INTERNATIONAL TRADE AND BUSINESS LAW JOURNAL

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Foreword

The Australian Institute of Foreign and Comparative Law and the Study of International Trade Law

Gabriël Moens and Geoffrey de Q Walker

The publication of the very first issue of a new journal is always an exciting and eagerly awaited event. *International Trade and Business Law Journal* publishes articles, comments, case notes, and book reviews on foreign law, comparative law, and international trade law. This first issue contains articles on the International Sales Convention (Honnold), European Monetary Union (Follak), quality and title warranties in transfers of computer software (Adams), and legal aspects of foreign investment in Vietnam (Trai Le).

International Trade and Business Law Journal recognises that international trade law is one of the growth areas of legal practice. One of the reasons for this development relates to the sheer volume of international trade and commerce that characterises the international economic order. The world has become a global market with interdependent economies. The internationalisation of trade and commerce is coupled with a demonstrable attempt, by international institutions such as the World Trade Organisation, to liberalise world trade. This process of global liberalisation of trade has accelerated since the successful conclusion of the Uruguay Round in early 1994. In this light, it is not surprising that the objectives of private enterprises throughout the world are influenced noticeably by the many complex developments in the field of international trade law. The timely publication of *International Trade and Business Law Journal* is expected to facilitate the transmission and consideration of information which is vital to the successful completion, by businesspeople, of international commercial deals.

International Trade and Business Law Journal is the official publication of *The Institute of Foreign and Comparative Law* of the T C Beirne School of Law, University of Queensland, Australia. For this reason, it is appropriate in this foreword to describe the activities of the Institute, especially its involvement in the promotion of the study of international trade law.

A tradition of teaching international trade law

International trade law has been offered as a subject by the T C Beirne School of Law, University of Queensland, for many years. During the last two decades, the School has developed an enviable reputation in this field, a reputation acknowledged by Emeritus Professor John O Honnold in his article ÔUniform Laws for International Trade: Early ÒCare and FeedingÓ for Uniform GrowthÕ which is published in this issue The groundwork for this development was laid by Professor Kevin W Ryan who taught the subject at the T C Beirne School of Law before he was appointed to the Supreme Court of Queensland, and was the author of a leading text, entitled *International Trade Law*.[1] Professor Ryan was succeeded by Professor Kenneth Sutton, who acquired an international reputation in the field of contract law, including the United Nations Convention on contracts for the international sale of goods (Vienna Convention, 1980). Professor Sutton participated in the Twelfth International Congress of Comparative Law held in 1986 in Sydney. He delivered a noted paper ÔMethodology in Applying Uniform Law for International SalesÕ.[2] Following Professor SuttonÕs departure to James Cook University of North Queensland, the study of international trade law became a responsibility of The Australian Institute of Foreign and Comparative Law, which is an integral part of the T C Beirne School of Law.

The Australian Institute of Foreign and Comparative Law

Teaching activities

The Institute oversees the development of foreign and comparative law courses in the department. The Institute now offers courses in comparative law, European Union law, and international trade law. These courses are based on the assumption that the economic well-being of Australia depends on its trade with other nations and that the expansion of trade links is facilitated by advanced knowledge of the legal systems of our trading partners. Many Australian law firms now need the expertise of lawyers, or prospective lawyers, who are familiar with foreign legal systems and international trade law. The establishment of the courses mentioned above will help to alleviate some of the pressing legal problems encountered by exporters and help to make Australia more competitive in world markets.

1 KW Ryan, *International Trade Law* (1975) Law Book Company Ltd, Sydney.

2 In AES Tay ed, *Law and Australian Legal Thinking in the 1980s* (1986) pp 91-98, University of Sydney.

The Institute administers the SchoolÕs *Master of Comparative Law Program* (MCL). It also offers a *Graduate Certificate in Comparative Law* (GCCL). The MCL degree is a one-year coursework degree offered only to students who have obtained their basic law degrees in non-common law jurisdictions. It is designed to allow non-common law lawyers to obtain an appreciation and knowledge of the common law as it functions in common law jurisdictions, with particular emphasis on Australian common law and business practices. The degree is particularly suitable for international legal practitioners, or the in-house counsel of large organisations who do business in Australia or other common law countries. The GCCL certificate is a six-month course offered to foreign students who successfully complete studies in comparative law and common law. The InstituteÕs teaching programs, in addition to imparting knowledge about the common law, enable participants to develop trade and cultural links with Australians. In 1994, the Institute administered study programs for students from Bangladesh, Japan, Germany, Sweden and Vanuatu.

The Institute organises visits by European scholars who wish to contribute to its academic programs. It also sponsors a T C Beirne School of Law team to participate in the finals of the prestigious Willem C Vis International Commercial Arbitration Moot held in Vienna from 22 to 26 March 1995.

Research activities

The Institute encourages advanced research on European Union law, foreign and comparative law, and international trade law. For example, a book entitled *Business Law of the European Community*[3], co-authored by the present Director of the Institute, Professor Gabri‘l Moens, is reviewed in this first issue of the Journal. The Institute now undertakes a Research Project which aims to ascertain the contribution that trading blocs make to the global liberalisation of world trade. It is appropriate in this Foreword to provide readers with a detailed outline of this project, not only to acquaint readers with current research undertaken in the Institute, but also to invite potential contributors to write articles on this issue which are suitable for publication in a later issue of this Journal.

Although AustraliaÕs economic prosperity is greatly influenced by trade with the NAFTA and EU trading blocs, it is not yet clear whether regional trading blocs are steps towards global liberalisation of trade or are protectionist economic groupings. Resolution of this issue is fundamental to assessing the desirability of Australia becoming a member of a South Pacific trading bloc.

3 G Moens and D Flint, *Business Law of the European Community* (1993) DataLegal Publications, Brisbane.

Many would argue that trade blocs are compatible with liberalisation of world trade: ÔRegional FTAs [Free Trade Areas] should not be viewed as discriminatory trade pacts which will lead to the breakdown of a global trade framework. Instead, they should be viewed as an alternative means of achieving global free trade.Õ[4] Others contend that all regional trade agreements are inimical to free trade and are a form of neo-protectionism through the creation of external barriers to trade originating from outside the trading bloc.[5] The question may thus be posed: are regional free trade blocs building blocks toward global free trade, or are they strategic economic groupings designed to become more competitive vis-ˆ-vis other blocs?[6] This issue is vital for AustraliaÕs future because strengthening our export performance depends upon the elimination of artificial barriers impeding free trade in goods and services. This project thus aims at ascertaining whether trading blocs contribute to or impede the establishment of a liberal world trading order.

The project focusses on the North America Free Trade Agreement (NAFTA) and the European Union (EU), undertaking a comparative analysis of legislative and jurisprudential developments within each that concern free movement of goods and services across national frontiers. The compatibility of these trade laws with the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organisation (WTO), are examined, for these treaties have been the chief international instruments designed to promote trade liberalisation.

NAFTA and the EU have been chosen for this project because they account for an enormous proportion of total world trade. In 1992-93 the EU was AustraliaÕs largest economic partner according to balance of payments data by country and region released by the Australian Bureau of Statistics.[7] Australia must improve its export performance and the EU is one of the regions where we can and should do so.

The NAFTA Agreement aims to eliminate barriers to trade in goods and services between the United States, Canada and Mexico. It will gradually reduce and eventually abolish customs duties and tariffs between participating countries. NAFTA is therefore likely to facilitate trade within North America. Thus one of its principal aims is that its benefits remain in North America. Strict rules of origin will protect the North American market against importation into the United States and Canada of products assembled in

4 Kevin A Wechter, ÔNAFTA: a complement to GATT or a setback to global free trade?Õ (1993) 66 *Southern California Law Review* 2611, p 2628.

5 See Department of Foreign Affairs and Trade, *Asean Free Trade Area: trading bloc or building block*? (1994) Australian Government Printing Service, Canberra, pp 15-6).

6 See Ernest H Preeg, ÔThe US Leadership Role in World Trade: Past, Present, and FutureÕ (Spring 1992) *The Washington Quarterly* 81, p 88.

7 Delegation of the European Commission to Australia and New Zealand (1994) *European Union News*, Vol 12, No 8 November/December, p 1.

Mexico by companies from non-NAFTA countries. Products in which non-NAFTA content is higher than that permitted under these rules of origin will not have duty-free access to the North American market.[8]

The economic impact of NAFTA on Australia is likely to be great, for the rules of origin may make it more difficult to compete with North American companies. On the other hand, a benefit for Australian manufacturers is that they will be subject to a uniform set of product specifications.

The results of the project will yield valuable insights as to the desirability of entry by Australia into a South Pacific trading bloc. The importance of this region to Australian business is already clear and will only increase with the passage of time. Within the Pacific region, Ô[s]teady growth is expected over the coming ten years and [its] ... rate of economic expansion is likely to be higher than that for the rest of the worldÕ.[9] What would be AustraliaÕs wisest course of action in this context will depend upon the extent to which such an agreement would secure to Australia the benefits of free trade.

The significance of this project may be measured in both theoretical and practical terms. From a theoretical standpoint, the project will assess the effect of trading blocs upon liberalisation of world trade. It is especially important to test the hypothesis that establishment of a regime of free movement of goods within the trading bloc, together with the adoption of an external tariff, will achieve an increase in the total volume of world trade.

The practical significance of this project is even greater. Comparative study of the trade laws of AustraliaÕs trading partners will help the formulation of trade policy, particularly policies directed to the removal of barriers to fair trade. The feasibility of a South Pacific trading bloc depends upon the compatibility of the legal systems of the prospective participants. Published work resulting from this study will enable lawyers and economic consultants to give reliable advice to Australian businesses seeking to fortify their export potential.

International Trade and Business Law Forum

The Institute, in conjunction with Clarke and Kann Lawyers, also organises an annual *International Trade and Business Law Forum*. The Third Forum, which was part of International Business Week, was held on Tuesday 11 October 1994. Speakers presented papers on the following topics: The European Union: The First Twelve Months; Doing Business in Japan: The Practicalities of Joint Venture Co-operation; International Franchising; The

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8 See Joseph A LaNasa III, ÔRules of origin under the North American Free Trade Agreement: a substantial transformation into objectively transparent protectionismÕ (1993) 34 *Harvard International Law Journal* 381, p 384.

9 *Asian Business Review* (June 1991) p 18.

European Union-Australia Wine Agreement; GATT: Impact on AustraliaÕs Anti-dumping Law and Practice; The Regulation of Foreign Investments by the Foreign Acquisitions and Takeovers Act. Previous Forums were held on 13 October 1992 and on 12 October 1993. The keynote speaker in 1994 was Professor Alice E-S Tay, University of Sydney, whose address dealt with *Trading with China: Pitfalls and Harvests*. Future Forums will include discussion of the World Trade Organisation (WTO), the conflict between environmental protection and international trade, and regional trade developments. The Forum provides participants with an opportunity to present their ideas in a logical and coherent manner to an audience of legal practitioners, businesspeople, judges and public servants.

Conclusion

It is, of course, impossible for any person to obtain a perfect, or even a satisfactory, knowledge of every aspect of international trade law. It is a vast, indeed infinite area that is subject to constant change. These changes, as any practising lawyer knows, are an eternal source of frustration. It is hoped that *International Business and Trade Law Journal* will contribute to providing the legal profession, businesspeople and students with an opportunity to stay abreast of these developments.

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Uniform Laws for International Trade: Early ÔCareÕ and FeedingÕ for Uniform Growth

John O Honnold

Introduction

This important journal has been launched at an auspicious time and place. The time is right: the importance and feasibility of uniform law for international trade have been established. Five years have passed since Australia implemented the UN Convention on Contracts for the International Sale of Goods (CISG) Ð the most basic of the uniform laws prepared by the United Nations Commission on International Trade Law (UNCITRAL). The Sales Convention (CISG) has already been implemented by 38 countries, with adherents from each economic and legal system of the world. This is also the right place for this journal. The reasons include AustraliaÕs many-faceted leadership in developing uniform law and the scholarly support provided by the University of Queensland Law Faculty.

This article considers measures for the Ôcare and feedingÕ of young international conventions to promote healthy growth for their lifeÕs mission: uniformity not only in words but, especially, in their interpretation and application. For clarity, examples will be drawn from the Sales Convention but principles for achieving uniformity can apply to other international uniform laws. Of special significance here are the UNCITRAL laws that are already on the statute-books in Australia: the 1980 Sales Convention (CISG), the 1985 Model Law on International Commercial Arbitration and the 1978 Convention on the Carriage of Goods by Sea (ÔHamburg RulesÕ).[1]

At this point I can not resist recalling memories that made it impossible to decline the invitation to submit this paper. In 1972 one of the series of distinguished Solicitors-General who represented Australia in the work of UNCITRAL asked me to come and help explain what we were doing. What resulted was an intensive introduction to Australia, with lecture-stops at Bar Associations, universities and government offices stretching from Brisbane via

1 The ÔHamburg RulesÕ were enacted by the Australian Parliament on 11 November 1991, to become effective on 1 November 1994, unless each House of the Parliament passed resolutions which had the effect of retaining the Amended Hague Rules: see *Carriage of Goods by Sea Act* (Cth) 1992, s 2(3). Such resolutions were passed in October 1994. See also J Honnold, ÔOcean Carriers and Cargo: Clarity and Fairness Ð Hague or HamburgÕ, (1993) 24 *J Mar L & Comm* 75. Materials on the wider scope of UNCITRALÕs work will appear in the Proceedings of the May 1992 Congress celebrating the 25th anniversary of UNCITRAL, held in the UN General Assembly: ÔUNCITRAL CONGRESS: UNIFORM COMMERCIAL LAW IN THE 21ST CENTURYÕ.

Sydney, Canberra, Melbourne, and Adelaide to Perth! These memories were kept warm by the opportunity to participate in important conferences on legal developments organised by the Attorney-GeneralÕs department.

Finally, some background for this paper: In 1986 the Twelfth International Congress of Comparative Law was held in Australia. As a General Reporter my topic was this: Do differing approaches to interpreting legislation affect uniform application of international conventions? What can be done? A study plan with pointed questions on these questions was answered by national reporters from 16 countries; both Ôcommon lawÕ and Ôcivil lawÕ traditions were represented.[2] These national reports provided the grist for my General Report to the Congress; this led to further work in this area that is reflected in this paper.[3]

Can national approaches to interpretation be reconciled?

With important unifying laws in force world-wide, jurists and scholars face this problem: What approaches to interpretation will best promote uniform application of these laws? A thorough study of the various approaches of the worldÕs legal systems would require a multi-volume treatise prepared by a substantial team of comparative law scholars.[4] Fortunately, all that is necessary now is to red-flag some of the differences of approach that pose special hazards for unification.

A second caveat: comparative studies often refer to the approaches of Ôcommon lawÕ and Ôcivil lawÕ systems Ð a necessary but desperate measure to avoid unmanageable fragmentation of the subject. This study will also need to refer to some of these commonly accepted traditions, but with the understanding that legal systems of Ôcommon lawÕ or Ôcivil lawÕ ancestry have their own distinct features. Fortunately, for our purpose we do not need to try to pin labels on the legal systems of the world. The job at hand is to consider and evaluate different approaches to interpretation; ancestry will have only historical interest. In practice, the patterns of the law at hand are what matter.

2 A particularly helpful study was prepared by Professor and Dean Kenneth Sutton of the University of Queensland. Sutton, Methodology in Applying Uniform Law for International Sales, in AES Tay, ed, *Law and Australian Legal Thinking in the 1980s* (1986) (Paris), 91-98. Other national reporters were L Popov (Bulgaria), JS Ziegel (Canada), C Samson (Canada & Quebec), A Kanda (Czechoslovakia), P Schlechtriem (FR Germany), L Sev—n (Finland), D Maskow (German DR), G Ešrsi (Hungary), MJ Bonell (Italy), F van der Velden (Netherlands), JH Farrar (New Zealand), J Rajski (Poland), WLH Khoo (Singapore), Malcolm Clarke (UK), and LC Arria, Venezuela.

3 J Honnold, ÔUniform Words and Uniform Application: The 1980 Sales Convention and International Juridicial PracticeÕ, in P Schlechtriem, ed,*Einheitliches Kaufrecht Und Nationales Obligationenrecht* (1987) (Nomos, Baden-Baden), 115-147. (This study will be cited herein as ÔJH, Report to Comparative Law CongressÕ.) See also report based on a 1990 Lecture at the University of Stockholm, ÔJuridisk Tidskrift, Stockholms UniversitetÕ (1990-1991) 1-14.

4 See, eg, R Schlesinger, *et al*, *Formation of Contract, A Study of the Common Core of Legal Systems* (1968) (Dobbs Ferry, NY: Oceana), 2 Vols.

Different types of domestic laws (eg statutes governing taxes and crimes) call for sharply different approaches; by the same token, international conventions designed to control sovereign states need to be handled differently from conventions that govern commercial transactions between private parties.[5]

In sum, this study asks only this question: Which approaches to interpretation are most appropriate for uniform laws for international trade? With this in mind, the baton passes to jurists and scholars of the country where the international law is being applied: Do our practices fit the problem at hand? If not, how can one develop more appropriate responses to the special needs of this young and promising member of our legal family?

ÔPlain meaningÕ: context; legislative history

We start with the basic obligation of fidelity to the words of the statute; departures from this principle undermine further constructive international work.[6] Unfortunately, legal terms can have an elusive, chameleon-quality even in domestic legislation; in international legislation that must be translated into many other languages the use of domestic legal terminology can produce chaos. What can be done?

The decade of work that led to the Sales Convention included rooting out words with domestic legal connotations in favour of non-legal ÔearthyÕ words that refer to physical acts. Instead of connecting risk of loss with domestic concepts such as ÔpropertyÕ or ÔtitleÕ, risk passes when the goods are Ôhanded over to the first carrierÕ; if the buyer is to come for the goods, risk passes when the buyer Ôtakes overÕ the goods (CISG 67(1) and 69(1)). A vital measure of control was provided by the repeated review of multi-lingual drafts in UNCITRAL; when a draft failed to be clear in translation, alarms would be sounded by delegations from other legal and linguistic systems. Drafting in this setting imposed demanding standards for imagination, intellectual rigour and patience.

A confession: this writer was slow to grasp the full power of the ConventionÕs full context in resolving ambiguities. For example: the Convention (Article 1) applies when the partiesÕ Ôplaces of businessÕ are in different Contracting States. ÔPlace of businessÕ could be ambiguous in this setting: Party P, based in State A, sends agents to State B where extended

5 The present writer has ventured to suggest that those provisions of the 1980 Sales Convention (CISG) that are designed to settle commercial disputes between private parties, including the flexible provisions on trade usages (Article 9(2)) and other unwritten expectations (Article 8(2)), do not apply to the ConventionÕs ÔFinal ProvisionsÕ (Articles 89-101) that govern the obligations of States to each other; these inter-State obligations appropriately fall under the strict rules of the Vienna Convention on the Law of Treaties (1969). See J Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (1991) ¤ 103 and note 44, (Deventer (Neth) & Boston: Kluwer) 2d ed (cited herein as ÔJH, Commentary on CISGÕ).

6 One dares to hope that the spread of literary ÔdeconstructionÕ of law has run its course.

negotiations lead to an international contract: under the ConventionÕs rules on applicability (Article 1(1)) did party P have a Ôplace of businessÕ in State B? Only if one ignores that under CISG 10(a) the relevant Ôplace of businessÕ is the one Ôwith Ôthe closest relationship to the contract *and its performance*Õ and that Articles 31(c), 42(1)(b) and 69(2) (delivery of goods; passage of risk) refer to important acts of ÔperformanceÕ at the sellerÕs or buyerÕs Ôplace of businessÕ. There are many other instances where the full context of the Convention resolves ambiguities.[7]

Legislative history

Experience with domestic statutes that govern a large and complex field tells us that the language of the Sales Convention, even in context, will not give a clear answer to all problems. In these early years of the Convention, before broad development of consensus by international case law (below), in addition to the statutory words there is only one other common international point of reference Ð the legislative history (*travaux préparatoires*).

A decade or so ago it would have been necessary to speak of the resistance of English courts to references by counsel to parliamentary debates Ð subject to the charming exception that HansardÕs reports of debates may be placed before the court for use by the judges, should they wish to consult this material of their own initiative.[8]

Significantly, the House of Lords made its first important departure from this tradition in construing an international convention Ð surely a necessary step for multi-lingual instruments that, even in the English version, have been influenced by representatives of rebellious ex-colonies who may have lost touch with traditional English legal idioms and the patterns established by Parliamentary draftsmen.[9] A broader outlook is mandated by multi-lingual international conventions. For example, the Sales Convention (Article 7) underscores the obvious point that interpretation should have regard for the ConventionÕs Ô*international character* and the need to *promote uniformity* in

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7 The basic term ÔgoodsÕ as moveable tangible property is clarified by a series of exclusions in Article 2, and by ÔpackagingÕ (Article 35), replacement of defective parts (Article 46), and warehousing to prevent deterioration (Article 85-88). See also JH, Commentary on CISG, above note 5 (scope of Ôsales on execution or otherwise by authority of lawÕ (Article 2(c)) clarified by any of the following Articles: 49, 64, 75, 81 and 88.

8 See the comments on English practice in JH, Report to Comparative Law Congress, above note 3.

9 *Fothergill v Monarch Airlines* [1980] 2 All ER 696 (HL), construing an Act of Parliament that gave effect to the Warsaw Convention on the liability of air carriers. Later decisions in English and the Commonwealth have followed this lead.

its *application*.Ó When important and difficult issues of interpretation are at stake, diligent counsel and courts will need to consult the ConventionÕs legislative history. In some cases this can be decisive.[10]

When researching points of legislative history of the Sales Convention one needs to be aware of special features of the legislative process during the decade of UNCITRALÕs preparation of the 1978 draft for a Sales Convention Ð the document that was the basis for discussion and decisions at the 1980 Diplomatic Conference. One happy and astonishing feature of this decade of work in UNCITRAL is that consensus was reached on each provision without ever taking a formal vote. Summaries of the discussions were faithfully recorded, but the lack of votes on proposals that were not explicitly accepted or rejected in reaching consensus could blur contours of the decision.[11]

Clearer light, however, was shed by the CommissionÕs response to Reports of the Secretary-General; these Reports, distributed in multi-lingual versions in advance of UNCITRAL sessions, usually provided the basis for discussion and action.[12] The significant point is that these Reports typically developed the commercial and legal background of alternative proposals. When, as often, one of these alternatives was accepted, relevant legislative history would include not only the discussion by the Commission but also the background and implications of that proposal in the Secretary-GeneralÕs Report Ð materials that resemble a domestic Commission or Committee report that leads to legislation.

The Secretary-GeneralÕs report, in addressing particularly complex or contentious issues, employed an approach that, at the outset, struck some delegates as a Ôcommon lawÕ oddity. Instead of proposing a draft, the Report would set forth a set of facts at the cross-roads of important decisions, and would invite the group to choose among alternative outcomes Ð e.g. outcome ÔAÕ, ÔBÕ, or ÔCÕ. Starting with decisions on outcomes Ð results provided a helpful route to decision in difficult situations where starting with a legal draft would often produce alternative drafts, misunderstanding and impasse. In addition, starting with agreement on results speeded agreement on a draft.

10 For the legislative history shedding light on the apparent conflict between Articles 14 and 55 on the validity of Ôopen priceÕ contracts, see JH Commentary on CISG, above note 5 at ¤¤ 137.6, 324-325.3. The present writer must confess that in preparing the CommentaryÕs first edition he had overlooked this decisive material, which came to light only in the preparation of his *Documentary History of the Uniform Law for International Sales* (1989) (Kluwer: Deventer & Boston). The difficulties of finding legislative history, spread over 10 volumes and 1,000 pages, led to the preparation of this volume; see *id*, Preface (vii) and 4-6.

11 This was not true of proceedings at the 1980 Diplomatic conference, where proposals were acted on by recorded votes. At the end of the conference, each of the 101 articles received approval by a two-thirds majority, followed by unanimous approval of the final text.

12 These Reports appear in Volumes I-X of UNCITRALÕs Annual Reports in conjunction with consideration and action by the Commission, and are included, with indexing and cross-referencing, in the Documentary History cited in note 10, above.

What is relevant here is that an unintended by-product of this approach was clearer legislative history.[13]

Statutory ÔgapsÕ and international uniformity

Assume that a problem falling within the scope of a uniform law like the Sales Convention is not addressed by an express provision of the statute. How should this problem be solved Ð by turning to domestic law or by analogical extension of the provisions or underlying general provisions of the uniform law?

Domestic approaches to this issue differ; it is important to consider which approach best serves the objectives of international unification.

The problem is clearly exposed by contrasting provisions of the two conventions to establish uniform law for international sales. The 1964 Sales Convention (ULIS), prepared by the Rome Institute (UNIDROIT) primarily by drafters of Ôcivil lawÕ background, provided (Article 17):

ÔQuestions concerning matters governed by the present Law which are not expressly settled therein shall be settled in conformity with the general principles on which the present Law is based.Õ

In UNCITRAL and the 1980 Diplomatic Conference, many delegates pressed for the above-quoted provision of 1964 ULIS. On the other hand, delegates primarily of Ôcommon lawÕ background were concerned by the lee-way that the 1964 Convention might allow for judicial extrapolation of the ConventionÕs Ôgeneral principlesÕ. This concern led to the inclusion in Article 7(2) of a provision substantially the same as the above-quoted provision of 1964 ULIS, with the addition, at the end, of the following:

> Ô... or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.Õ

In spite of the warning (above) of dangers from loose generalisations about Ôcommon lawÕ and Ôcivil lawÕ, at this point we need to take account of historic differences in approach.[14]

For example, the French Civil Code was designed to supersede the law of the *ancien régime*. To guard against back-sliding, judges were required to anchor decisions in some article of the code Ð an approach that required creative extensions by analogy of the codeÕs provisions to meet the myriads of new problems that arose during the following centuries. Our Ôcommon lawÕ

13 The focus on facts and outcomes as a tool for mutual understanding in a multi-lingual, multi-legal setting was first suggested to the present writer by R Schlesinger, *Formation of Contract, A Study of the Common Core of Legal Systems* (1968) (Dobbs Ferry, NY: Oceana), 2 Vols. This pioneering study included scholars from common law and civil law backgrounds.

14 For a fuller development of this background see A Von Mehren and J Gordley, *The Civil Law System* (1977) 2d ed (Boston: Little Brown); JH Commentary on CISG, above note 5 at ¤¤ 96-102.

approach has been basically different. For example, the (UK) Sale of Goods Act, the (US) Uniform Sales Act and even our relatively modern (US) Uniform Commercial ÔCodeÕ all depend on supplementary support from the surrounding ocean of judge-made common law.

When a ÔgapÕ seems to appear in the Sales Convention we face this question under the above-quoted final clause of CISG 7(2): Should the tribunal place primary stress on the first alternative in CISG 7(2) and look *hard* for Ôthe general principles on which [the Convention] is basedÕ, or should the tribunal quickly turn to the second alternative and decide in conformity with domestic law Ôapplicable by virtue of the rules of private international lawÕ?

For judges of the Ôcommon lawÕ tradition the latter alternative may seem more natural, familiar and consistent with accepted ways of dealing with domestic statutes. In addition, local, familiar domestic law may be easier to apply Ð unless, of course, counsel lead the court into the dismal swamp of private international law Ð ÔconflictsÕ.

However, the tribunal (aided by able counsel) may well ask: Which course is more consistent with the ConventionÕs central goal to promote international uniformity? A decision, pursuant to Article 7(2) applying by analogy the principles underlying express provisions of the Convention is *an interpretation of the Convention* which judges in other countries will be obliged to consider, and will thereby contribute to the growing body of applicable international case law. On the other hand, domestic law invoked by the court is *not an interpretation of the Convention*, and need not be respected in other countries. Moreover, domestic law often will not provide principles that are compatible with the structure of the Convention and the special needs of international trade. The choice between the above alternatives has stimulated thought and writing by many scholars. All that is feasible here is to note that these inquiries have produced a remarkable degree of consensus favouring analogical extension of the ConventionÕs principles over recourse to domestic law.[15]

If a court sees a ÔgapÕ and flinches from seeking, or fails to find, an applicable Ôgeneral principleÕ, the Sales Convention still provides an important alternative to domestic law.

Article 9 provides that parties are bound not only Ôby practices they have established between themselvesÕ but also by international trade usages; both not only supplement the Convention but also, in case of conflict, supersede the

15 See, eg, CM Bianca and MJ Bonell (eds) *Commentary on the International Sales Law,* (1987) (Milan: GiuffrŽ), 75-83 (citing other studies); JH, Commentary on CISG, above note 5 at 99-102, pp 152-155. See also Hellner, Gap-Filling by Analogy, *Festskrift till Lars Hjerner, Studies in International Law* (1990) (Stockholm: Norstedts), 219-233; Volken, CISG: Scope, Interpretation and Gap-Filling, in P Sarcevic and P Volken (eds) (1986) *Dubrovnik Lectures* (NY: Oceana), 239-264; Guneskara, Judicial Reasoning by Analogy with Statutes, 1993 *NZ Law* J 446.

ConventionÕs provisions (CISG 6, 9(2)). Counsel who face a Ôgap problemÕ and who do not welcome the prospect of domestic law should take advantage of the opportunity (which many seem to ignore) to learn how the parties, or others in the trade, have handled this problem.

International case-law and doctrine

Our last topic concerns the role of international case law in response to the Sales ConventionÕs call for interpretation Ôto promote uniformity in [the ConventionÕs] *application* ...Õ Ð a mandate that clearly calls for due regard for interpretations in other countries.

One often faces this question: How can we expect uniformity without supervision by an international tribunal? True, no international court has jurisdiction to review these private law decisions, nor is there significant support for establishing such a court because of the delays this would create in settling commercial disputes.

Domestic experience helps to put this problem in perspective. Many who are not specialists in the US federal system are dismayed to learn that our ÔSupremeÕ Court has no jurisdiction to correct conflicting interpretations of the many uniform laws of our 50 states, for example, the Uniform Commercial Code (UCC).[16] Divergent interpretations have, of course, developed. The important point, however, is that they have not significantly detracted from the great value of our uniform state laws; the Ôsaving graceÕ is the shared conviction by our courts of the need to preserve uniformity by giving weight to decisions in other states. As a result, a generally satisfactory uniformity of result has been achieved.[17]

We should expect (and insist) that tribunals construing an international convention will appreciate that they are colleagues of a world-wide body of jurists with a common goal. To this end, strenuous efforts are under way to provide world-wide access to decisions applying uniform laws. In response to a request by the UN Secretary-General, nearly all of the Contracting States have appointed national correspondents who undertake to transmit decisions to the UNCITRAL Secretariat in Vienna. To help the Secretariat overcome language barriers, the National Correspondents are requested to prepare a short summary of the decision in one of the six UN Languages Ð English, French, Spanish, Russian, Chinese and Arabic. These summaries are then translated into the other UN languages, and are periodically issued as an

16 Perhaps even more surprising to one not familiar with our complex parallel structures of state and federal (US) courts is the requirement that our federal (US) courts follow the interpretations of the courts of the state whose law is applicable under ÔconflictsÕ rules.

17 Indeed, a carefully considered decision to differ from decisions in other states probably provides a healthy opportunity for reconsideration of doubtful decisions Ð a value that can counterbalance some degree of loss in uniformity.

UNCITRAL document for world-wide distribution.[18] Systems for electronic Ôon-lineÕ distribution of this material are now in place; others are in process of development. The original texts of decisions and other materials may be obtained from the UNCITRAL Secretariat on payment of the cost of copying and mailing.[19]

In assessing interpretations of uniform laws in other countries, counsel and courts need to take into account the principle espoused in some civil law countries that the writings of leading scholars (*doctrine*) have more weight than court decisions. The extent to which this principle reflects current practice may vary, but in situations where it is important to the weight of international authority one should not neglect available writings of scholars familiar with other legal systems.[20]

For many counsel and courts, confronting international uniform law may seem strange and daunting. Fortunately, extremely helpful guides have been prepared for finding the remarkable outpouring of writing inspired by these new developments. For bibliographic help on the Sales Convention the present writer is especially grateful for WinshipÕs bibliography of studies in English, and for WillÕs multi-lingual bibliography.[21]

Counsel who, like most of us, would prefer not to litigate before a foreign court will naturally consider a contract clause that designates a forum in this country or (an alternative often more acceptable to the foreign party) a clause calling for arbitration. Australia has become an especially attractive site with its adoption of the UNCITRAL Model Law on International Commercial Arbitration. The Model Law establishes modern, international standards

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18 The fourth in this series of publications was issued on 30 August 1994: UN Document A/CN.9/SER.C/ABSTRACTS/4.

19 The system for reporting and distribution of decisions is described in the UNCITRAL document, Case Law on UNCITRAL Texts (CLOUT), A/CN.9/SER.C/GUIDE/1 (19 May 1993). The UNCITRAL Secretariat can be reached at Vienna International Centre, PO Box 500, A-1400 Vienna, Austria; Fax (43 1) 237 485; Telex 135612 uno a; Tel 21131-4061. The National Correspondent for Australia is Ms Jenny Clift, Business Law Division, Attorney-GeneralÕs Department. The sixth meeting of National Correspondents was held at UN Headquarters, NY, on 16 June 1994. See also G Fisher, ÔUNCITRALgives International Trade Law CLOUTÕ, 21 *Australian Bus L Rev* 362 (1993).

20 See JH, Report to Comparative Law Congress, above note 3 at 127. On the weight that common law jurisdictions give to domestic scholarly writing and to court decisions in civil law jurisdictions see id. 123-126. See also R Schlesinger, H Baade, M Damaska & P Herzog, *Comparative Law* (1988) especially the note at 643 (Westbury, NY: Foundation Press), 597-656.

21 A current consolidated bibliography by Peter Winship, Professor of Law at SMU Law School, Dallas, was published in 28 *The International Lawyer* (Summer 1994), 401-424; Winship has also written important articles about the Sales Convention. For the bibliography of studies, in a wide range of languages, by Michael R Will, Professor of Law at Heidelberg University, see Internationale Bibliographie zum UN-Kaufrecht, KŠln, Bundesstelle fŸr Aussenhandels ... BJAI (1990).

which, *inter alia*, minimise judicial interference by providing maximum finality for the award.[22]

Conclusion

The development of the worldÕs commerce has been accompanied by uniform international laws which call for special Ôcare and feedingÕ. At this formative stage the present study has suggested a few lines of thought and development that could promote healthy and sturdy growth. This, however, is only the beginning; much more needs to be done.

22 The Model Law has already been implemented by Canada, Mexico, Germany, Finland, Scotland, The Russian Federation, Bulgaria, Hong Kong, Bermuda, Cyprus, Tunisia and Nigeria. (A small committee of the American Arbitration Association (AAA) has prepared draft legislation for US adoption. The present writer, a member of this committee, ventures to hope for Ð but dares not predict Ð enactment here. Australia has reason to be proud of the favourable international reception of a study of the Model Law for the Commonwealth Secretariat, prepared by Dr Gavan Griffiths, Solicitor-General of Australia.

AustraliaÕs attractiveness as a venue is further enhanced by being one of the 90 parties to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Monetary Union: A Complement to the Single European Market or a New Dimension on the Way to International Personality?

Klaus Peter Follak

Introduction

The European Community and the Single Market have always attracted an astonishing interest from other parts of the world. This may be true on one hand because of the economic strength of over 340 million customers and the related impact on world trade. On the other hand, the ongoing process of creating a region with free economic relations, subject to supranational legislation, may recommend itself for reference when other countries are aiming at facilitating cross-border relations. This is certainly the case with a view to the legal structure of the related monetary order, because it started in the shape of a pure inter-governmental co-operation and is supposed to end up with an independent institution established with international personality.

The Single Market

The European Monetary system in its current shape and the European capital market should be seen in the context of a common financial sector with free cross-border payments and capital transactions, ie as a part of the single common market (Article 8a of the EC Treaty). The integration[1] of the financial markets is meant to pave the way for the economic and monetary integration.

Cross-border supply requires similar conditions of competition, cross-border demand requires equivalence in standards regarding services and products. Therefore, abolishing discriminations subject to nationality or residence has proved to be insufficient. The target has to include:

1. harmonisation of the legal framework as far as the supply of financial services is concerned;
2. harmonisation of stock exchange regulation;
3. tax harmonisation regarding capital transactions.

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1 Smits, ÔFree Movement of Capital and PaymentsŒ *European Law Review* (1986) pp 456; Mizzau (ed), *The Policy of Liberalization of International Monetary and Financial Relations* (1986) Milan; Hahn/Follak, *Kapital-und Zahlungsverkehr* (1993) (Munich) (Dauses, ed, Handbuch des EuropŠischen Wirtschaftsrechts).

The freedom of payments and capital movements means the freedom of cross-border payments and capital transactions, whereas the integration of capital markets means the harmonisation of related regulations.

The liberalisation of cross-border payments, subject to the liberalisation of the underlying transactions (for example, exchange of goods, services, labour or capital transfers) is based on Article 106 of the EC Treaty. The freedom of payments is part of the basic Community freedoms and is applied directly. Regarding the freedom of capital movements, Article 67 para 2 is the only rule of the EC Treaty which is applied directly. As a result, current payments related to capital movements are free. Apart from that, the extent of the freedom of capital movements is set by the Directive of 26 June 1988.[2] Basically, cross-border transactions between EC countries (but not third states) are free. The related freedom includes freedom of cross-border transactions only, but not internal deregulation of the individual national markets. Regarding national market regulation, only the principle of non-discrimination will be applied. This means that regulations must be equally applied to domestic and other EC nationals.

The basis of the harmonisation of national regulations has been provided by Article 100a of the EC Treaty. The main areas of harmonisation in the financial field are as follows:

1. banking regulation;
2. insurance services;
3. investment funds and similar units;
4. stockmarkets.

The principles of harmonisation can be circumscribed as follows:

1. harmonisation of minimum requirements only;
2. home country control on the basis of home country legislation and a europewide extension of licences for financial institutions, connected with co-operation of the national supervisors;
3. competition between the individual national financial systems;
4. as a result: mutual recognition rather than harmonisation, which is expected to follow automatically due to the mechanisms of competition.

The present monetary system[3]

As opposed to this current state of mutual recognition of national regulation on a minimum harmonisation basis, economic and monetary union would

2 EC OJ 1988, L 178.

3 Zehetner, *European Monetary Cooperation* (1983) (Amsterdam) (Bernhardt, ed, Encyclopedia of Public International Law, Vol 6, pp 184).

result in a quantum leap requiring convergence of monetary and economic policy which explicitly had not been part of the Single European Market. In particular, liquidity and monetary policy have been definitely excluded from the Ô1992Õ measures, subject to the future harmonisation process related to the European Currency Unit. Article 6 of the EC Treaty provides a mere obligation to coordinate the national economic policies, subject to the legally binding principles of price stability and equilibrium of the balance of payments, whereas Article 104 sets economic targets known as the Ômagic polygonÕ: high employment, stable prices, equilibrium of the balance of payments, and trust in the stability of the currency. Following standing decision practice of the EC Court of Justice, these principles, albeit legally binding, can only set guidelines for political decisions, but they are not concrete enough to enforce specific actions or to serve as a basis for monetary measures of the Community. Following prevailing interpretation, the EC CouncilÕs power regarding adequate measures related to the economic policy, which is provided by Article 103 of the EC Treaty, may not be extended to monetary policy. Article 105(1) requests the national governments to secure cooperation between their central banks within the coordination of the economic policies. Article 107, again, reserves exchange rate parities to national responsibility, although exchange rate policy is to be treated as a matter of common interest (Article 107 para 1), and consultation is obligatory in case a change of the exchange-rate is intended. Prior to the Maastricht amendments, the only institutional basis in the monetary field mentioned by the EC Treaty directly was the Monetary Committee (Article 105 para 2) with the aim to coordinate monetary policies.

The Single European Act Ð the legal basis of the so-called ÔEurope 92Õ Ð confirmed that the monetary policy remains within national responsibility and that the further development of economic and monetary policy depends on formal amendments to the EC Treaty (Article 102a). However, a new term is introduced into the Treaty, as well as an outlook:

1. the target of an economic and monetary union (preface and headline);
2. cooperation in order to secure the development of convergence of the economic and monetary policies.

The European Monetary System (EMS) had been developed pragmatically and independently from the EC institutions as an answer to changing economic needs rather than by means of an innovative approach of conscious Community creativeness. The targets of monetary cooperation and monetary integration are facilitating bordercrossing financial relations and the attempt to keep stable currencies. They are considerably older than the Community itself. The historical ancestor had been the European Payments Union (EPU), established in 1950 as an intergovernmental organisation with lawmaking and executive enactments only addressed to the Member States. The EPU was a clearing agreement for facilitating the collective settlement of pecuniary

claims between creditors and debtors in different currency areas. The result was:

> Ô... that the EPU mechanism by the end of 1958 had made all Western European currencies transferable between themselves ... Conditions were created which enabled most of the OEEC countries to extend ... the intra-European transferability of their currencies to their external convertibility with the dollar and then to replace the EPU ... by the application of the Articles of Agreement of the International Monetary Fund.Ó[4]

The system of Bretton Woods secured the convertibility of all currencies by means of their fixed parity to the US$ (or gold), which was maintained by interventions of the national monetary authorities. Therefore, the EC Treaty did not include any specific monetary targets. Following the collapse of the world monetary order in 1971-73, a group of European countries established the monetary cooperation of European countries known as the ÔsnakeÕ. The ÔsnakeÕ was based on the Basle agreement of participating governments and central banks. It established a 2.25% floating band maintained by interventions which were supported by drawings on a fund for monetary cooperation, subject to monthly settlement.

Following the enforcement of the new version of Article IV of the IMF Articles of Agreement on 1 April 1978, the European Monetary System (in effect from 13 March 1979) was set up. The EMS has always been considered as an establishment of the European Community. However, although the European Court of Justice had stated that the target of free cross-border relations required fixed exchange rates, its basis in Community law was unclear for many years. Established in conformity with Article IV para 2b(ii) of the IMF Articles of Agreement, the hybrid legal basis entails acts by the European Council, the EC Council, the EC Commission, the Board of Governors of the European Monetary Cooperation Fund (EMCF), as well as agreements between the central banks of the EC members. Following the prevailing opinion, the issue fixing the most specified details Ð the agreement of the central banks Ð was set up under public international law, but not under Community law. The French Conseil Constitutionnel[5] stated that the Council Decision[6] on establishing the EMS was a mere political declaration. A normative anchor in primary Community law was not established earlier than the Single European Act which provided the above-mentioned Article 102a as an ex-post basis.

4 Hahn, From European Monetary Cooperation to European Monetary Integration Ð Legal Traits of a Regional Evolution, International Law Association, Cairo Conference 1992, Report of the Committee on International Monetary Law, p 3.

5 Conseil Constitutionnel Decision of 29 December 1978.

6 5 December 1978.

