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The Legal Climate for Foreign Investment in China after its WTO Accession

Chen YongMei
chenym226@tom.com

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Abstract
A good investment climate is essential for business development and growth and therefore the legal rules which govern investment are crucial. The legal regime regulating foreign investment in China is still developing after its WTO accession. This paper discusses China's achievements in creating a positive climate for foreign investment, seeking to elucidate the challenges ahead and to explore some possible options.

Keywords
foreign investment, China, WTO, accession, regulation

THE LEGAL CLIMATE FOR FOREIGN INVESTMENT IN CHINA AFTER ITS WTO ACCESSION

CHEN YONGMEI[*]

Introduction

'Investment climate', refers to all the external elements and conditions which contribute to allowing international capital to operate effectively, function well and make a profit. It is a combination of many external elements and conditions, including natural resources, politics, economy, law, culture, education and scientific technology, as well as national conscience, psychology, historical traditions and customs.[1] A favourable investment climate encourages businesses to improve efficiency and productivity in order to increase revenues and capital available for investment. It also gives investors confidence in the market and encourages them to invest more capital.[2] But a good investment climate is not just about generating profits for firms – if that were the goal, the focus could be limited to minimizing costs and risks.[3] However, if there is

* CHEN YongMei (Hannah), PhD, is an Associate Professor in the Economic and Trade Law School of Southwest University of Political Science and Law, Chongqing. From September 2007 to April 2008, she was a visiting scholar at the Faculty of Law, Bond University, Australia. The author would like to thank Professor Duncan Bentley and Associate Professors Terry Gygar and Kay A. Lauchland for their kind encouragement. The author specially thanks Associate Professor Gygar for his comments and assistance with this paper.

1 See YAO MeiZhen, 'Comparative Study of Foreign Investment Law', *Wuhan University Press*, 1993, p.19.

2 See 'Investopedia Says', available at http://www.investopedia.com/terms/i/investmentclimate.asp

3 'A Better Investment Climate for Everyone', World Development Report, *the World Bank and Oxford University Press*, 2005, p.2.

no sound investment climate, no investment security or no guarantee of returns, then incentives and preferential tax polices will be ineffective in attracting investment.

An investment climate has both hard elements (eg, natural resources and infrastructure) and soft elements (eg, culture and law). The legal climate is a soft element and is of fundamental importance. Since investors will rely on the legal protection provided by the host government when they decide to invest in a capital importing country, there is a close relationship between investor confidence and the laws, regulations and measures implemented by the host. If a country wishes to have an attractive investment climate, it must ensure that its legal system is investor-friendly.

Any political and economic climate will be given expression by its legal systems and legal regulations. The legal climate reflects a country's basic attitude to utilizing foreign capital. The main purpose of capital flow is to make money so capital will go where it is safe and profitable. Investors can forecast the profits which they may earn and the crises which they may face by estimating, evaluating and analyzing the legal climate in a host country. That is the reason why they focus such attention on the legal rules and regulations of capital importing countries.

On December 11, 2001, after fifteen long years of formal negotiations, China became the 143rd member of the World Trade Organization (hereinafter, WTO).[4] On the one hand, China could now consult and negotiate with other WTO members and take part in the policy-making process in international trade and trade-related fields. It could now also resort to the dispute settlement mechanism if a benefit accruing to it was nullified or impaired, or

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4 See Press Release, WTO, China to join on 11 December: Chinese Taipei's membership also approved (Nov.11, 2001) (announcing that China had ratified its membership), available at http:// www.wto.org/english/thewto_e/minist_e/min01_11nov_e.htm.

the attainment of its trade objectives were being impeded because of other members' WTO-incompatible policies. On the other hand, China was obliged to reform its tariff structure, procedural requirements and domestic protection trends in investment and fulfil its commitments made in *China's Protocol of Accession to the WTO* and *Report of the Working Party on the Accession of China*. This meant that China was committed to reforming its laws, regulations, decisions, etc in order to ensure the implementation of the WTO agreements.

