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# **FDI Regimes in the Chinese Triangle**

A thesis

submitted in partial fulfillment of the requirements

for the Degree of Master of laws

at the

University of Waikato

by

**Yucai Wang**

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## ***Abstract***

The existence of regimes on foreign direct investment (FDI) in the Chinese triangle (China, Hong Kong and Taiwan) is one of the most important elements that promote rapid FDI inter-flows and economic integration within the triangle. The economic policies and FDI inter-flows are leading to their regimes harmonize with international standards. Cultural backgrounds and ideological conflicts have an impact on shaping legalism towards their FDI regimes. Their FDI regimes also reflect the interaction between market and government.

As their domestic markets being oriented toward a bigger and more competitive international market, FDI regimes in the triangle need to be, at least, harmonized with each other and with international standards. Learning from East Asian countries' past examples of rapid economic growth and recent lessons of financial crisis, governments within the triangle need to improve their FDI regimes to support the Chinese triangle to be more dynamic and harmony.

In this thesis, after exploiting the backgrounds of FDI regimes in the triangle, I first compared the systems and effects of FDI regimes in the Chinese triangle, then analyzed their integration and harmonization trends. In conclusion, both market mechanisms and government strategies can and have played an important and effective role in the triangle in building regimes to attract FDI inflows to support their economic development and integration with each other. Meanwhile, as part of their legal systems that belong to three major different legal systems in the world, the integration and harmonization of FDI regimes in the triangle could be a useful preparation for the harmonization of international investment law.

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## *List of Abbreviations*

- ADB: Asian Development Bank
- APEC: Asian-Pacific Economic Cooperation
- ARATS: the Association for Relations across the Taiwan Straits (PRC)
- Chinese Triangle/Triangle: PRC, ROC and Hong Kong
- CJVs: contract joint ventures
- EC: European Community
- EJVs: equity joint ventures
- FDI: foreign direct investment
- FIEs: foreign investment enterprises
- GATS: the General Agreement on Trade in Services
- GATT: the General Agreement on Tariffs and Trade
- HKSAR/ HK/ Hong Kong: Hong Kong Special Administrative Region
- IBRD/ World Bank: the International Bank for Reconstruction and Development
- MNEs: Multinational Enterprises
- MOFTEC: the Ministry of Foreign Trade and Economic Cooperation
- NAFTA: North American Free Trade Area
- NIEs: New Industrialized Economies (HK, Taiwan, Singapore and South Korea)
- TNCs: Transnational Corporations
- PRC/ China/ Mainland China: the People's Republic of China
- ROC/ Taiwan: the Republic of China
- SEF: the Straits Exchange Foundation (ROC)
- SEZs: special economic zones
- SOEs: state owned enterprises
- TRIMs: the Agreement on Trade-Related Investment Measures
- TRIPs: the Agreement on Trade-Related Aspects of Intellectual Property Rights
- WFOs: whole foreign owned enterprises
- WTO: World Trade Organization



# FDI Regimes in the Chinese Triangle

Yucai Wang

## ***1. Introduction: the Asian Century and FDI regimes in the Chinese triangle***

Countless commentators assert that, if the twentieth century was the century of America, the next century will be that of Asia and the Pacific. As if to herald and symbolize the coming ascendancy, the stroke of midnight on 30 June 1997 saw millions of people around the world glued to their television sets as the colonial flags came down in Hong Kong and the flag of the People's Republic of China was raised. This was at once a telling political and cultural transition. But it was also a legal one. Power, legal power, passed peacefully from one civilization to another; from a European nation surrendering the last major remnant of its empire in Asia to a newly confident Asian power of global importance.<sup>1</sup>

In the last 40 years, historically significant economic growth has taken place in Asia and has made Asia an attractive region for foreign direct investment (FDI) flows in the global market. In the 1990s, world geopolitics is increasingly shaped by the dynamism of Asian economies. The "Asian economic miracle" embraces firmly the Chinese triangle which includes the People's Republic of China (PRC, China or Mainland China), Hong Kong Special Administrative Region (HKSAR, HK or Hong Kong) and the Republic of China (Taiwan or ROC). The remarkable economic growth performed of the triangle over the past decades has been accompanied by a significant increase in mutual interdependence and co-operation among the

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YUCAI WANG: Lawyer and Associate professor, the Department of Management Studies, Xi'an Petroleum Institute, the People's Republic of China. This thesis was prepared to fulfil partially the requirements for the LLM degree at the University of Waikato, New Zealand.

constituent economies, through regional trade and investment flows. FDI inter-flows in an important part of these flows. Foreign direct investment

involves the transfer of tangible or intangible assets from one country into another for the purpose of use in that country to generate wealth under the total or partial control of the owner of the assets. It is contrasted with portfolio investment where there is a movement of money for the purpose of buying shares in a company formed or functioning in another country, the distinguishing element being that in portfolio investment, there is a divorce between management and control of the company and the share ownership in it.<sup>2</sup>

In addition, there is increasing interaction and interdependence of FDI regimes within the triangle and made it a dynamic economic region for FDI inflows in the world economy. “[T]he inter-Chinese communities provide perfect networks for flows of finance, management and technology, besides huge market and investment opportunities.”<sup>3</sup>

As demonstrated by the development experiences of Asian countries, the economic performance of a country depends on its ability to acquire and allocate economic resources efficiently. Such resources, which may be developed domestically or attracted from overseas, include capital, technology and infrastructure, as well as human and natural resources. The right choice of FDI policies by governments, which depends on their individual domestic history and cultural background, can contribute to their economic growth and development.

Today, within the world business environment, there is a increasing trends of regional integration and global harmonization<sup>4</sup> which in turn is opening up opportunities for FDI flows’ interdependence and FDI regimes’ harmonization. Regional blocs such as European Community (EC), North American Free Trade

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1 Kirby, M. “Foreword” in Tan, P. (ed.) *Asian Legal Systems* (1997) Foreword.

<sup>2</sup> Sornarajah, M. *The International Law on Foreign Investment* (Melbourne, Cambridge University Press, 1994) 4.

<sup>3</sup> Lees, F. & Liaw, T. *Foreign Participation in China’s Banking and Securities Markets* (1996) 414.

<sup>4</sup> In this thesis, I use the term of “harmonization” to refer to regime’s harmony, especially for international level of harmonization of different legal systems; while the terms of “integration” and “unification” for regional level with “integration” on economy and regime, but “unification” on sovereignty.

Area (NAFTA), Asian-Pacific Economic Co-operation (APEC), and international organizations such as World Trade Organization (WTO) and World Bank are two major forces actively promoting and facilitating FDI regimes' integrating regionally and harmonizing globally.

Realizing that FDI is an engine for economic growth, China, Russia, and Eastern Europe have introduced market-oriented reforms welcome FDI inflows since the end of Cold War. Other market economy countries are also making policy adjustments to attract FDI to promote their domestic economic growth and international competitiveness. With this competition to attract economic resources, markets are getting globalizing and regimes are becoming harmonizing.

Given the strong trends towards integration and harmonization at regional and global levels which is reflecting increased FDI flows accompanied with trade flows, what should be the role of governments? Are they only bystanders, or can they play a positive role to lead and guide FDI in their domestic market and to harmonize their FDI regimes with international standards? An analysis of the roles assumed by governments in the experiences in the Chinese triangle can provide a basis for answering these questions.

A review of the relevant current literatures indicates that several contrastive answers to these questions have been proposed. Some favor active government intervention while others thought government should play a hands-off role to rely upon market mechanism operating. These answers have been derived from either developing countries' experiences with out foresee that they might be developed in the future, or developed countries' experiences while missing out the transformation process from non-market to market economy. In addition, countries' institutional framework is influenced by their cultural, historical and ideological backgrounds. Therefore, there is a need to address the above questions of economic development and institutional construction in a bigger historical and international context.

To analyze the FDI linkages within the triangle, regime effects on FDI inter-flows and their harmonization with international standards is the object of this thesis. However, to discuss detailed FDI regulations, such as business registrations; labor management; requirements on environment, accounting and auditing; financing,

banking and foreign exchanging; contracts and technology transfers and etc., is not my desire in this thesis.

## **2. Background**

Since the middle of the 1980s, the economies of Hong Kong and Taiwan have been increasingly influenced by economic growth in China. Integration of the three economies had begun, and will continue.

Trade and FDI flows within the Chinese triangle have acquired a strong inter-regional character. During the period of 1980-1992, Hong Kong's re-export that links with China increased at 33% each year. Since 1985, trade across the Taiwan Strait increased at more than 30% each year. By 1992, realized FDI from Hong Kong and Taiwan in China had reached US\$ 212 billion, which represented as 61.4% of the total amount of realized FDI in China. China is now Hong Kong's third largest source of FDI.<sup>5</sup>

Meanwhile, Taiwan has become the second largest FDI source in China. In 1997, Taiwan's FDI in China had reached 36,000 projects, real investment amounted US\$ 166 billion (compared with US\$ 3.5 billion in 1991). In that year, within Taiwan's growth rate of 6%, about 2% came from trade and investment activities across Taiwan strait.<sup>6</sup> It was observed that "Taiwan's economy and that of the adjoining provinces of mainland China [such as Fujian] are fast becoming integrated, with flows of capital and technology overwhelming political barriers."<sup>7</sup>

FDI is important for both domestic and export industries within the triangle. Ethnic investors from HK and Taiwan have dominated FDI flows into China, the FDI inter-flows within the triangle follows with comparative advantages and the "Wild Pagoda Phenomena" which describes an international product cycle, based on comparative advantage, in which leader countries or regions passed on patterns of production to follower countries or regions as the former capital deepened, their cost in labor and nature resources increased. Moreover, the rapid increase of FDI inter-flows within the triangle is based on its backgrounds as following.

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<sup>5</sup> Ferris, "The Economy" in Smart, P. and Halkyard, A. (eds.) *Trade and Investment Law in Hong Kong* (1993) 36.

<sup>6</sup> "Business persons in the triangle called for co-operation" *Mandarin Times*, #356, 1997.

<sup>7</sup> Abegglen, J. *Sea Change* (1994) 91 & 117.



## 2.1 Culture background

### 2.1.1 Monism and collectivism

Not like Western culture that is a pluralism and individualism one, Chinese culture is a monism and collectivism one. So, by Chinese tradition, it is easy for governors to regulate individuals' behaviors by ethic instead of law. But as regarding to a market economy age, there are more selfish than righteousness on individuals' behaviors, so general laws or rules are called for to serve as criteria for market competitions.

Not like Western ethic which is an individual-oriented and rights-oriented one and developed from "multiple centers of economic power with which the government may need to negotiate,"<sup>8</sup> Chinese ethic is a family-oriented and obligations-oriented one and developed from agriculture countries, and which had become the deep foundation of today's society. This difference result in that the Western law system emphasizes on property law or civil law (adjust function) but traditional Chinese law system emphasizes on criminal law (punishment function). The criminal characterized legal system in China lasted until the 1980s.

The elevation of law over politics is very new in China and the extent to which it is to be taken seriously is not always clear to the Chinese involved. The Chinese official and the Chinese citizen are part of a political structure in which the Party's will and policies have long been the most effective law. They are also part of a bureaucratic hierarchy, which is traditionally personalized and nepotistic, in which your superior's friendship and approval are as important as your legal position.<sup>9</sup>

These kinds of culture backgrounds easily leads to authoritarianism, whether Old Authoritarianism as in China at Mao's time, or New Authoritarianism as in most East Asia countries. It also leads to the importance of developing relationships and

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<sup>8</sup> Cooter, R. "The Rule of State law and the Rule-of-Law State: Economic Analysis of the Legal Foundations of Development" (1996) *Annual World Bank Conference on Development Economics* 191, 212.

<sup>9</sup> Tay, A. & Leung, C. "The Relation Between Culture, Commerce and Ethics" in Tay, A. & Leung, C. (eds.) *Greater China: Law, Society and Trade* (1995) 7.

connections (Guanxi) to exchange favor in such society. From this point of view, Chinese culture is a harmony-oriented one.

International competition in army force is weakening; international competition in economic is carrying on; international competition in culture will come. As a result, “‘global century’ should be anticipated with open institutional and cultural competition begins to mirror the competition in goods and services”.<sup>10</sup> If this hypothesis can be improved, the trends of integration and harmonization will be stronger in the triangle.

### **2.1.2 Confucianism and Taoism**

By history, China was not a private law-oriented culture. “Chinese law was preeminently public law; penal law on the one hand, administrative rules on the other.”<sup>11</sup> “Personal relationships, and the moral duties tied to such relationships, were elevated above abstract impersonal laws of rights. This view of society lies at the heart of Confucianism, the state-supported philosophy.”<sup>12</sup> Emperors of course welcomed this kind of theories.

[T]he emperor had exclusive power to make law, which all officials and subjects had to obey strictly. Law was thus a regulatory tool of the emperor, rather than a means of protecting citizens against the state or resolving private disputes, both of which are considered functions of law in modern Western legal thought.<sup>13</sup>

Confucianism emphasizes on individuals’ harmony, through their behavior or manner in the society. However, it is only the surface of traditional Chinese culture that based on the greater harmony philosophy -- Taoism. Without Taoism, the deep root of Chinese culture will be missed.

The primary Chinese religion, or philosophy, is Taoism, which was founded by Lao Tzu and outlined in the book of *Canon on Tao and Virtue (Tao Te Ching)*.

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<sup>10</sup> Lingle, C. “The end of the beginning of the ‘Pacific century’? Confucian corporatism and authoritarian capitalism in East Asia” (1996) 9(3) *The Pacific Review* 189, 406.

<sup>11</sup> Haley, J. *Authority without Power: Law and the Japanese Paradox* (1991) 20.

<sup>12</sup> Tay, A. “People’s Republic of China” in Tan, P. (ed.) *Asian Legal Systems* (1997) 15.

<sup>13</sup> Wang, T. “Taiwan” in Tan, P. (ed.) *Asian Legal Systems* (1997) 129.

*Tao*, or “the way”, has three overlapping meanings. First, it can be known only through mystical insight. Second, it refers to the ordering principle behind the universe or all life, and it represents the rhythm and driving force of nature. Third, humans should order their lives to be in balance with the universe.

*Power* [or virtue], the second element in the book’s title, refers to the belief that a person gains power by leading a life that is in harmony with the dictates of the universe. This approach continues to shape the Chinese character and is manifested in the desire to achieve a state of serenity and grace.<sup>14</sup>

“A predominant principle of the traditional Chinese conception of law has been the belief in a cosmic order of the universe, involving an interactive relationship between heaven, earth and men.”<sup>15</sup> This had been clearly stated by Lao Tzu: Individual follows the laws of earth; Earth follows the laws of heaven; Heaven follows the laws of Tao; Tao follows the laws of its intrinsic nature.<sup>16</sup>

Taoism is the root of traditional Chinese culture and Confucianism is only the surface of traditional Chinese culture. However, both Confucianism and Taoism put emphasis on harmony, harmonizing with other social members, with social environments, with nature and the universe as a whole.

Moreover, “the Confucian master-pupil model was applied to the relationship between government and industry,”<sup>17</sup> and also affected their FDI regimes. This is reflected in their internal ideologies, un-law costumes, and even some of written law and regulations.

### **2.1.3 National concept and individuals**

Chinese people have an admirable national consciousness that based upon the harmony of family and state rooted in their culture value. By Chinese tradition, family should take responsibility for its family members, and the state, as the biggest

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<sup>14</sup> Gannon, M. *Understanding Global Cultures* (1994) 327.

<sup>15</sup> Cruz, P. *Comparative Law in a Changing World* (1995) 201.

<sup>16</sup> Lao, Z. *Canon on Tao and Virtue*, Chapter 25, in Shi, J. (ed.) *Selected Readings From Famous Chinese Philosophers* (1988) vol. 1. 37.

family, should take responsibility for its social members in respects of defence, political stability, economic development policy and so on.

Individuals' or even regions' fates are depended upon their social context rather than themselves. For example, the extraordinary growth of the South China regional economy is due to the "Economic reform and Open-door policy" of the state. Three "special economic zones" (SEZs) were established in Guangdong province to attract HK and other overseas investment; another SEZ was established in Fujian province to welcome Taiwan and other overseas investment. "At the same time, government investment was greatly increased in the area to build a minimum infrastructure to support increased investment."<sup>18</sup> All of this is planed by the state, the biggest family, rather than just its local members' own desire.

Looking through East Asian nations, it can be said that family businesses dominate the corporate sector in countries that are influenced by Chines culture. This again attests the core value of family in Chinese culture. "The largest problem of the family company in the contemporary period, however, is its difficulty in developing strategic approaches to the marketplace which requires company owners to sacrifice personal control."<sup>19</sup>

As a rationale remedy, governments have to play more important roles in these countries. This is a major reason why governments in Chinese culture influenced countries play more important role in their economic growth and social development. At some extent, it looks like similar to parents' responsibility in a family. As there are flaws on the market mechanism, Governments' positive activities are called for to make public policies that have clear economic objectives for the nation and serve as guidelines for business behaviors. So,

It is impossible to understand the regulatory framework of many of the countries in the region without appreciation the planning and administrative process and the deference shown by politicians, banks, managers, employees, and consumers.<sup>20</sup>

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<sup>17</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 33.

<sup>18</sup> Abegglen, J. *Sea Change* (1994) 85.

<sup>19</sup> Bierling, J. & Murray, G. "The emerging Powers: China, Singapore, Hong Kong and Taiwan" (1995) 43(1) *Current Sociology* 65, 80.

<sup>20</sup> Gutterman, A. & Brown, R. *Commercial Laws of East Asia* (1997) 15.



## 2.2 Market background

### 2.2.1 International situation changes

Looking over the big picture of international economic environment the liberalization of trade and investment after-War on the one hand, and the regional economic blocs on the other are the external impulses for the increase of FDI flows in the triangle.

There are two critical differences between trade and FDI as cross-border transactions. First, trade does not normally imply any movement in resources and capabilities; second, unlike trade, FDI implies no change in ownership or control. ... In general, anything that raises cost or taxes and lowers revenues in one location tempts a firm to produce in another location; anything that lowers cost or its net tax burden or increases revenue has the opposite effect.<sup>21</sup>

Comparative advantages of low cost of labor and other resources in a global market environment, attracted international businesses to wherever costs is low and efficiency is high. "When rising costs exceed productivity gains, production facilities will migrate to areas where greater profit opportunities are available."<sup>22</sup> It had been noticed that while Asia is a dynamic attractive region in global market, the international competition and diffusion of comparative advantage are increasing. "Hence, the likelihood of one country becoming the recipient of FDI from another depends on: the degree of (dynamic) complementary between the resource endowments of both countries."<sup>23</sup>

Luckily taken the after-war international climate of liberalization of trade and investment, new industrialized economies (NIEs, which includes HK, Taiwan, Singapore and South Korea) started from import substitution strategy in 1950s and then transited to export promotion strategy in 1960s and achieved successful

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<sup>21</sup> Dunning, J. "The global economy, domestic governance, strategies and transnational corporations: interactions and policy implications" (1992) 1(3) *Transnational corporations* 7, 12.

<sup>22</sup> Lingle, C. "The end of the beginning of the 'Pacific century'? Confucian corporatism and authoritarian capitalism in East Asia" (1996) 9(3) *The Pacific Review* 189, 398.

<sup>23</sup> Jackson, S. & Markowski, S. "The Attractiveness of Countries to Foreign Direct Investment" (1995) 29(5) *JWT* 159, 164.

economic growth. "By the early 1970 to mid 1980s the NIEs were approaching full employment and wages had begun to rise",<sup>24</sup> which made them difficult to compete internationally in labor intensive exports further more. "They began to move into more higher value added products which required more skill and more capital such as electronics components, semiconductors and light manufacturing."<sup>25</sup>

This process created a niche in labor intensive manufacturing into "Asian Four" (Thailand, Malaysia, Philippine and Indonesia), China and other Asian countries. The comparative advantage changes produced the "Wild Pagoda Phenomena" in Asia. It describes the continuous growth, beginning with Japan in the 1950s, spreading to the NIEs in the 1960s, to China and Asian Four in the 1980s and to Vietnam and India in the 1990s. Meanwhile, the FDI "shift in interest toward Asia was reinforced by the low rate of return on investment in industrial countries during the long recession which began in 1990."<sup>26</sup>

Let us take the investment relationship between Taiwan and China as an example. Accompanied by economic growth the wage rates in Taiwan have risen substantially which undermined its competitiveness in labor extend industries. Firms have been forced to exploit in high technology industries, or to move their business into other location where labor costs are much lower to offset their rising labor costs. The "open door" of Mainland China market provides an idea chance for them.

### **2.2.2 China's Open Door Policy**

"Policy changes are important in shaping the business environment. Whether the government is fuelling or cooling down the economy certainly has a direct impact on market and helps shape the strategies of firms."<sup>27</sup> The rapid increasing of FDI flow in the triangle is complemented and promoted by the success of China's economic reform and open door policy.

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<sup>24</sup> Dowling, M. "Asia's Economic Miracle: An Historical Perspective" (1997) 30(1) *The Australian Economic Review* 113, 115-16.

<sup>25</sup> Ibid, 116.

<sup>26</sup> Ibid.