Economically, the EMS is a regional system of fixed exchange rates comprising the Member States of the EC, with Greece and Portugal not yet participating in the exchange-rate mechanism and with a temporary, however unlimited departure of Italy and the UK. The system is maintained by means of three instruments:

1. the European Currency Unit (ECU);
2. an exchange rate mechanism;
3. a credit mechanism.

The ECU[7] is defined as a basket comprising determined amounts of each currency in the Community. The name is somewhat misleading, because it is not a currency. There exist only three categories of legal holders:

1. member central banks;
2. the European Monetary Cooperation Fund (EMCF);[7a]
3. on EMCF authorisation, other central banks and international monetary institutions.

The legal functions of the ECU are restricted to the system itself:

1. denominator for the exchange-rate mechanism;
2. basis for a divergence indicator, ie an indicator for the deviation of a currencyÕs market rate from its ECU-defined central rate;
3. unit of account in the intervention and credit mechanism;
4. means of settlement between the monetary authorities in the EC.

Apart from these legally defined functions, the ECU serves as a unit of account in private business operations, eg in an increasing market of ECU bonds.[8] This function, albeit encouraged by the EC Commission, is kept strictly outside the EMS. Any unification of the official and the private ECU circuits would result in the undermining of the individual national central banksÕ money market instruments, as long as a centralised monetary authority does not exist. Therefore, claims within the private ECU clearing system consisting of the BIS,[9] the ECU Banking Association and the SWIFT system have to be settled on a daily basis. Otherwise the BIS would take over the role of a lender of last resort, ie the function of a European central bank without having a related legal basis.

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7 Gold, A New Universal and a New Regional Monetary Asset: SDR and ECU, *Österreichische Zeitschrift für öffentliches Recht und Völkerrecht* (1983), 117; Gramlich, The European Currency Unit Ð A Foreign Currency, *Rivista di diritto valutario e di economia internazionale* (1988), 305; Hahn, The European Currency Unit (ECU) and the Special Drawing Right (SDR): Legal Aspects of a World-wide and a Regional Basket Unit (Sarcevic/Volken, ed, *International Contracts and Payments* (1992), 1).

7a Since January 1994, the functions of the EMCF have been taken over by the EMI.

8 Half of which has been issued by public entities.

9 Giovanoli, ÔThe Role of the Bank for International Settlement in International Monetary Cooperation and its Task Relating to the European Currency UnitÕ, *International Lawyer* (1989), 841.

The exchange rate mechanism consists of the Ômonetary gridÕ which gives each member currency a fixed value vis-ˆ-vis the other members, usually measured by its parity against the ECU. This value Ð or rather a band Ð is maintained by interventions of the national central banks.

The credit mechanism can be divided into two categories of facilities: One which is necessary for the operation of the exchange rate mechanism and the other which is related to balance-of-payments deficits.

1. The very short-term facility of two and a half months at a maximum is restricted to intervention purposes. In case of an intervention at the official limit, drawings may be made without the consent of the central bank of the currency of intervention; in other cases, the related central bank can express its disapproval.
2. The short-term facility of three months at a maximum may include balance-of-payments financing.
3. The medium-term facility with a duration of two to five years is based on Article 108 of the EC Treaty.

None of these facilities may be used for purposes of economic and structural policy, eg social cohesion.

The EMS institutions are as follows:

1. The Monetary Committee, the only one with a direct basis in EC primary law (Article 105 para 2 of the EC Treaty)[10] is established with an advisory status only.
2. The Committee of Governors of the Central Banks of the Member States of the European Community,[11] set up by a Council decision on 8 May 1964, is not subject to the instructions of any Community organ. Its purpose is to foster cooperation between EC central banks with the aim of coordinating more closely the monetary policies of the EC members. As per 1 January 1994, these functions have been taken over by the European Monetary Institute (EMI).
3. The European Monetary Cooperation Fund has a technical function only: settlement of borrowing and lending related to interventions within the exchange rate mechanism. These functions have also been taken over by the EMI since January 1994.

Obviously, none of these institutions is established with the power of decision-making. According to the legal situation, both exchange-rates and monetary policy are reserved to national discretion. Therefore, realignments ie central rate changes are fully within the governmentsÕ competences and subject to the unanimity rule, EC Commission and central banks only

10 At the beginning of the third stage, it will be replaced by the Economic and Financial Committee.

11 With the beginning of stage 2, it was to be dissolved (Article 109f para 1 of the EC Treaty).

participating in the process of decision-making. Current operations ie interventions as well as related borrowing or lending with the aim to secure the exchange rates set by the government fall within the national central banksÕ responsibility

So far the monetary environment of ÔEurope 92Õ still circumscribes the present situation and is meant to entail free movement of capital and financial services throughout what once were 12 national markets.[12] However, the Single European Act Ð the legal basis of this stage Ð had also provided a mandate Ôfor the further development of the CommunityÕ in the monetary field, which finally resulted in the well-known Maastricht Treaty on European Union of 7 February 1992.

On the way to Monetary Union[13]

A few milestones on the way to Maastricht should be mentioned. Following the ÔReport on Economic and Monetary Union in the European CommunityÕ which was submitted to the European Council on 17 April 1989 Ð the so-called Delors Committee Ð the Council set in motion two intergovernmental conferences: one on political union; the second one on economic and monetary union. Various drafts in 1990/91 finally ended up in the Maastricht framework.

The European Union[14]

Again, the name of a European Union may sound more far-reaching than the actual result. As a matter of fact, the political and economic union does not comprise more than a deepening of the related cooperation, whereas the competence regarding economic policy will remain within national responsibility. The new version of Article 103 of the EC Treaty related to economic policies provides coordination within the Council which shall formulate broad guidelines, adopt recommendations and perform overall assessment and monitoring.

On the contrary, within the future monetary union (new Article 73 of the EC TREATY), the related competence will be transferred to the Community. The future institutional system to be created Ð the European System of Central

12 This article was completed before the latest enlargement of the European Union (EU) which occurred on 1 January 1995. The EU now has 15 members, including Austria, Sweden and Finland (eds).

13 Hahn, The European Community as a Currency Union: From the European Monetary System towards a European Monetary Authority, *Rivista di Divitto Valutario e de economia internazionale* 1989, pp 728; Tietmeyer, EMU Ð Prospects and Perspectives, Deutsche Bunderbank, Press Excerpts No 24, 25 March 1992, pp 1.

14 Treaty on European Union, EC OJ 1992, C 224/1; Bleckmann, Der Vertrag Ÿber die EuropŠische Union, *Deutsches Verwaltungsblatt* (1992), 335; HŠde, Die EuropŠische Wirtschafts- und WŠhrungsunion, *Europäische Zeitschrift für Wirtschaftsrecht* (1992), 171; *Hahn, Der Vertrag von Maastricht als völkerrechtliche Übereinkunft und Verfassung* (1992) Baden-Baden.

Banks (ESCB) and the European Central Bank (ECB) Ð will therefore exercise the CommunityÕs competences under Community law:[15] Moreover, a strict timetable of implementation will apply.

The European Union does not create a new supranational body nor a federal state.[16] Following the negotiation documents, the clear intention of the parties was not to touch the basic structure of the Community.[17] This is true, although a federal organisation will be created in the monetary field, and

> Ô... a monetary union presupposes a constitutional organisation which is or approximates that of a single (federal) state.Õ[18]

Stages of the Monetary Union

In order to give an outline of the quality of the institutional structures to come, an overview of the timetable of implementation seems appropriate. The basic idea was to set in motion a unified process in the sense that the decision to install the first stage should be understood to represent a decision for the project in its entirety. However, a strict timetable will only apply to the monetary union, but not to that part of the Treaty which is related to economic policy and the political union.

Nearly three years prior to the Maastricht Treaty, the Madrid European Council resolution of 27 July 1989 had fixed the start of stage 1 to be 1 July 1990. The program of the individual stages, however, has been defined in the Maastricht Treaty. The coincidence of the starting point with the date of the enforcement of the liberalisation of capital movements demonstrates a close connection of the monetary union with the financial services sector of the Single European Market which is underlined by the contractual obligation to implement the related liberalisation. Other issues of stage 1 are:

1. adaptation of the national regulations on drawings of central bank credits by the public sector to the restrictions as defined in the Maastricht Treaty;
2. setting up programs to secure future convergence in the monetary field, particularly regarding price stability and orderly public finances.

Stage 2 was set in force on 1 January 1994[18a] (new Article 109e of the EC Treaty); the program is restricted to the monetary field:

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15 National competences will be restricted to the field where only specific countries are concerned, eg the French Franc Zone.

16 Hahn, *Der Vertrag von Maastricht als völkerrechtliche Übereinkunft und Verfassung* , (1992) (Baden-Baden), 38.

17 Banque de France, Exercice 1993, Compte Rendu prŽsentŽ ^ M le PrŽsident de la RŽpublique au nom du Conseil GŽnŽral de la Banque de France par M Jacques de Lavosi•re, Gouverneur, 85.

18 Mann, *The Legal Aspect of Money* (1992) 5th ed, 509.

18a Related secondary legislation, see EC OJ L332, 31 December.

1. enhancing cooperation between the national central banks;
2. establishment of a European Monetary Institute (EMI, new Article 109f of the EC Treaty) with advisory and coordinating functions. However, the monetary competences will remain with the original national authorities which will not be subject to an obligatory agreement on monetary policies during this stage;
3. adaptation of national legislation on central banks to the requirements of stage 3, ie harmonisation of monetary jurisdiction (new Article 108 of the EC Treaty);
4. obligation to avoid excessive government deficits (new Article 109e para 4);
5. The liberalisation of capital movements is cemented in that the basic regulations of the Capital Movements Directive[19] obtain an immediate normative basis in primary Community law (new Article 73g para 2 of the EC Treaty). The freedom of capital movements and payments is combined in a new chapter of the EC Treaty. The related liberalisation does not stop with the prohibition of all restrictions on the movement of capital and on payments between Member States (Article 73b of the EC Treaty). The aim is Ô... to achieve the objective of free movement of capital between Member States and third states to the greatest extent possible ...Õ (Article 73c) as well. In this respect, the state on 31 December 1993 is frozen in that new measures on the movement of capital to or from third countries can only be introduced by the Council, where Ôunanimity shall be required for measures ... which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third statesÕ (new Article 73c). In the context of the basic prohibition of all restrictions on capital movements and payments (new Article 73b), this means that the national competence in this field is restricted to safeguard measures on capital movements and payments from or to third states (new Article 73g). In short: third countries will enjoy the same liberalisation as Member States did before the Capital Movements Directive came into force.

With the start of phase 3, the quantum leap from cooperation and coordination to the Community-wide central direction of monetary policy by an independent institution, devoted exclusively to monetary stability, will take place. This means the establishment of the European Central Bank (ECB), the European System of Central Banks (ESCB) as well as the introduction of a single European currency, the ECU (new Article 3a, 109g, 109l of the EC Treaty).[20] The start of stage 3 is under condition that certain requirements are met which are mainly related to monetary stability defined as Ônecessary

19 EC OJ 1988, L 178.

20 Hahn, ÔA Single Currency and a Single Central Bank?Õ *Michigan Journal of International Law* (1990), 121.

conditions for the adoption of a single currencyÕ (Article 109j of the EC Treaty). The formal proceedings on stage 3 may start in 1996 (new Article 109j of the EC Treaty). If a qualifying majority of the EC Council states that the majority of the members is meeting the above-mentioned criteria, stage 3 can be set in force Community-wide. Should this not be the case, primary law (Article 109e para 1) requires that stage 3 will irrevocably start on 1 January 1999, however only with those members meeting the convergence criteria according to the CouncilÕs resolution (new Article 109j para 4 of the EC Treaty) . With the remaining members, the present EMS in the shape of stage 2 would continue to exist.[21]

Basic principles of the Monetary Union

The monetary union will comprise of four principles:

1. Autonomy and independence of the European Central Bank and the European System of Central Banks;
2. Regarding the institutional structure, a two tier system comprising of European Central Bank and the national central banks;
3. Exclusive jurisdiction of the community institutions over monetary policy;
4. Absolute precedence of price stability (new Article 105 para 1 of the EC Treaty; Article 2 of the ESCB Statute).

The details of these principles can be circumscribed as follows:

Institutional autonomy

Regarding institutional autonomy Ð principle 1 Ð the ECB, the ESCB and the national central banks will be independent of instructions from Member States and the political bodies of the Community (new Article 107 of the EC Treaty and Article 7 of the ESCB Statute). Reporting commitments are basically restricted to the annual report to the EC Council, the Commission and the Parliament, which may hold a general debate on that basis (new Article 109 para 3 of the EC TREATY/Article 15.3 of the ESCB Statute). At present, all related central banks with the exception of France, Germany, Netherlands and to a certain extent Belgium and Italy are subordinate to their governments.[21a]

Two tier system

The two tier system (new Article 106 para 1 of the EC Treaty) Ð principle 2 Ð comprises the establishment of the European Central Bank on one hand and the further existence of national central banks on the other hand, which,

21 So-called ÔMember States with a derogationÕ (new Article 109k of the EC Treaty).

21a France and to a lesser extent Belgium have anticipated related legislation in 1993.

however, will become subordinate to the ECB (new Article 106 para 3 of the EC Treaty):

> ÔThe national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECBÕ (Article 14.3 of the ESCB Statute).

In order to not undermine the autonomy of the whole system, the institutional independence will be extended to the national central banks, which is secured by primary Community law (new Article 109e para 3, 107; 109 of the EC Treaty).

Monetary sovereignty

The monetary sovereignty, ie the power to create money, will reside with the ECB. Moreover, exclusive jurisdiction over monetary policy comprises money market surveillance, rule-making and decision-making including general and individual corrective measures (new Article 108 of the EC TREATY; Article 3.4 of the ESCB Statute). The ECB has to be consulted on any proposed national or Community act in its field of competence and may submit opinions (new Article 102 of the EC Treaty; Article 25 of the ESCB Statute). The ECB will have the exclusive right to authorise the issue of banknotes within the Community (new Article 105a of the EC Treaty) and will regulate minimum liquidity requirements and payment systems.

In the field of prudential supervision of the financial system, however, a clear quantum leap from harmonisation to convergence cannot be seen. The Council may confer upon the ECB specific tasks in this area (new Article 105 para 6 of the EC Treaty; Article 3.3 of the ESCB Statute), but otherwise there is only an obligation to Ô... contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial systemÕ (new Article 105 para 5 of the EC Treaty). The final outcome of convergence in the field of banking supervision seems undecided.

Apart from that, the ESCB will hold and manage the official foreign exchange reserves of the Member States and conduct foreign exchange operations consistent with the provisions of Article 109 of the EC Treaty. However, the prerogatives of the EC political organs on external relations will be reserved, particularly their power to fix exchange rates. This may lead to certain target conflicts.

As compared with the present situation, there is a long way to go, because basic means for influencing money market operations are in the hands of the national governments, for example, enactment and modification of the bank rate in France and in the UK.

Monetary stability

At the first glance, principle 4 Ð precedence of monetary stability Ð seems to be established on a fairly secure basis.

Following the contract, there is no assumption of responsibility by the Community or its Member States for one MemberÕs public debts (new Article 104b of the EC Treaty). Community financial assistance to Member States in difficulties is regulated by new Article 103a of the EC Treaty. Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States will be prohibited, as well as purchases of related debt instruments or any privileged access of Community or national public institution to financial institutions (new Article 104 of the EC Treaty; Article 21 of the ESCB Statute).

Primary Community law (new Article 104a of the EC TREATY) sets guidelines of reasonable budget policy, the ratios of which are fixed in a Protocol annexed to the Treaty[22] Ð a limit of the annual new indebtedness of all public entities of a country to 3% and of their overall indebtedness to 60% of the GDP. The Council may decide on sanctions against unreasonable deficits of Member States (new Article 104c para 11 of the EC Treaty).

Apart from this sanctioning authority and the provision regarding financial aid, all these regulations are applied with the start of stage 2. This means that from 1 January 1994, a Member StateÕs creditworthiness determines its ability to borrow. However, a considerable excess of public expenditure over income in many states may make the indirect financing of habitual deficits indispensable, especially when the TreatyÕs authorisation clauses of protective measures in case of a MemberÕs difficulties with regard to its balance of payments will be phased out with the start of stage 3 (new Article 109h, i of the EC Treaty). This problem is obvious in an analysis of the Edinburgh summit.

Institutions and functions

The European Monetary Institute (EMI)

At the beginning of phase 2, the transitional period, the European Monetary Institute was established in the shape of a legal personality of international public law (new Article 109f para 2 of the EC Treaty).[22a] The EMI takes over the former European Monetary Cooperation Fund (EMCF) as well as the functions of the Committee of Governors of the Central Banks of the Member States of the European Community (new Article 109f of the EC Treaty; Article 1 of the EMI Statute). The EMI is directed and managed by the EMI

22 Protocol on the excessive deficit procedure.

22a On 29 October 1993 the Council decided on the localisation at Frankfurt, and on 10/11 December 1993, Baron de Lamfalussy was appointed as the first president of the EMU.

Council (new Article 109f of the EC Treaty; Article 9 of the EMI Statute), which consists of a Governor from outside the national central banks, unanimously appointed by the governments, on one hand, and the Governors of the national central banks on the other hand (new Article 109f para 1 of the EC Treaty).

An extensive catalogue of functions, albeit on an advisory and coordinating basis only (new Article 109f of the EC Treaty; Article 2 and 4 of the EMI Statute) may be used to exercise considerable political power. The most important operational and technical functions are as follows:

1. taking over the functions of the European Monetary Cooperation Fund (Article 1 of the EMI Statute);
2. clearing of positions resulting from interventions by national central banks;
3. administering the EMS financing facilities;
4. receiving monetary reserves and issuing ECUs in return;
5. holding and managing foreign exchange reserves as an agent for national central banks;
6. promoting the efficiency of cross-border payments;
7. facilitating the private use of the ECU and securing the ECU clearing.

Other functions will be of an advisory nature (mainly Article 5 of the EMI Statute):

1. basically, the full range of advisory functions of the future ECB (on the basis of a 2/3 majority;
2. initiating consultations on banking supervision (respectively on the stability of financial institutions and markets);
3. the EC Council and the authorities of Member States have to consult the EMI prior to lawmaking proposals in the monetary field (from a German point of view, this would include the fixing of the discount rate);
4. developing instruments for the future ECB.

Following the nature of these functions, the EMI will mainly deliver opinions, make recommendations and adopt guidelines for the future ESCB, ie take measures without any binding force. Within the operational functions, decisions addressed to the national central banks are binding upon those to whom they are addressed (Article 15 of the EMI Statute).

The EMI is established with a budget by the national central banks and enjoys an independence similar to that of the future ECB:

> ÔIn exercising the powers and performing the tasks and duties conferred upon them by the Treaty and this Statute, the Council of the EMI may not seek or take any instructions from Community institutions or bodies or governments of Member States.Õ (Article 8 of the EMI Statute)

The members of the EMI Council are acting according to their own responsibilities. Like the future ECB, the EMI has to supply the EC Council, the Commission and the Parliament with an annual report.

European System of Central Banks/European Central Bank[23]

The functions of the ESCB and the ECB will basically comprise monetary jurisdiction (new Article 105 of the EC Treaty; Article 3.1 of the ESCB Statute):

1. defining and implementing the monetary policy of the Community;
2. conducting foreign exchange operations, following Article 109 of the EC Treaty;
3. holding and managing the official foreign exchange reserves of the Member States;
4. promoting the smooth operation of payment systems.

Other tasks and duties will be:

1. advisory functions (new Article 1.5 para 4 of the EC Treaty; Article 3.3 of the ESCB Statute);
2. collection of statistical information (Article 5 of the ESCB Statute);
3. contribution to the conduct of policies regarding prudential supervision of credit institutions and stabilising the financial system (new Article 105 para 5 of the EC Treaty; Article 3.3 of the ESCB Statute).

A range of monetary instruments and technical functions is based on the ESCB Statute:

1. accounts of the public with the ECB and national central banks (Article 17);
2. open market and credit operations (Article 18);
3. setting minimum reserves on credit institutions (Article 19);
4. other instruments of monetary control, to be decided with a two-thirds majority of the ECB Governing Council (Article 20);
5. supplying facilities and regulations regarding payment systems (Article 22).

There will be two organs of the ESCB (new Article 109a of the EC Treaty; Article 10-13 of the ESCB Statute):

1. The Executive Board with a President, a Vice President Ð both appointed unanimously by the Member governments on recommendation by the EC Council Ð and four other members. The Executive Board will mainly be

23 Hahn, ÔThe European Central BankÕ, *Common Market Law Review* (1991), 783.

responsible for the day-to-day business ie the implementation of the monetary policy in accordance with the guidelines and decisions laid down by the Governing Council.

2. The Governing Council comprising the Executive Board and the Governors of the national central banks shall formulate the monetary policy of the Community, including decisions on monetary objectives, key interest rates and the supply of reserves within the ESCB.

Whereas normally decisions will be made on a majority basis, matters concerning the ECB capital, transfers of monetary reserves and the distribution of profits and losses will require voting according to the participation in the share capital. An extended council will be formed including the Governors of the non-participating national central banks with a competence which is restricted to the remaining EMS.

Legal structure

The legal structure of the monetary union is somewhat complex, which may cause certain problems of ranking and conflict. On one hand, there is a dualism of the EC Treaty and the Statutes of the ESCB/ESB and the EMI, both laid down in Protocols annexed to the Treaty. Regarding the ESCB Statute, only certain articles of a more technical nature may be amended following the procedure of the (new) Article 106 of the EC Treaty. These articles, subject to amendment, are laid down in the EC Treaty itself (new Article 105 para 5). On the contrary, such a procedure is not provided for the EMI Statute (new Article 109f para 1 of the EC Treaty), which means that this Statute is fully subject to the unanimity rule. Both the EC Treaty and the related Statutes, dealing with institutional matters and competences of the ESCB and the EMI, are ranking par. On the other hand, there exists a convergence protocol supplying guidelines on the requirements of the enforcement of stage 3 only, which, however, is to be replaced by details on the basis of an EC Council resolution. The Council will be bound to the principle of unanimity. This means that the circumstances of the enforcement of stage 3 Ð the monetary union Ð have not yet been finally defined and remain in practice within the responsibility of the governments Ð ie subject to amendment.

Which laws have to be applied to the ECB and the ESCB?

Following the general clause (Article 35 of he ESCB Statute), acts of the ECB including its relationship with the control and interpretation by the European Court of Justice in those cases and under those conditions which are provided by the EC Treaty:

1. actions by the ECB for the purpose of protecting their prerogatives (new Article 173 of the EC Treaty);

2. proceedings in areas fully within the ECBÕs field of competence (new Article 175 of the EC Treaty);
3. validity and interpretation of acts by the ECB (new Article 177(b) of the EC Treaty);
4. fulfilment by national central banks of obligations under the EC Treaty and the ESCB Statute (new Article 180(d) of the EC Treaty);
5. regulation by the ECB (new Article 184 of the EC Treaty).

In these cases, the ECB has also the right to initiate legal proceedings. However, it is unlikely that the European Court would be inclined to define guidelines of monetary and currency policy, which, following standing practice, will be reserved to the politically competent organs. Other specific rules of competence:

1. In cases between the ECB and its debtors, creditors or other third parties, the national courts shall decide, provided the European Court is incompetent (Article 35.2 of the ESCB Statute). In this area, conflict law with the national legal systems will be created.
2. Contractual and non-contractual responsibilities of the national central banks shall be subject to the national legal systems (Article 35.3 of the ESCB Statute).
3. The European Court shall exercise the competence of arbitration on the basis of arbitration clauses which contracts by the ECB may contain (Article 35.4 of the ESCB Statute).

The European Monetary Institute is subject to similar rules on legal competences (Article 19 of the EMI Statute).

Regarding the legal personality of the monetary institutions, the following rules will apply:

The EMI, the monetary institution of the second stage, is established to be a legal personality of international public law (new Article 109f para 1 of the EC Treaty; Article 14 of the ESCB Statute) in relation to the Member States and the Community as well as a legal person within the individual national legal systems. Following the basic principles of international public law, the extent and the character of the legal entity in relation to third countries will depend on the actual activity rather than on a per se existence.[24]

Within the monetary union (stage 3), a legal personality will be only applied to the ECB (new Article 106 para 2 of the EC Treaty; Article 9 of the ESCB Statute) and to the national central banks, but not to the ESCB as a separate entity. According to the EC Treaty and the Statute, the ECB will be established:

24 Hahn, *Der Vertrag von Maastricht als völkerrechtliche Übereinkunft und Verfassung* (1992) (Baden-Baden), 58.

1. in Member States with a full personality in accordance with the individual national legal systems;
2. in relation to the EC Communities, the Member States, international organisations and third states with an international personality, but with a limited function depending on the quality and on the extent of relations and transactions which the parties directly or indirectly apply to international law and not to the national or other non-international law.[25] The space for extending these relations is already established with an anchor in the Statute (Article 6): the ECB may decide how the ESCB should be represented in international cooperations and the ECB may participate in international monetary institutions.

Open questions

Although the result of a long-term negotiation process, the Maastricht Treaty leaves open questions and even contains contradictions, caused by compromises or rather hidden dissents of the parties on basic items. These dissents partly became evident during the ratification procedure, partly they might arise during the implementation process, particularly in case of economic problems.

Opting out

The British and the Danish right of opting out of the monetary union prior to the third stage[26] leaves us with a realistic possibility that the final monetary union might not comprise all EC members.

Convergence criteria

It is a question of how many members will meet the convergence criteria to enforce stage 3 of the monetary union. The treatment of these convergence criteria, defined as Ônecessary conditions for the adoption of a single currencyÕ (new Article 109j para 2 of the EC Treaty) is complex both legally and economically. As the enforcement of the final monetary union hinges on it, an in-depth analysis seems necessary.

Basic details of convergence criteria are set by primary Community law (new Article 109 para 1 of the EC Treaty):

25 Hahn, *Der Vertrag von Maastricht als völkerrechtliche Übereinkunft und Verfassung* (1992) (Baden-Baden), 66.

26 Laid down in the Protocol on Certain Provisions Relating to the United Kingdom of Great Britain and Northern Ireland and the Protocol on Certain Provisions Relating to Denmark.

1. a high degree of price stability, i.e. a rate of inflation close to that of, at most, the 3 best performing Member States in terms of price stability;
2. sustainability of the governmentÕs financial position, i.e. in accordance with the new Article 104c (6) of the EC Treaty;
3. observance of the normal fluctuation margins following the exchange rate mechanism of the EMS for at least two years, without devaluing against the currency of any other Member State;
4. durability of convergence, reflected in the long-term interest rate levels;
5. the development of the ECU, the results of the integration of the markets, the situation of the balance of payments, the development of unit labour costs and other price indices should also be taken into account.

These criteria have been developed further in the Protocol on the Convergence Criteria Referred to in the Article 109j of the Treaty Establishing the European Community, annexed to the Treaty:

1. price stability is defined as a deviation of the consumer price index of 1.5 percentage points at a maximum from the best performing Member States (Article 1);
2. a governmentÕs budgetary position is deemed satisfactory in case it is not subject to a related Council Decision (Article 2);
3. the observance of normal exchange rate fluctuations may not have caused severe tensions; with regard to devaluations, only acting of a Member State on its own initiative would be critical, which should allow for unanimous realignments within the EMS;
4. the convergence of interest rates would be measured on the basis of long-term government bonds or comparable securities; for one year, the average nominal long-term interest rate should not exceed by more than 2 percentage points that one of, at most, the three best performing Member States in terms of price stability (Article 4).

There exist opinions maintaining that in an environment of free payments and capital movements massive and rapidly changing capital flows will put pressure on any state that chooses the slow lane in a two-speed Europe:

> ÔOnce effective freedom of capital movement is in place ... it is impossible to envisage a state moving at a different speed for any length of time without incurring the risk of such destabilising flows that it will effectively have to adopt the faster speed.Õ[27]

However, such cases have always resulted in the related Member State temporarily opting out of the EMS and returning to floating exchange rates like recently the UK. With this background, a two-speed Europe with the

27 Bishop, Ô1992 and Beyond: The Creation of an EC ÒHard Money UnionÓ Õ (1990) (Salomon Bros, European Business Analysis), 5.

strongly performing economies moving towards the monetary union and the weaker economies maintaining the EMS in its current shape does not seem unlikely.

The formal process of defining the related criteria Ð reserved to the EC Council, ie in practice to the national governments Ð implies an additional risk of weakening the requirements set by the target of monetary stability:

> ÔThe Council shall, acting unanimously ... adopt appropriate provisions to lay down the details of the convergence criteria ... which shall then replace this protocol.Õ[28]

Subsidiarity

Regarding remaining national competences, the outcome of the Edinburgh summit underlines a certain tendency back to national power.[29] This tendency might find a legal basis in the Maastricht Treaty itself: Basically, the denial of any collective assumption of one member StateÕs debts is a key to maintaining power at national level.[30] Moreover, with a new Article 3b, the principle of subsidiarity has been introduced to the EC Treaty. Together with the background of related negotiations, the intention to set limits to the competence of the Community is obvious and might lead to an interpretation of competences by the European Court which would be more restrictive than was the case in the past. With regard to the monetary union, one might furthermore argue that according to the Maastricht Treaty, the national central banks will keep those of their original competences which are not explicitly transferred to the ECB.

However, the principle of subsidiarity in Article 3b of the Treaty cannot be applied to the monetary union.[31] On one hand, the ESCB lies within the exclusive competence of the EC. On the other hand, the principle of

28 Article 6 of the Protocol on the Convergence Criteria Referred to in Article 109j of the Treaty Establishing The European Community. However, following the decision of the German Constitutional Court on 12 October 1993 (NJW (1993), pp 3047), the implementation of the monetary union may be based only on an interpretation but not an extension of the EU Treaty. Therefore, the German government may go ahead only on the basis of strict adherence to the convergence criteria. Article 88, para 2 of the German Basic Law authorises the delegation of the power of the Bundesbank to an ECB which is independent and under condition of price stability as a primary target. See also Lenz, *Der Vertrag von Maastricht nach dem Urteil des Bundesverfassungagerichts*, NJW 1993, pp 3038.

29 Over 20 proposed Directives will be eliminated, but on the other hand, it was resolved to press ahead with the implementation of a couple of outstanding Directives.

30 Bishop, Ô1992 and Beyond, The Creation of an EC ÒHard Money UnionÓ Õ (1990) (Salomon Bros, European Business Analysis), 5.

31 Article 14.4 of the ESCB Statute says clearly: ÔNational central banks may perform functions other than those specified in the Statute ...Õ on their own responsibility. This means that monetary policy is reserved to the ESCB and hence is not subject to the principle of subsidiarity. See also Mšschel, *Zum Subsidiaritätsprinzip im Vertray von Maastricht*, (1993) NJW, 3025.

subsidiarity is only applied to the EC and its organs but not to the ECB which is an independent EC institution.

Autonomy of monetary institutions

The autonomy of the ECB and its comprehensive jurisdiction in the monetary field might come under pressure by the EC CouncilÕs competence of determining the broad guidelines for the economic and monetary union (Title 1 Article D of the Maastricht Treaty). The statement of F Mitterand on French TV on 3 September 1992[32] may serve as an example of an extremely extended interpretation in this direction. Following his statement, the ECB has only to apply the CouncilÕs decisions on economic policy to the monetary field. As a result, the ECB would be left as a mere instrument of execution. This view cannot be legally based on the Maastricht treaty which clearly says:

> ÔThe basic tasks to be carried out through the ESCB shall be: Ôto define and implement the monetary policy of the Community ...Õ (new Article 105 para 2 of the EC Treaty).

However, the annual reporting of the ECB to the Council, the Commission and the Parliament will trigger discussions and political pressure from the public. On the contrary, the function of the EMI in stage 2 might be subject to an extended interpretation, because limiting national competences was not explicitly excluded in the related negotiations. One basis for an extended influence of the EMI lies in its right of statements prior to lawmaking in the monetary field.

Exchange rate policy

The CouncilÕs competence to fix or to agree on exchange rates or the exchange rate system, which is an outflow of their responsibility for external relations, might cause some problems.[33] The related EC competence, however, will not be applied earlier than the third stage.

> ÔUntil the beginning of the third stage, each Member State shall treat its exchange rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in cooperation within the framework of the EMS ... and shall respect existing powers in this fieldÕ (new Article 109m of the EC Treaty).

In the monetary union, exchange rate policy will be treated as a matter for

32 Deutsche Bundesbank, Press Excerpts No 61, 9 September 1992, 1.

33 A similar situation has been successfully mastered by the Deutsche Bundesbank for many years. See Gold, *Exchange Rates in International Law and Organisation* (1988) Chicago/Washington DC.

the EC political organs, and the ESCB has to conduct foreign exchange operations consistent with the provisions of Article 109 (new Article 105 para 2 of the EC Treaty). Within this framework, the Council:

1. may conclude formal agreements on an exchange rate system for the ECU in relation to non-Community currencies;
2. may adopt, adjust or abandon the central rates of the ECU within the exchange rate system;
3. may formulate general orientations for exchange rate policy;
4. shall decide the arrangements for the negotiation and for the conclusion of agreements concerning monetary or foreign exchange regime matters, which will be binding on the EC institutions, on the ECB and on the Member States;
5. shall decide on the position of the Community at international level as regards issues of particular relevance to the economic and monetary union.

Foreign reserve assets, as opposed to fixing exchange-rates, will be treated as a part of the ECBÕs monetary jurisdiction. The national central banks will provide the ECB with foreign reserve assets up to an amount equivalent to ECU 50 bn and may hold and manage IMF reserve positions and SDRs. Moreover, operations in foreign reserve assets remaining with the national central banks shall be subject to approval by the ECB above a certain limit (Article 30/31 of the ESCB Statute). Nevertheless, the national governments will remain the owners of their foreign reserve assets, as long as they will not have to be supplied to the ECB following the above-mentioned rule.

Basically, the situation with regard to foreign exchange rates is rather close to the present EMS, on the basis, however, of the existence of a single common currency. Therefore, the competence to fix exchange rates is only a matter of the ECÕs relationship to third countries, whereas the Ômonetary gridÕ and the internal EC exchange rate mechanism will have ceased to exist.

Monetary sovereignty, economic policy and other principles of primary EC law

A constant matter of concern will lie in the basic contradiction between the fiscal and monetary sovereignty, ie the monetary union on one hand and the national responsibility for economic policies on the other hand, connected with target conflicts. The ECBÕs main target of monetary stability can be undermined by the remaining national competence of economic policy.

Additionally, the inter-relationship of the monetary order with other principles of primary Community law should not be neglected:

> ÔThe primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to

> contributing to the achievement of the objectives of the Community as laid down in Article 2Õ (new Article 105 para 1 of the EC Treaty; Article 2 of the ESCB Statute).

The priority of price stability is extended to both monetary policy and exchange rate policy (new Article 3a para 2 of the EC Treaty). On the other hand, we have to face the separate existence of

> Ô... economic policy which is based on the close coordination of Member StatesÕ economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competitionÕ (new Article 3a, para.1 of the EC Treaty).

The basic guideline of this economic policy is supplied by the definition of the Ômagic economic polygonÕ in Article 2 of the EC Treaty: harmonious and balanced development of economic activities, sustainable and non-inflationary growth respective to the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and the quality of life, and economic and social cohesion and solidarity.

The outcome of these inter-relationships will depend on the political process, because following standing decision practice, general terms of primary law requiring concretisation for political guidelines cannot be defined by the European Court but only by the political organs of the EC and Member governments. The economic policy basically being reserved to the Member States, the related antagonism will mainly exist between the ESCB/ECB and the national governments.

Fiscal and monetary sovereignty

A similar antagonism might arise between fiscal sovereignty, which is reserved to the national governments, and the monetary jurisdiction of the ESCB.

Fiscal sovereignty is the freedom to spend and tax as a country sees fit.[34] Within the EC monetary union there does not exist any collective assumption of one Member StateÕs debts. As opposed to the EC, financial mechanisms are a substantial part of the German federal constitution. The monetary unions of Australia and Canada had to import capital during their formative periods. Such circumstances provided a powerful incentive to offer assistance between their constituents.[35] The lack of any collective budgetary guarantee, connected with the budgetary discipline laid down in Article 104c of the EC Treaty and the separation of monetary policy from fiscal policy, will mean that the power

34 Bishop, Ô1992 and BeyondÕ (1990) (Salomon Bros, European Business Analysis), 3.

35 Bishop, Ô1992 and BeyondÕ (1990) (Salomon Bros, European Business Analysis), 2.

to borrow by the Member States will exclusively depend on their creditworthiness. Only the independence of monetary jurisdiction is able to secure that public debts cannot be financed by money-printing.

However, the EC budgetary stability legally based on Article 104 EC Treaty will be under permanent pressure from the demand for support programs, accompanied by EC budget interventions. The Protocol on Economic and Social Cohesion annexed to the Maastricht Treaty already supplies some arguments in this field. The aim of the related Cohesion Fund, for example, is

> a Ô... greater margin of flexibility in allocating financing from the Structural Funds ...Õ and the Ô... willingness to modulate the levels of Community participation ... with a view to avoiding excessive increases in budgetary expenditure in the less prosperous Member States.Õ

The result might well be a more or less permanent transfer of financial means to the less resourceful Member States. Although such transfer cannot be based on a general legal principle of federal state structures, the ratification process of the Maastricht framework and the EU enlargements in 1995 have already resulted in considerable financial aid and structural funding programs.

Outlook

The economic development, particularly the tumultuous period in the early 1970s, has demonstrated that a stable monetary basis is necessary for free trading. The present EMS with its clearing system has provided a workable basis for the minimum harmonisation of the financial markets resulting in the Single European Market. Tumultuous periods could jeopardise achievements not on the legal but on the economic side. Since the Maastricht agreement, the Italian Lira and the British Pound had to retreat from the exchange rate mechanism, the Spanish Peseta and the Portuguese Escudo had to be devalued. By extending the floating band within the EMS to an allowance of 15% in both directions, the last tumultuous period could be settled.

The integration of the new members which joined the EU in January 1995 will be an additional challenge.

With this background, the development from the EMS to the Economic Union as an instrument of monetary and economic policy seems desirable. Moreover, although the result of Maastricht will be far beyond the present and successful principle of harmonisation, an even further development of the economic union with the target of common economic policies seems inevitable to avoid basic systemic contradictions. This is also true regarding the extension of national banking supervision to the integration of a common overall supervision on financial markets.

Following a statement by the former Governor of the German Bundesbank, Schlesinger, the target of a single currency by the end of this century seems rather ambitious, keeping in mind that only very few countries are meeting the standards for the monetary union at the moment. But reasonable alternatives do not exist. A failure might result in consequences similar to that of the Werner plan in 1971 which had postponed the formation of a common capital market for as long as 20 years.

Quality and Title Warranties in Transfers of Computer Software

John Adams

Introduction

There are as yet few decisions on the application of the quality and title warranties of the Sale of Goods Act to contracts for the supply of computer software. In this paper, I attempt to sketch out an approach to the problems raised. I propose first of all to deal with the question of breach of the quality warranties, which is the more difficult one. I will then go on to deal with breach of the title warranties, the position with regard to which is now, in the UK at least, fairly straightforward.

Defective computer software obviously can cause economic loss. An accounting system, for example, may lead to insolvency because its stock control program had a ÔbugÕ. A computer ÔvirusÕ may cause serious damage to a companyÕs entire system. Defective software can also lead to physical damage. In an American case, for example, a computer generated label for a prescription drug failed to warn that it should not be taken with alcohol, with fatal consequences.[1] Obviously, the type of damage which results may be of considerable relevance to recovery on any tort theory, or under a product liability statute, but, in the present paper, I intend to focus only on the liability for defective software under the quality warranties of the Sale of Goods Act, under which, in principle, damages for both economic and physical loss are recoverable. Nevertheless, rather than jump straight in to the obvious question as to whether or not software is goods, it is helpful as a first step to look at the ways in which a product can be defective, and for this purpose it is helpful to look at the *Restatement (Second) of Torts*.

The meaning of ÔdefectiveÕ

Under the *Restatement (Second) of Torts* it is a requirement of strict liability under ¤402A that the product in question is unreasonably dangerous. In answering the question: Ôwhen is a product unreasonably dangerous?Õ the

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1 *Frye v Medicare-Glaser Corp* 579 NE 2d 1255 (Ill APP 1991) Ð no liability: it turned out that the pharmacist had not activated the warning which the software could generate on the ground that she had not wanted to suggest her customers drank!

learned editors of *Prosser on Torts* suggest that there are essentially three instances where a product may be unreasonably dangerous because of a defect.[2] It may contain a flaw in manufacture rendering it unreasonably dangerous; it may be unreasonably dangerous due to a failure to warn of hazards; or it may be unreasonably dangerous because of defective design. Although it is not, of course, a necessary pre-condition to recovery under the Sale of Goods Act quality warranties that a product be unreasonably dangerous, nevertheless, the above analysis is quite helpful in characterising the ways in which software could be found not to be merchantable, or fit for the purpose for which it was sold.

Thus, software containing a virus would clearly be unmerchantable, because it is flawed. Similarly, examples which do not correspond to the manufacturerÕs specification in other respects would be flawed. A program for operating a machine tool which failed to warn that it should not be operated to process certain materials which it might reasonably have been supposed it would deal with, should be held to be unfit for the purposes for which it was sold.[3] The facts in *Jones v Minnesota Mining & Manufacturing*[4] can be used to illustrate the third way in which the quality warranties might be broken. In that case software was used to calculate the dose of radiation to be given to cancer patients. Some patients suffered serious injury through being given overdoses. Although at the end of the day the defect was found to have been due to the fact that faulty data had been fed into the program, presumably if the data had been correct, but the cause of the over-prescribing been that the program had been wrongly written, there could have been liability under the third head on this ground.

It is also quite helpful, for reasons which will become apparent in due course, to look at the justifications which are generally put forward for strict product liability.

Justifications for strict product liability

The first justification, one given in the comments to ¤402A of the *Restatement*, is loss spreading. The risk of loss for personal injury and property damage resulting from a defective product should be borne by the manufacturers because they are in a better position to absorb the loss by distributing it as a cost reflected in the price of the goods. A second justification, also to be found in the comments, is that manufacturers assume a duty of care in putting a product into the stream of commerce: the difficulties of discovering potential flaws in modern mass produced goods forces the

2 *Prosser on Torts* (1984) 5th ed W Page Keeton *et al* ¤99.

3 On the basis that failure to warn can render a product unfit Ð see *Vacwell Engineering v BDH Chemicals* [1971] 1 QB 88.

4 669 P 2d 744 (NM App 1983).

consumer to rely upon the expertise and reputation of the manufacturer. Finally, potential liability encourages manufacturers to exercise proper quality control, and to improve product safety.[5]

Armed with the above analysis, we are in a position to approach the difficult question as to whether software is ÔgoodsÕ within the meaning of the Sale of Goods Act.

Is software goods?

