Taiwanese national with PRC party were not necessarily deemed as treason.<sup>43</sup> Doing business with the

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40. Ying-hsien Liu and Liu-chi Chiang, "Taiwan-Mainland Economic and Trade Relations Over the Last Decade: Retrospect and Prospect", *Tai-Sheng* (Voice of Taiwan), (Taipei: Tai-Sheng Press, 1989), No. 2, pp. 9-14.

41. Exports of Taiwanese goods to the PRC must be conducted indirectly through a third country. However, Taiwan maintained during 1985 to 1987 that import of PRC goods was illegal.

42. See Article 4(4) and 4(6) of Taiwan's Statute on Punishment Against Rebellion (in force 21 June 1949) which made any act of transporting goods for or supplying funds to the rebel a criminal offence punishable with no less than ten years in prison. The offence could even result in life imprisonment or death. For further studies, see Ming-Min Peng, "Political Offences in Taiwan Laws and Problems", *The China Quarterly*, July-September 1971, p. 472. This Statute was abandoned in 1991 following the announcement of the end of the "Period of National Mobilisation for Suppression of the Communist Rebellion" which meant the communist regime in Beijing was no longer considered as rebels by the Taiwan government.

43. Ibid. In Taiwan, many statues treated the PRC regime as a rebel organisation and deemed any act favourable to

PRC in order to make a profit was not treated any more as assisting financially the "communist rebels" in the PRC. Taiwan's courts supported such policy by maintaining the same stance in similar subsequent cases.<sup>44</sup>

### 3.2.5 A Breakthrough in 1987

Until July 1987, Taiwan was ruled under the provisions of an emergency decree (or "martial law"), in force as a result of the civil war with the CCP. After the lifting of martial law, the Taiwan authorities enjoyed greater flexibility in adopting more liberal measures in Taiwan-PRC economic relations.<sup>45</sup> At the same time, the PRC allowed direct and extensive private relationships with Taiwan, and its State Council announced that trade activities with Taiwan would be jointly managed and approved by its Ministry of Foreign Economic Relations and Trade (MOFERT).<sup>46</sup>

Trade between Taiwan and the PRC has expanded quickly. As a result, by 1988, Taiwan had become the

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that regime as treason. See *Zhongguo Shibao* (Taipei: China Times, 1 February 1991), p. 11.

44. Paiff Huang, "Prospects for Economic and Trade Development Between Taiwan and Mainland China", (Paper presented at the seminar of International Business Fellows, Atlanta, Georgia, USA, 13 April 1989), *Formosa Transnational Law Review*, no. 46, Taipei: Formosa Transnational Attorney-at-Law, 1 August 1989, p. 42.

45. For Taiwan's official policy towards the PRC, see the text of a speech, entitled *Zhonghua Minguo de Dalü Zhengce* (The ROC's Mainland Policy), delivered by Taiwan's Government Spokesman Shao Yu-min, at the American Enterprise Institute, reprinted in *Shijie Ribao*, New York: The World Daily, 8 August 1989, p. 37.

46. See, for example, *Dagong Bao* (Hong Kong: Ta Kung Po, 7 September 1989), pp. 1-2, (trans.), in "Beijing Authoritative Person Reiterates That Policy Toward Taiwan Remains Unchanged", *Foreign Broadcast Information Service - Daily Report, China* [FBIS-China], 12 September 1989, pp. 58-59.

sixth largest trading partner of the PRC and the PRC had become Taiwan's number five trading partner. While Taiwan suffered a labour shortage at this time, the PRC had a massive labour surplus. Businesses in Taiwan, attracted by cheap labour and other incentives offered by the PRC,<sup>47</sup> invested large amounts to create new manufacturing enterprises in the PRC. By 1988, the total investment exceeded US\$600 million, more than three times the amount invested over the preceding decade.<sup>48</sup>

In March 1989, Taiwan lifted the curb on business visits to the PRC, but the rules on indirect trade and investment have remained unchanged. Such indirect business activities ought, by law, to be conducted via a third party. But in most cases this "third party" was merely a shell company set up for this purpose, in Hong Kong or elsewhere in Asia, by a Taiwanese company. According to Hong Kong Customs statistics in early 1991, Taiwan-PRC indirect trade through Hong Kong was estimated to have exceeded US\$4 billion in 1990. The total value of PRC-approved investment from Taiwan was estimated at US\$2.2 billion, with some 2,000 Taiwanese companies investing in the PRC by the end of 1990.<sup>49</sup>

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47. See *Guowuyuan Guanyu Guli Taiwan Tongbao Touzi de Guiding* (State Council Provisions for Encouraging Investment by Taiwanese Compatriots, or the Taiwanese Investment Provisions), promulgated on 3 July 1988, text published in *Renmin Ribao*, 7 July 1988, p. 2. Unless otherwise indicated, the Chinese English translation of all laws cited in this thesis can be found in the *PRC's Foreign Economic Legislation*, Beijing: Foreign Language Press, Vol. 1, 1982; Vol. 2, 1986; Vol. 3, 1987; other volumes forthcoming), or in the loose-leaf service collection of Chinese laws and regulations published by Commerce Clearing House (CCH), Australia, *China Laws for Foreign Business*. Here see [2 Special Zones & Cities] *China Laws for Foreign Business* (CCH-Australia) ¶ 96-500.

48. Li Dahong, *supra* note 35.

49. See *Asian Survey*, vol. 31, no. 1, January 1991, p. 47.

On 9 August 1988, the Vice-President of the PRC Supreme People's Court, Ma Yuan, outlined the policy of the Court toward a selected series of substantial issues concerning civil law relations between individuals from the two sides of the Taiwan Straits.<sup>50</sup> This policy statement was safely regarded as quasi-law because of Ma's senior official status in her address during a press conference. It was the first attempt by the PRC to find a legal solution to private inter-regional conflicts between the two regimes. Moreover, the President of the PRC Supreme People's Court, Ren Jianxin, further indicated on 4 April 1991 that the PRC would recognize civil decisions handed down by Taiwan courts if they did not violate basic legal principles in the PRC. With the permission of the People's Supreme Court, the PRC courts could entrust Taiwan courts to handle legal proceedings and accept cases from them.<sup>51</sup>

In the area of trade and investment links between two regimes, business transactions and transfer of funds or materials in return for a direct or indirect share of the earnings of the enterprises should be defined as "foreign" trade and investment.<sup>52</sup> It should be noted that the PRC still has no special legislation regarding its trade with Taiwan. In contrast with many other countries, under current PRC law, Taiwan is accorded no preferential treatment in trading with the PRC. However, Taiwan does have some incentives for trading with the

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50. Address by Ma Yuan, in her first news conference held by the Supreme People's Court on 9 August 1988, "Some Legal Issues of the People's Court Dealing With Civil Cases Relating to Taiwan", reprinted in *Collections of the Laws of the PRC*, Wang Huaian, Gu Min, Lin Zhun & Sun Wanzhong (eds.), 1989, p. 369.

51. See *Zhongguo Shibao* (Taipei: China Times), 4 April 1991, p. 1.

52. See Stefan Riesenfeld, "Foreign Investment", *Encyclopedia of Public International Law*, (ed.) Rudolf Bernhart, instalment 8, Amsterdam, New York, and Oxford: North Holland, 1985, p. 246.

PRC. For example, Taiwanese goods are taxed at about one-half the normal levy for foreign goods since the PRC government does not recognize Taiwan as a separate country.<sup>53</sup>

The PRC adopted special provisions on encouraging Taiwanese investors (Taiwan Investment Provisions, or TIP) in 1988.<sup>54</sup> The TIP applies to companies, enterprises, other economic organisations and individual investors in Taiwan that make investment in the PRC. Moreover, it affirms that the general body of foreign economic legislation of the PRC applies to the Taiwanese investors in their business dealings with parties in the PRC. Nevertheless, some local provincial authorities still offer special incentives for the Taiwanese investors for the political reason of establishing conditions for re-unification.<sup>55</sup>

### 3.2.6 Present Situation Since 1990: Pragmatism and Progress?

With an awareness of the need for capital and technology transfer from Taiwan, the PRC offered a series

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53. Ming-cheung Tai, "China-Taiwan trade growth suffers a setback: The water margin", *Far Eastern Economic Review*, (15 November 1990), p. 77.

54. Supra note 47.

55. For example, the "Provisional Regulations of Shantou Special Economic Zone for Encouragement of Taiwanese Investment" were promulgated in June 1990. The Regulations made clear the concessions for Taiwanese investing in the special economic zone in terms of registration procedures, land prices, development and tax rates. Also, a special zone established in Zhuhai offered a number of incentives for Taiwanese investors whereby they would be exempt from land use fees for ten years, from local income tax for six-ten years, while the general foreign investors enjoyed only a six-year and a three-year exemption from land use fees and local income tax respectively.

of incentives to attract more trade and investment, resulting in greater autonomy and certain economic benefits for Taiwan. The broadening of economic ties also had political significance, in the sense that it could hasten the end of the *status quo* between the two, and lessen the likelihood of the development of an independent Taiwan.<sup>56</sup> However, the question of whether or not to legalise these indirect business transactions or even to lift the ban on direct trade and investment has sparked off heated debates in Taiwan. Taiwan's current trade and investment policy towards the PRC shows significant change, but caution is still the order of the day.<sup>57</sup>

On 6 October 1990, Taiwan's Ministry of Economic Affairs promulgated the "Measures Governing Control Over Making Indirect Investment or Undertaking Technical Cooperation Projects in the Mainland." There are now 3,679 low-technology and labour-intensive items for which indirect investment in the PRC is permitted.<sup>58</sup> Since April 1991, Taiwanese companies can easily conduct indirect trade and investment by setting up shell companies in a semi-official Taiwan trade centre in Hong Kong.

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56. Chia-chuan Li and Hsia-chia Kuo, "The Evolving Relations Between the Two Sides of Taiwan Straits: An Assessment And Prospect", *Tai-sheng*, supra note 40, p. 5.

57. For Taiwan's current official policy toward the PRC, see the text of a speech entitled "Zhonghua Minguo de Dalu Zhengcee" (The Republic of China's Mainland Policy), delivered by the Shao Yu-min, supra note 45. Also see *Zhongyang Ribao* (Taipei: Central Daily News), 20 September 1989, p. 4. Taiwan's Premier Lee Huan laid down a five-point mainland policy: reunification which constitutes the main thrust of Taipei's mainland policy, is to be achieved through peaceful means, democratic evolution, initiative, security, concern, and gradualism.

58. Zhichun Zou, "Shishi Paoqianmian, Juece Yiluzhui, Falü Pinming Gan" (The Current Events Are Always in Front of Policy and Law), *Zhongshi Wanbao* (Taipei: China Times Evening Post, 10 September 1992), p. 3.

On 7 March 1991, Taiwan announced a re-unification initiative in its relations with the PRC called "Guidelines for National Re-unification." These "Guide-lines" divided the re-unification process into three stages, namely: in the short-term, promoting exchanges for mutual benefit; in the medium-term, promoting mutual trust and cooperation; and in the long-term, achieving re-unification through consultation. Although no time-frame for these three stages was set, a semi-official "Straits Exchange Foundation" (SEF) was created to deal with Taiwan-PRC relations in the short-term. Moreover, an opening up of direct trade and contacts within the next few years is believed to be inevitable. With regard to the medium-term stage, it has been expected that Taiwan will eventually lift the barriers on direct trade and direct investment with the PRC.<sup>59</sup>

In 1992, Taiwan's Mainland Affairs Council of the Executive Yuan lifted the ban on indirect investment to the PRC by certain service industries.<sup>60</sup> Moreover, in July 1992, Taiwan promulgated a special law - entitled the "Statute Governing Relations Between People of the Areas of Taiwan and Mainland China" (hereinafter, Taiwan's Mainland Relationship Statute, or the TMRS), designed to serve as the primary source of legal authority to direct any civil exchanges across the Taiwan Strait and to resolve any conflicts that might result from such interaction.<sup>61</sup>

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59. *Jingji Zibao* (Taipei: Economic Daily News), 18 March 1991, p. 1. It was reported that Taiwan government would allow direct trade links with the PRC in one to six years.

60. Taiwan to Let Service Industry Invest in China, *Reuter Libr. Rep.*, 12 June 1992.

61. See note 37 of Chapter 1.

On the other hand, in July 1991, MOFERT in the PRC proposed five principles for promoting bilateral economic and trade relations with Taiwan. The five principles are first, economic and trade exchanges should be direct and bilateral; secondly, exchanges should be in line with the principle of mutual benefit and equality; thirdly, exchanges should not be confined to the fields of trade and investment, but be expanded to the fields of technology, scientific research, labour cooperation, and so on; fourthly, bilateral exchanges should be maintained and promoted for a long period; finally, both sides should respect contracts and try to protect the legitimate rights and interests of business people from the other side of the Straits.

In December 1991, the PRC established the "Association for Relations Across the Taiwan Straits" (ARATS) which is believed to be a counterpart of Taiwan's SEF. In March 1994, the PRC promulgated the Law of Protecting Taiwanese Investment (hereinafter, Taiwan Investment Law, or TIL) thereby supplementing its earlier legislation -- TIP in this area.<sup>62</sup> The TIL is enacted in response to demands by Taiwanese investors for better protection as they believe provisions as administrative orders are less than a law in the PRC.

### 3.3 Main Features of Political Structures and Legal Systems of the PRC and Taiwan

The efficiency of a country's economic activities is always conditioned mainly by the presence of its political and legal systems. The two systems are typically constrained by a country's constitution, which

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62. The TIL was adopted by the sixth Session of the Standing Committee of the eighth National People's Congress on 6 March 1994. See *China Economic News* (No. 11), 21 March 1994, pp. 6-7.

sets forth the political structure and basic laws against which all other economic activities occur.

### 3.3.1 The political systems of the PRC

The PRC government is organised in accordance with the PRC Constitution, the most recent version of which was adopted by the NPC in 1982 and amended in 1988 and 1993.<sup>63</sup> The government consists of an elected legislature, which is the repository of authority, and appointed administrative bodies that implement decisions of the legislature, a structure which characterises the relationship between the NPC and the various administrative organs of the national government.<sup>64</sup> This structure is duplicated at each of the lower levels of government.<sup>65</sup> The administrative organs at each level of government derive their authority from the People's Congress at local level and are accountable thereto.

The legislative and administrative authority of PRC governmental bodies is coterminous with its territory. Thus, the NPC enacts national legislation, and central governmental administrative bodies adopt regulations and issue orders, decrees and decisions that have national

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63. The most recent constitution of the People's Republic of China was promulgated for implementation on December 1982 and was amended in 1988 and 1993. The PRC constitutions were designed to outline political goals as well as to establish a state structure. So, the constitution can be amended by a simple majority vote of the NPC. The preamble proclaimed the central role of the CCP in the political and economic life of the state. See Alvin Rabushka, *The New China*, USA: Westview Press Inc., 1987, p. 25.

64. The PRC administrative organs of the national government include the State Council, the Central Military Commission, and the Courts.

65. The lower levels of government in the PRC are provincial, county, prefectural and municipal governments.

application. By contrast, legislation adopted for example by a regional People's Congress at the provincial level, is effective only within the jurisdiction of that Congress. The same is true for administrative decisions by regional governmental agencies. So, a regional People's Congress is accountable to any People's Congress which is superior to it and ultimately to the NPC. A regional administrative agency is accountable to any People's Congress on the same level and is also accountable to administrative agencies at higher levels.

The NPC is the highest ranking organisation in the state hierarchy. It consists of nearly three thousand representatives from all provincial-level bodies and from the People's Liberation Army. It is authorised to supervise the implementation or amendment of the nation's Constitution. The NPC is also charged with the adoption and amendment of basic laws, such as, the Criminal Code, the General Principles of Civil Law, and so on. The NPC has the authority to elect or remove the State Chairman and Vice Chairman, the Chairman of the Central Military Commission, and President of the Supreme People's Court. It has ultimate authority over all major matters of state, including the review and approval of the plan for national economic and social development and the state budget.<sup>66</sup>

The NPC appoints the Premier of the State Council on the recommendation of the State Chairman. The State Council is the highest administrative organ of the state. It has responsibility for the operations of all ministries and commissions at state level as well as for state administrative agencies at local levels. It also proposes the state plan and the state budget and sees to their implementation. There are currently forty one ministries and state commissions under the State Council.

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66. The duties and powers of the NPC are specified in the Chapter Three of the 1982 PRC Constitution.

Administratively, the PRC is divided into twenty-three provinces and, in addition, three municipalities directly under the Central Government which are Beijing, Shanghai and Tianjin. There are also five autonomous regions: Inner Mongolia, Guangxi, Ningxia, Xinjiang and Tibet. The provinces, municipalities and regions all have equal status and report directly to the State Council. The four principal levels of government administration are the central, the provincial (which includes provinces, autonomous regions and directly administered municipalities), the county and the township.

The PRC Constitution provides for multiple political parties, of which the CCP is the governing party. There is no formal intersection between party and government.

### 3.3.2 Political System of Taiwan

When the CCP took control China in 1949, the KMT under Chiang Kai-shek moved to Taiwan and has since then continued its 1947 Constitution<sup>67</sup> in Taiwan. The constitution was amended in 1991, 1992, and 1994 for three times with ten supplementary articles. The KMT, existing as a ruling party, has been relaxing its grip on political life in Taiwan. The opposition party was allowed to mount a serious challenge to the KMT.

Under the President and Vice-President of the state, the constitution in Taiwan provides for five branches of government which are known as five Yuans (similar to Chambers in the West) with five powers: Executive Yuan,

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67. Taiwan's Constitution is officially called Constitution of the Republic of China, promulgated on 1 January 1947 and became effective from 25 December 1947.

Legislative Yuan, Juridical Yuan, Control Yuan, and Examination Yuan.

The Executive Yuan is the state's highest administrative organ, and in most ways resembles the cabinet of Western countries. The Yuan's President, the Premier, is nominated and appointed by the President of the state with the consent of the Legislative Yuan.<sup>68</sup> It is responsible to the President of the state and its members are ministers in charge of ministries and ministers without portfolio.

The Legislative Yuan is the highest law-making organ of the state. It is made up of members elected for a term of three years by direct popular suffrage.<sup>69</sup> The Legislative Yuan has a President and Vice-President elected by and from among its members.<sup>70</sup> According to Article 57 of the Constitution, the Executive Yuan is responsible to the Legislative Yuan.

The Judicial Yuan is the highest judicial organ of the state. To it are entrusted the duties of safeguarding the rights of the people, maintaining social order, and consolidating the security of the state. It consists of a Council of Grand Justices, the Supreme Court, the Administrative Court, and the Committee on the Discipline of Civil Service Personnel.<sup>71</sup> The Judicial Yuan has a President and a Vice-President, who are nominated by the President of the state and with consent of the National Assembly.<sup>72</sup>

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68. Ibid., art. 55.

69. Ibid., art. 62.

70. Ibid., art. 66.

71. See Law of Organisation of the Judicial Yuan, amended in 1992, art. 3 and 7.

72. See Supplementary Articles of the Constitution, amended in 1994, art. 4.

The Examination Yuan is the state's highest examination organ. Under it, the Ministry of Examination and the Ministry of Personnel attend to matters pertaining to the examination, recruitment, and placement of civil service personnels at all levels of government. The Examination Yuan has a President, a Vice-President, and a certain number of members, all of whom are nominated by the President of the state and with the consent of the National Assembly.<sup>73</sup>

The Control Yuan, the highest supervisory organ of the state, is composed of members elected by provincial and municipal councils for a term of six years.<sup>74</sup> It exercised the powers of consent, impeachment censure, and audit.<sup>75</sup> The Control Yuan has a President and a Vice-President elected by and from among its members.<sup>76</sup>

Under Taiwan's present Constitution, the national government is empowered to delegate wide administrative powers to provincial and county governments. Thus, under the Taiwan Provincial Government are county and city governments; and under control of the counties, are district and town municipal administrations. The Provincial Governor, members of the Provincial Assembly, county magistrates, mayors, city and county councillors, and chiefs of townships and villages are elected by direct suffrage.

Political parties and government structures do not coincide at any point as Taiwan has many political parties of differing lines, of which the KMT is the

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73. Ibid., art. 5.

74. Supra note 67, art. 91 and 93.

75. Ibid., art. 90.

76. Ibid., art. 92.

ruling one and the Democratic Progress Party (DPP) is the main opposition party.

### 3.3.3 Legal System of the PRC

The PRC is still in the process of developing a comprehensive system of laws, although a significant number of laws and regulations dealing, in particular, with economic matters and foreign investment have been promulgated since 1978, when the PRC first embarked on its policy of economic reform.<sup>77</sup> In December 1982, the PRC amended its Constitution to authorise foreign investment and to guarantee the "lawful rights and interests" of foreign investors in the PRC.<sup>78</sup> The Constitution was amended again in 1988 and in 1993 to provide for a "socialist market economy".<sup>79</sup>

National laws of the PRC are promulgated by the NPC.<sup>80</sup> The State Council (and certain of the entities affiliated with the State Council) and the People's Congresses at the provincial and municipal levels also have the power to promulgate administrative measures, rules and regulations having the force of law at provincial and municipal levels respectively.

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77. See generally, James V. Feinerman, "Economic and Legal Reform in China, 1978-91", *Problems of Communism*, Sept.-Oct. 1991, p. 62.

78. See art. 18 of the 1982 PRC Constitution.

79. The term "socialist market economy" (*Shehui Zhiyi Schichang Jingji*) was initiated by Deng Xiaoping in 1993 as a new economic reform in which the market economy is described as compatible with either socialist or capitalist economies.

80. See art. 62 of the PRC Constitution.

The civil legal system of the PRC is one based upon written statutes. Decided cases do not have binding force on the courts, although such cases are sometimes referred to for guidance. All foreign individuals, enterprises and other entities have the same rights and obligations as PRC individuals, enterprises and other entities instituting or defending proceedings in PRC courts. If, however, the rights and obligations of PRC individuals, enterprises or other entities to institute or defend legal proceedings are subject to any restriction in a foreign jurisdiction, then reciprocal restrictions may be imposed by the PRC courts on the rights and obligations of the individuals, enterprises or other entities of that foreign jurisdiction to institute or defend legal proceedings in the PRC. All foreign individuals, enterprises and other entities who wish to retain legal counsel in instituting or defending any proceedings in a PRC court may only retain lawyers qualified to practice in the PRC.<sup>81</sup>

The Supreme People's Court is the highest judicial body in the PRC.<sup>82</sup> It is responsible for supervising all other courts. In case of uncertainty in relation to the interpretation of any law, rule or regulation, the Supreme People's Court may be asked to provide a binding opinion on the interpretation of such law, rule or regulation.<sup>83</sup>

If any PRC court is asked to recognise or enforce a judgement or award handed down by a foreign court, such judgement or award will be recognised and enforced in the PRC where there is an applicable international treaty or

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81. The author was informed of this by a judge of the People's Court in Beijing in May 1992 while carrying out interviews in the PRC.

82. See art. 30 of the PRC's Law of the Organisation of the People's Court, amended in 1983.

83. Ibid., art. 33.

other arrangement for reciprocal enforcement of judgements between the PRC and the country in which the judgement or award is made.<sup>84</sup> Enforcement of such judgement or award must not, however, run counter to the basic principles of PRC law, PRC sovereignty, PRC security or the public interest.<sup>85</sup> Application for enforcement of foreign arbitral awards is dealt with in accordance with international treaties to which the PRC is a party, most importantly the Convention on the Recognition of Foreign Arbitral Awards, often known as "The New York Convention", to which the PRC acceded in 1987.

#### 3.3.4 Legal System of Taiwan

Taiwan law today towards the end of the nineteenth century is a codified system which was established in China on the model of continental countries. Between 1929 and 1935, the KMT finalised work on various drafts and provisional codes by enacting what came to be known as the Six Codes: the Constitution, the Civil Code, the Criminal Code, the Code of Civil Procedure, the Code of Criminal Procedure, and the Commercial Law. These Six Codes are still in force and having been retained by the KMT since 1949 when it moved from China to Taiwan.

As a general rule, there are three levels of courts, with appeals possible from the lower to the higher level.<sup>86</sup> The lowest court is the District Court, with its branch courts functioning in the "hsien" (county) or municipality.<sup>87</sup> Except in those cases otherwise provided

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84. See art. 267 of the PRC Civil Procedure Law, promulgated in 1991.

85. Ibid., art. 268.

86. See art. 1 of Taiwan's Law of the Organisation of the Court, amended in 1989.

87. Ibid., art. 8.

for the law, it is a court of first instance in all civil and criminal cases, and it also has jurisdiction over non-contentious matters. Cases are tried before one judge; only in exceptionally serious or complicated cases is a bench of three judges required.

Above the district Court level is the High Court which has jurisdiction in appeals from District Courts. In criminal cases involving offences against the internal or external security of the state, the High Court has jurisdiction at first instance. Cases are tried before three judges sitting as a bench.<sup>88</sup>

Above the High Court is the Supreme Court which sits in the capital of the state. It is the court of final resort. Except for minor civil and criminal cases, all cases can go on appeal to the Supreme Court.<sup>89</sup>

As for business laws, the Taiwan Civil Code applicable to every contract while Company Law, the Law of Negotiable Instruments, Maritime Law and Insurance Law (known as the special laws of Civil matters) take precedence over the provisions of the Civil Code in commercial matters.

In general, a judgement or award made by a foreign court is not recognised or enforced in Taiwan if Taiwan's court judgement or awards are not recognised or enforceable in the jurisdiction where the judgement or award was given. If a foreign judgement or award is from

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88. Ibid., art. 32.

89. In general, in civil cases in which the pecuniary value of litigation is less than NT\$100,000 (about T2,500), the parties cannot appeal to the Supreme Court. In criminal cases where the maximum legal penalty is less than three years' imprisonment, the accused is not allowed to appeal to the Supreme Court. See Code of Civil Procedure, art. 466; Criminal Code, art. 61, and Code of Criminal Procedure, art. 376.

a jurisdiction without reciprocity, it may still be submitted for recognition and/or enforcement to a Taiwan court in a separate action which would admit the foreign decision as evidence of the legal position in the case. As is the case in the PRC, the enforcement of a foreign judgements or awards must not run counter to public order and good morals of Taiwan.

### 3.4 Legal Framework for Private Links

#### 3.4.1 A General Theory

Private contracts create legal relationships, raise legal problems, and give rise to situations that may deteriorate into legal disputes. Basic issues such as the legal capacity of persons, jurisdiction, and recognition and enforcement of court judgements and of arbitration awards, all demand resolution. Specific disputes in areas such as trade and investment arise inevitably. The traditional legal order, expressed in domestic substantive law, in rules of conflict and, to a lesser extent, in principles of public international law, is usually sufficient to resolve such issues.

Taiwan and the PRC, however, do not recognise each other as separate states. The political reality is that the PRC views Taiwan as a local government and Taiwan regards the PRC as a political entity with "incomplete" sovereignty.<sup>90</sup> Accordingly, a strict application of

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90. An interview with Professor Chih-wen Wang, Chairman of Law Research Institute, Chinese Taiwan Cultural University, by Taiwan's *Zhongguo Shibao* (Taipei: China Times). See *Free China Journal* (Taipei), 28 May 1990, p. 5. As regards the official position, the Taiwan government is very unlikely to accept the PRC's proposal for reunification under a "one country, two systems" formula. Taiwan still treats itself as the sole legitimate government representing the whole China and agrees with the PRC that there is only "one China", but prefers to define the Taiwan-PRC relationship as "one

notions of non-recognition as understood in orthodox international law would be extremely detrimental to the conduct of private relations between Taiwan and the PRC.

However, there is a modern alternative to the orthodox view. According to "newer" theory, recognition of foreign law in private international law is largely independent of recognition of foreign governments in public international law. Public recognition is an executive act, influenced by moral approval of foreign governments and constrained by the vagaries of international politics. Recognition in private international law, whether through judicial, administrative, or legislative acts, is influenced by considerations of fairness to the parties and by a desire to facilitate private relations. The fundamental aim of private recognition is different from that of public recognition. Thus, the modern theory holds that the capacity, laws, and immunity of a firmly established but unrecognised foreign government can be given full legal effect in the domestic jurisdiction, provided that such recognition is not contrary to the public policy of the forum.<sup>91</sup>

From the point of view of state practice, a government may be recognised as the *de facto* government of a state based on a purely political judgment.<sup>92</sup> The *de facto* recognition of a state or government involves

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country, two areas." See *Free China Journal* (Taipei), 4 October 1990, p. 1.

91. The modern theory of conflict of laws makes recognition of private law relationships independent of political recognition of the government under which they were formed. See A. Anton, *Private International Law* (1967), pp. 82-85 and its second edition (1991), pp. 95-98. This modern view has been widely held by the international legal scholarship for over thirty years.

92. Ian Brownlie, *Principle of International Law*, 4th ed., Oxford: Clarendon Press, 1990, p. 94.

the recognition that a state is able to acknowledge the external facts of political power, as well as protect its interests, trade, and citizens, without committing itself to condoning illegalities or irregularities in the emergence of the *de facto* state or government.<sup>93</sup> The recognition of *de facto* is probably a necessary legal expedient. The distinction between "de jure/de facto recognition" and "recognition as the *de jure/de facto* government" is insubstantial. If there is a distinction it does not seem to matter legally<sup>94</sup>, because in the political sense recognition of either *de jure* or *de facto* can always be withdrawn; in the legal sense it cannot be unless a change of circumstances warrants it.<sup>95</sup>

From a legal point of view, the *de facto* government can be an "independent subject" in international law. The overwhelming weight of legal scholarship over the last quarter century supports this modern theory.<sup>96</sup> In regard to relations between Taiwan and the PRC, recognition of each other's laws does not necessarily imply recognition

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93. J. G. Starke, "Recognition", *Introduction to International Law*, 10th ed., London: Butterworths, 1989, p. 145.

94. *Ibid.*

95. *Ibid.*

96. Giving full legal status to the acts of unrecognized regimes for private law purposes has become a trend in international practices. See R. D. Leslie, "Non-Recognition of Government and the Conflict of Law: The Rhodesian Situation", 19 *Juridical Review* (1974), p. 127. See also "The Doctrine of Recognition - A Case note on *Bilang v. Rigg*", 7 *Victorial University Wellington Law Review* (1975), p. 477; Casenotes, "Access to United States Courts by Juristic Entities Created by Unrecognized Governments: *Federal Republic of Germany v. Elicofon*, Motion to Intervene by *Kunstsammlungen zu Weimar*" (E.D.N.Y. 1972), 12 *Columbia Journal of Transnational Law* (1973), p. 155; V. Li, "The Law of Non-Recognition: The Case of Taiwan", 1 *NW. J. Int'l L. & Bus.* (1979), p. 134; Wakamizu Tsutsui, "Subjects of International Law in the Japanese Courts", 37 *Int'l & Comp. L. Q.* (1988), p. 325.

of each other's governments. Political recognition of a government is not a prerequisite to the recognition of its laws.<sup>97</sup> Therefore, traditional concepts of sovereignty and national recognition should be subject to revision in accordance with the times and actual prevailing conditions. The orthodox international practice and international law are malleable. The problem between Taiwan and the PRC is not one of sovereignty, but one of law district which means jurisdiction. Sovereignty belongs to the nation itself and can *de jure* be claimed, while jurisdiction is a matter of political reality and can *de facto* be restricted within the law district.<sup>98</sup>

#### 3.4.2 A Particular Theory: Inter-Regional Conflicts of Laws

Since both Taiwan and the PRC adhere to a "one China" policy, an inter-regional conflict of laws approach is most appropriate for establishing a legal framework for private relations. Both Taiwan and the PRC recognise the authority of the other within their respective geographic jurisdictions. Under international law, the concept of "territorial sovereignty" signifies that within within thi territorial ddomain, jurisdiction is exercised by the state over persons and property to the exclusion of other states.<sup>99</sup> Using this framework, each side can apply its own established private

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97. See Tung-Pi Chen, "Bridge Across the Formosa Strait: Private Relations Between Taiwan and Mainland China", 4 *Journal of Chinese Law* 101 (1990), pp. 106-112.

98. See Wei Yung, "Dual Recognition Is No Obstacle To One China", *Zhongshi Wanbao* (Taipei: China Times Evening Post, 13 July 1991), p. 2.

99. J. G. Starke, "State Territorial Sovereignty and Other Lesser Territorial Rights of States", *Introduction to International Law*, 10th ed., London: Butterworths, 1989, p. 178.

international law rules to regulate private legal aspects of inter-regional relations.

Both Taiwan and the PRC would be well advised to adopt the private inter-regional model in conducting their trade and investment activities. This means that whenever it is proper, the laws and regulations of the other side should be applied by the courts. It is almost always possible to apply established principles of private international law. But a jointly-agreed code of law or any treaty arrangement regulating private relations between Taiwan and the PRC is unlikely for the foreseeable future.

However, nothing prevents each jurisdiction from separately enacting laws to govern private economic relations between them.<sup>100</sup> Examples are the TMRS of 1992, the TIP of 1988, and the TIL of 1994.<sup>101</sup> However, certain aspects of both Taiwan's and the PRC's existing private international law rules would require amendment

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100. "Fa" is the usual generic term for positive or written law as an abstraction ("law or "the law"), but it may also be used to mean particular laws. The term "fa" is a model or standard imposed by the Chinese superior authority, to which the people must conform. For both Taiwan and the PRC, "fa" is used in two different ways in this thesis. The first is in a broad sense, meaning all types of legally binding norms. The second refers to a particular subset of those legal norms with the title of "law" as opposed to "provision", "regulation", "measure", and so on.

101. The TIL was promulgated on 5 March 1994. This Law responded to the TIP of 1988. It is noted that the State Council of the PRC and its subordinate organs can promulgate provisions that are considered narrower in scope and less important than the National People's Congress and its Standing Committee, the supreme power organs of the PRC with legislative authority. The English word "provision" is used as a translation for two different Chinese words. The first is "fagui", a category of legal enactments usually of lesser significance than the category "falü" (laws). The second is "tiaoli", a term used in the title of certain individual enactments.

or replacement when incorporated as private inter-regional law.<sup>102</sup> In particular, nationality is an important connecting factor in the international conflict rules of Taiwan and of the PRC,<sup>103</sup> but is inappropriate for inter-regional conflict of laws. As both governments maintain that there is but one "China" and one "nationality", domicile or residence should replace nationality as a connecting factor for conflict rules governing relations between the two regimes.

In keeping with their rival positions, trade and investment between Taiwan and the PRC are ruled by two distinct systems of municipal law both of which are applied in the regulation of business transactions involving the other's legal system. As discussed, a political accord between the two leading to mutual official recognition is difficult, if not impossible, in the near future. Both Taiwan and the PRC require a legal basis for private relations independent of official recognition. According to the above stated modern theory

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102. For example, in the field of conflict of laws, the PRC could simply deem that Taiwan is a special legal jurisdiction for the purpose of chapter VIII of the General Principles of Civil Law and of other conflicts provisions. See T. P. Chen, "Private International Law of the People's Republic of China: An Overview", 35 *AM. J. Comp. L.* (1987), p. 445. Here the General Principles of Civil Law of the PRC was adopted on 12 April 1986. See [2 Business Regulation] *China Laws for Foreign Business* (CCH-Australian) ¶ 19-150 (1450-1452), [hereinafter, PRC Civil Law]. Similarly, Taiwan could amend its Law Governing the Application of Laws to Civil Matters Involving Foreign Elements so that the conflicts rules would also apply to the PRC. See *Laws of the Republic of China* (Taipei: Law Revision Planning Group, Executive Yuan, 1961) [hereinafter, *Laws of the ROC*], p. 828. For the relevant Taiwanese laws and regulations, see *Zhonghua Minguo Xianxing Fagui Huibian* (Compilation of Current Laws and Regulations of the Republic of China), published in Taipei, 1970 cited frequently as CCLRRC, is updated periodically in Chinese.

103. See, for example, *Laws of the ROC, id.*, Article 1; PRC Civil Law, *id.*, Art. 143, p. ¶ 19-150 (145); also see T. P. Chen, *id.*

of international law, the result of conflict of laws between the two would not be a legal vacuum: legally sanctioned transactions would exist, companies legally established by the laws would be considered existent and could sue or be sued in their non-recognizing jurisdiction, and court judgements on commercial affairs would not be nullities.<sup>104</sup>

### 3.4.3 Taiwan's Mainland Relations Statute

In July 1992, the Taiwanese government promulgated a special law, intended to address the complexities of the whole private Taiwan-PRC relationships, called the TMRS.<sup>105</sup> This Statute has ninety six articles covering civil, penal and administrative matters and applies conflicts of laws rules in civil matters. The structure of the TMRS is built around recognition of two fundamental distinct legal systems of the "Taiwan Region" and of the "Mainland Region." Most significantly, a number of the provisions of the TMRS indirectly but

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104. For an explanation of the theory of a legal vacuum, see, for instance, Lord Wilberforce's opinion in *Carl-Zeiss-Stiftung v. Rayner & Keeler Ltd.* (No. 2), (1966) 2 All E. R., p. 536, 575-92 (H.L.). The British House of Lords in this case allows unrecognized governments to bring suit if they can be viewed as a "subordinate body" of a recognized government. What will be decided by the British government is only whether it will deal with that foreign government or not by giving full legal status to the acts of unrecognised regimes for private law purposes. See Ian Brownlie, "Recognition in Theory and Practice," *British Yearbook of International Law* (1982), Vol. VIII, pp. 209-210.

105. *Supra* note 61. An unofficial draft law of similar nature was also prepared by a group of the PRC academics. See "Act on the Relationship Between the People of the Mainland Region and the People of the Taiwan Region", in *Taiwan Falü Yanjiu* (Taiwan Law Studies), Beijing: Taiwan Law Research Institute, 1989, p. 10.

effectively recognise the authority of the PRC law in the context of private inter-regional law.<sup>106</sup>

To some extent, the TMRS gives effect to the modern theory outlined above, authorising and recognising private law relations despite the continued absence of political recognition.

The PRC and Taiwan would be well advised to adopt the private inter-regional model. The modern approach in the conflict of laws makes recognition of private law relationships independent of political recognition of the government under which they were formed. In the area of commercial relations, the two governments should consider using an established intermediary to authenticate legal documents received from the other side.

As discussed above, some non-government intermediaries such as the Taiwan's SEF and the PRC's ARATS should not only be created in both regimes' own jurisdiction but also be established in each other's jurisdiction. Their presence would provide an especially practical solution to the need for an intermediary, as the services would be backed with professional accountability if there were any abuse of authority.

#### 3.4.4 Issues of Substantive Law

From 1949 to 1979, contacts between separated spouses and family members, as well as bequests or

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106. For example, Article 74 provides that civil law judgements and civil law arbitration decisions rendered in Mainland China may be given legal recognition and enforced in Taiwan after a Taiwanese judicial ruling accepting the judgement is obtained. This means that the PRC legal judgements must be first wrapped in a layer of Taiwan legality, so that the enforcement of such judgement is not recognition of the PRC law but execution of Taiwan law.

successions across the Taiwan Straits were forbidden because of the political intransigence of both the PRC and Taiwan. Since 1979, private relationships have been permitted, and even encouraged by the authorities of the PRC.<sup>107</sup> Despite the PRC's seemingly friendly posture, Taiwan government has adhered strictly to its "Three No's" policy of "no contact, no negotiation, and no compromise".<sup>108</sup> Nevertheless, the PRC has made continued efforts to promote direct and extensive private relationships with Taiwan, especially in trade and investment.<sup>109</sup> By contrast, Taiwan has been more cautious in easing restrictions on contacts with the PRC. Many of these restrictions continue to be detailed in formal legislation.<sup>110</sup>

Under such circumstances, those articles of the TMRS which address issues of substantial law generally take a cautious and restrictive approach to the opening of private relations with the PRC. Almost all relationships

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107. *Supra* note 33.

108. For Taiwan's "Three No's" policy, see Leung, "Taiwan Officials Urge Reunification Comprises," *Hong Kong Standard*, 12 April 1989, p. 6. Reprinted in *Foreign Broadcast Information Service - Daily Report, China*, 13 April 1989, p. 59.

109. As the modernization movement took hold around 1979, the PRC began to assume a more peaceful posture toward Taiwan, partly because a good international image was crucial to attracting the capital it so desperately needed for economic development. See, for example, Yan Mingfu on Trade Cooperation with Taiwan, *Foreign Broadcast Information Service - Daily Report, China*, 7 April 1989, p. 79.

110. Since July 1987, lifting of martial law in Taiwan, the various executive and judicial measures have paved the way for legislative action. Prior to the promulgation of TMRS in 1992, the government itself had only a few amendments in the law for the just implementation of its so-called Mainland policies. With regard to visitations, for example, there was no Taiwan legislation affirming the legality of Taiwan residents visiting to Mainland China until the introduction of the TMRS in 1992.

are subject to "approval" by the "authorities." Two sensitive areas "succession rights" and "family law" between Taiwan and the PRC are discussed below.

#### A. Succession Rights

Article 66 and 67 of the TMRS govern succession rights. In both underlying rationale and proposed effect, these articles are misconceived. They create unfair restrictions on the inheritance rights of people in the PRC and impose excessive administrative burdens. In addition, they are politically counterproductive in promoting evolution towards a peaceful relationship between the two regimes.

Article 66 stipulates a time limit of two years for a PRC heir to come to Taiwan and to claim the estate of the deceased. This is an unrealistic time frame in which to secure an exit visa from the PRC and to pass through Taiwan's security and various other checks for admission to the island country. In the absence of any logic for such a short limitation period, it should be extended to a more reasonable length.

Article 67 provides that PRC successors to an estate situated within the Taiwan Region are only entitled to a one-half share of their inheritance not exceeding NT\$2 million per successor, roughly equivalent to US\$80,000.<sup>111</sup> The well-publicized rationale is that the PRC heirs have not contributed to the accumulated wealth

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111. Normally, according to Article 1141 of the Taiwanese Civil Code, "[w]here there are several heirs of the same order, they inherit in equal shares per capita..." See *Laws of the ROC* (1961), supra note 70, p. 83. A similar provision is found in Article 10 and 13 of the PRC Succession Law. See *Collections of the Laws of the PRC*, supra note 50, p. 326.

of the deceased.<sup>112</sup> This argument is patently weak. The theory of succession has never been based on the beneficiary's contribution to the wealth of the estate of the deceased. The restriction and the reason behind it gives an impression of petty provincialism and has drawn severe criticism from the PRC.<sup>113</sup>

A preferable solution would be to allow the PRC heirs equal shares in the estate.<sup>114</sup> By deferring successors' rights to collect their shares, the interests of the heirs could be safeguarded, and at the same time Taiwan's political requirements could be satisfied. The estate could be held in trust by the government until such time as the PRC heirs could benefit substantially from the inheritance without possible government interference, and until such time as the two sides are in a state of peaceful relations. In the interim, a sum from the estate could be extracted for the necessary maintenance of the heirs and dependents which could be far below the US\$80,000 maximum allowed in the TMRS.

A precedent for the suggested temporary trusteeship can be found by examining American alien inheritance statutes enacted during the immediate post-war era when the United States and the former Eastern bloc countries were locked in bitter rivalry. Money and property were often withheld under statutes intended to safeguard the beneficiary's rights until the person could show that he

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112. On "Succession to the Taiwanese estate by Mainland Chinese Compatriots," *Shijie Ribao* (New York: The World Daily), 1 June 1989, p. 12.

113. Art. 67 of the TMRS is seen by many as purely discriminatory. The severe criticism was seen, for example, on PRC legal scholar Yu Sinzu's article "Guanyu Haixia Liangan Jichenfa de Bijiao Yanjiu", *Faxue Yanjiu* (Beijing: Study of Jurisprudence), No. 2, 1990, pp. 1-2.

114. For theories of wealth by inheritance, see Tai Yan-hui & Tai Tung-hsiung, *Zhongguo Jicheng Fa* (Chinese Succession Law), (rev. ed.), 1986, pp. 1-4.

or she alone would receive the intended benefits, and to ensure that American resources would not be used by the former Eastern bloc countries against the United States.<sup>115</sup>

## B. Family Law

The hundreds of thousands of "successive" marriages contracted by KMT followers who came to Taiwan from Mainland China before the Communist takeover in 1949 -- these constitute one of the most vexed questions in private Taiwan-PRC inter-regional conflicts. One or both of the spouses who were married on the Mainland before 1949 have new spouses in Taiwan or in Mainland China through subsequent marriages. The case of Deng Yuan-jeng is a typical illustration: for all legal purposes, the second marriages were bigamous.<sup>116</sup>

The background of this case is that Deng married his Chinese wife Chen in Fujian in 1940. When the PRC was founded in 1949, Deng left for Hong Kong alone and then resettled permanently in Taiwan. In 1960, lying about his marital status, Deng married a Taiwanese wife Woo. In 1986, Chen, after having left for Hong Kong herself, through a Taiwanese lawyer, brought suit against Deng for bigamy, seeking to annul his second marriage. Taiwan's district court ruled in favour of Deng's mainland Chinese wife and stripped the twenty eight-year relationship with Deng's Taiwan wife of all legal effect. The High Court and Supreme Court upheld the same decision.<sup>117</sup>

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115. See Dorman, How "Cold War" Freezes Funds Due to "Iron Curtain" Nationals, 20 *Brooklyn Barrister* (1968), p. 54; see generally Note, Alien Inheritance Statute and the Foreign Relations Power, *Duke Law Journal* (1969), p. 153.

116. For further discussion of the Deng case, see Tung-hsiung Tai, *Faxue Congkan* (Taipei: *China Law Journal*), Vol. 133, January 1989, p. 25-26.

117. See Dongwei Dai, "Ershiba Nian de Laogong Zenmo Meile?" (Why was a Twenty-eight Years Husband Gone?),

During this case, successive marriages between parties in the PRC and Taiwan, and many others, violate the elementary principle of monogamy which forms the cornerstone of Taiwan's marriage system as embodied in its Civil Code, and of the PRC's marriage system as provided in its Marriage Law.<sup>118</sup> The action commenced in Taiwan courts by Deng's first wife in Taiwan courts to render the Taiwanese marriage void was upheld by all three levels of the judiciary.

This outcome seemed to have harsh and impractical consequences, and it is possibly in view of these that the Grand Judicial Council, Taiwan's body responsible for constitutional interpretation held the Supreme Court decision to be a violation of Article 22 of Taiwan's Constitution which guarantees the "freedoms and rights of the people". The remedial provisions in the TMRS (Articles 63 and 64) confirm the Grand Judicial Council's decision. By so doing, however, they create the extraordinary and unintentional situation whereby polygamy can be tolerated in a society where Taiwan's Civil Code has unequivocally established the basic principle of monogamy. The same stance is taken in PRC policy statements,<sup>119</sup> placing Taiwan and the PRC in identically anomalous positions.

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*Faxue Congkan* (Taipei: *China Law Journal*), Vol. 133, January 1989, pp. 27-33.

118. The elementary principle of monogamy is expressly stipulated in the Taiwanese Civil Code. Article 985 declares, "A person who has a spouse may not contract another marriage." See *Laws of the ROC*, *supra* note 70, p. 304. Polygamy is a criminal offence punishable by imprisonment, Criminal Code, Article 237, See *LAW OF THE ROC*, *supra* note 70, pp. 960-61. Similar provisions are in Article 312 of the PRC Marriage Act of 1980 and in Article 180 of the PRC Criminal Code of 1979.

119. The PRC seems to have taken a similar position. See an address by Ma Yuan, *supra* note 50, p. 1.

If however the second marriage were to be presumed valid, and the first marriage void from the time of the second marriage, this measure would effectively serve not only to preserve monogamy but also to mitigate the harsh consequences created by rendering one of the successive marriages voidable. This presumption would be conclusive if both of the original spouses had remarried. If only one spouse had remarried, the validity of the first marriage would be contingent on the previously unmarried spouse of the second marriage choosing to opt out of that marriage; the choice would thus be given to the previously unmarried spouse of the second marriage as that individual would be the most innocent victim of the three parties involved. To enable the courts to deal most effectively with the huge number of possible applicants, the decision in such cases could be made within a prescribed time period by means of summary procedure. To protect the interests of spouses, whenever a marriage has been declared void, it would still be given civil effect. The spouse of the voided marriage would enjoy all civil rights previously enjoyed, such as the rights to support, inheritance, workman's compensation, and division of property, which are inherent in a marriage.

This solution would give effect to the expectations of all parties. It recognizes that the ongoing relationship is usually the stronger bond and should at first view be preserved over another marriage. At the same time, the solution compensates the party whose marriage has been rendered void or voidable by introducing legislation to maintain the civil effect of marriage. If this measure were to be adopted, Taiwan and the PRC could deal fairly with individuals caught in a common and disturbing situation, and at the same time preserve the basic principle of monogamy.

