# FOREIGN DIRECT INVESTMENT LAWS OF CHINA AND CANADA

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# ABSTRACT

FDI plays an important role in economic life. It is arguably an even more significant driving force behind economic growth than trade in goods and services nowadays.

China and Canada are both important FDI absorbers, but their FDI laws display various characteristics due to their different economic bases, political structures and legal systems etc. In order to guide FDI practice in the two countries and to draw on Canada's experience for China's FDI law, this thesis mainly introduces the FDI policies of China and Canada, analyzes the FDI law systems of the two countries, and expounds their general regulations on FDI.

# RÉSUMÉ

FDI joue un rôle important dans la vie économique de nos jours. Par rapport au commerce et au service, il est discutable une force motrice même plus significative de la croissance économique.

La Chine et le Canada sont deux grands pays recevant FDI. Or, leurs lois concernant FDI témoignent des caractéristiques différentes à cause des différences de bases économiques, de systèmes politique et juridique des deux pays. En vue de diriger la pratique de FDI dans les deux pays et de tirer profit de l'expérience canadienne pour les lois chinoises de FDI, à part une introduction sur les politiques de FDI de la Chine et du Canada, la présente étude analyse également leurs systèmes juridiques et fait une présentation approfondie des réglementations dans ce domaine.

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# FOREIGN DIRECT INVESTMENT LAWS OF CHINA AND CANADA

## I. INTRODUCTION

In today's world of technical advancement and economic interdependence, no country can proceed with construction and modernization by depending solely on its own resources.

In the past twenty years between 1979 and 1999, China absorbed about US$ 306 billion of FDI. It has become the second largest FDI recipient in the world besides the U.S. and the largest FDI absorber among the developing countries.[1] Along with the deepening of its domestic reforms and opening to the outside world, especially its gradual establishment of a market economy, China will attract more FDI by providing greater investment opportunities for businesses from around the world. It is practically worth studying China's FDI law.

Extensive foreign investment has been a part of Canada since its earliest days. Its inward FDI is generally more extensive than in any other developed country[2] and it also has the highest level of FDI control in the industrialized world. It is meaningful to study the way that Canada administers its FDI by law, the system of which was once presented as a model for other host countries[3] from the perspective of a market economy.

China's FDI abroad has achieved positive results over the past twenty years[4] with a

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[1] Xinhua News Agency (Paris), *China: Second Largest FDI Recipient Worldwide*, Oct. 9, 2000

[2] A. F. Lowenfeld, *International Private Investment: International Economic Law*, Vol. II, 2nd ed., Matthew Bender, 1982, p.19

[3] In Fisher's "Canada's Foreign Investment Review Act as a Model for Foreign Investment Regulation in the United States" (7 *Can.: U.S.L.J.* 61, 1984) and Osunbor's "Nigeria's Investment Laws and the State's Control of Multinationals" (3 *ICSID Rev.: F.I.L.J.* 38, 75-75, 1988), the Canadian FDI law system was recommended both to a developed country and a developing country. – See Ross B. Leckow and Ian A . Mallory, "The Relaxation of Foreign Investment Restrictions in Canada", *ICSID Rev.: F.I.L. J.*, Vol. 6, No. 1, Spring 1991, p.2, note 2

[4] APEC Committee on Trade and Investment, *Guide to the Investment Regimes of the APEC Member Economies*, 3rd ed., 1996, p.137

total investment amount exceeding US$ 6 billion up to the beginning of 1999.[5] China takes Canada as one of its major investment destinations among the developed countries[6] because the latter has long been an ideal location for worldwide FDI. China's overseas investment in Canada was estimated at C$ 178 million in 1998 and it is now the sixth largest Asian investor in Canada.[7] Meanwhile, Canada's direct investment in China also shows a consistent increase in recent years. Up till now, Canada directly invested US$ 2.33 billion in China[8] and it remains among the top ten investment nations in China.[9] With the further development of Sino-Canadian relations, the economic cooperation and bilateral trade between the two countries hold broader prospects and greater potentials. The mutual economic interchange makes it more pragmatic to study FDI laws of China and Canada.

Since the start of the reforms, the environment for FDI in China keeps improving but is not yet ideal. Over a relatively short period of twenty years, the legal system for investing in China has become increasingly complete but is not yet perfect.[10] China is transferring to the market economy, under which circumstances its current FDI law is sometimes inadequate to deal with new conditions. The legal rules of other countries with

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[5] "China's Total Amount of Investment Abroad Has Reached More Than US$ 6 Billio", http://www.china.org.cn/ceec-e/zgtzzn/tzzn4.html

[6] *Supra* note 4, p.138

[7] Canada Department of Foreign Affairs and International Trade (DFAIT), *Canada China Relations*, http://www.dfait-maeci.gc.ca/china/relations/menu-e.asp

Canada was China's tenth largest trading partner. – See *Canada's Direct Investment in China*, http://www.chinafiw.com, Feb. 11, 2001

[8] *Canada's Direct Investment in China*, http://www.chinafiw.com, Feb. 11, 2001

China was Canada's fourth largest export market after the U.S., Japan and the U.K. in 1999. And this export market for Canada has demonstrated steady expansion. – See *supra* note 7

[9] *Supra* note 7

Another source shows that by 1998 Canada ranked thirteenth of the top fifteen capital exporters in China. – See feature article, "A Summary of China's Absorption of Foreign Investment", *Foreign Investment in China*, Issue 82, Sept. 1999, p.15

[10] Liu Chu, "Laws and Regulations Concerning Business Enterprises with Foreign Participation" in Rui Mu and Wang Guiguo (eds.), *Chinese Foreign Economic Law: Analysis and Commentary*, International Law Institute, 1994

an established market economy can be introduced to and transplanted in the country.[11] Canada's experience with FDI is a long one.[12] Governments in many countries are following Canadian developments with great interest[13] as its way of regulating FDI may provide advance notice of what is to be expected in the host countries.[14] The study of Canada as a host country for FDI may also draw on experience for China's FDI law.

Any laws are reflections of the economics and politics of a given society. For knowing FDI laws of China and Canada, therefore, we had better find out first the actual FDI situations in the two countries and their FDI policies. Parts II and III of the thesis present an introduction on the concept of FDI and the role of FDI law as well as an overview of history and development of FDI in China and Canada as a background for further legal studies.

FDI law is part of the legal superstructure. To understand FDI laws of China and Canada, the legal framework within which FDI laws function in the two countries must also be understood. Part IV tries to depict a clear picture of interrelating and complex legal systems of the tow different countries.

FDI laws of general application are the centerpieces of FDI regulations of China and Canada. The thesis thus focuses on the subject in Part V. But the number of special laws on industrial sectors in both China and Canada is so numerous that a study of them is well beyond this single thesis. However, a brief introduction on the issue would display a fuller view of FDI laws of the two countries. Part VI is just for this purpose.

After reviewing the legal situations of FDI in China and Canada and studying their general FDI laws and regulations, Part VII concludes the thesis by comparing and commenting on certain FDI issues between the two countries from a legal point of view. Besides, it puts forward some referential legal suggestions with regard to FDI for China's sake.

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[11] Actually, China's legislative practice has accepted the idea of legal transplant and borrowed extensively from many foreign jurisdictions. – See Wang Chenguang and Zhang Xianchu, *Introduction to Chinese Law*, Sweet and Maxwell Asia, 1997, p.28

[12] A. E. Safarian, *Foreign Ownership of Canadian Industry*, 2nd ed., University of Toronto Press, 1973, p.5

[13] Earl H. Fry, *The Politics of International Investment*, McGraw-Hill, 1983, p.79

[14] R. McCullogh and R. F. Owen, "Linking Negotiations on Trade and Foreign Direct Investment" in *The MNC's in the 1980's*, p.338

## II. FDI AND FDI LAW

### 1. Concept of FDI

#### *1.1 Definition of FDI*

In its broadest sense, investment is the sacrifice of certain present value for future value.[15] Specifically speaking, it indicates utilization of capital to leverage (obtain more capital) or to take equity or debt positions in securities, with the intention of gaining an increase in that capital from growth or income; or general term applied to a program designed as an investment, offering the chance for gain against risks of loss; or description of a business purchase of fixed assets or in speculative ventures related to the purposes of the operation.[16] Investment can be categorized as direct investment and indirect investment.

Indirect investment, also called portfolio investment, is made through debt and equity instruments on the capital market. The debt instruments include bonds, commercial paper and certificates of deposit. The equity instruments are composed of bonds, stock offerings and direct purchases of shares.[17] Indirect investment provides for a transfer of capital that is made in response to profit incentives reflecting relative expected rates of return, risks and uncertainties, and financial intermediation plays an important role in determining its flows.[18] Indirect investment is made solely in order to secure an income and it does not directly affect local ownership and control.[19] Direct investment is opposed to indirect investment or short-term capital flow. It implies that the investor "purchases the power to exert some kind of control over the decision making process" of the invested enterprise.[20] While indirect investment is made solely to secure an income, direct investment is made to secure control of or influence in an enterprise.[21] Whether it involves the control of the enterprise is the fundamental distinguishment between direct and indirect investment. In

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[15] William F. Sharpe, *Investments*, 2nd ed., Prentice-Hall, 1981, p.2

[16] "Investment Entry" in Michael C. Thomsett (ed.), *Investment and Securities Dictionary*, McFarland, 1986

[17] Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines*, Martinus Nijhoff Publishers, 1993, p.2, note 4

[18] Grant L. Reuber etc., *Private Foreign Investment in Development*, Ciarendon Press, 1973, pp.53-54

[19] Ping Lan, *Technology Transfer to China through Foreign Direct Investment*, Avebury, 1996, p.36

[20] John H. Dunning, *Studies in International Investment*, George, Allen and Unwin, 1970, p.4

[21] Frank A. Southard, *American Industry in Europe*, Houghton Mifflin, 1931, p.191, note 1

addition, there are some other differences between the two forms of investment. First, indirect investment implies a fixed obligation to repay interest and principle whereas direct investment implies a flexible repayment obligation geared to the success of the investment.[22] Second, the flows of indirect investment tend to be more general in character while direct investment tends to be more industry specific[23] that involves a flow of resources of managerial skills, technology and marketing knowledge etc. besides a capital transfer.[24]

On top of its intrinsic nature, direct investment becomes "foreign" when it goes beyond its original border. As the IMF defines, foreign direct investment (FDI) is the "investment that is made to acquiring lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective voice in the management of the enterprise".[25] FDI involves the transfer of tangible or intangible assets[26] from a source country investor to a host country for the purpose of using the assets in the host country to generate wealth under the total or partial control over the assets.[27] There are three components in FDI, i.e., equity capital, reinvested earnings and intra-company transactions. Equity capital is the foreign investors' purchase of shares of an enterprise in a country other than themselves. Reinvested earnings comprise the foreign investors' share of earnings not distributed as dividends by their invested enterprise in the host country or earnings not remitted to the foreign investors. The retained profits are instead reinvested in the host country. Intra-company transactions (loans or debt) constitute short and long-term borrowing and lending of funds between the foreign investors and their invested enterprise.[28]

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[22] *Supra* note 18, pp.53-54

[23] *Id.*

[24] Stephen J. Kobrin, *Foreign Direct Investment, Industrialization and Social Change*, Jai Press, 1977, p.30

[25] IMF, *Balance of Payments Manual*, 1980, para.408

[26] Intangible assets refer to those long-lived revenue-producing assets that lack a tangible physical presence. (Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines*, Martinus Nijhoff Publishers, 1993, p.92, note 61) They include such intellectual property rights as patent, copyright, trademark and know-how.

[27] Robert K. Paterson and Martine M. Band, *International Trade and Investment Law in Canada*, 2nd ed., Carswell, 1998, p.10-3

[28] UNCTD, *World Investment Report 1998: Trends and Determinants*, 1998, p.351

### *1.2 Characteristics of FDI*

From the concept of FDI, the following features of FDI can be further induced.

FDI indicates private investment. The sources of international capital flows can be public and private. The public investment includes loans and financial aids made by governments and their agencies of various countries and by international organizations such as the IMF and the World Bank. The private source comprises (a) export credit provided by commercial suppliers and manufactures; (b) cash loans and export credit provided by commercial banks and other financial institutions; (c) direct and portfolio investment made by private investors; and (d) donations supplied by charitable organizations.[29] FDI only refers to the investment made by private investors, excluding public investment and other types of private international capital flows. The private investor, namely, foreign direct investor, includes individual, incorporated or unincorporated public or private enterprise, and even government that has a direct investment enterprise, i.e. a subsidiary, branch or associate operating in a host country.[30]

FDI indicates ownership control. Whether to have control or not is yet uneasy to define[31] because the question touches upon a more complex matrix of economic interactions[32] than some other types of international capital flows. It is ordinarily assumed that a controlling interest involves at least 51% of the total voting shares. But the possession of stock less than this percentage can also gain a working control where the stock of a company is widespread.[33] Under the circumstances, the dividing line between some control and no control becomes arbitrary[34] and the percentage of stock ownership for equity investment varies form country to country. For example, the U.S. Department

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[29] Yao Meizhen and Yu Jinsong, *Comparative Foreign Direct Investment Laws*, Wu Han University Press, 1993, p.4

[30] OECD, *Detailed Benchmark Definition of Foreign Direct Investment* 7 (1992) quoted from Ibrahim F. I. Shihata (ed.), *Legal Treatment of Foreign Investment: The World Bank Guidelines*, Martinus Nijhoff Publishers, 1993, p.1, note 3

[31] S. H. Hymer, *The International Operations of National Firms: A Study of Direct Foreign Investment*, the MIT Press, 1976, pp.1-2

[32] La Croix etc., *Emerging Patterns of East Asian Investment in China – From Korea, Taiwan and Hong Kong*, An East Gate Book, 1995, p.5

[33] *Supra* note 21, p.8

[34] *Supra* note 31

of Commerce considers a foreign enterprise to be American-controlled if 50% of the equity is held by Americans, or if 25% of the equity is held by a single American or a group of affiliated Americans. When the enterprise is deemed by this way to be American-controlled, all American investment in that enterprise is classified as FDI.[35] Recognized in the *Foreign Direct Investment Regulations*, the stock ownership of FDI can even be as low as 10%.[36] The OECD holds the same views on the issue. In its *Detailed Benchmark Definition of Foreign Direct Investment*, "an incorporated or unincorporated enterprise in which a single foreign investor owns 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise" is classified as a direct investment enterprise.[37] In Canada, for a foreign investment to be classified as "direct" the foreign interest generally also holds 10% or more of the voting equity.[38] The rationale for lower percentage of stock ownership to be recognized as having control and thus as FDI is based on the fact that foreign investors can obtain *de facto* control over their invested enterprises through such other methods as managerial expertise, advanced technology and marketing skills than stock ownership.[39] China's FDI law stipulates, however, that the percentage of the investment in an enterprise made by foreign investors should be at least 25% in order to be classified as foreign investment enterprises.[40]

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[35] *Id.*

[36] S. 1000.305 of the *Foreign Direct Investment Regulations*, CCH Bal. of Payments Rep. II 506E, defines "direct investor" as "any person ... within the United States ... [who] directly or indirectly owns or acquires a 10% of interest in a corporation or partnership organized under the laws of a foreign country or in a business venture conducted within a foreign country ...". The term "10% interest" is defined as "(i) 10% or more of the total combined voting power of all outstanding securities of such corporation or (ii) 10% or more of the profits interest in such partnership or business venture. (s. 1000. 304(b)(2); CCH Bal. of Payments Rep. II 506c.) – Quoted from C. H. Fulda and W. F. Schwartz (eds.), *Regulation of International Trade and Investment*, 1970, p.567, note 2

[37] *Supra* note 30

[38] D. Swimmer etc., *Foreign Investment in Canada: Measurement and Definitions*, 1992, p.ii

[39] *Supra* note 20, pp.4-5

[40] Art. 4 of the *Law of Chinese-Foreign Equity Joint Ventures* provides that "[i]n the registered capital of an equity joint venture, the proportion of the investment contributed by the foreign parties shall in general not be less than 25%".

### *1.3 Forms of FDI*

FDI can take the form of either the establishment of a new enterprise by foreign investors in a host country or the acquisition of an existing domestic enterprise in that country.[41]

The greenfield establishment can be a branch, a subsidiary, an associate or a joint venture.[42] A foreign company is a foreign legal person incorporated outside the territory of a host country. A branch of the foreign company is a component of the company without separate juridical and independent corporate status. It is only a local office of the foreign company that operates in the host country.[43] The branch may engage in business operations in the name of its parent company in the host country but its civil responsibilities should be borne by the latter. A subsidiary is an incorporated enterprise in the host country in which its parent company directly owns more than 50% of the shareholders' voting power and has the right to appoint or remove a majority of the members of the administrative, management or supervisory body.[44] The subsidiary is an independent domestic legal person of the host country, and it is under the jurisdiction of the host national law although its capital relationship, administration ideology and management method are all in fact controlled by its foreign parent company. If foreign investors own a total of at least 10% but no more than 50% of the shareholders' voting power, the incorporated enterprise in the host country is then called an associate of the foreign company.[45] Unlike the parent-subsidiary relationship where there is control by a single dominant company, a joint venture involves shared control by the parent companies.[46] The joint venture can take the form of contractual joint venture, equity joint

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[41] Rachel McCulloch, "New Perspectives on Foreign Direct Investment" in Kenneth A. Froot (ed.), *Foreign Direct Investment*, The University of Chicago Press, 1993

[42] A. J. Easson, *The Design of Tax Incentives for Direct Investment: Some Lessons from the ASEAN Countries*, Ontario Center for International Business, WP1993-(53), p.1, note 1

[43] Cynthia Day Wallace, *Legal Control of the Multinational Enterprises*, Martinus Nijhoff Publishers, 1982, p.9

[44] *Supra* note 28, p.350

[45] *Id.*

[46] According to Edgar Herzfeld (*Joint Ventures*, 2nd ed., Jordans & Sons, 1989, p.xiv, note2), a fullest definition about "joint venture" is contained in *American Jurisprudence* Vol. 46, 2nd ed., 1969, which reads "[a] Joint Venture is an association of persons with intent, by way of contract expressed or implied, to

venture or partnership.[47]

A contractual joint venture[48] refers to a contractual arrangement[49] whereby the foreign investors and their partners in the host country cooperate in a joint project and relevant activities according to the terms and conditions stipulated in the joint venture contract. The terms and conditions spell out their respective liabilities, rights and obligations,[50] all of which are shared among the foreign investors and their partners accordingly but unnecessarily in the light of their respective capital contribution. The contractual joint venture itself is not a separate legal person from the parties, either the foreign investors or their partners who cooperate to establish it. In an equity joint venture, the foreign investors and their partners share equity and management in conformity with their equity shares. The key difference between the equity joint venture and the contractual joint venture is whether the profits and risks between the venturers are proportioned in accordance with their respective capital contribution or determined only by the terms and conditions stipulated in their venture contract without considering such capital contribution. Unlike the contractual joint venture, the equity joint venture has independent legal status. It is not the subsidiary of either the foreign investors or the local partners because its control is shared between the partner companies. For the consolidated accounting purpose, however, it can be considered as a subsidiary of the partner company that holds 51% or more of the equity although all major decisions of the venture still

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engage in and carry out a single business venture for joint profit for which purpose they combine their efforts, property, money, skill and knowledge, without creating a partnership or a corporation pursuant to an agreement that there shall be a community of interest among them as to the purpose of the undertaking, and that each Joint Venturer shall stand in the relation of principal, as well as agent, as to each of the other co-venturers, with an equal right of control of the means employed to carry out the common purpose of the Venture". The definition has revealed the basic features of a joint venture. But it seems to indicate only the contractual joint venture and exclude the other two forms of joint ventures, i.e., equity joint venture and partnership. Therefore, this definition might not be the "fullest".

[47] Peter Muchlinski, *Multinational Enterprises and the Law*, Blackwell Publishers, 1995, p.72

[48] In China, it is also called cooperative joint venture.

[49] In a contractual arrangement, the management contract and the license of patents and know-how are the most important. – See C. H. Fulda and W. F. Schwartz, *Regulation of International Trade and Investment*, 1970, p.567

[50] The rights and obligations could include the investment provision, the cooperation conditions, the distribution of profits or products, the sharing of risks and losses, the form of operation and management, and the ownership of property or assets at the termination of the contract.

require the consent of the other partner.[51]

Not replacing greenfield FDI, cross-border acquisition has become a widely-used FDI alternative.[52] Acquisition refers to any transaction in which a buyer acquires all or part of the assets and businesses of a seller, or all or part of the seller's stocks or other securities. It may take such different forms as merger, consolidation, asset acquisition and stock acquisition.[53] A merger is a combination of two corporations with one of them being merged into the other. Upon completion of the merger, one corporation disappears and the other corporation survives and falls heir to all the assets and businesses as well as liabilities of the two corporations.[54] A consolidation involves a combination of two corporations too, but both the corporations disappear and are then consolidated into a third new corporation that falls heir to all the assets and businesses as well as liabilities of the two consolidated corporations.[55] An asset acquisition is an acquisition in which a buyer acquires all or part of the assets and businesses of a corporation, with the corporate structure remaining intact and the stockholders' ownership of stock of the corporation not affected. Acquisition may also involve purchase of the outstanding stocks from the stockholders of a corporation. Traditional acquisition is willingly negotiated between the buyers and the sellers. When the seller's management opposes the acquisition and the buyer thus makes a bid directly to the seller's stockholders to acquire the seller's stocks and gain control over the seller, the acquisition becomes a takeover.[56]

Besides, FDI may still take non-equity forms, including subcontracting, management contracts, turnkey arrangements, franchising, licensing and product sharing and so on.[57] In comparison with traditional FDI, these forms are relatively new but they are getting more

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[51] *Supra* note 47

[52] Worldwide cross-border majority-owned M&A even represented 3/5 of global FDI inflows in 1997. The U.S., followed by the U.K., France and Germany, accounted for the biggest share of the large M&A deals. – See *supra* note 28, p.10

[53] Charles A. Scharf, Edward E. Shea and George C. Beck, *Acquisitions, Mergers, Sales, Buyouts and Takeovers: A Handbook with Forms*, 3rd ed., Prentice-Hall, 1985, p.5

[54] *Id.*

[55] *Id.*

[56] *Id.* pp.1-2

[57] *Supra* note 28

popular nowadays.[58]

## 2. FDI Law and Its Role

From the viewpoint of customary international law, the degree of freedom that a host country regulates its inward FDI is basically a matter of policy left to the country's discretion. This theory is well testified by the fact that countries in all regions around the world have adopted specific FDI regulatory frameworks to support their economic objectives in the past forty years.[59] Principal FDI policy comprises rules and regulations governing the activities of FDI, from its entry and acceptance to its operation and administration. The policy serves for various ends of the host countries by restricting or encouraging FDI,[60] influencing its sectoral composition and geographical distribution, and affecting the ways in which it is made. FDI law is a legal means concentratively reflecting FDI policy of the capital importing state, and it is the overall legal norms made by the host country regulating various relations with regard to FDI in the territory.[61] FDI law plays an important role.

(1) FDI law is a particular measure reflecting FDI policy.

Between policy and law, the former is a principle and a macroscopic decision while the latter is the specification of the relevant policy and a microscopic measure to implement it. Law is enforceable, through which policy can therefore be better carried out. Irrespective of different FDI law systems and regardless of various FDI law forms, all FDI laws are enacted by the legislatures of the host countries and carried out by their judicial organs to regulate FDI activities and to implement FDI policy.

(2) FDI law is a legal means to adjust and regulate FDI relations and to stipulate and protect foreign investors as well as their business rights and interests.

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[58] C. Oman, *New Forms of Investment in Developing Country Industries: Mining, Petrochemicals, Automobiles, Textiles, Food*, OECD, Paris, 1989

[59] According to the UNCTD, at least 143 countries and territories had enacted FDI-specific legislation by 1997. – See *supra* note 28, p.55

[60] Many FDI laws were initially intended to control the entry and operation of FDI. Since the early 1980s, however, most host countries have intended to create a favorable investment climate for FDI and adopted frameworks designed to attract its inflow. – See *supra* note 28, p.55

[61] As for the different relations concerning portfolio investment in the capital importing country, they are not regulated by FDI law but by ordinary civil law, business law, company law and securities law etc. – See *supra* note 29, p.7

FDI relations are complicated and relate to a wide range of factors concerning private law and public law. They involve the contract of investment, the legal standing of foreign investors and their rights and duties, the organizational structures and management of foreign investment enterprises and their production, sales, capital movement, investment return, winding-up and liquidation and so on. They also involve the review and approval of FDI and its registration, exchange control, taxation, and investment dispute settlement procedure etc. The role of FDI law is to determine all these relations by setting code of conduct for foreign investors and their business activities, making a distinction between legitimation and unlawfulness and maintaining stable investment relations.[62]

(3) FDI law is an important factor in adjusting and improving the investment environment of the host country.

Investment environment of the host country consists of both its material factors like natural resources and infrastructure and its social elements, such as economic, political, ideological and legal status. Although the size and growth of the host country's economy is a more powerful motivation for FDI, the law regulating FDI without doubt has an important influence on the level of its inflows.[63] Judging the investment environment of a perspective host country when making investment decisions over there, foreign investors typically consider the legal factor in addition to other elements of that country.[64] FDI law is an important ingredient of the investment environment.[65] More significantly, it is through the specific regulations of FDI law that measures to adjust and improve the investment environment of the particular country can be finally assured because of its authority and enforceability.

Owing to various political consideration, economic objectives, natural resources, infrastructure status, technology standards and industrialization necessities, the rules of

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[62] *Supra* note 29, p.239

[63] UNCTC, *Government Policies and Foreign Direct Investment*, ST/CTC/SER.A/17, UN, Nov. 1991, p. (iii)

[64] Price Waterhouse, *Information Guide: Doing Business in Canada*, 1994, pp.27-32

[65] Peter J. Buckley and Eugen Jehle, "Forms of Enterpreneurial Cooperation between Chinese and Foreign Enterprises: Taxation Implications" in Peter J. Buckley (ed.), *Foreign Direct Investment and Multinational Enterprises*, 1995

domestic law governing FDI differ between countries.[66] This is also true with China and Canada. Since the economics and politics of any given society are the basis of law, it is helpful to find out the actual FDI situations and FDI policies of China and Canada before further studying the FDI laws of the two countries.

## III. FDI IN CHINA AND CANADA

### 1. Overview of FDI in China

#### *1.1 Development of FDI in China*

Before 1979, China's economic policy was based on the principle of self-reliance and China did not permit FDI for historical, ideological and objective reasons. The exception was that it allowed a few joint ventures with then Soviet and other East European companies that were terminated by the mid-1950s, set up the Sino-Polish Joint Stock Shipping Company that has continued till the present day, and permitted some overseas Chinese to invest in certain State-private companies.[67]

Since 1979, China has opened for FDI and has been absorbing FDI in earnest. In the past twenty years, the development of FDI in China has undergone four stages.

(1) Stage of experiment (1979-1983)

It was the initial phase of FDI in China. During the four years, only 1,558 FDI projects were approved and approximately US$ 2.7 billion was utilized. [SEE TABLE 1] FDI inflow was slow because most foreign investors took a wait-and-see attitude[68] and hesitated to conduct FDI in China as they lacked knowledge of China's policy change and its investment environment.

(2) Stage of initial development (1984-1986)

After 1983 China accelerated its opening to the outside world. The expansion of foreign trade, the achievements made in domestic economic reforms[69] and the adoption of

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[66] D. Kokkini-Iatridou, "Protection of Foreign Investments" in Hague-Zagreb Colloquium, *Essays on the Law of International Trade*, Asser Institute, 1976

[67] UNCTC, *Foreign Direct Investment in the People's Republic of China*, 1988, pp.54-55

[68] Zongli Tang, *China's Foreign Economic Policy in Post-Mao Time*, Nova Science Publishers, 1996, p.72

[69] Most notably, China's economic reforms achieved huge success in rural areas by transforming the mode of land use and thus greatly enhanced the production initiative of peasants and increased grain yield.

some important legislation in respect of FDI[70] led to the first influx of FDI into China. 6,737 FDI projects were approved in the three years, over four times more than those of the first stage. But the growth was stopped in its track in the late half of 1985 and early 1986. The growth rate of utilized FDI was reduced from 37.8% in 1985 to 14.7% in 1986 and the number of approved FDI projects even became a negative growth of 51.3% compared to the previous year. [SEE TABLE 1] The decline was attributed to several factors. First, China experienced certain economic problems at that time. The rapid economic growth in 1984 and 1985 gave rise to high inflation and a growing trade deficit. The Chinese government took an austerity policy of curbing the overheated economy by severely curtailing domestic spending of foreign exchange and screening more tightly new investments[71] including those "non-productive" FDI projects.[72] Second, due to the shortage of foreign exchange the Chinese government required foreign investment enterprises (FIE) to be self-sufficient in foreign exchange. The requirement proved to be so restrictive that the FIEs ran into operational difficulties.[73] Third, foreign investors had been disappointed in China's investment environment, particularly the bureaucratic red tape, restraints on management autonomy and high investment costs.[74]

(3) Stage of steady development (1987-1989)

The decline of FDI inflow led the Chinese government to reassess its attitudes towards FDI.[75] To reverse the trend, China began to carry out some new measures concerning FDI after 1986, among which the most import was the promulgation of the *Regulations on Encouragement of Foreign Investment* ("22 Articles") by the State Council on Oct. 11, 1986. The "22 Articles" and a set of other national regulations to

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[70] In Sept. 1983, China put the *Implementing Regulations on the Law of Chinese-Foreign Equity Joint Ventures* into effect to improve the investment environment, which provided more details about profit repatriation, technology transfer and foreign exchange.

[71] Gang Tian, *Shanghai's Role in the Economic Development of China: Reform of Foreign Trade and Investment*, Praeger, 1996, p.168

[72] Haishun Sun, *Foreign Investment and Economic Development in China: 1979-1996*, Ashgate, 1998, pp.14-15

[73] *Id.*

[74] Guiguo Wang, *China's Investment Laws: New Directions*, Butterworths, 1988, p.11

[75] *Supra* note 71, p.190, note 5

implement it[76] as well as a flurry of relevant provincial and municipal regulations marked the gradual relaxation of China's business environment for FDI. A number of operational measures were adopted to assure the management autonomy of the FIEs and facilitate their exports. Swap centers were also established to allow foreign investors more possibilities of balancing their foreign exchange so that they could repatriate their profits.[77] In response to the improved investment environment, FDI recovered quickly after the fall of 1986 and maintained a high growth rate in 1987, 1988 and the first half of 1989, resulting in its second influx into China.

(4) Stage of large-scale development (1992 - present)

The FDI influx of 1987-1988 was broken off in 1989 and 1990. A worsening economic and political climate was largely to blame.[78] As a result, the growth rate of utilized FDI fell sharply to 6.2% in 1989 and even further to 2.8% in 1990. [SEE TABLE 1] In recognition of the negative reaction of foreign investors, in early 1991 the Chinese government concluded the "austerity program" that had started in late 1988 and replaced it with a promotion for investment through loosening the control over the domestic loans and opening up the domestic market to FDI.[79] At the same time, the impact of the Tiananmen Square Event of Jun. 4, 1989 also diminished by 1992.[80] The improvement of China's overall investment environment facilitated the recovery of its inward FDI and its third FDI influx. Beginning in 1992 FDI moved aggressively into the country, and since then China has experienced an unprecedented boom in FDI inflows. By the end of 2000, China altogether approved 364,000 FIEs and utilized US$ 348.62 billion. [SEE TABLE 1]

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[76] There were promulgated about fourteen implementing regulations by various ministries and departments at that time, relating to such issues as employment, import and export, loans, taxation and capital registration. – See Rui Mu, "Chinese Economic Law and the Chinese Legal System" in Rui Mu and Wang Guiguo (eds.), *Chinese Foreign Economic Law: Analysis and Commentary*, International Law Institute, 1994, pp.1-24, 25, note 70

[77] Rui Mu, "Chinese Economic Law and the Chinese Legal System" in Rui Mu and Wang Guiguo (eds.), *Chinese Foreign Economic Law: Analysis and Commentary*, International Law Institute, 1994, pp.1-24, 25

[78] *Supra* note 72, pp.15-16

[79] *Supra* note 72, pp.16-20

[80] Actually the Tiananmen Square Event did not have a significant short or long-term deterrent effect on inward FDI into China. The Chinese market is too great to ignore. – See *supra* note 47, p.192

**TABLE 1: STATISTICS OF FDI IN CHINA (1979-2000)**

Unit: US$ 100 million

| Year | Approved FDI Projects | Utilized FDI Value | Growth Rate % | Contractual FDI Value | Growth Rate % | Realization Ratio* % |
|---|---|---|---|---|---|---|
| 1979-82 | 920 | 17.69 | -- | 49.58 | -- | 35.7 |
| 1983 | 638 | 9.16 | -- | 19.17 | -- | 47.8 |
| 1984 | 2,166 | 14.19 | 54.9 | 28.75 | 50 | 49.4 |
| 1985 | 3,073 | 19.56 | 37.8 | 63.33 | 120.3 | 30.9 |
| 1986 | 1,498 | 22.44 | 14.7 | 33.30 | -47.4 | 67.4 |
| 1987 | 2,233 | 23.14 | 3.1 | 37.09 | 11.4 | 62.4 |
| 1988 | 5,945 | 31.94 | 38.0 | 52.97 | 42.8 | 60.3 |
| 1989 | 5,779 | 33.93 | 6.2 | 56.00 | 5.7 | 60.6 |
| 1990 | 7,273 | 34.87 | 2.8 | 65.96 | 17.8 | 52.9 |
| 1991 | 12,978 | 43.66 | 25.2 | 119.77 | 81.6 | 36.5 |
| 1992 | 48,764 | 110.08 | 152.1 | 581.24 | 385.3 | 18.9 |
| 1993 | 83,437 | 275.15 | 149.9 | 1,114.36 | 91.7 | 24.7 |
| 1994 | 47,549 | 337.67 | 22.7 | 826.80 | -25.8 | 40.8 |
| 1995 | 37,011 | 375.21 | 11.1 | 912.82 | 10.4 | 41.1 |
| 1996 | 24,556 | 417.26 | 11.2 | 732.76 | -19.7 | 56.9 |
| 1997 | 21,001 | 452.57 | 8.5 | 510.03 | -30.4 | 88.7 |
| 1998 | 19,799 | 454.63 | 0.46 | 521.02 | -2.2 | 87.3 |
| 1999 | 16,918 | 403.19 | -11.3 | 412.23 | -20.9 | 97.8 |
| 2000 | 22,532 | 407.72 | 0.93 | 626.57 | 50.84 | 65.1 |
| 1979-20 | 364,000 | 3,486.2 | 28.4 | 6,767.2 | 44.2 | 51.5 |

* Realization ratio = utilized FDI value ÷ contractual FDI value

Source: The Ministry of Foreign Trade and Economic Cooperation (MOFTEC), *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsj/wztj/2000_9-22-7.html; *FDI in China Picked Up in 2000*, http://www.chinafiw.com, Jan. 19, 2001

### *1.2 China's FDI Policy*

Policies here refer to statements of aims made by a government or a political party.[81] Although they are different from laws, the policies can help people to better understand the laws as they provide the background of legislation, the annotation of legal enforcement and the development trend of the laws. Therefore, it is essential to know China's FDI policy before understanding its FDI law.[82]

#### 1.2.1 General FDI Policy

For a long time after its founding in 1949, China was isolated from the outside world due to ideological, political and historical reasons and it thus implemented a policy of

[81] A. S. Hornby etc., *The Advanced Learner's Dictionary of Current English*, Oxford University Press, 1963

[82] Zhenquan Wang, *Foreign Investment and Economic Development in Hungary and China*, Avebury, 1995, p.51

"independence and self-reliance", the substance of which is identical with the close-door policy. During that time, China's development strategy was orthodox state socialism. The state in the industrial sector and the collective in the agricultural sector were sole producers.[83]

In the late 1970s, China suffered from four major economic problems: a chronic shortage of both consumer and production goods; massive waste; stagnation of research, development, innovation, and diffusion of modern technology with deleterious effects on the quality of growth; and deficient incentives to labor, management and entrepreneurship.[84] As a result of a fundamental shift in political leadership marked by the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China (CPC), China formally embarked on the policy of domestic reforms and opening to the outside world in Dec. 1978 to overcome the problems and revitalize its economy. The open policy is one of China's long-term basic state policies,[85] the goal behind which is to absorb FDI and raise the level of managerial skills and technology.[86] This policy reflects China's recognition of economic interdependence among nations in the world and its desire to cooperate with other members of the international community. China regarded FDI as a necessary and beneficial complement to its socialist economy.[87]

On Jul. 1, 1979, China promulgated the *Law of Chinese-Foreign Equity Joint Ventures* (EJVL)[88] as a first legal response to its FDI policy. The EJVL stipulates that China permits foreign companies, enterprises, other economic organizations or individuals to incorporate themselves, within the territory of China, into joint ventures with Chinese companies, enterprises or other economic organizations.[89] On Dec. 4, 1982, the policy of absorbing FDI was elevated to constitutional status. *The Constitution of China* states that

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[83] Reginald Yin-Wang Kwok: "Hong Kong Investment in South China" in La Croix etc. (eds.), *Emerging Patterns of East Asian Investment in China – From Korea, Taiwan and Hong Kong*, An East Gate Book, 1995, pp.73-74

[84] Jans Prybyla, "Why China's Economic Reforms Fail", *Asia Survey*, 1989, p.1017

[85] *Supra* note 67, p.22

[86] Francis A. Lees and Thomas Liaw, *Foreign Participation in China's Banking and Securities Markets*, Quorum, 1996, p133

[87] *Supra* note 67, p.66

[88] The EJVL was passed at the 2nd Session of the 5th NPC.

[89] The EJVL, art. 1

the country "permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other economic organizations in accordance with the laws of the People's Republic of China. All foreign enterprises and other economic organizations located in China, as well as joint ventures with Chinese and foreign investment in China, must abide by the laws of the People's Republic of China. Their lawful rights and interests are protected by the laws of the People's Republic of China."[90] This constitutional provision has laid the foundation for the lawful existence of FDI in China and provided the constitutional basis for later laws and regulations with regard to FDI in the country.[91] On Oct. 20, 1984, the 3rd Plenary Session of the 12th Central Committee of the CPC in its *Decision on Reform of the Economic Structure* announced that China would build a socialist commodity economy. The decision moved China away from its long-practiced central planned economy by assigning a larger role to the market.[92] On Mar. 29, 1993, the 1st Session of the 8th National People's Congress (NPC) amended the *Constitution*, the amendment of which stipulates that China "carries out a socialist market economy".[93] On Nov. 14 of the same year, the 3rd Plenary Session of the 14th Central Committee of the CPC in its *Decision of the Issues Concerning the Establishment of a Socialist Market Economic Structure* resolved to "push ahead with further reforms and open policies to create a socialist market economy".[94] The constitutional amendment and the CPC's decision are the most significant policy resolutions adopted by China ever since it started the reforms and open policies as they indicate China's further deviation from the socialist orthodoxy. Although the so-called socialist market economy is meant to be established as a market economy with Chinese socialist characteristics, namely, a combination of market factors and socialist elements,[95]

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[90] *The Constitution of China*, art. 18

[91] *Supra* note 10

[92] *People's Daily* (Overseas ed.), Oct. 22, 1984, p.11

[93] *The Amendment of the Constitution of China* (1993), art. 7

[94] *Supra* note 82, p.48 and p.307

[95] Harry J. Walters deems that China's socialist market economy is a hybrid along the lines of capitalist socialism or a free market within a communist society. (*China's Economic Development Strategies for the 21st Century*, Quorum, 1997, p.15) And Ernst & Young regards it as a hybrid planned-and-market economy

it is without doubt an obvious progress of economic liberalization in China. As long as China sticks to this socialist market economy, the economic liberalization process will certainly develop and the country will have a more attractive investment environment for FDI. On Mar. 17, 1996, the 4th Session of the 8th NPC passed the *Ninth Five-Year Plan*[96] *for National Economic and Social Development and the Long-Term Development Program to Year 2010* recommended by the Central Committee of the CPC. According to this program, China will further its open policy by establishing a unified and standardized system of foreign trade and economic relations that meets the requirements of socialist market economy and general international rules and practice, and will absorb FDI in an active, rational and effective way.[97]

### 1.2.2 Special Economic Areas

Policies that affect FDI but are not designed for its location constitute only the "outer ring" of the policy framework whereas policies influencing FDI's location constitute the "inner ring" of the policy framework.[98] China's FDI policy is at the very beginning characterized by the establishment of special economic areas in the country, which forms a pivotal part of China's open policy.[99]

The special economic areas are set up as exceptions to the general policies of a country.[100] They are broadly defined as specifically allocated geographical areas where special economic policy and administration are implemented in order to attract foreign investment.[101] Owing to their different establishment purposes, countries over the world name these areas variously, such as free port, free trade zone, customs area, duty-free

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in which strategic commodities and industries are controlled by the state while other industries and the commercial and private sectors are governed by a market-oriented system. (*Investing in China*, 1994, pp.6-7)

[96] China's 9th Five-Year Plan was from 1996 to 2000.

[97] *Supra* note 4, p.114

[98] *Supra* note 28, p.28

[99] *Supra* note 47, p.235

[100] *Supra* note 47, p.234

[101] Henry R. Zheng, "Law and Policy of China's Special Economic Zones and Coastal Cities", *N.Y.L. Sch. J. In'l & Comp. L.*, Vol. 8, No. 2, Spring 1987, p.196 and Zhao Xichen and Tang Rongzhi, *An Introduction to Foreign Economic Law of China*, Press of the University of Political Science and Law of China, Oct. 1994, p.423

trade zone, export processing zone, frontier trade area, investment development area, scientific and industrial park, special economic zone, and economic and technological development zone.[102] In China, however, the special economic areas constitute special economic zones, coastal open cities, economic and technological development zones, coastal open economic areas, Pudong new area, bonded areas, high and new technology industrial development zones, tourist resort areas, and border economic cooperative zones.

China's special economic areas are aimed to attract FDI more effectively by specially granted policies and thus to bring rapid development in the designated locations. Through linkage and distribution effects, growth is then expected to filter downward and ultimately transfer horizontally to the other regions in the country.[103] These special economic areas enjoy special economic and administrative status in varying degrees. They are noted for three features.[104] First, the nature of their establishment is economic. China's special economic areas differ from either the special or the ordinary administrative areas of the country. They are established only for the economic purpose. Special administrative areas, like Hong Kong Special Administrative Region (SAR) and Macao SAR, are areas specially arranged out of political considerations, and in fact the two SARs are both products of the policy of "one country and two systems". The ordinary administrative areas are principally divided on the basis of their geographic features. Second, their district limits are specific. In order to carry out different policies effectively, the special economic areas are usually delimitated clearly about the district limits of their geographic lines and many of them are even kept apart from other parts of the country with checkpoints or barriers. Third, the policies within the areas are special. The particularity of the special economic areas is that they exercise different economic policies and administrative systems from the other parts in the country. They enjoy a series of

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[102] *Supra* note 29, p.894

There existed more than 800 specialized zones in the world as of 1996. – See *supra* note 28, p.59

[103] *Supra* note 83, p.74

[104] Li Xueling, *Laws of the Special Economic Areas*, Law Publishers, June 1997, pp.2-4 and Zhao Xichen and Tang Rongzhi, *An Introduction to Foreign Economic Law of China*, Press of the University of Political Science and Law of China, Oct. 1994, pp.423-425

preferential treatment in respect of taxes, land use, customs control, business management and foreign exchange etc. and their operating system is more market-oriented and closer to the international rules and practice.

(1) 5 Special Economic Zones (SEZ)

The idea of establishing the SEZ was initially conceived in 1978 when the open policy just started to take shape.[105] Inspired by export processing areas in foreign countries,[106] the then leaders of Guangdong proposed to experiment on the establishment of special export zones in the province during a working conference of the Party Central Committee (PCC) in Apr. 1979. Supported by Fujian Province, the proposal was accepted by the PCC that decided to establish the special export zones on an experimental basis.[107] In Jul. 1979, the PCC and the State Council jointly issued *Document No. 50*, providing for the establishment of four special export zones in Guangdong and Fujian.[108] In Dec. 1979, the Provincial Party Committee of Guangdong suggested to change the mane of "special export zones" into "special economic zones" because they thought it necessary to develop housing and other economic undertakings in addition to export industries in the zones.[109] The PCC and the State Council accepted the advice.[110] On Aug. 26, 1980, the Standing Committee of the NPC passed the *Regulations on Special Economic Zones in Guangdong Province* and legally established the SEZs of Shenzhen, Zhuhai and Shantou

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[105] Liang Xiang: "Shenzhen: Opening to the World", *Beijing Review*, Jan. 23, 1984, p24

Mr. Liang Xiang was then Mayor of Shenzhen and Vice-Governor of Guangdong Province. He wrote that "[s]pecial economic zones are an important part of China's open policy. The idea was first put forward at the end of 1978".

[106] As the PCC confirmed later in Jul. 1981, "experiences of many countries in the world have proved that special zones provide a relatively successful form for expanding exports, attracting foreign capital, absorbing technology and developing economies". – See *supra* note 82, p.36

[107] *Supra* note 29, p.914

[108] Harry J. Waters, *China's Economic Development Strategies for the 21st Century*, Quorum, 1997, p.52

[109] The SEZ is thus involved in a broader range of economic activities that have "a positive meaning in international economic cooperation and technical exchange including the fields of industry, agriculture, animal husbandry, breeding, tourism, housing and other construction work and advanced technological research and manufacturing work". – See *supra* note 47, p.236

[110] Ou Yuyang: "Legal Status of China's Special Economic Zones", *Jurisprudence Review* (Chinese), 1985, No. 3, p.21

in Guangdong.[111] In Oct. of that year, the State Council approved Xiamen in Fujian as the fourth SEZ.[112] Satisfied with the initial growth of the four SEZs, the State Council granted Hainan Island the status of the SEZ in 1987.[113] On Apr. 13, 1988, the 1st Session of the 7th NPC adopted two important resolutions relating to Hainan: one was the *Resolution on the Establishment of Hainan Province* and the other was the *Regulation on the Establishment of the Hainan Special Economic Zone.*[114] China thus founded its thirtieth province and formally created its biggest SEZ.

The sites of the SEZs were selected in consideration of their coastal locations and close proximity to the outside world: Shenzhen next to the former British colony of Hong Kong; Zhuhai adjacent to the former Portuguese colony of Macao; Xiamen across the straits from Taiwan;[115] and Hainan near the newly-industrialized countries in Northeast and Southeast Asia on the West Pacific Rim. They provide foreign investors with easier access to the mainland of China. The locations were chosen secondly in view of their traditional strong ethnic ties with expatriate Chinese. All the SEZs are well-known hometowns of overseas Chinese and they have wide connections with countries and areas in the world. For instance, over 120,00 natives of Shenzhen live in fifty-four different countries and areas, and more than 200,000 people of Xiamen and close to 2 million people of Hainan are distributed around the world.[116] The SEZ was expected to attract investments from these Chinese compatriots.[117] Furthermore, the establishment of the

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[111] Li Xueling, *Laws of the Special Economic Areas*, Law Publishers, June 1997, p.8 and Zhongli Tang, *China's Foreign Economic Policy in Post-Mao Time*, Nova Science Publishers, 1996. p.93

[112] Zhao Xichen and Tang Rongzhi, *An Introduction to Foreign Economic Law of China*, Press of the University of Political Science and Law of China, Oct. 1994, p.426

[113] *Supra* note 108, p.53

Hainan had originally been a region under the administration of Guangdong Province.