The question as to whether or not the sale of computer software should be treated as a sale of goods does not admit of a simple answer. On the one hand, much software is sold over the counter in stores in the same way as books and records. If there is a defect in the medium carrying the program, there should be no difficulty in holding that there is a breach of the quality warranties of the Sale of Goods Act. It does not seem to push this analysis much further to say that if a malicious employee of the software house has infected the software with a virus which damages the data and other matter stored in the purchaserÕs computer, the seller should be liable under the Sale of Goods Act. In the first place, that is a way of transferring liability back to the software house, whom the shop will no doubt sue in turn.[6] Secondly, the situation is analogous to that where, for example, an infected animal spreads disease through the purchaserÕs herd.[7] There seems, in fact, to be little reason why a shop should not become liable in respect of Ôoff-the-shelfÕ software if it should prove to be defective in any of the ways suggested above.

But other software is either specially written for the customer, or requires work to be done to it by the supplier to adapt it to the customerÕs needs. There is a continuing relationship between the parties. The customer may eventually need itself to have access to the source codes if the supplier is unable to cure the defect. The sale of goods analogy which presupposes a particular point in time when the parties can be said to have Ôsold the goodsÕ seems inappropriate.[8] Clearly if there are defects in the underlying product, the medium or any Ôoff-the-pegÕ program which is to be adapted, then these can be dealt with under the Sale of Goods Act. But does the supplier, so far as the other aspects are concerned, merely have to use reasonable care and skill as required by the Supply of Goods and Services Act 1982, s 13 (or by the common law of negligence)? The answer is that usually, because of the suppliers representations to the customer, more than that is required. In

5 *Prosser op cit* ¤98.

6 See *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454.

7 See *Smith v Green* (1875) 1 CPD 92.

8 See *Saphena Computing Ltd v Allied Collection Agencies Ltd* (1989) 3 May (unreported) *per* Staughton LJ in passage cited below.

Saphena Computing Ltd v Allied Collection Agencies Ltd[9] the purchasers sought damages for failure to supply customised software which was reasonably fit for the purpose for which it was supplied. Staughton LJ observed:

> ÔIt was, we are told, common ground that the law governing these contracts was precisely the same whether they were contracts for the sale of goods or for the supply of services. It is therefore unnecessary to consider into which category they might come. But it is important to remember that software is not necessarily a commodity which is handed over or delivered once and for all at one time. It may well have to be tested and modified as necessary. It would not be a breach of contract at all to deliver software in the first instance with a defect in it. That seems to be confirmed by the expert report ... [the expert said]
>
> > ÒJust as no software developer can reasonably expect a buyer to tell him what is required without a process of feedback and reassessment, so no buyer should expect a supplier to get his programs right first time. He too, needs feedback on whether he has been successful ...Ó
>
> So I conclude that it was part of the contract that the suppliers in this case should have the right and the duty to test and modify as necessary the software they supplied.Õ

It was held at first instance that there was an implied term as to the fitness of the software for the purpose for which it was required, and that this obligation had not been fulfilled by the time the parties terminated their relationship, but that the effect of the termination agreement was, *inter alia*, that the plaintiffs were not required to carry out further work on the software, and had to make available to the defendants the source codes in order that the defendants might make the software reasonably fit for the purposes specified. The Court of Appeal upheld this decision.

It follows from the above that the sellerÕs assertions about the performance of the software will often be crucial. These representations may themselves, of course, give rise to a claim for damages for misrepresentation.[10]

Towards a workable approach

It follows from the above analysis that some contracts for the supply of software are, for practical purposes, indistinguishable from sales of goods, some are more-or-less entirely contracts for the supply of services, but many

9 Court of Appeal 3 May 1989 (unreported).

10 See *Europdynamics Systems plc v General Automation Ltd* 6 September 1988 (unreported) Ð statement by the seller that their system supported ANSI Cobol 74 programming language.

will be of a mixed nature being contracts for the supply of off-the-shelf software with a significant element of customisation. For English courts, this should not cause a problem, since they have long abandoned the need to pigeon-hole contracts as *either* contracts for the supply of goods, or contracts for the supply of services.[11] Thus, in *Myers v Brent Cross Service Co*[12] the court held that a contract for the repair of a car was one of services, but that the warranty of fitness for purpose applied to the goods supplied as part of the services. Under the 1982 Supply of Goods and Services Act, the warranties implied in such Ôwork and materialsÕ contracts are identical, so far as the goods element is concerned, to those contained in sales of goods.[13]

Whether it is because the Uniform Commercial Code still contains a Statute of Frauds provision,[14] or simply judicial conservatism, American courts have shown themselves more reluctant to abandon the goods/services dichotomy. Some courts have adopted the traditional Ôessence of the contractÕ test.[15] Others, at least in other contexts, have considered the application of the policies justifying strict product liability to the particular fact situation, in order to determine if the transaction was the sale of a product or a sale of goods.[16] In *RRX Industries Inc v LAB-CON Inc*[17] applying both the Ôessence of the contractÕ test, and the case-by-case policy test, the court held that a contract for a software system for use in medical laboratories was essentially a contract for the sale of goods, although it had a service element in the requirements of employee training, debugging and upgrading. Neither of these approaches is entirely satisfactory, and the approach which the English courts are able to take of separating out the different elements of the contract would appear to be the better one. The case-by-case approach does, however, provide a pointer to the answer to the question as to when the software manufacturer should be liable as a supplier of a product.

11 The need to do this was largely engendered by the requirement of the Statute of Frauds that contracts for the sale of goods in excess of £10 had to be evidenced in writing. This requirement was removed from the Sale of Goods Act by the Law Reform (Enforcement of Contracts) Act 1954 s 1.

12 [1934] 1 KB 46.

13 Sections 3 and 4. As noted above, the supplierÕs duty in a contract for the supply of a service is simply to carry out the service with reasonable care and skill Ð s 13. The Act makes it clear that a contract is a contract for the transfer of goods within the meaning of the Act whether or not services are also supplied Ð s 1(3).

14 Article 2-201.

15 The so-called ÔEnglish ruleÕ derived from cases such as *Clay v Yates* (1856) 156 ER 1123. And see *Robinson v Graves* [1935] 1 KB 579.

16 *Johnson v Sears, Roebuck & Co* 355 F Supp 1065 (E D Wis 1973) Ð hospital strictly liable in respect of its administrative and mechanical services.

17 772 F 2d 543 (9th Cir 1985). See also, and compare *Chatlos Systems Inc v National Cash Register Co* 479 F Supp 738 (3rd Circ 1982); *Triangle Underwriters v Honeywell Inc* 457 F Supp 765 (EDNY 1978); *Communications Groups v Warner Com.* 527 NYS 2d 340 (NY City Civ Ct 1988).

The justifications for imposing ultimate liability on a software supplier under the Sale of Goods Act, or the Supply of Goods and Services Act, must be the same as that for imposing product liability generally. These were set out above. In *Winter v GP Putnam's Sons*[18] the court stated by way of an obiter dictum that software might be a product for the purposes of strict product liability. This dictum caused a furore amongst software manufacturers,[19] and due weight must be given to the software manufacturersÕ concerns, as no one should wish to discourage the marketing of innovative and beneficial software by over zealous imposition of product liability. It is helpful at this point to examine the policy reasons why the liability imposed on the suppliers of services under the Supply of Goods and Services Act is less strict than the liability imposed on the supplier of goods.

In the first place, the suppliers of services are usually providers of expert services to individual customers. They simply do not have the high volumes necessary to spread the risk amongst a large number of customers.[20] Secondly, the customers usually deal directly with the providers of the services, and are therefore in a better position to prove negligence than is the consumer injured by a defective product.[21] Thirdly, the provider of the services and the customer are in a position to bargain for the level of liability to be undertaken. If nothing is said, the suppliers duty is only to exercise reasonable care and skill, but if a higher level of liability is accepted, as in the *Saphena* case, then so be it (contracting for a *lower* level of liability than than specified in s 13 will, of course, be subject to the Unfair Contract Terms Act 1977). Finally, the provider of a service which is essentially a Ôone-offÕ is not in a position to test the software in the way in which the manufacturer of a mass produced product is.

Conversely, the imposition of a stricter standard of liability on a supplier of mass produced Ôoff-the-shelfÕ software would seem to be justified by precisely the considerations which apply in contracts for the sale of goods generally. It must be realised, however, that the standard ultimately imposed on the manufacturers of products ought not to be strict in the sense that software is to be treated as defective simply because it has caused economic or physical damage. It must at least be defective in one of the senses set out above. Moreover, as with pharmaceuticals, the state of scientific knowledge at the time ought to be a relevant consideration. The reason why a pharmaceutical manufacturer ought not to be liable for marking chemotherapeutic products for terminal cancer with serious and possibly occasionally fatal side effects, whilst the perfumier who put into the market an after-shave lotion which killed one person in 10 million should be, is that in the last analysis, the basis

18 938 F 2d 1033, 1036 (9th Cir 1991).

19 See Victoria Slind-Flor, National LJ, 29 July 1991 p 3.

20 See *La Rossa v Scientific Design Co* 402 F 2d 937, 942 (3d Cir 1968).

21 See for example *Daniels v White and Tarbard* [1938] 4 All ER 258.

of liability is not merely the possibility of loss distribution by the manufacturer: that is a necessary precondition for liability.[22] The real justification for imposing liability is negligence, if we understand that in the sense laid down by Mr Justice Learned Hand in *US v Carroll Towing*.[23] In that case Mr Justice Hand suggested that the duty of care in negligence is a function of three variables: (1) the probability of harm; (2) the gravity of the resulting injury; and, (3) the burden of adequate precautions. If we build into (3) opportunity costs, we have a fairly good workable formula to provide answers to questions of the sort posed above. Thus it is the opportunity costs element in the equation which explains why it would be negligent to market the after-shave, but not the therapy.

The Products Liability Directive

It is implicit in the argument set out above that the liability of a manufacturer who is sued up the chain from the actual supplier of software under the Sale of Goods Act (or the Supply of Goods and Services Act), ought, in principle, to be the same as that of a manufacturer sued directly under the Consumer Protection Act 1987, which implements the EC Products Liability Directive.[24] Like ¤402A of the *Restatement (Second) of Torts,* recovery under that Act is only possible in respect of physical damage to person or property. It is not altogether clear on what basis the Directive proceeds. It simply refers in the Recitals to Ôliability without faultÕ and states ÔThe producers shall be liable for damage caused by a defect in his productÕ,[25] but as implemented in the UK by the Consumer Protection Act 1987, it seems consistent with the Learned Hand formula, and the rest of the analysis suggested above. The Act provides a Ôstate of the artÕ defence:[26]

> Ôthat the state of scientific and technical knowledge at the relevant time was not such that a producer of products of the same description as the product in question might be expected to have discovered the defect if it had existed in his products while they were under his control.Õ

This is supposed to implement Article 7(e) of the Directive, which states, in wording somewhat simpler than that of the UK Act, as follows:

> ÔThat the state of scientific and technical knowledge at the time when he put the product into circulation was not such as to enable the existence of the defect to be discovered.Õ

22 See *Goldberg v Kollsman Instruments* 191 NE 2d 81 (1963).

23 159 F 2d 169 (1947).

24 85/374 of 25 July, 1985. As to whether software is a ÔproductÕ within the meaning of the Directive see Rowland [1993] *Cambrian LR* 78. For the reasons suggested in the text above, the best view must be that it can be.

25 Article 1.

26 In s 4(1)(e).

Whether or not these provisions amount to exactly the same thing, at least they are both aimed at bringing the state of scientific knowledge into the equation. This is consistent with Learned Hand negligence, but not with product liability based on a pure loss distribution theory.

The title warranties

The sale of goods which infringe the intellectual property rights of a third party will amount to a breach of the title warranties found in s 12 of the Sale of Goods Act.[27] The principal source of protection for software is copyright law: in countries adhering to the European Patent Convention it cannot be patented as such.[28] Copyright comes into existence automatically by virtue of the act of creation, consequently, the title warranty can only be broken if the software infringes a third partyÕs rights at the time of sale. The problems which arise in patent law because of the length of time which can elapse before the patent is granted cannot therefore arise. This problem led in *Microbeads v Vinhurst Road Markings*[29] to the court holding that there was a breach of the covenant for quiet enjoyment, but not of the title warranty as such, because no third party rights yet existed at the time of the sale. The principal question therefore is simply: does the software infringe any third partyÕs rights at the time of the sale? If this issue has already been adjudicated by another tribunal, the trial courtÕs task is relatively straightforward. If, on the other hand, it falls to be adjudicated because the purchaser of the software has been sued by the copyright proprietor, and has joined the seller as third party, the court dealing with the sale of goods issues will have to deal with the difficult technical questions involved in the infringement of copyright in software.

The state of UK law on the infringement of copyright in computer software was in a state of some confusion as a result of the decisions in *Total Information Processing Systems v Damon*[30] and *Richardson and another v Flanders and Chemtec.*[31] In the latter case, Ferris J had analysed the American case law, and concluded that of the two streams of authority in that case law he preferred *Computer Associates v Altai*.[32] He held that there was nothing in the English case law to conflict with the general ÔfiltrationÕ approach adopted in that case to find the Ôcore of protectable expressionÕ. Fortunately, the decision of Jacob J in *Ibcos Computers Ltd and another v*

27 *Niblett v Confectioners' Materials* [1921] 3 KB 387; *Microbeads v Vinhurst Road Markings* [1975] 1 All ER 529.

28 European Patent Convention Article 52(2)(e); Patents Act 1977 s 1(2)(c).

29 [1975] 1 All ER 529.

30 [1992] FSR 171.

31 [1993] FSR 497.

32 983 F 2d 693 (2nd Cir 1992).

Poole and others[33] has put the law on a more certain foundation. He pointed out that there were significant differences between US and UK copyright law, and observed that reaching a result via the route of a Ôcore of protectable expressionÕ, merely complicated matters. It was necessary to undertake a detailed analysis of the two programs, not only of their literal similarities, but also the program structure and design features in order to decide if there had been copying by the defendant. Copying is, after all, the basis of the action for copyright infringement! He embarked on a detailed analysis of the two programs in question (including the source codes), and reached the conclusion that there had been disc-to-disc copying. The result of this decision is that it will be easier to establish whether or not third party rights are infringed, and thus the title warranty in s 12 broken.

Conclusion

The above analysis suggests that so far as the quality warranties are concerned, provided a court is prepared to distinguish in a contract to supply software the goods elements from the service elements, the applicable principles are relatively straightforward. Distinguishing these elements can be justified for the reasons suggested. Similarly, the application of the title warranties is relatively straightforward. The real difficulty for the court adjudicating disputes involving computer software will often be that of evaluating the evidence, for this may require a real understanding on the part of the judge of the technology. This can be especially the case regarding the title warranties, because determining whether or not there is infringement in those cases where the same court is required to adjudicate upon this issue, in order to determine whether or not there has been a breach of warranty, requires a detailed comparison of the two programs involved in order to resolve the issue as to whether or not there has been copying.

33 Judgment 24 February 1994 (unreported).

The Legal Aspects of Foreign Investment in Vietnam

Tang Thanh Trai Le[1]

Introduction

Recent years have brought burgeoning interest in foreign investment in Vietnam. Although a few observers have sounded discordant notes about VietnamÕs economic potential,[2] they have been drowned out in the chorus of the prevailing opinion that Vietnam appears set to become the next ÔtigerÕ of Southeast Asia.[3] Recognising this potential, the US lifted its trade embargo of Vietnam in early 1994.[4] By this time, foreign investors from other nations had already established a presence in Vietnam.[5]

Foreign investors have well-founded reasons underlying their interest in Vietnam. VietnamÕs plentiful natural resources, including timber, oil, agricultural resources, a long coastline, tourism, and seafood production, present ample opportunity for development.[6] The labour force has a 90% literacy rate,[7] partly due to the ease of reading and writing the language thanks to the efforts of early Portuguese missionaries to phonetically transcribe the language into the Roman alphabet. The people also possess unique qualities; they demonstrated their resilience throughout nearly 40 years of warfare. Finally, the countryÕs isolation until recent years makes Vietnam the Ônew kid on the blockÕ in terms of investment opportunities; the investment vacuum

1 Professor of Law, University of Notre Dame Law School. The author wishes to thank Arthur Povelones (JD, 1995) for his invaluable assistance in the preparation of this article.

2 See, e.g, Sally Golston, ÔVietnam: Cautionary AssessmentÕ East Asian Executive Rep, 15 January 1994, at 7 (describing American Ôthink tankÕ report skeptical of prospects for economy); Peter Passell, ÔVietnam May Be Too Poor to Justify a Big Business InvasionÕ, NY Times, 10 February 1994, at D2; Linus Chua, ÔThe DoorÕs Open But DonÕt Expect a StampedeÕ, LA Times, 7 February 1994, at D3.

3 See, e.g., ÕDTI Ð Vietnam Ð Another Asian Tiger Says Richard NeeddhamÕ, Hermes Ð UK Government Press Releases, 3 May 1994, LEXIS, News Library, Txprim File; Mark Evans, ÔForeign Interest in Vietnam GrowingÕ, South China Morning Post, 25 March 1994, at 14 (citing government data indicating 52% growth rate in foreign investment); Karl Schoenberger, ÔChamping at the BitÕ, LA Times, 4 February 1994, at D1.

4 Memorandum on Trade with Vietnam, 30 Weekly Comp Pres Doc 212 (3 February 1994).

5 The Vietnamese government reported that through the end of 1993, it had approved 820 foreign investment projects with a value of over $7 billion. Ton Si Kinh, ÔVietnam: Renovation and Expansion of Cooperative Relations with Other CountriesÕ, 2 (1994) (unpublished manuscript, on file with author).
Australia ranks among the top five countries in terms of number of projects and amount invested, with 40 projects and $477.4 million through the end of 1993; Agreement on the Reciprocal Promotion and Protection of Investment, 5 March 1991, Austl.-Vietnam, 30 ILM 1064; Margaret Harris, ÔVietnam Ð Frenzy as the Last Great Gold Rush BeginsÕ, Sydney Morning Herald, 5 February 1994, at 26.

6 See generally W Gary Vause, ÔInvestment in Vietnam: Prospects and Concerns for the 1990sÕ, 4 Fla IntÕl LJ 231, 235 (1989).

7 But see Malcolm W Browne, ÔOvercrowded Vietnam is Said to face CatastropheÕ, NY Times, 8 May 1994, at sec 1, 1 (mentioning declining educational system and lack of managerial skill).

inevitably attracts investors wishing to gain an edge in an untapped market. Indeed, Vietnam now seeks investment in everything from new golf courses to infrastructure overhaul.

The Vietnamese governmentÕs first attempt to attract foreign capital came with the promulgation of a foreign investment code in 1977,[8] not long after the communist leadership made clear its intent to establish communism throughout Vietnam. In 1976, the countryÕs name, formerly the ÔRepublic of VietnamÕ, became the ÔSocialist Republic of VietnamÕ, and the WorkersÕ Party became the Communist Party at the Fourth Party Congress later that year.[9] The 1977 foreign investment code accordingly placed strong emphasis on the role of the state, and subordinated foreign investment to the communist structure of the economy. Thus, only the state could enter into a joint venture with a foreign party, and the foreign party could not invest more than 49% of the joint ventureÕs capital.[10] Furthermore, the code refused to rule out the prospect of nationalisation.[11] So while Vietnam courted capital from western nations, it did so only halfheartedly. As a result,

> Ô... [a]lmost every item in [the code] is vague. Virtually every statement is accompanied by reservations or qualifications. Concerning fiscal privileges, for example, the Code speaks of Òexemptions or reductionÓ of income tax for Òa number of yearsÓ, Òdepending on the branch of the economyÓ, Òon the area of operationÓ and Òon the amount of capital investedÓ. The same vagueness exists concerning customs duties, export tariffs and reinvestment treatment. On the crucial question of nationalisation, the Code mentions nationalisation from ten to fifteen years after the initial investment date, but hastens to add that Òin particular cases this period may be longerÓ. There are no criteria for defining Òparticular casesÓ.[12]

Not surprisingly, then, the 1977 foreign investment code could only attract a handful of investments from socialist countries. In fact, Vietnam licensed only one western foreign enterprise, a French pharmaceutical firm, under the old code.[13] This left development needs to the state enterprises, which lacked the ability to fill the gap.[14] As a result, Vietnam could not shake its status as one of the poorest nations in the world.[15]

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8 Regulation on Foreign Investments, Decree 115/CP, 18 April 1977 (hereinafter Ô1977 CodeÕ).

9 Tang Thi Thanh Trai Le, ÔThe Foreign Investment Code of Socialist Republic of VietnamÕ, 13 IntÕl Law 329, 331 (1979).

10 1977 Code, note 8, at Article 7(3).

11 The government guaranteed no nationalisation only for a period of 10 to 15 years, or for an extended period in particular cases. at Article 10(1).

12 Le, *supra* note 9, at 329-30.

13 Douglas Pike, ÔVietnam: The Winds of LiberalisationÕ, 12 Fletcher Forum 245, 247 (1988).

14 Prime Minister Vo Van Kiet recently commented on Ôthe negativity and attitude of dependence under the former subsidised system ...Õ, ÔVo Van Kiet Gives Speech at Assembly OpeningÕ, Hanoi Voice of Vietnam, FBIS, 9 December 1993, at 65, 66 (hereinafter ÔVo Van Kiet speechÕ).

15 Even today, VietnamÕs per capita income remains around $200, among the lowest in the world, according to a World Bank report ÔVietnamÕs Transition to a Market EconomyÕ (pt 1), East Asian Executive Rep, 15 December 1993, at 9 (hereinafter ÔTransition, pt 1Õ).

Winds of change

A well-known communist theoretician in Vietnam has noted:

> ÔThe winds of change which swept our country happened at the peak of the ÒperestroikaÓ movement in the Soviet Union. VietnamÕs Sixth Party Congress and the Soviet 27th Congress were progressing together, supporting each other.Õ[16]

The Sixth Party Congress adopted its own ÔperestroikaÕ in 1986 and named it Ôdoi moiÕ, or renovation. The Soviet Union reportedly warned Vietnam that it would cut off the $1.4 billion of aid and subsidised trade it gave to Vietnam if Vietnam did not enact economic reform.[17] Still, the communist leaders remained reluctant to launch an all-out effort to attract investors from capitalist countries. The same theoretician summed up the reason for this reluctance:

> ÔDo not believe that the investment from capitalist countries will save us ... To pursue the route of socialism and at the same time to ask capitalism for help is but a daydream.Õ[18]

The cutoff of assistance from the Soviet Union in 1991,[19] though, further hastened the need for subsequent foreign investment reforms, as foreign capital became a substitute for direct economic assistance.

Meanwhile, China, a country simultaneously emulated and feared by Vietnam, had embarked on a program of economic development. Its dual emphasis on economic openness and rigid political control presented an attractive model for the Vietnamese government. Furthermore, the rapid economic development in China in the wake of the new policy undoubtedly impressed the Vietnamese leaders. Vietnam consciously incorporated much of ChinaÕs foreign investment law into its new law.[20] The other countries of the Pacific Rim also developed rapidly, which certainly played a role in the desire of Vietnam for economic reform.

VietnamÕs invasion of Cambodia adversely affected its economic development. In addition to the human and economic costs of the invasion itself, the US explicitly conditioned lifting of the trade embargo upon withdrawal of troops and assistance in reaching a settlement.[21] By

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16 Nguyen Khac Vien, ÔDoi MoiÕ 18-19 (1988).

17 Gerald Segal, ÔThe USSR and Asia in 1987Õ, 28 Asian Surv 1, 3-4 (1988).

18 Vien, *supra* note 16, at 19.

19 Harris, *supra* note 5, at 26.

20 Jerome Alan Cohen, ÔInvestment Law and Practice in VietnamÕ, xii (1990). The Vietnamese law did not, though, simply copy the Chinese law. The drafters evaluated foreign investment law in many nations and solicited the advice of a United Nations body, and made many substantial changes as a result. At xii, 2.

21 See generally Douglas Pike, ÔChange and Continuity in VietnamÕ 89 Current Hist 117, 132 (1990); Douglas Pike, ÔVietnam in 1991Õ, 32 Asian Surv 74, 81 (1992) (hereinafter ÔVietnamÕ).

disentangling itself from Cambodia through the signing of the agreement on the Cambodian peace process in Paris in October 1991, Vietnam sought to establish normal relations with China and the US and to end its isolation from its ASEAN neighbours.

The most crucial impetus for change, however, came from within Vietnam itself. Even before the formal division of Vietnam with the 1954 Geneva Accords following the French armyÕs defeat at Dien Bien Phu, the northern and southern regions had separate economic and political cultures. The French policy of Ôrule and divideÕ translated into the division of Vietnam into three distinct political entities: Cochinchina, Annam, and Tonkin. Cochinchina in the south, compared to the northern regions of Annam and Tonkin, enjoyed a measure of prosperity as a result of its superior natural resources, especially rice and rubber. It also had greater familiarity with western political ways, an inevitable outgrowth of French colonialism and the lack of an indigenous government. The Geneva Accords entrenched the differences with a western economic system taking hold in South Vietnam and a communist system in North Vietnam.

By the time of reunification in 1975, private enterprise, except for some small vendors, had become virtually non-existent in North Vietnam. State and collectivised enterprises accounted for 88.4% of national output and 84.4% of national income.[22] In contrast, a fully capitalist system operated in South Vietnam. Thus, the attempt of the government to impose communism on the south resulted in a debilitating economic crisis.[23]

In spite of the austerity brought about by communist rule, the standard of living of southerners remained substantially higher than that of northerners. This occurred, in no small part, due to the remittances of overseas Vietnamese, especially those who fled in 1975, to their families and relatives remaining in Vietnam. Overseas Vietnamese remitted an estimated $300 million annually in kind and in cash.[24] As early as 1979, private enterprise resurfaced, this time with the implicit blessing of the authorities, especially in Ho Chi Minh City. Visitors from the north, led to believe during the war years that the south required ÔliberationÕ because the people there lived in misery, instead came away amazed by the relative affluence of their new compatriots. Residence in the south soon became a privilege that only select northerners could enjoy. Socialisation, then, plunged the country into a deep economic crisis while failing to eliminate the differences between north and south.

The Vietnamese leadership realised the futility of continued efforts to impose socialism, and decided to dramatically change its economic approach. Thus, the Sixth Party Congress officially embraced Ôdoi moiÕ, or ÔrenovationÕ.

22 Tap Chi Cong San, March 1994, at 46-48.

23 See eg, Pike, ÔVietnamÕ, *supra* note 21, at 78 (Ôvirtually no true economic developmentÕ during the 1980s).

24 Joseph Kahn, ÔSeeking an End to Trade Hostilities: Vietnam Gears up for Lifting of U.S. EmbargoÕ, Dallas Morning News, 8 February, 1993, at 1D.

Article 15 of VietnamÕs constitution, amended in 1992 in order to reflect the new party line, sets out the official meaning of Ôdoi moiÕ. Under the Ôdoi moiÕ system

> Ô[t]he state develops the multisectoral commodity economy in accordance with the market mechanism based on state management and socialist orientations. The multisectoral economic structure with its various diverse forms of production organisation depends on the system of ownership of the entire people, of collectives, and of private parties with the system of ownership of the entire people and collectives being at the core.Õ[25]

Put simply, Ôdoi moiÕ means that the government has abandoned its attempts to impose a planned economy and collectivisation in favour of a free market structure and private enterprise.

Foreign investment law

Generally

As part of the Ôdoi moiÕ policy, the Communist Party decided to Ômobilise every means and use every form to attract foreign capital ...Õ[26] Prime Minister Vo Van Kiet reiterated that foreign investment represented a cornerstone of the economic openness policy, as only an attractive investment environment would enable Vietnam to obtain Ôthe most important foreign capital resourcesÕ.[27] Liberalisation of the foreign investment laws, then, served as the most essential part of the Ôdoi moiÕ policy.

VietnamÕs law on foreign investment,[28] passed in 1987 in the wake of the watershed Sixth Party Congress, repealed, rather than amended, the 1977 law because the party had radically changed the underlying policy and purpose of foreign investment. While under the 1977 law the state had to maintain 51% ownership of all enterprises, the 1987 law permitted complete foreign ownership if desired.[29] Also, the new law explicitly ruled out nationalisation,[30] a position that Vietnamese leaders have consistently emphasised.[31]

25 Constitution of the Socialist Republic of Vietnam, Article 15 (1992), reprinted in ÔConstitutions of the Countries of the WorldÕ, (Albert P Blaustein & Gisbert H Flanz eds, 1992 Supp) (hereinafter ÔConstitutionÕ). ÔDoi moiÕ applies only to economics, not politics. The Vietnamese Constitution, broadly amended in order to reflect the Ôdoi moiÕ policy, retains the monopolistic role of the Communist party. *Id* at Article 4.

26 ÔStrategy for Socio-Economic Stabilisation and Development Up to the Year 200Õ, 30, quoted in Tap Chi Cong San, April 1994, at 9.

27 Vo Van Kiet speech, *supra* note 14, at 68.

28 ÔLaw on Foreign Investment in VietnamÕ (1987), reprinted in 30 ILM 932 (1991) (hereinafter ÔlawÕ).

29 *Id* at Article 8.

30 *Id* at Article 21.

31 See ÔVietnam: Xuan Rules out NationalisationÕ, Vietnam Investment Rev, 30 August 1993 (chairman of SCCI saying that Vietnam would not nationalise property of foreign enterprises).

The party has pursued foreign capital with the same singlemindedness that characterised its conduct of the war.[32] The Seventh Party Congress in 1991 and the subsequent mid-term party congress in 1994 have reinforced the renovation policy

Ô... with respect to foreign capital. VietnamÕs revised constitution reflects this policy:

The state shall encourage foreign organisations and individuals to invest capital and technology in Vietnam in accordance with Vietnamese law and international law and practice. The state shall guarantee the right of ownership of the legitimate capital, property, and other interests of foreign organisations and individuals. Business enterprises with foreign invested capital shall not be subject to nationalisation.Õ[33]

The amendments to the Law on Foreign Investment in 1990[34] and 1992[35] and the implementing regulations in 1993[36] have made a law already considered quite liberal even more so. The flurry of legislation passed in order to create a legal system underscores VietnamÕs focus on pleasing foreign investors.

Areas open to foreign investment

The 1987 foreign investment law permits foreigners to invest Ôin any sectors of its national economyÕ.[37] The law specifically encourages foreign investment in five areas:

1. Ô[i]mplementation of major economic programs, export oriented production, and import substitutionÕ;
2. Ô[t]he use of high technology, skilled labour, and concentrated investment in the exploitation and exhaustive utilisation of potential resources and in the increasing of the production capacity of existing factoriesÕ;
3. Ô[p]roduction which is labour intensive and uses the existing materials and natural resources available in VietnamÕ;
4) Ô[b]uilding of infrastructure projectsÕ;and

32 Tap Chi Cong San, March 1994, at 48. The government has calculated the amount of foreign investment it needs by 2000 in order to raise the countryÕs per capita to $500, and has made that amount its goal. Kahn, *supra* note 24, at 1D.

33 Constitution, *supra* note 25, at Article 25. The constitutional amendments avoided the potential dilemma that the permissive rules of the foreign investment laws and regulations violated the constitution, which only permitted state and collective enterprises. See Harish Mehta, ÔVietnam: Govt Drops Central economic PlanningÕ, Business Times, 2 January 1992 (quoting Ngo Ba Thanh, chairwoman of the Vietnamese Law Commission).

34 ÔLaw on Amendment and Addition to a Number of Articles of the Law on Foreign Investment in VietnamÕ (1990), 30 ILM 939 (1991) (hereinafter Ô1990 AmendmentsÕ).

35 ÔLaw on Amendment of and Addition to a Number of Articles of the Law on Foreign Investment in VietnamÕ (1992) (hereinafter Ô1992 AmendmentsÕ). The full text of the law as amended through 1992 appears in ÔForeign Investments of VietnamÕ (SCCI & Phillips Fox, 1993).

36 (1993), reprinted in ÔForeign Investment Laws of VietnamÕ note 35 (hereinafter ÔRegulationsÕ).

37 Law, *supra* note 28, at Article 3.

5. Ô[f]oreign currency earning services such as tourism, ship repairing, airports, and sea ports and other services.Ó[38]

The ability of foreign investors to invest in any part of the economy contrasts with restrictions imposed upon domestic entrepreneurs. For instance, the law on private enterprises and the law on companies prohibit formation of businesses in areas Ôprohibited by lawÕ and requires approval of the Chairman of the Council of Ministers in the following areas:

> Ô(1) Manufacturing and distribution of explosives, poison, and toxic chemicals. (2) Mining of certain precious minerals. (3) Production and supply of electricity and water on a large scale. (4) Manufacture of information transmitting facilities, postal and telecommunication services, broadcasting, television, and publication. (5) Ocean shipping and air transportation. (6) Specialist export and import business. (7) International tourism.Ó[39]

Although the foreign investor has access to all areas in principle, in practice the discretion of the State Committee for Cooperation and Investment (SCCI), the department that oversees foreign investment, to grant or refuse licences will carry out the governmentÕs intent to open or close certain areas to foreign investment.[40] In fact, the American embassy in Bangkok has reported that Le Xuan Trinh, Minister of the government, has announced that the government will draw up a list of areas forbidden to foreign investors, in order to Ôspare foreign investors wasted effortÕ.[41]

Forms of investment

Under the 1987 Law on Foreign Investment, foreign investment may take one of three forms:

1. Ô[c]ontractual business co-operationÕ;
2. Ô[j]oint venture enterprise or corporation, generally called joint venture enterpriseÕ; and
3. Ô[a]n enterprise with one hundred (100) per cent foreign owned capitalÕ.[42]

The 1992 amendments added two new subsets of investment: investment in ÔExport Processing ZonesÓ[43] and ÔBuild-Operate-TransferÕ contracts.[44] Separate laws control the operation of representative offices.[45]

38 *Id*.

39 Law on Private Enterprises, Article 5 (1990), reprinted in Foreign Investment Laws of Vietnam, *supra* note 35; Law on Companies, Article 11 (1990), reprinted in Foreign Investment Laws of Vietnam, *supra* note 35.

40 See infra Part III D for a discussion of the heightened procedural review given to projects in certain areas.

41 ÔVietnam Ð Economic NewsÕ, Market Reports, 17 March 1994, LEXIS, News Library, Curnws File.

42 Law, *supra* note 28, at Article 4.

43 1992 Amendments, *supra* note 35, at Article 1(7).

44 *Id* at Article 1(7).

45 See infra Part III C 6.

For foreign enterprises other than those with 100% foreign-owned capital, a Ôforeign partyÕ and a ÔVietnamese partyÕ must participate in the venture. Since 1987, the foreign investment law has consistently permitted Ôone or more foreign individuals or legal economic entitiesÕ to invest as a Ôforeign partyÕ in Vietnam.[46] The definition of who may represent the ÔVietnamese partyÕ has evolved with time. Article 2 of the 1987 Law defined the ÔVietnamese partyÕ as Ôone or more Vietnamese legal economic entities.Õ[47] That meant that only state entities could serve as the Vietnamese party, although private Vietnamese could Ôcontribute capital to Vietnamese legal economic entities to form the Vietnamese party for the purposes of business co-operation with a foreign party.Õ[48] The 1990 amendments clarified that the Vietnamese party could operate in any economic sector,[49] and amended Article 3 of the 1987 Law to authorise private Vietnamese economic organisations to enter into business co-operation contracts subject to conditions stipulated by the Council of Ministers.[50] The 1992 amendments redefined ÔVietnamese partyÕ for purposes of all forms of foreign investment as Ôone or more business enterprises from any economic sector,Õ thus permitting direct private participation in joint ventures.[51] The 1993 regulations define Vietnamese enterprises as state-run businesses, cooperatives, businesses established under the Law on Companies, and private enterprises established under the law on private enterprises.[52] The regulations further explain:

> ÔEnterprises established in accordance with the *Law on Companies* or the *Law on Private Enterprises* may independently enter business co-operation contracts with foreign organisations and individuals in every sector of the national economy, except those in which investment is prohibited by the law and regulations of Vietnam.Õ[53]

Given that the laws and regulations permit foreign investors to invest in

46 Law, *supra* note 28, at Article 2(1).

47 *Id* at Article 2(2).

48 *Id*.

49 1990 Amendments, *supra* note 34, at Article 1(1).

50 *Id* at Article 1(2). The Council of Ministers did not put forward these conditions before it amended the law again.

51 1992 Amendments, note 35, at Article 1(1). A discussion of the Club of Women Economic Managers of Ho Chi Minh City shows the intensity of the desire to please foreign investors. One member, worried about this amendment, stated, ÔAfter all, our country is a socialist country; if we allow private citizens to do everything, we are no longer a socialist country.Õ Another member responded, ÔA foreign party prefers to cooperate with private parties.Õ Tuoi Tre Chu Nhat, 6 December 1992, at 4.

In practice, however, the need for governmental connections to navigate the procedural hurdles has discouraged most foreign investors from choosing a private partner for substantial projects. Sesto E. Vecchi, , East Asian Executive Rep., 15 December 1992, at 9.

52 Regulations, *supra* note 36, at Article 3. See Part III.I for a discussion of the law on private enterprises and the law on companies.

53 Regulations, *supra* note 36, at Article 4. As of the end of 1993, Vietnam had 4,212 private enterprises. ÔBig Boom of Private EnterprisesÕ, Saigon Times, 13-19 January 1994, at 19.

any sector, however, the question arises whether the authorisation for foreign investors would take precedence over the restrictions on domestic enterprises, or vice versa. Of course, the discretionary power granted to the SCCI might make this question academic.

In the case of the more than 2 million overseas Vietnamese (Viet kieu),[54] the law remains ambiguous. The first regulations implementing the 1987 Law on Foreign Investment had explicitly given overseas Vietnamese Ôthe same rights and obligations as foreign investorsÕ.[55] The amended constitution does not assimilate the overseas Vietnamese who invest in Vietnam as a Ôforeign partyÕ, but it does not make them a ÔVietnamese partyÕ either.[56] Article 3 of the 1993 regulations established a special status for Ô[o]verseas Vietnamese who make direct investment in Vietnam or jointly contribute capital with one or more Vietnamese economic organisationsÕ, and hinted at Ôfavorable conditionsÕ for these investors.[57] This ambiguity reflects VietnamÕs dual objectives of maintaining jurisdiction over overseas Vietnamese and of attracting their capital.[58]

The government has yet to codify any of these Ôfavorable conditionsÕ in the law on foreign investment or the regulations. In 1993, however, it did act outside of the foreign investment laws by lowering the tax on the repatriation of profits earned in Vietnam for overseas Vietnamese from 10% to 5%.[59] A circular issued in 1994 confirmed this reduction and added a 20% reduction in profit taxes for any economic unit with at least 50% ownership by overseas Vietnamese.[60]

The uncertainty surrounding the status of overseas Vietnamese has helped

54 The government estimates that one million Vietnamese have settled in the US, for just under one half of the total, ÔOverseas Vietnamese Return for Tet, InvestmentÕ, Hanoi VNA, FBIS, 8 February 1994, at 44.

55 Decree Regulating in Detail the Implementation of the Law on Foreign Investment, Article 4 (1988), 30 ILM 942 (1991).

56 Article 23 of the revised constitution, prohibiting nationalisation of domestic property, does not include overseas Vietnamese as a Vietnamese party. Article 25, however, distinguishes overseas Vietnamese from other foreign organisations and individuals by saying, ÔThe state creates favourable conditions for overseas Vietnamese to invest in VietnamÕ. Constitution, note 25, at Article 25.

57 Regulations, *supra* note 36, at Article 3.

58 The pending law on domestic investment may completely remove overseas Vietnamese from coverage as a Ôforeign partyÕ. See Tran Kim Giang, ÔVietnam Domestic Investment Law Expected to Unleash Flood of New InvestmentÕ, Vietnam Investment Rev, 4 April 1994. The role of overseas Vietnamese, though, probably will remain uncertain, as legislators could not decide on how to classify them. ÔNational Assembly Proceedings on 6 June Ð Home Investment DiscussedÕ, BBC Summary of World Broadcasts, 8 June 1994, available in LEXIS, News Library, Curnws File.

Recent political developments also suggests that Vietnam may not treat overseas Vietnamese as Vietnamese nationals. See John Rogers, ÔVietnam, US Settle Overseas Vietnamese IssueÕ, Reuters World Service, 30 May 1994, LEXIS, News Library, Curnws File, describing an agreement granting the United States consular access to Americans of Vietnamese origin accused of violating Vietnamese law.

59 ÔOverseas Vietnamese Receive Tax IncentiveÕ Voice of Vietnam, BBC Summary of World Broadcasts, 11 May 1994, available in LEXIS, News Library, Curnws File.

60 *Id*, note 59.

discourage investment by overseas Vietnamese. Through March 1994, only 39 of the 895 investment licences went to overseas Vietnamese, with registered capital of $72 million.[61] These investments have come mostly from overseas Vietnamese of Chinese descent, who either invested directly or entered into joint ventures with parties from Taiwan, Hong Kong, and Singapore.[62]

Business co-operation contracts

A Ôbusiness co-operation contractÕ is defined as Ôa document signed by two or more parties ... with the object of conducting jointly one or more business operations in Vietnam on the basis of mutual allocation of responsibilities and sharing of profits or losses, without creating a legal entity.Õ[63] The 1993 regulations distinguish business co-operation contracts from Ô[c]ommercial contracts and economic contracts for the mere exchange of goods, such as delivery of raw materials in return for finished products, or purchase of equipment in return for products in the future ...Õ[64] The business co-operation contract under Vietnamese law would appear similar to a partnership in American law. The regulations provide, however, that each partner sustains responsibility Ôfor its own activitiesÕ.[65] This raises questions about the liability of each partner beyond its own activities.

The parties may freely negotiate the terms of the contract, which takes effect when the SCCI issues a licence.[66] Each partner can assign its interest in the contract after granting the other contracting parties an opportunity to acquire the interest. The other contracting parties and the SCCI must approve any assignment to a third party.[67] The assignment must contain conditions no more favourable than those offered to the other contracting parties.[68] Profits and losses are split among the parties to the contract in accordance with the agreement.[69] The parties must apply for extension of the contract at least six months prior to its expiration; the SCCI has discretion to approve or disapprove the extension, and it decides within 15 days of the application for extension.[70] The contract may terminate prior to its expiration if specified termination provisions occur or if the SCCI finds that Ôthe business activities of the parties breach the law or do not conform with the objectives and provisions stated in the business licenceÕ; in these circumstances, however, the

61 ÔOverview of Foreign Investment from 1987 to 1993Õ, VNA Hanoi, 4 May 1994, LEXIS, News Library, BBCSWB File (hereinafter ÔoverviewÕ).

62 See generally Iain Simpson, ÔChinese Bring Business to New Vietnam: Would-Be Refugees are Now ExportersÕ, *Financial Times*, 15 March 1994, at 9.

63 Regulations, *supra* note 36, at Article 8.

64 *Id* at Article 8.

65 *Id* at Article 17. Each partner sustains full liability for payment of taxes to the government. *Id*

66 *Id* at Article 12.

67 *Id* at Article 13.

68 *Id* at Article 13.

