

Guang Shen

Regulation of Cross-border Establishment
in China and the EU
A Comparative Law and Economics Approach



Intersentia Ltd
Sheraton House | Castle Park
Cambridge | CB3 0AX | United Kingdom
Tel.: +44 1223 370 170 | Fax: +44 1223 370 169
Email: mail@intersentia.co.uk
www.intersentia.com | www.intersentia.co.uk

Distribution for the UK and Ireland:

NBN International
Airport Business Centre, 10 Thornbury Road
Plymouth, PL6 7PP
United Kingdom
Tel.: +44 1752 202 301 | Fax: +44 1752 202 331
Email: orders@nbninternational.com

Distribution for Europe and all other countries:

Intersentia Publishing nv
Groenstraat 31
2640 Mortsel
Belgium
Tel.: +32 3 680 15 50 | Fax: 32 3 658 71 21
Email: mail@intersentia.be

Distribution for the USA and Canada:

International Specialized Book Services
920 NE 58th Ave. Suite 300
Portland, OR 97213
USA
Tel.: +1 800 944 6190 (toll free) | Fax: +1 503 280 8832
Email: info@isbs.com

Regulation of Cross-border Establishment in China and the EU
A Comparative Law and Economics Approach
© Guang Shen 2016

The author has asserted the right under the Copyright, Designs and Patents Act 1988, to be identified as author of this work.

No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, without prior written permission from Intersentia, or as expressly permitted by law or under the terms agreed with the appropriate reprographic rights organization. Enquiries concerning reproduction which may not be covered by the above should be addressed to Intersentia at the address above.

Cover photograph © Zhao Jian Kang – Shutterstock

ISBN 978-1-78068-414-7
D/2016/7849/100
NUR 828

British Library Cataloguing in Publication Data. A catalogue record for this book is available from the British Library.



ACKNOWLEDGEMENTS

The following thesis, while an individual work, profited from the advice and comments of several people. First, I would like to express my gratitude to my supervisors Prof. Michael Faure and Dr. Niels Philipsen. Their insights and expertise, from the initial to the final level, allowed me to complete my project on schedule.

Besides my supervisors, I would like to thank the members of the reading committee: Prof. Anthony Ogus, Prof. Hildegard Schneider, Prof. Oswald Jansen and Dr. Xu Guangdong, for their constructive and thoughtful feedback on my research.

In addition to the academic assistance above, my sincere thanks go to those lawyers, businessmen and officials who helped me carry out the empirical research for this book. Without their support, it would not be possible to provide deep insights into the reality of the inter-provincial establishment in China.

I must also acknowledge my colleagues at the Law Faculty of Maastricht University for creating a pleasant working environment. Special appreciation goes out to my METRO colleagues for the stimulating discussions and for all the fun we had in the past four years.

Since my study at the China-EU School of Law laid a solid foundation for my PhD research, I also would like to thank the professors from Europe who fly to Beijing to teach. In particular, I want to express my appreciation to Prof. Remco van Rhee and Dr. Jackson Maogoto for encouraging me to pursue PhD research in Europe.

I also wish to thank my parents for supporting me throughout drafting this dissertation. They instilled in me, from an early stage, the desire to do a doctorate.

Finally, I recognize that this research would not have been possible without the monetary support of the China Scholarship Council.



CONTENTS

ACKNOWLEDGEMENTS	V
LIST OF ABBREVIATIONS	XVII
CHAPTER 1. INTRODUCTION.....	1
1. Societal Problems	1
2. Scientific Relevance.....	2
3. Research Questions.....	3
4. Methodologies.....	3
5. Structure.....	4

PART I. LEGAL ANALYSIS

CHAPTER 2. REGULATION OF THE INTER-PROVINCIAL ESTABLISHMENT OF COMPANIES IN CHINA	9
1. Introduction.....	9
2. Rules Concerning the Establishment of Domestic Companies.....	10
2.1. Initiator Requirements.....	11
2.1.1. Initiator Numbers	12
2.1.2. Initiator Qualifications	12
2.2. Capital Requirements	13

