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## Canadian Business Negotiations in Post-Mao China: A Progress Report on the New Foreign Economic Legislation

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In 1979, the People's Republic of China launched a drive to modernize its economy with the aid of foreign investment, promulgating *The Law of the People's Republic of China on Chinese-Foreign Joint Ventures (J.V.L.)*. Several Canadian corporations, anxious to boost their exports of technology and technical expertise, have responded to this overture. Some have negotiated equity joint ventures under the terms of the *J.V.L.* Others have interpreted the *J.V.L.*, which in itself is a very ambiguously-worded statute, simply as a signal of Chinese interest in developing foreign economic relations; this latter group, much larger than the first, has been content to enter into more informal contractual joint ventures or sales agreements. After summarizing the key provisions of the *J.V.L.* and related statutes and regulations, the author examines the experiences of these Canadian companies in the years since 1979 and isolates a number of factors which determine the success or failure of business negotiations in China. Some of these factors, such as the growing but still incomplete corpus of Chinese foreign economic legislation, Canadian export promotion programmes and the cumbersome Chinese bureaucracy, he sees as

En 1979, dans le cadre d'une campagne visant la modernisation de son économie à l'aide d'investissements étrangers, la République populaire de Chine promulgait *The Law of the People's Republic of China on Chinese-Foreign Joint Ventures (J.V.L.)*. Plusieurs sociétés canadiennes, anxieuses de voir augmenter leurs exportations de technologie et d'expertise technique, ont profité de cette occasion. Certaines sociétés ont négocié des entreprises à capitaux mixtes ("equity joint ventures"). D'autres ont interprété le *J.V.L.*, dont la rédaction est fort ambiguë, comme l'expression d'un désir de la Chine de développer ses relations économiques avec l'étranger. Ce dernier groupe de sociétés, considérablement plus nombreux que le premier, a préféré négocier soit des opérations conjointes moins formelles ("contractual joint ventures"), soit de simples contrats de vente. Après avoir résumé les dispositions de la *J.V.L.* et les autres lois et règlements pertinents traitant ce sujet, l'auteur étudie les expériences de ces compagnies canadiennes depuis 1979 et isole les facteurs déterminants du succès ou de l'échec de négociations commerciales avec la Chine. Certains de ces facteurs, tels l'insuffisance de la législation chinoise en matière de commerce extérieur, les programmes d'exportation canadiens et l'encombrante bureaucratie chinoise sont, selon l'auteur, des facteurs que

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essentially beyond the control of Canadian negotiators. He urges Canadian businessmen attempting to negotiate entry into the China market to concentrate instead on the factors over which they can exert some control. One such factor is the overall Canadian approach to this new market, an approach which to date has been insufficiently aggressive. Another is the outlook of Chinese negotiators, which the author perceives as amenable to influence by patient capitalist interlocutors. The decisive factor, and the one over which Canadian companies can exercise the greatest discretion, is price: it is only when they can offer their technology on more competitive terms that they will be invited to participate in more joint ventures in China.

ne peuvent contrôler les négociateurs canadiens. Il invite donc les milieux d'affaires canadiens intéressés à négocier leur entrée dans le marché chinois à concentrer leurs efforts sur des facteurs sur lesquels ils ont plus de contrôle. L'approche globale du marché chinois par le Canada qui, jusqu'à ce jour, n'a pas été suffisamment agressive, est un de ces facteurs. Un autre de ces facteurs est l'attitude des négociateurs chinois, laquelle, selon l'auteur, est susceptible d'être influencée par des interlocuteurs capitalistes patients. Le facteur concluant, qui est aussi celui sur lequel les compagnies canadiennes ont la plus grande liberté d'agir, est celui du prix. Ce n'est qu'en offrant leur technologie à des termes plus compétitifs que les investisseurs canadiens seront invités à participer à d'autres entreprises à capitaux mixtes et opérations conjointes en Chine.

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## Introduction

In a 1979 field study carried out by the Export Promotion Review Committee, Canada's export efforts were found to be hampered by, among other problems, noncompetitive export financing, lack of government coordination and too few exportable products designed and developed in Canada.<sup>1</sup> The Committee found that Canada's high trade volume resulted not from technical expertise or shrewd marketing strategy, but rather from the high margin for error that Canada's resource-based economy allowed its international entrepreneurs. Imports consisted mainly of manufactured products and exports were primarily made up of agricultural products and raw materials.<sup>2</sup> While natural resources might provide a springboard for Canada's entry into foreign markets, it was felt that increased amounts of technology and technical expertise should be exported to provide a more diversified trade balance. It was recommended that, in the future, Canadian businessmen and government officials ought to adopt a fresh approach to the export of goods and services.

The "Pacific Rim" in general, and the People's Republic of China (PRC) in particular, present the possibility for an innovative approach. The Pacific Rim encompasses approximately twelve East Asian nations which have been

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<sup>1</sup>Export Promotion Review Committee, "Strengthening Canada Abroad: Summary and Recommendations" in K.C. Dhawan, H. Etemad & R.W. Wright, eds, *International Business: A Canadian Perspective* (Don Mills, Ontario: Addison-Wesley, 1981) 719.

<sup>2</sup>See K.C. Dhawan, H. Etemad & R.W. Wright, "Introduction: Canada in the World Economy" in Dhawan, Etemad & Wright, *ibid.*, 1.

gathering economic strength for the past several decades.<sup>3</sup> When Canada's trade with Asia surpassed that with Europe in 1982, this shift in world economic power and its implications for this country were dramatically underscored.<sup>4</sup> Typical of the reaction was a declaration by one writer that "Canadians have awakened in the 1980s to the fact that the Asia Pacific region is the new locomotive of dynamism in the world today".<sup>5</sup> And indeed, since 1960, the Pacific Rim's share of total world economic output has risen from eight per cent to seventeen per cent.<sup>6</sup> Canadian businessmen, naturally, are anxious to exploit this opportunity to expand their markets in the Pacific Rim.

Geographically, demographically, and strategically, China is the principal player in the Pacific Rim. The proclamation of *The Law of the People's Republic of China on Chinese-Foreign Joint Ventures*<sup>7</sup> on 8 July 1979, raised hopes that the PRC would assume an equally dominant role economically. The *J.V.L.* signalled the start of the "open-door policy",<sup>8</sup> an increase in economic interaction with foreign entrepreneurs. While it provided only a flexible framework for potential investors, a great deal of interest was generated by this legal manifestation of the "Four Modernizations" programme first enunciated four years earlier.<sup>9</sup> The desire to penetrate a hitherto untapped market was given further impetus by the notion that "the greatest rewards are likely to go to those Western investors willing to be the first participants in the joint ventures".<sup>10</sup> The joint venture mechanism was to

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<sup>3</sup>The definition of the Pacific Rim adopted here includes: Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Taiwan and Thailand. This is in preference to the broader definition used in R.A. Matthews, "The Era of the Pacific" (1983) 4 *Pol'y Options* 53 at 54: "One can therefore view the Pacific area as having two sides: east Asia and Australasia on the west, and the western parts of North and South America on the east. That is the famous 'Pacific Rim'."

<sup>4</sup>N.V. Freeman, "Asia Pacific: Crisis or Challenge?", *Asia Pacific Business* (June 1984) 3.

<sup>5</sup>*Ibid.*

<sup>6</sup>C.P. Alexander, "Jumping for Joy in the Pacific", *Time* (12 November 1984) 72 at 74.

<sup>7</sup>Reprinted in *China's Foreign Economic Legislation*, vol. 1 (Beijing: Foreign Languages Press, 1982) 1, (1979) 18 *I.L.M.* 1163 [hereinafter the *Joint Venture Law* or *J.V.L.* cited to *C.F.E.L.*]. *C.F.E.L.* contains the official Chinese texts and unofficial English translations of the *Joint Venture Law* and related pre-1982 legislation and is used as the primary source of quotations from such legislation.

<sup>8</sup>The use of the term "open-door policy" in the context of this essay is not to be confused with the open-door policy proclaimed by the United States in the late nineteenth century to ensure that trade in China would not be monopolized by any one imperial power.

<sup>9</sup>The announcement of the "Four Modernizations" programme by Premier Zhou Enlai in January 1975 at the Fourth National People's Congress gave clear notice that foreign trade was to play an important role in the future economic development of China. The four targeted areas were agriculture, industry, national defence and science and technology.

<sup>10</sup>C.A. Jaslow, "Practical Considerations in Drafting a Joint Venture Agreement with China" (1983) 31 *Am. J. Comp. L.* 209 at 223 n. 79.

become a vehicle through which to channel the economic needs of China and the capital and expertise of Western entrepreneurs.

In view of the Communist regime's previous tenacious adherence to the principles of political independence and economic self-reliance, the *J.V.L.* was hailed as an invitation for business cooperation by foreign investors. A plethora of articles appeared in foreign legal and business publications, closely scrutinizing the terms of the *J.V.L.* and speculating on its likely impact.<sup>11</sup> These articles, though, were essentially predictive in nature, as they were based more on textual analysis than on any actual experiences of foreign investors operating under the new legislation. It is only in the years since the appearance of these first articles that foreign corporations have undertaken such operations. What, then, has been the actual experience of Canadian companies in the years since 1979? This article will build on the initial scholarly analyses of the *J.V.L.* and related legislation, examining the business arrangements, including sales contracts, cooperative production agreements, cooperative ventures, and equity joint ventures actually entered into by Canadian companies during the past few years in China. A list of practical considerations in negotiating a joint venture agreement with the Chinese will be compiled. These elements will then be analyzed in terms of fixed and variable factors. The conclusion will propose guidelines which Canadian negotiators may follow when drafting joint venture agreements.

## I. The Joint Venture Process in International Business

A basic definition of a joint venture was adopted in *Central Mortgage & Housing Corp. v. Graham*:

A joint venture is an association of persons, natural or corporate, who agree by contract to engage in some common, usually ad hoc undertaking for joint profit by combining their respective resources ...<sup>12</sup>

This definition of an "economic marriage" can just as easily be applied to international business. Whether in a domestic or international agreement, each partner brings to these undertakings something which the other needs. In both cases, the focus of the joint venture is usually quite restricted,

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<sup>11</sup>See, e.g., D.I. Salem, "The Joint Venture Law of the People's Republic of China: Business and Legal Perspectives" (1981-82) 7 Int'l Trade L.J. 73; Jaslow, *ibid.*; P.D. Reynolds, "The Joint Venture Law of the People's Republic of China: Preliminary Observations" (1980) 14 Int'l Law. 31; I.F.G. Baxter, "Business with the People's Republic of China" (1981) 59 Can. Bar Rev. 337; F.C. Rich, "Joint Ventures in China: The Legal Challenge" (1981) 15 Int'l Law. 183.

<sup>12</sup>(1973), 13 N.S.R. (2d) 183 at 207, 43 D.L.R. (3d) 686 (S.C. T.D.), Jones J. This definition is taken from W.H.E. Jaeger, ed., *Williston's Treatise on the Law of Contracts*, vol. 2, 3d ed. (Mount Kisco, N.Y.: Baker, Voorhis, 1959) at 555.

representing only a "narrow community of interest in a single area".<sup>13</sup> Such arrangements are becoming more common today as a prerequisite for greater expansion by foreign investors in host countries, even in the Communist world.

There are two types of joint ventures. First, there is a nonequity or contractual joint venture which entails a joining of interests with respect to a certain enterprise. Most contractual joint ventures are distinguished by three main characteristics, namely, pooled assets, shared profits and joint management. The contractual joint venture itself need not be a limited company; an agreement stipulating the rights and duties of the parties suffices. The agreement will generally combine the funds, equipment and technology of the foreign partner with the labour, factory premises and raw materials of the local associate.<sup>14</sup>

The second form of participation, an equity joint venture, normally requires more substantial capital investment. The essence of the equity joint venture arrangement is the creation of a new limited company. Much care is taken in negotiating the complex provisions of the agreement.<sup>15</sup> For instance, the parties must determine the share ratio of the new limited company. The capital contributed by each partner can be either in cash or in kind: factory buildings, machinery and equipment, land use rights, patented technology, know-how and industrial property rights are examples.<sup>16</sup> The duration of cooperation can vary from five years in the service and hotel sector to twenty years in heavy industry.

The problem of reconciling the ideology derived from Marx and Engels with the invisible hand of Adam Smith, a problem with which China is currently grappling,<sup>17</sup> was confronted in Eastern Europe almost two decades ago. In 1967, Yugoslavia began to allow Western investments in state-managed industrial enterprises, followed by Romania in 1971 and Hungary in 1972.<sup>18</sup> There are certain similarities in the socialist encounters with capitalism on the two continents. Both Eastern Europe and China had been

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<sup>13</sup>R.E. Cherin & J.J. Combs, eds, "Foreign Joint Ventures: Basic Issues, Drafting and Negotiation" (1983) 38 Bus. Law. 1033 at 1034.

<sup>14</sup>L. Fung, *China Trade Handbook* (Hong Kong: Adsdale People, 1984) at 172.

<sup>15</sup>R.J. Radway, "Overview of Foreign Joint Ventures" (1983) 38 Bus. Law. 1040 at 1043.

<sup>16</sup>Fung, *supra*, note 14 at 172.

<sup>17</sup>On 7 December 1984, an editorial in the *People's Daily* proclaimed: "We cannot expect the works of Marx and Lenin in their day to solve the problems of today." The hasty correction two days later, stating that the word "all" was inadvertently left out after "solve" only underscored the ideological confusion now reigning in China. See D. Bonavia, "The Marx Bothers", *Far Eastern Economic Review* (20 December 1984) 38 at 38-9.

<sup>18</sup>Rich, *supra*, note 11 at 189-90.

isolated from the West for many years and the desire for advanced technology was tempered by a suspicion of foreign investors. Nevertheless, the new laws promulgated in both areas were designed to encourage, not to restrict, foreign participation in the domestic economy within a regulated context.