### 3.5 Conclusion

Unless Taiwan and the PRC can reach a compromise for cooperation in the private law sphere, private relations between the two will continue to be impeded and political relations poisoned by an atmosphere of rivalry, suspicion, and intransigence. The potentially enormous benefits of a closer economic relationship will be put at risk. Rebuilding a suitable and workable legal framework in adapting to the economic development of both sides is essential.

As noted above, the TMRS encapsulates only the unilateral policy decisions and implementation measures Taiwan has arrived at with respect to private contacts with the PRC. Whether the PRC will move in the same direction and adopt similar procedures is not clear. The only official indication available is in the 1988 Supreme People's Court news conference on how civil cases involving parties from Taiwan are handled.<sup>120</sup>

Taiwan's development of a careful and balanced TMRS is an important step toward closer relations. Its cautious stance may be justified, given the present political rivalry with the PRC. The TMRS may even be criticised as an anachronistic legal provision, however, it is still a good model for the PRC to use as a reasonable legal framework, at least for Taiwanese trade and investment within its sovereignty. Although the Taiwan-PRC situation is unique, both governments may benefit from foreign experience on both theoretical and practical levels to move towards a prosperous economic relationship.

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120. Ibid.

## CHAPTER FOUR

### LEGAL FRAMEWORK OF PRIVATE BUSINESS CONTRACTS FOR TAIWANESE TRADE AND INVESTMENT IN THE PRC

The following description of legal problems of private business contracts for Taiwanese investment in the PRC is broadly applicable to the three forms of enterprises with foreign-investment that can be established in the PRC: equity joint ventures (hereinafter, EJV), contractual joint ventures (hereinafter, CJV) and wholly foreign-owned enterprises (hereinafter, WFOE).

At the outset, it is worth noting that the PRC's foreign investment policies first received recognition not very long ago: in 1979 and 1982 respectively. It was only after the Law of the PRC on Chinese-Foreign Equity Joint Ventures<sup>1</sup> (hereinafter, EJV Law) in 1979, that PRC's 1982 Constitution could, for the first time, expressly recognise the importance of foreign investment.

In regard to foreign trade activities, business contracts in the PRC are basically similar to investment contracts, subject to their own discrete set of laws, regulations and guide-lines.

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1. The Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures was adopted by the second Session of the fifth National People's Congress on 1 July 1979. An unofficial text of the law may be found in *Beijing Review*, 20 July 1979, pp. 24-26 [hereinafter Equity Joint Venture Law, or EJV Law]. At the outset, it is worth noting that the PRC's foreign investment policies first received recognition, after the adoption of this Law, by the 1982 Constitution.

#### 4.1 Characteristics of Legal Problems for Private Business Contracts

Taiwan and the PRC enjoy ties of international trade and investment *de facto*, but domestic trade and investment *de jure*.<sup>2</sup> To date, most trade and investment activities have been conducted indirectly through an intermediary. Trade and investment usually co-exist and are complementary. As in other countries, the final stage of trade and investment transactions between Taiwan and the PRC parties is ordinarily concluded by the creation of a valid contract. However, the contractual relations between the two parties involve a foreign-related (known as "shewai" in Chinese) element, and any agreement is, therefore, considered to have the general characteristics of an "international" business contract.<sup>3</sup>

In theory, Taiwan's trade and investment with the PRC has not been seen as "foreign" trade and investment. However, in reality, Taiwanese trade and investment in the PRC have been regarded as having "foreign" element, in view of PRC's economic law and policy. This was first shown in October 1986 when the PRC promulgated its "Provisions for Encouraging Foreign Investment." The Provisions are, in principle, applicable to the Taiwanese businesses when dealing with parties in the PRC.

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2. Both Taiwan and the PRC agree that there is only one "China". Thus, strictly speaking the use of the terms "international trade" and "international investment" seems inapplicable.

3. See Kuei-sheng Cheng, *Shewai Qiyefa Zhi Bijiao Yanjiu* (A comparative study of contract law involving foreign elements. It is a revised edition of a textbook of international contract law, published by the author in Taipei, 1980.), pp. 1-7. As regards contracts, also see D. M. Johnson & H. Chiu, *Agreements of People's Republic of China 1949-1967, A Calendar*, Mass.: Harvard University Press, 1968, p. 225, Glossary.

In the PRC, the vast majority of trade and investment relations with foreign countries are between foreign enterprises and the PRC's foreign trade corporations (FTCs).<sup>4</sup> In the absence of a controlling PRC contract law, the FTCs have used form contracts to conduct their commercial activities.<sup>5</sup> Domestic and foreign contract laws differ in the PRC, as evidenced by the introduction of the Economic Contract Law (ECL) in 1981 and the Foreign Economic Contract Law (FECL) in 1985. The ECL governs transactions between PRC entities in all areas of economic contracts, while the FECL is a codification of PRC's foreign economic practice.<sup>6</sup> For historical reasons and by reason of their peculiar status, compatriots from Hong Kong, Macao, Taiwan, and overseas Chinese may at present in principle conclude contracts with the PRC's domestic subjects based on the FECL. They are thus tantamount to foreign subjects. Moreover, the PRC promulgated special "Taiwanese Investment Provisions" (TIP) in July 1988. The TIP further affirm that the general body of foreign economic legislation of the PRC should be applied to Taiwanese businessmen in their business dealings with parties in the PRC.

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4. E. A. Theroux, "Technology Sales to China", 14 *Journal Of International Law & Economics* (1980), p. 185, 196; see generally pp. 21-24 and accompanying text for discussion of FTCs.

5. K. P. Herbst, "Selling into the People's Republic of China: The Legal Problems", *International Business Lawyer* (1987), Vol. 5, No. 7, pp. 303-306.

6. The Economic Contract Law of the PRC was adopted at the Fourth Session of the Sixth National People's Congress on 13 December 1981. See H. R. Zheng, "A Comparative Analysis of the Foreign Economic Contract Law of the People's Republic of China", 3 *China Law Reporter* (1986), pp. 227, 232. The Law was amended by the Standing Committee of the Eighth National Congress on 2 September 1993. For the text in Chinese, see *Renmin Ribao* (overseas ed.), 6 September 1993, p. 2.

Nevertheless, a business' contract signed between parties from Taiwan and the PRC -- still politically separate and intent on claiming their own domestic legitimacy -- is rather special. Since both parties have radically different political ideologies and economic systems, the legal, contractual and related problems involved in the principal forms of trade and investment are as a result totally different from those of countries which have formal diplomatic ties with each other or share the same economic system. Besides the problem of different economic systems existing between parties, mirroring East-West trade issues, there is also the political problem of lack of formal diplomatic ties. This gives rise to the complicated legal relations which exist in a situation of non-recognition.

Generally speaking, the legal, social, and economic systems of the former Eastern bloc states differ very much from those of Western capitalist countries. In trade, the Eastern bloc adopted the state trading system with their own government monopolies.<sup>7</sup> Accordingly, the state can therefore decide what is to be bought, sold, bartered, or "dumped" abroad. The government's monopoly goes beyond the regulation, direction and control of a nation's foreign commerce. State trading agencies have authority to transact with legal effect.<sup>8</sup> In the PRC, trade has remained more obviously subordinate to political strategy than in other countries and has to some extent been a shuttlecock in the country's internal

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7. Under a special decree promulgated by Lenin in April 1918, foreign trade was one of the first economic functions nationalized by the Soviet government. With the advent of other communist regimes in Europe and Asia, the same principle of state trading was established throughout the affected areas. See S. Pisar, *Coexistence and Commerce*, New York: McGraw-Hill Book Company, 1970, p. 141.

8. Pisar, *ibid.*, p. 142.

politics.<sup>9</sup> The extensive private elements in the PRC's foreign trade were virtually eliminated by 1954.<sup>10</sup> Since foreign trade activities after 1949 were governed by the principle of state monopoly, the PRC's foreign trade structure and organisations were quite similar to those of the Soviet Union.<sup>11</sup>

The machinery of central planning and strict state control of the conduct of foreign trade was established when the Chinese communist government came to power in 1949. This centrally controlled system of foreign trade remained unchanged until the reforms of the foreign trade system began in 1978. Before the reforms, the PRC's foreign trade institutions were structured as follows, with a Ministry of Foreign Trade (MFT), and under this, national FTCs with their branch offices located in principal cities. The foreign trade bureaux in provinces, municipalities, and autonomous regions were under the dual leadership of the MFT and the local government. Under this system, foreign trade was monopolized by the MFT, and the only institutions conducting import and export business on behalf of domestic suppliers and users were the national FTCs and their branch offices.

In 1978, the emergence of a new economic policy in the PRC, known as the "Open Policy", was accompanied by a rapid increase in contractual activities between the PRC

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9. See R. Starr, "Developing trade with China", 13 *Virginia Journal of International Law* (1973), p. 13, for an account of developments in this area.

10. See V. H. Li, "Legal Aspects of Trade with Communist China", *Columbia Journal Of Transnational Law* (1964), Vol. 3, p. 57.

11. K. D. Gott, "China's Foreign Trade Policies and Practices", *Trade with China*, (ed.), P. H. Boarman & Jayson Mugar, New York: Praeger Publishers, 1974, p. 91, 93.

and foreign enterprises.<sup>12</sup> As part of the comprehensive reforms of the economic system, a restructuring of the foreign trade system took place in the same year. Since then, foreign trade has been decentralized to localities, industrial enterprises and other ministries, which are permitted to authorize trading corporations to carry out import-export business and other economic activities after approval by the State Council. From 1978 to 1982, new corporations approved by the State Council or by the state-appointed corporations numbered 140, of which 69 were trading corporations, 13 contracted corporations and 30 advisory and service corporations.<sup>13</sup> Prior to March 1982, the MFT was responsible for all matters relating to foreign trade. After March 1982, the planning and control of foreign trade and economic cooperation with foreign countries were enhanced when the MFT became the Ministry of Foreign Economic Relations and Trade (MOFERT).<sup>14</sup>

At the present time, foreign trade activities are no longer monopolized by MOFERT alone, but MOFERT still retains decision-making power in administering a system of state monopoly.<sup>15</sup> Many legal peculiarities stem from

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12. J. P. Stevens, "The New Foreign Economic Contract Law in China", 18 *Law & Policy of International Business* (1986), pp. 455-457.

13. See U. N., Economic and Social Commission for Asia and the Pacific (comp., hereinafter, ESCAP), *Guidebook on Trading with the People's Republic of China*, London: Graham & Trotman Limited, 1984), p. 79.

14. *Ibid.* In February 1982, the PRC's State Administrative Commission on Import and Export Affairs, the Ministry of Foreign Trade, the Ministry of Economic Relations with Foreign countries and the State Foreign Investment Commission were merged into a new ministry, the Ministry of Foreign Relations and Trade (MOFERT).

15. As regards the state monopoly, the direction and performance of foreign trade activities is in the hands of some interlocking institutions of state but not the particular state institution itself. See Hsin-shan Liu, "Dongou Guojia Duiwaimaoyi Zhidu Zhi Yanjiu" (Analysis on Foreign Trade System in Eastern European Countries), *The National Chengchi University Law Review*, Taipei: Chengchi University Press, June 1980, No. 22, p. 41. Also see S.

foreign trade parties contracting as a result of the state monopoly in the PRC. It can be shown that the investment contract, however, is endowed with the same characteristics as the state monopoly. An example is that the native investment partner is in fact an agency of the PRC government.<sup>16</sup> The PRC, reflecting East-West trade practices, has developed its own trade contracting norms in many areas. Taiwan, in the non-recognition circumstances of its current separation from the PRC, plunged headlong into the rough and tumble of commerce before direct trade relations were established. However, recognition is a function of government and as a political action would have certain legal consequences.<sup>17</sup> It is also an issue of international law.

The fact of non-recognition will not necessarily interfere directly with the private business contracting activities between two countries. In East-West trade, business dealings between Eastern and Western countries have continued even in the absence of diplomatic relations, and when political tensions have been high.<sup>18</sup> However, non-recognition may give rise to some limitations in business transactions. In short, there will be conflicts of national interest as a result. A state can certainly be expected to adopt a policy or law to limit or prohibit private business transactions with

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Pissar, *supra* note 7, p. 142. For further studies, see Cheng Yuan, *East-West Trade, Changing Patterns In Chinese Foreign Trade Law and Institutions*, New York: Oceana Publications Inc., 1991, chapter 2 and pp. 324-328.

16. Under the socialist system in the PRC, the state owns all the means of production and consequently any Chinese participant in a joint venture is an organ of the government. See C. A. Jaslow, "Practical Consideration in Drafting a Joint Venture Agreement with China", 31 *The American Journal of Comparative Law* (1983), p. 210, note 5.

17. D. P. O'Connell, *International Law*, Vol. 1, London: Stevens & Sons, 1970, pp. 127-128.

18. S. Pissar, *supra* note 7, p. 3.

another state which it does not recognize. International law will of course not be able to exclude such domestic discriminatory policy or enactment between states which do not recognise each other. Although this kind of policy and law would not necessarily be adopted between those countries which do not publicly recognise each other, private commercial activities between them would be largely restricted by this policy or law. The policy of prohibiting commercial transactions across the Taiwan Straits which was followed in the past, and the banning of trade and investment with communist countries by the Republic of Korea and the Taiwan authorities are examples of this.<sup>19</sup>

Under these circumstances, the contracting parties could not sign a valid contract. Nowadays, bans imposed by domestic policies have, for the most part, been lifted. Thus, an enforcement decree on guide-lines on exchange and cooperation with communist countries took effect in the Republic of Korea in February 1991. In addition, Taiwan's Ministry of Economic Affairs drew up a clear list of 3,353 items, divided into sixty-seven types, of indirect investment or technical cooperation that would be allowed in the PRC after October 1990. Taiwan established a semi-official "Straits Exchange Foundation" (SEF) in February 1991. This SEF works as a mediation group to promote trade and investment contacts with the PRC. In July 1992, Taiwan promulgated a special TMRS, which is designed to serve as the primary source of legal authority to direct any civil exchange across the Taiwan Straits and to resolve any conflicts that might result from such interaction.<sup>20</sup> However, obstacles and

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19. See the Trade Law of the Republic of Korea (promulgated on 16 January 1967 in Law Series no. 1878), Article 2; and Taiwan's "Regulations of Punishment for Treason" (enacted on 21 June 1949), Article 4, the sedition for financially assisting the "communist bandits."

20. TMRS, see note 37 of Chapter 1.

hindrances to conducting such commercial activities between parties of Taiwan and the PRC still remain because of continued non-recognition.

#### 4.2 Contracting Parties and Legal Methods

International trade relations are recognised as civil legal relations which involve a foreign element. The parties to international civil legal relations are mainly legal persons operating as private business in countries. However, state organs are also sometimes participants in this kind of legal relationship.<sup>21</sup>

In Taiwan, the entities that conduct trade and investment with the PRC are either natural or legal persons. Their legal positions are mainly dealt with in the Civil Code or in the four "Special Laws of Civil Matters" namely Company Law, the Law of Negotiable Instruments, Maritime Law, and Insurance Law.<sup>22</sup> But entities which participate in trade and investment in the PRC differ in nature from their counterparts in Taiwan, this difference being mainly the result of the adoption by the PRC of a state monopoly in its foreign economic dealings.

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21. Zhao Chengbi, *Guoji Maoyi Falü* (International Trade Law), Beijing: China External Economic and Trade Publishers, 1986, p. 88. For a summary of the legal person concept in the PRC Economic law, see Wang Baoshu and Cui Qingzhi, *Jingji Faxue Yanjiu Zongshu* (Summary of Research on Economic Law) (1989), pp. 72-74.

22. H. P. Ma, "General Features of the Law and Legal System of the Republic of China", in *Trade and Investment in Taiwan* (ed.), H. P. Ma, Taipei: Institute of American Culture, Academia Sinica, 1985, pp. 12, 17.

#### 4.2.1 Authority of the PRC Party

In order to enter into legally binding business relations, PRC organisations must be registered as independent legal entities with their own organisation and have operating funds and capacity to undertake civil liability. If they wish to enter into contracts for business cooperation, investment or trade with foreign companies, they must have a general authorisation to do so or obtain special approval.

The business licence of a PRC party will normally testify to its legal authority and scope of business capacity including whether it is able to enter into contracts with foreign corporations. It will also contain such other information as the PRC party's registered capital, its chairman and general manager, the period of validity of the licence and its registered address.

PRC government departments will not normally have the requisite authority to sign legally binding contracts, though they are often the initial point of contact for foreign businessmen. Where necessary, business units of government departments have been transformed into semi-independent operating companies with separate funding and business registration, so that they satisfy the legal conditions for conducting business with foreign companies.

#### 4.2.2 The PRC Contracting Parties and their Legal Status

Before 1978, the PRC's foreign trade was conducted exclusively through the national FTCs under the aegis of the MFT, trade attaches or representatives of diplomatic missions overseas, and agencies or sub-agencies for

national FTCs in Hong Kong and Macao.<sup>23</sup> However, all foreign trade activities are now conducted on the basis of an overall plan by MOFERT.<sup>24</sup>

#### A. The PRC's "Foreign Trade Corporations"

Import-export corporations and enterprises presently found in the PRC include first, the national FTCs and their branches under MOFERT; secondly, the new FTCs organized mostly by industrial enterprises and some established by ministries or commissions; and thirdly, local FTCs in certain municipalities and provinces. MOFERT handles its responsibility for coordinating and supervising the PRC's foreign trade activities through nineteen major national FTCs.<sup>25</sup> The regional authorities of local FTCs may, in the light of local conditions, examine and approve small and medium-sized compensation trade ventures as long as the arrangements are within the general guide-lines devised by MOFERT.<sup>26</sup> FTCs are instruments by which the PRC has controlled its international trade. However, individual enterprises in the PRC are now entering the international market in increasing numbers despite the fact that the bulk of foreign trade is still handled by FTCs.<sup>27</sup>

The FTCs were established with full permission of the relevant authorities. They have from the outset been

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23. See A. R. Dicks, "The People's Republic of China", *East-West Business Transactions* (ed.), R. Starr, New York: Praeger Publishers, 1974, pp. 394-396.

24. *China Business Guide*, Hong Kong: Arthur Andersen & Co., 1986, p. 19.

25. *Ibid.*, pp. 20, 160-162.

26. *Ibid.*, p. 20.

27. S. J. Mitchell & D. D. Stein, "United States - China Commercial Contracts", 20 *International Law* (1986), p. 897. For an in-depth discussion of the PRC's FTCs, see E. A. Theroux, *supra* note 4, pp. 196-199.

organized as state enterprises. Like other state enterprises, they are endowed with legal personality, enabling them to finalise contracts with other legal or natural persons either within or outside the PRC. Their contractual relations with other enterprises and organizations are governed by the PRC's civil law and by the system of "economic accounting." This enables state enterprises to take part in economic activity as independent legal entities but at the same time ensures that such enterprises act in conformity with their obligations under the state plan.<sup>28</sup>

#### B. The PRC's Agency Companies in Hong Kong and Macao

The PRC has long established companies in Hong Kong and Macao which act as agencies for its national FTCs. Hong Kong has for much of its long history served as an entrepôt for China's foreign trade dealings. Moreover, it has been since 1949 an enclave where foreign firms may contact Chinese communist officials, including bankers and trade officials.<sup>29</sup> The CCP established an FTC in Hong Kong in 1948 called the China Resources Company, which was an agency of foreign trade enterprise in Hong Kong before the PRC itself was founded in October 1949. Other companies of a similar nature, but created after 1949, are the Chinese Arts and Crafts (H.K.) Limited, the Hua Yuan Company, the Ng Fung Hong, and the Tech Soon Hong Limited and, in Macao, the Nam Kwong Trading Company.<sup>30</sup> These foreign trade enterprises undertook representative

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28. *Zhonghua Renmin Gongheguo Minfa Jiben Wenti* (Basic Problems of the Civil Law of the People's Republic of China), (hereinafter referred to as Basic Problem of the Civil Law), Beijing: Legal Press, 1958, pp. 27-28.

29. K. D. Gott, *supra* note 11, p. 97.

30. Zhao, *supra* note 21, p. 88; see also ESCAP, *supra* 13, p. 85.

and, to some extent, agency functions in the PRC's import and export trades.<sup>31</sup>

In 1983, in order to meet the demand of developing business, the China Resources Company was enlarged and registered in Hong Kong as the China Resources Corporation (Group). This Group represents thirty-three important import-export corporations, including Tech Soon Hong Limited, the Hua Yuan Company, the Ng Fung Hong, and so on. This Group has been of major importance for foreign traders. These constituent corporations have their own individual capacities as legal persons. They are empowered to hold negotiations and conclude transactions within the scope of their business. The China Resources Corporation (Group) has played the role of general agency for the PRC's FTCs operating under MOFERT in Hong Kong.<sup>32</sup>

After 1978, many other trade enterprises were also established in Hong Kong by various PRC governmental bodies or local authorities. For example, the Commission of Foreign Economic Relations and Trade of Guangdong Province established a company called Sinomart Development Holding Company Limited to act as a base for its fifty nine representative offices and trading arms in Hong Kong and overseas. In general, such organizations have been established as limited corporations. In an attempt to unify the conduct of foreign trade and improve business management, these various agency companies are now on the whole being re-organized.<sup>33</sup>

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31. A. R. Dicks, *supra* note 23, p. 396; see also ESCAP, *supra* 13, p. 85.

32. Zhao, *supra* note 21, p. 115.

33. *Ibid.*

### C. The PRC's Overseas Representative Organs of FTCs

The PRC's FTCs, apart from promoting contacts with foreign traders and managing effectively related business matters, have also established many representative organs as single entities abroad. These representative organs under MOFERT are not the same as the commercial counsellors' offices and commercial representatives' offices, though all three are component parts of the PRC embassies.<sup>34</sup>

Their principal activities are mainly the operation of technical transfer businesses, investigating and researching current developments in foreign markets, providing services for local clients in the host country, building up relations as sales agents, assisting the domestic related corporations in the conclusion of contracts, entertaining the domestic corporations' temporary trade missions abroad and helping them accomplish their task, and other matters entrusted to them by the domestic corporations. In earlier years, before the introduction in 1979 of the "Open Policy", the PRC, with certain very limited exceptions, did not seek to extend its commercial contacts in this way.

It seems probable that one of the reasons for the failure to extend commercial contacts is that the PRC has attached great importance to avoiding, for as long as it has been possible, submission to the jurisdiction of the courts of foreign countries by any of its organisations.<sup>35</sup> The overseas representative organs act,

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34. Unlike PRC's commercial organisations stationed abroad, the representative organs of MOFERT are neither legal persons nor legal entities. Although they may not carry out business, they can perform legal acts related to their parent FTCs' business operations. For example, they may execute agreements, place orders, negotiate prices, and so on. For further studies, see ESCAP, *supra* note 13, p. 83.

35. A. R. Dicks, *supra* note 23, p. 395.

in effect, as business agencies of the various FTCs in the PRC. They are organized by the home-based FTCs as are the overseas permanent representatives sent by the other PRC import-export enterprises. They should be responsible for the business operations of their parent corporations or enterprises. In addition, they accept the leadership of the commercial attachés of PRC diplomatic missions overseas.

In general, these representative organs have the same legal status as the various states' commercial representatives permanently stationed abroad by their own parent enterprises.<sup>36</sup> As to the issue of whether PRC's FTCs can be established as permanently stationed representatives in Taiwan, there is little doubt that this is still impossible in view of Taiwan's current policy and law. However, it seems possible that this policy could be abandoned.<sup>37</sup> If the establishment of PRC representative organs could be allowed under Taiwan laws, then the procedure for establishing a representative office would be to register with Taiwan's Ministry of Economic Affairs.<sup>38</sup>

#### D. The PRC's Sino-Foreign Joint Ventures

Under the laws and regulations formulated for equity joint ventures (EJVs) in the PRC, many joint ventures have been established in the PRC. The EJV Law promulgated in 1979 was less than comprehensive. This

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36. See Zhao, *supra* note 20, p. 541.

37. See TMRS, *supra* note 20. To approve direct cross-Straits commerce, Article 95 of TMRS requires the organ-in-charge to first obtain a resolution from the Legislative Yuan which is equivalent to Parliament.

38. See S. H. Wu, "A Comparison between Branch and Representative Office", 37 *Formosa Transnational Law Review*, Taipei, Formosa Transnational Attorney-at-Law Press, 1988, p. 39.

law leaves most of the important details of the venture to the negotiation of the parties subject to PRC government approval.<sup>39</sup>

A "joint venture" under PRC law is the contractual formation by a foreign investor and a domestic PRC party of a single economic entity where the contracting parties share the profits and the risks of that entity (or "joint venture") in proportion to their relative investment in the capital of the venture. All these joint ventures are PRC legal persons subject to the jurisdiction and protection of PRC law.<sup>40</sup> This means that the single entity of a joint venture can be entitled to create or execute a contract and to bring independent litigation to sue, or to be sued in court.<sup>41</sup>

As regards the arrangements for foreign investment, PRC's new economic legislation has allowed numerous different kinds of bilateral investment agreement. There are two main types of joint ventures in the PRC. First, there are EJVs which take the form of limited liability corporations and jointly invest in, and are managed by, the PRC and foreign partners. Profits and losses are shared according to the joint venture contract but the contract usually specifies that the profits should be proportioned according to each partner's contributing investment. Each partner may contribute cash or other assets, such as buildings, equipment or industrial

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39. Supra note 1.

40. The Implementing Regulations, in addition to the EJV Law of 1979, were promulgated by the PRC's State Council on 20 September 1983 [hereinafter Implementing Regulations] which supplemented and clarified certain aspects of the basic EJV Law of 1979. Moreover, an additional "Provisions for Encouraging Foreign Investment" was promulgated on 11 October 1986 by the PRC's State Council which attempted to solve some of the problems which foreign investors had experienced under the existing framework.

41. Zhao, supra note 21, p. 114.

property, as well as know-how or equity investment. Foreigners may not own less than twenty five per cent of the equity, but the maximum amount of foreign ownership is not specified. Secondly, there are cooperative joint ventures (CJVs) which may take any form as agreed between the PRC and foreign partners. The rights and obligations of each partner are specified in the joint venture contract. Under this arrangement, the PRC partners generally provide contributions in kind, such as land, natural resources, labour, equipment, and so on. The foreign partners provide capital, advanced technology, materials, and so on.

With regard to joint ventures in the Special Economic Zones and joint ventures involved in petroleum, natural gas, and resource exploitation, these two categories like CJVs are either partially or completely excluded from joint venture laws and regulations. All the three forms of investment are dealt with in separate or specialized legislation.<sup>42</sup> A new type of contractual joint venture in the form of a "limited liability company" was introduced in late 1985.<sup>43</sup>

A joint venture has the right to conduct its business independently within the scope prescribed by PRC laws and regulations and the joint venture agreement, contract and articles of association. It has the autonomous right to perform every action related to the

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42. C. G. Fenwick, "Equity Joint Ventures in the People's Republic of China: An Assessment of the First Five Years", 40 *Business Law* (1985), p. 840, no. 5.

43. The PRC presently has developed a uniform corporation law or the so-called Company Law applicable nationwide since 1 July 1994. Relevant law of business organizations is covered in the Civil Code. Article 19 of the Joint Venture Law simply provides that the liability of parties is to be "limited to the amount of capital contribution subscribed by each." See M. J. Moser (ed.), "Foreign Investment in China: The Legal Framework", *Foreign Trade, Investment and the Law In the People's Republic of China*, Oxford: Oxford University Press, 1987, p. 106.

business from the beginning to the end. The PRC government encourages joint ventures to sell their products on the international market.<sup>44</sup>

The EJV Law of 1979 was amended on 4 April 1990. Changes included the addition of a paragraph which rules out the possibility of nationalization or requisition of EJVs by the PRC government, the end of a thirty-year limit on the life of certain ventures, and the lifting of restrictions on the foreign partner acting as chairman of the board. However, some foreign executives think that the changes fail to address other serious problems affecting investment decisions, such as balancing foreign-exchange shortfalls, production limits, restricted distribution channels and import controls.<sup>45</sup>

On 22 October 1990, the PRC through MOFERT promulgated the "Provisional Regulations on Sino-Foreign EJV Terms" which complemented the EJV Law amended on April 1990. The new regulations state that joint ventures eligible for unlimited terms are those "stipulated by the state as investment projects to be encouraged and permitted". However, what precise kinds of projects will be "encouraged and permitted" remains uncertain.

The new regulations also identify five types of business in which joint ventures cannot have unlimited terms namely service trades, land development and real estate, exploration and development of resources, projects restricted by the state and those which any other state law or regulation stipulates must have a fixed joint venture term.<sup>46</sup>

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44. See the PRC's Implementing Regulations, *supra* note 40, Article 19, 7, 60.

45. See 71 PRC Law Newsletter, Hong Kong: McKenna & Co., May 1990, p. 10.

46. See *ibid.*, No. 75, p. 8.

### E. Investment Partners of Taiwanese Enterprises in the PRC

Before 1979, the PRC considered that foreign investment was itself just a direct exploitation of the resources or labour of the Chinese people in the PRC. Prior to the adoption of "Open Policy" in 1979, no instance was recorded of PRC participation in a joint venture of any kind with a Western company, either inside or outside the PRC territory.<sup>47</sup> After 1979, foreign investment was allowed in the PRC.

However, it was still not clear if the FTCs could be involved with such foreign investment activities. Beside FTCs, what were the other organs for undertaking foreign investment with a joint venture? Usually, each FTC under MOFERT has its individual monopoly to run import-export business for particular categories of goods. This was designed to avoid two FTCs dealing in the same items.<sup>48</sup> But after 1979 the question arose of whether foreign enterprise investment fell within the particular monopoly of an FTC.

In fact, the business scope of some FTCs did include investment.<sup>49</sup> Since 1979, the FTCs established in some municipalities and provinces have been under the dual leadership of the respective local authorities and MOFERT. These new FTCs, co-ordinated with the national FTCs operating directly under MOFERT, have assumed a

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47. A. R. Dicks, *supra* note 23, pp. 398-99, 426-427. An apparent exception to the policy just stated might be the various enterprises operated in Hong Kong where considered by the PRC technically to be Chinese territory.

48. See ESCAP, *supra* note 13, p. 81.

49. See *ibid.*, p. 627 *et seq.*

direct supervisory role and responsibility for carrying out foreign trade plans and investment, joint ventures, compensation trade and other economic activities within their jurisdiction.<sup>50</sup>

Furthermore, the PRC's "Implementing Regulations" of EJV Law of 1983 stipulated that the foreign investor may authorize the China International Trust and Investment Corporation (CITIC), or the local trust and investment agency under the central authority, or a relevant government department or people-to-people organization, to introduce it to a partner with which it may cooperate.<sup>51</sup>

However, the above stated regulation does not seem to provide a clearcut explanation of what the cooperation "partners" are. Moreover, even township enterprises in the PRC have been allowed to develop joint ventures with overseas Chinese or foreign enterprises in order to acquire modern foreign equipment, technological knowledge, and managerial skill.<sup>52</sup>

Therefore, it can be concluded that, not only the monopoly FTCs but also the general corporations, enterprises, or the other economic and trade organizations can cooperate in joint ventures with a foreign investor. Nevertheless, the general PRC

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50. Ibid., p. 84. The terms of reference of the local corporations are somewhat different from those of the national FTCs and provincial foreign trade bureaux. One of their main objectives is to develop their joint business operations with other provinces and municipalities as well as economic co-operation with foreign or overseas entities.

51. See PRC's Implementing Regulations of Joint venture Law, *supra* note 38, Article 12.

52. Hsu Yi, "Xiangzhen Qiye Yu Duiwaimaoyi" (Township enterprises and foreign trade), 6 *International Trade Issue* (Beijing), (1987), p. 18.

investment partners except FTCs still remain *de facto* organs of the central government.<sup>53</sup>

#### 4.2.3 Taiwanese Contractors and their Legal Status

As stated above, the major barrier between Taiwan and the PRC is political and at present third parties are still needed for trade and investment links. However, in practice, it is only since 1979 that Taiwanese enterprises have been allowed to carry out indirect trade and investment via a third party. This has been done by establishing a resident representative office within the territory of the PRC.

Even the Taiwanese government has itself legalized this kind of indirect business relation across the Taiwan Straits since August 1988.<sup>54</sup> In Taiwan, the main bodies for carrying out trade and investment business with PRC enterprises are natural or legal persons. Their legal status is decided by Taiwan's civil law. In terms of the present policy of indirect trade with the PRC, Taiwanese enterprises have been allowed indirectly to send representatives or establish resident representative offices in the PRC.

On 6 October 1990, Taiwan's Ministry of Economic Affairs promulgated the "Measures Governing Control over Making Indirect Investment or Undertaking Technical Cooperation Projects in Mainland China." By these measures, individuals, legal persons, organizations or other institutions in Taiwan may not directly invest or

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53. Jaslow, *supra* note 16, p. 210.

54. See *The Economist*, (9-15 February, 1991), p. 68. Taiwan's Investment Commission approved a plan by the Chung Shing Textile Company to invest US\$900,000 in a joint venture in Shanghai, China. This is the first time Taiwan officially allowed its company to invest in the PRC.

undertake technical cooperation projects in the PRC. Indirect investment or technical cooperation projects may be implemented through companies or enterprises incorporated in a third country but must be approved by the Ministry's Investment Commission.

On 30 October 1980, an Interim Provision on the control of resident representative offices of foreign enterprises was promulgated by the State Council of the PRC. With this Interim Provision, notice of the registration procedure for foreign enterprises and resident representative offices was announced by the General Administration for Industry and Commerce of the PRC on 8 December 1980.

Any foreign enterprises desiring to establish a resident representative office in the PRC must present an application and, after receiving approval, complete registration procedures. Without such approval and registration, no foreign enterprise may commence resident business activities.<sup>55</sup>

The PRC government undertakes to protect, in accordance with the law, the legitimate rights and interests of resident representative offices and their members and also to facilitate their normal business activities. The resident representative offices may not set up radio stations within PRC territory. They should apply to the local telecommunications bureaux for the renting of such commercial communications lines or communications equipment as may be necessary for their business operations. The personnel of resident representative offices and their families should abide by PRC law, decrees and relevant regulations in all their

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55. See Interim Provisions of the State Council of the People's Republic of China for the Control of Resident Representative Offices of Foreign Enterprises, Article 2.

activities within the PRC, and in entering and leaving the PRC.<sup>56</sup>

If a resident representative office and its personnel violate these Interim Provisions or engage in other unlawful activities, the competent PRC authorities have the right to conduct an investigation and deal with the matter in accordance with the law.<sup>57</sup> Although Taiwanese enterprises at present can establish a resident representative office via a third party in the PRC, the legal status of these offices is different from that of offices set up by other capitalist countries which have the same representative organs abroad. For example, foreign companies registered in Taiwan have capacity to bring a civil action. According to Article 372 of Taiwan's Company Law, the foreign company should appoint an agent to represent the company in all litigation and non-litigation matters. However, in the PRC's Interim Provisions there is no mention of the right of litigation.

In the PRC, the status of foreign nationals in the matter of litigation is decided by the 1991 Civil Procedure Law.<sup>58</sup> According to Article 187 of this Civil Procedure Law, the PRC People's Courts shall apply the principle of reciprocity with respect to civil rights in proceedings involving a foreign party. The principle of reciprocity, according to the PRC's official interpretation of it, is one of equality and of mutual benefit. It means that civil litigation rights between PRC and foreign nationals are treated on an equal footing and should be equally beneficial. Neither of the parties

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56. Ibid., Article 12, 13, 14.

57. Ibid., Article 15.

58. The Law was promulgated on 9 April 1991 and officially became effective from the same date. For the English text of this Law, see *China Law and Practice* (No. 5, 1991), pp. 15-16.

is entitled to special privileges. If a foreign court imposes restrictions on the litigation rights of PRC parties, the PRC court will have to do the same towards a foreign party. Because of this principle, those foreign resident representative offices without reciprocal relations with the PRC will not be able to enjoy the right of litigation.

However, these foreign resident representative offices are nevertheless obliged to pay taxes.<sup>59</sup> According to Article 26 of the PRC's "Income Tax Law Concerning Foreign Enterprises" of 1991, in disputes over tax payment, the last legal remedy is the bringing of a lawsuit in the local courts. Thus, there is an obvious contradiction existing in this area of PRC's laws and regulations. In regard to private and commercial litigation procedures in the PRC, however, Taiwanese enterprises have been treated as a domestic party handled by the PRC local courts in coastal economic zones, but treated as "shewai" economic cases in inland areas.<sup>60</sup> Therefore, the representative organs of Taiwanese enterprises in the PRC are still uncertain as to their precise legal status.

#### 4.2.4 The PRC's Preliminary Project Approval

After having established the business capacity and legal authority of the PRC party, it is necessary for the

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59. See *supra* note 51, Article 9; also the Individual Income Tax Law of the People's Republic of China (Adopted by the Third Session of the Fifth National People's Congress and Promulgated on and Effective as of 10 September 1980), Article 1; and also the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises (Adopted by the Fourth Session of the Fifth National Congress and Promulgated on 13 December 1981), Article 1.

60. See *Jingji Ribao* (Taipei: Economic Daily News), 2 July 1990, p. 7.

other party to establish whether or not the project to be negotiated has already received all necessary preliminary government approvals. It is normally the responsibility of the PRC party to apply for "preliminary project listing" prior to or during the early stages of negotiation with a foreign company. It is not unknown for foreign companies to have committed themselves to a course of negotiation in the PRC only to find out later that the project had never received preliminary project listing and was unlikely ever to be approved.

#### 4.3 Some Problems on the Legal Status of PRC Contractors

We have noted that, in PRC law, PRC traders or investors are in fact independent legal persons. These persons are circumscribed by strict rules of restricted authority, limited liability, independent accounting and other signs of institutional separateness. But how does autonomy operate in the PRC? The question is important on practical and theoretical levels.

If the concept of corporate personality is a legal fiction, it is in this instance double fiction within the framework of a monolithic system.<sup>61</sup> On the one hand, the PRC FTCs have independent properties, limited liability, and can even go bankrupt.<sup>62</sup> On the other hand, these

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61. Pisar, *supra* note 7, p. 262.

62. See Article 2 and 3 of the PRC's Enterprise Bankruptcy Law (for Trial Implementation) which was adopted by the 18th Session of the Standing Committee of the Sixth National People's Congress on 2 December 1986 and became effective three months after the coming into effect of a separate statute entitled "Law of Industrial Enterprises Under the Ownership of the Whole People". Concerning the legislative background and characteristic of this Enterprise Bankruptcy Law, see T. K. Chang, "The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process", 28 *HARVARD INT'L L. J.* (1987), p. 333; see also Peng Xiaohua, "Characteristics

corporations, like the former Eastern bloc corporations, are administratively and organically interwoven with the state and with one another.<sup>63</sup>

#### 4.3.1 The Scope of Authority of the PRC FTCs

In former Eastern bloc corporations, the operating business organizations are subject to their government-approved charters of incorporation, the civil codes of their country of origin and the regulations which are sporadically prescribed for the state-trading apparatus as a whole. Transactions concluded in violation of these provisions are tainted with illegality and are precarious from the standpoint of foreign parties.<sup>64</sup>

For the PRC corporations, the General Principles of the Civil Law (GPCL) of 1986 clearly regulate the work of these corporations and should operate through the approved registration and within the scope of authority.<sup>65</sup> Every state-owned FTC in the PRC enjoys a monopoly in a number of import-export goods. It conducts its import and export activities within the defined sphere of its business. Thus, possibilities of duplication are avoided.<sup>66</sup>

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of China's First Bankruptcy Law", 28 *HARVARD INT'L L. J.* (1987), p. 373.

63. Pissar, *supra* note 7. p. 262.

64. See *ibid.*, p. 263.

65. See Article 42 of the PRC's General Principles of Civil Law (Civil Code) which was adopted by the Fourth Session of the Sixth National People's Congress on 12 April 1986, and effective as of 1 January 1987. For an English translation of the Law by W. Gray and H.R. Zheng, see 34 *American Journal of Comparative Law* (1986), pp. 715-743.

66. ESCAP, *supra* 13, p. 81.

Other new trading corporations, organized by industrial enterprises, can sell their products directly to foreign companies and purchase goods so long as the products or the goods are approved for import or export by the State Council of the PRC.<sup>67</sup> This explanation can also apply to the new FTCs in some municipalities and provinces of the PRC.

In the light of experiments by the former Eastern bloc corporations, business transactions entered into without a standing or special state license, or violating the principle of specialization should be made void.<sup>68</sup> This fundamental rule can be applied to the trade relations between Taiwan and the PRC. Therefore, Taiwanese enterprises should be cautious and spend time in seeing whether the PRC FTCs have proper authority. An East-West transaction concluded without proper authority on the state trading side is manifestly vulnerable from a legal point of view.<sup>69</sup>

#### 4.3.2 The PRC's FTCs and their Sovereign Immunity Status

According to the GPCL, a legal person of the PRC is an organization which is competent to exercise civil rights, perform civil acts, and shall independently enjoy civil rights and assume civil duties under the law.<sup>70</sup> Furthermore, the GPCL states that the civil liabilities of an "enterprise" legal person owned by the whole people shall be borne by property distributed by the state, and the civil liabilities of an enterprise legal person owned by a collective ownership shall be

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67. Ibid., p. 84.

68. See Pisar, *supra* note 7, pp. 263-264.

69. See *ibid.*, p. 265.

70. See the PRC's Civil Code, *supra* note 64, Article 36.

borne by the property of the enterprise.<sup>71</sup> Like the former Eastern bloc trade monopolies, the PRC FTCs adopt the doctrine of an independent corporate personality separated from the state itself. The concept of separation here has a very different function from that which it is meant to have in "bourgeois" legal systems.<sup>72</sup>

Internally, the notion of juridical separateness of corporate personality and independent accounting is largely a tool of management. Ultimately, the property belongs to the state and can at any stage be withdrawn or transferred to other entities. Externally, the veil which separates an enterprise from the state itself and from other state instrumentalities serves an additional purpose. Under a state monopoly, unincorporated foreign trade delegations have found it increasingly difficult to invoke the defence of sovereign immunity in foreign countries. In practice, no such immunity is claimed today for the corporations. A compensatory result is always achieved under the shield of their own laws.

The state's rights can be protected through the concept of an independent corporate personality. Put in other words, the state's commercial dealings in foreign markets are carried on through interposed suable enterprises. While its exchequer at home and property abroad are largely kept safe from the risk of legal claims founded on foreign laws that are diverse and which may occasionally be actually hostile.<sup>73</sup> The commerce of collective economies would be unmanageable if all state organisations and departments were jointly and severally liable for obligations incurred by each. By this reasoning, such adaptations of the legal framework made by the Eastern bloc states and by the PRC need not be

71. See *ibid.*, Article 48.

72. See *Pisar*, *supra* note 7, p. 265.

73. See *ibid.*, p. 266.

regarded as abuses of that framework but as modifications which they at least regard as completely necessary.<sup>74</sup>

The legal status of national sovereignty is inextricably linked with the phenomenon of state trading. Serious difficulties arose in the past both for a private trader seeking a juridical remedy against a public instrumentality and for the forum called upon to decide the issue. Sovereign immunity in the sphere of East-West trade is a dormant, if not an altogether dead issue.

The legal considerations, however, continue to be ill-defined, and clarifications are needed for the sake of certainty and predictability.<sup>75</sup> Former Eastern bloc states make a sharp distinction between sovereign immunity at home and abroad. Domestically, they do not, and logically cannot admit any such notion. Since all significant economic functions are exercised either by the state itself or by its organic components, there is no need to assert sovereign privilege.<sup>76</sup>

As regards sovereign immunity abroad, there are some differences from the way it applies at home. Initially, the Soviet trade monopoly sought to take full advantage of governmental immunities as recognised in international law and applied in Western courts. As regards foreign trade delegations, the case of *Fenton Textile Association v. Krassin* (1921), involved a suit against the head of the Russian trade delegation in England to obtain the balance of an amount owed for certain goods sold.

The former Russian trade delegation claimed in the English courts that it was entitled to sovereign immunity

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74. Ibid.

75. See *ibid.*, p. 268.

76. *Ibid.*, p. 269.

as it was the authorized representative of a foreign state.<sup>77</sup> Since the trade accord had been executed prior to *de jure* recognition of the Soviet government by the U.K., and, accordingly, by its terms did not extend diplomatic immunity to the trade delegation, the Court of Appeal rejected the defendant's contention.<sup>78</sup> For its decision, the court relied on two grounds: first, that the defendant had not been recognised by the British government in any capacity other than that of official agent; second, that the rights granted to the Russian trade officials were defined in the agreement (trade accord) which did not provide for immunity from civil process.

With regard to state trading companies, as distinguished from business-oriented diplomatic personnel or trade delegations, the British courts' attitude regarding immunity is reflected clearly in the landmark decision of the case *Krajina v. the Tass Agency* in 1949. In this case, the Tass news agency alleged in the British court that it was a department of the Soviet government entitled to immunity from suit.

The Court of Appeal held that even if Tass was a governmental department enjoying a separate legal status, it did not automatically follow that it was deprived of the right to assert sovereign immunity.<sup>79</sup> However, the

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77. See K. M. Starr, "The Framework of Anglo-Soviet Commercial Relations: The British View", *East-West Trade* (ed.), K. Grzybowski, New York: Oceana Publications, Inc., 1973, p. 64.

78. Ibid.

79. Ibid., p. 66. The British plaintiff contended that the doctrine of sovereign immunity is inapplicable since *Tass* has a separate legal existence from that of the sovereign state and that, therefore, the case was distinguishable from the United States Shipping Board -- In 1924, the British Court recognised the sovereign immunity of the "Board" in the case of *Compania Mercontil Argentina v. United States Shipping Board*-- since in

growing government intrusion into economic life everywhere and the emergence of a bloc of countries practicing total state commerce provoked a strong reaction against the concept of sovereign immunity.

In fact, reaction came in various ways from business quarters, from courts and from administrative authorities. The most effective form of pressure arose from the natural reluctance of private firms to deal with the Eastern bloc at all so long as this air of uncertainty persisted. Certain governments, notably the United States, simply refused to admit foreign trade delegations purportedly enjoying sovereign immunity into their territories.<sup>80</sup>

As to the English law of diplomatic immunity, adoption of the 1964 Diplomatic Privileges Act operated to eliminate the immunity defense as to diplomatic agents engaging in "an action relating to any professional or commercial activity ..... outside his official functions."<sup>81</sup> In 1952, the Tate Letter announced the State Department's adoption of a restrictive theory of sovereign immunity.<sup>82</sup>

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that case the Board was clearly a governmental department not enjoying a separate juridical status.

80. See Pizar, *supra* note 7, p. 271

81. See Starr, *supra* note 77, p. 68.

82. Letter of Acting Legal Adviser, Jack B. Tate, to Acting Attorney General Philip B. Perlman, 19 May 1952. Dept. State Bull. 26 (1952), p. 984. The Tate Letter proclaimed the intention of the United States Government to abandon the absolute theory of sovereign immunity, and thenceforth to grant suggestions of immunity only with respect to a government's sovereign or public acts (*jure imperii*). This was a definite change of position on the part of the United States Government. See also M. L. Werthan, N. L. Combs, J. L. Deitch & A. L. Fuoss, "Jurisdiction over Foreign Government: A Comprehensive Review of the Foreign Sovereign Immunities Act", 19 *VANDERBILT J. Of TRANS'L L.* (1986), P. 121-122.

At present, many countries have undertaken to codify the rules of foreign sovereign immunity in their own domestic statutes to eliminate the private and commercial acts (acts *jure gestionis*).<sup>83</sup> There can be no doubt that the restrictive approach is more just and reasonable in the contemporary commercial setting. Indeed, it is essential to eliminate the remnants of the immunity problem in business dealings with state traders of all origins.<sup>84</sup>

At a theoretical level, former Eastern bloc jurists did not concede that state entities, corporate or otherwise, were precluded from pleading their exempt sovereign status.<sup>85</sup> However, the present doctrine of sovereign immunity cannot be said to constitute a major obstacle to East-West trade.<sup>86</sup>

For the PRC, it was generally recognized that the FTCs were entitled as legal persons to take up law suits

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83. See M. B. Feldman, "The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder's View", 35 *INT'L AND COM. L. Q.* (1986), P. 303. Regarding the basic distinction between sovereign functions of a state (*jure imperii*) and state instrumentalities engages in commerce (*jure gestionis*), it can be found in the Matsuda Report. See *Matsuda Report on Competence of Courts in Regard to Foreign States, Committee of Experts for the Progressive Codification of International Law, League of Nations Doc.* (1927), v. 9, p. 6.