69 *Id* at Article 10.

70 *Id* at Article 14.

agreed dispute settlement mechanism remains in force.[71] The parties must submit a report on the results of the performance of the contract to the SCCI.[72] Liquidation follows the procedure specified in the contract and must occur within six months of the expiration of the contract (or one year if necessary).[73] Liquidation expenses receive top priority, followed in order by labor expenses, taxes, loans, and other liabilities.[74]

Joint ventures

Joint ventures represent the most popular form of foreign investment in Vietnam currently, constituting almost 90% of approved foreign investments.[75] Foreign investors gravitate toward this form of investment because of the need for access to the political, cultural, and business insights of a Vietnamese party.[76] A joint venture arises from a contract between a Vietnamese party or parties and a foreign party or parties (or, in special cases, from a treaty between governments) Ôfor the purpose of carrying out business activities in VietnamÕ.[77] The regulations stipulate that the Ôjoint venture shall be established as a limited liability company and shall have the status of a Vietnamese legal personÕ.[78] The joint ventureÕs status as a legal entity distinguishes it from the business co-operation contract, where no separate legal entity comes into being.

The law on companies, enacted after the law on foreign investment, sets out general characteristics for limited liability companies. Under Article 25 of the Law on Companies:

> ÔA limited liability company is a company in which: (1) Capital is contributed in full by all members when the company is established. All such contributed capital is expressly stated in the companyÕs charter. The company may not issue securities of any kind. (2) Transfers of part of contributed capital among the members may take place without restriction. Transfers of part of contributed capital to persons who are not members shall require unanimous approval from members who represent at least three quarters of the charter capital of the company.Õ[79]

71 *Id* at Article 15.

72 *Id* at Article 16.

73 *Id* at Article 18.

74 *Id.*.

75 ÔJoint Venture Merits in Doubt as SCCI Reviews PoliciesÕ, Saigon News Reader, 10 November 1993, at 2. The article expressed concern, though, about the extensive use of the joint venture for projects such as hotels and golf courses as opposed to infrastructural projects.

76 See generally Vecchi, *supra* note 51, at 9.

77 Regulations, *supra* note 36, at Article 19.

78 *Id.*

79 Law on Companies, note 39, at Article 25. The transfer provision apparently attempts to follow the Ôdouble majorityÕ requirement for assignment typical of limited liability company statutes in civil law countries.

The law on foreign investment, on the other hand, allows for capital contributions either in full or Ôby installments over a reasonable period agreed by the partiesÕ.[80] It presumably also bars any transfer of capital between the parties to the extent that the foreign party would end up with less than 30% of the contributed capital.[81] In addition, transfers to third parties require unanimous approval of the other parties and the approval of the SCCI.[82] Limited liability companies under the law on foreign investment, then, take on distinct characteristics from domestic limited liability companies under the law on companies.

The joint venture becomes a legal entity when the SCCI grants a licence and the local authorities register the charter of the joint venture.[83] Foreign partners must contribute at least 30% of the prescribed capital in a joint venture,[84] but the regulations permit a lower amount in Ôspecial casesÕ if the SCCI approves.[85] If the joint venture involves more than one foreign party, the 30% minimum applies to all foreign parties and the SCCI determines how much each party must contribute.[86] The law places no maximum limit on the contribution of a foreign party,[87] so the foreign party conceivably could contribute virtually all of the capital, thus making the Vietnamese partner purely nominal.

The foreign party may make its capital contribution in foreign currency, buildings, equipment, and patents and other technological processes.[88] The Vietnamese partner may make its capital contribution in Vietnamese currency, foreign currency, natural resources, buildings, building materials, land or water rights, equipment, and various intangible assets.[89] In practice, the Vietnamese usually contributes land to the joint venture as its capital contribution. If the Vietnamese party contributes assets other than land, except for residential houses the joint venture will have to rent land or any buildings affixed to the land.[90] The SCCI applies a fixed rate for land rental, although it

80 Regulations, *supra* note 36, at Article 28. The government, though, has reported that it revoked 129 of the 888 licences it had granted because of untimely capital contributions. Harish Mehta, ÔHanoi Cracks Down on Investment Licnece SpeculationÕ, Business Times, 19 March 1994, at 3.

81 The foreign party to a joint venture must contribute 30% of the joint ventureÕs capital. Law, *supra* note 28, at Article 8.

82 Regulations, *supra* note 36, at Article 30.

83 *Id* at Article 19. The details that the charter must contain vary little from the details that the contract must contain. See *id* at Articles 21-22.

84 Law, note 28, at Article 8. ÔPrescribed capitalÕ includes the initial capital as stated in the charter, excluding capital from loans. Regulations, note 36, at Article 2.

85 Regulations, *supra* note 36, at Article 27.

86 1990 Amendments, *supra* note 34, at Article 1(5).

87 Law, *supra* note 28, at Article 8.

88 *Id* at Article 7.

89 1992 Amendments, *supra* note 35, at Article 1(2).

90 Frederick Burke & David Howell, ÔVietnam: A Legal BriefÕ 207 (1993).

determines which rate applies and may grant an enterprise a lower rental rate in special circumstances.[91]

The regulations subject transfer of technology to the requirements of the technology transfer ordinance.[92] According to that ordinance:

> ÔThe transfer of technology into Vietnam shall be subject to the following requirements: (1) It shall enhance technological standards and production efficiency and improve the quality of products or be capable of developing new products. (2) It must not be detrimental to the safety of production. (3) It shall make rational use of energy, natural resources, and manpower. (4) It shall not adversely affect the environment.Ó[93]

The amended Law also states, ÔIn respect of important economic establishments determined by the Government, the parties shall agree gradually to increase the proportion of the Vietnamese partyÕs contribution to the prescribed capital of the joint venture enterprise.Ó[94] The regulations further specify that the joint venture partners may Ôagree upon the timing of and the rate at which the Vietnamese party shall increase the proportion of its capital contribution to the prescribed capital of the joint venture enterprise.Ó[95]

The crucial question surrounding capital contribution regards its valuation. The regulations state:

> ÔThe value of the capital contribution of each party shall be agreed by the parties, based on international market prices at the time the contribution is made.Ó[96]

This language, however, may prove misleading. In fact, the parties most likely will value capital contributions at the time they commit to the contribution, rather than at the time of the contribution itself.[97] Furthermore, the contribution of the Vietnamese party frequently will defy negotiation. The Vietnamese party often contributes land to the joint venture, and before it does, both the central government and the local peopleÕs committee must approve the use of the land as the capital contribution and value the land in question.[98]

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91 *Id*. See also Regulations on the Lease of Land, Water, and Sea Surfaces for Foreign Investment in Vietnam, Article 3 (1990), reprinted in Foreign Investment Law of Vietnam, *supra* note 35; Circular Guiding the Implementation of Regulations on Rent of Land, Water, and Sea Surface of Foreign Investment Projects (1993).

92 Regulations, *supra* note 36, at Article 60.

93 Ordinance on the Transfer of Foreign Technology into Vietnam, Article 4 (1988), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 35. See also Decree on the Transfer of Foreign Technology into Vietnam (1991), reprinted in Foreign Investment Laws of Vietnam, *supra* note 35.

94 1992 Amendments, *supra* note 35, at Article 1(3).

95 Regulations, *supra* note 36, at Article 27. See also, *id* Article 47 (for 100% foreign owned enterprises, if the SCCI finds the project of Ôeconomic importanceÕ, the investors must Ôconsent to a Vietnamese enterprise, on the basis of agreement, purchasing a share of the capital of the enterprise so as to have the result of converting it into a joint venture enterpriseÕ).

96 *Id* at Article 26.

97 Cohen, *supra* note 20, at 19.

98 See Circular Guiding the Implementation of Regulations on Rent of Land, Water and Sea Surface of Foreign Investment Projects (1993).

In addition, the SCCI will review the agreement between the parties and may force the parties Ôto reassess the attributed values of the prescribed capital.Ó[99] This aims at the common problem of foreign investors using outdated equipment as a capital contribution.[100]

The parties in a joint venture must select a Board of Management to manage the joint venture, which serves for no longer than five years.[101] Each party appoints members in proportion to its contribution to the declared capital, provided that each party has at least two members appointed to the Board.[102] If the joint venture has more than two parties, each party must have at least one member.[103] If the venture has only one Vietnamese party and more than one foreign party, however, the Vietnamese party must have at least two Board members.[104] Similar rules apply if the venture has only one foreign party and more than one Vietnamese party,[105] or if a pre-existing joint venture adds a new foreign party or parties.[106] The parties must unanimously approve a Chairman of the Board.[107]

The Board convenes at least once a year, or whenever the Chairman or two-thirds of the Board requests a meeting.[108] Two-thirds of the Board members must attend each Board meeting, but members may delegate attendance and voting power to representatives.[109] These quorum provisions raise two issues. First, if one party has more than two-thirds of the Board members it theoretically could hold meetings without the participation of the other party. Second, the regulations do not indicate whether non-Board members can serve as proxies or whether one person can proxy for several members. Board actions generally require two-thirds approval; the Board must unanimously approve long-term production and business plans, the budget, decisions to borrow, amendments of the charter, and appointment or dismissal of the Chairman of the Board, the general director, the first deputy general director, or the chief accountant.[110] In the event that Board members cannot reach a decision and Ôthe operation of the enterprise is adversely affectedÕ, the Board may dissolve the joint venture, ask the SCCI to settle the dispute, or appoint a Ôconciliatory councilÕ with an SCCI representative as chairman; the SCCI or conciliatory council decision would bind all parties.[111]

99 Regulations, *supra* note 36, at Article 26.

100 Ta Thi Xuan, ÔNot-so-Healthy Side-Effects Caused by Technology ImportsÕ, Saigon Times, 16-22 September 1993, at 10. The article estimates that Vietnam has lost up to $50 million as a result of overpricing, and also comments on the ecological impact of the older equipment.

101 Regulations, *supra* note 36, at Article 31.

102 Law, *supra* note 28, at Article 12; 1990 Amendments, *supra* note 34, at Article 1(6).

103 *Id.*

104 *Id.*

105 *Id.*

106 Regulations, *supra* note 36, at Article 31.

107 Law, *supra* note 28, at Article 12.

108 Regulations, *supra* note 36, at Article 32.

109 *Id.*

110 *Id.*at Article 23.

111 *Id.*

The Board chooses a general director and deputy general director to run the daily operations of the joint venture.[112] Either the general director or the first deputy general director Ôshall be a Vietnamese citizen residing in Vietnam and working for the Vietnamese joint venture party.Ó[113] The general directorÕs orders take precedence over the first deputy general director, but the first deputy general directorÕs opinion Ôshall be preserved and submitted to the board of management, and decided upon at the next meetingÕ, and the first deputy general director may propose a special board meeting.[114] The general director and first deputy general director remain liable to the Board for their actions, but the regulations do not say whether they also incur liability to third parties.[115]

Members of the company receive the right to ownership of an undivided part of the companyÕs assets in proportion to capital contribution and the right to earn profits and bear losses in proportion to capital contribution.[116] As a limited liability company, each partyÕs liability remains limited to its capital contribution.[117]

The joint venture must maintain accounting records that conform with Ôconventional international principles and standardsÕ and remain subject to SCCI review.[118] The joint venture must submit annually to the SCCI a balance sheet of the capital of the joint venture, a profit and loss account of expenditures and receipts, and a report by the Board of the activities and results of the joint venture.[119]

Likewise, the SCCI retains control over the transfer of interests to third parties. Parties can assign joint venture interests after providing the other parties with an opportunity to acquire the interest, but the conditions of any assignment to a third party must not contain more favourable terms than the terms offered to the other parties.[120] The Board and the SCCI must unanimously approve any assignment.[121] The SCCI also must approve any amendment to the contract or charter that the parties agree to.[122]

A joint venture may dissolve prior to its expiration date if a force majeure clause applies, a party fails to discharge its obligation and makes continuation of operations impossible, losses prevent continuation of operations, or other

112 *Id* at Article 34.

113 *Id.*

114 *Id.*

115 *Id.*

116 Law, *supra* note 28, at Article 10.

117 *Id.*

118 *Id* at Article 18.

119 Burke & Howell, *supra* note 90, at 185-86.

120 Regulations, *supra* note 36, at Article 30.

121 *Id.*

122 *Id at* Article 25.

causes set out in the contract occur.[123] In all cases, the Board and the SCCI must approve the dissolution.[124] If dissolution results from default of one of the parties, that party must indemnify the losses of the other parties.[125] The SCCI may also dissolve the joint venture prior to its expiration if it determines that the joint ventureÕs activities Ôbreach the law or deviate from the objectives and responsibilities stated in its charter and investment licenceÕ.[126]

When the parties decide to dissolve or six months prior to expiration of the licence, the Board must appoint a liquidation commission.[127] This commission must liquidate the joint venture within six months, or one year if necessary.[128] Liquidation expenses receive top priority, followed by labour expenses, taxes, loans, and other liabilities.[129] The SCCI may form a separate liquidation commission if the parties do not do so.[130] It may also liquidate the venture if a dispute arises over the liquidation of the joint venture.[131]

Enterprises with 100% foreign-owned capital

Under this form, a foreign party owns all of the enterpriseÕs capital.[132] This form has proven less popular than the other forms of foreign investment, in part because the foreign party prefers to have a local partner and in part because the SCCI has not viewed this form favourably. By the end of 1991, the SCCI had licenced only 11 enterprises with 100% foreign-owned capital.[133] Investors in Export Processing Zones, however, have increasingly turned to this form.[134]

Enterprises with 100% foreign-owned capital must take the form of limited liability companies.[135] Most of the requirements resemble those for joint ventures. The enterpriseÕs prescribed capital must constitute at least 30% of its invested capital.[136] The enterprise must also appoint a representative residing in Vietnam, who must register with the SCCI.[137]

123 *Id* at Article 37.

124 *Id* at Article 38.

125 *Id* at Article 37.

126 *Id* at Article 38.

127 *Id* at Article 39.

128 *Id*.

129 *Id*.

130 *Id* at Article 40.

131 *Id* at Article 42.

132 Law, *supra* note 28, at Article 2(11).

133 Burke & Howell, *supra* note 90, at 186.

134 *Id*.

135 Regulations, *supra* note 36, at Article 44.

136 *Id* at Article 47.

137 *Id* at Article 51.

Export processing zones

The law on foreign investment allows foreign organisations and individuals to invest in Export Processing Zones using any of the previous forms of organisation.[138] A separate set of regulations governs the operation of Export Processing Zones. They authorise Ô[p]roduction, processing, and assembly of export productsÕ and Ô[p]roviding services in relation to the above activities and to exportÕ.[139] The SCCI delegates authority over the zones, including the granting of licences, to a Ômanagement committeeÕ,[140] appointed by the Chairman of the Council of Ministers and the chairman of the local peopleÕs committee.[141] Enterprises must give priority to Vietnamese employees, but may freely advertise for employees without first using the Labour Office.[142] They may pay any wages agreed to by the employer and employee.[143]

Export processing enterprises receive substantial financial incentives. Enterprises involved with production receive a four-year exemption from payment of profits tax and pay 10% afterward.[144] Enterprises involved with services receive a two-year exemption and pay 15% afterward.[145] All enterprises pay a 5% tax on the repatriation of profits.[146] They also do not have to pay export or import duties on goods imported from or exported to a foreign country or another Export Processing Zone.[147]

To date, only one Export Processing Zone has come into operation, although others remain under construction.[148] Construction difficulties and the lack of a sufficient legal framework have inhibited further development of the zones.[149] Use of Export Processing Zones may represent a temporary development until Vietnam liberalises its general trade policies.[150]

Build-operate-transfer contracts

Under this form, a foreign organisation or individual, using its own capital or capital of a Vietnamese party, contracts to build an infrastructural project, and then transfers the project to the government for no compensation after

138 1992 Amendments, *supra* note 35, at Article 1(7).

139 Regulations on Special Export Processing Zones in Vietnam, Article 4 (1991), reprinted in ÔForeign Investment Laws of VietnamÕ, note 35.

140 Regulations, note 36, at Article 57.

141 *Id at* Article 58.

142 *Id at* Article 31. See Part III.E for the general rules pertaining to the labour of foreign enterprises.

143 *Id at* Article 32.

144 *Id* at Article 51.

145 *Id*.

146 *Id* at Article 54.

147 *Id* at Articles 40, 52.

148 Nguyen Van Phu, ÔNew Export Zone Prompts WarningÕ, Vietnam Investment Rev, 14 March 1994, at 1.

149 *Id*.

150 ÔVietnamÕs Transition to a Market EconomyÕ, (pt 3), East Asian Executive Rep, 15 February 1994, at 8 (World Bank report analysing VietnamÕs Export Processing Zones in light of the experience of other countries).

recovering invested capital and making Ôa reasonable profitÕ on the transaction.[151] Currently, 17 projects of this sort exist, with total investment capital of $926 million.[152]

The government has specified many incentives it intends to apply to this form of enterprise. These include exemption from land rent, profit and repatriation taxes at the highest priority rates, turnover taxes either exempted or at the highest priority rate, and import tax exemption for goods imported for the project.[153]

Representative offices

Foreign parties wishing to establish a presence in Vietnam but who do not have business to directly engage in may establish a representative office in Vietnam for Ôformulation of co-operation with Vietnamese partiesÕ or Ôformulation on a long-term basis of commercial contractsÕ.[154] Foreign lawyers working in Vietnam use representative offices as well.[155] The office cannot provide foreign currency services or export or import goods.[156] Parties submit applications to the Ministry of Commerce.[157] The Ministry of Commerce will grant a licence to potential investors only if they Ôintend in good faith to proceed with the negotiation or implementation of any investment projectÕ and prescribed capital exceeds $2 million.[158] For investment projects, the licence for the representative office cannot last for longer than one year.[159] The foreign party must also register the representative office with the local peopleÕs committee.[160] The foreign party must pay a $5,000 registration fee, plus $2,000 for any branch offices and $3,000 if the party wishes to renew the licence.[161]

Approval procedure

Potential foreign enterprises must submit various documents to the SCCI for consideration before the SCCI will grant the enterprise a licence. Parties to a

151 1992 Amendments, *supra* note 34, at Article 1(1) (defining the concept); Regulations, *supra* note 35, at Article 55.

152 ÔGovernment of Vietnam Facilities Implementation of BOT Projects by InvestorsÕ, Vietnam Investment Rev, 7 March 1994 (hereinafter ÔBOT projectsÕ).

153 *Id.*

154 Regulations on Representative Offices of Foreign Economic Organisations, Article 2 (1990), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 35 (hereinafter ÔRegulations on Representative OfficesÕ).

155 See generally Harish Mehta, ÔForeign Lawyers Cope with Uncertainties in VietnamÕ, Business Times, 19 May 1994, at 13.

156 Regulations on Representative Offices, *supra* note 154, at Article 2.

157 *Id* at Article 4.

158 Circular on Representative Offices, ¤ 2 (1991), reprinted in ÔForeign Investment Laws of VietnamÕ, note 35.

159 *Id.*

160 Regulations on Representative Offices, note 154, at Article 8.

161 Burke & Howell, note 90, at 189.

business co-operation contract must submit the proposed contract, information relating to legal status and financial capacity, and the Ôeconomic-technical statement of the contractÕ.[162] An application for a joint venture must include the proposed contract, the charter, information relating to legal status and financial capacity, and a feasibility study.[163] An application for an enterprise with 100% foreign invested capital must include the charter, information relating to legal status and financial capacity, and a feasibility study.[164] Parties must also submit an application fee of 0.01% of the invested capital of the enterprise (but no less than $50 and no more than $10,000).[165] If the parties do not know the amount of invested or contributed capital, they must pay $10,000 until the SCCI determines the proper amount.[166]

The application will receive review by the local peopleÕs committee if the peopleÕs committee serves as the Vietnamese partner or the supervisory agency. If an agency of the central government serves as the supervisory authority, the central government evaluates the application.[167]

The extent of review of an application depends on the scope and type of the project. The most important projects, ÔGroup A projectsÕ, require approval by the Chairman of the Council of Ministers after review by the National Council for Project Evaluation, chaired by the chairman of the State Planning Committee and made up of various government ministers.[168] Group A projects include: projects over $20 million in Ôexploitation or processing of precious or rare mineral resources; telecommunications, broadcasting, television, and publishing; marine, aviation, and railway transport and, construction of sea ports, airports, railways, and national highways; production of pharmaceutical products, poisons, and explosives; real estate business, finance, and banking; projects related to defence and security; and export and import business and international tourismÕ; projects over $40 million in Ôheavy industryÕ; projects over $30 million in other areas; and projects Ôwhich require a large area of land and will significantly affect environmentÕ.[169] ÔGroup B projectsÕ require approval by the Chairman of the

162 Regulations, note 36, at Article 9.

163 *Id* at Article 20.

164 *Id* at Article 46.

165 Circular on the Collection of Application Fees Paid in Respect of Foreign Owned Capital, ¤ II (1989), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 34 (hereinafter ÔCircular on Application FeesÕ). Invested capital includes all of the capital employed in the enterprise, including prescribed capital and loan capital. Regulations, *supra* note 36, at Article 2.

166 Circular on Application Fees, *supra* note 165, ¤ II.

167 Sesto E Vecchi, ÔForeign Investment in Vietnam: Application ProceduresÕ, East Asian Executive Rep, 15 September 1992, at 18.

168 Regulations on Evaluation of Projects With Foreign Owned Capital, Article 6 (1991), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 35.

169 *Id* at Article 4.

Council of Ministers after review by the SCCI and the Chairman of the National Council for Project Evaluation, and include projects in the specified industries of any value, projects over $30 million in heavy industry, and other projects over $20 million.[170] All other projects become ÔGroup C projectsÕ and receive review by the SCCI;[171] the SCCI obtains recommendations from various government agencies regarding the application.[172]

The Chairman of the Council of Ministers must reach a decision within 115 days of submission of the application for Group A projects and within 105 days for Group B projects.[173] No time limit exists for Group C projects, but decisions usually occur more quickly.[174]

The government approves build-operate-transfer projects through open bidding, selective bidding, or direct negotiation with foreign investors.[175]

Labour

Foreign investors must conform their operations to Vietnamese labour law and regulations.[176] The labour law only allows a foreign venture to directly recruit employees after the venture attempts to obtain employees through the Labour Office or the service company appointed by the Labour Office.[177] This dismays foreign investors, because the service companies routinely charge several times the monthly wage the Vietnamese worker actually will receive.[178] The law also requires foreign enterprises to employ Vietnamese citizens unless only foreign workers possess the requisite skills, in which case the foreign enterprise must train Vietnamese workers to replace the foreign employees as soon as possible.[179]

The law establishes a minimum wage of $35 per month for workers in Hanoi and Ho Chi Minh City and $30 per month for workers elsewhere, a rate higher than that for Indonesia and Bangladesh, two of VietnamÕs competitors

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170 *Id* at Article 4.

171 *Id.*

172 Vecchi, *supra* note 167, at 18.

173 *Id.*

174 *Id.*

175 ÔBOT ProjectsÕ, *supra* note 152.

176 Regulations, *supra* note 36, at Article 65.

177 Regulations on Labour for Enterprises with Foreign Owned Capital, Article 3 (1990), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 35 (hereinafter ÔLabour RegulationsÕ). But see *supra* text accompanying note 142 (enterprises in Export Processing Zones may recruit freely).

178 Burke & Howell, *supra* note 90, at 209-10.

179 Labour Regulations, *supra* note 177, at Article 5.

for foreign investment.[180] This wage does not apply in Export Processing Zones.[181] The worker must pay 10% of this wage to the general social welfare fund for unemployment and retirement. The company must pay an additional amount equivalent to 2% of the wage to the general social welfare fund. It must also pay 8% of the wage to a company-specific social welfare fund to cover employeesÕ sick leave, maternity leave, and medical expenses.[182]

The foreign enterprise must negotiate a collective labour agreement with the workersÕ representative or trade union every one to three years.[183] A labour code under consideration would require any joint venture or enterprise with 100% foreign-owned capital with 11 or more workers to set up a trade union.[184] The proposed code also would authorise strikes by workers in foreign enterprises;[185] strikes have occurred with increasing frequency recently,[186] as workers have become disgruntled with companies allegedly paying wages below the official minimum and requiring longer hours.[187] The growing unrest of the labour market, however, has begun to concern potential investors,[188] so, to reassure investors, the proposed code would keep the minimum wage at $35 per month rather than raise it to $50 as trade unions had hoped.[189]

Taxation of foreign investors

The tax structure for foreign investors in Vietnam comes from the foreign investment law and various other statutes. The taxes apply both to foreign investors and overseas Vietnamese investing in Vietnam, although overseas Vietnamese apparently have eligibility for a profit tax reduction, a lower remittance tax, and more extensive tax exemptions.[190]

180 Burke & Howell, *supra* note 90, at 211.

181 *Id.*

182 Labour Regulations, *supra* note 177, at Article 46.

183 *Id* at Article 26.

184 Dana Sachs, ÔVietnam: Labour LawsÕ, Vietnam Investment Rev, 22 November 1993.

185 Robert Templer, ÔÒRight-to-StrikeÓ Law to Dominate Vietnam Parliament SessionÕ Agence France Presse, 25 May 1994, available in LEXIS, News Library, Curnws File. If the strike involves a Vietnamese state enterprise, however, workers could only strike if doing so would not affect the general interest of society, ÔRight to Strike in New Vietnam Labour codeÕ, Reuters, 24 May 1994, LEXIS, News Library, Curnws File.

186 Eleven strikes occurred in Ho Chi Minh City alone in the first two months of 1994, compared to 17 strikes in the entire country in 1993. John Rogers, ÔLabour Investment Top Vietnam Asssembly AgendaÕ, Reuter Asia-Pacific Business Report, 25 May 1994, LEXIS, News Library, Curnws File.

187 Sachs, *supra* note 184.

188 Richard Wunderman, ÔVietnam: What does 1994 Hold for VietnamÕs Economy?Õ Vietnam Investment Rev, 7 February 1994.

189 Rogers, *supra* note 186.

190 Michael J Scown, ÔTaxation in VietnamÕ East Asian Executive Rep, 15 June 1993, at 8 (hereinafter ÔTaxationÕ); Michael J Scown, ÔCorporate Tax ChangesÕ, East Asian Executive Rep, 15 October 1993, at 8. See notes 59-60 and accompanying text for a discussion of incentives for overseas Vietnamese.

The regulations establish a basic Ôprofits tax at the rate of 25% of the profits earned, except in cases which are within the incentive category....Õ[191] The regulations set up several incentive categories. Projects at the 25% rate may receive a one-year exemption from taxation in the first year after it makes profits and a 50% exemption in the two subsequent years.[192] A project may receive a 20% rate, a full exemption for two years after making profits, and a 50% exemption for the three subsequent years if it has two of the following characteristics: 500 or more workers; use of advanced technology; export of 80% of its products; or legal or contributed capital over $10 million.[193] Projects of infrastructural construction, projects exploiting natural resources, heavy industry, Ôcultivation of perennial industrial crops,Õ projects in disfavored geographical regions, and projects transferring property without compensation to Vietnam upon completion may receive a 15% rate, a full exemption for two years after it makes profits, and a 50% exemption for the four subsequent years.[194] Finally, projects developing infrastructure in disfavored regions, projects of ÔreaforestationÕ, or projects of Ôspecial significanceÕ may receive a 10% rate, a full exemption for four years after it makes profits, and a 50% exemption for the four subsequent years.[195] The exemption periods of longer than two years in the 1993 regulations contradict the 1987 Law, which only authorizes two years of full exemptions and two years of a 50% exemption beyond that.[196] The Ministry of Finance has proposed legislation to correct this inconsistency.[197]

For purposes of calculating profits for taxation of enterprises with foreign-owned capital, revenue includes revenue from sales of products, provision of services, and other revenue.[198] Expenditures subtracted to determine taxable profits include cost of raw materials, wages, depreciation, patent costs and related fees, management expenses, taxes paid, interest on loans, marketing and service expenses, social insurance fund payments, insurance costs, losses brought forward from previous years, and other expenditures not exceeding 5% of total expenditures.[199] The taxation office reviews all claims in this respect.[200] For business co-operation contracts, the SCCI determines the method for calculating profits.[201]

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191 Regulations, *supra* note 36, at Article 66. ÔIn relation to the exploitation of oil and gas and a number of other rare and precious natural resources the profits tax rate applicable shall be determined on a case by case basis ... but shall be no less than 25% of the profits earned.Õ In other words, taxes for these investments will exceed those for other projects.

192 *Id at* Article 69(1).

193 *Id* at Articles 67(1), 69(2).

194 *Id* at Articles 67(2), 69(3).

195 *Id* at Articles 67(3), 69(4). Hotel, banking, finance, insurance, accounting, and auditing and commercial services projects do not qualify for these incentives. *Id* at Articles 68, 69(5).

196 Law, *supra* note 28, at Article 27.

197 ÔVietnam: Finance Ministry Proposes Tax CutsÕ, Vietnam Investment Rev, 4 April 1994.

198 Regulations, *supra* note 36, at Article 74.

199 *Id*.

200 *Id*.

201 *Id* at Article 75. The Ministry of Finance establishes this method in its Circular on Taxation of Foreign Investment in Vietnam (1993), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 34.

Foreign investors may obtain various other financial incentives. The law allows enterprises to carry over losses for up to five years.[202] Projects may also receive a refund of taxes paid on profits reinvested into capital.[203] An enterprise may depreciate assets using any acceptable accounting method.[204] An export processing enterprise will not have to pay export duties, which range from 0% to 35% for products receiving the ÔminimumÕ rate (products when a treaty applies) and from 0% to 45% for products receiving the ÔregularÕ rate,[205] on goods exported from the Export Processing Zone.[206] If an export processing enterprise imports goods into the Export Processing Zone, it will not have to pay import duties,[207] which range from 0% to 80% for minimum rate goods and from 0% to 100% for regular rate goods.[208] Other enterprises gain eligibility for exemption from import duties if the products relate to capital construction, production of export goods, or legal capital in the form of intellectual property.[209]

The law permits foreign investors to repatriate:

1. profit shares;
2. Ôany payments due as a result of provision of technology or servicesÕ;
3. principal and interest of loans;
4. invested capital; and
5. Ô[o]ther sums of money and assets lawfully owned by themÕ.[210]

Organisations or individuals who repatriate profits become subject to a withholding tax; if capital contributions exceed 50% of legal capital or invested capital exceeds $10 million, the investor must pay 5% of repatriated money; if invested capital exceeds $5 million, the rate climbs to 7%, and other investors must pay 10%.[211] The repatriation tax only applies to profits; individuals receiving income must pay income taxes.[212]

202 Law, *supra* note 28, at Article 27.

203 Regulations, *supra* note 36, at Article 72.

204 See Scown, ÔTaxationÕ, *supra* note 190, at 8.

205 *Id.*

206 1992 Amendments, *supra* note 35, at Article 1(10).

207 *Id.*

208 See Scown, ÔTaxationÕ, *supra* note 190, at 8.

209 Regulations, *supra* note 36, at Article 76.

210 Law, *supra* note 28, at Article 22.

211 Regulations, *supra* note 36, at Article 70. Overseas Vietnamese now must pay only 5% regardless of capital contribution, See *supra* note 59.

212 Law, *supra* note 28, at Article 23; Regulations, *supra* note 36, at Article 78. Income includes Ôirregular incomeÕ, such as income derived from the transfer of technology and service-generated income over a specified threshold; this type of income receives a lower rate. Scown, ÔTaxationÕ, *supra* note 190, at 8.

Companies also must pay a Ôturnover taxÕ, or a sales tax on enterprises with foreign-owned capital that sell certain products or services in Vietnam. The tax is calculated by multiplying the gross revenue by a tax rate set by the item or service category (these rates vary widely).[213]

Foreign investors must also pay royalties for the use of natural resources, including minerals, food, and marine products.[214] Rates range from 1% to 40%.[215] Resources contributed by a Vietnamese party remain exempt from the royalty.[216]

Duration

The parties to a business co-operation contract determine the duration of the contract, provided the SCCI approves.[217] The SCCI will likely require an appropriate durational limit before it will approve a project.[218]

Vietnam has expanded the potential duration of other foreign enterprises. Originally, an enterprise could not exist for longer than 20 years unless it received special approval.[219] The 1992 amendments extended the maximum period to 50 years, or 70 years in special cases approved by the government.[220] In practice, the duration of the enterprise will correspond to the duration of the lease of land used by the enterprise.

The SCCI will only grant a 50-year licence to large industrial or infrastructural projects; other projects will receive a licence of 20 to 40 years.[221] The regulations also empower the government to revoke licences of any foreign enterprise before expiration if the government finds a violation of the law or a deviation from the terms of the licence.[222] Indeed, the SCCI has revoked a large number of approved licences under these provisions.[223]

213 Scown, ÔTaxationÕ, *supra* note 190, at 8.

214 Ordinance on Royalties, Article 2 (1990), reprinted in ÔForeign Investment Laws of VietnamÕ, *supra* note 35.

215 *Id* at Article 6.

216 *Id* at Article 3.

217 Regulations, *supra* note 36, at Article 8.

218 Cohen, *supra* note 20, at 15.

219 Law, *supra* note 28, at Article 15.

220 1992 Amendments, *supra* note 35, at Article 1(5).

221 Nguyen Xuan Trinh, ÔVietnam: Factors Affecting the Duration of Foreign EnterprisesÕ, Vietnam Investment Rev, 17 January 1994.

222 Regulations, *supra* note 36, at Article 15 (government can revoke licence of business cooperation contract if Ôthe business activities of the parties breach the law or do not conform with the objectives and provisions stated in the business licenceÕ); *id* at Article 28 (government can revoke licence of joint venture if Ôthe joint venture parties fail, without reasonable cause, to comply with the timing for making contributions to the prescribed capitalÕ); *id* at Article 38 (government can revoke licence of joint venture if its activities Ôbreach the law or deviate from the objectives and responsibilities stated in its charter and investment licenceÕ); *id* at Article 52 (government can revoke license of a 100% foreign owned enterprise if its activities Ôbreach the law or deviate from the objectives and responsibilities as stated in the charter of the enterprise and the investment licenceÕ).

223 The government reported that it has revoked 129 of the 888 licences it had granted through March 7, 1994 because the investors had not implemented the projects within six months, as required. Mehta, *supra* note 80, at 3.

Dispute settlement

The 1987 law encourages amicable settlement through negotiation of any dispute between the parties.[224] The unanimity requirement for joint venture decisions represents a potential cause of frequent conflict. A recent decree emphasises the alternatives set out elsewhere in the regulations as the means of resolving these disputes.[225] Some observers in the government-controlled press have suggested granting more enforcement powers to the SCCI in order to break deadlocks.[226]

If negotiation fails, the parties may refer their dispute to a Vietnamese economic arbitration body, an arbitration body of a third country, an international arbitration body, or a council established pursuant to agreement between the parties.[227] If the dispute involves a Vietnamese economic organisation, however, the law of Vietnam applies and the dispute must go before a Vietnamese body.[228] If the dispute involves ÔState bodiesÕ of Vietnam, the parties must refer the dispute Ôto a competent State body.Õ[229]

Lacking a suitable role model, Vietnam has struggled to determine the role of law in its transition period to a market economy.[230] Vietnam has not yet become a party to the primary international arbitration treaties, so even if parties choose an international forum, they risk domestic non-enforcement of international arbitration decisions.[231] Domestically, parties filed 50 disputes in Ho Chi Minh City in 1992 for arbitration, but resolved them all before arbitration, at least partially because courts might not enforce arbitration decisions.[232]

Other laws

Investors have regularly complained that the provisions of the law on foreign investment mean little absent a system of laws to guarantee the rights of foreign investors.[233] In a continuing attempt to satisfy these concerns, Vietnam has passed a flurry of legislation in recent years to supplement the law on foreign investment.

224 Law, *supra* note 28, at Article 25.

225 See *supra* note 111 and accompanying text.

226 Phap Luat, 22 February 1994, at 5.

227 Regulations, *supra* note 36, at Article 100.

228 *Id at* Article 101.

229 *Id* at Article 102.

230 Mark Sidel, ÔLaw Reform in Vietnam: The Complex Transition from Socialism and Soviet Models in Legal Scholarship and TrainingÕ, 11 Pac Basin LJ 221, 225-26 (1993).

231 Transition pt 1, *supra* note 15, at 9.

232 Marcus W Brauchli, ÔAs US Firms Seek Access to Vietnam, Investors There Encounter ObstaclesÕ, Wall St J, 7 April 1993, at A10.

233 Indeed, the foreign investment law itself stood on shaky ground until Vietnam amended its constitution to protect the rights of investors, note 33 and accompanying text.

The law on private enterprises[234] and the law on companies[235] authorise three forms of private business organisations Ð the Ôprivate enterpriseÕ, with capital matching or exceeding legal capital and owned by an individual personally liable for its activities, the limited liability company, and the Ôshareholding companyÕ, where shareholders make capital contributions in the form of equal shares. The state guarantees to these businesses the right to long-term existence, the ability to exercise business discretion under the law, the right to own the means of production, the ability to inherit capital and assets, and the other legal rights of the owners.[236] More specifically, the businesses have the right to select the areas and size of business, choose the form and method of raising capital, select customers and enter transactions with them, recruit and hire labour, use foreign currency, make decisions regarding the use of remaining revenue, and take initiatives in the business activities.[237]

The Ordinance on Economic Contracts[238] sets out many provisions governing business agreements, and explicitly covers economic contracts between Vietnamese legal entities and foreign organisations and individuals.[239] The ordinance gives a legal entity and an individual with business registration the right to enter into an economic contract.[240] The state has the duty to protect the legal rights and interests of the parties as stated in the contract.[241]

The law on petroleum[242] establishes a specific set of rules governing production sharing contracts and joint ventures involving oil and gas operations. Petroleum contracts cannot last for longer than 25 years, or 30 years in the case of deep sea exploration, with five-year extensions at the discretion of the government.[243] PetroVietnam, VietnamÕs national oil company, has the right to participate in a contract and has priority status regarding any assignment of interest.[244] The law also sets out an extensive tax regime.[245]

234 Law on private enterprises, *supra* note 39.

235 Law on companies, *supra* note 39.

236 Law on private enterprises, note 39, at Articles 3-4; Law on companies, *supra* note 39, at Articles 4-5.

237 Law on private enterprises, note 39, at Article 22; Law on companies, *supra* note 39, at Article 12.

238 Ordinance on Economic Contracts (1989), *supra* note 35.

239 *Id* at Article 43.

240 *Id* at Article 2.

241 *Id* at Article 6.

242 Law on petroleum (1993).

243 See Vietnamese Law on Petroleum, Saigon Times, 12-18 August 1993, at 25.

244 *Id*.

245 See Vietnamese Law on Petroleum, Saigon Times, 19-25 August 1993, at 24.

The law on land, in keeping with the ideological orientation of the government, does not provide for private ownership of land.[246] Furthermore, aside from residential houses, the law does not affirm a right of ownership of other buildings attached to the property. This has concerned foreign investors, who have unsuccessfully sought to purchase buildings.[247] The land law, however, does give parties Ôthe right to exchange, transfer, rent, inherit, or mortgage the right to use land allocated by the stateÕ.[248] The government must approve any transfer or assignment of land rights.[249]

Vietnam recently passed a bankruptcy law, which takes effect on 1 July 1994, delineating the rights of the bankrupt and of creditors.[250] The law permits both ÔvoluntaryÕ and ÔinvoluntaryÕ requests for declarations of bankruptcy. If an enterprise becomes insolvent, the enterprise may file a petition on its own behalf for bankruptcy.[251] Secured or partially secured creditors may also file a request if they send a debt claim to an enterprise and do not receive payment within 30 days. Trade unions or employee representatives may request a bankruptcy declaration if an enterprise does not pay employee salaries for three months (other countries typically make the time period 60 days), provided that they have not accepted partial payments.[252]

The bankruptcy law emphasises reorganisation over bankruptcy by liquidation. When a judge decides to process the bankruptcy request, the enterprise must immediately present reconciliation and reorganisation plans. The reconciliation process includes a creditorsÕ meeting, which must include two-thirds of the total unsecured debt of the enterprise. Half of the creditors must approve any decision reached at this meeting, so that the largest creditors cannot dominate the meeting.[253] Article 36 states that judges may grant bankruptcy if one of the following six criteria exist:

1. the owner did not have a valid reconciliation or reorganisation plan;
2. the owner or legal representative did not comply with the reconciliation or reorganisation plan;
3. the creditorsÕ meeting did not approve the reconciliation or reorganisation plan;

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246 Law on land, Article 1 (1993), reprinted in ÔForeign Investment Laws of VietnamÕ, See Vietnamese Law on Petroleum,note 35.

247 Burke & Howell, *supra* note 90, at 206.

248 Law on land, *supra* note 246, at Article 3.

249 *Id at* Article 76.

250 The new bankruptcy law covers both domestic and foreign enterprises. See Le Dang Doanh, ÔBankruptcy Law Shores Up Market EconomyÕ, Vietnam Investment Rev, 21 February 1994, at 14; Le Dang Doanh, ÔBankruptcy Law Needs a Further Six Months of Ground WorkÕ, Vietnam Investment Rev, 28 February 1994, at 12.

251 *Id*.

252 *Id*.

253 *Id*.

4. the enterprise remained inefficient after reorganisation and the creditors request bankruptcy;
5. reorganisation resulted in a serious breach of the creditorsÕ meeting agreement and the creditors request bankruptcy; or
6. the owner died or fled during the resolution period and either the inheritor refused to comply or no inheritor existed.[254]

Article 39 lists the priorities for debt repayment from the enterpriseÕs remaining assets:

1. bankruptcy fees and expenses;
2. labour liabilities;
3. tax liabilities; and
4. debts to listed creditors, proportionally.[255]

Appraisal of investment climate

Foreign investment has become the single most important element of the Communist PartyÕs new economic strategy. As mentioned earlier, the party now seeks to Ômobilise every means and use every form to attract foreign capital ...Õ.[256] In order to implement this approach, the government has taken a U-turn from isolation to total openness, and has gone to any lengths to please foreign investors.

The governmentÕs openness to foreign investment has contributed to the economyÕs success in recent years. Through the end of 1993, Vietnam had granted licences to 820 foreign enterprises with estimated capital of over $7 billion.[257] The number has increased sharply each succeeding year, and should grow even more quickly with the lifting of the US embargo. The government estimated that through March 1994 joint ventures had produced goods and services worth $780 million, created almost 50,000 jobs, and paid $211 million to the government.[258] The increase in foreign investment also has helped Vietnam grow at a brisk pace in the last several years, while inflation has dropped significantly.[259] VietnamÕs ability to have companies implement their investment plans, though, has not matched pace. Although Vietnam had approved almost $5 billion in foreign direct investment through

254 *Id.*

255 *Id.*

256 Tap Chi Cong San, *supra* note 26, at 9.

257 See note 5.

258 See *supra* note 61.

259 ÔVietnam Plans Economic DevelopmentÕ, BNA IntÕl Bus & Fin Daily, 23 May 1994, LEXIS, News Library, Curnws File (hereinafter ÕPlansÕ) (quoting statistics provided by Vice Prime Minister Tran Duc Luong).