The comparison between China and the Eastern European nations is limited, however, in that the "Eastern European Laws were promulgated in the context of a sophisticated European legal tradition which China lacked".<sup>19</sup> While the Eastern European experience therefore cannot be used as a direct model for what may eventually occur with the joint venture process in China, some generalizations about socialist nations are useful. The use of joint ventures in Poland, for example, illustrates that "socialist countries recognize their need for technology from the Western democracies and wish to follow a non-dogmatic approach in negotiating such arrangements".<sup>20</sup> Moreover, many of the incentives used to encourage foreign investment in Eastern Europe have been adopted by China,<sup>21</sup> which is not surprising in light of the fact that Chinese officials studied the Yugoslavian, Romanian and Hungarian laws, among others, before enacting their own.<sup>22</sup> The *J.V.L.* is simply an enabling law made up of fifteen vaguely-worded provisions, similar in nature to the statutes of the Eastern European countries, which amount essentially to brief basic decrees of general application.<sup>23</sup>

## II. The Joint Venture Process in the People's Republic of China

The enactment of the *Joint Venture Law* in 1979 was not only an economic measure; it was also a political act. Thirty years earlier, Chinese Communist Party Chairman Mao Zedong had signalled the PRC's intention to steer a proud and independent course by proclaiming on 1 October 1949, from the Gate of Heavenly Peace, that "China has stood up". In Mao's vision of Marxism-Leninism, the responsibility for economic development rested on the shoulders of the ideal Communist Man whose "attributes of self-denial, total commitment, energy, struggle, initiative and inventiveness" would overcome China's lack of technical expertise.<sup>24</sup> This theoretical base translated into a policy of "men over machines" and "better red than expert".<sup>25</sup>

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<sup>19</sup>*Ibid.* at 190.

<sup>20</sup>J.G. Scriven, "Joint Ventures in Poland: A Socialist Approach to Foreign Investment Legislation" (1980) 14 J. World Trade L. 424 at 437.

<sup>21</sup>Rich, *supra*, note 11 at 190.

<sup>22</sup>Radway, *supra*, note 15 at 1045.

<sup>23</sup>Scriven, *supra*, note 20 at 428.

<sup>24</sup>A. Eckstein, *China's Economic Revolution* (Cambridge: Cambridge University Press, 1977) at 35.

<sup>25</sup>*Ibid.*

This model of economic development prevailed until Mao's death in 1976. With the arrest of the Gang of Four shortly thereafter, a new moderate government, first under Hua Guofeng and then under Deng Xiaoping, emerged to reassess the political and economic problems facing China. A pragmatic philosophy inspired by Deng's famous aphorism that "it doesn't matter whether the cat is black or white, as long as it catches mice" quickly came into vogue. In 1978, this new regime reaffirmed, at the Fifth National People's Congress, the Four Modernizations programme outlined three years earlier by the late Premier Zhou Enlai. The areas targeted for increased production, in which foreign investment was to play an important role, were agriculture, industry, science and technology and national defence. In view of the absence of a suitable legal framework for foreign entrepreneurs, the *J.V.L.* was enacted to regulate Western participation in the Chinese economy.

The *J.V.L.* was not merely fifteen articles regulating a particular form of business enterprise; rather, it symbolized the new Chinese open-door policy of economic cooperation with foreign investors. Given the Maoist doctrine of total self-reliance, full sovereignty and a classless society, the promulgation of the *J.V.L.* was said to represent "a major concession to the West, illustrating China's desire for Western investment".<sup>26</sup> The sincerity of China's objective of "expanding international economic co-operation and technical exchange" as stated in article 1 has been verified in retrospect. The attempts made since 1979 to clarify ambiguities in the *J.V.L.* and to implement complementary legislation<sup>27</sup> to alleviate the concerns of Western investors have confirmed the good faith of the Chinese. A Chinese official boasted in 1984: "People will find the full embodiment of China's firm and unshakeable open policy in all its legal documents, from the Constitution to concrete laws and regulations concerning foreign economic affairs, from bilateral to multilateral treaties."<sup>28</sup> While the legal system of China is only six years old, and wide gaps remain to be filled by legislative draftsmen, an energetic process of reorientation was indeed begun in 1979.

The *J.V.L.* sets forth a framework for the negotiation and operation of equity joint ventures. Contractual joint ventures, on the other hand, which

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<sup>26</sup>Jaslow, *supra*, note 10 at 231.

<sup>27</sup>See, e.g., *Provisions of the People's Republic of China for Labour Management in Chinese-Foreign Joint Ventures* (promulgated 26 July 1980) reprinted in *C.F.E.L.*, *supra*, note 7, 20, (1980) 19 I.L.M. 1454 [hereinafter the *Labour Management Provisions*] and *Interim Procedures for the Handling of Loans by the Bank of China to Chinese-Foreign Joint Ventures* (promulgated 13 March 1981) reprinted in *C.F.E.L.*, *supra*, note 7, 27.

<sup>28</sup>Xiao Yongzhen, "Legislation Firmly Holds Open China's Doors", *Beijing Review* (22 October 1984) 16 at 17.



in China appear in a variety of guises such as cooperative ventures<sup>29</sup> and cooperative production agreements, are separately and less extensively regulated. In practice, the terms of these various contractual joint ventures have been left primarily to the imaginations of the contracting parties.<sup>30</sup>

For some investors the *J.V.L.* has represented an opportunity to make a substantial investment in China; for others it has simply signalled an improving economic climate conducive to increased trade or the conclusion of a contractual joint venture. A more fundamental distinction, however, can be drawn on the basis of these potential investors' differing appreciations of the legal framework in China, as exemplified by the *J.V.L.*

On the one hand, those vigorously pursuing the China market stress that a knowledge of custom and law are crucial to an understanding of the *J.V.L.*<sup>31</sup> In their view the ambiguity of the provisions in the *J.V.L.* was not only to be expected given the limited "conceptual reservoir" of legal thought in China, but was deliberately designed that way as in other Communist countries.<sup>32</sup> The Chinese, who do not rely on positive law as heavily as do Western businessmen, treat the principles of equitable performance and amicable dispute resolution as paramount.<sup>33</sup> While article 2 provides statutory protection for the foreign partner's investment, it must be understood that "[p]revailing commercial custom and practice is more important in the Far East than dependence on legal rules and litigation skills for their enforcement".<sup>34</sup> The provisions of the *J.V.L.*, while undeniably incomplete, allow the relationship between the parties to overshadow the written law. From this point of view, the perceived vagueness of the *J.V.L.* could be viewed as conferring flexibility on the Western partner when negotiating the terms of an agreement. The *J.V.L.* was meant to provide a framework within which the details of participation were to be negotiated: "The forum for

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<sup>29</sup>The Chinese term for "cooperative venture" has also been translated as "cooperative enterprise". See, e.g., J.A. Cohen, "Some Problems of Investing in China" in J.A. Cohen, ed., *Legal Aspects of Doing Business in China 1983* (New York: Practising Law Institute, 1983) 65 at 69.

<sup>30</sup>Contractual joint ventures do have to abide by the terms of certain more general statutes such as the *The Income Tax Law of the People's Republic of China Concerning Foreign Enterprises* (promulgated 13 December 1981) reprinted in *C.F.E.L.*, *supra*, note 7, 64, (1982) 21 I.L.M. 802 [hereinafter the *Foreign Enterprise Income Tax Law*]. See also *infra*, note 114 and accompanying text.

<sup>31</sup>See Rich, *supra*, note 11 at 186: "Counsel preparing to enter a joint venture negotiation with the Chinese would be wise to study these concepts of 'self-reliance' and 'equality and mutual benefit', and be prepared to offer and defend proposed contract provisions in the context of those concepts."

<sup>32</sup>Baxter, *supra*, note 11 at 350.

<sup>33</sup>R. Edwards, "The Legal Framework of Chinese Trade" in H.M. Holtzmann, ed., *Legal Aspects of Doing Business with China* (New York: Practising Law Institute, 1976) 63 at 65.

<sup>34</sup>Baxter, *supra*, note 11 at 351.

filling in the details is exactly that which Western businesses would have wanted — the negotiating table.”<sup>35</sup> From this perspective, there is indeed a viable opportunity for Western entrepreneurs to explore the China market. The barrier to participation is not the lack of legal structure, but a mental block concerning a supposed absence of political stability. As one American commentator puts it, “[t]he question of security essentially is one of political risk”.<sup>36</sup>

On the other hand, other Western entrepreneurs, for whom effective legal guarantees are a prerequisite for investment in China, have proven unwilling to accept this political risk. The early statements by Chinese officials that detailed regulations and additional legislation dealing with company law, labour, banking, foreign exchange, intellectual and industrial property and taxes would follow the adoption of the *J.V.L.*, were viewed by these individuals with scepticism.<sup>37</sup> There were underlying fears among some foreign partners that a contract signed today might be altered by legislation promulgated tomorrow.<sup>38</sup> As a result, some transnational corporations were reluctant to embark on joint ventures until the legal framework was “more fully fleshed out”.<sup>39</sup> In 1979, for example, a Japanese electronics firm adamantly refused to sign any joint venture agreements until the law affecting potential business operations was clarified.<sup>40</sup> These concerns have mostly dissipated in the years since the proclamation of the *J.V.L.* as the Chinese have steadily solidified the legal foundation needed for business cooperation.<sup>41</sup>

In recent years, the Chinese have made a concerted effort to expand the legal protection available to foreigners. As one Chinese editorialist noted:

Since 1979 China has enacted more than 40 laws and regulations concerning such matters as Chinese-foreign joint ventures, the exploitation of offshore oil, taxation of foreign enterprises, organizations and individuals in China, labour management, administration of industry and commerce, foreign exchange, control, customs, import and export commodities inspection, banking and credit, trade marks, patents, special economic zones, etc.<sup>42</sup>

This process of legal codification and clarification has balanced the Chinese objective of facilitating the transfer of technology and the foreign investor's need for legal certainty.

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<sup>35</sup>Rich, *supra*, note 11 at 210.

<sup>36</sup>*Ibid.*

<sup>37</sup>*Ibid.* at 189.

<sup>38</sup>Cohen, *supra*, note 29 at 78.

<sup>39</sup>Rich, *supra*, note 11 at 188.

<sup>40</sup>*Ibid.* at 188 n. 47.

<sup>41</sup>Much work, of course, remains to be done. One of the shortcomings in China's commercial law system is the continuing absence of a company law. See K.C. Wong, “A Legal Opinion”, *China Trade Report* (June 1984) 13.

<sup>42</sup>Xiao, *supra*, note 28 at 16.

Illustrative of this process is the Chinese Constitution of 1982, which explicitly protects foreign investment at the constitutional level. Articles 18 and 32 envision cooperation between foreign enterprises and Chinese organizations and ensure protection of the "lawful rights and interests" of the former.<sup>43</sup>

Another significant legislative development, which attempts to address some major practical issues confronting Western investors participating in joint ventures, was the issuing of the *Regulations for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Joint Ventures* on 20 September 1983.<sup>44</sup> The Deputy Director of the Ministry of Foreign Economic Relations and Trade (MOFERT) Legal Division, speaking in Canada in 1984, addressed the concerns of Canadian businessmen by stressing that the *Regulations* "supply both assistance and guarantees to the joint venture in planning and permit the full autonomy for its management".<sup>45</sup> The Deputy Director also asserted that the *Regulations* provide detailed guidelines on domestic channels available to joint ventures for the purchase of raw materials and the sale of products.<sup>46</sup> The United States Department of Commerce responded favourably to the Chinese initiative, noting that "the *Regulations* represent significant positive steps towards the continued improvement in conditions encouraging foreign investment and its contribution to China's four modernizations".<sup>47</sup> The *Regulations* appear therefore to have allayed many Westerners' fears.

An even more recent development is *The Patent Law of the People's Republic of China*,<sup>48</sup> which became effective on 1 April 1985. This legislation is expected to "play an active role in accelerating the imports of technology [and] the utilization of foreign funds" by filling what Western investors have viewed as an important gap in Chinese law.<sup>49</sup> The *Patent Law* replaced the *Regulations for Rewards on Inventions*, under which all inventions belonged to the state and all work units in China could make use of inventions as

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<sup>43</sup>Translated as *The Constitution of the People's Republic of China* (Beijing: Foreign Languages Press, 1983) reprinted in A.P. Blaustein & G.H. Flanz, eds, *Constitutions of the Countries of the World*, vol. 3 (Dobbs Ferry, N.Y.: Oceana, 1983).

<sup>44</sup>Translated and reprinted in *Beijing Review* (10 October 1983) supp. i, as well as in (1983) 22 I.L.M. 1033 [hereinafter the *Regulations*].

<sup>45</sup>W. Gooding & A. Mathieu, "Royal's Deal Key Step in China Push", *The Financial Post* (8 September 1984) 1.

<sup>46</sup>*Ibid.*

<sup>47</sup>American Embassy, Beijing, *People's Republic of China: Foreign Economic Trends and their Implications for the United States* (Washington: International Trade Administration, 1984) at 14.

<sup>48</sup>Translated and reprinted in *Beijing Review* (9 April 1984) supp. i [hereinafter the *Patent Law*].

<sup>49</sup>Hu Mingsheng, "Patent Law Encourages Chinese and Foreign Investors", *Beijing Review* (9 April 1984) 23.

they deemed necessary. Most recently, the Chairman of the China International Trust and Investment Corporation (CITIC) reiterated the Chinese commitment to continue the liberalization of economic policies and promised "further tax cuts, longer tax holidays, greater access to domestic markets, and a longer life-span for joint venture projects".<sup>50</sup>

The joint venture process in China cannot be fully understood without an examination of the bureaucratic tangle through which most foreign investment agreements must pass.<sup>51</sup> Policy governing such agreements is generally coordinated and directed through the bureaucracy of the central Chinese government. The two organizations which administer the *J.V.L.* at this level are CITIC and MOFERT.