WTO focuses on fair trade between members. In practice, the fields WTO encompasses have been extended to investment, services, intellectual property rights and other issues far beyond pure trade. Agreements reached in the eighth round (Uruguay Round) negotiation and related to international investment are embodied in the overall requirements and also formulated in a number of specific instruments. First, the general requirements oblige WTO members engaged in international trade to comply with agreed principles regarding most-favoured nation treatment and national treatment in the investment field. Second, the *Agreement on Trade-Related Investment Measures* (hereinafter, TRIMs) regulates certain measures aimed at prohibiting or restraining international investment. Third, the *General Agreement on Trade in Services* (hereinafter, GATS) covers 'commercial presence' as one of the four aspects of service delivery.[5] Fourth, the *Agreement on Trade-Related Aspects of Intellectual Property Rights* (TRIPS) supports investment by protecting intellectual property rights. Finally, the *Agreement on Subsidies and Countervailing Measures* (hereinafter, SCM) provides

5 Commercial presence refers to a foreign company setting up subsidiaries or branches to provide services in another country - such as foreign banks operating in a foreign country. The other three aspects are cross-border supply, consumption abroad and presence of natural persons. See art 1.2, General Agreement on Trade in Services, available at http://www.wto.org.english.docs_e/legal_e?26-gats.pdf, also see http://events.streamlogics.com/wto/2004/html/018.html

that because investment incentive measures may amount to subsidies, they may, in those circumstances, be regulated. The above-mentioned agreements permeate WTO principles in the foreign investment field and influence laws and regulations in capital importing countries both directly and indirectly. With China's entry into the WTO, the legal climate for foreign investment in China has been changed to reflect these agreements and undoubtedly this process will continue.

Changes in the Legal Climate for Foreign Investment after China's WTO Accession

China has all the rights WTO grants to its members and must comply with all commitments and obligations following on its WTO accession. This has and will lead to tremendous changes in the legal climate for foreign investment in China.

Extending fields and territories for foreign investment

In terms of field of investment, the Ministry of Commerce and the National Development and Reform Commission of the People's Republic of China have jointly promulgated a guide for foreign investors, which has been published in the *Guidance Catalogue of Industries for Foreign Investment* (hereinafter, the *Guidance Catalogue*). The first *Guidance Catalogue* was released in 1995 and the further amendments became effective in 2004. The most recent revision of the *Guidance Catalogue* was promulgated on 31 October, 2007 and came into effect on 1 December, 2007. Several developments in the new *Guidance Catalogue* of 2007 will be addressed below.

Fields open to foreign investors have been further extended. There are 478 commercial activities listed in the *Guidance Catalogue* of 2007, which categorises selected industries as being either encouraged, restricted or prohibited. There are 351 industries specified as encouraged activities, an increase of 94 items over those stipulated in the *Guidance Catalogue* of 2004. Encouraged industries account for 73 per cent of the list, up from 69 per cent in 2004. The catalogue also identifies 87 industries as being restricted, accounting for 18 per cent, a decrease from 21 per cent in 2004, while 40 activities are prohibited, a decline from 9 per cent in 2004 to 8 per cent in 2007.[6]

The catalogue of restricted foreign-invested industries includes exploitation of ocean manganese nodules and sea sand (controlled by the Chinese parties), printing of publications (controlled by the Chinese parties, except for printing of advertising and similar publications), production of blood products, commercial companies such as direct sale, mail-order selling, online sale, franchise operation, sales agency and business administration, construction and operation of high-grade hotels, high-grade office buildings and international exhibition centres, setting up banks, financial, trust and investment companies, money brokerage companies, production projects for radio and TV programs and film production (limited to cooperative joint ventures), etc. The catalogue of prohibited foreign-invested industries includes prospecting, exploitation, and mineral separation of radioactive minerals, processing of traditional Chinese medicinal materials listed in the "*Regulations on Protection of Wild Medicinal Materials Resources*" and the "*Name List of China's Rare and Endangered Protected Plants*", production of products causing cancer or abnormalities, or permanent organic pollutants, conducting social surveys, construction and operation of natural reserves and important international wetlands, establishment of compulsory education institutions, education institutions in special fields such as military affairs, police, politics, etc.