1992,[260] only $900 million of non-oil investment had received implementation, resulting in a 20% rate of total implementation to total approved investment.[261] VietnamÕs foreign investment law requires implementation within six months of approval of the licence, but only 25 to 30% of approved projects receive implementation within one year of approval.[262] VietnamÕs economic needs should result in a sustained effort to secure foreign investment. The government wants to increase VietnamÕs per capita GNP, currently at approximately $200, to $500 by 2000,[263] and projects that it will need $26 billion in additional foreign investment in order to achieve that goal.[264]

The general investment climate of the country will prove more crucial to success in attracting foreign investment than the incentives set out in the laws themselves.[265] A favourable investment climate requires more than a set of liberal laws. Many serious impediments still block the creation of a genuinely favourable investment climate in Vietnam. Frequently cited impediments include the lack of infrastructural and educational development, the inadequacy of the legal system, cumbersome investment procedures, and widespread corruption. The maintenance of a one-party political system dedicated to socialism, however, may represent the most significant obstacle to a fully vibrant market economy.

VietnamÕs current structural weaknesses limit the potential for successful investment. The country encounters chronic power shortages and its water supply cannot meet the needs of many investors.[266] The countryÕs infrastructure desperately needs rebuilding after several years of neglect; the problems will worsen with time and the rate of growth will slow as a result unless the country invests more in infrastructure.[267] Vietnam has made a concerted effort to improve the nationÕs infrastructure, and has obtained substantial loans for purposes of infrastructural improvement.[268] Development of an adequate infrastructure, however, will take years.

260 By March 1994, this figure had increased to $8.5 billion, from 895 licensed projects, Overview, *supra* note 61.

261 Transition, pt 1, note 15, at 9. Although many developing countries experience low percentages of implementation, VietnamÕs rate still leaves much room for improvement. See Harish Mehta, ÔDeal with Vietnam Without the ÔDragonÓ LabelÕ, Bus Times, 28 April 1994, at 15. The implementation rate should improve as companies hesitant to commence operations in the face of the US embargo start up. See ÔPledges of Foreign Investment in Vietnam Up 29%Õ, Agence France Presse, June 12, 1994, LEXIS, News Library, Curnws File.

262 Transition pt 1, *supra* note 15, at 9.

263 Kahn, *supra* note 24, at 1D.

264 See ÔPlansÕ, *supra* note 259. The government also seeks $26 billion in domestic investment, a quite ambitious goal; note 26 and accompanying text for an official acknowledgement of the limits on attracting domestic investment.

265 Transition pt 1, *supra* note 15, at 9.

266 *Id.*

267 ÔVietnamÕs Transition to a Market EconomyÕ (pt 2), East Asian Executive Rep, 15 January 1994, at 8 (hereinafter ÔTransition, pt 2Õ).

268 The World Bank pledged $1.86 billion in aid for 1994, with total disbursements expected to reach $700 million. Shada Islam, ÔWelcome BackÕ, Far Eastern Econ Rev, 25 November 1993. Vietnam also has turned to build-operate-transfer projects for infrastructural development, See *supra* part III.C.5.

In addition to infrastructural difficulties, the educational system also faces decline, as Vietnam now charges for services provided for free before Ôdoi moiÕ. As a result, more children drop out and teachers move to better-paying jobs in the private sector.[269] A poor educational system threatens to exacerbate the nationÕs lack of management skills, already termed the countryÕs greatest deficiency by some observers.[270]

VietnamÕs legal system provides little support for its economic policies. This comes as no surprise given that Vietnam has created an entire legal system from scratch in a very short period of time.[271] The rapid additions and changes to foreign investment laws in order to attract investment, while laudable, have brought a great deal of uncertainty and confusion. Often the changes occur so quickly that local authorities and courts do not even know of them.[272] Instances of contracts requiring redrafting because of the changes in the law have occurred frequently. Investors could look to the guarantee against changes in the law adverse to the interest of the foreign investor,[273] but prudent investors cannot rely on this promise to secure their interests against the changes.[274]

Foreign investors face the added difficulty of receiving adequate protection of their rights in a judicial system lacking independent status.[275] Even when a foreign investor obtains a judgment in its favour, it has no assurance that the judgment will receive enforcement.[276]

VietnamÕs legal community presently consists of northerners trained in the Soviet legal system and southerners trained in the French and American systems.[277] While a legal system born from such diversity could become an interesting hybrid over the long term, the system currently lacks the coherence necessary to support the needs of the present market economy.

The cumbersome investment procedures begin with the SCCIÕs role in approving and implementing investment projects. The requirement of a feasibility study even for small and medium-sized projects makes little sense,

269 ÔVietnam: New Asian tiger Struggles to be BornÕ, Austl Fin Rev, 2 June 1994, at 67 (hereinafter ÔNew Asian TigerÕ). Warren Strobel, *Washington Times*, 9 May 1994, at A1 (health and education systems deemphasised); Browne, *supra* note 7, at sec 1, 1.

270 ÔNew Asian TigerÕ, *supra* note 269, at 67.

271 Prior to Ôdoi moiÕ, the only real law consisted of ordinances handed down by high-level government officials. Dana Sachs, ÔVietnam: Investment Series Ð The Centerpiece of an Open-Door PolicyÕ, Vietnam Investment Rev, 1 November, 1993. In its continuing effort to update its laws, Vietnam has asked the United Nations Development Program to fund a program for the reform of the legal system to further support the market economy. Robert L Brown, NatÕl LJ, 13 June 1994, at C1.

272 Brauchli, *supra* note 232, at A10.

273 Regulations, *supra* note 36, at Article 99.

274 ÔVietnam: Be Alert to Government Policy Shifts Ð BusinessmanÕ, *Business Times* (Malaysia), 23 March 1994, LEXIS, News Library, Curnws File.

275 Instances of foreign parties prevailing in Vietnamese courts remain the exception, although the situation has improved. See Harish Mehta, ÔSÕPore Car Dealer Wins case Against Viet PartnerÕ, *Business Times*, 22 November 1993, at 3.

276 Mehta, *supra* note 155, at 13.

277 Sidel, *supra* note 230, at 227.

especially given that the SCCI lacks the resources to evaluate so many feasibility studies anyway.[278] The State authorises and supervises all activities of foreign enterprises except for their everyday operations.[279] The SCCI retains a large amount of discretion in this regard and has the ability to revoke an enterpriseÕs licence or dissolve it.[280] This exercise of discretion, furthermore, occurs without any right of appeal or independent supervisory control.[281]

If the procedural faults concerned only the SCCI, foreign investors would at least have a discernible target for improvement. Vietnam, however, suffers from ÔhorizontalÕ and ÔverticalÕ inefficiencies in its foreign investment procedures beyond the SCCI itself. Horizontally, many separate agencies claim a role in the process, which may result in contradictory decisions. One typical story involved a company granted a licence by the SCCI to operate a duty-free shop in the Hanoi airport, only to discover that the Commerce Ministry had issued a licence to another company. Even after the Prime MinisterÕs office interceded on behalf of the company, the airport operator continued to block the company with the SCCI licence from entering the airport or securing an import permit.[282]

Vertically, local governments exercise control over projects approved by the central government. As the Vietnamese proverb puts it, sometimes Ôthe KingÕs laws must yield to the village rules.Õ Local governments often have imposed conditions beyond those in the law in reviewing applications for foreign investment, such as clearing mines as a condition of approval.[283] This local involvement extends the approval process beyond the three-month time period stipulated in the foreign investment law.[284]

In view of the multiple agencies claiming jurisdiction over an investment project, investors end up paying Ôunwritten feesÕ as well as Ôwritten feesÕ. The minister in charge of foreign investment has cited the example of a foreign investor who had to pay a total of 120 Ôunwritten feesÕ, three times the number of Ôwritten feesÕ.[285] The minister commented that streamlining of investment procedures would not succeed because no agency would relinquish its jurisdiction due to the income generated from the system.[286]

278 Transition, pt 1, *supra* note 15, at 9.

279 *Id.*

280 *Id.*

281 *Id.*

282 Murray Hiebert, ÔMiles To GoÕ, Far Eastern Econ Rev, July 29, 1993, at 24.

283 ÔForeign Investors Face Snags in VietnamÕ, Straits Times, 22 July 1993, at 36.

284 Transition, pt 1, *supra* note 15, at 9.

285 Tuoi Tre Chu Nhat, 17 April 1994, at 6 (quoting Minister Dau Ngoc Xuan).

286 *Id.*

All observers concur about the magnitude of the corruption problem in Vietnam.[287] In the first four months of 1993 alone, Vietnam faced 365 cases of official corruption and 61 smuggling cases.[288] The government has continually emphasised the problem of corruption, and has vowed to take tough measures to combat it.[289]

In the last analysis, however, political factors constitute the greatest impediment to the development of a genuinely favourable investment climate in Vietnam. Although party members generally agree about the necessity for change, they disagree over how much renovation they can permit before the market economy would unleash forces undermining the partyÕs monopoly of political power.[290] In spite of the dramatic market reforms brought about by Ôdoi moiÕ, socialism remains the official goal of the country. VietnamÕs revised constitution continues to affirm the role of the party as Ôthe leading force of the state and societyÕ.[291]

In order to maintain party unity, economic reformers in the party often must yield to the political hard-liners.[292] At the mid-term party congress of January 1994, the first mid-term conference in the 63-year history of the Vietnamese Communist Party,[293] the party stressed that pursuit of an economic open door policy would not evolve into a political open door policy. Do Muoi, the Secretary General, simultaneously exalted the renovation policy and its economic results and emphasised the goal of socialism and the necessity of one-party rule. Accordingly, the party characterised Ôpeaceful evolutionÕ, its euphemism for anything other than rule by the Communist Party, as the supreme enemy of the people.[294] The party, then, continues to emphasise socialism both as the foundation of and the justification for Communist Party rule. As one party theoretician noted, ÔIf the economy is privatised and the Communist Party no longer leads, there is no longer socialism ... This is what the enemy wants and tries by all means to push us in that direction.Õ[295]

287 In complaining about alleged bribery surrounding contracts with local governments, one official for an oil company remarked that Vietnam has become the greediest country in Southeast Asia, ÔSomething Smelly in VietnamÕs Doi MoiÕ, Economist, 4 June 1994, at 33.

288 Murray Hiebert, ÔOpening a PandoraÕs BoxÕ, Far Eastern Econ Rev, 29 July 1993, at 24, 25.

289 The midterm party congress called corruption a Ônational disasterÕ, and set out a series of measures to curtail its growth, ÔResolution Part IIÕ, Saigon Giai Phong, FBIS, 8 April 1994, at 57, 58; Saigon Giai Phong, FBIS, 12 April 1994, at 74, 75.

290 One party leader, Nguyen Van Linh, asked, ÔShould the gains of the revolution obtained at the price of the blood of so many generations of Vietnamese now be placed in the hands of forces taking the country on to the capitalist road?Õ Nicholas Cumming-Bruce, ÔVietnam: Leaders Stress Caution and Conservatism at Opening of Communist PartyÕs Seventh CongressÕ, The Guardian, 25 June 1991, at 8.

Some people already have left the party because they believed the party had abandoned socialism. Others have left in protest of the continuation of one-party rule.

291 Constitution, *supra* note 25, at Article 4.

292 Thai Quang Trung, ÔVietnam: The Challenge of the ReformistsÕ, *Business Times*, 13 January 1993, at 25.

293 Paul Cleary, ÔVietnam: Party to Air Concerns Over Market MovesÕ, Austl Fin Rev, 20 January 1994, at 6.

294 Fearing an outbreak of Ôpeaceful evolutionÕ with the lifting of the US embargo, the government has tightened down further on political dissent. Phillipe Agret, ÔVietnam Sends Clamp-Down on DissentÕ, Agence France Presse, 20 March 1994, available in LEXIS, News Library, Curnws File.

295 Tap Chi Cong San, March 1994, at 59.

The continuing allegiance to socialism, even if largely cosmetic, prevents the party from making decisions necessary to implement the market structure. One prime example involves the status of state enterprises. State enterprises in general have become largely inefficient,[296] 23% of them operate at no profit or at a loss, and 80% utilise obsolete equipment.[297] Purely economic considerations require that Vietnam shut down a great number of these enterprises, and in fact, its new bankruptcy law, as reformers have stressed, will enable it to close many state enterprises in an orderly fashion.[298] The prospect of closures, however, has led to proclamations by hard-liners stressing the leadership role of state enterprises in economic development[299] and articles declaring that state enterprises should always outnumber private enterprises.[300]

Another area held hostage to socialism concerns land ownership. Under the constitution, the state owns all land.[301] The Vietnamese party to a foreign enterprise typically makes its capital contribution in the form of land.[302] As a result, foreign investors have voiced concern that, under current law, foreign enterprises cannot use land as collateral for loans.[303] Thus, they have called for the promulgation of a mortgage law to give banks the power to directly resell foreclosed property.[304] A mortgage law with these provisions, of course, would create tension with the socialist principle of state ownership of all land.

Even if Vietnam successfully passes laws responding to the concerns of foreign investors, many investors may still worry that the gains will not last. As long as the ideological conflict within the party remains unresolved and VietnamÕs political future remains uncertain, investors may fear that the government proposes liberal foreign investment laws as a matter of expediency rather than out of a genuine desire to implement a market structure over the long term. Predictability must exist in order for investment to flourish, and Vietnam has yet to demonstrate that it can provide this security.

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296 The state sector operates at a 0.97% profit rate, compared to a 2.16% profit rate for the private sector. Tran Dinh Thanh Lam, ÔVietnam: Private sector Grow, Problems RemainÕ, Vietnam Investment Rev, 7 March 1994.

297 Kinh te Saigon, 24 February 1994, at 14.

298 Nguyen Tri Dung, ÔVietnam: National Assembly Passes Bankruptcy LawÕ, Vietnam Investment Rev, 3 January 1994.

299 Nhan Dan, 17 February 1994, at 1.

300 See eg, Tap Chi Cong San, March 1994, at 28, 59.

301 Constitution, *supra* note 25, at Article 17.

302 See *supra* text accompanying note 90.

303 Michael Collins, ÔInvestors Learn to Live with VietnamÕs Legal VacuumÕ, *Vietnam News*, 21 December 1993.

304 *Id*.

The Australia-China Double Tax Agreement

Alex Low

The problem of double taxation

Double taxation occurs when one or more jurisdictions impose on the same transaction two or more taxes of similar effect. International double taxation results when different countries simultaneously impose one or more of the following taxing principles:

1. taxation at the recipientÕs residence or domicile;
2. taxation at source (ie where the taxable income is produced);
3. taxation in the country of which the recipient is a citizen.

The problem arises when one country does not take notice of the taxing laws of another. Tax treaties operate to remedy this situation.

The OECD model is the basis of both Australian and Chinese treaty policies and this therefore means that there are many similarities in both AustraliaÕs and ChinaÕs taxation treaty positions.

The objects of tax treaties

The main object of a tax treaty is to prevent double taxation of income and to relieve individuals and companies of paying duplicative taxes.

To ensure that misunderstandings are minimised, treaty partners designate the scope of the treaty by setting out the persons covered, taxes covered and income or assets to be taxed and then defining the taxing rights of each country.

The treaty country then gives its citizens a credit or exemption for taxes paid to the treaty partner. Exchange of information is also provided by the partners to each other where the information is necessary to comply with the treaty or the domestic taxation laws of either country. This reduces avoidance and evasion of taxes.

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Tax treaties also have economic and political purposes. They encourage reciprocal investments, give international economic respectability and encourage multi-national ventures as they remove the threat of double taxation. They also promote the collection of tax revenues owed to a foreign country.

This is very well when the treaty is between developed countries. Where one partner is a developing country, the objectives of the developing country are to encourage foreign investment in that country by providing, in effect, subsidies to foreign investment.

The developed country, on the other hand, generally insists on limiting the taxation of income in the source country. This is only equitable when investment is roughly equal in each country.

Generally in developed/developing country treaties there is a revenue sacrifice by the developing country which, in most cases, receives the income producing investment vehicle.

So it is a delicate balancing act for developing countries to ensure there is tax revenue from the foreign investor and yet put in place tax holidays or subsidies in the form of taxation benefits to attract them.

Whilst China is such a developing country, it might surprise the reader to find that the Australia-China Agreement is not a typical one. Investment figures show that ChinaÕs investment in Australia is greater than that of

AUSTRALIA TO CHINA	CHINA TO AUSTRALIA
[1]1) Over last 10 years A $250m	A $350-400m
[2]2) By the end of 1993 i) Contracted investment $1,7B [3] ii) Actually utilised funds $463m	2) i) $5.0B ii) $4.1B

AustraliaÕs in China.

As previously mentioned the Agreement is one based on the OECD Model, which provides for treaties between developed and developing countries. If we examine the above flow of trade figures it is clear that the flow of investment favours Australia, the supposedly developed country. Yet, OECD Model treaties are supposed to favour the developing country in terms

1 Speech made by Mr. Robin Dulfer Hyams, Senior Trade Commissioner Commercial, Australian Trade Commission, Australian Embassy to Beijing, at Australia-Chinese Business Cooperative Committee, the Seventh China-Australia Senior Executive Forum, 28-29 May 1990, Shanghai.

2 Window, 1 July 1994 at page 52 article entitled ÔSino-Australian Trade Boosted by DelegationÕ.

3 This does not include 1993/94 investment decisions by major Australian companies including Cadbury Schweppes, Fosters Brewing, BHP Minerals, Pioneer Concrete and CSR.

of capital flow.

This is difficult to explain for it is no doubt true that the economic development of China depends upon inviting advanced technology by way of incentives as provided for in the Agreement.

It is questionable who is the developing country! Whilst AustraliaÕs per capita income is much higher than ChinaÕs ($A16,750 to $A469), China is beginning to forge to the forefront of world economic power through sheer size and control. This accords with the basic Chinese Taoist philosophy that the strongest matter is water, it takes the lowest position and eventually wears away everything in its path.

As can be seen, the Agreement encourages and facilitates a foreign partner to invest in China,[4] yet at the same time making it attractive enough for China to invest in Australia.[5] But in the future it may be that Taoist philosophy and the Chinese ploy will prevail.

The OECD Model

There is a principle of fiscal sovereignty in international law which means that there are virtually no limits imposed on taxing powers of sovereign states.

AustraliaÕs domestic taxation laws have been developed on a unilateral basis meaning that they have focussed on the taxation of residents and non-residents. However, these laws have been modified by double tax treaties which are bilateral agreements between countries stating how income flowing between the two countries is to be taxed and to prevent income being taxed twice. This happens because most countries exercise jurisdiction to tax on two bases: source and residence of the recipient.

As the world gets smaller because of more efficient communication and the growth in volume of trade the need for more double tax agreements becomes imperative. This means the standardisation of double tax agreements is more meaningful and relevant.

The OECD model is such a standardisation and adopts the position that the country of residence should bear the burden of eliminating double taxation of income via the foreign tax credit mechanism or the total exemption of resident country taxation of foreign source income.

Tax treaty with Australia

Australia has entered into a total of 39 Double Tax Agreements, the treaty with China being contained in the 28th Schedule to the Income Tax

4 See Article 23 and the concept of tax sparing which is discussed later in the paper.

5 Besides tax sparing, the Agreement aims at promoting economic efficiency through a neutral tax system that promotes both capital import and export neutrality.

(International Agreements) Act of 1953 (as amended).

The Australia-China Double Taxation Agreement is just one of 27 entered into by the Chinese with other countries. China, evidenced by the number of tax treaties it has entered into, is very keen to follow international standards in order to attract foreign investment.

The Australia-Chinese Agreement (hereafter Ôthe AgreementÕ) is relatively similar to the OECD Model Convention. This Agreement, where applicable, offsets the withholding tax provisions in China to the extent that certain earned income will be subject to withholding tax at treaty rates rather than domestic rates, and applies to income earned in Australia on or after 1 July 1991. It also sets out the circumstances in which China has the right to tax income earned on or after 1 January 1991 and any subsequent year of income.

Treaty provisions override a domestic tax rule if the tax treaty provisions confer more favourable treatment on the taxpayer. This supplements the more general rule of international law on conventions and treaties that, once ratified by a nation, treaties will prevail over domestic legislation. However, it should be remembered that in the Income Tax Assessment Act ÔITAAÕ, s 388 provides that for controlled foreign companies[6] the International Agreements Act is not to be taken into account in calculating income except where it is specifically referred to in the ITAA. Section 4(2) of the International Agreement Act incorporates the ITAA into the International Agreements Act, and gives the International Agreements Act priority over the normal taxing provisions, subject to priority given to s 160AO of the ITAA, and Part IVA of that Act (anti-avoidance provisions).

In relation to this Agreement, s 11S of the International Agreements Act treats certain income, profits or gains under ss 6, 8, 10-17 and 19-22 as having a source in Australia, and taxable there, while excluding certain royalties or interest paid to China.

Relief from double taxation

Australia provides relief by granting an exemption from Australian tax and a credit or a rebate against Australian income tax. Therefore, the amount of foreign income tax paid may be directly offset against, or deducted from, the Australian tax liability up to the amount of the Australian tax imposed on that income.

6 Section 340 sets out three tests. Where one of these tests is satisfied and the company is also a resident of a listed company or unlisted company, then it is a CFC. For further information see Australian Master Tax Guide, Section on Controlled Foreign Companies.

The treaty provisions

As clearly indicated in the Preamble to the Agreement, the intention of such treaties is to obviate taxing the same profits or income twice, provide for resolution and settlement of disputes over taxing rights, give a mechanism whereby subjects can have their governmentÕs protection on points of tax difficulties, and allow for international mechanisms to minimise tax avoidance and, in some cases, provide a joint recovery mechanism.

Article 23 sets out a foreign tax credit system enabling an Australian company or individual to apply the Chinese income tax paid as credit against any Australian income.

Article 24 provides for mutuality and consultation between the Australian Commissioner of Taxation and ChinaÕs State Taxation Administration regarding the tax laws of Australia and China. If a person is subjected to harsh tax treatment by one country, be it China or Australia, that person may show that he or she has been discriminated against by the taxation laws of that country. A case must be brought within three years of discovering that the person has been taxed in a discriminatory way and not in accordance with the spirit of the Agreement.

Taxes covered in the agreement

Article 2 sets out the taxes covered by the Agreement:

1. All Australian income tax and resource rent tax on offshore projects imposed by the Australian government.
2. All income taxes imposed by the PeopleÕs Republic of China.

The specific taxes that are covered by the Agreement for China are:

(a) Personal/individual income tax. This is set out in the Individual Income Tax Law[7] and the accompanying Detailed Rules and Regulations for the Implementation of the Individual Income Tax Law.[8]

Income tax is only paid by individuals earning 800 reminbi or above per month. It applies to anyone who satisfies the income minimum regardless of citizenship, in accordance with their residence and source of income. Effectively, this means very few locals pay this tax for they mostly earn less than the minimum amount under the law.

Non-residents and residents for less than one year are subject to the law for income earned within China. There is an exception for individuals who reside for less than 90 days within a calendar year (Article 5(1)).

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7 Adopted at Third Session of the Fifth National PeoplesÕ Congress on 10 September 1980.

8 Promulgated by the Ministry of Finance on 14 December 1980.

Residents of China who have been in China between one to five years pay tax only on their Chinese income. If they have been residents for more than five years then they are taxed on worldwide income. The following table sets out the categories of income subject to tax:

Scale of Individual Income Tax Rates

Monthly Income	Tax Rate (%)
RMB 800 or less	Exempt
RMB 801 to 1,500	5
RMB 1,501 to 3,000	10
RMB 3,001 to 6,000	20
RMB 6,001 to 9,000	30
RMB 9,001 to 12,000	40
RMB 12,001 upwards	45

The Provisional Regulations of the State Council Concerning the Reduction of the Individual Income Tax on Wages and Salaries of Foreign Nationals Working in China, promulgated on 8 August 1987, reduces the income tax on a foreignersÕ wages and salaries by 50%.

The remaining categories of income are taxed at 20% flat. These include royalties, dividends, rentals and non-employee personal service income (essentially professional people).

The Income Tax Law of the PeoplesÕ Republic of China Concerning Joint Ventures with Chinese and Foreign Investment and Foreign Enterprises adopted at the Fifth Session of the National PeoplesÕ Congress in April 1991, effective from 1 July 1991, repeals and replaces the Joint Venture Income Tax Law and the Foreign Enterprise Income Tax Law set out in the Agreement.

This law replaces the various rates of income tax in both the old laws with a flat national tax of 30% and a flat local tax of 3% applicable to all foreign investment enterprises and companies in China. This is subject to any further provincial concessions that may be available.

Income categories to which the agreement applies

The Agreement provides for four categories of income which may be taxed Ð business, property and personal income, and income from sporting and cultural pursuits.

1. Business income consists of industrial and commercial profits, professional income, and shipping and airline profits. Industrial and

commercial profits, professional services, shipping and airline profits are generally exempt from Chinese tax unless they are connected to a Ôpermanent establishmentÕ (Article 5) or Ôfixed baseÕ.

Article 7 provides that business profits are taxable only in the country of residence of the enterprise, unless they are attributable to a permanent establishment in the other country, in which case the other country may tax.

The concept of business profits was considered in the case of *Thiel v FCT*.[9] A good summary of the relevant law is made by Dawson J (referring to the Swiss agreement) in relation to Ôbusiness profitsÕ. ÔBusiness profits cannot be confined to profits (or taxable income) derived from the carrying on of a business but must embrace any profit of a business nature or commercial characterÕ. Profit from a single transaction may amount to a business profit rather than something in the nature of a capital gain even if it does not involve the carrying on of a business.

In the Agreement, the profits attributable to a permanent establishment are those which the permanent establishment might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. This ensures that in determining the profits attributable to a permanent establishment all of the transactions of that permanent establishment are ascertained on the basis of dealings at armÕs length with an independent enterprise. In so doing, Australia recognises that the manipulation of the profits of a permanent establishment may occur not only in the dealings between the branch and its head office but may also occur in the dealings between the branch and other enterprises, for example, a company related to the head office or one with which the head office has an off-setting arrangement.

For the purposes of determining the profits of the permanent establishment, the OECD model says that each country shall allow as deductions expenses incurred by the enterprise for the purposes of the permanent establishment. The Article allows as a deduction all expenses incurred for the purposes of the permanent establishment, irrespective of the position under that countryÕs domestic laws.

The elaboration of this basic rule for deduction of expenses is based on the UN model which broadly specifies that in determining the profits of a permanent establishment no account is to be taken of transactions between the permanent establishment, management fees and, except in the case of a bank, interest on money lent. Such transactions have no legal substance

9 (1990) 21 ATR 531.

under Australian law because dealings between a branch and its head office, or other branches of the enterprise, are dealings within the one legal entity, and for that reason the provision is in reality unnecessary from AustraliaÕs point of view.

Article 7(9) clarifies AustraliaÕs right to tax a share of business profits originally derived by a trustee of a trust estate (other than certain unit trusts that are treated as companies for Australian tax purposes) from the carrying on of a business in Australia to which a resident of China is beneficially entitled. Such distributions are subject to tax in Australia where, in accordance with the principles in the Agreement relating to a permanent establishment, the trustee of the trust estate has a permanent establishment in Australia.

This is similar to s 3(11) of International Agreements Act 1953 which applies in relation to AustraliaÕs earlier agreements signed before 19 October 1984.

2. Property income[10] is used by the writer as an umbrella term to cover:
   (a) income from real property
   (b) income from sale of property:
      (i) real property
      (ii) personal property
   (c) dividends, interest and royalties.[11]

(a) Income from real property

This is dealt with in Article 6. In many of ChinaÕs Agreements it is dealt with under the title ÔIncome from Immoveable PropertyÕ.

In Australia, we do not have a concept of immoveable property and our usual approach has been agreed to by China, in that income from real property can be taxed in the country where the property is located. Accordingly, local law will determine the meaning of real property. It includes income from leasing contracts, which are items of personal property, and extends the definition to include natural resource royalties and other payments connected with the extraction or exploitation of natural resources. Income from livestock and from equipment used in agriculture and forestry is in my view more appropriately considered in the context of the business profits article. However, doing it this way is consistent with the OECD Model and also the UN Model.

10 Commentators generally deal with dividend, interest and royalties as a separate issue.

11 This will be looked at in detail later in the paper.

(b) Income from sale of property

(i) Real Property Ð Article 13(1) is the relevant article applying to the gains from the sale of real property. One needs to look at Article 6 for a definition of real property and which in turn states you look to the local law for an interpretation. The tax is paid in the country where the real property is situated (Article 13 (4) and (5)).

(ii) Personal property Ð Article 13(2) once again is consistent in dealing with personal property such as shares or business assets in that they are subject to taxation in accordance with the laws where the property is situated. (Also see Article 13(4) and (5)).

3. Personal income consists of:

(a) Wages, salaries, pensions and income derived by non-Chinese resident employees.
Article 15(2) sets out the three point criteria that must be satisfied if one is to be granted a tax exemption;

(i) The workerÕs stay in China is not more that 183 days in any consecutive 12 months period;

(ii) The workerÕs wages, etc are paid by a person or company who is not a Chinese resident; and

(iii) The payment is not an expense that can be borne by a permanent establishment or fixed base in China.
For example, if a worker does not satisfy the above criteria he or she is subject to ChinaÕs Individual Income Tax Law (IITLaw) on China sourced income. The IIT Law will initially only tax the worker on Chinese sourced income until the worker has been in China for five years, whereupon the worker will be taxed on worldwide income.[12] The Agreement subjects an Australian employer to ChinaÕs tax if wages are paid by a Ôpermanent establishmentÕ.
Article 14 alludes to professional persons as it refers to independent personal incomes. It applies where there is a fixed base in, say, China, or where the professional stays in China in excess of 183 days in any consecutive 12 month period.
This means if an Australian accountant is sent to China by his/her employer to audit the books of a joint venture company, the accountant is subject to taxation if the stay is more than 183 days or if the employer has an office (a permanent establishment) in China. The amount of his/her income which is subject to Chinese tax is limited to China sourced income only. This follows the OECD Model.

12 IIT Law promulgated September 1980 and the Detailed Regulations promulgated on 14 December 1980.

(b) Income derived by students who receive payments for maintenance or education are tax exempt if the student is temporarily resident in China solely for education (Article 20). This is an article that is common to Chinese and Australian Agreements.

(c) Income derived by professors and teachers is not taxable, in China if the visit does not exceed two years and the visit is for teaching, studying or research purposes. Such persons are exempt from tax (Articles 21 and 22). This follows the OECD Model.

4. Article 17 refers specifically to artistes and athletes. Here visiting entertainersÕ and athletesÕ incomes are taxed at the venue where the activities are carried out. The only exception is where the activity is part of a cultural exchange between governments where the income is taxed in the country of residence.

Residence

This is a core concept in the Agreement and the OECD Model. Under s 6(1) of the ITAA an individual is a resident if domiciled in Australia and, if incorporated in Australia, or if incorporated elsewhere, carries on business and has either its central management and control in Australia or its voting power controlled by shareholders[13] who are residents of Australia.[14] Most other countries use similar criteria.[15] Article 3 of the Agreement defines ÔpersonÕ to include an individual, a company and any body of persons.[16] Article 4 then defines ÔresidentÕ as a person who is fully liable to tax therein by reason of being a resident of that state under the tax law of that state.

13 Meaning persons on the register Ð see *Patcorp Investments Ltd v FCT* (1976) 10 ALR.

14 As to control and management see *Malayan Shipping Co v FCT* (1946) 71 CLR 155. This decision illustrates that AustraliaÕs unilateral tax system requires that any corporate structure utilised for trade and investment must be so arranged to avoid being within the extended concept of residence applicable to companies, no matter how strong its other connection with the overseas country. Incorporation of a company in the overseas country, the location of its registered office there, the appointment of directors there will not accord the company non-resident status if its central management and control is in Australia.

15 Apart from the domicile test in Australia, s 6(1)(a) sets out four alternative tests of being resident: (1) Common Law test Ð look at the common law notion of residence; (2) Domicile test Ð a person whose domicile is Australia is a resident of Australia unless the Commissioner is satisfied the person has a permanent place of abode outside Australia; (3) 183 day test Ð a person who is an Australian more than half the year of income is a resident unless otherwise provided to the CommissionerÕs satisfaction; (4) Superannuation test Ð a person who is a member of a superannuation scheme established under the Superannuation Act 1990 is a resident.

16 See specifically Article 3(d).

Article 4 goes still further by setting out a method of eliminating double taxation through double residence by deeming single residence status to a taxpayer. The concept of residence under ITAA has a direct bearing upon the Agreement which primarily defines a resident to the extent that he or she is a resident for Australian income tax purposes, and not a resident of China (Article 4(1)). If a person is classified as a resident of each state by both states, then a tie-breaker provision applies in order to ascribe single residence status (Article 4(3)). These provisions are identical to those in the OECD Model Convention.[17] This tie-breaker Article attempts to eliminate dual residence thereby subjecting a taxpayer to the jurisdiction of a single taxing state. These concepts have not been developed in Australian law and can only be discussed in relation to the OECD Model Convention.

Dual residence of individuals and companies

Articles 14 and 15 of the Agreement applies a ÔworkÕ test in regard to payment of income tax. An individual who stays longer than 183 days in either country is liable to be taxed in the source country. If the Commissioner of Taxation is satisfied that an individualÕs domicile (permanent place of abode) is Australia and spends more than 183 days in China, then China may deem the individual a resident and tax him or her on that basis. Dual residence therefore arises when both Australia and China treat the individual as a resident under their internal laws.

Article 4(4) of the Agreement refers specifically to companies and is silent on other bodies of persons. Residence is attributed to the place of Ôeffective managementÕ. This is a concept well known in Australia and if a company carries on business with central control and management in Australia, then the company is treated as a resident of Australia. The facts of a particular situation are obviously important to satisfy this test.[18] The OECD Model Convention supports this by stating that Ôeffective managementÕ of a company is the place where Ôits business is managed or controlledÕ.[19]

This means dual residence of a company can occur when the central management and control of the company is spread between China and Australia. The test for residence of a company outside Australia is the central management and control test. If China deems the Australian corporation a resident it will have dual residency.

Article 4 of the Agreement is a Ôtie-breakerÕ provision and essentially adopts the OECD Model, which provides that where a person is resident of both Contracting States, residency status will be determined according to the following principles:

17 Article 4 Commentaries (September 1992).

18 See *Malaysia Shipping Co Ltd v FCT* (1946) AITR 258.

19 Article 4 Commentaries, para 8 (September 1992).

(a) a person is deemed to be a resident in the state in which the individual has a *permanent home* available;

(b) if an individual has a permanent home available in both states, that person shall be deemed to be a resident of the state with which *personal and economic relations are closer (centre of vital interests)*;

(c) if the state in which the individual has his/her centre of vital interests cannot be determined, or if he or she does not have a permanent house, he or she shall be deemed to be a resident of the state in which he or she has an habitual abode.

The key terms are therefore Ôpermanent homeÕ, Ôpersonal and economic relationsÕ (centre of vital interests) and Ôhabitual abodeÕ.

The Agreement uses the term Ôpermanent homeÕ, Ôpersonal and economic relationsÕ and includes ÔcitizenshipÕ as being a factor in determining the degree of this personal and economic relationship.

These terms may be unclear in their application as they involve factual determinations based on potentially differing interpretations of these terms. There is little jurisprudence explaining them. The OECD Commentary indicates that these terms are to be given an international meaning.[20]

The first principle contains three elements Ð ÔpermanentÕ, ÔhomeÕ and ÔavailableÕ, which are determined by objective criteria.

ÔPermanentÕ

This word implies that there exists a permanent home in one country and the stay in the other country is only of Ôsome lengthÕ. That is, the individual must have arranged for this permanent use as opposed to staying at a particular place for a short duration. Thus houses used for recreation are excluded from the definition, as are permanent holiday homes. Permanence therefore implies an extended period of time with some degree of regularity.

In *Applegate v FCT*[21] reference was made to the words Ôpermanent place of abodeÕ outside Australia in s 6(1)(a) ITAA and Foster J (at p 4317) said the word ÔpermanentÕ referred to Ôplace of abodeÕ and look at the physical environment of the place of abode. It is submitted this is not an international interpretation and is too narrow. Logically, a temporary dwelling would not be classified as permanent, even though the occupant uses the dwelling as a permanent home. State of mind is more important.

20 Article 4 Commentaries, para 5 (September 1992).

21 1979 ATC 4307.

Yet Article 4 of OECD commentaries at para 13 states that any type of home is sufficient provided it is available at all times continuously, not just for a stay. *FCT v Jenkins*[22] highlighted that intention of the taxpayer was paramount. Here the taxpayer tried to sell his house in Australia before going overseas, but couldnÕt and in the meantime fell ill and returned to Australia. It was held that the taxpayer could well be regarded as a resident for Australian tax laws.

Tax Ruling IT2650 (8 August 1991) is an attempt to clarify the situation by providing guidelines to determine when a citizen ceases to be an Australian resident.

Whilst it does not override *Applegate's* case it adds to *Applegate* by setting out certain factors which should be given weight in determining where a resident has a permanent place of abode. If a person is ruled a resident for the purpose of the ITAA then this interpretation will also apply to the Agreement.

The ruling seems to interpret ÔpermanentÕ in terms of time spent outside Australia, taking into account the intentions of the particular taxpayer.

The following factors considered by the Tax Office are also relevant in tie-breaker situations:

(1) the intended length of time the individual spends in a particular place outside Australia;

(2) any intention either to return to Australia at some definite point in time or to travel to another country;

(3) the abandonment of any residence or place of abode the individual may have had in Australia;

(4) the duration and continuity of the individualÕs presence in the overseas country; and

(5) the durability of association that the individual has with a particular place in Australia.

The ruling makes the point that the weight given to each factor will vary with the individual circumstances of each case and no single factor is conclusive.

ÔHomeÕ

The word ÔhomeÕ may be taken to refer to a house, apartment or rented furnished room belonging to or rented by the individual. ÔHomeÕ suggests more than just an address, it implies the situation where an individual lives with his/her family.

22 1982 ATC 4098.

In *Levene v IRC*[23] Viscount Cave LC stated (p.749):

ÔThe word ÔresideÕ is a familiar English word and is defined in the Oxford English Dictionary as meaning:

> Ôto dwell permanently or for a considerable time, to have oneÕs settled or usual abode, to live in or at a particular place.Õ

No doubt this definition must for present purposes be taken subject to any modification which may result from the terms of the ITAA and schedules; but, subject to that observation, it may be accepted as an accurate indication of the meaning of the word ÔresideÕ. In most cases there is no difficulty in determining where an individual has his/her settled or usual abode, and if that is ascertained he is not the less resident there because from time to time he or she leaves it for the purpose of business or pleasure.

In applying this principle the Lord Chancellor looked at the facts and found the taxpayer was a resident.

The idea that residence was but one relevant fact, was reinforced in *IRC v Lysaght*[24] where Viscount Case held on the facts that the taxpayer was not a resident.

He said at page 578:

> ÔThis case differs in an essential respect from the case of Levene v IR Comrs. In that case the appellant, Mr Levene, was during the period in question a homeless man living at different hotels in the United Kingdom and abroad. In the present case the respondent, Mr Lysaght, has a permanent home in Southern Ireland, where he lives with his family; but he comes to England once a month for business purposes, stays at an hotel and, when his business (which usually occupies about a week) is concluded, he returns home.Õ

In essence, a personÕs ÔhomeÕ is that personÕs dwelling place at the physical surroundings in which a person lives.

ÔAvailable to the personÕ

This refers to continuous availability at all times.[25] It is submitted that an individual need not own property to have a permanent home, but that it must be available on a long-term or long-continuous lease basis otherwise the requisite quality of permanence will be lacking.

In *Case R92*[26] an Australian engineer working in the Philippines, the taxpayer, negotiated a lease of a house and subsequently furnished it and

23 1928 AER 746.

24 1928 AER 575.

25 Article 4 Commentaries, para 13 (September 1992).

26 84 ATC 615.

became a member of the local community and was paid a housing allowance by his employer. It was held that he was a non-resident since he did set up a home in the Philippines on a continuing basis.

Proximity of personal and economic relations

If the individual still remains a dual resident after applying the Ôavailable permanent home testÕ then the personal and economic relations test is applied. ÔPersonal and economic relationsÕ is a problematic concept and it is very difficult to ascertain whether ÔpersonalÕ relations should prevail over ÔeconomicÕ ones. In Australia the concept and its application are unclear. It seems that Ôpersonal tiesÕ and Ôeconomic tiesÕ are given equal definitional weight by the OECD Model Convention.[27]

Article 4(3)(b) of the Agreement does not adopt the concept of Ôcentre of vital interestsÕ. This concept is used synonymously with Ôpersonal and economic relationsÕ as explained by the commentary. It is merely a pointer toward Ôpersonal and economic relationsÕ. This is the only sense the OECD Model Convention gives it.[28]

In practical terms whilst the situation is unclear, there appears to be a case law preference for family ties. For example, an Australian chartered accountant was seconded to his employerÕs London office for a period of two years or Ôsuch longer period as mutually agreed uponÕ. Upon arriving in London he initially rented accommodation and then decided to buy a house, all the time renting out his Australian home. The taxpayer did not stay on with the firm after his initial two year period of employment largely because his wife wanted to return to Australia. After holidaying in Europe, he returned to Australia. Although he decided to purchase a matrimonial home in London and not to stay overseas longer than the two-year secondment, the court concluded the taxpayer had a permanent place of abode outside Australia.[29]

On the other hand, a bank officer along with his family was posted to the New Hebrides for two years only and never intended to stay any longer. During his overseas posting he kept bank accounts in Australia, into one of which family allowance payments continued to be made, and rented out his Australian home. The court held that his place of abode in the New Hebrides was considered to be temporary or transitory for two reasons: (1) with the bankÕs continuing permission, he lived in a house leased by the bank in the New Hebrides; and (2) because the posting was limited to two years his relationship with his place of abode lacked Ôa more enduring relationshipÕ.[30]

27 Article 4 Commentaries, paras 12-19 (September 1992).

28 Article 4 Commentaries, para 15 (September 1992).

29 Case T28 86 ATC 276; Case 31 29 CTBR (NS) 238 31.

30 See 790 ATC at p 4317; 9 ATR at pp 910-911.

with the particular place of abode than that expected of a person who ordinarily resides there or has his usual place of abode there[31].

In Australia, it seems the weight of authority stresses Ôpersonal relationsÕ. There is no reason then why the Australian approach could not be regarded as consistent with the international approach. The OECD Commentary supports this proposition and stresses that emphasis should be placed on this.[32]

This means that in interpreting the Agreement, personal ties would be preferred over economic ones in the case where both are seemingly equally distributed between two countries. There is no equivalent provision or concept in the ITAA which may influence a court in accepting any other interpretation. There appears no reason why an Australian court would not follow the above approach.