84. Pisar, *supra* note 7, p. 272.

85. *Ibid.*

86. *Ibid.*, pp. 271-272. As matter of usage, no immunity is claimed on behalf of Eastern corporate instrumentalities. The current pattern of submission to foreign process is explained on the basis of waiver, either made explicitly, or implied from such factors as the sue-and-be-sued clause which is usually included in their charters. In the case of trade delegation], under a serious of bilateral commercial treaties, the USSR was required to waive, in respect of all economic activities, the entitlement to immunity which was allegedly afforded by customary international law.

and to answer inquiries of the court of justice and the arbitration organization.<sup>87</sup> As to the legal status of the representative office of the PRC FTCs, it should be deemed that the representative office was just a representative organ of a legal person; a civil but not an official organ.

It is different from the commercial staff or the commercial organs of the PRC diplomatic missions abroad. The practice of not giving a state's foreign trade agencies -- which means the representative organs, and its staff-- sovereign immunity and diplomatic privilege, has been established as an international custom and has been domestically legislated by various countries.

Nevertheless, the exceptional practice of giving sovereign immunity and diplomatic privilege exists, though only if national authorities have signed a treaty which makes provision for it. Therefore, the enterprise's representative organ abroad should in general be governed by the law of the country of its permanent residence.<sup>88</sup> In Taiwan, all commercial activities are governed by the Civil Code and the Code of Civil Proceedings; while public functions are governed by the Administrative Code.

In Taiwan, all cases involving government enterprises are to be tried by civil courts; while cases involving public functions of government agencies are to be tried by the administrative court of the Judicial Yuan. Since Taiwan's law recognizes the doctrine of restrictive immunity, the litigation status of the PRC's FTCs in Taiwan will in theory not be influenced as they

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87. Zhao, *supra* note 21, p. 113; see ESCAP, *supra* note 13, P. 81.

88. Zhao, *ibid.*, p. 539.

are considered to be simply dealing with commercial activities.<sup>89</sup>

#### 4.3.3 Responsibility of the PRC's FTCs for Government Action

As noted above, the concept of legal persons has a dual purpose under the state monopoly system. The FTC is closely linked with the state in terms of administration and organization. Therefore, the question arises whether the FTC can assert its responsibility to be exempted from an act of state. The issue most relevant to this question is whether a denial or cancellation of import-export licenses and a change of economic plan by the State is sufficient.

If the fact that the FTC belongs to the state in administration is emphasized, this corporation then cannot plead a *force majeure* for governmental acts. In these circumstances, the act of one is the act of the other and there can be no conflict of will between the two such as is necessary to call into play the concept of insuperable force.<sup>90</sup>

On the other hand, if the FTC is an independent legal entity and separate and distinct from the state, then this corporation can plead *force majeure* for governmental acts. In this situation, a state enterprise, by invoking an act of its own government, may evade with impunity all contractual obligations toward a damaged party.<sup>91</sup> Can the governmental acts for denial, cancellation, or alteration of import-export licenses be

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89. Yi-ting Chang, *Collected Essays on International Law*, Taipei: Asia & World Institute, 1986, pp. 110-111.

90. See Pisar, *supra* note 7, p. 276.

91. See *ibid.*

asserted as a *force majeure* plea? The approach held for most countries to international practice is not suitable for East-West trade.<sup>92</sup>

With regard to the change of economic plan, there was disagreement on this issue in the former Eastern bloc arbitration tribunals started in 1956. In the early stages, the view that an act of planning cannot cause a *force majeure* was not widely accepted. But, by the end of 1964, this view did prevail in these tribunals.<sup>93</sup>

Broadly speaking, former Eastern bloc parties have refused to assume responsibility for possible acts of their states. On the contrary, they usually seek and obtain broad contractual *force majeure* definitions which include the event of prohibitions of export or import.<sup>94</sup> Due to the various types of sovereign acts, the state must waive, in all situations, the right to act in contravention of a commercial contract.

No communist government can seriously be expected to limit its sovereign power to this extent,<sup>95</sup> and there have been various schemes to solve this problem.<sup>96</sup> However,

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92. Ibid.

93. See *ibid.*, pp. 277-278. The act of planning produces effects in regard to Bulgarian enterprises, but it does not free the Bulgarian enterprise from executing the contracts which it has concluded, nor from the consequences of its non-performance, *vis-a-vis* foreign parties [cited from p. 278].

94. See *ibid.*, p. 281.

95. See *ibid.*, pp. 279-280.

96. See *ibid.*, p. 282. Evidentiary criteria to determine state motivation, or party effort to reverse government interference with performance, implied contractual suggestions to an eventual adjudication, insurance coverage, sporadically available counter-guarantees or other improvisations by the parties do not offer permanent solutions to the fundamental problem of *force majeure* [cited from p. 282].

nothing can be more satisfactory than a provision which deals with the question directly and in specific detail. Ideally, it should obtain universal application pursuant to treaty stipulations, legislation and adoption by the courts.

The FECL became effective on 1 July 1985 in the PRC. Although the FECL has regulations for an event of *force majeure*, it did not mention the event caused by governmental acts.<sup>97</sup> According to the FECL, the scope of events of *force majeure* may be agreed to in the contract.<sup>98</sup>

In East-West trade, Western enterprises can aspire to a clause in all East-West agreements to which it is a party, to the effect that the risk of state action should lie on the state corporation whose government is at cause.<sup>99</sup> But in PRC contractual practice, it seems that this point has never actually been mentioned in its contractual clauses.

Unlike the former Eastern bloc legislation and practice, the PRC FTCs did not claim a *force majeure* plea concerning governmental denial of import-export licenses or change of economic plan.<sup>100</sup> An example is

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97. See Article 24 and 25 of the PRC's Foreign Economic Contract Law which was adopted at the Tenth Session of the Standing Committee of the Sixth National People's Congress on 21 March 1985.

98. See *ibid.*, Article 24.

99. See Pisar, *supra* note 7, p. 282.

100. *Ibid.* p. 279. For example, the Czechoslovak Code on Foreign Trade, under which the default or an official authorization necessary for the accomplishment of the duty of the obligee is specifically excluded from the realm of *force majeure*. While the denial or cancellation of an export license would undoubtedly result in impossibility of performance for the exporting state enterprise and would thus terminate its obligation to perform, it would not release it from reparation for damages caused [cited from p. 279].

provided by a large contract dispute which happened between the PRC and Japan in 1981.<sup>101</sup> This Baoshan dispute was caused by a change in the PRC's economic plan and was finally settled through negotiations.<sup>102</sup> Although the contract cancellation was caused by a change of economic plan, the China Technical Import Corporation in this case did not plead a *force majeure* and paid compensation.<sup>103</sup>

#### 4.4 Legal Methods of Taiwanese Trade

The State Council of the PRC has experimented with a marketing system in selected areas since September 1988. However, the PRC is still essentially a central planned economy. Most foreign trade is generally conducted

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101. The total value of the cancelled contracts came to approximately \$1.4 billion, the largest single cancellation in the history of Japanese trade. See D. A. Sneider, "The Baoshan Debacle: A Study of Sino-Japanese Contract Dispute Settlement", 18 *NEW YORK UNIV. J. OF INT'L L. AND POLITICS* (1986), p. 570.

102. See *ibid.*, p. 563 *et seq.*, 571 *et seq.*, 588, 589.

103. See *ibid.*, pp. 588-596. After lengthy negotiations, the two sides signed a "Memorandum for the Purpose of Contract Termination" on 21 August. The agreement awarded Mitsubishi ¥9.3 billion (\$40 million) in compensation, approximately 11 percent of the contract price and one half the amount initially demanded by the Japanese. Since Mitsubishi had already received a down payment, Techimport was obligated to pay an additional amount of approximately ¥1.3 billion (\$5 million), which it agreed to provide within one-year [cited from p. 587]. After Mitsubishi's settlement, the remaining four companies, including NSC, reached a similar agreement with Techimport in mid-September. The total value of the four cancelled contracts was between ¥14 and ¥15 billion (\$61-65 million). As compensation, the companies received a total of ¥1.18 billion (\$5 million), approximately eight and one half percent of the value of the contracts. Since the remaining Japanese companies had already received down payments of ten percent of the value of the contracts, they agreed to reimburse the difference to Techimport in the form of spare parts for other facilities at Baoshan [cited from p. 588].

either pursuant to bilateral exchange with foreign governments and trade associations or in accordance with individual trade contracts, comprising what the PRC refers to as "payment trade". Basically, trade conducted by the PRC with foreign countries can be divided into two types: agreement trade and non-agreement trade.<sup>104</sup>

Since a political barrier has existed between Taiwan and the PRC since 1949, indirect trade calling for the medium of an entrepôt has meant that Hong Kong or Singapore play an indispensable role. Indirect trade, or even direct trade, across the Taiwan Straits is still regarded as in the realm of foreign trade.

#### 4.4.1 Agreement Trade

Trade agreements have long been a channel for the PRC's involvement in foreign trade. In practice, there are two types of PRC's trade agreements, the intergovernmental trade agreement and the non-governmental trade agreement.<sup>105</sup> Up to 1986, the PRC had signed over one hundred trade agreements or protocols with foreign countries.<sup>106</sup> The majority of trade agreements took the form of bilateral governmental trade agreements, except for the agreement with the European Community (EC).<sup>107</sup>

However, there were differences in the nature of those PRC trade agreements made with the former Eastern

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104. ESCAP, *supra* note 13, p. 91.

105. *Ibid.*

106. Zhao, *supra* note 21, p. 22.

107. Trade Agreement between the European Economic Community and the People's Republic of China, done at Brussel on 3 April 1978; entered into force on 1 June 1978. Also ESCAP, *supra* note 13, p. 91.

bloc and those made with the West.<sup>108</sup> Since Taiwan and the PRC still do not recognize each other, Taiwanese enterprises are not able to trade under intergovernmental agreements.

In addition to intergovernmental trade agreements, the PRC trade organizations also conclude non-governmental trade agreements, namely private trade agreements, with parties of other countries having no diplomatic relations with the PRC. However, private trade agreements may still take place after the establishment of diplomatic relations and even after some kinds of governmental trade agreements have already been put in place.<sup>109</sup>

While Taiwan and the PRC continue their non-recognition, both contracting parties are free to adopt the method of private trade agreement as a means to conclude their present indirect and future direct business transactions.

#### 4.4.2 Non-agreement Trade

This form of trade, often referred to in the PRC as "payment trade", accounts for the greater part of the PRC's trade with other countries and regions. The main characteristic of this trade is that business is carried out through negotiations on the basis of both parties' needs by concluding separate contracts specifying terms and conditions of sales or purchases.<sup>110</sup>

The PRC's import procedures are somewhat different from those of Western market economies. However, the PRC

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108. See *ibid.*, pp. 91-91.

109. *Ibid.*, p. 93.

110. *Ibid.*

has adopted many conventional international trading practices since the implementation of its "Open Policy" in 1979 to facilitate trade exchange with trading partners.<sup>111</sup> The PRC's export procedures are generally similar to its import procedures.

Broadly speaking, the PRC's import and export corporations are mostly identical, as most of her FTCs conduct both import and export business.<sup>112</sup> Under the circumstances of non-agreement trade between Taiwan and the PRC, most of the commercial transactions are usually initiated by the following contacts:

A. Letter, cable and telex or oral negotiation

Contact with the PRC FTCs is usually made first by means of letter, cable or telex. Generally, the FTCs commence the transaction through a cable or telex for requesting information on the commodity's price, terms of payment, and so on. Once the transaction is agreed upon, the contract is normally prepared by the PRC party and sent to the foreign party for signature and return. If necessary, the foreign companies may be invited by the FTCS for business negotiations. The application for a business visa can be passed via the Commercial Section of the PRC Embassy in the applicant's country or sent by the company directly to the relevant FTC.<sup>113</sup>

B. The PRC's Export Commodities Fair

The PRC Export Commodities Fair which has been held twice a year in Guangzhou since 1957 is generally referred to as the Guangzhou Fair. This Fair is held primarily to promote the export of PRC products.

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111. Ibid.

112. Ibid., p. 106.

113. See ESCAP, *supra* note 13, pp. 94-95.

However, the FTCs at the Fair also carry out import business.<sup>114</sup> Moreover, the FTCs sometimes organize specialized mini-fairs in major cities. This kind of mini-fair concentrates on certain specific commodities and mainly conducts export business. In recent years, these specialised mini-fairs have been held frequently in the PRC.<sup>115</sup>

#### C. Exclusive Distributors

In promoting the sale of export goods, the FTCs may arrange for an exclusive distributorship with reliable foreign importers. A foreign exclusive distributor is given the exclusive right for a certain period of time (normally one year) to sell a product or products within a designated district or region. This foreign exclusive distributor is obliged to guarantee a certain quantity of sales and to provide the PRC supplier periodically with market reports within his district or region.<sup>116</sup>

#### D. Sales Agencies

In order to promote sales of new products, the FTCs sometimes find it necessary to conclude sales agency agreements with certain foreign business concerns. These agreements fall into two categories: sole and common agency. Sole sales agency agreements refer to giving the designated agency exclusive rights for the sale of the PRC's products in his district. The agencies may either place orders on their own account or procure business according to the conditions and terms of sales set by the principal so as to pave the way for direct sales contracts between the principal and the ultimate buyers. In the former case, the agencies themselves are

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114. Ibid., p. 99.

115. Ibid., p. 102, 108.

116. Ibid., p. 107.

buyers, while in the latter they act only in the capacity of middlemen. However, in both cases, the designated agencies are entitled to agreed commissions.

According to the sole sales agency agreement, these agencies are bound to refrain from acting as agencies for anyone else in sales of similar competitive products and to supply the principal regularly with all necessary market reports. As for the common sales agency agreements, the designated agencies differ from those for sole sales agencies in that they do not enjoy a sales monopoly of the products. In other words, the principal retains the right both to sign other such agreements with other concerns and to make direct sales in the same district.<sup>117</sup>

#### E. Brand Names Orders

The FTCs of the PRC in general have their own trade marks or brand names for their export commodities. But requests by foreign firms or importers for a foreign trade mark or brand name can be accepted so long as, in principle, their brand names or trade marks do no harm to the PRC.<sup>118</sup>

#### 4.5 Legal Methods of Taiwanese Investment

During the 1950s, the PRC was economically isolated from the West and in the late 1950s also broke off relations with the Soviet Union. The PRC's external trade at this time was mainly shaped by political and economic considerations, and its main trading partners were communist countries such as North Vietnam, Albania, and so on. Before 1979, the PRC's external economic

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117. Ibid.

118. Ibid., p. 108.

relations with foreign countries were based only on its trade.

After the initiation of its "Open Policy" in 1979, the PRC started foreign investment by introducing Western capital and technology. The PRC's southeastern provinces of Guangdong and Fujian were therefore the first to be drawn into an external nexus with Taiwan. Enterprises from Taiwan, usually via a third country, established joint ventures, or ventures owned exclusively by the Taiwanese capital, or in other forms, invested in the southeastern coastal provinces of the PRC including Hainan province.

On 6 October 1990, Taiwan promulgated the "Measures Governing Control over Making Indirect Investment or Undertaking Technical Cooperation Projects in Mainland China." According to the Measures, the term "indirect investment" was defined and the ban on direct investment by Taiwanese enterprises in the PRC was reaffirmed.

The PRC authorities, for their part, have made it clear that they would welcome direct investment from Taiwan, partly in the hope that it would reduce the chronic trade imbalance between the two, and partly to remove the inefficiencies inherent in dealing through intermediaries. Some PRC provinces and municipalities have already actively encouraged Taiwanese investment with special incentives.<sup>119</sup>

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119. For example, the PRC Fujian provincial government issued two sets of regulations designed to encourage and protect Taiwanese investors in July 1990. They specify that the Taiwanese investors can enjoy a three-year income holiday followed by a four-year fifty per cent reduction period. In addition, the Taiwanese investors will also enjoy a twenty per cent discount in land costs. See PRC Law Newsletter, London: McKENNA & Co., September 1990, No. 73, p. 9.

In 1985, Regulations were issued by the PRC's State Council detailing preferential treatment for overseas Chinese investors, including those in Hong Kong, Macao, and Taiwan. Moreover, the State Council's TIP were promulgated on 3 July 1988. However, these 1985 Overseas Chinese Regulations extend beyond the scope of concessions offered to non-Chinese investors and should be considered in conjunction with the 1988 TIP.<sup>120</sup> There are several forms of investment allowed in the PRC. These are introduced below:

#### 4.5.1 Equity Joint Ventures (EJVs)

EJVs take the form of limited liability corporations with the status of a legal entity. These ventures are still governed by the most comprehensive set of laws and regulations promulgated to date. According to the amended EJV Law of 1990, the share of foreign participants shall in general not be less than twenty five per cent. Both the PRC and foreign investors operate the ventures jointly and mutually share risks, profits and losses. The parties may make their investment in cash or in the form of technology, equipment, land use rights or other assets.

Income tax is levied on the venture itself, rather than on the investors individually, and the basic national rate of tax is thirty per cent, with a further three per cent of local tax. There is no withholding tax on the foreign investor's dividend remittances. Some preferential tax treatment (which typically takes the form of tax holidays during the first and second profit-making years may reduce income tax to ten per cent) is available for ventures established in several economic zones where foreign investment is encouraged such as

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120. See *China Law and Practice*, Vol. 2, No. 7 (August 1988), p. 61.

Special Economic Zones, various coastal cities and other economic open zones.

Refunds of income tax previously paid on net income which is reinvested in the registered capital of the same venture or to establish another venture may also be available to foreign investors. Moreover, ventures which are designated as "export-orientated" or "technologically advanced" are eligible for preferential tax treatment.

According to PRC's "Income Tax Law for Enterprises with Foreign Investment" and its "Implementing Provisions" of 1991, all forms of foreign investment in the PRC are unified under one set of regulations commonly referred to as the "Unified Tax Law".<sup>121</sup> However, in addition to income tax, EJVs may also be subject to other taxes such as the Consolidated Industrial and Commercial Tax, customs duties and import taxes, the Urban Real Estate Tax, the Stamp Tax and the Vehicle and Vessel License Tax.

The board of directors is the venture's main decision-making body, and day-to-day management is in the hands of a general manager. The amended EJV Law of 1990 allows foreign investors to hold the position of either chairman of the board or general manager. The PRC side will fill the other position. Prior to this, the chairmanship was required to go to the PRC party, with the foreign party taking the vice-chairmanship. The change has been interpreted by some as subtle recognition of the greater role foreign investors are taking in such venture management participation.

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121. See ESCAP, *supra* note 13, p. 167. Also see the "Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises", referred to as "Unified Tax Law", and its "Implementing Provisions" were promulgated on 1 July 1991 and 30 June 1991 respectively.

Prior to revisions to the EJV Law of 1990, all ventures were allowed to operate with a maximum of fifty years. Following the 1990 changes, the amended Law recognises that ventures in "certain industries" may apply to operate without time limits. Projects which can introduce advanced technology to the PRC and capital intensive projects with a long investment return period are believed to be most likely to be granted operation terms without limits by the PRC investment approval authorities.

#### 4.5.2 Contractual Joint Ventures (CJVs) - also known as "Cooperative Joint Ventures"

This type of joint venture is based on a contractual method of cooperation instead of asking investors of both parties to make a third legal person. Their proportions of distribution of products, revenues and profits are decided by all parties according to the terms of cooperation. Liabilities, rights, and obligations of both parties are stipulated in the agreements and contracts signed by both parties.

The CJVs are organised along slightly more flexible and variable lines, and for this reason have been more popular than EJVs among foreign investors especially for use in small investment projects. However, due to the flexibility of its proportions, the CJV has resulted in a great variety and diversification of practices.<sup>122</sup>

If an independent legal entity is created, the CJV will often appear the same as an EJV. If the CJV is a mere contractual arrangement between independent investors, they will not enjoy limited liability and, except where published laws and regulations apply, the

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122. H. R. Zheng, *China's Civil and Commercial Law*, Singapore: Butterworth & Co Pte Ltd, 1988, p. 236.

content of their rights and obligations will be basically as set out in their CJV contract. This provides the CJVs with a significant degree of flexibility, although the central policy is not to encourage this type of arrangement.

Prior to 1986, the CJVs were more popular than EJVs. However, due to the PRC's preference for EJVs and the trend towards treating CJVs in the same way as EJVs in law and in practice, the advantages of CJVs over EJVs have since 1986 diminished, and fewer CJVs than EJVs have been established over the past few years.

#### 4.5.3 Joint Development

This form of business is employed mainly in joint exploration for off-shore petroleum. It generally has two stages. In the first stage, that of geographical exploration, all risks including financial investment, are carried by the foreign partners. In the second stage, both the PRC and foreign parties make contributions to the joint business. Income from commercial production, less operating expenses, is distributed to the PRC party in a fixed portion. The other portion left is allowed to both the PRC and foreign parties to compensate for their invested capital together with accrued interest. The foreign parties are awarded a certain amount of the profits.<sup>123</sup>

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123. The PRC's Income Tax Law Concerning Foreign Enterprises was passed on 13 December 1981; and Detailed Rules and Regulations for the Implementation of the above stated Income Tax Law was approved by the State Council on 17 February 1982 and promulgated by the Ministry of Finance on 21 February 1982. Also see ESCAP, *supra* note 12, p. 168.

#### 4.5.4 Wholly Foreign-owned Enterprises (WFOE)

In order to expand foreign economic cooperation and technical exchange, and to further the development of the PRC national economy, the PRC has permitted foreign investors to operate WFOE within the territory of the PRC since 12 April 1986. The PRC protects the lawful rights and interests of this kind of enterprise. A WFOE is a wholly owned subsidiary of the foreign parent established as a PRC legal entity under the PRC WFOE Law of 1986 and its detailed Implementing Provisions of 1990.

WFOE will normally enjoy limited liability. However, with a few exceptions, it is not possible to establish a branch of a foreign company in the PRC, but a WFOE may function in a similar way as a locally incorporated branch. Before 1989, WFOEs were not very common because of restrictions imposed by the PRC government and an uncertain operating and regulatory environment. However, their numbers have increased considerably since 1990 following a change in the attitude of the PRC government.

Prior to April 1986, foreign investors had been cautious in investing in WFOE in the PRC, and by the end of 1986, there were a few WFOEs located in the PRC. On 12 April 1986, the "Law on Wholly Foreign-owned Enterprises" (WFOE Law) was finally promulgated and since then the growth of this form of investment has developed rapidly in the PRC's Special Economic Zones.<sup>124</sup> Following this 1986 legislation, more detailed implementing provisions and official explanations were announced in

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124. The PRC WFOE Law was adopted at the fourth Session of the sixth National People's Congress on 12 April 1986. By the end of 1986, there were 138 WFOEs in China, most of which are located in the Special Economic Zones. Foreign investors had become increasingly confident that China was indeed committed to its "Open Policy". By the end of 1993, there were 34,000 WFOEs in the PRC.

1990 and 1991 respectively.<sup>125</sup> The main reason for these is to meet foreign investors' demands for more control over their WFOE operations in the PRC, by allowing them to better respond to market conditions and protect trade secrets.

WFOE is established within the territory of the PRC in accordance with its relevant laws and regulations. In order to establish a WFOE, the project must benefit the development of the PRC national economy; moreover, it must utilize advanced technology and equipment, or export all or a major portion of its products. Industries in which the PRC prohibits or restricts the establishment of an enterprise of this nature shall be stipulated by PRC's State Council (see Article 1, 2, and 3, WFOE Law of 1986).

The same minimum statutory levels of registered capital apply to WFOEs as to EJVs and CJVs. Tax is levied on a WFOE in the same way as on an EJV, and it is generally able to enjoy the same tax holidays. However, because of the absence of a PRC party to a WFOE, the types of business in which they may engage tend to be narrower in scope than EJVs and CJVs.

#### 4.5.5 Other Forms of Investment:

##### A. Countertrade or Compensation Trade

This is the form of medium or small scale trade which is most common in the PRC. It may be regarded as a modified form of joint venture where the foreign investment is paid for by the export of finished goods or

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125. See detailed "Implementing Provisions on WFOE Law", approved 28 October 1990 by the State Council and "An Explanation of Several Terms Used in the Detailed Implementing Provisions on WFOE Law", issued on 6 December 1991 by the MOFERT.

another product. The practice of countertrade has been a significant feature of commercial relations among states in the Eastern Bloc. The PRC began to facilitate a significant volume of countertrade with the West only after 1979. Taiwanese enterprises have benefited in setting up an active partnership with PRC enterprises in countertrade via an intermediary.

In this type of trade, the PRC enterprise is normally responsible for providing factory buildings and labour force, while foreign investors supply production equipment, technology and possibly technical and supervisory personnel. When necessary, part of the raw materials may also be supplied by foreign investors. Foreign investors are paid directly by means of the goods produced in the project, in instalments. If repayment in this form is difficult, the foreign investors are paid indirectly by means of other products or by a combination of other products and cash as agreed upon by both parties.<sup>126</sup>

Countertrade can take many forms such as compensation trade, counterpurchase, and evidence account. In compensation trade, for instance, finished products are exported in exchange for machinery. Under a contractual compensation trade arrangement, a foreign investor will bring in advanced equipment and technology and manage a PRC manufacturing plant. The investor will take back as compensation a portion of the production of the plant. It is by far the most popular form of countertrade in the PRC.<sup>127</sup>

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126. See ESCAP, *supra* note 13, pp. 169-170.

127. See *China Business Guide*, *supra* note 24, p. 27.

## B. Processing and Assembling

Under this type of arrangement, foreign investors supply raw materials, components or parts, while the PRC enterprises process or assemble them into finished products according to the foreign contractor's design and specifications. The PRC enterprises receive a processing or assembling fee and re-export the finished products to the foreign investors. In principle, all the machinery and equipment used are PRC-made unless the relevant machinery and equipment are not available in the PRC. Such machinery and equipment can be imported and are exempted from duties and taxes. The supply costs of such machinery and equipment are paid for by the PRC enterprise out of its processing or assembling fees.

At present, processing and assembling contracts are no longer concentrated mainly in the labour-intensive industries such as garment, textile, cloth-making enterprises, and so on. The PRC has also accepted orders for the processing or assembling of quality goods including electronics, digital watches, calculators, and the like. The PRC government offers preferential treatment to encourage development of processing and assembling business.

In addition to paying no tax on the profits, the foreign investors are given preferential treatment within certain limits in matters of foreign exchange control, finance and taxation. Moreover, the foreign investors can get support in funds, materials, power and transport, insurance, settlement of accounts and consultant services.<sup>128</sup>

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128. See ESCAP, *supra* note 13, p. 170.

### C. Leasing

This is a new trading practice in the PRC. It is a letting or grant of equipment, machinery, or other facilities made between the foreign investor and a PRC enterprise. The foreign investor is called the lessor and the PRC enterprise is called the lessee. Usually, the foreign lessor provides the PRC lessee with the equipment, machinery, and also the technical and managing services directly or through leasing service corporations or leasing agents.

The PRC lessee makes payment by instalments according to the leasing charges agreed upon by the two sides. The foreign lessor (or leasing service corporation, or leasing agent), is responsible for customs formalities on imported equipment or machinery. The leasing length varies from three to five years or even longer, depending on the customer's needs.<sup>129</sup>

#### 4.6 Methods of Concluding Business Contracts for Taiwanese Trade and Investment in the PRC

The conclusion of business contracts for Taiwanese businesses in the PRC is broadly applicable to various forms of trade and investment activities such as the above mentioned EJVs, CJVs, and WFOEs. Besides, there are many other forms of business in the PRC, such as technology licensing contracts, compensation trade contracts, contracts for the establishment of service centres, construction contracts for the exploitation of natural resources (for example, oil).

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129. See *ibid.*

#### 4.6.1 Significance and Development of PRC Business Contracts

Since 1949, the PRC's trade representatives have been successfully negotiating business contracts with foreign enterprises. However, the business contract documents signed by the parties involved have never been unified or standardised in terms of their legal significance. These documents, to be signed in subsequent transactions have various titles, such as "contract", "agreement", "letter of intent", "memorandum of understanding", "minutes of the meeting", "protocol", "agreed memorandum", and so on. In the view of the PRC party, the legally enforceable commitments in these documents are quite complicated and differ markedly from the Western understanding of them.<sup>130</sup>

During the early stages of negotiation, the PRC party often seeks to conclude a letter of intent (which may also be described as a memorandum of understanding, minutes of the meeting, protocol, heads of agreement, or agreement in principle). A letter of intent is usually a document of two or three pages that sets out the main parameters of cooperation, such as the location and nature of the project, amount of investment, basic responsibilities of the parties, production capacity, export requirements, and term of cooperation.

Letters of intent are ordinarily non-binding statements of principle, and will often be modified or superseded during the process of negotiation and the formulation of the feasibility study. They can be made

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130. Instead of a final contract or agreement, the PRC parties would simultaneously sign business documents such as memorandum of understanding, letter of intent, protocol, and so on on the same project with various foreign parties. See J. A. Cohen, "Negotiation Complex Contracts with China", *Business Transactions with China, Japan, and South Korea*, (eds.), P. Saney & H. Smit, New York: Matthew Bender, 1983, pp. 2-16, ¶ 2.04.

binding if the parties wish to provide for the confidentiality of information exchanged during negotiations, the preclusion of other foreign companies from competing for the same project, or the allocation of feasibility study costs between the parties.

Legislation that governs both EJVs and CJVs requires that the PRC and foreign parties conduct a joint feasibility study of the project and that the resulting feasibility study report be submitted to the PRC approval authorities together with the final contract, if not submitted previously. In theory, a feasibility study should be a genuine joint effort to ensure that it accurately reflects domestic PRC conditions and any relevant international considerations, as well as the understanding of both parties.

In practice, however, one party often bears a disproportionate share of the work of preparing the feasibility study. Feasibility studies that are prepared in considerable detail are really the first stage of contract negotiations and can take on a *quasi*-contractual nature, as the parties rely on the contents and conclusions of such studies when negotiating and signing their contracts. Sometimes contracts contain specific references to feasibility studies, or such studies are incorporated into the contracts as appendices.

#### 4.6.2 Significance of the PRC Business Contract

##### A. Definition of the PRC Business Contract

As regards PRC business practices, there is confusion in concept between a contract (*hetong*) and an agreement (*xieyi*).<sup>131</sup> Both types of documents are

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131. "Contract: An agreement between two or more persons which creates an obligation to do or not to do a particular thing. Its essentials are competent parties,

legally binding in PRC law, but the terms are not legally synonymous. Although often used as synonymous with "contract", "agreement" is a broader term on the principal points involved; for instance, an agreement might lack an essential element of a contract.<sup>132</sup>

According to the PRC "Implementing Provisions" of EJV Law of 1983, an "agreement" records the parties' shared understanding of "certain important points and principles governing the establishment of the joint venture", but is not the final, detailed expression of "their mutual rights and obligations in establishing the joint venture." The latter is recorded in the joint venture "contract." The parties may or may not choose to resort to an "agreement" as a staging-post en route to a joint venture "contract", but, at least according to the Regulations, no joint venture can be established without official approval of the signed contract and articles of association. When negotiating an investment with PRC parties, as R. Randle Edwards has observed:

There is confusion between agreement and contract. Whereas Anglo-Americans would not ordinarily distinguish between an agreement and a contract, in some instances, as in the joint venture law itself, the Chinese do, maintaining that an agreement, although binding, only embraces the basic agreement on the principle points involved and leaves open many matters of detail that are ultimately to be concluded in a contract.<sup>133</sup>

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subject matter, a legal consideration, mutuality of agreement, an mutuality of obligation" [H. C. Black, M. A., *Black's Law Dictionary*, (15th ed.), Minnesota: West Publishing Co., 1979), pp. 291-292]. "Agreement: In law, a concord of understanding and intention between two or more parties with respect to the effect upon their relatives rights and duties, of certain past or future fact or performance. The consent of two more persons concurring respecting the transmission of some property, right, or future fact or performance. The consent of two benefits, with the view of contracting on obligation, a mutual obligation" [Ibid., p. 62].

132. Ibid., p. 62.

133. J. A. Cohen, *supra* note 130, p. 2-16, ¶ 2.04

According to the view stated above, it is only the contract that is the final and complete expression of the transaction parties' will. Sometimes, however, PRC parties treat "contract" and "agreement" synonymously.<sup>134</sup> In 1985, the use of the word "contract" was made uniform in accordance with the FECL.<sup>135</sup> With regards to the other documents such as "letter of intent", "memorandum of understanding", "protocol", and so on, these are generally recognized as being only preliminary documents without any legally binding force.<sup>136</sup>

However, in certain particular circumstances or for special purposes, these preliminary documents are considered to have legal content and significance.<sup>137</sup> When negotiating with a PRC entity, the foreign party must be aware whether or not the signed "memorandum of understanding" allows the possibility of the PRC party continuing to negotiate with a third party on the same project. The foreign parties, therefore, have to be careful to have clearly defined legal expressions in the various documents to be signed.<sup>138</sup>

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134. Ibid.

135. J. A. Cohen, "The New Foreign Contract Law", 12 *The China Business Review*, No. 4, 1985, pp. 53-54.

136. J. A. Cohen, *supra* note 130, p. 2-16, ¶ 2.04.

137. In international business transaction practices, the "letter of intent" is not a legal term and is generally of a non-binding nature. However, it is often the first document signed by the parties and is sometimes submitted by the PRC parties to the relevant authorities when applying for project approval. If the promises recorded in the document are meant to be enforceable commitments, the document is then thought to have a legal significance. See J. A. Cohen, *Contract Laws of the People's Republic of China*, Hong Kong: Longman Group Ltd., 1988, p. 17.

138. J. A. Cohen, *supra* note 130, pp. 2-17, ¶ 2.04.

## B. Characteristics of PRC Business Contracts

A business contract, signed between a party in the PRC and a party in Taiwan or some other Western countries, has always appeared to have the general characteristics reflecting East-West trade issues.

Although Communist enterprises employ the Western terminology of "contract" in domestic as well as foreign commerce, the conventional concepts are superimposed upon fundamentally different economic structures.<sup>139</sup> In the West, an agreement is negotiated, concluded and enforced according to the private interests of the signatory, with minimal governmental interference. In contrast, however, the former Eastern contract is imposed upon the parties by the specific provisions of the national economic plans, and by the centrally prescribed allocation of materials.

The state is in effect a third party to all agreements, lack of privity notwithstanding. The main substance of every transaction and even the contractors themselves are predetermined by the authorities with a view to achieving public objectives. Indeed, the implementation of the economic plan is the formal expression of both the contract and the entities which conclude it.<sup>140</sup>

Contractual practice in commerce among several Eastern bloc countries is clearly distinguished from that prevalent in trade with the West. Foreign enterprises

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139. S. Pizar, *supra* note 7, pp. 287-288.

140. *Ibid.* The act of economic planning creates at once, a public law obligation on the part of two affected enterprises to comply with the directive of a competent government department and a civil-law obligation to enter into an appropriate contract with one another. This contractual phenomenon can only be found in a communist country.

are required, pursuant to each nation's economic plan, to enter into appropriate arrangements with corresponding communist enterprises abroad.<sup>141</sup> Generally speaking, the former Eastern bloc practice involved public, that is governmental, interference in private civil-law relations when a commercial treaty instrument was signed.<sup>142</sup>

The contractual arrangements were in accordance with a network of bilateral treaties and protocols concluded at the level of governments. Therefore, like the ambit of "principle of party autonomy", the foreign trade enterprises' residual function of negotiating and defining the detailed conditions of their relationship was also limited.<sup>143</sup>

The characteristics of contractual practice in commerce among former Eastern bloc enterprises is entirely different from those of East-West trade. A Western government would not compel a private enterprise to assume obligations against its will, therefore, the

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141. Ibid., p. 290.

142. In fact, issues arising from the interplay between a treaty instrument signed by two socialist governments and a contract entered into by two of their operating enterprises have caused conceptual difficulties in several of the Eastern foreign trade tribunals. For further discussion on the nature of communist contract and the extent of governmental interference in civil-law relations, see S. Pizar, *supra* note 7, pp. 292-293. Also see T. W. Hoya, "The Legal Framework of Soviet Foreign Trade", 56 *Minnesota Law Review* (1971), pp. 8-10. Here the "socialist countries" means Eastern bloc countries under 1958 "Council for Mutual Economic Aid".

143. The important items in commerce among the state-trading economies such as the types and quantities of goods, the delivery of schedules, the methods of payment, and so on were all arranged in advance in a network of bilateral treaties or protocols by governments. Therefore, the function of negotiating the detailed commercial conditions of a foreign trade enterprise can be defined as "residual." See Pizar, *supra* note 7, p. 291.

Eastern states cannot hope to establish the same rigid system of intergovernmental trade agreements which characterize relations within the socialist world.

Furthermore, of necessity, communist enterprises are compelled to enter the international market place to search for and select co-contractors and also to negotiate terms and conditions -- in short, to behave like private enterprises in the pursuit of individual transactions. As a result, the state-trading entities have more freedom to bargain over commercial arrangements with Western enterprises than could ever be imagined in their own environment.<sup>144</sup>

Under East-West trade relations, the content of bilateral trade agreements is also quite different.<sup>145</sup> They do not attempt to establish a detailed blueprint for contractual relations, much less dictate the conditions of individual transactions.<sup>146</sup> Bilateral commercial agreements between communist and non-communist countries are no more than loose frameworks for the achievement of flexibly defined goals.<sup>147</sup>

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144. See *ibid.*, pp. 293-294.

145. See "Text and Appendices of USA-USSR Trade Agreement, October 18, 1972", *Business Transactions with the USSR*, (ed.), R. Starr, U.S.: ABA Press, 1975, pp. 349-365; "Text of China-United States Agreement on Trade Relations, July 7, 1979", 18 *International Law Materials* (1979), pp. 1041-1051; "Text and Appendices of Romania-United States: Agreement on Trade and Relation, April 2, 1975", 14 *International Legal Materials* (1975), pp. 671-680; "Text of EEC-PRC: Trade Agreement, April 3, 1978", 17 *International Legal Materials* (1978), pp. 1459-1462.

146. S. Pisar, *supra* note 7, p. 294.

147. The nature and style of Sino-Japanese Trade Agreement is quite similar to the trade agreements signed among communist countries. See G. T. Hsiao, "Non-recognition and Trade: A Case Study of the Fourth Sino-Japanese Trade Agreement", *China's Practice of International Law: Some Cases Studies*, (ed.), J. A. Cohen, Mass.: Harvard University Press, 1972, pp.139-143.

Within the structure of these agreements, business entities are permitted to negotiate with one another freely and to contract more or less as they please.<sup>148</sup> In East-West trade, certain contractual provisions are sought by the former Eastern party as a matter of need and habit under the influence of a planned economic environment. However, in the framing of East-West contracts, the *force majeure* definitions, arbitration submissions and choice-of-law elections are of special importance.<sup>149</sup>

As for concluding investment contracts in the PRC, the contractual negotiations are comparatively lengthy affairs and have their own special characteristics which are similarly of the nature of East-West trade. Furthermore, like the trade contracts, the contracts for the establishment of foreign-invested enterprises are normally signed in two languages: Chinese and English (or the language of the foreign party).

Investment contracts that must be approved by the PRC government authorities (including contracts for licensing technology and establishing foreign-invested enterprises) do not become legally binding upon signature, but only upon the issue of an approval certificate. After an approval certificate is issued, both parties must apply for the issue of a business licence, and it is only upon the issue of the latter that the new enterprise is legally established in the PRC.

The approval by the PRC government authorities does not constitute approval for all matters encountered in the course of implementing the investment contract. In particular, separate applications must be made to the tax

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148. S. Pisar, *supra* note 7, p. 294.

149. *Ibid.*, pp. 296-297.

authorities, foreign exchange authorities and customs administration, and the consent and active support of local authorities must be obtained for a host of matters under local jurisdiction, such as assuring the supply of utilities, materials and labour, the plans and costs for the construction of buildings, compliance with environmental regulations, and so on. When possible, it is desirable to pin these matters down prior to signing the contract or to try to make their satisfactory resolution conditions precedent to contributing the investment called for by the contract.

In the light of contractual practices, the PRC did not treat inter-governmental treaty instruments such as trade agreements or investment protection agreements as an essential prerequisite to business transaction. Without such inter-governmental agreements, the private enterprises of the West still engage in drawing up bilateral commercial contracts with the parties of the PRC. These contracts, of course, reflect the contractual characteristics of East-West trade.

### C. Limits of PRC's Contractual Freedom

As stated above, the former Eastern state-trading entities have been allowed a certain degree of freedom to negotiate with Western enterprises. However, this does not mean that they are absolutely exempt from local law in opting for particular terms. Certain provisions of domestic legislation necessarily apply to all foreign trade dealings, whether intra-East or East-West, and cannot be displaced by an autonomous exercise of will.<sup>150</sup>

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150. C. M. Schmitthoff, "The Law of International Trade, Its Growth, Formulation and Operation", *The Sources of the Law of International Trade*, (ed.), C. M. Schmitthoff, London: Stevens & Sons, 1964, p. 29.

In the internal economic life of a socialist country, party autonomy is severely restricted by the dictates of a national plan. Although freedom of will is given ample play in external commerce, it is still circumscribed by provisions which the state monopolies consider essential to the regulation of their activities.<sup>151</sup> The contracting parties, foreign laws, international customs and treaty instruments are forbidden to encroach upon the territory of the "law-making character of the export-import plan", the "capacity of foreign trade operating corporations", the "authority of foreign trade representatives", and the "formalities governing the execution of contracts." Beyond this ambit, the parties are, at least ostensibly, as independent of domestic law as in the West. Both the state trader and the private merchant are left free to establish in their bargain the regime they desire.<sup>152</sup>

In contractual precedents, foreign negotiators will find that the negotiation with a PRC entity is, to a considerable degree, limited in freedom of choice of

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151. Ibid., The concept of "freedom of will", "freedom of contract", and "party autonomy" should be paid more attention. In the law of international trade, the principle of party autonomy or freedom of contract is applied in two ways. In its classical form, the doctrine of party autonomy means that the parties have discretion to choose the proper law governing their contract. Whereas, in its more revolutionary form, it means that the parties have freedom to regulate their contractual relations in manner intend to be independent of any municipal law. In private international law, the concept of "freedom of contract" is different from that of civil law. As regards the party autonomy in communist countries, it seems the concept was not only defined within private international law but also within civil law. See A. R. Dicks, *supra* note 23, pp. 415-416; see also S. Pisar, *supra* note 7, pp. 297-300; and also A. Kiralfy, "The Union of Soviet Socialist Republics", in *East-West Business Transactions*, (ed.), R. Star, New York: Praeger Publishers, 1974, pp. 327- 328.

152. S. Pisar, *supra* note 7, p. 298; cf. C. M. Schmitthoff, *supra* note 150, pp. 10-11.

contract terms.<sup>153</sup> In fact, if the project negotiation involves matters of investment, it will generally need consultation and approval from the PRC central government. If the investment amount is less than a certain figure, or the project itself needed no assistance from the central government, the project would probably still need approval from the local authority.<sup>154</sup>

Although PRC law appears to lay down no restrictions on the extent to which FTCs can vary the terms of their standard form contracts, their foreign trade officials are in practice by no means free to adopt any terms.<sup>155</sup> But the most serious problems for contract drafting arises not from the legal principles set out above but from the lack of close contact between the contractor and the end-user, the enterprise that ultimately is to use the goods which are to be supplied.<sup>156</sup> This becomes one factor which limits the scope of party autonomy.

In trade with the Western capitalist world, the former Eastern parties seem to enjoy virtually unlimited discretion from a legal point of view. However, this unexpected display of sovereign liberality must not be taken at face value. In fact, there is little renunciation of authority, and the appearance of laissez-faire procures considerable advantages for the state. Two examples being, first, the state monopoly gains strong bargaining power from contractual autonomy; secondly, it gains the means of influencing contractual relations through the various administrative channels

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153. J. A. Cohen, *supra* note 130, pp. 2-14, ¶ 2.03.

154. *Ibid.* Also see art. 7 of PRC's 1985 FECL.

155. A. R. Dicks, *supra* note 23, pp. 415-416.

156. *Ibid.*, p. 416.

which are peculiarly available in a collectivist government.<sup>157</sup>

In socialist countries, the principle of party autonomy is still at risk of being abused. The danger resides in the fact that this principle may become a vehicle for near-constraint when applied as part of an organized government policy.<sup>158</sup>

As mentioned above, in contractual precedents, PRC entities seem to apply wholly the doctrine of party autonomy as used in the East. However, limits of contractual freedom are still circumscribed by the PRC domestic law as shown in the themes of state approval, social and public interest, and so on.<sup>159</sup>

In the PRC, the limits on contractual freedom in trade with the capitalist world is mainly a characteristic of the structure of a state planned economy and PRC's general observance as enshrined in law since 1949.<sup>160</sup> At present, various economic laws and regulations appear to tend realistically towards increasing the scope of contractual autonomy with parties from the West. Nevertheless, the characteristics and

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157. See S. Pizar, *supra* note 7, pp. 298-300. Once properly concluded, the contract is recognized as the primary source of the parties' rights and duties. It is not the sole source, however. An attempt at total self-regulation is deemed null and void.

158. *Ibid.*, p. 299.

159. J. P. Stevens, "The New Foreign Contract Law in China", 18 *Law and Policy in International Business* (1986), p. 473. Also see art. 4 and 7 of PRC's 1985 FECL.

160. All say that law is a part of the superstructure of society, a manifestation of the ruling class's will and a ruling instrument with a class nature. Socialist China adheres to this law. See Byron S. J. Weng and Chang Hsin (eds.), *Introduction to Chinese Law*, Hong Kong: Red River Co. Ltd., 1991, p. 7].

limitations of a centrally planned-economic structure still exist in the PRC.

#### 4.6.3 Development of PRC Business Contracts

##### A: Application of the PRC Standard Form Contract

The various FTCs of the PRC prefer to use their own standard forms of contract for imports and exports.<sup>161</sup> The FTCs have different forms to meet the requirements of trade with other socialist states. Those that relate to trade with the West have been formulated entirely by the PRC side. However, Sino-Japanese trade has been an exception in that the contract terms were negotiated through commercial delegates from both sides.<sup>162</sup>

As the PRC modelled its foreign trade system on that of the former Soviet Union, its standard form contract is similar to that which is used in the Soviet trade institutions.<sup>163</sup> There were no multilateral substitutes for binding norms in East-West trade activities until the "General Conditions for the Supply

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161. S. J. Mitchel & D. D. Stein, *supra* note 27, p. 898; see also J. P. Stevens, *supra* note 159, p. 460; B. P. Fishburne III, "Trade with the People's Republic of China", *A Lawyer's Guide to International Business Transactions*, (eds.), W. Surrory and D. Wallace, Jr., Philadelphia: American Law Inst., 1977, Part I, p. 38.

162. A. R. Dicks, *supra* note 23, p. 413.

163. With regard to Soviet's standard form contract, see T. W. Hoya & D. D. Stein, "Drafting Contracts in U.S. Soviet Trade", *7 Law and Policy in International Business* (1975), p. 1057. See also T. W. De Pauw, *Soviet-American Trade Negotiations*, New York: Praeger Publishers, 1979, pp. 53-60. As regards Soviet's foreign trade contract, see A. Kiralfy, *supra* note 151, p. 320 *et seq.* Concerning the PRC modelling its foreign trade system on that of Soviet Union, see S. J. Mitchell & D. D. Stein, *supra* note 161, p. 899; see also K. D. Gott, *supra* note 11, p. 93.

of Plant and Machinery for Export" was made by the Economic Commission for Europe (ECE) in 1955.

An additional series of standard forms was then published with a view to making available to traders, on an optional basis, a uniform set of contract rules and practices. The socialist countries' "Council for Mutual Economic Aid" (CMED) had also a treaty named the "General Conditions for the Delivery of Goods" in 1958. However, the ECE conditions obtained little acceptance and the CMED conditions are also not applicable in East-West trade. In the absence of effective international regulation, each party prefers its own standard form of contract.<sup>164</sup>

There are various types of standard form contract in the PRC. One contract consists of two pages only by which the PRC entities purchase an individual item of equipment or a commodity. The other is a complex document in which the PRC entities secure the whole "Turn-key plant" as well as the licensing of the technology.<sup>165</sup> All clauses of the standard form contract regulate only the basic commercial terms. But sometimes other details such as technical specifications of the equipment purchased, employment training of the PRC personnel, and so on are regulated in its extensive appendices.<sup>166</sup>

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164. See S. Pizar, *supra* note 7, p. 291, 295; see also C. M. Schmitthoff, *supra* note 163, pp. 17-19.