6 See Press Release, available at http://www.mofcom.gov.cn/article/zhengcejd/bm/200712/20071205276415.html

Transparency of foreign investment polices is enhanced. The areas the Chinese Government committed to open when it applied for access to the WTO and the ratio of foreign shareholders that are allowed are all listed in the *Guidance Catalogue* of 2007. The catalogue therefore contributes to transparency by clearly indicating the group into which each industry will fall, thereby clarifying which policies and regulations are relevant to them. This makes the relevant instruments easy to ascertain and access, so facilitating foreign investment.

Domestic innovation and upgrading of industrial structure are encouraged. In order to promote domestic innovation and to upgrade the national industrial base, foreign investment is encouraged in modern agriculture, high-tech industries, modern service industries, cutting-edge manufacturing and infrastructure. Furthermore, the Ministry of Science and Technology and Ministry of Commerce jointly promulgated *the Catalogue of Encouraged High-Technology Product for Foreign Investment*. It lists the products that China urgently needs to develop as well as the products in which there is a big gap between China and the rest of the world in terms of technology and equipment. Hence, apart from *the Guidance Catalogue of Industries for Foreign Investment*, foreign investors should also consult this catalogue when making investment decisions in China.[7]

Energy-saving and environmentally-friendly industries are encouraged. In order to promote the more effective use of resources, environmental management and sustainable development, the *Guidance Catalogue* of 2007 encourages industries in the area of clean production technology, recycling resources, ecological environment protection and the comprehensive utilization of resources.

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7 See Vai Io Lo and Xiaowen Tian, 'Law and Investment in China', *RoutledgeCurzon*, 2005, pp.96-98.

Coherent development across regions is encouraged. The eastern and coastal regions of China were the first areas opened to the world, whereas the western, central and northeastern regions are relatively underdeveloped. The general list of industries in which foreign investment is encouraged applies to all of China, while other industries which are specifically encouraged in central and western regions, and northeastern traditional industrial regions are laid out in *the Catalogue of Encouraged Foreign Invested Industries in the Central and Western Regions of China* and its amendments.

China particularly encourages investment in underdeveloped regions. For example, the framework for developing western regions was established at the first 'western region development seminar' in October, 2000, sponsored by the central government. The government determined to improve infrastructure significantly, improve the investment climate, allow more market access for foreign investment and attract expert personnel to western regions. In order to achieve this, the *Notice on Policy Measures to Promote Western Region Development* was promulgated by the State Council in 2000 and those policy measures came into force on 1 January, 2001.

The Notice includes, inter alia, measures to expand foreign investment access to service industries and increases the number of areas in which foreign investment in banking, retail and foreign trade corporations was permitted so as to include municipalities directly answerable to the central government, eg, Chongqing. It also allows foreign banks to conduct business in Renminbi (Chinese currency) when deemed appropriate and allows foreign investor access to telecommunications, insurance, tourism, accounting firms, project design companies, cargo transportation companies, municipal public companies and other companies which China committed to open under the WTO agreement.

More diverse methods of investment, changes in management teams, transfers of shares and mergers and acquisitions were also permitted in western regions in those industries on the list.[8] Further, on 29 November, 2001, the *Catalogue of Encouraged Foreign Invested Industries in Central and Western Regions* was announced. The catalogue provides that 255 encouraged industries in central and western regions are to be granted special incentives. The industries listed in the catalogue enjoy privileges according to the preferential policies specified in the *Provisional Rules on Directing Foreign Investment and the Notice on Further Encouraging* Foreign Investment, which were issued by the Ministry of Foreign Trade and Economic Cooperation [9] and endorsed by the General Office of the State Council. These policies and measures, such as exempting foreign firms from enterprise income tax for the first few years and allowing foreign investors land rent concessions, are designed to create a favorable investment climate for foreign investors in the central and western regions of China.