<sup>27</sup> Wu, Y. "Away from socialism: the Asian way" (1996) 9(3) *The Pacific Review* 410, 415.

Different with its past “bitter experiences with Western imperialism in which China was forced by gun-boost diplomacy to open its door,”<sup>28</sup> the PRC government led a historical process of “reform and open door” in modern China since 1978. It is this policy that promoted China’s economic growth and the rapid FDI inter-flows within the triangle, except the FDI flow from China to Taiwan which is prohibited by Taiwan government.

Before China began its current reform process in 1978, China had maintained “a centrally planned economic system, including centralized determination of firms’ output targets, material allocation, employment, investment, and foreign trade”.<sup>29</sup> The initial challenge for China’s regime was how to reform its system to increase productivity to maintain its governance and to participate in the world economy.

There are mainly three aspects, or steps, of this economic reform and open door policy: first is the encouragement of co-operative and private economy in rural and urban; second is the development of ESZs and outward-oriented economy; and third is the on-going state owned enterprises (SOEs) reforms which include the reform of state owned banks. The process of such reform has not completed, but China’s success has been internationally recognized.

This ‘open-door’ policy has proved to be very successful. From 1979 to the end of 1994, more than 220,000 foreign funded ventures were approved, with contracted investment of US\$ 300 billion and US\$ 95 billion of utilized investment, making the country the most important recipient of FDI in the developing world.<sup>30</sup>

Especially since 1992, after China moved away from a strict application of the foreign exchange balance requirement and its FDI policy changed from regional-preference-based one into an infrastructure-led and industry-driven one, China begin get large FDI inflows which broken all past records. (See Table 1.)

Table 1. FDI in China, 1979-1997

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<sup>28</sup> Chan, G. “‘Three Chinas’ and International Organizations after 1997” (1997) 6(16) *Journal of Contemporary China* 435, 438.

<sup>29</sup> Noland, M. *Pacific Basin Developing Countries: Prospects for The Future* (1990) 149.

Year	Projects No.	Contracted FDI (US\$ billion)	Utilized FDI (US\$ billion)	per cent of FDI in GDP
1979-1992	90,791	110.46	34.35	2.7 *
1993	83,000	111	21.3	6.4
1994	46,209	78.54	39.35	6.5
1995	37,126	90.3	37.7	NA
1996	NA	66.98	42.3	NA
1997	NA	51.8	45.3	NA
Total	NA	509.08	221.3	NA

Note: \* 1992.

Source: <sup>31</sup>

Since the end of 1980, China started its economic taking off stage. Main characters of such stage are as follows: economic growth rate kept at continually high level; transformed from low-level income to middle-level income; increased continually in purchase power; industry structure changed obviously; total economic amount increased times. GDP in 1994 was 4.24 times than 1978. The economy was trebled within 16 years.<sup>32</sup> This market-oriented reform and rapid economic growth in China's huge market provide great opportunities to FDI from HK, Taiwan and other countries.

Hong Kong's economy has taken off since the later-1970s and early-1980s, when China started its open policy. The timing is no coincidence. It is common knowledge that Hong Kong's economic success has benefited to a large extent from China's policy of opening to the outside world and its domestic economic reforms. ... The decade saw the re-emergence of Hong Kong as a major entrepot, serving the Asia-Pacific region in general and

<sup>30</sup> Kaiser, S.; Kirby, D. & Fan, Y. "Foreign Direct Investment in China: An Examination of the Literature" (1996) 2(3) *Asia Pacific Business Review* 44, 45.

<sup>31</sup> Ibid, 44, 49.

Also:

World Bank *world Debt Tables* (1996)

Mulvenon, J. *China: facts & figures, Annual Handbook* (1997).

Rosen, D., Liu, L. & Dwight, L. "Financial Fallout" (1998) 25(2) *The China Business Review* 44, 46.

<sup>32</sup> Shi, P. (ed.) *Megatrends China* (1996) 2.

China in particular. Nearly 90 percent of Hong Kong's re-exports involve China as a source or as a destination.<sup>33</sup>

If FDI from Japan and US was a crucial factor for transmitting growth impulses in East Asia in the 1960s and 1970s, "China's gradual approach of transforming its economic system gave a strong impulse to supply-side adjustment and demand-side buoyancy in total East Asia"<sup>34</sup> after the end of 1970s. The increasing FDI flows from HK and Taiwan into China have been taking place upon this background.

### ***2.2.3 Identity and overseas Chinese***

China's economy is quite vulnerable to its resources from overseas Chinese funds. These overseas Chinese control an equivalent of a \$670 billion and account for 80 per cent of the direct foreign investment into China.<sup>35</sup>

The expatriate Chinese are influential in most of the countries in which they reside. Business for Chinese has become both a key to survival and a way to harmonize with the resident countries. They like keep in contact with both resident and home country. So there are so-called "space-persons" that fly consequently between resident and home countries seeking business opportunities. It is mainly them who built on the bridge for FDI flows into their home country. This is also one of the reasons for allowing Chinese immigration in some countries.

Because of their culture background and behavioral customs, many business opportunities for these "space-person" are linked with their home country or even hometown. Meanwhile, the commonality of culture and language can reduce the communication cost of business transactions.<sup>36</sup> For example, the common dialect

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<sup>33</sup> Wang, G. "the Investment Laws of Hong Kong under 'One Country, Two System'" (1997) 31(6) J.W.T. 113.

<sup>34</sup> Langhammer, R. "Regional Integration in East Asia. From Market-Driven Regionalisation to Institutionalised Regionalism?" (1995) 131(1) *Weltwirtschaftliches Archiv* 167, 168.

<sup>35</sup> Bierling, J. & Murray, G. "The emerging Powers: China, Singapore, Hong Kong and Taiwan" (1995) 43(1) *Current Sociology* 65, 73.

<sup>36</sup> Fan, C. "Why China Has Been Successful in Attracting Foreign Direct Investment: a transaction cost approach" (1998) 7(17) *Journal of Contemporary China* 21,24.



languages, family connections and other relations made it is easier for overseas Chinese investors, most of them emigrated from Guangdong and Fujian, to invest in Guangdong (for FDI from HK) and Fujian (for FDI from Taiwan).

As a result, factors "such as language, culture, and the need to identify joint venture partners have made Hong Kong the logical base for foreigners interested in investment in China."<sup>37</sup> Meanwhile "Chinese minorities in ASEAN countries are often quoted as performing an important bridging function in inter-country trade."<sup>38</sup> Moreover, overseas Chinese, with deep national consciousness, are feeling proud of their increasingly growing and powerful motherland.

### ***3. Institutional environment for FDI***

#### **3.1 Theory**

As a most important institutional factor or public goods in the world investment environment, FDI regime reflects particularly theory ideologies. Regarding the relationship between market and government, there are some conflicting economic theories where the most important are orthodox neoclassic economics and heterodox new institutional economics. Those theories reflect the ideological conflicts on market and government.

The neoclassic economics expresses a strong preference for the market over government intervention and for the common law over civil law.<sup>39</sup> They believe that market is perfect and free competition will create efficiency, and as a force/factor beyond market government should take no intervention, minimize regulations (as a method of intervention) and rely on market mechanism. While the new institutional economics try "to explain the existence of political, legal, or more generally social, institutions by reference to a model of individual behavior, tracing out its consequences in terms of human interactions."<sup>40</sup> The new institutional economics, especially the Austrian school,

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<sup>37</sup> Chakwin, N. & Hamid, N. "Economic Environment in Asia for Investment" in Oman, C. Brooks, D. & Foy, C. *Investing In Asia* (1997) 221.

<sup>38</sup> Langhammer, R. "Regional Integration in East Asia. From Market-Driven Regionalisation to Institutionalised Regionalism?" (1995) 131(1) *Weltwirtschaftliches Archiv* 167, 182.

<sup>39</sup> Bottomley, S., Gunningham, N. & Parker, S. *Law in Context* (1991) 244.

<sup>40</sup> Hodgson, G., Samuels, W. & Tool, M. *The Elgar Companion to Institutional and Evolutionary Economics* (1994) 398-99.

do not accept that competitive or spontaneous evolutionary forces can be relied upon to produce socially desirable outcomes. They have adopted the view that, through scientifically guided government intervention, social institutions can be reformed and the economy planned for greater social benefit.<sup>41</sup>

According to the new institutional economy theory market is not perfect, and government policy is an essential institutional factor which can be reformed to prompt the efficiency of market. This theory emerged from Ronald Coase's "The Problem of Social Cost" (1960), and developed by Oliver Williamson (1975), Harold Demsetz (1967), Richard Posner (1972), F.A. Hayek (1973), Douglass North and Robert Thomas (1973, 1990), Richard Langlois (1986, 1993). Major strands of this theory include transaction costs, property rights, law and economics, institutional economic history and Austrian.<sup>42</sup> They recognized that because there are friction and cost in market operation, the market mechanism is not perfect and institutional mechanism is necessary.

The costs of using property rights through the market by buying, selling, or renting are called "transaction costs" (and when property is used internally within a firm or other organization, we speak of "organization costs"). ... Information costs present the decision-maker with difficult problems. ... The costs of defending and using property rights can be greatly reduced by appropriate institutions [that is the rules that prevail in a society and which constrain individual behavior]. ... Government can do much ... to switch competitive behavior from rent-seeking<sup>43</sup> to innovative rivalry and therefore to enhance the probability of evolutionary progress... opening factor markets,

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<sup>41</sup> Rutherford, M. "Austrian economics and American (old) institutionalism" in Boettke, P. (1994) 533.

<sup>42</sup> Rutherford, M. *Institutions in Economics: The old and the new institutionalism* (1994) 2-3.

See also:

Williamson, O. "Transaction Cost Economics and Organization Theory" in Smelser, N. & Swedberg, R. (eds.) *The Handbook of Economic sociology* (1994) 79.

<sup>43</sup> See Buchanan, J., Tollison, R. & Tullock, G. (eds.) *Toward a Theory of the Rent-Seeking Society* (1980) 4 & 359:

"The term *rent seeking* is designed to describe behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus." "Resources that could

attracting internationally mobile production factors, and creating conditions in which foreign capital and firms could thrive.<sup>44</sup>

As the institution forms of firms serve as institutional factor in market, the experiences of the triangle have attested that government is a fundamental institutional factor for market mechanism. However, why are some governments', or some times', interventions very successful while others' failed? It justs like the situation of firms competing in the market: some fail, some win. It depends upon how successfully they get necessary information and how efficient they attract and use production factors.

Because there are frictions, the market is not perfect. So, an institutional form -- firms as vertical integration - appeared to set off the inefficiency. This kind of institution can decrease transaction cost, which increases efficiency, while might increase organization cost which decreases efficiency. If the organization cost was too high, such as most state owned enterprises (SOEs), unable to produce net efficiency of the vertical integration, another extreme reached and markets competition as horizontal integration would be more efficient. This can be see from economic reforms and policy adjustment in both pre-socialist countries and some capitalist countries in some periods.

If the firm's level institutional cost is too high to set off the transaction cost, see the information cost is too high for individual firms, government level institutions are called for to prompt resources (including information resources) mobilization and allocation to complement the market mechanism. That is why over

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otherwise be devoted to value-producing activity are engaged in competitive effort that determines nothing other than the *distributive* results."

<sup>44</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 12-13, 22, 28. See also in details:

Coase, R. *The Firm, the Market, and the Law* (1990).

Williamson, O. *Markets and Hierarchies* (1975).

Demsetz, H. "Toward a Theory of Property Rights" (1967) 57 *American Economic Review* 347-59.

Posner, R. *Economic Analysis of Law* (1992 2cd).

Hayek, F. *Law, Legislation and Liberty Vol. I: Rules and Order* (1973).

Noth, D. *Transaction Costs, Institutions, and Economic Performance* (1992).

Langlois, R. (ed.) *Economics as a Process: Essays in the New Institutional Economics* (1986).

Boyer, R. *The Regulation School: A Critical Introduction* (1990).

Johnson, B. & Nielson, E. (eds.) *Institutions and Economic Change: New Perspectives on Markets, Firms and Technology* (1998).



the last century, especially the most recent 30 years, the size and scope of governments have expanded enormously.<sup>45</sup> The successfulness or efficiency of government level institution mechanism depends upon their efficiency in information collection, sector attraction (whether domestic or overseas), and providing sound environment to reduce transaction cost in a wider sphere to support the market mechanism to operate more efficiently.

As the market becomes more and more globalizing, institutional solutions at a wider level, such as WTO and other international institutions, are called for. "The WTO can be regarded both as an institution embodying a set of rules and principles on the use of policies that affect trade flows, and as a 'market' in which members exchange market access concessions and agree on rules of the game."<sup>46</sup>

However, if the institution cost is too high to adopt the most optimal choice, the process of such institutional building or reforming need to be taken the form of a gradual or pragmatic one. The same case has been shown by China's experimental and pragmatic reform and open door strategy which has been tested by its economic success as a rational approach.

In the more and more globalizing market economic environment, there are market failure, firm failure and government failure. Market failure, which is caused by transaction cost and externalities, is "a state of affairs where privately optimal decisions based on utility-maximizing behavior of individual economic agents diverges from social optimality".<sup>47</sup> Firm failure, which is caused by inefficient property institution and lack of essential incentives to managers, is a state of affairs where firms' decision based on other objects rather than utility maximum (such as SOEs in China where some managers' behavior is based on personal utility maximum rather than firm's utility maximum). Government failure, which is caused by inefficient governing mechanism such as "frailty or abuse of public power from incompetence, corruption, goal displacement ... or from the disproportionate commitment of public resources to satisfy small pressure groups",<sup>48</sup> is a state of

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<sup>45</sup> The World Bank, *world Development Report 1997: The State in a Changing World* (1997) 2 & 22.

<sup>46</sup> Ibid, 134.

<sup>47</sup> Islam, I. & Chowdhury, A. *Asia-Pacific Economies: A survey* (1997) 28.

<sup>48</sup> Wade, R. *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (1990) 333-34.

affairs where politicians are not responsive to voters and state intervention is under the socially optimal level.

The existence of such kinds of failure is why we need to build up an institutional mechanism to decrease those failures to get social optimality.

Just as good roads, ports, telecommunications, and other elements of the hard infrastructure reduce transport costs, appropriate institutions form a “soft infrastructure” that reduces transaction cost. Both hard and soft infrastructures are essential if one wants to compete successfully in global markets.<sup>49</sup>

Ideology or theory conflicts have an impact on shaping legalism towards FDI. FDI regime reflects the interaction between firms and governments in accordance with the economic, politic and culture environment.

From the point of view of the Neoclassical economic theory FDI is wholly beneficial to both the host and the home countries. So government should minimize intervention on FDI and reliance on market mechanisms. Most developed countries hold such ideal. The 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment was based on such theory.

From the point of view of the Dependency theory FDI leads to unequal development within a host state, benefiting parent company in home country and the elite in host country but exploiting the other groups within the host society. So it “will not bring about meaningful economic development.”<sup>50</sup> Such Dependency ideal is popular among Latin American and other developing economies, and was showed in the Draft UN Code of Conduct on Transnational Corporations (TNCs) of 1975.

From the point of view of New institutional economic theory FDI has advantages such as transfer of capital, technology and managerial skills; but also has disadvantages such as transfer price and environmental pollution. So government should play a positive role to screen and guide FDI to serve domestic economic growth. This ideal is dominant in East Asian countries. “There was considerable

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<sup>49</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 5.

<sup>50</sup> Sornarajah, M. *The International Law on Foreign Investment* (1994) 42 & 43.

state regulation and intervention which accompanied the process of industrialization of these states.”<sup>51</sup>

The object of foreign investors is to take advantage of host nations’ cheap resources, “potential access to a new market, and various tax and other incentives”. “Host nations invite FDI [intending] to obtain capital, technology, and management training.”<sup>52</sup> Although they can usually benefit each other, there are conflicts between foreign investors and host countries. So a legal regime is called for to adjust the relationships between them.

The costs of an inefficient legal system ... [and] of not having property rights for market participants included inefficient use of resources; reduced investment; ... limited use of property as collateral; and stagnation resulting from the lack of a system for transferring and organizing property rights. As to the costs associated with their inability to use a contract system, market participants ran up against an inability of legal coercion to ensure compliance with agreements; unenforceable agreements; fewer long-term agreements; slower economic progress due to the need to develop personal relationships to replace contract-based relationships; increased time and costs associated with investigating and monitoring contractual relationships; restrictions on the scope of business relationships to kin and villagers, rather than the most qualified partners; greater use of violence for enforcement of agreements.<sup>53</sup>

However, what legal regimes do is to reduce uncertainty for investors (whether foreign or domestic) who want to invest their capital or labor in the market. As where inefficiency exists in market, uncertainty prevails.

### **3.2 Practical models**

Comparing with industrialized countries which have experienced market mechanism for a long time, it is more important for developing and transitional countries to establish the appropriate institutional infrastructure for the market. To do

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<sup>51</sup> Ibid, 49.

<sup>52</sup> Roehrig, M. *Foreign Joint Ventures in Contemporary China* (1994) 2.

<sup>53</sup> Gutterman, A. & Brown, R. (cd.) *Commercial Laws of East Asia* (1997) 20, 24 & 25.

so, however, it calls for “a strong government to establish the institutional infrastructure that facilitates the viability of a strong market”.<sup>54</sup>

With both similarities and differences, the FDI regimes within the Chinese triangle provide representative models for comparative studies. Here I would like to briefly discuss these models and leave detailed analysis in the following part.

For the FDI regimes within the triangle, the Hong Kong's is under the umbrella of common law; the Taiwan's is under the umbrella of civil law; and the China's is under the umbrella of socialist law but with civil law concepts and forms. However, all these three societies are based on the same traditional Chinese culture background, with accompanied by different current history periods (HK had been a colony of the United Kingdom, Taiwan had been a colony of Japan, while China is governed by the Communist Party). In some content, their legal systems reflect the major legal families in the world.

HK's FDI regime, as its legal system as a whole, takes a 'private' or 'liberal' legalism approach and serves merely “a conflict resolution role”. Under this approach, “the legal subject is viewed as a ‘right’ or entitlement holder; these rights are universal and lead to the identification of the law and the state, ... it led to the constitution of the legal person (natural or juristic) as the rights bearer.”<sup>55</sup> The government takes a non-invention approach. The market is based on free competition and protected by judges.

In contrary to civil law system where judges interpret code law (they are more influenced by politicians, as they need to be approved by voters' representatives) and more influenced by social norms, judges in common law system follow precedents and “respond to a proliferation of novel disputes by making new law.”<sup>56</sup> So, generally speaking, there is less government's invention in common law system countries than civil law system countries.

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<sup>54</sup> Stiglitz, J. “The Role of Government in Economic Development” (1996) *Annual World Bank Conference on Development Economics* 11, 23 Notes 4.

<sup>55</sup> Jayasuriya, K. “The rule of law and capitalism in East Asia” (1996) 9(3) *The Pacific Review* 367, 368-69, 372-73.

<sup>56</sup> Cooter, R. “The Rule of State law and the Rule-of-Law State: Economic Analysis of the Legal Foundations of Development” (1996) *Annual World Bank Conference on Development Economics* 191, 205-6.



While FDI regimes in both China and Taiwan, under the same form of civil law though different in content, take the 'public' or 'authoritarian' legalism approach and "play a policy implementing role in that they serve to enforce government objectives and policies".<sup>57</sup> This reflects the legalism that law is an instrument of rule that is made by the ruler, rather than a set of fundamental principles that bind both the government and individuals.

Rather than the law reflecting and balancing the divergent social interests created by the market, the state uses law to promote the market. In this later conception, law is seen in instrumental terms as a means to an end. ...The legal subject ... is not the individual property right holder but the *enterprise* conceived as an institutional entity. Within this framework, regulations govern institutional entities rather than the individual's property claims. ... [Especially in the transitional economy of the PRC,] the ability of an 'enterprise' to manage itself independently rather than by means of the specification of property rights was a key objective of market oriented reform.<sup>58</sup>

Foreign investors operate under both their home legal regime and host legal regime, but especially the host one. While governments may choose different approaches to build on their legal institution, here we will concentrate on their FDI regime in the triangle. As the governments sought to increase trade and attract FDI they experienced "greater pressures to open their economies and bring their practices more closely in line with those in industrial economies".<sup>59</sup> This is more distinct in China's current process of joining the WTO.

The development of an efficient and fair legal and regulatory regime is a particularly important element of an attractive investment climate, ... Contrary to a pervasive perception in developing countries, an attractive legal framework is not one simply which offers prospective investors tax holidays or other favorable treatment. ... Much more important is a framework which

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<sup>57</sup> Jayasuriya, K. "The rule of law and capitalism in East Asia" (1996) 9(3) *The Pacific Review* 367, 369.

<sup>58</sup> Ibid, 372, 373 & 374.

<sup>59</sup> The World Bank *The East Asian Miracle* (1993) 365.

provides investors with reliable protection for property and contractual rights through comprehensive legislation, effective enforcement and the availability of efficient conflict resolution mechanisms.<sup>60</sup>

Nations may choose from a variety of strategies for their economic development, for example “outward-oriented” development strategies which based on free trade policies, or “inward-oriented” development strategies which depend on domestic industries’ development under state protection from international competition. However, in order to achieve their objectives they need efficient legal environments to set and implement such strategies.