CITIC's stated purpose is "to introduce, absorb, and apply foreign investment".<sup>52</sup> Confusion has been widespread among foreign investors since CITIC is not the sole organization through which contact can be initiated; various provincial development groups, municipalities and Special Economic Zones (SEZs)<sup>53</sup> may agree to contract up to specified amounts.<sup>54</sup> Some argue that the most sensible route is to take advantage of CITIC's broad mandate to

undertake under commission from foreign corporations, enterprises, other economic entities or individuals to negotiate and enter into short-term or long-term joint venture agreements and related contracts with the various local administrations and departments in China, and the corporations, enterprises, and other economic entities thereunder, and vice versa.<sup>55</sup>

This allows the foreign investor to circumvent as many dealings with the bureaucracy as possible. On the other hand, often the best contract may be obtained by contacting all the provincial, municipal, and SEZ organizations which offer the desired services and then striking the best deal available.<sup>56</sup>

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<sup>50</sup>A. Mathieu, "China to Offer More Incentives", *The Financial Post* (20 October 1984) 16.

<sup>51</sup>Jurisdiction varies with the amounts involved. See *infra*, note 54.

<sup>52</sup>Salem, *supra*, note 11 at 78 [footnote omitted].

<sup>53</sup>At present, there are four Special Economic Zones, all in South China. These are small enclaves, modelled after the export processing zones prevalent in many other East Asian countries. They have been designed to attract foreign and Overseas Chinese capital by offering special concessions and modern infrastructures conducive to assembly operations and other industry. The four SEZs are located in: Shenzhen, opposite Hong Kong; Zhuhai, adjacent to Macao; and the old treaty ports of Shantou (Swatow) and Xiamen (Amoy).

<sup>54</sup>*Regulations, supra*, note 44, art. 8.

<sup>55</sup>Salem, *supra*, note 11 at 79 [footnote omitted].

<sup>56</sup>For a description of this process of decentralization, see S.L. Ellis, "Decentralization of China's Foreign Trade Structures" (1981) 11 *Ga J. Int'l & Comp. L.* 283. See also Cohen, *supra*, note 29 at 97; W.P. Alford & D.E. Birenbaum, "Ventures in the China Trade: An Analysis of China's Emerging Legal Framework for the Regulation of Foreign Investment" (1981) 3 *Nw. J. Int'l L. & Bus.* 56 at 84.

Once the two parties have agreed to undertake an equity joint venture and have agreed on the scope of the contract, the basic terms are expressed in a signed letter of intent. This letter is then submitted to MOFERT which is responsible for approving large-scale joint ventures and for maintaining continual scrutiny and control of their operations.<sup>57</sup> Such approval is often contingent on the results of a feasibility study. While there is occasional disagreement over which participant will bear the costs of the study, the Chinese tend to be flexible, though not overly generous.<sup>58</sup> The process by which joint ventures are approved, which was shrouded in mystery in the early 1980s, has now been clarified in the *Regulations*.<sup>59</sup> Still, while the Chinese criteria for the approval of a joint venture have been specified, "a lengthy process of negotiation and documentation" remains the rule.<sup>60</sup> MOFERT exerts considerable control over the final form of the joint venture, as the terms of the contract must be vetted at various stages of the negotiation process.<sup>61</sup> MOFERT also supervises the implementation of the provisions of the joint venture and approves any subsequent modifications to the contract.<sup>62</sup>

If the joint venture is designed to export products, which the Chinese prefer in order to obtain foreign exchange, other organizations within the bureaucracy are mobilized. Foreign trade is directed by MOFERT, assisted by the quasi-governmental China Council for the Promotion of International Trade (similar in certain respects to a Chamber of Commerce). The actual conduct of foreign trade was previously the exclusive preserve of the various Foreign Trade Corporations (FTCs), which have staff specialized in dealing with a range of commodities from agricultural products to manufactured goods.<sup>63</sup> The monopoly of the FTCs, however, is eroding as the rapid expansion of foreign trade has led to a decentralization of business contacts with Western entrepreneurs in a drive to facilitate the sale of exports and the transfer of technology.<sup>64</sup>

The Chinese bureaucracy resembles a maze in which the starting point is clear but the path leading out to a functioning joint venture is difficult to trace. The *Regulations* are an attempt to remedy this situation. Article

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<sup>57</sup>Cohen, *ibid.* at 95.

<sup>58</sup>*Ibid.* at 97.

<sup>59</sup>Among the documents which must be submitted are the joint venture agreement, the joint venture contract and the articles of association. *Regulations, supra*, note 44, art. 9(2)(c).

<sup>60</sup>Rich, *supra*, note 11 at 193.

<sup>61</sup>*Ibid.*

<sup>62</sup>Cohen, *supra*, note 29 at 96.

<sup>63</sup>Baxter, *supra*, note 11 at 342.

<sup>64</sup>Since the advent of the open-door policy, the province of Guangdong and the municipalities of Beijing, Shanghai and Tianjin, for example, have been granted greater authority to conduct foreign trade. See L. do Rosario, "That Old Sleeping Dragon is Awakening at Last", *Far Eastern Economic Review* (21 March 1985) 75.

6 sets out the line of authority which applies when a joint venture has more than one Chinese participant. Article 8 stipulates that MOFERT will yield to the governments of the provinces, autonomous regions and municipalities or related ministries under the State Council (the Cabinet) the power to examine and approve smaller-scale joint ventures. This attempt at decentralization is designed to render the processing of joint venture applications more efficient and to make the procedure less painful for foreign investors.

### III. General Considerations for Negotiating Joint Ventures in the People's Republic of China

Experience in the negotiation process is as crucial as understanding the law, since lacunae in the existing legislation compel the partners to engage in "serious, in-depth, personal negotiations".<sup>65</sup> Because a chief characteristic of Chinese law is "the bargain's the thing", an understanding of the manner to approach the negotiation of a joint venture is necessary for full participation in the China market.<sup>66</sup>

A dual approach will be used to compile the practical considerations for Canadian companies in negotiating joint venture agreements with China. First, the *J.V.L.* and related laws and regulations will be examined, in order to provide insight into the vexing issues which often arise. Second, the experience of Canadian investors in the bargaining process will be studied. The Canadian experience in China, which consists mainly of negotiating contractual joint ventures and a number of other types of business relationships, is relevant in its entirety in providing a framework of considerations to be taken into account when drafting a complex contractual or equity joint venture agreement.

#### A. Management Control

The *J.V.L.* establishes in article 6 two fundamental provisions with respect to the Board of Directors and management personnel. First, control of the Board is ostensibly tipped in favour of the Chinese, as the office of the chairman is filled by the local participant, while the one or more vice chairmen are foreign representatives. From the standpoint of the Chinese, however, an equitable balance is struck since "[m]anagement participation [itself] is a major concession made to Western investors".<sup>67</sup> Second, the Board resolves disputes "through consultation by the parties to the venture,

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<sup>65</sup>Salem, *supra*, note 11 at 73.

<sup>66</sup>O. Lee, "Formation of Contract and Contract Law through Multinational Joint Ventures: Indonesia, China and the Third World" (1983) 17 *Int'l Law* 257 at 261.

<sup>67</sup>Jaslow, *supra*, note 10 at 217.

in accordance with the principle of equality and mutual benefit".<sup>68</sup> Since this implies a form of "unanimity requirement",<sup>69</sup> the question "what if there is no consensus?" need not be asked. "The Chinese way is to discuss things until agreement is reached."<sup>70</sup> It may be easier to stipulate unanimity than to achieve it in practice and therefore the foreign partner should consider the possibility of a stalemate and its consequences.<sup>71</sup> In addition, overloading the joint venture with too many unanimity requirements, which is tantamount to a veto power for each participant, could paralyze day-to-day operations.<sup>72</sup>

One can argue that while ultimate control rests with the Chinese partner, *de facto* power in the enterprise will tend to gravitate towards the foreign participant.<sup>73</sup> As a general rule, extensive management experience and superior technological expertise will give the edge to the foreign partner, at least in the early stages, with the Chinese chairman adopting a purely supervisory role. Even ultimate control is not beyond the foreign investor's grasp if during the negotiation process the latter holds out for the right to appoint a majority of the Board members. A resourceful foreign participant can secure a significant degree of control, as China has proven more flexible in apportioning risk and control than have other socialist countries.<sup>74</sup> The failure of article 6 to delegate exhaustively lower management positions also allows Western experts to perform functions essential to the day-to-day operations of the joint venture, such as those of technical director, quality control director, production manager, engineering manager, commercial manager and chief accountant.<sup>75</sup>

Another consideration which should be taken into account when negotiating the management provisions of the joint venture contract is the length of time necessary for foreign managers to remain involved in the joint venture. While the contract can stipulate a phase-out of managers within certain guidelines or a rotation between foreign and Chinese managers, it should retain flexibility in order to provide for contingencies which may arise during the life of the joint venture.<sup>76</sup> The power of the manager to hire and fire personnel must also be determined. While article 6 of the *J.V.L.* permits conditions governing "[t]he employment and dismissal of

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<sup>68</sup>*J.V.L.*, *supra*, note 7, art. 6.

<sup>69</sup>Jaslow, *supra*, note 10 at 219.

<sup>70</sup>Cohen, *supra*, note 29 at 85.

<sup>71</sup>*Ibid.*

<sup>72</sup>Jaslow, *supra*, note 10 at 219.

<sup>73</sup>*Ibid.* at 221.

<sup>74</sup>Salem, *supra*, note 11 at 91.

<sup>75</sup>Jaslow, *supra*, note 10 at 222-3.

<sup>76</sup>Cohen, *supra*, note 29 at 93.

the staff and workers" to be negotiated by the parties, the *Labour Management Provisions* now offer more explicit guidelines.<sup>77</sup> Another consideration is whether less experienced Chinese managers should receive the same pay as foreign executives. If so, from a foreigner's standpoint, the joint venture would be incurring unnecessary overhead.<sup>78</sup>

### B. Profit and Pricing Policy

With the proclamation of the *J.V.L.*, Chinese Communist Party cadres came face to face with the quintessential capitalist objective of profit maximization. While ideologically uncomfortable with the profits concept, the Chinese hierarchy accepted it as a necessary lure to attract foreign investors. But many felt that this concession on their part went unappreciated and they criticized Western participants for being too concerned with achieving minimum returns on investment, requiring regular profit transfers, and seeking maximum profits over the shortest time possible. The mode of calculation and distribution of profits therefore must be resolved through negotiation, since there is no applicable Chinese legislation.<sup>79</sup>

The process of establishing a pricing policy to determine the margin or profit on goods produced by the joint venture graphically reveals the different approaches of the two participants. The *J.V.L.* refers to but does not define the relevant terms: the "profits due" the foreign partner will be protected (article 2) and the "net profit" of the joint venture minus the joint venture income tax on "gross profit" and stipulated deductions in the articles of association are to be distributed in proportion to the partners' "registered capital" (article 7). Chapter VIII of the *Regulations* does not establish guidelines for pricing policy, but refers to those who will carry it out. For example, joint venture products for sale in the Chinese domestic market "shall correspond with state-set prices, be rated according to quality and paid in renminbi (RMB)", while prices of export products "will be fixed by the joint venture itself".<sup>80</sup> Even though the pricing of joint venture goods is a major issue in completing a contract, policy guidelines are intentionally absent from the *J.V.L.*, thereby forcing the parties to reach an acceptable compromise on the matter.<sup>81</sup>

Problems can easily arise with the accounting of profits and their repatriation. It is important to address various concerns such as whether local accounting procedures will be used, whether accounting is to be done in the

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<sup>77</sup>*Supra*, note 27.

<sup>78</sup>Cohen, *supra*, note 29 at 89.

<sup>79</sup>Jaslow, *supra*, note 10 at 230-3.

<sup>80</sup>*Regulations, supra*, note 44, art. 66.

<sup>81</sup>Salem, *supra*, note 11 at 104.



local currency or whether accelerated depreciation and other Western concepts can be used.<sup>82</sup> The conciliatory policy of China and the lack of qualified accountants allow foreign investors to dictate more of the terms than was possible in Eastern Europe.<sup>83</sup> The repatriation of profits presents a problem since the RMB is not readily exchangeable on the world market and imports must be paid for with hard currency.<sup>84</sup> Of course, profits are of little use if they cannot be converted to hard currency. While adequate export earnings are probably the best remedy, what if the joint venture is unsuccessful in the export market?<sup>85</sup> Clearly, a number of difficulties in negotiating a joint venture centre on reconciling the opposing approaches to the concept of profits.

### C. *Technology Transfer and Capital Contribution*

The *J.V.L.* stipulates that “[e]ach party to a joint venture may make its investment in cash, in kind, or in industrial property rights, etc.”<sup>86</sup> The contribution of the foreign partner shall “generally not be less than 25 [per cent] of the registered capital of a joint venture”.<sup>87</sup> Problems may arise when assessing the Chinese contribution. The “right to the use of a site” (article 5) may be part of the Chinese investment and, one writer suggests, the value of such a contribution may be inflated as a retaliatory measure depending on the valuation of the foreign partner’s assets.<sup>88</sup> Also, since the joint venture is required to give “first priority” to purchases in China (article 9), the contract should stipulate a ceiling on the cost of certain raw materials, perhaps based on the value of the products on the international market and the cost of their transportation to China.<sup>89</sup> MOFERT recommends that precious metals and natural resources “be priced in the light of the international market prices and paid in RMB”, and that water, electricity, gas and motor vehicle oil costs be calculated according to domestic prices.<sup>90</sup>

The provisions of the *J.V.L.* governing the transfer of technology raise a number of issues. For example, the requirement, in article 5, that the transferred technology be both advanced and suitable to China’s needs has

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<sup>82</sup>Jaslow, *supra*, note 10 at 233-4.

