

# CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE FOREIGN INVESTMENT LAW

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## Introduction

A new topic in the Uruguay Round, Trade-Related Investment Measures (TRIMs) was incorporated into the multilateral trade system under the government of WTO. The Agreement on Trade-Related Investment Measures (the TRIMs Agreement) is now an inherent part of the WTO Agreement. As well as several components of international trade, the multilateral trading system resembles an incipient investment regime.<sup>2</sup>

In order to develop its market-oriented economy, China made a formal application to rejoin GATT in 1986, later to accede to the WTO.<sup>3</sup> Negotiations lasted about 15 years, and the agreement on the terms of membership was concluded on 11 November 2001, and one month later, China became a full WTO Member.<sup>4</sup> China's entry into the WTO is the crowning achievement of the efforts of that country

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  - 2 The objectives of the TRIMs Agreement, as defined in its preamble, include 'the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particularly developing country members, while ensuring free competition'. See The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts, The WTO 1995, 163.
  - 3 China was a founding father of the GATT in 1947, but the Jiang Jieshi government withdrew from the Agreement on 6 March 1950. See Yang Guohua and Cheng Jin, 'The Process of China's Accession to the WTO', (2001) 4 *Journal of International Economic Law* 2, 297-315.
  - 4 11 Dec 2001, China becomes 143rd WTO member, <[http://www.wto.org/english/news\\_e/news01\\_e/news01\\_e.htm](http://www.wto.org/english/news_e/news01_e/news01_e.htm)>. Also see WTO Ministerial Conference Approves China's Accession, <[http://www.wto.org/english/news\\_e/pres01\\_e/pr252\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr252_e.htm)>.

since 1978 to integrate itself into the world economy and international economic institutions.<sup>5</sup>

Upon accession, China must comply with the TRIMs Agreement to eliminate all TRIMs in existence.<sup>6</sup> This article discusses Chinese Foreign Investment Law (FDI Law) and the criteria to be used in assessment of TRIMs. The standard for identifying TRIMs existing in Chinese FDI Law is the TRIMs Agreement and its extension in the Protocol of China's Accession which will be addressed.

### **A TRIM under the TRIMs agreement**

With 9 clauses and 1 annex, the TRIMs Agreement, which includes a commitment by the WTO member governments to consider the need for complementary provisions on investment policy,<sup>7</sup> deals with trade-related investment measures (TRIMs).

There has been some reference in panel reports on discussion of what a TRIM is, notably Canada FIRA within GATT 1947 jurisdiction<sup>8</sup> and *Indonesian Car Programmes* within the WTO regime.<sup>9</sup>

### **Measures in respect of laws, regulations and requirements**

The TRIMs Agreement states:

An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.<sup>10</sup>

This shows the relationship between Article 2.2 of the TRIMs Agreement and Article III (4) and XI (1) of GATT 1994. The versions of GATT 1994 Article III (4)

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- 5 Hiddo Houben, 'China's Economic Reforms & Integration into the World Trading System', (1999) 33 *Journal of World Trade* 3 1-18, 2.
  - 6 The Protocol on the Accession of the People's Republic of China, accepted by the Ministerial Conference, Decision of 10 November 2001, Doha, WT/L/432 (23 November 2001) 3, Section 7, Part I.
  - 7 Foreign Direct Investment Seen as Primary Motor of Globalization, by Renato Ruggiero, speech on 13 Feb 1996, <<http://www.wto.org/wto/wtonews/1996pressreleases.html>>.
  - 8 Canada - *Administration of the Foreign Investment Review Act*, Report of the Panel (7 February 1984) GATT L/5504 - 30S/140.
  - 9 Indonesia - *Certain Measures Affecting the Automobile Industry*, Report of the Panel (2 July 1998) WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R.
  - 10 Paragraph 2 of Article 2 of the Agreement on TRIMs.

and Article XI (1) invoked by paragraph 2 of Article 2 above are set out below. The former states:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin *in respect of all laws, regulations and requirements affecting* their internal sale, offering for sale, purchase, transportation, distribution or use. (Emphasis added)

GATT 1994 Article XI (1), General Elimination of Quantitative Restrictions says:

*No prohibitions or restrictions* other than duties, taxes or other charges, whether made effective through *quotas, import or export licences or other measures*, shall be instituted or maintained by any contracting party on the importation of any product of territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party. (Emphasis added).

From these provisions, it can be concluded that TRIMs are measures, which may be constituted by or in respect of laws and regulations and/or government policy and administrative action of the host country.

