Leaky Technology

The new law on foreign-owned enterprises will give the foreign investor complete control over its technology and will hopefully alleviate current anxiety about possible technological leakages.

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China needs economic cooperation in any form. Although the rest of the world needs access to the Chinese market this access is not possible unless the goods are produced in China. Experience of the past few years has shown that different forms of economic cooperation have been devised. There are at present three main forms of economic cooperation:

- Joint venture – the most popular and widely used. There are around 2,300 of such structures.
- Cooperative venture – this includes compensation trade where technology is used to process imported materials with a view to exporting the finished goods either through buy-back or direct sales overseas.
- Wholly-foreign-owned enterprise – where the technology imported and management remains under the complete control of the foreign investor. The foreign investor can raise further capital by borrowing from the Chinese financial agencies.

The new law relates to the establishment, conduct and control of the last mentioned form of cooperation. It is an important addition to the economic legislation of the People's Republic of China and will certainly lure more foreign investment. The law will also cultivate further the mutual understanding required for the promotion of trust and sharing equally the benefits of the economic partnerships. The new law was adopted on 12 April 1986 at the Fourth Session of the Sixth National People's Congress.

Some foreign investors had expressed their anxiety about leakage of their technology through the previous two forms of economic cooperation. The new law gives the foreign investor complete control over the technology and alleviates the anxiety about possible leakage.

The law also enables the foreign investor to market all or most of his goods with effective control of costs, organization and methods.

The law describes this type of investment as 'wholly-foreign-owned enterprise' (hereinafter referred to as enterprise) and has the following features:

- The proposed establishment of the enterprise must be conducive to the development of China's national economy. It appears that the word 'conducive' implies that the investment should relate to such projects which are not saturated industries. It may not include establishment of banks, insurance companies, and industries involving national defence.
- The law guarantees that China shall not nationalize or expropriate the enterprise. This is stated in very clear and explicit terms.
- Foreign firms, other economic entities and individuals can apply to set up the enterprise. Setting up of branch offices is not covered by the term 'wholly-foreign-owned enterprise'.
- Business of the enterprise will be subject to the approval of the State Council or by the department in charge of foreign economic relations and trade or by authorities so empowered by the State Council.
- The authorities in charge of the administration of industry and commerce are given the power to inspect and monitor the investment situation of the enterprise. This includes reporting of all major changes in its corporate structure, mergers and transfers for record.
- The books of accounts are required to be set up and kept in the PRC where an independent audit will be required to be conducted for submission of all fiscal documents.
- The operations and management of the enterprise are promised freedom from interference. Full decision-making power is given to the foreign investor but the enterprise will be subject to the local Chinese laws in labor and employment matters.
- Although the enterprise may purchase raw materials, semi-finished materials, fuels and other materials from the world market, the law requires that preference be given to Chinese sources.
- The new law provides similar tax reductions and exemptions and preferential treatment to be enjoyed by the enterprise as are presently given to enterprises in China's special economic zones and the 14 open coastal cities. China already has an agreement with the UK on tax concessions.
- The legitimate profits, any other lawful earnings and any fund may be remitted abroad after payment of tax in accordance with Chinese law.
- The enterprise is expected to provide its own foreign exchange. The Chinese authorities will assist in eliminating any imbalance in the enterprise's foreign exchange only if the enterprise, with the approval of the Chinese authorities markets its quality goods in China and suffers an imbalance as a result.
- Chinese labor laws are to apply in respect of employment, dismissal, remuneration, welfare, labor protection and worker's insurance.
- The law mentions the appointment of certain departments to be in charge of wholly-foreign-owned enterprises. It would appear that these departments will assist the enterprises to overcome any difficulties rather than acting in any supervisory role.
- The duration of the enterprise has to be approved by the authorities in charge of examination and approval upon application by the investor. It would seem that similar duration will be acceptable to the Chinese as is applied in other Sino-foreign joint ventures i.e. 10 to 30 years extendable to 50 years in special circumstances. There is no prohibition in fixing the duration and it may even be more than 50 years.
- 'Timely' notification is required to be given for the termination of operations. Pending the completion of termination the foreign investor may not dispose of the assets of the enterprise except for the purpose of liquidation. After the completion of termination the enterprise is required to nullify its registration and return the business licence to the authorities in charge.
- Detailed rules and regulations for the implementation of the law will follow and will come into effect after approval by the State Council. It is expected that the rules will be promulgated before the end of 1986.

About the author:

Mr Ajmal Hameed is a lawyer based in London who has extensively spoken and written about Chinese legal developments. He is the current President of the Lawchina Society and has chaired several seminars on Chinese law.

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