[114] Chen An, "Special Economic Zones and Coastal Port-Cities: Their Development and Legal Framework" in Rui Mu and Wang Guiguo (eds.), *Chinese Foreign Economic Law: Analysis and Commentary*, International Law Institute, 1994

[115] Robert Kleinberg, *China's "Opening" to the Outside World: The Experiment with Foreign Capitalism*, Westview Press, 1990, pp.14-15

[116] Li Xueling, *Laws of the Special Economic Areas*, Law Publishers, June 1997, p.28

[117] Guangdong Province, where most of the SEZs are located, is the regional home of 19 million overseas Chinese. – See Xiaohe Zheng and Wan-sing Hong, "Foreign Investment as an Engine of Economic Growth: the Case of Guangdong" in Stewart MacPherson and Joseph Y. S. Cheng (eds.), *Economic and Social Development in South China*, Edward Elgar, 1996, p.165

SEZ was part of the Chinese government's preparation for the reunification of Hong Kong and Macao with the mainland at the end of the 20th century.[118] Since their establishment, the SEZ has primarily fulfilled the following functions:

(A) It has attracted FDI, advanced technology and managerial skills from abroad, through which the local modernization has been sped up;

(B) It has given impetus to China's open policy and served as "window" to the inland areas and as "bridge" to the outside world. The SEZ has played a radiating function of disseminating the capital, commodities, technology, information and human resources etc. to the hinterland of the country. Meanwhile, it has played an important role in promoting the economic connection between China and the rest of the world and lead China to participate in the international economic cooperation;[119] and

(C) It has served as "laboratory" for China's reforms and acted as a testing ground for the creation of Chinese socialist market economy. Outside the present systems, the Central Government has granted the SEZ considerable freedom to experiment on various reform measures. The reform has transformed certain functions of the governments, cultivated various markets, and built up the systems of modern corporation and social security in conformity with the market economy etc. The successful experiences have been extended to the other places of the country.[120]

(2) 15 Coastal Open Cities

Owing to the success of the original SEZ, China decided to allow FDI to go beyond the boundary of the SEZ. For this purpose, in 1984 China opened fourteen coastal cities: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai along its eastern seaboard from the north to the south.[121] Weihai in Shandong Province was added on the list later on, bringing the total number of the Coastal Open Cities to fifteen.[122] Special policies similar

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[118] *Supra* note 47, p.237

[119] *Supra* note 116, p.33

[120] *Supra* note 116, p.32

[121] *Supra* note 74, p.4, note 7

[122] Marian Russell and Aileen Thompson, "Foreign Direct Investment in China and North America" in Leonard Waverman (ed.), *Sino-North American Trade: Challenges and Opportunities*, 1996

to those of the SEZ are applied in these cities.[123] However, the strategy of opening them differs from that of the SEZ. The SEZs were originally underdeveloped areas. The Coastal Open Cities are historically commercial and industrial centers, the opening of which has stressed using FDI to upgrade existing rather than build new facilities in these cities.[124]

(3) 32 Economic and Technological Development Zones (ETDZ)

As a continuity of the policy on the SEZ, China allocated certain areas in the Coastal Open Cities to establish the ETDZ in 1984. Except for Wenzhou and Baihai, all the Coastal Open Cities set up the ETDZ under their jurisdiction.[125] In Aug. 1986 and Jun. 1988, the State Council separately approved in Shanghai three ETDZs of Minhang, Hongqiao and Caohejing. It approved six ETDZs of Wenzhou, Kunshan, Yingkou, Weihai, Rongqiao and Dongshan in 1992 and another seven ETDZs in some inland provincial capitals and cities along the Changjiang (Yangtze) River, i.e. Shenyang, Harbin, Changchun, Hangzhou, Wuhan, Chongqing and Wuhu in Mar. 1993. Plus five ETDZs of Beijing, Wulumuqi, Xiaoshan, Huizhou (Daya Bay) and Nansha approved later on, there were thirty-two state-level ETDZs all together up to 1994.[126]

Backed by the located cities, the ETDZ was designed to introduce China's much-needed advanced technology from abroad and to focus on the establishment of cooperative scientific research institutions, the development of cooperative research, designing and production, the development of new techniques, and the manufacturing of high-grade products. It has been given priority to the development of advanced processing and technology-intensive industries.[127] Although it reflects the expansion of China's open policy, the ETDZ differs from the SEZ in several respects. First, the SEZ is

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[123] "Report on the Work of Government", *Beijing Review*, May 21, 1984, p.18

[124] Ernst & Young, *Investing in China*, 1994, p.18

[125] *Supra* note 74, p.4

[126] *Supra* note 116, pp.295-296 and Tian Jianghai, "An Introduction to Economic Development Zones of China" in *A Summary of China's Development Areas*, Building Material Industry Publishers of China, Jul. 1996, p.12

The other eleven ETDZs are Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Fuzhou, Guangzhou and Zhanjiang.

[127] Tian Jianghai, "An Introduction to Economic Development Zones of China" in *A Summary of China's Development Areas*, Building Material Industry Publishers of China, July 1996, pp.13-14

involved in a broader range of economic activities including industry, agriculture, animal husbandry, building, tourism, and high-tech research etc. The ETDZ emphasizes production enterprises as well as scientific and technological research institutions.[128] Second, preferential treatment in the SEZ is available to FDI enterprises in both production and service operations whereas the ETDZ grants preferential treatment to FDI enterprises of a production nature only.[129] Third, the ETDZ is spread among the cities that are geographically closer to the markets and suppliers of the vast inland and where there are plenty of scientific workers and skilled labor due to their development over a long period of time. The ETDZ has obvious advantages of geography and human resources over the SEZ.[130]

(4) 5 Coastal Open Economic Areas (COEA)

The liberalization of China's FDI policy was implemented on a larger scale in 1985 when China decided to open up as its COEA three most fertile river delta areas: the Changjiang River Delta centering around Shanghai, the Zhujiang River Delta adjacent to Shenzhen and Zhuhai in the south and Guangzhou in the north, and the Xiamen-Zhangzhou-Quanzhou Triangular Area in southern Fujian Province.[131] Two years later, the COEA was expanded to include Liaodong Peninsula and Jiaodong Peninsula.[132] Unlike the SEZs, the Coastal Open Cities and the ETDZs, the COEAs cover extensive regions. They extend across several provinces, comprising not only big cities and small towns but also many rural areas. With a total area of 32,000 km$^2$ and a population of 160 million, they are the most developed areas in China and full of the potential for development.[133] Without establishing their own administrative organizations, the COEAs, were designed to be economic backup each for nearby SEZs and Coastal Open Cities.[134]

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[128] "Mr. Gu Mu Talks about the Open Policy of Coastal Cities", *International Trade* (Chinese), 1985, No.2, p.3

[129] Henry R. Zheng, "Law and Policy of China's Special Economic Zones and Coastal Cities", *N.Y.L. Sch. J. Int'l & Comp. L.*, Vol. 8, No. 2, Spring 1987, p.263

[130] *Id.*

[131] *Supra* note 74, p.4

[132] *Supra* note 112

[133] *Supra* note 68, p.23

[134] *Supra* note 114

(5) Pudong New Area

In Apr. 1990 China decided to open up Pudong New Area in Shanghai. The decision is worth particular mentioning.

Pudong New Area, originally an uncultivated rural tract, is on the East China Sea and the Changjiang River in the north, covering an area of 350 km² and having a population of 1.1 million.[135] The major advantage of this new area is that it is part of Shanghai that is the largest Chinese city traditionally with the most developed industry, foreign trade and international finance. The development of Pudong New Area[136] has primarily three aspects: (a) to improve the infrastructure and tertiary industry of Shanghai for its further economic development in general and to absorb foreign capital in particular; (b) to accelerate the technical transformation in the old industry base of Shanghai; and (c) to "trickle down" the benefits of its economic development through the Changjian River Delta and Valley.[137]

China has attached such importance to Pudong New Area that it is expected to act as the country's economic engine in the 21st century.[138] Pudong New Area has consequently

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[135] *Supra* note 116, p.283

[136] Pudong New Area is composed of five functional divisions, each with its development emphasis.

The first is Waigaoqiao-Gaoqiao division, covering 75 km². It is largely to absorb foreign investment from MNEs and focus on developing export products of advanced technology and high quality.

The second is Qingningsi-Jinqiao division, covering 21 km². Its objective is to develop the export processing and manufacturing industry by fully utilizing its existing industrial infrastructures of ship building and navigation instrument.

The third is Lujiazui-Huamu division with an area of 28 km². Facing Waitan of Shanghai across the Huangpu River, it is the heart of Pudong New Area. As the extension of Waitan, its established Lujiazui financial and trade zone is particularly to develop the service industry of finance, trade and information.

The fourth is Zhoujiadu-Liulifen division with an area of 34 km², and the division is modeled on an export-processing zone.

The fifth is Beicai-Zhangjiang division covering 19 km². It is primarily to develop high-tech and new industries based on its established scientific and technological part. – See *supra* note 116, pp.283-284

[137] The Changjiang River Valley is a region including Shanghai and seven other provinces of Sichuan, Hunan, Hubei, Guizhou, Jiangxi, Anhui and Jiansu through which the Changjiang River flows. There is some dispute as to whether Zhejiang Province should be included since it connects with the River by canal. – See Sumio Kuribayashi, "Economic Development of the Yantze River Valley", *China Newsletter*, No. 100, Sept.-Oct. 1992 and also *supra* note 71, pp.52-53

[138] Xinchao Tong, "Investment Law and Polices in China", *Can. Int. Lawyer*, Vol. 1, No. 3, 1995

been granted similar privileges that the SEZ enjoys.[139] Unlike the SEZ that was given initial development priority to the first and second industries with processing and manufacturing as the leading factors, however, Pudong New Area laid stress on developing the tertiary industry with priority to finance, trade and technology at the outset.[140]

(6) 15 Bonded Areas

Encouraged by the success of the SEZ, China determined to set up its bonded areas to promote export by allowing in duty-free import goods and materials. In Dec. 1987, the Shenzhen government created Shatoujiao Bonded Area, the first of this kind on the mainland, which was followed by Futian and Yantiangang Bonded Areas in the same city. In Sept. 1990 and May 1991, the State Council approved the construction of Waigaoqiao Bonded Area in Pudong New Area and Tianjin Port Bonded Area respectively. In May 1992, the other two Bonded Areas of Dalian and Guangzhou were approved as well. To this day, there are fifteen Bonded Areas in China, including those of Xiangyu of Xiamen, Zhangjiagang, Haikou, Qingdao, Ninbo, Fuzhou, Zhuhai and Shantou in addition to those mentioned above.[141]

Compared with the SEZ, the Bonded Areas are more closely managed. They are kept apart from non-bonded areas by perfect installations. Although there are established administrative offices and enterprises, people except security personnel are not allowed to reside in there. On the other hand, however, the Bonded Areas enjoin more flexible treatment than the SEZ and the ETDZ. Import licenses are not required for goods imported into the areas, and the importation of production equipment, office articles, component and packing materials etc. needed for export processing and consumption within the areas are exempt from tariffs, VAT and consumption tax.[142] Foreign currencies are also allowed to circulate there. The Bonded Areas are engaged in international entrepot trade, export processing, as well as related warehousing, packing, transportation

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[139] *Supra* note 71, p.190, note 1

[140] *Supra* note 116, pp.282-284

[141] *Supra* note 116, p.330

[142] Shenzhen Municipal Foreign Investment Bureau, *Where and How to Invest*, http://www.fdi-shenzhen-cn.com/area.html

and commercial exhibition with goods, capital and labor basically passing in and out there freely.[143]

(7) 52 High and New Technology and Industrial Development Zones (HNTIDZ)

In order to attract FDI with high and new technology, China started to set up the HNTIDZ in the1980s. The first HNTIDZ was initiated at Zhongguancun at Beijing in 1984, which was called the New Industrial Development Zone of Science and Education. In May 1988, the State Council formally approved it as the New Technology Industrial Development Experimental Zone. On the basis of Beijing's experience, the State Council approved other twenty-six high and new technology development experimental zones in 1991. Up till now, there are established all together fifty-two HNTIDZs at state level.[144] They are generally set up in provincial and regional capitals or traditional industrial centers where universities and research institutes are concentrated and scientists,

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[143] *Supra* note 108, pp.53-54

[144] *Supra* note 116, pp.350-351

52 HNTIDZs at state level are: (1) the New Technology Industrial Development Experimental Zone of Beijing, (2) the New Technology Industrial Zone of Tianjin, (3) Shijiazhuang in Hebei, (4) Baoding in Hebei, (5) Taiyuan in Shanxi, (6) Baotou in Neimenggu (Inner-Mongolia), (7) the Nanhu Science and Technology Development Zone of Shenyang in Liaoning, (8) Dalian in Liaoning, (9) Anshan in Liaoning, (10) the Nanhu-Nanling New Technology Industrial Zone of Changchun in Jilin, (11) Jilin in Jilin Province, (12) the High-Tech Development Zone of Haerbin in Heilongjiang, (13) Daqing in Heilongjiang, (14) the New Technology Development Zone of Caohejing in Shanghai, (15) Pukou HNTIDZ of Nanjing in Jiangsu, (16) Suzhou in Jiangsu, (17) Wuxi in Jiangsu, (18) Changzhou in Jiangsu, (19) Hangzhou in Zhejiang, (20) the Industrial Zone of Science and Technology of Hefei in Anhui, (21) the Scientific and Technological Zone of Fuzhou in Fujian, (22) the Torch HNTIDZ of Xianmen in Fujian, (23) Nanchang in Jiangxi, (24) the Torch HNTIDZ of Weihai in Shandong, (25) Jinan in Shandong, (26) Qingdao in Shandong, (27) Weifang in Shandong, (28) Zibo in Shandong, (29) Zhengzhou in Henan, (30) Luoyang in Henan, (31) the New Technology Development Zone of Donghu of Wuhan in Hubei, (32) Xiangfan in Hubei, (33) the Experimental Development Zone of Science and Technology of Changsha in Hunan, (34) Zhuzhou in Hunan, (35) the Torch High Technology Industrial Development Zone of Zhongshan in Guangdong, (36) Tianhe HNTIDZ of Guangzhou in Guangdong, (37) the Industrial Park of Science and Technology of Shenzhen in Guangdong, (38) Fushan in Guangdong, (39) Huizhou in Guangdong, (40) Zhuhai in Guangdong, (41) the New Technology Industrial Development Zone of Guilin in Guangxi, (42) Hanning in Guangxi, (43) the International Industrial Park of Science and Technology of Hainan, (44) Chengdu in Sichuan, (45) Mianyang in Sichuan, (46) Chongqing, (47) Guiyang in Guizhou, (48) Kunming in Yunnan, (49) the New Technology Industrial Development Zone of Xian in Shanxi, (50) Baoji in Shanxi, (51) the New Technology Industrial Development Experimental Zone of Ningwozhuang of Lanzhou in Gansu, and (52) Wulumuqi in Xinjiang. – See *supra* note 127, p. 12 and *supra* note 116, pp.353-354

technicians and skilled workers are sufficient.[145]

The purpose of the HNTIDZ is to speed up the permeation of high and new technology through China's traditional industries and to improve its industrial and product structure. But unlike the ETDZ, the HNTIDZ is underlined to promote the industrialization and internationalization of China's achievements in high and new technology by relying on its own scientific and technological force. Therefore, the preferential policies of the HNTIDZ suit all approved high-tech enterprises in the zones, both foreign invested and purely domestic enterprises.[146]

(8) 11 State Tourist Resort Areas

The State Tourist Resort Areas are aimed to develop a kind of extroversive tourist industry in China. The building capital and source tourists of the areas are thus expected chiefly to come from foreign countries. Owing to this particularity, their establishment must be approved by the State Council.

On Oct. 4, 1992, the State Council approved the establishment of eleven such areas. They are Jinshitan (Golden Stone Beach) in Dalian, Shilaoren (Old Stone Man) in Qingdao, Taihu (Tai Lake)[147] in Jiangsu Province, Zhijiang (Zhi River) in Hangzhou, Hengsha Island in Shanghai, Nanhu (Nan Lake) in Guangzhou, Yintan (Silver Beach) in Beihai, Dianchi (Kunming Lake) in Yunnan Province, Yalong Bay in Sanya, Mount Wuyi and Meizhou Island in Fujian Province.[148]

(9) 14 Border Economic Cooperative Zones (BECZ)

The name of the BECZ first came out on Mar. 9, 1992 when the State Council put forward in a circular that four border cities of Heihe and Suifenhe in Heilongjiang Province, Huichun in Jilin Province and Manzhouli (Manchuria) in Neimenggu (Inner

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[145] The New Technology Industrial Development Experimental Zone of Beijing is typical. At Zhongguancun in which the zone is located, there are 55 universities, 138 research institutes, and more than 36,000 scientific and technological workers. – See *supra* note 116, pp.350-351

[146] *Supra* note 127, p.18

[147] The State Tourist Resort Area of Taihu consists of two centers, Xukou in Suzhou and Mashan in Wuxi. Some people therefore call the former Taihu State Tourist Resort Area of Suzhou and the latter Taihu State Tourist Resort Area of Wuxi. The number of the State Tourist Resort Areas thus becomes twelve. – See *The Yearbook of Tourism in China (1994)*, pp.94-95

[148] *Supra* note 127, p.13

Mongolia) Autonomous Region could each designate a particular area within the city to set up a BECZ. On Jun. 9 of that year, the State Council granted other eight border cities and towns of Pingxiang and Dongxing in Guangxi Zhuang Autonomous Region, Wanting, Ruili and Hekou in Yunnan Province, and Yining, Tacheng and Bole in Xinjiang Uygur Autonomous Region to establish their BECZs. Plus Dandong in Liaonin Province and Erlianhaote in Neimenggu approved later, there are fourteen BECZs at present, covering a total planned area of 78.45 $km^2$.[149]

The purpose of setting up the BECZ is to develop the economic cooperation with neighboring countries and accelerate the industrialization progress and economic growth of both the border cities and the nearby regions. This purpose is designed to be achieved through the establishment of processing enterprises in the zones, the products of which are orientated to export to the neighboring countries.[150] Because of their geographic conditions, two features distinguish the BECZ from all the other special economic areas in China. First, it puts emphasis on the absorption of investment from the inland instead of from abroad. Second, its macroeconomic function is to make the areas prosperous as well as to build good relations with neighboring countries.[151]

To sum up, selected cities along the coast, on the river and near the border combining with interior provincial capitals and other inland cities have shaped China's geographic pattern of opening to the outside world at multiple levels.

### *1.3 Impact of FDI on China*

The role that FDI plays in the economic growth of a developing country has been well documented.[152] As a developing country, China also intended to achieve its objectives by utilizing FDI. These objectives include (a) compensating for a capital shortage by using

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[149] *Supra* note 127, pp.12-13 and *supra* note 116, pp.382-383

[150] *Supra* note 127, p.14

[151] *Supra* note 116, p.384

[152] For instance, Hart listed the benefits that could flow from FDI: (a) the infusion of scarce development capital, generating growth and income; (b) the acquisition of technology, knowledge and managerial skills; (c) the stimulation of positive balance-of-payments effects, including import-replacing domestic production, the potential for expanded export; (d) the creation of employment, both directly and indirectly; and (e) the generation of additional tax revenues. – See M. Hart, *A Multilateral Agreement on Foreign Direct Investment: Why Now?* Center for Trade and Law, Carlton University, 1996, p.4

FDI to increase the proportion of capital investment and thereby accelerate domestic economic development; (b) obtaining modern technology and thereby improving the quality of old products, developing new products, updating equipment, reducing the technology, and adjusting the economic structure; (c) acquiring greater expertise for management skills; and (d) generating foreign exchange and fiscal revenue.[153] No matter to what extent China has achieved its intended objectives after all these years of FDI practice, it is without doubt that FDI has greatly benefited the country.

### 1.3.1 Gains

(1) Capital contribution and effect on output

As is the norm with all developing countries, China's economic growth has been constrained by a capital shortage. FDI as a type of foreign capital inflow has provided China with addition to its domestic savings. This additional capital has helped relieve the bottlenecks of China's capital supply and augmented the financial resources available for its domestic investment. During the period of 1991 to 1999, China's utilized FDI made up 12.32% of the national gross fixed asset investment [SEE TABLE 2] and the additional

**TABLE 2: FDI CONTRIBUTION TO CHINA'S TOTAL FIXED ASSET INVESTMENT (1991-1999)**

| Year | Total Fixed Asset Investment | | Utilized FDI (US$ 100 mil.) | FDI Share in Total Investment (%)* |
|---|---|---|---|---|
| | (RMB 100 mil.) | (Converted into US$ 100 mil.) | | |
| 1991 | 5,594.5 | 1,050.97 | 43.66 | 4.15 |
| 1992 | 8,080.1 | 1,465.22 | 110.07 | 7.51 |
| 1993 | 13,072.3 | 2,268.71 | 275.15 | 12.13 |
| 1994 | 17,042.3 | 1,977.34 | 337.67 | 17.08 |
| 1995 | 20,019.3 | 2,397.23 | 375.21 | 15.65 |
| 1996 | 22,974.0 | 2,763.22 | 417.26 | 15.10 |
| 1997 | 25,300.0 | 3,059.97 | 452.78 | 14.79 |
| 1998 | 28,457.0 | 3,437.29 | 455.82 | 13.23 |
| 1999 | 29,876.0 | 3,608.00 | 403.98 | 11.20 |

* Calculated according to US dollar equivalents based on the average exchange rate of that very year.
Source: MOFTEC, *FDI Statistics*, http://www.moftec.gov.cn/moftec.cn/tjsj/wztj/2000_9-22-5.html

investment made the share of FDI in the national gross industrial output value increase from 2.28% in 1990 to 27.75% in 1999. [SEE TABLE 3] It doubtlessly contributed to China's

[153] M. Hart, *A Multilateral Agreement on Foreign Direct Investment: Why Now?* Center for Trade and Law, Carlton University, 1996, p.4

average annual growth of 9% over the past decade[154] and dynamically promoted China's economic development.

**TABLE 3: FDI CONTRIBUTION TO CHINA'S TOTAL INDUSTRIAL OUTPUT VALUE (1990-1999)**

Unit: RMB 100 million

| Year | Total Industrial Output Value | FDI Industrial Output Value | FDI Share in Total Value (%) |
|---|---|---|---|
| 1990 | 19,701.04 | 448.95 | 2.28 |
| 1991 | 23,135.56 | 1,223.32 | 5.29 |
| 1992 | 29,149.25 | 2,065.59 | 7.09 |
| 1993 | 40,513.68 | 3,704.35 | 9.15 |
| 1994 | 76,867.25 | 8,649.39 | 11.26 |
| 1995 | 91,963.28 | 13,154.16 | 14.31 |
| 1996 | 99,595.55 | 15,077.53 | 15.14 |
| 1997 | 56,149.70 | 10,427.00 | 18.57 |
| 1998 | 58,195.23 | 14,162.00 | 24.00 |
| 1999 | 63,775.24 | 17,696.00 | 27.75 |

Source: MOFTEC, *FDI Statistics*, http://www.moftec.gov.cn/moftec.cn/tjsj/wztj/2000_9-22-5.html

(2) Technology progress

Science and technology are key to economic development. China seeks modern technology by various ways like importing equipment, licensing foreign technology and conducting turnkey projects. Through the absorption of new technology brought with FDI, China has gained access to better technology and improved its industrial structure. In the past twenty years, FDI has enhanced the technological level of a series of China's industries, notably in those of automobile, electronics, machinery, communication, pharmacy, chemicals, construction materials, light and textile.[155] There are numerous examples of how FDI high-tech products have contributed to China's economy. In automobile industry, Shanghai Volkswagen, Beijing Jeep, Changchun Auti and Hubei Citreon etc. adopted automobile-making technology from the foreign partner companies and brought in a short period of several years the technological level of China's car manufacturing from the 1950s to the 1980s.[156] Tianjin Otis and Shanghai Shilinder etc. replaced China's manual-controlled with computerized high-speed elevators and helped

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[154] Zhang Changyu, *Alert: IFI – The Killer on the FDI Market*, Press of the University of Foreign Economic and Trade of China, 1997, p.26

[155] *Id.*, p.28

[156] *Id.*

the country catch up the 1990's advanced standards of elevator industry.[157] Shanghai CASCO Signal made a notable contribution to modernizing China's rail transportation system with its manufactured railway signal apparatus.[158] The Daya Bay Nuclear Plant in Guangdong Province is assisting China to master large-capacity nuclear power technology and to consolidate the foundation for its nuclear power industry.[159]

(3) Management improvement

China considers it important to introduce scientific management methods for its economic development.[160] Chinese managers and staff working in the FIE have learned modern management techniques that come together with FDI, which include production management, quality assurance, sales service, and administration of human resources and finance. Meanwhile, the management models of the FIE have created strong exemplary effects in China's state-owned and other enterprises. In fact, many features of the FIE, e.g., separation of ownership from management, joint-stock system, profit centers in factories and incentive systems for managers and workers have been adopted in China in varying degree.[161] For example, nineteen large and medium-sized state-owned enterprises in Shanghai were chosen in Sept. 1991 as experimental units to start management reform in reference to the management system of the FIE. Because the FIE is market-oriented, its large presence in the country has further promoted the growth of China's market mechanisms.[162]

(4) Export promotion

The FIE is experienced in international production and trade. Utilization of its foreign trade channels has extended China's foreign trade, enhanced its capabilities in the open world market and promoted its development of an outward-oriented economy.[163] The FIE

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[157] *Id.*

[158] *Supra* note 82, p.228

[159] *Supra* note 82, p.229

[160] *Supra* note 4, p.113

[161] Zafar Shah Khan, *Patterns of Direct Foreign Investment in China*, World Bank Discussion Papers, No. 130, 1991, p.16

[162] Zhang Zhongli etc., "On American Direct Investment in China" in La Croix etc. (eds.), *Emerging Patterns of East Asian Investment in China – From Korea, Taiwan and Hong Kong*, An East Gate Book, 1995, pp.58-61

[163] *Id.*

**TABLE 4: CHINA'S NATIONAL IMPORTS/EXPORTS & FIE IMPORTS/EXPORTS (1986-1999)**

Unit: US$ 100 million

| Year | Imports/Exports | | | Imports | | | Exports | | |
|---|---|---|---|---|---|---|---|---|---|
| | National | FIE | Share(%) | National | FIE | Share(%) | National | FIE | Share(%) |
| 1986 | 738.46 | 29.85 | 4.04 | 429.04 | 24.03 | 5.60 | 309.42 | 5.82 | 1.88 |
| 1987 | 826.53 | 45.84 | 5.55 | 432.16 | 33.74 | 7.81 | 393.70 | 12.10 | 3.07 |
| 1988 | 1,027.84 | 83.43 | 8.12 | 552.68 | 58.82 | 10.64 | 475.16 | 24.61 | 5.18 |
| 1989 | 1,116.78 | 137.10 | 12.28 | 591.40 | 87.96 | 14.87 | 525.38 | 49.14 | 9.35 |
| 1990 | 1,154.36 | 201.15 | 17.43 | 533.45 | 123.02 | 23.06 | 620.91 | 78.13 | 12.58 |
| 1991 | 1,357.01 | 289.55 | 21.34 | 637.91 | 169.08 | 26.51 | 719.10 | 120.47 | 16.75 |
| 1992 | 1,655.25 | 437.47 | 26.43 | 805.85 | 263.87 | 32.74 | 849.40 | 173.60 | 20.44 |
| 1993 | 1,957.03 | 670.70 | 34.27 | 1,039.59 | 418.33 | 40.24 | 917.44 | 252.37 | 27.51 |
| 1994 | 2,366.21 | 876.47 | 37.04 | 1,156.15 | 529.34 | 45.78 | 1,210.06 | 347.13 | 28.69 |
| 1995 | 2,808.48 | 1,098.19 | 39.10 | 1,320.78 | 629.43 | 47.66 | 1,487.70 | 468.76 | 31.51 |
| 1996 | 2,899.04 | 1,371.10 | 47.29 | 1,388.38 | 756.04 | 54.45 | 1,510.66 | 615.06 | 40.71 |
| 1997 | 3,250.60 | 1,526.20 | 46.95 | 1,423.60 | 777.20 | 54.59 | 1,827.00 | 749.00 | 41.00 |
| 1998 | 3,239.23 | 1,576.79 | 48.68 | 1,401.66 | 767.17 | 54.73 | 1,837.57 | 809.62 | 44.06 |
| 1999 | 3,606.49 | 1,831.33 | 50.78 | 1,657.18 | 858.84 | 51.83 | 1,949.31 | 886.28 | 45.47 |

Source: MOFTEC, *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsj/wztj/ 2000_9-22-30.html

**TABLE 5: FIE EXPORT COMPOSITION IN SELECTED YEARS**

Unit: US$ 100 million

| Commodity | 1991 | | 1993 | | 1995 | | 1997 | | 1999 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Value | % | Value | % | Value | % | Value | % | Value | % |
| Total | 120.47 | 100 | 252.28 | 100 | 468.91 | 100 | 749.00 | 100 | 886.28 | 100 |
| 1. Primary products | 7.89 | 6.50 | 18.32 | 7.20 | 29.99 | 6.30 | 140.77 | 18.79 | 52.21 | 5.89 |
| Foodstuff & live animals for food | 5.65 | 4.60 | 13.62 | 5.30 | 16.30 | 3.40 | 18.19 | 2.43 | 32.58 | 3.68 |
| Beverage & tobacco | 0.23 | 0.10 | 0.13 | 0.00 | 0.82 | 0.10 | 13.98 | 1.87 | 0.83 | 0.09 |
| Non-edible raw materials (excluding fuel) | 1.02 | 0.80 | 2.91 | 1.10 | 3.93 | 0.80 | 21.19 | 2.83 | 7.65 | 0.86 |
| Fossil fuel, lubricants & Related materials | 0.31 | 0.20 | 0.51 | 0.20 | 5.14 | 1.00 | 10.80 | 1.44 | 10.27 | 1.16 |
| Animal & vegetable oil, fat & wax | 0.67 | 0.50 | 1.15 | 0.40 | 3.80 | 0.80 | 44.40 | 5.93 | 0.88 | 0.10 |
| 2. Industrial manufactures | 112.58 | 93.40 | 233.96 | 92.70 | 438.93 | 93.60 | 606.29 | 80.95 | 834.03 | 94.10 |
| Chemicals & chemical products | 2.46 | 2.00 | 5.12 | 2.00 | 12.14 | 2.50 | 31.05 | 4.15 | 26.10 | 2.94 |
| Manufactures classified by raw materials | 17.22 | 14.20 | 30.63 | 12.10 | 59.94 | 12.10 | 164.31 | 21.94 | 115.66 | 13.05 |
| Machinery & transport equipment | 31.25 | 25.90 | 61.99 | 24.50 | 162.31 | 34.60 | 31.90 | 4.26 | 383.17 | 43.23 |
| Miscellaneous | 55.37 | 45.90 | 136.19 | 53.90 | 207.53 | 44.20 | 279.15 | 37.27 | 309.10 | 34.88 |
| Other non-classified products | 6.29 | 5.20 | 0.03 | 0.00 | 0.01 | 0.00 | 93.04 | 12.41 | – | 0.00 |

Source: MOFTEC, *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsj/wztj/ 2000_9-22-31b.html

spurred China's export over the past twenty years. Although its exports in 1986 were less than US$ 0.6 billion, making up only 1.88% of the total national exports, the figure reached more than US$ 88.6 billion in 1999, accounting for 45.47% of the national total. During the thirteen years, the exports made by the FIE averagely increased by over 50% every year. [SEE TABLE 4] This rapid expansion has led to the phenomenal growth of China's export.

China's export after the 1986 oil price crisis moved away from exporting fuels and raw materials towards exporting manufactured products.[164] The FIE contributed to this shift and played an important role in improving China's export structure. Among the goods exported by the FIE, manufactured products accounted for 90% on average during the period of 1991 to 1999. [SEE TABLE 5] The proportion has greatly increased the ratio of China's manufactured products to its total export.

(5) Employment benefit

According to Dunning, there are at least two major benefits that host countries would obtain from inward investment in terms of employment. One is the enlargement of the volume of employment. The other is the creation of various employment opportunities.[165] FDI is beneficial to the employment of China's labor force. As FDI expands rapidly, large numbers of local employees are increasingly employed in the FIE. By the end of 1999, about 20 million Chinese men and women who account for nearly 10% of China's non-agricultural work force[166] are working in 160,000 FIEs in the country.[167]

(6) Revenue generation

Like most other developing countries seeking FDI, China has granted many special incentives including tax preference to foreign investors. Therefore, tax income collected by the governments was limited in the early stages of FDI practice. As time went on and more FIEs became profitable and thus taxable, however, government revenue increased.[168] China's foreign-related tax revenue was a bit over RMB 12 billion yuan in 1992, making up only 4.25% of the national tax revenue. The figure reached nearly RMB 165 billion in 1999, almost accounting for 16% of the national tax revenue. From 1992 to

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[164] *Supra* note 82, p.221

[165] *Supra* note 19, p.46

[166] *Shenzhen Special Zone Daily*, Jun. 22, 2000, p.10

[167] *Id.*, Aug. 27, 1999, p.3

[168] *Supra* note 161, pp.14-15

1999, China's foreign-related tax revenue grew approximately by 47% each year on average, nearly 28% higher than that of the national increase over the corresponding period. [SEE TABLE 6] FDI-generated tax revenue is now the fastest growing source of China's tax revenues.[169]

**TABLE 6: CHINA'S FOREIGN-RELATED TAX REVENUE* (EXCLUDING TARIFF AND LAND USE FEES) (1992-1999)**

Unit: RMB 100 million

| Year | National Tax Revenue in Industrial & Commercial Circles | Growth Rate (%) | Foreign-Related Tax Revenue | Growth Rate (%) | Foreign-Related Tax Revenue Share in National Total (%) |
|---|---|---|---|---|---|
| 1992 | 2,876.10 | -- | 122.26 | -- | 4.25 |
| 1993 | 3,970.52 | 38.05 | 226.56 | 85.31 | 5.71 |
| 1994 | 4,728.74 | 19.10 | 402.64 | 77.72 | 8.51 |
| 1995 | 5,515.51 | 16.64 | 604.46 | 50.12 | 10.96 |
| 1996 | 6,436.02 | 16.69 | 764.06 | 26.40 | 11.87 |
| 1997 | 7,548 | 17.31 | 993 | 29.97 | 13.16 |
| 1998 | 8,551.74 | 13.30 | 1,230 | 25.94 | 14.38 |
| 1999 | 10,311.89 | 13.40 | 1,648.86 | 33.78 | 15.99 |

* FIE revenue accounted for over 98% of foreign-related tax revenue.

Source: MOFTEC, *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsj/wztj/2000_9-22-6.html

The above facts demonstrate that FDI has become an important ingredient in Chinese economy and China has positively gained from inward FDI. Because of the inherent negative influence of FDI on the economy of host countries[170] and side effects of certain FDI policies of China, however, China has also come across problems in using FDI to develop its economy.

### 1.3.2 Problems and Redressing Trends

(1) Negative influence on national industries

Comparing with its domestic counterparts, the FIE in China possesses more advanced equipment, technology and managerial skills and its products are usually of higher quality. As a result, China's national industries have been hit seriously along with growing FDI inflows, especially those from the MNEs. For instance, the products of the FIE occupy very high market shares in such industries as detergent, cosmetics, drink and beverage,

[169] CCPIT, *An Overview of China: Information on China*, http://www.ccpit.org/engVersion/cp_infor/cp_vest/cp_fvest.html

tyre and electronics. The domestic enterprises in these industries have been affected so badly that some of their originally famous brands were forced out of the market completely.[171] In establishing joint ventures, the MNEs often choose China's leading domestic enterprises. Where foreign shares are in control, R&D capabilities of these enterprises decline.[172] Furthermore, some foreign investors deliberately purchased in batches China's domestic enterprises in particular industries and cities,[173] the practice of which could cause more serious damage to the independence of China's national industry.

FDI can bring about both benefits and negative influence to China. The balance of its overall effects depends upon the way that China makes use of FDI. Competition is essential for an efficient market economy. It encourages healthy rivalry, innovation and productivity.[174] The additional competition provided by foreign investment enterprises has been found to stimulate productivity improvement in domestically owned enterprises,[175] and a competitive economy at home also enhances a nation's competitiveness abroad.[176] Facing the competition from the FIE, unsuitable Chinese enterprises could be eliminated out of the market. But those domestic enterprises that have stood up to the tests of the competition through accelerating technological advancement, strengthening management and administration, improving product quality and increasing economic benefits would grow in more strength in the long run, the result of which will eventually enhance the competitiveness of China's national industry as a whole and speed up the economy of China both at home and abroad. In view of these considerations, China is increasing the dynamics of its reform of state-owned enterprises. The reform emphasizes on the

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[170] *Supra* note 153

[171] *Supra* note 154, p.33

[172] *Id.*

[173] The problem was once so serious that the purchase of enterprises with this character was called "Zhongce Phenomenon" that was named after a foreign investment company incorporated in a Southeast Asian country. According to art. 4 of the *Circular on Further Strengthening Administration and Registration of Foreign Investment Enterprises* issued by the State Administration for Industry and Commerce on Nov. 3, 1994, any FDI project relating to this practice has been suspended for approval and registration.

[174] *Supra* note 4, p.68

[175] Steven Globerman and Daniel Shapiro, *Canadian Government Policies toward Inward Foreign Direct Investment*, Industry Canada, Working Paper No. 24, Nov. 1998, p.33

[176] *Supra* note 4, p.68

restructuring of large and medium-sized enterprises and the privatization of small businesses with the expectation to lighten the burden on the State as well as to improve and enhance the competitive capabilities of the domestic enterprises.

(2) Uneven FDI distribution in regions

Regional dualism is one of the basic features of China's contemporary economy.[177] The development of the country has been unbalanced geographically between the regions.[178] Since it was difficult for the government to adopt uniform development policies that would accommodate the particular needs and fit the specific characteristics of various regions,[179] the uneven development was regarded as the guiding principle in shaping its FDI policy. Instead of spreading FDI as well as other limited resources over the vast territory, therefore, it was considered better to concentrate them in the selected eastern region[180] where superior infrastructure, service facilities and human resources, i.e., a more favorable investment environment existed. As a result, the distribution of FDI in China has been highly uneven.

China consists of three macro-regions. The eastern region contains twelve provinces (autonomous regions and municipalities directly under the Central Government), including Beijing, Tianjin, Hebei, Liaoning, Shandong, Shanghai, Jiansu, Zhejiang, Fujian, Guangdong, Guangxi and Hainan.[181] The central and western regions cover Shanxi, Neimenggu, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, Hunan, Chongqing, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang, and Xizang (Tibet), with the former nine being the central region and the latter ten the western region.[182] As shown in TABLE 7, 87.84% of the total FDI was made in the eastern region by 1999 although the region accounts for only about 14% of the land and 40% of the

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[177] *Supra* note 72, p.117

[178] *Supra* note 71, p.1

[179] Henry R. Zhen, "Law and Policy of China's Special Economic Zones and Coastal Cities", *N.Y.L. Sch. J. Int'l & Comp. L.*, Vol. 8, No. 2, Spring 1987, p.196

[180] *Supra* note 68, p.109

[181] CCPIT, *China Business Guide: 1998/1999*, http://www.ccpit. org/engVersion/cp_infor/cp_cbg/cbg2 _4. html

[182] Feature article, "A Summary of China's Absorption of Foreign Investment", *Foreign Investment in China*, Issue 82, Sept. 1999, p.14

**TABLE 7: REGIONAL DISTRIBUTION OF FDI IN CHINA (1983-1999)**

Unit: US$ 100 million

| Time & Value / Region | 1983 - 1989 | | 1990 – 1996 | | As of 1999 | |
|---|---|---|---|---|---|---|
| | Value | Percentage (%) | Value | Percentage (%) | Value | Percentage (%) |
| **Eastern** | **102.25** | **90.7** | **1,388.55** | **88.1** | **2,702.28** | **87.84** |
| Guangdong | 51.41 | 45.6 | 458.29 | 29.1 | 869.11 | 28.25 |
| Fujian | 7.57 | 6.7 | 168.89 | 10.7 | 300.79 | 9.78 |
| Jiangsu | 3.24 | 2.9 | 188.07 | 11.9 | 373.05 | 12.13 |
| Zhejiang | 1.60 | 1.4 | 53.41 | 3.4 | 95.75 | 3.11 |
| Shanghai | 9.44 | 8.4 | 135.19 | 8.6 | 251.80 | 8.19 |
| Shandong | 6.46 | 5.7 | 106.23 | 6.7 | 181.38 | 5.90 |
| Hebei | 0.72 | 0.6 | 24.90 | 1.6 | 61.18 | 1.99 |
| Beijing | 12.56 | 11.1 | 55.44 | 3.5 | 127.15 | 4.13 |
| Tianjin | 3.87 | 2.5 | 53.58 | 3.4 | 121.09 | 3.94 |
| Liaoning | 3.79 | 3.4 | 69.75 | 4.4 | 128.00 | 4.16 |
| Guangxi | 2.02 | 1.8 | 32.72 | 2.1 | 64.18 | 2.09 |
| Hainan | 2.92 | 2.6 | 42.08 | 2.7 | 57.99 | 1.89 |
| **Central** | **4.70** | **4.2** | **133.88** | **8.5** | **275.02** | **8.94** |
| Heilongjiang | 0.97 | 0.9 | 17.49 | 1.1 | 33.63 | 1.09 |
| Jilin | 0.16 | 0.2 | 14.51 | 0.9 | 25.85 | 0.84 |
| Shanxi | 0.18 | 0.2 | 3.82 | 0.2 | 13.01 | 0.42 |
| Henan | 1.26 | 1.1 | 17.95 | 1.2 | 37.53 | 1.22 |
| Hubei | 0.78 | 0.7 | 27.23 | 1.7 | 54.86 | 1.78 |
| Hunan | 0.58 | 0.5 | 21.40 | 1.4 | 45.65 | 1.48 |
| Jinagxi | 0.37 | 0.3 | 11.86 | 0.8 | 24.86 | 0.81 |
| Anhui | 0.29 | 0.2 | 16.91 | 1.0 | 27.16 | 0.88 |
| Inner Mongolia | 0.12 | 0.1 | 2.71 | 0.2 | 5.35 | 0.17 |
| **Western** | **5.84** | **5.2** | **49.48** | **3.1** | **99.01** | **3.22** |
| Shaanxi | 3.44 | 3.0 | 12.41 | 0.8 | 27.58 | 0.90 |
| Sichuan | 1.24 | 1.1 | 26.01 | 1.7 | 27.42 | 0.89 |
| Other* | 1.16 | 1.0 | 11.06 | 0.7 | -- | -- |
| **Total** | **112.79** | **100** | **1,575.96** | **100** | **3,076.31** | **100** |

* It refers to all the other western provinces (autonomous regions and municipalities directly under the Central Government) except Shaanxi and Sichuan.

Source: MOFTEC, *Almanac of Foreign Economic Relations and Trade of China* (1984-95) and *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsj/wztj/2000_9-22-28.html; SSB, *Statistical Yearbook of China* (1984-97)

population.[183] In contrast, the central region accounts for 14.3% of the land and 31.8% of the population and the western region makes up 71.7% of the land and 28.2% of the population,[184] but the two regions received only a small share of 8.94% and 3.22% of FDI respectively during the same period. The inflow FDI has been highly concentrated in the eastern region. The unbalanced FDI distribution has widened the economic gap between

[183] *Supra* note 181

[184] "China Shall Implement the Western Development", *Shenzhen Economic Daily*, Oct. 18, 1999, p.A6

China's eastern and other regions and increased its inter-regional economic disparity although many other factors, such as domestic capital flows from the central and western regions, and unbalanced export and rural development have all contributed to this effect.[185]

**TABLE 8: GDP PER CAPITA IN THE EASTERN AND WESTERN REGIONS OF CHINA**

Unit: RMB yuan

| Year | GDP Per Capita (1978 price) | | | GDP Per Capita (current price) | | |
|---|---|---|---|---|---|---|
| | Eastern | Western | E/W (%) | Eastern | Western | E/W (%) |
| 1978 | 448 | 264 | 1.848 | 448 | 264 | 1.848 |
| 1979 | 534 | 282 | 1.894 | 541 | 294 | 1.840 |
| 1980 | 566 | 300 | 1.887 | 601 | 321 | 1.872 |
| 1981 | 578 | 317 | 1.823 | 635 | 344 | 1.846 |
| 1982 | 618 | 347 | 1.781 | 695 | 381 | 1.824 |
| 1983 | 672 | 371 | 1.811 | 766 | 425 | 1.805 |
| 1984 | 784 | 423 | 1.853 | 928 | 507 | 1.830 |
| 1985 | 885 | 477 | 1.855 | 1,108 | 591 | 1.875 |
| 1986 | 942 | 501 | 1.880 | 1,242 | 643 | 1.932 |
| 1987 | 1,035 | 540 | 1.917 | 1,447 | 731 | 1.979 |
| 1988 | 1,143 | 588 | 1.944 | 1,784 | 900 | 1.982 |
| 1989 | 1,167 | 599 | 1.948 | 1,983 | 970 | 2.044 |
| 1990 | 1,202 | 621 | 1.936 | 2,116 | 1,104 | 1.917 |
| 1991 | 1,298 | 665 | 1.952 | 2,412 | 1,231 | 1.959 |
| 1992 | 1,518 | 731 | 2.077 | 3,001 | 1,422 | 2.110 |
| 1993 | 1,789 | 804 | 2.225 | 4,153 | 1,785 | 2.327 |
| 1994 | 2,060 | 876 | 2.352 | 5,680 | 2,443 | 2.325 |
| 1995 | 2,315 | 942 | 2.458 | 7,104 | 2,948 | 2.410 |
| 1984-95 Growth (%) | 9.59 | 7.77 | 1.69 | 17.06 | 15.25 | 1.57 |

Source: *Provincial Statistical Yearbooks* for 19 provinces from 1984 to 1995 and the *Statistical Yearbook of China* (1995 and 1996)

The most important indicator demonstrating the disparity is the increased income gap between the eastern and other regions. As TABLE 8 indicates, the GDP per capital at 1978 constant prices grew at 9.59% on average in the eastern region each year from 1984 to 1995 while the growth rate was only 7.77% in the western region during the same period. The ratio of eastern to western GDP per capita was 1.848 in1978 but increased to 2.458 by 1995. The differential growth rates have enlarged the income inequality between the two regions.[186] This situation has aggravated the originally unbalanced geographical pattern as well as the social structure of the country, and it is detrimental to the overall

[185] *Supra* note 72, pp.123-140

[186] *Supra* note 72, p.117-119

development of the national economy and therefore the stability of the Chinese society in the long run.

The problem of the uneven FDI distribution catches attention of Chinese government. To eliminate the exacerbating impact, China tried to introduce FDI into the central and western regions in the past decade. However, it is the western development policy, which was put forward at the 4th Plenary Session of the 15th Central Committee of the CPC in 1999,[187] that marks China's vigorous efforts to redress the problem. China has started actively to encourage foreign investors to invest in the central and western regions and has adopted several preliminary measures for this purpose:[188]

(A) The corporate income tax of the FIE that is established in the central and western regions and under the encouraged or restrictive categories specified in the *Catalogue of the Guidance for Foreign Investment Industries* can be levied at a reduced rate of 15% for an extended period of 3 years after its present preferential tax treatment expires;[189]

(B) All provincial capitals of the central and western regions enjoin the same preferential policies as those offered to the eastern region;[190]

(C) When the FIE reinvests in the central and western regions, its reinvested enterprise may be regarded as a FIE and thus enjoy the same preferential treatment granted to the FIE provided that the reinvestment is over 25% of the capital share of the reinvested enterprise;[191]

(D) The conditions that restrict industrial entrance of FDI or foreign equity share in the eastern region are relaxed for the establishment of the FIE in the central and western regions, and the domestic market for goods produced by the FIE in the two regions is

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[187] "Zeng Peiyan (Minister of the State Development Planning Commission) Talked about Western Development", *Shenzhen Special Zone Daily*, Jan. 6, 2000, p.3

[188] It is reported that the Central Government is working hard on the formulation of a set of new rules, including preferential treatment to FDI, with regard to the western development strategy. It is believed that these new regulations will be promulgated soon.