Under the *Indonesian Car Programmes*, the measures were in respect of the government's regulations and policy, using the titles of 'decree', 'regulation' and 'presidential instruction'.<sup>11</sup> Although Indonesia argued that the reduced customs duties were not internal regulations and as such could not be covered by the wording of Article III (4), the Panel did not consider that the matter before them in connection with Indonesia's obligations under the TRIMs Agreement was the customs duty relief as such but rather the internal regulations.<sup>12</sup> In the light of the findings, the Panel noted:

All the various decrees and regulations implementing the Indonesian car programmes operate in the same manner. They provide for tax advantages on finished motor vehicles using a certain percentage value of local content and additional customs duty advantages on imports of parts and components to be used in finished motor vehicles using a certain percentage value of local content.<sup>13</sup>

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11 Above n 9, [2.4] –[2.41]. Indonesian regulations and policies concerned are Decree No 114/1993, Decree No 645/1993, Decree No 647/1993, Decree No 223/1995, Decree No 36/1997; Presidential Instruction No 2/1996, Decree No 31/1996, Decree No 82/1996, Government Regulation No 20/1996, Decree of the State Minister for Mobilization of Investment Funds /Chairman of Investment Coordinating Board No 01/SK/1996, Ministry of Industry and Trade Decree No 002/SK/DJ-ILMK/II/1996, Presidential Decree No 42/1996, Regulation No 36/1996, Decree No 142/1996.

12 Ibid, [14. 89].

13 Ibid, [14.85].

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

Perhaps it is easy to identify the measures ‘*in respect of all laws, regulations*’, but identification of ‘*requirements*’ or ‘*prohibition or restriction ...through ...other measures*’ sometimes is not so simple.

For instance, the ‘purchase undertaking’ under the 1974 Canada *FIRA* formed a ‘measure’ which violated the provision on the obligation of national treatment, so Canada should bring its *FIRA* consistent with GATT Article III (4). Whether such a ‘purchase undertaking’ was within the meaning of ‘*requirements*’ was debated.

The Panel could not subscribe to the Canadian view that the word ‘requirements’ in Article III (4) should be interpreted as ‘mandatory rules applying across-the-board’ because this latter concept was already more aptly covered by the term ‘regulations’ and the authors of this provision must have had something different in mind when adding the word ‘requirements’.<sup>14</sup>

After having found that written purchase undertakings, once they were accepted, became part of the conditions under which the investment proposals were approved, and could be legally enforced, the Panel, therefore, noted that the word ‘*requirements*’ as used in Article III (4) could be considered a proper description of existing undertakings.<sup>15</sup>

The word ‘requirements’ is to have its ordinary meaning. In general, the word ‘requirement’ means:

1. The action of requiring something; a request;
2. A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something; and
3. Something called for or demanded; a condition which must be complied with.<sup>16</sup>

So in the light of its context in Article III (4), the Panel in *Canadian Automobile* said the word ‘requirements’ clearly implied government action involving a demand, request or the imposition of a condition but the term did not carry a particular connotation with respect to the legal form in which such government action is taken.<sup>17</sup> In this respect, the Panel went on to say:

In applying the concept of ‘requirements’ in Article III (4) to situations involving actions by private parties, it is necessary to take into account that there is a broad variety of forms of government action that can be effective in influencing the conduct of private parties.<sup>18</sup>

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14 Above n 8, [5.5].

15 Ibid, [5.4].

16 *The New Shorter Oxford English Dictionary*, (1993) Vol II, 2557.

17 Canada – Certain Measures Affecting the Automotive Industry, Report of the Panel (11 February 2000) WT/DS139/R, WT/DS142/R, [10.107].

18 Ibid.

Similarly, in *Parts and Components*, the panel recognized that requirements that an enterprise voluntarily accepted to gain government-provided advantages were nonetheless 'requirements'.<sup>19</sup>

In the context of GATT/WTO, a 'measure' is interpreted broadly. For example, under the GATT, a 'measure' means any measure by a Member, whether in the form of law, regulation, rule, procedure, decision, administrative action, or any other form'.<sup>20</sup> So Japan in *Indonesia Car Programmes* insisted that 'in the light of the usage of the term within the context of the TRIMs Agreement, the notion of a 'measure' should be interpreted similarly'.<sup>21</sup>

Therefore, a measure under the TRIMs Agreement should be interpreted as any TRIMs of the host country, whether in the form of law, regulation, rule, and as requirement through procedure, decision, administrative action, etc. Restrictive business practices and restrictions by investors' country are not covered by the TRIMs Agreement.