FDI regimes which include laws and procedures set up the principles of the host country towards foreign participation in their domestic markets. Any full FDI require takes the form of laws, regulations and procedures to guide FDI operation in the domestic market, to restrict the proportion of foreign ownership, and to provide incentives, protections and controls to FDI flows. Accompanied with market-oriented reform and international business participation,

legal reform is often synonymous with economic reform. Most economic policies are implemented through laws and regulations, and economic analysis helps guide policymakers as they design such laws and regulations. ... Three ingredients appear to be essential to a well-functioning legal system in a market economy -- a supply of market-friendly laws, adequate institutions to implement and enforce them, and a demand for those laws from market participants. In some circles, legal reform -- or, indeed, institutional reform more generally -- is viewed as a prerequisite for successful economic change, but, in fact, the two are inextricably linked.<sup>61</sup>

## ***4. FDI regimes in the triangle***

### **4.1 China: socialist law approach**

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<sup>60</sup> Shihata, I. *Legal Treatment of Foreign Investment: The World Bank Guidelines* (1993) 24.

<sup>61</sup> Gray, C. “Reforming Legal Systems in Developing and Transition Countries” (1997) September, *Finance and Development* 14, 14-15.

Unlike Hong Kong and Taiwan, PRC is a communist country and is considered a significant actor in the international community. Even since the end of 1970s, China is endeavoring to structure its legal system as the product of a conscious process of modernizing Chinese law using the basic formal structure and conception of the civil law system accompanied by Chinese features. So, by form, its legal system is more like the Civil law system, but its legal system is still a socialist one. "Law is an integral part of the political structure but is also merely the instrument of the political will of the ruling class."<sup>62</sup> Primarily instrumentalist in nature, Chinese legislation is relied upon by the state as instruments for achieving economic and political goals. So, China's legal approach towards FDI is still quite different from that of Hong Kong or Taiwan.

#### ***4.1.1 Reasons and structure***

PRC's economic success started from the policy change from a central-planned economy to the "reform and open door" towards the international market two decades ago. This policy change and economic reform have generated significant FDI inflows into China which promoted China's economic growth and helped in structuring its market-oriented system institution.

In order to solve the deep economic troubles that China faced in the 1970s after nearly 30 years' central planning economy experience, and to achieve the goal of "Four Modernization" to put China on the level of the economies of the advanced industrialized nations within several decades, China has been adopting a strategy to attract FDI for capital, technology and managerial skill support.

FDI inflows in China have played an important role in the process of open door economic reform. On the one hand, it has accelerated China's economic growth and development; on the other hand, it has facilitated China's market-oriented economic reform and its legal system construction.

To be maximally effective, a liberal FDI regime needs to be embedded in an overall institutional framework conducive to foreign and domestic investment (McMillan, 1993). The liberalization of the country's FDI framework has therefore exerted constant pressure in the direction of

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<sup>62</sup> Cruz, P. *Comparative Law in a Changing World* (1995) 133.

introducing other market mechanisms. Numerous laws and regulations governing both international business and domestic economic activities were prompted --in some case to a large extent --by the legal framework specifically pertaining to FDI.<sup>63</sup>

As part of its foreign-related law, China's FDI legislation comprise three parts: special FDI laws, external relations established in the forms of special chapters or articles in general domestic laws, and relative international treaties which China concludes or in which it participates such as the Convention for Settlement of Investment Disputes (ICSID 1965).

Within the process of its economic reform and door open, since China's domestic economy was dominated by SOEs, the contract, corporate and tax legislation applicable to these enterprises was not appropriate for FIEs. "Therefore, China established two separate legal systems for domestic and foreign investment entities." "The new legislation over the last 15 years had allowed China to effectively implement reform in both of these sectors."<sup>64</sup>

Under the Constitution of the People's Republic of China (Constitution 1982) which laid down the law for the principles of other legislation, the legal regime regulating FDI has gradually been established in China. This regime consists of laws and regulations which provide legal protection and preferential treatment to FDI.

The major special laws in this FDI regime are: the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures (EJV Law, which was promulgated in 1979, and amended in 1990) and its implementation regulations, the Law of the People's Republic of China on Contractual Joint Ventures (CJV Law 1988), the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (WFOE Law 1986) and its implementation rules, Provisions of the State council for the Encouragement of Foreign Investment (Encouragement Provisions 1986), the Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Co-operation with Foreign Enterprises (1982), the Regulations of the People's Republic of China on Administration of Technology-

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<sup>63</sup> Xiaoning, Z "The role of foreign direct investment in market-oriented reforms and economic development: the case of China"(1993) 3/2 *Trans Cos* 121,128.



Introduction Contracts (1985) and its implementation rules, Income Tax Law of the People's Republic of China on Foreign Investment Enterprises and Foreign-Capital Enterprises (Income Tax Law 1991), and Regulations on the Management of Foreigners' Employment in China (1996).

Besides this national legislation, there are also local legislation and central government departmental regulations. As any FDI project in China is whether governed by local government or relevant department of central government, these local and departmental regulations, especially those of Special Economic Zones (SEZs) at local level and central departments such as the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), the Ministry of Finance, the People's Bank of China and the State Administration of Industry and Commerce, are important to FDI in China.

The FDI related general domestic laws including: the Company Law of the People's Republic of China (Company Law 1993, within which articles 199-205 regulate branches of foreign companies in China), the Commercial Banking Law of the People's Republic of China (Commercial Banking Law 1995, article 88 of which provides that it applies not only to domestic commercial banks but also to foreign-owned and joint venture commercial banks and branches of foreign commercial banks), the Insurance Law of the People's Republic of China (Insurance Law 1995, article 148 of which provides that it also applies to insurance companies with foreign capital and branches of foreign insurance companies), the Regulations of the People's Republic of China on Administration of Registration of Companies (1994), the Regulations on Administration of Registration of Company Registered Capital (1995), and the Regulations of the People's Republic of China on Administration of Foreign Exchange (1996).

The most common form of FDI in China is the joint venture (see Table 2). Although joint ventures depend upon the maintenance of comparative advantages in partners' relationships and which lead to a high rate of conflict, there are some significant advantages for joint ventures.

For the local sponsor, joint ventures can be a way to ensure the supplier's interest in the success of the enterprise instead of only in selling the service

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<sup>64</sup> Gutterman, A. & Brown, R. (ed.) *Commercial Laws of East Asia* (1997) 280.

or product. ... For foreign sponsors, bringing in a local partner in a joint venture can sometimes reduce project risk in several ways. First, it can reduce the financial commitment of the foreign sponsor and cross-border transfers of resources. Second, the local partner can help reduce risks to the venture, through greater familiarity with the local business climate, government policies, and economic conditions. Third, a local partner can help mobilize additional local financing and may have better access to land.<sup>65</sup>

Joint ventures in China are divided into Equity joint ventures (EJVs), contractual joint ventures (CJVs) and joint development ventures (JDVs) which last was popular at the beginning of the open door policy on offshore oil exploration. The major different between EJVs and CJVs is that there is more flexibility for CJVs.

An equity joint venture is a legal person, takes the form of a limited liability company formed in accordance with the JV Law, and bears limited liability. Parties in a contractual joint venture distribute profits and bear the risk of loss according to the ratio of their capital contributions.

A contractual joint venture can be settled either as a legal person, like an equity joint venture, or as just a legal entity within which the parties make their contributions to the project and bear the risk of loss according to the terms and conditions stipulated in their contract. Unlike an equity joint venture, parties in a contractual joint venture may decide the distribution of profits according to a ratio different from that of their capital contributions.

A wholly foreign-owned enterprise is formed and managed solely by foreign investor in accordance with the WFOE Law. As mentioned above, joint development ventures are used mainly in oil exploration. Other foreign investment includes compensation trade, export processing, and international leasing.

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<sup>65</sup> IFC *Foreign Direct Investment* (1997) 74-75.

Table 2. Percentage shares of FDI forms to total FDI in contractual value in China

Year	EJVs	CJVs	WFOs	JDVs	Others*
1979-1984	13.4	45.6	4.6	23.5	12.9
1988	50.6	26.2	7.8	1.0	14.4
1989	42.3	17.2	26.3	3.2	11.0
1993	49.3	22.8	27.2	0.3	0.4

Note: \* Includes compensation trade, export processing, and international leasing.

Source: <sup>66</sup>

In order to facilitate the absorption of FDI, introduce advanced technology and expand exports in generating foreign exchange to fulfil the modernization policy; China's FDI regime, taking the similar approach with most developing countries, provides preferential treatments to foreign investors in foreign investment enterprises (FIEs) which are encouraged by China's continually updated policy. Among that, fiscal incentive is the most important method. Tax concessions, especially in SEZs and coast regions, have played an important role in encouraging FDI inflows and contributing to China's economic growth. In China, especially before 1994, FDI is entitled to complex income tax incentive treatments. The favorable income tax treatments for FDI can be classified as follow.

(1) General favorable income tax treatment

The taxable income of a FIEs is its gross income, either derived from China or overseas, in that tax year less deductible costs, expenses and losses which may be used to set against its income for the following maximum five tax years. The income tax of a FIEs is levied at the rate of 33% (3% of which is local income tax).<sup>67</sup> Compared with the income tax at the rate of 55% paid by domestic SOEs at the same time, the tax rate is favorable. However, besides this, there are some other preferential tax treatments for FIEs.

(2) Regional favorable income tax treatment

FIEs established in SEZs (include Shenzhen, Zhuhai, Shantou, Xiamen and Hainan province), or in the Economic and Technological Development Zones

<sup>66</sup> Computed from *Almanac of China's Foreign Economic Relations and Trade* (various years).  
Li, K. (ed.) *Financing China Trade and Investment* (1997) 59.

(ETDZs) and belonging to production-oriented joint ventures, can enjoy reduced income tax at the rate of 15%.

Income tax on production-oriented FIEs in Coastal Economic Open Zones (CEOZs, such as Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, Beihai, and Chongqing as an inland city since 1997 <sup>68</sup>) or in the old urban district of cities within which the SEZs or the ETDZs are located, is levied at the rate of 24%.

The local government at provincial level has the discretion of providing income tax reduction or exemption to FIEs established in the local area.<sup>69</sup>

### (3) Special business favorable income tax treatment

A. Production-oriented FIEs which are scheduled to operate for a period of ten years or more are income tax exempted for the first two profit-making years, and tax rate is reduced 50% in the following three years. FIEs engaged in agriculture, forestry, or animal husbandry, and located in remote underdeveloped areas may get a reduction of 15% to 30% for an additional ten years after the initial period of tax exemption and reduction.<sup>70</sup>

B. Export-oriented FIEs whose value of export products amounts to 70% or more of the value of their total products in that year, may, after the expiration of the period of exemption and reduction of income tax, pay income tax at a reduced rate of 50% of the current tax rate. FIEs that already pay income tax at a rate of 15% and comply with the foregoing conditions, may pay income tax at 10%.

C. Advanced technology-oriented FIEs may, after the expiration of the period of reduction or exemption, extend the favorable 50% reduction for another three-year.<sup>71</sup>

### (4) Reinvestment incentive

Foreign investors in FIEs who reinvest their share of profit in FIEs again for a period of not less than five years, may receive a refund of 40% of the income tax

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<sup>67</sup> Income Tax Law, art5.

<sup>68</sup> *People's Daily*, Overseas Edition, 25 July 1997.

<sup>69</sup> Income Tax Law, arts7 and 9.

<sup>70</sup> *Ibid*, art8.

<sup>71</sup> Encouragement Provisions, arts8 and 9.

paid on the reinvested amount, or a 100% refund for foreign investors in export-oriented and advanced technology-oriented joint ventures.<sup>72</sup>

In order to strengthen its central government's fiscal power, build an equal competitive investment environment to meet the requirements of GATT, China reformed its tax system in 1994. The reform is aimed at establishing a turnover tax (indirect tax) system based mainly on value-added tax, and sharing revenues between central and local governments. It also provided an equal income tax rate of 33% for all enterprises whether related to FDI or not.

In addition to income tax, foreign invested enterprises are also subject to turnover taxes composed of VAT, consumption tax, business tax, and other taxes as a result of the unification of turnover taxes for both domestic investment enterprises and foreign invested enterprises. However, to avoid increasing the tax burden for foreign invested enterprises established prior to December 31, 1993, China allows those foreign invested enterprises a refund for the extra tax payments resulting from the newly-introduced turnover taxes for a maximum of five years.<sup>73</sup>

After the difficult years of 1989-1991, in seeking to release the pressure of uneven regional development and improve its investment environment, China has reshaped its FDI absorption policy. An industrial orientated approach has apparently taken over the regional orientated approach. Preferential treatments are more linked with industrial policies.

[M]any spheres which were previously closed to, or restricted from, foreign investments are now in the process of opening up, including commerce, retail business, finance, insurance, inland transportation, air navigation, land and property development and consultancy.<sup>74</sup>

Beside tax preference treatment, FDI which is encouraged by the government, can enjoy other preferential treatment as while. Such non-fiscal

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<sup>72</sup> Ibid, art10.

<sup>73</sup> Gutterman, A. & Brown, R. (ed.) *Commercial Laws of East Asia* (1997) 327.

<sup>74</sup> Tsang, S. "The Political Economy of Greater China" (1996) 2(3) *Asia Pacific Business Review* 23, 35.



preference includes: reduced land-use fees, priority in obtaining public facilities and loans, simplified customs procedures and export- import licensing procedures.

For the legal procedure aspect of the FDI regime, although there is a court system in China which takes the form of a civil law system and follows the principle of “basing on facts and judging by law”. However, most disputes involving China’s foreign investment relations “are resolved through non-judicial methods.” “Informal consultation and discussion between the disputants is encouraged by Chinese tradition and practice”<sup>75</sup> on the one hand, and by the high cost and inefficient judicial process on the other.

#### **4.1.2 Characteristics and evaluation**

As an important part of China’s economic law system, the FDI regime has been an example and had positive influence to its legal system restructure. As an institutional reform or revolution, this decreases transaction costs and fosters harmonization of China’s FDI regime with international standards. However, China’s FDI regime has some its own significant Chinese characteristics.

Characteristic of policy domination.

“[W]hile expressing greater support for replacing the state planned economy with a socialist market economy, do not dilute the centrality of the state’s role as the agent for development.” “The continued expansion of the Chinese legal system regarding foreign investment has been meant to strengthen the state’s managerial role.”<sup>76</sup> With legislation to provide general principles for FDI, government’s policies a play more important role at least from a practical point of view. The continually updated Foreign Investment Guidelines divide FDI projects into encouraged, permitted, restricted and prohibited categories in 1977.

Investments labeled “encouraged” may take advantage of preferential policies and include those utilizing high technology, especially in agriculture, environmental protection. ... Investment projects in the “restricted” category,

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<sup>75</sup> Feinerman, J. “Chinese Participation in the International Legal Order: Rogue Elephant or Team Player?” (1995) 141 *The China Quarterly* 186, 195.

<sup>76</sup> Potter, P. “Foreign Investment Law in the People’s Republic of China: Dilemmas of State Control” (1995) 141 *The China Quarterly* 155, 156 & 168.

meanwhile, require government approval. ... In the third category of “prohibited” sectors are services and internal trade, including distribution.<sup>77</sup>

The 1997-revised Guidance Directory on Industries Open to Foreign Investment is designed to benefit China’s economic restructuring and improve its investment structure. “The State Planning Commission has also listed industries, products and technology projects to which the state is currently giving priority. This covers 29 industries, including agriculture, forestry, power, machinery, and electronics.”<sup>78</sup>

As a result, the pragmatic piecemeal approach towards economic reform has now produced a large system of law consisting of many individual statutes and administrative regulations and rules made under different *ad hoc* policy orientations. ... Law in general has gained no independent status: it serves solely the purposes of economic reform and its usefulness depends entirely on the process of economic reform.<sup>79</sup>

By Chinese tradition and especially PRC’s 30 years of centralized economy, law is guided by policies instead of policies being made depending upon law. Law was pushed by administration instead of administration being come out under law. For example, before a law or regulation was promulgated there was usually an internal policy or regulation pre-leading the practice. This experimental and pragmatic approach of institutional reform is applicable with China’s realistic social background and had achieved significant success.

However, there are disadvantages of this approach. It is in lack of comprehensive harmonized legislation and the independent jurisdiction to protect and enforce property rights. This is one of the reasons why Chinese people think political power prevails over legal right and always appeal for *GanXi* first. It is also why China’s FDI regimes are considered in less of stability by foreign investors. This policy-dominated approach has also leads to encourage political power

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<sup>77</sup> McDaniels, I. “Beijing Rethinks Investment Policies” (1998) 25(2) *The China Business Review* 4.

<sup>78</sup> *Beijing Review*, (1998) 41(4) 4.

<sup>79</sup> Chen, J. “China: Constitutional Changes and Legal Developments” in Tay, A. & Leung, C. (ed.) *Greater China: Law, Society and Trade* (1995) 182.

engaging in non-political area such as market competition and property right field. For example,

it is a very brave westerner that considers doing business in China without a 'Tai Zi Dang' aboard their scheme. The Tai Zi Dang are the children of the revolutionaries or less flatteringly 'the fat cats of China's new order', who are apparently rich, privileged and the owners of fat contact books. The Tai Zi Dang are the princelings, sons and daughters of China's political elite -- and no self-respecting foreign venture that wants to make it big in the new China should be without at least one. Numbering about 3500, they grease the wheels of China's socialist market.<sup>80</sup>

#### Characteristic of preferential fiscal treatment and uneven development.

It was said that tax regimes appeared to be important to FDI growth generally; growth of FDI and growth of share of FDI in investment are both high in low-tax countries.<sup>81</sup> Compared with its neighbor countries' corporate income tax rate (18.5% in HK, 35% in Malaysia, 31% in Singapore, and 35% in Thailand<sup>82</sup>), China's preferential tax treatment has played an incentive role in attracting FDI inflows.

However, the tax incentive treatment to FDI in sector and geographic has also resulted in uneven development and regional disparities. For example "the coastal regions attracted over nine times as much FDI as the inland regions in aggregate terms; they attracted over 12 times as much FDI on a per capita basis". "[I]n recent years, the gap between FDI flows into Guangdong and all other provinces has been enlarging."<sup>83</sup> This is due to government's interference with resources allocation in the country which takes the form of state planed preferential treatment towards coastal areas.

Every government needs a certain amount of revenue to maintain its governing. If it give preferential tax treatment to part of its residents, other parts

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<sup>80</sup> Bierling, J. & Murray, G. "The emerging Powers: China, Singapore, Hong Kong and Taiwan" (1995) 43(1) *Current Sociology* 65, 72.

<sup>81</sup> Jackson, S. & Markowski, S. "The Attractiveness of Countries to Foreign Direct Investment" (1995) 29(5) *JWT* 159, 174.

<sup>82</sup> Fan, C. "Why China Has Been Successful in Attracting Foreign Direct Investment: a transaction cost approach" (1998) 7(17) *Journal of Contemporary China* 21,29.



must take up some extra-tax burden. The preferential income tax treatment to FDI inevitably had effects on the distribution of tax burdens, and therefore on the distribution of income and wealth among taxpayers.

Following the incentive approach of China's FDI regime and the uneven development policy, individuals and business in SEZs can enjoy lower tax rates but residents of other areas can not. Only employees working in a company can buy shares issued by that company at an initial lower price and later sell them on the stock market for profit. Only residents in SEZs can buy shares issued by companies in SEZs (at beginning shares can nearly only be issued in SEZs). Because residents in other areas can not enter SEZs freely, they can not get those advantages, which puts them at a disadvantageous position in the nation's wealth redistribution.

As a result, nearly every reform policy has become a means of social wealth redistribution. Such "gradual reform" helped a part of individuals and regions getting richer and richer while let other parts decrease in shares of social wealth. Such "demonstrative reform" demonstrated to other individuals and regions how to be used to a market economy, also demonstrated to them how to avoid and break laws (not limited only to written law). Such defaults in institutional transition result in corruption, inefficiency, and polarization and decrease the prestige of the government. Finally people's unsatisfactory view of such disorder became a major reason of the 1989 Tiananman Square Demonstration. An interesting phenomenon is that there is hardly any demonstration in SEZs at that time. The only demonstration behavior in SEZs was about the unfairness in issuing company shares in 1992.

In China the Gini coefficient (a measure of relative inequality) for incomes rose from 30 to 39 among 1985 and 1995.<sup>84</sup> In 1995 the total amount of residents' deposits in banks in China amounted to 42,771.2 billion Yuan (about 60% of the total amount of loans of banks in China), but 40% of it belonged to high incomers which was less than 10% of residents.<sup>85</sup>

Fortunately, China has started changing from regional-oriented FDI policy to an industrial and infrastructure-oriented policy. For example, China has signed many

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<sup>83</sup> Broadman, H. & Sun, X. "The Distribution of Foreign Direct Investment in China" (1997) 20(3) *The World Economy* 339, 345.

<sup>84</sup> Walton, M. "The Maturation of the East Asian Miracle" (1997) September, *Finance and Development* 7, 9.

huge projects with foreign investors for inland industrial and infrastructure projects such as water conservancy, highways, power plants and energy projects since 1992. This change will decrease policy-made or legislation-made unfairness in the future.