Developing foreign investment laws in China

China joined the WTO as an enormous, largely untapped market and in the process of transition from a planned economy to a 'socialistic market economy'.[10] There is no uniform investment code in China. Detailed investment laws and regulations are made by different legislative organs at the national, provincial and municipal levels. *The Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures, the Law of the People's Republic of China on Chinese-foreign Contractual Joint Ventures, the Law of the People's*

8 See LIU XiangShu, 'Macro-analysis on Several Legal Issues of Utilizing Foreign Capital in Western Region Development', *Jurist*, Issue 2, 2001, p.21.

9 The Ministry of Foreign Trade and Economic Cooperation was replaced by the Ministry of Commerce in March 2003.

10 A socialistic market economy has been described as a market economy with socialistic characteristics.

Republic of China on Wholly Foreign-Owned Enterprises and their implementation measures provide the national framework for the regulation of foreign investment. These laws and regulations were amended just before China's WTO accession. Changes and developments in these laws and regulations are the focus of the following discussion.

Foreign exchange balance requirements

Previously, foreign exchange balance requirements restricted an enterprise's access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise. Before 2001, all foreign capital enterprises in China had to meet these requirements. Since this is prohibited in the Annexes to TRIMs,[11] China's amendments cancelled the requirements which were inconsistent with these rules. This was not controversial because China's economy already had the capacity to cancel foreign exchange balance requirements because of the increase in foreign exchange deposits and the continuation of development in foreign trade in recent years.

Also Article 5 of the *Regulations of the People's Republic of China on Foreign Exchange Control* states:

> The State shall not restrict the payment in and transfer of foreign exchange for current international transactions.[12]

Therefore foreign exchange for current international transactions in China is no longer subject to restrictions. Foreign exchange needed for the purchase of raw materials and spare parts and the payment of salaries, share interests and profits could be withdrawn from the

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11 See annex of the *Agreement on Trade-related Investment Measures*, available at http://www.wto.org/english/docs_e/legal_e/18-trims.doc

12 See art 5, *Regulations of the People's Republic of China on Foreign Exchange Control, a*vailable at http/://www.isinolaw.com/isinolaw/english/detail.jsp?iscatalop=

foreign exchange accounts of enterprises or processed through domestic banking arrangements.

Local content requirements

In the past, certain local content requirements required enterprises to purchase or use products of domestic origin or from a domestic source. This reflected discrimination against imported products. Also, before 2001, foreign capital enterprises were required to give priority to Chinese products in their purchase of raw and semi-processed materials, fuels, auxiliary equipment, etc.

Such measures are prohibited under Article 2 of TRIMs and article 1(a) of the Annex to TRIMs, but China had already cancelled these rules prior to its WTO accession.[13] Any domestic law or administrative ruling which requires the purchase or use by an enterprise of products of domestic origin or from a domestic source is specifically prohibited under TRIMs. This applies whether the requirement is specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.[14] China's pro-active approach shows its determination to conform to both the spirit and letter of the WTO. Now foreign capital enterprises are free to purchase raw materials, fuels and other materials needed for their approved business in the free market either in China or externally.

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13 See art 10.1, *Decision on Revision of the Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures*, promulgated by the National People Congress on 15 March, 2001, and art 15, *Decision of the Standing Committee of the National People's Congress on Revising the Law of the People's Republic of China on Foreign-owned Enterprises*, promulgated by the Standing Committee of the National People Congress on 31, October, 2000, available at http://www.isinolaw.com/isinolaw/english/statutes.jsp

14 See art 2, *Agreement on Trade-related Investment Measures* and art 1, annex of the *Agreement on Trade-related Investment Measures,* available at http://www.wto.org/english/docs_e/legal_e/18-trims.doc

Export performance requirements

In the past, export performance requirements obliged foreign capital enterprises to export either the whole or a specified percentage of their products and treated export of products as a pre-condition to the establishment of a foreign capital enterprise. Article 2 of TRIMs and article 2(a) of the Annex to TRIMs prohibit export performance requirements based on a percentage of either the value or volume of local production.[15] The October 2000 amendments cancelled the export performance requirements in compliance with the TRIMs agreement.[16]