2.2.1.	Minimum Capital Requirements	13
2.2.2.	Capital Forms	13
2.2.3.	Capital Contributions	14
2.3.	Articles of Association	14
2.4.	Procedural Requirements	16
2.4.1.	Steps to Incorporate a LLC	16
2.4.2.	Acquiring a Notice of Pre-approval of the Company Name	17
2.4.3.	Applying for Establishment Registration	17
2.4.3.1.	Rules on How to Fulfil Establishment Registration	18
2.4.3.2.	Obtaining Approval for the Establishment of a Company	20
2.4.3.3.	The Approval for Licensed Operations.....	22
2.4.3.4.	The Establishment Registration of Companies	31
2.4.3.5.	Remedies of the Refusal of a License Application.....	32
2.5.	Summary	35
3.	Regulations on the Establishment of FIEs	35
3.1.	Capital Requirement of a WFOE.....	36
3.1.1.	The Amount of Registered Capital	36
3.1.2.	Capital Forms	37
3.1.3.	Capital Contributions	40
3.2.	Capital Requirement of a JV	40
3.2.1.	The Amount of Registered Capital	40
3.2.2.	Capital Forms	40
3.2.3.	Capital Contributions	42
3.3.	Procedural Requirements for the Establishment of an FIE	43
3.3.1.	Steps to Establish an FIE	43
3.3.1.1.	The DRC Project Approval	43
3.3.1.2.	The Commerce Department Approval	47
3.3.1.3.	The Approval of Industry Regulators (if Necessary)	48
3.4.	Summary	49
4.	Rules on the Inter-provincial Establishment for Companies in China	50
4.1.	Rules on the Inter-provincial Establishment by Domestic Companies	50
4.1.1.	Rules in Terms of Establishing Subsidiaries.....	50
4.1.2.	Rules Regarding Establishing Branches.....	51
4.1.3.	Policies to Facilitate the Cross-regional Establishment of Branches and Subsidiaries.....	52
4.1.4.	Summary	56
4.2.	Rules on Inter-provincial Establishment by FIEs.....	56
4.2.1.	Rules in Terms of Establishing Branches	56
4.2.2.	Rules in Terms of Establishing Subsidiaries.....	57
4.2.2.1.	Capital Requirements	59
4.2.2.2.	Procedural Requirements for the Establishment of Subsidiaries	60
4.2.3.	Summary	62

5.	The Reality of Cross-provincial Establishment by Domestic Companies	63
5.1.	Classification of Barriers Faced by Companies	64
5.1.1.	Abuse of Administrative Powers	64
5.1.2.	Under-enforcement of State Regulations and Policies	65
5.2.	Xia, Lu and Yu's Essay on the Creation of Obstacles for the Inter-provincial Establishment by Local Governments	67
5.3.	Restrictions on the Freedom of Establishment Created by Various Authorities at Local Levels	70
5.3.1.	The Hampering of the Freedom of Establishment by Licensing Authorities	70
5.3.2.	The Possibility for other Institutions to Impose Barriers	73
6.	The Practice of the Cross-provincial Establishment by FIEs	74
6.1.	Difficulties to Obtain Licenses	74
6.1.1.	Imposing Licensing Requirements in Excess of Authority	75
6.1.2.	The Delay in Granting Licenses	80
6.1.3.	Variable Licensing Practice	81
6.1.4.	The Increased Difficulties to Acquire Licenses from MOFCOM in the Retail Field	82
6.2.	Local Authorities' Support to Acquire Licenses	82
6.2.1.	Local Agencies' Preference for Granting Licenses to FIEs	82
6.2.2.	Recognizable Ways to Support FIEs' License Obtainment	84
6.2.3.	Reasons to Assist FIEs with the Acquisition of Licenses	87
6.3.	Local Authorities' Assistance other than License Obtaining Facilitation	89
7.	Rules Coping with Administrative Monopolies in China	91
7.1.	The Provisions of the State Council on Prohibiting Regional Blockades in Market Economic Activities	91
7.2.	The Administrative License Law	94
7.2.1.	Other than Lawful Authorities Exercising Licensing Authority	98
7.2.2.	The Arbitrary Range of Licensing Items	99
7.2.3.	The Violation of Article 15(2)	102
7.3.	The Anti-Monopoly Law	105
7.4.	Limits of Dealing with Administrative Monopolies through Legislation in China	108
8.	Causes for the Widespread Occurrence of Barriers to Inter-provincial Establishment	109
8.1.	Deficient Contents of National Law	110
8.2.	Undesirable Implementation of National Law	110
8.2.1.	The Problems of Administrative Remedies	111
8.2.2.	Absence of Judicial Review of the Establishment of Illegal Licensing Regimes	112
9.	Important Changes in the Regulation of Establishment Following the Reform Measures 2013	115