165. Turn-key plant means the plant could be operated when the key was put in and turned. The so-called turn-key contract here means the transaction was conducted only if a whole plant was accepted. With regard to complex document, see S. J. Mitchell & D. D. Stein, *supra* note 161, p. 898, *cf*; J. P. Stevens, *supra* note 159, p. 460.

166. S. J. Mitchell & D. D. Stein, *supra* note 161, p. 898.

When commercial negotiation with the Western enterprise is under way, FTCs in the PRC usually offer standard form contracts.<sup>167</sup> Other than price and quantity, the other clauses of the contract cannot theoretically be revised. However, as foreign trade and investment have been emphasized to be a key to modernization since 1979, the foreign parties are in fact entitled to revise the clauses of the PRC standard form contract. For example, under certain circumstances, a revisory contract may be influenced by the consideration of some factors such as the designated function of the FTC, the nature of the transaction itself, the status of the competitive contractors, and so on.<sup>168</sup>

#### B. Development of the PRC Complex Contracts

Before the 1980s, the majority of the PRC international contracts were signed with regard to those common import-export goods and commodities. For instance, during the early 1950s, the PRC usually bought the complete plants and the other major capital goods from foreign countries.<sup>169</sup> Following the increase of economic contacts with foreign countries in the 1970s, the PRC began to buy much more complicated goods such as ammonia plants, earth satellite groundstations, or aircrafts. These resulted in protracted as well as complicated contractual negotiations.<sup>170</sup>

Upon entering the world business community in 1979, PRC entities eventually became equipped with a much more

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167. Ibid.

168. See P. M. Tobert, "Contract Law in the People's Republic of China", *Foreign Trade, Investment and the Law in the People's Republic of China*, (ed.) M. J. Moser, Oxford: Oxford University Press, 1984, p. 215.

169. J. A. Cohen, *supra* note 130, at 2-2, ¶ 2.01.

170. Ibid.

advanced standard intellectual apparatus, that is, complex contracts.<sup>171</sup> Since 1979, most foreign capital has been attracted through the use of complex contracts in the PRC.

### C. Other Distinct Business Contracts

In addition to the standard form contract and the complex contract, several terms can be found in a PRC commercial contract such as a Foreign Trade Corporation Contract (FTC contract), non-FTC contract, negotiated contract, and so on.<sup>172</sup> These are illustrated below.

It seems that the vast majority of foreign trade transactions have been conducted by FTCs under MOFERT. However, some of the other related ministries of the PRC central government, local authorities, and some special manufacturing-enterprises are also entitled to conclude a business contract. These play a vital role in developing the PRC's foreign trade and investment.

A contract concluded by an FTC is called a FTC contract. It is called a non-FTC contract if concluded by a non-FTC. While FTC contracts are always made in the same format, by contrast the non-FTC contract, without a standard form, has a much greater variety of styles and content. The non-FTC contracting parties usually lack foreign trade experience.<sup>173</sup>

The "negotiated" contract is a name used specifically to distinguish it from the standard form contract. In the Western view, the negotiated contract is one merely concluded through a negotiation. It is of no special

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171. Ibid.

172. S. J. Mitchell & D. D. Stein, *supra* note 161, p. 897, 900.

173. Ibid., p. 898.

significance. But in principle, a standard form contract should be used in East-West trade,<sup>174</sup> and the negotiated contract therefore has its own special significance in East-West trade. Generally speaking, the non-FTC contract and the complex contract are categorized as negotiated contracts.

In the PRC, a standard form contract is most often used in trade. In contrast, a negotiated contract and a complex contract are more often to be found in investment. In fact, due to its own idiosyncrasy, the standard form contract is not suitable for complicated projects.<sup>175</sup> However, in practice, the complex contract is usually found to be within the scope of a standard form contract. For example, the "turn-key plants purchasing contract" is a complex contract but it is categorized as a standard form contract.<sup>176</sup> Contracts such as contract of license and technical know-how transfer are the same, being used as a standard form contract in the PRC.<sup>177</sup>

#### 4.7 Laws Relating to PRC Business Contracts

##### 4.7.1 Background

The FECL was adopted at the PRC's tenth Session of the Standing Committee of the sixth National People's

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174. F. A. Orban, "The Challenge to the Enforcement of Socialist Arbitral Awards", 17 *Virginia Journal of International Law* (1976-1977), p. 379.

175. See P. M. Tobert, *supra* note 168, pp. 215-216.

176. See U.S. Department of Commerce (comp.), *Doing Business with China*, Washington: Government Printing Office, 1983, p. 14.

177. Concerning PRC's Sample Contract of License and Know-how Transfer, see L. Fung, *China Trade Handbook*, Hong Kong: Adsale People, 1984, p. 233.

Congress on 21 March 1985. Three days later, the Standing Committee announced the "Regulations of the People's Republic of China Governing Contracts for the Import of Technology".<sup>178</sup> In promulgating a new law or a new regulation, the PRC usually, in practice, passes a general law and then passes a more detailed and illustrative regulation. The "Regulations of the PRC Governing Contracts for the Import of Technology" were therefore enacted for the special legal issues involved in the FECL.<sup>179</sup>

Starting in 1978, the PRC initiated the modernization of its legal system as a part of its economic reform. Prior to 1979, there were no civil, commercial or procedural codes in the PRC. Following the EJV Law of 1979, a great deal of commercial legislation specially addressed to "shewai" matters has been promulgated. After the introduction of domestic Economic Contract Law (ECL) in 1981, the PRC finally had its first contract legislation. There had been no "shewai" contract law in the PRC until the promulgation of 1985 FECL.<sup>180</sup>

Before 1979, the great majority of the PRC's foreign trade contracts were signed exclusively through its nine FTCs under the aegis of the MFT.<sup>181</sup> As there was no contract law to be applied, the foreign entities had to use their own contract law as a basis on which to sign a Sino-foreign contract.<sup>182</sup> A standard form contract has

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178. J. L. deLisle, "Foreign Investment: Foreign Economic Contract Law", 27 *Harvard International Law Journal* (1986), p. 275.

179. *Ibid.*, p. 279.

180. J. P. Stevens, *supra* note 159, p. 455.

181. *Ibid.*, see also B. P. Fishburne III, *supra* note 161, p. 232; cf. A. R. Dicks, *supra* note 23, p. 394.

182. J. P. Stevens, *supra* note 176, p. 459.

normally been used in the PRC when concluding business with entities from the capitalist countries.

After the PRC's decentralization of its foreign economic and trade system commenced in 1979, regional authorities and local enterprises were permitted to negotiate directly with foreign parties.<sup>183</sup> Business contracts could be directly signed between the foreign party and the FTCs from PRC ministries other than the MFT, or PRC state entities at lower levels.

The conduct of foreign business contracts at that time was no longer monopolized by the MFT. In addition to standard form contract, the negotiated contract is also used in the PRC.<sup>184</sup> And due to an increase in foreign trade, the complex contract is increasingly found there.

In these circumstances, many problems in foreign trade contracts arose from the absence of related legislation. The increase of transaction costs and the decline of willingness to contract on the part of foreign parties are examples of the consequences of these problems.<sup>185</sup> The situation is even worse in foreign investment. In developing the PRC's economic reform, central legislation is required to resolve the consequential contractual problems. This is the background which gave birth to the FECL and the related "Regulations Governing Contract for the Import of Technology".<sup>186</sup>

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183. For a review of PRC's decentralization policy in this area, see Fung, "China's Decentralization of Foreign Trade", *Asian Wall Street Journal* (Weekly, 24 November 1982), p. 6.

184. J. P. Stevens, *supra* note 159, p. 460.

185. See *ibid.*, pp. 461-462; see also J. L. deLisle, *supra* note 178, p. 281.

186. See J. P. Stevens, *supra* note 159, p. 459.

#### 4.7.2 Contents of the PRC's FECL

The FECL consists of seven chapters and forty three articles. Chapter topics are as follows: General Provisions; Conclusion of Contract; Performance of Contracts and Liabilities for Breach of Contract; Assignment of Contracts; Modification, Rescission, and Termination of Contracts; Dispute Resolution; Supplementary Provisions.<sup>187</sup>

##### A. General Provisions

The FECL stipulates that the parties to a contract are the PRC enterprises and other economic organizations on one hand and foreign enterprises, economic organizations or individuals on the other. This law applies to all foreign economic contracts, except those regarding international transport.<sup>188</sup>

Furthermore, this law has general principles governing contracts in its Articles 3 and 4; the delicate issue of which country's law should govern the resolution of disputes in its Article 5; and the issue of preemption of PRC law by international treaties in its Article 6.<sup>189</sup>

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187. See the text of PRC's 1985 FECL, *China Business Review*, Vol. 12, No. 4, July-August 1985; also appears at 24 *International Legal Materials* (1985), p. 799.

188. Art.2 of PRC's 1985 FECL. J. A. Cohen observed that purchase and sale contracts, supply of utilities, establishment of agency relationships and service centres, warehousing goods, constructing buildings, obtaining insurance, licensing technology and trademark, processing, assembly, compensation trade, joint equity and cooperative ventures, natural resource projects, financial transactions, and property and equipment leases are all applied to this FECL. See J. A. Cohen, *supra* note 135, p. 52.

189. Art. 3, 4, 5, and 6 of PRC's 1985 FECL.

## B. Conclusion of Contract

The FECL stipulates that a contract is formed when the parties have reached agreement on and signed in written form the provisions of the contract. An agreement is not void if it is reached by exchange of letters, telegrams or telexes. If one party requests the signing of a confirming document, the contract is considered to be formed only when the confirming document is signed.<sup>190</sup>

Some agreements, like the "joint venture" agreement or the "import of technology" agreement, only become valid contracts after an approval is granted.<sup>191</sup> All contracts that violate the PRC's laws, and social or public interests are void; moreover, no contracts concluded by means of fraud or duress are deemed to be valid.<sup>192</sup>

The FECL demands that a contract should contain the main provisions<sup>193</sup> and also specifies that the appendices are an integral part of it.<sup>194</sup> Also, this law details the limits to the risks involved in undertaking the contract, insurance coverage, term of validity of the contract, and guarantees.<sup>195</sup>

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190. Ibid., art. 7. If one party asks for a letter of affirmation, this letter of affirmation should reach him before the contract is validated. See J. P. Stevens, *supra* note 159, p. 464.

191. Ibid., art. 7.

192. Ibid., art. 9 and 10.

193. Ibid., art. 12.

194. Ibid., art. 8.

195. Ibid., art. 13, 14, and 15.

### C. Fulfilment of Contract and Liability for Breach of Contract

The parties must perform the agreed obligation of the contract. Non-performance or failure to fulfil the contract in accordance with stipulated terms is a breach of contract.<sup>196</sup> When one party has actual evidence that the other party cannot fulfil the contract, the prospective injured party of a breach may temporarily cease performance of the contract. The injured party may ask for compensation or other remedies, or may even ask for a rescission of the contract.<sup>197</sup>

If a contract contains several mutually independent parts, the injured party may rescind some parts of it.<sup>198</sup> Where compensation is given, the compensation may not exceed the losses which the contract-breaching party should have foreseen in concluding the contract.<sup>199</sup> The injured party may not demand compensation for any additional losses.<sup>200</sup>

When one party cannot perform all or part of its contractual obligations because of an event of *force majeure*, it shall be fully or partially relieved from liability.<sup>201</sup> In foreign economic contracts, the parties

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196. Ibid., art. 16 and 18. In East-West trade, the principle *Pacta Sunt Servanda* retains both validity and efficacy. With regard to contractual commitment in East-West trade, see S. Pizar, *supra* note 7, pp. 283-287. In PRC's contractual practices, breach of contract can be found in a precedent of *Baoshan Debacle* which was discussed in D. A. Sneider, *supra* note 100, p. 541 *et seq.*

197. Ibid., art. 17, 19, 29, 32, and 33.

198. Ibid., art. 30.

199. Ibid., art. 19.

200. Ibid., art. 22.

201. Ibid., art. 24 and 25.

may agree on liquidated damages and any penalty.<sup>202</sup> In addition to demanding a recovery of losses because of breach of contract, one party may ask compensation from the other party for losses suffered as a result of the invalidation of the contract.<sup>203</sup>

#### D. Assignment, Modification, Rescission, and Termination of the Contract

The FECL allows for assignment of contractual rights and obligations. If a contract needs no approval from the state, it may be assigned to a third party after mutual consent is obtained between the two parties. If the contract needs state approval, the contractual parties should be given permission from the original approving authority.<sup>204</sup>

A party may unilaterally rescind the contract if there is a breach of contract, an event of *force majeure*, or other ground for rescission.<sup>205</sup> There are three circumstances in which a contract may be terminated. First, if the contract has already been fulfilled; secondly, if it is given a court judgement or is settled by arbitration; and finally, if it is agreed to by both parties.<sup>206</sup>

The contract may be modified following a written agreement between the parties. But if state approval is needed, the contractual parties should gain consent from

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202. Ibid., art. 20.

203. Ibid., art. 11.

204. Ibid., art. 26 and 27.

205. Ibid., art. 29. The rights to demand compensation for losses will not be influenced if there is a modification, rescission, and termination of contract. See also *ibid.*, art. 34.

206. Ibid., art. 31.

the original approving authority.<sup>207</sup> The provisions regarding final accounting, liquidation, and resolution of dispute do not lose effectiveness because of the rescission or termination of the contract.<sup>208</sup>

#### E. Dispute Resolution

When contractual disputes arise, the parties should try to resolve them through private negotiation or relatively informal mediation.<sup>209</sup> If both methods fail to resolve the dispute, the parties may make a written "arbitration agreement." This agreement is not necessarily a part of the original contract. If consent is given, the dispute may be submitted to a PRC arbitration agency or to a non-PRC arbitration body.<sup>210</sup>

If the parties failed to perform any arbitration provision in the contract or did not agree to arbitration in writing, they may bring a suit in the PRC courts.<sup>211</sup> The parties to a contract may choose the law to be applied to the handling of a contractual dispute. PRC law has to be applied in the case of an EJV contract, a CJV contract, and contracts for cooperative exploration and development of natural resources to be performed within the PRC.<sup>212</sup>

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207. Ibid., art. 28, 32, and 33.

208. Ibid., art. 35 and 36.

209. Ibid., art. 37.

210. Ibid.

211. Ibid., art. 38. See J. K. Lockett, "Dispute Settlement in the People's Republic of China; The Developing Role of Arbitration in Foreign Trade and Maritime Disputes", 16 *The George Washington Journal of International Law and Economics* (1982), p. 265.

212. Ibid., art. 5; cf. art. 6.

With regard to other contractual disputes, the parties may choose themselves which law is to be applied. If there is no applicable law, the law with the closest relation to the contract has to be applied.<sup>213</sup>

#### F. Supplementary Provisions

The time limit for submitting a dispute to litigation or arbitration in respect of a contract for the purchase and sale of goods is four years from the time that the party knew, or ought to have known, of the infringement of its rights. The statutes of limitations for other contracts are to be enacted separately.<sup>214</sup>

With regard to contracts for EJVs, CJVs, and exploration and development of natural resources, they are still implemented in accordance with the provisions of these contracts. However, the parties may consult and agree to the FECL being applied to contracts formed before the FECL itself takes effect.<sup>215</sup>

#### 4.7.3 Contents of the PRC "Regulations Governing Contracts for the Import of Technology"

These Regulations consist of thirteen articles. All contracts referring to transfer or license, patent rights and other industrial property rights, technical know-how, and technical services between PRC individuals and foreigners shall be implemented in accordance with

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213. Ibid., art. 39.

214. Ibid., art. 5. See H. R. Zheng, "China's New Civil Law", 34 *The American Journal of Comparative Law* (1986), p. 200.

215. Ibid., art. 40, 41, 42, and 43.

these Regulations.<sup>216</sup> MOFERT of the PRC State Council shall itself be responsible for interpreting these Regulations.<sup>217</sup>

Furthermore, all technology import contracts require MOFERT or its authorized agencies' examination and approval. In Article 9 of these Regulations, there are nine unfair restrictive requirements which need special authorization.<sup>218</sup> Since the technology import contracts are not pure leasing agreements but contracts "to sell" technology to the PRC parties, there are prohibitions on the recipient's continued use of the imported technology following expiration of the contract term.

This is one of the nine "unfair restrictive requirements" included in Article 9. In signing technology import contract, the supplier party shall guarantee that the technology being provided meets the technical requirement. All the performance standards should be stipulated in the contract.<sup>219</sup> The recipient shall undertake the obligation to maintain the confidentiality of the technology being provided by the supplier. However, this obligation is limited to the confidentiality portion of the contract.<sup>220</sup>

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216. Art. 2 of PRC's Regulations Governing Contracts for the Import of Technology. Officials from MOFERT said contracts between foreigners and Chinese individuals were to be applied under the scope of these Regulations. See Foreign Broadcast Information Service (FBIS), 8 June 1985, p. K 11 which was cited from J. L. deLisle, *supra* note 178, p. 279.

217. *Ibid.*, art. 12.

218. *Ibid.*, art. 9. An official from MOFERT admitted that these "restrictive requirements" can be made flexible under special circumstances. See FBIS, 5 June 1985, p. K 12, cited from J. L. deLisle, *supra* note 178, p. 280.

219. *Ibid.*, art. 5 and 6.

220. *Ibid.*, art. 7.

#### 4.7.4 Evaluation of the PRC's Laws Relating to Business Contracts

In order to further encourage foreign trade and investment, the PRC expedited the promulgation of both the FECL and "Regulations Governing Contracts for the Import of Technology", which became incomplete parts of the PRC economic regulatory system. Some very important questions therefore remain unanswered, for foreign enterprises and investors.<sup>221</sup> For example, should the FECL be applied to contracts that were concluded before the date the FECL itself went into effect?<sup>222</sup> Also, should the PRC government's lawful actions constitute events of *force majeure* when such actions induced a failure of fulfilment in a contract?<sup>223</sup> Under what conditions, would the PRC authorities give approval to the contractual assignment and rescission? What about the recognition by the PRC authorities of the claim of "unfair restrictive requirements"?<sup>224</sup> What contracts would be recognized as being against the principles of

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221. J. L. deLisle, *supra* note 178, p. 281.

222. Art. 40 of PRC's Regulations Governing Contracts for the Import of Technology. It is not clear in legal significance when the word "may" is used instead of "shall." One PRC legal scholar suggested that reciprocity provisions should be applied to all contracts which had already existed before the Regulations' effectiveness. See J. A. Cohen, *supra* note 130, pp. 52-53; see also J. P. Stevens, *supra* note 159, pp. 471-472.

223. There are no clauses of *force majeure* stipulated in a contract with regard to items of state approval of import-export, trade scheme, and economic plan. See Lubman & Randt, "Another Legal Milestone of China Trade", May 1985, p. 12. This was cited from J. L. deLisle, *supra* note 178, p. 282, note 55; cf. C. M. Schmitthoff, *Export Trade*, London: Stevens & Sons, 1981, pp. 113-114.

224. Art. 27 and 33 of PRC's 1985 FECL; Art. 9 of PRC's Regulations Governing Contracts for the Import of Technology.

"social or public interests" and "equality and mutual benefit" in the PRC?<sup>225</sup>

The issue of how to address such problems has been the source of serious concern to foreign businessmen. Since 1979, the pattern of the PRC's policy and law-making has become the main indicator as to whether or not foreign economic contracts should be validated.<sup>226</sup>

#### 4.7.5 Significance of the PRC's Laws Relating to Business Contract

Both the FECL and "Regulations Governing Contracts for the Import of Technology" are often ambiguous and conservative in places, but though far from perfect, they are much more clear than the PRC's regulations of Special Economic Zones (SEZ).<sup>227</sup> As a result, both items of legislation were welcomed by Western businessmen and legal experts. Their clauses and articles have become ground rules for Sino-foreign contract negotiations.<sup>228</sup>

The FECL especially deals with certain international business practices and American contract law.<sup>229</sup> The clauses and articles of both pieces of legislation serve to reduce the high transaction costs

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225. Art. 3 and 4 of PRC's 1985 FECL.

226. J. L. deLisle, *supra* note 178, p. 282.

227. *Ibid.*, p. 281.

228. See J. A. Cohen, *supra* note 135, p. 52.

229. *Ibid.*; also see J. L. deLisle, *supra* note 178, p. 281. The PRC's Civil Procedure Law and Criminal Law adopted the continental European format. However, its contractual concept of Economic Contract Law involved in a common core of continental law as well as Anglo-American law. See J. A. Cohen, *supra* note 130, pp. 2-18 to 2-19, ¶ 2.05.

which were seriously criticized by foreign parties in the past.<sup>230</sup>

The FECL and "Regulations Governing Contracts for the Import of Technology" together constituted the first nationwide legislation in the PRC to standardise all Sino-foreign business contractual patterns.<sup>231</sup> As in other countries, the two PRC legislations should be applied to Taiwan-PRC business contracts in the area of private law.

In the early stages, difficulties often arose, as most Taiwanese enterprises had no experience of dealing with PRC parties in the context of business contracts. Under these circumstances, the ground rules to be gleaned from both PRC legislations are of undoubted value to both Taiwan and the PRC business parties in conducting trade and investment transactions.

#### 4.7.6. Barriers to Taiwan-PRC Business Contracts

##### A. The Present Private Law Relations on Trade and Investment

Due to the lack of formal diplomatic relations and recognition, Taiwan and PRC parties face special legal problems in concluding trade and investment contracts. Trade opportunities and business activities are usually seriously prejudiced if there is no bilateral governmental relationship.<sup>232</sup> Private business parties in principle have the freedom to conclude contracts in both domestic and international business transactions.

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230. J. L. deLisle, *supra* note 178, p. 281.

231. J. A. Cohen, *supra* note 135, p. 52.

232. See C. A. Jaslow, *supra* note 16, p. 212.

However, this freedom of concluding contracts is limited to private law in both Taiwan and the PRC.<sup>233</sup>

With increasing cooperation in the sphere of private law, private relations between Taiwan and the PRC should not be further impeded. Important overtures have been made on both sides for finding legal solutions to private inter-regional conflicts. Mutual non-recognition should not necessarily be an inhibiting factor influencing private business activities between parties of two countries. For example, business activities were conducted between Japan and the PRC although there were no diplomatic relationships prior to 1972.<sup>234</sup>

Generally speaking, East-West business dealings have continued in the absence of diplomatic relations, even when political tensions have been high.<sup>235</sup> Therefore, the non-existence of diplomatic relations or recognition should not directly interfere in private business activities and freedom of contract conclusion.

Without formal diplomatic relations, private business activities are usually conducted in accordance with domestic legal norms. Some domestic laws can be applied only to friendly countries with *de jure*

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233. See art. 2 and 72 of Taiwan's Civil Code in 1 A Compilation of the Laws of the Republic of China (Taipei, 1967). Taiwan fully recognizes the philosophy of freedom of contract. However, if the parties' will is directed to an end prohibited by law or contrary to public policy or good morals, then, to that extent, the court will deny recognition of the agreement by refusing to enforce the rights created by the contract. See also art. 9 of PRC's 1985 FECL. Contracts that violate the laws of the PRC or contravene the social or public interest shall be void.

234. At that time, there was a Sino-Japanese non-governmental trade agreement which had no need for governmental recognition. The non-governmental trade agreement has the nature of a private contract. See G. T. Hsiao, *supra* note 147, p. 147.

235. S. Pisar, *supra* note 7, p. 3.

recognition. Other laws may demand the countries to have a certain degree of recognition before they are applied. Whether these laws can be applied totally depends upon the will of the concerned governments.

Also, there are varieties of domestic laws which may be applied specifically between countries without *de jure* recognition.<sup>236</sup> Domestic laws under non-diplomatic relations can be classified into two categories: firstly, laws made to maintain or build up commercial relations. The United States's "Taiwan Relations Act" is one such example.<sup>237</sup> The second category involves laws made to limit or prohibit commercial relations. In fact, the laws applied between countries with non-diplomatic relations usually belong to the second category. Private legal relations between such countries will be impeded if the second category of laws takes precedence.

#### B. The Present Obstacles Encountered in Taiwan-PRC Business Contracts

In the past, Taiwanese enterprises have usually encountered two main barriers when concluding business contracts with parties of the PRC. One is political and the other is legal.<sup>238</sup>

##### a. Political Barrier

Since the end of the Second World War, an East-West conflict has existed in international politics. In

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236. See C. Y. Huang, *Guoji Shangshi Fa* (International Commercial Law), Taipei: published by the author, 1984, pp. 483-484. With regard to the law specially applied to a country without formal recognition, see, for example, the United States' Taiwan Relations Act which can be found in 22 U.S.C. 3301-3316 (1988).

237. *Ibid.*, Taiwan Relations Act.

238. See K. D. Gott, *supra* note 11, p. 92.

East-West trade, business activities have been limited or prohibited between hostile countries or those having no diplomatic relations. Political factors have played a vital role in the conduct of East-West trade. In other words, the political situation has always been a major consideration in East-West trade.<sup>239</sup>

Although the quest for profitable economic exchanges seems strong enough to transcend ideological barriers, no one can ignore the political and diplomatic environment in which antagonistic societies pursue their economic ends. The flow of goods is often at the mercy of state policies which subordinate economic needs to political considerations. Notable examples are the severe export restrictions, import discrimination and credit limitations which have existed in such circumstances.<sup>240</sup>

In contrast, the political barrier to Taiwan-PRC trade is one which cuts off trade completely by government decree, rather than reducing the trade flow either through higher prices (given the price-elasticity of demand for imports) as in the case of tariffs, or by an arbitrary upper limit, as in the case of import quotas.

Furthermore, the political barrier even now calls for the trade medium of entrepôts, and herein lies the indispensable role of Hong Kong in the Taiwan-PRC trade.<sup>241</sup> With no direct trade and investment relationship, a political barrier exists to prevent business transactions being conducted between Taiwan and the PRC.

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239. L. Gomes, *International Economic Problems*, New York: St. Martin's Press, 1979, p. 63.

240. See S. Pisar, *supra* note 6, p. 3.

241. See C. Y. Huang, *supra* note 236, p. 484.

## b. Legal Barrier

Given the prevailing protectionism in trade, certain commercial actions, which are limited or prohibited by domestic law, are often adopted. This situation occurs even between countries with diplomatic relations. For instance, such can be seen in the trade actions to pressure other countries to take substantial measures to improve market access under the United States's "Special 301 Provisions of the Trade Act." In spite of the rapid development of the PRC legal system in recent years, legal barriers in business transactions persist: examples are statutes and regulations, often vague and untested. Besides, case law is not recognized as legal precedent in the PRC.<sup>242</sup>

In Taiwan, the TMRS will authorize and recognize private law relations despite the continued absence of political recognition of the PRC. However, this Act is far from comprehensive and lacks regulations concerning commercial relations with the PRC. In comparison, the PRC for its part is still in need of a sound legal structure refined enough to accommodate the Western (including Taiwan) practices of international commercial law. The main legal barrier arising in Taiwan-PRC commercial relations is the reality of non-recognition. The absence of a status of Most-favoured Nation (MFN) and other guarantee agreements on trade and investment are the most important features of this.<sup>243</sup>

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242. The PRC trade organizations usually conclude what may be called non-governmental trade agreements with business and economic groups of other countries having no diplomatic relations with the PRC. See ESCAP, *supra* note 13, p. 92.

243. For example, Agreement on Trade Relations between the PRC and the USA, *supra* note 145.

#### 4.8 Conclusions - Legal Methods to Overcome Barriers to Concluding Taiwan-PRC Business Contracts

Since political and legal barriers exist in East-West trade, various legal methods may be adopted to overcome these barriers. In general, there are three legal methods. First, to annul or amend the present trade law, or to promulgate a new trade law. Secondly, to sign a bilateral non-governmental or governmental trade agreement. Thirdly, to join an international multiple trade treaty.

Political considerations have practical implications for the short-term evolution of Taiwan-PRC trade. Such political considerations have no legal effect which influences or even protects the commercial benefits of private enterprises. Given the absence of formal recognition, the protection of private enterprises in law has emerged as an important issue. In commercial practice, business contracts are not readily concluded if there is no guarantee of legal protection. Without diplomatic relations between governments, the unrecognized party will lack the usual channels for protection of national interests.<sup>244</sup> Taiwanese enterprises are taking commercial risks by doing business within the territory of the PRC.<sup>245</sup> Risks of this kind can be reduced if there is a proper application of domestic as well as international law.<sup>246</sup>

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244. D. P. O'Connell, *supra* note 17, pp. 124-125.

245. See G. H. Hackworth, *Digest of International Law*, Washington: Government Printing Office, 1940, Vol. I, pp. 234, 235, 300. Although the commercial risks cited by D. P. O'Connell were different, Taiwan-PRC business transactions to date incur similar risks in the eyes of the international law.

246. See L. A. Pinard, "United States Policy Regarding Nationalization Decree of 1950", 14 *California Western International Law Journal* (1984), p. 148 *et seq.*

A lack of proper protective legislation has now become the biggest barrier to Taiwan-PRC business transactions. In addition to the change of domestic law,<sup>247</sup> a bilateral non-governmental agreement or an international multiple treaty may be adopted in order to overcome the barriers encountered in concluding business contracts between the two.<sup>248</sup> This is why it has become necessary for Taiwan, when dealing with trade and investment in the PRC to demand, at least, such a bilateral non-governmental agreement with binding effect.

What Taiwan wants of the PRC is not merely a new proper protective statute. Admittedly, such a law would offer much more protection than an administrative order. But such legislation will be only as good as any of PRC laws. It cannot possibly have the binding effect provided by a bilaterally signed treaty or agreement. That is why it has become popular for countries trading with and investing in the PRC to demand signing a guarantee treaty or, at least, a non-governmental agreement.<sup>249</sup>

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247. The TIL, promulgated on 3 March 1994, is intended to upgrade the TIP of 1988 which was issued by the State Council. For an English text, see Appendix III of this thesis.

248. To date, no non-governmental trade agreements have been signed between Taiwan and the PRC. However, the "Taiwan-Chinese Repatriation by Sea Agreement" signed by the Red Cross representatives on 20 September 1990 might be a model to be adopted. A mediation group such as Taiwan's Straits Exchange Foundation (SEF) and PRC's Association for Relations Across the Taiwan Straits (ARATS) could undertake this mission. The bilateral non-governmental agreement or treaty may be signed in order to avoid these barriers encountered in concluding business contracts between the two. It is understood that the possible establishment of such offices in the PRC for SEF and in Taiwan for ARATS will not involve the protocol of foreign relations since both governments adhere their separate own "one-China policy".

249. For example, at present (1994), the PRC has signed bilateral investment treaties with more than forty countries. See Osman Tseng, "Risky Business", *Free China*

## CHAPTER FIVE

### LEGAL PROTECTION OF TAIWANESE TRADE AND INVESTMENT IN THE PEOPLE'S REPUBLIC OF CHINA

As noted above (see p. 39), the Taiwanese government is willing to consider establishing direct trade, shipping and air links with the PRC only if the PRC renounces the use of force against Taiwan and recognises the island as a separate political entity. However, by the end of 1993, some 20,000 Taiwan-funded enterprises -- with US\$30 billion of accumulative investment had already been established in the PRC. Taiwan-PRC two-way trade was more than US\$8 billion in 1994.<sup>1</sup> At present, all such trade and investment is indirect, concluded mostly through intermediaries in Hong Kong. Taiwan seeks to establish a sound legal framework for the protection of such business transactions although the PRC claims the existing laws are adequate.<sup>2</sup>

#### 5.1 The Significance of Legal Protection for Taiwanese Trade and Investment in the PRC

The various types of risks encountered in international trade and investment include those of credit, politics, economics, transfer, emergency, and those of business risks, non-business, commercial, managerial, to name but some. However, these can be broadly grouped into credit risks, non-commercial (political) risks, and enterprise risks.<sup>3</sup> Credit risks

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1. *Zhongyang Ribao* (Taipei: Central Daily News), 2 July 1994, p. 4; and also source from Taiwan's Board of Foreign Trade and Hong Kong Customs of 1994. See Appendix II.

2. Kieran Cooke, "'Bridge built' between Taiwan and China", *The Financial Times*, 30 April 1993, p. 4.

3. For further studies, see J. Chang ed., *Guoji Jinrong Maoyi Daxidian* (International Finance and Trade

mean that when a contract is concluded, notwithstanding that the buyer has a problem with credit (either payment is not then made or delayed), the seller therefore bears the risks of the commercial loss. Non-commercial risks are usually unpredictable under normal circumstances and none of the parties in the business transaction are liable for the loss caused, except when there is a concession agreement.<sup>4</sup> As for enterprise risks, examples of loss liable in enterprise itself are mistakes in policy, business misconduct, managerial failure, and so on.

In international trade, the above classification of three risks is of practical use. The most significant category in foreign investment is non-commercial risks.<sup>5</sup> The scope of non-commercial risks in foreign investment is as follows: first, war; secondly, expropriation without compensation or nationalisation; thirdly, discriminatory regulations; fourthly, currency restrictions; lastly, quota limitations on foreign

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Dictionary) (Taipei: China Credit Information Service Press, 1988), pp. 156, 198, 644.

4. Non-commercial risks consist of emergency risks, non-business risks, economic risks, and transfer risks. See R. Y. Dong, *Protection of Foreign Investment under International Law*, Taipei: Modern Management Foundation, 1989, pp. 124-125. It can also refer to some other old articles in this field such as E. Synder, "Protection on the Private Foreign Investment, Examination and Appraisal", 10 *International and Comparative Investment Law Quarterly* (1961), p. 472; and R. C. Pugh, "Legal Protection of International Transaction against Non-Commercial Business Risks", *A Lawyer's Guide to International Business Transaction*, (eds.), W. S. Surrey and C. Shaw, Philadelphia: Joint Committee on Continuing Legal Education, 1963, p. 302.

5. For example, the Overseas Private Investment Corporation of the United States guaranteed only the non-commercial risks but not the commercial risks. See W. S. Surrey, "Exporting to the PRC: Government Policies, Financing and Other Transaction Problems", *Business Transactions with China, Japan, and South Korea*, (eds.), P. Saney and H. Smit, New York: Matthew Bender, 1983, pp. 3-20.

trade.<sup>6</sup> Although foreign trade and foreign investment are different, in nature, the methods for protecting them are not so very different. For foreign investment, either domestic law or international law is adopted in every country as a method for avoiding non-commercial risks. The common situation is that countries which receive capital investment will offer incentives, and the capital exporting country will protect its overseas investment through investment insurance or diplomatic protection. Under such circumstances, the possibility of a bilateral or multilateral investment law has always emerged as an issue much debated between both countries.<sup>7</sup>

As for international trade, many legal methods are used to protect traders from non-commercial risks. Examples are export insurance, trade agreements, or even multilateral agreements.<sup>8</sup> International trade is a

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6. See E. Synder, *supra* note 4, p. 472; see also R. C. Pugh, *supra* note 4, p. 302.

7. For bilateral or multilateral investment law, see E. Synder *supra* note 4, p. 469 et seq.; E. I. Nwogugu, *The Legal Problems of Foreign Investments in Developing Countries*, New York: Oceana Publications, Inc., 1965, pp. 135-159. These laws seem always to be suggested by capital exported countries and not to be accepted particularly by the capital imported developing countries. The main difficulty is that there is little agreement on many international law principles and further, each country is reluctant to limit its own sovereignty. See also E. I. Nwogugu, *id.*, p. 156 et seq.

8. For example, the General Agreement on Tariffs and Trade (GATT) under the United Nations. There are trade limitations. See J. H. Jackson, *World Trade and the Law of GATT: A Legal Analysis of Gatt*, Indianapolis: The Bobbs-Merill Co. Inc., 1969, p. 193. The People's Republic of China applied to rejoin GATT on 10 July 1986 although China was one of the founding members which itself suspended relationship on the establishment of the People's Republic in 1949. See R. E. Herzstein, "China and the GATT: Legal and Policy Issues raised by China's Participation in the General Agreement on Tariffs and Trade", 18 *Law and Policy in International Business* (1986), p. 374. Since the PRC applied to resume its GATT status in 1986, there have been many recent trade and economic reforms but a number of issues still need to be resolved and their status has not yet been confirmed. A

commercial exchange that is completed in one transaction, and involves much less risk than such long-term commercial activities such as international investment. Therefore, the protection of non-commercial risks in trade is always made in one of two ways, either through the administrative measures of the exporting country or through a bilateral or multilateral agreement.

In regard to trade and investment across the Taiwan Straits, the above-stated legal protection methods may be adopted against non-commercial risks. However, in the present situation in which there is a lack of any kind of government-imposed protection such as diplomatic relations, the non-commercial risks still exist in trade and investment ties between the two. In line with both Taiwan and the PRC's overall policy towards each other, direct trade and investment links are likely to be implemented in the near future. However, that policy has no legal restrictive power which would reduce the non-commercial risks. In the interest of enterprise itself, investment can always be abandoned if the non-commercial risks appear to outweigh its expected returns.

Because of the very special political situation existing between the PRC and Taiwan, non-commercial risks are ever-present in trade and investment activities between Taiwan and the PRC. Under these circumstances, legal protection plays a vital role in business transactions between the two regimes. At present, Taiwan is seeking a formal treaty or agreement similar to those which the PRC has extended to other countries. The PRC has claimed that safeguards in its domestic law are

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complication arises from the submission by Taiwan of an application to join GATT which was made in 1990. The PRC has expressed a willingness to discuss Taiwan's participation in GATT in accordance with its one-China policy but only on the basis that Taiwan would join as a separate customs territory of China, rather than as an independent member nation.

sufficient. The PRC believes that such a treaty would boost Taiwan's claim to be treated as an equal political entity and has eschewed a bilateral or even multilateral agreement or treaty. The legal protection methods of Taiwanese investment in the PRC will be discussed by examining the PRC's own measures.

## 5.2 The PRC's Legal Protection Measures in Investment

Business and economic environments differ as between Taiwan and the PRC. In terms of production, Taiwan has management expertise, abundant capital, well developed market distribution channels and excellent applied technologies; the PRC, meanwhile, possesses plenty of land, labour and natural resources, and a high standard of basic technology. In line with the government's policy of industrialisation, the PRC continues to attract foreign capital and encourages further foreign investment in its push towards economic reforms.<sup>9</sup>

### 5.2.1 The PRC's Protection Measures and Responsibility for Foreign Investment

The PRC's decision to accept foreign investment was the result of a fundamental shift in political leadership and economic policy that began after the Cultural Revolution, and which crystallised during the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist party (the Third Plenum) in December 1978. The new leadership declared that the primary

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9. For further studies on efforts of PRC's economic reform since 1979, see Cheng Yuan, *East-West Trade, Changing Patterns In Chinese Foreign Trade Law and Institutions*, New York: Ocean Publications, Inc., 1991, pp. 319-320. As for the importance of foreign capital for economic development, see A. A. Fatouros, *Government Guarantees to Foreign Investors*, New York: Columbia University Press, 1962, p. 12, note 3.

national objective of the PRC was to raise the living standards of its people through economic development.<sup>10</sup> In order to achieve this objective, the PRC leadership realised that the country needed greater access to foreign capital, and therefore adopted many measures since 1979 to attract foreign capital.<sup>11</sup>

The risks associated with governmental actions are not infrequently a very real source of concern to foreign investors. Governmental action of this kind commonly consists of breaking concessive promises or other agreements, or withdrawing favourable guarantees. Foreign investors are greatly disquieted by non-commercial risks such as these, and moreover by the unfair or inadequate remedies available in cases of expropriation or nationalisation. With an eye to allaying such fears, developing countries seeking to attract foreign capital always offer guarantees aimed at assuring potential foreign investors that commercial commitments will be honoured. Guarantees of this kind are invariably underpinned either by policy or by law. Different countries have differing approaches, but investment protection measures in general almost without exception are to be found enshrined in the following three: first, Governmental Policy Statements; secondly, Municipal Legislation; lastly, Constitutions.

Governmental Policy Statements are a form of guarantee or warranty to attract foreign investment. For example, the PRC Vice Minister of the Ministry of Foreign

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10. See, for example, Li Peng's Report on "Continue to Work for Stable Political, Economic and Social Development in China", to the 3rd Session of the 7th National People's Congress in March 1990.

11. For example, there were many forms of promoting foreign direct investment in the early 1980s in the PRC. See Economic and Social Commission for Asia and the Pacific (United Nations) [Hereinafter, ESCAP], *Guidebook on Trading with the People's Republic of China*, London: Graham & Trotman Ltd., 1984, pp 167 - 170.

Economic Relations and Trade (MOFERT) said openly in June 1982 during an investment promotion meeting that:

During the past 30 years, the Chinese government has always abided by its promises in its relationship with foreign countries. As long as foreign investors do not violate the laws of the Chinese government and the joint ventures and cooperative enterprises do not infringe upon the PRC's public interests and public order, we will not confiscate their investments. Even in cases involving factors such as large-scale war and disastrous natural calamities-when and if foreign assets have to be requisitioned-the Chinese government will handle affairs according to legal procedures and compensate in accordance with the principles of fairness and reasonableness.<sup>12</sup>

Such statements are purely expressions of intention but have no legally binding force. They are therefore not reliable and may be withdrawn at any time.<sup>13</sup>

Municipal Legislation is a form of legal protection for the guarantees or warranties of foreign investment. Since the 1980s, there have been many important investment laws promulgated in the PRC. The EJV Law of 1979 is the most striking example.<sup>14</sup> The Law itself is a kind of investment statute and is a landmark symbol of the PRC's commitment to attracting foreign investment. The types of laws used by the PRC to regulate foreign business activities and their sources, in general, fall into two different categories which are: published

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12. See *Beijing Review*, No. 30, 26th July 1982, p. 20.

13. The statement could be more significant protection if it were included in investment contracts or municipal legislation. See E. I. Nwogugu, *supra* note 6, p. 54; see also A. A. Favours, *supra* note 9, p. 121.

14. The EJV Law was promulgated on and effective as of 8th July 1979. This Law consists of 15 simple articles, and may be viewed more as a road map than as substantive legal authority. The PRC government has supplemented the Law with extensive regulations.

legislation, and internal or restricted regulations.<sup>15</sup> Generally speaking, investment statutes are much more effective than the other methods of legal protection. With real binding force, the statutes can be amended only through special legal procedures and can alone enable a legal remedy to be obtained in that country.

As for Constitutional protection, the current PRC Constitution, adopted in late 1982, grants recognition and protection for foreign investment. Article 18 of the Constitution specifically authorises foreign investment in the PRC, provided that foreign investors abide by the PRC law, at the same time offering foreign investors protection under the PRC law.<sup>16</sup>

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15. The PRC's published legislation is issued in a variety of forms by legislative bodies and administrative agencies. Under PRC's Constitution, the power to enact and amend basic statutes (*falü*) in the civil area is granted to the NPC. The NPC's Standing Committee may enact statutes in certain areas not specifically reserved to the NPC itself and may issue decrees (*faling*), decisions (*jueyi*), orders (*mingling*), and instructions (*zhishi*) based on existing laws when the NPC is not in session. In addition, the PRC's State Council, designated by the Constitution as the highest organ of state administration, as well as administrative organs directly responsible to the State Council, are authorised to issue administrative regulations (*guiding*) and measures (*banfa*) to implement existing legislation. Finally, local organs of state power such as local people's congresses and their standing committees at the provincial, municipal and autonomous region levels are empowered to enact local laws and administrative regulations subject to the approval of the central government. For further studies, see M. J. Moser (ed.), *Foreign Trade, Investment and the Law in the People's Republic of China*, Oxford: Oxford University Press, 1984. p. 2.

16. The Constitution of the People's Republic of China was amended in 1982 and its Article 18 has been recognised as the basic legal framework for the PRC's foreign investment laws and regulations adopted after 1982 (Beijing: Foreign Language Press, 1983).

## 5.2.2 Contents of the PRC's Protection Measures and Responsibility for Foreign Investment

Generally speaking, the protection measures for the capital-investing country need to be quite general in character, and include a declaration for foreign investors and a protection regulation providing for fair or non-discriminatory treatment. Some countries even ask for reciprocity to be a prerequisite condition of granting non-discrimination treatment.<sup>17</sup>

### A. General Aspects

According to Article 2 of the 1990 EJV Law, the PRC government protects the investment of foreign joint ventures, the profits due to them and their other lawful rights and interests in a joint venture, pursuant to the agreement of contract and articles of association approved by the Chinese government. Articles 1 and 4 of the 1986 WFOE Law have relevant regulations.<sup>18</sup> As in the 1982 PRC Constitution, there is a general protection regulation in its Article 18 which is worth quoting in toto:

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17. In order to be granted the same treatment, there must just have been investments made within that other country, which normally is a developed and capital-exporting country. Thus, the wisdom of inserting such a provision is questionable. See R. Y. Dong, *supra* note 4, pp. 125-126.

18. The WFOE Law was promulgated on and effective as of 12th April 1986. Article 1 provides that in order to expand foreign economic cooperation and technical exchange, and further the development of the Chinese national economy, the People's Republic of China permits foreign enterprises and other economic organisations or individuals to operate wholly foreign-owned enterprises within the territory of China, and protects the lawful rights and interests of wholly foreign-owned enterprises. Article 4 provides that the investment, profits earned and other lawful rights and interests of foreign investors within the territory of China shall receive the protection of the laws of China.

"The People's Republic of China permits foreign enterprises, other foreign economic organisations and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other economic organisations in accordance with the law of the People's Republic of China... Their lawful rights and interests are protected by the law of the People's Republic of China."

It appears that no provisions relating to national treatment, non-discrimination treatment, or reciprocity treatment may be found in the PRC's investment rules.<sup>19</sup> It is not clear if the PRC can offer fair, just and equitable treatment in its own law.<sup>20</sup> Thus, the PRC regulations on foreign investments are thought to be a general assurance without any concrete content. This assurance is no more than an indication of the attitude of the PRC to its present investment climate.

## B. Specific Aspects

Just like other capital-importing countries, the PRC has certain specific protection measures for foreign investments.

### a. Expropriation

In attracting foreign investment, capital-importing countries are also concerned that expropriation of foreign assets will become an obstacle to investment.<sup>21</sup>

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19. National treatment means that all rights, immunities and facilities granted to domestic investors and companies shall be available on equal terms, to foreign investors and companies engaged in the same fields. See R. Y. Dong, *supra* note 4, p. 131. As for non-discrimination, see *ibid.*, pp. 126-129.

20. The principle of fair, just, and equitable treatment is always interpreted as the minimum standard of treatment to alien, or the international law standard of treatment. See E. I. Nwogugu, *supra* note 7, p. 135 *et seq.*; see also R. Y. Dong, *supra* note 4, p. 346.

21. Apart from expropriation, there are several similar expressions such as nationalisation, socialisation,

In general, there are regulations in law or even in the Constitution for protecting people's private assets which include those of foreign investors. The investment laws may not refer to nationalisation or expropriation under the Constitution. However, some related regulations in the Constitution are *de facto* applicable. According to the current PRC Constitution, foreign investments will be protected by its "national law." The WFOE Law of 1986 has started to consider the protection of foreign investment assets. In Article 5 of the Law, the PRC will not nationalise or carry out expropriation of WFOEs; but in special circumstances, the state may carry out expropriation. The pre-requisites are that the expropriation must meet the needs of social and public interest, in accordance with legal procedures, and give commensurate compensation. To date, there are no other

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confiscation, creeping taking, and so on. Regarding the concept of expropriates, the author would like to refer to some old books such as G. White, *Nationalisation of Foreign Property*, London: Stevens & Sons, 1961, p. 32 and B. A. Wortley, *Expropriation in Public International Law*, Cambridge: Cambridge University Press, 1959, p. 24. As for the concept of nationalisation, see B. A. Wortley, *ibid.*, p. 36; D. P. O'Connell, *International Law*, New York: Oceana Publications Inc., 1965, Vol. 2, p. 843; and also M. Domke, "Foreign Nationalisation: Some Aspects of Contemporary International Law", 55 *American Journal of International Law* (1961), pp. 587 - 588. Upon referring to socialisation, see S. Friedmann, *Expropriation in International Law*, London: Stevens & Sons, 1953, p. 5 and D. P. O'Connell, *ibid.*, p. 838. The principle of expropriation in orthodox international law is also applicable for nationalisation and socialisation. See B. A. Wortley, *ibid.*, p. 37; M. Domke, *ibid.*, p. 588; L. B. Sohn & R. R. Baxter, *Responsibility of State for Injuries of International Law* (1961), p. 554. In regard to the expression of confiscation, see B. A. Wortley, *ibid.*, p. 39 and J.E.S. Fawcett, "Some Foreign Effects of Nationalisation or Property", 27 *British Year-book of International Law* (1950), p. 355. The expression of creeping taking can be referred to R. C. Pugh, *supra* note 4, p. 302; J.E.S. Fawcett, *ibid.*, p. 356; M. Domke, *ibid.*, p. 359; and also H. J. Steiner & D. F. Vagts (eds.), *Transnational Legal Problems, Materials and Text*, New York: The Foundation Press, 1968, pp 363 - 367.

laws regulating nationalisation of expropriation for foreign investment in the PRC.<sup>22</sup>

A detailed standard of remedy for nationalisation has been laid down in investment protection treaties between the PRC and foreign countries.<sup>23</sup> In the present legal framework, the international treaty takes priority over domestic law in the PRC.<sup>24</sup> Therefore, the investment protection treaty has become an important legal source regarding nationalisation in PRC law.<sup>25</sup>

#### b. Taxation

In order to escape discriminatory or higher taxation treatment, some protection measures need to be adopted to avoid such kinds of non-commercial risks. If the taxation rate were to be based on the nationality of assets owners, foreign investors would never hazard their business activities in such a country.<sup>26</sup> To assure

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22. H. R. Zheng, "Foreign Investment Law in the People's Republic of China: A 1986 Update", 19 *Journal of International Law and Politics* (1987), pp. 287-288.