### **Investment measures in relation to trade**

First, the TRIMs should relate to trade in goods.

To determine whether certain measures are 'trade-related' is required by the TRIMs Agreement.

The panel in *FIRA* found, that measures in the practice of Canada inconsistent with Article III (4) of GATT, which allowed certain investments subject to the Foreign Investment Review Act conditional upon written undertakings by the investors to purchase goods of Canadian origin or goods from Canadian sources, were in relation to trade between contracting parties. According to that, the contracting parties should accord to imported products treatment no less favourable than that accorded to like products of national origin in respect of all internal requirements affecting their purchase<sup>22</sup> of the imported products.

Having considered that, the Panel in *Indonesian Car Programmes* analyzed that, if those measures (1993 and 1996 car programmes) were local content requirements, they would necessarily be 'trade-related' because such requirements, by definition, always favoured the use of domestic products over imported products, and therefore affected trade.<sup>23</sup>

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19 EEC - Regulation on Imports of Parts and Components, Report of the Panel (16 May 1990) BISD 37S/132, [5.21].

20 Article XXVIII (a) of GATT 1994.

21 Above n 9, [6.3].

22 Above n 8, [6.1].

23 Above n 9, [14.82].

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

Such a factor of 'trade-related', in *Canada Automobile*, is regarded as measures which 'affect' the 'internal sale, ...or use' of imported products, notwithstanding the fact that CVA requirements, which confer an advantage upon the use of domestic products and deny that advantage in case of the use of imported products, must, do not in law, require the use of domestic products.<sup>24</sup>

Second, the TRIMs should refer to certain investment measures related to trade.

In *Indonesian Car Programmes*, claims raised by Japan showed:

- (a) That the Indonesian National Car Programme had been established specifically 'with a view to supporting the development of the automotive industry';<sup>25</sup>
- (b) That the Programme included 'investment measures' was also obvious from the fact that one of its implementing regulations was entitled '*Investment Provisions for Realization of the National Automobile Industry*';<sup>26</sup> and
- (c) That Indonesia confirmed this by the statement that 'these policies were expected to encourage car companies to increase their local content, *resulting in a rapid growth of investments* in the automotive component industry.'(Emphasis added).<sup>27</sup>

So the complainants EU and USA, as well as Japan, regarded all those 1993 and 1996 Car Programmes as trade-related investment measures. Based on the facts, the Panel then found:

These measures are aimed at encouraging the development of a local manufacturing capability for finished motor vehicle and parts and components in Indonesia. Inherent to this objective is that these measures necessarily have a significant impact on investment in these sectors. For this reason, we consider that these measures fall within any reasonable interpretation of the term 'investment measures'.<sup>28</sup>

The report pointed out that the sales tax benefits and customs duty benefits under the 1993 and 1996 car programmes were provided for local automobile manufacturers so as to encourage the development of a local manufacturing capability for finished motor vehicle and parts and components in Indonesia.

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24 Above n 17, [10.82].

25 Indonesia, Government Regulation No 36/1996, Preamble.

26 Indonesia, Decree of the State Minister for Mobilization of Investment Funds /Chairman of Investment Coordinating Board No 01/SK/1996.

27 Indonesia, Minutes of the Meeting Held on 30 September and 1 November 1996, G/TRIMS/M/5, [24], 27 November 1996.

28 Above n 9, [14.80].

Third, under the TRIMs Agreement, there is no requirement that TRIMs cover foreign investment.

TRIMs are adopted for FDI normally as the host country might impose certain conditions requiring the foreign investors to use locally produced materials and /or to export their products in order to avoid the negative impact of FDI.<sup>29</sup> Nevertheless, under the TRIMs Agreement, a TRIM must be an investment measure relating to trade. There is no particular requirement in the Agreement that TRIMs should cover foreign investment.

In *Indonesian Car Programmes*, the Panel noted:

The use of the broad term 'investment measures' indicates that the TRIMs Agreement is not limited to measures taken specifically in regard to *foreign* investment. Contrary to Indonesia's argument, we find that nothing in the TRIMs Agreement suggests that the nationality of the ownership of enterprises subject to a particular measure is an element in deciding whether that measure is covered by the Agreement.<sup>30</sup>

### **Mandatory and Disincentive investment measures**

Generally speaking, TRIMs are restrictive and mandatory, such as '*in respect of laws and regulations*' and '*prohibition and restriction*'. So the TRIMs Agreement uses the wording of 'TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, ...and which require' local content requirements, and 'which restrict' trade balancing requirements.<sup>31</sup> Nevertheless, that is not always the case. Not all local content requirement and trade balancing requirements are legally binding as such. Article III (4) applies not only to mandatory measures but also to measures compliance with which is necessary to obtain an advantage, since incentive measures may sometimes be covered by the TRIMs Agreement though TRIMs are usually disincentives.