These policies also supported the Chinese Government's objectives by encouraging foreign capital enterprises in order to help the development of its national economy. However, these measures also have the effect of encouraging export-oriented and technologically advanced foreign capital enterprises, as foreign capital enterprises are no longer restricted as to how they sell their products. Companies can decide for themselves to sell their products either in China or on the world market. In so doing, they may sell their export products on foreign markets directly or through associated agencies or through China's foreign trade agencies. Their products may also be sold on the Chinese domestic market. Enterprises have the right to sell their products wherever they can find a willing market, and this is a basic requirement of a market economy, such as that to which China has committed itself by joining the WTO.

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15 Ibid art 2, annex.

16 See art 3.1, *Decision on Amendment of the Law of the People's Republic of China on Wholly Foreign-owned Enterprises*, promulgated by the Standing Committee of the National People Congress on 31, October, 2000, available at http://english.mofcom.gov.cn/

Other amendments

In addition to the restructuring discussed above, other changes have also been implemented. For example, the production and business operating plans of foreign capital enterprises were formerly required to be reported to the competent authorities for recording.[17] This was the product of a planned economy. In the amendments before China's WTO accession, all these requirements were cancelled. The government of China now focuses on the regulation of the macro-economy and no longer involves itself in these areas of the operation and management of enterprises. Enterprises are obliged to conduct their operations and management in accordance with the general law but are free from any other interference.

Challenges ahead

As is shown above, in the field of investment, legislative organs at different levels in China have amended laws, regulations and by-laws related to foreign investment pursuant to the new obligations under the WTO rules. Since WTO accession, the legal climate of foreign investment in China has been significantly improved, but there are still challenges facing China which require practical solutions.

Market access in service industries

Developed and developing countries alike have become more actively engaged in service delivery industries since the 1990s. The Uruguay Round identified and compiled all tradeable services into a systematic and progressive liberalisation package under the

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17 See art 9.1, the Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures, promulgated by the National People Congress on 4 April, 1990, and art 11.1, the Law of the People's Republic of China on Foreign-owned Enterprises, promulgated by the National People Congress on 12 April, 1986, available at http://www.google.com

auspices of a General Agreement on Trade in Services (GATS) within the WTO multilateral trading system.[18]

'Commercial presence'[19] is one of the four modes of delivery which are addressed in GATS and has a close relationship with investment. In China, there are stringent restrictions on foreign investors regarding access to service industries, especially in the telecommunications, finance and insurance fields. 'Encouraged items'[20] in service industries are limited. In addition, methods of review vary from province to province and procedures for review are complicated and lack transparency.[21] These factors impose barriers on foreign investors wishing to engage in service industries in China.

Both international agreements and transnational business realities have vastly expanded the global free market in telecommunication and financial services. On February 1997, the agreement, *Negotiations on Basic Telecommunications* was concluded, expanding freedom in global telecommunication. On December 1997, the *Negotiations on Financial Services Agreement*, which extended the free market to 95 per cent of global financial services, was successfully concluded. Despite this background, China still seems to be cautious in these fields. China's service industries are generally less competitive and this is the main reason that the Chinese Government seeks their protection. But China cannot avoid facing the challenges of the free market in telecommunications, financial services and other service industries.

How can China approach this problem? A three step approach would seem logical:

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18 M Rafiqul Islam, 'International Trade Law of the WTO', *Oxford University Press*, 2006, pp.342-343.

19 See above N 5.

20 See above page 5.5-5.7.

21 See CHEN YiXi, 'International Trade Law in Service', *Fudan University Press*, 1997, pp.170-171.

First, the scope of access should be extended gradually. As discussed above, China has amended the *Guidance Catalogue* for foreign investors as its economy has developed.[22] The most recent amendments were made in December 2007. The continued support of the Chinese Government for economic openness and the pace of economic development indicate that further amendments will be made in the near future and at regular intervals thereafter. The basic principle of these amendments is to extend encouraged foreign investment, and at the same time, reduce prohibited and restricted areas.