23. *Ibid.*, for example, under Article 3 of the investment protection treaty between China and Sweden, the level of compensation for nationalisation is to place investors in the same financial position they would have been in without nationalisation. Article 3 further provides that the nationalisation may not be discriminatory and the compensation, which must be in convertible currency, may not be unjustifiably delayed. Article 3 specifies that compensation will include the loss of regular income from the investment.

24. *Ibid.*, p. 288; see also H. R. Zheng, "China's New Civil Law", 34 *The American Journal of Comparative Law* (1986), p. 700; see also General Principles of Civil Law (GPCL), adopted 12 April 1986 and an English translation in 34 *The American Journal of Comparative Law* (1986), pp. 715-743.

25. H. R. Zheng, *supra* note 22, p. 288.

26. The taxation right is a kind of state sovereignty. Except for some certain immunities, the taxation right should be effective for aliens within the state territory. This is a recognised principle of

foreign investors that no such risks exist, certain special taxation treatments such as National Treatment, Non-discriminatory Treatment (Most-favoured Nation Treatment), or even Fair Treatment are offered unilaterally by a country. There is no mention of such taxation treatments in the PRC Constitution or its investment laws. However, there are some relevant regulations in the PRC investment laws.<sup>27</sup>

Prior to the 1983 Joint Venture Implementing Regulations, an Individual Income Tax Law and a Foreign Enterprise Income Tax Law and associated regulations were also promulgated in the PRC from 1980 to 1982. All of these established, at least in principle, a generally fair and rational tax regime. Moreover, for policy reasons, further tax incentives have been granted to all foreign investing enterprises if they meet specified criteria, and not merely to joint ventures.<sup>28</sup>

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international law. See D. P. O'Connell, *supra* note 21, p. 787; see also E. I. Nwogugu, *supra* note 7, pp. 9-10; A. R. Albrecht, "The Taxation of Aliens under International Law", 29 *British Year-book of International Law* (1952), p. 145; see also C. C. Hyde, *International Law Chiefly as Interpreted and Applied by the United States*, Boston: Little, Brown & Company, 1947, Vol., I, p. 655.

27. See Article 7 of the 1979 EJV Law; Article 9 and 10 of the 1988 CJV Law; Article 17 of the 1986 WOFE Law; and also Article 69, 70, 71, 72 of the Regulations for the Implementation of the EJV Law (promulgated on 20 September 1983).

28. The Income Tax Law of the PRC on Sino-Foreign Equity Joint Ventures was adopted on 10th September 1980 (amended in September 1983); Detailed Rules and Regulations for the Implementation of this Income Tax Law was promulgated on 14 December 1980. The Individual Income Tax Law of the PRC was promulgated on 10 September 1980; Detailed Rules and Regulations for the Implementation of this Individual Income Tax Law was promulgated on 14 December 1980. The Foreign Enterprises Income Tax Law of the PRC was adopted on 13 December 1981; Detailed Rules and Regulations for the Implementation of this Foreign Enterprises Income Tax Law was promulgated on 21 February 1982.

### c. Foreign Exchange

In order to balance international receipts and expenditure, an importing country will usually establish a system of controlling its foreign exchange. This method will hinder the remittance of capital and profits back to the capital exporting country. Therefore, foreign exchange incentives are commonly adopted for foreign investors by allowing remittance of their capital and incomes. However, the capital importing country may abuse its monetary sovereignty or commit a tort such as will expose foreign investors to unexpected non-commercial risks.<sup>29</sup>

To reduce such risks, certain protection legislation in the capital importing countries is adopted for foreign investments. For the same reason, the PRC investment laws have such regulations governing foreign exchange.<sup>30</sup> Furthermore, the PRC's handling of the foreign exchange issue now appears less arbitrary after a series of foreign exchange regulations were issued.<sup>31</sup>

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29. Every state has an exclusive monetary sovereignty. The Permanent Court of International Justice (PCIJ) pointed out in the verdict of the *Serbian and Brazilian Loan Case* that it is indeed a generally accepted principle that a state is entitled to regulate its own currency. See PCIJ Ser. A. No. 20 (1929), p. 44. For further discussion on the monetary sovereignty of a state, see F. A. Mann, *The Legal Aspects of Money*, Oxford: Oxford University Press, 1992, p. 461 at seq. and also refer to J. E. S. Fawcett, "The International Monetary Fund and International Law", 40 *British Yearbook of International Law* (1964), p. 49.

30. See Article 8, 10, 11 of the 1979 EJV Law; Article 8, 11 of the 1988 CJV Law; Article 18, 19 of the 1986 WFOE Law; and Article 73, 74, 75, 76, 77, 78, 79 of the Regulations for the Implementation of the EJV Law (1983).

31. Provisional Regulations for Foreign Exchange Control of the People's Republic of China were promulgated on 18th December 1980; Rules for Implementation of Foreign Exchange Control Relating to Foreign Institutions in China and Their Personnel were promulgated on 10 August 1981; Rules Governing the Carrying of Foreign Exchange,

### 5.3 Legal Effectiveness of the PRC's Protection Measures and Laws

In additional question is: what about legal effectiveness should the PRC government unilaterally withdraw its guarantee or warranty of Constitution, national legislation, or policy statements by introducing new legislation or administrative measures toward foreign investments? According to international law, under the principles of territorial jurisdiction, the alien's substantive and procedural rights are neither better nor worse than those of local nationals.<sup>32</sup>

#### 5.3.1 International Minimum Standard

It should be noted that a state is obliged to meet the international minimum standard of treatment in its legal and administrative measures for the protection of aliens' freedom and security.<sup>33</sup> According to the

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Precious Metals and Payment Instruments in Convertible Currency into or out of China were promulgated on 10 August 1981; Rules for the Implementation of the Control of Foreign Exchange Relating to Individuals were promulgated on 31 December 1981; Rules for the Implementation of the Examination and Approval of Applications by Individuals for Foreign Exchange were promulgated on 31 December 1981.

32. L. Oppenheim - H. Lauterpacht (ed.) *International Law*, London: Longmans, Green and Co., 1955, Vol. I, p. 641; see also S. D. Metzger, *International Law, Trade and Finance: Realities and Prospects*, New York: Oceana Publications Inc., 1962, pp. 2-3. The reciprocity treatment, non-discrimination treatment, or national treatment are adopted in the investment laws of various countries. See R. Y. Dong, *supra* note 4, pp. 125-132.

33. See G. H. Hackworth, *Digest of International Law*, Washington: Government Printing Office, 1943, Vol. 5, p. 471; see also D. P. O'Connell, *supra* note 21, pp. 1019-1023.

international standard of justice, a state should comply with the rule of non-discrimination towards aliens in international law. All the legal and administrative benefits such as substantive and procedural rights for aliens should meet the international standard of civilisation.<sup>34</sup> A state has responsibility for any injuries to aliens caused by the violation of such a standard.<sup>35</sup>

However, developing countries have given a variety of reasons for adopting the national treatment standard, thus denying equality of treatment, a traditional principle of international law. For example, the former Soviet doctrine states that foreigners cannot enjoy greater rights than the local nationals, and may enjoy less.<sup>36</sup> The PRC attitude towards aliens' treatment has not been clear. In the early 1960s, a jurist named Chou Keng-sheng mentioned the international minimum standard of the international law in the PRC. He believed that the protection of nationals abroad is the exercise of the

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34. Non-discrimination treatment has become a principle of international law. See R. Y. Dong, *supra* note 4, p. 126, 346, see also E. I. Nwogugu, *supra* note 7, p. 135 et esq. see also F. A. Mann, *supra* note 29, pp. 471-478.

35. See G. H. Hackworth, *supra* note 33, Vol. 5, p. 4711; see also G. Schwarzenberger, *International Law*, London: Stevens & Sons, 1957, Vol. 1, pp. 200-206; see also W. W. Bishop, Jr., *International Law, Case and Materials*, Boston and Toronto: Little, Brown & Company, 1971, p. 745; see also W. G. Friedmann, O. J. Lissitzyn, R. C. Pugh, *Cases and Materials on international Law*, St. Paul, Minn.: West Publishing Co., 1969, p. 748.

36. See S. N. Guba Roy, "Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?", 55 *The American Journal of International Law* (1961), pp. 881-883; see B. P. Amad, "Attitude of the Asian-African States toward Certain Problems of International Law", 15 *International and Comparative Law Quarterly* (1962), pp. 61-62; see also W. G. Friedmann, O. J. Lissitzyn and R. C. Pugh, *supra* note 35, pp. 762-764; see A. A. Fatouros, "International law and the Third World", 50 *Virginia Law Review* (1964), p. 807; see also H. S. Steiner & D. F. Vagts, *supra* note 21, p. 259.

personal supremacy of all sovereign states. No one can deny this minimum standard of international law. It is a standard which must be observed by every state. In contrast, another jurist, Li Haipei mentioned in 1960 that the best treatment foreigners may claim is merely equal treatment with nationals. Their treatment cannot surpass that of nationals.<sup>37</sup> At present, it seems that the international minimum standard of treatment is denied by developing countries. PRC scholars strongly criticised the label of "international law" for the body of orthodox and conventional rules which are considered legally binding by "civilised states" in their intercourse with each other. The PRC denied recognition of such a definition, which was adopted before the 1950s by western scholars.<sup>38</sup> One can therefore infer that the PRC, like the other developing countries, has no intention of adopting the international minimum standard of treatment in orthodox international law.

### 5.3.2 Some Limitations in Customary International Law

Under international law, only those rights which are recognised can become effective. A state can unilaterally amend its laws if not in direct contravention of international law. But any amendments must be limited by the principles of international law.

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37. See J. A. Cohen and H. Chiu, *People's China and International Law: A Documentary Study*, Princeton, N. J.: Princeton University Press, 1974, Vol., 1, pp. 82, 718, and 722.

38. See L. Oppenheim - H. Lauterpacht (ed.), *International Law*, Vol. I. 1948. 7th ed., p. 4. In the version issued in 1955, the term "civilised" was removed, see L. Oppenheim - H. Lauterpacht, *supra* note 32, pp.4-5. As for the Chinese attitude, see H. Chiu, "Communist China's Attitude Toward International Law", 60 *The American Journal of International Law* (1966), p. 250. Further studies, see J. A. Cohen and H. Chiu, *ibid.*, pp. 29-30.

Only if such limitations were violated by state action would the state have international responsibility in accordance with international law. Once there is an international tort, the capital importing country assumes international responsibilities, such as the duty of making reparation to the investing state and the investing state being able to claim the right of diplomatic protection.<sup>39</sup>

The PRC can unilaterally amend its own legislation or adopt administrative measures with the effect of breaking its former assurances or guarantees of the Constitution, or contravening its former national legislation, or policy statements for foreign investments. There will however be a violation of international law when such actions constitute an international tort.

#### A. Nationalisation

Nationalisation may be carried out either through legislation or through the administrative measures of a state. Expropriation can be recognised if it is not internationally unlawful, which means there being no violation of international commitments of the state and orthodox international obligation; and breaks no contractual obligations between interested parties.<sup>40</sup> When there are no such contractual obligations, the expropriation or nationalisation of foreign properties is recognised as a restrictive right of the state in international law.<sup>41</sup> Orthodox international law

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39. See B. A. Wortley, *supra* note 21, p. 151; see also G. Schwarzenberger, *supra* note 35, p. 563; see also L. B. Sohn & R. R. Baxter, *supra* note 21, p. 546.

40. See A. A. Fatouros, *supra* note 9, p. 53, 232 et seq.; see also E. I. Nwogugu, *supra* note 7, pp. 21-24.

41. See A. Akinsanya, "Permanent Sovereignty over Natural Resources and the Future of Private Foreign Investment in the Third World", 18 *The Indian Journal of International*

recognises the nationalisation if three conditions are satisfied: first, that the expropriation should meet the needs of public interest; secondly, that the expropriation should not be discriminatory to aliens; and thirdly, that the expropriation should offer adequate, prompt and effective compensation. Generally speaking, international law is violated if the expropriation of the capital importing country does not meet one or more of the three conditions. However, an international responsibility arises no matter whether the nationalisation is lawful or unlawful.

Any award for an unlawful nationalisation should be assessed punitively with the aim of keeping exact *status quo ante*.<sup>42</sup> On the other hand, lawful nationalisation has as its legal basis of compensation, the principle of the prevention of unjust enrichment. This principle means that a person who has obtained a benefit from another, not intended as a gift and not legally justifiable, must repay it or make restitution to, or recompense the other party. There are three requirements relating to the compensation itself - it must be adequate, effective, and prompt, in order to make it a so-called "just" compensation.<sup>43</sup> In international practice, the compensation of nationalisation has tended to result in compromise between the two states. However, the three requirements of just compensation should not be unilaterally decided by the expropriating state. It is established that some developing countries set their own levels of compensation recoverable, without compromising

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*Law* (1978), pp. 176-177; see also Z. A. Kronfol, *Protection of Foreign Investment: A Study in International Law*, Leyden: Sijthoff, 1972, p. 22.

42. See A. Akinsanya, *ibid.*, p. 181; see also Z. A. Kronfol, *ibid.*, p. 99.

43. For example, B. A. Wortley, *supra* note 21, p. 24; Hyde, Fachiri, and Cheng in E. I. Nwogugu, *supra* note 7, p. 22, note 2; A. A. Fatouros, *supra* note 9, p. 314, note 58; G. White, *supra* note 21, p. 32.

with the party suffering expropriation. Such attitudes have caused friction between the parties and also violate the obligations of international law.<sup>44</sup> Under the circumstances, diplomatic protection is usually sought by the government of the investing party. The Permanent Court of International Justice clearly supports the primacy of the obligations of international law in many of its verdicts.<sup>45</sup>

Issues of the scope of any remedy involve a discussion of direct and indirect damage. There has been much debate in international law on whether the state carrying out the nationalisation should be responsible for indirect damage caused to foreign investors. The direct damage, caused immediately by the conduct done in breach of duty, consists of all actual loss such as the capital and raw materials of the investors. The indirect damage consists of all intangible assets such as good will and the loss of prospective profits except for the interests of the investors. According to the principles of orthodox international law, it is generally accepted that where there is lawful nationalisation the government should be responsible for remedying its direct damage; and where there is unlawful nationalisation the government should be responsible for the loss of prospective profits and other indirect damage.<sup>46</sup>

#### B. Taxation

A state has its own fiscal jurisdiction over the subject-matter of taxation for the people, assets, and economic activities within its territory. However, the

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44. For example, Columbia Constitution Article 30; India Constitution Act 1955, Article 31 (1). Also see E. I. Nwogugu, *supra* note 7, p. 23.

45. PCIJ Series A/B No. 46, p. 167, Series A. No. 7 (1926) p. 19, Series A. No. 17, pp. 33-34.

46. See Z. A. Kronfol, *supra* note 41, pp. 104-107.

taxation process for aliens should not violate any treaties signed between the two states; and cannot justify confiscation of the assets of aliens by using the taxation right as a method. If the capital importing country establishes unfair taxation for aliens and their assets, such a discriminatory measure could be seen to be violating the existing treaty or the contractual obligations. This constitutes an unlawful act in international law and the foreign investor has the right via his/her government to apply for diplomatic protection. Confiscatory taxation on foreign properties breaches orthodox international law.<sup>47</sup>

### C. Foreign Exchange

A state has exclusive sovereignty to exercise monetary jurisdiction. However, the exercise should be limited by international law. There are four principles to limiting monetary jurisdiction under orthodox international law. First, legislative and administrative measures cannot be adopted which aim to damage aliens; secondly, there should be no discrimination against aliens; thirdly, rights cannot be abused; and lastly, *Pacta Sunt Servanda* which means undertakings and contracts must be observed and implemented.<sup>48</sup> If any state acts or measures violate the principles of orthodox international law, the state concerned should be responsible for any damage incurred by foreign investors. To avoid such damage, the so-called "gold clause" is popularly to be found in bilateral or multilateral treaties covering currency devaluation or depreciation.

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47. See C. C. Hyde, *supra* note 26, p. 664; see also B. A. Wortley, *supra* note 21, pp. 106-107; see also E. I. Nwogugu, *supra* note 7, p. 10; see also A. R. Albrecht, *supra* note 26, p. 171 et seq.

48. See F. A. Mann, *supra* note 29, pp. 471-478; see also F. A. Mann, "Money in Public International Law", 26 *British Year-book of International Law* (1949), pp. 262-270.

#### D. The PRC's Attitude Towards International Law

In practice, the PRC has recognised the existence of international law.<sup>49</sup> However, there are various differences between the PRC and Western countries in their interpretations of the role, the definition, the nature, and the sources of international law.<sup>50</sup> There has been an ideological conflict between communist countries and capitalist countries. That is to say, the question of whether there should be a co-existence of socialist international law, general international law, and bourgeois international law has not been agreed upon by PRC legal scholars.<sup>51</sup> Before 1979, there was a debate upon the issue of whether to recognise bourgeois international law in the PRC. The PRC had its so-called "principles" in signing a treaty between itself and socialist countries. "Proletarian Internationalism" was one of these principles and this had not been mentioned between the PRC and the capitalist countries.<sup>52</sup> This might suggest that the PRC recognised general international law (which is not definitely orthodox international law). However, no in-depth research in this field conducted by the outside world. In the 1960s, the PRC attitude towards the function of international

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49. For example, by reference to the principle of international law in the text of a number of treaties; by condemning the action of another country as violations of international law in diplomatic statements or notes; by justifying its position in an international dispute in terms of international law. See H. Chiu, *supra* note 38, p. 246.]

50. *Ibid.*, at relevant parts.

51. Regarding the existence of Universal (general) international Law between the communist countries and capitalist countries, see H. Chiu, *supra* note 38, pp. 252, 254-256.

52. *Ibid.*, pp. 256-257.

law was to use it as a bargaining tool in its diplomatic policy.<sup>53</sup>

After 1979, following the "open policy" of economic reform, the PRC adopted many of the international business practices and principles of the United States Contract Law in its private international law.<sup>54</sup> However, the PRC's attitude towards public international law remained unchanged. Yet the PRC's position towards expropriation of foreign assets has not been easy to understand. One PRC jurist Li Haopei stated that public international law regards nationalisation as a lawful exercise of state power. As to whether or not the nationalising state must compensate original owners of foreign nationality, this is a question of public international law. In discussing various opinions with respect to this question, Mr Li supported the theory which maintains that the nationalising state has no obligation to compensate foreign owners of assets if the state does not compensate nationals who are owners.<sup>55</sup>

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53. One PRC scholar, however, did assert that international law is one of the instruments for settling international problems. In his view "if this instrument is useful to our country, to socialist enterprises, or to the peace enterprises of the people of the world, we will use it. However, if this instrument is disadvantageous to our country, to socialist enterprises, or to the peace enterprises of the people of the world, we will not use it and should create a new instrument to replace it. Today, we have a majority of the old international law jurists who still adhere to the purely legalistic view and thus they subject themselves to the disposal of imperialism". See Chen Ti-chiang, "Refute the Absurd Theory Concerning International Law", *Renmin Ribao* (People's Daily), 18 September 1957, cited from H. Chiu, *supra* note 38, pp. 248-249.

54. J. L. deLisle, "Foreign Investment Law", 21 *Harvard International Law Journal* (1986), p. 281; see also J. A. Cohen, "The New Foreign Contract Law", *The China Business Review*, July-August 1985, p. 52.

55. There are three different opinions regarding whether the nationalising state should compensate foreign nationals. The first theory maintains the compensation must be adequate, effective, and prompt. The second theory requires partial compensation. The third maintains

On 11 May 1979, the agreement between the PRC and the United States concerning the settlement of claims became the compensation precedent for PRC nationalisation of foreign assets. To date, the PRC has no special legislation regarding the nationalisation or expropriation of foreign assets. Nevertheless, there is usually a detailed standard of compensation for nationalisation in the PRC's investment protection treaties with foreign countries.<sup>56</sup> In practice, it can be inferred that the PRC recognises the principles of orthodox international law. Whilst the exact attitude of the PRC toward the sources of international law is not clear, its recognition of treaties and customs as the principal sources of international law seems beyond any doubt.<sup>57</sup> Under such circumstances, the best protection measure for Taiwanese investment in the PRC is to adopt an agreement or a treaty between the two.

#### 5.4 The PRC's Contractual Responsibility towards Private Taiwanese Investors

In a sovereign state, there are various ways to protect foreign investment. For a foreign investor, the standard procedure is always first to apply for an Instrument of Approval from the authorities of the state.

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that no compensation is needed. The Chinese jurist Li Haopei supported the third theory. See J. A. Cohen & H. Chiu, *supra* note 37, pp. 718-720, 722.

56. See L. A. Pinard, "United States Policy Regarding Nationalisation of American Investment: The People's Republic of China's Nationalisation Decree of 1950", 14 *California Western International Law Journal* (1984), pp. 149, 181, 182. As for the compensation standard of China's investment protection treaties, see H. R. Zheng, *supra* note 22, pp. 287-288.

57. See H. Chiu, *supra* note 38, p. 258; see also H. Chiu, *The People's Republic of China and the Law of Treaties*, Mass.: Harvard University Press, 1972, p. 3.

#### 5.4.1 Responsibility of the State

The authority is usually a screening board or national investment board. This decides whether an investment project can be accepted and under what conditions it may be accepted. The Instrument of Approval varies and differs between countries. The most common situation is that the Instrument of Approval is delivered through the State's administrative order, cabinet verdict, or some administrative action. Before the approval of such an instrument, there are always formal or semi-formal negotiations for an "agreement or contract" between the state itself and the private foreign investors. Such an instrument includes not only detailed assurances and incentives offered to investors but also various undertakings and representations required of investors. Some countries have even recognised both instrument and act of approval as an "agreement or contract" in terms of their investment laws.<sup>58</sup>

As noted above, the "agreement or contract" is created by a sovereign state and a private individual. This cannot be described either as a private contract or as an international treaty. Such an "agreement or contract" shares special features of contract in public law, in accordance with the practice in many countries.<sup>59</sup> However, this is not a pure contract in the nature of public law. Since this "agreement or contract" is

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58. For example, the Chilean Foreign Investment Promotion Law of 1960, Article 25; Panamanian Production Development Law of 1957, Article 8, 17, and 23.

59. For example, A. A. Fatouros, *supra* note 9, p. 204 et seq.; see also W. G. Friedmann, *The Changing Structure of International Law*, London: Stevens & Sons, 1964, p. 201 et seq.; see also E. I. Nwogugu, *supra* note 7, p. 172, note 4.

neither a contract of private law nor a contract of public law or even an international treaty, what then is the nature of such "agreement or contract"? As domestic private law and orthodox international law are applicable only for two parallel legal subjects, there should be a third law applicable in turn to the "agreement or contract" between a state and a foreign private investor.

In 1956, the United States jurist Philip Carlyl Jessup declared a so-called "Transnational Law", as a third law order, aside from domestic law and international law, to be applied to business transactions between a state and a private person.<sup>60</sup> The legal sources of such transnational law comprise public international law, private international law, public domestic law, and private domestic law. According to his viewpoint, any domestic or international courts have the right to choose a fair and reasonable legal system in settling business disputes. The judge should reach a just verdict based on a consideration of international law, international relations, and domestic law, together with his own views. In some arbitration practices, this transnational law was found to be the general principle of law in settling business disputes.<sup>61</sup>

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60. As for the concepts of transnational law, see Norbert Horn and Clive M. Schmitthoff (eds.), *The Transnational Law of International Commercial Transactions*, Deventer/The Netherlands: Kluwer Law and Taxation Publishers, 1983, pp. 12-13.

61. See Chin-Lung Chen, *Guoji Siren Touzi zhi Falü Wenti* (Legal Problems of International Private Investment), Taipei: Jiaxin Cement Corporation Cultural Foundation, 1976, p. 92. For example, in the arbitration case between Petroleum Development (Trucial Coast) Ltd. and the Sheikh of Abu Dhabi, the arbitrator Asquith deemed the application of principles rooted in the good sense and common practice of civilised nations -- a sort of "modern law of nature"; and also in the arbitration case between Saudi Arabia and the Arabian American Oil Company (Aramco), the arbitration court stated that "in so far as doubts may remain on the content or on the meaning of the agreements of the parties, it is necessary to resort to the general principles of law and to apply them in

When a state breaches its agreement or contract with foreign investors, how can responsibility be established? According to general principles of law, the legal effectiveness of a state's breach of agreement or contract should be measured in terms of whether adequate reparation for any violations of foreign assets is given. An international responsibility arises if the state is in breach of its contractual liability. It may even cause "international delinquency" if the state's breaching of agreement or contract does violate international law. The methods of reparation can be either returning the wronged party to his previous situation, exact *status quo ante*, or through compensation with a sum of equal monetary value. The former returns the wronged party to the exact *status quo ante* just as if the unlawful act had never been committed; and if this is not possible, then a fair, adequate, and effective money remedy is given in time. The money remedy should in principle cover the entire loss suffered, including prospective profits.<sup>62</sup>

#### 5.4.2 Limitation of the PRC's Application

Article 7 of the PRC 1985 FECL stipulates that a contract which, pursuant to the provisions of the laws and administrative legislation of the State itself is to be approved by the State, shall be considered to be formed only when the approval is obtained. In the PRC, the MOFERT under the State Council has overall authority for the examination and approval of foreign investment. MOFERT may "entrust" this authority to provincial governments, municipalities, or any relevant ministries

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order to interpret, and even to supplement, the respective rights and obligations of the parties".

62. See Ren-hung Wang, *Waiguo Siren Touzi zhi Jianli yu Baohu* (The Incentives and Protections of Foreign Private Investment), Taipei:Law World Monthly, 1975, pp. 195-196.

or bureaus only if the foreign investment complies with two conditions: first, that the total amount of investment must be within the limit set by the State Council and the PRC participants' source of capital ascertained; secondly, that no additional allocations of raw materials by the state may be required, and the national balance of fuel, power, transportation, and foreign trade export quotas must not be affected.<sup>63</sup> The procedures of negotiation and approval of such investment agreement or contract are complex. Hence, acts of approval are usually in the nature of an agreement or contract.

However, in a socialist country, the actions of PRC state enterprises in signing such an investment agreement or contract are not recognised as having the quality of sovereignty as a state. The reason is that these state enterprises are economic organs but not organisations with state sovereignty. One PRC jurist Yao Meizhen even maintained that the approval of foreign investment is an exercise of economic administrative power under the state itself. As economic organs having legal personality, the actions of PRC state enterprises approving foreign investment are not recognised as having any semblance of "international agreement or contract."<sup>64</sup> As noted above, the PRC government's examination and approval of foreign investment agreements or contracts is a legitimate exercise. In Article 5 of the PRC's 1985 FECL, it stipulates that the PRC law is to be applied in the case of Chinese-foreign equity joint venture contracts, Chinese-foreign cooperative venture contracts and

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63. For details, see *China Investment Guide*, Hong Kong: China International Economic Consultants Inc., Longman, 1986, (3rd, ed.), Also see Article 8 of The Regulations for the Implementation of the EJV Law, which was promulgated by the State Council on 20 September 1983.

64. See Yao Meizhen, *Guoji Touzi Fa* (International Investment Law), Wuhan: Wuhan Daxue Chubanshe, 1985, pp. 344-345.

contracts for the Chinese-foreign cooperative exploration and development of natural resources to be performed within the PRC. Therefore, all interpretations, legal effectiveness, and disputes arising from the agreements or contracts signed between the PRC and the foreign investors are derived from and applied by PRC law only.<sup>65</sup>

Once investment has occurred in the PRC, the general principles of law or principles of Transnational Law can be applied only to matters for which PRC law has not yet made provision.<sup>66</sup> Under such circumstances, foreign investors including Taiwanese enterprises in the PRC feel that their agreement or contract rights can be protected only to a limited extent.

#### 5.5 Significance of the PRC Protection for Taiwanese Investors

Since 1978, many PRC national and local laws and regulations have been promulgated in order to provide a more stable, predictable business environment for both domestic and foreign investors. Here the foreign investors include, of course, the overseas Hong Kong, Macao, and Taiwan enterprises.

##### 5.5.1 The Policies and Measures

PRC government officials have spared no effort to assure these foreign investors that no major policy reversal lies ahead. The pattern of the PRC's politics, policy and law-making since 1978 provides substantial grounds for giving credence to their assertions.<sup>67</sup>

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65. Ibid.

66. See Article 5, FECL.

67. See J. L. deLisle, *supra* note 54, p. 282.

Following the introduction of the modernisation movement in 1978, the PRC began to attract Taiwanese investment by indicating that all Taiwanese investment in the PRC would receive preferential treatment.<sup>68</sup>

In addition to various economic laws and regulations applicable to foreign investors, the PRC particularly promulgated special Provisions on Encouraging Taiwanese Investment (Taiwan Investment Provisions, or TIP) in 1988 and Law on the Protection of Taiwan Compatriots' Investment (Taiwan Investment Law, or TIL)<sup>69</sup> in 1994. The TIP has not provided sufficient protection. A prime reason is that these provisions as administrative orders are less binding than a law, meaning Taiwanese investors have less assurance of enforcement. The TIL, admittedly, is enacted in response to demands by Taiwanese investors for better protection. However, such a legislation will only be as good as any of PRC laws. It cannot possibly have the binding effect provided by bilaterally signed investment guarantees. Besides, both TIP and TIL affirm that the general body of foreign economic legislation of the PRC applies to Taiwanese investors in their business dealings with parties in the PRC.

Since the above stated laws and regulations are couched in broad, ambiguous and sometimes conflicting terms, are left local or central implementing agencies much scope for interpretation and leads to inconsistent treatment. In such an environment, with new laws and regulations appearing one after another to govern

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68. See Yan Zong-da, *Liang'an Jingmao Guanxi yu Woguo de Dalu Jiangmao Zhengce* (Cross-Strait Commercial Relations and Our Mainland Commercial Policy), Taipei: China Strategic Studies Journal, Summer 1990, P. 45.

69. See *China Economic News* (No. 11), 21 March 1994, pp. 6-7. The TIL was adopted by the Sixth Session of the Standing Committee of the eighth National People's Congress on 5 March 1994. There are fifteen articles of this new legislation. See an English translation of the Law on Appendix III.

previously unregulated sets of circumstances, the fear of retroactive legislation effectively amending the approved contractual terms and adversely affecting the interests of the foreign party has caused concern among Taiwanese investors.

Two examples are given by way of illustration. The first one is Article 40 of the PRC's 1985 FECL, which provides desirable protection to certain kinds of investors against adverse changes in law after their contract has been approved. It is vague in content and only effective where the contract specifically addresses the matters in question.<sup>70</sup> The second example is Article 20 of the TIP and Article 14 of the TIL, which the former provides that the arbitration may only take place pursuant to agreement either on the mainland or in Hong Kong but not in a third venue; and the latter does not clearly stipulate whether the arbitration can be venued abroad (neither in Hong Kong nor in a third country). This discrimination seems to be unfair and unjust for Taiwanese investors.

It is plain to see that PRC's general approach to economic relations with Taiwan is characterised by greater openness, whether in visits or in exchange of goods and services. It has emphasised the need for parity for the flow of goods and services as well as personnel. As far as investment is concerned, the PRC's policy of encouragement is evident. The preferential measures introduced by the central government are often supplemented by additional or more favourable treatment for Taiwanese investors. However, these preferential policies mask certain special difficulties encountered by Taiwanese businesses in the PRC.

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70. See W. G. Friedmann, O. J. Lissitzyn, and R. C. Pugh, *supra* note 35, p. 745.

First, some of the restrictions on trade, such as prohibition of unacceptable markings of national origin or flag, are irritants, although similar restrictions are to be found in other countries without diplomatic relations with Taiwan. Secondly, inasmuch as the PRC decisions to import and export are not always determined by market forces, there is a high degree of fluctuation in demand and supply. Thirdly, there has also been administrative wavering as to whether imports from Taiwan should be treated as domestic or foreign, and whether tariffs are applicable. Some of the special preferences, moreover, raise questions of compatibility with the General Agreement on Tariffs and Trade (GATT) principles inasmuch as both the PRC and Taiwan have applied for membership of the organisation.<sup>71</sup> The preferential treatment of Taiwanese investment in the PRC further raises questions of deviations from the principle of national treatment as well as discrimination against domestic competitors. Admittedly, some of the measures are introduced in response to investor demands.<sup>72</sup> Zones especially reserved for Taiwan investors have, therefore, been set up in many localities. Some of them are reminiscent of concessions in developing countries in earlier years.

In evaluating preferential arrangements, a distinction has to be made as to whether important principles are involved. For example, differential tax rates applied to investors of different origin constitute clear discrimination, but zones reserved for Taiwanese investors may be justified as contractual arrangements, while the burden of proof of discrimination in

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71. See Frances Williams, "China and Taiwan Membership Drive Tests GATT Loyalties", *The Financial Times*, 17 February 1992, p. 4.

72. For example, the Formosa Plastics Group, the largest private industrial concern in Taiwan, announced in 1990 interest in investing in Fujian province. See *Zhongyang Ribao*, (Taipei: Central Daily News), 22 July 1990, p. 3.

streamlining administrative procedures probably rests with the accuser.

#### 5.5.2 The Law

The TIL of 1994 is so couched as to include specific reference to Taiwan investors only, to protect their safety and interests, and to allow them to use investment returns to make new investments. There are fifteen articles of this Law which apply to Taiwanese investments, and in circumstances where the law does not provide a stipulation, they shall be enforced according to other state laws and administrative rules governing Taiwanese investments.<sup>73</sup>

This new legislation is intended to upgrade and amplify the TIP of 1988 which has been criticised by Taiwanese investors as not having done enough to protect their interests in the PRC. It is true to say that the TIP, as administrative orders, is less binding than the TIL. However, it is still doubtful that the TIL could provide fair and adequate assurances effective enough to satisfy Taiwanese investors in the PRC. Below are some areas which are of most concern to Taiwanese investors.

##### A. Nationalisation and Expropriation

The Law stipulates that the State shall not nationalise or expropriate the investment of Taiwanese investors. Under special circumstances, according to the need of public interest, Taiwanese investment could be expropriated according to legal procedure with due remuneration.<sup>74</sup> However, the Law makes no mention of the manner in which compensation will be calculated or paid.

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73. Art. 2, supra note 69.

74. Art. 4, *ibid.*

According to many PRC legal experts' opinions, no existing PRC laws provide concrete rules for compensating Taiwanese investors in such circumstances.<sup>75</sup>

#### B. Business Dispute Resolution

Unlike the TIP, the TIL does not stipulate clearly an arbitration venue to be used for business disputes concerning Taiwanese investment in the PRC.<sup>76</sup> The TIP has been criticised by Taiwanese investors since it prescribes that arbitration may only take place pursuant to agreement either in the PRC or in Hong Kong (but not in a third venue). The TIL is even worse and more unreasonable in prescribing no arbitration place, which means the arbitration can be held only in the PRC and may possibly exclude Hong Kong. Like foreign investors, Taiwanese investors always believe their interests can be protected only if disputes are settled by third parties, such as in countries of the West.

Given the absence of diplomatic protection, Taiwanese investors cannot claim from the PRC non-discriminatory treatment in order to exclude non-commercial risks. Without any restriction of the general principles of international law, it seems admittedly that the PRC can enact discriminatory legislation for Taiwanese enterprises at any time. Therefore, at present, the PRC's unilateral policies and measures, or even the TIL, have little significance for Taiwanese enterprises. Taiwanese investors can only rely on their own protection measures.

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75. The author was informed of this in Beijing and Shanghai in May 1994 while carrying out interviews in the PRC.

76. Art. 14, *supra* note 69.

## 5.6 Protection Measures for Taiwanese Enterprises to Adopt

Because of the non-recognition relationship, possible non-commercial risks of trade and investment exist between Taiwan and the PRC. According to international practice, trade protection measures comprise trade agreements and export insurance systems while investment protection measures comprise investment agreements, diplomatic protection, and investment insurance systems. On the whole, diplomatic protection has played a large part in foreign investment but not foreign trade.

However, in my view, diplomatic protection can also be given if the non-commercial risks were unavoidable. This function should be taken for granted in the light of the nature of diplomatic protection. Since there has been no trade or investment protection agreement, both diplomatic protection and an export insurance system are the only options for protecting the interests of Taiwanese enterprises in dealing with parties of the PRC.

### 5.6.1 Diplomatic Protection of Taiwan Government

#### A. Significance of Diplomatic Protection

According to the doctrines of orthodox international law, a delinquent state is responsible for making reparations or giving satisfaction for the wrong-doing to the injured state and its individual nationals or entities of that nationality.<sup>77</sup> Either the state or the individual national or entity is entitled to make international claims for the unlawful delinquency. When the capital importing state violates any of the

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77. Supra note 70.

substantive principles of international law, the capital exporting state can claim remedies through diplomatic protection.

The term diplomatic protection is loose and ill-defined. It can denote either diplomatic assistance, given by a consulate or an embassy to its nationals, or protection through diplomatic channels. This may include lodging a protest or initiating a legal action before an international court or arbitration tribunal. In an even wider sense, it may include the use of economic or military coercion.<sup>78</sup> Strictly speaking, diplomatic protection can be exercised only when the legal interests of the individual national or entity of a state are violated by another state. Under such circumstances, the injured state can then make an international claim against such delinquent state. Only the state itself is entitled to the diplomatic protection. The Permanent Court of International Justice maintained that the state itself is the sole claimant on behalf of its individual national or entity to sue in the court.<sup>79</sup> A state cannot be deprived of the right to make an international claim even if a *Calvo Clause* is being used. According to international law, a clause in a private agreement cannot deprive the state from giving diplomatic protection to its individual nationals or entities.<sup>78</sup>

International law imposes no duty on a state to pursue a claim based on the injury caused by a foreign

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78. See R. Y. Dong, *supra* note 4, p. 398.

79. PCIJ, Series A. No. 2 (1924), p. 12.

78. The *Calvo Clause* is a clause named after the Argentinian jurist who devised it. It is frequently used by Latin-American governments when making concession contracts with aliens, that the alien agrees not to seek the diplomatic protection of his own state and submits matters arising from the concession to the local jurisdiction. For further studies, see R. Y. Dong, *supra* note 4, pp. 192-208.

state to one of the former's individual nationals or entities. The injured individual national or entity has no legally enforceable right to compel his government to espouse his claim. Nevertheless, the state can exercise an unfettered discretion in determining when and how the claim will be presented and pressed, or withdrawn or compromised. Even if payment is made as a remedy, the state has complete control over the fund paid, and which is held by it. Except for an executive agreement, the claimant government enjoys exclusive control over the handling and disposition of the payment of sums in remedy.<sup>81</sup>

#### B. Limitations on the Exercise of the Right of Diplomatic Protection for Taiwan

In the absence of a recognition relationship, how can the Taiwanese government make international claims against the PRC government? Would the exercise of diplomatic protection be limited because of the non-recognition relationship? The mutual non-recognition relationship between the PRC and the United States before 1979 is a vivid illustration. Only after 1979, the problem of PRC's nationalisation of United States national assets in the PRC in 1950 was finally and reasonably solved.<sup>82</sup>

Under international law, there are two theories regarding the legal significance of recognition. The

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81. Ibid., p. 399; also see W. G. Friedmann, O. J. Lissitzyn, and R. C. Pugh, *supra* note 35, pp. 766-767; see also D. P. O'Connell, *supra* note 21, vol. 2, pp. 1114-1115.

82. See L. A. Pinard, "United States Policy Regarding Nationalization of American Investment: The People's Republic of China's Nationalization Decree of 1950", 14 *California Western International Law Journal* (1984), pp. 169-170.

first one is a declaratory theory and the other one is a constitutive theory. The declaratory theory holds that the issue of recognition can be denied while entering into treaty engagements with a new entity. The new entity is *de facto* a subject of international law. In contrast, the constitutive explanation is that the issue of recognition cannot be denied. Article 3 of the Convention of Rights and Duties of States supports the declaratory theory.<sup>83</sup> However, every state can have its own interpretation regarding the issue of recognition.

In discussing the effect of recognition on international liability, D. P. O'Connell said:

Recognition or non-recognition leaves untouched the liability as well as the rights of the state itself, though enforcement measures may have to await the appearance of a recognized government. Also as we have seen, a government may commit the State as a whole to liability towards a state withholding recognition of it, for non-recognition can never amount to *carte blanche* to cause injury to foreign nationals.<sup>84</sup>

This announcement seems to be supporting the above stated declaratory theory. On the contrary, L. A. Pinard took the view that a state is not required by international law to recognize an entity as a state or regime as the government of a state. On the basis of his theory, it seems that the constitutive theory gained support when it was maintained that the PRC had no right to claim its properties in the United States before 1979, due to a lack of *de jure* recognition between the two.<sup>85</sup>

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83. Ibid., p. 171. See also W. G. Friedmann, O. J. Lisstzyh, and R. C. Pugh, *supra* note 35, pp. 168-169.

84. See D. P. O'Connell, *supra* note 21, Vol. 1, p. 179.

85. See Section 99 (1) of the Restatement (Second) of Foreign Relations Law of the United States; and see also L. A. Pinard, *supra* note 82, pp. 171-172.

Under the declaratory theory, the Taiwanese government is entitled to have international claims against the PRC but these claims can only be exercised under the relationship of mutual recognition. On the other hand, in the eyes of the constitutive theory, the Taiwanese government is not entitled to have its international claims against the PRC without a relationship of mutual recognition. According to either declaratory or constitutive theory, the recognition of a state or government is retroactive to the commencement of the activities of the authority recognised. Therefore, the right of the Taiwanese government to international claims on the PRC is retroactive only after mutual recognition. Until then, such diplomatic protection is limited in its application to Taiwanese enterprises in the PRC.

C. Significance of the Right of Diplomatic  
Protection for Taiwanese Businesses  
in the PRC

The right of diplomatic protection has been developed as a principle of international law over the years. Due to the difficulties emerging in law or diplomatic politics, the protection function of this right has not been seen to be fairly exercised.<sup>86</sup> However, the significance of diplomatic protection is still greatly valued under international law.<sup>87</sup> In the

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86. For opinions of various jurists, for example, see T. H. Moran, "Transnational Strategies of Protection and Defence by Multinational Corporations: Spreading the Risk and Raising the Cost for Nationalization in Natural Resources", 27 *International Organization* (1973), p. 273; see also M. Bourquin, "Arbitration and Economic Development Agreements", *Selected Readings on Protection by Law of Private Foreign Investments*, New York: Matthew Bender & Co., 1973, p. 106.

87. See R. B. Lillich, "The Diplomatic Protection of Nationals Abroad: An Elementary Principle of

present situation in trading with and investing in the PRC, Taiwan has always claimed to be a part of divided China but not of the PRC. Until mutual recognition exists between the two, Taiwanese businesses cannot get prompt, adequate, and effective protection via the functioning of diplomatic protection.

#### 5.6.2 Initiating Export Insurance Protection for Taiwanese Businesses

##### A. Significance and Development of Export Insurance Protection

Export insurance first developed as a means of spreading the huge credit and non-business risks on businesses for trade exports at the end of nineteenth century in the United Kingdom. In the practice of international trade and investment, there have been two insurance schemes providing for such credit or non-business risks. The first one is marine insurance on trade export in delivery. The second one is export insurance on trade export in payment.<sup>88</sup> In addition to many various private insurance companies, the United Kingdom even created a government organ named "Export Credits Guarantee Department" which was first set up in 1919 to provide protection for export trade. Many other European countries followed the United Kingdom in establishing export insurance of a similar protective nature. The United States scheme was handled by the

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International Law Under Attack", 69 *The American Journal of International Law* (1975), p. 364.

88. See Chun-ying Huang, *Shijie Zhuyao Suchu Baoxianzhidu zhi Bijiaoyanjiu* (The Comparison and Research of Major Insurance Systems in the World), Taipei: Import-Export Bank of the Republic of China, 1983, p. 2.

Export-Import Bank of the United States and the Foreign Credit Insurance Association formed in 1961.<sup>89</sup>

The concept of investment insurance originated in the investment guaranty programme which was regulated by the 1948 Economic Cooperation Act of the United States. The main purpose of this programme has been to guarantee the protection of transfer risks by encouraging United States nationals to invest in Europe.<sup>90</sup> Following the Foreign Assistance Act in 1961, the United States government established the "Overseas Private Investment Corporation" (OPIC) by amending the Act in 1969 to regulate matters of investment insurance and investment guaranty program under OPIC.<sup>91</sup> Up to 1971, eleven countries had followed the United States in establishing a similar investment guarantee programme by offering investment insurance.<sup>92</sup> To date, many more countries have adopted this insurance protection scheme for their overseas investment activities.

Generally speaking, overseas investment insurance has been included in the overall functions of export insurance by many countries of the world, except for the

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89. Ibid. 16-18; also see Foreign Credit Insurance Association (FCIA.), *Export Credit Insurance: the Comparative Edge*, USA: FCIA Press., 1978, p. 3.

90. See Chin-lung Chen, *supra* note 61, p. 147.

91. For details of the development of the United States Investment Guaranty Program, see Marina von Newmann Whitman, *Government Risk-Sharing in Foreign Investment*, Princeton, NJ: Princeton University Press, 1965, pp. 69-120; see also R. B. Lillich, *The Protection of Foreign Investment: Six Procedural Studies*, New York: Syracuse University Press, 1965, pp. 148-152. As for the introduction of the United States Overseas Private Investment Corporation (OPIC), see OPIC, *An Introduction to OPIC*, Washington, D.C.: OPIC, 1973.

92. See S. D. Metzger, "Nationality of Corporate Investment Under Investment Guaranty Schemes: The Relevance of Barcelona Traction", 65 *The American Journal of International Law* (1971), p. 535.

United States and Germany.<sup>93</sup> In trading with and investing in various overseas countries, Taiwan, like many other countries, initiated such a protection scheme for export insurance through its Export-Import Bank of the Republic of China. However, this scheme runs only for trade and not investment. Even though Taiwan was not included in the "Treaty of the Multinational Investment Guaranty Agency" of 1988,<sup>94</sup> Taiwan does indeed need such an insurance protection measure for its overseas investment.

#### B. Problems of Initiating Export Insurance by Taiwanese Enterprises

In various studies concerning private investment in developing countries before the 1970s, the risk of expropriation or nationalisation consistently ranked highest in the category of risks which deter foreign investment. After the 1970s, such anxieties have rarely materialised in developing countries due to the threat of either being isolated in the international community or through a domestic economic recession. However, the stealthy taking of expropriation measures still continues to be seen in some developing countries.<sup>95</sup> The non-commercial risks of such stealthy expropriation have become the main difficulties of insurance guaranties for overseas investment. If Taiwan initiates such an export insurance scheme for its overseas investment, the

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93. Examples are Article 27-33 of the Australia Export Finance and Insurance Corporation Act 1974, Article 1 and 14 of the Japan Export Insurance Act 1981, the United Kingdom Export Guarantees and Overseas Investment Act 1978, and so on. See Chun-yin Huang, *supra* note 88, pp. 137-138.

94. See I. Shihate, *Multinational Investment Guaranty Agency and Foreign Investment* (1988), pp. 31-55.

95. See R. C. Pugh, *supra* note 4, p. 302; see also J. E. S. Fawcett, *supra* note 21, p. 356; see also E. I. Nwogugu, *supra* note 7, p. 23.

creeping taking of expropriation will emerge as a most serious problem in the contents of insurance contract.

The other important issue is related to the right of subrogation. Under the schemes of export insurance in Taiwan, the insurers should be entitled to all rights and remedies of the assured in respect of the subject matter and the assured must do nothing which might prejudice the right of subrogation. In other words, if an assured is compensated for his loss by the insurers, the latter are entitled to stand in the assured's place and exercise all rights competent to him to recover from the party who caused the loss. However, the right of subrogation has never been exercised, since Taiwan and the PRC do not recognise each other. Even in trade activities, the Export-Import Bank of the Republic of China is still not entitled to the right of subrogation in the PRC until mutual recognition exists between the two.