[189] *People's Daily* (Chinese), Jan. 25, 2000, p.1

[190] "Foreign Capital Encouraged to Central/Wet Parts", *Beijing Review*, Vol. 41, No. 46, Nov. 16-22, 1998

[191] "Foreign Investment in Central & West China Encouraged", *Beijing Review*, Vol. 41, No. 24, Jun. 15-21, 1998

opened wider;[192] and

(E) For the sectors and projects on which the Central Government permits to experiment, the central and western regions can proceed simultaneously with the eastern region. Provincial capitals in the central and western regions can, with the approval of the Central Government, carry out trials in allowing FDI in the domestic commercial, foreign trade and travel services.[193]

(3) Irrational FDI distribution in sectors

China's inward FDI concentrated in the industrial and real estate sectors over the past twenty years. By 1999 the contractual FDI in the two sectors respectively accounted for 59.56% and 24.44% of the total FDI in China. [SEE TABLE 9] Within the industrial sector,

**TABLE 9: SECTORAL DISTRIBUTION OF CONTRACTUAL FDI IN CHINA (1983-1999)**

Unit: US$ 100 million

| Time & value / Sector | 1983 – 1987 | | 1988 – 1991 | | 1992 – 1993 | | 1994 – 1995 | | As of 1999 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Value | % | Value | % | Value | % | Value | % | Value | % |
| Agriculture, forestry, animal husbandry, fishing | 4.1 | 2.3 | 6.73 | 2.3 | 18.7 | 1.1 | 27.08 | 1.6 | 108.27 | 1.76 |
| Industry | 58.42 | 33.1 | 238.77 | 81.0 | 838.41 | 49.4 | 1055.5 | 60.7 | 3655.5 | 59.56 |
| Building | 3.05 | 1.7 | 5.01 | 1.7 | 57.17 | 3.4 | 43.12 | 2.5 | 188.6 | 3.07 |
| Transport, post & telecommunication | 3 | 1.7 | 3.45 | 1.2 | 30.33 | 1.8 | 37.27 | 2.1 | 149.69 | 2.44 |
| Commerce,catering | 8.05 | 4.6 | 3.4 | 1.2 | 60.51 | 3.6 | 73.49 | 4.2 | 219.6 | 3.58 |
| Real estate | 63.93 | 36.2 | 30.1 | 10.2 | 618.51 | 36.9 | 416.97 | 24 | 1499.8 | 24.44 |
| Health care, sports, education | 1.45 | 0.8 | 2.56 | 0.9 | 14.21 | 0.8 | 34.25 | 2 | 66.58 | 1.08 |
| Research, technical services | 0.08 | -- | 0.62 | -- | 6.5 | 0.4 | 5.51 | 0.3 | 18.74 | 0.31 |
| Other sectors | 20.15 | 11.4 | 4.04 | 1.4 | 50.44 | 3 | 45.92 | 2.6 | 230.45 | 3.75 |
| Geological prospecting | 13.97 | 7.9 | 0.02 | -- | 0.84 | -- | 0.54 | -- | -- | -- |
| Total | 176.68 | -- | 294.7 | -- | 1695.6 | -- | 1739.1 | -- | 6137.2 | -- |

Source: MOFTEC, *Almanac of Foreign Economic Relations and Trade of China* (1984-1995) and *FDI Statistics*, hppt://www.moftec.gov.cn/moftec_cn/tjsj/wztj/2000_9-22-21.html; BSB, *Statistical Yearbook of China* (1990-1997)

light labor-intensive industries attracted more than 70% of the total FDI from 1984 to 1992, leaving less than 30% of the FDI with chemical, machinery, transport and precision

[192] "China is Formulating New Policies of Encouraging FDI into Central/West Parts", *Investment Guidance Weekly* (Chinese), Aug. 27, 1999, p.15

[193] *Supra* note 191

equipment, and electrical and electronics industries during the same period. [SEE TABLE 10] China identified agriculture as the foundation of its national economy, infrastructure construction as its basic industry, and machine-building, electronics, petrochemical, automobile and building as its pillar industries.[194] The sectoral distribution pattern of FDI was obviously inconsistent with China's endeavor to divert FDI into those technology-intensive industries. The irrational FDI distribution in sectors has aggravated the original contradiction of China's industrial structure.

**TABLE 10: DISTRIBUTION OF CONTRACTUAL FDI IN INDUSTRIAL SECTOR (1984-1992)**

Unit: UDS 100 million

| Industry | 1984 – 1989 | | 1990 – 1992 | |
|---|---|---|---|---|
| | Value | Percentage | Value | Percentage |
| Textile | 12.05 | 10.8 | 42.19 | 8.8 |
| Chemical | 5.38 | 4.8 | 23.97 | 5.0 |
| Machinery | 7.40 | 6.6 | 22.21 | 4.6 |
| Transport vehicle | 0.45 | 0.4 | 8.57 | 1.8 |
| Electrical | 3.53 | 3.2 | 22.13 | 4.6 |
| Electronic | 8.84 | 7.9 | 35.09 | 7.3 |
| Precise | 0.45 | 0.4 | 3.71 | 0.8 |
| Oil exploration | 2.76 | 2.5 | 1.38 | 0.3 |
| Oil processing | 7.87 | 7.1 | 13.96 | 2.9 |
| Coal mining | -- | -- | 0.30 | 0.06 |
| Coal processing | 0.12 | 0.1 | 0.34 | 0.06 |
| Other industries* | 66.32 | 59.4 | 304.76 | 63.7 |
| Total | 111.63 | 100 | 478.59 | 100 |

* Other industries include clothing, toys, footwear, food, beverage, clocks, bicycles, furniture, plastic products, tobacco processing, and printing etc.

Source: MOFTEC, *Annual Statistics Report* (1985-1992)

To guide the direction of FDI rationally, China issued for the first time the *Catalogue of the Guidance for Foreign Investment Industries* on Jun. 20, 1995 (revised on Dec. 31, 1997). Projects in the *Catalogue* are divided into three categories in which FDI is encouraged, restricted and prohibited. Under each of the categories, a detailed list of projects is set out. FDI is considered permitted where a project is not listed. *The Catalogue* serves to guide the examination and approval of FDI, and it represents China's resolve to encourage FDI in capital and technology-intensive industries while discouraging it in projects using standard technologies, controlled by the State, or where

[194] *Supra* note 181

there is already excess domestic supply.[195]

## 2. Overview of FDI in Canada

### *2.1 Development of FDI in Canada*

Canada has relied heavily on investment from other counties since its first stirrings in the 16th century[196] as domestic savings have typically been insufficient to fully satisfy its need for capital.[197] Foreign investment provided the nation with the money to build railways, canals, roads and other public utilities and made possible the exploitation of its great staples of fish, fur, wood, mineral deposits and new sources of power.[198] The nature of the capital inflow has shifted over the years. The early mercantile investors were those of New France.[199] In the late 19th century, most of the foreign investment came from the U.K.[200] and was concentrated in the construction of railways and other basic utilities as well as in financing the requirements of governments at all levels. At the beginning of the 20th century, American direct investment fluxed into the country as the most important form of investment.[201]

Prior to World War I, foreign control of Canadian business apart from railways was not great[202] because much of its foreign capital was supplied in the form of debt securities as opposed to equity investments.[203] During the time, FDI constituted no more than 1/3 of Canada's inward foreign investment.[204] The source and nature of foreign investment in Canada changed after World War I. By 1926 the American capital stake exceeded that of

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[195] M. John Foster, "Foreign Trade and Investment: Policy Reforms in China in the Mid-1990s" in Roger Strange, Jim Slater and Limin Wang (eds.), *Trade and Investment in China: The European Experience*, Routledge, 1998

[196] Charles A. Barrett etc., *The Future of Foreign Investment in Canada*, the Conference Board of Canada, Study No. 85, Jan. 1985, p.3

[197] Robert B. Ross, *A Summary*, the Conference Board of Canada, Jan. 1985, p.6

[198] *Foreign Direct Investment in Canada* published by Government of Canada, 1972, p.13

[199] *Supra* note 196, pp.3-4

[200] T. Kennish, "NAFTA and Investment – A Canadian Perspective" in S. J. Rulin (ed.), *NAFTA and Investment*, Kluwer Law International, 1995

[201] Walter Gordon etc., *The Royal Commission on Canada's Economic Prospects, Final Report*, Nov. 1957, pp.380-381

[202] *Supra* note 198

[203] *Supra* note 201, p.380

[204] *Supra* note 198

the U.K., [SEE TABLE 11] and since then the U.S. has replaced the U.K. as the principal investment source.[205] U.S. investment in Canada has in great part been in the form of equity participation in subsidiaries[206] although its direct investment was still 14% less than its portfolio by 1930.[207]

**TABLE 11: FOREIGN INVESTMENT IN CANADA (1900-1964)**

Unit: C$ 1 million

| Year | Total | U. S. | U.S. Percentage To Total | U. K. | U.K. Percentage to Total |
|---|---|---|---|---|---|
| 1900 | 1,232 | 168 | 14 | 1,050 | 85 |
| 1914 | 3,837 | 881 | 23 | 2,778 | 72 |
| 1918 | 4,536 | 1,630 | 36 | 2,729 | 60 |
| 1926 | 6,003 | 3,196 | 53 | 2,637 | 44 |
| 1930 | 7,614 | 4,660 | 61 | 2,766 | 36 |
| 1933 | 7,365 | 4,492 | 61 | 2,683 | 36 |
| 1939 | 6,913 | 4,151 | 60 | 2,476 | 36 |
| 1945 | 7,092 | 4,990 | 70 | 1,750 | 25 |
| 1946 | 7,181 | 5,158 | 72 | 1,670 | 23 |
| 1950 | 8,664 | 6,549 | 76 | 1,750 | 20 |
| 1955 | 13,473 | 10,275 | 76 | 2,356 | 18 |
| 1956 | 15,569 | 11,789 | 76 | 2,668 | 17 |
| 1957 | 17,464 | 13,264 | 76 | 2,917 | 17 |
| 1958 | 19,010 | 14,441 | 76 | 3,088 | 16 |
| 1959 | 20,857 | 15,826 | 76 | 3,199 | 15 |
| 1960 | 22,214 | 16,718 | 75 | 3,359 | 15 |
| 1961 | 23,606 | 18,001 | 76 | 3,381 | 14 |
| 1962 | 24,889 | 19,155 | 77 | 3,399 | 14 |
| 1963 | 26,134 | 20,479 | 78 | 3,331 | 13 |
| 1964 | 27,354 | 21,443 | 78 | 3,463 | 13 |

Source: Dominion Bureau of Statistics, *The Canadian Balance of International Payments* (1963-1965) and *National Income and Expenditure* (1965 and previous years). – See John H. Dunning, *Studies in International Investment*, George Allen & Unwin, 1970, pp.191-193

After the Great Depression and World War II that slowed capital inflow, foreign investment was vitalized in Canada as a result of post-war economic expansion. During the period of 1946 to 1956, the stock of foreign investment more than doubled from C$ 7.18 billion to C$ 15.57 billion, [SEE TABLE 11] and the predominant component of the

[205] Isaiah A. Litvak and Christopher J. Maule, "Foreign Investment in Canada" in Isaiah A. Litvak and Christopher J. Maule (eds.), *Foreign Investment: The Experience of Host Countries*, Paeger Publishers, 1970

[206] *Supra* note 200

[207] *Supra* note 198, pp.13-14

**TABLE 12: ESTIMATED BOOK VALUE OF FOREIGN CAPITAL INVESTED IN CANADA (SELECTED YEARS: 1900 – 1967)**

Unit: C$ 1millon

| Year & Value / Owned by residents | 1900 | | 1914 | | 1930 | | 1946 | | 1950 | | 1960 | | 1967 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % |
| **U.S.** | | | | | | | | | | | | | | |
| Direct | – | | – | | 1993 | 26.1 | 2428 | 33.8 | 3426 | 39.5 | 10549 | 47.4 | 17000 | 48.9 |
| Portfolio & other | – | | – | | 2667 | 35.0 | 2730 | 38.0 | 3123 | 36.0 | 6169 | 27.7 | 11030 | 31.7 |
| Totals | 168 | 13.6 | 881 | 23.0 | 4660 | 61.2 | 5158 | 71.8 | 6549 | 75.5 | 16718 | 75.2 | 28030 | 80.7 |
| **U.K.** | | | | | | | | | | | | | | |
| Direct | – | | – | | 392 | 5.1 | 335 | 4.6 | 468 | 5.4 | 1535 | 6.9 | 2152 | 6.2 |
| Portfolio & other | – | | – | | 2374 | 31.1 | 1335 | 18.5 | 1282 | 14.7 | 1824 | 8.2 | 1424 | 4.1 |
| Totals | 1050 | 85.2 | 2778 | 72.4 | 2766 | 36.3 | 1670 | 23.3 | 1750 | 20.1 | 3359 | 15.1 | 3576 | 10.3 |
| **Other foreign countries** | | | | | | | | | | | | | | |
| Direct | – | | – | | 42 | 0.5 | 63 | 0.8 | 81 | 0.9 | 788 | 3.5 | 1547 | 4.4 |
| Portfolio & other | – | | – | | 146 | 1.9 | 290 | 4.0 | 284 | 3.2 | 1349 | 6.0 | 1549 | 4.4 |
| Totals | 14 | 1.1 | 177 | 4.6 | 188 | 2.4 | 353 | 4.9 | 365 | 4.2 | 2137 | 9.6 | 3096 | 8.9 |
| **All foreign countries** | | | | | | | | | | | | | | |
| Direct | – | | – | | 2427 | 31.8 | 2826 | 39.3 | 3975 | 45.8 | 12872 | 57.9 | 20699 | 59.6 |
| Portfolio & other | – | | – | | 5187 | 68.1 | 4355 | 60.6 | 4689 | 54.1 | 9342 | 42.0 | 14003 | 40.3 |
| Totals | 1232 | | 3837 | | 7614 | | 7181 | | 8664 | | 22214 | | 34702 | |

Source: DBS estimates for 1900 and 1914 by Viner and Knox. – See *Foreign Direct Investment* published by Government Canada, 1972, p.15

expansion was FDI that expanded from C$ 2.83 billion to C$ 8.87 billion.[208] [ALSO SEE TABLE 12] Coupled with growing reinvested profits, continuing inflow of foreign capital led to a sharp increase in the value of FDI in the 1960s,[209] the amount of which reached nearly 60% of the total book value of foreign investment in Canada at the end of 1967. [SEE TABLE 12] Canada became the largest destination of international direct investment

[208] *Supra* note 196, p.6

[209] Lucie Laliberté, *Globalization and Canada's International Investment Position: 1950 to 1992*, Statistics Canada, Balance of Payments Division, Research Paper No. 6, Apr. 1993, p.6

with over 18% of the world's stock of inward FDI.[210] Since then, however, Canada's importance as a destination of global direct investment has continued to decline.[211] Its share of inward FDI stock in the world dropped by more than four times from 1967 to 1996 [SEE TABLE 13] and its share of North American inward FDI stock fell from 24% to 16% between 1985 and 1996.[212] Canada is no longer a preferred location for international direct investment[213] although with a total stock of C$ 188 billion by 1997[214] inward FDI is still a much important element within its economy.[215]

**TABLE 13: CANADA'S SHARE OF WORLD INWARD FDI STOCK (SELECTED YEARS: 1967 – 1996)**

| Inward stock | 1967 | 1973 | 1980 | 1985 | 1990 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| Canada as world percentage (%) | 18 | 16 | 11.5 | 8.7 | 6.5 | 4.4 | 4.0 |

Source: "Annex Tables" in UNCTAD, *World Investment Report 1997*; Industry Canada, *Formal and Informal Investment Barriers in the G-7 Countries: The Country Chapters*, Occasional Paper No. 1, Vol. 1, May 1994, p.240; Ronald Hirshhorn, *Industry Canada's Foreign Investment Research: Message and Policy Implications*, Industry Canada, Discussion Paper No. 5, Oct. 1997, pp.3-4

### *2.2 Canada's FDI Policy*

Traditionally, there had been no barriers affecting inward and outward capital in Canada. One of its early policy elements was openness to foreign investment with virtually no general restrictions or even government administrative processes to impede foreign investors.[216] It actually offered an array of bonuses, grants and tax exemptions to induce investors to place their savings in Canada[217] and even purposely erected a high tariff to encourage foreigners to invest in the country during its first National Policy era

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[210] Industry Canada, *Formal and Informal Investment Barriers in the G-7 Countries: The Country Chapters*, Occasional Paper No. 1, Vol. 1, May 1994, pp.239-240

[211] *Id.*

[212] Micro-Economic Policy Analysis Branch Bulletin, *Micro*, Vol. 4, Special Issue, Spring 1998, http:// strategis.ic.gc.ca/pics/ra/special.pdf

[213] Hon. John Manley, *Who Benefits from Foreign Investment?* http://strategis.ic.gc.ca/SSG/ii1824le.html

[214] "Foreign Direct Investment (FDI) to Canada", http://strategis.ic.gc.ca/SSG/ii1832le.html

[215] *Supra* note 212

[216] John Fayerweather, *Foreign Investment in Canada: Prospects for National Policy*, International Arts and Sciences Press, 1973, p.8

[217] *Supra* note 196, p.33

from 1867 to 1940.[218] Its general tenor was to introduce maximum of foreign investment inflows until the mid-1950s.[219]

In modern times, Canada's FDI policy could be broken into three time periods, namely, restricting inward FDI from 1960 to 1985, restricting and promoting at the same time from 1985 to 1994, and nondiscrimination under the *North American Free Trade Agreement* (NAFTA) from 1994 afterwards.[220]

(1) Focus on restricting FDI (1960-1985)

Due to the history of unrestricted entry, foreign investors acquired significant ownership positions in many segments of the Canadian economy. By the late 1950s, foreign investment controlled more than 70% of Canadian oil and gas industry, nearly 60% of its mining industry and over 50% of its manufacturing industries.[221] [ALSO SEE TABLE 14] American capital dominated these economic sectors and even controlled 97% of

**TABLE 14: FOREIGN CONTROL AS A PERCENTAGE OF SELECTED INDUSTRIES IN CANADA (SELECTED YEARS: 1926-1963)**

| Industry \ Year | 1926 | 1930 | 1939 | 1948 | 1954 | 1958 | 1963 |
|---|---|---|---|---|---|---|---|
| Manufacturing | 35 | 36 | 38 | 43 | 51 | 57 | 60 |
| Petroleum & natural gas | | | | | 69 | 73 | 74 |
| Mining & smelting * | 38 | 47 | 42 | 40 | 51 | 60 | 59 |
| Railways | 3 | 3 | 3 | 3 | 2 | 2 | 2 |
| Other utilities | 20 | 29 | 26 | 26 | 8 | 5 | 4 |

* Mining and smelting combined with petroleum and natural gas for years 1929, 1930, 1939 and 1948.

Source: John Fayerweather, *Foreign Investment in Canada: Prospects for National Policy*, International Arts and Sciences Press, 1973, p.7

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[218] Lorraine Eden, "Foreign Direct Investment in Canada: Charting a New Policy Direction", *Can. F. Pol'y*, Vol. 2, No. 3, Winter 1994 and S. J. Rubin, *NAFTA and Investment*, Kluwer Law International, 1995, p.5

[219] *Supra* note 216

Although there was some criticisms made primarily by the left in the 1920s. For example, A. A. Heaps, Labor member, said in 1928 that he did not want to see "the Canadian people become ... hewers of wood and drawers of water to American capitalists". – See Gordon Laxer, *Open for Business: The Roots of Foreign Ownership in Canada*, Oxford University Press, 1989, p.221, note 3

[220] Lorraine Eden, "Foreign Direct Investment in Canada: Charting a New Policy Direction", *Can. F. Pol'y*, Vol. 2, No. 3, Winter 1994

[221] M. Bliss, "Founding FIRA: The Historical Background" in J. M. Spence and W. P. Rosenfeld (eds.), *Foreign Investment Review Law in Canada*, Butterworths, 1984, p.3

Canadian automobile manufacturing.[222] U.S. investment was so significant that concern was expressed that high levels of foreign investment contributed over-specializing in natural resource industry and resulted in a "branch plant" economy.[223] A string of government sponsored reports helped to direct attention to the results of the high level of foreign, particularly U. S., ownership.

In 1957 Canadian government appointed a Royal Commission on Canada's Economic Prospects headed by Walter L. Gordon to investigate the economic trends and the effects of foreign investment on the country. *The Gordon Report* analyzed the positive effects of foreign investment and also pointed out:

"...[Canadian] productive resources are controlled by non-residents, mostly Americans. Many Canadians are worried about such a large degree of economic decision-making being in the hands of non-residents or in the hands of Canadian companies controlled by non-residents. This concern has arisen because of the fact that most of it is centered in one country, the United States, and because most of it is in the form of equities which, in the ordinary course of events, are never likely to be repatriated. ... [T]he possible dangers of foreign investment in this country ... do in fact exist and if a period of political or economic instability should occur, they might develop into demands for restrictive or discriminatory action of an extreme kind, the consequences of which would be unfortunate for all concerned. ...American capital in the dynamic resources and manufacturing sectors becomes ever more dominant, [and] our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear that continuing integration might lead to economic domination by the United States and eventually to the loss of our political independence."[224]

*The Gordon Report* set forth the first significant expression of concern about the magnitude and effects of FDI in Canada[225] and recommended the government to adopt some measures such as "key sectors" system to administer FDI in the country. Although it

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[222] *Supra* note 205, p.77

[223] H. Heward Stikeman, *The Foreign Investment Review Act: The Shape of Things to Come*, Richard De Boo, 1974, p.2

[224] *Supra* note 201, pp.389-390

[225] *Supra* note 216, p.9

had little immediate impact to the political community,[226] the *Gordon Report* was an anticipation of Canada's FDI policy change.

In the 1960s, Canadian government was forced to reconsider its FDI policy as a result of concern over the extraterritorial application of U.S. legislation to Canadian subsidiaries of American companies,[227] the behavior of which irked many Canadians.[228] The government established a special Task Force on the Structure of Canadian Industry that was made up of eight prominent Canadian economists and economics professors chaired by Melville H. Watkins. In 1968 the Task Force produced a report entitled the *Foreign Ownership and the Structure of Canadian Industry*. Like the *Gordon Report*, the *Watkins Report* referred to the increase in and concern over FDI in Canada. It pointed out that "[n]o other country ... seems prepared to tolerate so high a degree of foreign ownership as exists in Canada".[229] "Foreign ownership and control are not only pervasive in Canada but are likely to remain so". Therefore "[t]here is a need to ensure Canadian participation in the benefits of foreign direct investment".[230] However, "[n]o systematic overall policy has emerged" in the country.[231] After warning the costs of FDI to Canada, the *Watkins Report* noted some other countries' screening policies on FDI and advised that "a special agency be created to coordinate policies" in respect of FDI.[232] *The Watkins Report* went a little further than the *Gordon Report* but was not accepted by the cabinet committee either.[233]

Following a decade of growing concern about the high degree of foreign ownership in its economy, Canadian government once again undertook to examine the problem concerned in the early 1970s. A working group led by Herb Gray, Minister of National

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[226] Walter L. Gordon, *A Political Memoir*, 1977, p.68

[227] For instance, the U.S. Justice and Commerce Departments and other federal agencies attempted to force Canadian subsidiaries of American companies to desist from trading with Cuba when Canada had normal relations with the country. – See *supra* note 13

[228] *Supra* note 13

[229] The Task Force of the Structure of Canadian Industry, *Foreign Ownership and the Structure of Canadian Industry*, Jan. 1968, p.363

[230] *Id.*, p.411

[231] *Id.*, p.364

[232] *Supra* note 221, pp.6-7

[233] *Supra* note 216, p.9

Revenue, was established in 1970 to study the foreign investment in Canada and examine factors that should be considered in the government's review of foreign investment policy.[234] In 1972 the working group published the *Foreign Direct Investment in Canada*, a report that became the genesis of foreign investment review in Canada.[235] *The Gray Report* was the most comprehensive survey of the issues arising from FDI[236] and it was a clearer indication of government thinking on Canada's FDI policy than the two previous reports.[237] It attributed to FDI a host of economic, social and political effects, all of which combined to deny Canada "an efficient, productive, well balanced and innovative economy".[238] A central point in the *Gray Report* was the idea of truncation.[239] This concern led, among other things, to indicate that "[i]f a review process were established, legislation could be enacted directing the review agency to reject foreign investment proposals",[240] and the *Gray Report* thus recommended the establishment of a screening mechanism to oversee FDI in Canada. The government's first reaction was to table the *Foreign Takeovers Review Bill* on May 4, 1972, which intended to build a governmental mechanism for screening foreign acquisitions of existing Canadian businesses. *The Bill* died without final vote because it was seen as addressing too small a portion of the problem. In 1973 the government introduced a revised bill to establish the *Foreign Investment Review Act* (FIRA), which received approval in the House of Commons in Nov. of that year. The FIRA extended the review process, with all takeovers, mergers and acquisitions of established businesses as well as new FDI reviewable. It came into force in Apr. 1974 regarding takeovers and in Oct. 1975 respecting the establishment of new

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[234] *Supra* note 198, p.v

[235] Ross B. Leckow and Ian A. Mallory, "The Relaxation of Foreign Investment Restrictions in Canada", *ICSID Rev.: F.I.L.J.*, Vol. 6, No. 1, Spring 1991, p.25

[236] Richard Schultz etc., *The Cabinet as a Regulatory Body: The Case of the Foreign Investment Review Act*, Economic Council of Canada, Working Paper No. 6, Sept. 1980, p. 13

[237] *Supra* note 216, p.3

[238] *Supra* note 198, p.6

[239] A. E. Safarian, *Foreign Direct Investment: A Survey of Canadian Research*, the Institute for Research on Public Policy, 1985, pp.39-40

[240] *Supra* note 198, p.515

businesses.[241] The FIRA was enacted with the purpose of reducing the adverse effects of FDI on Canada and securing FDI commitments to Canadian "significant benefits".[242] It was Canada's first comprehensive law dealing with FDI and embodied the government's most visible policy orientation on the issue.[243] Until this time, Canada's FDI policy formally changed to a restrictive direction.

(2) Restricting and promoting FDI at the same time (1985-1994)

Since its promulgation, the FIRA engendered severe criticisms both from within and outside the country. Criticism from the outside mainly came from America. U.S. government officials frequently reiterated their complaints about the FIRA's vague standards and criteria, secretive and protracted review process, obliged undertakings requirement and even unwarranted extraterritoriality effect.[244] Criticism was also strong within Canada. "The absence of meaningful standards and criteria, ... the confidential nature of the review process, the failure to provide reasons for individual decisions, all these factors have produced a process which denies accountability. There is no answerability for actions because there is no meaningful information available".[245] The FIRA processes were too bureaucratic.[246]

In the early 1980s, Canada's economy sank into a recession. Canadian share of global FDI flows declined significantly from over 18% in the 1970s to under 10%[247] and more FDI left than entered Canada since 1973.[248] The FIRA was recognized to have deterred or

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241 *Supra* note 175, p.19; Lorraine Eden, *Multinationals as Agents of Change: Setting a New Canadian Policy on Foreign Direct Investment*, Industry Canada, Nov. 1994, p.15; and *supra* note 221, p.9

242 *Supra* note 220

243 *Supra* note 196, p35

244 J. M. Spence, "FIRA: A Decade of Evolution" in J. M. Spence and W. P. Rosenfeld (eds.), *Foreign Investment Review Law in Canada*, Butterworths, 1984, pp.316-319

245 R. Shultz and F. Swedlove, *The Cabinet as a Regulatory Body: The Case of the Foreign Investment Review Act*, Economic Council of Canada, Working Paper No. 6, Sept. 1980

246 Shultz et al. so argued. – See *supra* note 239, pp.41-42

247 E. Smythe, *Multilateralism or Bilateralism in the Negotiation of Trade-Related Investment Measures?* Orono, 1995, p.14

248 Earl H. Fry, "Foreign Investment in the United States and Canada: The Setting" in Earl H. Fry and Lee H. Radebaugh (eds.), *Regulation of Foreign Direct Investment in Canada and the United States*, Brigham Young University, 1983

at least diminished the FDI inflow.[249] Canadian government felt it imperative to make use of more FDI to revive its economy. In 1984 the political climate for FDI policy changed radically with the election of the Progressive Conservative Party. The new government declared Canada "open for business" once again.[250] For this purpose, *Bill C-15* was introduced in Nov. 1984. Designed to make Canada a friendlier environment for FDI, it incorporated provisions intended to remedy the procedural defects that had been criticized so much under the FIRA. On Jun. 6, 1985 the House of Commons passed the *Bill* as the *Investment Canada Act* (ICA), which repealed the FIRA and came into force on Jun. 30, 1985.[251]

The passage of the ICA reversed a restrictive FDI trend of twenty years in Canada.[252] It marked a major departure from Canada's previous restrictive FDI policies[253] and signaled a significant shift towards Canada's FDI relaxation with an emphasis on its desirability of inward FDI.[254] Under the *Act*, the review of greenfield investments by foreign investors is eliminated with minor exceptions and the chief subject of review is the direct acquisition of control of existing Canadian businesses.[255] The overall thrust of policy has shifted to promote Canada as a site where inward FDI is most welcomed and actively sought.[256]

However, Canada has an ambivalent attitude towards FDI due to its small market. On the one hand there is a need for FDI to bring capital, technology and expertise; on the other hand there is a high degree of foreign ownership and control of Canadian industry. Canadian attitudes towards FDI seek to reconcile these two realities and government's

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[249] *Supra* note 196, p.29

By 1985, over 3,600 proposed FDI projects had been reviewed, of which 16% were either rejected or withdrawn perhaps in anticipation of non-approval. (UNCTD, *World Investment Report 1998: Trends and Determinantes*, 1998, p.93) Many foreign investors were even deterred from submitting proposals in the first place because of the complicated nature of FIRA's review process. (Earl H. Fry, *The Politics of International Investment*, McGraw-Hill, 1983, p.89)

[250] S. J. Rubin, *NAFTA and Investment*, Kluwer Law International, 1995, p.5

[251] *Supra* note 27, p.11-6

[252] *Supra* note 235, p.40

[253] *Supra* note 210, p.238

[254] *Supra* note 210, p.275

[255] *Supra* note 175, p.21

[256] OECD, *International Direct Investment: Policies and Trends in the 1980s*, Paris, 1992

FDI policy aims to balance the conflict.[257] This policy attitude is also displayed in the ICA. From the very beginning, the ICA makes clear that its purpose is "to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities" while "to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada."[258] The basic principle of FDI screening mechanism characteristic of the FIRA remains in the ICA.[259] Canadian government has a double mandate: to promote FDI while screening it, that is, an open policy for most inward FDI with a screening window for certain kinds of sensitive projects.[260]

(3) Nondiscrimination of FDI under the NAFTA (1994 hereafter)

The dual nature of the ICA had an overall negative effect on FDI.[261] Over eight years after the promulgation of the ICA, Canada indeed attracted a decreasing share of global FDI.[262] For instance, the book value of U.S. FDI continued to decline from 74%, 67% to 64% of the total FDI in Canada from 1984, 1988 to 1992 respectively.[263]

The situation changed in 1994. In the spring of that year, Investment Canada disappeared as an independent agency.[264] Although the screening function still exists, Canada has actually liberalized the regulation on inward FDI with its FDI reviewing staff significantly reduced to no more than ten.[265] Externally, the *Canada-U.S. Free Trade Agreement* (CUFTA)[266] marked an important step towards liberalizing Canada's trade and investment relations with the U.S. Under the CUFTA, the floor for screening of U.S. acquisitions was raised from C$ 5 million to C$ 150 million with an inflation

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[257] *Supra* note 210, p.237

[258] The ICA, R.S., 1985, c.28 (1st Supp.), s.2

[259] *Supra* note 196, p.33

[260] Lorraine Eden, *Multinationals as Agents of Change: Setting a New Canadian Policy on Foreign Direct Investment*, Industry Canada, Nov. 1994, p.15

[261] *Supra* note 175, p.22

[262] *Supra* note 175, pp.16-17

[263] *Supra* note 175, p.18

[264] Investment Canada had been established to administer the ICA. The Canadian government placed it within the newly revitalized and enlarged Department of Industry (present Industry Canada).

[265] *Supra* note 220

[266] The CUFTA was signed on Jan. 2, 1988 and became effective on Jan. 1, 1989. It is an agreement of trade in goods in part and extends into investment, services, and temporary movement of businesspersons.

adjustment.[267] The treatment of U.S. direct investment to Canada was thus considerably relaxed. In 1992 the governments of Canada, the U.S. and Mexico successfully negotiated the NAFTA.[268] Although it is primarily concerned with the removal of specific barriers to trade in goods and services, the NAFTA reflects the recognition of the three party countries that liberalization of investment restrictions is equally important. Its effectiveness has resulted in an extension of the provision governing U.S. investment in Canada to Mexican investment[269] and further liberalized the Canadian environment for FDI.[270] In Feb. 1995, Canada took a further step towards multilaterizing its FDI policy by extending the NAFTA review thresholds to all investors who belong to a member country of the WTO.[271] Canada thus has an increasingly liberal FDI policy under the NAFTA.[272]

### *2.3 FDI Impact on Canada and Its Differences between Canada and China*

Canada, perhaps more than any other industrialized nation, has felt the impact of FDI throughout its history.[273] FDI has brought Canada with capital contribution,[274] higher labor productivity and economic efficiency,[275] technological transfers and product innovation, international management expertise,[276] export promotion, the creation and preservation of

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[267] *Supra* note 220

[268] On Dec. 17, 1992, the leaders of Mexico, Canada and the U.S. signed the NAFTA. Canada's House of Commons approved the *Agreement* in May 1993 and it became effective on Jan. 1, 1994. The NAFTA superseded but did not terminate the CUFTA pursuant to an *Exchange of Notes* between Canadian and the U.S. governments. The suspension of the CUFTA will remain in effect such time as the two countries remain Parties to the NAFTA. – See F. M. Abbott, *Law and Policy of Regional Integration: The NAFTA and Western Hemispheric Integration in the World Trade Organization System*, Kluwer Academic Publishers, 1995, pp.23-24

[269] *Supra* note 210, p.237

[270] *Supra* note 175, p.23

[271] Someshwar Rao and Ash Ahmad, "Formal and Informal Investment Barriers in the G-7 Countries" in Pierre Sauvé and Daniel Schwanen (eds.), *Investment Rules for the Global Economy: Enhancing Access to Markets*, C. D. Howe Institute, 1996

[272] Andrew Jackson, "The MAI. What Is It?" in Andrew Jackson and Matthew Sanger (eds.), *Dismantling Democracy – The Multilateral Agreement on Investment (MAI) and Its Impact*", Canadian Center for Policy Alternatives, 1998

[273] Allan R. Roth ect., *A Guide to Foreign Investment: Under United States Laws*, Law & Business, 1979, p.248

[274] *Supra* note 213

[275] *Supra* note 175, p.5

[276] Investment Canada, *International Investment and Competitiveness*, Working Paper No. 9, Oct. 1991, p.27

jobs,[277] and tax revenue and retained earnings.[278] It has greatly contributed to Canadian growth in the past and has benefited Canada just like what it has done in many other countries including China. However, FDI has also caused problems to Canada besides those mentioned above.

In Canada like China, there are large disparities between the different regions. The persistence of uneven regional economic development creates problems to the country.[279] FDI transactions to Canada are all assigned a principal province of destination but their distribution is highly uneven. As **Table 15** shows, Ontario has received a large portion of

**Table 15: Provincial Distribution of FDI in Canada (Jun. 30, 1985 - Mar. 31, 1991)**

| | Ontario | Quebec | Alberta | British Columbia | Other * |
|---|---|---|---|---|---|
| Value (C$ bil.) | 54 | 16.8 | 15.2 | 10.5 | 4.0 |
| Percentage of National FDI | 54% | 17% | 15% | 10% | 4% |

* Canada has 10 provinces and 2 territories. Besides Ontario, Quebec, Alberta and British Columbia, the other provinces are Manitoba, New Brunswick, Newfoundland, Nova Scotia, Prince Edward Island, and Saskatchewan. The two territories include Northwest Territories and the Yukon.

Source: D. Swimmer and W. E. Krause, *Foreign Investment in Canada: Measurement and Definitions*, Investment Canada, Working Paper 12, Aug. 1992, pp.18-19

FDI in relation to the size of its economy than have other parts of the country. In addition, per capita income levels and unemployment rates differ dramatically from province to province with the Atlantic region in much worse shape than Ontario and the western provinces.[280] The uneven distribution of FDI has helped to sustain and accentuate the existing regional disparities,[281] attributed to occasional breakdowns in relations between the federal and provincial governments,[282] and even to some extent irritated problems of

[277] FDI accounts for more than one out of every ten jobs today. It is estimated that 1.3 million jobs and over half of all exports (3/4 of manufacturing exports) derive from FDI. – See *supra* note 214

[278] *Supra* note 4, p.57

[279] Serge Coulombe, *Regional Disparities in Canada: Characterization, Trends and Lessons for Economic Policy*, Industry Canada, Working Paper No. 18, Nov. 1997, p.3

[280] *Supra* note 13, p.97

[281] Alan D. MacPherson, "Shifts in Canadian Direct Investment Abroad and Foreign Direct Investment in Canada" in John N. H. Britton (ed.), *Canada and the Global Economy*, McGill-Queen's University Press, 1996

[282] *Supra* note 13, p.97

Canadian national unity.[283]

Due to the unique economic, geographic and historical relationship, no two sovereign nations in the world are so closely intertwined as Canada and the U.S. in terms of trade, investment, resource and tourist linkages.[284] Over 1991 to 1996, almost 3/4 of the cumulative net FDI inflows to Canada originated from the U.S.[285] The presence of volumes of foreign investment concentrated in U.S. hands has increased the difficulty of developing a distinctive Canadian culture.[286] At one time, foreign films accounted for more than 90% of all box-office receipts, foreign magazines 85% of the entire magazine circulation and foreign books over 80% of the total domestic book sales.[287] Canadian firms produced about 20% of textbooks and only 1% of paperback books.[288] Over 2/3 of all Canadians live within 100 miles of the American border and they are inundated with U.S. television programs.[289] With the significant U.S. cultural impact, Canadians have actually invited in the American value system, American institutions and American touchstones[290] while having enriched their life by introducing greater cultural variety.[291] It has more serious implications when the culture does not simply mean arts, architecture, films, books, sculpture and paintings of a nation but implies a historically developed value and pattern of behavior covering the whole range of human activity, that is, an entire way of a nation's life.[292] The situation possibly leads to the loss of Canadian political sovereignty[293] as well as its national identity.[294] This might be the most serious problem in Canada's long-term FDI practice and also the most notable difference of FDI

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[283] *Supra* note 205

[284] *Supra* note 13, p.78

This comment was made nearly twenty years ago. It still might be true although the situation in the EU today must more or less affect its accuracy.

[285] *Supra* note 212

[286] *Supra* note 198, p.291

[287] *Supra* note 13, p.80

[288] *Supra* note 273, p.251, note 21

[289] *Supra* note 13, p.80

[290] *Id.*

[291] *Supra* note 198, p.298

[292] *Supra* note 198, p.291

[293] *Supra* note 205, p77

[294] *Supra* note 198, p.298

practice between Canada and China.

Owing to different development levels and natural endowments, Canada is different from China. With reference to FDI, their differences can also be observed as follows:

(A) Estimates for 1983 to 1991 showed that 57% of all U.S. investment in Canada came from the reinvestment of profits earned by U.S. branch plants. In recent time, it is still true that the source of Canada's FDI is mainly made up of its retained earnings within the country rather than of newly flow-in FDI from outside sources.[295]

(B) Over the period 1983 to 1990, the share of acquisitions in the foreign investment in Canada increased from 8% (C$ 0.3 billion) to 36% (C$ 3.2 billion). FDI in Canada has recently been characterized by M&A rather than by greenfield plant construction.[296]

(C) As we mentioned before, FDI in Canada is highly concentrated in manufacturing and such capital-intensive resource industries as petroleum, natural gas, mining and smelting.

(D) Because of the capital accumulation over a long period of time, Canada's outward FDI started to grow faster than its inward FDI in the early 1970s[297] and the trend is continuing as never before. Canadian FDI abroad averaged C$ 9 billion per year from 1990 to 1996 with a 50% increase from 1983 to 1989 and Canadians invested C$ 4.1 billion to acquire foreign companies in 1997.[298] As a consequence of this development, the gap between Canada's inward and outward investment stocks has largely disappeared.[299] Canada has become a relatively minor capital exporter in the global economy.[300]

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[295] *Supra* note 281

[296] European and U.S. corporations are more prone to invest by M&A, whereas investors from Japan and other parts of the Pacific Rim appear to prefer the greenfield route. – See *id.*

[297] *Supra* note 281

[298] *Supra* note 213

[299] *Supra* note 212

[300] Andrew Jackson, "The MAI and Foreign Direct Investment" in Andrew Jackson and Matthew Sanger (eds.), *Dismantling Democracy: The Multilateral Agreement on Investment (MAI) and Its Impact*, Canadian Center for Policy Alternatives, 1998

## IV. LEGAL FRAMEWORK FOR FDI IN CHINA AND CANADA

### 1. China's Legislative Structure

China's legislation can be described as a unitary structure of two types, three levels and multi-layers.[301]

(1) *The Constitution*

*The Constitution of China*[302] is the paramount law of China and it carries the highest authority. Unlike other laws that stipulate specific matters, the *Constitution* stipulates the most fundamental issues including basic principles of China's social and state systems. Its adoption and amendment require a special procedure that is stricter than those of the other laws, in which the agreement of over 2/3 of all the deputies to the NPC is a must.[303]

(2) The NPC, its Standing Committee and the law

China is a unitary country, under the structure of which the state power is an indivisible whole. *The Constitution* stipulates that "the National People's Congress and its Standing Committee exercise the legislative power of the State".[304] As the highest organ of state power, the NPC has the unitary legislative power over the entire nation and its legislation is superior to that adopted by all other legislative bodies in the country. The NPC has a wide range of powers and responsibilities.[305] Stipulated under the *Constitution*, the NPC can enact basic laws such as criminal law, civil law and organic laws of state institutions.[306]

The NPC meets once a year. When it is not in session, its permanent organ, the Standing Committee, exercises many of its powers including legislation. Normally convening every two months,[307] the Standing Committee can pass laws "outside the scope of laws that only the NPC has the competence to enact"[308] provided that the enactment

[301] Perry Keller, "Source of Order in Chinese Law", *Am. J. Comp. L*, Vol. 42, NO. 2, Spring 1994, p.732

[302] The subsisting *Constitution of China* was adopted by the NPC at the 5th Session of its 5th Congress on Dec. 4, 1982 and amended in 1988, 1993 and 1999.

[303] The other laws can be adopted with the agreement of only more than 1/2 of all the deputies to the NPC. – *The Constitution of China*, art. 64, para. 2

[304] *The Constitution of China*, art. 58

[305] *Id.*, art. 62

[306] *Id.*

[307] *Supra* note 77, p.1-4

[308] *The Constitution of China*, art. 67, para. 2

does not contravene the principles of the basic laws.[309]

All normative documents promulgated by the NPC and its Standing Committee are laws.[310] But the laws enacted by the NPC are basic laws that have a general impact throughout the nation whereas the laws made by the Standing Committee are non-basic laws with a wide impact in the country yet in certain areas only.[311]

(3) The State Council and the administrative regulations

There are two types of organs in China that are empowered to make enactments.[312] The first are power organs, which indicate people's congresses at various levels including the NPC and the local people's congresses of provinces (autonomous regions and municipalities directly under the Central Government[313]) and "quite big" cities.[314] The second are administrative organs, containing the State Council, its ministries and various local governments.

The State Council is the Central Government of China. As the highest organ of state administration, it is the next tier in China's legislative hierarchy and empowered to enact administrative regulations (*xingzheng fagui*)[315] in accordance with the *Constitution* and the law.[316] Due to the administrative mission of the State Council, the administrative

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[309] *Id.*, art. 67

[310] *Supra* note 77, p.1-5

[311] Wang Chenguang, "Introduction: An Emerging Legal System" in Wang Chenguang and Zhang Xianchu (eds.), *Introduction to Chinese Law*, Sweet & Maxwell Asia, 1997, p.18

[312] Peter Howard Corne, *Foreign Investment in China: The Administrative Legal System*, Hong Kong University Press, 1997, p.55

[313] Presently there are four such municipalities, that is, Beijing, Tianjin, Shanghai and Chongqing, the last of which attained the status on Sept. 1, 1996.

[314] They refer to cities in which the governments of provinces and autonomous regions are situated, cities where the SEZ is located, and cities designated by the State Council as such. – See the *Legislation Law*, art. 63. This Law was adopted at the 3rd Session of the 9th NPC on Mar. 15, 2000.

[315] The nomenclature in administrative legislation causes confusion among Chinese, needless to say to foreigners out of a lack of English equivalence. On Apr. 21, 1987, the General Office of the State Council issued the *Provisional Regulations on the Formulation of Administrative Regulations*, in which three terms were provided to identify the administrative regulations (*xingzheng fagui*). They are *tiaoli* (regulation), *guiding* (provision) and *banfa* (measure). The term *tiaoli* is used to mean the regulation that is relatively comprehensive in relation to an area of administrative work. The term *guiding* is used to name the regulation that is not as comprehensive or deal partially with the area to be regulated. The term *banfa* focuses on one particular aspect of an area and its content is rather specific. – See *supra* note 312, pp.64-65

[316] *The Legislation Law*, art. 56

regulations are emphatically devoted to the regulation of economic promotion of the country with an eye on the actual situations and problems of economic matters.[317]

Two forms of legislative power are exercisable by the State Council.[318] One is inherent administrative lawmaking (*zhiquan xingzhen lifa*). It is vested in the State Council by virtue of the *Constitution*,[319] the rationale of which arises from the natural and intrinsic administrative function of the State Council. The other is authorized administrative lawmaking (*shouquan xingzheng lifa*), the power of which is entrusted by specific authorization from the NPC or its Standing Committee.[320] The authorization is vested in one of the two ways. The laws enacted by the NPC are mostly general in nature and more detailed regulations are required for their practical implementation. The NPC or its Standing Committee provides the State Council with a specific article in the body of a law authorizing the latter to formulate implementing regulations for this purpose. *The Law of Wholly Foreign-Owned Enterprises* (WFOEL) is such an example. Art. 23 of the WFOEL provides that "the department responsible for the foreign economic and trade under the State Council formulates implementing regulations in accordance with this *Law*, which shall go into effect after being submitted and approved by the State Council".[321] The second is for the NPC or its Standing Committee to pass a resolution authorizing the State Council to enact administrative regulations in a certain area. One of the examples is the *Resolution Authorizing the State Council to Enact Provisional Regulations Concerning the Reform of the Economic System and the Implementation of the Open Policy* that was adopted by the NPC at the 3rd Session of its 6th Congress in 1985.[322] This

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[317] *Supra* note 77, p.1-7

[318] *Supra* note 312, pp.57-58

[319] *The Constitution of China*, art. 89

[320] *Id.*

[321] Another example could be observed in the practice of the enactment of the EJVL and its implementing regulations. The NPC adopted the EJVL on Jul. 1, 1979. The State Council promulgated the *Provisions on Labor Administration in Chinese-Foreign Equity Joint Ventures* on Jul. 26, 1980 and the *Implementing Regulations on the EJVL* on Sept. 20, 1983. Both the regulations provide more detailed provisions for the establishment and administration of the EJV. However, we can not find the specific article in the EJVL authorizing the State Council to formulate the two implementing regulations. The omission might be imputed to China's legislative imperfection at the beginning of its legal reconstruction and reform.