9.1.	The 2013 Reform Concerning the Regulation of Establishment	115
9.1.1.	Business Deregulation as Main Changes	115
9.1.1.1.	Removing the Requirements of Capital and Licensing for the Establishment of Domestic Companies.....	116
9.1.1.2.	Creating a Record-filing System for the Establishment of FIEs	117
9.1.2.	To Sustain Economic Growth through Deregulation.....	117
9.1.3.	Social Background of the Business Deregulation	118
9.1.3.1.	Curbing the Abuse of Licensing Power to Provide Economic Impetus	118
9.1.3.2.	Launching Pilot Business Registration Reforms in a Number of Regions	120
9.1.3.3.	Extending the Deregulation of Establishment to the Entire Nation.....	120
9.1.3.4.	Fighting Corruption.....	121
9.1.3.5.	Leading to Inter-jurisdictional Competition to Ease Control on Market Access	122
9.1.3.6.	Summary	123
9.1.4.	Possible Reasons for Shanghai to Agree to Initiate Business Deregulation	124
9.1.5.	Prospects for the Business Deregulation Test	126
9.1.5.1.	Driving Forces from the President and the Premier to Sustain Economic Growth	126
9.1.5.2.	Opposition from Central Regulators for Department Interests.....	127
9.1.5.3.	Support from Local Areas to Win Investment	131
9.1.5.4.	Summary	134
9.2.	An Amendment to Company Law on the Basis of the 2013 Initiatives	134
10.	Conclusion	134
CHAPTER 3. THE EU REGULATION OF CROSS-BORDER ESTABLISHMENT OF COMPANIES. 137		
1.	Introduction.....	137
2.	The Evolution of the Internal Market.....	137
2.1.	From the Treaty of Rome to the Single European Act	138
2.1.1.	The Treaty of Rome: Providing for Negative Integration and Positive Integration.....	138
2.1.2.	The CJEU: Introducing Mutual Recognition	139
2.1.3.	The Commission: Bringing in Legislation Based on Negative Integration and Positive Integration Measures	139
2.2.	From the Single European Act to the Maastricht Treaty	140
2.2.1.	The Single European Act: Institutionalizing Minimum Harmonization....	140
2.2.2.	The CJEU: Delimiting the Scope of the Free Movement of Goods and Taking a Purposive Approach to Treaty Interpretation	141
2.2.3.	The Commission: Introducing Legislation Based on Minimum Harmonization	141
2.3.	From the Maastricht Treaty to the Lisbon Treaty	142

2.3.1.	Treaty Amendments: Creating an Economic and Monetary Union and Assigning the Internal Market to Shared Competence.....	142
2.3.2.	The CJEU: Refining the Scope of the Union’s Competence and Ensuring Effective Use of Power	143
2.3.3.	The Commission: Turning to Maximum Harmonization.....	144
3.	The EU Regulation of Cross-Border Establishment of Companies	145
3.1.	Treaty Provision on Freedom of Establishment of Companies	145
3.1.1.	Freedom of Establishment of Companies	145
3.1.2.	Derogation from the Freedom of Establishment of Companies	146
3.2.	Judicial Interpretation on the Freedom of Establishment of Companies ...	146
3.2.1.	C-81/87 The Queen v Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC, [1988] ECR 5483.....	146
3.2.2.	C-212/97 Centros Ltd v Erhvervs-og Selskabsstyrelsen , [1999] ECR I-1495.....	147
3.2.3.	C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH, [2002] ECR I-9919.....	148
3.2.4.	C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, [2003] ECR I-10155.....	150
3.2.5.	C-210/06 CARTESIO Oktató és Szolgáltató bt, [2008] ECR I-09641	151
3.2.6.	Main Trends in the Case Law on the Freedom of Establishment.....	152
3.3.	The Provision of the Services Directive on Establishment of Service Providers	153
3.3.1.	Authorization Schemes	153
3.3.2.	Prohibited Requirements	154
3.3.3.	Suspect Requirements	155
3.3.4.	The Actual Effect of the Directive Provision on Cross-border Establishment	155
4.	Removing Remaining Barriers to Cross-border Establishment.....	156
4.1.	Remaining Barriers to Cross-border Establishment.....	156
4.2.	Tackling the Remaining Barriers through Intergovernmental Negotiations and Judicial Integration	157
5.	Conclusion	160