Even though efforts have been made in China to remove partial treatment of different investments, such as the 1994 tax reform which laid down an equal income tax rate of 33% for foreign and domestic investment and the 1995 foreign exchange system reform which eliminated the dual currency system, partial treatment still existed. For example foreign investors still can enjoy the income tax rate of 15% and tax holidays. However, the deliberate grant of privileges by local government was curbed. Those will be definitely good for China's future even development. They will also be helpful for China to pursue a legal framework to protect property rights and transactions to improve its investment environment.

Characteristic of difficulties in law application.

As some person said that "[i]n China, published rules on foreign investment may be relatively less important, and the somewhat intangible matter of official attitude more critical, and increasingly liberal."<sup>86</sup> This results in the difficulties in application of law and regulation and which can be said to come from or linked with the first two characteristics.

Taking the issue of transfer price as an example, it was said that transfer pricing by FIEs in 1990 had made China a total loss of US\$ 27 billion. Some investors use "an accounting procedure to report a lower-than-actual value of their exports and a higher-than-actual value of their imports. This gave the illusion that they earned less profit than was the actual case."<sup>87</sup> This is one way which made it easier to remit their earnings; at the same time it is a method of tax evasion. As a result, as FDI is a contributor of China's economic growth, it also becomes a vehicle of tax evasion and avoidance.

These application difficulties of law and regulation are due to the policy domination approach and the complex and discretion preferential treatment policies

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<sup>85</sup> Ibid, 154 -55.

<sup>86</sup> Lim, L. & Siddall, N. "Investment dynamism in Asian developing countries" in Dunning, J. & Hamdani, K. *The New Globalism and Developing Countries* (1997) 105.

at both national and local levels, the weak and unindependent judicial systems, and the legislation lag behind transformation practice. In order to guarantee the efficiency of promulgated laws and regulations, effective evaluating and monitoring mechanisms need to be established. "Without effective evaluation mechanisms in place, the legal regime for foreign investment runs the risk of becoming ineffective in achieving the very goals for which it was established."<sup>88</sup>

#### Characteristic of legislation lag.

During the process of economy transformation, FDI legislation some times, at least in some areas, was lagged behind the requirement of economic transform practice. This had resulted in the strange phenomena of "retroactive application of laws, regulations and government policies".<sup>89</sup> Some examples are: sale real estate to foreign investors operated first, then corresponding legislation followed; both RMB and HK dollar circulated in SEZs first, then following legislation confirmed; corporate shares issued first as a "bold experiment", then following legislation regulated. This was due to the policy domination approach and resulted in the unstrictability and unsanctity of FDI legislation.

#### **4.1.3 Future options**

##### Strategy transformation: international harmonization.

It was said that the population growth and the declining ability of agriculture and state-owned industries to expand employment would be the major pressures for China's future development. <sup>90</sup> In order to avoid such pressures bringing its economic and political conflicts to a boil which were showed by history usually shaped not only by growing poverty but also by growing prosperity with uneven and/or unfair; China need to continue to encourage foreign trade and FDI inflow to sustain its economic growth and to absorb its un-and under-employment.

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<sup>87</sup> Myers, R. & Chao, L. "Cross-Strait Economic Relations" in Lin, B. & Myers, J. (eds.) *Contemporary China in the Post-Cold War Era* (1996) 387.

<sup>88</sup> Potter, P. "Foreign Investment Law in the People's Republic of China: Dilemmas of State Control" (1995) 141 *The China Quarterly* 155, 178-80.

<sup>89</sup> Gao, X. "Developments in Securities and Investment Law in China" (1996) 6(2) *Aust Jnl of Corp Law* 228, 236.

<sup>90</sup> Goldstone, J. "The Coming Chinese Collapse" (1995) 99 *Foreign Policy* 35.

Looking to penetrate China's huge potential domestic market is one of the important lures for FDI inflows. However China takes a policy of "exchanging markets for technology" -- gradually open the domestic market to investors who bring in valuable technology and service skill. Accompanied by this process, China's FDI regime is being harmonized with international standards.

As fiscal incentives to foreign investors are reduced, access to the domestic market will be the main bargaining chip for China to achieve its goals of promoting certain industries, acquiring sophisticated technology and developing regions which thus far have been left out of the industrialization process.<sup>91</sup>

As China's economy moves toward an internationalized market-oriented one, its dual legal regimes will be merged into one based on an integrated market in the future. As the economic, legal and political reforms are going on, China is attempting to consolidate both its domestic and foreign investment laws to produce a coherent pattern of statutory regulation, such as contract, corporation, registration, taxation and arbitration. For example, in order to join the WTO, the income tax treatments for domestic and foreign invested enterprises are being unified to meet the requirement of national treatment; a comprehensive contract law is being drafted to replace different contract laws; foreign exchange control is being loosened greatly since 1994.

Restructuring China's FDI regime to harmonize with international standards to attract FDI and maintain its international competitive is called for by such new investment environment. China's FDI regime is changing from an incentive approach to a promotion approach which involves providing more information and assistance to potential foreign investors. This strategy transformation has been started and will be carrying on forward in China in the future time.

#### FDI legislation: from quality to quantity.

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<sup>91</sup> Chakwin, N. & Hamid, N. "Economic Environment in Asia for Investment" in Oman, C. Brooks, D. & Foy, C. *Investing In Asia* (1997) 226.

In order to perform further or deeper domestic economic reform such as state-owned enterprises' reform, financing and banking reform, while promulgating new laws and regulations, more attentions need to be paid whether those laws and regulations being operated efficiently. For otherwise good-law and regulation will achieve little if they are badly implemented.

For example, responding to the process of economic reform and door's opening, China has promulgated significant financial laws since 1995 which included the PRC's Law of People's Bank of China, the PRC's Commercial Bank Law, the PRC's Insurance Law, the PRC's Guarantee Law and the General Lending Provisions (Trial Implementation); and the Bills of Trust and Bankruptcy has been drafting. This will no doubt contribute to deeper domestic economic reform and improve the FDI environment in China. However, there is a dilemma for financial, especially banking system, reform in China. Banks need to be transformed to real commercial banks to reduce or avoid bad debts resulted by loans lent to unprofitable SOEs. However, the reduction of policy loans to this SOEs will increase unemployment and the "triangular debt"<sup>92</sup> problem.

In order to solve this dilemma, the government had set up three policy banks: the State Development Bank which replaces the policy financial functions of the Construction Bank of China and the Industrial and Commercial Bank of China to provide loans to support construction and technology improvement; the Agriculture Development Bank which replaced the policy financial function of the Agriculture Bank of China to provide financial support to agriculture development; and the Export-Import Bank of China which provides financing to prompt foreign trade. However, if these policy banks practice as the same as former banks, similar results could be happened. Moreover,

Many of the new laws, while now widely published, have not yet been subjected to critical analysis, and judicial and administrative interpretations are also lacking. Foreign investors also remain concerned about the inaccessibility of local judicial systems, a problem which has led to

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<sup>92</sup> The inter-debts within enterprises, which was accumulated to over 700 billion yuan in 1995. See "Business Post" *South China Morning Post*, 18 January 1996, 11.



development of international conventions and agreements relating to dispute resolution for commercial contracts.<sup>93</sup>

The question is: how to reform the legal regime to build up a legal institutional mechanism to reduce social cost and to increase efficient stimulate, instead continuing to rely just on policy. Law, as an institutional factor and mechanism in a market society, can not just serves as tools.

A legal institutional mechanism needs not only codes and regulations but also intermediate institutions and communities such as courts, judges, arbitrators, lawyers and accountants. Deferent with just making law and policy, "rule of law cannot come from top-down planning because central officials lack both sufficient information and the right motivation."<sup>94</sup> While constructing its FDI legislation, China should put more effort on the practicability of their implication and to build a legal institutional mechanism to guarantee laws and regulations to work well in life.

In order to secure the efficient operation of laws and regulations, necessary professional standards need to be built and obeyed, especially for those of accountants, auditors, lawyers and brokers. This needs co-operation between different professional groups, for it might be multi-professional ones. Take the principle of "true and fair" as an example, it is really "a matter of law rather than a matter purely of accounting theory".<sup>95</sup>

Otherwise, the well-designed laws and regulations will only exist on paper and might be distorted by practice. For example, because the fraudulent statements of accountants and auditors who audited for PRC's first listed joint venture company, resulted tremendous loss for both shareholders and the local government in Shenzhen. The kinds of arbitrary, or some times fraudulent, professional practice is also one of the reasons for cheating FDI forms and transfer price issues.

#### Decrease income inequity and regional disparity.

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<sup>93</sup> Gutterman, A. & Brown, R. (ed.) *Commercial Laws of East Asia* (1997) 7-8.

<sup>94</sup> Cooter, R. "The Rule of State law and the Rule-of-Law State: Economic Analysis of the Legal Foundations of Development" (1996) *Annual World Bank Conference on Development Economics* 191,212.

<sup>95</sup> Freedman, J. & Power, M. (eds.) *Law and Accountancy - Conflict and Co-operation in the 1990s* (1992) 108.



It is rational for the Chinese government to have relied upon a indirect tax system (turnover tax which mainly deals with horizontal equity) at the beginning stages of the “economic reform and open door policy,” because incomes were more equal at that time and, after 30 years planning economy, tax payers were not costumed with direct tax. But after 20 years of economic reform and growth which have increased income polarization among both residents and regions, the government should change its focus to a reliance on direct tax (income tax which will deal vertical equity) to improve equality in the society.

Law-made residential and regional disparity should be diminished. A sound FDI should provide national treatment for investors and also provide equal competition opportunities for residents and regions. Meanwhile, in order to establish a sound tax system to adjust social wealth distribution and to serve the goals of economic and social development, China needs to improve its tax judicial and administration systems as well.

## **4.2 Hong Kong: common law approach**

The structure of the legal system in Hong Kong mirrors that of English Common law. It possess the following features of the common law tradition: a case-based system of law which functions through analogical reasoning; an hierarchical doctrine of precedent; sources of law which include statutes as well as cases; typical institutions like the trust, tort law, estoppel, and agency; a distinctive improvisatory and pragmatic legal style.<sup>96</sup> These are also reflected in its FDI regime.

### **4.2.1 Reasons and structure**

Hong Kong, previously as a colony of the United Kingdom, mirrors the legal system and economic policy of Western market economy countries and “used to deal in a British-dominated administrative, legal and public service context”.<sup>97</sup> However, as an important part of market institutions, the European approach of legal system and economic policy has also the European historic and geopolitical background.

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<sup>96</sup> Cruz, P. *Comparative Law in a Changing World* (1995) 104.

<sup>97</sup> Tay, A. & Leung, C. “The Relation Between Culture, Commerce and Ethics” in Tay, A. & Leung, C. (eds.) *Greater China: Law, Society and Trade* (1995) 9.

[T]he “European miracle” owed much to the small size and openness of the various European economies. ... In contrast to the big, closed empires of Asia, this limited the absolute power of the rulers and turned despotism and the urge for rent-seeking towards institutional reforms which governed liberty and the wealth of nations. Almost against their instincts, European governments thus laid the foundations for competitive capitalism and became support organizations for merchants and industrialism.<sup>98</sup>

Since the end of the Opium War, Hong Kong has been acting as a major door between China and the outside world. Gradually the 1,061.8 square kilometer island became an internationalized metropolis as an international center of trade, finance, transport and information.

As one of the freest economies in the world, HK follows the policy of “minimum intervention, but maximum support”. There is no prohibition on or incentive for investment in any particular industry or area. The Hong Kong government does not provide any tax reductions or exemptions for any investment whether foreign or domestic, nor does it control the investment in any particular industry. Generally speaking, a foreign investor can incorporate a company in Hong Kong without obtaining any government approval. Laws and procedures with respect to registration of a company in Hong Kong are equal for both domestic and overseas investors. Under the Banking Amendment Ordinance, the authorization criteria for a banking licence from the Hong Kong Monetary Authority (HKMA) for locally incorporated applicants and overseas applicants are broadly the same.<sup>99</sup>

On the whole it can be said that Hong Kong treats foreign businesses no differently than domestic ones. Hong Kong does not distinguish or discriminate against foreign owned companies. However, there are some restrictions as to the amount foreign investors can own in licenced television broadcasters. Hong Kong has no specific foreign investment legislation.

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<sup>98</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 29. See detail in:

Jones, E. *The European Miracle* (Cambridge: Cambridge University Press, 2d ed., 1987).

<sup>99</sup> Wang, G. “the Investment Laws of Hong Kong under ‘One Country, Two System’” (1997) 31(6) *J.W.T.* 104, 108 & 109.

...Hong Kong does not discriminate in favor of foreign business and does not normally offer preferential tax treatment to incoming businesses.<sup>100</sup>

One point of Hong Kong's attractions to foreign visitors is its favorable tax system: simple tax structure, low tax rate and proper administration system. As an example of free market, HK's tax structure is relatively simple which included three major kinds of tax: profits tax, salaries tax and property tax; and its tax rate is relatively low. The profits tax of individual unincorporated enterprise is 16%, and of corporations 18%.<sup>101</sup> There is no capital gains tax and no payroll tax. "The tax system does not discriminate against foreign companies. Foreign businesses in Hong Kong will be liable in Hong Kong for its profits tax only on income derived in Hong Kong."<sup>102</sup> There is no tax advantage for foreign investors compared with HK residents, just the same simple tax structure and overall low rates for both residents and non-residents. Another point is that there is no foreign exchange control in Hong Kong, instead the exchange rate of the HK dollar is fixed with US dollar at the rate of US\$ 1 = HK \$ 7.8.

Considering the principle of separation of legislation, jurisdiction and administration, HK's court system is an independent judicature which maintains the free trade and investment environment in HK. In order to continue this system, according to the Basic Law, the Hong Kong Court of Final Appeal was established to take over the function of the Privy Council in relation of final adjudication.<sup>103</sup> Meanwhile, Hong Kong is also one of the best arbitration sites in the world, and probably handles the largest number of cases in which neither party is local. Arbitration awards made in Hong Kong are enforceable through the courts of most of the world's trading economies.<sup>104</sup> This approach placed Hong Kong at a better institutional environment to FDI.

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<sup>100</sup> Lederman, D. "Hong Kong" in Gutterman, A. & Brown, R. (ed.) *Commercial Laws of East Asia* (1997) 161-62.

<sup>101</sup> Wang, G. "the Investment Laws of Hong Kong under 'One Country, Two System'" (1997) 31(6) *J.W.T.* 107.

<sup>102</sup> Lederman, D. "Hong Kong" in Gutterman, A. & Brown, R. (eds.) *Commercial Laws of East Asia* (1997) 174.

<sup>103</sup> The Basic Law, art. 19. The Hong Kong Court of Final Appeal Ordinance s.1.

<sup>104</sup> Wang, G. "the Investment Laws of Hong Kong under 'One Country, Two System'" (1997) 31(6) *J.W.T.* 112.

Looking back low tax, equality, transparency of laws and regulations, and an impartial legal and judicial system are among the factors which have successfully attracted a large number of foreign investments in Hong Kong. The situation has remained the same after the hand over on 1 July 1997.<sup>105</sup>

#### **4.2.2 Characteristics and evaluation**

Developed from a British colony, HK's FDI regime has a characteristic of importation of a foreign legal culture and system. As most capitalist market economies, the government in HK has been committed to a free trade policy, and allowing market competition to allocate resources and to prompt economic growth. Therefore FDI regulations are minimal. But, as a common law jurisdiction, case law has at least the same affect as statutory provisions in HK.

Hong Kong has a strong common law tradition based on the English system. The common law was imposed on Hong Kong in 1844. This provided a source of stability upon which business flourished. ... [A]ll business must be registered, whatever the form, under the Business Registration Ordinance. Foreign firms are treated equally with domestic firms.<sup>106</sup>

This non-interventionist approach maintained HK's status as a free port and tariff-free zone with complete freedom from FDI and foreign exchange controls. "The Hong Kong government does not have an industrial policy and has refrained from using fiscal subsidies or preferential tax treatment to promote particular sectors or industries."<sup>107</sup>

However, while limiting its activities on basic functions, the government "has never shied away from using its public expenditure program to fine-tune the economy." "During the 1970s, for example, government expenditure accounted for 22 per cent of aggregate demand."<sup>108</sup>

Considering this non-interventionist approach, HK's FDI regime is highly harmonized with international standards. On the one hand, HK is a member of WTO,

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<sup>105</sup> Ibid, 110, 105.

<sup>106</sup> Lederman, D. "Hong Kong" in Gutterman, A. & Brown, R. (eds.) *Commercial Laws of East Asia* (1997) 126, 131.

<sup>107</sup> Husain, A. "Hong Kong, China in Transition" (1997) September, *Finance and Development* 3, 5.

the Asian Development Bank, the United Nations and many other international conventions. On the other hand, HK is internationally recognized a free trade port and banking center. There are approximately 500 foreign banks and 624 regional headquarters of foreign firms in HK, and they are promoting and enjoying the harmonized business environment in HK.<sup>109</sup>

### **2.2.3 Future options**

According to the Basic Law of HKSAR, “[t]he socialist system and policies shall not be practiced in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for 50 years”.<sup>110</sup> Based on this constitutional provision and following the market economy tradition in Hong Kong, the government in HKSAR could keep on the policy of “minimum intervention, but maximum support” to maintain its position as an international trade and finance center. This will be good for both HK and the mainland China.

Hong Kong’s free market economy is based upon and guaranteed by its legal system which include its FDI regime. However, this legal system is not completely built up yet, instead it is improving by its experience. For example,

During the worldwide stock market crash of October 1987, the Hong Kong stock and futures exchanges closed for four days, locking outside investors into growing losses while permitting some influential insiders to escape them. ... In the aftermath of the crisis, the chairman of the stock exchange and several of his associates were tried and convicted on corruption charges, and ... a new regulatory agency, the Securities and Futures Commission (SFC) [was established].<sup>111</sup>

While maintaining its tradition of rule by law, as its status transited from a colony to the SAR of the PRC, the government needs also to improve its legal system to accompany its new role and to maintain HK’s prosperity. Take the intellectual property system as an example. Prior to 1 July 1997 the examination and

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<sup>108</sup> Islam, I. & Chowdhury, A. *Asia-Pacific Economies: A survey* (1997) 192.

<sup>109</sup> Ibid, 152 & 162.

<sup>110</sup> The Basic Law, art 5.

<sup>111</sup> Noland, M. *Pacific Basin Developing Countries: Prospects for The Future* (1990) 20-22.



registration of patents and trademarks had been done in the United Kingdom. On 27 June 1997, with the enactment of the Copyright Ordinance, the Patent Ordinance and the Registered Design Ordinance by the Hong Kong government, "for the first time in the history, Hong Kong has a completely independent, modern and user-friendly intellectual property regime based on local laws."<sup>112</sup> This improvement will help maintain HK's intellectual property regime and guarantee intellectual property transactions in HK.

Another example is HK's company law. In order to changes of the existing laws to meet the demands of circumstance changing, Hong Kong is now reviewing its Companies Ordinance. The revising was recommended by a report to

shift to a new, coherent ordinance, drawing on new models rather than cobbling bits and pieces of foreign legislation together with the current ordinance. ... The report has adopted a "core company law" approach to a new companies legislation for Hong Kong. It means the Companies Law should confine itself to birth, life and death of the enterprise. ... Under this plan, foreign companies will be allowed to reincorporate in Hong Kong under the new Ordinance, without the necessity of liquidation and the resulting disruption and interruption in corporate existence.<sup>113</sup>

As HK reunified with China, there is a trend of inter-influence between Hong Kong and China in the aspects of economy, culture, politics and law as well. This will benefit both HK and China. However a challenge for HK's future is how to avoid the influence of political propaganda, bureaucracy and corruption which are common phenomena in China. Especially the problem of corruption will be a real challenge to the free FDI regime and the independent judicature in HK. For example, it was said that start before 1997, corruption cases are increased significantly in HK and especially collective corruption is warring the government.<sup>114</sup>

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<sup>112</sup> Wang, G. "the Investment Laws of Hong Kong under 'One Country, Two System'" (1997) 31(6) *J.W.T.* 118.

<sup>113</sup> *Ibid*, 118-19.

The phrase "core company law" has been coined recently by the New Zealand Law Reform Commission with the aim of providing a simple, efficient and cost-effective means of incorporating and maintaining a business.

<sup>114</sup> Guo, J. "Great view of the social development in Hong Kong" in Chen, X. (ed.) *Four Place on Both sides: China, Taiwan, Hong Kong and Aomen* (1997) 225.



HK's experience attests that institutions of restraint and competitiveness of delivery can reduce incentives for corrupt behavior. With regard to maintain HK's status as a free trade and investment market in the future, to keep these institutions is necessary.

### **4.3 Taiwan: civil law approach**

The structure of the ROC legal system basically derives from that of the European continental legal system. As a sub-branch of the civil law system, Taiwan shared characteristics such as reliance on elaboration of statutory and codified precepts, separate and specialized courts, and collegiate judiciary.<sup>115</sup> These characteristics made Taiwan's FDI regime taken the form of the written law.