<sup>83</sup>*Ibid.* at 234.

<sup>84</sup>*Ibid.*

<sup>85</sup>For a discussion of the six primary contractual methods which are utilized to solve this problem in Eastern Europe, see *ibid.* at 235-6.

<sup>86</sup>*Supra*, note 7, art. 5.

<sup>87</sup>*Ibid.*, art. 4.

<sup>88</sup>Salem, *supra*, note 11 at 88.

<sup>89</sup>Cohen, *supra*, note 29 at 98.

<sup>90</sup>*Ibid.*

been criticized as contradictory;<sup>91</sup> the requirement “is simply too imprecise and amenable to unilateral Chinese interpretation”.<sup>92</sup> Furthermore, the foreign partner may be liable in damages if it causes “losses by deception through the intentional use of backward technology and equipment”.<sup>93</sup> There is neither a definition of “intentional deception” nor a stipulation of what tribunal is responsible for that determination.<sup>94</sup> Should such a finding be made, there is no compensation scale.<sup>95</sup> The Chinese are also free to determine whether a joint venture “possesses advanced technology by world standards” entitling it to a reduction in taxes.<sup>96</sup> The significant degree of discretion vested in the Chinese and the lack of stipulated guidelines for its exercise contrast sharply with Canadian or American boilerplate contracts, which exhaustively detail the rights and liabilities of each party.

Advanced technology may be a source of relative bargaining strength during negotiations, but its transfer often results in problems later in the joint venture.<sup>97</sup> A detailed list of all items of technology should be drafted in order to clarify the expectations of the parties.<sup>98</sup> A number of problems may arise, however. The foreign partner must provide enough information about the technology to convince the Chinese of its benefits, without revealing trade secrets.<sup>99</sup> He must also discuss “the fate of the technology after the expiration of the joint venture”.<sup>100</sup> The Western partner may also be obligated to meet the demands of the local partner by supplying modifications and improvements to the technology and encouraging local research and development during the joint venture.<sup>101</sup>

Before the *Patent Law* became effective, the only written protection for the Western partner was in the negotiated terms such as specific security measures, non-disclosure and secrecy provisions.<sup>102</sup> Without such precautions, the technology used at a particular joint venture site could be duplicated at numerous other factories throughout China without remuneration for the patent holder. Whether the *Patent Law* provides sufficient protection for Western investors will depend upon the good faith of the Chinese in its implementation.

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<sup>91</sup>Jaslow, *supra*, note 10 at 246.

<sup>92</sup>Salem, *supra*, note 11 at 103.

<sup>93</sup>J.V.L., *supra*, note 7, art. 5.

<sup>94</sup>Salem, *supra*, note 11 at 103.

<sup>95</sup>*Ibid.*

<sup>96</sup>J.V.L., *supra*, note 7, art. 7.

<sup>97</sup>Jaslow, *supra*, note 10 at 243.

<sup>98</sup>*Ibid.* at 244.

<sup>99</sup>*Ibid.* at 244 n. 231.

<sup>100</sup>*Ibid.* at 245.

<sup>101</sup>*Ibid.*

<sup>102</sup>*Ibid.* at 245-6.

#### D. Banking and Financing

Article 8 of the *J.V.L.* lists three basic guidelines concerning financing: joint ventures must open accounts with the Bank of China, or a bank approved by the Bank of China, and conduct foreign exchange transactions in accordance with the foreign exchange regulations of China, but they are free to obtain funds directly from foreign banks. The basic functions of the state-run Bank of China are as follows: management of China's international trade, operation in international money markets, exchange control, establishment of relations with foreign correspondent banks where foreign currency accounts are established, conduct of commercial and branch deposit banking, and control of the payment of business enterprise taxes.<sup>103</sup> Like the FTCs, though, the Bank of China's monopoly is quickly eroding in the face of increased competition from CITIC, among others.<sup>104</sup>

The Chinese have had to reacquaint themselves with the idea of secured financing since the advent of the open-door policy. The Bank of China rules for lending to joint ventures allow the parties to obtain collateral security for their loans. If security is not available, guarantees of payment by the partners are often crucial to obtaining foreign credit. The Bank of China, however, has issued no guidelines as to the kinds of guarantees permitted, by whom they can be made, and in what circumstances they will be granted.<sup>105</sup> Another problem is that while the Bank of China has financial experts, many officials still lack the sophistication required to carry out complex international transactions.<sup>106</sup> Since the Chinese are unsure of their own expertise, no stable methods of financing have been perfected as yet. A Canadian writer observed in 1981 that "the picture in regard to financing of business in the PRC seems to keep changing and to indicate a government that modifies its principles (even radically) if they hinder the pragmatic requirements of a general policy of rapid modernization",<sup>107</sup> and the situation remains unsettled several years later. Obviously, a prerequisite to industrialization is the ability to finance projects as they are conceived. This explains, in short, the failure of China to accommodate more foreign investment since 1979. In negotiating a joint venture agreement, difficulties in financing should be resolved early, as the time invested will be lost if funding for the operation cannot be arranged.

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<sup>103</sup>Baxter, *supra*, note 11 at 357.

<sup>104</sup>N. Langston, "Fame is the Spur: Two Chinese Financial Institutions Compete for International Recognition", *Far Eastern Economic Review* (6 June 1985) 58.

<sup>105</sup>Cohen, *supra*, note 29 at 94.

<sup>106</sup>*Ibid.*

<sup>107</sup>Baxter, *supra*, note 11 at 359.

### E. Taxation

The *J.V.L.* barely refers to taxation. The PRC's first comprehensive tax system was established in 1980 with the promulgation of *The Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures* and *The Individual Income Tax Law of the People's Republic of China*.<sup>108</sup> This legislation was a necessary supplement to the *J.V.L.* since "[i]n setting out tax bases, rates, incentives and administrative procedures, the tax laws establish a structure which allows foreign investors to calculate the costs of investing in the PRC".<sup>109</sup> The *J.V.T.L.* assesses worldwide income derived from the joint venture and offers a number of investment incentives: tax holidays, loss carryforwards, reinvestment refunds and foreign tax credits.<sup>110</sup> The *I.I.T.L.* provides for a progressive tax on income. Individuals residing in China for more than one year are taxed on worldwide income while all others are taxed only on income earned within China.<sup>111</sup>

The *J.V.T.L.* incentives are designed to encourage use of the equity joint venture vehicle, as opposed to the various forms of contractual joint ventures for which fewer such incentives exist. Equity joint ventures engaged in low-profit enterprises or in remote underdeveloped areas, for instance, may receive a fifteen to thirty per cent reduction on income tax.<sup>112</sup> A firm reinvesting profits in China for five years may have forty per cent of the reinvested amount refunded as an investment incentive under the *J.V.T.L.*<sup>113</sup> Businesses to which the *Foreign Enterprise Income Tax Law* applies are offered no similar concessions.<sup>114</sup> There is also preferential treatment of Chinese and non-Chinese employees and the withholding of individual income taxes with respect to equity joint ventures.

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<sup>108</sup>*The Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures* (promulgated 10 September 1980) reprinted in *C.F.E.L.*, *supra*, note 7, 36, (1980) 19 I.L.M. 1452 [hereinafter the *J.V.T.L.*]; *The Individual Income Tax Law of the People's Republic of China* (promulgated 10 September 1980) reprinted in *C.F.E.L.*, *supra*, note 7, 75, (1980) 19 I.L.M. 1451 [hereinafter the *I.I.T.L.*]. This new legislation replaced China's two previous major taxes: industrial and commercial consolidated tax, and industrial and commercial income tax. For a discussion of the pre-1980 legislation, see Price Waterhouse, *Doing Business in the People's Republic of China* (New York: Price Waterhouse, 1979) at 17.

<sup>109</sup>P. Fields, "Taxation: The People's Republic of China Income Tax Laws" (1981) 22 *Harv. Int'l L.J.* 234 at 238.

<sup>110</sup>*J.V.T.L.*, *supra*, note 108, arts 5, 7, 6 and 16 respectively.

<sup>111</sup>*I.I.T.L.*, *supra*, note 108, art. 1.

<sup>112</sup>Fields, *supra*, note 109 at 235.

<sup>113</sup>Cohen, *supra*, note 29 at 113-4.

<sup>114</sup>The *Foreign Enterprise Income Tax Law*, *supra*, note 30, applies to cooperative ventures, cooperative production agreements and foreign business establishments. It does contain a loss carryforward provision in art. 6 identical to that in art. 7 of the *J.V.T.L.*, *supra*, note 108; otherwise, it is considerably less generous.

Besides taking notice of the preferred treatment of equity joint ventures, the foreign partner negotiating an agreement should be aware of potential problem areas in the revenue laws. These stem from the ambiguity inherent in much Chinese legislation which makes the extent of tax liability of foreign partners uncertain. Tax planning is not facilitated by the absence of definitions of such terms as "cost", "expense", "losses" and "residing".<sup>115</sup> The considerable discretion vested in the revenue authorities, which allows them to treat investors differently, may also backfire as foreign partners could react negatively to any indication of favouritism by Chinese officials for certain investors. A number of other unresolved tax-related questions persist. What type of foreign income tax will the Chinese allow to be credited against their own? Will joint venture subsidiaries and branches be permitted the same tax credits? Is there a limit on the amount which can be offset? In order to benefit from these various tax incentives, the foreign investor must clarify his status for tax purposes in advance — at the bargaining table.

### F. *Dispute Settlement*

While both parties plan to resolve present and foreseeable differences through negotiation, the possibility of a deadlock must be provided for. Article 14 of the *J.V.L.* provides that a dispute "may be settled through mediation or arbitration by a Chinese arbitration agency or through arbitration by another arbitration agency agreed upon by the parties". The Chinese will go to great lengths to avoid arbitration on the assumption that reasonable people should be able to resolve their differences without resorting to legal confrontation before a judge. No matter how carefully drafted the arbitration clause, the Chinese "will almost certainly attempt to negotiate or invoke conciliation if a dispute arises, and only if these pre-arbitration techniques fail will they resort to arbitration".<sup>116</sup> This approach is alien to the usually-litigious North American businessman. The likelihood of arbitration in China is less than in Eastern Europe since "an externally imposed, binding arbitral decision runs contrary to Chinese tradition and practice".<sup>117</sup> But since the Chinese and foreign partners both wish to avoid arbitration in the interests of a successful joint venture, the presence of an arbitration clause has a useful *in terrorem* effect.<sup>118</sup>

The foreign partner should insist on a provision requiring "friendly negotiations" and mediation before recourse is had to a third party in order to prevent the involvement of an arbitral body. If a contentious matter can

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<sup>115</sup>Fields, *supra*, note 109 at 238.

<sup>116</sup>S.L. Ellis & L. Shea, "Foreign Commercial Dispute Settlement in the People's Republic of China" (1980-81) 6 *Int'l Trade L.J.* 155 at 172.

<sup>117</sup>Jaslow, *supra*, note 10 at 230.

<sup>118</sup>Cohen, *supra*, note 29 at 109. See also Jaslow, *ibid.* at 229.

be resolved without arbitration this will save costs and avoid the risk of destroying good relations between the parties.<sup>119</sup> The terms of the arbitration clause will vary depending upon whether the issue is to be resolved by reference to Chinese law or to public international law. In the domestic context, an arbitrator must be chosen from among members of the Chinese Foreign Economic Trade Arbitration Commission.<sup>120</sup> The principles guiding the approach of an arbitrator from this Commission are equality and mutual benefit, independence and initiative by the disputants and consideration of international practice.<sup>121</sup> With respect to the use of public international law, China has not yet ratified any international arbitration conventions but has apparently abided by foreign arbitration awards involving domestic corporations.<sup>122</sup>

The arbitration clause should address a number of issues. Procedural rules must be chosen. Those most often used are the International Chamber of Commerce Rules, the Arbitration Rules of the United Nations Economic Commission of Europe, or the UNCITRAL Arbitration Rules.<sup>123</sup> The language of the proceedings should be specified. An appointing authority, such as the Arbitration Institute of the Stockholm Chamber of Commerce, should be included. Lastly, the forum of arbitration, which will determine the scope of the arbitration powers, must be stipulated. Sweden is often favoured since its laws are liberal in allowing parties to set their own standards and the arbitrator is empowered to decide all issues brought before him.<sup>124</sup> Added care in the drafting of an arbitration clause may therefore be rewarded in the event of a dispute.

#### IV. A Canadian Framework for Joint Venture and Other Business Negotiations in the People's Republic of China

##### A. *Canadian Business Involvement in the PRC*

The information used to develop this framework for negotiating joint ventures is based on a survey of Canadian businessmen by means of personal interviews and responses received from a printed questionnaire.<sup>125</sup> While a number of transnational corporations were contacted, they are not meant

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<sup>119</sup>Ellis & Shea, *supra*, note 116 at 173.

<sup>120</sup>Salem, *supra*, note 11 at 107.

<sup>121</sup>*Ibid.* at 108.

<sup>122</sup>*Ibid.* at 109.

<sup>123</sup>Cherin & Combs, *supra*, note 13 at 1039.

<sup>124</sup>*Ibid.*

<sup>125</sup>Results of the Questionnaire are reprinted in the Appendix to this article. To protect the anonymity of the respondents, their communications are identified by roman numerals only, unless their business activities in China have already been publicized.

to represent a cross-section of the Canadian business community. These companies were surveyed precisely because they had become involved in some form of business relationship with China. This in itself may indicate certain characteristics atypical of Canadian companies, such as large reservoirs of capital and aggressiveness.