Second, access conditions and procedures should be simplified. The structures of foreign capital enterprises and the ratio of foreign shareholders should not be restricted unless the Chinese Government has declared specific exceptions in specially designated industries. It may be necessary for the review process to be regulated but that responsibility should be exercised by a single regulatory agency rather than the multiple levels of provincial and regional regulations which inevitably lead to complexity and confusion. The criteria for review should be transparent and, where possible, mere registration regimes could, in most cases, replace requirements for specific individual approvals.

Third, available exceptions are sufficient to protect national security and cultural interests without the need for China to impose further specific provisions. For example, action considered necessary for the protection of essential security interests relating to the supply of services is exempted. Action carried out directly or indirectly for the purpose of provisioning a military establishment or taken in time of war or other emergency in international relations, etc. is also protected. These exceptions are also preserved by other WTO members and are permitted by WTO rules.[23]

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22 See above page 5.5.

23 See WANG XinKui, 'World Trade Organization and Developing Countries', *Shanghai Yuandong Press*, 1998, pp.192-196.

Treatment of foreign investment

National treatment is one of the principles in the WTO. The General Agreement on Tariffs and Trade (hereinafter, GATT) requires equal treatment for both imported and domestic products. Therefore internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, as well as internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, may not be applied to imported or domestic products so as to afford protection to domestic production.[24]

In GATS,[25] national treatment is addressed by specific commitments, requiring that each Member accords treatment no less favourable than that it accords to domestic suppliers of service, to services and service suppliers of any other Member.

However, foreign capital enterprises can still receive preferential treatment under the laws and regulations related to foreign capital enterprises in China, particularly in the areas of establishment, operation, management and taxation. Tax has been the main focus of preference clauses, with local governments having less demanding policies for foreign investors in order to attract capital. This leads to a loss of government revenue and, more importantly, it induces unfair competition between foreign capital enterprises and domestic capital enterprises. Furthermore, it encourages foreign investors to seek out and negotiate with different provinces for the best preferential policies, resulting in disorder in management and lack of transparency in regulations and rules. Preferential policies attract more foreign capital but often at the cost of tax outflows and damage to the environment.

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24 See art 3, *General Agreement on Tariffs and Trade*, available at http://www.wto.org.english.docs_e.legal_e.gatt47_01_e.htm

25 *The General Agreement on Trade in Services.*

While the TRIMs agreement prohibits some investment measures which would distort the trade in goods, it is not comprehensive in its coverage. Listed in the annex of prohibited measures in TRIMs are measures regarding local content, foreign exchange balance requirements, foreign exchange utilization restrictions and local sale requirements.[26] No Member can take any of the above measures in relation to foreign capital enterprises resident in its territory because those measures are inconsistent with the provisions of Article III (National Treatment) or Article XI (Quantitative Restrictions) of GATT 1994. It is apparent that the prohibited investment measures in TRIMs are those which might restrict trade and trade-related investment, but there is no strict prohibition on measures which encourage investment, such as tax preferences. In theory, measures to encourage investment are not prohibited in TRIMs, but we cannot avoid the fact that TRIMs is an agreement which tries to prohibit all measures which may distort the trade in goods.

In the TRIMs negotiation process, there was disagreement between members as to what kind of investment measures should be prohibited. Developed members, (eg, the United States of America) had a different attitude towards preferential policies from that of less developed countries. Before the Uruguay Round negotiations, the USA called for the inclusion of investment incentives such as tax preference in the Annex of TRIMs, but was not successful because of compromise and other complicated reasons.[27] Amongst academics, there is also an opinion that all investment measures which may distort the trade in goods, no matter whether they promote or restrict trade, should be prohibited or regulated by TRIMs. They assert that the ultimate aim of TRIMs is to regulate all investment measures which may distort the trade in goods.