[322] Xianchu Zhang etc., "China Law", *The Int'l Lawyer*, Summer 1998, Vol. 32, No. 2

type of authorization is intended to provide a kind of legal measure for the administration of society in the absence of the law while accumulating experience so that the NPC will able to enact the proper law when the situation is considered mature.[323]

(4) Local people's congresses as well as local regulations, autonomous and special regulations

China is a vast country with diverse regional conditions. Local legislation is needed to adapt various circumstances and necessities although in limited scope. Local people's congresses at different levels are local organs of state power. The people's congresses of provinces (autonomous regions and municipalities directly under the Central Government) as well as their standing committees possess legislative power. *The Constitution* provides that "[t]he people's congresses of provinces and municipalities directly under the Central Government and their standing committees may adopt local regulations, which must not contravene the *Constitution*, the law and the administrative regulations"[324] and autonomous regions exercise the same power.[325] The local regulations (*difangxing fagui*) belong to the third legislative level of China. According to the *Organic Law of Local People's Congresses and Local People's Governments* (the *Local Organic Law*) and the *Legislation Law*, the people's congresses of the "quite big" cities and their standing committees may also enact local regulations suitable for their specific conditions and practical necessities. But these local regulations should be in conformity with the laws and the regulations of higher levels and must be reported to the standing committees of their jurisdictional provinces (autonomous regions) for approval before becoming effective.[326] The local regulations fall into three categories: regulations made according to local conditions to implement the laws of the Central Government, regulations to supplement broad national laws that lack details, and regulations that deal with strictly local issues not covered by national legislation.[327]

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[323] *The Legislation Law*, articles 9 and 11

[324] *The Constitution of China*, art. 100

[325] *Id.*, art. 115

[326] *The Local Organic Law*, art. 27 and the *Legislation Law*, art. 63

[327] Hsia, T. and C. A. Johnson, "Lawmaking in China, Part 4", *East Asian Executive Reports*, Aug. 1987, p11

China is multi-national. For minority nationalities, the *Constitution* stipulates that the people's congresses of autonomous minority areas have the power to enact autonomous regulations (*zizhi tiaoli*) and special regulations (*danxing tiaoli*) in accordance with the political, economic and cultural characteristics of local nationalities.[328] The autonomous regulations and special regulations can be regarded as a special legislative category.[329] Without contravening principles of the law or the administrative regulations,[330] they can be flexible to the stipulation of the law and the administrative regulations according to the special local conditions. Unlike the local regulations (*difangxing fagui*), the effectiveness of which do not take the approval of the Standing Committee of the NPC as a condition, however, the autonomous regulations and special regulations enacted by autonomous regions must be approved by the Standing Committee of the NPC before coming into force.[331]

China's administration is currently of three-levels, the system of which divides the country into three different administrative units, i.e., provinces (autonomous regions and municipalities directly under the Central Government), counties or cities (autonomous prefectures and counties) and towns. In non-autonomous areas, most of the counties and cities[332] as well as all the towns do not have lawmaking power even though local people's congresses exist in these areas and the standing committees of the local people's congresses are established at the county's or city's level.[333] As a special policy of regional autonomy of minority nationalities, the people's congresses at the level of autonomous prefectures and counties are yet allowed to make autonomous regulations and special regulations although these regulations must be reported to the standing committees of the people's congresses of their administrative autonomous regions (or provinces) for approval before going into effect.[334]

(5) Ministerial regulations and local government regulations

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[328] *The Constitution of China*, art. 116

[329] *Supra* note 301, pp.726-727

[330] *The Legislation Law*, art. 66

[331] *The Constitution of China*, art. 116

[332] Except those "quite big" cities.

[333] *The Constitution of China*, art. 95

[334] *Id.*, art. 116

Art. 90 of the *Constitution* confers ministries under the State Council with inherent power to formulate ministerial regulations (*bumen guizhang*)[335] within the jurisdiction of their respective departments in accordance with the law and the administrative regulations, decisions and orders issued by the State Council. China's central power and administrative authorities only legislate to deal with national concerns, the contents of which are expressed in the form of broad principles. The onus is intentionally put on central government ministries to make detailed provisions with regard to every aspect of social and economic life.[336] Many ministerial regulations are actually detailed implementing regulations for the administrative regulations. Immediately after the State Council promulgated the *Regulations on Encouraging Foreign Investment* in Oct. 1986, for instance, the then Ministry of Foreign Economic Relations and Trade, the People's Bank of China and the Ministry of Finance subsequently issued a series of implementing regulations concerning the examination and confirmation of export-oriented enterprises and technology-advanced enterprises with foreign investment, import and export licenses, loans in Chinese currency and taxation and so on.[337] The ministerial regulations are the most numerous of any of the enactments made by national legislative and administrative bodies[338] and they are said to be the most important source of administrative law in China.[339] A ministerial regulation is usually signed for promulgation by the responsible minister.[340] But when it involves subject matter relating to an administrative area that is the responsibility of another ministry, the ministerial regulation must be either jointly issued by the two ministries concerned or submitted to the State Council for enacting.[341]

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[335] Art. 2 of the *Provisions on the Recording of Rules and Regulations* issued by the State Council embraces in ministerial regulations the normative documents like provisions (*guiding*), measures (*banfa*), implementing rules (*shishi xize*) and rules (*guize*). – See *supra* note 312, p.69

[336] *Supra* note 312, p. 125

[337] *Supra* note 74, p.15

[338] *Supra* note 312, p.68

[339] Luo Yuzhen, *Encyclopaedia of Administrative Implementation and Lawsuits Concerning Administrative Authorities*, Press of the University of Political Science and Law of China, 1990, cit. 10

An illustrative example is ministerial regulations issued by the MOFTEC. They are most useful for practical issues regarding FDI.

[340] *The Legislation Law*, art. 76

[341] *Id.*, art. 72

China's state structure at local levels is a symmetrical replication of that of the Central Government. The division of legislative authority between the NPC and the State Council is mirrored in a similar division between lower level people's congresses and governments. Accordingly, the governments of provinces, autonomous regions, municipalities directly under the Central Government as well as "quite big" cities may enact local government regulations (*difang zhengfu guizhang*) according to the law, administrative regulations and local regulations.[342]

In China, there has been a problem of so-called partition of *tiao* and *kuai*. *Tiao* indicates the vertical system stretching from central state organs to local units and *kuai* refers to the system of horizontal territorial governing bodies at local levels.[343] This partition does not bring about conflicts between *tiao* and *kuai* infrequently. The conflicts could be worse especially when two involved parties in *tiao* and *kuai* are at the same level. Central government ministries and governments of provinces (autonomous regions and municipalities directly under the Central Government) are at the same level in Chinese administrative hierarchy. Both ministerial regulations and local government regulations (*difang zhengfu guizhang*), therefore, are equally authoritative within their respective jurisdiction.[344] Since neither has the authority to impose its will on the other, any clash between the two is required to be ruled by the State Council.[345]

The problem of *tiao* and *kuai* is more complicated between ministerial regulations and local regulations (*difangxing fagui*) because the former are enacted by central government ministries and the latter by state power organs even locally. Although ministries and provincial people's congresses are still at the same level, their different power source make it more difficult to decide whose enactments should prevail. According to the *Legislation Law*, it is up to the State Council to put forward proposals for any clash between these two types of regulations. The local regulations surpass the ministerial regulations if the State Council considers that the former should be applies. Otherwise,

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[342] *Id.*, art. 73

[343] *Supra* note 312, p.87

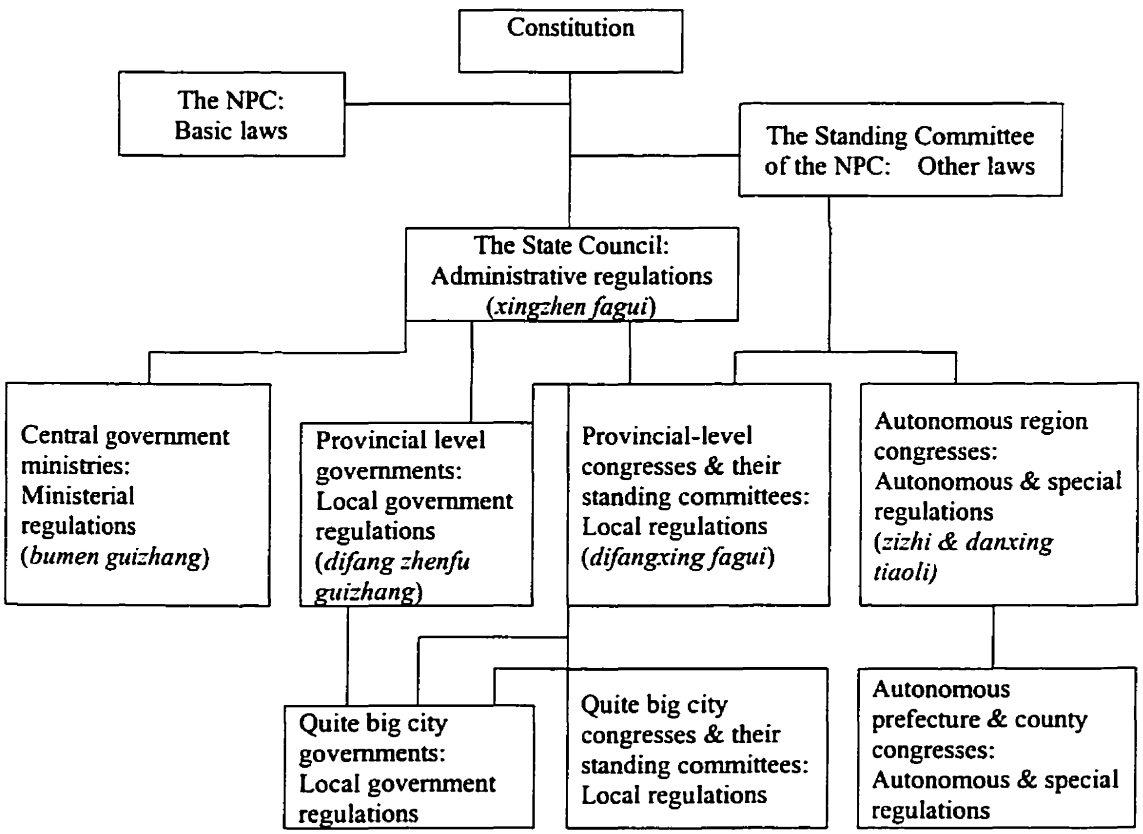
[344] *The Legislation Law*, art. 82

[345] *Id.*, art. 86(3)

the proposals must be submitted to the Standing Committee of the NPC for ruling.[346]

In general, under the supreme *Constitution* the legislation in China can be divided into three levels: laws adopted by the NPC and its Standing Committee, administrative regulations enacted by the State Council, as well as ministerial regulations and local regulations made by provincial-level people's congresses, their standing committees and governments.[347] [ALSO SEE CHART] All of these laws are laws in the fullest Chinese sense of the word. They are accorded full and equal legal effect and are to be strictly observed by all citizens, equitably applied at court and other legal instrumentality and carried into effect with appropriate sanctions.[348]

**CHART: THE LEGISLATIVE STRUCTURE OF CHINA**

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[346] *Id.*, art. 86(2)

[347] *Id.*, articles 78, 79 and 80

[348] *Supra* note 77, p.1-6

## 2. FDI Law System in China

Countries differ in social and political conditions, economic bases and structures, and legal systems and traditions. All these factors give rise to various forms of their FDI law systems. Basically there are three types of FDI law systems in the world nowadays.[349]

The first takes the form of a code or a single piece of legislation that states all the pertinent rules relating to the making of FDI in a country.[350] The unified FDI law systematically stipulates common legal issues such as the concept of FDI, the jurisdiction of FDI law, investment terms, prohibited and restricted industries, capital profit repatriation, reinvestment, FDI protection and expropriation. The existence of a single code enables the FDI law of a country to be acquainted with more easily.[351] Different countries name the unified laws variously like foreign investment law, investment code and investment incentive etc.

The second type regulates FDI with general domestic laws. Foreign investors mostly receive the same treatment as local nationals and FDI is neither specially protected nor specially restricted in these countries. A survey made by the UNCTC showed that most of the developed countries regulate FDI in this way.[352]

The third system regulates FDI primarily with special laws that function as basic FDI law other than general domestic laws. Many developing countries have set forth the rules governing FDI in their territories through elaborating the special laws.[353]

As a developing country, China also adopts the third system in regulating its FDI. It has neither made a unified FDI law by virtue of the lack of experience since the FDI inflow into the country commenced only twenty years ago, nor administered FDI with its general domestic laws because there were actually no such laws two decades ago due to the destructive lawlessness in its history[354] and such laws are still in the progress of fast development today. China's FDI law system, therefore, is a comprehensive one consisting

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[349] *Supra* note 29, pp.241-244

[350] M. Sornarajah, *The International Law on Foreign Investment*, Cambridge University Press, 1994, p.86

[351] *Id.*

[352] *Supra* note 29, pp.243-244

[353] *Supra* note 66

[354] Wang Chenguang and Zhang Xianchu, *Introduction to Chinese Law*, Sweet & Maxwell Asia, 1997, pp.9-13

of various special and relevant laws and regulations. In view of China's legislative structure, its FDI law system can also be divided into three levels, i.e., the supreme *Constitution*, special laws and regulations at state level, and local laws and regulations.

(1) *The Constitution* and its stipulation on FDI

*The Constitution of China* is the foundation of various laws including FDI law in China. Art. 18 of the *Constitution* stipulates: "[t]he People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic cooperation with Chinese enterprises and other economic organizations in accordance with the laws of the People's Republic of China. All foreign enterprises and other foreign economic organizations in China as well as joint ventures with Chinese and foreign investment located in China shall abide by the laws of the People's Republic of China. Their lawful rights and interests are protected by the laws of the People's Republic of China". This provision is the theoretical basis of China's FDI law system and it has provided explicit constitutional protection for FDI in China.

(2) Special national laws and regulations on FDI

Special laws and regulations on FDI at national level can be grouped roughly into the second level of China's FDI law system. The group includes laws adopted by the NPC and its Standing Committee, administrative regulations enacted by the State Council and ministerial regulations made by central government departments. These laws touch upon a wide range of FDI issues, including entering forms, approval procedure, business registration, land use, exchange control, financial issues, labor, management and tariffs and so on. They are numerous and constitute the basic level of China's FDI law system, in which the principal legislation affecting FDI is founded. There are three basic FDI laws passed by the NPC, which are the *Law of Chinese-Foreign Equity Joint Ventures* (EJVL), the *Law of Chinese-Foreign Cooperative Joint Ventures* (CJVL) and the *Law of Wholly Foreign-Owned Enterprises* (WFOEL). The three laws are so influential that they are frequently regarded as a synonym of China's FDI law. Besides the laws especially dealing with FDI, many national laws enacted for other purposes sometimes relate to FDI and their relevant provisions are also a component part of China's FDI law. These general laws include such legislation as the *General Principles of the Civil Law*, the *Company Law*, the *Contract Law*, the *Securities Law*, the *Labor Law*, the *Environmental Protection Law*, the *Civil Procedure Law* and the *Arbitration Law* etc. In order to understand the general situation of this category of laws, some of the most important national FDI laws and regulations as well as major general laws relevant to FDI are listed in Appendix 1.

(3) Local regulations on FDI

Local regulations on FDI belong to the third level in China's FDI law system. Although they are attached to national laws and regulations, the local FDI regulations co-exist with the national law. The local FDI regulations are localized FDI law and applied within specific districts only.[355] However, they constitute a significant part of the legal framework for FDI in China. It is particularly true in view of the fact that local governments have considerable authority in approving FDI projects in their own jurisdiction. The local governments have made various regulations that fill the vacuum left temporarily by the national law and supplement the national laws and regulations in areas where they are silent.[356]

To sum up, China's legal framework for FDI is composed of the *Constitution* as its cardinal principle, the basic laws of the EJV, the CJV and the WFOE as its mainstay, their implementing laws and regulations as its major contents, and the relevant local laws and regulations as its supplements. The FDI laws and regulations of the three levels combine to have formed China's FDI law system.[357]

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[355] Cao Jianming and Chen Zhidong, *An Introduction to International Economic Law*, Law Publishers, Dec. 1994, p.255

[356] John S. Mo, "Foreign Investment Law" in Wang Chenguang and Zhang Xianchu, *Introduction to Chinese Law*, Sweet & Maxwell Asia, 1997, p.277

[357] Liu Chu classified China's FDI laws into five categories:

(1) those dealing generally with the formation of a particular kind of the FIE, namely, the EJV, the CJV and the WFOE;

(2) those dealing with a specific aspect of each kind of the FIE, such as registration, labor management, taxation, exchange control, customs duties and provision of loans;

(3) those dealing with specific regions or industries, such as the SEZ or port projects undertaken by joint ventures;

(4) those not specifically directed at the FIE but affecting the FIE because of their fundamental functions to the Chinese legal system, such as the *Contract Law*, the *Civil Procedure Law*, and the *General Principles of Civil Law*; and

In addition to the domestic law, China has entered into a number of international and bilateral agreements that affect the rights of foreign investors. The most significant of them are investment protection agreements[358] and agreements on the avoidance of dual taxation and the prevention of tax evasion.[359] The international and bilateral agreements belong to the international law. Although they are different from the domestic law, they are the reflection of the latter. The provisions relating to FDI in these agreements therefore play a role further guaranteeing China's FDI law.[360]

### 3. Canada's Legal System

(1) Federal state and distribution of legislative power

The constitution of Canada is the supreme law of the country[361] and establishes the framework for Canada's legal system. Canada's constitution does not comprise a single document but several constitutional enactments, the major portions of which are the *Constitution Act, 1867* and the *Constitution Act, 1982*.[362] *The Constitution Act, 1867* was initially a British statute and passed by the British parliament in 1867 as the *British North*

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(5) those promulgated by local authorities.

He reckoned that these are composed of the legal framework of FDI in China. – See *supra* note 10, p.5

[358] China entered into bilateral investment treaties with twenty-nine countries: the U.S., Romania, Sweden, Germany, Canada, France, Belgium, Luxemburg, The Netherlands, Finland, Norway, Italy, Thailand, Denmark, Austria, Kuwait, Singapore, Sri-Lanka, Great Britain and Northern Ireland, Switzerland, Poland, Australia, Japan, Malaysia, New Zealand, Pakistan, Bulgaria, and Ghana. – See *supra* note 77

[359] Zhang Lixing, "The Statutory Framework for Direct Foreign Investment in China", *Florida Int. L. J.*, Vol. 4, No. 2, Spring 1989, p.297

To solve taxation problems between countries, since Sept. 1983 China has signed agreements on comprehensively avoiding dual taxation and preventing tax evasion with some fifty countries including Japan, France, Britain, Belgium, Germany, Malaysia, Norway, Denmark, Singapore, Finland, Canada, Sweden, New Zealand, Thailand, Italy, the Netherlands, Czech, Slovakia, Poland, Australia, Yugoslavia, Bulgaria, Pakistan, Kuwait, Switzerland, Cypress, Spain, Romania, Austria, Brazil, Mongolia, Hungary, Malta, the United Arab Emirates, Luxembourg, the Republic of Korea, Russia, Papua New Guinea, India and Mauritius and so on.

[360] *Supra* note 29, p.249

[361] *The Constitution Act, 1982*, s.52(1)

[362] Gerald L. Gall, *The Canadian Legal System*, 3rd ed., Carswell, 1990, p.55

Besides the two major constitutional enactments, Canada's constitution comprises the *Canada Act, 1982* and eleven other statutes and orders listed in Schedule I of the 1982 *Act*. In addition, several matters of constitutional importance, e.g., human rights and parliamentary procedures, are governed by ordinary legislation or unwritten custom and convention. – See Patrick Fitzgerald and King McShane, *Looking at Law: Canada's Legal System*, 2nd ed., Bybooks, 1982, p.24

*America Act* (the *B.N.A. Act*),[363] by which the four original provinces of Ontario, Quebec,[364] Nova Scotia and New Brunswick created the Dominion of Canada.[365] *The Constitution Act, 1982* has seven parts, including (a) *Canadian Charter of Rights and Freedom*; (b) *Rights of the Aboriginal Peoples of Canada*; (c) *Equalization Regional Disparities*; (d) *Constitutional Conference*; (e) *Procedure for Amending the Constitution of Canada*; (f) *Amendment to the Constitution Act, 1867*; and (g) *General Provisions*.[366]

In a unitary state like China, state power is vested in one national authority and the power of the local governments that are subordinate to the national government is granted, controlled, altered or taken away by the national authority at any time.[367] The essence of a federation or the principle of the federalism is yet the distribution of legislative power between a general government and each of the regional governments. Under this system of shared sovereignty, each government acts directly on its electorate within its own sphere of jurisdiction.[368] The constitution of Canada sets out the basic principles of government in Canada, through which its legislative power is divided between the federal Parliament[369] and the legislatures[370] of the ten provinces.[371]

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[363] Frederick B. Sussmann, *The Law in Canada: A Citizen's Introduction to the Canadian Legal System*", Kenlaw Communications, 1976, p.15

[364] Under the *Constitutional Act*, S.C. 1791, c.31, from Aug. 24, 1791 Quebec was divided into two provinces of Upper and Lower Canada, which eventually became the modern Ontario and Quebec. – See H. Heward Stikeman and R. Fraser Elliott etc., *Doing Business in Canada*, Vol. 1, Matthew Bender, Oct. 1998, p.1-24 and *supra* note 362, p.53

In addition, *the B.N.A. Act* provided for the possibility of future admission of the provinces and territories of the North-Western Territory (1870), Manitoba (1870), British Columbia (1871), Prince Edward Island (1873), the Yukon Territory (1898), Alberta (1905), Saskatchewan (1905) and Newfoundland (1949). – See *supra* note 362, pp.51-52 and Gregory Tardi, *The Legal Framework of Government: A Canadian Guide*, Canada Law Book, 1992, pp.51-52

[365] *The Constitution Act, 1867*, II.5

[366] Patrick Fitzgerald and King McShane, *Looking at Law: Canada's Legal System*, 2nd ed., Bybooks, 1982, p.27

[367] Peter W. Hogg, *Constitutional Law of Canada*, 4th ed., Carswell, 1996, p.98

[368] Dwight Herperger, *Distribution of Powers and Functions in Federal Systems*, Institute of Intergovernmental Relations, 1992, pp.1-2

[369] The Canadian Parliament is composed of three institutions: the Queen (represented by the Governor General), the appointed Senate (or the Upper House) and the elected House of Commons.

[370] Unlike its counterpart of the federal Parliament, a provincial legislature is formed unicameral. It consists of the Lieutenant-Governor as representative of the Sovereign and a single elected representative legislative body generally known as a legislative assembly yet with two different titles in three of the provinces: the

The Parliament of Canada is responsible for enacting laws for the country as a whole with respect to matters assigned to it by the constitution. S. 91 of the *Constitution Act, 1867*[372] outlines twenty-nine areas over which the Parliament has exclusive legislative power:

1A) The Public Debt and Property.

2) The Regulation of Trade and Commerce.

2A) Unemployment Insurance.

3) The raising of money by any Mode or System of Taxation.

4) The borrowing of Money on the Public Credit.

5) Postal Service.

6) The Census and Statistics.

7) Militia, Military and Naval Service, and Defense.

8) The fixing of and providing for the Salaries and Allowances of Civil and other Officers of the Government of Canada.

9) Beacons, Buoys, Lighthouses, and Sable Island.

10) Navigation and Shipping.

11) Quarantine and the Establishment and Maintenance of Marine Hospitals.

12) Sea Coast and Inland Fisheries.

13) Ferries between a Province and any British or Foreign Country, or between Two Provinces.

14) Currency and Coinage.

15) Banking, incorporation of banks, and the Issue of Paper Money.

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"House of Assembly" in Nova Scotia and Newfoundland and the "National Assembly" in Quebec. – See H. Heward Stikeman and R. Fraser Elliott etc., *Doing Business in Canada*, Vol. 1, Matthew Bender, Oct. 1998, p.2-15

[371] There are ten different sets of provincial laws in Canada since it has ten different provinces. – See *supra* note 366, p.25

The power of the two territories is set out in ordinary federal legislation rather than in the *Constitution Act, 1867*. – See Burnard W. Funston and Eugene Meehan, *Canada' Constitutional Law in a Nutshell*, Carswell, 1994, p.59

[372] The original division of federal and provincial powers first set out in the *B.N.A. Act, 1867* remains intact. The *Constitution Act, 1982* is a lesser source of jurisdictional distribution. – See Neil Boyd, *Canadian Law: An Introduction*, Harcourt Brace Canada, 1995, p.118

16) Saving Banks.

17) Weights and Measures.

18) Bills of Exchange and Promissory Notes.

19) Interest.

20) Legal Tender.

21) Bankruptcy and Insolvency.

22) Patents of Invention and Discovery.

23) Copyrights.

24) Indians, and Lands reserved for the Indians.

25) Naturalization and Aliens.

26) Marriage and Divorce.

27) The Criminal Law, except the Constitution of courts of Criminal Jurisdiction, but including the Procedure in Criminal Matters.

28) The Establishment, Maintenance, and Management of Penitentiaries.

A provincial legislature can make laws that come within the subject matter over which it has been assigned jurisdiction. Under s. 92 of the *Constitution Act, 1867*, sixteen specific heads of power are exclusively assigned to the provinces:

1) The Amendment from Time to Time, notwithstanding anything in this Act, of the Constitution of the Province, except as regards the Office of the Lieutenant Governor.

2) Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes.

3) The borrowing of money on the sole Credit of the Province.

4) The Establishment and Tenure of Provincial Offices and the Appointment and Payment of Provincial Officers.

5) The Management and Sale of the Public Lands belonging to the Province and of the Timber and Wood thereon.

6) The Establishment, Maintenance, and Management of Public and Reformatory Prisons in and for the Province.

7) The Establishment, Maintenance, and Management of Hospitals, Asylums, Charities,

and Eleemosynary Institutions in and for the Province, other than Marine Hospitals.

8) Municipal Institutions in the Province.

9) Shop, Saloon, Tavern, Auctioneer, and other Licenses in order to the raising of a Revenue for Provincial, Local, or Municipal Purposes.

10) Local Works and Undertakings other than such as are of the following classes:

(a) Lines of Steam or other Ships, Railways, Canals, Telegraphs, and other Works and Undertakings connecting the Province with any other or others of the provinces, or extending beyond the Limits of the Province;

(b) Lines of Steam ships between the Province and any British or Foreign Country;

(c) Such Works as, although wholly6 situate within the Province, are before or after their Execution declared by the Parliament of Canada to be for the general Advantage of Canada or for the Advantage of Two or more of the Provinces.

11) The Incorporation of companies with Provincial Objects.

12) The Solemnization of Marriage in the Province.

13) Property and Civil Tights in the Province.

14) The Administration of Justice in the Province, including the Constitution, Maintenance, and Organization of Provincial Courts, both of Civil and of Criminal Jurisdiction, and including Procedure in Civil Matters in those Courts.

15) The Imposition of Punishment by Fine, Penalty, or Imprisonment for enforcing any Law of the Province made in relation to any Matter coming within any of the Classes of Subjects enumerated in this Section.

16) Generally all Matters of a merely local or private Nature in the Province.

Sections 91 and 92 of the *Constitution Act, 1867* have listed in detail the respective matters on which the federal Parliament and the provincial legislatures have exclusive lawmaking power. But times are changing and the stipulated matters can not cover all new social issues. When an unpredicted situation happens, it must be determined which party has the legislative power on the matter that is not clearly listed in the constitution, that is, where the residuary power rests. Two methods are applied. One is that the legislative power exercised by the general government is specified and the residue is left to the regional governments. The U.S. is typical of this kind of federation. Its constitution names certain subjects over which the general legislature has control and legislative power not so delegated to the general government remains with the states.[373] The other is that the legislative power of the regional governments is specified and the residuary power is assigned to the general government. S. 91 of the *Constitution Act, 1867* provides a general phrase of "peace, order and good government". This provision gives the Parliament of Canada residuary power over areas of jurisdiction not expressly noted in either s. 91 or s. 92. This means that if any matter does not fall within the province's list or if any power is left over, the legislative power falls within the sphere of the federal Parliament. Canadian courts have upheld this standpoint[374] and identified three areas where the power of "peace, order and good government" is available: new areas where there is no constitutional jurisdiction, situations of emergency and national concerns.[375]

Canada is so innovative of this method[376] that it was even declared an untrue federation.[377] It is true that there are unitary elements in the Canadian constitution. We can observe these elements from the following points. First, the federal government has power to disallow any provincial statute, whether or not the statute deals with subjects falling within the legislative field exclusively assigned to the provinces.[378] Second, the federal government appoints the Lieutenant Governor of each province,[379] through whom the federal government can withhold provincial bills, reserve them for its consideration and refuse its assent.[380] Third, the federal government is empowered to appoint in the provinces all the important judicial positions, namely, judges of the superior, district and county courts.[381] These matters tend to result in subordination of the provincial governments to the federal government rather than coordination with each other and they

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[373] K. C. Wheare, *Federal Government*, 4th ed., Oxford University Press, 1963, pp.11-12

[374] Burnard W. Farston and Eugene Meehan, *Canada's Constitutional Law in a Nutshell*, Carswell, 1994, p. 106

[375] B. Appleton, *Navigating NAFTA: A Concise User's Guide to the North American Free Trade Agreement*, Carswell, 1994, p.8-12

[376] *Supra* note 368, p.4

[377] *Supra* note 373, p.12

[378] *The Constitution Act, 1867*, s. 90

[379] *Id.*, s. 58

[380] *Supra* note 373, p.18

[381] *The Constitution Act, 1867*, s. 96

are contrary to the practice of all other federations in the world except India and Nigeria.[382] For this reason, the Canadian constitution is regarded a quasi-federal one, that is, a federal constitution with considerable unitary modifications.[383]

However, the practice of case law and convention in Canada has virtually eliminated the unitary elements in its constitution.[384] Although the federal power to disallow provincial statutes was frequently used in the early years of confederation, the modern development of ideas of judicial review and democratic responsibility has left no room for the exercise of the federal power of disallowance.[385] In fact the power of disallowance has not been employed since 1943.[386] The power of reservation is also out of date.[387] By convention the Lieutenant Governor must appoint only those who command a majority in the provincial legislature,[388] upon whose decision the provincial cabinet are formed. Because of the prevailing system of cabinet government, the Lieutenant Governor is obliged to act on the advice of the provincial cabinet except for the situation where the provincial government does not have the confidence of its legislature.[389] As for the appointment of judges, the tradition of judicial independence is so strong that it has never been seriously claimed that the federally appointed provincial fudges would tend to favor the federal interest in disputes coming before them.[390] Therefore, it can be concluded that Canada is still a federal state[391] although its constitution is quasi-federal in law.

Apart from primary laws[392] made by the federal Parliament and the provincial legislatures, there exists another category of laws in Canada that are referred to as

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[382] *Supra* note 368, p.4

[383] *Supra* note 373, pp.18-19

[384] *Supra* note 367, p.109

[385] Hogg points out that the province concerned may insist that a court is the appropriate forum to determine the issue if the federal objection to a provincial statue is that it is *ultra vires*, and the province may reply that it is its voters who should be responsible for the determination of the policies of their government if the federal objection to a provincial statute is that it is unwise. – See *supra* note 367, p.112

[386] *Supra* note 367, p.112

[387] *Id.*, p.113

[388] John T. Saywell, *The Office of Lieutenant-Governor*, 1957

[389] *Supra* note 367, p.113

[390] *Id.*

[391] *Id.*, p.97

[392] Laws passed by sovereign legislative bodies themselves are called so.

subordinate (or delegated) laws. They are called differently: by-laws, ordinances, statutory instruments, orders in Council, rules and regulations etc.[393] A good example is municipal by-law. Under s. 92(8) of the *Constitution Act, 1867*, the provincial legislatures have the power to create such legal entities as municipalities to manage local affairs. Although municipal councils are not granted any lawmaking power directly under the *Constitution Act, 1867*, they have the delegated power over municipal institutions and matters of merely local or private nature from the provincial legislatures,[394] according to which they can make by-laws or ordinances dealing with a variety of local matters such as parking regulations, local building standards, and issuance of construction permits. As a result, a business may be regulated at each of the three levels, i.e., federal, provincial and municipal, in Canada.

(2) Two systems of law in one country

Canada is bi-jural.[395] All the other provinces of Canada are common law jurisdiction but Quebec is a civil law jurisdiction.[396]

As a result of the colonial history, Canada's present legal system derives from two major European origins: common law of England and civil law of France, both of which were brought to Canada by settlers from these countries in the 17th and 18th centuries.[397]

The common law developed in feudal England after the Norman Conquest in 1066. Its system was not made by any legislative bodies but developed on the decisions of judges, the principle of which is that the case before the court today should be decided in the same way that similar cases were decided in the past.[398] The common law was first brought to colonial Canada by the Hudson's Bay Company under its *Charter* of May 3, 1670.[399] In nearly three hundred years afterwards, rules of both the English common law

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[393] *Supra* note 362, p.37
[394] *The Constitution Act, 1867*, s. 92(8) and (16)
[395] *Supra* note 366, p.13
[396] H. Heward Stikeman and R. Fraser Elliott etc., *Doing Business in Canada*, Vol. 1, Matthew Bender, Oct. 1998, p.1-6
[397] *Supra* note 366, p.16
[398] *Supra* note 363, p.9
[399] *Supra* note 362, p.51

and the common law developed in Canada were applied in most part of the country.[400] This situation lasted till 1949 when the Supreme Court of Canada became the final court of appeal and Canadian courts were no longer bound to follow English cases although decisions of English courts are still greatly respected.[401]

The Canadian territory was a French colony from 1534 to 1760.[402] Quebec was originally settled by French inhabitants who brought with them the civil law derived from French sources.[403] With the capitulation of Montreal in 1760, English law was imposed in what is now Quebec.[404] After years of intense political struggle between the two opposing wills of French and English population,[405] in 1774 the *Quebec Act* re-established French civil law for civil matters while English law for criminal matters remained. The dual legal system has lasted till today.[406] In addition to the common law, there is a civil law system governing the private law[407] in Quebec nowadays.

Therefore, Canada is a unique nation in that the two major systems of the common law and the civil law exist side by side in the country.[408]

### 4. FDI Law System in Canada

Canada is a federal state. The federal characteristics are also reflected in its FDI law system.

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[400] *Supra* note 366, p.17

[401] *Id.* and *supra* note 362, p.53 and p.58

[402] *Supra* note 362, pp.65-66

[403] *Supra* note 64, pp.5-6

[404] *Supra* note 366, p.16

[405] *Supra* note 362, p.170

[406] *Supra* note 366, p.16

[407] Private law manages the relationships between individuals or groups of persons (including organizations like corporations, unions or clubs etc.) in society and deals with such matters as contracts, property ownership, the rights and obligations of family members, and damage to one's person or property caused by others. Public law, on the other hand, has to do broadly with the conduct of government and with its relationships with individuals and private organizations. It includes areas concerning criminal law, constitutional law and administrative law. (Frederick B. Sussmann, *The Law in Canada: A Citizen's Introduction to the Canadian Legal System*, Kenlaw Communications, 1976, p.8) Of the mixed legal system in Quebec, the civil law system is applied to its private law while its public law is governed by the common law system. (Gerald L. Gall, *The Canadian Legal System*, 3rd ed., Carswell, 1990, p. 165 and p.174)

[408] The State of Louisiana in the U.S. is in a similar situation to a minor extent. Although it has a civil law tradition, there is no duality of languages of English and French that parallels the two legal systems in Quebec and the rest of Canada. – See *supra* note 362, p50, note 3

Under sections of 91 and 92 of the *Constitution Act, 1867*, there is no specific power conferred on either the federal Parliament or the provincial legislatures to make laws regulating FDI.[409] The lack of clear and definite constitutional basis leads to the difficulty in judging whether the power of FDI lawmaking is within the spheres of the federal government or the provincial governments.

One opinion holds that under the general regulations of trade and commerce and naturalization and aliens[410] of the *Constitution Act, 1867* as well as its implied federal residuary power the federal government possesses full authority to regulate FDI[411] provided that such regulation does not constitute an attempt to regulate a particular industry not otherwise within federal jurisdiction.[412] This federal jurisdiction is so broad[413] that it would virtually exclude any power of the provinces to regulate FDI.[414]

The other opinion deems that the regulation of investment is a matter concerning property and civil rights within the provinces[415] and the *Constitution Act, 1867* obviously grants power to the provinces for investment matter.[416]

In Canada, however, the fact is that on the one hand not only the provinces claim the rights to regulate FDI in their respective jurisdiction by having legislated relevant laws[417] but the dictum in such case as *Morgan* v. *A.-G. P.E.I.* (1975)[418] made by the Supreme Court of Canada suggested that the provincial law that imposed property-owning restraints on aliens (therefore regulated foreign investment) be sustained as a valid

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[409] *Supra* note 235, p.2, note 4

[410] J. Nixon and J. Burns ect. hold this opinion. – See "An Examination of the Legality of the Use of *Foreign Investment Review Act* to Control Intra and Extraterritorial Commercial Activities by Aliens", *23 Int'l Comp. L.Q.*, 1984

[411] E. James Arnett, "Canadian Regulation of Foreign Investment: The Legal Parameters", 50 *Can. Bar Rev.*, 1972, p.214

[412] *Id.*, p.247

[413] Castel, de Mestral and Graham, *The Canadian Law and Practice of International Trade*, Emond Montgomery Publishings, 1991, p.314

[414] *Supra* note 411, p.229

[415] *Supra* note 411, p.214

[416] *Supra* note 375

[417] See Canada's Provincial Legislation Re Foreign Investment in Appendix 3

[418] [1976] 2 S.C.R. 349

property law;[419] on the other hand the federal Parliament has also asserted jurisdiction over FDI in the ICA (and its predecessor, the FIRA) as well as some other enactments,[420] the practice of which was supported by dicta as well in the cases of *A.-G. Can.* v. *A.-G. Alta.* and *A.-G. Ont.* v. *Reciprocal Insurers*[421] to the effect that the federal Parliament could "by properly framed legislation" impose restrictions on aliens seeking to do business in Canada.[422] In Canada, therefore, the truth is that the matter of FDI belongs to one of the concurrent powers of the federal and provincial governments and the regulation of FDI is subject to both federal and provincial legislative power. It is only that the FDI laws and regulations at the provincial level might be less influential[423] and their impact on FDI in Canada is not as extensive although in practice foreign investors are suggested to approach both the federal and provincial governments for their intended investments.[424]

To get a full view of Canada's FDI laws at either the federal or the provincial levels, please refer to Appendices 2 and 3.

## V. FDI LAWS OF GENERAL APPLICATION IN CHINA AND CANADA

### 1. China's General Regulation on FDI

#### *1.1 Forms of FDI in China*

The forms of FDI mostly adopted in China are Chinese-foreign equity joint venture, Chinese-foreign cooperative joint venture and wholly foreign-owned enterprise. Collectively these three forms of FDI are often referred to as foreign investment enterprises that are abbreviated for FIEs.

(1) Chinese-foreign equity joint venture (EJV)

An EJV refers to a jointly established limited liability company with a foreign company, enterprise, other economic organization or individual as one party and a

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[419] *Supra* note 367, p.490

[420] See Canada's Federal Legislation Re Foreign Investment in Appendix 2

[421] *A.-G. Can.* v. *A.-G. Alta. (Insurance)* [1916] 1 A. C. 588, 597; *A.-G. Ont.* v. *Reciprocal Insurers* [1924] A. C. 328, 346

[422] *Supra* note 367, p.490

[423] *Supra* note 235, p.2

[424] Peter Hayden and Jeff Burns, *Foreign Investment in Canada*, Carswell, 1996, p.II30,000-44

Chinese company, enterprise or other economic organization as the other.[425] It has three major characteristics: joint capital contribution, shared profits and losses, and cooperative management by the parties thereto.[426]

The EJV has significant advantages for both foreign investors and the host country. For the foreign investors, it offers an opportunity to enter a new market with the advantage of the local business knowledge of the local partner that may prove invaluable in an unfamiliar business environment. Besides, the foreign nationality of the investment can be subsumed behind the local nationality of the EJV and thus reduce the risk of being identified as "foreign" and subjected to possible discriminatory treatment. For the host country, the EJV offers a means of introducing new capital and technology into the country while retaining the legal form of control over the foreign investors.[427]

(2) Chinese-foreign cooperative joint venture (CJV)

A CJV is an enterprise established with investment and conditions for cooperation jointly offered by a foreign company, enterprise, other economic organization or individual on one side and by a Chinese company, enterprise or other economic organization on the other side. According to the CJVL, a CJV may be an independent legal person just like an EJV with its highest authority lying in a board of directors or may operate as a non-legal person with its top authority residing in a joint management body.[428] The CJV that has obtained the status of a legal person is a limited liability company.[429] The partners of a non-legal person CJV maintain their identities as separate legal entities. The non-legal person CJV resembles a partnership[430] and it is not endowed with limited liability. If this kind of the CJV is unable to meet its debts, the investing

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[425] Zhou Ziya, "A Comparative Study of Three Kinds of Enterprise Involving Foreign Investment in China" in William Tai (ed.), *Legal Aspects of Foreign Investment in the People's Republic of China*, China Trade Translation Company, 1988, p.111

[426] Zhou Ziya, "An Analysis and Study of the Law on Chinese-Foreign Joint Ventures and its Implementation Regulations" in William Tai (ed.), *Legal Aspects of Foreign Investment in the People's Republic of China*, China Trade Translation Company, 1988, p.55

[427] *Supra* note 47, p.185

[428] *The Implementing Regulations on the CJVL*, articles 4 and 24

[429] *Id.*, art. 14

[430] Ralph H. Folsom and John H. Minan, *Law in the People's Republic of China: Commentary, Readings and Materials*, Martinus Nijhoff Publishers, 1989, p.750

partners must use their own assets to pay off the debts.[431]

**TABLE 16: UTILIZED FDI BY FORMS IN CHINA (1979-1999)**

Unit: US$ 100 million

| Utilized FDI | EJV | % | CJV | % | WFOE | % | CE | % |
|---|---|---|---|---|---|---|---|---|
| 1979-81 | 0.65 | 8.8 | 3.53 | 47.8 | 0.01 | 0.1 | 3.18 | 43.1 |
| 1982 | 0.34 | 7.9 | 1.78 | 41.4 | 0.39 | 9.1 | 1.79 | 41.6 |
| 1983 | 0.74 | 11.7 | 2.27 | 35.7 | 0.43 | 6.8 | 2.92 | 46.0 |
| 1984 | 2.55 | 20.3 | 4.65 | 37.0 | 0.15 | 1.2 | 5.23 | 41.6 |
| 1985 | 5.80 | 35.0 | 5.85 | 35.3 | 0.13 | 0.8 | 4.81 | 29.0 |
| 1986 | 8.04 | 42.9 | 7.94 | 42.3 | 0.16 | 0.9 | 2.60 | 13.9 |
| 1987 | 14.86 | 64.2 | 6.20 | 26.8 | 0.25 | 1.1 | 1.83 | 7.9 |
| 1988 | 19.75 | 61.8 | 7.80 | 24.4 | 2.26 | 7.1 | 2.12 | 6.6 |
| 1989 | 20.37 | 60.0 | 7.52 | 22.2 | 3.71 | 10.9 | 2.32 | 6.8 |
| 1990 | 18.86 | 54.1 | 6.74 | 19.3 | 6.83 | 19.6 | 2.44 | 7.0 |
| 1991 | 22.99 | 52.7 | 7.64 | 17.5 | 11.35 | 26.0 | 1.69 | 3.9 |
| 1992 | 61.15 | 55.6 | 21.23 | 19.3 | 25.20 | 22.9 | 2.50 | 2.3 |
| 1993 | 153.48 | 55.8 | 52.38 | 19.0 | 65.06 | 23.6 | 4.24 | 1.5 |
| 1994 | 179.25 | 53.1 | 71.20 | 21.1 | 80.36 | 23.8 | 6.78 | 2.0 |
| 1995 | 190.78 | 50.8 | 75.36 | 20.1 | 103.17 | 27.5 | 5.90 | 1.6 |
| 1996 | 207.55 | 49.7 | 81.09 | 19.4 | 126.06 | 30.2 | 2.56 | 0.6 |
| 1997 | 195.77 | 43.2 | 89.22 | 19.7 | 161.51 | 35.7 | 3.41 | 0.8 |
| 1998 | 188.35 | 41.3 | 93.41 | 20.5 | 165.16 | 36.2 | 2.87 | 0.6 |
| 1979-99 | 1,454.31 | 47.27 | 649.17 | 21.10 | 907.54 | 29.50 | 62.00 | 2.02 |

Source: MOFTEC, *Almanac of China's Foreign Economic Relations and Trade* (1984-95) and *FDI Statistics*, http://www.moftec.gov.cn/moftec_cn/tjsi/wztj/2000_9-22-9.html; SSB, *Statistical Yearbook of China* (1985-97); feature article, "A Summary of China's Absorption of Foreign Investment", *Foreign Investment in China*, Issue 82, Sept. 1999, p.13; Anhui Investment Info Net, *Concise FDI Statistics of China*, http://www.china-anhui.com/gb/jjsj/cnsj/ 1998.htm and http://www.china-anhui.com/gb/jjsj/cnsj/199919.htm

The CJV is a flexible FDI form for several reasons. First, it does not need to take on the identity of a separate legal entity and thus allows the joint partners to maintain their respective legal status. Second, it is subject to fewer legal restrictions and thus easier to establish and manage. Third, the partners to the CJV share profits and risks of the venture in accordance with the stipulations of the contract rather than the proportion of their respective capital contributions.[432] This last reason is the most notable feature of the CJV and many difficult problems between the partners can be solved through negotiations and

[431] Jerome Alan Cohen, "The Long-Awaited Cooperative Venture Law" in Ralph H. Folsom and John H. Minan (eds.), *Law in the People's Republic of China: Commentary, Readings and Materials*, Martinus Nijhoff Publishers, 1989, p.781

[432] Barbara Campbell Potter, "China's Equity Joint Venture Law: A Standing Irritation to the West for Foreign Investment?" *U. Pa. J. Int'l Bus. L.*, Vol. 14, No. 1, Spring 1993, p.12

relevant arrangements. At the beginning of China's open policy, therefore, the CJV was the most important FDI form, accounting for nearly 50% of the total FDI in the country. As FDI becomes more locally market-oriented, however, the EJV witnessed a more rapid growth, the proportion of which in the total utilized FDI went up from about 9% in the period of 1979-1981 to about 47% in 1999. As a result, the EJV has outweighed the CJV and become the most important FDI form in China since 1987. [SEE TABLE 16] The reason for the shift is that the EJV is more suitable for foreign investors who want to acquire specific local knowledge like access to domestic market resources and information, political links, improved bureaucratic accessibility and more favorable government decisions.[433]

*The Implementing Regulation on the CJVL* prohibits the CJV from reducing its registered capital during the operational term,[434] but it allows the foreign investor to recover his capital in advance[435] on condition that the Chinese party owns all the fixed assets of the CJV when the contracted term expires.[436] By doing so, the Chinese party virtually uses its share of the profit from the CJV to purchase the capital withdrawn by the foreign investor, the process of which is a gradual transfer of the invested capital from the foreign investor to the Chinese party. Under the circumstances, the capital structure of the CJV changes synchronously along with the recovery of the foreign investment although its registered capital does not diminish as a whole. The recovery can be made by extending the net profit ratio of the foreign investor[437] or on a pre-tax basis[438] upon the

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[433] Haiyan Zhang and Danny Van Den Buckle, "China: Rapid Changes in the Investment Development Part" in John H. Dunning and Rajneesh Narula (eds.), *Foreign Direct Investment and Governments: Catalysts for Economic Restructuring*, Routledge, 1996

[434] *The Implementing Regulations on the CJVL*, art. 16

[435] *Id.*, art.44

[436] *Id.*

[437] *Id.*, art. 44 (1)

In practice, the recovery is made in accordance with an agreed proportion of net profits or products. The recovery ratio changes in stages, sometimes from year to year. – See Zhang Jielin, "The Rise of Chinese-Foreign Cooperative Ventures and Their Legal Characteristics" in William Tai (ed.), *Legal Aspects of Foreign Investment in the People's Republic of China*, China Trade Translation Company, 1988, pp.130-131

[438] For example, a real estate development company in Shanghai provided in its cooperation contract that "[a]ll rentals (incomes) after deduction of the construction cost of the apartment buildings shall be

approval of the relevant financial and tax authorities.[439] Rights and obligations are equal. Normally, the profits of each of the Chinese and foreign investors should be increased or decreased corresponding to the capital restructuring.[440] Yet the earlier capital recovery of the foreign investor has been taken as a preferential treatment to FDI in China and the foreign investor can continue to enjoy the right to profit distribution accruing from his originally invested capital share during the remaining contract term of the CJV.[441] To reduce the impact of this practice, however, the *Implementing Regulation on the CJVL* simultaneously provides that the foreign investor should bear responsibility for the debts of the CJV if he has chosen to recover his investment earlier.[442] Practically the foreign investor is asked to provide certain guarantees as security for his obligation to return his early-recovered capital when needed to shoulder a fair share of the CJV's debts. One of the practices is that the parties treat the early-recovered capital as an interest-free loan to the foreign investor that is subject to call by the CJV to honor his debt obligations if necessary.[443]

(3) Wholly foreign-owned enterprise (WFOE)

A WFOE is an enterprises organized by foreign investors who solely contribute its equity capital, enjoy its entire profits and exercise full management control in a manner unassisted by any local partners. According to the WFOEL, the WFOE that meets the

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exclusively the pre-tax net profit of the foreign party." The cooperation contract of a large hotel also in Shanghai provided that "[s]tarting from the year in which the hotel begins making profit, 20% of the pre-tax profit shall be drawn and divided equally between the Chinese and foreign parties." – See Zheng Yanbiao, "An Inquiry into the Legal Issue of the Capital Structure of Chinese-Foreign Cooperative Ventures" in William Tai (ed.), *Legal Aspects of Foreign Investment in the People's Republic of China*, China Trade Translation Company, 1988, pp.140-141

[439] *The Implementing Regulations on the CJVL*, art. 44 (2)

To distribute profit and pay back capital from pre-tax gross earnings is in fact an evasion of income tax payable on the amount that has been withdrawn. *The Law* thus regulates that this method must be approved by the relevant financial and tax authorities before being applied.