PART II. THEORETICAL FRAMEWORK

CHAPTER 4. AN ECONOMIC ANALYSIS OF THE REGULATION OF THE ESTABLISHMENT OF COMPANIES.....	163
1. Introduction.....	163
2. Theory of Regulation.....	164

2.1.	The Public Interest Approach.....	164
2.2.	The Private Interest Approach	167
2.3.	Regulatory Instruments in the Set-up Process	169
2.3.1.	Registration.....	169
2.3.2.	Licensing	170
2.3.2.1.	GSL (General Set-up Licensing)	171
2.3.2.2.	SSL (Sectoral Set-up Licensing).....	172
2.3.3.	Certification	174
2.3.4.	Minimum Capital Requirements	174
2.4.	Other Legal Instruments to Internalize Externalities in Establishment.....	174
2.4.1.	Coase Theorem.....	174
2.4.2.	Pigouvian Tax.....	175
2.4.3.	Market Based Instruments.....	176
2.4.4.	Liability Rules.....	177
3.	Market Failure Justifications for Regulation in the Set-up Process	177
3.1.	Externalities	178
3.2.	Information Asymmetry	179
4.	Choosing Regulatory Instruments to Tackle Market Failure in the Set-up Process.....	180
4.1.	Opting for Regulatory Instruments to Tackle Externalities	180
4.2.	Choosing Regulatory Instruments to Remedy Information Asymmetry ...	181
4.3.	Summary	183
5.	Private Interest Considerations for Licensing in the Set-up Process.....	183
6.	An Economic Approach to Minimum Capital Requirements in the Set-up Process.....	186
6.1.	Market Failure Justifications for Minimum Capital Requirements in the Set-up Process.....	186
6.1.1.	Information Problems.....	186
6.1.2.	Externalities	190
6.2.	Private Interest Explanations for Minimum Capital Requirements in the Set-up Process.....	191
7.	Conclusion	194
CHAPTER 5. A LAW AND ECONOMICS VIEW ON CENTRALIZATION OF THE REGULATION OF THE CROSS-BORDER ESTABLISHMENT OF COMPANIES.....		197
1.	Introduction.....	197
2.	An Economic Analysis of the Regulation of the Cross-border Establishment of Companies	197

2.1.	Public Interest Reasons for Regulating the Cross-border Establishment of Companies.....	197
2.2.	Private Interest Explanations for Regulating the Cross-border Establishment of Companies.....	198
3.	The Economics of Federalism.....	199
3.1.	Competitive Federalism.....	199
3.2.	Fiscal Federalism.....	200
4.	Economic Arguments in Favour of Centralization.....	201
4.1.	Internalizing Trans-boundary Externalities.....	201
4.2.	Avoiding a 'Race to the Bottom'.....	201
4.3.	Reducing Transaction Costs and Profiting from Scale Economies.....	203
5.	Centralization of the Regulation of the Cross-border Establishment of Companies from an Economic Perspective.....	204
5.1.	Trans-boundary Externalities.....	204
5.2.	A Race to the Bottom.....	205
5.3.	Economies of Scale and Transaction Costs.....	207
6.	Centralization and Internal Market.....	209
7.	A Public Choice Analysis of the Centralization of the Regulation of the Cross-border Establishment of Companies.....	210
8.	Conclusion.....	212

PART III. ECONOMIC EVALUATION

CHAPTER 6. AN ECONOMIC ANALYSIS OF REGULATION OF THE INTER-PROVINCIAL ESTABLISHMENT OF COMPANIES IN CHINA.....	217
1. Introduction.....	217
2. Regulation of the Inter-provincial Establishment of Companies in China.....	218
3. A Public Interest Analysis of Regulation of Inter-Provincial Establishment in China.....	218
3.1. Public Interest Reasons for Having Different Requirements for Inter-Provincial Establishment and General Establishment.....	219
3.2. Public Interest Reasons for Regulating the Inter-Provincial Establishment of Companies at Central Level.....	219
3.2.1. Disadvantages of Centralization.....	219
3.2.2. Trans-boundary Externalities.....	223