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[26] See *Annex of Agreement on Trade-Related Investment Measures*, available at http://www.wto.org/english/docs_e/legal_e/18-trims_e.htm

[27] See XIA Sen, CHU XiangYing, 'Dictionary of General Agreement on Tariffs and Trade', *Foreign Trade Education Press*, 1993, p.190.

The final outcome remains to be negotiated and the whole field of investment incentives is attracting increased international attention. It is possible that the regulation of incentives may eventually be resolved by subsidiary agreement.

In China, under some preferential tax policies, foreign capital enterprises can enjoy a package of preferential policies in income tax, domestic tax refunds, tariffs, and value-added taxes in the process of import.[28] Investment incentive measures will not be prohibited by TRIMs, but they may be treated as subsidy measures.

Under SCM,[29] a subsidiary agreement under WTO, subsidies, contingent in law or in fact, will be prohibited if they are placed upon export performance, or upon the use of domestic over imported goods either solely or as one of several other conditions.[30] If these investment incentive measures fall into the scope of banned subsidies in SCM, they will be prohibited.

China must comply with all the agreements it has ratified, including TRIMs, SCM, or other trade related treaties. The preferential treatment of foreign capital enterprises may have attracted more foreign investors but this approach had not been argued as being in breach of WTO rules until this possibility arose under SCM. However, these incentives violate the fair competition principles of a market economy, discriminate against domestic capital enterprises and put them at a competitive disadvantage. Though they may initially attract foreign involvement, as domestic expertise and capital emerge, unequal competition only perpetuates unfairness in market outcomes and has an unfavourable influence on the long term development of domestic industries.

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28 See FANG Dong, 'Analysis on influence of WTO accession to foreign tax preferential polices', *Probe to International Economy and Trade*. Issue 2, 2001, p.44.

29 *The Agreement on Subsidies and Countervailing Measures.*

30 See art 3, *Agreement on Subsidies and Countervailing Measures*, available at http://www.wto.org/english/docs_e/legal_e/24-scm_01_e.htm

National Interests

It is submitted that foreign investment in China should be governed by economic realities and international treaties, but that national sovereignty and internal policies still have an important role to play.

First, all enterprises should be treated equally, which is consistent with the principle of 'national treatment' in the WTO. However, when national policy seeks to encourage investment in a particular sector or geographic area, domestic investors who meet the requirements and conditions set forth by a capital importing country should also be able to benefit from preferential policies as determined by the host. These preferences will usually be granted according to the industries or territories the government seeks to develop, but all enterprises which agree to establish in these areas should be treated equally regardless of their ownership. Therefore, policies designed to encourage these forms of investment should be available to both domestic and international entrepreneurs. This should not be controversial, as it would support the accelerated investment objectives which such measures are designed to achieve.

Second, in the field of investment, national treatment should be distinguished from market access. The former refers to the treatment granted to foreign capital enterprises after they enter into the market of a host country, while the latter refers to when and how foreign capital enterprises are permitted to enter into the market. Pursuant to the national treatment obligation, a WTO member is not allowed to discriminate against foreign products, services and service suppliers which are operating in their country, but a WTO member does have the right to decide whether foreign capital enterprises should be permitted to participate in its domestic market.

For the trade in services, the national treatment obligation applies only to the extent a WTO member has explicitly committed itself to grant access to those specific service sectors in the host country. Market access for services is not automatic under the WTO. Such commitments to give access to the domestic market are made in a Member's Schedule of Specific Commitments on Services.[31] The nature and extent of the access allowed are strictly a matter of choice for members, who can stipulate particular aspects and areas of concern and the subsequent manner in which they propose that these issues be dealt with.[32] When necessary, access may be restricted in order to protect a Member's national security and cultural interests. Usually, market access will be dealt with through bilateral and multilateral negotiations.