#### **4.3.1 Reasons and structure**

Taiwan is one of the most successful cases of economic development on record. As an industrialized economy and with high foreign currency reserve, "It has begun to show those twin characteristics of countries toward the top of the economic hierarchy: outflows of investment in search of cheaper labor, and inflows of illegal foreign workers in search of higher wages."<sup>116</sup> Lim, D., provides the reasons for Taiwan's miracle, like other NIEs, as following:

[S]carcity of natural resources forced the economies to export, eventually accumulating foreign exchange; some of the economies in the region were fortunate enough to receive foreign aid; the Confucian background incorporated harmony and hard work; and businesses and governments often joined forces to reduce competition, increase co-operation, and provide state supported protectionism.<sup>117</sup>

After the ROC moved its government to Taiwan island, the policy-makers followed the path from import substitution to export promotion, and finally to

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<sup>115</sup> Cruz, P. *Comparative Law in a Changing World* (1995) 99.

<sup>116</sup> Wade, R. *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (1990) 6.

<sup>117</sup> Anwar, S. "Trends in International Business Thought and Literature: Reviewing East Asia's Miracle, Its Economic Dynamism, and Future Issues" (1997) 1(39) *The International Executive* 83, 90.

capital-and technology-intensive industries. Foreign trade and investment thus became the predominant economic activity. Taiwan's experience of moving from a poverty economy to the status of newly industrialized county renders it a successful example for other developing economies to learn.

As an important sector of its economic growth, FDI in Taiwan is regulated by either the Statute for Investment by Foreign Nationals (SIFN, which was promulgated in 1954 and last amended in 1989) or by the Statute for Investment by Overseas Chinese (SIOC, promulgated and amended as SIFN but governs investment by overseas Chinese who may be nationals of another country but are ethnically Chinese), Depending on the identity of the investing party. "Investments in Taiwan under either one of theses statutes must be approved by the Investment Commission of the Ministry of Economic Affairs. ... Once approved, foreign investment projects are entitled to certain privileges."<sup>118</sup> These include the privilege of freely repatriating investment proceeds, the ability to transfer approved foreign investment, exemptions from political risks and government requirements such as requisition and expropriation, mandatory employee subscription right, compulsion to go public and certain Company Law provisions relating to the domicile and nationality requirement.<sup>119</sup>

As to the recipient of foreign investment, it can be either a new company formed locally with capital contribution solely from the foreign investor, i.e., a wholly owned subsidiary, or one with local participation, that is, a joint venture company ("JVC"). It can also be an existing local company to which the foreign investment flows through capital increases or stock purchases.<sup>120</sup>

Since the 1980s, as international situation changed for Taiwan export-oriented economy, a series of political and economic reforms has taken place in Taiwan. As a result of the liberalization of foreign exchange control which took place in 1987 under the Regulations for Non-governmental Outward Remittance and

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<sup>118</sup> Klatt, G. "Taiwan" in Gutterman, A. & Brown, R. (cd.) *Commercial Laws of East Asia* (1997) 536-37.

<sup>119</sup> SIFN, art. 12-18.

<sup>120</sup> Wu, S. "Taiwan" in Buhart, J. (cd.) *Joint Ventures in East Asia: Legal Issues* (1992) 71, 72 & 74.

the Regulations for Non-governmental Inward Remittance, the SIFN was amended in 1989.

The new SIFN relaxed the FDI policy of the ROC from a positive listing approach which identified industries and businesses in which FDI was allowed or encouraged<sup>121</sup>, to a negative listing approach which identifies industries and businesses in which FDI is prohibited or restricted<sup>122</sup>. Those changes made Taiwan's FDI regime more harmonized with the international approach and made its industries and businesses more competitive.

The other pillar constituting Taiwan's legal framework with respect to FDI is the Statute for Encouragement of Investment (SEI) which was enacted in 1960. It played an important role in Taiwan's economic policy. The varieties of incentives provided in this 1960 statute included acceleration for depreciation of capital assets, tax deferral or exemption given to certain selected investments, or tax deferral or exemption for the encouragement of saving and facilitating the development of the capital market. According to the SEI, foreign investors organized in the form of a company limited by shares or its equivalent forms under the SIFN, whether as a local subsidiary or a branch office in the ROC, may qualify for the incentive package offered in the SEI.<sup>123</sup>

Under the SEI, the government regularly promulgated and updated lists of industries and businesses that would be entitled to investment incentives under the SEI. This approach was criticized for promoting certain economy sectors (especially manufacturing) instead of balanced development and for making the tax administration more difficult and complicated.<sup>124</sup> So, on 29 December 1990, as part of the government's efforts to revitalize Taiwan's economic growth, new legislation - the Statute for Upgrading Industries (SUI) - was promulgated to supersede the SEI. The approach of the SUI was basically similar to the SEI, but focused preferential treatment on those investment activities which are conducive to structural improvements in local industries, such as automation, the building up of

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<sup>121</sup> SIFN, 1954, art. 5.

<sup>122</sup> SIFN, 1989, art. 5.

<sup>123</sup> Ibid, art 19.

<sup>124</sup> Liu, L. "The Legal Framework for Foreign Investment" in Silk, M. (ed.) *Taiwan Trade and Investment Law* (1994) 166.

international brand names, personnel training, the purchase of technological equipment for environmental protection, and research and development (R & D).

The major elements of the encouragement scheme provided by the SUI for foreign invested enterprises in Taiwan can be summered as following:

- \* Accelerated depreciation for certain qualified machinery and equipment;
- \* A qualified company is entitled to an investment tax credit of 5% to 20% on automation production equipment, technology or energy recycling, pollution control production/technology, R & D, personnel training, creation of an international brand image, energy saving, industrial waste recycling equipment/technology, and in a district short of resources or with a slow pace of development;
- \* A company can credit against its income tax up to 20% of the price paid for the shares of an important technology-based enterprise, an important invested enterprise or a venture capital investment enterprise, an important invested enterprise or a venture capital investment enterprise after holding it for over two years;
- \* For investment in an important technology-based enterprise or important invested enterprise, the shareholders can waive their investment credit and select to have a five year tax holiday for the investee company;
- \* Income tax on reinvested earnings for certain purposes can be deferred;
- \* The withholding income tax on dividends distributed by a qualified company to a non-resident shareholder, whose investment has been approved under the SIFN, shall be 20% as opposed to the regular 35%;
- \* A company can retain, rather than distribute, retained earnings up to its paid-in capital or twice that amount if the industry is designated as important, instead of the otherwise applicable ceiling of 50% of its paid-in capital.<sup>125</sup>

There are more incentives in Export Processing Zones (EPZ) such as EPZs in Kaohsiung, Nantze and Taichung, and Science-based Industrial Park (HSBIP) such as Hsinchu HSBIP.<sup>126</sup> The Statute for Establishment and Management of the Export Processing Zones was promulgated in 1965 to encourage processing for export in free trade zones. The Statute for the Establishment and Administration of Science

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<sup>125</sup> SUI, art. 5-20.

<sup>126</sup> Price Waterhouse Asia-Pacific Guide Tax and Investment (1997).

Based Industrial Parks was enacted in 1979 to implement the proposal of the ROC government to attract high-tech investment.

The above changes in FDI regime in Taiwan reflected its economic transformation from labor-intensive industries to capital and technology-innovative industries. Besides the legislature change, the jurisdiction in Taiwan also provides protection to FDI.

The judicial system consists of the Supreme Court (the highest court), the High Courts of Justice (the intermediate courts), and District Courts. ...A judgement made by a foreign court may be enforceable in the ROC provided that such a judgement is recognized by a Taiwanese court to be consistent with the pertinent provisions of ROC law.<sup>127</sup>

[An] arbitration award has the same effect as a definitive judgement, and is enforceable after approval by the court on the procedure and format of the award. Certain awards are enforceable automatically if a waiver of the court's scrutiny is opted for by the parties in the arbitration agreement. To overturn an award, the parties must instigate a formal suit.<sup>128</sup>

However, a foreign arbitration award can only be executed after a Taiwanese court has recognized its effectiveness.<sup>129</sup>

#### ***4.3.2 Characteristics and evaluation***

##### **Policy orientation.**

Learning from its failure in the mainland, the government played a more important role in promoting Taiwan's economic growth since exiled to Taiwan. "As gatekeeper for the national economy, it has scrutinized inflows and outflows and affected the terms of transactions in line with national objectives," as well as restricting "the opportunities for accumulating wealth through unproductive

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<sup>127</sup> Kwang, M. "Taiwan - The Republic of China: A profile of Recent Constitutional Changes and Legal Developments" in Tay, A. & Leung, C. (eds.) *Greater China: Law, Society and Trade* (1995) 77.

<sup>128</sup> Wu, S. "Taiwan" in Buhart, J. (ed.) *Joint Ventures in East Asia: Legal Issues* (1992) 81.

<sup>129</sup> The Commercial Arbitration Act, arts 30-33.



investment.”<sup>130</sup> This gives Taiwan’s FDI regime a characteristic of policy orientation.

Macroeconomic policy and “formal economic planning has existed in Taiwan since 1953, when the Economic Stabilization Board (ESB) was created and the leading role of the private sector reaffirmed”.<sup>131</sup> Some of examples are: using high interest rates (The highest at 125% in 1950) to curb high inflation and encourage high saving; concentrating on “big projects on infrastructure constructions”; transforming from indirect tax to direct tax to curb income polarization; using tax incentives and favorable interest rate loans to woo FDI, especially for high-tech FDI projects. “Commonsense therefore suggests that the overall Taiwan experience supports the proposition that purposeful involvement by government in support of economic development *can* be enormously helpful.”<sup>132</sup>

Historic influences.

Capital and personnel flow from mainland China at the end of the 1940s and United States’ aid in the 1950s and 1960s is the background of the origin of Taiwan’s FDI regime. Besides military defence, the US aid also supported Taiwan government to curb inflation, maintain economic stability and supplementary its government deficit.<sup>133</sup> In order to get US aid, Taiwan had to build essential institutional system to fulfil the requirement of US. This had led Taiwan structure its FDI regime.

It was said that with the support and aid of the US and with the input of Mainland industrialists who had fled with the government to the island, Taiwan was well placed to develop and grow.<sup>134</sup> However, we should keep in mind that without the good guidance of its government, the economic miracle could not have happened in the island.

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<sup>130</sup> Wade, R. *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (1990) 157 & 262.

<sup>131</sup> Sheridan, K. (ed.) *Emerging Economic Systems in Asia: a political and economic survey* (1998) 51.

<sup>132</sup> Ibid, 66.

<sup>133</sup> Wen, X. *Behind Economic Miracle: politic economic analysis of US aid in Taiwan (1951-1965)* (1990) 92-3.

<sup>134</sup> Hutcheon, R. “Capitalist Bulls in the Socialist China shop, How the two learned to co-exist” in Tay, A. & Leung, C. (eds.) *Greater China: Law, Society and Trade* (1995) 37.



#### Intimate government- business co-operation.

Besides foreign aid and investment, generally speaking, Taiwan's miracle was based on the co-operation between government and individual business. One example of such "collaboration is provided by the entry of Taiwan's firms into the personal computer (PC) market"<sup>135</sup> which was achieved by the joint effort of government and local private business.

The largest of Taiwan's electronics firms, Tatung and Sampo, first opted not to enter the industry. So *government* took the initiative and established the Electronics Research and Service Organization (ERSO) by grant in 1975. ERSO developed its own integrated circuit (IC) production facility, offered design and production services to the private sector, and became the source of a number of spin-offs for Taiwan's semiconductor industry.<sup>136</sup>

#### Strong government but small and weak family business.

Compared with government's strong power in the economic field, individual business is relatively weak. Family-dominated individual business, just like members in a family, protects by and obeyed to their parent - the government. That is why family business continues to dominate the corporate sector in Taiwan and they are dependent on *Guanxi* (interpersonal relations) with government officials. It has been said that

There are several distinguishing features of this Chinese capitalism: (1) a strong preference for family business; (2) a common sinic cultural heritage; (3) adherence to Confucian values (obedience, loyalty and collectivist ethics); and (4) an emphasis upon relational rather than transactional values -- 'rule of relationships' rather than 'rule of law.'<sup>137</sup>

#### **4.3.3 Future options**

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<sup>135</sup> Sheridan, K. (ed.) *Emerging Economic Systems in Asia: a political and economic survey* (1998) 69.

<sup>136</sup> Ibid, 68.

<sup>137</sup> Jones, C. "Capitalism, Globalization and Rule of Law: an Alternative Trajectory of Legal Change in China" (1994) 3(2) *Social & Legal Studies* 195, 197.

Not like HK, which has already, became an international trade and finance center, Taiwan needs to improve its FDI regime to guide its outward-oriented economy to be more attractive and competitive. As the international markets become both globalizing and regionalizing, Taiwan's economic ties unavoidably link with China. "In 1992, the government announced its goal of developing Taipei as a regional center for finance, communications and commerce, to benefit from Taiwan's advantages in dealing with China."<sup>138</sup> This will be helpful to FDI integration and national unification across the Taiwan Strait.

The successful hand over of HK had an important and positive impact on the relations across the strait. Will the principle of "One country two systems" be applied on Taiwan? It depends upon the governments' co-operation across the strait. From an optimistic point of view, Taiwan is governed by Chinese themselves instead by a colonial government like HK before the hand over, which might be easier for the reunification. From a pessimistic point of view, there is a long-time hostility between the two governments, with their own armed forces and a more complex international concern on the issue of Taiwan which could be more difficult for the reunification across Taiwan Strait.

In respect of the above issues, trade, investment and cultural links between the strait are unavoidable. For sooner or later, the integration of FDI regimes across the strait is a necessity, and this will be both helpful to the national reunification and benefit to people living on both sides of the strait.

With huge foreign currency reserve and sensitive international status, Taiwan's FDI regime is more variable and dimensional. It needs to protect and lead both FDI inflow and outflow. Further more, following the trends of socialization of production and for the seek of increasing its international competitive ability, Taiwan's FDI regime should lead is individual business go forward to be more socialized and integrated.

#### **4.4 Summary**

The experiences in the triangle attested that an outward-oriented market system is the main impetus for economic growth. However, this relies upon a stable

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<sup>138</sup> Islam, I. & Chowdhury, A. *Asia-Pacific Economies: A survey* (London: Routledge, 1997) 181.

social institutional environment such as legal, political and economic systems. To build such a sound institutional environment to support market to operate efficiently, government can and should play a positive role.

FDI as an institutional setting, reflects ideologies based on different history and cultural background. It is interesting that governments, similar to judges, play different roles in different legal regimes.

In the common law countries, ... the judge is not supposed to direct a line of questioning or develop an argument. In this *adversarial process*, the judge acts more or less as a neutral referee who makes the lawyers follow the rules of procedure and evidence. The principle underlying the adversarial system is that the truth will emerge from a vigorous debate by the two sides.

In contrast, the civil law judge takes an active role in directing questions and developing arguments. In this *inquisitorial process*, the judge is supposed to ferret out the truth.<sup>139</sup>

Within the triangle, HK's government based upon the neoclassic theory of free trade and investment plays a negative role, like judge's neutral function in common law system, to make market competitions to choose for optimum. Its FDI regime follows an approach of "positive non-interventionist policy";<sup>140</sup> Governments in both Taiwan and China are based upon new institutional and neo-authoritarian theory and play a positive role in guiding economic growth and the process of economic reform. Taiwan's FDI regime took an approach of "Discretionary control of structural incentives to supplement market signals";<sup>141</sup> and China's FDI regime adopted an approach of regional and structural incentive to supplement the transformation to a market-oriented economy. Their experience attests again that "underdevelopment was attributed to the failure of the market mechanism."<sup>142</sup> However,

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<sup>139</sup> Cooter, R. & Ulen, T. *Law and Economics* (1997 2nd ed.) 57.

<sup>140</sup> So, A. & Chiu, S. *East Asia and the World Economy* (1995) 241.

<sup>141</sup> Chu, Y. "State structure and economic adjustment of the East Asian newly industrializing countries" (1989) 43(4) *International Organization* 647, 652.

<sup>142</sup> Rimmer, P. "Industrialization policy and the role of the state: Newly industrializing economies" in Heron, R. & Park, S. (eds.) *The Asian Pacific Rim and Globalization* (1995) 21.

[t]he government did not simply control markets; it also offered periodically updated visions of the appropriate industrial and trade profile of the economy and gave a directional thrust to private sector choices in line with these visions.<sup>143</sup>

In civil law system countries, generally speaking, government -- like judges -- play a more positive role. This is one important reason why there is “economic law” -- government intervention law -- in civil law countries but not exist common law countries. However, even though FDI regimes in both China and Taiwan take the civil law form concepts, it is commented that:

There are three main ways in which East Asian legal institutions differ from those of Western Europe. First, they differ in the degree to which law is seen as a method for resolving conflict between autonomous private parties; second, in how far law is seen as implementing the public objective of the state; and, third, in the extent to which legal standards, rather than formal law, are utilized. In East Asia, unlike in Western Europe, all of these lead to the development of different notions of legalism. Whereas in Western Europe, legalism is about restraining the power of the state, in East Asia, it is employed as a managerial and technocratic device for the effective organization of the market and the state.<sup>144</sup>

Holding different ideals, reflecting on different theories and taking deferent approaches for their FDI regimes; but based on outward-oriented market strategies and common culture background, all of the three have successfully attracted “productivity-enhancing mobile resources”.<sup>145</sup> Their experiences had demonstrated that outward-oriented market economic regimes encourage efficiency and are thus more beneficial to both domestic and international economy, and shown that there is mane than one way to skin a cat. So, their experiences can be learned but might not be copied by other developing countries.

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<sup>143</sup> Wade, R. *Governing the Market: economic theory and the role of government in East Asian Industrialisation* (1990) 4.

<sup>144</sup> Jayasuriya, K. “The rule of law and capitalism in East Asia” (1996) 9(3) *The Pacific Review* 367, 376-77.

## ***5. Integration and Harmonization***

As I mentioned earlier above, regional integration and international harmonization are the two sides of world market environment today. In this part, I will first analyze the regional integration in the Chinese triangle, then discuss their harmonization with international standards.

### **5.1 Regional integration**

#### ***5.1.1 Market-driven integration***

Within the triangle, the advantages of HK are service industry, especially finance services, and real estate development. One of the most important roles that Hong Kong plays in the development of China's economy is as a financial center. China mostly raises its funds in Hong Kong through syndicated loans, issuing negotiable certificates of deposit, bonds and "H" shares. The advantages of Taiwan are high-tech products and management experience. But both regions are insufficient in land, labor and other industrial resources.

Furthermore, in late 1970s and the first half of 1980s, both HK and Taiwan faced domestic constraints of rising costs as well as external market restrictions. For example, the nominal wage index in Hong Kong increased from 100 to 242.1 during the period of 1982-1992.<sup>145</sup> Technological upgrading and market diversification seemed to be the unavoidable solutions.<sup>146</sup> Costs increase pressured labor-intensive business to migrate from HK and Taiwan to mainland China.

Meanwhile, the advantages of mainland China are its huge market, abundant supplies of natural resources and cheaper labor but it is insufficient in finance, high-tech and management experience. FDI has a very important role in China's economic and social development. "For example, about 50 per cent of the country's industrial output value is due to FDI, and enterprises with foreign investment earned about

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<sup>145</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 43.

<sup>146</sup> Census and Statistics Department of Hong Kong *Hong Kong Annual Digest of Statistics* (1993) 40.

<sup>147</sup> Tsang, S. "The Political Economy of Greater China" (1996) 2(3) *Asia Pacific Business Review* 23, 28.



one-third of the country's foreign exchange, employing about 17 million workers."<sup>148</sup>

Making use of China's low labor cost, foreign direct investments in the manufacturing sector are geared mainly to the export market. In the 1985-1990 period, industrial output grew by an average of 28.2 percent in nominal terms. Between 1990-1994, industrial output grew by an annual average of 55.4 percent.<sup>149</sup>

The complementary to one another within the triangle and the economic integration among them makes them a core region "in the world economy utilizing the following cooperative assets: China's abundant cheap labor, raw materials, and market; Taiwan's capital and technology-intensive industries; and Hong Kong's established world-wide financial and trading network."<sup>150</sup>

If they cooperate one another, they can mutually supplement and mutually benefit one another. And this will increase their competitive ability in the world market. For example, China, relatively resource-rich, complements the resource-poor Hong Kong and Taiwan; HK and Taiwan, relatively fund-rich, complement the fund-short mainland China. China's open door policy "coincided with the loss of comparative advantage in labor-intensive manufactured goods by Hong Kong [Taiwan] and other NIEs, whose entrepreneurs were thus keen to combine their skills and used machinery with China's abundant low-cost labor."<sup>151</sup>

For the integration between China and Hong Kong, HK is the major contributor of FDI inflow in China -- though the figure is overstated as some FDI from HK is capital of other foreign investors or even branches of mainland business brought back by the channel of HK - as showed below (Table 3); China's investment abroad in HK is far the biggest for any of China's foreign investment.<sup>152</sup> Investors from mainland China have accumulated significant property and equity assets in HK. "Traditionally, the biggest foreign investor in Hong Kong was Britain. Currently the

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<sup>148</sup> Zhang, X. "Investment in China's Future" in Oman, C. Broods, D. & Foy, C. *Investing In Asia* (1997) 41.