[440] Zheng Yanbiao, "An Inquiry into the Legal Issue of the Capital Structure of Chinese-Foreign Cooperative Ventures" in William Tai (ed.), *Legal Aspects of Foreign Investment in the People's Republic of China*, China Trade Translation Company, 1988, p.145

[441] *Id.*, p.146

[442] *The Implementing Regulations on the CJVL*, art. 44, para. 5

[443] *Supra* note 431, p.782

legal person requirements set by law obtains such status in China.[444]

China is the first socialist country enacting a law governing the establishment of domestic enterprises wholly owned by foreign interests.[445] The WFOE accounted only 0.1% of the total utilized FDI in China during the period of 1979-1981, but as the Chinese market is becoming more open to the outside world it has displayed a strong growth momentum since 1990, with an increase of 56.7% per year on average from 1987 to 1996.[446] The number of the WFOE approvals outnumbered the EJV approvals in 1997[447] and many foreign investors even seek to convert their existing joint ventures into the WFOE.[448] The propensity for foreign investors to establish the WFOE is to control their invested enterprises more efficiently and to better protect their proprietary rights of high technology including sophisticated products or services.

The term of the WFOE does not comprise branches and representative offices set up by foreign investors in China[449] although these establishments are all purely foreign-owned. They are regulated by different laws: the WFOE by the WFOEL whereas the foreign company branch by the *Company Law* and the representative office by the

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[444] The WFOEL, art. 8

It merits attention that a WFOE is considered to be a Chinese company when it (not with after-tax profits distributed to its investors) invests in China and the new enterprise established by this way does not enjoy the preferential treatment to FDI.

[445] Preston M. Torbert, "Wholly Foreign-Owned Enterprises Come of Age" in Ralph H. Folsom and John H. Minan (eds.), *Law in the People's Republic of China: Commentary, Readings and Materials*, Martinus Nijhoff Publishers, 1989, p.765

[446] *Supra* note 72, p.23

[447] Stuart Valentine, "Going Solo: As They Learn the Ropes, an Increasing Number of Foreign Investors are Turning to Wholly Owned Ventures", *China Trade Report*, Oct. 1998 and Chae Yong-hee, "Keeping the Faith: Foreign Investors Remain Bullish on China", *China Trade Report*, Vol. 36, Nov. 1998

[448] Stuart Valentine, "Going Solo: As They Learn the Ropes, an Increasing Number of Foreign Investors are Turning to Wholly Owned Ventures", *China Trade Report*, Oct. 1998

The WFOE is the primary form of Taiwanese investment on the mainland of China and the rapid growth of Taiwanese investment since 1988 has contributed to this situation. The Taiwanese investment in the form of WFOE made up of 64.1% and 65.8% of their total contractual investment amount in 1989 and 1990 respectively. – See the *MOFTEC Almanac*, 1990 and 1991

[449] Foreign companies can set up representative offices in China. But these offices are prohibited from carrying on direct business activities, such as negotiating and concluding contracts with customers or issuing sales invoices. They can only carry out functions of business information collection, market research, consulting, and general liaison with suppliers and customers. – See *supra* note 124, p.29

*Implementing Regulations on the Approval and Administration of Resident Representative Offices of Foreign Enterprises.*

(4) Cooperative exploitation (CE)

The CE was created for Chinese-foreign cooperation in the exploration and development of China's resources like offshore and continental oil and gas. It involves risk sharing and output distribution and is characteristic of the feature of both CJV and compensation trade.[450] The CE is generally carried out in three stages: exploration, exploitation and production. During the first stage, the foreign contractor bears all the costs and takes all the risks arising from the exploration. If no oil and gas deposits of business value are discovered, the CE contract is automatically terminated. If the deposits worth exploitation are discovered, the contract implementation enters into the second stage. At this time, the Chinese side may contribute investment in the CE by purchasing shares from the foreign contractor in the line with the ratio set in the CE contract. When the oil and gas field is put into commercial production, both the Chinese and foreign sides share the profits in kind according to the ratio as defined in the contract.[451] Presently, two state-owned corporations are vested with monopoly status to deal with CE business in China. One is the China National Offshore Oil Corporation and the other is the China National Oil and Gas Corporation.[452] Because of unfruitful exploration records, this form of FDI has come at a standstill since 1990s.[453]

(5) Other FDI forms

As China continues to open to the outside world, there has been a gradual increase in the forms of foreign investment and the implication of FDI has become broader than conventional understanding. In addition to the above FDI forms, some other arrangements are identified as FDI in China. They include compensation trade, processing and assembly arrangement, and BOT.[454]

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[450] *Supra* note 72, p.21

[451] CCPIT, *China Business Guide: 1998/1999*, http://www.ccpit.org/engVersion/cp_infor/cp_ cbg/cbg4_5.html

[452] *Id.*

[453] *Supra* note 72, p.23

[454] *Supra* note 142

(A) Compensation trade

Compensation trade (also known as "product buy-back") is a FDI form through which Chinese enterprises purchase equipment and technology from foreign investors on credit and pay off the principal and interest of the purchase by installments or on deferred terms using the products produced.[455] In China, there are three modes of compensation trade: direct compensation, indirect compensation and comprehensive compensation. Direct compensation is the basic mode of compensation trade, in which the compensated products are those produced directly with the purchased equipment and technology. For indirect compensation, the compensated products are those produced not with the purchased equipment and technology but still by the same purchaser. Comprehensive compensation actually is a combination of direct and indirect compensation, in which the compensated products are provided partially with those produced by using the purchased equipment and technology and partially with goods generated otherwise.[456]

(B) Processing and assembly arrangement

The processing and assembly arrangement is a FDI form, whereby Chinese enterprises, according to the requirements of certain qualities, specifications and styles, process and assemble with the whole or part of raw and auxiliary materials, parts and components supplied by foreign investors[457] and collect fees for such service.

(C) BOT

BOT is initials for Build-Operate-Transfer. It is popularly used for construction of large infrastructure facilities. A typical BOT is that a government signs a contract with a private project company, obliging the company to raise the construction funds and undertake the building. The company owns and operates the facility within the stipulated period while recovering the investment and earning the profits by collecting fees for use of the facility. Upon expiration of the contract, the facility is transferred to the government gratuitously.[458] In order to reduce the bottleneck of its infrastructure, China has adopted the BOT formula in its FID development, encouraging FDI in building power

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[455] China International Economic Consultants, *The China Investment Guide*, 3rd ed., Longman, 1986, p.318

[456] *Supra* note 451

[457] *Supra* note 455, p.32

[458] *Supra* note 451

stations, railways and highways and so on.

### *1.2 Scope of FDI*

All sovereign states without exception take their choice in utilizing inward FDI on the basis of their industrial policies. In the light of the respective economic development conditions, they make decisions on or alterations to the kinds of FDI to be encouraged, restricted, permitted or prohibited. In 1995 China adopted the *Provisional Regulations on Guidance for Foreign Investment* and the *Catalogue of the Guidance for Foreign Investment Industries* by which it has specified its sectors for FDI. *The Provisional Regulations on Guidance for Foreign Investment* classifies FDI in four categories of "encouraged, permitted, restricted or prohibited". Under each of the encouraged, restricted and prohibited categories, a detailed list of industries is set out. Where an industry is not listed, FDI is generally considered permitted. Under the encouraged and restricted categories, limitations are introduced on the level of foreign shareholding for certain industries that are qualified by "the WFOE not permitted" or "Chinese party having control interest or occupying dominant position".

*The Provisional Regulations on Guidance for Foreign Investment* encourages FDI in the following areas and projects: (a) new agricultural technology, comprehensive agricultural development, natural resources, transportation and essential raw materials; (b) new, high-tech and advanced technology as well as new equipment and materials capable of improving products, saving energy and raw materials, enhancing economic profits of enterprises or satisfying the market demand that can not be met by domestic industries; (c) projects that are capable of meeting the international markets, enhancing the competitiveness of products, developing new markets or increasing exports; (d) new technology or equipment for effective use of resources, recycling and environmental protection; or (e) projects that can develop human and natural resources of the central and western regions of China in conformity with the State's industry policies.[459] It restricts those FDI projects (a) using technology that has been developed in China or introduced into the country for which the existing production capacity in the relevant field has satisfied domestic demand; (b) falling under the industries on experiment for FDI

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[459] *The Provisional Regulations on Guidance for Foreign Investment*, art. 5

absorption or the monopoly industries by the State; (c) for exploring and exploiting rare and valuable mineral resources; or (d) falling under the industries subject to the overall arrangement and planning of the State.[460] In order to protect the interests of the country, FDI is prohibited in the projects that are (a) to jeopardize national security or social and public interests; (b) to pollute environment, destroy natural resources or cause harm to public health; (c) to occupy large tracts of farmland, run counter to the protection of land resources or harm the security and effectiveness of military appliances; or (d) to manufacture products with unique craft or technology owned by China.[461]

### *1.3 Review and Approval of FDI*

(1) Review and approval authorities

Prior authorization by competent authorities is a prerequisite for FDI in China. Various government agencies such as the State Development Planning Commission jointly review and approve or disapprove proposed FDI establishment, but the major screening authority is the Ministry of Foreign Trade and Economic Cooperation (MOFTEC).

At the initial stage of the open policy, all FDI projects were required to be reviewed by the Central Government. Along with the development of FDI, relevant local governments at provincial level have been entrusted to perform the screening duty where (a) the proposed FDI project is within the investment amount limit stipulated by the State Council; (b) the capital subscribed by the Chinese party to the project has been assured; (c) the proposed project does not require additional allocation of raw materials by the State; and (d) the project does not adversely affect the national balance of fuel, power, transportation and export quotas.[462] Originally this authorization was very restricted. The local governments competent to approve projects with a total FDI investment amount below US$ 30 million were only two of the largest cities, i.e., Shanghai and Tianjin. With a circular issued by the MOFTEC in Jan. 2000, the authorization has been extended to all the provinces, autonomous regions and provincial-level municipalities[463] although the

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[460] *Id.*, art. 6

[461] *Id.*, art. 7

[462] *The Implementing Regulations on the EJVL*, art. 8(1) and (2)

[463] *International Economic and Trade Information Weekly*, Jan. 20, 2000, p.1

review documents should be submitted to the MOFTEC for record after approved FDI projects are established. According to the same circular, FDI projects with a total investment amount between US$ 30 million and US$ 100 million still need to be reported to the MOFTEC for final review and approval after the initial screening by the relevant local governments (or state ministries), and FDI projects with a total FDI investment over US$ 100 million must be reported to the State Council for final approval.[464]

(2) Establishment requirements

Generally, FDI projects are required to promote and benefit the development of China's economy.[465] Specifically, they must satisfy certain standards for their establishment in China.

Art. 4 of the *Implementing Regulations on the EJVL* sets forth four positive criteria for the establishment of the EJV and provides that at least one of them must be met for a proposed EJV. The criteria are (a) adopting advanced technology, equipment and scientific management to develop new products, enhance product quality and output, and save energy resources and raw materials; (b) facilitating technical renovation of the enterprise; (c) expanding exports and increasing foreign exchange income; and (d) training Chinese technical and managerial personnel. These requirements are actually neither harsh nor rigid. In practice, however, it is advisable for foreign investors to contact the relevant screening authorities during the application to ensure that both sides have a better understanding about the issue.[466]

There are two alternate tests for the establishment of the WFOE. The first is that the proposed project must adopt advanced technology and equipment, develop new products, save energy resources and raw materials, enhance products or substitute import products. The second test requires the project to balance its foreign currency by exporting over 50% of its products annually.[467] A WFOE must satisfy either of these standards to justify its

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[464] *Id.*

[465] *The Implementing Regulations on the EJVL*, art. 3 and the WFOEL, art. 3

[466] *Supra* note 10, p.7

[467] The WFOEL, art. 3 and the *Implementing Regulations on the WFOEL*, art. 3

But it seems that this test will be deleted before long by China's legislative authorities due to its inconsistency with the TRIMs under the WTO. For this purpose, an amendment draft was submitted at the 18th Session of the Standing Committee of the 9th NPC in Oct. 2000.

establishment. These tests are common to foreign investors in China[468] and considered essentially the same as those for an EJV.[469] The specific establishment requirements suggest that China want those FIEs capable of bringing in advanced technology and equipment as well as generating foreign currency.

(3) Application procedure

In applying for the establishment of a FIE, the investors concerned[470] generally go through the following procedure:[471]

(A) To submit to the relevant government agencies the application or proposal on the proposed FDI project;

(B) To submit to the relevant government agencies the feasibility studies report on the project;

(C) To submit to the relevant government agencies the contract and articles of association concerning the establishment of the FIE;[472]

(D) After all the legal documents are reviewed and approved, the approval authorities issue a certificate of approval for the FIE; and

(E) To register the FIE with the relevant administrative department for industry and commerce.[473]

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[468] *Supra* note 430, p.766

[469] *Supra* note 10, p.27

[470] For the establishment of a joint venture enterprise, the Chinese partner is responsible for submitting the application and relevant legal documents for review and approval.

[471] *Supra* note 451

[472] To simplify the procedure, the application for the establishment of a small-size project can go through all the procedural steps from (A) to (C) at one time.

[473] When applying for the establishment of a FIE in Shenzhen SEZ, for example, the foreign investor concerned is required to submit the following documents for review and approval procedure: (1) the Project Clearance Form for Foreign Investment in Shenzhen; (2) feasibility studies repot; (3) the Environmental Protection Examination and Approval Form for Construction Projects in Shenzhen when the proposed project is environmentally concerned; (4) EJV or CJV contract (the WFOE need not submit this contract), (5) articles of association; (6) original copy of the resolution of the Board of Directors or the Meeting of Shareholders; (7) capital verification certificate; (8) balance sheet of the corporate for the last three years; (9) corporate income tax certificate issued by the taxation authorities; (10) the papers authorizing the use of the facilities and a copy of the approval document issued by the Municipal Planning and Land Bureau for businesses in hotel, catering, recreations and warehousing; (11) certificate of personal financial credibility and ID duplicate when the foreign investor is a natural person. – See Shenzhen Municipal Foreign

When establishing a joint venture, the Chinese and foreign partners often sign a preliminary agreement or pre-contract in practice although the process is optional. This document actually is a letter of intent about key points and principles for the establishment of the venture and it purports to guide further negotiations.

The MOFTEC or other government agencies authorized by the State Council are required to review the application and decide approval or disapproval within 3 months upon submission of the application to establish an EJV[474] or 90 days to set up a WFOE.[475] In case of a CJV, the screening authorities are obliged to make a decision within 45 days, half the time allotted to the applications of the EJV or the WFOE, after receiving the application.[476]

(4) Existing problems in screening procedure

While screening FDI is a legitimate exercise of the government,[477] foreign investors are sometimes frustrated by the complex and lengthy decision-making process in China.[478] It is said that the review of an ordinary FDI project involves about twenty government departments, and for a large FDI project the Central Government generally needs one year for the processing.[479] To avoid cumbersomeness, it is suggested that countries should streamline their review procedures through "one-stop shop" arrangements, which means that responsibilities for all the screening matters vest in a single organization.[480] In China, some places have adopted an expedient measure[481]

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Investment Bureau, *Submission Requirement for Establishing Enterprises with Foreign Investment*, http://www.fdi-shenzhen-con.com/procedure/ submission.html

[474] *The Implementing Regulations on the EJVL*, art. 10

[475] The WFOEL, art. 6

[476] The CJVL, art. 5

[477] *Supra* note 67, p.85

[478] *Supra* note 82, p.37

[479] "China Report" interview with Ma Yu on CCTV, Apr. 28, 2000

[480] This method was once suggested by Shihata. – See *supra* note 17, p.73, note 32

[481] For instance, Shenzhen SEZ has adopted a "one-stop" arrangement in its FDI review and approval mechanism. But this arrangement in essence differs from that suggested by Shihata for the local government only provides an office building in which all the relevant government departments that have administrative power over FDI matters establish separate offices and perform individual duties. In this "one-stop shop", named as the Office of Investment Service Center of Shenzhen, there are more than a dozen offices, which are set up by the Foreign Investment Bureau, the Industrial and Commercial Administration Bureau, the State Taxation Bureau, the Local Taxation Bureau, the Foreign Exchange

similar to this suggested arrangement in appearance within its present framework of government administration.[482] But a through reform of the FDI review and approval procedure is uneasy under the present circumstances since it involves redistribution of the vested interests among various government departments.

### *1.4 Capital Ratio*

Contrary to the prevailing FDI practices in most developing countries, there is no upper limit on foreign contribution in a joint venture in China except certain industries regulated in the *Catalogue of the Guidance for Foreign Investment Industries*. To be classified as the FIE, China's FDI law demands instead that the investment proportion contributed by foreign investors in a joint venture should be at least 25% of the registered capital of the enterprise.[483] This 25% floor clearly indicates China's endeavor to encourage FDI into the country.

The registered capital of an enterprise is the capital sum contributed by the investors as registered with the relevant industrial and commercial administration. The investors usually need to invest in their project more than the registered capital. The total sum of the registered capital plus loans[484] or, to put it another way, the capital funds for the construction of the venture plus the circulating capital for its production operations[485] is the total investment amount of the enterprise. Originally there were no regulations on the ratios between the registered capital and the total investment amount of an EJV. However, this non-regulation caused problems in FID practice. Foreign investors tended to put less and less of their own capital to their investing enterprises. To run the projects they tried to borrow large funds from other sources like banks instead. This practice could reasonably reduce the liabilities of the investors, but its extreme exerted a bad influence upon the FDI development in China. For example, a large hotel in Shanghai had a registered capital of

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Authority, the Finance Bureau, the Customs, the Environmental Protection Bureau, the Labor Bureau, the Personnel Bureau, the Technological Supervision Bureau and the Public Health Bureau and so on.

[482] "China Report" interview with Ma Yu on CCTV, Apr. 28, 2000

[483] The EJVL, art. 4

[484] In China, part of the loans is borrowed from overseas banks with certain guarantees provided by the Chinese side. This external debt is monitored by the State Administration of Exchange Control. – See *supra* note 124, p.20

[485] *Supra* note 426, p.58

RMB 1 million yuan but its total investment amount reached J¥ 14 billion (equivalent to RMB 134.7 million yuan). The ratio of the registered capital to the total investment amount was as high as 1:135. Under the circumstances, the greater part of the risks is shifted onto the lending financial institutions and other third parties that maintain business relations with the venture.[486] To discourage the establishment of thinly capitalized enterprises, on Mar. 1, 1987 the State Administration for Industry and Commerce promulgated the *Provisional Regulations on the Ratios between Registered Capital and Total Investment for Chinese-Foreign Equity Joint Ventures*, providing minimum requirements for the ratios between registered capital and total investment amount for the EJV. The stipulated ratios vary according to the value of FDI:[487]

| Total Investment | Ratio of Registered Capital to Total Investment |
|---|---|
| US$ 3 mil. and under | At least 7/10 |
| Between US$ 3 mil. and US$ 10 mil. inclusive (when under US$ 4.2 mil.) | At least 1/2 (not under US$ 2.1 mil.) |
| Between US$ 10 mil. and US$ 30 mil. inclusive (when under US$ 12.5 mil.) | At least 2/5 (not under US$ 5 mil.) |
| US$ 30 mil. and above (when under US$ 36 mil.) | At least 1/3 (not under US$ 12 mil.) |

### *1.5 Foreign Capital Composition*

The FIE can be invested in the form of cash,[488] such capital goods as machines, equipment and other materials as well as industrial property rights, proprietary technologies or know-how,[489] land use and other property rights.[490] When the capital is not contributed in cash, foreign capital goods must meet the specific standards set by law: (a) they are indispensable to the production of the joint venture; (b) China is unable to manufacture them, or able to do only at a higher price, or their technical performance and

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[486] *Supra* note 440, p.135

[487] *The Provisional Regulations on the Ratios between Registered Capital and Total Investment for Chinese-Foreign Equity Joint Ventures*, art. 3

[488] Foreigners must invest with foreign currencies. They may invest with RMB only if they have earned it as the profits from some other FIE(s) in which they are investors. – See the *Provisions on the Question of Balancing Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures*, art. 10

[489] Proprietary technologies or know-how include manufacturing or processing methods, material formulae, business know-how and so on. They are mainly sold and purchased under licensing agreements. – See *supra* note 426, p.58

[490] The EJVL, art. 5, the CJVL, art. 8, and the *Implementing Regulations on the WFOEL*, art. 26

time of availability can not meet the demand; and (c) the evaluated price should not be higher than the current international market price.[491] To verify whether they are up to the standards, the imported machines and equipment are required to undergo an evaluation by the relevant administrative department for import and export commodity inspection before being calculated as part of the investment of the enterprise concerned.[492]

There are also some restrictions on industrial property rights and proprietary technologies or know-how that are contributed by foreign investors as capital composition. According the *Implementing Regulations on the EJVL*, to be part of the registered capital of an EJV foreign intangible property must meet one of the following conditions: (a) capable of manufacturing new products urgently needed in China or products suitable for export; (b) capable of markedly improving the performance and quality of existing products and increasing productivity; or (c) capable of notably saving raw materials, fuel or power.[493] In addition, the proportion of industrial property rights and proprietary technologies or know-how as investment are normally not allowed to exceed 20% of the registered capital of the enterprise concerned, no matter whether they are contributed by foreign investors, Chinese parties, or both.[494] However, this 20% ceiling can exceptionally be raised up to 35% if the industrial property rights and proprietary technologies or know-how are held to be an achievement of a high and new technology by the State Science and Technology Commission or scientific and technological administrative departments at provincial level.[495]

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[491] *The Implementing Regulations on the EJVL*, art. 27 and the *Implementing Regulations on the WFOEL*, art. 27

[492] To facilitate the inspection, the State Administration of Import and Export Commodity Inspection and the Ministry of Finance jointly set out the detailed rules in 1994.

[493] *The Implementing Regulations on the EJVL*, art. 28 and also the *Implementing Regulations on the WFOEL*, art. 28

[494] The immaturity of China's FDI law can still be observed here. Among the three major FDI laws, this rule was explicitly provided only in the *Implementing Regulations of the WFOEL* (art. 28, para. 2) with the other two not mentioning the issue at all. *The Company Law*, however, has filled up the blank, art. 24 of which provides that every limited liability company in China must abide by this 20% limit.

[495] *Regulations Concerning Some Issues of Achievements of New and High Technology as Investment Capital* (the State Science and Technology Commission and the State Administration for Industry and Commerce, Jul. 4, 1997)

### *1.6 Time Limit of Capital Contribution*

Parties to an EJV should set the time limit of capital contribution in their joint venture contract. If the contract stipulates that the capital contribution is paid up in one lump sum, the parties are required to make the full payment of their respective capital contribution within 6 months from the date when the business license is issued. If the contract stipulates that the capital contribution is paid in installments, the first payment from each party shall be no less than 15% of their respectively subscribed capital amount and shall be paid within 3 months from the date when the business license is issued.[496]

The time limit of capital contribution of a WFOE is required to specify in its establishment application and its articles of association. The foreign investor may make the capital contribution in installments. In this case, the first payment should constitute at least 15% of the total amount of the registered capital of the enterprise within 90 days after the date when the WFOE is granted the business license and the balance must be paid off within 3 years of that same date.[497]

On Nov. 3, 1994, the State Administration for Industry and Commerce and the MOFTEC jointly promulgated the *Circular of Further Strengthening Administration and Registration of Foreign Investment Enterprises. The Circular* sets out a time framework for paying off the registered capital in accordance with its various value:

| Sum of Registered Capital | Time Limit of Capital Contribution |
|---|---|
| US$ 0.5 mil. or under | Within 1 year from the license issued date |
| Between US$ 0.5 mil. and US$ 1 mil. inclusive | Within 1.5 years from the license issued date |
| Between US$ 1 mil. and US$ 3 mil. inclusive | Within 2 years from the license issued date |
| Between US$ 3 mil. and US$ 10 mil. inclusive | Within 3 years from the license issued date |
| US$ 10 mil. and above | Negotiated |

According to the *Circular*, the *Regulations on the Capital Contribution by Parties to Chinese-Foreign Equity Joint Ventures* and the *Implementing Regulations on the WFOEL*, the time requirements of capital contribution are summed like this. First, the FIE must explicitly stipulate in their joint venture contracts and/or articles of association the time limit of capital contribution; otherwise the relevant authorities will not approve and

[496] *The Regulations on the Capital Contribution by Parties to Chinese-Foreign Equity Joint Ventures*, art. 4
[497] *The Implementing Regulations on the WFOEL*, art. 31

register the proposed projects.[498] Second, if the registered capital schedules to be paid in one lump sum, the foreign investor of an EJV should pay off his subscribed capital within 6 months from the date when the business license is issued.[499] Third, in the case of installment payment, the foreign investor is required to make the first payment of no less than 15% of his subscribed capital within 3 months (or 90 days) from the date when the business license is issued. Fourth, the foreign investor has to comply with the new requirements set in the above table under all the other circumstances.

When a foreign investor is establishing a FIE through purchasing the assets or shares of a domestic enterprise, he should pay all the purchasing funds within 3 months from the date when the business license of the FIE is issued. Under the special circumstances where the payment needs to be delayed, the foreign investor is required to pay for his purchase within 1 year, with the first installment of at least 60% of the total funds paid within 6 months from the date when the business license is issued. Before the foreign investor has fully contributed his subscribed shares, his profits shall be distributed only in accordance with the shares of his actual payment and his other interests and rights shall not be included in his annual financial report.[500]

### *1.7 Operational Term*

China's FDI law generally permits unlimited duration for the EJV. In the light of the amended EJVL,[501] the MOFTEC promulgated the *Provisional Regulations on the Term of Chinese-Foreign Equity Joint Ventures* on Oct. 22, 1990, according to which parties to an EJV may or may not fix the operational term of the EJV that falls within the category of FDI encouraged and permitted by the State.[502] But the other EJVs do not benefit from

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498 *The Circular of Further Strengthening Administration and Registration of Foreign Investment Enterprises*, art. 6

499 The law is silent on the time limit requirements for the foreign investor of a CJV or a WFOE to pay his subscribed capital in one lump sum.

500 *The Additional Regulations of the Provisions on the Capital Contribution by Parties to Chinese-Foreign Equity Joint Ventures*, art. 1

This regulation applies to all the EJV, the CJV and the WFOE.

501 China amended the EJVL on Apr. 4, 1990. The amendment was aimed principally at abolishing restrictions on the operational term of the EJV. – See Konzue Hiraiwa, "Foreign Investment in the PRC, 1990-91", *China Newsletter*, No.96, Jan.-Feb. 1992

502 *The Provisional Regulations on the Term of Chinese-Foreign Equity Joint Ventures*, art. 2

unlimited duration and they should specify their operational term in the EJV contracts in accordance with the relevant laws and regulations. These unprivileged EJVs are those engaged in any of the following lines of business: (a) services trades like hotel, apartment or office buildings, entertainment, catering, taxi, color developing, maintenance and consultations; (b) land development, operation and management of real estate; (c) exploration and exploitation of resources; and (d) investment projects restricted by the State.[503] The required term varies for different industries and projects. *The Implementing Regulations on the EJVL* sets 10 to 30 years for an ordinary project.[504] A regulation promulgated by the State Council in Jan. 1986 provides that the operational term of an EJV may be extended to 50 years for the project requiring large amount of investment, long construction period and low rate of capital return, or the project producing sophisticated products or products competitive on the international market by using advanced or key technology provided by the foreign investors. This term may exceed 50 years subject to special approval of the State Council.[505]

There is no mandatory regulation concerning operational term of a CJV or a WFOE. The term of the CJV can be stipulated in its venture contract[506] and the term of the WFOE can be submitted in its application.[507] Their operational term can then be determined through flexible negotiations between the foreign investors and the Chinese review and approval authorities on a case by case basis.[508]

### *1.8 Repatriation of Profits and Principal*

Subject to the balance of foreign exchange, foreign investors can remit home their profits, dividends and interests earned in China by presenting an agreement or other relevant documents of profit distribution provided by the board of directors of the FIE concerned. The remittance does not require any special approval of the State Administration of Foreign Exchange Control.[509]

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[503] *Id.*, art. 3

[504] *The Implementing Regulations on the EJVL*, art. 100

[505] *Supra* note 10, p.19

[506] *The Implementing Regulations on the CJVL*, art. 47

[507] *The Implementing Regulations on the WFOEL*, art. 73

[508] *Supra* note 354, p.285

[509] *Supra* note 4, pp.122-123

As mentioned before, the FIE is prohibited from diminishing its registered capital during the term of business operation.[510] This means that China restricts free repatriation of FDI principal. However, the residual properties of a liquidated FIE including the partial or whole principle as well as the value in excess of the registered capital[511] that belong to the foreign investors can be repatriated freely after the appropriate income tax being paid.[512]

### *1.9 Types of Taxation and Tax Incentives for FDI*

With a view to create a favorable environment for equal competition between the FIE and domestic enterprises[513] and to introduce a new tax-sharing system between the central and local governments,[514] China made a fundamental tax reform towards the end of 1993.[515] Effective Jan. 1, 1994, the reform introduced a new system of indirect taxation composed of a value-added tax (VAT), consumption tax and business tax. The result has narrowed the tax gap between the domestic enterprises and the FIE[516] by adjusting the corporate income tax rate of the former to 33%, equivalent to that of the latter.[517]

(1) Taxes concerning the FIE

Presently, there are twelve types of taxes applicable to the FIE. They are corporate income tax, personal income tax,[518] VAT,[519] consumption tax,[520] business tax,[521] house

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[510] *The Implementing Regulations on the EJVL*, art. 22; *the Implementing Regulations on the CJVL*, art. 16; and the *Implementing Regulations on the WFOEL*, art. 22

[511] The liquidation of a FIE begins at the expiration of its operational term, its closure permitted by the original review and approval authorities, or its termination judged by the court or arbitrated by the arbitration agency. – *The Procedures for the Liquidation of Foreign Investment Enterprises*, art. 5

[512] *The Implementing Regulations on the EJVL*, art. 106

[513] *Supra* note 4, p.113

[514] *Supra* note 195

[515] Liu Fengming, *Joint-Stock Companies and FDI Law*, Press of the University of Political Science and Law of China, Apr. 1998, p.213

[516] *Supra* note 433

[517] *Supra* note 4, p.113

[518] Individuals who have a permanent place of abode in China or who have no such a place but reside in the country for a full year or more are required by law to pay personal income tax for their worldwide income. Individuals who neither has residence nor reside in China or who have no residence but reside there for less than one year shall pay personal income tax on their income earned within China. Individuals who travel to China temporarily are exempt from personal income tax if they stay in there less than 90 days in one calendar year cumulatively. – See the *Law of Individual Income Tax*, art. 1 and the *Implementing Regulations on the Law of Individual Income Tax*, art. 7

property tax,[522] land appreciation tax,[523] resource tax, customs duty, stamp duty,[524] tax on vehicle and vessel license plate,[525] and tax on slaughtering animals. The Central

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[519] China's VAT is levied on sales of goods or services of processing, repairs and replacement or importation of commodities within the country. Its rate is categorized into two: one is 13%, applicable to nineteen items of sales and importation of goods; the other is 17%, applicable to all the rest of sales and importation of commodities as well as to services of processing, repairs and replacement. – See the *Provisional Regulations on Value Added Tax*, articles 1 and 2

[520] Consumption tax is a turnover tax levied as an adjunct to the VAT in order to monitor the consumption of certain luxury commodities. In China, it is levied on production, sub-contracting for processing and importation of eleven items of consumer goods, including tobacco, alcoholic drinks and ethyl alcohol, cosmetics, skin care and hair protection products, jewelry and jade and precious stones, firecrackers and fireworks, gasoline, diesel oil, automobile tyres, motorcycles and motor cars. It is levied either *ad valorem* or on volume of the goods. – See the *Provisional Regulations on Consumption Tax*, art.1 and the attached table of taxable items.

[521] The business tax covers three kinds of business activities: provision of services (transportation, construction, finance and insurance, posts and telecommunications, culture and sports, entertainment and servicing), transfer of intangible assets and sale of immovable properties within the country. It is levied at either 3% or 5% according to the turnover of different taxable items except for that of the entertainment industry, in which case a business tax as high as 20% could be levied. – See the *Provisional Regulations on Business Tax*, art. 1 and the attached table of taxable items.

[522] House property tax is levied on a house property at 1.2% (this rate can be decided by the local provincial-level governments between 1% and 5%) on the basis of the residue of its original value deducted 10% - 30%, or at 12% in line with the rental of the house. – See *supra* note 515, p.220 and Hu Jinshan, *Comparison between New and Old Tax Laws and Detailed Interpretation of New Tax Law*, Reform Publishers, 1994, pp.308-309

[523] On Dec. 13, 1993, the State Council promulgated the *Provisional Regulations on Land Appreciation Tax*, according to which the land appreciation tax is levied on the income that derives from the transfer of land use rights, buildings and premises as well as related facilities attached thereon. The tax is imposed on a progressive basis:

| Gain in Excess of Cost | Tax Rate |
|---|---|
| Less than 50% | 30% |
| Portion between 50% and 100% | 40% |
| Portion between 100% and 200% | 50% |
| Portion above 200% | 60% |

Source: Hu Jinshan, *Comparison between New and Old Tax Laws and Detailed Interpretation of New Tax Law*, Reform Publishers, 1994, p.298

*The Provisional Regulations* grants tax exemption to the real property transaction in which the attributable gain of standard residential properties does not exceed 20% of the cost basis.

[524] This is a minor tax category and its rates range from 0.003% to 0.1%.

[525] Tax on vehicle and vessel license plate is a minor tax category. For example, the amount levied for a vehicle license plate in Shenzhen is between RMB 160 yuan and RMB 300 yuan, equivalent to US$ 19 to US$ 36, per year. – See Legend Holdings Co., Ltd., *Legend Science Park: Investment Policy*, p.4

Government collects corporate income tax, VAT,[526] consumption tax and customs duty while the local governments are responsible for the collection of the others.

The basic rate of the corporate income tax for the FIE is 30%. On top of this, a local surtax of 10% of the assessed tax, i.e., 3% of the taxable income of the FIE, is levied. The corporate income tax rate for the FIE as well as foreign enterprises[527] is thus 33% in general.[528] Foreign enterprises that have no establishments in China but derive income in the nature of dividends, interests, rentals, royalties and other earnings from sources within the country or that have establishments but the income is not necessarily derived from these establishments are subject to a 20% withholding tax on gross receipts.[529] The term "establishment" here includes a place of management, a branch, a representative office, a factory, a workshop, a mine, an oil and gas well or any other place of extraction of natural resources, a building site, a construction or installation project, a place for the provision of labor services, and a business agent and so on.[530] Upon approval, a reduced rate of 10% may be granted to the foreign investors with regard to certain royalties derived from their supplied proprietary technology for energy resource exploitation, transportation promotion, scientific research, important technology development as well as production of agriculture, forestry and animal husbandry. When these dividends, interests, rentals and royalties etc. are derived from within the SEZ, the ETDZ, and the old urban areas of the Coastal Open Cities, the same reduced 10% is applicable.[531] The withholding tax may be exempted totally if the foreign technology is advanced and their provided conditions are preferential.[532]

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[526] The central and local governments share the VAT, with the former possessing 75% and the latter 25%. – See *supra* note 515, p.214

[527] Under the *Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises* (art. 2, para. 2), foreign enterprises refer to foreign companies, enterprises or other economic organizations that have production or management establishments in China or that have no such establishments but derive income from sources within China.

[528] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 5

[529] *Id.*, art. 19

[530] *Supra* note 124, p.45

[531] *The Provisional Regulations on the Reduction and Exemption of Corporate Income Tax and Unified Industry and Commerce Tax in the Special Economic Zones and Fourteen Coastal Open Cities* (the State Council, Nov. 15, 1984), articles. 1(4), 2(4) and 3(3)

[532] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 19, (4)

In order to preserve and extend its attraction to foreign investment, China grants to FDI many incentives, the major form of which is preferential tax treatment with stress on the corporate income tax.

(2) Preferential taxation in prescribed periods

Any FIE of production nature scheduled to operate for no less than 10 years is exempt from the corporate income tax for 2 years from its first profit-making year and allowed a 50% reduction of this tax for the following 3 years.[533]

(3) Preferential taxation in designated areas

For the FIE established in the SEZ, foreign enterprises having establishments in the SEZ to engage in production or business operations, and the FIE of a production nature located in the ETDZ, Pudong New Area and the Bonded Areas,[534] the corporate income tax rate is reduced to 15%.[535]

For the FIE of a production nature established in the COEA, the old urban districts of the SEZ or the ETDZ,[536] the open cities near the border and the inland provincial capitals as well as the FIE in the State Tourist Resort Areas,[537] a reduced rate of 24% is applied.

(4) Preferential taxation both in designated areas and in prescribed periods

The FIE established in remote underdeveloped areas may upon approval be allowed a 15% to 30% reduction of the corporate income tax for 10 years following the expiration of its original period of tax exemption and reduction.[538]

(5) Preferential taxation both in defined industries and in prescribed periods

The EJV engaged in port and wharf construction with an operational term of no less than 15 years may upon approval be exempt from the corporate income tax for 5 years from its first profit-making year and allowed a 50% reduction of this tax for the following 5 years.[539] If this EJV does not operate more than 15 years, a 15% corporate income tax

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[533] Id., art. 8

[534] *Supra* note 127, p.19

[535] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 7

[536] *Id.*

[537] *Supra* note 127, p.19

[538] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 8, para. 3

[539] CCPIT, *China Business Guide: 1998/1999*, http://www.ccpit.org/engVersion/cp_infor/cp_cbg/cbg 4_2.html

rate applies.

The FIE engaged in agriculture, forestry and animal husbandry may upon approval be allowed a 15% to 30% reduction of the corporate income tax for 10 years following the expiration of their original period of tax exemption and reduction.[540]

(6) Preferential taxation both in designated areas and in defined industries

(A) The FIE established in the COEA, the old urban districts of the SEZ and the ETDZ, or other areas designated by the State Council may be levied at a reduced corporate income tax rate of 15% if it falls under the project of energy, transportation, port and wharf and that encouraged by the State.[541]

(B) With regard to the FIE of production nature that is established in the old urban areas of the Coastal Open Cities and the cities proper of the three SEZs of Shantou, Zhuhai and Xiamen, a reduced 15% corporate income tax rate is applied upon approval when it is technology-intensive or intelligence-intensive. And the FIE of production nature in these areas may enjoy the same corporate income tax treatment if it has a total investment of over US$ 30 million and needs a long period for capital return or if it falls into a project of energy, transportation and port construction.[542]

(C) High and new technology enterprises located in the HNTIDZ enjoy a reduced 15% corporate income tax rate from the date when they have been identified to the status.[543] Enterprises outside the HNTIDZ are entitled to the same tax treatment if they are granted the same standing.[544]

(D) For the FIE established in the central and western regions and falling under the encouraged or restrictive categories specified in the *Catalogue of the Guidance for Foreign Investment Industries*, its corporate income tax rate is reduced to 15% for 3 years

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[540] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 8, para. 3

[541] *Id.*, art. 7, para. 3

[542] *The Provisional Regulations on the Reduction and Exemption of Corporate Income Tax and Unified Industry and Commerce Tax in the Special Economic Zones and Fourteen Coastal Open Cities*, art. 3(1)

[543] *Supra* note 127, p.19

[544] On Jan. 17, 1996, the State Science and Technology Commission promulgated the *Requirements and Methods of Identifying New High-Tech Enterprises outside the HNTIDZ*, according to which enterprises outside the HNTIDZ are tested in order to have the status. – See *supra* note 515, p.228

after the expiration of the original tax exemption and reduction.[545]

(E) Foreign banks and EJV banks established in Shenzhen SEZ are exempt from the business tax for 5 years commencing on the date of their operation.[546]

(7) Preferential taxation in designated areas, defined industries and prescribed periods

(A) The FIE engaged in infrastructure and agriculture development projects in Hainan Province with an operational term of over 15 years are upon approval entitled to an exemption from the corporate income tax for 5 years from its first profit-making year and a 50% reduction for the following 5 years.[547]

(B) The FIE engaged in energy and transportation projects of airport, port, railway, highway and power station in Pudong New Area with an operational term of over 15 years are upon approval entitled to the same preferential tax treatment from its first profit-making year.[548]

(C) For foreign invested high and new technology enterprises established in the HNTID and with an operational term of no less than 10 years, its corporate income tax is entitled to a 50% reduction for 6 years after 2 years of exemption of the corporate income tax from its first profit-making year,[549] of which 3 years are granted under the *Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*[550] and another 3 years under the *Regulations on Encouragement of Foreign Investment.*[551] In Shenzhen SEZ, this kind of enterprises is allowed such a reduction for 2 more years.[552] Plus a reduced 15% corporate income tax rate, foreign investors at present enjoy the most preferential tax treatment in China when they invest in the high and new technology enterprises. The status of these enterprises, however, must be officially approved according to a set of

[545] *Id.*

[546] Shenzhen Municipal Foreign Investment Bureau, *Investment Policies: 1999*, http://www.fdi-shenzhen-cn.com/policy.html

[547] *The Provisions on the Encouragement of Investing and Developing on Hainan Island*, art. 12 (1)

[548] "Appendix IV: Preferential Policies in Pudong New Area" in Zhao Qizheng (ed.), *New Era, New Pudong*, Fu Dan University Press, Apr. 1994

[549] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art. 8

[550] *Id.*

[551] *The Regulations on Encouragement of Foreign Investment*, art. 2

[552] Shenzhen Council for the Promotion of International Investment, *Summary of the Preferential Policies of Shenzhen Concerning Foreign Investment*, Jul. 1998, p.10

standards[553] by the government authorities in charge of science and technology administration at or above provincial level.

(D) The FIE of service nature established in the SEZ with an investment of over US$ 5 million and an operational term of more than 10 years is upon approval entitled to an exemption from the corporate income tax for 1 year from its first profit-making year and a 50% reduction of this tax for the following 2 years.[554]

(E) Branches of foreign banks, wholly foreign-owned banks, Chinese-foreign jointly invested banks and financial companies as well as other financial institutions established in the SEZ and with an operational term of more than 10 years are entitled to exemption from the corporate income tax for 1 year from their first profit-making year and a 50% reduction of this tax for the following 2 years provided that their registered capital is more than US$ 10 million or their operating funds allocated by the head offices exceed the same figure.[555]

(F) For wholly foreign-owned banks, Chinese-foreign jointly invested banks and financial companies as well as other financial institutions established in Pudong New Area and with the registered capital of US$ 10 million or more and an operational term of 10 years or longer, the corporate income tax can be levied at a reduced rate of 15%.[556]

(8) Preferential taxation for export-oriented enterprises and technology-advanced enterprises

An export-oriented enterprise is a "production enterprise that produces primarily for export and that has a foreign exchange surplus after deducting its foreign exchange expenditures and its foreign exchange profits repatriated by the foreign investors from the total foreign exchange earnings of the enterprise".[557] A technology-advanced enterprise is an "enterprise to which foreign investors provide advanced technology to explore the

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[553] *The Circular on Revising the Methods of Identifying New High-Tech Enterprises in Shenzhen* (the Science and Technology Bureau of of Shenzhen, Document No. Shenke [1998] 32)

[554] *The Provisional Regulations on the Reduction and Exemption of Corporate Income Tax and Unified Industry and Commerce Tax in the Special Economic Zones and Fourteen Coastal Open Cities*, art. 1(1), para.2

[555] *Supra* note 539

[556] *Supra* note 548

[557] *The Regulations on Encouragement of Foreign Investment*, art. 2. 1

production of new products, upgrade and replace present products in order to increase export and foreign exchange earnings or substitute imports".[558] The MOFTEC has provided detailed criteria for identifying a technology-advanced enterprise, which are (a) the technology, process and major equipment adopted by the enterprise are advanced and practically applicable; (b) the provided technology, process and equipment are scarce or non-existing in China; (c) the products made by the enterprise are newly developed, or the enterprise can upgrade and replace similar existing domestic products and increase exports or substitutes imports.[559] Based on the individual investment contract, the identification of an export-oriented enterprise or a technology-advanced enterprise should be confirmed jointly by the local department of foreign trade and economic cooperation where the enterprise is located and the other relevant local governmental department.[560]

Preferential tax treatment for these two types of the FIE is like this. Upon the expiration of its initial period of tax exemption and reduction, the export-oriented FIE may receive a 50% reduction of the corporate income tax in any particular year when the value of its exported products reaches or surpasses 70% of its total production value in that year. If this tax rate goes below 10% subsequent to the reduction, a 10% rate applies. As for the technology-advanced FIE, it is entitled to a 50% reduction of the corporate income tax for additional 3 years following the expiration of its initial period of tax exemption and reduction. When this tax rate goes below 10% subsequent to the reduction, a 10% rate is applicable as well.[561]

(9) Preferential taxation on reinvestment of profits

Foreign investors reinvesting their share of profits in the same FIE by increasing its

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[558] *Id.*, art. 2

[559] *The Procedures for Determining and Examining the High-Tech and Export Foreign Investment Enterprises* (Feb. 2, 1992), art. 4

[560] *The Regulations on Encouragement of Foreign Investment*, art. 18

[561] According to the *Provisions for the Encouragement of Foreign Investment*, the preferential treatment conferred on export-oriented and technology-advanced enterprises also includes site development and land use fees etc. The site development fee covers the costs of resettling residents living on the site and establishing basic public utilities such as water, electricity and roads. The land use fee is simply a rental. There are two ways of collecting the fees. One is imposing a lump sum payment for the site development fee and collecting the land use fee on an annual basis, and the other is combining the two and collecting them annually.

registered capital or in a newly created FIE with an operational term of no less than 5 years is entitled to a 40% refund of the corporate income tax paid on the reinvestment. When the reinvestment is made for the establishment or expansion of an export-oriented enterprise, a technology-advanced enterprise, or an enterprise engaged in infrastructure or agriculture development projects in Hainan SEZ,[562] a full amount of the corporate income tax paid on the reinvestment is entitled to be refunded.[563]

(10) Customs duties and import-related VAT

For FDI projects that fall under the encouraged category and restricted category B specified in the *Catalogue of the Guidance for Foreign Investment Industries* and that are involved in technology transfer, their equipment imported for self-use within the total investment amount as well as the accompanying technology, spare parts and accessories provided in the contract can be exempted from customs duties and import-related VAT except those commodities listed in the *Non-Exempted Import Items for Foreign Invested Projects*.[564] In order to encourage FDI, this preference has been extended. For foreign invested R&D centers as well as technology-advanced and export-oriented enterprises that are involved in technology transfer, their imported equipment, technology, spare parts and accessories within the approved business scope are also entitled to the exemption from customs duties and import-related VAT on condition that these equipment and accessories are not available in China or their functions can not meet the demands of the projects.[565]

Products produced by the FIE for export are exempted from export duties except the commodities that are restricted for export or where there exist special provisions of the State.[566]

(11) Preferential local surtax of corporate income tax

Governments of provinces, autonomous regions and municipalities directly under the

[562] *The Provisions on Encouragement of Investing and Developing on Hainan Island*, art. 19, para. 2

[563] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, Art. 10

[564] *The Circular on Adjusting the Taxation of Imported Equipment*, articles 1(1) and 1(3)

[565] The decision was made by the General Customs Office. – See *International Business Daily*, Jan. 22, 2000, p.7

[566] *Supra* note 4, p.136

Central Government are allowed to reduce the local surtax of the corporate income tax (the 3% part) or to exempt it totally in the light of their individual situations.[567]

Subject to the provisos provided by law, local governments also grant the FIE that is deemed to be beneficial to the local economy incentives such as reduction of and exemption from other local surcharges including land use fee.