The right of subrogation may only be exercised in limited circumstances.<sup>96</sup> How can Taiwanese enterprises, as creditors, protect such a right of subrogation in the PRC? The author believes that the method of exercising the right of diplomatic protection discussed earlier can be followed under the same circumstances. In other words, the Taiwanese government should espouse the creditors' right of subrogation and then claim the remedies from the PRC when mutual recognition is realised.

### 5.6.3 Legalising the Commercial Activities of Taiwanese Businesses in the PRC

Although the Taiwanese government has still not yet been recognised by the PRC, the Taiwanese government

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96. See D. P. O'Connell, *supra* note 21, Vol. 1, p. 187.

promulgated in July 1992 a special law, called the "Statute Governing Relations Between People of the Areas of Taiwan and Mainland China" (Taiwan's Mainland Relations Statute, or TMRS). This is designed to address the entirety of private Taiwan-PRC relations.<sup>97</sup> On the issues of trade and investment, TMRS is by far the most comprehensive primary source of legal authority to direct any economic contacts across the Taiwan Straits and to resolve any conflicts that might result from such interaction.

As a Taiwan interim regulation dealing with trade and investment in the PRC, TRMS affirms the government's liberalised attitude by essentially legalising economic activities between the two. Article 35 allows Taiwan persons and organisations to engage in investment, technical cooperation, trade and other commercial activities with PRC persons and organisations with the permission of the organ-in-charge.<sup>98</sup> To approve direct cross-Straits commerce, Article 95 requires the organ-in-charge to first obtain a resolution from the Legislative Yuan which is equivalent to Parliament. However, Article 95 provides that failure by the Legislative Yuan to come to a resolution within one month during the time it is in session shall be deemed as consent.<sup>99</sup>

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97. The TMRS, see note 37 of Chapter 1.

98. Ibid., Article 35 provides in part:

People, legal persons, groups or other organizations of the Area of Taiwan may not engage in investment or technical cooperation in the Area of Mainland China nor engage in trade or other commercial activities with any person, legal person, group or other organization of the Area of Mainland China without permission from the organ-in-charge.

99. Ibid., Article 95 provides:

Before the implementation of direct commerce or transportation between the Area of Taiwan and the Area of Mainland China or before permitting people from the Area of Mainland China to work in the Area of Taiwan, the organ-in-charge shall obtain a resolution within one

Nevertheless, TMRS simply states the Taiwanese government's new policy towards the PRC and does not mention how governmental regulations can protect Taiwanese enterprises and enhance the efficiency of bilateral economic relations.

## 5.7 Difficulties of Legal Reform in the PRC

When Deng Xiaoping initiated the legal reforms in late 1979, he placed greater emphasis on economic development and tried to play down the role of the party.<sup>100</sup> However, since the mid-1980s, many PRC lawyers have called for radical legal reforms in pursuing economic development.<sup>101</sup> There have been, and still are, considerable difficulties in carrying out meaningful legal reforms.

Laws that govern the rights and obligations of parties to a contract are an important source of protection in economic interaction. However, numerous problems with the PRC legal system, ranging from the laws themselves to the enforcement mechanism, give rise a cause for concern in the conduct of commercial activities with PRC enterprises.

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month during the time it is in session or it shall be deemed a consent.

100. The 1982 Constitution represented significant progress in the legal development of the PRC. In it, Deng Xiaoping strengthened the role of the NPC vis-a-vis the Communist Party in matters of law making. See C. A. Johnson, "The 1982 Constitution of the PRC: One Small Step for Legal Development", 2 *Journal of Chinese Studies*, No. 1 (April 1985), pp. 87-93.

101. See, for example, Wang Jiafu, Liu Hannian and Li Buyun, "Lun Fazhi Gaige" (On Legal Reforms), *Faxue Yanjiu* (Beijing: Study of Jurisprudence), No. 2, 1989, pp. 1-9.

### 5.7.1 Lack of Legal Protection

First, it must be noted that the PRC legal system is still in a fairly primitive state of development. With respect to civil law, given the Communist rejection of private ownership of property, it was not until 1980 that the Economic Contract Law was promulgated and not until 1985 that an Inheritance Law came into existence.<sup>102</sup> These two are examples of the mass of legislation and administrative regulations that emerged in the 1980s, in the midst of PRC's desperate attempt to bring some order to socialist society and great certainty to commerce and investment.

However, some are poorly thought-out and hence are of no practical value even when promulgated, while others have simply remained in draft form. Therefore, even if Taiwanese enterprises are prepared to abide by PRC laws, achieving a clear and fair resolution under these in the event of a dispute may be very difficult, if not impossible.

According to international practice in civil disputes, the normal case should be that where there is no law on the civil dispute, legal tradition governs, and, where there is no legal tradition, legal reasoning shall be employed. In Article 6 of the PRC 1986 GPCL<sup>103</sup>, it states in contrast that all civil activities must conform to law and where there is no law on the dispute, that state policy governs. Thus, judgements of the PRC courts are just as likely to be the creations of

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102. *Zhonggong Fayuan Minshi Panjue zhi Chengren yu Zhixing Wenti* (The Problems of recognition and enforcement of the Civil Verdicts of the PRC Courts), 134 *Faxue Congkan* (China Law Journal), Taipei: Faxue Congkan Press, April 1989, p. 150.

103. GPCL, *supra* note 24.

political winds and judicial discretion as of law and legal reasoning.<sup>104</sup>

Furthermore, law has been used in the PRC as a political tool for the Communist Party to implement its policies and to promote its platforms. The Supreme People's Court, the State Council, and even the Public Security Bureau can issue "judicial orders" that instantaneously have the force of law in the PRC. Given that PRC laws are secretive, discretionary, political and of a "class nature", they are naturally difficult to interpret and utilise in the absence of a clear understanding of PRC politics.<sup>105</sup> Indeed, separation of powers, institutionalised law-making and an independent judiciary are not yet ingrained in the PRC political and legal systems.

#### 5.7.2. Prospects of Legal Protection

Since there is a clear lack of fair and adequate legal protection, Taiwanese businesses can only seek their own government's protection measures while doing trade with or investment in the PRC. However, under the present circumstances of mutual non-recognition, the Taiwanese government cannot adopt the right of diplomatic protection for its businesses' trade and investment in the PRC. A better option is to initiate an export insurance scheme not only for trade but also for investment.

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104. Ibid.

105. See *"Kaifang Tanqin Yansheng de Liangan Falü Wenti Zuotan"* (The Panel Talk on the Laws that have Emerged Across the Taiwan Straits after the Liberalization of Visitations by Taiwan Residents of Relatives in Mainland China), 22 *Zhongguo Dalu* (Mainland China), Taipei: National Chengchi University Press, 1989, pp. 23-31.

As discussed previously, the Export-Import Bank of the Republic of China is still Taiwan's sole insurer dealing with export insurance of overseas trade. To date, this sole insurer has not been allowed by the government to handle export insurance business for Taiwan businesses' trade and investment in the PRC. Even if it were allowed, that Bank should still consider whether it has the ability to indemnify for export insurance. Like the right of diplomatic protection, it seems that protection measures for export insurance can only be initiated when there is mutual recognition.

## 5.8 Conclusions

To sum up, the protection measures available for Taiwanese businesses to adopt are all limited due to the present political situation of mutual non-recognition. Last but not least, it is anticipated that protection measures for Taiwanese businesses could act as a similar guaranty or warranty if it were workable, like a trade and investment agreement or treaty between Taiwan and the PRC. The PRC itself has extended such legal guarantees by providing assurances effective enough to satisfy foreign businesses since the early 1980s. The principal objective is to cover non-commercial risk, such as loss through foreign exchange control and confiscation, and to provide for reciprocal non-discriminatory treatment.

However, a trade and investment agreement or treaty between Taiwan and the PRC involves many and varied political and diplomatic factors. Chief among these factors is that a Taiwan-PRC trade and investment agreement or treaty, like any other bilateral pact, is something that can exist only between countries with equal sovereignty. The PRC has been unwilling to adopt such a measure towards Taiwan. Furthermore, the legal

problems encountered within such a measure are also highly complex.

It seems that the process of mending relations between Taiwan and the PRC will be slow and painstaking. Nevertheless, important overtures have been made by both sides to find methods of legal protection for Taiwanese trade and investment in the PRC. Continuing these efforts will enhance the possibility of an emerging trade and investment agreement or treaty, at least on a non-governmental basis, between the two. For the present, it is not clear whether either Taiwan or the PRC quite knows how to go about it.

## CHAPTER SIX

### LEGAL SOLUTIONS FOR SETTLING DISPUTES INVOLVING TAIWANESE TRADE AND INVESTMENT IN THE PRC

Taiwanese trade and investment with the PRC can be viewed as a form of East-West Trade.<sup>1</sup> The problem of how to resolve disputes has been a vital issue since the development of East-West trade reduced much of the political tension during the Cold War.

In the West, arbitration has a definite competitive edge against its main rival of litigation in the courts. Because of its private and consensual character, arbitration is more acceptable than litigation. However, conciliation or mediation is held to be more effective than arbitration in reaching a mutually acceptable settlement. The prevention of confrontation in the first place is more admired than conciliation or mediation in its effect on the outcome when resolving business disputes.<sup>2</sup> In the East, however, foreign trade and investment activities have been recognised as *acts jure imperii* but not *acts jure gestionis*, and therefore these business disputes have always been settled in arbitration tribunals. National courts are not suitable for the settlement of East-West business disputes, because of a mutual suspicion of prejudice and widely divergent concepts of business and law. In the absence of treaties that specifically exclude regular courts from adjudication in this area, the contracting parties should invariably seek to settle their differences by arbitration.<sup>3</sup> As regards East-West trade dispute

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1. S. Pissar, *Coexistence and Commerce*, New York: McGraw-Hill Book Company, 1970, p. 381.

2. C. M. Schmitthoff, *Export Trade: The Law and Practice of International Trade*, London: Stevens & Sons, 1980, p. 411.

3. S. Pissar, *supra* note 1, p. 494-495.

resolution, it seems that arbitration has been the rule, and that litigation has been the exception.

Since 1949, the PRC has not been inclined to rely on the formal system of People's Courts for dispute settlement in either internal or external trade. This does not mean that the PRC lacks jurisdiction in its first Constitution of 1954 and its organic law of the People's Courts (which are enacted in pursuance of the Constitution): both confer on the People's Courts a very wide jurisdiction in civil as well as criminal matters.<sup>4</sup> However, the PRC has commenced development of the economic tribunals in the People's Courts at various levels following the introduction of its "Open Policy" in 1979. The mere development of such People's Courts is another step by the PRC towards a western-style legal system and a further indication that the PRC may slowly be losing its collective dread of litigation.<sup>5</sup>

The PRC established its arbitration institutions in the 1950s on the basis of the model provided by the former Soviet Union.<sup>6</sup> Its foreign trade has been based on state monopoly, economic planning and the intervention of the Party. These are the characteristics of the

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4. A. R. Dicks, "The People's Republic of China", *East-West Business Transactions*, in R. Starr (ed.), New York: Praeger Publishers, 1974, pp. 428-429; S. L. Ellis & L. Shea, "Foreign Commercial Dispute Settlement in the People's Republic of China", 6 *The International Trade Law Journal* (1981), p. 175; see also J. P. Stevens, "The New Foreign Contract Law in China", 18 *Law and Policy in International Business* (1986), p. 468.

5. J. K. Lockett, "Dispute Settlement in the People's Republic of China: The Developing Role of Arbitration in Foreign Trade and Maritime Disputes", 16 *The George Washington Journal of International Law and Economics* (1982), pp. 265-266.

6. See A. R. Dicks, *supra* note 4, p. 429; and P. K. Chew, "A Procedural and Substantive Analysis of the fairness of Chinese and Soviet Foreign Trade Arbitration", 21 *Texas International Law Journal* (1986), p. 292.

former Soviet model for settling foreign business disputes. However, the PRC has also developed its own methods for settling foreign business disputes. These methods are often classified as: first, friendly consultation (*youhao xieshang*); secondly, mediation (*tiaojie*); thirdly, arbitration (*zhongcai*); and finally, litigation (*susong*)<sup>7</sup>. At present, disputes from Taiwan-related (hereinafter, "*shetai*") economic cases in the PRC are resolved through the PRC's own internal system of these above four methods. For Taiwan, the PRC dispute resolution system, its practices and procedures for foreign trade and investment are too vital to be ignored.

To date, Taiwan and the PRC have not yet reached consensus on how to settle business disputes between parties from the two jurisdictions. Although friendly consultation and mediation are both informal, they have been treated as two effective methods in settling "*shetai*" business disputes in the PRC. Nevertheless, these two methods of dispute resolution do not carry much legal significance and therefore this chapter will focus specifically on the arbitration and litigation methods.

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7. According to Art. 37 and 38 of the 1985 Foreign Economic Contract Law of the PRC, the dispute settlement procedures include consultation, mediation, arbitration and judicial proceedings, with an emphasis on consultation and mediation. Regarding the friendly consultation or negotiation (*youhao xieshang*), which is referred as an informal method of disputes resolution in the PRC. As for mediation (*tiaojie*), also known as (*tiaoting*) or (*tiaochu*), is also referred as an informal method of disputes resolution in the PRC. This mechanism for handling civil and economic disputes is officially designated "conciliation" or "mediation" in English. For further studies, see Michael Palmer, "The Revival of Mediation in the People's Republic of China", in W. E. Butler (ed.), *Year-book on Socialist Legal System 1987*, New York: Transnational Publishers, 1988, pp. 219-276, and see also Ren Jianxin, "Zhonghua Renmin Gongheguo de Tiaojie, Zhongcai, he Susong" (Mediation, Arbitration, and Litigation in the People's Republic of China), *Zuigao Renmin Fayuan Gongbao* (Gazette of the Supreme People's Court), No. 2, 1987, published on 20 June 1988.

## 6.1 The Role of Law in Business Disputes Settlement in the PRC - Legal Solutions and Limitations

During the long period of the Cold War, experience proved that the development of foreign trade and investment was a path to political reconciliation, and a means of reducing tensions between East and West. Legal method plays a major role in the operation of international business transactions. Obviously, business disputes will take different forms depending on the nature of the commercial interests at stake, but there are really four broad options for dealing with them. These are: conciliation, mediation, arbitration and litigation.<sup>8</sup> In the field of East-West trade, conciliation and mediation methods were used with much experience and skill by the East, especially by the PRC.<sup>9</sup> The PRC has had four methods of resolving disputes in turn and these are consultation, conciliation/mediation, arbitration and litigation. However, the last two methods of dispute settlement have recently become more highly valued in terms of their effect on the outcome.

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8. See the speech on the settlement of disputes in international trade by Lord Wilberforce, Chairman of the Executive Committee of the International Law Association, delivered at the Judges Training College in Taiwan on 14 November 1984, reprinted in *Ya-Ou Pinglun (Euroasia Review)* (London: Euroasia Review Press, 1985), vol. 23, pp. 87-102.

9. Conciliation is a process by which the parties to a dispute are helped by a neutral and independent third party who may be either an official by the State or a private person, to reach a mutually acceptable settlement. Mediation involves a further step and the mediator not only conciliates but make his own recommendations. The author was informed that the function of conciliation had been included into mediation in the PRC during fieldwork to the PRC in May 1992. See also Ren Jianxin, President of the Supreme People's Court, "Mediation, Conciliation, Arbitration, and Litigation in the PRC", *International Business Lawyer*, Vol. 15, No. 9 (1987), p. 397.

Through conciliation or mediation, the contracting parties negotiate amicably outside the law and reach a compromise. In arbitration, one or a number of arbitrators are selected by the contracting parties to follow appropriate arbitral procedure and make an award according to law, business practice or custom. In litigation, the contracting parties go to the courts to receive a court decision. In international business transactions, arbitration is generally accepted by businesses of both East and West. Conciliation or mediation is an extra-judicial method of settlement, whereas litigation is purely by law. Arbitration is however an in-between method and is generally influenced by law.

The PRC has a distinct feature in its legal culture, a very strong aversion to public confrontation and adversarial conflicts which result in a clear winner and a clear loser. Hence, for PRC parties litigation is distasteful and conciliation, mediation and arbitration are preferred since public procedures are not involved. This is not to say however that confrontation may not have its uses. Sometimes the threat of litigation proceedings (or actually starting proceedings) can be a powerful influence in bringing a PRC party to an acceptable settlement. Since 1987, a method called joint conciliation or joint mediation (*lianhe tiaojie*) has been developed in the PRC as an effective mechanism for handling foreign economic disputes.<sup>10</sup>

#### 6.1.1 Consultation and Mediation

This is invariably the preference of all contracting parties for most businessmen whether in the PRC or

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10. See Cheng Yuan, *East-West Trade: Changing patterns in Chinese Foreign Trade Law and Institutions*, New York: Oceana Publications, 1991, p. 277.

elsewhere: arbitration or litigation wherever it may take place means to most businessmen expense, dealings and complication. Business disputes clauses in the PRC will often require the parties to conduct consultation or "friendly negotiation" before a more formal procedure can be triggered. The majority of PRC standard business contracts invariably contain a clause making consultation or "friendly negotiation" the first stage of settling disputes.

As an informal method of dispute resolution, consultation is conducted directly between the contracting parties without any third-party participation. Although it is optional, it aims to clarify existing misunderstanding and then reach a compromise between the contracting parties. In the PRC, a contract is always seen as a framework for co-operation rather than a statement of immutable rights set in stone, so pointing to the words of a contract may not be considered as conclusive as Western businesses might expect.

Provisions for the second stage of settling disputes are not usually included as contractual clauses. However, mediation, or the recently-emerging joint mediation, is widely adopted as the second stage of settling disputes in the PRC. Only when the methods fail at the first and second stages may the contracting parties turn to the third stage, which is always arbitration.<sup>11</sup>

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11. See S. L. Ellis & L. Shea, *supra* note 4, p. 161. Texts of several PRC standard trade contract appear at *Guidebook on Trading with the People's Republic of China*, U.N., Economic and Social Commission for Asia and the Pacific (comp., hereinafter, ESCAP), London: Graham & Trotman Ltd., 1984, p. 335 et seq. As for PRC standard investment contract, the term of consultation or friendly negotiation is also mentioned in its contractual clause. See Contract of An Equity Joint Venture Elevator Company in China, Art. 16 in *China Trade Handbook*, ed., L. Fung (Hong Kong: The Adsale People, 1984), p. 191.

Consultation or "friendly negotiation" is a PRC term used to describe conduct that Westerners simply consider as "discussions". Without the participation of a third party, consultation is used directly by both contracting parties to resolve their differences. It has been generally considered as one of the best methods of handling business disputes in the PRC. Should consultation fail, the China Council for the Promotion of International Trade (CCPIT) of the PRC encourages contracting parties to rely on mediation.<sup>12</sup> The CCPIT was originally set up in 1952 and has been revitalised and expanded in the PRC since 1979.

What is mediation? It is the process by which the contracting parties are encouraged to reach their own solution to their dispute with the assistance of a neutral third party. For a long time, the PRC's mediation system has been recognised, as an alternative to state law, to be a good way on resolving contracting parties' dispute.<sup>13</sup> Michael Palmer points out the rediscovery of the traditional value of "yielding" and a social order of "no litigation" in post-Mao China. As he observes:

In recent years, however, the traditional Confucian emphasis on yielding has been officially resurrected and, in keeping with the current concern to stress the value of mediation as a Chinese tradition, the legal press explicitly identifies *Rang* as a salient feature of mediation in pre-socialist times that has an important role to play in the post-Mao era.<sup>14</sup>

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12. The CCPIT, as a social organisation within the PRC foreign trade system, performed the functions of a chamber of commerce in other nations. See S. L. Ellis & L. Shea, *ibid.*, p. 161.

13. See Fu Hualing, "Understanding People's Mediation in Post-Mao China", *Journal of Chinese Law*, Vol. 6, (Fall 1992), No. 2, p. 211.

14. See Michael Palmer, *supra* note 7, p. 233.

The 1991 Civil Procedure Law (hereinafter, CPL) of the PRC actually provides that in conducting civil proceedings, the trial court must always attempt to promote a voluntary agreement between the disputants. Only if that fails should the court move to judgement.<sup>15</sup>

The CCPIT has a Mediation Centre located in Beijing which was established in 1985. This Centre has a co-operative arrangement with the Hamburg Mediation Centre in Germany; the two centres published a joint set of rules in 1987. It is possible to conduct a joint mediation involving both institutions. Since 1985, this Centre has acted as an intermediary in disputes between the PRC and foreign parties. Joined with a neutral third party, this method of mediation provides a better forum for discussion, exchange of views, and negotiation in a harmonious atmosphere. It not only solves civil disputes in a simple and practical way but also helps to brief and update ordinary people regarding government policies and decrees of the PRC.<sup>16</sup>

The procedure is fairly simple; first, the contracting parties must agree in writing to mediation. The parties may each appoint a mediator or jointly a sole one. The mediators will examine all the documentary evidence and try to promote a compromise, either by correspondence or if that is unsuccessful, by calling parties together for face-to-face meetings, with or without lawyers. As part of the process the mediators will be expected to establish the facts and form a view on liability. However, the mediators cannot compel a compromise -- they may only use persuasion. It can

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15. See art. 257, CPL. The Law was promulgated by the Fourth Session of the Seventh National People's Congress on 9 April 1991. For an English text of this Law, see *China Law and Practice* (No. 5, 1991), pp. 15-16.

16. *Supra* note 12.

therefore be unsuccessful. The parties can request a mediation of their case before the arbitration tribunal is formed. If mediation doesn't work, then arbitration proceedings are commenced with a view to an award being made soon as possible. The example below is an illustration:

Two foreign parties made a joint application to one arbitration centre for mediation in Beijing. Party A's complaint was that its former manager had joined a rival company Party B, and Party B had thus benefited from party A's "know-how" and the close connection that the manager had been able to establish with a major PRC corporation.

The mediator apparently investigated the position and reported his findings that there was no evidence that Party B had benefitted from Party A's "know-how" and he additionally thought that there was sufficient business for both parties to benefit from a commercial relationship with the PRC corporation. The parties then did reach an agreement whereby one party relinquished certain business opportunities to the other in return for a payment of money and the lawsuit was withdrawn.

This above account is fairly typical. Inevitably it is a rather over-simplified version but the features of mediation come through, that is to say the mediator makes his investigatin and tells the parties what he has concluded on the facts and then makes recommendations as to how the parties should go about resolving their differences.

It is so frequently used and flexible a process that not only can it be conducted within a mediation institution such as the Beijing Mediation Centre (according to that Centre's specific rules of mediation), but also concurrently during court or arbitration proceedings, either at the request of the contracting parties or purely on the judge's or arbitration tribunal's own initiative.<sup>17</sup> In the latter case, the

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17. For characteristics of mediation in the PRC, see Michael Palmer, *supra* note 7, pp. 222-223.

court or arbitration proceedings will be suspended and be resumed only if mediation fails.

As for joint mediation, both the PRC and foreign contracting parties may appoint an arbitrator themselves from the arbitration or mediation institution of their own countries. If such mediation succeeds, an agreement will be signed by both contracting parties and a mediation statement will be made to that effect. This is not enforceable outside the PRC. Within the PRC, it can be enforceable in the courts as part of the normal civil law. If it fails, the contracting parties may go to court or seek arbitration according to the original arbitration agreement.<sup>18</sup>

In practice, the PRC stresses the function of consultation and mediation for avoiding disputes on foreign trade and investment.<sup>19</sup> The 1979 Sino-American Agreement on Trade Relations is one of the best examples of this approach.<sup>20</sup>

#### 6.1.2 Origins of the PRC Arbitration System

Socialist countries' models of arbitration machinery have their origins at the beginning of the 1930s in the work of the All-Union Chamber of Commerce. Attached to the Chamber, there were two agencies composing of the

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18. James A. R. Nafziger and Ruan Jiafang, "Chinese Methods of Resolving International Trade, Investment and Maritime Disputes", *Willamette Law Review*, Vol. 23 (1987), pp. 647-650.

19. Ren Jianxin, "Mediation, conciliation, Arbitration, and Litigation in the PRC", *International Business Lawyer* (1987), Vol. 15, No. 9, p. 397.

20. See Agreement on Trade Relations between the United States of America and the People's Republic of China, 7 July 1979. Full text appears at 18 *International Legal Materials* (1979), art. VII, 1, p. 1041.

arbitration model -- the "Maritime Arbitration Commission", founded in 1930 and the "Foreign Trade Arbitration Commission", created in 1932. The former purported to arbitrate all disputes arising from trade transactions between Soviet organisations and foreign firms. The latter was designed to handle differences in connection with maritime disputes.<sup>21</sup>

During the period 1956 to 1960, the Soviet legal system was treated as a model for the enactment of law in the PRC, and during that time the above-mentioned Chamber arbitration model was imitated.<sup>22</sup> However, unlike in the Soviet Union, the PRC's two arbitration bodies -- the "Foreign Trade Arbitration Commission" (FTAC) of 1956 and the "Maritime Arbitration Commission" (MAC) of 1959, due to the unusual political climate in the 1960s and 1970s, hardly ever functioned as genuine arbitration agencies, and only after some twenty years did their work take on an orthodox form.<sup>23</sup>

With increased economic co-operation between the PRC and foreign countries, the FTAC expanded its business and became the "Foreign Economic and Trade Arbitration Commission" (FETAC) in 1980.<sup>24</sup> Again, both FETAC and MAC changed their respective names as the "China International Economic and Trade Arbitration Commission"

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21. See Cheng Yuan, *supra* note 10, p. 24. [cited from W. E. Butler, *Soviet Law* (2nd ed.), London: Butterworths, 1988, pp. 337-340.]

22. See Tse-Tung Ko, "The Role of Law in Foreign Trade Dispute Settlement in Communist China", *Guoji Maoyifa Zuanlun* (Special Analysis on International Trade Law), Taipei: National Taiwan University Law School Press, 1981), pp. 191-192.

23. See Cheng Yuan, *supra* note 10, p. 55, also see Jerome A. Cohen, "The Legal Framework of China's Foreign Trade" in A. Eckstein (ed.), *China Trade Prospects and U.S. Policy*, New York: Praeger Publications, 1971, pp. 164-166.

24. See ESCAP, *supra* note 11, p. 198.

(CIETAC) and the "China Maritime Arbitration Commission" (CMAC) in August 1988.<sup>25</sup> As noted above, both commissions were established under the aegis of the CCPIT in order to deal with matters relating to foreign trade and maritime disputes. Although the missions of these two commissions were identical with those of the former Soviet Union, it is worth noting that their function and practice which the PRC exerts over foreign trade and investment are very different from those of the former Soviet Union.<sup>26</sup> At present, it is the CIETAC, under the CCPIT which is responsible for foreign trade and investment disputes in the PRC.<sup>27</sup>

In modern foreign trade and investment practice, dispute settlement has depended greatly upon the arbitration method rather than on adjudication by courts. Michael Palmer has pointed out that in the PRC:

Arbitration is considered most appropriate in cases involving important economic issues, especially those in which the parties are governmental bodies, enterprises, or other large-scale organisations.<sup>28</sup>

Reasons for choosing arbitration in preference to litigation include speed of resolution, reduced costs, a continuing commercial relationship between the parties, the possibility of more creative solutions, the need for specialised evaluation by expertly-trained arbitrators,

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25. Both FETAC and MAC changed their respective names as the China International Economic and Trade Arbitration Commission (CIETAC) and the China Maritime Arbitration Commission (CMAC) in August 1988. See *Remin Ribao* (domestic ed.) (Beijing: People's Daily), 12 August 1988, p. 8.

26. *Ibid.*

27. See M. J. Moser, "Arbitration in China", *China Business Review* (Sept./Oct., 1990), p. 42.

28. See Michael Palmer, *supra* note 7, p. 222.

and confidentiality. In recent years, arbitration has become a preferred means for resolving disputes in international trade and investment.<sup>29</sup>

Arbitration in the PRC has long been considered a particularly suitable method for resolving disputes in foreign trade and investment. In the early stages of becoming involved in foreign trade, it appeared that the PRC authorities showed no willingness to practise arbitration, to the extent that they seemed reluctant to publicise the existence of arbitration institutions, and to disclose the functions of these institutions.<sup>30</sup> But what then is the significance of the PRC demand that an arbitration clause be stipulated in a private trade contract? The terms contained in the clause are definite and they manifest clearly that the disputing parties must submit their differences to arbitration, in the event that previous amicable settlement has failed.

Socialist countries, following Marxist-Leninist doctrine, distinguish sharply between domestic and international legal relations. This is indeed the case in the PRC. The definition of law as the explicit "state's will" is merely applicable to the first category of relations. The law governing the relations at international level, either public or private, should have a different basis of definition, inasmuch as international obligations are given great emphasis in order to maintain harmonious relations and peaceful coexistence with other countries. This attitude has been approved by some jurists of the world in their analysis of the nature of "International Law".<sup>31</sup>

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29. Peter Chen and Marcus Woo, "Enforcing Foreign Arbitration Awards", *Asia Law*, September 1993, p. 27

30. See Jerome A. Cohen, *supra* note 23, p. 169.

31. For example, In the PRC, law (often, party decisions) is frequently seen as a means to promote economic change or development, and not as something that develops as a result of changes elsewhere. See J. Feinerman, "Economic

In matters concerning foreign trade and investment, the major drawback to arbitration in the PRC is that many PRC arbitrators have not been properly trained in law but are appointed after a long career as party bureaucrats in reward for long service.<sup>32</sup> Although the number of arbitrators with formal legal training has been increasing over the past few years and the arbitration agency is handling more and more foreign trade and investment cases, the lack of familiarity of the PRC arbitrators with international business transactions remains a significant disincentive to arbitration in the PRC. This is especially true when international commercial customs were developed as the most important source of law for prevailing international business transactions. In the PRC, the continuing growth of commercial exchanges with foreign countries will generate an increasing need for the development of law in this field.<sup>33</sup>

### 6.1.3 Characteristics of PRC Arbitration

Ideological considerations are not the only reason for the PRC's reliance on arbitration as an instrument for its foreign trade and investment operations. It seems that the PRC distrusted foreign national laws and

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and Legal Reform in China: 1978-1991", *Problems of Communism*, (Sept.-Oct. 1991), p. 66.

32. The author was informed of this by the Chinese legal experts in May 1992 while carrying out interviews in the PRC.

33. See Henry R. Zheng, *China's Civil and Commercial Law* (Singapore: Butterworth & Co., 1988), p. 229. For opinions of PRC jurists, see Li Shuangyuan (chief ed.), *Guoji Sifa* (Private International Law), Beijing: Beijing University Press, Sept. 1991, p. 279; Chen Zhidong & Chao Jianming (eds.), *Guoji Jingjifa Gailun* (General Analysis of International Economic Law), Beijing: Zhengfa Daxue Chubanshe, 1993, p. 3; and so on.

judgements of the courts over business disputes resolution; particularly between countries with different social, political and economic structures.<sup>34</sup> PRC-style arbitration must be seen as one which reduces the scope of court jurisdiction and minimises the applicability of national law. Arbitration consists of a third party or an intermediary who imposes a judgement or ruling. The third party is either an arbitrator selected by the two contracting parties or an *ad hoc* or permanent arbitration body of large administrative organisation. The third party is also encouraged to apply customs favourably, instead of national laws. The philosophy has been that the "rule of law", having its root in individualism, is by its very nature not appropriate for dispute settlement. Arbitration remedies through the application of customs and other norms are more effective than national court jurisdiction.<sup>35</sup> PRC law limits access to judicial remedies in instances where the contracting parties have an arbitration agreement.<sup>36</sup>

The PRC stresses arbitration as a way of solving business disputes arising from domestic economic contracts. Therefore, it has also encouraged the employment of this model of dispute resolution as a means for coordination and compromise with regard to disputes and conflicts between contracting parties within government bodies, state enterprises, and private companies in the PRC. By choosing this route, the contracting parties can escape national court jurisdiction. Further, by employing such arbitration systems in solving business disputes arising from foreign trade and investment, the foreign policy of the PRC, in general, serves its national interests well from the point of view of "peaceful coexistence". The

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34. *Supra* note 22, p. 195.

35. *Ibid.*

36. Henry R. Zheng, *supra* note 33, p. 220.

establishment of arbitration agencies in the PRC and maintenance of the provisional regulations are therefore necessary, especially when the PRC deals in foreign trade and investment with partners from the West.

PRC arbitration law consists of two sets of rules and two sets of agencies. One set applies to domestic arbitration and the other applies to arbitration of foreign-related (hereinafter, "shewai") cases.<sup>37</sup> The 1981 ECL was amended in 1993 and now the procedures and effects of domestic arbitration are similar to those of 1985 FECL. However, the two systems differ in three major respects. First, domestic arbitration rules greatly resemble PRC judicial procedures, because they impose responsibilities on the arbitrators to verify evidence, investigate facts and collect data for determining the case.<sup>38</sup> "Shewai" arbitration, on the other hand, is similar to the common law adversarial system and places the primary burden of proof on the party making the allegations. Secondly, unlike "shewai" arbitration, the domestic arbitration system does not provide that parties to a dispute may choose their arbitrators. Although it does allow parties to object to the appointment of arbitrators, the arbitration authority will ultimately determine whether to sustain such objections or not.<sup>39</sup> Finally, arbitral awards issued by domestic arbitration authorities are subject to judicial review if one party commences the judicial proceeding within fifteen days from the date of the award.<sup>40</sup>

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37. Ibid., p. 218, The Chinese term "shewai" means foreign-related though the Chinese law does not contain a clear definition of "shewai". For further studies, see *ibid.* pp. 200-202.

38. See art. 21, Regulations of the People's Republic of China for Arbitration over Economic Contracts, promulgated by the State Council on 22 August 1983, CCH Austl. ¶ 10-620.

39. Ibid., see art. 17 and 18.

40. *Supra* note 39, see art. 49.

"Shewai" arbitral awards are final, and PRC law does not allow the courts to intervene except to assist in enforcement of the arbitral award.<sup>41</sup>

Arbitration in the PRC demonstrates the importance of inserting an arbitration clause in the contract which will then satisfy both contracting parties. The arbitration should be conducted in accordance with the provisional rules of the PRC's arbitration system. For the foreign party, the arbitration clause means that dispute settlement relies on a sort of legal solution by an independent third party. However, in practice, it is found that the arbitration clause places "mediation" before "arbitration". A mediation agreement can be published as an arbitration award and then can, of course, be enforced as such. The contracting parties, choosing to arbitrate, agree that an arbitrator should be appointed to resolve their dispute. Unless they settle during the course of the proceedings, the matter will be decided by the arbitrator whose award will be binding upon the parties regardless of what they think of it.<sup>42</sup> It is to be noted that in a mediation, no solution can be imposed upon the parties. Mediation means amicable settlement between parties in business disputes, and is a non-legal or "extra-judicial" settlement. Mediation of this type is similar to the procedure of consultation in dispute settlement in the PRC.<sup>43</sup>

Furthermore, the method of "mediation" or "amicable settlement" in practice, means the replacement of the

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41. See art. 257, CPL, supra note 15.

42. The arbitration award is final and no party to the dispute may later bring suit in a PRC or foreign court. See art. 257, *ibid*.

43. See art. 37, FECL. This Law encourages the parties to settle their disputes through consultation or mediation, but is also permits parties to resort directly to arbitration.

proper method of "arbitration". Therefore, in the PRC, "to arbitrate" is similar in meaning "to mediate" and "must be amicably settled". It seems that the arbitration clause does not really mean what it says in the PRC. Arbitration can be held either in the PRC or abroad, depending upon the provisions of the arbitration clause in the contract or the subsequent special agreement, if any, between the parties.<sup>44</sup> However, just as the foreign party may be reluctant to accept the PRC arbitral institutions, the PRC party often has reservations about accepting arbitration in the country of the foreign party. Both contracting parties will usually agree to submit disputes to arbitration in a neutral jurisdiction.<sup>45</sup> The 1985 FECL of the PRC does not favour judicial proceedings. It only permits parties to resort to judicial settlement if the contract does not contain an arbitration clause, and if parties are unable to reach an agreement on arbitration after a dispute has arisen.<sup>46</sup>

#### 6.1.4 Arbitration at Present in the PRC

The popularity of arbitration as a means of resolving international disputes stems from its dual advantages of neutrality and privacy. Mistrust of domestic laws and the impartiality of local courts make arbitration an attractive alternative. In the PRC, the trend to arbitration has been encouraged for domestic

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44. Ibid.

45. The Stockholm Institute, the London Court of Arbitration, and the Zurich Chamber of Commerce are the neutral arbitration tribunals often accepted by the PRC party. The PRC will not resort to the International Chamber of Commerce because of Taiwan's representation in that organisation.

48. See art. 38, FECL.

business resolution but also for sophisticated commercial disputes involving foreigners.

#### A. Arbitration Bodies

There are two main administrative bodies in the PRC dealing with international arbitrations. As noted, the first is CMAC which deals exclusively with maritime disputes involving foreign interest. The second is CIETAC which deals with the greatest number of international arbitrations that take place in the PRC.<sup>47</sup>

CIETAC's jurisdiction is over disputes in the area of commerce and trade where the parties have made arbitration agreements. Provided that an arbitration agreement is in writing, no specific form is necessary. CIETAC has a recommended arbitration clause which reads as below:

Any disputes arising from the execution of or in connection with this contract shall be, as far as possible, settled first through consultations between both parties. In case of settlement being reached through consultation the dispute shall be submitted to the China International Economic and Trade Arbitration Commission, Beijing China for arbitration in accordance with its arbitration rules of procedure. The arbitral award shall be final and binding upon both parties."<sup>48</sup>

It is seen that this clause is frequently reproduced in standard form PRC contracts.

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47. Cheng Yuan, *supra* note 10, p. 277. It was reported that the CIETAC handled over 500 arbitration cases in the single year of 1993. *Fazhi Ribao* (Beijing: Legal Daily), 27 March 1994, p. 1.

48. See Arbitration Rules of the CIETAC which can be found in *China Economic News*, 31 October 1988, pp. 8-9; and 7 November 1988, pp. 7-9.

## B. Arbitration Procedure

An arbitration starts with a written application containing the claimant's details, details of the arbitration agreement and a statement of the case and the evidence to support it. The claimant must also either appoint his own arbitrator or authorise CIETAC to make the appointment.<sup>49</sup> A CIETAC arbitration tribunal is composed of one or three arbitrators. Where the tribunal comprises three members, the presiding arbitrator will be appointed by CIETAC. The tribunal must hold oral hearing unless the parties agree otherwise. These hearings may be postponed for good reason upon the request of either party.

The tribunal may consult experts, PRC or foreign nationals<sup>50</sup>, for clarification and the parties themselves are entitled to question each other and any witnesses or experts involved. Awards are decided by majority decision and should be rendered within forty-five days of the closing of proceedings. The award, under the PRC law, is final and binding upon both the parties and is not subject to revision by the courts.<sup>51</sup>

## C. Enforcement of Arbitral Awards

Since the PRC's accession in 1987 to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, it has, in theory, been relatively straightforward to register and enforce a

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49. Art. 4, *ibid.*

50. The CIETAC amended its arbitration rules in 1988 to allow the CCPIT to appoint foreign arbitrator in dealing with arbitration cases in the PRC. The author was informed that the CCPIT has a list of 290 arbitrators, and among them about sixty are foreign nationals, while carrying out interviews with CCPIT officials in May 1994 in Beijing.

51. See art. 257, CPL, *supra* note 15.

foreign arbitral award in the PRC.<sup>52</sup> Prior to this, there was a discretion for the trial courts to refuse enforcement where an award contradicted the "basic principles of the law of the PRC or violated public interest". After 1987, it has been the Convention's enforcement rules that apply. These afford far less discretion for PRC courts to refuse to enforce awards.

An application for enforcement of a foreign arbitral award should be made in the appropriate Intermediate People's Court. It is noted that the Intermediate People's Courts have jurisdiction in major cases involving foreign parties and are therefore distinctly a cut above the People's Courts which deal with domestic disputes. The theory is that the judges of the People's Intermediate Court will have a working knowledge of international law and treaty obligations.

#### D. PRC Arbitral Awards

The CPL says that if a party fails to perform an arbitral award, the winning party must apply to execute the award in the local Intermediate People's Court.<sup>53</sup> The local court has discretion to refuse to enforce on "public interest" grounds but basically the procedure gives the courts very few grounds to refuse to enforce. However, the enforcement is regrettably not straightforward. There are great difficulties and this is where the system at present fails. The enforcement of arbitral awards remains a problem in terms of giving credibility to the process.

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52. The PRC's arbitration award can be now recognised and enforced in more than ninety countries in the world. The list of these countries can be seen in *Zhongcai yu Falü Tungxun* (Beijing: Newsletter of Arbitration and Law), Oct. and December 1993, No. 5 and No. 6, pp. 47-50.

53. Art. 259, CPL, supra note 15.

Why do difficulties of enforcement occur? The main reason seems to be the reluctance of local courts to take enforcement measures against local interests. It is perhaps an inherent weakness of the system that it is necessary for a successful claimant to have to go to the unsuccessful respondent's place of domicile in order to get his award enforced. It is also generally admitted that the quality of judges in the courts is not consistently high.<sup>54</sup> In such an increasingly decentralised economic and political system, local courts are tending to take a parochial view of their obligations, driven perhaps more by concern to avoid damaging local economic and political interests rather than by respect for the objective application of the law.

In addition to the revised arbitration rules of 1993, the PRC has recently promulgated the Arbitration Law which will become effective on 1 September 1995.<sup>55</sup> Both prove that the PRC has committed the development of a sound arbitration system.

#### 6.1.5 Litigation at Present in the PRC

The Chinese are generally believed to be nonlitigious people.<sup>56</sup> In the absence of an agreement to arbitrate or mediate, litigation is likely to be the only remaining option for pursuing a disputed claim. In the PRC, the most relevant legislation in this respect is the CPL of 1991. The differences in litigation inside and outside the PRC are discussed below:

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54. The author was informed of this while doing fieldwork in the PRC respectively in 1992 and 1994 during a discussion with several legal experts in Beijing.

55. The 1994 Arbitration Law of the PRC can be found in *Renmin Ribao* (Beijing: People's Daily, overseas ed.), 2 Sept. 1994, p. 2.

56. Fu Hualing, *supra* note 13, p. 211.

## A. Litigation Inside the PRC

In order to start litigation in the PRC, a plaintiff must instruct a PRC lawyer and pay a security deposit to the court. Most cases involving foreigners are handled at first instance by an Intermediate People's Court.<sup>57</sup> A case involving major implications for the PRC as a whole goes straight to the Supreme People's Court in Beijing.<sup>58</sup> The CPL imposes a duty on the courts to first attempt to mediate disputes. This can have a frustrating delaying effect on PRC litigation proceedings.

A special summary procedure is available for recovering a debt.<sup>59</sup> It is also possible to freeze the property of a debtor.<sup>60</sup> The Courts have wide powers of execution including the freezing and transfer of bank deposits, attachment of income, distraint and sale of property. As with arbitration awards, the practice of enforcement may be rather different from the theory.<sup>61</sup>

The major drawback to litigating in the PRC is that many PRC judges have not been properly trained in law but, rather, are appointed after a long career as party or military bureaucrats as a reward for long service.<sup>62</sup> Although the number of judges with formal legal training

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57. Art. 19, CPL, *Supra* note 15.

58. Art. 21, *ibid.*

59. Art. 189, *ibid.*

60. Article 92, *ibid.*

61. The difficulties of enforcing arbitration awards are seen in *Zhongcai and Falü Tongxun*, *supra* note 52, No. 4, Aug. 1992, pp. 44-49. For example, the local courts are sometimes tending to take a parochial view -- region protectionism to avoid damaging local economic interests.

62. The author was informed of this by the Chinese legal experts in 1992 and 1994 respectively while carrying out interviews in the PRC.

has been increasing over the past few years and the courts are handling more and more cross-border commercial cases (particularly the maritime courts and the commercial courts in Guangdong and Shenzhen), the lack of familiarity of PRC judges with international commercial transactions remains a distinct element of litigation in the PRC.<sup>63</sup>

#### B. Litigation outside the PRC/Enforcement

A foreign creditor is in the strongest position if he or she can obtain a judgement overseas and execute it against assets outside the PRC. Otherwise, foreign judgements only have intangible benefits (such as the pressure of adverse publicity) since their tangible worth can only be measured by enforceability.

Judicial assistance treaties have only been concluded with a small number of countries (including Belgium, France, Italy and Spain). There are also reciprocal arrangements with Eastern European countries. The issue of enforcement is brick wall in the PRC. The enforcement of judgements obtained anywhere else such as London, New York, Hong Kong, and so on, for example, has to rely on the principle of "mutual reciprocity".<sup>64</sup>

The exact meaning of mutual reciprocity as a concept in PRC law is unclear. However, the debate is somewhat academic as outside observers still know of no reciprocal enforcement that has actually taken place.

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63. Ibid.

64. Art. 266, 267, CPL, supra note 15. The guiding principle of "mutual reciprocity" is similar to that of the FECL, i.e. first, parties to a contract are equal; secondly, lawful rights and liabilities of the parties are reciprocal; lastly, no party is allowed to take undue advantages of another party. See art. 3, 10, FECL.

## 6.2 PRC Arbitration Involving Taiwanese Business Disputes in Trade and Investment

Compared with litigation, arbitration for settling "shetai" business disputes in the PRC is a much more suitable method since it involves less bureaucracy. With a background of mutual non-recognition, the PRC stipulated in its TIP of 1988 that disputes arising from the performance of, or in connection with, a "shewai" investment contract in the PRC should, as far as possible, be settled through consultation or mediation between the parties. If parties do not wish to consult with each other or submit disputes to mediation, or where consultation or mediation is unsuccessful, such disputes may, pursuant to the arbitration clause in the contracts or subsequent written arbitration agreements, be submitted for arbitration to an arbitration agency either in the PRC or in Hong Kong.<sup>65</sup> However, there are three problems likely to be encountered under such circumstances. First, there is the nature of "shetai" arbitration; secondly, the applicability of law; and lastly, recognition and enforcement of arbitral awards. These will be discussed below.

### 6.2.1 The Nature of Arbitration

How does the PRC determine the nature of "shetai" arbitration for disputes resolution? The TIP stipulates that the arbitration may only be held in the PRC or in Hong Kong. However, there is no such kind of limit in the other "shewai" arbitrations of business dispute. For example, Article 37 of the Foreign Economic Contract Law 1988 of the PRC stipulates that the parties may, in

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65. See art. 20, Provisions of the State Council on Encouraging Investment by the Taiwanese Compatriots of the People's Republic of China (Taiwan Investment Provisions, or TIP), promulgated on 3 July 1988. See *China Law and Practice*, Vol. 2, no. 7, pp. 56-62.

accordance with the arbitration provisions in the contract or a written arbitration agreement reached subsequent to the dispute, submit the dispute to a PRC arbitration agency or another arbitration agency.

Another example which needs to be noted is found in Article 20 of the State Council's Provisions on Encouraging Investment by Overseas Chinese, Hong Kong and Macao Compatriots 1986. These permit the parties, in accordance with the arbitration provisions in the contract or a written arbitration agreement reached subsequent to the dispute, to submit their dispute to an arbitration agency within the territory of the PRC or another arbitration agency.<sup>66</sup> Therefore, it seems that the PRC differentiates between the treatment of "shetai" and "shewai" arbitration and arbitration involving Hong Kong and Macao compatriots (hereinafter, "Hong Kong and Macao related", or "Shegang'ao").<sup>67</sup>

This discriminatory treatment gives rise to the difficult question regarding the definition of the legal nature of "shetai" arbitration. Is it PRC domestic arbitration, PRC international arbitration or "shewai" arbitration? The PRC arbitration system (regarding economic affairs) has been divided into domestic contractual arbitration and "shewai" contractual arbitration. The two systems differ greatly not only in

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66. See art. 20, Provisions of the State Council on Encouraging Investment by the Overseas Chinese, Hong Kong, and Macao Compatriots of the People's Republic of China, promulgated in 1986.