The Questionnaire was a means of obtaining first-hand information on current Canadian business involvement in China. Overall, the results were quite satisfactory. Thirty-three companies were polled, and twenty responded. (Seven of those stated that the Questionnaire did not apply to the activities of their organization.) The interviews, which varied in length from thirty minutes to two and one-half hours, resulted in thoughtful and comprehensive commentary on the company's involvement in China. The businesses surveyed were involved in sales relationships, contracts for the transfer of technology, and joint ventures. One of the most important findings of the survey is that there appears to be a progression of involvement which usually begins with the selling of goods or services to China. If the Chinese are pleased with their purchases, there may be an exploration of the possibility of transferring some of the technology used to manufacture the product. Where China offers a competitive advantage, such as inexpensive labour or the required natural resources at a reasonable cost, then discussions might ensue in order to establish a joint venture to exploit the opportunity.

A number of Canadian companies with the potential to become involved in joint ventures in the future are presently involved in a "simple sales relationship".<sup>126</sup> These sales encompass a broad range of goods and services. Company XI, for example, is involved in activities "of a developmental/marketing nature".<sup>127</sup> It has not yet entered into any agreements, although company representatives have been sent to China on several occasions over the past five years and relations with various government authorities have been established.<sup>128</sup> The main thrust of Company XXIII, which designs and manufactures data communications products, is to pursue business opportunities which lead to direct sales of its products.<sup>129</sup> While these two Canadian companies have had some limited success in sales relationships with China, other corporations have made no progress whatsoever. Company II's discussions over selling a nuclear power reactor and radiotherapy equipment to China have not developed beyond the preliminary stage.<sup>130</sup> Company VI, which recently purchased woven cotton goods from China, found "business relations with them very unsatisfactory with

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<sup>126</sup>Letter from Company XIX.

<sup>127</sup>Letter from Company XI.

<sup>128</sup>*Ibid.*

<sup>129</sup>Letter from Company XXIII.

<sup>130</sup>Letter from Company II.

them [sic] not meeting their shipping date obligations". The Vice President stated unequivocally: "We do not have and will not entertain any joint venture agreements with this country."<sup>131</sup>

The types of contracts entered into by these companies fall along a spectrum ranging from simple sales agreements to complex equity joint ventures. At one extreme, for example, Company XII completed two contracts for the sale of technology and equipment for an energy recovery project in a sulphuric acid plant.<sup>132</sup> The Corporation agreed to install this technology and the Chinese merely had to pay the price. Other Canadian companies furnished such services as the design and manufacture of subsea and offshore production systems,<sup>133</sup> the exploration and development of offshore oil resources,<sup>134</sup> and consulting services for the study of transportation and coal-handling facilities.<sup>135</sup> In these agreements Canadian expertise was put to work in China, while the host country, besides payment, provided the opportunity for Canadian companies to explore a new market.<sup>136</sup>

The sale of technology is often accompanied by a training programme provided by the Canadian company for Chinese personnel. In return, if the Chinese are able to manufacture the product at a lower cost than that prevailing worldwide, the Canadian company may distribute its wares through its international network. Spar Aerospace Ltd's sale of thirty-one satellite earth stations and related technology was accompanied by an agreement for extensive technical cooperation, including an exchange of technical personnel.<sup>137</sup>

Some of the companies included in the survey were involved in joint ventures, primarily contractual rather than equity arrangements.<sup>138</sup> Company VII is presently carrying out a "Cooperative Development Agreement" with China's Ministry of Post and Telecommunications in which Chinese personnel will be trained to develop the product. If the technical device can be economically manufactured, the Canadian company will market it, with

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<sup>131</sup>Letter from Company VI.

<sup>132</sup>Interview with Process Manager, Company XII (10 January 1985).

<sup>133</sup>Interview with Vice President, Company X (9 January 1985).

<sup>134</sup>Pamphlet of Company VIII.

<sup>135</sup>Reply to Questionnaire, Company IX.

<sup>136</sup>See Appendix, Section I, Part B, question 4.

<sup>137</sup>Reply to Questionnaire.

<sup>138</sup>Besides the equity joint ventures entered into by the companies contacted there are two others of which the author was aware as of early 1985. One entails the construction and operation of the Canoble Hotel in Beijing by Josephine Chong and Ray Noble of Toronto; interview with Richard Ling of Dorais & Martin, Avocats, Montreal (24 October 1984). The other involves the training of office personnel in China by Temporary Manpower Services of Toronto.



the Chinese receiving a percentage of the royalties.<sup>139</sup> A cooperative production agreement was entered into between Unican and a FTC, namely the China National Light Industrial Products Import and Export Corporation.<sup>140</sup> The Chinese received technology and training while Unican obtained world marketing rights for Chinese padlocks.<sup>141</sup> The Royal Bank of Canada is involved in a contractual joint venture with CITIC to manage a Hong Kong-based merchant bank, China Investment and Finance, which has been in operation since 3 December 1984. This fifty-fifty partnership, with total capital of U.S.\$4.1 million, will promote and finance overseas investment and capital construction projects in China.<sup>142</sup> Equity joint ventures were being pursued by two Canadian companies. Company XXIX, which is involved in management consulting, recently signed a joint venture agreement with the Chinese Ministry of Coal for a coal gasification project due to come on line in 1985.<sup>143</sup> A facility is being built in China, with each side supplying fifty per cent of the equity, to combine Canadian technology with a Chinese catalyst.<sup>144</sup> Company I examined four proposals during 1984. Two of the projects were abandoned, but it appears that the remaining two will be consummated. A calcium bauxite project to manufacture refractory bricks for furnaces, in its third year of negotiation in 1985, appears to be near completion. The other joint venture project involves manufacturing anodized extrusions for windows and doors by building a showpiece factory with "world state-of-the-art technology".<sup>145</sup>

Significantly, each of the companies participating in the equity joint venture process has been present in China for between ten and forty years. The confidence of the Chinese must be nurtured through lengthy economic interaction. This state of affairs has led a former Chairman of the United States Senate Subcommittee on International Trade to caution investors: "The Chinese place a great deal [of emphasis on] honesty, word, and saving of face. If you're not cut out that way, stay home!"<sup>146</sup> The development of a relationship built on trust is therefore a prerequisite for any intensive involvement in China.

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<sup>139</sup>Interview with executive, Company VII (25 November 1984).

<sup>140</sup>A.D. Gray, "Unican Moving to Lock in Promising Future", *Financial Times of Canada* (13 April 1981) 24.

<sup>141</sup>*Ibid.*

<sup>142</sup>"New China-RBC Venture Makes Headlines", *Intertell* (September/October 1984) 1; Gooding & Mathieu, *supra*, note 45.

<sup>143</sup>Interview with Director, Marketing Asia, Company XXIX (25 January 1985).

<sup>144</sup>*Ibid.*

<sup>145</sup>Interview with Vice President, Planning and Business Development, Company I (4 January 1985).

<sup>146</sup>A. Ribicoff (Address to the Asian Financial Society Conference on "Investment in the People's Republic of China", 18 June 1985) quoted in R. Rachid, "Experts Tallying Results of US-China Business Ties", *Journal of Commerce* (21 June 1985) 5A.

The negotiation of joint venture agreements, or of any business arrangement, takes place within a framework of contractual expectations. Both parties assume, for example, that they will be able to benefit from the completion of an agreement. The Chinese have attempted to clarify their expectations to Western investors through legislative preambles,<sup>147</sup> publications,<sup>148</sup> and trade delegations dispatched overseas.<sup>149</sup> Interested foreign governments have then been able to notify domestic economic sectors of opportunities available in China. In Canada, for example, *China Economic Overview: A British Columbia Perspective* was published in 1982, pinpointing areas of business involvement where B.C. firms have significant expertise.<sup>150</sup>

Another assumption is that Canadian companies have something to offer the Chinese in the form of a competitive advantage over their rivals. The Canadian companies contacted for this study were generally large and successful, enhancing the notion that their corporate growth was achieved through an edge over other business associations. The competitive advantage generally lay with the advanced technology marketed by the Canadian business. For two companies this advantage was achieved by developing a system which no competitors had as yet been able to match. A Company XII executive cautioned, however, that in China strong competition from Japan meant that "our technology must be better, because if it is just as good as, we cannot compete".<sup>151</sup> Other Canadian companies argued that their competitive advantage was based more broadly on such factors as their company's initiative,<sup>152</sup> its willingness to share technology and to train Chinese personnel,<sup>153</sup> or its superior knowledge and expertise.<sup>154</sup>

As noted earlier, all negotiations take place with the relevant branch of the Chinese bureaucracy. Once the appropriate organization has been notified, depending on the nature of the transaction, the negotiation process can take place in two ways. If the foreign company wishes to purchase

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<sup>147</sup>Official statements are often made in China concerning the purpose of a new law which is to affect foreigners. In the case of the *J.V.L.*, *supra*, note 7, such a pronouncement was contained in art. 1, explaining that this new legislation was proclaimed "[w]ith a view to expanding international economic co-operation and technical exchange".

<sup>148</sup>The *Beijing Review* provides a Chinese commentary on the motives behind the proclamation of various laws. See, e.g., Hu, *supra*, note 49.

<sup>149</sup>See, e.g., Gooding & Mathieu, *supra*, note 45 at 24: "A senior mission from Peking completes an eight-city tour of Canada this week, explaining some of the structure behind China's open-door policy and hoping to drum up interest in closer economic ties between the two countries."

<sup>150</sup>M. Cox, *China Economic Overview: A British Columbia Perspective* (Victoria: Ministry of Industry & Small Business Development, 1982).

<sup>151</sup>*Supra*, note 132.

<sup>152</sup>*Supra*, note 143.

<sup>153</sup>Reply to Questionnaire, Company XXVIII.

<sup>154</sup>*Supra*, note 133.

Chinese products, initial contact and negotiation will usually take place at the Guangzhou (Canton) Chinese Export Commodities Fair.<sup>155</sup> The Fair, held twice a year since 1957, has lost some of its importance, however, owing to the increasingly decentralized approach of the Chinese government to foreign trade.<sup>156</sup> The first meetings have an almost ritual format starting with preliminaries and formalities, and then proceeding to substantive issues.<sup>157</sup> There is a division of duty and responsibility among Chinese officials. There are Chinese representatives who meet the prospective purchasers and function as passive note-takers rather than as sales personnel, while other Chinese officials make the actual decisions.<sup>158</sup>

For Canadian companies selling technology, the process is often initiated at the invitation of a Chinese government organization. The negotiations will move to Beijing (Peking) only when the Chinese are ready to receive the Western businessmen. The Chinese will expect detailed information prior to the meeting in order to make the interaction more productive. In discussions regarding the sale of technology, there are two steps in the negotiation process. There is an encounter with technical experts who "ask everything" with respect to the operation of the technology.<sup>159</sup> If the technology is deemed satisfactory, the Canadian representatives meet with a group of commercial officials whose purpose is "to drive the price down".<sup>160</sup> Just as is the case for negotiations at an Export Commodities Fair, the authority of these officials is limited as they cannot negotiate over a ceiling price or change any of the terms of the contract.<sup>161</sup> This is not to say that the Chinese are inflexible. The experience of Canadian companies is that while the Chinese are willing to compromise, this flexibility must be exercised at the appropriate level of the bureaucracy.

Part of the framework of the bargaining process is the use of standard form contracts in order to clarify the expectations of the parties. When a specific Chinese project is opened up to bids by foreign companies, a model contract may be supplied in order to indicate the financial considerations which should be taken into account. The China National Oil Corporation, for example, supplied model contracts to thirty-three oil companies to assist them in submitting bids on designated contract areas on the Pearl River

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<sup>155</sup>Canada, *People's Republic of China: A Guide for Canadian Exporters* (Ottawa: Department of External Affairs, 1983) at 21.

<sup>156</sup>do Rosario, *supra*, note 64 at 76.

<sup>157</sup>E.A. Theroux, "The Chinese Export Commodities Fair" in Holtzmann, *supra*, note 33, 41 at 55.

<sup>158</sup>*Ibid.* at 56.

<sup>159</sup>*Supra*, note 132.

<sup>160</sup>*Ibid.*

<sup>161</sup>*Ibid.*

Basin in the South China Sea.<sup>162</sup> Canadian companies, when initiating discussion for an equity joint venture, may make use of specimen contracts and articles of association as points of departure.<sup>163</sup> While the specimen contracts leave many terms to be clarified by the parties themselves, they do attempt to strike a reasonable balance between the aspirations of the two parties, and thereby prepare the Canadian company for the negotiation process.<sup>164</sup>

In general, joint venture agreements will be completed in three stages.<sup>165</sup> An initial draft will be submitted by the foreign company which may be an adaptation of a specimen contract. At the second stage, the contract will be revised to reflect Chinese concerns. Lastly, the final draft will be hammered out. While this three-stage process is not followed in all cases, the use of specimen contracts as a starting point illustrates the give-and-take which characterizes the negotiation process.

### *B. Elements of the Framework*

In order to determine how Canadian companies should approach the negotiation of a joint venture, the experience of businesses in consummating sales agreements, cooperative production agreements, cooperative ventures and equity joint ventures will be synthesized. One must bear in mind that the extent of the experience of Canadian businessmen to this point is based largely on the negotiation of contractual rather than equity joint ventures. Many of the same problems occur in negotiating sales agreements and cooperative ventures as arise in equity joint venture discussions and thus all forms of involvement can be integrated.

The success of bargaining depends upon one party, say the Canadian company, knowing where the other, here the Chinese negotiators, will compromise and where they will not and perhaps cannot. A valid framework for the negotiation of a joint venture must take this into account. Accordingly, the framework comprises factors which are beyond the control of the

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<sup>162</sup>*Supra*, note 134.

<sup>163</sup>One example, a confidential document drawn up by a large accounting firm and dated 15 September 1984, includes some general comments on equity joint ventures in China, a model contract of forty-nine clauses and forty-two proposed articles of association.