### *1.10 Labor Management*

The FIE has full decision-making power in its labor management, including independently deciding the structure of the business organization, the establishment of the work force and the dismissal of the employees.[568]

The labor management of the FIE is based on employment contract. The FIE is required to sign the employment contracts with its Chinese employees, collectively or individually. Matters pertaining to employment and dismissal, tasks of production and other duties, wages, awards and punishment, working and vacation, labor insurance and welfare, labor protection and discipline are all stipulated the employment contracts. With approval of the relevant labor administrative authorities, the FIE can employ workers and staff members beyond the regions where the FIE is located as well as recruit the personnel of special technical ability from abroad and senior foreign technicians and administrators who are unavailable in China.[569]

The FIE can terminate the employment contracts and dismiss the employees when (a) the employees are proved to be unqualified for their jobs on probation or after training and adjustment; (b) they have gravely infringed the rules and regulations of the FIE or caused great losses to the enterprises because of their serious dereliction of duties; or (c) they have violated the law and committed crimes.[570] However, the FIE is not allowed to

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[567] *The Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises*, art.9

For detailed introduction on the local corporate income tax reduction and exemption, refer to Xuanhui Wang, "Summary of the Local Corporate Income Tax Reduction and Exemption Concerning FIEs in Provinces, Autonomous Regions and Municipalities Directly under the Central Government", *Taxation*, the Association of Taxation of Fuzhou, No.3, 1995, pp.11-17

[568] Xu Jinghe etc., *China's Utilization of FDI: Legal Theory and Practice*, Vol. 2, the People's Court Publishers, Jan. 1999, pp.365-366

[569] *Supra* note 4, p.124

[570] *The Labor Law*, articles 25 and 26

fire the employees when its workers or staff members are in one of the following circumstances: (a) they have lost their total or partial labor capabilities owing to occupational diseases or injuries at work; (b) they are receiving treatment for illness or injuries during provided treatment period; or (c) they, for female employees, are pregnant, giving birth or nursing.[571]

The FIE assumes legal responsibilities of providing welfare and insurance for the employees. It is required by law to pay for the workers and staff members the social insurance of medical treatment, unemployment and work injury to the social insurance organizations designated by the Chinese government.[572] It also needs to set aside housing subsidiary funds for the employees according to the stipulations.[573]

## 2. Canada's FDI Law of General Application

*The Investment Canada Act* is the major statute on the subject of FDI in Canada[574] and the only domestic law with regard to FDI general application.[575] It concentratively reflects Canada's legislative approach to FDI.[576]

### *2.1 Provisions of the ICA*

#### 2.1.1 Applicable Scope

The ICA only applies to non-Canadians when they invest in Canada,[577] so the first question that confronts foreign investors is what a non-Canadian is. Under the ICA, a non-Canadian means an individual or a government that is not a Canadian, or an entity that is not Canadian-controlled.[578] But what is a non-Canadian individual, government or entity? To further answer these questions, we had better first to clarify the meaning of a Canadian individual, government and entity.

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[571] *Id.*, art. 29

[572] *Supra* note 4, p.124

[573] *Id.*

[574] Graeme C. Hughes, *Foreign Investment Law in Canada*, Carswell, 1983, "Preface"

[575] *Supra* note 4, p.57

[576] *Supra* note 574, p.64.1-17

[577] Non-Canadians must file either notifications or applications for review of their investments unless a specific exemption applies.

[578] The ICA, s.3

An individual Canadian means a Canadian citizen[579] or a permanent resident who has been ordinarily resident in Canada for no more than one year after the time at which he first became eligible to apply for Canadian citizenship.[580] Under the *Citizenship Act*, R.S.C. 1970, c.C-19, it is possible to have dual citizenship, yet a person resident in Canada with Canadian citizenship and another citizenship would be considered a Canadian citizen for the purpose of the ICA. For a permanent resident who has never resided in Canada, he is treated as a Canadian for four years from the date of arrival in Canada.[581] But this Canadian status will be lost if he does not apply for Canadian citizenship after the four-year period for it is considered that a landed immigrant who does not take out Canadian citizenship may not be deeply committed to Canada and thus should not enjoy all the benefits of Canadians.[582] However, for the investments made in Canada during the four-year period by the permanent residents who never take out their Canadian citizenship afterwards, the ICA is not retroactive.[583] The ICA does not apply where the investor is a Canadian citizen or a permanent resident defined as the above.

A Canadian government includes the federal, a provincial or local government. The ICA applies only to those other than these governments.

An entity could be a corporation, partnership, trust or joint venture.[584] What is a Canadian or Canadian-controlled entity? The ICA defines as follows:

(A) It is a Canadian-controlled entity if one Canadian or two or more Canadian members of a voting group[585] own its majority voting interests;[586]

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[579] Under the *Citizenship Act*, R.S.C. 1970, c.C-19, it is possible to have dual citizenship. A person resident in Canada with Canadian citizenship and another citizenship would be considered a Canadian citizen for the purpose of the ICA.

[580] The ICA, s.3

[581] Russell Deigan, *Investing in Canada: The Pursuit and Regulation of Foreign Investment*, De Boo, 1991, p.48

[582] *Id.*, p.49

[583] *Id.*

[584] The ICA, s.3

[585] Under s. 3 of the ICA, "'voting group' means two or more persons who are associated with respect to the exercise of rights attached to voting interests in an entity by contract, business arrangement, personal relationship, common control in fact through the ownership of voting interests, or otherwise, in such a manner that they would ordinarily be expected to act together on a continuing basis with respect to the

(B) It is a Canadian-controlled entity if Canadians own its majority voting interests and the entity is not controlled in fact through the ownership of its voting interests by one non-Canadian or a voting group dominated by non-Canadians' voting interests;

(C) It is a Canadian-controlled entity if the entity is controlled in fact through the ownership of its voting interests by one Canadian or a voting group dominated by Canadians' voting interests, even though Canadians own less than a majority of the entity's voting interests;

(D) In the case of a corporation or limited partnership, it is a Canadian-controlled entity if the corporation or limited partnership is not controlled in fact through the ownership of its voting interests and 2/3 of its board members or general partners are Canadians, even though Canadians own less than a majority of the voting interests of the corporation or limited partnership;[587]

(E) In the case of a trust, it is a Canadian-controlled entity if the trust is not controlled in fact through the ownership of its voting interests and 2/3 of its trustees are Canadians;[588] and

(F) For a publicly traded Canadian incorporated corporation, it is deemed to be Canadian if the corporation can on application satisfy the responsible minister that: (a) the majority of its voting shares are owned by Canadians; (b) 80% of its board members, its chief executive officer and three of its four highest paid officers are Canadian citizens ordinarily resident in Canada; (c) its board of directors supervises the management of its business and affaires on an autonomous basis without direction from any shareholder other than through the normal exercise of voting rights at shareholders' meetings; (d) its

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exercise of those rights". Its two preconditions are (a) the ownership of shares or other voting interests by the alleged group members and (b) the existence of a relationship between the alleged group members.

[586] The determination of Canadian or Canadian-controlled status generally focuses on the ownership of the entity's voting interests, yet the ICA acknowledges two forms of *de facto* control where the control is not exercised through the ownership of voting interests. The most important is minority or working control, in which a minority shareholder can attract sufficient proxies to control a majority of the votes or has considerable influence over or affinity with company management. The other is a minor form where the minority shareholder is placed in a majority position when attendance at shareholders' meetings is very low. – See *supra* note 581, p.41

[587] The ICA, s.26(1)

[588] *Id.*, s.26(2)

principal place of business is located in Canada; and (e) these circumstances have existed for at least one year immediately preceding the application.[589] It must be noticed, however, this deeming remains valid only for a maximum of two years or less where there is a change in material facts [590] although a new application is allowed after the expired time. Furthermore, this deeming does not apply to the purchase and establishment of cultural businesses. Any foreign investment concerning a company with deemed Canadian status needs undergo the notification process of the ICA although it is exempted from the ICA's review provision.[591]

When an entity does not fall into the category of the above, it is a non-Canadian entity and thus has to consider the ICA's application for its investment in Canada.

Non-Canadian is a specific term used in the ICA to indicate foreign investor of a more general sense. In this thesis hereafter, therefore, the term of foreign investor can refer to non-Canadian.

### 2.1.2 New Canadian Businesses

When a foreign investor makes an investment in Canada, the next concerned legal issue is whether he acquires or establishes a Canadian business.

Generally, business is an active business that makes profits or has the potential to do so.[592] The ICA defines that "business includes any undertaking or enterprise capable of generating revenue and carried on in anticipation of profit".[593] In the light of this definition, two components, i.e., a revenue-generating capability and a profit motive, must be present for a business. Accordingly an undertaking or enterprise must actively produce revenue earning goods or services to earn revenue. Activities other than revenue-generation are not considered to be a business within the meaning of the ICA. These activities could include market research, test marketing or feasibility studies if they are in a pre-operational state due to the lack of an essential asset, source of supply or

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[589] *Id.*, s.26(3)
[590] *Id.*, s.26(5)
[591] *Supra* note 581, p.75
[592] *Supra* note 424, p.II15,000-3
[593] The ICA, s.3

manpower.[594] To be qualified as a business, there must also be an intention to make a profit for an undertaking or enterprise. Otherwise this undertaking or enterprise is not a business. An undertaking carried on with a charitable or other non-profit objective rather than in anticipation of profit is thus not a business according to the *Interpretation Note No. 4*.[595] Foreign investors can acquire the control of charitable or other non-profit undertakings without the application of the ICA. However, a few charities in Canada use their charitable activities to justify their status but pay big salaries and benefits to the organizers and operators. The question has been raised whether these payments constitute a profit and these charities have been accused of being businesses producing profits for their organizers.[596] The acquisition of these undertakings may thus be challenged one day in the future.

A Canadian business is defined in the ICA as a business that has a business place, employs an individual or individuals[597] and uses assets in carrying on the business, all in Canada. Under the ICA, a new Canadian business means a business that is not already being carried on in Canada by a foreign investor and that, at the time of its establishment, is either unrelated to any other business being carried on in Canada by that foreign investor or in a type of business related to Canada's cultural heritage or national identity.[598]

(1) Related business

A new foreign invested Canadian business is undoubtedly subject to the ICA. However, certain related businesses, i.e., businesses related to any other established Canadian business carried on by the same foreign investor are not considered to be the establishment of new businesses and thus not subject to the ICA's provisions. The related business indicates (a) continuity of the existing business that only involves new premises, new personnel or internal reorganization; (b) expansion of the existing business that involves producing goods or services which are substantially similar to the goods or

[594] Industry Canada, Investment Canada, *Interpretation Note No. 4*, http://investcan.ic.gc.ca/ en_doc_i. htm
[595] *Id.*
[596] *Supra* note 424, p.II15,000-9
[597] A Canadian business can also mean a self-employed business. – Also see the ICA, s.3
[598] The ICA, s.3

services produced by the existing business or using all of the newly produced goods or services in carrying on the existing business;[599] (c) vertical integration, the providing business of which produces goods or services used as inputs into or in furtherance of the other business and these goods or services represent more than 50 % of the integrated providing business' output in value terms; (d) import substitution in which the business is predominantly engaged in the manufacture or assembly of proprietary goods that are currently being imported into Canada by the existing business; (e) product substitution in which the business produces a product or service that is directly substituted for an existing product or service being produced in Canada by the existing business and the substituted product or service represents more than 50% of the new business' output in value terms; (f) similar technology in which the technology and production processes used in the new business are essentially the same as those used in the existing business; or (g) research and development in which the products or services produced by the new business are based on research and development carried out in Canada by or on behalf of the existing business. For such status, both the new and existing businesses must be in an industrial sector with the same three digital category of the *Standard Industrial Classification* published by Statistics Canada[600] and the new business generally should be the more effective carrying on of the existing business.[601]

Besides, other interpretation notes issued by the responsible minister[602] give detailed interpretations on other forms of businesses, some of which are subject to the ICA and

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[599] According to the *Related-Business Guidelines* issued by Industry Canada, however, a foreign investment proposing to publish, distribute or sell a magazine or periodical in print or in a machine readable form in Canada is always deemed to be a new Canadian business rather than an expansion of an existing business and is thus subject to notification, no matter whether the foreign investor is already in this business activity or not. – See Industry Canada, Investment Canada, *Related-Business Guidelines*, http://investcan.ic.gc.ca/en _doc_g.htm

[600] *The Standard Industrial Classification* contains a codification of Canadian economic activities. It divides businesses into groups, classes and categories with a three-digit identification number. – See *supra* note 424, p.II25,000-13

[601] Industry Canada, Investment Canada, *Related-Business Guidelines*, http://investcan.ic.gc.ca/en _doc_ g. htm

Although the *Guidelines* are issued under the authority of the ICA, they are only administrative rules and do not have the force of law.

[602] Industry Canada, Investment Canada, *Interpretation Notes*, http://investcan.ic.gc.ca/en_doc_i. htm

some are not. Foreign investors have to know these interpretations to further judge their investments in Canada.

(2) Defunct business

A business is a defunct one when it has been ceased normal operations and permanently closed, abandoned or discontinued due to its unprofitability, depletion of reserves, or obsolete plant, machinery, equipment, technological processes or product lines.[603] A defunct business is not a business as defined in the ICA and its acquisition of control is therefore not subject to the *Act*.[604] However, if the assets of the defunct business are purchased as the basis for establishing a new Canadian business, such establishment may be subject to the ICA.

(3) Temporary closure

A business that has temporarily closed or suspended its operations is still considered to be a business and thus subject to the ICA. The reasons of the closure or suspension could be labor disputes, shortages of raw material, decline in demand for products, periodical fluctuations in the business cycle or temporary financial difficulties.[605] The boundary between a defunct business and the temporary closure of a business lies in the "temporary" time limit. The temporarily closed business becomes a defunct business if it was first closed out of a temporary decision for some above-mentioned reasons but eventually ends up with the result of permanent closure due to the continuing problems that could not be solved during the course of its temporary closure. The meaning of "temporary" suggests that the temporarily closed business still function to certain extent, such as retaining some employees to keep the business in a minimum condition to start up again.

(4) Bankruptcy or receivership

When the assets of a business can no long compensate its liabilities but has not gone defunct only because the assets have been placed in the hands of a trustee in bankruptcy or a receiver-manager, there could be two ways how the trustee or receiver handles the

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[603] Industry Canada, Investment Canada, *Interpretation Note No. 1*, http://investcan.ic.gc.ca/en_ doc_i. htm

[604] *Id.*

[605] *Id.*

assets. If the trustee or receiver takes the responsibility of the business and continues to carry on its operations with a view to disposing of the business as a going concern or to reorganize its affairs, the business still retains its basic character and therefore subject to the ICA. If the trustee or receiver ceases to carry on the business and liquidates the assets on a piecemeal basis, the operation is no longer considered to be a business and therefore not subject to the ICA.[606]

(5) Separate or separable business

A Canadian business includes a part of a business that is capable of being carried on as a separate or separable business.[607] This sort of business is an identifiable part of an existing Canadian business that has the capacity to be carried on separately. Whether it has such capacity depends on the degree of actual or necessary interconnection or interdependence between the separate or separable part and the remainder of the Canadian business. Its determination is relevant to the answers to the following factors. (a) Does the part have separate accounting mechanisms, management, advertising, selling, purchasing, delivery, customers or an identifiable group of employees? (b) Are the operations of the part carried on under a separate license, patent or similar right? (c) Is the part carried on in separate premises, or are the physical assets of the part segregated from the remaining business operations? (d) And does the part supply or provide some service that is more than purely incidental or ancillary to the remaining business operations?[608]

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[606] *Id.*

[607] The ICA, s.31(2)

[608] Industry Canada, Investment Canada, *Interpretation Note No. 2*, http://investcan.ic.gc.ca/en_doc_i. htm

For the determination of a separate or separable business, Hayden suggested to consider the following factors:

(1) Whether the physical location of the business operation is different from those of the other divisions of the business;
(2) Whether the equipment of the business operation is connected with any of the other divisions;
(3) Whether inventory is purchased and accounted for separately;
(4) Whether the sources of material for the business operation are different from those for the other divisions;
(5) Whether the customers for the business are different from those for the other divisions;
(6) Whether the staffs are separate and distinct from each other;
(7) Whether the general accounting procedures are broken down as between business operations;
(8) Whether the operations are under control of different members of the board of directors;
(9) Whether there is a single union or employee contract for the whole corporation; and

The concept of the separate or separable business extends the acquisition of control provisions of the ICA to the acquisition of control of a part of a Canadian business that is capable of being carried on separately, but it is only relevant to the ICA when a foreign investor is acquiring control of a Canadian business by purchasing all or substantially all of the assets of such a business.[609] Many Canadian businesses are carried on partly in and partly outside Canada. It must be noticed that the acquisition of the assets of the separate parts of a Canadian business that is carried on outside Canada is not subject to the ICA because these separate business parts do not fall within the ICA's definition of Canadian business.

(6) Oil, gas and other mineral properties

*Interpretation Note No. 4* states that as opposed to producing properties, undeveloped potential oil and gas properties do not constitute businesses. An exploratory oil and gas property without knowing its reserves is not a business, but it is considered to be a business when the property has been determined to contain economically recoverable quantities of oil or gas and the drilling of a well to recover the oil or gas for the purpose of production has commenced.[610] In the case that a property contains recoverable oil or gas reserves and is capable of production but has been temporarily shut-in, the property is still considered to be a business.[611] The above rules are applicable to determining whether other mineral properties are businesses or not[612] for the purpose of the ICA.

### 2.1.3 Acquisition of Control

For the purpose of the ICA, foreign investors acquire control of a Canadian business by these manners: (a) acquisition of voting shares of a Canadian incorporated corporation carrying on a Canadian business; (b) acquisition of voting interests of an entity that

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(10) Whether there is a single insurance and pension plan covering all employees of all the corporation. – See *supra* note 424, pp.II 20,000-22-23

[609] *Supra* note 424, p.II15,000-20.

The issue of "substantially all" of the assets used in carrying on a Canadian business will be discussed more in the next part of the thesis.

[610] Frank J. Sixt and Donald H. Watkins, "The Oil and Gas Extractive Industries" in H. Heward Stikeman and R. Fraser Elliot etc., *Doing Business in Canada*, Matthew Bender, Oct. 1998, Vol. 3, p.23-30

[611] *Supra* note 594

[612] *Id.*

carries on a Canadian business or directly or indirectly controls another entity carrying on a Canadian business; or (c) acquisition of all or substantially all of the assets used in carrying on a Canadian business.[613]

(1) Share purchase

When determining who controls a corporation, the central concept is voting share. Voting share means a share in the capital of a corporation to which is attached a voting right ordinarily exercisable at meetings of shareholders of the corporation, and a right to receive a share of the profits or to share in the assets of the corporation on dissolution or both.[614] For differently structured corporations, the acquisition of control rules of the ICA is different.

(A) Direct acquisition of control – Canadian incorporated corporation

The acquisition of a Canadian enterprise is considered direct where it involves the acquisition of a corporation carrying on a Canadian business.[615] Under the ICA, whether the corporation is controlled through acquisition is decided on the basis of its purchased amount of voting shares. When more than 50% of its voting shares is acquired, it is deemed to be the acquisition of control of that corporation.[616] When less than 1/3 of its voting shares is acquired, it is deemed to be non-acquisition of control.[617] When a foreign investor purchases between 1/3 and 50% inclusive of its voting shares, it is presumed that he has acquired control of the corporation,[618] but he will be exempted from the jurisdiction of the ICA if he can prove that he does not control the corporation in fact through the ownership of voting shares.[619]

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[613] The ICA, s.28(1)

[614] *Id.*, s.3

[615] *Supra* note 210, p.245, note 290

[616] The ICA, s.28(3)(a)

[617] *Id.*, s.28(3)(d)

[618] But if the foreign investor purchases less than 50% of the voting interests of an entity other than a corporation, such as a partnership, a trust or a joint venture, it is deemed that he has not acquired the control of that non-corporate entity instead. – See the ICA, s.28(3)(b)

It also merits attention that if a Canadian and a non-Canadian each own 50% of the voting interests of a corporation, the non-Canadian is deemed to have controls over the corporation. This "equal ownership" rule is provided unconditionally, but it comes into play only where there are two shareholders. – See the ICA, s.26(6)

[619] The ICA, s.28(3)(c)

(B) Chain of control – Canadian company that controls Canadian company

When a foreign investor purchases a Canadian holding company that owns an interest in another Canadian company carrying on a Canadian business, it must be decided whether the Canadian holding company controls the other Canadian company for the purpose of the ICA. If the Canadian holding company is found to control the other Canadian company, it is an acquisition of control of a Canadian business and the transaction is subject to the ICA.[620] If it is found that the Canadian holding company does not control the other Canadian company, there is no acquisition of control of the Canadian business and the ICA is thus not applicable. This rule would be so regardless of how many companies are interposed in the corporate chain between a Canadian holding company and other Canadian companies.[621]

(C) Indirect acquisition of control – foreign company with Canadian subsidiary, partnership, trust or joint venture

An entity that controls another entity is deemed to control indirectly any entities controlled by that other entity.[622] Where a foreign investor acquires control of a corporation incorporated outside Canada that in turn controls a Canadian subsidiary, partnership, trust or joint venture, an indirect acquisition of control occurs.[623]

(D) Foreign company with Canadian branch business

The offshore share purchase of a foreign corporation carrying on a branch business in Canada is not within the jurisdiction of the ICA,[624] and such a transaction is neither reviewable nor notifiable. The rationale behind this is that there has been a change in ownership of a foreign company but no change whatsoever in the title to the assets in Canada that constitutes the branch business.[625]

(2) Asset purchase

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[620] *Supra* note 581, p.121

[621] *Supra* note 424, p.II20,000-33

[622] The ICA, s.28(2)(a)

[623] *Supra* note 424, p.II20,000-32

[624] *Supra* note 424, p.II20,000-31

[625] This viewpoint was clearly explained by Canadian government officials as early as in 1972. – See *supra* note 581, p.126

Assets include "tangible and intangible property of any value".[626] Tangible assets are those visible assets such as buildings and machinery etc. and licenses, goodwill, patents, trademarks, accounts receivable and leasehold interests are all intangible property.[627] A foreign investor acquires control of a Canadian business if he acquires all or substantially all of the assets used in carrying on the Canadian business.[628]

The distinction between subsidiaries and branch businesses is decisive to the ICA's jurisdiction when the shares of a foreign company are purchased but this distinction is irrelevant to the ICA when assets are bought. It means that the ICA does not apply to the foreign investors who purchase the shares of a foreign company with a Canadian branch business but applicable to the foreign investors who buy all or substantially all of the assets of the Canadian branch business of the same foreign company. As mentioned before, this is because title to the assets of the branch business remains unchanged when the shares of the foreign company that owns those assets are purchased while the assets like real estate and vehicles have to be registered in the name of the new owners when the branch business is purchased directly.[629] It must also be noted that the ICA captures the purchase of a business that leases its assets. Foreign investors who take assignments of leases from the vendor are accordingly in no better position than purchasers of the underlying assets. However, rights granted to a Canadian business under a license agreement are not assets since a license passes no interest and such transactions are not under the ICA's jurisdiction.[630] For the application of the ICA, the purchased assets are supposed to be those in carrying on a business. If the business has ceased to operate, the purchase of all or substantially all of its assets does not affect the *Act*.

What does "substantially all" imply? The ICA does not define. *Interpretation Note No. 3* yet gives quite a detailed explanation. It is not purely a quantitative issue based on the proportionate value or number of assets. *The Note* sets a quality criterion for the consideration. Assets have a qualitative value that has a significant effect in determining

[626] The ICA, s.3
[627] *Supra* note 581, p.128
[628] The ICA, s.28(1)(c)
[629] See *supra* note 581, pp.127-128
[630] See *supra* note 581, pp.128-129

whether the acquisition of less than all the assets of a business constitutes the acquisition of substantially all of the assets used in carrying on the business. Where the operating assets essential to the continuance of the business are acquired, the control of the business would probably be met; otherwise the control of the business is not acquired. How to determine "essential assets"? *The Note* goes on to explain that they are the assets without which the business can not reasonably be expected to carry on. These interpretations have explained and clarified the "substantially all" issue. In practice, however, the question whether an asset purchase constitutes the acquisition of control of a Canadian business is still arisen.[631] A look at *Burnaby Paperboard Ltd.* v. *M.N.R.*, [1967] Tax A.B.C. 1053, 68 D.T.C.12, one Tax Appeal Board case in which the similar problem was considered, may help to understand the issue. The Board concluded that: "[n]othing in the evidence shows that the consideration paid was not received for the assets, rights and good will of the building materials business as a whole, or that any part of the consideration was paid or received for inventory alone, or for equipment alone, or for any asset or right by itself. In this transaction, substantially all of the tangible and intangible assets of the building materials business were sold, and what is more significant is the fact that [the] appellant renounced its former name in favor of the purchaser. As a matter of fact, the above-mentioned document says that [the] appellant could no longer compete in the roofing business in Canada within a certain limited period of time".[632] In *Re 85956 Holdings Ltd.* v. *Fayerman Brothers Ltd.*, the court simply said that "substantially all" means an asset "sale that would effectively destroy the corporate business".[633]

Whatever "substantially all" of the assets are, its proportion in the assets is, within the purview of the ICA, certainly much higher than the proportional majority (50%) of the shares of a corporation. Consequently, foreign investors may escape the ICA's review procedure by structuring a transaction as an asset purchase instead of a share acquisition and at the same time own a much higher interest without being subject to Canadian government scrutiny.[634]

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[631] *Supra* note 424, p.II20,000-18

[632] *Supra* note 424, p.II20,000-21

[633] *Re 85956 Holdings Ltd.* v. *Fayerman Brothers Ltd.*, [1986], 25 D.L.R.(4th)119, at 124

[634] *Supra* note 581, p.132

*Interpretation Note No. 3* clearly indicates that liquid assets such as cash, promissory notes and investment portfolios are not considered assets essential to the continuance of a business under the ICA in most cases.[635]

(3) Partnership, trust and joint venture[636]

The ICA defines voting interests under three categories. The first means a voting share in respect of a corporation with share capital. The second means an ownership interest in the assets in respect of a corporation without share capital, which entitles the owner to rights similar to those enjoyed by the owner of a voting share. The third means an ownership interest in the assets with respect to a partnership, trust or joint venture. This voting interest entitles the owner to receive a share of the profits and to share in the assets on dissolution.[637]

Foreign investors who purchase an interest in a Canadian or offshore partnership, trust or joint venture that carries on a business in Canada or controls a Canadian-based partnership, trust, joint venture or corporation that carries on a business in Canada may have to comply with the ICA. The acquisition of control rules for partnerships, trusts and joint ventures are similar to those for corporations[638] with one exception. If the foreign investor purchases less than 50% of the voting interests of an entity other than a corporation, such as a partnership, a trust or a joint venture, it is deemed that he has not acquired the control of that non-corporate entity.[639]

(4) Acquisition by more than one transaction

For the purposes of the ICA, acquisition is not necessarily the result of any single one transaction. The acquisition of control can be established as a result of the cumulative effect of a series of related transactions although no one of such transactions is an

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[635] Industry Canada, Investment Canada, *Interpretation Note No. 3*, http://investcan.ic.gc.ca/en_doc_i. htm

[636] A joint venture, defined in the ICA, is an association of two or more persons or entities, in which their relationship does not constitute a corporation, a partnership or a trust and all the undivided ownership interests in the assets of the Canadian business or in the voting interests of the entity that is the subject of the investment are owned by all the persons or entities that are so associated. – The ICA, s.3

[637] The ICA. s.3

[638] *Supra* note 581, p.135. And also see 2.1.3, (1), (A) of this thesis.

[639] The ICA, s.28(3)(b)

acquisition of control.[640]

(5) Acquisition through associated entities

Entities that are directly or indirectly controlled by the same entity are associated entities. Acquisition through associated entities means that separate acquisitions by various members of the associated entities are treated as one acquisition controlled by the ultimate controlling entity.

(6) Acquisition rule concerning Canada's cultural heritage or national identity

In the business area of Canada's cultural heritage or national identity, the ICA allows the responsible minister to determine whether an entity proposing to carry on such a business in Canada is Canadian-controlled notwithstanding Canadian ownership of a controlling share interest in the business or whether a foreign entity has acquired control of the Canadian business regardless of share or equity interests.[641] This provision gives the Canadian government discretion to find that a foreign entity in fact controls a supposedly Canadian entity so that it is subject to the application of the ICA. The reasons for such determination could be many, from the terms of financing and the manner of supplying goods or services to technological or managerial controls.[642]

#### 2.1.4 Notification and Process

Generally, any FDI to establish or acquire control of a business carried on in Canada is either notifiable or reviewable under the ICA.[643]

A foreign investor is required to file a notification with the Director of the Investment Review Division of Industry Canada when he either commences a new business activity in Canada[644] or acquires control of an existing Canadian business[645] that is not reviewable. Foreign investments that are required for the notification under the ICA are: (a) all new

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[640] *Id.*, s.29(1)

[641] *Id.*, s.28(4 )

[642] *Supra* note 424, p.II20,000-7

[643] Castel, de Mestral and Graham, *The Canadian Law and Practice of International Trade*, 2nd ed., Montgomery Publications, 1997, p.622

[644] The foreign investor is required to file a form of the "Notification to Establish a New Canadian Business". This form can be downloaded from the Internet: http://investcan.ic.gc.ca/enotnew.htm

[645] The foreign investor is required to file a form of the "Notification to Acquire Control of an Existing Canadian Business (or Businesses)". This form is available at: http://investcan.ic.gc.ca/enotacq.htm

Canadian businesses; (b) all direct acquisitions of Canadian businesses with a book asset value under C$ 5 million; and (c) all indirect acquisitions of Canadian businesses with a book asset value under C$ 50 million.[646]

The foreign investment notification must be filed before the implementation of the investment[647] or within 30 days thereafter.[648] When the investment notification provides all the required information or reasons for the inability to provide any part of the required information, the Director must send the applicant a receipt certifying the date on which the notification was received and advising that the proposed investment is not reviewable. If the notification is incomplete, the Director must notify the applicant of the fact, specify the information required to complete the notification, and request that such information be forwarded.[649] Once the complete notification is filed and the receipt is issued, the foreign investment can proceed without further government intervention unless it falls within the business activities relating to Canada's cultural heritage or national identity, in which case the government has a reserve review power.

What a cultural business is for the purpose of the ICA? It is identified as a business carrying on any of the following activities in Canada:[650] (a) the publication, distribution or sale, other than the sole activity of printing or typesetting, of books, magazines, periodicals or newspapers in print or machine readable form; (b) the production, distribution, sale or exhibition of film or video recordings; (c) the production, distribution, sale or exhibition of audio or video music recordings; (d) the publication, distribution or sale of music in print or machine readable form; or (e) radio communication in which the transmissions are intended for direct reception by the public, any radio, television and cable television broadcasting undertakings, and any satellite programming and broadcast network services.[651] However, the actual scope of this definition of a cultural business is much wider than might first appear because there is no *de minimis* exception to the

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[646] The ICA, s.14(3)

[647] In Deigan's opinion, an investment is implemented only when it has a place of business, employees, and assets used in carrying on the business. – See *supra* note 581, p.197

[648] The ICA, s.11 and s.12

[649] *Id.*, s.13

[650] *Id.*, s.14.1(6)

[651] *Id.*, s.14(6)

determination of whether a business carries on any cultural activity. A convenience store that sells newspapers is thus likely to be considered a cultural business.[652] For FDI in the business area of Canada's cultural heritage or national identity, the Director can first send the applicant a certificate of receipt, advising that the proposed investment is not reviewable although all the acquisitions or greenfield establishments in this sector are normally subject to review.[653] Where the Governor in Council considers the proposed investment in the public interests on the recommendation of the responsible minister[654] and issues an order for review, the Director must then send the applicant a notice within 21 days after his initial certified date, requiring the foreign investment undergo a review procedure.[655] Under the circumstances, the foreign investor has to file a new application for review. However, even this culturally sensitive foreign investment is not reviewable if no review notice is sent within the 21-day period.[656]

Deigan, in his *Investing in Canada: The Pursuit and Regulation of Foreign Investment*, presented in detail Canadian government's working process in respect of FDI relating to its sensitive cultural business after a foreign investor files a notification with the Director:[657]

(A) First, both the province where the proposed investment will take place and Communication Canada that is responsible for cultural matters for the federal government are consulted;

(B) Next, staffs of the Investment Review Division deliver to the Minister of Industry Canada a memo containing their recommendation on whether the proposed investment merits a review;

(C) Unless he determines that no review is necessary, the Minister then submits a written recommendation to the Governor in Council by delivering it to the Clerk of the Privy Council;

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[652] *Supra* note 643, p.623

[653] *Supra* note 256, p.69

[654] The ICA, s.15(b)(i)

[655] *Id.*, s.13(1)(b)(ii)

[656] *Id.*, s.13(3)

[657] *Supra* note 581, p.198

(D) The Governor in Council decides whether it is in the public interests to review the proposed investment. If the decision is to hold a review, an order is issued. Typed on the letterhead of the Privy Council, the order reads as follows:

"HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL, on the recommendation of the Minister of [Industry Canada], pursuant to section 15 of the *Investment Canada Act*, hereby orders that the investment by ___ (name of foreign investor) to acquire control of the business carried on by ___ (Canadian company) be reviewed."

(E) When the Investment Review Division receives this order for review, the Director sends a certified copy to the foreign investor.

The intention of the notification requirement is to allow Canadian government to monitor FDI for its policy and statistical purposes and to use it as a further safeguard for its sensitive industrial sectors such as cultural heritage and national identity. For those who want to find the information on notified investments, lists of the received notifications are available on *The Globe and Mail*.[658]

**2.1.5 Review, Criterion and Process**

(1) Reviewable investments

The acquisition of control of a Canadian business is subject to review where the acquisition mode of the targeted enterprise and the asset value of the acquired business[659] meet the following reviewable conditions:

(A) a direct acquisition of control of a Canadian business with a book asset value over C$ 5 million;

(B) an indirect acquisition of control of a Canadian business with a book asset value over C$ 50 million;

(C) an indirect acquisition of a Canadian business with a book asset value between C$ 5 million and C$ 50 million if the Canadian book asset value acquired comprises more than 1/2 of the book asset value acquired in the total deal;

(D) any acquisition of control not reviewable or establishment of a new Canadian

[658] *Supra* note 581, p.195

[659] *Supra* note 47, p.200

business in the business area relating to Canada's cultural heritage or national identity if the Director sends a notice within 21 days after his initial certified date requiring the review procedure;[660] and

(E) Notwithstanding the above review thresholds, only the direct acquisition of control of a Canadian business that has assets in excess of C$ 192 million in 2000[661] is reviewable where either the foreign investor or vendor is ultimately controlled in a WTO member country.[662] This provision means that if either the foreign investor is a WTO member investor or the subject of the acquisition is controlled by a WTO member investor immediately prior to the investment, the transaction is reviewable only when it exceeds C$ 192 million in 2000. The provision recognizes the character of both the existing ownership and control of the target business in the case of WTO member investors. Under the ICA, WTO member investors indicate nationals or permanent residents of WTO members, WTO member governments at federal, state or local levels and their agencies, as well as entities owned or controlled by WTO member investors.[663] Regardless of nationality of the investor or vendor, however, the lower review thresholds remain unchanged if the Canadian business is involved in uranium production, financial services, transportation industries or cultural businesses.[664] For the indirect acquisitions made by WTO member investors, they are not reviewable at all[665] unless the book asset value of a business located in Canada accounts for more than 50% of the book asset value of the total transaction concerned.

(2) Review criterion – net benefit to Canada

Canada declares that it welcomes FDI yet maintains that it must ensure that only those

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[660] The ICA, s.14 and *supra* note 424, p.II6000-10

[661] The amount of the review threshold for WTO investor is calculated according to this formula: Current Nominal GDP at Market Prices ÷ Previous Year Nominal GDP at Market Prices x Amount Determined for Previous Year. It is adjusted by the Minister in every Jan. and published in Canada Gazette. – See the ICA, s.14.1(2) and (3) and also Industry Canada, Investment Canada, *Thresholds for Review*, http://investcan.ic.gc.ca/en_tresh.htm

[662] *Supra* note 4, p.59

[663] The ICA, s.14.1(6)

[664] *Id.*, s.14.1(5)

[665] Yet any indirect acquisition is still subject to notification under the ICA when the investor or vendor is a WTO member investor.

investments that are likely to be beneficial to the country are permitted.[666] Therefore, the Canadian government requires foreign investors to undergo review for their proposed investments and for this purpose sets a review criterion of "net benefit" to Canada. To test whether a foreign investment is of "net benefit", the ICA lists six groups of factors.[667]

(A) Economic activity in Canada

This group of factors is generally to assess the effect of the foreign investment on the level and nature of economic activity in Canada. The investment's effect on employment, resource processing, utilization of parts, components and services produced in Canada and exports from Canada are specifically considered.[668]

(B) Canadian participation

This standard is to test the degree and significance of participation by Canadians in the Canadian business.[669] Canadian participation may contain various activities, which can be Canadian ownership, the appointment of Canadians as directors and managers and a profit sharing plan. It can also include making some equity available to Canadians through a stock option plan and seeking Canadian partners and so on.[670]

Canadian participation and control in foreign-invested Canadian businesses were once considered to be the most important review standard because it was believed that Canadians are more responsive to Canada. But its importance as a review standard seems to have declined since 1978 and some other factors like export, employment, productivity and R&D have instead been given more weight by the government.[671]

(C) The effect of the investment on productivity, industrial efficiency, technological development, product innovation and variety in Canada[672]

In this group of factors, technology transfer from foreign investors is attached special consideration as advanced technology is generally recognized as one of the most important productive factors in the world nowadays and it is vigorously competed for by

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[666] Investment Canada, *Annual Report 1988-1989*, p.27

[667] The ICA, s.20

[668] *Id.*, s.20(a)

[669] *Id.*, s.20(b)

[670] *Supra* note 581, pp.228-229

[671] *Supra* note 581, p.227

[672] The ICA, s.20(c)

all the modern countries. The transferred technology can take the forms of patents, trademarks as well as such know-how as design and engineering concepts, methods of manufacturing or packaging and marketing strategy etc. R&D expenditure plans are also important, which may contain a promise to establish or expand R&D facilities in Canada, a detailed plan about Canadian employment relating to R&D work, a proposed R&D budget, an estimated extention for Canada to exploit new processes resulting from the foreign-generated R&D efforts, or even an R&D contracting-out to independent Canadian organizations.[673]

(D) Effect on competition

It is a review factor testing the effect of a foreign investment on competition in Canada.[674] The major issues in this test are relevant to the function of the *Competition Act*, the role of the Competition Bureau and the relationship between the ICA and the *Competition Act*, which will be discussed separately in section 2.3.1 of Part V of this thesis.

(E) Compatibility with national and provincial policies

When testing a foreign investment, it is also taken into account whether the investment is compatible with Canada's national industrial, economic and cultural policies as well as its various provincial policy objectives because the foreign investment could significantly affect the policies of the governments and their specific objectives.[675]

(F) Canada's international competitiveness

This review factor is to test whether a foreign investment contributes to Canadian competitiveness abroad by offering its products greater access to the world markets.[676]

The ICA does not provide how much weight is given to each factor in reviewing a foreign investment. But in practice some factors are given more weight than the others and all the positive and negative factors are balanced to produce an overall net effect to determine whether the foreign investment is of "net benefit" to Canada. As stated in Industry Canada's *Guidelines-Administrative Procedures*, "[i]n reaching a decision,

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[673] *Supra* note 581, p.230

[674] The ICA, s.20(d)

[675] *Id.*, s.20(e)

[676] *Id.*, s.20(f)

judgements will be made both in measuring the effects of a proposal in relation to the relevant individual factors of assessment and in measuring the aggregate net effect after offsetting the negative effects ... against the positive ones. An investment will be determined to be of net benefit when the aggregate net effect is positive, regardless of its extent."[677]

The "net benefit" review criterion is extensive. Some opinion reckons that the above list is exhaustive and the consideration of additional factors is not permitted.[678] Yet the official opinion holds that the list is simply a general guide. This tendency can clearly be observed from Industry Canada's *Application for Review*, according to which a factor of "additional investment" is required.[679] Because the "net benefit" test is fluid and each factor lacks an explicit definition, this review criterion creates uncertainty to foreign investors and grants the reviewing officers discretion to determine whether their investments are of "net benefit" or not.

(3) Review process and its time limits

A foreign investor is required to file an application for review with the Director of the Investment Review Division when his investment is reviewable. The review application must be filed before the implementation of the investment.[680] However, there are three exceptions to this general rule. First, the review application can be filed within 30 days after the implementation of an investment where the investment is implemented as the result of an acquisition of control of a corporation incorporated outside Canada, that is, in the case of an indirect acquisition. Second, the application can be filed within 30 days after the implementation of an investment if the investment is allowed by the responsible minister to proceed on the ground of either undue hardship to the foreign investor or jeopardy of the operations of the Canadian business. Third, the application can be filed upon receipt of a notice of review when the investment is related to Canada's cultural heritage or national identity.[681]

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[677] Industry Canada, *Guidelines-Administrative Procedures*, http://investcan.ic.gc.ca/en_doc.htm

[678] *Supra* note 27, p.11-24, note 135

[679] Industry Canada, Investment Canada, *Application for Review*, http://investcan.ic.gc.ca/eappacq. htm

[680] The ICA, s.17.(2)(a)

[681] *Id.*, s.17.(2)(b) and (c)

As indicated in a report[682] of former Investment Canada and other references, the general process of review for a foreign investment and the time limits of this process set by the ICA are as follows:

(A) The foreign investor prepares a business plan for the Canadian business, outlining his intentions and plans for the business with particular reference to the "net benefit" criterion.

(B) The foreign investor fills in the *Application for Review Form*,[683] and submits it with the business plan to the Director of the Investment Review Division.

(C) If the application is found incomplete, the Director must notify the foreign investor of the fact, specify the information required to complete the application, and request that such information be forwarded. If the Director does not send a receipt or a notice within 15 days of receipt of the application,[684] this incomplete application is deemed to be complete as of the date when it was received.

(D) When the application contains all the required information or reasons for the inability to provide any part of the required information, the Director sends the foreign investor a receipt certifying the date on which the complete application was received.

(E) Staffs of the Investment Review Division send a photocopy of the application and a case summary to relevant federal departments[685] and provincial governments concerned[686] to seek their views on the proposed investment.[687] Meanwhile, the assigned

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[682] Investment Canada, *Annual Report 1988-1989*

[683] It can be downloaded from the Internet: http://investcan.ic.gc.ca/eappacq.htm

[684] The ICA, s.18(3)

[685] The relevant federal governments could be the Department of Energy, Mines and Resources in energy cases; Communication Canada in cultural cases; External Affairs where foreign governments or bilateral issues are involved; and Employment and Immigration Canada when there are significant employment ramifications. In any case, the Competition Bureau is routinely consulted. – See *supra* note 581, p.249

[686] The contacted provinces are those "significantly affected" by the proposed foreign investment. They could include the provinces in which the investment is going to have presence or the provinces from which an operating Canadian business may be affected. – See *supra* note 581, p.248

[687] The chances are excellent that the federal government will grant the necessary approval if foreign investors can gain the support of the local governments for their proposed projects. Therefore, it is suggested that the foreign investors, when making FDI in Canada, should often use the strategy of garnering local support before submitting the formal applications to the Director of the Investment Review Division. – See *supra* note 13, pp.98-99

review officer commences a series of review work, such as gathering information, analyzing, consulting and discussing with the investor and executives of the involved Canadian business, to identify and assess key issues of the case.

(F) The Director prepares a report and makes recommendations to the Minster of Industry Canada. If the Minister is not satisfied with the "net benefit" test and does not approve the proposed investment, the Minister sends the foreign investor a notice to that effect.[688] The foreign investor has the right to make representations and submit undertakings within 30 days from the date of the notice or within such further period as agreed on by the Minister and the applicant[689] so as to convince the Minister of the investment's benefit to Canada.[690] The ICA does not define the contents of representations and undertakings. But from the explanation by Industry Canada, such contents can be understood as the same factors as the "net benefit" criterion.[691] As for the form of these representations and undertakings, it should be executed under the seal of the applicant and addressed to Her Majesty in right of Canada so that it has the effect of creating an enforceable contract with the Crown.[692]

(G) When the representations and undertakings have been made, the Minister will reconsider his original position in light of the new information and inform the foreign investor of his decision by notice.[693] If the decision is favorable, the notice letter reads:

"I have concluded my review of your application and I am satisfied that your

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688 The notice letter usually reads:

"This is to advise you that the Minister responsible for [Industry Canada] has reviewed your application and is not satisfied that your proposed investment is likely to be of net benefit to Canada. This [letter] constitutes a notice under section 23(1) of the Act that you, as applicant, have the right to make representations and submit undertakings within 30 days from this date or such further period of time as may by mutually agreed upon." – See *supra* note 581, p.213, note 7

689 The ICA, s23(1)

690 The foreign investor yet does not have to wait till this happens before making representations and submitting undertakings. He is allowed to do so throughout the course of the review. – See *supra* note 424, p.II30,000-37

691 Industry Canada, in its document the *Frequently Asked Questions*, states that the investors make additional representations and undertakings which would demonstrate the 'net benefit' of the investment". – See http://investcan.ic.gc.ca/en_faq.htm

692 *Supra* note 424, p.II30,000-41

693 The ICA, s.23(3)

investment is likely to be of net benefit to Canada. This letter constitutes approval of your investment pursuant to the *Investment Canada Act*."[694]

(H) The review process has firm deadlines regarding the initiation and completion of the proposed investment.[695] The Minister is supposed to respond within 45 days from the date when the Director receives the foreign investor's application for review. If the Minister is unable to reach a decision on the application within 45 days, he can at discretion extend the review time for additional 30 days by sending the applicant an extension notice[696] prior to the expiration of the initial 45-day period. In practice, it is not unusual that the Minister extends the initial review period to 75 days for reviewing.[697] Plus possible 30 days for foreign investors' representations and undertakings, the total time period for the Minister to render the decision on a foreign investment review is 105 days unless both the foreign investor and the Minister consent to a further extension. The ICA imposes strict time limits on the review process. If any time limit is overlooked, namely, no approval or notice of extension is received within the applicable time,[698] the proposed foreign investment is deemed approved.