Conclusions

The New Legal Climate in China

Access to the WTO promotes China's policy to reform its economy and open up to world competition. It also benefits China by the implementation of a market economy. After its WTO accession, China has been entitled all the rights the WTO grants to its members and is obliged to implement all the obligations to which it has committed. Inevitably, market access in investment has been expanded in China. Therefore, in order to implement compliance with WTO rules, China had amended the Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures, the Law of the People's Republic of China on Chinese-foreign Contractual Joint Ventures, and the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises respectively, which were the national framework for the regulation of foreign investment before it formally became a Member of the WTO. These amendments are an active step which demonstrates China's

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31 See Peter Van den Bossche, 'The Law and Policy of the World Trade Organization', *Cambridge University Press*, 2006, pp.40-41.

32 M Rafiqul Islam, 'International Trade Law of the WTO', *Oxford University Press*, 2006, pp.360-361.

determination to comply with WTO rules and have significantly improved the legal climate for foreign investment in China.

The opening of China to international investment calls for higher standards and requires the drafting and implementation of better investment laws and regulations. The Chinese Government has made the commitment to treat resident foreign enterprises no less advantageously than domestic firms. Foreign capital enterprises will be accorded 'national treatment' after they enter into the domestic market and any preferential policies should be granted to all qualified enterprises regardless of their ownership. At the same time, China has reserved the right to decide the nature and extent of market access for foreign investment in the trade in services.

Challenges and Options

As China proceeds on this path of massive change from a demand economy to a global free market, it faces significant challenges in opening up its domestic markets to foreign investment and participation. These include major issues concerning market access and protection of national sovereignty.

As it faces the challenges of meeting its WTO obligations to open domestic markets, China is still developing policies to address the problems which this inevitably brings. It requires a determined effort to achieve this objective, but the scope of access must be both measured and gradual or it may cause unacceptable disruptions to domestic industries unused to the fierce and sophisticated competition which will inevitably follow. At the same time, the complex and confusing conditions and procedures which previously governed foreign business inflow must be simplified and made more consistent across the country. This can only benefit both China and prospective investors.

The treatment of foreign investment interests is, as yet, neither uniform nor always well thought out. With various provinces and regions all seeking to attract foreign business, there is a real danger that bigger investors will seek to 'auction' their involvement between the regions to get the best concessions and advantages. If this continues, doing business in China will become even more complex, with provinces losing massive potential revenues in the scramble for foreign capital and smaller and less sophisticated foreign participants will be significantly disadvantaged both in what incentives they can negotiate and also in trying to navigate a maze of differing schemes. There is a real and urgent need for the regulation of incentives between cities and regions in China to achieve uniformity and predictability and to protect China's national interests. Failure to do this may also result in more powerful international interests calling for intervention under TRIMS or SCM to eliminate these market distortions, with results that may not be in the interests of either all investors, or the Chinese people.

China's national sovereignty concerns regarding foreign involvement have so far been adequately addressed by the WTO exemptions and associated bilateral and multilateral agreements. However, in the drive for modernity, China must remain very conscious of its core social, historical and strategic interests and not sacrifice them for apparent short term gains. Some of the urban projects which have been allowed to vandalize historical areas have already demonstrated that constant vigilance will be required. Foreign interests must also be very conscious that China is an ancient land with much to be proud of. It will continue to do many things in its own Chinese way. Western companies which hope to be successful in China must resist any temptations towards economic and cultural imperialism and be relaxed and flexible when these issues arise. A failure in this area is the reason why many otherwise excellent prospective partners have departed from China bewildered and sometimes bitter.

Chinese domestic lawyers must quickly build up their expertise and sophistication in order to meet two major challenges. First, to assist governments at all levels in the development and implementation of adequate legal regimes which advance the WTO objectives, and also protect Chinese domestic interests. Secondly, they must build up their expertise both individually and in substantial domestic law firms, or they risk being outmanoeuvered by the very experienced foreign lawyers who will be seeking to gain commercial advantages for their clients.

Foreign lawyers who understand the modernization process in China and appreciate both the complexities and opportunities that are present in this new environment will be strongly positioned not only to assist their western clients, but also to establish strong relationships in China based on mutual understanding.