<sup>164</sup>*Ibid.*

<sup>165</sup>J.J. Combs & R.E. Cherin, "Negotiating Session" (1983) 38 *Bus. Law.* 1069 at 1069.

Canadian negotiator and those which are not. The former are thus, from the Canadian standpoint, "fixed" factors, while the latter are "variable".

### 1. Fixed Factors

Fixed factors are basic structural components of the negotiation process; they are constants which must be accepted by the Canadian negotiator. For example, the existence of Chinese legislation and its consequences are simply part of doing business in China. The fixed factors which will be discussed include the legislative framework in China, the Canadian identity of the company, the assistance provided by the Canadian government, the strategy of Chinese negotiators and the procedural requirements of the Chinese bureaucracy. While efforts directed at changing the fixed factors in this negotiating environment may be rewarded, ultimate contractual success is more likely to result from efforts expended on the variable factors.

#### *a. Existing Legislation*

One fixed factor, from the Canadian point of view, is the body of existing foreign economic legislation. While many of the concerns expressed by Western investors are slowly being incorporated into the law, the basic statutory framework is unlikely to be altered. Complying with this legislation, although it is rudimentary and still in flux, is unavoidable. Among the businesses included in the survey, two attitudes emerged, depending on how directly the state of the law impinged on the negotiation process and the relationship of the parties.

On the one hand, the legal system was assessed in relation to the basic question: "Can we rely on the Chinese to perform their obligations?"<sup>166</sup> The lack of law with respect to protecting the investment of Canadian companies was not considered to be important.<sup>167</sup> China was viewed as "a reasonable place to do business, in terms of reliability and solvency".<sup>168</sup> This overshadowed any consideration of legal provisions since the development of a business relationship proceeded on "the basis of trust".<sup>169</sup> As a Company I executive pointed out, "the day you have to take that agreement out to make your point your deal is finished".<sup>170</sup>

The other assessment of the importance of the legal system was grounded in concerns over the state of the law governing the actions of the contracting parties. A Company XXIX representative noted that a lack of sufficiently

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<sup>166</sup>*Supra*, note 139.

<sup>167</sup>*Supra*, note 132.

<sup>168</sup>*Supra*, note 139.

<sup>169</sup>*Ibid.*

<sup>170</sup>Interview with Senior Vice President, Company I (28 September 1984).

detailed law created uncertainty, and this was compounded by China's ongoing process of legislative reform.<sup>171</sup> With the Chinese market "rapidly changing from year to year", legal stability would be useful.<sup>172</sup> The changing nature of the law led to direct problems for one company. An executive explained that the government's recent attempts at a comprehensive reform of China's economic structure, summarized in a document entitled *A Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure* (which he referred to as "The Decision"), led to confusion within the Company.<sup>173</sup> This document, which was approved by the third plenary session of the Twelfth Central Committee on 20 October 1984, applied the "responsibility system",<sup>174</sup> adopted several years earlier in the agricultural sector, to the industrial sector.<sup>175</sup> Company representatives were unsure as to what industries were still centrally planned and which Chinese officials to talk to.<sup>176</sup> At the time of the interview on 4 January 1985, the executive contacted still did not know whether or not the relevant sector would be centrally planned.<sup>177</sup> Under these circumstances, the Company decided it would be too risky to proceed with this particular joint venture since any project requires the official approval of the appropriate branch of the Chinese bureaucracy.

#### b. *Canadian Identity*

All the companies contacted agreed that the Canadian identity of their corporation was an asset.<sup>178</sup> Whether this is translated into tangible benefits is, however, another matter. All other things being equal, would a Canadian company receive a contract instead of an American, Japanese, British or German company simply because of its place of incorporation? Given the competitiveness of the Chinese market, national identity may be a true asset if it allows a Canadian company to benefit economically from the uncontrollable political factor of how one's nation is perceived abroad. At the

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<sup>171</sup>*Supra*, note 143.

<sup>172</sup>*Ibid.*

<sup>173</sup>*Supra*, note 145.

<sup>174</sup>The responsibility system, as applied in the agricultural sector, basically turned over responsibility for crop selection, tillage, harvesting and marketing of production on particular tracts of land to individual families. Title to the land, however, remained with the production team or production brigade (village-level collective units). By analogy, the responsibility system in the industrial sector will yield authority over production, pricing and marketing to professional managers at individual factories and enterprises. Ownership of these factories and enterprises, though, will be retained by the state.

<sup>175</sup>R. Delfs & D. Bonavia, "A New Kind of Socialism", *Far Eastern Economic Review* (1 November 1984) 24.

<sup>176</sup>*Supra*, note 145.

<sup>177</sup>*Ibid.*

<sup>178</sup>See Appendix, Section I, Part G, question 4.

same time, however, Canada is among the smallest of the Western industrialized nations in terms of domestic market and Gross National Product. Canada's economic limitations restrict its political clout.

A Company I executive explained this dichotomy. The United States is the major political and industrial force in the West: "It can afford to deal with China in one way. China has its own perception of the United States, and I'm sure puts it in a special category for dealings." Canadian companies therefore "are not treated as highly when competing with American investors". On the other hand, Canadian identity is a "plus" since "the Chinese don't perceive us as a threat to them in any way".<sup>179</sup> The experience of Company VII was similar to that of Company I; the goodwill felt among the Chinese toward Canada was transferred to the Company representatives. A Company VII executive noted that a favourable impression of Canadians contrasted starkly with the attitude, common among the Chinese, that American corporations represented the worst excesses of capitalism.<sup>180</sup>

### c. *Role of the Canadian Government*

There were mixed reactions on the part of the companies surveyed to the role of provincial and federal government organizations in offering assistance to exploit the Chinese market. The financial support supplied by provincial governments varies substantially. British Columbia, for example, takes a direct interest in what occurs in the Pacific Rim.<sup>181</sup> The Ministry of Industry and Small Business Development attempts to assist B.C. firms wishing to become involved in the China market.<sup>182</sup> In Quebec, by contrast, until recently there has been little provincial money available for the marketing or development of products overseas. A Company VII executive posited that the provincial government, burdened by domestic issues, was not emphasizing the development of overseas markets.<sup>183</sup> The federal government is involved through various agencies. The role of the Department of External Affairs, especially through the Canadian Embassy in Beijing,<sup>184</sup>

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<sup>179</sup>*Supra*, note 170.

<sup>180</sup>*Supra*, note 139.

<sup>181</sup>See, e.g., "Bank of China Considers Putting Branch in Canada When Conditions Are Right", *The [Montreal] Gazette* (5 October 1984) B5; "B.C. Looks at China Market", *Canadexport* (28 January 1985) 2.

<sup>182</sup>Cox, *supra*, note 150.

<sup>183</sup>*Supra*, note 139. See also A. Booth, "Quebec Scratching Surface of Business, Trade Potential", *The Financial Post* (13 July 1985) S20.

<sup>184</sup>See Appendix, Section I, Part G, question 1(d)(i).

was generally viewed as helpful, while the reaction to the Export Development Corporation (EDC)<sup>185</sup> and the Canadian International Development Agency (CIDA)<sup>186</sup> was less enthusiastic.

External Affairs, through its Office of Trade Development, provides information on various world markets open to potential Canadian exporters.<sup>187</sup> As a recent advertisement in *Asia Pacific Business* states, the Department will provide "practical help, current market intelligence, [tips on] how to bid on contracts [and] how to set up agency representation, helpful advice, introductions and tips on local customs".<sup>188</sup> A Company VIII executive explained that the assistance of the Canadian Embassy in Beijing was helpful in organizing meetings and giving relevant advice on current Chinese policies.<sup>189</sup> Although Company XXXII went to China "on its own", its representatives were given valuable assistance by the Embassy once they arrived.<sup>190</sup> One Company X executive did suggest, however, that the number of Embassy staff should be increased to deal with the growing workload.<sup>191</sup>

The EDC is a Crown corporation that reports to Parliament through the Minister of State for International Trade. One of the main functions of the EDC is to "finance foreign buyers of Canadian capital goods and related services when extended credit terms are necessary [and] are not available from commercial lenders".<sup>192</sup> In October 1984, the EDC and the Bank of China signed a general financing agreement which included a \$2 billion line of credit for Canadian capital goods and services exports to China and official Chinese guarantees for supplier credits arranged by the EDC.<sup>193</sup> This arrangement should facilitate Canadian involvement in major Chinese projects, requiring \$25-30 billion for coal mines, nuclear power plants and the South China Sea oil exploration programme.<sup>194</sup> But a previous agreement,

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<sup>185</sup>See Appendix, Section I, Part G, question 1(d)(ii).

<sup>186</sup>See Appendix, Section I, Part G, question 1(d)(iii). See also "How to Get the Best from CIDA Programs" (1984) 5 *China Reporter* 24.

<sup>187</sup>As a starting point, companies requesting information will receive a packet, entitled "Exports Build Canada", including brochures of interest to Canadian exporters, such as the Directory of Trade Publications, Business Directory of Canadian Trade Representation Abroad, and Trade Promotion Support.

<sup>188</sup>*Asia Pacific Business* (June 1984) at 14.

<sup>189</sup>Reply to Questionnaire, Company VIII.

<sup>190</sup>Reply to Questionnaire, Company XXXII.

<sup>191</sup>*Supra*, note 133.

<sup>192</sup>*People's Republic of China: A Guide for Canadian Exporters*, *supra*, note 155 at 32-3.

<sup>193</sup>B. Simon, "Canada's EDC Signs C\$2bn Export Finance Agreement with China", *Financial Times [of London]* (3 October 1984) 5.

<sup>194</sup>P. Lush, "China to Require Over \$25 Billion for Projects", *The [Toronto] Globe and Mail* (9 October 1984) IB1.



also for \$2 billion in credits, resulted in only two sales totalling \$26 million.<sup>195</sup> While the financing structure is in place, Canadian investors have competition since China has reached agreements for export credits with numerous other countries as well.<sup>196</sup> In addition, a Company X executive noted that the financing provided by the EDC is not as attractive as the arrangements which other countries have negotiated for their exporters.<sup>197</sup>

Canadian companies have mixed appraisals of their experience with the Industrial Cooperation Division of CIDA. The Division provides a maximum of \$15,000 to undertake preliminary starter studies for possible business opportunities, a maximum of \$100,000 for a more in-depth viability study and, if appropriate, up to \$250,000 to offset costs incurred in the early stages of the business venture.<sup>198</sup> Company IX, a consulting services corporation, received financial assistance for its transportation and coal-handling facilities studies, but felt CIDA's procedures for handling funding requests took too long.<sup>199</sup> Company VII expressed the same concern. The Company applied for \$72,000 from CIDA to initiate a viability study. A Company executive complained on 25 November 1984: "We applied on January 16, 1984, and they [CIDA] are still dithering whether or not to provide funds for covering expenses for four Chinese [technicians] in Canada during a four-month period. We went ahead and did it anyway."<sup>200</sup> Government approval in such instances is extremely important in its effect on corporate decision-making. If CIDA shows reluctance, a department head is likely to wonder why his company should invest more money in a project when even his own government will not support it.<sup>201</sup>

#### *d. Chinese Negotiating Strategy*

The strategy of the Chinese negotiators, from the perspective of the Canadian company, is a fixed factor in the bargaining process. While the Chinese are willing to compromise on many issues, their approach is rooted in a vastly different culture and is a constant in the negotiation process. Most Canadian companies agreed that the Chinese are "excellent negotiators".<sup>202</sup> One gets the impression that Canadian companies, along with other Western entrepreneurs, hoped that the lack of expertise among the Chinese in technological matters would extend also to the sphere of negotiation.

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<sup>195</sup>*Ibid.*

<sup>196</sup>*Ibid.*

<sup>197</sup>*Supra*, note 133.

<sup>198</sup>C. Gray, "CIDA: The Canadian Catalyst", *Asia Pacific Business* (June 1984) 6.

<sup>199</sup>*Supra*, note 135.

<sup>200</sup>*Supra*, note 139.

<sup>201</sup>*Ibid.*

<sup>202</sup>Reply to Questionnaire, Company XXIX.

Often the Chinese are in a stronger bargaining position than the Canadians, since with so many to choose from, the Chinese can play one foreigner off against the other.

Canadian companies were confronted with other difficulties by the Chinese negotiators. In some cases the Canadian company became frustrated at the apparent lack of understanding of fundamental business concepts by Chinese negotiators. A Company I executive complained that the Chinese do not genuinely comprehend the meaning of the words "joint venture", which he understood as conveying the concept of working together to develop and exploit a comparative advantage.<sup>203</sup> The Chinese viewed themselves as a separate entity within the joint venture and did not comprehend the idea of working for the benefit of the company, the success of which benefits both parties.<sup>204</sup> In other words, the Chinese do not "contribute to the total but attempt to maximize their [own] position".<sup>205</sup> While this concern for protecting their own interests is understandable given China's history, it may destroy the competitive advantage of the joint venture company. For example, if Chinese negotiators demand that the domestic employees be paid United States equivalent wages, which would eliminate the comparative cost advantage, the *raison d'être* of the joint venture vanishes. While the root problem seems to be the reluctance of the Chinese to recognize that decisions must be taken jointly for the benefit of the company, the obstacle to rectification of this situation, according to the Company I executive, is that the Chinese have not yet seen this as a barrier to the operation of a successful joint venture.<sup>206</sup>

The negotiation experience of Canadian companies has led to a questioning of the "good faith" of Chinese representatives. In other words, there seemed to be a discrepancy between the rhetoric of Chinese publications and the hard facts of negotiation. The basic principles followed in China's legislation concerning foreign economic affairs, according to published statements, are to safeguard state sovereignty, to protect the lawful rights and interests of foreign business people, and to provide real benefits to foreign investors.<sup>207</sup> An integration of these principles is found in the *Patent Law* which is meant to protect the patent rights of foreigners within China and to help China proceed with the transfer of technology.<sup>208</sup> Some Canadian executives expressed the view that the concern with the interests of foreigners was not, however, always accounted for in practice. One Canadian

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<sup>203</sup>Interview with Director of Business Development, Company I (4 January 1985).