In a case where an individual sets up another home whilst retaining the first, it is more likely that the individual will be considered a resident in the state where he or she has always lived, worked or where family and possessions are located.

Obviously in a case like Case S.19[33] where the taxpayer rented out his house in Australia, advised the Department of Social Security that the family was leaving Australia and to cease child endowment payments, the taxpayer had intended to live outside Australia and so would be classified a non-resident for Australian taxation purposes.

The Chinese position is not as clear. There is no case law and, as far as the author is able to ascertain, there have been no administrative circulars issued by the Chinese government. In view of the fact that China has entered into a Double Tax Agreement with Australia and the undeniable desire of China to be part of the international community, one can only surmise that China would adopt the same approach as the Australian courts.

Habitual abode

If a person still remains a dual resident, the OECD Model Convention then refers to Ôthe state in which he has an habitual abodeÕ[34].The comparison of each abode must cover:

(1) A sufficient length of time for it to be possible to determine which residence in each of the two states is habitual; and

(2) The intervals at which the stays take place.[35]

31 Case Q68 83 ATC 343; Case 132 26 CTBR (NS) 913.

32 Article 4 Commentaries, para 15 (September 1992).

33 85 ATC 225.

34 Article 4 Commentaries, para 2(a) (September 1992).

35 Article 4 Commentaries, para 19 (September 1992).

(3) If an individual stays frequently in both places then look at where living is normal. In the Agreement it is suggested stays of 183 days or more may be used as a guideline.

However, it is very difficult to say that a resident can have more than one habitual abode or permanent home. Therefore, one could conclude that when the previous tie breakers are not helpful then the habitual abode test would also be on its own, unhelpful, for it may be that an individual has an habitual abode in both states.

Permanent establishment

The term permanent establishment sets a standard to determine the business presence required to justify taxing an enterprise by a host country. It is an effective means to eliminate double taxation without the loss of revenue for each country, for experience indicates that capital and investment flows between countries is relatively equal and neutralise each other. This is the OECD Model and is unlike the UN Model.[36]

Once a permanent establishment is set up in one country then income derived is taxed in the country in which the establishment is located provided that income earned is attributable to it. Whilst there is no mention of permanent establishment in the ITTA it is submitted that s 25(1)(b) of that Act echoes this view by providing that the assessable income of a non-resident includes the gross income derived directly or indirectly from all Australian sources.

Definition and deeming provisions

The Agreement under Article 7 attempts to resolve double taxation by limiting tax to income where economic penetration into China constitutes a Ôpermanent establishmentÕ as defined in Article 5. Article 5 of the Agreement basically follows the OECD Model Convention.[37] ÔPermanent establishmentÕ is also comprehensively defined in s 6(1) ITAA and applies to persons as well as companies. Section 6 expressly applies to Ôany businessÕ which includes any profession, trade, employment, vocation or calling but does not include occupation as an employee. The scope of this provision is wider than the definition of Ôpermanent establishmentÕ in the Agreement. Article 5 defines it

36 See Article 5 of the ÔUN Model Double Taxation Convention between Developed and Developing CountriesÕ in UN Department of International Economic and Social Affairs, UN Doc ST/ESA/102, UN Sales No E 80 XVI 1.2 (1980). For a detailed analysis of the UN Model, see Surrey ÔUnited Nations Group of Experts and the Guidelines for Tax Treaties between Developed and Developing CountriesÕ (1978) 19 *Harvard International Law Journal* 2.

37 Article 5 Commentaries (September 1992).

as follows: Ôa fixed place of business through which the business of an enterprise is wholly or partly carried on.Õ

The term is elaborated upon by specific examples of what might constitute a permanent establishment so as to make it clear that it is not limited to the conduct of business through a formal branch but extends to other Ôfixed presencesÕ. It expressly includes:

1. a place of management;
2. a branch;
3. an office;
4. a factory;
5. a workshop;
6. a mine, quarry, or any other place of extraction of natural resources;
7. an agricultural, pastoral or forestry property;
8. a building site or construction, installation or assembly project which exists for more than six months.

These provisions serve as examples of permanent establishments, and do not exhaust all the possibilities. Other types of businesses conducted by the establishment may well be permanent under the general provision of the first paragraph or the deeming provisions of the same Article which deem an enterprise a permanent establishment.

Article 5 in later subsections then proceeds to set out more indicators of a permanent establishment:

1. Article 5(3)(c) Ð use of substantial equipment for more than three months;
2. Article 5(4) Ð sets out activities that will not be deemed to constitute a permanent establishment. These are activities that have an auxiliary character, where that fixed place only purchases or collects goods for the enterprise. Engaging in more than one category of activity is irrelevant for determining its permanence. Unfortunately, there are no guidelines in either the Agreement or the OECD Model to assist in determining what is an ÔauxiliaryÕ activity.
3. Article 5(5) Ð an agent may be a permanent establishment if it exercises its authority to conclude contracts.

China deems a permanent establishment to exist if the agent habitually exercises an authority to conclude contracts. Australia uses a wider formulation of the test to take into account the fact that under Australian domestic law an agent can contract under his or her own name and just as effectively bind the principal.

Australia also deems such an agent to constitute a permanent establishment in a country, if the agent manufactures or processes in that country goods or merchandise belonging to the enterprise. This provision

makes it less open to an enterprise that carries on very substantial manufacturing or processing activities in a country through an intermediary to claim that it does not have a sufficient presence to warrant being taxed by the host country.

The six month period in the Chinese Agreement (Article 5(3)(a)) deeming a construction or building site a permanent establishment may in fact be used to minimise the tax burden. For example, construction, assembly or other similar activities could be of less than six months duration and still result in high profits for the enterprise carrying on those activities used to minimise the tax burden. Such profits could be repatriated out of China tax free because there is not a permanent establishment. Thus the AgreementÕs purpose of preventing fiscal avoidance, may be thwarted. It is submitted that building and construction or similar activities constitute a form of doing business in another country and should, as such, bear their share of tax in the host country.

Regarding Article 5(5)(a) and Article 6, the criteria used in the Commentary[38] to determine an agentÕs status have not been adequately delineated. It is therefore not possible to determine with any certainty whether an agent will be deemed a permanent establishment on behalf of his or her principal. There are no indications as to the means whereby an agentÕs authority can be ascertained or how independent status will be determined in relation to the principal. In the Chinese Agreement it is possible, under a literal reading in relation to the provision deeming an agent not to be a permanent establishment if he or she is independent and acts in the ordinary course of his or her business, to conclude that such an independent agent, if he or she habitually fills in orders or concludes contracts, will not be a permanent establishment because independent agents are excluded by that provision from being permanent establishments. No provision is made for determining when an agent loses his or her independence.

Under the Chinese Agreement it is possible to have a situation where an agent holds out that he or she is acting on his or her own behalf whilst in fact acting on behalf of a foreign principal, thus securing business for which the principal is not taxed if there is income earned from the foreign source. This represents another form of Ôfiscal evasionÕ that the Agreement cannot deal with. The situation would be more certain under AustraliaÕs unilateral provisions. The term Ôpermanent establishmentÕ is defined more comprehensively under the ITAA and the common law would provide a more reliable basis for ascertaining the meaning of terms such as ÔagentÕ. Without the Agreement, the simple position would be that all income earned in China by an Australian resident would be taxed under s 25(1)(a) ITAA. Where income is earned by a non-resident in Australia it would be taxed according to the principle of source and s 25(1)(b).

38 Article 5 Commentaries, paras 31, 32 (September 1992).

Capital gains and other income

All of ChinaÕs agreements have an article dealing with capital gains. The broad effect is to ensure that the source country may tax most capital gains to the extent specified in its domestic law. In the past, Australia has not dealt comprehensively with capital gains because, as Australia did not tax such gains, there could be no double taxation. AustraliaÕs usual approach was to ensure that income from the alienation of real property, as defined in Article 13, could be taxed in the source country. Generally, AustraliaÕs agreements do not prevent Australia from taxing, as ordinary income, in accordance with its recently enacted domestic law, capital gains made on assets acquired after 19 September 1985.

A question that may arise is the extent to which the other country will press Australia to give up taxing rights over gains of residents of the other country Ð gains that by our domestic law would be taxed here. The OECD Model attributes to the source country a more limited taxing right over capital gains than our domestic law exercises.

Article 13 of the Agreement deals with the alienation of real or personal property. The Article is self explanatory in that income or gains are taxed at the place of the establishment. Express mention is made of the case of sale of aircraft and ships, in which case the country of residence of the owner is the proper tax forum.

An area of concern for this Article is the meaning of Ôincome or gainsÕ and its relationship to the taxing of capital gain under Part IIIA of Australian taxation legislation which applies to a capital gain if the asset is acquired after 19 September 1985.

Both China and Australia suffer from the same confused income and capital dichotomy. Both countries proceed to depart from the definition of Ôincome according to ordinary conceptsÕ without spelling out the extent of the departure. Australia generally treats income as including profits in an accounting sense, yet Part IIIA attempts to include it as capital gain. China, on the other hand, does not include it in anything except broadly as taxable profit.

Because Article 13 applies to Ôincome or gainsÕ, then it is submitted, it would include capital gains arising from alienation of capital assets (sale of assets). Therefore it is reasonable to assume that Article 13 covers income from capital gains.

This logic is extended and supported by Article 13(5) which preserves AustraliaÕs capital gains legislation and which applies to a non resident owning Ôtaxable Australian AssetsÕ, as defined in s 160T of ITAA.

It would appear that Article 13(5) with its specific reference to capital gains was intended to stop the use of the Business Profits Article (Article 7). Yet it can be submitted that this is less than fair where a capital gain is made in a business context. Surely then it is subject to Article 7.

If the submission is correct then the taxable income has a broad interpretation (as against Ôincome according to ordinary conceptsÕ). This could well mean that Article 22 is authority for the proposition that the source of profit from the sale of property is the place where the property is situated provided that the gain is not covered in an earlier Article. Therefore Article 22 protects the non-resident person.

An example of a case supporting this view is *Australian Machinery and Investment Company Ltd v Deputy Commissioner of Taxation*.[39] The facts were that an Australian, ostensibly a share trading company, purchased some mining leases and transferred them to a number of West Australian incorporated companies. Under a Power of Attorney from the company, a second person sold these shares to English interests between 1933-1955 in return for money and shares in the English companies. The costs of acquiring and developing the leases and incorporation of the companies amounted to $238,502.

The majority of the High Court held that the sale of Australian shares was English sourced and the sale of English shares in Australia was Australian sourced. Starke J held that the sale of the Australian shares in England was obviously sourced in England because that was where the shares were situated. Dixon J postulated that if it could be shown that the value of the shares depended to some extent on manipulation in Australia, then the value of that manipulation may change the source. However, he found this difficult to prove and agreed essentially with Justice Starke.

Article 22 is further significant in that it gathers up any remaining income that is not caught elsewhere. Anything that is otherwise left out and is deprived by a resident of one country from a source in the other is to be taxed in the country of residence. On the other side of the coin, providing tax relief is given by the resident country (Article 23), income earned can be taxed in the source country.

Again, sales tax, stamp duties and rental taxes imposed upon Australian residents in China cannot be used as deductions from income for Australian tax purposes since they do not fall within the three heads of income, business, property or personal, as defined above. As a result an Australian who, for example, sells a rental property in China will pay double taxation, as capital gain from profit made from the sale will be classified as assessable income and the Australian will not be allowed to deduct sales tax, stamp duty and rental taxes that have already been paid in China when purchasing and renting the property. Clearly an amendment needs to be made to the Agreement to allow reciprocity in this area.

39 (1946) 3 AITR 359.

Dividends, interest and royalties

Introduction

Australia and China have in their treaties a broadly similar approach to the taxation of dividends, interest and royalties. The approach adopted by both Australia and China with other treaty countries is that both the source country and the resident country may generally tax interest, royalties and dividends flowing between them, with the source country tax being limited and the resident country relieving the resultant double taxation.

Dividends, interest and royalty are dealt with in Articles 10, 11 and 12 of the Chinese Agreement. If the activities of an Australian citizen do not provide a base for China taxation by being in China for more than 183 days or by having a permanent establishment in China, then China tax is only paid on dividends at 15% of the gross, interest at 10% of the gross amount of the interest and royalties have a 10% limit on the rate if tax is imposed on the gross amount of the royalty.

Royalties are deemed to have a China base. Article 12(5) states, if the payer is the country ie China, a political subdivision, a local authority, or a resident, they are deemed to arise in China if the payer has a permanent establishment or fixed base in China in connection with which the obligation to pay the royalties arises, and the royalties are borne by the permanent establishment or fixed base.

But it will not apply if the recipient of the royalties carries on business or earns fees through a permanent establishment or fixed base in China, and the right of property in respect of which the royalties arise is effectively connected with the permanent establishment or fixed base. Under these circumstances the provisions of Article 7 of the Treaty, with respect to business income earned by independent professionals, applies.

Dividend, interest and royalty payments are the only types of income taxed at a restricted rate in the Agreement. This restriction represents one of the few changes in the pattern of Australian taxation. Assuming that this measure advances the projected aims of the Agreement, which are prevention of fiscal evasion of taxes on income, and the avoidance of double taxation, it is necessary to examine how the provisions of the Agreement affect these types of income. Given the fact that these measures in part operate to relieve the burden of double taxation, one appropriate and very important function of these provisions is the reconciliation of definitional differences between Australia and China, in order to avoid whatever double taxation arises out of these discrepancies.

Dividends

Australia does not generally tax income other than dividends, interest and royalties derived from a source outside Australia provided the income was taxed in the country of source. Dividends are included in the assessable income of a recipient shareholder paid by a company out of profits derived by it from any source in or out of Australia.

Under Article 10 of the Agreement, the term ÔdividendÕ is defined under sub-Article 3 as income from shares or other rights participating in profits and which are not debt related. Domestic law determines whether a payment represents equity or debt.

Source of dividends

Under Article 10(l) of the Agreement, dividends may be taxed by the country of source. The Agreement does not define ÔsourceÕ except to the extent that the source of income is specified to be the country which has the right to tax that income. It is therefore important to explain the source rules relating to dividends under the ITAA as this bears directly upon the scope of Article l0.

The generally accepted rule is that the source of dividends is the place of residence of the corporation paying it. Primarily, in Australia the immediate source of a dividend is the location of the shares in respect of which the dividend is paid. Shares are located where they can be effectively dealt with or transferred Ð ie the share registry where they are registered. A series of cases have refined and modified these containments to the extent that the ultimate source of dividends is now generally accepted to be the location of profits where the dividend has been paid. Therefore, a non-resident shareholder receiving dividends paid from profits derived in Australia by a non-resident corporation will be taxed on those dividends. This merely reasserts the principle of taxation being limited to income sourced within the jurisdiction of the taxing country.

Article 10 relieves the double taxation of dividend. Tax is limited to 15% and if a country exercises its right to tax the dividend the other country must grant a credit in respect of the tax paid on that dividend (Article 23 (6)).

The recipient must be beneficially entitled to the dividend (Article 10(1)). The residence of the company paying the dividend is its domestic law residence (Article 10(1)) whilst the residence of the recipient is determined according to the criteria previously discussed (Article 10(3)).

The 15% rate of tax does not apply in the case where the person beneficially entitled to the dividend carries on business through a permanent establishment or performs professional services from a fixed base in the other country where the company paying the dividend is a resident. In this case (Article 10(4)) the dividend paid must be effectively connected with that permanent establishment or fixed base. The dividends are then taxed at source

and are classified according to Articles 7 or 14 which relate to business profits and independent personal services.

Dividends paid by a corporation resident in one country to a non resident of the other are exempt from tax unless the holding giving rise to the dividends is effectively connected with a permanent establishment or fixed base in that country (Article 19(5)).

Article 22 provides rules for the allocation between the two countries of taxing rights in relation to items of income not expressly mentioned in the preceding Articles of the Agreement.

Broadly, such income derived by a resident of one country is to be taxed only in the country of residence unless it is derived from sources in the other country, in which case the income may also be taxed in the country of source.

However, the first-mentioned exclusive taxing right of the country of residence does not apply where the income is effectively connected with a Ôpermanent establishmentÕ or Ôfixed baseÕ which a resident of one country has in the other. In such cases the provisions of Article 7 or 14 will apply.

Article 23 sets out the basis on which each country will provide double taxation relief for those forms of income which the agreement allows both countries to tax viz, the country of residence of the income recipient provides tax relief by granting the recipient a credit against its tax for the tax paid in the source country.

An Australian resident may seek a tax credit under Article 23(2) for Chinese income tax paid as a result of income being derived in China. The actual amount of credit is calculated in accordance with Division 18 of Part III of ITAA which provides for foreign tax credits. In particular, s 160AF(1) provides that where a taxpayer has actually paid foreign tax in relation to foreign income, the taxpayer receives a credit equivalent to whichever is the lesser of the foreign tax paid and the amount that would have been paid on that foreign income in Australia.

Article 23(3) deals with the situation where an Australian resident company controls 10% or more of the voting power of the Chinese resident company and which pays a dividend to the Australian company. Here the Australian tax credit must also include the Chinese tax paid by the company on the profits used to pay the dividend, as well as Chinese tax paid on the dividend.

This is in line with Division 18 and, in particular s 160AFC, which provides for credits on dividends that have passed through unlimited tiers of related companies.

Interest

Under Article 11 of the Agreement, interest is deemed to arise in the country when the payer is the government of that country, or a person who is a resident of that country for tax purposes. Where that person, whether or not a resident, has in a country other than that in which he or she resides or has a permanent establishment, or fixed base, any interest generated from that residence, establishment or fixed base, then that place is the deemed source of that interest.

Under the Chinese Agreement, interest payments, like dividends, are treated broadly under Article 11(3). The definition includes income earned from any form of indebtedness, as well as all other income including any income derived from the lending of money in the same country.

Unlike the terms ÔdividendsÕ and ÔroyaltiesÕ there is no comprehensive definition of ÔinterestÕ in the ITAA. However, interest may be defined as payment by time for the use of money or as the cost to a lender for the use of money provided to the borrower. Interest is derived when it is paid to the taxpayer or when the debt owing in respect of the interest is paid. Two requirements exist for a payment to amount to interest Ð money must be due to the person entitled to the interest, and be taxed at the time it is received.

Interest is deemed to be received when it is not paid over, but reinvested, accumulated, capitalised, put in a reserve, sinking fund or insurance fund. Interest upon money secured by mortgage of any property in Australia is deemed to be derived from a source in Australia. Also, interest on loans raised in Australia by foreign governments and received, directly or indirectly, by an Australian resident is covered. Under AustraliaÕs taxation laws and juridical concepts, it constitutes income and is assessable under s 25(1).

Do the same principles apply to investment in Australia by the Chinese government? The Agreement is silent on this, but apparently the doctrine of sovereign immunity applies to non-business activity only.

As stated by the Commissioner of Taxation:[40]

> ÔAustralia recognises the principle of sovereign immunity and extends its application to non-business activities of other governments. But we do not accept that the principle applies to ordinary commercial undertakings carried on by government. Accordingly, Chinese enterprises undertaking or commercial activities in Australia can generally be expected to be subject to AustraliaÕs domestic taxation laws, and to be treated for the purpose of the tax treaty in the same way as any other foreign enterprises.Õ

40 Mr Trevor Boucher, reported in (1989) 18 Butterworths Weekly Tax Bulletin 271.

Royalties

ÔRoyaltiesÕ are defined in Article 12(3). They include payments made for the use of copyright in:

1. Artistic works including films and tapes used in television and radio work.
2. Patents, designs, plans, secret formulas or processes and trademarks.
3. Scientific, technical, industrial or commercial know-how and information.

Section 6(1) of the ITAA defines ÔroyaltyÕ as including any amount paid or credited for the use of materials or rights held by another person, such as patents, copyrights and other forms of intellectual property and know-how. It also includes agreements not to supply such information to a third party.

Under the ITAA, s 26(f) includes royalties as part of a taxpayerÕs assessable income. However, IT2660 states that royalties do not include a payment for services, but do include payments for ancillary services which facilitate the transfer or use of information, know-how, copyright, technology or machinery.

Royalties arising in a contracting country to which a resident is beneficially entitled are taxed at a rate of 10% of the gross amount of the royalty (Article 12 (1)). This 10% restriction does not apply in two situations:

1. The restricted tax rate does not apply in the case where a resident beneficially entitled to the royalty carries on business through a permanent establishment and the property or right in respect of which the royalties are paid is effectively connected with such permanent establishment ((Article 12(4)).
2. The restricted rate does not apply where there is a special relationship between the payer and the payee, or between both of them and some other person, when it appears that the amount of royalties, having regard to what they are paid for, is excessive in relation to the amount that might have been expected to have been agreed upon in the absence of such a relationship. The 10% rate of tax is only applicable in respect of the latter amount (Article 12(6)).

Where the royalty is connected to a permanent establishment then Articles 7 and 14 are applicable ((Article 12(4)).

Finally, Article 12(5) sets out the position where royalty payments are made by the government that uses the know-how. For example, when the Chinese government uses Australian government know-how, the royalty payment is deemed to arise in China.

The Income Tax (International Agreements) Act 1953

As a general comment on interest and royalties both Articles 10 and 11 are founded on the International Tax (International Agreements) Act (IT(IA)A)

1953 under which beneficially entitled residents of contracting countries are generally limited to 10 and 15% respectively, except where the indebtedness, or right, property or know-how giving rise to the royalty, is effectively connected with trade through a permanent establishment. Withholding tax on interest is limited to 10% on interest, and no withholding tax is payable on royalty payments.

For the limitation to apply, the transaction must appear to be Ôat armsÕ lengthÕ, that is, the interest or royalty paid must not appear to be excessive. There must not appear to be a special relationship between the payer and beneficial owner, or between both of them and some other person. If such a relationship is found to exist, the limitation will apply only in respect of the amount which would have been agreed upon in the absence of such a relationship.

In order to qualify for the restricted rate of tax, the recipient must be Ôbeneficially entitledÕ to the interest or royalty payment. This term is not defined in the Agreement so it is difficult to accurately assess the class of payee to which the limitation will apply. From the words Ôbeneficially entitledÕ it is clear that payments will cover the situation where the payee is both legal and equitable owner of the interest or royalty. Under Articles 10(1) and 11(1), dividends and interest derived in a particular country by a non-resident may be taxed by the government of the other country in which the taxpayer resides.

Dividends, interest and royalties Ð some other issues

1. The Articles pertaining to dividends, interest and royalties fail to provide the necessary detail for the application of precise definitions of concepts and terms in order to ensure uniform application of source rules. There is little evidence in the Articles discussed that due consideration has been given to this problem. The Agreement provides that the terms ÔdividendÕ and ÔinterestÕ are to be defined according to each countryÕs taxation legislation.
2. The general definitions provided do not make any attempt to reconcile definitional differences and allocate source accordingly. It is merely provided that dividend, interest and royalty payments Ômay be taxedÕ in the other country.
3. It is not possible to gauge from the Agreement precisely what payments will be taxed, because this involves expertise in the foreign countryÕs taxation law, so that it is also not possible to accurately predict whether a payment will be exempted as an industrial or commercial profit.
4. The Agreement specifies that the source of a payment, or indebtedness, right or know-how giving rise to that payment, is the country where it may

be taxed. Once again this may result in complex legal analysis of a countryÕs taxation laws. This type of provision does not lend itself to simple, clear and swift interpretation. Although a credit will be obtainable if the amount is taxed in the other country, this does not eliminate potential problems connected with such inefficient operation. It is possible under the vague guidelines drawn in the Agreement that a country may not agree to grant a credit where it believes that the other country had no right to tax the payment.

5. Little attempt has been made by China or Australia to make allowance for peculiarities in their laws and to bring within the definitions of dividend, interest and royalties, payments that are not readily classified or which are treated inconsistently. For example, the profits of partnerships are not dividends within the meaning of the definitional paragraphs unless partnerships are treated the same as companies.
6. There are many terms that require definition in the Articles which, if left in their present state, would result in considerable uncertainty. The Agreement uses broad language designed to cover a multitude of systems, being based on concepts such as ÔresidenceÕ, Ôpermanent establishmentÕ, and ÔprofitsÕ Ôeffectively connected withÕ such establishments. This does not fit well with Australian terminology and concepts of ÔresidenceÕ of taxpayer as defined in s 25(1) of the ITAA, and particularly not with the common law concept of ÔsourceÕ of income. Indeed, to address modern problems of siting of royalties for taxation purposes, the ITAA had to virtually create two new separate concepts of ÔroyaltyÕ, one for the domestic situation and the other for international use.

   China, on the other hand, still has a simple, but chaotic tax structure, which is rapidly changing. Terms such as Ôeffectively connectedÕ, Ôbranch profits taxÕ, ÔpaidÕ, Ôlocal authorityÕ, Ôpolitical sub-divisionÕ, Ôspecial relationshipÕ, income ÔassimilatedÕ to income from shares or to interest, all require accurate definition. The fact that these types of terms are left undefined presents significant difficulty of interpretation. In the Agreement, if one country decides to tax the classes of income above, but not as dividend, interest or royalties, then the limited rate of tax may not apply as set out in the Agreement. Under its present format the Agreement does not facilitate a method of ascertaining how a country will view such a payment. Inevitably, there will always be uncertainty in peculiar fact situations.
7. In the case of interest payments several peculiar problems arise. Firstly, interest as defined does not extend to deferred payment sales. Sales income is generally taxable in the source country only if the seller has a permanent establishment in that country. When goods are sold in a country on credit, the question arises whether a portion of the sale price should be treated as interest income and thus taxable under the Article, or whehter the whole price should be exempt if the seller does not operate through a permanent

establishment. The Agreement does not enable a decisive answer to be formulated in respect of this question. It should be noted that the mere buying and selling of goods does not create a permanent establishment.

Secondly, considering the combined effect of the right to tax given to the source country, and the allowance to be made for the tax levied there against that due in the country of residence, double taxation may arise in the situation where a beneficiary of the interest has borrowed in order to finance the operation which earned that interest. The profit realised by way of interest will be much smaller than the nominal amount of interest received. If the interest paid and that which is received balance out, there will be no profit at all. In this case an allowance under the credit provisions raises the problem that the tax levied in the country where the interest is earned is calculated without reference to tax credits from the government of the country, ie the gross amount, comprising interest earned and the potential tax payable in the source country. This constitutes an excess charge for the beneficiary who, to that extent, suffers double taxation. This situation would force the beneficiary to increase the rate of interest charged to the debtor whose financial burden would be increased correspondingly. This situation has no solution under the Agreement and arises particularly with the sale on credit of equipment, commercial credit sales and loans granted by banks.

8. A principal problem of the Articles dealing with royalties (as in the case of interest) under the Agreement is the treatment to be accorded expenses in view of the tax imposed on royalties by the source country. These expenses consist of expenditures attributable to the establishment, or work in process, the development of a successful patent or know-how. The patent or know-how is generally also used in the country of residence so that expenditures at least in part can be allocated to that use, and the residence country may have already permitted a partial deduction for the expenses. The situation becomes complex where monies have been expended in both countries in developing the patent or know-how. Under the Agreement no indications are given if such expenditure is deductible in the foreign country and, if so, the means whereby it can be calculated.

The difficulties that have been presented are indicative of the major problem associated with the Articles relating to dividend, interest and royalties. It should be noted that the question of adequate classification and definition of these types of income is not necessarily so much a problem of legal analysis as rather the preferences of the countries as to the practical effects that flow however the income is characterised. It is here that practical attempts must be made to curtail endless combinations by establishing clear and precise rules and definitions attaching to the terms and concepts used in relation to these Articles of the Agreement.

Relief from double taxation and taxation incentives

The OECD Model[41] provides for an exemption method and a credit method to give relief from double taxation.

Explaining it in Australian terms, it means Australia provides relief by granting an exemption from or a credit against Australian income tax. This means the amount of foreign income tax paid may be directly offset against or deducted from the Australian tax liability, up to the amount of the Australian tax imposed on that income.

The effect of the exemption is that where tax has been paid overseas that income will be exempted from Australian tax. Therefore, if the foreign tax on the foreign income is lower than the Australian rate, the taxpayer will not be required to pay any make-up tax if that income was taxed and sourced out of Australia.

The effect of the credit is that when the foreign tax is lower than the Australian rate, tax is paid in Australia on the foreign income only to the extent that the Australian tax exceeds the foreign tax. When the foreign rate equals or exceeds the Australian rate, the credit (or exemption) cancels Australian tax liability on foreign sourced income. The credit, therefore, operates to reduce the aggregate tax rate to the higher of the foreign or the Australian rate.

The Agreement[42] uses the credit method providing that credit given, say in China, will not be greater than the total amount of Chinese tax on that income. For Australians, the credit given is that allowed under Australian tax laws. In negotiating the Agreement, Australia had agreed with China to include a tax sparing Article in the Agreement to ensure there is an incentive to attract Australian investment into China. The Article provides an incentive to the Australian investor to benefit from a tax holiday via tax incentives provided in ancillary legislation.

At a general level, there are arguments for and against tax sparing. It affects tax neutrality in the investorÕs home country by creating a tax advantage for investment abroad. The country offering the tax incentives of course does so in order to attract investment and seeks tax sparing arrangements so that its revenue forgiveness does not simply benefit a foreign Treasury. Tax sparing may therefore increase the flow of investments from the country granting the credits to the other, perhaps at the expense of domestic investment. So far as the developing country is concerned, tax sparing may encourage repatriation of profits to the investorÕs home country. There is also the fundamental question of whether or not the tax incentives, that tax sparing measures are designed to protect, ever fully achieve their desired effect.

41 See OECD Model, Articles 23A and 23B.

42 See Article 23.

ChinaÕs approach, and Australia has agreed, is that with a tax sparing credit provision in place they are able to provide inducements for foreign investment, on the basis that China is a developing country and foreign technology is an economic necessity.

Article 23(2) provides specifically that Australia will give its residents a credit if their income has been taxed in China. This regime is set out in Article 23(5) paragraphs (a) to (f). However, whilst the specific details are outdated, it still applies to all exceptions and deductions that are made under any of ChinaÕs national and regional tax laws.

As mentioned earlier, at the national level, effective from 1 July 1991 China passed the Income Tax Law Concerning Foreign Investment Enterprises and Foreign Enterprises, replacing the Joint Venture Income Tax Law and the Foreign Enterprise Income Tax Law. This legislation consolidated and replaced the different taxes with a flat 30% national tax and a flat 3% local tax applying on all foreign investment enterprises.

Personal taxation is still covered under the Individual Income Tax Law, 1980. This legislation sets out six categories of tax depending on income, ranging from 5% to 45%.

Note that there are also area-specific taxation preferences and incentives. The Special Economic Zones are only one of three types of designated areas targeted by the Chinese government for concentrated foreign investment and preferential treatment.[43]

This means that the Australian investor would receive a credit on the basis that all China taxes have been paid when in fact they have not. Note also that the ITAA s 160AFF provides that incentives may be given to Australians to invest in a specific country. Regulations under the ITAA may be made to provide for a limited application of the foreign tax credit rules. To date, no such regulations have been made.

It can be seen that China has a regime of taxation incentives to encourage and promote foreign modes of investment. Article 23(5) therefore provides that an Australian resident recipient of income on which China has foregone tax (either by exemption or reduction) will be given tax credit relief as if the Chinese tax foregone had been paid. This type of arrangement is known as tax sparing. These incentive measures can apply to concessions made after the signing of the Agreement, provided that the Australian Treasurer and the Chinese taxation authorities concur.

In the case of dividends, interest and royalties the degree of tax sparing permissible is reduced to the following rates:

43 The others are Open Coastal Cities, Open Coastal Economic Zones and Economic and Technological Development Zones.

1. 15% of gross amount of dividends and royalties;
2. 10% in the case of interest earnings.

In the Agreement the direct credit method of tax sparing is used, whereas in many other double taxation agreements the gross up and credit method is used, which is consistent with Australian taxation law. This means that under the Agreement, for example, an amount exempted under Article 5 dealing with a permanent establishment is included in the Australian taxpayerÕs assessable income. It does not have to be grossed up to include the foregone Chinese tax, and so a credit equivalent to the tax foregone is immediately applied against Australian tax.

In summary, Australia assures that tax exemptions or deductions have not been given and grant to the taxpayer the deduction of the amount of the tax as set out under Chinese taxing laws. This will undoubtedly help in attracting investment to China.

Finally, Article 23(7) provides that the tax sparing will operate for 10 years or as set out in the Explanatory Memorandum, until 1 January 2000 and in any subsequent years only if expressly agreed between the Australian Treasurer and the Commissioner of State Council Taxation in China.

An example is the best way to illustrate the working of taxation incentives. Assume a joint venture with a term of more than 10 years set up in a Special Economic Zone, engaged in manufacturing export oriented goods using technologically advanced equipment.

Being:

1. in a Special Economic Zone, its national tax rate will be reduced from 30% to 15%;
2. involved in manufacturing with a term of 10 years or more, it would be tax exempt for a two year period with a subsequent three year 50% reduction on enterprise income tax.

The 15% national rate could be lowered to 10% if it applied for and received either export oriented[44] or technology advanced status.

The Agreement and the position of Hong Kong

In 1984 China and the United Kingdom concluded the Hong Kong Treaty[45] returning sovereign control of Hong Kong to China in 1997.

Prior to 1984, after two years of protracted negotiation, Britain reluctantly agreed to relinquish its claims over Hong Kong. In the end, it was ChinaÕs

44 If it exports 70% or more of its production it is accorded this status.

45 The Agreement between the government of the United Kingdom of Great Britain and the government of the PeoplesÕ Republic of China on the Future of Hong Kong, 19 December 1984, United Kingdom-PeopleÕs Republic of China 1984 Great Britain TS No 20 (Cmd 9352), 23 ILM, 1366.

ability to project the acceptable face of socialism since 1978 and the promise of special and reasonable treatment for Hong Kong that persuaded the British they had secured the best terms possible. In exchange for British acquiescence, China promised to establish, in accordance with Article 31 of the Constitution of the PeoplesÕ Republic of China, a Hong Kong Special Administrative Region in July 1997 which Ôwill enjoy a high degree of autonomy, except in foreign and defence affairsÕ.[46] What a high degree of autonomy means is spelt out in Article 3, Clause 3 of the Joint Declaration which states:

> ÔThe Hong Kong Special Administrative Region will be vested with executive, legislative and independent judicial power, including that of final adjudication. The laws currently in force in Hong Kong will remain basically unchanged.Õ

Most important of all, Article 3, Clause 5 of the Joint Declaration promised the people of Hong Kong the following:

> ÔThe current social and economic systems in Hong Kong will remain unchanged, and so will the life-style. Rights and freedoms, including those of the person, of speech, of the press, of assembly, of association, of travel, of movement, of correspondence, of strike, of choice, of occupation, of academic research and of religious belief will be ensured by law in the Hong Kong Special Administrative Region. Private property, ownership of enterprises, legitimate right of inheritance and foreign investment will be protected by law.Õ

This arrangement, known as the concept of Ôone country two systemsÕ, was enunciated by ChinaÕs supreme leader Deng Xiaoping, and these policies of the PeoplesÕ Republic of China towards Hong Kong were set out in a basic law of the Hong Kong Special Administrative Region prescribed by the National PeopleÕs Congress of China and are to remain unchanged for 50 years.

The basic law of the Hong Kong Administrative Region was duly promulgated by the National PeoplesÕ Congress in April 1990, approximately nine months after the tragic events of 4 June 1989.

This means that Chinese taxes will not be in force in Hong Kong for 50 years, for Hong Kong is not within the definition of China as set out in the Agreement. Article 3(1)(c) defines China as Ôall the territory of the PeoplesÕ Republic of China, including its territorial sea in which the laws relating to Chinese tax applyÕ.

If this argument is accepted by the Chinese government then Hong Kong is not within the AgreementÕs definition of China.

46 Article 3(2) of the Joint Declaration of the government of the United Kingdom of Great Britain and Northern Ireland and the Government of the PeoplesÕ Republic of China on the Question of Hong Kong.

Conclusion

Australia and China must decide who and what to levy tax upon. Each country must decide the taxable unit and the basis of taxation. This usually involves looking at policy questions, jurisdiction and enforcement. The Australia-China Double Taxation Agreement is an attempt to clarify these questions in an equitable and efficient manner.

Yet it is a failed attempt. In Australia we start from the assumption that residents pay tax on income from all sources whilst non-residents ought to pay tax on Australian sourced income.

In Chinese foreigners pay tax if classified essentially as a resident and derive income from China. External sourced income is not included. Whilst the latest piece of taxation legislation attempts to end ChinaÕs dual income tax approach, it cannot do so because of taxation incentives and allowances given to foreigners to encourage investment.

Again, China lumps together capital and revenue into income, yet in Australia we have a capital gains tax and other concessions. The Agreement is no help here for it does not attempt to distinguish capital and income and the only way such an issue can be resolved is at a government to government level.

Finally, in Australia we have in place a withholding tax, but in China when income is derived by overseas residents there is a tax levied, but rarely collected because of ChinaÕs inefficient taxation administration.

The positive aspects of the Agreement are that it provides a degree of certainty regarding tax consequences of activities by residents of Australia within China. For China, the Agreement will encourage Australian technology and investment to assist in the modernisation of China.

The Australia New Zealand Closer Economic Relations Trade Agreement

Peter Prove

The development of the Free Trade Area, and the abandonment of the anti-dumping provisions

The Australia New Zealand Closer Economic Relations Ð Trade Agreement (ÔANZCERTAÕ)[1] has come a long way in its 12 year career. Its beginnings as a vehicle principally for the progressive reduction and elimination of trans-Tasman trade barriers in respect of goods were fairly simple and straight forward. Without denying the importance of that original principal purpose and the comparative elegance of its machinery, ANZCERTA has evolved into something much more complex and adaptable.

Having achieved free trade in goods in the trans-Tasman market substantially ahead of schedule, it has extended its purview to trade in services and harmonisation of business laws between Australia and New Zealand, and now shows every indication of evolving into the major continuing forum for the working-out of trade-related issues in the region. Indeed, it now treads the world stage as an exponent of the application of domestic competition laws to the territory traditionally covered by anti-dumping measures.[2] This latter issue will form the focus of the second part of this paper.

History and development[3]

Diplomatic and particularly trade links between Australia and New Zealand appear to have been slow to develop, despite the obvious common

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1 Otherwise known in the literature by the anagram ÔCERÕ.

2 The trans-Tasman competition laws which have replaced anti-dumping measures in relation to goods originating within the area have been monitored and discussed extensively at recent meetings of the OECD Competition Policy Committee. In May 1993 a joint paper on this initiative was presented by Australia and New Zealand to the OECD Competition Policy Committee, and I have had the benefit of discussing its contents with one of its authors, Mr J Dick of the Australian Treasury Department, Canberra.

3 The writer has drawn much of the material relating to the pre-ANZCERTA history of trade relations between Australia and New Zealand from the following articles:
Brazil, P ÔThe Developing Closer Economic Relationship between Australia and New ZealandÕ, paper delivered at Fifteenth International Trade Law Conference (1988) (Canberra), 309-337 and 311-313.
Alchin, T M, ÔThe Role of the CER in improving Australia-New Zealand RelationsÕ, The Australian Quarterly (Autumn 1990), 21-35 and 22-25.

denominators of language, socio-political tradition and culture (the European part thereof) and shared isolation from the rest of the developed world. Both countries independently pursued their respective trade objectives with the rest of the world, and particularly with Great Britain. The first reciprocal tariff preferences between Australia and New Zealand were introduced in 1922 as part of the British Preference System, and applied to a limited range of goods only. This arrangement was extended in 1933, when the preferential tariff regime between the two countries was significantly widened.

A new emphasis on co-operation between Australia and New Zealand in trade matters was born of necessity in the 1960s when the UK moved towards joining the European Economic Community. Thereby excluded from their existing preferential trade arrangement, Australia and New Zealand recognised the need for a formal free trade agreement between their two nations.

The New Zealand-Australia Free Trade Agreement (NAFTA), dealing mainly with tariffs and some other types of trade barriers, came into force on 1 January 1966. The negotiation of this Agreement was informed by the provisions of the General Agreement on Tariffs and Trade (GATT), of which both countries had become members in 1947. Initially highly successful in developing trade between the two countries,[4] NAFTA was, however, a limited and flawed agreement. A genuine free trade regime did not ensue, because the range of items to be traded free of duty thereunder covered only forest products and a limited range of manufactured goods, amounting to about half of the value of goods then traded between Australia and New Zealand. In addition, the parties were not bound to remove quantitative import restrictions, and ÔsensitiveÕ goods were exempted from the duty-free regime so as to avoid injury to domestic producers in either country. By early 1979, NAFTA had descended into chaos and petty disputation, because of frustrated aspirations for the broadening of trans-Tasman free trade.

In early 1980, the then Prime Ministers of the two nations met in Wellington, commencing the negotiations that resulted ultimately in ANZCERTA.

ANZCERTA

Signed in Canberra on 28 March 1983, ANZCERTA is deemed to have come into force on 1 January 1983.[5] The stated objectives of the Agreement, as set out in Article 1, are:

Ô(a) to strengthen the broader relationship between Australia and New Zealand;

4 Brazil (*op cit* at 312) reports that bilateral trade grew by 800% between 1966 and 1980. How much of this growth is due directly to NAFTA is unclear (see Alchin, *op cit* at 22-23).

5 Article 16, ANZCERTA.

(b) develop closer economic relations between the Member States through a mutually beneficial expansion of free trade between New Zealand and Australia;

(c) to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with a minimum of disruption; and

(d) to develop trade between New Zealand and Australia under conditions of fair competition.Õ

The preamble to the Agreement also refers to the Member StatesÕ Ôcommitment to an outward looking approach to tradeÕ, and their belief that:

> Ôa closer economic relationship will lead to a more effective use of resources and an increased capacity to contribute to the development of the region through closer economic and trading links with other countries, particularly those of the South Pacific and South East Asia.Õ

The principal operative provisions of the Agreement relate to:

1. the reduction and elimination of tariffs on goods traded between the Member States (Article 4);
2. the reduction and elimination of quantitative import restrictions and tariff quotas on such goods (Article 5);
3. the reduction and elimination of quantitative export restrictions on such goods (Article 8);
4. the reduction and elimination of export subsidies and incentives in respect of such goods (Article 9);
5. the amelioration of measures for the stabilisation and support of agricultural goods (Article 10);
6. the elimination of government purchasing preferences for domestic suppliers over suppliers from the other Member States (Article 11); and
7. anti-dumping action and countervailing action (Articles 15 and 16 respectively).