For the review process two points should be noted. One is that the foreign investor can not appeal against the Minister's unfavorable review decision based on the further representations although he is allowed to resubmit the application when there are significant new factors or undertakings to be offered for consideration.[699] The other is that for monitoring the approved investment s. 25 of the ICA requires the foreign investor

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[694] The news is then sent to the province where the approved investment will occur and a press release is issued in the *Globe and Mail*. – See *supra* note 581, pp.255-256

[695] *Supra* note 210, p.247

[696] The extension notice usually states:

"This is to advise you that the Minister is unable to complete the consideration of your investment within the 45-day period referred to in subsection 21(1) of the *Investment Canada Act*. As prescribed in subsection 22(1) of the Act, this is to notify you that within 30 days from the date of this letter, or within such further period as may be mutually agreed upon, the Minister will complete the consideration of your investment." – See *supra* note 581, p.212, note 5

[697] In the case of investments relating to Canadian cultural business, the review usually requires at least 75 days to complete. – See Industry Canada, Investment Canada, *Frequently Asked Questions*, http:// investcan. ic.gc.ca/en_faq.htm

[698] The ICA, s.22

[699] *Supra* note 4, p.65

submit information relating to the investment to see whether it is carried out in accordance with the application and any representations or undertakings. The monitoring policies stipulated in one of Industry Canada's *Guidelines*[700] provide that: (a) an evaluation of performance will ordinarily be made 18 months after the implementation of the investment; (b) investment performance will be judged in the context of the overall results; (c) no further monitoring will ordinarily take place if the evaluation discloses implementation substantially consistent with the original expectations and subsequent economic circumstances; and (d) the government and the investor will together determine an appropriate time for future follow-up if the evaluation discloses otherwise.

### 2.1.6 Administration

(1) Administrative structure and duties under the ICA

Until 1993, Investment Canada under the supervision of the responsible minister administered the ICA.[701] As of 1994, Investment Canada disappeared as an independent agency and the responsibilities pertaining to the review process were divided to the Investment Review Division and the Legal Services Branch, both in Industry Canada.[702] The Division exercised the notification and review process and the Branch handled the legal aspects of the ICA and provided any advice or opinions as to its application. Now the department responsible for the administration of the ICA is Industry Canada[703] and the Director of the Investment Review Division advises and assists the Minister of Industry Canada in exercising his powers and performing his duties under the ICA.

The Minister's powers and duties are as follows:[704] (a) to ensure that all the notification and review of FDI are carried out in accordance with the ICA; (b) to make use of the services and facilities of other departments, branches or agencies of the federal

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[700] Industry Canada, Investment Canada, *Guidelines*, http://investcan.ic.gc.ca/en_doc_g.htm

[701] *Supra* note 643, p.623, note 2

[702] Industry Canada was then formed by merging parts of Investment Canada, Consumer and Corporate Affairs Canada, and Communications Canada with the Department of Industry, Science, and Technology. – See *supra* note 210, Vol. 2, p.51

[703] Industry Canada, *An Overview of the Investment Canada Act (FAQ)*, http://investcan.ic.gc.ca/en-faq. htm

[704] The ICA, s.5

government;[705] (c) to enter into agreements with any provincial government or agency for the purpose of the ICA with the approval of the Cabinet; (d) to consult with and organize conferences of representatives of industry and labor, provincial and local authorities and other interested persons; and (e) to issue and publish guidelines and interpretation notes in respect of the application and administration of the ICA.[706] The current personnel of the Investment Review Division includes 1 director, 5 screening officers, 1 policy officer and some auxiliary staff members such as technical officer (1), administrative assistant (1), certification and review assistant (1) and legal services staff (1).[707]

(2) Written opinions

An investor may seek a written opinion from the Minister or the Director respecting any matter of interpretation of the ICA. Opinions are generally sought with regard to the status of an individual or entity as Canadian, questions of interpretation and whether there are grounds for an early implementation of the investment.[708] The first type of opinions is called status opinions and those concerning all the other matters are non-status opinions.[709]

Status opinions are issued by the Minister on the advice of the Investment Review Division and the Director issues non-status opinions.[710] Once the written opinion is provided, it is binding on the Minister and the Director.[711] In two cases, however, the Minister may refuse to issue opinions. First, the Minister can legally decline to do so if the information supplied by the applicant is considered insufficient. Second, the Minister has full discretion to decide whether to provide an opinion for a non-status matter.[712]

Requests for written opinions are dealt in the order in which they have been received. No time limit is specified within which they must be replied. The reply time period

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705 Relevant departments could be Departments of External Affairs, Regional Industrial Expansion, Communications and Finance, Secretary of State for International Trade and Statistics Canada and so on. – See *supra* note 424, p.II35,000-5

706 The ICA, s.38

707 Industry Canada, *Investment Review Division Personnel*, http://investcan.ic.gc.ca/en_staff.htm

708 The ICA, s.37(1)(2)

709 *Supra* note 581, p.189

710 *Id.*

711 The ICA, s.37

712 *Supra* note 581, p.193

depends upon the complexity of the request and the number of requests on hand.[713]

### 2.1.7 Exemptions

The ICA does not apply to all capital transactions involving FDI in Canada and it contains a number of exemptions.[714]

(1) Stockbrokers' exemption

The acquisition of voting shares or other voting interests by traders or dealers in securities in their ordinary business course is exempted from the ICA.[715] This exemption is designed for foreign-controlled financial intermediaries that engage in underwriting or block trading, considering that they may as principal purchase over 50% of a Canadian company's voting shares for the purpose of resale. Without this exemption, these foreign-controlled stockbrokers can not operate the security business as it is impractical for them to get a governmental approval each time when they make a big deal.[716]

(2) Venture capitalists' exemption

A venture capitalist is usually an institution that provides "seed money" in the form of equity or loans to budding entrepreneurs with some innovative technology (especially high-tech) or even a promising idea but lack of capital. It normally does not exercise routine control of the business in which it invests. Its purpose is only to sell its interest in that business at a higher price after the business has become profitable.[717] The acquisition of voting interests by foreign-controlled venture capitalists in their ordinary business course of providing venture capital in Canada is excluded from the ambit of the ICA,[718] but this exemption can only be granted under the following terms and conditions:

(A) The foreign investor must have made venture capital available in Canada for at least 2 years immediately before the proposed transaction;

(B) The foreign investor should provide venture capital substantially through the purchase of voting interests, other unsecured investments or loans;

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[713] *Supra* note 424, p.II35,000-23
[714] The ICA, s.10
[715] *Id.*, s.10(1)(a)
[716] *Supra* note 581, p.147
[717] *Supra* note 581, p.148
[718] The ICA, s.10(1)(b)

(C) No single venture capital investment at original cost should normally constitute more than 20% of the foreign investor's total venture capital portfolio;

(D) The objective of the foreign investor is not permanent control of the acquired business but rather eventual resale; and

(E) The foreign investor normally sells the voting interests of any entity that he has purchased within 10 years of the acquisition.[719]

(3) Lenders' exemption

The acquisition of control of a Canadian business through the realization of security granted for a loan or other financial assistance[720] is not subject to the ICA.[721] A foreign investor lending money or providing other financial assistance to a Canadian business may thus on the basis of the security agreement realize his security by acquiring the voting interests and control of the Canadian business without the application of the ICA. But this exemption certainly does not apply if the foreign investor tries to circumvent the law by deliberately doing so.

(4) Financing exemption

The ICA exempts foreign investors from their acquisition of control of a Canadian business for the purpose of facilitating their financing on the condition that they divest themselves of control within 2 years or such longer period as the responsible minister approves.[722] This exemption allows a foreign investor to take over a Canadian business, rearrange its capital structure by reducing the debt burden and increasing the equity, and then sell the solvent business without the application of the ICA.[723] This rule extends beyond the giving of controlling voting shares to the extent that the foreign investor has control of a Canadian business. This transfer of control is still a type of security arrangement, upon which both the financing exemption and the lenders' exemption is based. However, the two exemptions distinguish from each other on the point that control

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[719] These terms and conditions have been fixed by the Minister. – See *supra* note 424, p.II7500-5

[720] Other financial assistance includes the given of a guarantee or the arranging of credit for a Canadian business. – See *supra* note 424, p.II7500-7

[721] The ICA, s.10(1)(c)

[722] *Id.*, s.10(1)(d)

[723] *Supra* note 581, p.150

is acquired when the financial assistance is given while beneficial ownership of the pledged assets or shares remains with the borrower until default.[724]

(5) Exemption of business structure reorganization

The ICA does not apply to the acquisition of control of a Canadian business by reason of an amalgamation, a merger, a consolidation or a corporate reorganization following which the ultimate control of the Canadian business remains unchanged.[725]

(6) Exemption of agent of the Crown

The acquisition of control of a Canadian business by foreign investors is exempt from the ICA when the vendor of the Canadian business is the federal government, a provincial government or a Crown corporation.[726]

A government is assumed to be a "living creature" with one directing mind and many appendices and its one department is supposed to know the intention of its other departments.[727] When the federal or a provincial government has decided to sell its business to foreign investors, one of their administrative bodies, hereby the Investment Review Division of Industry Canada, does not necessarily review the work done by the other department. For this reason, the ICA is not applicable where the foreign investors acquire the control of a Crown corporation. However, such a transaction still requires the issuance of an order in council. As stated in the *Investment Canada Act: Briefing Document*, furthermore, "[p]artly-owned Crown corporations or agents are not exempt from the [IC] *Act*"[728]

What is a Crown corporation? *The Financial Administration Act* (R.S.C.1985,c.F-11) defines it as a corporation that is ultimately accountable, through a responsible minister, to Parliament for the conduct of its affairs. And where to find them? We can (a) read the Crown corporation list in the appendices to the *Financial Administration Act*; (b) check the *Government Companies Operation Act*, in which some Crown corporations are declared; (c) examine the relevant statutes when a corporation is established statutorily

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[724] *Supra* note 581, pp.150-151

[725] The ICA, s.10(1)(e)

[726] *Id.*, s.10(1)(f)

[727] *Supra* note 581, p.152

[728] *Supra* note 581, pp.152-153

rather than under the *Canada Business Corporations Act* or its provincial equivalents; or (d) look over the common law to decide if an agency relationship exists.[729]

(7) Exemption of mainly government-owned corporation

The ICA is not applicable when it happens that the acquisition of control of a Canadian business carried on by a corporation, commission or association in which the federal government, a province or municipality owns 90% or more of the shares or capital. But it must be noted that these corporations, commissions or associations still apply to the ICA if they have outstanding rights or options to purchase shares or capital to persons other than Canadian governments.[730]

(8) Bank exemption

Any transaction to which s. 522 of the *Bank Act* applies is exempt from the ICA.[731] These exempted transactions include: (a) the acquisition of control of a bank or a foreign bank subsidiary; (b) the establishment of a bank or a foreign bank subsidiary; (c) the acquisition of control of an entity by a foreign bank, or the establishment of a new Canadian business by a foreign bank, whose principal activity in Canada consists of (i) providing banking services, (ii) providing fiduciary services, (iii) performing the functions of an investment dealer, stock broker, investment counselor or portfolio manager; (iv) the business of insurance, including insurance agency or brokerage; or (v) any combination of such activities; (d) the acquisition or holding of all or substantially all of the assets of a Canadian entity whose principal activity in Canada consists of any activities of the above (c) (i) to (v).

(9) Exemption of devolution of estate

In Canada, owners of businesses who die without a will have their estates distributed according to provincial laws dealing with intestate succession.[732] In view of this situation, s. 10(1)(i) of the ICA provides that the foreigners concerned do not need to comply with the *Act* when they involuntarily acquire the control of Canadian businesses in this way. Because the devolution of an estate appears to cover a disposition of property pursuant to

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[729] *Supra* note 581, p.153

[730] The ICA, s.10(1)(g), the *Income Tax Act* ( R.S.C.1985,5th Supplement ) and *supra* note 424, p.II7500-15

[731] The ICA, s.10(1)(h)

[732] *Supra* note 581, p.155

a will, foreign investors who acquire Canadian businesses under a will also benefit from the exemption.[733] However, this exemption rule does not include a transaction under an *inter vivos* trust.[734]

(10) Insurance company exemption

The ICA allows three types of acquisition of control of Canadian businesses to be excluded from its application,[735] which are (a) the acquisition of control of a Canadian business by an insurance company incorporated in Canada to which the *Insurance Companies Act* applies; (b) the acquisition of control of a Canadian business by an non-resident insurance company by which the insurance of risks in Canada has been approved under the *Insurance Companies Act*; and (c) the acquisition of control of a Canadian business by a Canadian-incorporated subsidiary that is wholly owned by either a foreign-controlled Canadian-incorporated insurance company or a non-resident insurance company. The effect of the exemption is to grant the same treatment for the investments of both foreign-owned and Canadian-owned insurance companies.[736]

For this exemption rule, however, the ICA imposes certain restrictions:[737]

(A) For a foreign-controlled Canadian-incorporated insurance company, it must include its gross investment revenue from the Canadian business in computing its taxable income under subsection 138(9) of the *Income Tax Act*;

(B) For a non-resident insurance company, the shares or assets of its Canadian business must be vested in trust in accordance with the provisions of the applicable Canadian insurance company legislation in addition to its gross investment revenue from the Canadian business being included in computing its taxable income under subsection 138(9) of the *Income Tax Act*; and

(C) For a Canadian-incorporated subsidiary that is wholly owned by either a foreign-controlled Canadian-incorporated insurance company or a non-resident insurance company, the shares or assets of its Canadian business must be vested in trust under Part

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[733] *Id.*

[734] *Supra* note 424, p.II7500-19

[735] The ICA, s.10(1)(j)

[736] *Supra* note 581, p.157

[737] The ICA, s.10(1)(j)

XIII of the *Insurance Companies Act*.

(11) Farming exemption

The ICA excludes its application to the acquisition of control of a Canadian farming business if the real estate on which the farming business is carried out is also acquired.[738] This provision suggests that the exemption only be allowed when both the acquisition of control of a farming business and the acquisition of the real estate on which the farming business is carried on take place at the same time.

The ICA does not define what a farming business is. Generally, all activities involving the raising of crops or livestock, i.e., tillage of the soil, dairying, fruit growing, and poultry or livestock raising, are considered to be farming. According to Deigan, the purchase of an agribusiness like an automated factory-like operation for raising poultry on a small piece of land can also take advantage of this exemption although this kind of operation lacks certain attributes of a farming business.[739]

(12) About real estate

The acquisition by a foreigner of real estate in Canada would not likely be subject to the ICA if the foreign acquirer can clearly prove that the acquired real estate is only property that will be owned by him and managed by a third party. The proof would be strengthened if the foreigner has no presence in Canada and simply receives remittances of the rents less expenses from the Canadian manager.[740]

### 2.1.8 Remedies

The ICA contains a series of remedial provisions in case of foreign investors' non-compliance with obligations under it.

(1) Ministerial demand

The responsible minister has various injunctive and mandatory remedies available under the ICA. When the minister believes that a foreign investor has acted contrary to the ICA's provisions, the minister may send a demand requiring the foreign investor within specified time cease, justify or remedy his non-compliance. The demanded non-

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[738] *Id.*, s.10(1)(k)

[739] *Supra* note 581, p.159

[740] *Supra* note 424, p.II15,000-14

compliance can be that[741] (a) the foreign investor has failed to file the required notification or review application for his investment; (b) the foreign investor has implemented an investment, the implementation of which is prohibited or on terms and conditions that vary materially from those contained in his application; (c) the foreign investor has failed to comply with his undertaking; or (d) the foreign investor has failed to divest himself of control of a Canadian business as required. The effect of the ministerial demand is to give the foreign investor an opportunity to have an exchange of view with the minister.

(2) Court orders

Where the foreign investor fails to comply with the ministerial demand, the Attorney General of Canada on behalf of the responsible minister[742] may apply to a superior court, either the Federal Court or a provincial supreme court, for an order. If the court is satisfied that the minister's demand is justified, it may make the following orders to remedy the foreign investor's non-compliance with the ICA.

(A) Divestiture order

When a foreign investor has first purchased a Canadian business but the minister finally turns down his application, the court may make an order to direct the investor to sell enough shares of the purchased business so that he is no longer in control of the Canadian business.[743]

(B) Injunction

The court can make an injunction to enjoin a foreign investor from taking any action specified in the order in relation to the investment.[744] The injunction can be interim where the foreign investor is found to be seeking to implement his investment before the minister reviews it or where the purchase has occurred without the minister's consent and its result has been proved to be harmful to the purchased Canadian business. The injunction can also be permanent if the foreign investor tries to buy a Canadian business

[741] The ICA, s.39(1)

[742] The power to determine whether legal proceedings should be commenced lies with the Attorney General of Canada in stead of the Minister of Industry Canada. – See the *Department of Justice Act*, s.5

[743] The ICA, s.40(2)a

[744] *Id.*, s.40(2)b

after the minister has concluded that the proposed purchase will not be of net benefit to Canada.[745]

(C) Compliance order

If a foreign investor clearly and definitely promised to the Canadian government certain undertakings for his investment in Canada during the review process but has failed to keep his word, the court can enforce the foreign investor to comply with his promise by making an order of compliance.[746]

(D) Financial penalty

The court may impose against the foreign investor a penalty not exceeding C$ 10,000 for each day of his non-compliance of the ICA.[747]

(E) Revocation order

When a foreign investor does not comply with the relevant ministerial demand, the court would probably make an order to revoke or suspend any rights like that of dividend attached to any voting interests acquired by the investor for specified period.[748] The court may do so by ordering all the dividends declared by the Canadian business and belonging to the foreign investor to be paid to a trustee until the ICA is not violated.[749]

(F) Disposition order

This order aims to direct a foreign investor to dispose all the shares or assets acquired by him that are or were used in carrying on a Canadian business.[750] It could be a very useful alternative of a divestiture order when the latter is not feasible to restructure the transaction so that the foreign investor can sell control but retain an interest.[751]

Every one who fails or refuses to comply with the order may be cited and punished by the court as for other contempt.[752] If the investor objects to any order or decision made by

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[745] *Supra* note 581, p.276

[746] The ICA, s.40(2)c

[747] *Id.*, s.40(2)d

[748] *Id.*, s.40(2)e

[749] *Supra* note 581, p.279

[750] The ICA, s.40(2)f

[751] *Supra* note 581, p.280

[752] The ICA, s.39(2)and (4)

the court, however, he has the rights to appeal[753] although the ICA does not provide appeals from ministerial review determinations.

### *2.2 ICA's Improvement and Drawbacks*

The ICA does not come out from nowhere. There is an evolution between the FIRA and the ICA, which is manifested in the fact that the ICA retains the FIRA's basic approach, i.e., a FDI screening mechanism. However, the ICA has made some significant changes in the FIRA and replaced the FIRA as Canada's FDI law of general application.

(1) The FIRA was introduced in nationalist concern over the level of FDI in Canada. It aimed to maintain effective Canadian control over FDI from an attitude of protectionism.[754] In contrast, the ICA adopts a positive attitude towards FDI and its purpose is to encourage FDI in Canada with a fundamental principle of "open for business".[755] The ICA is a turning point of the relaxation of Canada's FDI policy and law.

(2) The FIRA required that all acquisitions of control of Canadian businesses and all establishments of new businesses except related businesses should be subject to review.[756] In keeping with the "open for business" policy, the ICA allows a wider range of inward FDI to be made without approval.[757] *The Act* eliminates the establishment of new Canadian businesses from review requirement with only exception of those involving Canada's cultural heritage or national identity, and it further reduces review range by introducing review thresholds, below which acquisitions of control of Canadian businesses are not reviewed any more. The reviewable acquisitions of Canadian businesses have thus been dropped significantly.[758] Foreign investment proposals under the ICA is treated more favorably than under the FIRA. For example, during the eleven years of the FIRA administration 3,116 acquisitions and 3,048 new businesses were reviewed[759] with a substantial number of applications rejected[760] and deterred possibly

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[753] *Id.*, s.39(5)
[754] The FIRA, s.2(1)
[755] DFAIT, *Canada's International Investment Policy*, http:// www.dfait-maeci.gc.ca/investcan/60160-e.htm
[756] The FIRA, s.8
[757] *Supra* note 47, p.202
[758] *Supra* note 27, p.11-7
[759] *Supra* note 210, p.271, note 324
[760] 11.3% of all applications were rejected in 1982. – See *supra* note 210, p.271, note 324

because of restrictive practices.[761] In contrast, Investment Canada did not reject a single one of more than 4,600 acquisitions reviewed under the ICA between Jun. 1985 and Sept. 1992.[762]

(3) Under the FIRA, the government was entitled to extend the review period indefinitely without the investor's consent if it was unable to reach a decision within 60 days.[763] The ICA considerably streamlines and thus speeds up the review process. Moreover, further extension of review time suggested by the responsible minister has to be agreed by the investor.

(4) By introducing thresholds for review and an ownership test to ascertain control, the federal government has rendered the administration of Canada's screening legislation more precise.[764]

The ICA has resolved many technical and non-technical issues that arose under the FIRA, but the changes that it has made are not as radical a departure from the spirit of the FIRA.[765] From the viewpoint of foreign investors, the ICA still has some drawbacks.

(1) The ICA has retained the confidentiality provisions of the FIRA almost intact.[766] Many people criticized the secrecy of its review process for they think that it not only causes frustration and a sense of unfairness to foreign investors[767] but also risks discouraging them from applying for potentially productive projects in Canada.[768] Disclosure to the foreign investors remains so limited that opinions were voiced to subject this "discretionary administrative structure to the procedural standards of the country's administrative law".[769] In fact, however, the Canadian government has never prepared to provide reasons for its review decisions, disclose the identity of intervenors and publish

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[761] *Supra* note 210, p.271

[762] *Supra* note 210, p.271, note 324

[763] The FIRA, s.11.(1)

[764] *Supra* note 581, p.43

[765] *Supra* note 47, p.202

[766] The ICA, s.36 and Robert K. Paterson, *Canadian Regulation of International Trade and Investment*, Carswell, 1986, p.331

[767] *Supra* note 235, p.40, note 259

[768] *Supra* note 235, p.40, note 258

[769] *Supra* note 235, p.41

guidelines on the meaning of net benefit for the purpose of reviewing FDI.[770]

(2) The cultural heritage and national identity provision of the ICA is more characterized by uncertainty.[771] Foreign investments that would otherwise meet the criteria for non-reviewability may be ordered by the Governor in Council to be reviewed if they involve businesses relating to Canada's cultural heritage or national identity. This provision is uncertain because the terms of "cultural heritage" and "national identity" are not defined in the ICA[772] and they are "ambiguous enough to be capable of very broad and far-reaching interpretation". More uncertainty could be created since the Governor in Council is given a very broad discretion to determine what a "public interest" is. And the situation could become worse due to the fact that the government determination on foreign investments of cultural related Canadian businesses can be made after the investment has already been implemented.

(3) Indirect acquisitions under the FIRA involved an extraterritorial exercise of jurisdiction, about which many foreign governments and corporations complained. Although the Canadian government sought to mollify the critics by abolishing its all-inclusive indirect investment review policy,[773] the ICA has still preserved such extraterritorial jurisdiction in cases where the acquisition of a Canadian business forms a major part of a larger foreign takeover.[774] This extraterritorial requirement is considered ironic because that the origins of the ICA lay in a desire to counter the extraterritorial application of the U.S. legislation to Canadian subsidiaries should itself create the same difficulties.

(4) As early as Jul. 25, 1983, a panel of the Council of the GATT ruled that "the practice of Canada to allow certain investments subject to the *Foreign Investment Review Act* conditional upon written undertakings by the investors to purchase goods of Canadian origin or goods of some Canadian sources is inconsistent with Article III:4 of the *General*

[770] *Supra* note 581, pp.43-44

[771] *Supra* note 27, p.11-16

[772] The ICA does supply a definition of "cultural business", and "heritage" and "business" are not the same thing anyway.

[773] During the time of the FIRA, all indirect acquisitions were subject to review regardless of the size of the Canadian business. – See *supra* note 581, p.168

[774] *Supra* note 47, p.201

*Agreement* according to which contracting parties shall accord to imported products treatment no less favorable than that accorded to like products of national origin in respect of all internal requirements affecting their purchase". Although the federal government of Canada announced its willingness to comply with the panel's findings at that time, Canadian sourcing plans are still expressly included in s. 20(a) of the ICA as one of the review factors for FDI.[775]

### *2.3 Other Federal Laws Concerning General FDI Issues*

Although a number of federal as well as provincial acts, regulations and policies have implications for FDI in Canada,[776] the cornerstone of Canada's FDI policy[777] is the ICA that has general application to FDI in Canada. However the ICA does not stand alone. Just as s. 34 of the *Act* states, "[n]othing in or done under the authority of this *Act* affects the operation of any other Act of Parliament that applies to or in respect of any particular business or class of Canadian businesses". These federal laws can be divided into two categories in respect of FDI regulation in Canada. One is related to laws for the purpose of other general issues. Parts of these laws possess some provisions relating to FDI regulation in Canada. *The Competition Act*, the *Canada Business Corporations Act*, the *Income Tax Act* and the *Citizenship Act* etc. belong to this category. The other regulates FDI in Canada on the basis of economic sectors, covering such businesses as energy, financial services, transportation services and culture and so on. Among those federal laws concerning general FDI issues, the *Competition Act* and the *Canada Business Corporations Act* mostly affect FDI in Canada.

#### 2.3.1 *The Competition Act* and Its Regulation on Mergers

The ICA only applies to foreign investors when they invest by either the greenfield establishment of businesses or the acquisition of control of existing businesses in Canada. *The Competition Act*[778] contains notification requirements about mergers but it applies equally to domestic-owned and foreign-owned businesses in Canada. *The Competition Act* has great impact on foreign investors when they are implementing mergers in Canada.

[775] *Supra* note 424, p.II30,000-42

[776] *Supra* note 210, p.242

[777] "Investment Policy", *The Canadian Edge*, Investment Canada, Feb. 1988

[778] It was proclaimed into force in June 1986. – See *supra* note 210, p.256

(1) Notifiable mergers and thresholds

Under the *Competition Act*, a merger is defined as a direct or indirect acquisition, or establishment by one or more persons of control over a significant interest in the whole or a part of the business of a competitor, supplier, customer or other person. Part IX of the *Competition Act* contains notification requirements with regard to proposed mergers. To decide whether a notification is required two thresholds must be met.[779] The first is about the combined size of parties. If the parties to the transaction together with their affiliates have aggregate assets in Canada exceeding C$ 400 million or have gross sales revenue in, from or into Canada exceeding the same money threshold, the transaction may be required for a notification. The second is about the transaction size. If the takeover is for voting shares or involves an acquisition of assets, it may be required for a notification when the acquired corporation has gross assets in Canada or gross sales revenue in or from Canada generated from those assets in excess of C$ 35 million. Under the circumstances, two situations must also be observed. First, for publicly traded companies the notification requirements may apply only when the acquirer purchases over 20% of the company's voting shares, or more than 50% of the voting shares if the 20%-over voting shares are already owned by the acquirer. Second, for all companies other than publicly traded ones the voting share thresholds are 35% and 50% respectively.

According to the *Competition Act*, its notification requirements will apply only when both of the above two thresholds are met. But it merits attention that all mergers, whether they exceed the notifiable thresholds or not, are subject to examination of the Competition Bureau on its own initiative if they have or likely to have the effect of preventing or lessening competition in a market place substantially. In fact, small non-notifiable mergers that substantially affected competition in Canadian local market areas have been challenged by the Competition Bureau in the past.[780] *The Competition Act* yet clearly exempts from its notification requirements these classes of transactions:[781] (a) an acquisition of real property or goods in the ordinary course of business that does not

[779] *The Competition Act*, R.S.C. 1985. c.C-34, s.109 and s.110

[780] *Supra* note 210, pp.258-260

[781] *The Competition Act*, s.111

result in holding all or substantially all of the assets of a business or of an operating segment of a business; (b) an acquisition of voting shares for the purpose of underwriting the shares; (c) an acquisition of voting shares or assets resulting from a gift, intestate succession or testamentary disposition; (d) realization by a creditor in the ordinary course of business; (e) an acquisition of a Canadian resource property; and (f) an acquisition of voting shares of a corporation pursuant to an agreement requiring the acquirer to incur exploration and development expenses with respect to a Canadian resource property.

(2) Assessment factors of mergers with regard to competitive effects and efficiency gains

The Competition Bureau's analysis to decide whether a merger or proposed merger is likely to substantially prevent or lessen competition in the market place[782] is based on the following assessment factors of competitive effects.

(A) Market share of the merged company. This is one of the most important assessment factors.[783] *The Merger Enforcement Guidelines*[784] states that the market share of a merged company may be measured on the basis of dollar sales, unit sales or production capacity. If the merged company has less than 35% of the market, the Competition Bureau is not generally "concerned about the firm raising prices in the market by raising only its own price". If the top four firms in the market hold a total share of less than 65%, the Bureau is not generally "concerned about prices being raised in the market by firms acting together" either. If the top four firms have a share of greater than 65% of the market but the merged firm holds less than 10% of its share, the Bureau is still not concerned about the merger generally.[785]

(B) Industrial concentration ratio. It usually indicates the aggregate percentage share of market sales accounted for by the four largest companies in the market.[786]

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[782] *Id.*, s.92(1)

[783] *Supra* note 210, p.257

[784] Director of Investigations and Research, *Merger Enforcement Guidelines*, Supply and Services Canada, Mar. 1991

[785] Consumer and Corporate Affairs Canada, *Backgrounder*, News Release NR-00184-91-09, Apr. 17, 1991, p.3

[786] *Supra* note 581, p.234, note 29

(C) Effectiveness of foreign competition.[787] This is to see whether there will be enough buyers who switch to foreign suppliers to constrain the price rise when prices in the relevant market rise.

(D) The takeover of a business that is likely to fail is not held responsible for prevented or lessened competition in the market place.

(E) Will the availability of acceptable substitutes constrain a price increase?

(F) Barriers to entry. If new companies will not encounter such a high level of barriers that they can not enter the market after the proposed companies have merged, the takeover is unlikely to create problems for the purpose of the *Competition Act*. The barriers to entry can be regulatory ones and any cost advantages of established companies over newly entering companies arising from control over scarce resources, lower distribution costs and tariffs etc.[788]

(G) Will effective competition remain in the market after the merger?

(H) The takeover of a company that engages in vigorous and effective competition with other companies may more seriously prevent or lessen competition in the market place than its share of the market would represent at first sight. Therefore, it is necessary to analyze whether the proposed merger is going to eliminate formal competitors of the acquirer in the market.

(I) Since market power is more difficult to exercise in a dynamic market, the factor of change in innovation in a relevant market needs also to be considered when assessing whether a merger or proposed merger is likely to prevent or lessen competition in the market substantially.

(J) Any other factor relevant to competition that would be affected by the merger, such as countervailing power of buyers and suppliers and prior history of anti-competitive conduct, must also be assessed.[789]

Where a merger is found likely to substantially prevent or lessen competition in the

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[787] The following eight qualitative and quantitative assessment factors are identified in s. 93 of the *Competition Act*.

[788] *Supra* note 581, p.235

[789] The comment on the eight assessment factors can also be found in Deigan's *Investing in Canada: The Pursuit and Regulation of Foreign Investment* (De Boo, 1991) at 234-235.

market place through the above assessment, the Competition Bureau is authorized to apply to the Competition Tribunal for a remedial order. The Competition Tribunal, as a quasi-judicial body established under the *Competition Tribunal Act* to adjudicate the non-criminal provisions of the *Competition Act*, then rules on the contested merger. If it also finds the merger to be anti-competitive, the Tribunal may make a remedial order disallowing all or part of the merger. In the case of a completed merger, the Tribunal may dissolve the merger or order divestitures of the purchased shares or assets.[790] But the Tribunal will not be able to block the merger if the merging parties can successfully demonstrate that there would be "efficiency gains"[791] arising from the merger that can sufficiently offset its anti-competitive effects.[792]

(3) Notification under the *Competition Act* and its interaction with the ICA

The assessment criteria of a proposed takeover under the *Competition Act* and the ICA overlap to some extent.[793] For a foreign investor, therefore, his proposed acquisition of control of a Canadian business may result in two separate notices to two different Canadian regulatory bodies: the Competition Bureau under the *Competition Act* and the Investment Review Division under the ICA although the two bodies are both within the same ministerial department of Industry Canada at present.

In respect of the *Competition Act*, there are two forms of notification filing for the parties to the merger. One is "short" and the other is "long". The short form has a 7-day waiting period for the merging parties and the long form has for them a 21-day waiting period. In practice, neither of the time periods is long enough for the Competition Bureau to review large and complex mergers. The Bureau thus needs to extend the review time

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[790] *Supra* note 210, pp.257-259

[791] According to Grampton, an "efficiency gain" means all real resource savings that permit a company to produce more or a higher quality output for the same amount of inputs. – See Paul Grampton, *Mergers and the Competition Act*, op. cit. p.509

The efficiencies could include such production efficiencies as economies of scale, reduced inventory costs and elimination of duplication, dynamic efficiencies like R&D synergies and superior organizational structure as well as those achieved through long-term rationalization of the industry sector, greater consumer choice or an increased supply of goods and services with consequent downward pressure on prices. – See *supra* note 581, pp.236-237

[792] *Supra* note 210, p.257

[793] *Supra* note 581, p.237

with the acquirer's consent.[794] For the parties to a proposed merger on the other hand, they can apply to the Competition Bureau for an Advance Ruling Certificate (ARC), which is issued in the light of the efficiency gains that likely arise from the merger. Once granted, the ARC legally exempts the notifiable merger from being notified to the Competition Bureau and it assures that the merger will not be challenged solely on the basis of the provided information.[795]

The ICA requires the responsible minister to consider "the effect of the [foreign] investment of competition within any industry or industries in Canada".[796] Therefore, the minister or the Investment Review Division must take into this account when reviewing a proposed acquisition of control by a foreign investor of a Canadian business. As a result, the Investment Review Division usually consults with the Competition Bureau for its opinions on the proposed acquisition by sending it a written case summary and a photocopy of the application[797] when an application for review with regard to a large takeover is received. The Competition Bureau goes through its merger assessment on competitive effects and informs the Investment Review Division with reasons provided whether the competitive impact of the proposed takeover is likely positive or negative. The Investment Review Division generally accepts the Competition Bureau's competitive assessment for the purposes of the competition component of the "net benefit to Canada" test.[798] Having received the memo delivered by the Investment Review Division, the minister takes into account the recommendation made by the Investment Review Division as well as the comments by the Competition Bureau, but the minister comes to his own conclusion without the restraints of the Competition Bureau's opinion for the competition aspect is only one of the many factors that need considering under the ICA and all the factors have to be balanced for an overall effect to determine whether the proposed acquisition would be of net benefit to Canada. One the side of the Competition Bureau, however, within three years from the date when the minister approves the proposed

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[794] *Supra* note 210, p.258
[795] *Supra* note 210, pp.259-260
[796] The ICA, s.20(d)
[797] *Supra* note 581, p.231
[798] *Supra* note 210, pp.255-256

acquisition it is entitled to challenge the merger before the Competition Tribunal under sections of 92 and 97 of the *Competition Act.*[799]

### 2.3.2 Directors' Residency Requirements under the *Canada Business Corporations Act*

*The Canada Business Corporations Act* (CBCA) imposes seven residency requirements on all federally incorporated corporations in Canada. These corporate residency requirements include three directors' residency requirements and four other corporate residency requirements concerning locations of corporate records, registered office and shareholder meetings.

The CBCA requires that most of the corporate records of a federally incorporated corporation[800] should be maintained in Canada. These records can be kept at either the registered office of the corporation or any other places in Canada.[801] For the convenience of business operation, the accounting records of the corporation may be maintained outside Canada but their adequate part that enables the directors to "ascertain the financial position of the corporation with reasonable accuracy on a quarterly basis" must be available in Canada.[802] The CBCA also requires that the corporation have a registered office in Canada[803] and its shareholder meetings be held in the country unless all the shareholders entitled to vote agree to hold the meeting in other countries.[804] Besides these corporate residency requirements that are equally applicable to both foreign and domestic corporations, the directors' residency requirements are the main concerns of the CBCA with regard to foreign invested companies in Canada.

(1) Directors' residency requirements

The CBCA's directors' residency requirements are as follows:

(A) A majority of the directors of a federally incorporated corporation must be

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[799] *Supra* note 581, p.237 and *supra* note 4, pp.69-70

[800] Corporate records contain (a) the articles and bylaws; (b) minutes of meetings and resolutions of shareholders; (c) copies of a notice of directors and change of directors; and (d) a securities register. – See Industry Canada, *Directors' and Other Corporate Residency Issues*, CBCA Discussion Paper, Aug. 1995, p.2

[801] The CBCA, R.S.C., 1985, c.C-44, s.20(1)

[802] *Id.*, s.20(5)

[803] *Id.*, s.19(1)

[804] *Id.*, s.132

resident Canadians.[805] Only when the corporation is a holding company in which its revenue earned in Canada is below 5% of its gross revenues need 1/3 of the directors be resident Canadians on its board;[806]

(B) Directors shall not transact businesses at a board meeting unless a majority of directors present are resident Canadians;[807] and

(C) A majority of members of each committee of the board must be resident Canadians.[808] When the powers of the board have been delegated to a committee of directors or a managing director, a majority of the committee members or the managing director must be resident Canadian.[809]

Under the CBCA, a "resident Canadian" means (a) a Canadian citizen ordinarily resident in Canada; (b) a non-resident Canadian who is a member of a class of persons;[810] or (c) a permanent resident who is ordinarily resident in Canada but has not been in the same status for more than one year after the time at which he first became eligible to

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805 *Id.*, s.105(3)

806 *Id.*, s.105(4)

807 *Id.*, s.114(3)

808 *Id.*, s.115(2)

809 *Id.*, s.115(1)

810 S. 11 of the *CBCA Regulations* has prescribed this class of persons as follows:

(1) persons who are full-time employees of the Government of Canada or a province, of an agency of any such government, or of a federal or provincial Crown corporation;

(2) persons who are full-time employees of a body corporate

(i) of which more than 50% of the voting shares are beneficially owned or over which control or direction is exercised by resident Canadians,

(ii) a majority of the directors of which are resident Canadians, or

(iii) that is a subsidiary or a wholly-owned subsidiary of a body corporate described in subparagraph (i) or (ii),

where the principal reason for the residence of the employees outside Canada is to act as such employees;

(3) persons who are full-time students at a university or other educational institution recognized by the educational authorities of a majority of the provinces of Canada and have been resident outside Canada less than 10 consecutive years;

(4) persons who are full-time employees of an international association or organization of which Canada is a member; or

(5) persons who were, at the time of reaching their 60th birthday, ordinarily resident in Canada and have been resident outside Canada less than 10 consecutive years. – *The Canada Business Corporations Regulations*, SOR/79-316, s.11

apply for Canadian citizenship.[811]

(2) Background of the directors' residency requirements

As mentioned before, several reports under the organization of the Canadian government had been undertaken to examine FDI in Canada since 1950s. In the studies, many of them had concluded that a director residency provision was necessary in Canada's corporate law.[812]

In 1957, the *Gordon Report* recommended that foreign-owned concerns should "include on the their boards of directors a number of independent Canadian".[813] In 1968, the *Watkins Report* advised that "[t]here is a need to ensure Canadian participation in the benefits of foreign direct investment and a Canadian presence in the decision-making of multinational enterprises".[814] In 1972, the *Gray Report* also addressed the issue of Canadian directors. It indicated that "Canadian directors could possibly contribute in some measure to an improvement in the performance of foreign controlled firms" and suggested that "a designated proportion of the directors be Canadian citizens resident in Canada".[815] After years of concerns over FDI in the country, the directors' residency provisions were adopted in the CBCA in 1975.

(3) Objectives and pros of the directors' residency requirements

Generally, the directors' residency requirements came out as part of a lager federal government initiative to address concerns over increased FDI in Canada and they were aimed to promote Canadian ownership and control of the economy.[816] Specifically, the requirements were introduced to ensure that the Canadian viewpoint would be expressed in all meetings of directors of corporations controlled by foreign investors[817] and that there are some persons within the jurisdiction of Canada who can be held responsible for

[811] The CBCA, s.2

[812] Industry Canada, *Directors' and Other Corporate Residency Issues*, CBCA Discussion Paper, Aug. 1995, p.3

[813] *Supra* note 201, p.393

[814] *Supra* note 229, p.411

[815] *Supra* note 198, pp.515-516

[816] *Supra* note 812

[817] *Supra* note 812, p.i

any outstanding liabilities of the corporation.[818]

Some people have argued that the directors' residency requirements can help foreign investors to understand the economic, political and social environment of Canada[819] and enable foreign-controlled companies to contribute more effectively to Canadian economy through a stronger Canadian presence in their decision-making mechanisms.[820] These requirements are an extremely significant ingredient in encouraging the board to ensure statutory compliance.[821] There are hundreds of federal and provincial legislative provisions that might have something to do with a corporation in Canada, but their enforcement can only be assured when there are in the corporation certain resident directors with local assets from which a judgement can be satisfied.[822] This concern is especially important with regard to the tax issue (particularly income tax and GST), employment standard (such as unpaid wages) and environment legislation.[823]

(4) Cons of the directors' residency requirements

On the other hand, there are arguments against the directors' residency requirements. Some businessmen have complained that the requirements inhibit the ability of globally oriented Canadian companies to penetrate foreign markets because part of the outward orientation needs to obtain more foreign expertise on the boards of directors but doing this under the directors' residency requirements would increase costs of the companies.[824] Some other people have pointed out that these requirements hinder the FDI inflow to Canada.[825] They have therefore proposed to repeal the requirements so that the reduction could[826] (a) provide more flexibility to corporations regarding board composition; (b) enable corporations to put the best qualified people on their boards and thus help maximize profits to shareholders and returns to Canada; (c) remove the incentive for

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[818] The Honorable J. T. Clement, Minister of Consumer and Commercial Relations, *Legislature of Ontario Debates, Official Report*, Nov. 27, 1972, p.4855

[819] *Supra* note 198, p.515

[820] *Supra* note 229, p.411

[821] *Supra* note 643, p.631

[822] *Supra* note 812, p.ii

[823] *Supra* note 812, p.8

[824] *Supra* note 812, pp.21-22

[825] *Supra* note 643, p.629

[826] *Supra* note 812, p.26

corporations to incorporate or continue into a provincial jurisdiction that has no residency requirement; (d) reduce the regulatory burden placed on corporations; and (e) help to make federal corporate law more consistent with those of other countries.[827]

(5) Evasion of the directors' residency requirements

In Canada, six provinces impose the directors' residency requirements in their business corporation statutes, among which those of Ontario, Alberta, Saskatchewan, Manitoba and Newfoundland have similar requirements to the CBCA[828] whereas the *British Columbia Company Act* exceptionally requires that only one director should reside in the province in a corporation.[829] For foreign investors who want to incorporate corporations in Canada without restrictions of the directors' residency requirements, however, one of the following methods can be used to avoid the requirements:

(A) Four provinces (Quebec, Nova Scotia, New Brunswick and Prince Edward Island) and two territories (the Yukon and the Northwest Territories)[830] do not have the directors' residency requirements in their company laws.[831] Registering companies in one of these places can evade the directors' residency requirements since such companies are allowed to carry on businesses not only in their registered province or territory but also in all the other provinces and territories in Canada[832] although they still need to be registered or licensed in other provinces or territories where they wish to conduct businesses.[833]

(B) Using a unanimous shareholder agreement. Through this kind of arrangement, shareholders can transfer to themselves the directors' duties to manage and supervise the management of the corporation.[834]

(C) Appointing directors who are related to the corporation and also have a vested interest in reflecting the wishes of the holding company. Such directors could be

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[827] Very few countries now impose directors' residency requirements in their corporate laws. Concerns about corporate accountability are addressed through some other mechanisms such as the use of agents, a supervisory board, and minimum capital requirements and so on. – See *supra* note 812, pp.22-24

[828] *Supra* note 812, pp.13-14

[829] The *British Columbia Company Act*, s.133(2)

[830] See the *Yukon Business Corporations Act* and the *Northwest Territories Companies Act*

[831] *Supra* note 812, p.9

[832] *Supra* note 812, p.i

[833] DFAIT, *Establishing a Business in Canada*, http:// www.dfait-maeci.ge.ca/investcan/60200-e.htm, p.2

[834] *Supra* note 812, p.15

appointed from among parts suppliers, lawyers and accountants etc.[835]

## VI. SECTORAL RESTRICTION ON FDI IN CANADA AND CHINA

### 1. Host State's Control over Inward FDI

Generally accepted principles of international law recognize that a sovereign state may impose legal restraints on certain types of foreign investment where they are not considered to be of benefit to the country.[836] Any state thus has the right to regulate the entry of its inward FID and the establishment and administration of FDI enterprises in its territory.[837] Conditions can be attached to a foreign investor when he enters into the host country and conditions can also be attached to the manner in which the foreign investor operates his business within the country.[838] Virtually, no state currently grants full unconditional national treatment[839] to FDI[840] and all countries nowadays impose various restrictions on its activities.[841] The rationale for such restriction is to gear FDI to the economic goals of the host countries by maximizing its net benefits while eliminating its potential harmful effects.[842]

Host countries' control over FDI falls simply under three categories, i.e., FDI entry, its operation in and dis-investment from the host countries.[843] The control ranges from complete exclusion to restricted access to the host countries' economy[844] or authorization

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[835] *Supra* note 812, p.ii

[836] *Restatement (3rd) of Foreign Relations Law*, ss. 402(1)(b) and 414(2)(b)(i)(1986)

[837] Art. 50 of UNCTC's *Proposed Text of the Draft Code on Transnational Corporations*, E/1988/39/Add 1(1988)

[838] *Supra* note 350, pp.83-84

[839] National treatment means that host states should accord to foreign-controlled enterprises "treatment under their laws, regulations and administrative practices, consistent with international law and no less favorable than that accorded in like situations to domestic enterprises." – OECD, *Declaration on International Investment and Multinational Enterprises by the Governments of OECD Member Countries*, Paris, Jun. 21, 1976

[840] Edward M. Graham, "Towards an Asia Pacific Investment Code" in Carl J. Green and Thomas L. Brewer (eds.), *Investment Issues in Asia and the Pacific Rim*, Oceana Publications, 1995

[841] *Supra* note 31, p.29

[842] M. Somarajah, "The International Law on Foreign Investment", *ICSID Rev.: F.I.LJ.*, Vol. 11, Spring 1996, p.204

[843] *Supra* note 43, p.41

[844] *Supra* note 47, p.172

case by case.[845]

The most restrictive legal response to inward FDI is outright denial of its entry.[846] Certain countries practiced the total exclusion approach in the past. One of the examples was China before 1978 although it adopted the exclusion policy not without such reasons as ideological conflict between socialism (or communism) and capitalism and economic blockade enforced from the outside during the Cold War. Among the developed countries, Japan is considered the closest to this approach towards its inward FDI.[847] But today the total exclusion of inward FDI is viewed obsolete and viable since no country could subsist or prosper without the flow of goods, equipment, capital, services and manpower. Both developed and developing countries are turning away from the strict regulation of foreign ownership and they permit FDI on less stringent terms.[848]

The somewhat moderate FDI control approach widely used is the "key sector" control, whereby inward FDI is excluded from certain categories of industrial activities or limited from the percentage of share acquisition in the host countries. In fact, all countries have certain sectoral restrictions on foreign ownership[849] and they apply special FDI regulations in these key sectors. Generally, the restricted key sectors encompass industries relevant to national security and defense.[850] Specifically, they contains financing, natural resources, public utilities, transportation and telecommunications, broadcasting and cultural industries under the most circumstances.[851] All developed countries have sectors that are wholly or partly closed to FDI.[852] For example, all OECD countries have sectoral restrictions on inward FDI, with most of the barriers in the fields of banking, insurance, mining, petroleum, aviation and shipping.[853] As the most liberal regime with FDI, the U.S.