<sup>204</sup>*Ibid.*

<sup>205</sup>*Ibid.*

<sup>206</sup>*Ibid.*

<sup>207</sup>Xiao, *supra*, note 28 at 16.

<sup>208</sup>Hu, *supra*, note 49 at 23.

executive has stated that the Chinese “want technology for nothing”.<sup>209</sup> A similar view was that China’s purpose in enacting the *J.V.L.* is to “get your technology”, and not to supply the domestic Chinese market with goods produced by a joint venture.<sup>210</sup> The joint venture mechanism was looked upon as a “scheme to get advanced technology” without giving up any foreign exchange.<sup>211</sup> Canadian companies entering joint ventures in the future should treat published statements concerning the extent to which foreigners’ wishes will be satisfied with some scepticism, as this will make the bargaining process more tolerable.

*e. Chinese Bureaucracy*

All negotiations for business agreements with foreigners are channelled through the Chinese bureaucracy. The two problems encountered were quite basic: to whom does one talk and who makes the final decision? The difficulty in finding the proper person to communicate with was viewed by a Company I executive as one of the major barriers to completing a joint venture.<sup>212</sup> Other businessmen agreed that the excessive bureaucratization of doing business in China created unexpected problems. For example, many Chinese officials do not want to make a decision on their own — “they always answer to someone else”.<sup>213</sup>

Even when a representative of the appropriate department is found, there is still the problem of determining who actually makes the decision. Obviously, much time can be wasted if a company is addressing the inappropriate department. The situation is exacerbated since there are many government officials attempting to make arrangements with foreign businessmen “in a highly indiscriminate way”.<sup>214</sup> All branches report to a central bureau, and each department wants a project so that it can become involved with foreign investors.<sup>215</sup> The problem, according to a Company XII executive, is rooted in Chinese custom. If, for example, six possible projects were presented for consideration to a Canadian company, it would choose only the number which could be competently completed. In China, however, the head of the decision-making agency might approve all the projects so as to save face by not offending anyone.<sup>216</sup>

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<sup>209</sup>*Supra*, note 190.

<sup>210</sup>*Supra*, note 132.

<sup>211</sup>*Ibid.*

<sup>212</sup>*Supra*, note 145.

<sup>213</sup>*Supra*, note 132.

<sup>214</sup>*Supra*, note 203.

<sup>215</sup>Reply to Questionnaire, Company XII.

<sup>216</sup>*Ibid.*

At the same time, there is an element of decentralization within the bureaucracy with major cities, provinces, SEZs and the central government all competing for partners which further complicates matters for companies that are preparing proposals for projects in China. This is further compounded by technical considerations. The Company XII executive noted, for example, that “we don’t know [which factory or enterprise] would have the ability to fabricate and market the product best”.<sup>217</sup> While the Canadian companies are disoriented, the Chinese bureaucracy assumes added control by negotiating simultaneously with a number of Western businessmen. From a Canadian perspective, these are “friendly negotiations which put you at total risk”.<sup>218</sup>

## 2. Variable Factors

Variable factors are those over which the Canadian participants have immediate control and which are subject to compromise. They include the ability of Canadian negotiators to strike a bargain, the terms of the transfer of technology, the price paid for the goods and/or services provided and the outlook of Chinese negotiators. These factors allow scope for the creativity of the parties and enable a *consensus ad idem* to be reached within the framework for negotiations as defined by the fixed factors.

### a. Canadian Negotiators

Canadian businessmen have the power to exercise their contractual creativity through the variable factors in the negotiation process. One major factor is the approach taken by the Canadian entrepreneurs towards the enterprise. A charge commonly made against Canadian investors, domestically and internationally, is that they are not aggressive enough.<sup>219</sup> According to John Ellis, former Chairman of the Pacific Basin Economic Council’s Canadian Committee,<sup>220</sup> too many Canadian entrepreneurs have not considered the China market: “To the average businessman, the Pacific Rim is something distant where they can’t really perform; but they can — those

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<sup>217</sup>*Supra*, note 132.

<sup>218</sup>*Ibid.*

<sup>219</sup>*Ibid.* See also Freeman, *supra*, note 4 at 3.

<sup>220</sup>The Pacific Basin Economic Council (PBEC) is an organization of executives from fifteen countries with business interests in the Pacific Rim. Its role is twofold. First, Canadian businessmen can meet their counterparts from other countries. Second, according to a Company I executive, the real work of the Canadian Committee of the PBEC in Canada has been “to build up activities that will raise the level of understanding in the business community at large about the advantages that exist for Canada in developing the Asia and Pacific markets”. See “Interviews: Pacific Basin Economic Council”, *Asia Pacific Business* (June 1984) 17, and Freeman, *supra*, note 4 at 13-6.

markets need our goods and services."<sup>221</sup> A Hong Kong businessman sarcastically noted: "Everyone knows the Canadians need to sell exports; someday even the Canadians themselves will realize it."<sup>222</sup> The companies contacted for this study are among this country's most aggressive, yet the executives of these transnational corporations accepted this claim as an accurate generalization. The approach of Canadian companies is generally a reaction to the state of the market rather than an aggressive attempt to create openings for the sale of products. Among the companies consulted, the typical attitude was illustrated by Company XXIV: "Our efforts will be in proportion to the returns."<sup>223</sup> Because of the global perspectives of these transnational corporations, the approach to China had to be balanced with objectives in other world markets.<sup>224</sup> The management approach of Company I and Company VII is to develop niches for their products in numerous national markets. Specific goals and policies are only clarified once a foothold is established and the opportunities can be assessed in relation to the available resources of the corporation.<sup>225</sup>

Once a company decides to enter the China market, a primary requirement for successful negotiation is, as one executive put it, "patience, patience, and patience".<sup>226</sup> This quality is needed as a tonic for the slow-moving bureaucracy and the Chinese approach of developing trust over time with a foreign partner. Since time is an important consideration in placing estimates on the costs of a project, bureaucratic delays mean the contract may have to be revised to include price adjustments. Company I's experience with joint ventures is that an average of three years of negotiation is required.<sup>227</sup> Since this is "probably an unacceptably long-winded process", things are often done in parallel: the project is assessed and the joint venture is negotiated simultaneously.<sup>228</sup> A Company I executive noted that the time frame requires rapid short-term action or the opportunity disappears.<sup>229</sup> The Chinese bureaucracy, however, often allows form to take precedence over administrative efficiency. The Canadian company must therefore build up reserves of patience; this is easily said, but in practice one's patience wears thin.<sup>230</sup> Once the trust of the Chinese is earned, the process of negotiation will speed up. As a Company X executive stated, earning the confidence of

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<sup>221</sup>"Interviews: Pacific Basin Economic Council", *ibid.* at 18.

<sup>222</sup>Personal communication from T.K.H. Tsang (15 January 1985).

<sup>223</sup>Reply to Questionnaire, Company XXIV.

<sup>224</sup>See Appendix, Section I, Part F.

<sup>225</sup>*Supra*, notes 139 and 170.

<sup>226</sup>Reply to Questionnaire, Company XXVII.

<sup>227</sup>*Supra*, note 203.

<sup>228</sup>*Ibid.*

<sup>229</sup>*Ibid.*

<sup>230</sup>Reply to Questionnaire, Company X.

the Chinese is not as simple as merely buying and selling products, for a personal relationship must be established which will facilitate business interaction.<sup>231</sup>

Canadian businessmen must also be certain that they are communicating their ideas effectively to the Chinese negotiators. According to a Company XXIX executive, "communication is the key to the entire negotiation process".<sup>232</sup> Barriers to communication arise based on language and cultural differences. To remedy the language difficulties, competent translation facilities are crucial. Chinese custom may create obstacles for Canadian businessmen in understanding precisely what the Chinese negotiators mean. The Company XXIX executive explained that "[they] never explain exactly what ... [they] mean — it is a question of saving face".<sup>233</sup> As a result, "yes means maybe and maybe means no" and "nobody ever says no". A nodding of the head by a Chinese representative may mean "we understand you" and not "we agree with you". Company XXIX's negotiations for a coal gasification joint venture were almost scuttled because of a breakdown in communication. The Canadian side did not understand the Chinese viewpoint, but once this communication problem was rectified the joint venture agreement was eventually completed.<sup>234</sup>

*b. Technology Transfer*

The terms for the transfer of technology from the Canadian company to China allow for the greatest amount of contractual creativity. Problems arise on both sides of the bargaining table. The *J.V.L.* highlights the Chinese desire that the technology contributed be truly advanced and appropriate to China's needs. The Chinese will, of course, request detailed information on the nature and uses of the technology available for sale to determine whether it meets this legislative requirement.<sup>235</sup> If the conditions are satisfied, the Chinese may buy, lease, or cooperate with the foreign partner to develop modifications to the technology. Canadian businessmen encounter problems when selling technology to China. At the start of the open-door policy there was no protection of intellectual and industrial property. Will the new *Patent Law* ensure the confidentiality of technological expertise? There is the fear that if the Canadian company does sell technology, and it can be duplicated with impunity, the corporation's services will no longer be required by the Chinese.

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<sup>231</sup>*Ibid.*

<sup>232</sup>*Supra*, note 143.

<sup>233</sup>*Ibid.*

<sup>234</sup>*Ibid.*

<sup>235</sup>*J.V.L.*, *supra*, note 7, art. 5.

A number of forms for the transfer of technology based on the goals of the business enterprise have been negotiated by Canadian companies. In some cases, there is a straight sale of technology which is used to increase the productivity of an existing Chinese business.<sup>236</sup> More common among Canadian companies is some form of cooperative venture or production agreement. This sometimes involves a sale of equipment and related technology which China does not possess and the training of the Chinese to operate the process independently of the Western investor.<sup>237</sup> The Canadian company is in a stronger bargaining position in straight sales than when it enters into a true cooperative venture or production agreement with China. These latter contractual joint ventures are the result of more balanced negotiations since the Canadian company is seeking an advantage by expanding into China. One advantage often sought in China is inexpensive labour. Uican's cooperative production agreement, for example, resulted in the Chinese receiving equipment and technology for the manufacture of sophisticated locks. Uican will benefit since the Chinese-produced locks are two to three times less expensive than its own wares and, with the world marketing rights, there is an opportunity for tremendous growth abroad.<sup>238</sup> The problems inherent in marketing technology provide an opportunity for much flexibility in negotiation. While there is a danger that patent rights may not be effectively protected, a company cannot become a world leader by protecting existing technology, but only by having confidence that its research and development department will continue to give it a competitive edge.

*c. Pricing*

Another variable factor in the process of negotiation is price. When a Canadian company supplies a type of technology which none of its competitors has as yet developed, the price is weighed in relation to the benefits the technology can confer on the Chinese. Company XII's sale of technology and equipment could result in great savings to the Chinese by enabling recovery of a greater amount of energy from a sulphuric acid plant than the process presently used. This energy could then be used for heating, thereby lessening dependence on the use of coal.<sup>239</sup> If a Canadian company is offering technology identical to that of its competitors, the price is of paramount importance. This is especially true when China is soliciting bids on certain projects, such as the development of offshore resources. It is only when the price of Canadian goods and services is competitive that other factors will

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<sup>236</sup>*Supra*, note 215.

<sup>237</sup>*Ibid.*

<sup>238</sup>Gray, *supra*, note 140 at 24-5.

<sup>239</sup>*Supra*, note 132.

come into play. A Company X executive, for example, posited that if the price for a product offered by an American and a Canadian company was the same, the Chinese would choose the Canadian product based on the national identity of the company.<sup>240</sup> An official of Canada's Department of External Affairs argued, with respect to exporters, that "Chinese officials attach enormous importance to price", with the consequence that Canadian companies "are pricing themselves out of the market".<sup>241</sup> The criticism of Canadian exporters that their goods are too expensive has some merit to it.<sup>242</sup>

Another issue related to pricing is the manner of payment. A Company XII executive expressed the concern that should the profit be paid in RMB to the foreign partner, it would be of no use since it could not be converted on world money markets. The RMB is usually only bought and sold as needed for domestic commercial and travel purposes.<sup>243</sup> With respect to foreign exchange transactions, the RMB is used solely as a unit of account.<sup>244</sup> China's lack of foreign exchange has created difficulties for Western investors participating in joint ventures. Foreign employees must receive effective compensation for their services and a corporation entering a joint venture will require payment for its products in convertible currency. The foreign exchange shortage has caused many possible projects to be aborted. The joint ventures actually entered into are therefore often geared to marketing products overseas or to building Chinese hotels open only to foreign tourists, both proven means of maximizing hard currency earnings.

*d. Outlook of Chinese Negotiators*

In view of China's recent adoption of the open-door policy, the dearth of sophisticated capitalist expertise is understandable. While the Chinese continue the task of reforming and revitalizing their economy, the development of a business-oriented outlook among government officials is occurring more slowly. From a Canadian standpoint, this leads to what is perceived as unbusinesslike behaviour on the part of Chinese bureaucrats. The Chinese hesitancy to make concessions, a feature of Chinese negotiations experienced by Canadian businessmen, is sometimes misdirected when Western business concepts are not grasped. A Company I executive asserted

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<sup>240</sup>*Supra*, note 133.

<sup>241</sup>"Potential for China Trade Called Too Big to Ignore", *The Toronto Star* (11 October 1984) B16.

<sup>242</sup>*Supra*, notes 219 and 222.

<sup>243</sup>Price Waterhouse, *Doing Business in the People's Republic of China* (New York: Price Waterhouse Center for Transnational Taxation, 1985) at 8-9.