Under the relevant articles, progressive automatic timetables were established for the reduction and elimination of tariffs,[6] quantitative import restrictions and tariff quotas.[7] In respect of tariffs on goods traded between the Member States, they were to be finally eliminated within five years from the entry into force of the Agreement (ie by 1 January 1988).[8] In respect of quantitative import restrictions and tariff quotas on such goods, they were to be phased out by 30 June 1995.[9]

6 Article 4:3, ANZCERTA.

7 Article 5:3, 4, 5, 6, 7 and 15 ANZCERTA.

8 Article 4:3, ANZCERTA.

9 Article 5:14, ANZCERTA.

Article 15 of the Agreement proceeds on the following understanding:

> ÔDumping, by which goods are exported from the territory of a Member State into the territory of the other Member State at less than their normal value, that causes material injury or threatens to cause material injury to an established industry or materially retards the establishment of an industry in the territory of the other Member State, is inconsistent with the objectives of this Agreement.Õ[10]

Paragraph 2 of the Article provides that a Member State could levy anti-dumping duties in respect of goods imported from the territory of the other Member State if it had determined that there was dumping, material injury (including threatened material injury to an established domestic industry, or material retardation of the establishment of a domestic industry), and a causal link between the dumped goods and the injury, and if it had afforded the other Member State the opportunity for consultations.

Provisional measures, including the taking of securities, could be implemented in appropriate circumstances for up to six months.[11]

Provision is also made, in para 8 of the article, for one Member State to request the other to take action if it appears that goods are being dumped in the territory of the second Member State by a third country, and that that dumping is causing material injury or threatening to cause material injury to an industry located in the first Member State.

Article 16 provides that neither Member State shall take countervailing action in respect of subsidisation by the other Member State unless material injury is occurring or being threatened to a domestic industry, or the establishment of a domestic industry is being retarded by the subsidised goods, and no mutually acceptable alternative course has been determined by the Member States. Any proposed countervailing action is also stated to be subject to the provisions of the GATT and the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (Ôthe Subsidies CodeÕ).[12]

Provisional measures may also be taken under this Article, but only for a period of four months.[13]

Similar provision is also made for one Member State to request the other to take action against a third country in respect of subsidisation, in appropriate circumstances.[14]

10 Article 15:1, ANZCERTA.

11 Article 15:6, ANZCERTA.

12 Article 16:1 and 3, ANZCERTA.

13 Article 16:5, ANZCERTA.

14 Article 16:8, ANZCERTA.

1988 General Review

Article 22:3 of ANZCERTA made specific provision for a general review of the operation of the agreement in 1988. A number of very significant documents and initiatives arose out of that review.

1. A Memorandum of Understanding on the Harmonisation of Business Law was executed on 1 July 1988, whereby both Member States agreed to examine the scope for harmonisation of business laws and regulatory practices, including the removal of any impediments that were identified.

   ÔCompetition law, including in particular reliance on competition law to redress predatory trade between both countriesÓ[15] was amongst the topics specifically included in the wide-ranging programme.

   A Steering Committee of Officials was established to co-ordinate the examination process, and continues to meet and report to both governments on a regular basis.

2. A Protocol on Acceleration of Free Trade in Goods was signed on 18 August 1988. Under this Protocol:
   - (a) each Member State agreed to eliminate all remaining tariffs, quantitative import restrictions and tariff quotas on goods traded between them, by 1 July 1990 (Articles 1 and 2);
   - (b) from the same date, subject to domestic competition laws being extended by then to relevant anti-competitive conduct affecting trans-Tasman trade in goods, no further anti-dumping action would be taken by either Member State in relation to goods originating in the territory of the other Member State (Article 4);
   - (c) a further general review of ANZCERTA would take place in 1992 (Article 5).

3. Related to the above, the Mutual Determination on Quantitative Export Restrictions bound the parties to the elimination of quantitative export restrictions in relation to trans-Tasman trade in goods by 1 July 1990.

4. The Protocol on Trade in Services extended the liberalising influence of ANZCERTA to trade in services between the Member States. A consideration of this significant development is beyond the scope of this present paper.

5. Other significant documents and initiatives arising out of the 1988 review were the Protocol and Agreed Minutes on Harmonisation of Quarantine Administrative Procedures, the Memorandum of Understanding on Technical Barriers to Trade, and the Agreed Minute on Industry Assistance (whereby it was agreed that from 1 July, 1990, neither Member State would pay export incentives or like measures aimed at stimulating exports

15 Paragraph 5(b), Memorandum of Understanding on the Harmonisation of Business Law.

to the other country at the expense of industry in that country, or production bounties or like measures on goods exported to the other country).

Thus, on 1 July 1990 full free trade between Australia and New Zealand can be said, by and large, to have been achieved.

1992 General Review

The primary purpose of ANZCERTA having been achieved on 1 July 1990, the 1992 General Review was bound to be less dramatic. Nevertheless, ANZCERTA expanded its developing role as a regional forum for the resolution of trade-related issues, with the following initiatives arising from the 1992 General Review:

1. Annex F, the only remaining margin of preference obligation in ANZCERTA, was removed.
2. Additional notification and consultation procedures were attached to the Agreed Minute on Industry Assistance, which include specific provisions regarding consultations where each country forms a different initial conclusion as to whether or not a particular industry-specific measure has adverse effects on competition between industries within the trans-Tasman area.
3. The number of services exempted from the operation of the Protocol on Trade in Services was reduced.
4. Changes were made to the manner in which the rules of origin (contained in Article 3 of ANZCERTA) are administered, including the introduction of a 2% margin of tolerance in meeting the 50% area content requirement, and the allowance of some additional labour, overheads and materials costs to be included in the factory or works costs that can be counted towards the 50% area content requirement.
5. The Memorandum of Understanding on Technical Barriers to Trade was reviewed, and an exchange of letters was concluded recording developments since 1988, including AustraliaÕs accession in 1992 to the GATT Standards Code, by which both countriesÕ international obligations in relation to technical barriers to trade will henceforth be governed. The exchange of letters also notes the establishment of the 1990 Agreement on Standards, Accreditation and Quality (ASAQ) between New Zealand and the States and Territories of Australia, and of the Joint Accreditation System Ð Australia and New Zealand (JAS-ANZ) in 1991.
6. An agreed set of procedures for handling third country dumping complaints pursuant to Article 15:8 of ANZCERTA was established by an exchange of letters.
7. Preparatory work was done on a new double taxation agreement.
8. The negative impact of the trans-Tasman maritime union shipping accord (which presently has the effect of restricting the freedom of choice in

trans-Tasman shipping services to ships crewed by Australians and New Zealanders) was considered and decried.

9. Further harmonisation of customs and quarantine procedures was also considered.

In their Joint Statement in relation to the 1992 General Review, the Australian Minister for Trade and Overseas Development, Mr J Kerin, and the New Zealand Minister for Trade Negotiations, Mr P Burdon, expressed their commitment to meeting at least annually to review the operation of the Agreement, and to a further general review of the Agreement not later than 1995.

1993 Review

The first of the newly instituted annual reviews of ANZCERTA took place in Wellington from 2-4 August 1993, between Senator Peter Cook (Australian Minister for Trade) and Mr Burdon.[16] The most significant development announced subsequent to these talks was apparent agreement in principle to the extension of the Australian Mutual Recognition Agreement (which provides for mutual recognition of product standards and occupational qualifications between the Australian States) to New Zealand.

Developments in 1994[17]

1994 has seen considerable fluctuation in ANZCERTAÕs stocks. Meetings between Mr Bob McMullan, the new Australian Minister for Trade, and Mr Burdon took place on 28 February 1994[18] and 15 August 1994[19] at which each reaffirmed his countryÕs commitment to the Agreement. Talk turned to exploring possible linkages between ANZCERTA and the ASEAN Free Trade Area (AFTA), and the idea has met with some encouragement from key ASEAN leaders.[20] Thus it seems that the vision of ANZCERTA as a

16 Vide Ð News Release Ð Minister for Trade, Senator P Cook, 4 August 1993.

17 This section written as part of a November 1994 review of this paper, originally written in August 1993.

18 Vide Ð Joint Statement Ð Australian Minister for Trade, Bob McMullan, and New Zealand Minister for Trade Negotiations, Philip Burdon, 28 February 1994.

19 Vide Ð Media Release Ð Minister for Trade, Bob McMullan, 14 August 1994, and Media Release Ð Minister for Trade, Bob McMullan, 15 August 1994.

20 See:
Hickey, Bernard, ÔAustralia, NZ agree to pursue trade pact with ASEANÕ, Reuters News Service, 6 July 1994.
Wright, Tony, ÔKeating, Bolger eye Asia trade zoneÕ, Sydney Morning Herald, 7 July 1994.
Murdoch, Lindsay, ÔASEAN to discuss trade links with Aust and NZÕ, Sydney Morning Herald, 28 July 1994.
Murdoch, Lindsay, ÔThais to push ASEAN for Australian free trade tiesÕ, The Age (Melbourne), 22 September 1994.
Earl, Greg, ÔProgress on SE Asia trade link Ð AFTA-CER Ð the grapple for free tradeÕ, Australian Financial Review, 23 September 1994.
Murdoch, Lindsay, ÔASEAN to assess Australia linkÕ, The Age (Melbourne), 23 September 1994.

springboard for joint trade initiatives in the wider regional and global market may soon be realised.

However, industry-specific developments such as the Australian GovernmentÕs apparent protectionist motives in recently stepping back from the Prime MinisterÕs 1992 commitment to an Ôopen skiesÕ combined trans-Tasman aviation market[21] has significantly damaged the goodwill underpinning the Agreement. In the light of AustraliaÕs current trade preoccupations, it is difficult to escape the conclusion already reached by much of the financial press, that the present Australian government has lost interest in ANZCERTA and is looking to plough its own furrows in Asia.

This may be merely a matter of fashion, and a transitory perception, but there can be no doubt that as 1994 draws to a close, the ANZCERTA relationship is less confident than it was 12 months before.

Dumping Anti-Dumping

Article 4 of the 1988 Protocol on Acceleration of Free Trade in Goods (and consequent legislative changes) put an end to anti-dumping action between Australia and New Zealand as from 1 July 1990. Paragraph 1 of the Article states:

> ÔThe Member States agree that anti-dumping measures in respect of goods originating in the territory of the other Member States are not appropriate from the time of achievement of both free trade in goods between the Member States on 1 July 1990 and the application of their competition laws to relevant anti-competitive conduct affecting trans-Tasman trade in goods.Õ

The preamble to the Protocol records the partiesÕ belief that:

> Ôthe maintenance of anti-dumping provisions in respect of goods originating in the other Member State ceases to be appropriate as the Member States move towards the achievement of full free trade in goods between them and a more integrated market.Õ

As stated by Mr P Brazil at the 15th International Trade Law Conference in Canberra, the Protocol:

> Ôrecognises that, with the elimination of barriers normally raised by countries for protection of their domestic economies and with the effective integration of their trading economies, the means of operating against unfair international trade also cease to be appropriate.Õ[22]

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21 See:
Thomas, Ian, ÔComment Ð CER theory shot down in flamesÕ, Australian Financial Review, 26 October 1994.
Thomas, Ian, ÔBrereton declares air war on NZÕ, Australian Financial Review, 26 October 1994.
Graham, Pamela, ÔNZ seeks solution to Australasian air disputeÕ, Reuters News Service, 27 October 1994.
Riley, Mark, ÔAir NZ alarmed at BreretonÕs brush-offÕ, Sydney Morning Herald, 27 October 1994.
Templeton, Ian, ÔOpinion Ð from the BeehiveÕ, Reuters News Service, 31 October 1994.

22 Brazil, P, *op cit* at 314.

It was considered that, as of 1 July 1990, trans-Tasman trade was more in the nature of domestic rather than international commerce, and that:

> Ô[w]hile the operation of anti-dumping may be seen as an appropriate remedy to reduce distortions in the pattern of international trade, the retention of anti-dumping provisions is an anomaly in the context of a free trade area.Õ[23]

Article 4:2 of the Protocol provides that, from 1 July 1990, neither Member State would take anti-dumping action against goods originating in the territory of the other Member State; current investigations were to be terminated, and securities and undertakings released.

Paragraph 3 of the Article, whilst declaring that paras 1-7 of Article 15 of the original Agreement were now superseded, leaves para 8 (relating to dumping by third countries in the territory of one Member State causing injury to an industry in the territory of the other Member State) of that Article intact. It should also be noted that Article 16 of the original Agreement, relating to countervailing action, remains in force.

Article 4:4 of the Protocol contains the crucial obligation that:

> Ô[e]ach Member State shall take such actions as are appropriate to achieve the application of its competition law by 1 July 1990 to [relevant anti-competitive conduct affecting trans-Tasman trade in goods] in a manner consistent with the principles and objectives of the Agreement.Õ

Section 46A of the Trade Practices Act 1974 (ÔTPAÕ),[24] introduced by the Trade Practices (Misuse of Trans-Tasman Market Power) Act 1990 (Cth), is the means by which this obligation has been fulfilled in Australia. The cognate New Zealand provision is s 36A of the Commerce Act 1966 (ÔCAÕ).[25] The thrust of both provisions is that a corporation (ÔpersonÕ, under the New Zealand legislation) that has a substantial degree of market power (Ôa dominant positionÕ, under the New Zealand legislation) in a trans-Tasman market (meaning a market in either Australia or New Zealand or in Australia *and* New Zealand for goods or goods and services) shall not take advantage of (ÔuseÕ, under the New Zealand legislation) that power or position for certain proscribed purposes.

Under the Australian legislation, the proscribed purposes are:

1. eliminating or substantially damaging a competitor of the corporation ... in an impact market (defined to mean a market in Australia that is not a market exclusively for services); or
2. preventing the entry of a person into an impact market; or

23 *Ibid* at 315.

24 Based upon s 46 of the TPA, in relation to misuse of market power in Australia.

25 Based upon s 36 of the CA, in relation to misuse of market power in New Zealand.

3. deterring or preventing a person from engaging in competitive conduct in an impact market.[26]

Under the New Zealand legislation, the proscribed purposes are:

1. [r]estricting the entry of any person into any market, not being a market exclusively for services; or
2. [p]reventing or deterring any person from engaging in competitive conduct in any market, not being a market exclusively for services; or
3. [e]liminating any person from any market, not being a market exclusively for services.[27]

There are obviously a number of differences between the provisions enacted by Australia and New Zealand. The most significant of these would be the different market power tests, fulminated against by Dr (as he then was) W Pengilley.[28] In the Australian legislation, the test is Ôa substantial degree of market powerÕ. Under the New Zealand provision, Ôa dominant positionÕ is required.

This is not an ideal situation. As noted by Professor Pengilley, highly anomalous results may follow.

> ÔA New Zealand company can be engaging in conduct which inhibits entry to *both* the Australian and New Zealand market. The conduct is legal in New Zealand because of the higher threshold test. It may, under the new legislation, be illegal in Australia because the Australian threshold test is lower. The New Zealand company may then face action by an Australian company or the Australian Trade Practices Commission brought in the Federal Court of Australia. The Federal Court then has to determine questions of New Zealand market power and may issue orders to restrain conduct quite legal in New Zealand because of the impact of that conduct in Australia.Õ[29]

Whilst it has been suggested that in practice there is likely to be little significance in the differing market power tests,[30] it is significant that the Australian legislature, in its 1986 amendments to the Trade Practices Act, saw fit to lower the test in s 46 of the TPA (the parent provision of s 46A) from one of being Ôin a position substantially to control a marketÕ to the current Ôsubstantial degree of market powerÕ. Indeed, the Explanatory Memorandum to the 1986 Bill acknowledged that:

26 Section 46A(2) of the TPA.

27 Section 36A(2)(d), (e) and (f) of the CA.

28 Pengilley, W ÔA Patchwork of LegislationÕ (July 1990) Australian Law News, 26-27.

29 Pengilley, W, *op cit at* 27.

30 For example, by Steering Committee of Officials (Report to Governments, June 1990, 46) and by Vautier KM (ÔTrans-Tasman Trade and Competition LawÕ CER and Business Competition: Australian and New Zealand in a Global Economy, pp 87 and 106).

Ô[a] corporation having a Òsubstantial degree of market powerÓ may have a lesser degree of market power than that of a corporation which Òwould be, or would be likely to be, in a position to ... dominate a marketÓ as provided in s 50. ÒDominanceÓ connotes a greater degree of independence from the constraints of competition than is required by a Òsubstantial degree of market powerÓÕ[31]

The Australian provision is also seen to be wider in scope than its New Zealand counterpart in that one of the proscribed purposes is Ôeliminating *or substantially damaging* a competitorÕ (emphasis added). The New Zealand provision only refers to Ô[e]liminating any person from any marketÕ. However the word ÔsubstantiallyÕ in the Australian legislation may be interpreted, it is clearly a wider net than that cast by the New Zealand provision.

A discrepancy also appears between Ô*preventing* the entry of a person into an impact marketÕ (Australia) and ‘ *[r]estricting* the entry of any person into any marketÕ (New Zealand). In this respect, the New Zealand wording appears to be the wider. However, differentiating between the purpose of restricting entry and the purpose of preventing entry is likely to be difficult in practice.

Under the Australian legislation, a corporation with the requisite degree of market power may not Ôtake advantage ofÕ that power for any of the proscribed purposes. This seems to imply a higher degree of nefariousness or of hostile intent than the New Zealand provision, that a person may not ÔuseÕ a position of dominance in a trans-Tasman market for any of the specified purposes. However, since the High Court of AustraliaÕs decision in *Queensland Wire Industries Proprietary Limited v Broken Hill Proprietary Company Limited*[32] it is clear that the words Ôto take advantage ofÕ, as used in s 46 of the TPA, do not require hostile or predatory intent and may extend to the use of existing legal rights, if used by a corporation with the requisite degree of market power and for one of the proscribed purposes. It seems, therefore, that there is no appreciable difference between the two jurisdictions in this respect.

Finally, an anomaly arises from the definition of Ôimpact marketÕ in the Australian legislation. Whilst the source of the required degree of market power may be found, under either provision, in a market in Australia or New Zealand or in Australia *and* New Zealand, the target of the relevant purpose is limited, under the Australian provision, to a market in Australia. It follows that misuse of market power targeting a market in Australia *and* New Zealand *will not be caught* by s 46A of the TPA. Section 36A of the CA uses the expression Ôany marketÕ instead of Ôimpact marketÕ. Section 3(1A) of the CA specifically provides that every reference in that Act to the term ÔmarketÕ, apart from certain specified references, means a market in New Zealand. The

31 Trade Practices Legislation and Materials 1986, Attorney-GeneralÕs Department, 214. See also Blunt, G & Nygh, N ÔTrans Tasman Trade Practices Problems: Comity or ConfusionÕ (1994) 2 Competition & Consumer Law Journal, 16 at 28-33.

32 (1989) 167 CLR 177.

same anomaly therefore seems to apply in relation to the target market under the New Zealand legislation, notwithstanding the apparent broadening effect of the word ÔanyÕ in this context.

Article 8 of the Memorandum of Understanding on the Harmonisation of Business Law records the recognition by both governments that Ôeffective harmonisation does not require replication of laws, although that may be appropriate in some casesÕ. In relation to the differing market power threshold tests, Brazil comments that effective application of domestic competition laws to the trans-Tasman arena Ôwould not require the respective governments to have precisely the same threshold tests if domestic industry structure and economic circumstances required divergence of policy on those threshold testsÕ.[33] Professor Pengilley would presumably disagree, and vehemently at that. Indeed, it would seem that there are good grounds for suggesting that the threshold market power tests are one area where replication of laws would be appropriate, if only to avoid the sort of anomalies of which Professor Pengilley warns. The issue of the differing market power tests remains on the agenda of the Steering Committee of Officials. However, the writer is informed[34] that the Australian authorities believe that no further action in this regard is warranted unless and until the discrepancy proves to be a problem in practice.

Leaving aside the apparent potential difficulties in the application of the trans-Tasman competition laws, the abandonment of anti-dumping sanctions in favour of expanded application of domestic competition laws to trade between Australia and New Zealand is itself a matter of some controversy and concern.[35] The language of the relevant part of the preamble and of Article 4:1 of the Protocol suggests that anti-dumping action would no longer be appropriate once free trade in goods between the Member States had been achieved. This is, as *per* Waincymer, Ôby no means an unassailable propositionÕ.[36]

Commentary to the effect that the removal of trade barriers would render dumping largely redundant due to the scope for price discrimination between the domestic and export markets being thereby reduced,[37] may be in the nature of a pious hope. Assuming that there are such things as trade ÔpredatorsÕ, dumping will presumably occur whether or not trade barriers exist. General philosophical propositions that anti-dumping action, whilst

33 Brazil, P, *op cit* at 9.

34 by Mr J Dick, Australian Treasury Department, Canberra.

35 See Waincymer, J ÔInternational Trade and InvestmentÕ (August 1990) Australian Business Law Review, 267-274, and Kewalram, RP ÔThe Australian-New Zealand Closer Economic Relations Trade Agreement: An Experiment with the Replacement of Anti-Dumping Laws by Trade Practices LegislationÕ (October 1993) Journal of World Trade, Vol 27(5), 111-124.

36 Waincymer, J *op cit* at 273.

37 As *per* Brazil, P, *op cit* at 315.

appropriate to redress imbalances in international trade, is not appropriate in the trans-Tasman ÔdomesticÕ market established under ANZCERTA, will remain less than convincing unless and until New Zealand becomes the seventh State of Australia and whilst nationals of either country continue to regard the other country as ÔforeignÕ.

Whilst the experiment of replacing anti-dumping rules with competition laws has provoked much overseas interest, particularly in the forum of the OECD Committee on Competition Policy, the writer is informed[38] that similar initiatives are unlikely to be taken by any other countries in the foreseeable future. It must be emphasised that the Australia-New Zealand initiatives were greatly facilitated by the close historical associations of the two countries and their mutual confidence in each others judicial and administrative structures. These are features not necessarily to be found so easily in the European context or amongst the parties to the North American Free Trade Agreement.

Anti-dumping provisions and competition laws are clearly not interchangeable. They address different issues, and their objects, procedures and remedies are completely different.

Dumping, as defined by Article VI of the General Agreement on Tariffs and Trade (GATT), involves products of one country being introduced into the commerce of another country at less than the normal value of such products. These concepts are clarified in the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (Ôthe Anti-Dumping CodeÕ),[39] in Article 2:1 of which it is stated that Ôa product is to be considered as being dumped ... if the export price of the product exported from one country to another, is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.Õ

Any such Ôprice discriminationÕ which causes or threatens to cause material injury to a domestic industry, or which materially retards the establishment of a domestic industry, is the evil at which anti-dumping provisions are directed. Competition law, on the other hand, concerns itself not with price discrimination, but with damage to the Ôcompetitive processÕ *per se*.

Competition laws, such as the trans-Tasman misuse of market power provisions, protect against anti-competitive conduct only by corporations/persons with the requisite degree of market power. The old anti-dumping provisions did not include any requirement as to degree of market power, and anti-dumping action was available against anyone, whatever the level of their market power. Practically, of course, it would generally be untenable to pursue a policy of Ôpredatory pricingÕ without a Ôsubstantial

38 By Mr J Dick, Australian Treasury Department, Canberra and Ms T Reid, OECD & G7 Section, Department of Foreign Affairs and Trade, Canberra.

39 Which entered into force for Australia on 21 October 1982.

degree of market powerÕ or Ôa dominant positionÕ in the market. Nevertheless, the linkage is not absolute, and dumping certainly can occur in the absence of that level of market power on the part of the dumper.

Anti-dumping sanctions are ÔactivatedÕ by the *effect* that the dumping has upon a domestic industry, ie material injury (or threatened material injury) or material retardation of the establishment of a domestic industry. Under the competition laws, the crucial question is as to the *purpose* for which the market power was used, and specifically whether the use of the market power was for one of the proscribed purposes. It will generally be more difficult to establish *purpose* than *effect*. A case illustrative of this difficulty is *Trade Practices Commission v CSBP And Farmers Ltd*[40] (in relation to s 46 of the TPA), in which a distributor of fertiliser in Western Australia, which admitted having the necessary degree of market power, reduced its price at the same time as another company was about to commence importation of fertiliser from Italy. The Trade Practices Commission failed, however, to prove a breach of s 46 because it was unable to prove on the facts that conscious predatory behaviour was involved.

An anti-dumping regime provides protection for a domestic industry injured or threatened with injury by dumped goods. The protection offered by competition law is to the Ôcompetitive processÕ, and indirectly to the consumer. Injury to a domestic industry is not at all indicative of anti-competitive conduct. As stated by the High Court of Australia in relation to s 46, the object of competition law

> Ôis to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to ÒinjureÓ each other in this way. This competition has never been a tort ... and these injuries are an inevitable consequence of the competition s 46 is designed to foster.Õ[41]

Anti-dumping action is administered and levied by a public authority at no direct cost to the complainant. Anti-competitive conduct may be attacked under the competition laws, however, by private action as well as by the relevant public authorities.

The remedy available in any anti-dumping action is the imposition of an additional duty on imports of the relevant goods up to the level of the Ôdumping marginÕ, aimed at offsetting the injury to the domestic industry. The remedies provided by the competition laws are penal rather than remedial in nature, consisting principally of fines, although injunctive relief and damages

40 (1980) 53 FLR 135

41 *Queensland Wire Industries Proprietary Limited v Broken Hill Proprietary Company Limited* and another (1989) 167 CLR 177 at 191 (*per* Mason C J and Wilson J).

are also available.

It will be clear, however, that reliance on competition law in lieu of an anti-dumping regime will inevitably mean that a lesser degree of protection is available to domestic industries in the respective countries. Most obviously, the market power threshold tests applicable in competition law and the necessity of establishing purpose make it so. Some, perhaps many, circumstances which would have given rise to anti-dumping intervention will not be caught by the competition laws for the lack of Ôa substantial degree of market powerÕ or Ôa dominant positionÕ on the part of the perpetrator, or because of an inability to prove that the purpose was one of those proscribed.

This is not to suggest that in entering upon this experiment, the respective governments were under any illusions as to the extent to which competition law would replicate anti-dumping protection. The initiative and its effects are in accordance with economic policy and the expressed philosophy regarding the establishment of an integrated trans-Tasman market. Indeed, the New Zealand government specifically stated that:

> ÔSection 36 will not replicate the protection provided by anti-dumping measures. However, section 36 focuses on the competitive impact of conduct with far greater precision than do anti-dumping measures. In using the regime applying to domestic trade instead of that applying to international trade [it is] recognised that the greater precision afforded by competition law is more appropriate in the CER context where concern is with the misuse of market power rather than with discriminatory pricing per se.Õ[42]

However, whether it is really a single, integrated, ÔdomesticÕ market that has been achieved under ANZCERTA is open to question, whilst political and administrative integration lags and the perception of ÔforeignnessÕ persists.

Up until 1 July, 1990, dumping complaints against New Zealand businesses, whilst not a common event, had not infrequently been made. However, in the more than four years since the new trans-Tasman competition law regime came into being the writer understands[43] that only one investigation under s 46A of the TPA has been commenced, and action did not ensue on the advice of the Australian government solicitor that no breach had occurred;[44] nor have there been any actions in New Zealand under s 36A of the CA. Even allowing for the reduction in the potential for anti-competitive conduct by virtue of the removal of trade barriers, and the presumed deterrent

42 New Zealand Ministry of Commerce, Review of the Commerce Act 1986: Reports and Decision, Wellington, August 1989, Annex 1, at 1.

43 As advised by Michael Lusk, Legal Officer, Trade Practices Commission, Canberra.

44 The writer is aware of only one reported decision containing any reference to s 46A, a matter of *Berlaz Pty Ltd and others v Fine Leather Care Products Limited* (1991) ATPR 41-118. In this decision of Pincus J, nothing ultimately turned on s 46A.

effect of any such legislation, this lack of action seems surprising. As at the date of writing, the efficacy or otherwise of the trans-Tasman competition laws in protecting domestic industries still remains to be tested.

Historically, Australian industries have availed themselves quite frequently of the anti-dumping laws, particularly over the last decade or so. Given that regular recourse to such measures in respect of imports from countries other than New Zealand may reasonably be expected to continue, there may be some tension between the new trans-Tasman arrangements and AustraliaÕs obligations under the GATT and the GATT Anti-Dumping Code.

Although the GATT certainly does not oblige contracting parties to apply anti-dumping measures to dumped goods causing or threatening injury (indeed, despite the GATTÕs condemnation of dumping, strict limits are placed upon measures taken in response), Article 8:2 of the Anti-Dumping Code provides that:

> ÔWhen an anti-dumping duty is imposed in respect of any product, such anti-dumping duty shall be collected in the appropriate amounts in each case, *on a non-discriminatory basis* on imports of such product from *all sources found to be dumped and causing injury*.Õ (emphasis added)

It might therefore be argued that in circumstances where a product is imported into Australia from both New Zealand and a third country at ÔdumpedÕ prices, the *collection* of anti-dumping duty on the imports from the third country and not on the imports from New Zealand would be in breach of Article 8:2 of the Anti-Dumping Code.

However, by the wording of the Article, non-discriminatory collection of anti-dumping duty is required on imports from all sources *found to be dumped and causing injury*. Of course, no such finding can now be made by Australia in respect of imports from New Zealand, or vice versa.

Nevertheless, whilst Article XXIV of the GATT permits the formation of free trade areas provided they do not have the effect of raising barriers to the trade of other contracting parties with the constituent territories of such free trade areas, the abolition of anti-dumping measures in the trans-Tasman area can be seen to have the potential for some degree of anti-competitive effect. For example, Australian importers might be prompted to change their source of supply of products susceptible to anti-dumping action from *efficient* third country suppliers (in respect of whom anti-dumping action would still be available) to *less efficient* New Zealand suppliers.[45] Whether this is tantamount to raising barriers to the trade of third countries may well be arguable.

45 As suggested by Waincymer, J *op cit* at 272.

Conclusion

ANZCERTA is presently in a very interesting transitional phase. A true Free Trade Area has been achieved, with full free trade in goods and, to a large extent, in services. The way ahead in the development of the Agreement, assuming sufficient goodwill remains between the parties, will necessarily involve consideration of issues such as a trans-Tasman Competition Court, a common external tariff, and a common currency. There will be exquisite tension between resistance to the loss of national sovereignty which such initiatives entail, and the imperatives of economic integration for improved global trade performance.

The boldness of the experiment in abandoning the anti-dumping regime in favour of ÔdomesticÕ competition laws augurs well for this process. This particular initiative, however, driven by philosophy and economic policy as it was, is still to prove its practical effectiveness, and the lack of recourse to the trans-Tasman competition laws in the four years and more since their commencement has done nothing to dispel any lingering reservations.

Australian Export Controls: A Review

Richard Leahy

While there are certain obvious policy motivations for the imposition of controls on the import of goods into a country (such as the protection of local industries), justifications for regulating the export of goods[1] may be less obvious. However, it is inevitable and necessary that there are some controls on the export of goods from Australia.[2] Export controls may also serve to protect local industries. For instance, the First Schedule of the Customs (Prohibited Exports) Regulations (Cth) formerly prohibited the export of wine declared by the relevant Minister to be of such quality that its export would be harmful to the reputation of Australian wine.[3] Certain export controls may also be required to fulfil obligations arising under international treaties to which Australia is a party.[4]

An initial crucial consideration for any intending exporter of goods from Australia must be whether those goods may legally be exported and, if so, what conditions, if any, are placed upon such export. An intending exporter must ensure that applicable export controls are complied with to enable them to fulfil any contractual obligation to deliver those goods. There are currently

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1 This paper is confined to a consideration of the controls on the export of tangible commodities. The most comprehensive review of these controls is Australian Customs Service, *Australian Customs Service Manual (Public Edition) Volume* 12: Export Control (Canberra: AGPS, 1993). References to this manual are not footnoted as most topics dealt with in this paper are examined comprehensively in the manual. The ÔexportÕ of services is not generally subject to controls, unless the provision of the service also involves the provision of goods: see generally P Sacks and J Malbon (ed), *Australian Export Manual* (1992) (Melbourne: Longman Professional), 46-49, 287-291. The licensing of technology and intellectual property overseas is likewise free from export controls: Sacks and Malbon, 93-109.

2 *Cf* Sacks and Malbon, 268. See also E J Cooper, *Customs and Excise Law* (1984) (Sydney: Legal Books Pty Ltd), 277; Australian Law Reform Commission, Customs and Excise, Report No 60, (Canberra: AGPS, 1992), Vol II, 31 (hereafter ÔALRCÕ).

3 The First Schedule was repealed by Regulation 57 of 1989.

4 For example, under the General Agreement on Tariffs and Trade (GATT). However, the GATT focuses primarily on the treatment of goods on import into a country rather than the treatment on export: GATT, Part II, Articles IX-XIII. See also analysis in Sacks and Malbon, 264-266; CCH, *Australian Customs Law and Practice* (1990) (North Ryde, NSW: CCH Australia Ltd), 2,011-2,104.

few absolutely prohibited exports[5] and current export control legislation emphasises conditional export.[6]

The regulatory scheme

The power to legislate with respect to trade and commerce with other countries is conferred on the Commonwealth Parliament by s 51(i) of the Constitution. The power given by s 51(i) will support a law which prohibits absolutely or conditionally the export of any commodity: *Crowe v Commonwealth* (1935) 54 CLR 69, 96. This power has been exercised primarily through the Customs Act 1901 (Cth) and the Export Control Act 1982 (Cth). Much of the regulatory power over exports is contained in subordinate legislation under these two Acts.[7]

Where export control legislation is ambiguous it may be interpreted so as to preserve rather than detract from the right of a person to export goods. In *Mudginberri Station Pty Ltd v Langhorne* (1985) 7 FCR 482 at 490 the Full Federal Court stated that:

> ÔIn the absence of any statutory prohibition, citizens of this country have a common law right to prepare goods for sale and to sell them here or overseas.Õ

However, the legislation imposing controls on the export of goods from Australia is generally extremely complex and the opportunities for applying such an interpretation may be limited.

The Australian Law Reform Commission has recently undertaken a comprehensive review of a number of Acts dealing with customs and excise matters.[8] The Commission has proposed a single Customs and Excise Act[9] and the repeal of much existing legislation.[10] The ÔsubstantiveÕ export control[11] and customs clearance[12] provisions under the Customs Act (Cth) herein considered may therefore be the subject of amendment in the near future.[13]

5 For example, the export of goods to which a false trade description has been applied is prohibited by the Commerce (Trade Descriptions) Act 1905 (Cth). Previously the First Schedule of the Customs (Prohibited Exports) Regulations (Cth) prohibited absolutely the export of various items including certain wines, opium and goods intended for human consumption which were declared to be unfit for such purpose.

6 The ALRC report emphasises conditional export: ALRC, Vol II, 129.

7 See Substantive Export Controls and The Export Control Act.

8 Australian Law Reform Commission, Customs and Excise, Report No 60, (Canberra: AGPS, 1992) (hereafter ÔALRCÕ).

9 See Draft Bill in ALRC, Vol I.

10 ALRC, Vol II, 12, 207-208.

11 See Substantive Export Controls.

12 See The Process of Customs Clearance.

13 A Bill implementing many of the ALRC recommendations may be introduced in the Autumn 1994 session of Parliament.

In Sacks and Malbon[14] the consideration of Australian export controls is approached by dividing export commodities into four categories[15] Ð

1. goods which require only customs clearance for export;
2. goods which cannot be exported without an export permit issued by the relevant government department;
3. goods which require no customs clearance and no export permit;
4. goods which cannot be exported at all.

Since the repeal of the First Schedule to the Customs (Prohibited Exports) Regulations (Cth), category four is of limited significance. Also, goods in category three will generally not be in commercial quantities[16] and so in commercial export transactions there will usually be required at least customs clearance for the goods. There is thus essentially a two tier system of controls placed on the export of goods from Australia.[17] The first tier imposes what may be referred to as ÔsubstantiveÕ controls. These controls are imposed on a variety of specified goods and generally make the export of such goods conditional on obtaining a permit or licence from a specified government department or agency. The second tier of control is the necessity of obtaining customs clearance prior to loading goods for export. Customs clearance is required for most consignments of goods, even where an export permit must also be obtained in respect of those goods.

Substantive export controls

> ÔThere is a myriad of statutes and regulations that control the export of goods from Australia.Õ[18]

The principal enactment is the Customs Act (Cth). Section 112 of the Act allows the Governor-General to prohibit by regulation the export of any goods from Australia in specified circumstances, to a specified place, absolutely or conditionally. Export may be made conditional on the grant of a licence or permit by a specified ÔpermittingÕ body. There is thus a statutory power which enables the complete regulation of the export of goods as desired. The Customs (Prohibited Exports) Regulations (Cth) are the major relevant regulations under the Act and are the primary substantive export controls currently in force. These regulations regulate exports to specified

14 P Sacks and J Malbon (ed), *Australian Export Manual* (1992) (Melbourne: Longman Professional).

15 At 267.

16 See The Process of Customs Clearance.

17 There is a third level in that ss 118, 119 and 122 of the Customs Act (Cth) require ships or aircraft to obtain clearance from the Australian Customs Service prior to departure from Australia, but this is more a control on the carrier than the exporter.

18 P Sacks and J Malbon (ed), *Australian Export Manual* (1992) (Melbourne: Longman Professional), 266. See generally, Sacks and Malbon, 266-272; CCH, *Australian Customs Law and Practice* (1990) (North Ryde, NSW: CCH Australia Ltd), 2,303-2,304.

destinations[19] as well as placing conditions on the export of certain goods generally.[20] The goods subject to these conditions are prescribed in various schedules to the regulations. Goods prescribed by these regulations generally may not be exported unless an export permit or licence is obtained from the relevant government department or agency specified in the regulations.

A great many other Acts and regulations also impose substantive controls on the export of certain specified commodities, notably the Export Control Act (Cth). Hence there is a multitude of Acts and regulations which require some form of approval to be obtained as a condition of the export of various specified goods. For many such goods approval for export will be required from more than one permitting body, for example, the export of certain live animals will require permits from both the Department of Primary Industries and Energy (hereafter ÔDPIEÕ) and the Australian National Parks and Wildlife Service.

The Export Control Act

The Export Control Act (Cth) establishes a bare administrative framework[21] within which the DPIE controls the export of foodstuffs. Section 25 of the Act gives the Governor-General a wide power to make regulations and under s 7 the regulations may prohibit the export of Ôprescribed goodsÕ absolutely, to a specified place or conditionally. Under s 8 it is an offence to export goods in breach of the regulations. By virtue of s 25 the regulations may empower the Minister to make orders not inconsistent with the regulations. The Export Control (Orders) Regulations (Cth) set out the power of the Minister to make orders and the administrative and regulatory substance under the Act is largely set out in such orders.[22]

These orders establish various detailed schemes regulating the production, packaging, inspection and handling of foodstuffs which are intended for export and the licences and other conditions under which such commodities may be exported. For example, in relation to meat the Export Meat Orders (Cth) specify various procedures for the examination and slaughter of animals to be exported.[23] Orders may require that the goods prescribed are prepared in approved premises and adequately packaged and labelled. Section 6 requires a

19 Regulations 13C, 13CA, 13CB, 13CC and 13CD respectively prohibit the export of certain goods to South Africa, Iraq, Libya, Yugoslavia and the Republic of Bosnia and Herzegovina and the Republic of Croatia without the approval of the Minister for Foreign Affairs.

20 For example, r 8 requires the approval of the Department of Health, Housing and Community Services as a condition of the export of items specified in Schedule 6, which include blood and human tissue.

21 E J Cooper, *Customs and Excise Law* (1984) (Sydney: Legal Books Pty Ltd), 277 describes the Act as ÔskeletalÕ.

22 *Mudginberri Station Pty Ltd v Langhorne* (1985) 7 FCR 482, 487.

23 See the consideration of the Export Meat Orders (Cth) in Mudginberri, 487-494.

person exporting prescribed goods to inform the DPIE and have the goods available for inspection. Officers of the DPIE ensure the Act, regulations and orders are complied with. Under ss 10-13 of the Act these officers possess extensive powers of search and entry, to take samples and to board or detain any vehicle, ship or aircraft and to seize goods or evidence.

Goods Subject to Substantive Controls

The commodities presently subject to approval as a condition of export are[24] Ð

1. Meat and seafood

   Approval is required from the DPIE in relation to certain live seafood and meat: Customs (Prohibited Exports) Regulations (Cth) r 5, Schedule 3. Permits from the DPIE for the export of certain seafood and meat and various meat products, eg fats, are also required by the Fish Orders (Cth) and Export Meat Orders (Cth) respectively. Controls on the export of game, poultry and rabbit meat are specified separately in the Game, Poultry And Rabbit Orders (Cth).

2. Dairy products

   Approval from the DPIE is required under the Dairy Produce Orders (Cth).

3. Eggs

   A permit from the DPIE is required under the Egg Orders (Cth) and clearance is also required under the Quarantine (Animal) Regulations (Cth) from the Australian Quarantine Inspection Service.

4. Grains and seeds

   A permit from the DPIE is required under the Grain, Plants and Plant Products Orders (Cth). An additional permit is required for wheat: Customs (Prohibited Exports) Regulations (Cth) r 5, Schedule 3. The export of wheat is further regulated by the Australian Wheat Board.

5. Fruit and vegetables

   The Export Control (Fresh Fruit and Vegetable) Orders (Cth) require an export permit to be obtained from the DPIE. The export of apples and pears also requires a permit from the Australian Horticultural Corporation under the Australian Horticultural Corporation (Apple and Pear Export Control) Regulations (Cth).

6. Dried fruits

   A permit from the Australian Dried Fruits Corporation is required under the Australian Dried Fruits Corporation Act 1978 (Cth).

7. Minerals

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24 The orders referred to in this section are all orders under the Export Control Act (Cth).

An export permit from the DPIE must be obtained for certain minerals including alumina, bauxite and coal: Customs (Prohibited Exports) Regulations (Cth) r 9, Schedule 7.

8. Certain cultural objects

   The export of items of AustraliaÕs cultural heritage, including items relating to Aboriginal and Torres Strait Islander culture, is controlled by the Protection Of Movable Cultural Heritage Act 1986 (Cth). Permission to export such items is required from the Department of Arts, Sport, the Environment, Tourism and the Territories.

9. Certain wildlife

   The Wildlife Protection (Regulation of Exports and Imports) Act 1982 (Cth) controls the import and export of various species of plants and animals and products made from such plants and animals. Most native Australian plants and animals and their derivative products require permits for export from the Australian National Parks and Wildlife Service.

10. Live animals and animal reproductive material.

    A permit from the DPIE is required under the Export Control (Animals) Orders (Cth). The export of live sheep or sheep reproductive material is particularly closely regulated. Animals which require a permit for export from the Australian National Parks and Wildlife Service will also require a permit from the DPIE. The export of live animals must also comply with certain requirements as to housing, feeding and watering en route prescribed by the Bureau of Animal Health. The export of Australian native birds also requires a health certificate to be issued in respect of the birds by the Australian Quarantine Inspection Service under the Quarantine (Animals) Regulations (Cth).

11. Weapons and military goods

    Approval is required from the Department of Defence for the export of various weapons and military paraphernalia, including aircraft and vehicles: Customs (Prohibited Exports) Regulations (Cth) r 13B, Schedule 13.

12. Nuclear materials

    Approval is required from the DPIE for various materials specified in Schedule 9 of the Customs (Prohibited Exports) Regulations (Cth) under r 11.