<sup>149</sup> Tait, A. & Li, K. "Trade Regimes and China's Accession to the World Trade Organization" (1997) 31(3) *J.W.T.* 93, 96.

<sup>150</sup> So, A. & Chiu, S. *East Asia and the World Economy* (1995) 250.

<sup>151</sup> Pomfret, R. *Development Economics* (1997) 245.

<sup>152</sup> See table, (1997) 24(2) *The China Business Review* 12.

major investors in Hong Kong are China, Japan and the United States. Statistics of Foreign Direct Investment (FDI) show that China has invested US\$ 25 billion.”<sup>153</sup> Know China has become the largest investor in HK.

Table 3. Investment flows between China, HK and Taiwan (Contract, US\$ billion)

From		China		HK		Taiwan
To	1991-1994	1994	1991-1994	1994	1991-1994	1994
China			177.9	49.014	22.305	5.396
HK	0.13	0.00012			0.541	0.13
Taiwan	NA	NA	0.761	0.251		

Sources: <sup>154</sup>

Faced with Mainland China’s reunification policy, the official line in Taiwan was “one China, but not now,” i.e., there is only one China and Taiwan is part of China, but peaceful reunification is distant. However, under the pressure of market integration and international competition, indirect trade and investment across the Taiwan Strait has increased rapidly since 1988.

Despite the absence of official ties, economic integration between China and Taiwan has proceeded at a fast pace, largely through the efficient intermediary of Hong Kong. In 1991, Taiwan passed Hong Kong and the United States to become the second largest supplier of goods to China after Japan; Taiwan also overtook the United States and Japan to become the second largest investor in China after Hong Kong. ... However, if Taiwan continues to liberalize its relations with the mainland, Taiwanese investment in China will probably rival that of Hong Kong in the long run.<sup>155</sup>

<sup>153</sup> Wang, G. “the Investment Laws of Hong Kong under ‘One Country, Two System’” (1997) 31(6) *J.W.T.* 104.

<sup>154</sup> China Statistical Yearbook (1995), China Statistical Yearbook for Foreign Economic and Trade (1992-1995) and etc.

See Table 5. in Cheng, J. “China, Taiwan and Hong Kong in the mid-1990a” (1996) April/May *Current Affairs Bulletin* 14, 23.

<sup>155</sup> Sung, Y. “Subregional economic integration: Hong Kong, Taiwan, South China and beyond” in Chen, K. & Drysdale, P. (eds.) *Corporate Links and Foreign Direct Investment in Asia and the Pacific* (1995) 59 & 75.

Table 4. FDI in China by Source Country 1979-1993 US\$ billion

Items Countries	No. of FDI Companies	%	Registered Capital	%
Hong Kong	108,914	63.8	103.9	72.7
Taiwan	20,612	12.3	13.2	9.3
USA	11,554	6.9	8.2	5.7
Japan	7,096	4.2	5.2	3.6
Macao	4,116	2.5	4.1	2.9
Singapore	3,037	1.8	3.3	2.3
S. Korea	2,321	1.4	1.3	0.9
Canada	1,595	0.9	1.0	0.7
Thailand	1,361	0.8	1.6	1.1
Australia	1,269	0.8	1.0	0.7
Total	167,507	100	142.9	100

Source: *Jingji Yanjiu Cankao* (Beijing), 12 October 1994.

According to the MFTEC, HK and Taiwan are the first two of China's top 5 accumulated FDI investors in 1995. They counted to a total of US\$ 90.201 billion.<sup>156</sup> Meanwhile, inter-investment between Taiwan and HK are also significant. By 1995, Taiwan had more than \$ 2 billion investments in HK while HK had over \$ 12 billion in Taiwan.<sup>157</sup>

Hong Kong, later joined by Taiwan, has contributed in a significant way to China's export-oriented economic development strategy since 1979. They have provided capital, technology, management expertise and business connections which have facilitated China's entry into the global trading system which in turn has much benefited China's impressive economic growth.<sup>158</sup>

<sup>156</sup> As at the end of 1995, actual FDI in China in US\$ billion: HK 78.616; Taiwan 11.585; US 10.851; Japan 10.506; and Singapore 3.923. See: Walker, T. "China: this way up" (1996) July, *Accountancy* 28, 30.

<sup>157</sup> Calder, K. *Asia's Deadly Triangle: How Arms, Energy and Growth Threaten to Destabilize Asia-Pacific* (1997) 114-5.

<sup>158</sup> Cheng, J. "China, Taiwan and Hong Kong in the mid-1990s" (1996) April/May *Current Affairs Bulletin* 23.

Like the interdependency between Hong Kong and Mainland China, with the growing of cross-trait trade and investment, the interdependency between both sides of the Taiwan Strait is increasing. At the end, the economic and cultural links will push the governments to progress on integration and reunification. Even now, the huge amount of cross investment and trade within the triangle implies that the interests of China, Hong Kong and Taiwan have been tied together tightly.

Many barriers to the economic integration of the triangle remain, the main ones being the remnants of central economic planning in China and Taiwan's ban on direct business linked with the mainland. Despite the lack of an overall institutional framework for coordinating economic integration, geographic and cultural proximity and the huge gains to be made from economic complementarity have overcome many of the barriers to closer ties within the region.<sup>159</sup>

#### ***5.1.2 Institution-driven integration***

Compared with the rapid integration in the triangle at the level of trade and investment, integration at regime level is slow and quite difficult, especially cross the Taiwan Strait. Although China and Taiwan take similar forms and approaches toward FDI, due to fundamental ideological problems and political conflicts, the integration of their FDI regimes can be quite complicated and slow.

Fortunately, Taiwan has begun to realize the value of the mainland economic connection and has made attempts at institutional and legal reform to accommodate the situation. Towards the middle of 1988 Taiwan officially condoned indirect trade with the mainland, and subsequent legislative and judicial developments clarified that indirect investment through a third party (commonly HK) would be allowed. Since the early 1990s,

Taiwan adopted a new policy toward mainland China. Unlike the policy which it replaced, this policy shows that the leadership of the ROC has finally assumed a positive and realistic approach toward the issue of

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<sup>159</sup> Sung, Y. "Subregional economic integration: Hong Kong, Taiwan, South China and beyond" in Chen, K. & Drysdale, P. (eds.) *Corporate Links and Foreign Direct Investment in Asia and the Pacific* (1995) 58.

unification and a willingness to view the mainland regime in a nonideological and pragmatic way.<sup>160</sup>

Facing PRC's reunification policy, Taiwan initially took the "Three No's" (no contact, no talk, no compromise) as a response. However, because the magnetic effect of PRC on Taiwan is very strong, ultimately the "Three No's" became more a policy of "no avoidance, no restriction, and no interference". Thus Taiwan attended, under the designation "Taipei, China" instead of "the Republic of China," in the 22nd Annual Conference of the Asian Development Bank (ADB) which was held in Beijing in 1989. In 1990, the Ministry of Economic Affairs (MOEA) enunciated its three condition precedents to direct economic relations with the mainland. Taiwan promulgated the Regulations on Indirect Investment and Co-operation in Mainland in 1990, the Statute Governing the Relations Between People of the Taiwan Area and the Mainland Area in 1992 and the Regulation on Permit Investment and Co-operation in Mainland in 1993. In 1991, Lee Teng-hui's edicted conditioned "completely open academic, cultural, economic, trade, scientific, and technological exchanges" with the mainland on Beijing promoting democratization and economic liberalization, renouncing the use of force against Taiwan, and refraining from isolating Taiwan in the international community.<sup>161</sup>

As a response to such changes on Taiwan, China promulgated the Regulations Regarding the Encouragement of Investment by Taiwan Compatriots in 1988 (which was upgraded into the Law on Protection of Investment Made by Taiwan Compatriots in 1994) provide that enterprises with Taiwan investment can enjoy all of the benefits offered to FIEs under PRC's law and regulation.<sup>162</sup>

Furthermore, since 1989 the governments on both sides of the Strait have taken numerous concrete steps to accommodate institutionally the increased economic and cultural contacts. At the non-governmental level, there is the Coordination Council for Commercial Affairs across the Taiwan Strait of ROC and the Coordination Council for Economic and Trade Affairs across the Taiwan Strait

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<sup>160</sup> Lu, A. "Taiwan's Search for a More Effective Mainland Policy" in Yu, G. (ed.) *China in Transition: Economic, Political and Social Developments* (1993) 21.

<sup>161</sup> Silk, M. "Investment in the People's Republic of China" in Silk, M. (ed.) *Taiwan Trade and Investment Law* (1994) 287-90.



of PRC. At the quasi-governmental level, there are the Straits Exchange Foundation (SEF) of ROC and the Association for Relations Across the Taiwan Straits (ARATS) of PRC.

After much diplomatic haggling, the SEF and ARATS conducted their first officially sanctioned talks in Singapore in April 1993, at which they concluded four agreements covering verification of official documents, delivering of registered mail, a schedule for future meetings, and an agenda for future topics of discussion.<sup>163</sup>

For institutional integration between China and HK, because legal systems in China and HK are very different, the Basic Law vests HKSAR with executive, legislative and independent judicial power (including that of final adjudication); and permits the system in HK, which include its FDI regime, to remain unchanged for 50 years from 1997.<sup>164</sup> This process of integration has been foreseen.

As a result, China will continue to benefit from Hong Kong's investment and technology transfer, as well as its position as a venue for external financing, enforcing contracts, settling accounts, banking, and insurance.<sup>165</sup> China can learn from HK's experience to develop a legal system to serve its socialist market economy. For example,

in recent years, China has adopted a number of laws, including the Company Law, the Banking Law, the Securities Law, the Law Relating to Real Estate, the Foreign Trade Law and the Law on Negotiable Instruments. When preparing for such laws, the law drafters studied the relevant laws in Hong Kong and also borrowed or transplanted the existing laws and legal concepts of Hong Kong to the Chinese laws. For example, ... [t]he concept of central banking and commercial banking are undoubtedly taken from the developed

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<sup>162</sup> The Regulations Regarding the Encouragement of Investment by Taiwan Compatriots, art. 5.

<sup>163</sup> Silk, M. "Investment in the People's Republic of China" in Silk, M. (ed.) *Taiwan Trade and Investment Law* (1994) 294-95.

<sup>164</sup> The Basic Law, art. 2 & 5.

<sup>165</sup> Lai, E "The Economic Implications of the Reunification of Hong Kong with China" (1997) 30(4) *Vand. J. Transnat'l L.* 735, 734.

market economies and have the success of the banking system based on such structure in Hong Kong in mind.<sup>166</sup>

However as a common law jurisdiction and a free trade market, HK's FDI regime is quite different from that of either Taiwan or China. Moreover, on any issues regarding economic activities between a private party and the government, under the common law system the government is in no way better placed than a private party. Under the civil law system, however, the government and private parties do not have equal status; the government is always treated as being higher than the private parties.<sup>167</sup> Does the economy take precedence over politics or vice versa? How to balance the "visible hand" and the "invisible hand"? These will be fundamental arguments for the future integration in the triangle.

## **5.2 East Asian financial crisis and the Chinese triangle**

### ***5.2.1 Reasons for the financial crisis***

In the last ten years, a significant amount of research was produced on the East Asian miracle. Researchers present various theories to discuss this debate. One school of thought, mainly from the World Bank (1993), contends that East Asian economies do not belong to the neoclassical model. Instead, often state-led development and gradual industrial development was preferred in Japan, South Korea, Singapore, Taiwan, and China. On the other hand, in the last three years, a new debate has emerged regarding the East Asian miracle. The proponents of this school believe that the Asian miracle, though marvelously undertaken, is based on an illusion. In the coming years, this debate will intensify as East Asian and other Pacific Rim countries achieve visible and aggressive export-led initiatives in the world market.<sup>168</sup>

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<sup>166</sup> Wang, G. "the Investment Laws of Hong Kong under 'One Country, Two System'" (1997) 31(6) *J.W.T.* 116.

<sup>167</sup> *Ibid*, 112.

<sup>168</sup> Anwar, S. "Trends in International Business Thought and Literature: Reviewing East Asia's Miracle, Its Economic Dynamism, and Future Issues" (1997) 1(39) *The International Executive* 83,86.

Before the 1997 financial crisis in East Asia, some people had noticed that “there are signs that returns on investments in East and Southeast Asia are diminishing and financial markets are apparently more volatile”; “euphoria has prompted finance and property bubbles”.<sup>169</sup>

Followed with the sharp export slowdown in 1996, the world had witnessed the currency turmoil influenced in East Asian in 1997. This currencies’ collapse has raised questions not only about the impact of the crisis on the region and the world as a whole, but also about what kinds role should government play in a market economy and what kinds government and inter-government policies should be taken as responses to the crisis to fix the problem and sustain their economic growth.

Even so the financial crisis should not obscure how successful the East Asian model has been, the East Asian experience of rapid economic growth had shown that it is a miracle instead of an illusion. “The region is suffering from the strains arising from the tension between very rapid growth and significant institutional and structural constraints.”<sup>170</sup> East Asian governments, which include governments in the triangle, should learn from these lessons to prevent similar occurrences and to prompt future economic growth and social development. The lessons of the finance crisis can be analyzed as following.

#### The role of government:

We can not deny that within the process of economic growth, governments in East Asian countries have played important roles. The common theme in the East Asian development has been the role of the state in fostering the establishment of outward-oriented economies and “using market mechanisms to promote development”.<sup>171</sup>

Political discipline and economic performance have always gone hand in hand in East Asia. ... [New] authoritarianism in East Asia is an integral part of development strategy, useful not just for steadying societies in developmental flux but for creating the class that carried all before the

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<sup>169</sup> Lingle, C. “The end of the beginning of the ‘Pacific century’? Confucian corporatism and authoritarian capitalism in East Asia” (1996) 9(3) *The Pacific Review* 189, 398 & 405.

<sup>170</sup> Walton, M. “The Maturation of the East Asian Miracle” (1997) September, *Finance and Development* 7.

modern world - the entrepreneurial class - and in the shifting of resources to that class.<sup>172</sup>

Because there are flaws in reliance on the “invisible hand” -- the market failures, which refer to the situation where the market system produces an inefficient allocation of resources, the “visible hand”, -- the government’s intervention is called for. Most governments in East Asian countries make public policies which have clear economic objectives for the nation, and take different kinds of means to influence and monitor business behavior to implement such objectives and to offset market failures.

However, while the state may take a positive and crucial role at some stage of economic development such as economic take-off progress, a supervisory regime needs to be built to balance the political or administrative power to reduce unproductive, inefficient and unfair behaviors such as rent-seeking which was very common in East Asian countries. And ultimately the time will come at a time for the state to step aside and allow the market to develop independently. In order for this type of transition to occur, however, the state must work to establish and maintain an environment within which market transactions can occur efficiently. One prerequisite to this environment is the establishment of a set of laws and legal institutions for the conduct of business and commerce. ... [T]he role of the government must change substantially...to a new indirect management mode which emphasizes policies and regulations which provide the support necessary for the establishment and maintenance of efficient markets, including the legal framework that provides the basis for market contracts and transactions.<sup>173</sup>

After pushing its economy to take off, government should gradually rely on the market to adjust their economic activities. New authoritarianism should be replaced by “rule by law” to improve social equality and stability. Both the lessons

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<sup>171</sup> Ibid, 157.

<sup>172</sup> Meredith, W. “The ‘New Authoritarianism’ in East Asia” (1994) December, *Current History* 413,416.

<sup>173</sup> Gutterman, A. & Brown, R. *Commercial Laws of East Asia* (1997) 18.

of the 1980s finance crisis in Latin America and the 1990s finance crisis in East Asia have shown that income distribution equality and political stability are helpful to overcome or release the pain of financial crisis. Policies that promote greater income equality could help to adjust successfully the external shock.<sup>174</sup>

#### Internal elements:

“FDI is attracted to individual developing countries largely by their intrinsic competitive advantages, such as natural and human resources, and potential market size.”<sup>175</sup> Loss of competition ability in international competition, partly because China takes part in the competition of providing cheaper labor resources, is one of the reasons which caused some East Asian countries’ uneven finance situations. For example, Taiwanese investment in the Philippines, Indonesia and Thailand fell sharply in 1992 while investment in China grew three-fold<sup>176</sup>. Keeping institutional improvement to increase their international competitive ability is a common issue for those countries.

Facing the risk of finance crisis, fearing that fiscal contraction would cut government spending; monetary restraint would impose credit restraints; and currency depreciation would result in rising import costs and external debt repayment burdens; these Asian governments did not make institutional adjustment such as domestic fiscal and monetary policies adjusting to austerity, nor devalued their currencies. Instead, they “sold foreign exchange reserves to maintain their pegged rates. ... The result was a classic overinvestment ‘bubble’ that was ripe for bursting.”<sup>177</sup>

Other internal reasons for this crisis are: blindly and overfast developing securities and derivative securities markets, over investment and foam economy, rigid finance and foreign exchange system, economic rights overlapped with political power and combined with corruption.

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<sup>174</sup> Kaminsky, G. & Pereira, A. “The debt crisis: lessons of the 1980s for the 1990s” (1996) 50(1) *Journal of Development Economics* 1, 13 & 22.

<sup>175</sup> Lim, L. & Siddall, N. “Investment dynamism in Asian developing countries” in Dunning, J. & Hamdani, K. *The New Globalism and Developing Countries* (1997) 119.

<sup>176</sup> Langhammer, R. “Regional Integration in East Asia. From Market-Driven Regionalisation to Institutionalised Regionalism?” (1995) 131(1) *Weltwirtschaftliches Archiv* 167, 178.

<sup>177</sup> Ibid, 66 & 67.



### External elements:

The tightening of monetary policy in the United States during the first half of 1994 and the US dollar appreciating against the yen and European currencies started in 1995; the 34 percent devaluation of RMB in China in 1994 and economic stabilization in Latin America and Eastern Europe; made exports from and investments in Southeast Asia less competitive.<sup>178</sup> This gradually led to decrease in FDI inflows in the region.

Meanwhile, international floating “hot money” and international rates profiteering or “currency speculators” had prompted the crisis as well. “The resultant influx of short-term ‘hot money’ first contributed to currency appreciation and loss of competitiveness, and then to the “overshooting” of currency devaluation when ‘herd instinct’ later caused a massive outflow of foreign funds.”<sup>179</sup>

It had been noticed that because of the increased international competition and diffusion of comparative advantage, while Asia is still a dynamic economic region,

Latin America and Eastern Europe are on the verge of entering the catch-up phase of the cycle of growth whereby the Asian tigers approached the development status of mature economies. ... In the end, competitive advantages as the basis for continued growth can be expected to shift towards those countries with responsive institutions and economic arrangements that are attractive to globalized capital.<sup>180</sup>

### **5.2.2 Lessons for the triangle**

For the Chinese triangle, Hong Kong and Taiwan had been influenced by this East Asian financial crisis. For Taiwan, NT dollar depreciated 15 percent. For HK, although the fixed peg to US dollar was maintained, the “loss of competitiveness for

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<sup>178</sup> Lim, L. “The Southeast Asian Currency Crisis and its Aftermath” (1997) 13(4) *Journal of Asian Business* 65, 65 & 66.

<sup>179</sup> Ibid, 67.

<sup>180</sup> Lingle, C. “The end of the beginning of the ‘Pacific century’? Confucian corporatism and authoritarian capitalism in East Asia” (1996) 9(3) *The Pacific Review* 189, 400 & 406.

Hong Kong's tourist and financial and business services sectors"<sup>181</sup> and the rising of other long-term economic cost is evidence.

China also can not avoid some extent form of this Asian financial crisis. The crisis among China's neighbors has posed great challenges to China's exports. For example, the country's income from overseas labor service contracts has been influenced since 70 percent of those contracts are concentrated in Southeast Asia and South Korea; "China will also suffer from a loss of export competitiveness versus Southeast Asia" "which may reduce its current account surplus",<sup>182</sup> and China's state-enterprise reform, finance reform and especially the reform of capital-account currency convertibility will be delayed; Furthermore, "investment from Japan, Hong Kong, South Korea, Taiwan and Southeast Asian countries is drooping after the financial crisis."<sup>183</sup>

The foreign investors who have begun to shy away from the rest of the region are nervous of China, too; contracted foreign investment plummeted by 50 percent in the first half of 1997 to \$23 billion. China's machinery imports are down 14 percent, a sign that manufacturers are already holding back on expansion. ... Until recently, a state-owned Chinese company's quickest path to recapitalization ran through the Hong Kong stock exchange, where investors snapped up new China stocks mindless of the company's assets and performance. That changed when the market crashed. China Telecom, a mobile-phone company with networks in Guangzhou and Shanghai, had a dismal October listing and now trades far below its initial offering price.<sup>184</sup>

Learn from the lessons of Asian financial crisis, governments in the Chinese triangle should pay more attention in the following two issues for their future economic reform and development.

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<sup>181</sup> Lim, L. "The Southeast Asian Currency Crisis and its Aftermath" (1997) 13(4) *Journal of Asian Business* 65, 77.

<sup>182</sup> Ibid, 78.

<sup>183</sup> Beijing Review (1998) 41(10) 4.

<sup>184</sup> "Will China Be Next?" *Newsweek*, December 1, 1997, 38-39.