<sup>244</sup>*Ibid.*



that when negotiations for a joint venture with the Shanghai State Development Corporation began in 1981, his Chinese counterparts were inexperienced, almost naive.<sup>245</sup> For example, when negotiations over the valuation of the capital contributions to the joint venture were taking place, the Chinese asked to receive the equivalent of New York value for the land on which the factory was to be built and United States equivalent wages for the work force.<sup>246</sup> One Canadian company also found it difficult to convince the Chinese that the quality of the product was crucial to its pricing,<sup>247</sup> in other words, that with a small improvement of the product, much more could be charged.

Company XII encountered similar attitudinal problems in its negotiation over the terms of an energy recovery project. There was a disagreement over valuation, the Chinese negotiators contending that their contribution of land, building and labour was equal to the value of the technology and managerial expertise supplied by the Canadian company.<sup>248</sup> The Chinese proposed that their managers be paid the same high salaries as the Company XII executives. This, according to a Company XII officer, was simply not feasible given the relative inexperience of the Chinese. There was also a problem regarding the use of accounting methods. To the Canadian company the overhead represented a fixed cost, while for the Chinese it was counted as profit.

Still, what is perceived as an "unbusinesslike" outlook on the part of the Chinese represents a variable factor as it can be altered during the negotiation of a joint venture, which often lasts several years. During the course of Company I's negotiations, for example, the Chinese became more aware of the ramifications of their own proposals and their original "naïveté" was replaced by more reasonable expectations. This accumulated experience helped accelerate the process. Thus, by patient and unrelenting reiteration of their positions, Canadian investors can in time cultivate an attitude of mutual understanding and cooperation with their Chinese partners.

## V. Conclusion

This article has examined the framework in which Canadian companies' negotiations for joint ventures and other forms of business involvement in the PRC are carried out. In light of this experience over the past few years, the time may now be opportune to propose some tentative guidelines for Canadians attempting to reach equity joint venture agreements under the

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<sup>245</sup>*Supra*, note 145.

<sup>246</sup>*Ibid.*

<sup>247</sup>*Supra*, note 203.

<sup>248</sup>*Supra*, note 132.

*J.V.L.* These guidelines, based on an assessment of the fixed and variable factors in the negotiation process, are designed to compensate for some of the deficiencies in the present approach of the Canadian business community in the PRC, as the potential exists for much more extensive use of the joint venture vehicle.

Among the fixed factors, China's existing foreign economic legislation should be a concern of Canadian companies, but not a bar to a commercial relationship. Representations ought to be made to the Chinese to plug the still numerous gaps in their statutes and regulations, but efforts channelled in various other directions (to be outlined below) are likely to be more productive. The Canadian identity of the companies is clearly a positive, if somewhat nebulous, factor and should be emphasized in all marketing activities, though not to the exclusion of more substantive qualities like price and technology. The Canadian government could perhaps allocate its resources more efficiently; a lobbying campaign aimed at the EDC and CIDA might eventually yield more competitive financing and quicker action by those two agencies. External Affairs might also be prevailed upon to add more commercial attachés to the staff at the Embassy in Beijing and to open up consulates in entrepôt centres like Shanghai and/or Guangzhou.

Some of the fixed factors are not peculiar to Canadian investors. All foreign investors are similarly affected by the ability of Chinese negotiators to play one foreign company off against another and thereby to extract significant concessions from putative investors before coming to any agreement. Likewise, Canadian companies are beset with exactly the same frustrations in dealing with the cumbersome Chinese bureaucracy as their rivals.

The more serious impediments to success lie in the variable factors, those over which Canadian companies have direct control. While Canadian businessmen have been gaining experience in negotiating business agreements with the PRC, for the most part they appear to lack aggressiveness, especially in contrast with their American and Japanese counterparts. While this is obviously a gross generalization, it is noteworthy that few executives dispute it. The time is now at hand for Canadian corporations to commit themselves firmly to pursuit of the China market. This can be achieved in various ways, from the establishment by more companies of permanent offices in Beijing, Shanghai or Guangzhou to the endowment by those same companies of chairs in the study of Chinese law at Canadian law schools.<sup>249</sup> The required aggressiveness will only come after a greater and more informed commitment to involvement in the PRC. The biggest barrier to success is the pricing

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<sup>249</sup>For a discussion of similar policy considerations, see M.A. Goldberg, *The Chinese Connection: Getting Plugged into Pacific Rim Real Estate, Trade and Capital Markets* (Vancouver: University of British Columbia Press, 1985) at 73-95.

of Canadian goods and services. It is only when, and if, these are competitively priced that serious negotiations can be undertaken; not until Chinese officials can envision a transaction which complements their modernization process at a reasonable price do the other factors even come into play. Therefore, top priority must be given to bringing prices down to such "reasonable" levels.

With respect to the other variable factors, they have not generally proven to be critical obstacles. The often "unbusinesslike" outlook of Chinese cadres can in time be modified by continued exposure to Canadian and other capitalist interlocutors across the bargaining table; in any case, the patience of Canadian businessmen has not yet been exhausted. The terms of technology transfer have, for the most part, gone smoothly, with Canadian companies generally proving quite cooperative. And the increasing competition between various Chinese provinces, municipalities and SEZs for the same foreign investment funds can even be turned to advantage by well-informed Canadian businessmen. The Chinese custom of playing one foreign company off against another could thereby be nullified, with Canadian companies in turn playing one province or SEZ off against another before deciding where to locate their equity joint venture.

In short, with the proper preparation and attitude, the opportunity is ripe for Canadian businessmen to take full advantage of what is potentially the largest market in the fast-growing Pacific Rim. The problems associated with China's *Joint Venture Law* and other foreign economic legislation, while numerous, are not insurmountable. If Canada's businessmen can surmount them, they will have taken a step towards resolving their own country's structural economic problems, as well.

### Appendix: Questionnaire Results<sup>250</sup>

#### Section I: General Questions Concerning Your Business Relationship with the People's Republic of China (PRC)

##### Part A: Company Data

1. What are the chief products or activities of your company?
2. What was your total value of consolidated sales for the year 1983?

##### Part B: Process of Involvement

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<sup>250</sup>This Questionnaire, reproduced here in abridged form, was originally drafted by Mr Gary M. Lawrence and the author in consultation with Mr William Coleman of the Canada-China Trade Council and has received the support and encouragement of Mr W.R. Robinson of the East Asia Trade Development Division of the Department of External Affairs. Despite the assistance provided by these agencies, full responsibility for the initiation and coordination of this project remains with the author alone.

1. How long has your company been involved in a business relationship with the PRC?

2. What was the nature of your initial involvement and to what extent has your business relationship progressed?

3. Are you currently involved in a commercial agreement or negotiations for a commercial agreement with the PRC?

If yes, what is the nature and extent of this business involvement?

4. Why did you choose to pursue a business relationship with the PRC?

- (a) Developing new markets
- (b) To overcome tariff barriers
- (c) Future protection for existing market
- (d) Matching competitors
- (e) Geographical diversification
- (f) To obtain new materials
- (g) Political stability
- (h) Host government attitude
- (i) Using patents/licences
- (j) Facilities/resources available
- (k) Lower cost conditions
- (l) Host government tax incentives
- (m) Other reasons (Please describe)

5. What sources of information assisted you in coming to this decision?

6. Was anyone in your company familiar with the PRC before your decision was taken?

Yes [9] No [4]

7. Was anyone in your company aware of potential associates in the PRC?

Yes [8] No [5]

8. How long did you deliberate before deciding to enter into a commercial agreement with the PRC?

9. Was this longer or shorter than the time it would usually take for your company to make such a business decision?

Longer [5] Shorter [2]

#### Part C: General Assessment of Experience

1. How does your company evaluate the efficacy of your business relationship with the PRC? (Please describe briefly)

(a) In terms of return on investment:

Positively [4] Negatively [1]

(b) In terms of percentage of overall profit:

Positively [3] Negatively [2]

(c) Rate of growth of sales:

Positively [5] Negatively [1]

(d) Achievement of other scheduled objectives:

Positively [3] Negatively [1]

2. Has your business relationship with the PRC been as fruitful as initially anticipated?

Yes [4] No [1]

Please briefly explain some of the unexpected problems that your company has encountered, and some of the unexpected advantages that your company has profited from.

3. How important are your local associates and contacts to the success of your commercial involvement in the PRC?

4. Is your company satisfied with the manner in which your business relationship with the PRC has developed?

Yes [6] No [3]

5. Are you content with your present operations in the PRC?

Yes [6] No [3]

6. Would your company be willing to participate in other commercial agreements with the PRC in view of your experience to date?

Yes [12] No [0]

#### Part D: Problems Encountered

1. Please comment upon any effects which the host government's policies, or its actual application of those policies, have had upon your operations, your plans for expansion, and your competitive position. Please comment briefly with reference to any of the following areas which may be relevant:

(a) Methods of allocation of foreign exchange

(b) Allocation of import licences

(c) Application of import duties

(d) Allocation of manufacturing licences

(e) Regulations or pressure for exporting

(f) Regulations or pressure against profit levels

(g) Regulations or pressure against proposed or actual payments or returns for patents, licences, or technical assistance

(h) Remittance of profits or repatriation of capital

(i) Employment or salaries of expatriates

(j) Taxation policies

(k) Special attitudes toward the private sector

(l) Special attitudes toward foreign investors

(m) Intervention on political grounds

(n) Intervention on social and cultural grounds

(o) Any other areas

**Part E: Conflict Resolution**

1. How are the conflicts which arise between your company and your associates resolved?

2. Have you ever been involved in a conflict with the PRC that was ultimately resolved by international commercial arbitration?

Yes [0] No [9]

3. If yes, what was the nature of the dispute, and what was its solution?

4. Why was arbitration chosen as the means of dispute resolution?

5. From which countries were the arbitrators chosen?

**Part F: Future Outlook**

1. Does your company have any long term objectives with respect to your business relationship with the PRC?

Yes [11] No [1]

2. What is the emphasis placed on these objectives in comparison to those pursued in other national markets?

**Part G: Assistance of Canadian Government and Non-Government Organizations**

1. Were any of the following organizations helpful in initiating and maintaining your business relationship with the PRC?

(a) Canada-China Trade Council

Yes [4] No [9]

(b) Pacific Basin Economic Council

Yes [1] No [12]

(c) Asia Pacific Foundation of Canada

Yes [0] No [13]

(d) Government organizations:

(i) Department of External Affairs

Yes [11] No [2]

(ii) Export Development Corporation

Yes [4] No [9]

(iii) Canadian International Development Agency

Yes [7] No [6]

Please describe the nature of the assistance that was provided by each or any of these organizations.

2. Could these organizations have been more helpful in your effort to establish and maintain a business relationship with the PRC?

Yes [5] No [6]

3. Were any non-Canadian foreign businesses benefiting from advantages provided by their national governments that were not being provided by the Canadian government?

Yes [2] No [2]

4. Was the nationality of your company, in any way, an asset in your business dealings with the PRC?

Yes [13] No [0]

## Section II: The Equity Joint Venture

### Part A: Introduction

1. Is your company involved or has your company ever been involved in an equity joint venture with the PRC, pursuant to *The Law of the People's Republic of China on Chinese-Foreign Joint Ventures*, effective 8 July 1979?

Yes [2] No [11]

2. Please briefly describe the nature of this equity joint venture.

- (a) Name of the joint venture company
- (b) Chief products/activities
- (c) Date of agreement, and date of commencement of operations
- (d) Value of total sales last year
- (e) Percentage of share of host country market
- (f) Projected future share of this market

3. Is your company involved in similar equity joint ventures in other countries? (Please list.)

4. Who made the first approach or suggestion regarding a joint venture and in what year was this initiative taken?

5. Why was the joint venture form chosen by you and your associates for this project? (Please rank reasons in order of importance and explain briefly.)

- (a) Host government regulations or pressure
- (b) Spread risk
- (c) Convenience of associates' complementary resources/facilities
- (d) Associates' established control of resources/facilities/channels of supply or distribution made association necessary
- (e) Better access to loan funds/capital/preferential treatment by government (Please describe.)
- (f) Easier to establish identity as "local concern"
- (g) Other reasons (Please describe.)

6. What degree of control does your company feel to be necessary before participating in a joint venture? Please discuss under the following headings:

- (a) Percentage of the equity
- (b) Percentage of representation on the Board of Directors
- (c) Company representatives in key positions

(d) Voting rights

Part B: The Negotiation Process

1. Is an understanding of the PRC's past experience with Western entrepreneurs an asset in the negotiation process? Explain briefly.

Yes [9] No [1]

2. Was knowledge of the political ideology of the PRC helpful in understanding the bargaining approach adopted by the Chinese?

Yes [10] No [1]

3. Were difficulties encountered in negotiating the following aspects of the joint venture agreement? (Some companies answered on the basis of other types of agreements which they had negotiated.)

(a) Taxation laws and tax incentives:

Yes [1] No [3]

(b) Banking arrangements:

Yes [0] No [4]

(c) Management control:

Yes [3] No [1]

(d) Calculation of profits:

Yes [3] No [1]

(e) Manner of termination of participation:

Yes [0] No [3]

(f) Technology transfer:

Yes [4] No [2]

(g) Pricing and marketing:

Yes [3] No [3]

(h) Dispute settlement:

Yes [1] No [3]

How were these issues resolved?

4. What areas of the negotiation listed in question 3 presented the greatest impediment to the completion of a commercial agreement?

5. In which areas was the PRC willing to compromise?



6. Did the following factors play a role in altering the balance of your company's bargaining power in the negotiation process? (Please explain briefly.)

(a) Level of technology:

Yes [7] No [1]

(b) Management expertise:

Yes [4] No [3]

(c) Type of product your company could supply:

Yes [6] No [2]

7. At what level was this commercial agreement negotiated? The level of your representatives? The level of the negotiators for the PRC?

8. What are your competitive advantages or disadvantages with respect to your competitors in the PRC?

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