67. The PRC treats Chinese citizens living within its territory, excluding Hong Kong, Macao, and Taiwan, as mainland citizen (*dalü gongmin*) and Chinese nationals living in Hong Kong, Macao, and Taiwan as compatriots (*gang-ao-tai-tongbao*). All Taiwan related cases in the PRC are cited as "shetai" cases, and Hong Kong and Macao related cases are cited as "Shegang'ao" cases. For further studies, see Cheng Yuan, "Law and Policy of the People's Republic of China", *Immigration and Nationality Law & Practice*, October 1990, pp. 136-144.

their own procedures but also in their application of governing law (as detailed above).<sup>68</sup>

Although existing PRC laws and regulations have not clearly defined this problem, the PRC treats a "shetai" business disputes resolution as a "shewai" disputes resolution, just as it does "shegang'ao" economic cases. All such economic cases are decided by "shewai" arbitration agencies under "shewai" proceedings of arbitration. This is mainly because the PRC domestic arbitration agencies are based on the system of socialist planned economy which is contrary to the nature of "shetai" business dispute resolution. Furthermore, PRC domestic arbitration proceedings are different from international norms of arbitration proceedings, which are generally adopted in the West.<sup>69</sup> This situation should not be accepted by the Taiwanese party, should they wish for a sound and fair "shetai" business dispute resolution in the PRC. A special political goal of the PRC for peaceful reunification with Taiwan has been in existence since 1979. However, this political consideration has not made any difference to the PRC arbitration agency with regard to "shegang'ao" and "shetai" economic cases. Therefore, it would be reasonable and fair for the PRC "shewai" arbitration agencies to decide to handle "shetai" economic cases.<sup>70</sup>

The second difficult problem is the applicability of law regarding arbitration for "shetai" business disputes

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68. See Chu Chiwu, "Zhongguo Duiwai Jingji Maoyi Zhongcai Zhidu (The Arbitration System of China's Foreign Economic and Trade), in Huang Binqun (ed.), *Zhongguo Shewai zhi Jingji Falü Wenti* (The Problems of China's Foreign-related and Economic Laws), (Guangxie: Guangxie People's Press, 1991), p. 353.

69. *Supra* note 40, 41, 42.

70. The author was informed of by a PRC judicial personnel while carrying out interviews in the PRC in May 1992.

in the PRC. The law of the PRC applies in the case of Sino-foreign equity joint venture contracts, Sino-foreign cooperative venture contracts and contracts for Sino-foreign cooperation in the exploration and development of natural resources. These three kinds of contracts exclude the possibility of choosing the applicable law of another country or law district. However, parties to other kinds of "shewai" business contracts may choose the law to be applied in the handling of contract disputes.<sup>71</sup> The PRC Supreme People's Court, through judicial interpretation, has expanded the above stated regulation to cover "shegang'ao" trade and investment contracts.<sup>72</sup> There is now the question of whether or not this regulation will also apply to "shetai" arbitration. In other words, will the "shetai" contracting parties be able to choose Taiwanese law as the governing law in settling business disputes? Alternatively, will PRC arbitration agencies respect the choice of the contracting parties?

With regard to the above, there is still no authoritative answer to be found in present PRC policy and law. However, it is assumed that PRC arbitration agencies are less bureaucratic and that the arbitrators themselves have more discretion than do the court judges. If the PRC acquiesces to recognition and applicability of

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71. See art. 5, FECL, and art. 145, General Principles of Civil Law of the People's Republic of China (hereinafter, GPCL), adopted by the Fourth Session of the Sixth National People's Congress on 12 April 1986, reprinted in Chinese in *Renmin Ribao*, overseas edition, 12 April 1986, pp. 2-3. For an English text, 34 *American Journal of Comparative Law* (1986), pp. 715-743. GPCL addresses many basic legal issues currently facing the PRC and lays down a groundwork for further development of the PRC law.

72. "Minutes of the Working Panel of the Supreme People's Court of the People's Republic of China on the Judgement of Economic Cases Involving Foreigners or the Overseas Chinese from Hong Kong and Macao Within the Coastal Areas of the Country", issued on 12 June 1989, and reprinted in Chinese in *Bulletin of the Supreme People's Court* on 20 June 1990, p. 15.

the Taiwanese law, it will begin with arbitration. The reason for this is that arbitration is a natural area to start with as it is much more flexible than the courts.

The third difficult area is the recognition and enforcement of arbitral awards. There are four points to be discussed in this respect. First, arbitral awards made by PRC's "shewai" arbitration agencies in "shetai" economic cases can be recognised and enforced in the PRC. Secondly, since the PRC joined the Convention on the Recognition and Enforcement of Foreign Arbitral Awards in New York (hereinafter, the New York Convention) in 1987,<sup>73</sup> there has been recognition and enforcement by the PRC of most arbitral awards made in, or involving parties from countries and areas such as Hong Kong and Macao where they were trading with PRC parties. Thirdly, will "shetai" arbitral awards made by the PRC be recognised and enforced in Taiwan? This is a difficult question. In Taiwan, the TMRS of 1992 does not stipulate clearly enough whether the final court judgement or arbitral awards of civil cases made by the PRC must be recognised and enforced in Taiwan.<sup>74</sup> There is still no legal basis to be found for "shetai" arbitral awards made by the PRC being recognised and enforced in Taiwan.

Nevertheless, worthy of attention in this respect, is the fact that the PRC Supreme People's Court has expressed its intention to recognise and enforce any court judgements or arbitral awards made by Taiwan. All

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73. See *Zhongguo Jiaru Waiguo Zhongcai Caijue Gongyu* (China Acceded to Convention on the Recognition and Enforcement of Foreign Arbitral Awards), Xinhua News Agency, news release, 2 December 1986. The Convention on the recognition and Enforcement of Foreign Arbitral Awards was created in New York on 10 June 1958 and came into force since 7 June 1959.

74. See Adk Koon Hang Tse, "The Emerging Legal Framework for Regulating Economic Relations between Taiwan and Mainland China", *Journal of Chinese Law*, vol. 6, (Fall 1992), No. 2, p. 162.

such procedural problems arising from this will be solved in a suitable way.<sup>75</sup> The TIP has explicitly excluded the possibility of choosing Taiwanese arbitration agencies in settling "shetai" business disputes.<sup>76</sup> Therefore, at present, it seems unlikely that "shetai" arbitral awards made in Taiwan will be recognised and enforced in the PRC. In fact, it is not rational, in light of the nature of civil arbitration and the practical needs of private Taiwan-PRC links, for the TIP to debar "shetai" contracting parties from choosing the applicable law of Taiwan or a third country. This situation implies that the result of the arbitration might not be just and fair. It is hoped that the PRC will at least rectify this regulation or even remove entirely the restrictions of the TIP.

#### 6.2.2 Taiwan-PRC Mediation and Arbitration Agencies

At present, the Taiwan-PRC political relationship has not yet been normalised. Choosing Taiwan as an arbitration venue seems difficult for Taiwanese businesses in the PRC. Taiwanese businesses feel insecure about arbitration in Hong Kong or by PRC "shewai" arbitration agencies. In addition, due to the absence of PRC-Taiwan direct contacts for almost forty years, some vestigial prejudices exist between Taiwan and the PRC. Considering the labour shortage arising from labour costs and land shortages, Taiwan now stands high on the list of potential sources of help for PRC's investment. Taiwanese businesses in the PRC hope to have

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75. See "Work Report" of the Supreme People's Court by Ren Jianxin, President of the Supreme People's Court of the PRC, *Renmin Ribao* (Beijing: People's Daily), overseas edition, 13 April 1991, p. 3.

76. On the issue of arbitration for Taiwanese investors in the PRC, see *Liaowang Weekly* (Beijing: Xinhua News Press), overseas edition, no. 50, 1988, 12 December 1988, p. 22.

a trustworthy arbitration agency, with Taiwan's participation, in order to handle business disputes fairly. Therefore, in order to establish a just Taiwan-PRC arbitration agency, the two regimes should negotiate a suitable compromise which will satisfy and be trusted by both sides.

In December 1989, Taiwan and the PRC set up separate arbitration agencies. These are, in Taiwan, the "Coordination Council of Business Affairs across the Taiwan Straits" and in the PRC, the "Coordination Council of Economy and Trade across the Taiwan Straits".<sup>77</sup> Both agencies share the same objective of promoting the development of trade and investment between Taiwan and the PRC. These two councils have jointly formulated "Rules of Mediation" for governing their mutual business disputes. Undoubtedly, this is a good start in settling business disputes between the two regimes.<sup>78</sup> However, mediation itself is not a panacea in this respect. The mediation agencies can do nothing if there is no place for mediation. Therefore, establishment of a non-governmental arbitration agency has become one of the important issues confronting those in Taiwan and the PRC. Of course, this arbitration agency needs to enjoy the common trust of the governments of Taiwan and the PRC, and the arbitral awards made by this agency need to be recognised and enforced by the courts of both sides.

It is reported that both of the above Councils, in formulating the "Rules of Mediation", discussed the possibility of establishing a common arbitration agency. However, the PRC still maintained that the time had not yet come for this. It seems the PRC believes that the

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77. See *Renmin Ribao* (Beijing: People's Daily), overseas edition, 10 February 1990, p. 5.

78. See *Zhongguo Falü Nianjian* of 1991 (Law Year-book, 1991), (ed.), *Zhongguo Falü Nianjianshe* (Beijing), 1991, pp. 1000-1001.

establishment of such an arbitration agency will involve too many problems of Taiwan-PRC law and sovereignty. This proposal was therefore finally abandoned.<sup>79</sup> Nevertheless, since the establishment of the "Association for Relations Across the Taiwan Straits" (ARATS) by the PRC in 1991, the PRC has expressed the intention of working actively to set up a committee of arbitration for maritime disputes across the Taiwan Straits. The proposal was also ratified by officials of the Mainland Affairs Council (MAC), a powerful government committee in Taiwan.<sup>80</sup>

Given this, the establishment of a system of Taiwan-PRC business arbitration is the best measure for dispute resolution between the two. However, this kind of non-governmental agency for business arbitration still has to be bilaterally recognised by the authorities of both Taiwan and the PRC. It is true to say that such arbitration agencies are quasi-judicial in nature. But a mutual recognition of such an arbitration agency will come to nothing if there is still no governmental approval.

There should be no legal barrier to establishing a non-governmental arbitration agency between Taiwan and the PRC. In fact, a study of the PRC law shows that there is no barrier at the moment. According to the TIP, the contracting parties may choose a Hong Kong arbitration agency for Taiwan-PRC business disputes resolution. Here a Hong Kong arbitration agency should be interpreted as meaning an agency located in Hong Kong, and thus it would cover the non-governmental arbitration

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79. See *Zhongcai yu Falü Tongxun* (The Newsletter of Arbitration and Law) (Beijing), May 1991, Vol. 2, pp. 1-2.

80. See *Shijie Ribao* (New York: The World Daily), 19 January 1992, p. 1; see also *Asian Bulletin* (Taipei), Vol. 17, No. 2, February 1992, p. 23.

agency (as described above) established jointly by both Taiwan and the PRC.

As Hong Kong and the PRC are both signatories to the New York Convention, they are bound by its obligations in recognising and enforcing foreign arbitral awards. There are precedents to be followed in the recognition and enforcement of Hong Kong-PRC arbitral awards. Therefore, the PRC courts should recognise and enforce the arbitral awards made by the Taiwan-PRC arbitration agency in Hong Kong.

Last but not least, it seems the PRC is ready to remove the restrictions stipulating a Taiwan-PRC place for arbitration, and directly recognise arbitral awards made by such Taiwan-PRC arbitration agencies.<sup>81</sup> Judging from the fact that the ARATS is preparing to set up a Taiwan-PRC arbitrating committee for maritime dispute settlements, there should be no problem for the PRC officially to recognise and enforce the arbitral awards made by such Taiwan-PRC arbitration agencies. It is hoped that the TIP or even the TIL can relax the control of "shetai" arbitration venue and treat "shetai" arbitration in the same way as "shegang'ao" arbitration. If the TIP or the TIL can further allow "shetai" business disputes to undergo arbitration by other signatory countries or areas of the New York Convention, then this will be more acceptable to Taiwanese businesses operating in the PRC.

In the light of Taiwanese laws on the other hand, no legal barrier exists to establishing a Taiwan-PRC arbitration agency for dispute resolution. Taiwan's

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81. See *Renmin Ribao* (Beijing: People's Daily), overseas edition, 3 July 1991, p. 4. According to the spokesman for the Ministry of Foreign Economic Relations and Trade (MOFERT) of the PRC on 3 July 1991, if a business dispute arises between Taiwan and the PRC, the contracting parties may seek relevant arbitration agencies between Taiwan and the PRC for business dispute settlement.

"Commercial Arbitration Act"<sup>82</sup> does not limit arbitration solely to an arbitration agency established in Taiwan. So long as the contracting parties agree, arbitration may proceed anywhere abroad. Arbitral awards made in Taiwan have the same legal force and effect as affirmed court judgements. The relevant party may ask for enforcement of the arbitration award by the court.<sup>83</sup> One Taiwan official of the ROC Ministry of Justice has unequivocally stated that Taiwanese courts will recognise an arbitral award for Taiwan-PRC business disputes made by a third party in a foreign country.<sup>84</sup>

To sum up, establishing a non-governmental arbitration agency is the most practical and effective way for business dispute resolution between Taiwan and the PRC. It is believed that this proposal will technically avoid many sensitive Taiwan-PRC political problems which for the time being are very difficult to solve.

### 6.3 PRC Litigation Involving Taiwanese Business Disputes in Trade and Investment

It has been found that many "shetai" business disputes are settled non-judicially through

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82. Taiwan had first Commercial Arbitration Act on 20 January 1961, and then was subsequently revised and the Law, as amended, was promulgated on 11 June 1982, with the last amendments being made on 26 December 1986. See K. C. Fan, "Legal Commentary on Commercial Litigation, Arbitration, and the Enforcement of Foreign Judgement and Arbitral Awards in the Republic of China", *Formosa Transnational Law Review* (Taipei: Formosa Transnational, Attorney at Law, February 1990), Vol. 49, pp. 37-42.

83. Ibid. p. 39.

84. See *Sing Tao Daily*, (Hong Kong), 24 March 1989), p. 8.

administrative mediation and arbitration.<sup>85</sup> However, there are still quite a number of these business disputes which are settled by PRC courts. For example, in Fujian Province, in southern China, between 1987 and 1990, the provincial courts handled more than 300 "shetai" civil and economic lawsuits.<sup>86</sup> It is obvious that litigation is one of the most important methods of settling "shetai" business disputes in the PRC.

With reference to litigation procedures for "shetai" business disputes, the President of the PRC Supreme People's Court, Ren Jianxin, pointed out in his 1991 "Work Report" that it was necessary to abide by PRC law, policy and the relevant judicial interpretations made by the Supreme People's Court.<sup>87</sup> However, there are not many PRC laws or regulations which directly or individually define "shetai" business activities. Also, there are not many PRC laws or regulations which explicitly state that they are applicable to "shetai" business disputes. To date, there are no explicit or concrete legal definitions from the PRC National People's Congress or the Supreme People's Court in regard to the adjudication of "shetai" economic cases.

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85. The author was informed of this while doing fieldwork in the PRC in May 1992, during a discussion with several Taiwanese businessmen based in the PRC.

86. *Supra* note 70. Unlike the West, there is a different system of law for "civil" and "economic" disputes in the PRC. For further studies, see Henry R. Zheng, *supra* note 33, pp. 15-18.

87. See *Renmin Ribao*, overseas edition, 13 April 1991, p. 3. Ren Jianxin also said that the PRC will recognise civil decisions handed down by Taiwan courts if they do not violate basic legal principles in the PRC. With the permission of the Supreme People's Court, the PRC courts can entrust Taiwan courts to handle legal proceedings and accept cases from them. Taiwan authorities began recognising documents of marriage, divorce, birth and transfer of property issued in the PRC on a case-by-case basis in 1990.

### 6.3.1 The Procedure Problem - Jurisdiction

The PRC has been separately handling economic and civil cases involving Taiwan in its economic courts and civil courts.<sup>88</sup> As the natures of such cases are basically similar, both are governed by the same procedural law.<sup>89</sup> The Civil Procedure Law 1984 (for trial use) of the PRC has now been replaced by a new Civil Procedure Law of the PRC. The latter was adopted in 1991.<sup>90</sup>

Regarding the jurisdiction over business disputes involving Taiwanese, the PRC generally adjudicates this type of dispute in accordance with relevant stipulations applicable to its Civil Procedure Law. However, on the grounds that business disputes have special features, the PRC courts have introduced certain special stipulations for economic cases involving Taiwanese. These special stipulations are below:

#### A. The Level of Jurisdiction

The PRC court system consists of local People's Courts, special People's Courts and the Supreme People's Court. Local People's Courts include Basic People's Courts, Intermediate People's Courts and Higher People's Courts. Under Article 16 of the 1982 Civil Procedure Law, the Basic People's Courts, except as otherwise

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88. See art. 19, 24, 27, 31, *Zhonghua Renmin Gongheguo Fayuan Zuzhifa* (The Law of Court Organisation of the People's Republic of China).

89. See "Opinions of the Supreme People's Court of the PRC on Some Questions Concerning the Implementation of the Civil Procedure Law in the Adjudication of Economic Cases", issued on 17 September 1984, and reprinted in Chinese in *Bulletin of the Supreme People's Court*, 20 June 1985, p. 17.

90. *Supra* note 15.

stipulated, have jurisdiction as courts of first instance over civil cases.<sup>91</sup> This Law stipulates that the Intermediate People's Courts are the trial courts for "shewai" cases.<sup>92</sup> Under a Supreme People's Court ruling, Intermediate People's Courts also exercise jurisdiction over "shegang'ao" economic cases.<sup>93</sup> The truth is that "shegang'ao" economic cases are similar in nature to "shewai" cases. The same situation applies to "shetai" economic cases. Since 1979, the PRC has deemed the Intermediate People's Courts to be the trial courts for "shetai" business disputes.<sup>94</sup>

The quality of the judgements from the Intermediate People's Courts is much better than it is for those from the Basic People's Courts. It is therefore necessary and significant to have another similar ruling from the Supreme People's Court on raising the level of jurisdiction for "shetai" economic cases, directly from the Basic to the Intermediate People's Courts. In recent years, the number of "shewai" cases in the PRC has been increasing year by year. The various Intermediate People's Courts of the PRC have therefore accumulated a body of experience in handling such "shetai" cases over the years. However, the 1991 Civil Procedure Law, replacing that of 1982, stipulates that the Intermediate People's Courts will handle only major "shewai" cases.<sup>95</sup> This means that the Basic People's Courts will in the future be the trial courts in handling ordinary "shewai" cases. Thus, by analogy, similar "shetai" and "shegang'ao" cases should also be handled at the level of

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91. Ibid., art. 16.

92. Ibid., art. 17.

93. Supra note 89.

94. Supra note 70.

95. Supra note 15, art. 19.

the Basic People's Courts. This will be a serious challenge for the judges at trial courts in the PRC.

#### B. The Scope of Exclusive Jurisdiction

According to the Civil Procedure Law 1991, the PRC has defined exclusive jurisdiction over a given category of cases.<sup>96</sup> Prior to this, the PRC Supreme People's Court, in light of the existing problems with the judgement of "shewai", and "shegang'ao" economic lawsuits, published its "Minutes of the Working Panel of the PRC's Coastal Areas on the Judgement of "shewai" and "shegang'ao" Economic Lawsuits" in June 1989. These Minutes specifically stipulate that foreign courts and courts in Hong Kong and Macao have no jurisdiction over those economic lawsuits which the CPL and other relevant laws have characterised as being under the exclusive jurisdiction of the PRC Courts. The so-called economic lawsuits include cases arising from immovable property; cases arising from events occurring during harbour operations; cases arising from registration;<sup>97</sup> and cases arising from concluding investment contracts in the PRC such as equity joint venture, co-operative joint ventures and joint exploitation of natural resources.<sup>98</sup>

Given the above situation, it is inferred that "shetai" investment disputes in the PRC are naturally under the exclusive jurisdiction of the PRC courts. Of course, if the contracting parties have defined articles or agreements on arbitration, and agree to file this dispute to an arbitration agency for an award, both parties would not be under the control of such exclusive

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96. Ibid., art. 22-39.

97. The 1991 Civil Procedure Law of the PRC has abolished the proceeding concerning registration to be under the exclusive jurisdiction of the PRC courts. See *ibid.*, art. 34.

98. *Supra* note 72.

jurisdiction.<sup>99</sup> Besides these examples, cases involving administrative torts of public law are also under the exclusive jurisdiction of the PRC courts.<sup>100</sup> Administrative torts always originate when disputes arise between the PRC relevant trade or investment authorities and "shewai", "shegang'ao", and "shetai" parties.<sup>101</sup> Examples of this kind are: the approval of contracts, the issue of business licences, and so on. Contracting parties can only seek legal protection from the PRC courts, instead of choosing international arbitration or judicial remedies from the courts of foreign countries, including Taiwan, Hong Kong and Macao.<sup>102</sup>

### C. The Scope of Jurisdiction

According to the CPL, proceedings arising from contractual disputes fall within the jurisdiction of the People's Court, and are determined by the location of the performance of the contract and the defendant's residence.<sup>103</sup> Since 1989, the PRC courts, through

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99. Ibid.

100. Supra note 15, art. 29; see also art. 2, 22, 70 and 71 of the Administrative Litigation Law of the People's Republic of China, promulgated on 4 April 1989 and became effective in October 1990, which covers suspension of business licences, government interference with contracts, and so on. For an English text, see *China Law and Practice* (No. 5, 1989), p. 37.

101. Ibid., see also Zhou Haiping, *Qiantan Shewai Qinquan Xingwei De Falü Shiyong* (Tentative Discussion on the Application of Law to Torts Involving Foreign Elements), *Zhongguo Fazhibao* (*Chinese Legal System Daily*), 1 August 1986, p. 3.

102. Ibid. The act of the PRC authorities is an administrative practice which is under no jurisdiction of the courts of foreign countries or international arbitration.

103. Supra note 15, art. 24. The contract disputes fall within the jurisdiction of the court of the place where the contract is signed (*forum contractus*) or the court of the place of the performance (*forum solutionis*).

judicial interpretation, have expanded the scope of their exclusive jurisdiction over "shewai" and "shegang'ao" economic cases.<sup>104</sup> According to this interpretation, they now have jurisdiction over the property of the defendant in the PRC, no matter whether this property is the subject matter of the dispute or not. This jurisdiction also includes the place where the contract was signed (*forum contractus*), the place where it was performed (*forum solutionis*), and cases where the defendant has residence, business address, or representative agencies in the PRC. In addition, the parties may file a written agreement with the PRC courts over which the PRC courts have no jurisdiction. Where there is no such agreement, the PRC courts have jurisdiction when a lawsuit is brought, and over the procedure for debating matters of substance.<sup>105</sup> The CPL has explicitly defined the agreed jurisdiction and the quasi-agreed jurisdiction.<sup>106</sup> This practice of the PRC courts in the coastal areas is also applied in "shetai" economic cases.<sup>107</sup>

Could "shetai" economic cases of the PRC be handled by Taiwanese courts? Jurisdiction has become an emerging issue between Taiwan and the PRC. The PRC authorities have so far not clarified their position on this matter. The reality, however, is that PRC courts treat "shetai" economic cases in the same way as "shewai" and "shegang'ao" economic cases. The PRC courts even adopt the relevant regulations and practices of "shewai" litigation proceedings in the jurisdiction of "shetai" and "shegang'ao" economic cases. Having been recognised by the PRC courts, this choice of jurisdiction is made

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104. Supra note 72.

105. Ibid.

106. Supra note 15, art. 243.

107. Supra note 70.

via an agreement or dealt with by the contracting parties. Therefore, such "shewai" and "shegang'ao" practices in acknowledging the choice of jurisdiction of non-PRC courts should, by analogy, also be applied to Taiwanese courts.

### 6.3.2 The Application of Substantial Law

As mentioned above, the PRC judicial authorities have not specified whether or not the laws of Taiwan or the PRC should be used in handling "shetai" economic cases. To comply with the needs of judging "shegang'ao" economic cases, the PRC Supreme People's Court has stipulated a series of judicial interpretations which have had a decisive impact on the courts trying "shetai" economic cases.<sup>108</sup>

#### A. Applicability of Substantial Law for "Shegang'ao" Economic Cases

According to judicial interpretations made by the PRC Supreme People's Court, "Shegang'ao" economic cases are handled in the same basic way as "shewai" economic cases. The PRC Supreme People's Court has given definitions on the applicability of substantial law on "shegang'ao" economic cases, in the following terms:

##### a. Application of PRC Laws and Regulations

The PRC has several limited "shewai" laws or regulations which are explicitly stated to be applicable for "shegang'ao" cases of a similar nature. Most PRC laws and regulations have no such stipulations and thus cause much trouble when an application is filed. To this end, in 1987, the PRC Supreme People's Court clarified

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108. Examples of such judicial interpretations are found in supra note 72 and 89.

the position in its "Explanation on Several Issues Relating to the Application of the Law on Foreign Economic Contracts" by saying that:

The Foreign Economic Contract Law 1985 of the PRC is also applicable to economic contracts signed between Hong Kong and Macao contracting parties and contracting parties within the territory of the PRC. Moreover, this Law is also applicable to economic contracts signed or performed between Hong Kong and Macao contracting parties and foreign contracting parties who are themselves within the territory of the PRC.<sup>109</sup>

b. Application of Hong Kong or Macao Laws

According to the "Explanation on Several Issues Relating to the Application of the Law on Foreign Economic Contracts" of 1987, the PRC trial courts allow the contracting parties, in accordance with an agreement, to choose applicable Hong Kong or Macao law as the governing law.<sup>110</sup> For example, the above stated "Explanation" explicitly state that the people's court should apply the law chosen by the contracting parties on entering into contract or for settling "shewai" and "shegang'ao" business disputes. The law chosen can be either the PRC laws or the laws of foreign countries including Hong Kong and Macao. However, the choice made by the contracting parties must be unanimous and explicitly stated in the contract.<sup>111</sup>

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109. "Explanation of the Supreme People's Court of the PRC on Several Questions Relating to the Application of the Foreign Economic Contract Law", issued on 19 October 1987, *China Law and Practice*, Vol. 2, No. 4, 2 May 1988, pp. 52-66.

110. *Ibid.*, also see art. 5, FECL.

111. *Ibid.*

### c. The Principle of Closest Connection<sup>112</sup>

According to Article 145 of the PRC Civil Code and Article 5 of the PRC Foreign Economic Contract Law, the law of the country with the closest connection to the contract should be applied if both contracting parties have not made a choice.<sup>113</sup> In other words, if the contracting parties have not chosen the applicable law, the law of the country with the closest connection to the contract is deemed applicable. The PRC courts adopt the "Principle of Closest Connection" of private international law in their adjudication of "shegang'ao" economic cases. Moreover, The PRC Supreme People's Court specifies, in light of this Principle, the applicable law for thirteen of the most common contracts. The contract of international transportation is an example.<sup>114</sup>

### d. Confirming Legal Personality

According to PRC judicial interpretation, the international rule of the *lex loci contractus* is used in determining the legal personality of foreign contracting parties,<sup>115</sup> that is to say whether the contracting parties

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112. The Principle of Closest Connection was first adopted by the English scholar John Westlake as the "Most Real Connection" and then popularly found in many practices of private international law over the application of foreign laws. See Henri Batiffol, G. C. Cheshire (eds.), *Private International Law*, Oxford: Oxford University Press, 1957, p. 5. Also see A. E. Anton, *Private International Law* (2nd ed.), Edinburgh: W. Green & Son Ltd., 1990, pp. 64-65.

113. The PRC Civil Code which means the GPCL, *supra* note 71. For further studies on PRC law governing a contract, see Cheng Yuan, *supra* note 10, pp. 266-267.

114. *Supra* note 109.

115. *Ibid.* *Lex loci contractus* means the law of the place in which a contract was made. *Lex fori* means the law of the place in which a case is tried. For example, if an action were brought in England on a contract made in France, the law of England would, as regards such action,

in Hong Kong and Macao have the capacity of a legal person and bear their own limited or unlimited liabilities. All these fall to be determined in accordance with the *lex loci contractus*.<sup>116</sup>

To sum up, PRC judicial practices have recognised Hong Kong and Macao as independent legal areas whose laws are applicable in the PRC. This is to say that the PRC judiciary has in practice recognised, adopted and practically applied the theory of inter-regional conflict of law as noted earlier (see above pp. 71-74). By analogy, the applicable private international law in resolving inter-regional conflict of laws has become a model for Taiwan-PRC dispute resolution.<sup>117</sup>

#### B. Applicable Law in "Shetai" Cases

Though the PRC has made much progress in the applicability of law for "*shegang'ao*" economic cases, it has done little in the field of "*shetai*" conflict of law. Except for a professed emphasis on the observance of law, policy and judicial interpretation in handling such lawsuits, the PRC has not to date proposed any significant measures to help resolve Taiwan-PRC legal problems.

However, various People's Courts in the coastal areas of the PRC have made their so called "local" definitions of the applicability of a number of general "*shetai*" laws and regulations, and have referred to the

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be the *lex fori*, and the law of France the *lex loci contractus*.

116. Supra note 72.

117. The progress of private international law has caused the development of PRC private international law jurisprudence. For further studies, see Henry R. Zheng, supra note 33, pp. 229-231.

applicability of law for "shegang'ao" economic cases. Under the framework set by central government, definitions have been made in the light of the characteristics of "shetai" economic cases.

a. Lawsuits Involving Trade

The PRC courts treat Taiwanese trade lawsuits based on the models of Hong Kong, Macao, or foreign businesses, as general "shegang'ao" or "shewai" economic cases. The Foreign Economic Contract Law 1985 and other relevant laws or regulations for foreign trade are referred to and applied.<sup>118</sup> It is believed that "shetai" dispute resolution, as a result of Taiwanese businesses trading directly with the PRC, should be handled in the same way as "shewai" and "shegang'ao" cases.

b. Lawsuits Involving Investment

Dispute resolution of economic cases amongst parties of Taiwan-PRC equity joint ventures and co-operative joint ventures is to be handled in accordance with the applicable laws for foreign related enterprises in the PRC, such as the Sino-Foreign Equity Joint Ventures Law of 1990, and the Sino-Foreign Co-operative Joint Ventures Law of 1988.<sup>119</sup>

c. Application of International Custom

PRC courts have in the past looked to international custom in deciding "shewai" cases.<sup>120</sup> If the contracting parties have an agreement to abide by international

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118. Supra note 18. Also supra note 70.

119. See Margaret Maggio, "Important Developments in Mainland China's Foreign Investment Laws", *International Business Law Journal*, No. 3, 1993, pp. 290-294.

120. Henry R. Zheng, supra note 33, p. 204.

custom, the PRC courts will apply international custom in respect of the choice of the contracting parties. If no such agreement has been reached, the contracting parties will do likewise when there are no explicit stipulations in the PRC laws or regulations. For example, the PRC courts have handled "*shetai*" economic cases of equity joint ventures in light of general international customs and rules concerning stock sharing limited liability of a company.<sup>121</sup>

d. Capacity of Legal Person and Applicability of Law Governing Acts of Agents

According to *lex loci contractus*, the PRC courts decide the capacity of legal persons involving Taiwanese businesses by the PRC law. The force of any contract of agency on commission, which has been created in Hong Kong or Taiwan, is determined in the light of the laws of Hong Kong or Taiwan.<sup>122</sup>

Given this, the local People's Courts of the PRC have, to a certain degree, adopted the principle of applicability of law for handling "*shegang'ao*" economic cases in the same way as "*shetai*" economic cases. This shows the great influence exercised by judgements of "*shegang'ao*" economic cases on "*shetai*" economic cases in the PRC. However, both "*shegang'ao*" and "*shetai*" economic cases have fundamental differences in their applicability of substantial law. These are manifested mainly in the fact that the PRC authorities do not allow "*shetai*" contracting parties to choose Taiwan law as the applicable law for business dispute resolution. The PRC authorities even disallow the Principle of Closest Connection of private international law being applied in "*shetai*" economic cases. In other words, the People's

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121. *Supra* note 18.

122. *Ibid.*

Courts of the PRC cannot directly apply Taiwan law in handling "*shetai*" economic cases.<sup>123</sup>

Viewed from the perspective of private law, Taiwanese laws and PRC laws are independent legal systems. The need for an inter-regional basis for resolving conflict of law disputes will become a necessity after Hong Kong returns to the PRC in 1997, when a completely new legal system will co-exist with the PRC legal system. Regarding business dispute resolution, "*shetai*" economic cases do not differ much from "*shegang'ao*" economic cases in terms of the relationship to private law. The fact is, however that the PRC differentiates "*shetai*" economic cases from "*shegang'ao*" economic cases so far as the applicability of law is concerned. This fact arises purely from a political consideration, and there is uncertainty in governmental recognition of public international law and foreign law in private international law as noted above (see pp. 52-54). Taiwan and the PRC should concede that recognition of the other's laws does not necessarily imply recognition of each other's government since the political recognition of a government is not a prerequisite for recognition of its laws. This differing treatment for "*shetai*" economic cases has no legal basis in the PRC.<sup>124</sup>

The PRC should choose the applicable substantial law in handling "*shetai*" economic cases in the same way as it does in handling "*shegang'ao*" economic cases. On the basis of this, the principles of conflict of law or private international law could be adopted in the handling of "*shetai*" economic cases in the PRC. Only in

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123. Supra note 87.

124. For further studies, see Tung-Pi Chen, "Bridge Across the Formosa Strait: Private Law Relations Between Taiwan and Mainland China", 4 *Journal of Chinese Law* (Spring, 1990), pp. 106-115.

this way may PRC courts directly use experiences acquired in the handling of "shewai" or "shegang'ao" economic cases in the judgement of "shetai" economic cases. In the meantime, the PRC courts could also avoid legal confusion on applicability of law towards "shetai" economic cases. This would prompt Taiwan to do likewise in handling business dispute resolution between itself and the PRC. The process of restoring relations in Taiwan-PRC business dispute resolution will benefit not only mutual economic development but also mutual political understanding.

#### 6.4 Conclusions

It is evident that present PRC law and policy for "shetai" economic cases differ from those for its domestic, "shewai" and "shegang'ao" economic cases. Such differences in "shetai" economic cases are attributable to the *de facto* relationship of mutual non-recognition and political standing, poisoned by the atmosphere of rivalry, suspicion, and intransigence existing between Taiwan and the PRC.

Much the same as the status quo of Hong Kong and Macao, Taiwan has long been a political entity and a legal region independent of PRC jurisdiction. Against such a background, it is imperative for the PRC to authorise some special preferential treatment and thus to stipulate some relevant "shewai" economic laws or regulations which are to be applicable not only to overseas Chinese from Hong Kong and Macao but also to the Taiwanese. In addition to attracting overseas capital, the PRC has had the political objective of a United Front policy towards Taiwan for the reunification of China. Therefore, in litigation procedure, the PRC basically treats "shetai" proceedings of economic cases in the same

way as "shegang'ao" economic cases with references from some "shewai" laws or regulations. As for substantial law, the PRC adopts some rules of conflict of laws or private international law. Examples are *lex loci contractus* for recognising the capacity of a legal person, international customs applied as the applicable law, and so on. Regarding arbitration, the PRC "shewai" arbitration agencies deal with "shetai" dispute resolution in accordance with "shewai" arbitration procedures. All these performances are attributed to conforming to the objective needs of equal treatment for "shetai" economic cases and "shewai" economic cases in the PRC.

The PRC tries to define the prospects of Taiwan-PRC relationships not only from a legal perspective but also with an eye to a political agenda. Due to the difference of political standing, Taiwan insists on the policy of "one China but not now" while the PRC stands by the model of "one country, two systems". The PRC fears that introducing the applicability of Taiwan law will lead to recognition of the Taiwanese government and thence to the *de jure* recognition of "two Chinas" or "one China, one Taiwan". Based on such considerations, the PRC distinguishes between "shetai" economic cases and "shegang'ao" economic cases, and insists on excluding the applicability of Taiwan law in "shetai" economic cases.

Due to the need to improve economic relationships between Taiwan and the PRC, the PRC attempts to differentiate between arbitration of "shetai" economic cases and arbitration of "shewai" and "shegang'ao" economic cases. Taiwanese businesses afford a special status for disputes resolution in the PRC. As one clear-cut example, the TIP allows contracting parties to choose only the PRC or Hong Kong as their arbitration venue.

The future development of Taiwan-PRC economic and political relationships depends on the fundamental resolution of "shetai" legal problems in the PRC. It is imperative that both Taiwan and the PRC jointly formulate a concrete, progressive and rational economic policy. On the premise of mutual benefit, there should at least be a guarantee of protection for the legitimate rights of Taiwanese businesses in the PRC. If there is progress in this direction, then the economic relationship between Taiwan and the PRC should be supported by normalisation, co-operation and legalisation.

## CHAPTER SEVEN

### CONCLUSIONS AND FUTURE PROSPECTS

China became a divided nation in 1949; since then, the ROC on Taiwan and the PRC on the mainland have existed almost entirely as mutually exclusive entities. Relations between the two were, until recently, relatively straightforward: mutual non-recognition and even hostility. This division of Taiwan and the PRC since 1949 has resulted in two separate independent political and legal systems.

Driven by forces of economic expansion and nationalist sentiment, as well as by political and economic pragmatism, Taiwan and the PRC are now moving toward a closer informal relationship. Since 1983, the PRC has adopted a "one country, two systems" formula, offering Taiwan terms even more favourable than those devised for the PRC's takeover of Hong Kong in 1997.<sup>1</sup> Similarly, Taiwan has responded by opting for a more flexible and pragmatic foreign policy and has countered Deng's proposals with the "one country, two governments"<sup>2</sup> concept. Under this formula, Taiwan is, in fact, maintaining a policy of "one China but not now" or "one

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1. This proposal first became known in a discussion between the PRC paramount leader Deng Xiaoping and Professor Yang Liyu of Seton Hall University. For an account of the discussion and for a summary of the proposal, see Deng Xiaoping, in *Fundamental Issues in Present-Day China* (1987), p. 19.

2. For comments from Taiwan's perspective, see T. S. Chao, "Lun Yige Zhongguo Liangge Dui Deng Zhengfu Wenti" (Analyse the Problems of One China, Two Equal Governments), *Wenti Yu Yanjiu* (Issues and Studies) (Taipei: Institute of International Relations, May 1989), p. 1.

China, two entities".<sup>3</sup> However, such political propositions have still failed to solve a number of legal problems which have arisen since the time when both Taiwan and the PRC started making private and commercial contacts indirectly in the early 1980s.

There are *de facto* two exclusive entities with lawful international personalities which exist separately in both Taiwan and the PRC. Based on political considerations, both Taiwan and the PRC have increasingly complicated their rapidly developing economic relations and further confused any basis of legal principles. For example, the legal status of Taiwan-related (hereinafter, "*shetai*") businesses in the PRC has appeared especially conspicuous for the outside world. Nevertheless, as regards "*shetai*" economic cases, the PRC has in practice discriminated against its so-called Taiwanese compatriots. Therefore, the question of how to rationalise and legalise problems of this kind in order to stabilise bilateral economic relations has become a major task for both Taiwan and the PRC.

This concluding chapter seeks first to summarise Taiwan's economic relations with the PRC. Secondly, it clarifies the complicated "*shetai*" economic relationship that has emerged in the PRC, and also attempts to analyse the status of the Taiwanese businesses under PRC law and practice. Thirdly, it illustrates the defects of the PRC's existing method for resolution of disputes concerning "*shetai*" economic cases, and explores the feasibility of establishing a joint mediation and arbitration system. Lastly, it looks at the possibility of signing agreements for judicial assistance and investment protection between the two territories.

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3. Jason Hu, "President Lee's Pragmatic Diplomacy and China's Re-unification", a special report of *The Daily Telegraph* (London), 21 May 1990, p. 2.

## 7.1 Taiwan's Growing Economic Convergence with the PRC

Economic relations between Taiwan and the PRC have been intricately related to political developments from the 1950s to the present. Nominally, trade between Taiwan and the PRC did not break through before 1988, the year after Taiwan lifted its ban on private visits between people living across the Taiwan Straits. As a matter of fact, 1988 was the year underground trading activities between Taiwan and the PRC legally surfaced.<sup>4</sup> Since then, the Taiwanese investment in the PRC has increased steadily despite obvious political and legal uncertainties.<sup>5</sup>

At present, a growing number of Taiwanese business people have endorsed the notion of a pan-Chinese economic market with a high-level of optimism, as revealed in both their committed PRC investment decisions and public predictions for the future of their business expansion in the PRC.<sup>6</sup> Despite the identical ultimate goal of reunification cherished by both sides, exactly how this goal to be achieved remains elusive. However, there is a consensus that even if official negotiations for reunification must wait until conditions are more conducive to mutual agreement, economic relations can be facilitated or promoted.<sup>7</sup>

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4. Zha Daojiong, "A 'Greater China'? The Political Economy of Chinese National Reunification", *The Journal of Contemporary China*, No. 5, Spring 1995, p. 44.

5. For example, prior to 1993, the officially approved Taiwanese investment in the PRC had reached eighteen provinces, covering nineteen major industries. See Investment Commission, Ministry of Economic Affairs, Republic of China (comp.), *Statistics on Approved Indirect Mainland Investment by Area and by Industry*, May 1993, pp. 68-73.

6. *Supra* note 4.

7. *Ibid.*, p. 47.

Economic integration between Taiwan and the PRC is not to say that political considerations can be safely forgotten. The foregoing chapters of this thesis have demonstrated that the political framework affects importantly the willingness, especially on the Taiwan side, to enjoy expanded economic relations with the PRC. Conversely, expanded economic relations can pave the way for political negotiations. A skilful management of the transitional stages is thus called for, and existing and evolving problems and anomalies in economic relations must be dealt with as they arise. At the present juncture, several major positive steps appear feasible.

First, although negotiations for reunification have had to be postponed, unofficial discussions of various modalities of coexistence should be encouraged. Such discussions may reduce the polarisation of those who insist on annexation of Taiwan by the PRC and those who clamour for Taiwan's independent nationhood. They should take place periodically in third countries as well as on both sides of the Taiwan Straits.<sup>8</sup>

Secondly, although the PRC may be unwilling to renounce the use of force or threat of force as a bargaining counter, it could certainly help to reduce tension by narrowing the conditions under which, as a last resort, force is considered. The contention that force is needed in the event of foreign interference or secession implies that it will not be used purely for the purpose of reunification.<sup>9</sup> A more explicit definition and narrowing down of the conditions would be helpful.

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8. For example, Taiwan's SEF and PRC's ARATS had their first historic talk on mutual economic exchange in Singapore in 1993.

9. The use of force is PRC's final option for national reunification. See *supra* note 4, pp. 58-59.

Thirdly, although dual recognition of both political entities is unacceptable to the PRC and to most of the countries concerned,<sup>10</sup> unofficial arrangements for facilitating Taiwan's commerce and business travel should be encouraged by the PRC. These include speedy processing of visas as well as arrangements for avoidance of double taxation and treatment of investment.<sup>11</sup>

Fourthly, with Taiwan's termination of the Period of Mobilisation for the Suppression of Communist Rebellion in 1991, the political and legal rationale for prohibition of direct trade and investment became tenuous. From the point of view of economic integration, it seems that prohibition has become increasingly indefensible, especially as progressive liberalisation is being applied in relations with other socialist countries.<sup>12</sup>

Lastly, economic relations between Taiwan and the PRC should play a positive and dynamic role in the 1990s and beyond for both sides.<sup>13</sup> This is all the more crucial for Taiwan since it is unthinkable that Taiwan can turn its back on the proven course of

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10. Taiwan has made it clear to regain its lost membership in the United Nations and has achieved equal status with the PRC in eleven international organisations such as Asian Development Bank, Asian Pacific Economic Council, and so on. See *ibid.*, pp. 49, 58.

11. The author was informed of this by several Taiwanese business persons based in the PRC in 1992 and 1994 respectively while carrying out interviews there.

12. In addition to political consideration, Taiwan's present policy of indirect trade and investment with the PRC is justified to avoid having its economy too reliant on the PRC in the future. Interview with a Taiwanese government official of the Ministry of Economic Affairs in May 1994.

13. Tzong-shian Yu, *Taiwan's Economic Development and Its Economic Relationship with Mainland China* (Occasional Paper Series No. 9307), Taipei: Chung-Hua Institution For Economic Research, November 1993, 14-15.

internationalisation and liberalisation. Given the general strategy of an island economy and, in spite of its problems the rising position of the PRC in the world economy, a head-in-sand policy is both inconsistent and costly. Instead, a positive approach should make use of the comparative strengths of both sides.<sup>14</sup>

The main thrust of the government's role should therefore be one of facilitation. The first priority is the removal of artificial restraints dictated by yesterday's political considerations. More positively, the encouragement of the establishment of intermediate bodies that will be able to assist traders and investors to obtain information, locate partners, and settle disputes is a step that has proved its worth in numerous cases where normal official channels are deficient. For example, the useful role played by Taiwan's SEF and PRC's ARATS is well-known as an unofficial umbrella with some behind-the-scene official involvement.

For economic integration, as a large entity, the strategic choices for the PRC within the general framework of an open policy since 1979 are far greater than for an island economy like Taiwan. In contrast, as a relatively small island economy, Taiwan must compete globally. Taiwan's economic relations with the PRC must be justified on global grounds because they are economically superior to alternative relations. The role of Taiwan in the world is thus very similar to that of a transnational or global corporation. It engages in

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14. For example, a Chinese scholar Fang Sheng from the People's University proposed an "economic joint commission", a non-political commission to work to coordinate a wide range of economic activities and issues among businesses between Taiwan and the PRC without demanding changes of their respective political stances. See Fang Sheng, "Guanyu Jianli Dalu, Taiwan he Xianggang Jingji Lianheti de Jidian Shexiang" (A Proposal for Establishing a Mainland-Taiwan-Hong Kong Joint Economic Commission), *Jingji Ribao* (Beijing: Economic Daily, 24 June 1992), p. 4.

activities and has facilities globally, including in the PRC, taking into account the special risks and problems in each case. The guiding spirit is multilateralism rather than bilateralism or regionalism.<sup>15</sup>

## 7.2 A Complicated "Shetai" Economic Relationship

Being deeply influenced by political considerations, Taiwanese businesses in the PRC are operating under special economic laws and regulations. Because of this, these Taiwanese businesses have varying status in trading with or investing in the PRC. This varying status can be divided into three major types: "foreign businesses", "quasi-foreign businesses", and "Taiwanese investors". These three types enjoy different legal relations with their contracting parties in the PRC. In consequence, when a dispute occurs, the resulting legal problem invariably becomes doubly complicated.

### 7.2.1 Status of Taiwan Businesses in Law

In October 1986, the State Council of the PRC promulgated the FIP<sup>16</sup> in order to improve the investment environment by absorbing more foreign investment and introducing advanced technology. The FIP applies to overseas Chinese investors from Hong Kong, Macao, and Taiwan.<sup>17</sup> This was the first time that investors from Hong Kong, Macao, and Taiwan came under jurisdiction of laws or regulations applicable to foreign investors.

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15. Supra note 12.

16. As a national policy of encouraging more foreign investment, the State Council of the PRC promulgated the "Provisions for Encouraging Foreign Investment" (Foreign Investment Provisions, or FIP) on 11 October 1986. See CCH Austl. ¶ 13-509.

17. Ibid., see Article 20.

In June 1988, in order to promote economic and technological exchange between Taiwan and the PRC, the State Council promulgated the TIP.<sup>18</sup> This TIP was upgraded and amplified to the TIL of 1994.<sup>19</sup> Besides applying the TIP or TIL to EJVs, CJVs, and WFOEs established in the PRC by Taiwanese investors, relevant state foreign economic legislation was to be implemented.

Taiwanese businesses were to enjoy treatment corresponding to that enjoyed by businesses with foreign investment. In addition to applying the TIP or TIL, relevant state foreign economic laws and regulations could also be implemented as appropriate in respect of other forms of investment conducted in the PRC by Taiwanese investors, as well as to PRC-derived income derived from individuals, interest, rentals and royalties, and to other PRC-derived income derived by Taiwanese investors who do not maintain business establishments in the PRC.<sup>20</sup>

Given these circumstances, Taiwanese investors are basically regarded by the PRC economic laws as foreign investors and thus become entities which are subject to the PRC's foreign economic laws and regulations. Such status happens to coincide with Taiwan's official policy of indirect investment in the PRC. Under this policy, Taiwanese businesses may only invest in the PRC through a

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18. The "Provisions on Encouraging Taiwanese Investment" (Taiwanese Investment Provisions, or TIP) was promulgated on 3 July 1988 by the State Council of the PRC. For an English text, see *China Law and Practice*, 22 August 1988, vol. 2, no. 7, pp. 56-62.

19. A special legislation with the same background as the TIP, the Law of the People's Republic of China on the Protection of Taiwan Compatriots' Investment (Taiwanese Investment Law, or TIL), was promulgated on 3 March 1994. For an English text, see *China Economic News* (No. 11), 21 March 1994, pp. 6-7.