First, financial business is the blood of the operation of a market economy. In order to build a sound financial system, an efficient regulation system is a must. Financial enterprises must be operated basing upon market rules instead of unstable policies which too easily results in "bubble economy." Financial systems hobbled by bad debts need to be cleaned up by taking actions to accept short-term pains for long-term economic gains, otherwise the burden can crush the whole economic system.

"[L]ike the afflicted countries, China has a deeply troubled banking sector."<sup>185</sup> Bad debt has been a near-fatal problem for China's further reform and development. By the end of 1996, bad debt ratio in state banks had reached 25%; capital ratio in state banks has decreased to only 3%.<sup>186</sup>

China's own banks can do little, given their crushing debt. Bad loans total 15 to 30 percent of China's annual GDP, depending on the estimate, compared with 10 percent in Japan before its current banking crisis and 2 percent in the United States during the 1980s, when savings and loan institutions failed.<sup>187</sup>

Second, an efficient economic system can not be built isolated from "rule by law" and a democratic political system. Otherwise it will be easy for political power to take advantage into economic competition, resulting in exchanges between political powers and economic rights. This means those market transactions no longer function at a socially optimal level, but support only small part menders to take uneven opportunistic advantages. Promoting institutional transparency and curbing corruption are badly needed in some East Asian countries.

It is hard to estimate the further influence of this financial crisis, but what can be foresaw is that after the financial crisis, the coming of Asian megatrends which were described by Naisbitt, such as "changing role of a nation state to collaborative network structures; changing from an export orientation to a consumer orientation; changing Western orientation and influence and emergence of Asian capitalism

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<sup>185</sup> Rosen, D., Liu, L. & Dqight, L. "Financial Fallout" (1998) 25(2) *The China Business Review* 44, 45.

<sup>186</sup> He, L. "China will face finance crisis at millennia juncture" (1997) 12 *The Twenties century* 152.

<sup>187</sup> "Will China Be Next?" *Newsweek*, December 1, 1997, 39.

based on Asian values; governments' planned activities to market competition,"<sup>188</sup> will be accelerated.

Furthermore, no matter whether the next century will be an Asian-Pacific one or a Global one, Asia will continuously be a dynamic region and the Chinese triangle will play a more important role in the future of the global market. Domestic institutional preparation and international standards harmonization will be an essential function of governments in the triangle.

### **5.3 International harmonization**

Compared with regional integration, there is a strong trend of economic regime harmonization in current global market environment. If the 1944 Bretton Woods System can be described as the first stage of this harmonization which built up three legs (World Bank, IMF, and the GATT as a temporary organization) for harmonizing international trade regime, the 1994 World Trade Organization (WTO) will be the second stage of this harmonization which succeeded the GATT leading to harmonizing international investment regime for the first time.

FDI regimes within the Chinese triangle do not operated in an isolated region; they are eye-catching in the world economic picture. While promoting economic integration in the triangle, it is also important to orient their market economies and FDI regimes to harmonize with the global market and international standards.

In the more and more globalizing world economic environment, international organizations are playing more and more important roles, WTO and World Bank - at international level- and APEC, ADB and OECD - at regional level- are good examples. In order to improve their FDI regimes to increase economic benefits, governments in the Chinese triangle need to harmonize with these international organizations.

#### **5.3.1 WTO and the triangle**

As the product of the Uruguay Round of GATT negotiations which finished in April 1994 in Marrakesh, the WTO is the legal and institutional foundation of the

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<sup>188</sup> Anwar, S. "Trends in International Business Thought and Literature: Reviewing East Asia's

multilateral trading system. It provides the principal contractual obligations determining how government's frame and implement trade policy.

Developed from an interim agreement (GATT 1947), the WTO eventually became the dominant international organization in world trade and investment. As the best example, it performs three important roles in harmonization of business law: forum and instrument creation; rule making and supervision; and dispute resolving.

The most important multilateral agreements achieved by WTO include the Agreement on the World Trade Organization; the General Agreement on Tariffs and Trade (GATT) 1994; the General Agreement on Trade in Services (GATS); the Agreement on Trade-Related Investment Measures (TRIMs); the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) and the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) which is administered by its Dispute Settlement Body in Geneva.

#### GATS: FDI in services

GATS are the first private law agreement in the service area, which integrates questions of trade and investment into a single multinational agreement. Although GATS does not use the term "investment," the annexation of investment issues is apparent. In the GATS we can find more substantial investment-related provisions and rules than in the TRIMs.

GATS treats the supply of the market by foreign enterprises through a local enterprise as a kind of trade in services. In the scope of services, the GATS deals with issues of rights of establishment and the treatment of foreign enterprises once established. So, FDI issues are caught by GATS.

Like GATT before it, GATS intends to be a framework for the progressive liberalization of trade in services through further negotiations. Though still weak at current stage, the GATS constitutes a framework with an inbuilt agenda for further negotiations on FDI matters in the area of services.<sup>189</sup> In order to take part in WTO, governments of PRC and ROC need to prepare to provide national and most favored

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Miracle, Its Economic Dynamism, and Future Issues" (1997) 1(39) *The International Executive* 96.

<sup>189</sup> Ruggiero, R. "Foreign direct investment and the multilateral trading system" (1996) 5(1) *Transn Co.* 1, 3-4.



national treatment to FDI to fulfil the requirements of regulation transparency, and to provide market access to foreign services.

#### TRIMs: FDI in manufacture

TRIMs are those investment measures which contravene the principles of the GATT principles. The Uruguay Round of negotiations has produced a list of 14 TRIMs as illustrations of the types of investment measures which can be categorized in four groups: (1) Incentives such as investment incentives based on the acceptance of other TRIMs; their intended effects are to provide subsidy on FDI inflows. (2) Performance requirements, such as manufacturing limitations, manufacturing requirements, product mandating requirements, remittance restrictions, foreign exchange restrictions; their intended effects are to increase domestic predictability. (3) Corporate measures, such as licensing requirements, transfer of technology requirements, export requirements and import substitution requirements; their intended effects are to encourage R&D and boost exports. (4) Host-country measures, such as local equity requirements, requirements for supplying specified markets, local content requirements and trade balancing requirements; their intended effects are to protect domestic market. This broad approach is applied now and then by both developed and developing countries.

TRIMs is an inherent part of the WTO Agreement. It requires investment measures to be consistent with WTO provisions on national treatment and calls for the elimination of quantitative restrictions within two years, unless there is a justifiable exception.<sup>190</sup> It is the first time in GATT history that the foreign investment issue is actually being dealt with under GATT principles, although the opinions about TRIMs still conflict between North and South countries.

The North seeks to lift FDI "out of the control of the national system and subject it to an international system which they claim consists of customary principles of international law."<sup>191</sup> The North argues that TRIMs cause distortions in patterns of trade and investment because business decisions on the part of TNCs come to be made on the basis of considerations other than market forces. In the Neo-

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<sup>190</sup> GATT 1994, Art. III and XI.

<sup>191</sup> Sornarajah, M. *The International Law on Foreign Investment* (1994) 194.

classical model, under assumptions of perfect competition, TRIMs are clearly distortionary to patterns of trade and of investment.

The South claims that FDI processes should be governed to a larger extent by the national law of the host state and “argues that TRIMs can be useful policy tools to promote development objectives and strengthen trade balances”.<sup>192</sup> They insist that only those investment measures directly related to GATT principles should be prohibited.

Thus, article 1 of the Agreement limits the coverage of TRIMs: “This Agreement applies to investment measures related to trade in goods only”; and article 2 provides that as to national treatment and quantitative restrictions, “without prejudice to other rights and obligations under the GATT 1994, no member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of the GATT 1994.”

Article III of the GATT 1994 requests members to comply with the principle of national treatment when applying internal laws, regulations, taxes, charges and requirements to the manufacture, sale, purchase, transportation, distribution or use of products. Meanwhile article XI deals with elimination of quantitative restrictions, i.e., Non-discriminatory treatment.

These mean that an investment measure prohibited by the TRIMs must have a restrictive, adverse or distorting effect to trade in goods under Articles III and XI of the GATT. So, any conflict on whether or not a particular investment measure breaches the Agreement must be solved within the provisions of the GATT. Therefore, the Agreement on TRIMs has introduced the FDI issues into the regime of the GATT. Instead of adding any new principle to the GATT, the TRIMs provides new interpretations to the GATT.

Once China and/or Taiwan join the WTO, they will have to exam their FDI regime to check which FDI regulation violate the TRIMs, and “have to inform the WTO of such policies and begin to phase them out”<sup>193</sup> within 90 days.

TRIPs: FDI with intellectual property

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<sup>192</sup> Moran, T. “The Impact of TRIMs on Trade and Development” (1992) 1(1) *Transn Cor.* 55, 57.

Intellectual property has become an increasingly important component of FDI today. Countries around the world are competing in upgrading their intellectual property systems in order to attract FDI with intellectual property right. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) will help to safeguard FDI.

TRIPs deals with the protection of the intellectual property of foreign companies and individuals and requires WTO members to provide national treatment, most favored nation treatment and high levels of protection of intellectual property rights. It covers copyrights, trademarks, patents geographical indications, industrial designs, commercial secrets, as well as anti-competition practices in contractual licenses.

Building on these three investment-related aspects of the Uruguay Round, the eventual agenda for the next round of negotiations in the new World Trade Organization (WTO) could include the development of a comprehensive multilateral agreement on investment, the so-called MAI. ... The MAI will need to include many provisions, such as: the right of establishment; national treatment; legal rights to machinery for dispute settlement in specific cases of expropriation and /or unilateral changes in the rules; transparency, notifications, binding obligations, and general dispute resolution procedures; agreements on transfer pricing, taxation, and competition policy; etc.<sup>194</sup>

As a major organization in the world economic environment, WTO provides favorable environments for trade and investment. As previously granted GATT membership by its statute as a colony of the United Kingdom and by the Sino-British joint effort to ensure the maintenance of HK's participation in the GATT, Hong Kong joined GATT/WTO separately in 1986 and is enjoining the favorable treatment. Article 152 of the Basic Law of Hong Kong has provided that the HKSAR

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<sup>193</sup> Daniels, M., King, R. & Bernstein, P. "TRIMming Protectionism" (1995) 22(2) *The China Business Review* 20, 21.

<sup>194</sup> Rugman, A. & Gestrin, M. "New Rules for Multinational Investment" (1997) 1(39) *The International Executive* 21, 23 & 24.

may, "using the name 'Hong Kong, China,' participate in international organizations and conferences not limited to states."

Since 1980s the ROC has been eager to gain admission to GATT/WTO, but its desire has met two troubling prospects. One prospect is that Taiwan neither is a member of the UN nor is recognized by most of the world as the government of a sovereign nation. Another prospect is that the PRC is itself a candidate for membership in the GATT/WTO.

At its September 1992 meeting, the GATT Council decided that it should examine the Report of the China Working Party and adopt the Protocol on the status of China before examining the Report and adopting the Protocol on the accession of Chinese Taipei. ... The terms of Chinese Taipei's accession to the WTO have largely been agreed and finalized. Further delay in finalizing China's Protocol, therefore, would also delay the entry of Chinese Taipei.<sup>195</sup>

As an original Member of the GATT when it was first established in 1947, and never agreed to the withdrawal which was made by Taiwan in early 1950, China was granted observer status in 1982. In 1987, GATT established a Working Party to consider China's resumption of its former status.

China's accession to the WTO will change the world pattern of comparative advantage, improve the world business environment, and lead to impacts on China's reform and its integration into world economy. In line with the requirements specified by the WTO, China has, based on principles of "mutual respect, equal opportunity, share in advantages, open trade and shared prosperity," introduced a series of liberalization activities, such as the expansion of domestic market, the protection of intellectual property rights, and the opening markets for foreign services. Though China's accession is supported by most WTO Members as a milestone towards eventual integration of the global economy, this multilateral accession negotiation is mainly done between China and the "quad" members: United States, Japan, Canada and the EC countries, especially dominated by the

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<sup>195</sup> Tait, A. & Li, K. "Trade Regimes and China's Accession to the World Trade Organization" (1997) 31(3) *J.W.T.* 93, 109.

politicized Sino-US relationship. In 1995, China missed the chance of accepting the WTO Agreement as an original WTO member.<sup>196</sup>

While struggling to join WTO, China and Taiwan need to reform their FDI regimes according to the principles of the WTO system. This means that the integration in the triangle should be harmonized with international standards. Taking China as an example, as many provisions under China's present FDI regime fall in various categories of TRIMs, the Working Party has concentrated on five areas of rectification, and come up with demands on China if accession is to be granted. They are:

- A. Quantitative restrictions: a grace period for the elimination of remaining quantitative restrictions;
- B. National treatment: "foreign trade rights" must be eliminated, environmental and safety regulations should equally be applied to both domestic and foreign producers;
- C. Industrial policy: discrimination on product inspection and certification should be removed;
- D. Market access of goods and service: adoption of a "multilateral trading" spirit in which trade takes place on a free, open and equal basis; and
- E. Other issues, in particular intellectual property rights: more legal and administrative means must be established to protect intellectual property rights.<sup>197</sup>

As China intends to be a member of WTO, China needs to improve its FDI regime to meet the requirement of WTO. "Although the agreement does give a developing country like China some extra time for compliance, China will have to face the issue sooner or later," as "China's entry into the WTO is only a matter of time."<sup>198</sup>

For the issue of intellectual property, it is now sensitive for China within the triangle at the present stage. However, history shows that the process of

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<sup>196</sup> Ibid, 98, 99 & 108.

<sup>197</sup> Ibid, 101 & 102.

<sup>198</sup> Mo, J. "Foreign Investment Law" in Wang, C. & Zhang, X. (eds.) *Introduction to Chinese Law* (1997) 301.



harmonization of FDI regime in one country with international standards is in accordance with economic growth and market development.

Taking Taiwan as an example, "Once labeled a 'pirate kingdom,' the ROC has now made strenuous efforts to cleanse its image by enacting perhaps the harshest laws in the world concerning the protection of intellectual property rights.<sup>199</sup> As its economy increasingly turned to a high-tech base and as the US continued to exert pressure for its reform, "The protection afforded under Taiwan's intellectual property laws is now comparable to that which can be obtained in other industrialized nations."<sup>200</sup>

Though China needs to do better to meet the criteria of WTO, we should note that China has made great progress. It has issued new legislation regarding trade, investment, patents, trademarks, copyrights, and computer software. It has become a signatory to many multinational treaties such as the Paris Convention, the Patent Co-operation Treaty of the World Intellectual Property Organization (WIPO), the Berne Convention, the Universal Copyright Convention, the Geneva Convention and the Madrid Agreement concerning the International Registration of Marks. However, "China's efforts to implement this legislation have been perceived as inadequate by some foreign countries, particularly in the software, movie and recording industries."<sup>201</sup>

### **5.3.2 World Bank, ADB and the triangle**

Established in 1945, the International Bank for Reconstruction and Development (IBRD, or World Bank) has become an important international organization in world economic environment today. It aims at helping promote the economic development of member countries by making loans to their governments; "providing member countries with technical assistance on matters relating to their economic development; and trying to increase the effectiveness of the international

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<sup>199</sup> Kwang, M. "Taiwan - The Republic of China: A profile of Recent Constitutional Changes and Legal Developments" in Tay, A. & Leung, C. (eds.) *Greater China: Law, Society and Trade* (1995) 83.

<sup>200</sup> Klatt, G. "Taiwan" in Gutterman, A. & Brown, R. (ed.) *Commercial Laws of East Asia* (1997) 543.

<sup>201</sup> Torbert, P. & Zhao, J. "People's Republic of China" in Gutterman, A. & Brown, R. (eds.) *Commercial Laws of East Asia* (1997) 329 & 331.

development effort by fostering co-operation with and among other donors of financial and technical assistance.”<sup>202</sup>

Now concentrating on aiding development of the less developed countries in the world, instead of only as originally assisting with the reconstruction of Europe, the World Bank “seeks to promote free trade through imposing conditions on grants in terms of domestic economic policy for those countries and also utilizes open tenders for World Bank-aided projects.”<sup>203</sup>

The most important multilateral agreements achieved by World Bank include the Convention for the Settlement of Investment Disputes (ICSID 1965), Convention Establishing Multilateral Investment Guarantee Agency (MIGA 1985), and Guidelines on the Treatment of Foreign Direct Investment 1992.

After studying existing legal instruments governing FDI at the national, bilateral and regional levels, the World Bank adopted a set of Guidelines on the Treatment of FDI in 1992. The objective of the World Bank Guidelines is to improve the relationship between foreign investors and host Governments and to encourage greater FDI flows. The Guideline is not legally binding, but is intended to have influence on the development of an international FDI regime. Different from the Draft UN Code of Conduct on Transnational Corporations, which was promoted by “77 Countries Group” in 1975 with emphasis on the conduct of TNCs, the World Bank guideline emphasizes the treatment of FDI by host countries. This is because,

[t]he World Bank is an institution with voting rights weighted according to financial contributions. As such, the policy directions of the World Bank and its constituent bodies are fashioned by the developed countries which contribute the most to the Bank. ... The guidelines drafted by the World Bank Group, on the other hand, seek to emphasize the protection and standards of treatment owed to the foreign investor by the host state. ... The guidelines are stated to be supplementary to bilateral and multilateral treaties and as a possible source on which national legislation on foreign investment may be based.<sup>204</sup>

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<sup>202</sup> Union of International Associations *Yearbook of International Organizations* (1996) 828.

<sup>203</sup> Pryles, M. Waincymer, J. and Davies, M. *International Trade Law commentary and Materials* (1996) 95.

<sup>204</sup> Sornarajah, M. *The International Law on Foreign Investment* (1994) 70, 211 and 215.

Working closely with the World Bank, the Asian Development Bank (ADB) also “has increasingly supported the development of an appropriate social, economic and legal framework in its developing member countries (DMCs) to accompany more traditional loan and investment projects”<sup>205</sup> since the late 1980s.

As a major loan receiver from the World Bank, China received a total of World Bank of US\$ 9,207 million between 1981 and 1991.<sup>206</sup> China also has strong links with the ADB. Examples are ADB technical assistance to China to strengthen its legal framework for customs administration in order to coincide with the re-entry of the PRC into the world trading system, and technical assistance to China for the integration of its securities market.<sup>207</sup> These kinds of links are helpful for government to harmonize its FDI regime with international standards.

### **5.3.3 APEC and the triangle**

Established 1989 in Canberra, the Asia-Pacific Economic Co-operation Group (APEC) aims to: serve as a forum for top officials to regularly discuss regional trade and investment issues and economic co-operation; enhance co-operation between developed and developing countries within the Asia Pacific region based on mutual benefit; work towards reducing barriers to flows of goods, services and technology; work as a lobbying group to press for changes in the global trading system; resist protectionism.<sup>208</sup>

Representing two of the “three economic/geographic poles”(East Asia, EC and North America) <sup>209</sup>, APEC eighteen members’ combined economies have more than half of the world’s annual GDP, account for about 40% of the world’s population, and represent about 46% of the world’s total merchandise trade.<sup>210</sup> Intra-

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<sup>205</sup> Asian Development Bank, *Law and Development at the Asian Development Bank* (1997) 1 & 3.

<sup>206</sup> Bierling, J. & Murray, G. “The emerging Powers: China, Singapore, Hong Kong and Taiwan” (1995) 43(1) *Current Sociology* 73-74.

<sup>207</sup> Ibid, 9 & 15.

<sup>208</sup> Union of International Associations *Yearbook of International Organizations* (1996) 89.

<sup>209</sup> Koning, M. “APEC: Seven Years of Progress in Trade Liberalisation in the Asia Pacific?” (1997) 25(4) *ABLR* 258, 280.

<sup>210</sup> Ibid, footnotes 11.

APEC trade constitutes more than 62 per cent of the group's total international trade.<sup>211</sup>

APEC has a wide representation. It includes both developed countries such as United States (it considers Asia as the center stage of its foreign and economic policy after the Cold War), Japan and Australia (they fear to be left out of any major regional groupings); and developing countries such as the ASEAN countries (They fear that the status of ASEAN might be reduced, but welcome the forum which facilitated dialogue in the region) and China (it aims to improve its international public profile and to increase its chances of becoming a WTO member).

Furthermore, under the APEC umbrella there are some important subgroups such as the North American Free Trade Agreement (NAFTA), the ASEAN Free Trade Area (AFTA), the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), the Chinese triangle and the Johore (Malaysia)-Singapore-Batam (Indonesian) triangle. It can be said that APEC links the North and the South, and meanwhile joins the West with the East. As a result, "[t]here is a significant function for APEC in formulating and pressing an Asia Pacific point of view in the WTO context."<sup>212</sup>

In the 1993 APEC Ministerial Meeting, a recommendation was made that "APEC should adopt an Asia Pacific Investment Code (APIC) to reduce the uncertainties and transactions costs of trade and investment in the region".<sup>213</sup> In order to establish a set of uniform basic standards for treatment of FDI and for regional economic co-operation, APEC adopted a set of Non-binding Investment Principles in 1994. Later, in the Bogor Declaration of 1994,

[T]he members adopted a "declaration of common resolve" to pursue "free and open trade and investment" over the period extending to the year 2020. The declaration contemplates that the region's developed nations would

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<sup>211</sup> Skubik, D. "International economic institutions" in Wilde, K. (ed.) *International Transactions: trade investment, law and finance* (1993) 433.