13. Certain chemicals

    Approval of the Department of Foreign Affairs is required for the export of chemicals specified in Schedule 15 of the Customs (Prohibited Exports) Regulations (Cth) under r 13D.

14. Unprocessed wood

A permit is required from the DPIE under the Export Control (Unprocessed Wood) Regulations (Cth).

15. Coffee

    The Customs (Prohibited Exports) Regulations (Cth) r 6 allows regulation of the export of coffee by the imposition of quotas by the Minister for Primary Industries and Energy in accordance with the International Coffee Agreement 1983 to which Australia is a party.

16. Wine and other grape products such as brandy.

    Approval for the export of a consignment of grape product of 200 litres and over is required from the Australian Wine and Brandy Corporation under the Australian Wine and Brandy Corporation Act 1980 (Cth).

17. Honey

    The Australian Horticultural Corporation controls the export of honey from Australia under the Australian Horticultural Corporation (Honey Export Control) Regulations (Cth). An exporter of honey must be licensed by this body.

18. Human tissue, blood and certain drugs

    Approval is required from the Department of Health, Housing and Community Services for the export of human tissue and blood as specified in Schedule 6 by Customs (Prohibited Exports) Regulations (Cth) r 8 and for the export of the drugs specified in Schedule 8 under rr 10-10F.

19. Various live biological agents

    The Customs (Prohibited Exports) Regulations (Cth) rr 13F and 13G prohibit the export of various pathogens and toxins as specified in Schedule 16 without the permission of the Minister for Foreign Affairs.

Residual controls

There are a small number of Acts and regulations which impose controls on the export of goods from Australia but which do not conform to the general pattern of requiring the approval of a designated permitting body as a condition of the export of specified goods.[25] For instance, the export of cash of $5,000 or greater or its foreign currency equivalent must be advised to the Australian Transaction Reports and Analysis Centre under the Financial Transaction Reports Act 1988 (Cth) but approval is not required for such export.

Export charges and duties

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25 See eg Commerce (Trade Descriptions) Act (Cth); Narcotic Drugs Act 1967 (Cth). See generally P Sacks and J Malbon (ed), *Australian Export Manual* (1992) (Melbourne: Longman Professional), 266-267.

Export duties may impede export growth and make exporting a less attractive commercial proposition. In Australia until recently export duties were imposed on the export of coal[26] and uranium.[27] The duty on coal has now been removed[28] and export duties are currently payable only on the export of various uranium products. There are, however, numerous charges levied in relation to the export of primary produce. Under the Export Inspection Charges Collection Act 1985 (Cth), the Export Inspection (Establishment Registration Charges) Act 1985 (Cth), the Export Inspection (Quantity Charge) Act 1985 (Cth) and the Export Inspection (Service Charge) Act 1985 (Cth) a general scheme of such charges has been established, but there are also a great many other Acts which impose charges in relation to the export of specific commodities.[29]

The Australian customs service

The Australian Customs Service (hereafter ÔACSÕ) administers AustraliaÕs various customs Acts and regulations[30] and is empowered by this legislation to perform a variety of functions. These functions include supervising the passage of goods across AustraliaÕs borders. The various customs Acts generally require all persons, goods, ships and aircraft leaving or entering Australia to do so under the supervision of the ACS, where the various controls on the export and import of goods can be enforced.[31] There is a conceptual ÔbarrierÕ[32] placed around Australia by the laws which regulate the import and export of goods and it is primarily the responsibility of the ACS to ensure that goods do not cross AustraliaÕs borders unless they comply with those laws. The geography of Australia makes this task a practical impossibility.[33] In addition to administering and enforcing this customs legislation, the ACS enforces a number of Acts which are primarily administered by other government departments and agencies, for example, the

26 Under the Customs Tariff (Coal Export Duty) Act 1975 (Cth).

27 Under the Customs Tariff (Uranium Concentrate Export Duty) Act 1980 (Cth).

28 The Customs Tariff (Coal Export Duty) Act (Cth) was repealed by s 3 of the Coal Tariff Legislation Amendment Act 1992 (Cth). However, there is provision in s 3 for continued application of these duties.

29 For example, Honey Export Charge Act 1973 (Cth).

30 For example, the Customs Act (Cth); the Customs Tariff (Anti-Dumping) Act 1975 (Cth); the Customs Securities (Penalties) Act 1981 (Cth); the Customs Undertakings (Penalties) Act 1981 (Cth); the Customs Tariff Act 1987 (Cth).

31 CCH, *Australian Customs Law and Practice* (1990) (North Ryde, NSW: CCH Australia Ltd), 2,153.

32 Australian Law Reform Commission, *Customs and Excise*, Report No 60 (Canberra: AGPS, 1992), Vol II, 31-34 (hereafter ÔALRCÕ).

33 See generally the House of Representatives Standing Committee on Finance and Public Administration, *Risky Business – the 37,000 Kilometre Challenge* (1990) (Canberra: AGPS); ALRC, Vol II, 6-7.

ACS enforces the Wildlife Protection (Regulation Of Exports And Imports) Act (Cth), which regulates the import and export of various plants and animals, on behalf of the Australian National Parks and Wildlife Service.

Role of the ACS in export transactions

The principal concern of the ACS and the legislation under which it operates is control of the importation of goods into Australia.[34] However, the ACS also has the primary responsibility for enforcing export controls. The role of the ACS is essentially one of ÔpolicingÕ the substantive controls imposed on the export of goods by the various Acts and regulations in force by ensuring that the conditions for export that are imposed by this legislation are fulfilled, that is, that the appropriate permits, authorisations and licences for export have been obtained. This role is facilitated by the requirement under the Customs Act (Cth) that all goods intended for export be cleared by the ACS prior to being loaded for export.[35] The ACS also has extensive powers to examine goods intended for export under the various Acts by which it is empowered, eg under the Customs Act (Cth) Part XII. Administration of the substantive controls and the grant of export permits and licences is a matter for the permitting bodies responsible for the legislation imposing those controls, for example, the DPIE administers the controls established under the Export Control Act (Cth) in relation to the export of foodstuffs. There is thus a sharing of responsibilities: the relevant permitting bodies control the issue of export permits as are required by law and the ACS ensures the appropriate permits have been obtained before allowing goods to be exported.

The process of customs clearance

Under s 113 of the Customs Act (Cth) goods cannot be loaded for export unless an ACS authority (known as an Export Clearance Number or ÔECNÕ) for export has been obtained. Obtaining customs clearance involves ÔenteringÕ the goods with the ACS.[36] ÔEntryÕ entails providing certain information about the consignment of goods to the ACS which enables the ACS to evaluate whether the consignment is in compliance with applicable substantive controls. The Customs Act (Cth) s 114 provides that entry may be by document (ACS Form B957) or electronically via the EXIT computer network. If an export permit is required for the goods this should ideally be

34 Australian Law Reform Commission, *Customs and Excise*, Report No 60 (1992) (Canberra: AGPS), Vol II, 129-140.

35 See The Process of Customs Clearance.

36 See generally P Sacks and J Malbon (ed), *Australian Export Manual* (1992) (Melbourne: Longman Professional), 268-270.

obtained prior to entry and the permit number advised to the ACS on entry.[37] If satisfied that the information is correct and that all applicable substantive controls have been complied with, the ACS will clear the consignment for export and issue an ECN in relation to the consignment in accordance with the Customs Act (Cth) s 114C. Section 114A enables withholding of clearance pending verification of the particulars contained in the entry, although in some cases an export may be allowed to proceed with information to be confirmed to the ACS under s 114B. An entry may be withdrawn prior to export and the goods dealt with by the exporter as desired, but another entry must be lodged and processed prior to again attempting to export those goods. The Customs Act (Cth) s 114C also empowers the ACS to cancel an authority to export at any time prior to export.

Certain goods are exempted from the requirement of entry. The major relevant exceptions are a consignment of goods with a value not exceeding $500 and a consignment of goods sent through the post valued at not more than $2,000. However, where consignments consist of Ôprescribed goodsÕ they must still be entered for export even though within these monetary limits. ÔPrescribed goodsÕ include dutiable goods on which the duty is unpaid and goods in respect of which sales tax is payable but unpaid.[38] Other exceptions from entry include accompanied or unaccompanied personal or household effects of a passenger or crew member of a ship or aircraft, shipping containers and certain shipÕs or aircraftÕs stores.[39]

Conclusion

It may appear that AustraliaÕs export control regime is fragmented. There is no one single Act or set of regulations but a myriad of enactments with which exporters must contend. However, it is arguable that this fragmentation is necessitated by the disparate policy aims of AustraliaÕs export controls and to ensure that the appropriate government agency has responsibility for the set of controls to which it is best suited, for instance the ACS performs its policing function while the DPIE administers the controls on production and quality standards of export commodities which are within its natural ambit, ie primary produce and mineral resources. This fragmentation may not present as much a practical problem for exporters as it does for anyone compiling a general review of the export control regime as attempted here. The exporter with a single commodity to export will not be faced with the whole range of enactments referred to but only those as are applicable to the exporterÕs goods. Additionally, goods not specifically made subject to the grant of an export

37 Customs Act (Cth) s 114.

38 Customs Regulations (Cth) r 97.

39 Customs Act (Cth) S 113, Customs Regulations (Cth) r 97.

permit as a condition of export, which will include most manufactured goods other than weaponry and other goods with military applications,[40] will require only clearance from the ACS under the Customs Act (Cth) for export. This is not to suggest that negotiating even a single set of substantive controls or the process in obtaining customs clearance is likely to be easy. The Australian Law Reform Commission report on customs legislation tends to suggest that there may be a degree of simplification and rationalisation possible in other export control legislation. The rationalisation of export charge legislation may also suggest this. However, different policy motivations in relation to different goods and the necessity of specialised control in relation to some goods, for example nuclear materials, undoubtedly make a single set of export regulations impractical and to an extent necessitates the fragmentation of export controls.

40 See Goods Subject to Substantive Controls.

Book Review 1

John Trone

BUSINESS LAW OF THE EUROPEAN COMMUNITY(1993)

by Gabri‘l A Moens and David Flint

(Brisbane: DataLegal Publications) pp 1-361 ISBN 0 646 15622 5

This book would undoubtedly make an ideal textbook for university study of Community law. Its coverage is comprehensive. Its style is scholarly. Its discussion of the law avoids verbosity, yet never falls into the sin of superficiality. The clarity of its text is commendable. The authors evidently possess a talent for imparting both information and understanding. Few readers of this publication will find themselves merely passive absorbers of information, for its style continually encourages them to think and to inquire, a cardinal aim of meaningful education.

It is encouraging that an Australian textbook on European law has finally been published. Given the increasing interest of Australian lawyers in the European legal system since the Union (Maastricht) Treaty [1992] 1 CMLR 719, its publication is timely. This book is likely to satisfy all their most immediate needs and will be a standard reference in this area. Given that it avoids the needless complexity one associates with many British works in this area, it is also a valuable contribution to the literature on this subject generally. And while this is not a book on comparative law, its availability as a work on foreign law facilitates the informed study of comparative law.

A highlight of the book is its discussion of the principle of equal pay for equal work (Article 119 of the EEC Treaty), including the landmark decision in *Defrenne (No 2) v Sabena* [1976] ECR 455. Equally fascinating is its examination of the principle of direct effect. By this doctrine individual rights conferred by the Treaty are directly enforceable in national courts. See s 2 (1) of the European Communities Act 1972 (UK). The authors admirably describe the inevitable competition that has occurred between national courts and the European Court of Justice. The apparent demise of parliamentary sovereignty in the *Factortame* decision [1990] ECR 2433; [1991] AC 603 provides an insight into the massive changes that Community law has brought to British law. The chapter on freedom of movement of goods shows some fascinating similarities between s 92 of the Australian Constitution and Article 30 of the

EEC Treaty. Moens and Flint draw attention to the similarity between the Australian case *Castlemaine Tooheys Ltd v South Australia* (1990) 169 CLR 436 and the European Court case *Re Disposable Beer Cans; EC Commission v Denmark* [1988] ECR 4607.

It is also commendable that the authors place the European Community in a global context. In so doing they give the clearest explanation of the General Agreement on Tariffs and Trade (1947) 55 UNTS 194 that I have read. It is pleasing to see that the North American Free Trade Agreement (1993) 32 ILM 289, 605 is included.

It may be trite to make this observation expressly, but this book is of interest because of the differences that those who read it will see between the European legal system and our own. But I was particularly fascinated to observe the way in which European law and the British common law have converged, both through the absorption of European law by the UK and by the adoption of certain common law concepts (such as legal professional privilege and the *audi alteram partem* rule) by the European Court of Justice. And the result oriented approach the European Court takes towards deciding cases is familiar the world over. It is interesting to observe that the authors are more defensive of the European CourtÕs policy-making role than Professor Moens has been of what he sees as judicial activism by other courts, particularly the High Court of Australia.

I understand that this work is to be updated by the authors through annual electronic supplements. I will be heartened by their appearance because in a field such as this, new developments occur almost daily. Shortly after this book was released, the Union (Maastricht) Treaty came into effect Ð on 1 November 1993. The challenge in the British courts to the ratification of that treaty (referred to at at p 45 without a name) has now been reported as *R v Secretary of State for Foreign and Commonwealth Affairs; Ex parte Rees-Mogg* [1994] QB 552. The constitutional litigation in the German Federal Constitutional Court has been resolved in the treatyÕs favour by a decision of 12 October 1993: *Brunner v The European Union Treaty* [1994] 1 CMLR 57. An important recent decision of the European Court concerning copyright protection for non-nationals is *Collins v Imrat Handelsgesellschaft mbH* [1993] 3 CMLR 773.

All these are new developments since the book went to press. The rapidity of change in European law underscores the necessity for regular updating and revision, which is something that electronic publishing is well placed to provide. In time we will have the advantage of reading the authorÕs latest insights into this subject and having all the most recent case and statute law concisely and accurately summarised. I hope that the annual electronic supplements are cumulated in printed form every few years for the benefit of those without ready access to the electronic version.

Given the pioneering work being done by the publishers, a few comments about the dual formats of this work are in order. As with all publications by DataLegal, it appears in both paperback and electronic versions. The crisp clear typeface of the book makes for pleasant reading. The page layout is not cluttered. By all accounts the electronic version is impressive. The easy retrieval of information it offers makes comprehensive research possible without any wastage of time. Access to the places where selected terms have been used is so exceptionally prompt that no book can compare. Hence this work is a considerable achievement for both its authors and publishers.

Book Review 2
Another Oxymoron?

Barbara Ann Hocking

Another Oxymoron? A review of

BUSINESS ETHICS AND THE LAW (1993)

edited by C Sampford and C Coady

(The Federation Press) pp 212 ISBN 1 86287 105 1

These essays on business ethics make capital of the fact that the title will represent for some a contradiction in terms: an inherent oxymoron set in stone by the commercial excesses of the 1980s. A Wall St Journal joke heralds the introduction.

> ÔTwo drunks are in a cemetery. One stumbled over a headstone, and, as he was picking himself up, read the inscription: ÒHere lies an investment banker and an honest manÓ. He quickly yelled to his companion, ÒHey Charlie, itÕs getting so crowded here theyÕre burying them two to a grave!Ó

According to the authors of this collection, however, the joke is now on the other foot. The authors collectively make it plain that they consider this an outmoded way of looking at the subject. Gone are the excesses of the 1980s and business ethics are set to step in to fill the theoretical vacuum confronting our morally and financially bankrupt commercial enterprises. Fortunately, the authors all recognise the need for theory to be met in practice.

The book grew out of a Working Group which was established in 1991 by the Centre for Philosophy and Public Issues to consider issues which fell under the broad heading of Ôthe futureÕ of business ethicsÕ. The project developed into a joint one between the Centre and the National Institute for Law, Ethics and Public Affairs. The book comprises a key part of a ÔLaw, Ethics and BusinessÕ project and stresses the need for reflective debate on the subject. The whole issue is indisputedly a singularly important one and one which was certainly at the time of the commencement of this initiative much neglected. The initiation of a debate in this crucial area is therefore much to be welcomed.

Thus any contribution to the debate is greatly to be welcomed and indeed, several of the contributors to this collection are valuable contributors to the ethics debate in other areas.[1] Unlike many collections of relatively short pieces, there is a fluidity between these contributions. The essays are written in a readable style which should appeal to a range of readers from various disciplines who are interested in the subject matter.

The book consist of three separate yet interconnecting parts. The first part deals with approaches to business ethics. The second section deals with the role of law and regulation in enhancing business conduct. The final collection of essays is concerned with the ethical contexts within which businesses operate. Each section appears to contribute to the debate while overlapping and flowing consistently with the previous section. The introduction itself contains a handy potted synopsis of the contents of each part and a guide to the essays in each part. Given this helpful assistance from the editors, this review will highlight interesting aspects of each section of the book.

In The Future of Business Ethics in Part One, Approaching Business Ethics, Sampford and Wood link the future of business ethics to the future of business, making a distinction between ethics as self-interest in this context and ethics based on Ôother-regarding values.Õ[2] The attempt at constructing a thesis around a combination of legal regulation, ethical standard setting and institutional design is an admirable one: the justification of modern business is seen to underpin the entire attempt at formulating Ôvalues around which ethical standards may be proposedÕ.[3] The authors note in the opening paragraph that business ethics is a Ônew area of speculative investment that has yet to establish a track recordÕ.[4] Yet their analysis indicates that this is by no means completely speculative and that the formulation of some Ôpositive prescriptionÕ can be derived from the concept of business ethics which they outline.

The authors contend that they base their argument less upon the common tendency to see ethical problems in essentially individual terms, a tendency they consider emphasised by the return of Ôhighly individualistic ideologies during the 1980sÕ.[5] Thus, they adopt a more stringently institutionally based approach. This concluding perspective, however, renders somewhat less clear the authorsÕ assertion in the second paragraph that it is not their purpose to suggest that some universities which like to see themselves as Ôbusiness-likeÕ are becoming more like the businesses of the 1980s. If a focus upon ethics in highly individualist terms is inadequate and corporation unfriendly because it

1 See, for example, M Charlesworth, *Bioethics in a Liberal Society* (1993) Cambridge University Press.

2 Business Ethics, 3.

3 *Id* 4.

4 *Id* 2.

5 *Id* 22

sees non-government institutions as Ômade up entirely of contracts between lone individualsÕ[6], what of the hundreds of university employees labouring at present precisely on contracts they undertook as lone and lonely individuals? At what point is ethics an institutional or individual issue? And in that respect, how does the university of the 1990s differ from the university and business of the 1980s?

Yet part of the answer here is provided as the authors conclude their introductory essay: the significant and often neglected point is made that it is business that made the investment decisions that have accompanied us into decline:

> ÔAustralian business must accept some of the responsibility for this decline and should not try to lay all the blame on government.Õ[7]

With the reservations expressed above aside, Sampford and Wood provide an instructive introductory essay which sets the tone for the readable and accessible volume.

Robert Solomon also addresses, but in significantly more detail, the critical problem of the individual and individual concepts, values and role behaviour. In arguing persuasively for a consideration of Ôthe neglected importance of micro-business ethicsÕ[8] Solomon refers to the inaccessibility and/or inapplicability of the Ôgrand theories of the philosophy of economicsÕ and the classic theories of Locke, Kant and Mill to the manager in the office or on the shop floor. For Solomon, this inadequacy is Ônot just a pragmatic problem but a failure of theory as wellÕ.[9] The solution lies in the development of theory which marries the current tendency to draw upon economics (which is recognisedly essential to the subject) and individualistic ethics and develops a Ômore appropriate focus for business ethics theory, one which Ôcentres on the-individual-within-the-corporation.Õ[10] The more abstract notions of public policy with which business ethics has come to be associated, the Ôlarge questionsÕ[11] of government regulation and intervention, have come to function as Ôan exclusionary practiceÕ[12] which denies the pressing need for personal solutions. The search for Ôpersonally oriented ethicsÕ[13] is one which seeks a closer match between business and everyday life, drawing back to the Aristotelian infuriation at the Ôschism between business and the rest of lifeÕ.[14]

6 *Id* 23.
7 *Id* 20.
8 *Id* 27.
9 *Id* 26.
10 *Id* 27.
11 *Id* 28.
12 *Id* 29.
13 *Id*.
14 *Id* 31.

SolomonÕs account of the approaches with which the Aristotelian theory may be contrasted and of the six dimensions of virtue ethics makes for interesting reading. The arguments in this essay have some parallels with the arguments of many feminist theorists who assert the need to inject values of caring and connection rather than reason and rationality into a vast range of subject areas.[15]

The collection stemmed from a working group which took a structured approach to the production of the papers and circulated the papers within the group for comment and appraisal. This pre-existing structured approach has lent a coherence to the overall collection, something often lacking in a collection of this kind. The range of the essays in this collection is, as a result, kept fairly tight and the collection does not therefore run the risk of overwhelming the reader with ill-fitting and diverse perspectives. Yet this is not to suggest that this is a monochromatic collection: the interesting inclusion of John LanganÕs ÔThe Ethics of Business and The Role of ReligionÕ provides an unusual dimension to the debate. Langan reflects *inter alia* upon the current PopeÕs recent encyclical and notes that while Catholicism Ôwill not become an uncritical acolyte of capitalism in its time of triumphÕ nevertheless the critique advanced by the church Ôwill be directed to actual failures and to dangerous tendencies rather than to fundamental principles of the system.Õ[16] LanganÕs argument that we must recognise the gap between the morality of the family, church and home and the morality of contemporary business, while indisputable in ideal family circumstances, may appear naive and idealistic from a feminist perspective. By that view, it might more appropriately be questioned whether the homes that contain domestic violence and exploitation of the vulnerable family members by the stronger member (usually men) do not operate precisely along the same ethical and moral lines as many businesses.

In an ideal world, however, no doubt much of LanganÕs insights into the input which religious ethics could give into business ethics would prove not only interesting but appropriate, and from both perspectives. Noting their alien nature in the corporate world, Langan observes that religious groups

> Ôeven in their imperfections ... constitute a continuing example of an alternative example in the shaping of social life, an aspiration which may be significantly more democratic, more egalitarian, more communal, or more solidaristic than we ordinarily find in corporations and government bureaucracies.Õ[17]

15 See, to take just one example, Bender, L (1990) ÔFeminist (Re)Torts: Thoughts on the Liability Crisis, Mass Torts, Power and ResponsibilitiesÕ 4 *Duke Law Journal* 848.

16 *Business Ethics,* 59.

17 *Id* 62.

In Part Two, The Role of Law and Regulation, one of the themes that characterises the several essays is that of the seemingly inherent problem of corporate evasion of regulation. It would be tempting to be as cynical about the corporate capacity for evasion of regulation and sanctions as it would to continue to joke about the contradiction in the term Ôbusiness ethicsÕ. The section, however, contains several convincing, well argued and persuasive essays which point a way ahead from theory to practice. Bob Baxt notes in ÔThe Role of RegulatorsÕ that regulation plays an important part in overseeing the activities of many sectors, including the corporate sector. By this view, we must be critically aware of the consequences and implications of deregulation. Baxt makes the highly rational point by way of introduction that in the climate of AustraliaÕs relaxation of regulation, it must be considered that ÔIt is impossible to regulate for goodness in the citizens of this landÕ.[18]

Neil GunninghamÕs essay on flexibility and cost-effective business regulation examines particular situational approaches to regulation. Detailing first the initiatives in occupational health and safety in Victoria, Gunningham then turns to the problematic question of the regulation of futures markets. Noting that futures markets possess Ôenormous, if little understood, implications for the economyÕ Gunningham suggests that their capacity for money mismanagement at best and Ôdeception, fraud and outright criminalityÕ[19] at worst, requires stringent consideration of appropriate regulatory strategies. Concluding with an examination of environmental issues, GunninghamÕs key argument is for the development of particular regulatory regimes in different contexts.

Amanda Sinclair provides one of the few more formally business oriented perspectives in ÔImproving Ethics Through Organisational CultureÕ. This is a thorough and interesting analysis of the relevance of business culture to ethics, an area which is indisputedly critical to the central topic. Although the essay is a particularly analytical one, it would have benefitted from the inclusion of just some of the many related feminist critiques of organisational culture. Thornton,[20] for example, has written widely[21] on the institutional legitimising processes involved in the concepts of merit and potential in relation to womenÕs career development (or the lack thereof) which effectively

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18 *Id* 68.

19 *Id* 98.

20 Thornton, M, *The Liberal Promise: Anti-Discrimination Legislation in Australia* (1990).

21 See ÔAffirmative Action, Merit and the Liberal StateÕ (1985) 2 *Australian Journal of Law and Society*, 28; ÔFeminist Jurisprudence: Illusion or Reality?Õ (1986) 3 *Australian Journal of Law and Society*, 5; ÔDiscrimination Law/Industrial Law: Are they Compatible?Õ (1987) 59 *Australian Quarterly*, 162; `Hegemonic Masculinity and the AcademyÕ (1989) 17 *International Journal of the Sociology of Law* 115; ÔEquivocations of Conciliation: The Resolution of Discrimination Complaints in AustraliaÕ (1989) 52 *Modern Law Review* 733; ÔThe Public/Private Dichotomy Ð Gendered and DiscriminatoryÕ (1991) 18 *Journal of Law and Society* 448

undermine anti-discrimination law. Claire Burton[22] and Rosemary Hunter[23] have contributed significant contributions to the debates about corporate culture from the perspective of the exclusion of women. Particularly salient conclusions are advanced in HunterÕs ÔIndirect Discrimination in the WorkplaceÕ concerning the effect of corporate culture and the dynamics of organisational behaviour on patterns of discrimination.

The injection of just some of the considerable volume of feminist arguments in this regard would have given still greater edge to the highly interesting attempt at formulating a framework for moulding organisational culture towards ethical ends. Nevertheless, the evaluation of two approaches to organisational culture in relation to the shaping of ethical values is an instructive one. Should we aim for the creation of a strong, unitary and cohesive organisational culture bonded around core ethical values or recognise the existence of subcultures, opposing forces, controversies and differences within the organisation? How should we define ethical actions?

The analysis of the fostering of ethics through the subcultural approach has some parallels with much of the feminist analyses in this area, yet in failing to take some of those arguments into account, the astute observations concerning the achievement of better ethical ends are blunted somewhat. Nevertheless, this is a criticism that might be directed at much of the essays and in this, as in many of the other contributions, salient conclusions are advanced within the framework of the particular material that is under consideration. Sinclair notes on the subject of organisational culture and better ethics that:

> Ô(T)he most risks lie where a dominant group is insulated from those who offer a different definition of ethical actions.Õ[24]

Concluding that the subcultural culture is the more productive one, Sinclair notes that any attempt at building better ethics within this culture Ôultimately relies on individual, rather than institutional processesÕ.[25] It might be suggested that through this conclusion, which really links up with that of Sampford and Wood in the opening section, more power is attributed to the individual within an institution, particularly a business or commercial institution, than is consistent with reality.

The plethora of books on bullying at work and harassed workers[26] might indicate that many individuals at work in these institutions work under a different perception of the relationship between the institution and the individual.

22 Burton, C *The Promise and the Price: The Struggle for Equal Opportunity in Women's Employment* (1991) 3.

23 Hunter, R, *Indirect Discrimination in the Workplace* (1992).

24 Business Ethics, 144.

25 *Id* 148.

26 For example, Robert BramsonÕs *Coping with Difficult Bosses (Dealing Effectively with Bullies, Schemers, Stallers and Know-alls)* (1992) Allen and Unwin.

SinclairÕs noteworthy essay leads into an analysis of ethics viewed from a somewhat troubling yet powerful dimension, one contended by author Tony Coady to comprise a neglected aspect of business ethics: the question of ÔethosÕ.[27] CoadyÕs essay on ethos and ethics attempts an analysis and application of the Ôethos of cultural contentmentÕ in relation to large scale entities such as the state and the community as a whole. CoadyÕs point in using a recognisedly ÔextremeÕ example: the position of doctors in Nazi Germany, is that within an avowedly immoral macro situation, concern about ethics can persist at the micro level. The inherent absurdity Ð and tragedy Ð of ethics in this situation is rendered particularly clear from the example. This is a forceful piece, posing something of a contrast with the more theoretical approaches of many of the other writers in the collection. The reference to the masks which individuals and organisations may wear Ð the need to recognise the hidden fascist in liberal clothing Ð is an instructive one which should be familiar to us all.

Max CharlesworthÕs reflective conclusion is a fitting finale to what is on the whole an interesting and challenging collection. While the authorsÕ commitments to and concepts of the notion of business ethics clearly varies, they do make a collective contribution to the debates about the place (and they all agree that there is one) for ethics and law in the commercial context. If the reader is left with a vague feeling of disappointment it is probably partly because of the inevitable recognition, which this collection does not deny, that theory and practice need to meet up before we can advance matters and genuinely refer to business ethics. For this reviewer, too, a closer philosophical and practical engagement with the protracted problems of commercial circumvention of our anti-discrimination laws and the continuing workplace exploitation of a vast range of employees, particularly women, would have given an extra dimension to what is on the whole an interesting and challenging book. Perhaps a quote from another writer might usefully conclude this review: ÔWe think about Òlegal ethicsÓ in a time in which uncertainty abounds concerning the possibilities of knowing (let alone approaching) either a ÒjusticeÓ that would support Òthe legalÓ or a ÒgoodÓ that would support Òthe ethicalÓÕ.[28]

27 Business Ethics, 149.

28 Ashe, M Ô ÒBad MothersÓ, ÒGood LawyersÓ, and ÒLegal EthicsÓ Õ (1993) 81(7) *The Georgetown Law Journal* 2533.

Book Review 3

John Trone

MABO: A JUDICIAL REVOLUTION

THE ABORIGINAL LAND RIGHTS DECISION AND ITS IMPACT ON AUSTRALIAN LAW (1993)

Edited by MA Stephenson and Suri Ratnapala

(St Lucia, Qld: University of Queensland Press) pp xvii + 225

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This special issue of the University of Queensland Law Journal presents a varied series of perspectives on the High CourtÕs recognition of common law native title: *Mabo v Queensland (No 2)*.[1] So far as its title might imply that there has been a radical overthrow of the common law, it is a misnomer. But it is possible that the title is not so inappropriate after all, since in antiquated usage ÔrevolutionÕ merely connoted the turning of a full circle. It could be argued that the common law of Australia has now turned full circle to what it was upon the arrival of British law.

This book is not directed at the business community. Indeed, little academic discussion among lawyers has been directed to the specific implications of native title for business and investment. This should not be surprising nor should it be lamented: whether or not investment will suffer from the recognition of common law native title is a matter of politics not law. Those concerned with this issue are able to turn to publications on business and economics for predictions on this score. But those with business interests would be assisted in reaching a fully informed understanding of the implications of the common law by reading a legal book such as this in order to be better appraised of the law in this area, so that they can assess for themselves how the law may affect their interests.

Though little methodical attention has been given by academic lawyers to the business implications of ÔMaboÕ, in passing many have traversed this political issue to suggest that those implications will be disastrous or at least

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1 (1992) 175 CLR 1.

highly disadvantageous. Some of the essays in this book play this theme. These views and their merits are political issues. I am reluctant to enter this Ôpolitical thicketÕ.[2] But it is at least clear that there exist plausible alternative views that the hazards involved may be exaggerated. Both Canada and the United States have recognised native title for extended periods of time, yet remain attractive targets for investment. On this view, recognition of native title need not pose an insurmountable obstacle to development if people cease complaining and begin dealing.

The foreword Sir Harry Gibbs has written to the book certainly does not praise the CourtÕs judgment, but refrains from express criticism of the Court. He expresses the view that use of the term terra nullius is inappropriate because Ôpublic understanding is not assisted when [common law] principles are described by a phrase which is misleading and perhaps emotiveÕ (p xvi). He appears to prefer that reference be made to a common law doctrine that the property rights of inhabitants of Ôbarbarous countr[ies]Õ were not to be respected. It is difficult to resist the conclusion that use of the phrase Ôbarbarous countryÕ is even less likely to assist public understanding than is use of the term terra nullius. The description Ôbarbarous countryÕ is misleading and is not merely emotive but understandably liable to *inflame* emotion.

In his chapter, historian Henry Reynolds casts doubt on one aspect of the courtÕs decision: the effect on native title of a grant of leasehold by the Crown. This issue is of considerable practical significance, since half of this continent is held under leasehold. The evidence he produces to prove his claim that the grant of a pastoral lease does not extinguish common law native title consists of legal opinions prepared by eminent colonial lawyers in the 1830s rather than parliamentary enactments or case law. It goes to the intentions entertained by Colonial Office officials but could not contradict legislation expressly evincing a contrary intent.

Given the contrived denial of native title in Australia until 1992, the title of Noel PearsonÕs chapter, Ô204 Years of Invisible TitleÕ, is appropriate. The author poses the problem: ÔHaving abandoned the pitfalls of persisting in characterising certain groups Òas people too low in the scale of social organisation to be acknowledged as possessing rights and interests in landÓ, there is a grave danger that courts will persist in characterising certain groups as possessing *particular kinds* of rights and interests in land, presumably in accordance with the nature of their particular social organisationsÕ (p 81). This is most likely to be the case where native title is viewed as *sui generis*.

Kerry MulqueenyÕs essay raises the possibility of incorporation of Aboriginal customary law into areas of the law other than title to land. Mabo did not address this issue, so his argument is speculative only. But *Mabo* itself recognised one aspect of Aboriginal customary law. MulqueenyÕs thesis is that there is no reason in principle to draw a distinction between recognition of

2 *Colegrove v Green* (1946) 328 US 549 at 556.

Aboriginal customary law in respect of land and in respect of other categories of law, and that customary law has survived in other areas and, within the rubric of Justice BrennanÕs leading judgment, stands independent of the common law (p 172). Particular attention is given to the criminal law, an area that was of special concern in the Australian Law Reform Commission investigation of recognition of Aboriginal customary law.

Margaret Stephenson gives a methodical and detailed examination of the impact of the CourtÕs decision on land tenure Ð Ôthe mode of holding or occupying landÕ (p 96). A problem the writer identifies is that the judges appear to regard native title as property for certain purposes but not for others.

Dr John ForbesÕs article, ÔMabo and the MinersÕ, concentrates on the implications that the High CourtÕs decision has for the law of natural resources. There is some discussion of agricultural and forestry resources, but as the title suggests the greater part of the essay is primarily directed to implications for the mining industry. Most interesting are Dr ForbesÕs comments on the process of a *Mabo* style land claim, with an emphasis on the law of evidence.

Professor Darrell Lumb contributes an absorbing discussion of the public law aspects of the decision. He laments that Ôthe common law of other Commonwealth countries is utilised to establish the new doctrine as to the effects of settlement in AustraliaÕ (p 11). But the common law of other countries was referred to in *Mabo* because it was strongly indicative of what the common law of Australia was. A key reason why the common law of comparable jurisdictions was subject to such close scrutiny was that such scrutiny clearly demonstrates the existence of a remarkable consistency in the common law as to the existence of native title in areas colonised by Britain.

It is noteworthy that whilst Professor Lumb criticises the High Court for broadening its analysis beyond the Murray Islands, he curiously appears to suggest that the International Court of Justice in the *Western Sahara case*[3] should have done just that (p 6), perhaps because it might have afforded some support for the notion that the concept of terra nullius could have been applicable to places with different social organisation to that of the Western Sahara.

The paper contributed by Professor Gabri‘l Moens, ÔMabo and Political Policy-Making by the High CourtÕ, is, as always, refreshing to read because of the quality of his written expression. His arguments are customarily made in plain and direct language. Given the tortured phraseology of much legal prose, that is no vice and should be a cherished virtue.

It is with his characterisation of the CourtÕs ruling as an example of politically motivated judicial activism that I would express disagreement. A more accurate view of the decision is that it is a respectable conservative

3 [1975] ICJ Reports 12.

reaction to past judicial activism which had been motivated by political considerations of a rather base nature. Because many of the other contributors to this volume share the views of Professor Moens on this point, I will kill two birds with one stone by expressing myself at greater length upon this essay than I have in my comments upon the others.

It is quite probable that the common law of the 1800s was incorrectly applied to the Australian continent and that this error was magnified and legitimated by subsequent judicial decision. The view taken in Australian decisions such as *Attorney-General v Brown*[4] was a false revisionist one and involved political, as opposed to judicial, policy-making.

These decisions ignored prior authority. For instance, a distinguished common law court and a great Chief Justice decisively affirmed the concept of native title in *Johnson v McIntosh*[5], a quarter of century before an Australian colonial court presumptively denied it in BrownÕs case in 1847 without argument from those parties most interested. Indeed there were no indigenous parties before the courts in any of the cases before the *Gove Land Rights case*[6] in 1971. The doctrine was more an assumption than a settled rule of law because the issue had never been decisively tested.

I admit some astonishment at the confident reliance by commentators before the Mabo decision upon the *Gove Land Rights case* as though it had settled the matter. That single judge decision must be the only Northern Territory judgment that anyone has ever thought decided an important legal issue for the whole of Australia. It is also worth bearing in mind that Justice Hall of the Canadian Supreme Court had described Justice BlackburnÕs view of the authorities in the *Gove Land Rights case* as Ôwholly wrongÕ[7].Its reconsideration was inevitable. The prior Australian cases were suspect as a matter of law.

Consideration by Professor Moens of the correctness of the Australian decisions is conspicuous in its absence. Such a discussion would surely be essential to justify any insistence upon their precedential force and denial of *Mabo's* propriety in rejecting Ôsettled common lawÕ. The respect to be accorded to such decisions must depend in large measure upon their fidelity to the law at the time when they were rendered, and that faithfulness is most dubious.

Certainly if these decisions were plainly mistaken as an original matter it should not be necessary to show any greater error than that. Elsewhere, Professor Moens has endorsed a recent statement by the Chief Justice of the United States that makes a similar point with some force:

Ôsurely there is no requirement, in considering whether to depart from

4 (1847) 1 Legge 312; 2 SCR (NSW) App 30.

5 (1823) 21 US (8 Wheaton) 543.

6 *Milirrpum v Nabalco* (1971) 17 FLR 141.

7 *Calder v Attorney-General* [1973] SCR 313 at 415-6.

> *stare decisis* ... that a decision be more wrong now than at the time it was rendered. If that were true, the most outlandish ... decision could survive forever, based simply on the fact that it was no more outlandish later than when it was originally rendered.Õ[8]

Surely consistency demands that Professor Moens adopt a similar approach to stare decisis in respect of prior Australian cases on common law native title. Australian cases suggesting the total extinction of native title in 1788 without so much as a word to that effect from the legislature are of the outlandish character of which the quotation speaks, and can truly be characterised as judicial usurpation of the proper province of the Parliament. Extinguishing property rights is a matter for the political process, where it is open to public debate and scrutiny.

In addition, the prior decisions involved far more than the incremental changes to the law which Professor Moens advocates. They involved major policy changes from the traditional understanding of the law, a matter Professor Moens would otherwise concede to be Ôfor the political processÕ. The earlier decisions were an aberration in the development of previously accepted legal doctrine.

To steadfastly maintain such erroneously decided precedents, based largely in political considerations as they were, would itself be a heavily political decision. To confirm earlier judicial activism under the guise of adherence to stare decisis would constitute an abdication of the judicial function.

Statements made by the judges themselves are misconstrued by Professor Moens. For example, referring to Justice Brennan, he says:

> ÔHis HonourÕs treatment of the concept of Òcommon lawÓ sits uneasily with his statement, made in a recent address, that Ôradical changes must be mandated by substantial non-ephemeral shifts in community values or by palpable defects in existing legal doctrine.Õ

His statement indicates that the role of common law judges is limited to the identification, articulation or declaration of common law which corresponds to changing values of the Australian people (p 54).

This argument misses the mark because Justice BrennanÕs statement also indicated that Ôpalpable defects in existing legal doctrineÕ are another acceptable mandate for legal change. Justice Brennan is not limited by his expressed philosophy to changes in Ôpublic opinionÕ, but can modify the common law to remove clear defects. In *Mabo* he convincingly demonstrated the intellectual bankruptcy of applying the prior Australian case law.

The tone of disapproval throughout the essay appears to have been inspired

8 *Planned Parenthood v Casey* (1992) 60 USLW 4795 at 4829 (per Rehnquist CJ, dissenting), quoted in Gabri‘l A Moens, ÔThe wrongs of a constitutionally entrenched Bill of RightsÕ, in Margaret Stephenson and Clive Turner (eds) *Republic or monarchy? Legal and constitutional issues* (1994), (Brisbane: University of Queensland Press, p 237

by the decisionÕs alleged radicalism. The radical nature of the *Mabo* decision is open to question. Professor Moens does not refer to a highly relevant consideration that Professor Lumb adverts to Ð that there was no binding precedent on the issue (p 5). That circumstance must be decisive where existing legal doctrine bears Ôpalpable defectsÕ. To overturn inferior court decisions that are based upon a mistaken appreciation of the common law and a Privy Council decision[9] that contradicts other rulings by the same court is not radical, but is in fact a natural consequence of an evolving organic system of law. Given the overseas authorities, there was no plausible choice open to the court but to recognise native title. Even if the authorities did not Ôsing with one voiceÕ (p 54), as Professor Moens suggests, they certainly did not provide unanimous support for the notion that native title was automatically extinguished upon settlement.

It would be more plausible to argue the reverse of what Professor Moens does: that to refuse to recognise native title in circumstances where the authorities provide an array of views would itself amount to a political choice, with a political and moral agenda of its own. Assertions that the High Court assumes the mantle of a political actor merely by overruling earlier political decisions have an artificial air about them.

Complaints about Ôchang[ing] the law with retrospective effectÕ (p 59) have a hollow ring about them. For one, the status of common law native title had never been authoritatively declared by the High Court. For another, the early cases had retrospectively altered a traditional understanding of the law, to the enormous detriment of property interests. A restoration of those wronged interests is entirely consistent with the common lawÕs staunch protection of individual rights and liberties. Were there longstanding but mistaken precedents which had decisively and authoritatively settled an issue, weighty arguments could perhaps be made against overruling them because of the reliance that had been placed upon them by people. Professor Moens makes some of these arguments in his article.

I find myself in agreement with Professor Moens on a major point of substance. In denying the availability of compensatory damages for extinguishment of native title, the majority in *Mabo* probably erred in their task of identifying the common law. The necessity for compensation is supported by at least one well reasoned Privy Council decision: *Adeyinka Oyekan v Musendiku Adele*.[10] As Professor Moens points out, if the court extended recognition to a property right, the Ôcommon law would recognise an entitlement to compensatory damages if there has been an infringement of that titleÕ (p 58).

Space has not permitted me to deal with all the essays this book contains,

9 *Cooper v Stuart* (1889) 14 App Cas 286.

10 [1957] 1 WLR 876 at 880.

but my overall assessment of this book is favourable. Overall, it represents a valuable contribution to the academic literature on common law native title. Its essays are scholarly, original and readable. The collective worth of its essays is greater than the sum of each part. The publication of this book was both timely and prompt, making it the first book on the Australian common law of native title. A follow-up volume examining the subject in the light of the Native Title Act 1993 (Cth) (passed after publication of this book), would be a deserving sequel.