20. *Ibid.*, art. 5.

third country. Since they must therefore establish a presence in a third country, such investors thus obtain the status of foreign businesses before they enter the PRC. Therefore, they become entities subject to the PRC's foreign economic laws and regulations.<sup>21</sup> Nevertheless, the legal status of Taiwanese businesses which are "legally regarded" as foreign investors, and those who are *de facto* foreign investors in law is substantially different.

Taiwanese businesses which have no foreign status from the basis of residence in a third country are treated as quasi-foreign investors even though they are "legally regarded" as foreign investors. These Taiwanese businesses are protected by foreign laws which are the laws reciprocally enforced in Taiwan. This is the direct result of differences of policy and ideology between Taiwan and the PRC. In its economic laws and regulations, the PRC pursues discriminatory practices against *de facto* Taiwanese businesses. Though the TIP or TIL gives preferential treatment to Taiwanese investors, Taiwanese businesses are nevertheless discriminated against on the basis of differing political ideology. For example, Taiwanese investors can choose arbitration organs for dispute resolution only in the PRC and choose only PRC courts for litigation.<sup>22</sup>

Taiwanese businesses which have foreign status on the basis of existence in a third country are *de facto* foreign investors in law, and are protected not only by foreign laws but also by the bilateral agreements on

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21. For detailed PRC's foreign economic laws and regulations, see Dominique T. Wang, *China's Foreign Trade Law*, Taipei: National Taiwan University Law School, 1992.

22. *Supra* note 19, art. 14; see also art. 246 of the 1991 Civil Procedure Law (CPL) of the PRC which became effective on 9 April and replaced the Civil Procedure Law (For Trial Implementation) of 1982. For an English text, see *China Law and Practice* (No. 5, 1991), pp. 15-16.

investment protection signed between the foreign country and the PRC.<sup>23</sup> In other words, like foreign businesses, Taiwanese businesses are entitled to rely on Article 110 of the Detailed Rules for the Implementation of EJV Law,<sup>24</sup> Article 26 of the CJV Law,<sup>25</sup> Articles 243 to 246 of the CPL,<sup>26</sup> and the "Answers of the Supreme People's Court on Some Questions Concerning the Applicability of Foreign Economic Contracts"<sup>27</sup> by choosing foreign laws and foreign courts or arbitration organs to take legal proceedings or arbitration procedures.

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23. Are Taiwanese businesses *de facto* protected by these bilateral agreements? This depends on the individual contents of such bilateral agreements. According to the law of some signatories, the foreign business is asked to establish a company in the country. The foreign business is even required to set up its main business office or main operation office within the territory of the signatory. To date, the PRC has signed relevant investment protection agreements with sixty five countries. The Agreement on Promoting and Protecting Investment concluded between the People's Republic of China and Republic of Singapore in 1985 is an example. On the part of Singapore, according to this Agreement, the company to be protected means company, enterprise, social organisation, or institution which is formed, established or registered in the Republic of Singapore under its valid law and is irrespective of whether it is a legal person or not [Article 1, section 4 (2)]. To avoid misunderstanding, this Agreement even states explicitly that all investment should be governed by the Agreement itself and under jurisdiction of the valid laws within the territory of the signatory where the investment is made [Article 10].

24. The Detailed Rules for the Implementation of the Law of the PRC on Chinese-Foreign Equity Joint Ventures, promulgated by the State Council on 20 September 1983, CCH Austl. ¶ 6-550.

25. The Law of the People's Republic of China on Sino-foreign Co-operative Joint Ventures, promulgated on 13 April 1988.

26. The CPL, *supra* note 22.

27. "Explanation of the Supreme People's Court of the People's Republic of China on Several Issues Relating to the Application of the Law on Foreign Economic Contracts", No. 27, 1987. See *China Law and Practice*, Vol. 2, No. 4, 2 May 1988.

All such legal proceedings or arbitration procedures may be stipulated in the contracts between the parties. That is to say, Taiwanese businesses can use for business disputes resolution either the PRC law or foreign law which is applicable to and has been chosen by the contract as the governing law. During consultation, mediation, arbitration, and even litigation in people's courts, the applicable law should be used as the primary legal basis. Certainly, the applicable foreign law should not violate the basic principles of PRC law and hamper the PRC's public interest.<sup>28</sup> Furthermore, the applicable foreign law should not be used in dealing with contracts performed by EJVs, CJVs, and Sino-foreign co-operative exploitation of natural resources within the territory of the PRC.<sup>29</sup>

The contracting parties may have not chosen the applicable law in the contract in handling disputes in the PRC. Under these circumstances, both parties are still entitled to choose the applicable law even though the dispute has been sent to the PRC arbitration organs or People's Courts. If the parties fail to reach agreement, the applicable law should be applied in the light of the Principle of Closest Connection under private international law (see p. 281). As for the choice of trial courts, the contracting parties of "shewai" cases may choose courts located in a place which has a practical connection with the dispute. This choice may be made through a written agreement, and should not contravene the regulations of both exclusive jurisdiction and level of trial court stipulated in the 1991 CPL of the PRC. In regard to choice of arbitration agency, besides selecting the CIETAC located in Beijing, Shanghai and Shenzhen, the "shewai" economic contract may equally

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28. See supra note 24-27.

29. Supra note 27.

select an arbitration agency in the country of the foreign party or in a third country.

To summarise, Taiwanese businesses investing in the PRC via a foreign third country are regarded as having a legal relationship between the PRC and the foreign third country. Here the foreign third country does not include the jurisdiction of Hong Kong and Macao. For example, if a Taiwanese business establishes a subsidiary in a third country such as Singapore, Japan, or Britain and then invests in the PRC in the name of that subsidiary, a *de facto* legal relationship arises between the PRC and the relevant country where the subsidiary is located. Unless Taiwanese businesses set up branch offices in a third country or apply for themselves to be recognised as "foreign" businesses, they are still *de facto* Taiwanese businesses in law when they invest in the PRC. Under such circumstances, the status of these Taiwanese businesses is regarded as one of quasi-foreign businesses in the PRC. They are what are so-called Taiwanese investors in the PRC, but not *de facto* foreign businesses.<sup>30</sup>

We must also examine the status of those Taiwanese businesses which invest in the PRC via Hong Kong and Macao. According to the 1990 Provisions of the State Council on Encouraging Investment by Overseas Chinese and Hong Kong and Macao Compatriots of the PRC, relevant foreign economic laws and regulations may be applicable, in addition to those provisions applicable in the PRC.<sup>31</sup> These businesses enjoy the same treatment as foreign businesses. As a result, Taiwanese businesses which

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30. See art. 1, *supra* note 18.

31. See art. 5, Provisions of the State Council on Encouraging Investment by Overseas Chinese and Hong Kong and Macao Compatriots of the People's Republic of China, promulgated in August 1990, see Dominique T. Wang, *China's Foreign Trade Law*, Taipei: National Taiwan University Law School Press, 1992, p. 44.

invest in the PRC via Hong Kong and Macao are basically similar to those which invest via a foreign third country as stated above. However, in the practice of handling economic cases, these Taiwanese businesses seem to be treated in the same way as Taiwanese investors rather than foreign investors in the PRC. They are given similar treatment to the *de facto* Taiwanese businesses operating in the PRC.

#### 7.2.2 Status of Taiwanese Businesses in Practice

Though the status of the Taiwanese businesses varies in "shetai" economic cases in the PRC, Taiwanese businesses are in fact popularly known as "Taiwanese investors" in the PRC. As long as they can prove this status, they can enjoy preferential treatment, but at the same time they will suffer discrimination for being "Taiwanese". In order to encourage their so-called Taiwanese compatriots to invest in the PRC, the State Council not only gives them the same treatment as it does to foreign investors but also gives additional preferential treatment such as in forms of investment, extended term of investment, special approval of investment, tax reduction and exemptions, entry and exit permits, and so on.

However, both Taiwan and PRC contracting parties may have chosen the applicable law or jurisdiction of forum and the arbitration organ in settling disputes arising out of such economic contracts. According to the opinions of the PRC Supreme People's Court, the choice of the applicable law, jurisdiction of forum and arbitration organ should be based on that of the contracting parties. That is, both contracting parties can choose only the law, trial court, and arbitration agency of either the

PRC or in the areas of Hong Kong and Macao, but not Taiwan.<sup>32</sup>

Though Taiwanese businesses engage in economic activities indirectly via Hong Kong, Macao, or other foreign countries, they are regarded as "shetai" economic activities in the PRC. The PRC People's courts treat such economic cases in the same way as they do "shewai" or "shegang'ao" (Hong Kong and Macao related) economic cases. These cases should be dealt with according to the regulation of foreign economic laws of the PRC. This principle should also be followed for economic cases concerning those *de facto* Taiwanese businesses engaged in their economic activities directly in the PRC. That is to say, the applicable law, trial court and arbitration organ of Taiwan should be chosen in handling Taiwan-PRC economic cases.

### 7.3 Establishing Taiwan-PRC Joint Mediation and Arbitration

As noted earlier, "shetai" economic cases have been treated as one part of the PRC's foreign economic cases. According to the practice of international business transactions, consultation, mediation, arbitration and litigation are all used to varying degrees in business disputes resolution.

#### 7.3.1 Rules for Resolving "Shetai" Economic Cases

Under PRC law, contracting parties should faithfully and justly perform their responsibilities in line with the provisions of the contract when it has been signed. If the provisions are ambiguous or have

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32. Ibid., art. 20; supra note 18, art. 20; supra note 14, Article 246; and supra note 15.

oversights and omissions, a dispute may occur and need to be settled between the contracting parties. According to the PRC 1985 Foreign Economic Contract Law (FECL), the methods of such dispute resolution for economic cases include consultation, mediation, arbitration, and litigation.<sup>33</sup> Since the PRC favours bilateral resolution of such disputes, the first three of these are particularly important in practice for maintaining a friendly relationship and mutual confidence between the parties. The resolution of disputes arising from "shetai" economic cases in the PRC is no exception to this.

At present, the PRC is still a socialist country with a centrally planned economy. In order to attain national economic objectives, the PRC first promulgated the 1982 domestic Economic Contract Law<sup>34</sup> (ECL) and then the 1985 FECL. There are two separate different procedures and forums of jurisdiction for resolution of contractual disputes in the PRC.<sup>35</sup> For example, Article 48 of the ECL stipulates that:

If disputes over an economic contract arise, the parties shall promptly resolve them first through consultation. If consultation is not successful, any party may apply to the contract administration authorities specified by the State for mediation or arbitration, and may also directly bring suit in the people's courts.

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33. Art. 37, FECL, adopted on 21 March 1985, CCH Austl. [ 5-550.

34. The domestic Economic Contract Law of the People's Republic of China was adopted at the Fourth Session of the Sixth National People's Congress on 13 December 1981. The Law has been amended by the standing committee of the Eighth National People's Congress on 2 September 1993. For an English text, see *China Law and Practice*, 18 November 1993, pp. 40-48. This Law only applies to contractual relations between the PRC legal persons which mostly are the PRC domestic business entities.

35. See Dominique T. Wang, *supra* note 21, pp. 801-888.

In contrast, Article 37 and 38 of the FECL stipulate that:

When contractual disputes arise, the parties should do everything possible to resolve them through consultation or through third party mediation. If the parties are unwilling to consult or mediate, or if consultation or mediation is not successful, they may, in accordance with the arbitration provisions in the contract or a written arbitration agreement reached after the dispute arose, submit the dispute to a PRC arbitration organ or another arbitration agency for arbitration.

If the parties did not conclude any arbitration provision in the contract, and also did not reach a written arbitration agreement after the dispute arose, they may bring suit in the people's courts.

It can be seen that it is unnecessary to have arbitration provisions or a written arbitration agreement in accordance with the ECL for arbitration of economic contractual disputes.<sup>36</sup> There are many differences in the approach to arbitration between ECL and FECL. As far as procedures are concerned, the methods of settling contractual disputes under the FECL are more flexible than those of the ECL. However, in Article 257 of the PRC Civil Procedure Law, it is stated even more clearly that disputants involved in disputes relating to foreign trade, foreign economic relations, international transportation or maritime accidents may not bring a lawsuit in the people's courts if arbitration provisions have been provided in the contract, or if a written arbitration agreement has been reached after the dispute arose and was put to a PRC arbitration agency or another arbitration agency for arbitration.<sup>37</sup> On the other hand,

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36. Supra note 34, art. 49. Regarding the arbitral award, if one party or both parties do not agree with the arbitration, it or they may, within fifteen days from the date of receipt of the arbitral award, bring suit in the people's courts; if suit is not filed within that period, the award shall become legally effective. Such provisions are different from arbitration of contractual disputes in the FECL.

37. Supra note 26, art. 257.

the contracting parties may bring suit in the people's courts if there are no arbitration provisions included in the contract or no written arbitration agreement has been reached after the dispute arose.

The status of Taiwanese businesses in the PRC is comparable with that of foreign or Hong Kong and Macao businesses. All these Taiwanese businesses in the PRC also fall within the jurisdiction of the FECL. The disputes resolution for "shetai" economic cases in the PRC is dependant on the above-mentioned methods of consultation, mediation, arbitration and litigation. After Taiwanese businesses are set up in the PRC, they obtain the capacity of PRC legal persons just as do the foreign businesses or Hong Kong and Macao businesses. As a result of the change in the legal status, economic contracts signed between parties of these Taiwanese businesses or between one Taiwanese and one PRC party are governed by ECL and not by the FECL. All contractual disputes should be resolved in line with ECL, not the FECL. In contrast, economic contracts signed between these Taiwanese businesses and foreign, Hong Kong and Macao, and other Taiwanese businesses which have not set up in the PRC, are subject to the FECL and not ECL. These types of contractual disputes should be resolved in accordance with FECL and corresponding laws.<sup>38</sup>

### 7.3.2 Feasibility of Establishing Taiwan-PRC Joint Mediation and Arbitration Systems

In resolving Sino-foreign economic disputes, the practices referred to as joint mediation and arbitration systems were created as useful methods for settling "shewai" economic cases. Starting between 1977 and 1979, these systems were created when the PRC's Foreign

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38. Supra note 27.

Economic and Trade Arbitration Commission and the United States' Arbitration Association jointly mediated various trade disputes between the two countries. As required by both parties, arbitration agencies from both countries agreed to offer joint mediation. In such a contractual dispute about international trade, the mediators appointed by arbitration agencies from both countries helped the parties to reach agreements to their mutual benefit. The PRC, in its foreign trade practice, had for the first time accepted the jurisdiction of a foreign arbitral institution, in the United States.<sup>39</sup>

In 1978, the PRC Maritime Arbitration Commission and the Japanese Maritime Arbitration Commission signed the Protocol of Settling Sino-Japanese Shipping Disputes by Arbitration. This settlement initiated a form of joint arbitration for economic cases in the PRC.<sup>40</sup> Afterwards, several agreements on joint mediation for dispute resolution have been signed between the PRC and foreign countries.<sup>29</sup> Generally speaking, joint mediation is conducted at the request of the contracting parties and is carried out jointly by mediators appointed by both PRC and foreign arbitration agencies. The mediators from both sides can mediate face to face or through letter or telex to enable them to reach unanimous agreement.

Regarding the effectiveness of joint mediation, a PRC jurist Yao Yi pointed out:

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39. See Pitman Potter, "Resolving Contract Disputes", *The China Business Review*, Sept. - Oct. 1984, p. 21. United States and the People's Republic of China Agreement on Trade Relations, signed on 7 July 1979 and became effective on 1 February 1980.

40. The author was informed of this by Song Dihuang, an Arbitrator and Deputy Chief of Secretariat of PRC Maritime Arbitration Commission, in his address for the Chinese Legal Practitioners' Group at the School of Oriental and African Studies (University of London) in early 1993.

29. See Dominique T Wang, *Supra* note 9, p. 805-806.

Since joint mediators appointed by both parties are from different social, economic and legal backgrounds, their understanding of such disputes may differ and thus cause the disputes to remain unresolved. Moreover, as joint mediation lacks corresponding legal effectiveness, both parties are in no position to enforce the mediation agreements through people's courts. This is based on the circumstances that both parties do not perform voluntarily their duties laid down by the mediation agreements.<sup>42</sup>

However, since joint mediators are appointed by separate Sino-foreign arbitration agencies, they should be readily trusted by the parties and therefore be more convincing in mediation work. Furthermore, the different legal concepts and commercial customs of the contracting parties have to be considered in order to reach mediation agreements smoothly. Given this, the PRC had several agreements on joint mediation with the United States, Japan, France, Italy, and Germany.<sup>43</sup> A joint mediation system was thereby established by 1979 in the PRC and since then it has been widely noted in settling "shewai" economic disputes.

The emerging issue is whether "shetai" economic disputes can be settled by such joint mediation or even by means of a joint arbitration system. Alongside the development of an economic relationship between Taiwan and the PRC, "shetai" economic cases in the PRC will probably increase considerably. According to PRC's China Council for the Promotion of International Trade (CCPIT), the PRC is willing to consult and mediate all such "shetai" economic disputes through various means in order

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42. See Yao Yi, "Shilun Shewai Jingji Maoyi Zhengyi de Lianhe Tiaojie Zhidu" (Talk on Joint Mediation System Concerning Foreign Related Economic Disputes), *Zhongguo Faxue* (China Legal Study), vol. 1, 1990, p. 90 et seq.

43. *Supra* note 41.

to promote the Taiwan-PRC relationship.<sup>44</sup> This can be compared with the existing Sino-foreign models of joint mediation. This potential joint mediation could be established by an agreement between Taiwan's SEF and PRC's ARATS. In these circumstances, a joint Taiwan-PRC Arbitration system may be expected to come into being. As for the details arising from such joint mediation and arbitration system, these can be further discussed after the establishment of a framework for Taiwan-PRC dispute resolution.

Faced with such complicated "shetai" economic and legal relationships, a joint mediation and arbitration agency particularly should be established for handling of "shetai" economic cases while retaining existing ways of settling disputes between Taiwan and the PRC. These "shetai" economic disputes should be interpreted in a broad sense so as to include all Taiwanese businesses trading and investing in the PRC. In other words, the joint mediation and arbitration agency should enjoy jurisdiction over all "shetai" economic cases. Its jurisdiction over "shetai" economic cases is envisaged as subject to both PRC's domestic Economic Contract Law and Foreign Economic Contract Law.

It is necessary to avoid the tendency of failing to settle disputes due to defective mediation or through the ineffectiveness of enforcement under the systems of joint mediation and arbitration. The cure for such weakness is to give written rulings to endow joint mediation and arbitration with powers to settle economic disputes.<sup>45</sup>

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44. The author was informed of this by a CCPIT official in Beijing in May 1992 while carrying out interviews in the PRC.

45. Art. 36, 37 and 38 of the 1988 Arbitration Rules made by the China Foreign Economic and Trade Arbitration Commission (FETAC) under the CCPIT, see China Economic News, 31 Oct. 1988, pp. 8-9; and 7 Nov. 1988. Also see art. 49 and 52 of the ECL, supra note 34; and art. 6, FECL, supra note 33.

The written rulings should have the same effectiveness as if given under the framework of the New York Convention (the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards). That is to say, if one contracting party fails to perform its duty, the other party can bring a lawsuit either to the PRC trial courts in accordance with the PRC laws or take it to a foreign (including Taiwan) court which has jurisdiction in accordance with the New York Convention or other relevant international conventions acceded to by the PRC.<sup>46</sup>

#### 7.4 Prospects for Signing Taiwan-PRC Agreements Related to Commercial and Judicial Assistance

Since the PRC has not formulated any legislation similar to Taiwan's Mainland Relationship Statute (TMRS), many legal problems cannot be justly and fairly solved. Given this, investment protection and judicial assistance agreements should be concluded between Taiwan and the PRC. In 1992, the PRC established diplomatic relations with the Republic of Korea (South Korea) and signed four relevant agreements.<sup>47</sup> Such a concept and model is worthy of being carefully considered and consulted by both Taiwan and the PRC.

Furthermore, in early 1995, both the PRC and Taiwan agreed with each other to let their respective agencies, the ARATS and SEF exchange drafts of a proposed agreement on repatriation of hijackers. The two bodies even had

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46. See art. 269, CPL, *supra* note 22, p. 869.

47. See BBC: Summary of World Broadcasts (London), 1 October 1992. The PRC and South Korea signed on 30 September 1992 four agreements which are the Bilateral Investment Protection Agreement, the Bilateral Agreement on the establishment of Economic, Trade and technology Joint Commission, the Bilateral Trade Agreement, and the Bilateral Agreement on Scientific and Technological Cooperation.

worked out the framework of an agreement on sending back nationals who entered each other's territory illegally, and an agreement on ways of dealing with fishing disputes.<sup>48</sup> Such developments cannot be seen as anything less than a clear step along the road which, barring unforeseeable disruption, seems likely to lead eventually to *de facto* accommodation acceptable to both sides.

#### 7.4.1 Investment Protection Agreement between Taiwan and the PRC

In addition to private law for the resolution of business disputes, investment protection agreements are stipulated by public international law for settling investment disputes. In order to protect the interests of Taiwanese businesses in the PRC, any related disputes need to be appropriately resolved. The models of investment protection agreements concluded between international communities can be used for reference regarding Taiwanese investments in the PRC. This investment protection agreement could well be negotiated and reached by the responsible agencies such as Taiwan's SEF and PRC's ARATS.

Both Taiwan and the PRC should reach agreement on the following provisions: fair and just treatment, most favoured treatment (not lower than the treatment enjoyed by investors from a third country), compensation for damages, protection of intellectual property rights, transfer or remittance of investment or profits, solution of claims for compensation by investors' agents and investment disputes, agreement on settling disputes between the contracting parties, and so on. In so doing,

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48. Se *Asian Bulletin* (Taipei), Vol. 20, No. 3, March 1995, p. 24.

the domestic protection legislation can be remedied or strengthened.

#### 7.4.2 Judicial Assistance Agreement between Taiwan and the PRC

The models of international judicial assistance agreements can be adapted for Taiwan-PRC economic relationships. The separate responsible agencies like SEF and ARATS can negotiate to facilitate such agreements between the two. This aim of this would be to give mutual recognition and enforcement to the court judgements or arbitral awards of economic cases made by the separate trial courts or arbitration agencies of Taiwan and the PRC.<sup>49</sup>

#### 7.5 Conclusions

Taiwan is the fourteenth largest trading economy in the world. Overall trade expanded in 1994 when exports reached US\$93 billion and imports US\$85.3 billion, up by 9.4 per cent and 10.8 per cent respectively. The trade surplus continued to shrink (by 4 per cent compared to the previous year's 17 per cent) and amounted to US\$7.7

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49. See Article 74 of Taiwan's Mainland Relations Statute (TMRS) of 1992. The author interprets it as:

Civil law judgements and civil law arbitration decisions rendered in the Area of Mainland China that do not run counter to the public order and moral traditions of the Area of Taiwan may be given recognition by a judicial ruling upon application.

The judgements or decisions given recognition by judicial ruling referred to in the preceding paragraph which involve payments may be duly enforced.

At present, the PRC still has no clear legislation governing this issue.

billion.<sup>50</sup> At the same time the regional distribution of trade and the sources of the surplus continued to tilt towards Asia, and the PRC in particular.

Indirect trade with the PRC, mostly via Hong Kong, accounted for 9.3 per cent of Taiwan's total trade in 1994 (up from 8.54 per cent in 1993).<sup>51</sup> Hong Kong/the PRC is Taiwan's fastest growing market and is soon expected to be Taiwan's largest export market. Taiwan limits the range of imports from the PRC to a list of basic raw materials and semi-finished goods, but the list is growing faster and imports from the PRC increased by 83 per cent in 1994.<sup>52</sup>

Behind the growing indirect trade with the PRC is a steady flow of investments there by Taiwanese companies. According to a recent estimates, there are now between 15,000 and 20,000 Taiwanese projects worth a total of at least US\$12 billion.<sup>53</sup> These were initially low technology, labour-intensive operations that moved out of Taiwan in order to continue exporting to the overseas market, especially the United States of America. More recently however, the Taiwanese have poured capital into higher technology capital-intensive goods and services aimed at the domestic PRC market, and in 1994 Taiwan officially approved projects worth US\$888 million. These figures may understate the full picture.<sup>54</sup>

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50. All these statistics are based on data replies to a questionnaire used by the author from officials of Taiwan's Board of Foreign Trade, the Ministry of Economic Affairs in May 1995 in Taipei.

51. Ibid.

52. Ibid.

53. The author was informed of this from Taiwan's Straits Exchange Foundation in 1995 while carrying out interviews with officials there.

54. Ibid.

As a result, Taiwan's international trade is becoming heavily the PRC focused, so that a growing portion of Taiwan's GNP is derived from business with the PRC. There is undoubtedly potential for foreign and Taiwanese companies to exploit the PRC market jointly by combining advanced Western technology with Taiwanese financial strength, and Taiwanese negotiating and marketing knowledge.

With reference to intricate "shetai" business disputes in the PRC, the TMRS should advance the views and solutions offered by Taiwan, and which call for a response by the PRC.

In "shetai" business dispute resolution, the PRC's existing legal system basically excludes the use of Taiwan laws, and also rules out any possibility of mediation, arbitration and litigation made by courts or arbitral agencies located in Taiwan, far less making mention of recognising and enforcing their judgements or arbitral awards. This is discrimination against Taiwanese businesses based on the difference separating them from foreign or Hong Kong and Macao businesses.

The development of an economic relationship between Taiwan and the PRC is based on the principles of equality, mutual trust and benefit. Except by mutual recognition as independent political entities, there is no way of properly handling "shetai" business disputes in the PRC. As in East-West Trade, the principles of private international law should be respected. And only by using more models of various investment protection and judicial assistance agreements signed between international communities, can the Taiwan-PRC economic relationship be soundly improved, once agreements like these are in place.

The practice of discriminating against Taiwanese businesses in the PRC on the basis of political considerations is not conducive to economic cooperation between the two communities. Under a framework of East-West trade, business dispute resolution may be rationalised and legalised between Taiwan and the PRC, though neither still recognises the other. Establishing a joint mediation and arbitration system can certainly further mutual benefits, and develop a relationship of total economic trust between Taiwan and the PRC. Lengthy political enmity should not and need not continue to be a hindrance to the blossoming of commercial interaction and economic interdependence.

Although there are few indications of the emergence of a legal *modus vivendi*, those to whom such a goal is dear may be justified in drawing a measure of hope from this study.

APPENDIX I: Major Events Affecting Taiwan-PRC Economic Relations since 1949.\*

Year	Taiwan	PRC
1949	Retreat of the Nationalist government to Taiwan.	Establishment of the People's Republic of China.  Military attack on Jinmen.
1950	Announcement of decision for reconquest of mainland.  U.S. Seventh Fleet in Taiwan Straits and U.S. military and economic aid to Taiwan.	
1954	Mutual defense agreement with the U.S.	Artillery bombardment Jinmen.
1955		Announcement of desire for peaceful liberation of Taiwan.
1957		Announcement of conditions for peaceful settlement with Taiwan.
1958		Artillery bombardment of Jinmen.
1962	Emphasis on reconquest of the mainland by political means.	
1971	Loss of United Nations seat.	Admission to the United Nations.
1972		Shanghai Communique with the U.S.
1978	Government regulations stipulate that, except for Chinese medicinal herbs and industrial materials imported through Hong	Liberation of Taiwan included in constitution.  Call for trade

\* This is based on replies to a questionnaires used by the author, and on other data collected by him in the course of fieldwork in China and Taiwan (1992, 1994). Interviews were conducted in Mandarin, and subsequent compilation, editing, and translations were also by him.

Year      Taiwan

PRC

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	Kong, all other goods from the mainland will be confiscated by customs officials.	with Taiwan.
1979	Termination of mutual defence agreement with the U.S.	Establishment of diplomatic relations with the U.S.
	Government announces "Three-No policy" (No contact, no negotiation, and no compromise); direct trade with the mainland is forbidden.	Artillery bombardment of Jinmen stopped.  Call for three links (mail, transport, trade) and four exchanges (economic, cultural, technical, sport) with Taiwan.  The Government proclaims the Temporary Regulations Governing Developing Trade Relations with Taiwan.
1980		The Government promulgates the Supplementary Regulations Governing Taiwan Products, ruling that no tariff is applicable if the certificate of origin indicates that goods are imported from Taiwan. In addition, the purchase of daily-use articles from Taiwan is encouraged; purchase orders of goods from Taiwan are given priority.
1981		Non-tariff rule on Taiwan goods is cancelled and replaced by an adjusted tariff.  An favourable

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		discount for Taiwan orders is also cancelled, but exports to Taiwan and trade with fishermen at sea are encouraged.
1981		Announcement of the measures for peaceful reunification with Taiwan, also known as Ye Jianying's "Nine-point" Proposals, suggests working with Taiwan to reach a consensus on direct links; cross-Straits visits with relatives; and cross-Straits travel and academic, cultural, and sports exchanges.
1982		The Government proposes "One country, two systems" for dealing with Taiwan.  Imports from Taiwan require permit issued by Taiwan Working Group, at all levels of Taiwan Affairs Office.
1983		The State Council proclaims the Special Favourable Regulations Governing Taiwan Investment in the Four Special Economic Zones. These are later extended to include Hainan.
1984	Restrictions are relaxed on mainland products imported through Hong Kong and Macao. Private sector trade with the mainland via intermediaries is allowed.	Preferential treatment for Taiwan traders.

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| 1985  | Three principles concerning trade with the mainland through Hong Kong and Macao are announced: direct trade with the mainland is   | Purchase of consumer goods from Taiwan is restricted. Taiwan products must be centralised in and  |
| 1985  | prohibited; manufacturers cannot have direct contact with any mainland parties; the government will not intervene in trade with the mainland conducted via a third country.  | imported via Fujian or Hainan; no other provinces are allowed to import from Taiwan. This measure is later relaxed, mainly on electrical appliances and textile articles.   |
|   |  | All economic and trade agencies on the provincial and municipal levels are instructed to obtain approval before importing Taiwanese products.   |
| <hr style="border-top: 1px dashed black;"/> |  |   |
| 1987  | <p>Repeal of martial law.</p> <p>Restrictions on visits to the mainland are relaxed.</p> <p>Restrictions are lifted on the indirect import of twenty-nine categories of agricultural and industrial materials from the mainland.</p>       | <p>Import/export permit system introduced by the State Council. Permit must be authorised by the Ministry of Economic Relations and Trade (MOFERT) which is responsible for overall trade development with Taiwan. Other state agencies and the private sector are restricted from setting up trade agencies handling business with Taiwan.</p> |
| <hr style="border-top: 1px dashed black;"/> |  |   |
| 1988  | The 13th National Congress of the KMT (Kuomintang) approves a mainland policy for the current phase of relations, emphasising people-to-people contacts, indirect trade, gradual progress in relations, and maintaining Taiwan's security. | <p>The State Council announces the Provisions for Encouraging Taiwanese Investment.</p> <p>Xiamen, Fujian, issue preferential policies for Taiwan</p>   |

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	The Executive Yuan sets up the Mainland Affairs Task Force, convened by the vice premier.	investment. MOFERT adds the Department of Economic Relations
1988	The Ministry of Economic Affairs (MOEA) announces the Principles for Dealing with Indirect Importation of Mainland Products and issues a List of Items Allowed for Indirect Importation From the Mainland (a total of fifty items).	and Trade with Taiwan which being in charge of policymaking concerning trade and economic relations with Taiwan. This tightens control on policies in regard to trade with Taiwan.
	The Board of Foreign Trade, MOEA, promulgates the Important Points for Precautionary Measures Concerning Indirect Importation of Mainland Goods.	
	The customs office assumes full responsibility for dealing with illegal imports from the mainland. Minor violators are no longer punished, but the goods are refused entry.	
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1989	Forty more items are added to the List of Items Allowed for Indirect Importation From the mainland.  MOEA announces the Regulations Governing Mainland Goods which can be imported only if they do not endanger national security, have no negative effect on related industries, and help make export products more competitive.	The State Council announces new measures concerning Taiwanese investment in the mainland, offering favourable conditions to Taiwan.  The State Council approves the Fujian Province report on setting up Taiwan Investors' Districts. There are four such districts in Fujian Province. Several others are planned in Guangdong and Hainan. MOFERT restricts the number of traders

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		specialising in importing Taiwanese goods to sixty-eight. There is no limitation on export traders.
1990	<p>Another sixty-five items are added to the List of goods that can be imported from the mainland.</p> <p>The Regulations Governing Indirect Export to the Mainland Area are announced by MOEA.</p> <p>The Regulations Governing Indirect Investment and Technical Cooperation in the mainland are announced by MOEA.</p> <p>Manufacturers of 3,353 items (in sixty-seven categories) are allowed to invest in the mainland or to establish technical cooperation.</p> <p>The National Reunification Council, a non-partisan board, is established by the president in drawing up fundamental guidelines for national reunification.</p> <p>The Government approves the Statute Governing Relations Between People of the Areas of Taiwan and the Mainland (Taiwan's Mainland Relationship Statute, or the TMRS).</p>	<p>The Foreign Trade Administration under MOFERT announces a new measure that offers Taiwanese investors favourable treatment in taxation and investment categories; it also encourages land investment and development.</p> <p>At the Working Conference on Taiwan Affairs, President Yang Shangkun suggests that cross-Straits relations should focus on economic and trade exchange to promote political development, using people-to-people contact to promote official contact, and gear the development of cross-Straits relations toward reunification of the nation.</p>
1991	<p>The Mainland Affairs Council, a formal agency under the Executive Yuan, is set up for overall planning, coordination, and evaluation of government policy toward the mainland.</p> <p>Another nine items are added to the list of items allowed</p>	<p>MOFERT proposes five principles to enhance cross-Straits exchanges: exchange should be direct and two-way; be mutually beneficial; take various forms; be long-term and stable; and respect contracts</p>

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|       | for indirect importation from the mainland. The number of items allowed for investment in the mainland or for technical cooperation is increased to 3,679.  | and the spirit of justice.<br>The Association for Relations Across the Taiwan Straits is set up to counter  |
| 1991  | A semi-official Straits Exchange Foundation is set up to handle those technical and business relations with the mainland that might involve the government authority but would be inappropriate for the government to handle directly under its policy of no official contact with the mainland authorities.<br><br>The end of the Period of National Mobilisation for Suppression of the Communist Rebellion is announced by the president.<br><br>Foreign-based Taiwan fishing boats are allowed to hire mainland crew members, but non-Taiwanese crew are not allowed to make up more than one-third of the total. The mainland crew are not allowed to disembark in Taiwan. | Taiwan's Straits Exchange Foundation.   |
| ----- |   |   |
| 1992  | The Regulations Governing Mainland Goods are revised and promulgated. The Important Points for Precautionary Measures Concerning the Indirect Importation of Mainland Goods are repealed.<br><br>TMRS becomes effective.<br><br>In further relaxation of mainland trade and investment restrictions, the Mainland Affairs Council removes over 300 restrictions on private contacts with  | The Regulations Governing Chinese Citizens Travelling Between Taiwan and the Mainland are announced.<br><br>Pingtan island of Fujian Province is established as the mainland's first special district for trade cooperation with Taiwan.<br><br>The Government allows foreign businesses to invest in service |

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(continued)

	the mainland.	industries and the domestic market, opening up a broader range of categories for Taiwanese investment.
	The MOEA lifts the ban on exports to the mainland by state-owned firms in various industry sectors. Companies are allowed to apply for copyright and	
1992	trademark protection in the mainland.	
	The Mainland Affairs Council approves the first group group of service industries (158 categories) planning to invest in the mainland.	
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1993	The Regulations Governing the Entry of Mainland People Into Taiwan are announced.	The Association for Relations Across the Taiwan Straits meets with Taiwan's Straits Exchange Foundation in Singapore for the historic "Koo-Wang" talks on mutual economic exchange.
	The Regulations Governing Investment and Technical Cooperation in the mainland become effective. The former Regulations Governing Indirect Investment and Technical Cooperation in the Mainland are repealed.	The Government proclaims the Regulations Governing Small-scale Trade Between Taiwan and the Mainland, which covers trade conducted by fishing boats.
	The Straits Exchange Foundation meets with its mainland counterpart, the Association for Relations Across the Taiwan Straits in Singapore for the historic "Koo-Wang" talks on economic exchange.	
	The Government announces the Regulations Governing the Introduction of Technology From the Mainland.	
	The Regulations Governing Trade between Taiwan and the Mainland Area are promulgated, replacing the Regulations Governing	

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Indirect Export to the Mainland Area and the Regulations Governing Mainland Goods.

The Regulations Governing Taiwan Residents Entering the Mainland Area are announced.

1993 The Rules Governing Indirect Remittances to the Mainland are promulgated: business remittances to the mainland no longer have to be disguised as personal remittances.

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1994 The Mainland Affairs Affairs Council eases restrictions on the immigration of mainland people with experience in industry or commerce to stay in Taiwan for a period of time to work.

The Law on the Protection of Taiwan Compatriots' Investment is promulgated, upgrading the former Provisions for Encouraging Taiwanese Investment of 1988.

APPENDIX II: A. Taiwan-PRC Indirect Trade since 1979  
(Unit: U.S.\$ million)

Year	PRC imports from Taiwan via Hong Kong	PRC exports to Taiwan via Hong Kong	PRC trade balance with Taiwan
1979	21	56	35
1983	158	90	-68
1984	425	128	-297
1985	987	116	-871
1986	811	144	-667
1987	1,227	289	-938
1988	2,242	479	-1,764
1989	2,896	587	-2,310
1990	3,278	765	-2,513
1991	4,667	1,126	-3,541
1992	6,288	1,119	-5,169
1993	7,585	1,103	-6,482
1994	8,517	1,293	-7,224

Source: Statistics Office of Hong Kong (April 1995)

B. Major Foreign Investment in the PRC since 1979\*  
(Unit: U.S.\$ million)

Year	Hong Kong	U.S.A.	Japan	Taiwan	Total
1979-84	6,490	1,070	1,150	-	10,320
1985	4,130	1,150	470	-	6,330
1986	1,440	530	210	-	2,830
1987	1,950	340	300	100	3,730
1988	3,470	370	280	420	5,300
1989	3,160	640	440	520	5,600
1990	3,680	360	460	990	6,600
1991	6,830	550	810	1,400	11,980
1992	41,130	3,170	3,320	5,550	57,510
1993	39,250	-	-	5,200	57,500
1979-93	111,530	8,130	7,440	14,180	167,680
Percentage of total:	66.51	4.85	4.44	8.46	100.00

Source: *Zhongguo Dui Wai Jingji Maoyi Nianjian* (Almanac of China's Foreign Economic Relations and Trade), 1994.

\* The above figures do not include several other sources, e.g. Europe, South Korea, and Singapore. It is noted that a significant portion of Hong Kong investment to the PRC is generally believed to be from Taiwan. See Zhong Qin, "Liangyan Jingmao Jiaoliu", *Economic Outlook* (Taipei), Vol. 33, 10 January 1994.

### APPENDIX III:

Law of the People's Republic of China on the Protection of Taiwan Compatriots' Investment\* (Adopted by the sixth Session of the Standing Committee of the eighth National People's Congress on 5 March 1994)

#### Article 1

This law is enacted to protect and encourage Taiwan compatriots' investment and to promote economic development on both the mainland and Taiwan.

#### Article 2

This law applies to investment made by Taiwan compatriots. For matters involving Taiwan compatriots' investment that have not been stipulated in this law but in other related State laws or administrative regulations, stipulations in the latter shall apply.

#### Article 3

The State shall protect by law the investment of Taiwan investors, the return from their investment, and their other lawful rights and interests.

In making investment, Taiwan compatriots shall abide by State laws and regulations.

#### Article 4

The State shall not nationalise or expropriate the investment of Taiwan investors. Under special circumstances, according to the need of public interest, the investment of Taiwan investors could be expropriated according to legal procedure with a due remuneration.

#### Article 5

According to law, the invested property, industrial right, returns from investment, and other lawful rights and interests of Taiwan investors can be transferred or inherited.

#### Article 6

Taiwan investors can make investment in convertible currency, machinery, equipment or other objects, or industrial right, or non-patent technology.

They can re-invest the profits from their investment.

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\*. Reprinted from *China Economic News* (No. 11) 21 March 1994, pp. 6-7.

## Article 7

Taiwan investors can establish equity joint ventures, contractual joint ventures, or business solely funded by themselves (hereinafter referred to as "Taiwan investment businesses"). They can also adopt other ways of investment provided for by laws and administrative regulations.

The establishment of Taiwan investment businesses should conform to the State's industrial policies and be favourable to the development of the national economy.

## Article 8

To establish a Taiwan investment business, the investor should apply to the department or local people's government as designated by the State Council. The approval office shall approve or disapprove the application within forty five days beginning from the day it receives all the application documents.

The applicant should, within thirty days, go to the business registration office to get registered and obtain a business license beginning from the day he/she receives the approval certificate.

## Article 9

Taiwan investment businesses should operate and manage according to laws and administrative regulations, as well as to the contracts and articles of association approved by the approval office. The businesses shall have full self-decision power for operation and management without any interference.

## Article 10

In areas where Taiwan investment businesses are concentrated, associations of Taiwan investment businesses can be organised according to law, whose lawful rights and interests shall be protected by law.

## Article 11

Profits from investment, other lawful income and funds gained by Taiwan investors, can be repatriated to Taiwan or other places beyond the mainland after clearance.

## Article 12

Taiwan investors can entrust relatives or friends as their agents.

Article 13

Taiwan investment businesses shall enjoy preferential treatment according to related provisions of the State Council that encourage Taiwan compatriots to make investment.

Article 14

If disputes arise between Taiwan investors and companies, businesses, other economic organisations, or individuals in other provinces, autonomous regions, or municipalities directly under the Central Government, the parties concerned can resolve their disputes through consultation or mediation.

If the parties concerned refuse consultation or mediation, or if the consultation or mediation fails, they can submit the issue to the arbitral authority according to the arbitration clause in the contract or to written arbitral agreements if any.

If there are neither any arbitration clauses laid down in the contract nor a written arbitral agreement reached, they can bring the matter before the people's court.

Article 15

This law shall take effect on the day it is promulgated.

#### APPENDIX IV:

The Statute Governing Relations Between People of the Areas of Taiwan and Mainland China\* (Passed by the Legislative Yuan, the Republic of China on Taiwan, in July 1992 and came into force with its implementing on 18 September 1992)

Taiwan passed the above-stated landmark law which paves the way for Taiwan to expand economic and political links with the PRC. The Statute provides for Taiwan and the PRC to set up representative offices in each other's capitals for the first time since 1949. In terms of commercial activities that have rapidly flourished across the Taiwan Straits, this Statute is noteworthy for its potential impact on at least the following dimensions:

1. Individuals, legal persons, organisations or other institutions in Taiwan are required to obtain government permission before making investments, or entering into any technical cooperation projects, or conducting trade or other commercial activities with a counterpart in the PRC. The relevant regulations have been proposed by the Ministry of Economic Affairs to the Executive Yuan for enactment.

We note that the Ministry has, for expedient reasons, already taken up certain administrative measures even before promulgation of the Statute to screen manufacturing industries for investments in the PRC. For example, in August 1992, the Executive Yuan's Mainland Affairs Commission also gave the go-ahead to ten categories of service industries for indirect investment in the PRC.

2. Those who have participated in trade with the PRC before the Statute came in force without obtaining proper approval should apply for permission within three months after the permission regulations are announced; otherwise, they face a fine ranging from NT\$3,000,000 up to NT\$10,000,000.

3. Banking and insurance institutions in Taiwan as well as their off-shore branches should also obtain government permission before they engage in direct business transactions with persons or entities in the PRC or their off-shore branches. The permission regulations will be drafted by the Ministry of Finance and finalized by the Executive Yuan.

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\*. The above is edited and abridged by the author. For an English translated text of this Statute, see Ada Koon Hang Tse, "The Emerging Legal Framework for Regulating Economic Relations Between Taiwan and the Mainland", *Journal of Chinese Law* (New York: Columbia Law School, Fall 1992), Vol. 6, No. 2, pp. 179-210.

Any direct business relationship formed without prior permission will endanger the individual decision maker with criminal liability carrying a jail sentence up to three years, detention and/or fine ranging from NT\$1,000,000 up to NT\$15,000,000, with the juridical person whom such individual represents facing a fine of the same amount.

4. Individuals, legal persons, organisations and other institutions in Taiwan should obtain prior government permission to become members of or take positions in any legal persons, organisations or other institutions in the PRC, or to jointly establish or enter into alliance/affiliation with such entities. The permission regulations will be set out by the Executive Yuan.

As is widely known, quite a number of enterprises or firms in Taiwan have invested (including joint ventures) in the PRC and despatched personnel thereto before the promulgation of the Statute. Any individuals, legal persons, organisations or institutions involved in investment activities in such a fashion need to apply for permission within three months after the permission regulations take effect; otherwise, they will be subject to a fine ranging from NT\$100,000 up to NT\$500,000.

5. Applications for recognition of corporate status submitted by a foreign company in which more than 20% of the shares are held by individuals, legal persons, organisations or institutions in the PRC may be denied; or the granted recognition be recalled, as the case may be. The same rule applies where the controlling shareholder of a foreign company is an individual or a juridical person, organisation or institution in the PRC.

On the other hand, individual, legal persons, organisations and other institutions in the PRC need to obtain prior government permission to become members of or take positions in any legal persons, organisations or institutions in Taiwan. Overseas Chinese or foreign nationals who have either made or plan to make investments in Taiwan are cautioned to pay special attention to this provision.

6. A judgement or arbitral award made in the PRC may be submitted to the court in Taiwan for judicial recognition and enforcement if not contrary to the public order or good morals of Taiwan.

7. Individuals in the PRC may be hired to work in Taiwan, provided that prior permission obtained and their employment terms cannot exceed one year and they cannot change their job or employment. The provisions set forth in the Labour Standards Law relating to the fixed-term contracts shall apply to their employment.

8. The term "individuals in Taiwan" refers to those who maintain household registration in Taiwan, whereas the term "individuals in Mainland China" means those who maintain household registration in the PRC or who come from Taiwan and continuously reside in the PRC for a period exceeding four years. By this definition, foreign nationals or overseas Chinese who do not maintain household registration in Taiwan or the PRC will not be subject to the jurisdiction of this Statute.

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China Quarterly

Far Eastern Economic Review

FBIS: Foreign Broadcast Information Service - Daily Report, China

Financial Times (London)

Free China Journal (Taipei)

International Herald Tribune

McKenna China Newsletter (Hong Kong)

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- Jingji Jianzan (Taipei) - Economic Outlook
- Jiuling Niandai (Hog Kong) - The Nineties
- Liang'an Jingmao Tongxun - Newsletter of Economic and Trade Across the Taiwan Straits
- Liaowang Yuekan (Hong Kong) - Liaowang Monthly
- Min Bao Yuekan (Hong Kong) - Min Bao Monthly

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Renmin Ribao (Beijing) - People's Daily  
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Wanguo Falü (Taipei) - Formosa Law Journal  
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and Law  
Zhongguo Fazhibao (Beijing) - China Legal News  
Zhongguo Shibao (Taipei) - China Times  
Zhongshi Wanbao (Taipei) - China Times Evening Post  
Zhongguo Dalu (Taipei) - Mainland China Monthly  
Zuigao Remin Fayuan Gongbao (Beijing) - Gazette of the  
Supreme People's  
Court

## GLOSSARY

English	Chinese	Pinyin
application by analogy	類推適用	leitui shiyong
arbitration	仲裁	zhongcai
conflicts of laws	衝突法	falü chongtu
contract	合同	hetong
consultation	協商	xieshang
county	縣	xian
decision	決議	jueyi
decree	法令	faling
foreign-related	涉外	shewai
friendly consultation	友好協商	youhao xieshang
Hong Kong and Macao-related	涉港澳	shegang'ao
joint mediation	聯合調解	lianhe tiaojie
law	法	fa
legal action	訟訴	susong
measure	辦法	banfa
mediation	調解	tiaojie
one country, two systems	一國兩制	yiguo liangzhi
one country, two entities	一國兩實體	yiguo liangshiti
one country, two regions	一國兩區	yiguo liangqu
open-door policy	對外開放政策	duiwai kaifang zhengce

order	命令	mingling
planned economy	計劃經濟	jihua jingji
policy	政策	zhengce
provision	條例	tiaoli
regulation	規定	guiding
socialist market economy	社會主義市場經濟	shehui zhiyi schichang Jingji
Taiwan-related	涉台	shetai
three links, four exchanges	三通四流	santong siliu
township	鄉(鎮)	xiang (zheng)
with reference to	參照	canzhao