<sup>212</sup> Koning, M. "APEC: Seven Years of Progress in Trade Liberalisation in the Asia Pacific?" (1997) 25(4) ABLR 258, 260, 268, 269 & 281.

<sup>213</sup> Graham, E. "Towards an Asia Pacific Investment Code" in Green, C. & Brewer, T. (eds.) *Investment Issues in Asia and the Pacific Rim* (1995) 15.

dismantle their trade barriers by 2010, and that the other member states would follow suit by 2020.<sup>214</sup>

Because of its unique “open dialogue” structure, the approach of open association from diversity instead of unification in contrast to the legalistic treaty-based negotiations of the GATT/WTO and the EC, APEC is “an excellent candidate to perform the bridge function”.<sup>215</sup> However, the disadvantages of the non-binding agreement are that it will be easy to be ignored or disobeyed.

As members of APEC, China, HK and Taiwan participating in the forum will be good for maintaining pace and security in the region, and also for prompting their FDI regimes to harmonize with international standards. In turn this will be helpful for China and Taiwan to join the WTO system on the one hand, and improving world economic environment on the other.

#### **5.3.4 OECD and the triangle**

Another important international organization engaged in proliferating a sound international investment environment is the Organization of Economic Co-operation and Development (OECD). The OECD has worked out the Code of Liberalization of Capital Movements (1961, and 1992 review); the Guidelines for Multinational Enterprises (OECD Guidelines 1976, and 1991 review); the Model Tax Convention on Income and Capital (1992, 1995); the National Treatment for Foreign-controlled Enterprises (1985) and other agreements. Negotiations are underway among the OECD countries on a Multilateral Agreement on Investment.<sup>216</sup>

As vehicles of FDI, Multinational Enterprises (MNEs)/ Transnational Corporations (TNCs) are enjoying the internalization advantages of making good use of differences in regulatory environments among nations. Meanwhile, they may also lead to abuse of concentrations of economic power, such as avoiding or evading of tax obligations through their integrated international business networks. So,

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<sup>214</sup> Gutterman, A. & Brown, R. *Commercial Laws of East Asia* (1997) 4.

<sup>215</sup> Koning, M. “APEC: Seven Years of Progress in Trade Liberalisation in the Asia Pacific?” (1997) 25(4) ABLR 258, 281 & 284.

<sup>216</sup> Brewer, T. and Young, S. “Investment policies in multilateral and regional agreements: a comparative analysis” (1996) 5(1) *Transn Cor.* 9, 10.



“[t]he conflict caused by uncoordinated unilateral state policies has led to attempts at greater international co-operation in regulatory matters and at the evolution of an international consensus over the standards to be applied to the regulation of MNEs.”<sup>217</sup>

Aimed at improving TNC policy coordination and co-operation among the industrialized countries, the OECD has adopted the governmentally endorsed set of voluntary guidelines for TNCs’ behavior. The OECD Guidelines state that a focus upon the obligations of firms:

The Guidelines set out below are recommendations jointly addressed by member countries to multinational enterprises operating in their territories. These Guidelines, which take into account the problems which can arise because of the international structure of these enterprises, lay down standards for the activities of these enterprises in the different member countries.<sup>218</sup>

The OECD countries are important FDI providers and major bargaining forces in WTO. There are also significant interactions between OECD countries and governments in the triangle. To learn from OECD countries’ experiences and improve relationships with them will be a benefit for the Chinese triangle and for their FDI regimes to harmonize with international business environment.

## 5.4 Summary

With the integration aspect, the integration in the triangle belongs to the trends of regional integration but takes a different form. Not like EU, NAFTA, ANZCERTA or other regional integration which takes the form of some kind of multinational agreement, the integration in Chinese triangle takes the form of unification and autonomy.

With the harmonization aspect, although a first multilateral agreement on FDI (TRIMs) has appeared, the “conflicting approaches to the problem of foreign

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<sup>217</sup> Muchlinski, P. *Multinational Enterprises and the Law* (1995) 45.

<sup>218</sup> OECD Guidelines for Multinational Enterprises 1994, Introduction, para. 6.

investment protection and the existence of contending systems relating to the treatment of foreign investment” still exist.<sup>219</sup>

Because there are great gaps between the North and the South, nations and international organizations still need effort and time to adopt a unified code for FDI. There is no doubt that the UN agencies, especially the WTO, will be the major actors in the future development of this process, and their endeavors will contribute to the harmonization of FDI regime. However the international FDI regime will be neither a Northern nor a Southern one. Instead it will be a harmonized one, and combine both the advantages of Western value and Eastern value. This harmonized FDI regime will represent the common principles agreed by multinationals upon the rights and obligations of MNEs, host nations and home nations.<sup>220</sup>

The experience of the triangle attests that integration (from a regional point of view) and globalization (from the world point of view) may be promoted with liberalization and/or harmonization of trade and investment regimes. Integrating the triangle’s economy into the global one; involving in international organizations such as WTO and other international economic organizations will improve both the regional and global market benefits. As the PRC Vice-Premier Li Lanqing said: “China needs the WTO and vice versa. Without China’s membership, it will be difficult for the WTO to play a bigger role.”<sup>221</sup>

As “history has proven that the strengthening of ties between Europe and North America has contributed to growth on both sides of the Atlantic”,<sup>222</sup> the co-operation and harmonization among Asian-Pacific countries will encourage the growth around the Pacific and the world as a whole. Governments within the Chinese triangle have great roles to play in this process.

## **6. Conclusion**

### **6.1 FDI regimes and markets**

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<sup>219</sup> Sornarajah, M. *The International Law on Foreign Investment* (1994) 187.

<sup>220</sup> Detailed discussion see Bergsten, C. & Graham, E. “Needed: New International Rules for Foreign Direct Investment” (1992) 7(1) *The International Trade Journal* 15.

<sup>221</sup> Beijing Review (1998) 41(8) 4.

<sup>222</sup> Bonvin, J. “The Context for Investment in Asia” in Oman, C. Brooks, D. & Foy, C. *Investing in Asia* (1997) 19.

FDI regimes as institutional factors, like other legislation and regulations, have three major important consequences on market: reallocation of scarce resources, redistribution of wealth, and imposition of organizational cost on the economy. Accompanied by market extension and reconstruction, FDI regimes can have important consequences for attracting of FDI - an engine of economic growth and market integration, and effect the allocation of resources in a globalizing international economic environment.

Meanwhile FDI inter-flows push harmonization of FDI regimes to support the productive sector division and market integration. Taking the computer industry as an example, leading by FDI inter-flows, "South Korea concentrate on semi-conductors, Taiwan on monitors, Singapore on hard disk drives and Hong Kong on peripherals,"<sup>223</sup> but all of them need to supply their products to the same globalizing market. So there is a need for the harmonization of FDI regimes. As the experience of Asian development shows, FDI

provides opportunities for leaning new technologies and developing skills and knowledge that may eventually be used to develop indigenous technologies or to move more rapidly up the ladder of imported technologies, thereby raising local productivity and income. ... [D]eveloping countries today can expect to go through various stages in hosting FDI which parallel stages in their economic development, moving from resource-based to labor-based and then to skill- and technology-based exports, with local market-oriented production becoming increasingly attractive as rising incomes are achieved through both labor- and technology-based export production. ... [This] development path takes place as TNCs and other firms adjust to market shifts in comparative advantage, that is, upgrading their product lines and technology as labor surpluses are exhausted, wage costs and labor incomes rise, and host markets grow in size and affluence.<sup>224</sup>

## 6.2 FDI regimes and governments

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<sup>223</sup> Rimmer, P. "Industrialization policy and the role of the state: Newly industrializing economies" in Heron, R. & Park, S. (eds.) *The Asian Pacific Rim and Globalization* (1995) 27.

<sup>224</sup> Lim, L. & Siddall, N. "Investment dynamism in Asian developing countries" in Dunning, J. & Hamdani, K. *The New Globalism and Developing Countries* (1997) 113, 115 & 116.

Governments should and can lead to build up their FDI regimes to support market efficiency. Within the triangle, especially for China and Taiwan, government intervention "in relation to industrialization has been, and still is, a powerful influence in shaping investment patterns"<sup>225</sup> and FDI regimes. On the whole, government policies toward FDI have been based on straightforward objectives: maximizing economic gains while minimizing any socio-economic and political costs.<sup>226</sup> Therefore, the combination of market operation and government intervention have led to

an alternative economic system that lies between the extremes of laissez-faire capitalism and pure socialism - an ideal blend of both systems that manages to avoid the worst aspects of each.<sup>227</sup>

However, there are more than one way for such combination. As an example of the free market, the HK government takes a free trade approach towards FDI. However, in order to promote the infusion of FDI to aid their internal economic development, governments in both China and Taiwan take the approach of standing at the forefront guiding and screening FDI inflows. Although they have been receding to the background under the pressure of internationalization and harmonization, we should note that

[i]n cases where externalities, a lack of competition, and other market imperfections drive a wedge between private and social goals, there is general agreement that states can enhance welfare by regulating markets. There is much more controversy about whether states should try to accelerate market development through activist industrial policies. The rationale for industrial policy in developing and transition economies is that their information and coordination problems are especially acute and pervasive.<sup>228</sup>

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<sup>225</sup> Rimmer, P. "Industrialization policy and the role of the state: Newly industrializing economies" in Heron, R. & Park, S. (eds.) *The Asian Pacific Rim and Globalization* (1995) 17.

<sup>226</sup> International Finance Corporation, *Foreign Direct Investment* (1997) 6.

<sup>227</sup> Ikeda, S. "Interventionism" in Boettke, P. (ed.) *The Elgar Companion to Austrian Economics* (1994) 345.

<sup>228</sup> Levy, B. "How Can States Foster Markets?" (1997) September, *Finance and Development* 21, 23.

Although both approaches have shown success, according to the experience of East Asian countries' rapid economic growth and recent financial crisis, after play important role of guiding and protecting FDI before and during the process of foster a market-oriented economy, governments should try hard to build on a market system and legal framework to let markets themselves, instead government direct intervention, to generate optimal levels of foreign investment.

Instead of direct intervention, governments should concentrate upon matching their roles to their capabilities to provide 'pure public goods', such as stable political and economic policy; law and order; national defense; social services and public infrastructure; proper assignment and enforcement of property rights,<sup>229</sup> to build up a sound environment "in which entrepreneurs are enable to perform their functions efficiently".<sup>230</sup> It is important, to note that

[t]he state's power to intervene in economic activity is a double edged sword. While the state may use this power to promote the well-being of its citizens, it may also abuse it, to their detriment. Countries therefore need to adopt mechanisms that give state agencies the flexibility and the incentive to act in the public interest while restraining arbitrary action and corruption.<sup>231</sup>

Another point shown by experiences in the triangle is that FDI inward and economic development is closely interrelated with democracy. "Prosperity is essential or a prerequisite for promoting the momentum of civil rights."<sup>232</sup>

Brazil, Mexico, Chile, South Korea, and Taiwan have displayed impressive economic growth through private investment under authoritarian regimes. ... Once foreign capital became less significant relative to domestic capital, all these regimes faced pressures for democratization (and have become more democratic) in order to assure business, labor, and private savers that their

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<sup>229</sup> Islam, I. & Chowdhury, A. *Asia-Pacific Economies: A survey* (1997) 36.

<sup>230</sup> Hodder, R. *The West Pacific Rim: An Introduction* (1992) 87.

<sup>231</sup> Pradhan, S. "Improving the State's Institutional Capability" (1997) September, *Finance and Development* 24.

<sup>232</sup> Kwang, M. "Taiwan - The Republic of China: A profile of Recent Constitutional Changes and Legal Developments" in Tay, A. & Leung, C. (ed.) *Greater China: Law, Society and Trade* (1995) 90.



interests would be taken into account, and to avoid debilitating capital flight.<sup>233</sup>

While democratization and political development on Taiwan had long lagged behind the island's economic miracle, the 1990s witnessed a transition to electoral democracy culminating in the direct election of the Legislative Yuan in December 1992 and the president in March 1996.<sup>234</sup> This demonstrated that "authoritarian leaders introduce democracy only when they do not feel threatened by the opening of the political system."<sup>235</sup>

However, the situation should not be transferred from one extreme (autocracy) to another (non-government). Taiwan's experience also showed that victory on democracy and domestic politics is not always bountiful, "more open and democratic government produced raucous politics (e.g., frequent fistcuffs in legislative assemblies) and policy gridlock, and the growing importance of elections was also associated with burgeoning corruption and money politics."<sup>236</sup>

In summary, the trends of market-oriented transforms and market driven global harmonization have both together put pressure on governments. They need to change their roles, lose some traditional powers but enrich some fundamental functions - such as safeguards of property rights and legal system, maintaining stable macroeconomic policies, and improving infrastructures "with the aim of reducing the information, transaction, and organization costs of doing business".<sup>237</sup> This is the preparation for them to meet the new era of economic interdependence and politic multi-lateralization.

### **6.3 FDI regimes, integration and unification**

The inter-flow of FDI among China, Hong Kong and Taiwan has served as a mechanism for integration in the triangle. Reflecting integration at both market and

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<sup>233</sup> Goldstone, J. "The Coming Chinese Collapse" (1995) 99 *Foreign Policy* 35, 48-49.

<sup>234</sup> Clark, C. "Taiwan in the 1990s: Moving Ahead or Back to the Future?" in Josegh, W. *China Briefing: The Contradictions of Change* (1997) 195.

<sup>235</sup> Huang, Y. "Why China Will Not Collapse" (1995) 99 *Foreign Policy* 54, 60.

<sup>236</sup> Clark, C. "Taiwan in the 1990s: Moving Ahead or Back to the Future?" in Josegh, W. *China Briefing: The Contradictions of Change* (1997) 207.

<sup>237</sup> Kasper, W. *Global Competition, Institutions, and the East-Asian Ascendancy* (1994) 19, 26.

institutional level, FDI regimes in the triangle are contributor towards national unification.

“Great Unification” has a deep root in Chinese history culture. Since the Qin Dynasty, no matter what nationality the rulers were, no matter sooner or later, the rulers had had to implement such “Great Unification”. It has been part of the highest honor awarded to both the rulers themselves and the people who living under the dominion. At present time, “[o]pinion surveys in Taiwan have never shown a support for independence much above 20 per cent. After the missile tests by China in the Taiwan strait in July 1995, support fell to only 12 per cent”.<sup>238</sup>

Beijing’s strategy to unify Taiwan can be put in to three dimensions: (1) economically integrating Taiwan; (2) internationally isolating Taiwan; and (3) containing the pro-independence force within Taiwan.<sup>239</sup>

“Side by side with the open-door policy was the drive toward Chinese national unification,”<sup>240</sup> and the economic integration is an important part of this strategy. Not like Hong Kong or Taiwan which depend heavily on foreign resources and market, China has a huge domestic market with big regional differences and gaps which can provide long period of chance of continuous growth. The peaceful transformation and development of China and the interdependent FDI relationship within the triangle will definitely be of benefits to all parties of the triangle and lead toward Chinese national reunification.

Although Taiwan consistently declines any direct contact with the PRC, the developing economic ties and FDI links across the strait have rendered pressures for reunification on the government. Especially after HK’s hand over, the government in Taiwan is forced to set parameters for direct trade and investment with China. With the increasing FDI and economic link and culture inter-flow, the economic interdependence across the strait is increasing, and identity in the same nation and culture will be increased.

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<sup>238</sup> Tsang, S. “The Political Economy of Greater China” (1996) 2(3) *Asia Pacific Business Review* 23, 34.

<sup>239</sup> Hu, W. “China’s Taiwan Policy and East Asian Security” (1997) 27(3) *Journal of Contemporary Asia* 374,378.

<sup>240</sup> So, A. & Chiu, S. *East Asia and the World Economy* (1995) 244.

The economic link will increase the national consciousness and trustworthiness. This is one side of PRC leaders' strategy that is unification on the one hand and economic reform on the other. Meanwhile we should not forget what Deng Xiaoping had said: We hope the peaceful resolution of the Taiwan issue, but cannot exclude the possibility of using army force; we and our next generation must remember this point; this is a strategic consideration.<sup>241</sup> This strong position had been demonstrated by the missile tests which China conducted on Taiwan strait during 1995-1996 as a reaction to Lee Teng-hui's visit to the US, and the cancellation of next ARATS-SEF meeting and other contacts. However, to solve the Taiwan issue peacefully will definitely contribute to the triangle and the world as a whole.

Above all, the inter-flow of capital, technology and personnel, accompanied with international factors, had added diversity and complexity to the legal environment of all China, Hong Kong or Taiwan. This will result inter-influence of FDI regimes in the triangle and help their FDI regimes to be harmonized with international standards.

From the process of HK's reintegration with China, we can foresee that the integration process in the triangle will take the steps of economic, politic and then legal regime. As a start, "economic interaction is usually beneficial to all the contracting parties and are less threatening to national sovereignty than a direct attempt at political integration".<sup>242</sup> At the end, it is only after integration in sovereignty that legal integration can be realized.

Nevertheless, from an economic viewpoint, the national reunification project among the three Chinese states is mutually beneficial and has greatly enhanced the competitiveness of the mainland, Taiwan, and Hong Kong in the world economy. ... From a world-system angle, ... national economic integration is the best strategy for the three Chinese states to not only remain competitive in the world but also overcome being squeezed in the middle by the core's protection, and the periphery's intense competition. ... [I]t may

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<sup>241</sup> Deng, X. *Selected works of Deng Xiaoping* (1990) Vol.3 87.

<sup>242</sup> Wu, Y. "Mainland China's Economic Policy Toward Taiwan" in Lin, B. & Myers, J. (eds.) *Contemporary China in the Post-Cold War Era* (1996) 402.

further speed up the transformation of East Asia into a new epicenter of capital accumulation in the world economy.<sup>243</sup>

#### **6.4 FDI regimes and international harmonization**

Government policies, institutional frameworks, cultural backgrounds, and the international economic environments are main contributors for the shaping and changing of FDI regimes in the triangle. These regimes lead both regional integration and international harmonization for the Chinese triangle.

It is estimated that by 2010 the manufactured exports share of the Chinese triangle in the world will increase to 9.8% from 3.3% in 1980. The greater China will be the largest export region in the world.<sup>244</sup> Thus the FDI regimes in the triangle need to be harmonized with international standards to prepare for this change and avoid conflicts. However, experiences of both the Chinese triangle and the East Asian financial crisis show that it is rational to gradually liberalize domestic trade and investment market in line with a certain sequence of steps.

The economic interdependence and regime harmonization between China and Hong Kong have demonstrated the benefits of co-operation and harmonization. Both China and Taiwan have confirmed to join the WTO, which means they will improve their trade and investment environment to harmonize with international standards. However, when making policy in international organizations, the opinions of the triangle need to be also taken into account. For accept in China and Taiwan into WTO will benefit economic growth in the triangle, market deepening in the world, and Asian dynamic recovering.

There is a spirit of consensus between governments in Hong Kong, Taiwan and Singapore which view their economic futures strongly tied to the People's Republic of China. ... [T]he potential integration of Hong Kong, China and Taiwan offers enormous economic potential which will be a major stimulus to growth of Asia.<sup>245</sup>

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<sup>243</sup> So, A. & Chiu, S. *East Asia and the World Economy* (1995) 263-65.

<sup>244</sup> Shi, P. (ed.) *Megatrends China* (1996) 18.

<sup>245</sup> Bierling, J. & Murray, G. "The emerging Powers: China, Singapore, Hong Kong and Taiwan" (1995) 43(1) *Current Sociology* 65, 82.

Above all, as history has shown, harmonization is a stimulus for world economic growth and pace maintaining. Two centuries ago, since the Industrial Revolution, the dynamic economic growth which started in nations of Europe such as England, Spain and Portugal and spreader through Europe, North America and Oceania. This growth improved civilization on the one hand, induced the gap between the North and the South and conflicts between the East and West. By the end of this century, the world saw the end of conflict between the East and West, and witnessed the dynamic economic growth started in some countries in Asia such as Japan, "four tigers" and spread to Asia-Pacific which include China as a huge market with great potential. This new dynamic economic growth will spread to the South as a whole, and will finally bridge the gap between the South and the North and push the world economy toward a real global one. Moreover, this will also helpful for the reunification in the Chinese triangle. For

[g]lobalization is drawing serious attention these days because it challenges the concept of the modern territorial state... the problem raised by globalization is that rapid expansion of the market mechanism cripples the state's power and challenges the inviolability of sovereignty and the concept of national territory.<sup>246</sup>

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From an overall point of view, because of the inter-dependence and inter-activity, the current FDI regimes and even the legal systems in the triangle as a whole is in a state of transition. The success or failure of China's transformation and its capability to resolve conflicts will determine the future of FDI regimes and legal systems in the triangle as a whole.

According to the above studies, I believe that the next century will be a century of real world harmonization rather than just an Asia-Pacific or other regional one. As part of the trends of harmonization, Chinese people in the triangle will welcome FDI inter-flows, put effort on improve their FDI regimes and do their best to contribute to this harmonized new century.

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<sup>246</sup> Yoon, Y. "Globalization: toward a new nationalism in Korea" (1995) 26(1) Korea Observer 16



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