3.2.3.	A Race to the Bottom	224
3.2.4.	Scale Economies and Transaction Cost Savings	226
4.	A Private Interest Analysis of the Regulation of the Inter-Provincial Establishment of Companies in China	227
4.1.	Interests of the Actors Involved in Having Different Requirements for Inter-provincial Establishment and General Establishment	227
4.1.1.	Local Officials	227
4.1.1.1.	Promotion	228
4.1.1.2.	Corruption	230
4.1.2.	Local Industries	231
4.1.3.	Other Industries	232
4.1.4.	Interview Results	233
4.1.4.1.	Access Barriers Erected by Local Licensing Authorities.....	233
4.1.4.2.	Interests of Officials in Creating Entry Barriers	234
4.2.	Interests of the Actors Involved in Centralization of the Regulation of Inter-provincial Establishment.....	237
4.2.1.	Regulators of Inter-provincial Establishment	238
4.2.2.	SOEs under the Jurisdiction of the Regulators.....	239
5.	Conclusion	243
CHAPTER 7. REGULATION OF THE INTER-PROVINCIAL ESTABLISHMENT OF COMPANIES IN CHINA: LEARNING FROM EUROPE?		
245		
1.	Introduction	245
2.	Comparative Law and Economics: The Importance of Considering Institutional Differences in Comparative Study	246
3.	The EU Regulation of Cross-border Establishment.....	247
3.1.	Institutional Aspects.....	247
3.2.	Remaining Barriers to Cross-border Establishment.....	248
3.3.	Ways to Tackle the Remaining Barriers	248
4.	Regulation of Inter-provincial Establishment in China	248
4.1.	Institutional Aspects.....	248
4.2.	Barriers to the Inter-provincial Establishment of Companies.....	249
4.3.	Existing Ways to Tackle the Barriers	250
5.	Insights from Standards versus Rules Debate on China Learning from the EU	250
6.	Conclusion	252

CHAPTER 8. CONCLUSIONS	255
1. Research Questions and Summary of Findings	255
2. Policy Recommendations.....	259
3. Academic Achievements.....	261
4. Limits	261
5. Future Research.....	262
VALORISATION ADDENDUM	263
BIBLIOGRAPHY	267
CURRICULUM VITAE	299

LIST OF ABBREVIATIONS

AIC	Administration for Industry and Commerce
ALL	Administrative License Law
AML	Anti-Monopoly Law
APL	Administrative Procedural Law
ARL	Administrative Reconsideration Law
AUCL	Anti-Unfair Competition Law
BEPA	Bureau of European Policy Advisers
CAAC	Civil Aviation Administration of China
CBRC	China Banking Regulatory Commission
CCCCP	Central Committee of the Communist Party of China
CEN	European Committee for Standardisation
CFLP	China Federation of Logistics and Purchasing
CIRC	China Insurance Regulatory Commission
CJEU	Court of Justice of the European Union
CJV	Contractual Joint Venture
CPC	Communist Party of China
CPPCC	Chinese People's Political Consultative Conference
CSRC	China Securities Regulatory Commission
DRC	Development and Reform Commission
ECJ	European Court of Justice
EEC	European Economic Community
EJV	Equity Joint Venture
EMU	Economic and Monetary Union
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprise
FIHC	Foreign Invested Holding Company
GAQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
GDP	Gross Domestic Production
IPO	Initial Public Offering

List of Abbreviations

JSLC	Joint Stock Limited Company
JV	Joint Venture
JVC	Joint Venture Company
LLC	Limited Liability Company
LLP	Limited Liability Partnership
MEP	Ministry of Environmental Protection
MOFCOM	the Ministry of Commerce
NDRC	National Development and Reform Commission
NPC	National People's Congress (China)
OLS	Ordinary Least Squares
One-person LLC	One-person Limited Liability Company
PRC	People's Republic of China
PWC	PricewaterhouseCoopers
RACR	Regulation on the Administration of Company Registration
RMB	the renminbi
SAIC	State Administration of Industry and Commerce
SASAC	State-funded Assets Supervision and Administration Commission
SAT	State Administration of Tax
SEA	Single European Act
SERC	State Electricity Regulatory Commission
SFDA	State Food and Drug Administration
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
TEC	Treaty Establishing the European Community
TEEC	Treaty Establishing the European Economic Community
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
US	United States
USCBC	US-China Business Council
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise
WTO	World Trade Organization