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845 *Supra* note 256, p.37

846 *Supra* note 43, p.44

847 *Id.*

848 *Supra* note 47, p.204

849 See *supra* note 63, p.12 and *supra* note 276, p.44

850 *Supra* note 47, p.175

851 Ronald Hirshhorn, *Industry Canada's Foreign Investment Research: Message and Policy Implications*, Industry Canada, Discussion Paper No. 5, Oct. 1997, p.18

852 *Supra* note 239, p.44

853 H. E. Bale, "Trade Policy Aspects of International Direct Investment Policies", *Int'l Trade and Finance*, p.191

has sought for some years to protect certain selected industrial activities. Foreign investors seeking entry into the U.S. have met federally legislated exclusion from or limitations on ownership in the areas of banking, public broadcasting and telecommunications, coastal and internal shipping, internal air traffic, minerals exploitation on public lands and atomic energy and so on.[854] On the other hand, besides the generally more restrictive FDI policies all developing countries also have sectoral FDI restrictions. For instance, all developing countries in the Asia Pacific Economic Cooperation (APEC) impose various sectoral restrictions on their inward FDI.[855]

### 2. Sectoral Restriction on FDI in Canada and China

However, the criteria serving to establish key sectors for FDI are often ill defined. Relied on the particular historical and political factors, the sectoral FDI regulations vary between countries.[856]

Canada has a long history of sectoral restriction. Its earliest industrial regulation was related to transportation established in the $19^{th}$ century.[857] In modern times, the first conspicuous event of its sectoral control was the establishment of the Canadian Broadcasting Corporation in 1936, which was to protect radio from foreign control. But Canada's sectoral restriction appeared in the series of key sectors legislation largely after the mid-1950s.[858] Along with increasing nationalism, the 1960s saw the adoption of legislation restricting the allowable amount of foreign equity ownership in several key sectors.[859] The key sectoral policy demonstrates that Canada takes quite a restrictive and strong approach in particular fields of the economy that are considered especially important to national identity[860] despite its general open attitude towards FDI.[861] The rationale for this aspect of Canadian FDI policy is to safeguard the vital Canadian

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[854] *Supra* note 43, p.47

[855] *Supra* note 840

[856] *Supra* note 43, p.45

[857] James A. Robb and T. Gregory Kane, "Regulation of Specific Businesses" in H. Heward Stikeman and R. Fraser Elliot etc. (eds.), *Dong Business in Canada*, Vol. 2, Matthew Bender, Oct. 1998, p.19-3

[858] *Supra* note 216, p.10

[859] A. R. Roth etc., *A Guide to Foreign Investment: Under United States Laws*, p.254

[860] *Supra* note 216, p.155

[861] *Supra* note 216, p.11

national interests. Canada maintains a relatively wide number of sectoral restrictions on FDI.[862] In addition to the ICA, there are many federal and provincial laws applying to specific industry sectors.[863] Canada's restricted sectors cover a wide range, including financial services (banking, insurance, securities, and trust and loan), radio broadcasting and television, post and telecommunications, air and maritime transport, oil and gas, mining, fishing and fish processing, real estate, publishing and audiovisual works, public utilities (energy, water, gas and electricity distribution), road and rail transport etc. with the last two totally closed to foreign competition.[864] The sectorally restricted "government regulation is pervasive in Canada today"[865] and it will stay as "the penchant of Canadian governments for intervention" inexhaustibly.[866]

In China, FDI is also prohibited or restricted in certain industries. In order to guide FDI and adapt it to the national economic and social development, the State Planning Commission, the State Economic and Trade Commission and the MOFTEC promulgated the *Provisional Regulations on Guidance for Foreign Investment* and the *Catalogue of the Guidance for Foreign Investment Industries* on Jun. 20, 1995.[867] According to the *Catalogue*, FDI is prohibited from operating in these industrial activities: construction and management of electric, gas and heat networks as well as water supply and drainage; exploiting, dressing, smelting and processing of radioactive minerals; management and administration of post and telecommunications services; air traffic control; futures trade; broadcasting and television stations; production, publication and broadcasting of radio and television programs; production, release and projection of films; video projection; news media; military arms production; and horse racing, casino and sex services.[868] Restrictions are set on the level of foreign ownership for certain sectors, which include total exclusion of the WFOE and majority shareholding or dominant position by Chinese

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[862] *Supra* note 210, p.249

[863] *Supra* note 4, p.58

[864] *Supra* note 256, p.38

[865] *Supra* note 857

[866] W. T. Stanbury and F. Thompson, *Regulatory Reform in Canada*, the Institute for Research on Public Policy, 1982, p.115

[867] They were both ratified by the State Council and the latter was revised on Dec. 31, 1997.

[868] *The Catalogue of the Guidance for Foreign Investment Industries*, Part 3

cooperators. In the former case, the WFOE is not allowed to construct and operate feeder and local railways (bridges, tunnels and ferries), exploit and process certain non-ferrous metals, fish for aquatic products in coastal or inland waters and conduct vehicle transportation across the boarder.[869] The WFOE can not take up such services as domestic commerce, foreign trade, tourism and real estate either.[870] In the latter case, the Chinese side must hold the majority of shares or occupy a dominant position in an FDI related project. The related industries cover urban subway and light rail, arterial railway, civil airport, water and air transportation, oil and gas pipe, nuclear power station, car and motorcycle, civilian aircraft and satellite, printing and publishing, and audio and video production.[871]

Along with its anticipated accession to the WTO, China is gradually opening up its industries, particularly emphasizing the liberalization of its service sectors. The Chinese authorities have declared that in the near future China is going to relax its FDI restrictions on these sectors: banking and insurance, domestic and foreign trade, civil aviation, construction, telecommunications, tourism, and such intermediary services as accounting, assessment, legal counseling and so on. The relaxation is supposed to range widely, from foreign ownership requirements to FDI entrance into Chinese domestic market and from FDI regional limitation to the FIE's business scope in the country.[872]

In Canada and China, neither of their FDI sectoral policies is embodied in any one domestic legal document or applied with a single national regulatory instrument. Both of their key sector policies are the totality of the fragments of their respectively numerous laws and regulations dealing explicitly or implicitly with FDI issues. Therefore, a review of these federal or national laws and regulations is well beyond the scope of this thesis. For a full view of their FDI laws at the national or federal level, however, a list of China's FDI Laws and Regulations on Industrial Sectors (in Appendix 1) and a list of Canada's Federal Legislation Re Foreign Investment (Appendix 2) are attached in the Appendices.

Canada has one of the most decentralized federal systems in the world, with the

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[869] *Id.*, Parts 1 and 2

[870] *Id.*, Part 2, (B), s.14

[871] *Id.*, Parts 1 and 2

[872] *Shenzhen Economic Daily*, Sept. 9, 1999, p.5

provincial governments exercising a wide range of policymaking powers.[873] Like the federal government, all provinces in Canada impose certain limitations on FDI.[874] Some secoral restrictions are governed by federal laws, and others go far beyond the policies that are enacted at the federal level but fall under the purview of provincial laws.[875] Because the provincial governments have a wide variety of economic and industrial development strategy,[876] they possess various policies in response to the extensive foreign ownership[877] and have a broad range of restriction policies directed at FDI. While having sufficient autonomy to take substantial actions on FDI issues,[878] the provincial governments have also been quick to emulate some aspects of the federal government's FDI policies and to preserve their constitutional powers as well as to provincialize potential benefits.[879] As a result, different provinces have different sectoral restrictions on FDI,[880] ranging from a special tax on the acquisition of agriculture land even to ownership limitations in nursing homes[881] and more provincial laws and regulations as well as their relevant FDI restrictions exist in Canada. Therefore, reference must be made relevantly to both the federal and provincial legislation to determine the full extent of Canada's restrictions on FDI[882] when a foreign investor plans to invest in Canada. But the number of these sub-national laws and regulations is so numerous that their review here is more impossible for the task of the thesis. In order to get a complete picture of Canada's FDI law, however, an appendix of Canada's Provincial Legislation Re Foreign Investment is also attached at the end (Appendix 3).

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[873] *Supra* note 13, p.96
[874] *Supra* note 755
[875] *Supra* note 210, p.249
[876] *Supra* note 13, p.103
[877] *Supra* note 239, p.40
[878] *Supra* note 216, p.78
[879] *Supra* note 239, p.47
[880] *Supra* note 210, p.255
[881] *Supra* note 777, p.5
[882] Richard J. Cole, "Special Considerations for Foreign Investors" in Desmond B. Morin and Warren Chippindale (eds.), *Acquisition and Merger in Canada*, 2nd ed., Methuen Publications, 1977, p.337

## VII. CONCLUSION – COMPARISON AND COMMENTS

### 1. FDI Presence in Canada and China

FDI in Canada is generally more extensive than in any other developed country. Canada was once the largest host to FDI in the world although its importance as a destination of global FDI has been declining in the second half of the 20th century. Since its earliest days Canada has relied heavily on capital from other counties, mostly from the U.K. first and then the U.S. The large amount of debt securities flowed from the U.K. in virtue of their colonial link and the FDI flux of the U.S. resulted from the unique geographic, historical and economic relationship between the two countries. Nowadays, most of Canada's inward FDI is centered in the U.S. The dominance of U.S. FDI and the significant American cultural impact brought with it have been worrying Canadians almost all the time in modern times. They fear that their economy is becoming more and more integrated with the U.S. and the continuing integration might lead to economic domination by this powerful neighbor and eventually to the loss of Canadian national identity and political sovereignty.

China is now the second largest FDI recipient in the world and the largest FDI absorber among the developing countries. As a big country with a huge potential market and rapid economic development, large quantity of FDI will seemingly keep coming into the country in the near future. However, FDI is less extensive in China than in Canada considering its much bigger domestic market and relatively shorter FDI history. The sources of the inward FDI into China are also dispersed.[883] For these reasons, FDI presence in China does not give rise to any serious concerns over national identity and political sovereignty. In China, governments at various levels and business communities of different kinds actually have all been attracting FDI very vigorously.

### 2. Different FDI Law Systems

As a federal state, Canada has two-tiered, i.e., federal and provincial, jurisdictions (with municipal by-law in a minor importance to FDI). Both the jurisdictions regulate

[883] Besides Hong Kong that accounted for nearly 52% of the total FDI in China as of 1998, the other top four investors of Japan, the U.S., Taiwan and Singapore made up only 8.2%, 8.02%, 7.96% and 4.56% of the total FDI respectively during the same period of time. – See *supra* note 182, p.15

industries and the economic ordering associated with such activity,[884] but jurisdictional disputes frequently revolves around the issue of whether the matter is of provincial or local rather than national concern. Many areas of contention exist even where there have been definitive rulings from the Supreme Court of Canada.[885]

In *A Survey of United States Controls on Foreign Investment and Operations: How Much is Enough*, Corr pointed out: "[t]he U.S. ... maintains a variety of ... federal controls on foreign investment ... under disparate statutes that are enforced by a variety of agencies. Numerous state laws add to the regulatory array. Consequently, the system ... lacks coherence and effectiveness in carrying out national investment objectives. ... Furthermore, fragmentation of jurisdiction inhibits efforts to identify and monitor whether regulations are constantly applied and whether the system serves and protects U.S. interests."[886] Canada's FDI law system is not as complicated as that of the U.S. due to the fact that (a) it has a FDI law of general application, the ICA, which clearly declares Canada's general legislative approach to FDI and which can be taken as a commonly understood uniform policy underlying other federal statutes and (b) the amount of its laws, regulations and administrative practices at sub-national level is less as it does not have as many sub-national governments. Yet Corr's comments have revealed somewhat similar problems of Canada's laws and regulations concerning FDI. Although a two-tiered jurisdiction is characteristic of federalism, Canada's FDI legal framework in practice does disadvantage foreign investors who have trouble identifying the overlapping controls that may apply to their intended investments. The situation can eventually obscures accurate analyses of investment risks and cause potentially severe consequences.[887]

As a unitary country, the divergence of the central and local FDI laws and regulations are not materially serious in China. But since its opening to the outside world, China has adopted a model of double standard to investment in the country. The Chinese government adjusts domestic investment with its general law and regulates FDI with its

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[884] *Supra* note 857, p.19-10

[885] *Id.*

[886] C. F. Corr, "A Survey of United States Controls on Foreign Investment and Operations: How Much is Enough?" *Am. U. J. Int'l L. & Pol'y*, Vol. 9:1, 1994

[887] *Id.*

foreign investment law. The practice is understandable for FDI was a completely new issue to socialist China at the end of 1970s and the beginning of 1980s and China, in which there was no existing system for FDI at all, had to create a whole lot of new policies, laws and regulations to deal with FDI without radical affection to its existing legal system. Along with the FDI development, however, the coexistence of different application of the FDI laws and the laws concerning the other domestic investment in the same country has displayed more and more problems in Chinese economy.[888] It is necessary for China to gradually yet determinedly eliminate the double standard practice in its investment field and establish a unified investment law system in the country. Actually China has made a big step towards this direction. On May 15, 1999, the 2nd Session of the 9th NPC adopted the *Contract Law*, which has unified three formerly separate contract statutes, i.e., the *Economic Contract Law*, the *Contract Law Concerning Foreign Economy* and the *Technology Law*.[889] However, its company law and tax law systems still need adjusting for the unified purpose.[890]

### 3. Notification, Review and Approval

Screening FDI is lawful in international law.[891] Apart from key-sector restrictions, the screening process is perhaps the most widely used technique for controlling the entry and establishment of FDI in current practice.[892] Both developed and developing countries have adopted this screening approach.[893] Many countries set up FDI administrative agencies that perform a dual function. Externally they promote their states as venues for FDI. Internally these agencies vet FDI proposals to ensure that they mesh with the government's objectives of economic development.[894] Canada is one of the most comprehensive examples of FDI regulation through screening laws in the world,[895] from

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888 See III. 1.3.2 of this thesis

889 *The Contract Law*, s.428

890 Gang Wang, *From Preferential Treatment to National Treatment: Issues on FDI Treatment of China*, unpublished thesis, Huaqiao University, Jun. 1997, pp.26-28

891 *Supra* note 350, p.102

892 *Supra* note 43, p.61

893 *Supra* note 47, p.195

894 *Supra* note 350, pp.100-101

895 *Supra* note 47, p.197

whose experience China may draw some lessons.

(1) FDI review process should not rely primarily on administrative discretion. The review should be reformed to clarify the process by providing foreign investors with insights into the manner in which the government's discretion is exercised.

(2) Although the FDI review decision in Canada tends to be discretionary and is commonly exercised in the absence of effective judicial review against decisions unfavorable to foreign investors,[896] the Canadian government periodically issues policy guidelines governing relevant FDI issues. In contrast, a large number of FDI regulations are classed as "internal" in China and many of the FDI administrative rules may not accessible to foreign investors. This situation creates uncertainty for the planning and operation of FDI projects and impairs China's attraction to FDI. In order to construct a more competitive investment environment China needs to increase the transparency of its FDI administration by sorting out the internal FDI regulations and publicize relevant FDI guidelines so that potential foreign investors are able to evaluate their intended investments and predict their business operations.

(3) It is true that China's FDI law has provided specific time limits on the review process of different FIEs,[897] but none of the *Implementing Regulations on the EJVL, the WFOEL* and *the CJVL* mentions what shall be done if the review process concerning any particular FDI project is not completed up to time. For the purpose of raising efficiency as well as overcoming bureaucracy this loophole should be plugged by introducing a similar deemed approval mechanism adopted in Canada's ICA. This means that any applied foreign investments in China should be deemed approved if their regulated review time limits are overlooked by the responsible authorities.

(4) Canada's ICA allows a wider range of inward FDI to be made without approval process, and the required procedure concerned is only to file a notification with the responsible government agencies. According to the present FDI law in China, however, all investments relating to FDI must be reviewed and approved by the relevant authorities no matter how tiny and unimportant they might be. China has decided that opening to the

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[896] *Supra* note 47, p.203

[897] See V.1.3(3) of this thesis

outside world is one of its long-term basic state policies and is absorbing FDI with this policy tool vigorously. Meanwhile, it does not necessarily worry about the possible national identity problem caused by inward FDI from now to the near future due to the fact that it is a big country with a long history and strong culture of its own. In order to build a more attractive investment environment while reducing administrative costs, therefore, China could adopt the measures that Canada's ICA uses to handle its greenfield establishment and enterprise acquisition relating to FDI. Specifically speaking, China may eliminate from review and approval requirement the establishment of new FDI projects with the exception of those in some restricted industries and the acquisition of existing domestic enterprises below certain thresholds and just takes the notification measure for monitoring and administering purposes instead.

(5) In China, large number of government departments is involved in FDI review and approval and different administrative bodies enter the picture depending on the sector of the proposed investment. To prevent cumbersome review procedures and further solve the problem of bureaucracy and reduce FDI administrative costs, a genuine "one stop" screening structure should be set up. The establishment could be carried out in two stages. Based on the model of Shenzhen,[898] the first stage is structuring the present "one stop" FDI service center of the major counseling function into a combined FDI screening agency system, through which all administrative procedures and legal referrals can be dealt with right on the spot for foreign investors,[899] leaving the internal procedures with each agency and its delegating government department to handle among themselves. At the second stage, the present FDI screening experience of Canada can be learned. China could in due course restructure the combined FDI screening agency system into a single review and approval administrative mechanism established at several (central, provincial or lower) levels. Foreign investors only need go to one of these administrative departments for their FDI applications in accordance with the areas in which they are going to establish their businesses and the capital amount with which they are going to

[898] See V. 1.3 (4) of this thesis

[899] Korea is a good example that has succeeded in creating such a system. – See IMF, *Foreign Private Investment in Developing Countries*, Occasional Paper No. 33, 1985, p.17

invest. As for some other government departments that have to exercise certain FDI reviewing power, in most cases it is for this single review and approval administrative body to be responsible for the consultation with them.

**4. Capital Ratios and Directors' Residency Requirements**

In Canada, there are no minimum capital requirements for companies except in the financial services industry[900] but there exist directors' residency requirements for the corporations incorporated federally or in some of its provinces. The situation in China is just opposite. China's FDI law does not make any particular requirements for directors' residency. The directors of a company are only appointed by the shareholders in accordance with their respective voting shares. However, China's FDI law generally demands that minimum capital ratio in any FIE for foreign investors should be at least 25% of the registered capital of that enterprise and it also makes requirements for the ratio between registered capital and total investment amount of an FIE. These two capital ratio requirements have displayed China's endeavor to absorb FDI and its intention to discourage the establishment of thinly capitalized FDI projects.

**5. Time Limits of Capital Contribution and Business Operational Term**

Just like non-minimum capital requirements, there are no time limits of capital contribution as well as business operational term in Canada. But foreign investors in China are required by law to set time limits for paying off their capital contribution in their joint venture contracts and articles of association. This requirement seems uncommon in market economies but it is necessary in a country like China for the time being because it functions to prevent low and delayed capital payoff, encourage the execution of FDI contracts and enhance the quality of FDI in the country.[901] China's FDI law also imposes restrictions on operational term of some EJVs that fall under restricted lines of business although most of the EJVs are permitted unlimited operational duration. This practice is reasonable in directing FDI flows and rationalizing China's industrial structure. The case-by-case review and approval of operational duration of the CJV and

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[900] *Supra* note 64, p.30

[901] *The Circular on Further Strengthening Administration and Registration of Foreign Investment Enterprises*

the WFOE, however, appears to be uncalled-for since it is unnecessary to make a distinction among all the FIEs on the same operational term issue.

### 6. Investment Incentives

The justification for FDI incentives is that they may reduce risk to foreign investors and thereby make the host country more attractive to FDI. Such policies are likely to be favored by countries that would otherwise be of marginal interest to FDI on purely economic grounds.[902] However, tax incentives for FDI have been criticized on a variety of reasons.

(1) Tax incentives are ineffective because they have little influence upon decisions whether to invest abroad or not.[903] On the contrary, prudent investors avoid investment decisions that greatly depend on incentives for their profitability[904] and many MNEs seldom factor tax incentives in their investment decisions.[905] The UNCTC holds the same opinion that the determinants of FDI attraction lie largely outside the incentives.[906]

(2) Tax incentives are inefficient in so far as their cost in terms of revenue foregone greatly outweighs any benefit they produce.[907]

(3) Tax incentives are detrimental in that they induce distortions in the form and location of investment, confer unintended benefits, create local resentment, and generally do more harm than good. For example, tax holidays may discourage investment and stimulate non-productive types of behavior near the end of the holiday period as firms that are about to loose their holiday benefits often reorganize or relocate in order to qualify for a new holiday.[908]

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[902] *Supra* note 47, p.225

[903] Yitzhak Hadari, "The Role of Tax Incentives in Attracting Foreign Investments in Selected Developing Countries and the Desirable Policy", *The Int. Lawyer*, Vol. 24, No. 1, Spring 1990, pp.121-122

Although the choice of location within a particular country is still likely influenced by tax incentives when a decision has been made to invest in this foreign country. – See *supra* note 42, p.44

[904] Stephen E. Guisinger: "Putting an Investment Code to Work: Harmonizing Incentive Policies in the Asia Pacific Region" in Carl J. Green and Thomas L. Brewer (eds.), *Investment Issues in Asia and the Pacific Rim*, Oceana Publications, 1995

[905] Richard D. Robinson, "Government Policy Options vis-à-vis Foreign Business Activity: An Academic View" in Richard D. Robinson (ed.), *Direct Foreign Investment: Cost and Benefits*, Prager, 1987, p.8

[906] *Supra* note 63, p.26

[907] *Supra* note 42, p.5

[908] *Supra* note 904

(4) Tax incentives constitute not an incentive to foreign investors when they simply result in a sort of tax transfer from host countries that sacrifice the amount of tax revenue for attracting FDI to home countries. As the foreign investors derive no benefit from tax reductions of the host countries, there is no point in bringing the tax levels of the host countries below those of the home countries of the investors.[909]

There are many other economic and political variables that need to be taken into account with regard to FDI. Political stability, availability of natural and human resources, size of market, transport and communications infrastructure, and the general attitude towards FDI are all important elements in FDI decision.[910] In fact, a stable and favorable economic regime, including a good tax system with overall reasonable tax rates, is more attractive to FDI than a hostile general environment "mitigated by numerous incentives".[911]

As in all countries around the world, Canadian governments of various levels offer a wide range of investment incentives to investors who are starting or expanding a business.[912] These incentives can be classified into two categories. One is financial assistance.[913] It contains grants, loans, guarantees and equity investments as well as tax holidays, reductions and credits. The other is non-financial assistance, which includes business counseling, technical and scientific advice, referrals, training, mentoring, use of research facilities, and provision of business and economic data.[914] These assistance programs are typically targeted at specific sectors, activities or regions where the potential benefits to the country are perceived to be the greatest with an emphasis on high technology, value-added processing, export development and small and medium-sized enterprises.[915] However, neither the financial nor the non-financial incentives are aimed to

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[909] *Supra* note 42, p.21

[910] *Supra* note 42, p.6

[911] The Irish Commission on Taxation, *Direct Taxation – The Role of Incentives*, 1984, pp.17-18

[912] "Incentive Programs", *The Canadian Edge*, Investment Canada, Feb. 1988

[913] Although the majority of financial assistance programs are offered at the federal level, most provinces offer some useful programs. – See Lewis Smith, "Government Assistance" in H. Heward Stikeman and R. Fraser Elliot etc. (eds.), *Doing Business in Canada*, Vol. 3, Matthew Bender, Oct. 1998, p.32-24

[914] Lewis Smith, "Government Assistance" in H. Heward Stikeman and R. Fraser Elliot etc. (eds.), *Doing Business in Canada*, Vol. 3, Matthew Bender, Oct. 1998, p.32-3

[915] *Id.*, p.32-4

attract FDI specifically. They are available to targeted business activities for both foreign and domestic investors on a generally equal footing.[916]

Tax preference to FDI has provided a better incentive by offsetting other disadvantages inherent in China and greatly contributed to FDI absorption for the country in the past. But the preferential tax treatment available only to FDI badly hurt tax equity and brought about many problems. It has exacerbated the economic imbalance between the eastern and western regions within the country, aggravated the contradiction of China's industrial structure, caused the disorder of its FDI policies, and stimulated sham FIEs[917] by so-called "round-trip" investment[918] and so on.[919] It is necessary to abolish the special treatment to FDI. However, international competition to attract FDI is such that few countries are prepared to take the risk of eliminating their incentives so long as other countries provide similar incentives. Therefore, it seems that investment incentives will remain a feature of the international tax scene for many years to come.[920] This situation compels as well as justifies China's continuing to grant investment incentives to FDI. How to resolve the dilemma and create a favorable environment for equal competition between the FIE and domestic enterprises in China? To answer this question, some Canadian experiences can also be referred to.

The basic principle in this issue is that China takes a gradual step to eliminate its FDI preferential tax treatment while trying its best to maintain both certainty and consistency of its FDI policy.[921] For this purpose, two measures could be taken. One is to differentiate

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[916] Besides, tax incentives are only a second type of incentive program in Canada. – See *supra* note 64, pp.28-31

[917] Foreign "partners" invest only in name without contributing any capital.

[918] The Chinese side first moves its money offshore and then recycles the capital back into the country disguised as foreign investment. It is said that 1/5 of Hong Kong's FDI in the mainland of China actually came from the mainland-controlled enterprises in Hong Kong. (Zongli Tang, *China's Foreign Economic Policy in Post-Mao Time*, Nova Science Publishers 1996, p.79) Considering that Hong Kong has been the dominant capital importer to the mainland with nearly 52% of China's total inward FDI by the end of 1998, (Feature article, "A Summary of China's Absorption of Foreign Investment", *Foreign Investment in China*, Issue 82, Sept. 1999, p.15) the figure is shocking.

[919] *Supra* note 890, pp.6-9

[920] *Supra* note 42, p.65

[921] FDI regulations should be both certain and capable of being consistently applied so that the FDI regulatory regime is most effective. – See *supra* note 235, p.39

existing FIEs with those newly applying to set up, with the former treated under the conditions of the present FDI regulations till the expiration of their terms and the latter no more enjoying the preferential treatment from the outset of their establishment. The other is to treat both existing and new FDI projects the same but reserve a period of time to call off all the preferential treatment to FDI so that the FIE and other domestic enterprises will be treated alike. Actually the Chinese government put forward the gradual implementation of national treatment to FDI in its *9th Five-Year Plan for National Economic and Social Development and the Long-Term Development Program to Year 2010* several years ago.[922] After the national treatment has been implemented, investment incentives will then be granted equally to foreign and domestic investors if they are justified.[923]

As a developing country, China is not in a position to make much payment in hard cash to attract investment, either foreign or domestic. But by providing within its present economic capacity an additional government function of non-financial assistance like that in Canada, such as business counseling, technical and scientific advice, referrals, training and use of research facilities etc.,[924] China can greatly help potential investors, especially those small and medium-sized domestic ones. It could be a profound measure for China to construct a more favorable investment environment and thus bring about its economic dynamics both from FDI and domestic investment. This is particularly true since China is now undergoing transition from a planned to a market economy.

### 7. M&A and Antitrust Law

Under the planned economic system in the past, there was no need for China to have any law to adjust or regulate competition issues since competition was considered an element of capitalism and prohibited from its domestic economy. In 1993 China decided its goal of establishing a socialist market economy and has been going forward to this direction since then. Competition is the basic operational mechanism of the market economy and where is competition there is monopoly. Therefore, the problem of

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[922] It was adopted by the 4th Session of the 8th NPC on Mar. 17, 1996.

[923] *Supra* note 903, p.124

[924] It might be argued that there are certain services of this kind in China, but certainly they are only on a piecemeal basis if there exist any.

monopolies in Chinese domestic market is getting more and more serious these years. From automobile industry to color television sector and to civil aviation, monopolies and their harmful effects on the economy as well as consumers are everywhere. For this reason, the voice of promulgating an antitrust law is getting stronger and stronger in China.[925]

From 1979 to 1998, the form of FDI mostly employed in China was greenfield establishment of the FIE that has been regulated by China's FDI law established during the past twenty years. In 1999, however, a new tendency appeared that M&A took the major form of FDI in the country and its amount reached as high as 60% of the total inward FDI of that year.[926] Along with the deepening reform of state-owned enterprises and gradual relaxation on its capital market as well as in view of worldwide FDI development pattern, foreign investment is expected to get more involved in M&A in China from now on. To fill up the legal blank space so that FDI-related M&A can be handled under prescribed conditions, it is necessary to enact a Chinese antitrust law as soon as possible. Since China is constructing its market economy, the legal elements of other countries with an established market mechanism could be introduced. In addition to careful studies of other typical foreign laws, therefore, the rules with regard to M&A notification requirements, notifiable thresholds and assessment factors may be transplanted from Canada's *Competition Act* to China by conscious choice.

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[925] "Strong Voice of the Promulgation of Antitrust Law", *Yangcheng Evening Paper (Chinese)*, Oct. 10, 2000

[926] Xinhua News Agency, *China Has Become the Second Largest FDI Absorber in the World*, Oct. 10, 2000

# APPENDICES

## 1. CHINA'S MAJOR LAWS AND REGULATIONS CONCERNING FDI

**A. Laws and Regulations on General Principles and Business Organizations**

(1) Law of Chinese-Foreign Equity Joint Ventures (Adopted on July 1, 1979 and amended on Apr. 4, 1990)

(2) Implementing Regulations on the Law of Chinese-Foreign Equity Joint Ventures (Sept. 20, 1983)

(3) Law of Chinese-Foreign Cooperative Joint Ventures (Apr. 13, 1988)

(4) Implementing Regulations on the Law of Chinese-Foreign Cooperative Joint Ventures (Sept. 4, 1995)

(5) Law of Wholly Foreign-Owned Enterprises (Apr. 12, 1986)

(6) Implementing Regulations on the Law of Wholly Foreign-Owned Enterprises (Dec. 12, 1990)

(7) Regulations on Encouragement of Foreign Investment (Oct. 11, 1986)

(8) Provisions on Encouragement of Investments by Compatriots from Taiwan (Jul. 7, 1988)

(9) Provisions on Encouragement of Investments by Overseas Chinese and Compatriots from Hong Kong and Macao (Aug. 19, 1990)

(10) Provisional Regulations on the Establishment of Foreign Invested Joint Stock Limited Companies (Jan. 10, 1995)

(11) Provisional Regulations on the Establishment of Investment Companies by Foreign Investors (Apr. 4, 1995)

(12) Implementing Regulations on the Approval and Administration of Resident Representative Offices of Foreign Enterprises (Feb. 13, 1995)

**B. Laws and Regulations on Industrial Sectors**

(1) Provisional Regulations on Guidance for Foreign Investment (the State Development Planning Commission, the State Economic and Trade Commission, and the MOFTEC; Jun. 20, 1995)

(2) Catalogue of the Guidance for Foreign Investment Industries (the State Development Planning Commission, the State Economic and Trade Commission, and the MOFTEC; revised on Dec. 31, 1997)

(3) Regulations on Chinese-Foreign Cooperative Exploitation of Offshore Petroleum Resources (Jan. 30, 1982)

(4) Regulations on Chinese-Foreign Cooperative Exploitation of Continental Petroleum Resources (Oct. 7, 1993)

(5) Provisional Measures for the Administration of Foreign Invested Development and Management of Tracts of Land (the State Council, May 19, 1990)

(6) Interim Provisions on the Preferences for the Construction of Ports and Piers with Chinese-Foreign Joint Investment (Sept. 30, 1985)

(7) Policy on Automobile Industry (the State Development Planning Commission, Feb. 19, 1994)

(8) Circular on Relevant Policy for Foreign Investment in Civil Aviation (the Civil Aviation Administration of China and the MOFTEC, Jan. 25, 1994)

(9) Circular on the Explanation of Matters Concerning "Circular on Relevant Policy for Foreign Investment in Civil Aviation" (the Civil Aviation Administration of China and the MOFTEC, May 6, 1994)
(10) Provisional Regulations on Utilizing Foreign Investment in Electric Power Construction (the Ministry of Electric Power Industry, Jul. 1994)
(11) Regulations on the Administration of Foreign Banks and Chinese-Foreign Joint Venture Banks in Special Economic Zones (Ari. 2, 1985)
(12) Regulations on the Administration of Foreign Invested Financial Institutions (the State Council, Feb. 25, 1994)
(13) Detailed Rules of the Regulations on the Administration of Foreign Invested Financial Institutions (the People's Bank of China, Apr. 3, 1996)
(14) Provisional Measures on the Establishment of Branches by Banks with Foreign Capital in China (the People's Bank of China, Jan. 4, 1996)
(15) Circular on Relevant Issues Concerning the Establishment and Administration of Financial Companies by Foreign Invested Corporation Groups (the People's Bank of China, Jan. 28, 1996)
(16) Procedures for the Administration of Establishment of Resident Representative Offices in China by Foreign Banking Institutions (Jun. 1991)
(17) Provisional Regulations on Insurance Administration (the People's Bank of China, Jul. 25, 1996)
(18) Measures for the Experiment on Commercial Enterprises with Foreign Investment (the State Commission for Economy and Commerce and the MOFTEC, Jun. 25, 1999)
(19) Provisional Measures on the Establishment of Chinese-Foreign Joint Venture Trading Companies on a Pilot Basis (the MOFTEC, Sept. 30, 1996)
(20) Regulations on the Establishment of Chinese-Foreign Invested Advertising Enterprises (the State Administration for Industry and Commerce and the MOFTEC, 1995)
(21) Provisional Measures on Pilot Chinese-Foreign Equity Joint Travel Services (the MOFTEC and the State Tourism Bureau, 1999)
(22) Circular on Issues Concerning the Establishment of Foreign Invested Shipping Companies in China (the MOFTEC and the Ministry of Transportation, Dec. 22, 1995)
(23) Regulations on the Examination and Approval of Foreign Invested International Freight Forwarding Agencies (the MOFTEC, Sept. 9, 1996)
(24) Regulations on the Establishment of Foreign Invested Construction Enterprises (the Ministry for Construction and the MOFTEC, Sept. 18, 1995)
(25) Provisional Regulations on Chinese-Foreign Cooperation in the Designing of Engineering Projects (Jun. 5, 1986)
(26) Provisional Regulations Governing the Qualification of Foreign Contractors for Engineering Projects (Jul. 1, 1994)
(27) Supplementary Regulations on the Establishment of Foreign Invested Medical Institutions (the MOFTEC and the Ministry of Public Health, 1997)
(28) Circular on Issues Concerning the Establishment of R&D Centers by Foreign Investors (the MOFTEC, Apr. 18, 2000)
(29) Regulations on the Establishment of Foreign Invested Import and Export Commodities Inspection and Appraisal Enterprises (the State Administration of Import and Export Commodity Inspection and the MOFTEC, Oct. 9, 1995)

(30) Several Provisional Regulations on the Establishment of Foreign Invested Assets Assessment Services (the National Administrative Bureau of State Assets and the MOFTEC, Apr. 1997)
(31) Provisional Regulations on the Establishment of Offices by Foreign Law Firms in China (the Ministry of Justice and the State Administration for Industry and Commerce, May 26, 1992)
(32) Circular on Relevant Issues Concerning the Absorption of Foreign Investment in BOT Form (the MOFTEC, Jan. 16, 1995)
(33) Circular on Issues Concerning the Technology Import of Foreign Invested Enterprises (Sept. 28, 1999)

**C. Laws and Regulations on Approval, Registration and Administration**

(1) Regulations on the Capital Contribution by Parties to Chinese-Foreign Equity Joint Ventures (Jan. 1, 1988)
(2) Additional Regulations of the Provisions on the Capital Contribution by Parties to Chinese-Foreign Equity Joint Ventures (Sept. 29, 1997)
(3) Provisional Regulations on the Ratios between Registered Capital and Total Investment for Chinese-Foreign Equity Joint Ventures (Mar. 1, 1987)
(4) Procedures for the Administration of the Appraisal of Assets Invested by Foreign Enterprises (Mar. 1994)
(5) Principles for the Approval and Essentials for the Examination of Contracts and Articles of Association of Foreign Investment Enterprises (Oct. 5, 1993)
(6) Provisional Regulations on the Term of Chinese-Foreign Equity Joint Ventures (the MOFTEC, Oct. 22, 1990)
(7) Circular on Further Strengthening Administration and Registration of Foreign Investment Enterprises (the State Administration for Industry and Commerce and the MOFTEC, Nov. 3, 1994)
(8) Regulations on Registration of Enterprises with Foreign Investment (Nov. 3, 1988)
(9) Several Regulations Regarding the Change of Ownership Interest of the Investors in Foreign Investment Enterprises (May 28, 1997)
(10) Procedures for Liquidation of Foreign Investment Enterprises (Jul. 9, 1996)
(11) Circular Concerning the Authorization of Governments at Provinces, Autonomous Regions, Municipalities Directly under the Central Government, Special Economic Zones and Municipalities Separately Listed on the State Plan on the Examination and Approval of Applications for the Establishment of Foreign Investment Enterprises (Jun. 9, 1988)
(12) Circular Concerning the Extension of the Limits of Power Vested with the Inland Provinces, Autonomous Regions, Cities Separately Listed on the State Plan and the Departments Concerned under the State Council in Examining and Approving Foreign Direct Investment Projects (Aug. 22, 1996)

**D. Laws and Regulations on Foreign Exchange, Loans and Guarantee**

(1) Regulations of the Management of Foreign Exchanges (the State Council, Jan. 9,1996)
(2) Provisional Rules on Foreign Exchange Control in Bonded Areas (Jun. 29, 1991)
(3) Provisions Concerning Issues of Balance of Incomes and Expenditures in Foreign Exchange of Chinese-Foreign Equity Joint Ventures (Jan. 15, 1986)
(4) Measures on the Balance of Revenue and Expenditure of Foreign Exchange by Purchasing Domestic Products for Export (Jan. 20, 1987)

(5) Measures of the Bank of China with Regard to Granting Loans to Enterprises with Foreign Investment (Apr. 24, 1987)
(6) Guarantee Law (Oct. 1, 1995)

**E. Laws and Regulations on Labor**
(1) Labor Law (Jan. 1, 1995)
(2) Regulations on Labor Administration in Foreign Investment Enterprises (the Ministry of Labor and the MOFTEC, Aug. 11, 1994)
(3) Trade Union Law (Apr. 3, 1992)
(4) Circular on Several Issues Relating to Strengthening the Work of Trade Unions in Enterprises with Foreign Investment (Oct. 22, 1994)
(5) Regulations on the Management of Employment of Foreigners in China, (the Ministry of Labor, the Ministry of Public Security, the Ministry of Foreign Affaires, and the MOFTEC; Jan. 22, 1996)

**F. Laws and Regulations on Intellectual Property Rights**
(1) Copyright Law (Sept. 7, 1990)
(2) Implementing Regulations on the Copyright Law (Jun. 1, 1991)
(3) Patent Law (Sept. 4, 1992)
(4) Implementing Regulations on the Patent Law (Dec. 21, 1992)
(5) Trademark Law (Feb. 22, 1993)
(6) Implementing Regulations on the Trademark Law (Jul. 15, 1993)

**G. Laws and Regulations on Customs and Inspection**
(1) Customs Law (Jan. 22, 1987)
(2) Implementing Measures for the Administration of Import by Foreign Investment Enterprises (the MOGTEC, Jun. 9, 1995)
(3) Circular on Adjusting the Taxation of Imported Equipment (Dec. 29, 1997)
(4) Customs Regulations on Control over Bonded Materials Imported by Corporations for Foreign Investment Enterprises (Mar. 5, 1991)
(5) Customs Regulations Concerning Control over Import and Export Goods into Technological Industrial Development Zones (Sept. 2,1991)
(6) Circular on the Reimbursement of Export Duties to Foreign Investment Enterprises (1995)
(7) Law of Import and Export Commodity Inspection (Feb. 21, 1989)

**H. Laws and Regulations on Taxation**
**a. Turnover Taxes**
(1) Decisions on the Application of Provisional Regulations on Such Taxes as Value Added Tax, Consumption Tax and Business Tax to Foreign Investment Enterprises and Foreign Enterprises (Dec. 29, 1993)
(2) Provisional Regulations on Value Added Tax (Dec. 13, 1993)
(3) Detailed Implementation Rules of the Provisional Regulations on Value Added Tax (Dec. 25, 1993)
(4) Provisional Regulations on Consumption Tax (Dec. 13, 1993)
(5) Detailed Implementation Rules of the Provisional Regulations on Consumption Tax (Dec. 25,

1993)

(6) Provisional Regulations on Business Tax (Dec. 13, 1993)

(7) Detailed Implementation Rules of the Provisional Regulations on Business Tax (Dec. 25, 1993)

**b. Income Taxes**

(1) Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises (Apr. 9, 1991)

(2) Implementing Regulations of the Income Tax Law of Foreign Investment Enterprises and Foreign Enterprises (Jun. 30, 1991)

(3) Circular on Tax Matters Concerning Foreign Investment Enterprises Engaged in Investment Business (1995)

(4) Provisional Regulations on Payment of Royalties for Chinese-Foreign Cooperative Exploitation of Petroleum Resources on Land (Jan. 15, 1990)

(5) Regulations on the Tax Policy for the National New and High Technology Industrial Parks (Mar. 6, 1991)

(6) Law of Individual Income Tax (revised on Oct. 31, 1993)

(7) Implementing Regulations of the Individual Income Tax Law (Jan. 28, 1994)

**c. Other Taxes**

(1) Provisional Regulations on Land Appreciation Tax (Dec. 13, 1993)

(2) Implementing Rules of the Provisional Regulations on Land Appreciation Tax (Jan. 27, 1995)

(3) Provisional Regulations on Resource Tax (Dec. 13, 1993)

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(5) Provisional Regulations on the Vehicle and Vessel Usage License Plate Tax (Sept. 13, 1951)

(6) Provisional Regulations on Stamp Duty (Aug. 6, 1988)

(7) Provisional Regulations of Tax on Slaughtering Animals (Dec. 19, 1950)

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(1) General Principles of the Civil Law (Apr. 12, 1986)

(2) Civil Procedure Law (Apr. 9, 1991)

(3) Arbitration Law (Sept. 1, 1995)

(4) Company Law (Jul. 1, 1994)

(5) Contract Law (Oct. 1, 1999)

(6) Product Quality Law (Feb. 22, 1993)

(7) Consumer Protection Law (Jan. 1, 1994)

(8) Anti-Unfair Competition Law (Dec. 1, 1993)

(9) Environmental Protection Law (Dec. 26, 1989)

(10) Securities Law (Jul. 1, 1999)

(11) Law of the People's Bank of China (Mar. 18, 1995)

(12) Law of Commercial Banks (May 10, 1995)

(13) Insurance Law (Oct. 1, 1995)

(14) Civil Aviation Law (Mar. 1, 1996)

(15) Measures on the Control of Appraisal of State Assets (Nov. 16, 1991)

## 2. CANADA'S FEDERAL LEGISLATION RE FOREIGN INVESTMENT*

(1) Air Canada Public Participation Act
(2) Bank Act
(3) Broadcasting Act
(4) Canada Business Corporations Act
(5) Canada Corporations Act
(6) Canada Development Corporation Reorganization Act
(7) Canada Petroleum Resources Act
(8) Canadian National Railway Act
(9) Citizenship Act
(10) Coastal Fisheries Protection Act
(11) Competition Act
(12) Cooperative Credit Associations Act
(13) Fisheries Act
(14) Income Tax Act
(15) Investment Companies Act
(16) Northern Pipelines Act
(17) Petroleum Incentives Program Act
(18) Territorial Lands Act
(19) Canada Mining Regulations
(20) Canada Oil & Gas Land Regulations
(21) Trust Companies Act

* R. K. Paterson and M. M. Band: "International Trade and Investment Law in Canada", 2nd ed., Carswell, 1994, A11.1-1 to A11.1-2 and Department of Justice Canada, http://canada.justice.gc.ca/FTP/ EN/Laws/ index.html

## 3. CANADA'S PROVINCIAL LEGISLATION RE FOREIGN INVESTMENT**

**Alberta**

(1) Agricultural Development Act
(2) Agricultural and Recreational Land Ownership Act
(3) Alberta Energy Company Act
(4) Alberta Opportunity Fund Act
(5) Business Corporations Act
(6) Companies Act
(7) Insurance Act
(8) Land Titles Act
(9) Loan & Trust Corporations Mortgage Brokers Regulation Act
(10) Nova Corporation of Alberta Act
(11) Public Lands Act
(12) Real Estate Agents' Licensing Act
(13) Securities Act
(14) Small Business Equity Corporations Act

**British Columbia**

(1) Company Act
(2) Equity Investment Plan Act
(3) Land Act
(4) Land Title Act
(5) Liquor Control and Licensing
(6) Mineral Tenure Act
(7) Travel Agents Act

**Manitoba**

(1) Corporations Act
(2) Farm Lands Ownership Act
(3) Registry Act
(4) Securities Act

**New Brunswick**

(1) Insurance Act
(2) Real Estate Agents Act

**Newfoundland**

(1) Corporations Act
(2) Insurance Adjusters, Agents & Brokers Act
(3) Trust & Loan Companies Licensing Act

**Northwest Territories**

Real Estate Agents' Licensing Act

**Nova Scotia**

(1) Agriculture & Rural Credit Act
(2) Land Holdings Disclosure Act
(3) Trust Companies Act

**Ontario**

(1) Business Corporations Act
(2) Collections Agencies Act
(3) Commodity Futures Act
(4) Cooperative Corporations Act
(5) Credit Unions & Caisses Populaires Act
(6) Employment Agencies Act
(7) Insurance Act
(8) Labor Sponsored Venture Capital Corporation Act
(9) Land Transfer Tax Act
(10) Liquor License Act
(11) Loan and Trust Corporations Act
(12) Mortgage Brokers Act

(13) Non-Resident Agricultural Land Interests Registration Act
(14) Ontario Energy Corporations Act
(15) Ontario Mineral Exploration Program Act
(16) Ontario Transportation Development Corporation Act
(17) Paperback and Periodical Distributors Act
(18) Public Lands Act
(19) Real Estate and Business Brokers Act
(20) Securities Act
(21) Small Business Development Corporation Act
(22) Travel Industry Act
(23) Wild Rice Harvesting Act

**Prince Edward Island**

(1) Insurance Act
(2) P.E.I. Lands Protection Act
(3) Real Estate Trading Act

**Quebec**

(1) Act governing the acquisition of farmland by non-residents
(2) Act respecting the development of Quebec firms in the book industry
(3) Act respecting the Societe de developpement industriel du Quebec
(4) Act respecting the Societe de recuperation d'exploitation et de developpement forrestiers du Quebec
(5) Act respecting the Societe generale des industries culturelles
(6) Act respecting the Societe quebecoise d'exploration miniere
(7) Act respecting the Societe quebecoise d'initatives petroliers
(8) Act respecting trust companies and savings companies
(9) Act to preserve agricultural land
(10) James Bay Region Development Act
(11) Land Transfer Duties Act
(12) Securities Act
(13) Travel Agents Act

**Saskatchewan**

(1) Agricultural Credit Corporation of Saskatchewan
(2) Apiaries Act
(3) Business Corporations Act
(4) Securities Act
(5) Trust and Loan Corporations Act

** R. K. Paterson and M. M. Band: "International Trade and Investment Law in Canada", 2nd ed., Carswell, 1994, A11.1-2 to A11.1-8 and Department of Justice Canada, http://canada.justice.gc.ca/FTP/ EN/Laws/ index.html

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