In *India Car Sector*, Public Notice No 60, a measure adopted by the Indian Government, clearly required that an MOU be signed in order to gain the right to apply for an import license. Automotive manufacturers were expected to comply with the terms of the MOUs they had signed. Once signed, the MOUs became binding and enforceable, first under Public Notice No. 60 itself, and also under the FTDR Act and under general principles of contract law. Prior to 1 April 2001, failure to comply with these conditions could lead to the denial of an import

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29 M Rafiqul Islam, *International Trade Law* (1999) 246.

30 Above n 9, [14.73].

31 Illustrative List of the Annex to the TRIMs Agreement, [1].

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

licence.<sup>32</sup> By the jurisprudence<sup>33</sup> and on the facts, the Panel took into account that the TRIMs agreement expressly referred to mere enforceability in the context of the introductory paragraph of the Illustrative List, paragraph 1.<sup>34</sup>

In *EEC Parts and Components*, the Panel considered that the comprehensive coverage of 'all laws, regulations or requirements affecting' the internal sale, etc. of imported products suggested that not only requirements which an enterprise was legally bound to carry out, ... but also those which an enterprise voluntarily accepted in order to obtain an advantage from the government constituted 'requirements' within the meaning of that provision.<sup>35</sup>

In *Indonesian Car Programme*, the Indonesian producers or assemblers of motor vehicles (or motor vehicle parts) had to satisfy the local content targets of the relevant measures in order to take advantage of the customs duty and tax benefits offered by the Government.<sup>36</sup> So compliance with the provisions on purchase and use of domestic products was necessary to obtain an advantage. The lower customs duty rates were clearly 'advantages' in the meaning of the chapeau of the Illustrative List to the TRIMs Agreement although the chapeau is not strictly part of the List.<sup>37</sup> The Panel thus concluded that the tax and tariff benefits contingent on meeting local requirements under these car programmes constituted 'advantages' and 'compliance with which is necessary to obtain an advantage.'<sup>38</sup> Thus the TRIMs Article 2 applied to such voluntary measures or incentive measures, as long as they fallen within the concept of 'TRIMs'.

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32 India – Measures Affecting the Automotive Sector, Report of the Panel, (21 December 2001) WT/DS146/R, WT/DS175/R, [7.190].

33 The Canada – FIRA panel, in considering an argument by Canada that the undertakings were 'private contractual' arrangements, found that:

The Panel carefully examined the Canadian view that the purchase undertakings should be considered as private contractual obligations of particular foreign investors vis-à-vis the Canadian government. The Panel recognized that investors might have an economic advantage in assuming purchase undertakings, taking into account the other conditions under which the investment was permitted. The Panel felt, however, that even if this was so, private contractual obligations entered into by investors should not adversely affect the rights which contracting parties, including contracting parties not involved in the dispute, possess under Article III :4 of the General Agreement and which they can exercise on behalf of their exporters. This applies in particular to the rights deriving from the national treatment principle, which – as stated in Article III :1 – is aimed at preventing the use of internal measures 'so as to afford protection to domestic production'. (paras 5.4 to 5.6).

34 Above n 32, [7.192].

35 Above n 19.

36 Above n 9, [14.90].

37 Above n 9, [14.89].

38 Illustrative List of the Annex to the TRIMs Agreement, [1].



## International minimum criteria under the TRIMs agreement

The TRIMs Agreement, which has three main features provides international minimum criteria for investment measures.

### Investment measures relating to trade in goods

The investment activity is not a mere act of sale of goods, or supply of services, between parties from different countries. In international investment, a foreign direct investment (FDI) must involve ongoing operations in a foreign country<sup>39</sup> that lets a resident entity in one economy obtain a lasting interest through his capital control and management of an enterprise resident in another.<sup>40</sup>

The coverage of TRIMs was one of the hot topics in the Uruguay Round. During the negotiations, the United States actively promoted the notion of TRIMs, by identifying a number of measures which had distorting or prohibitive effects on FDI. But this approach stepped beyond the scope of the GATT in the sense that some measures—such as technology transfer requirements, remittance restrictions and local equity requirements—were not necessarily related to trade in goods. Then this broad approach was opposed by many countries, industrialized and developing alike.<sup>41</sup>

As a result, the negotiations on TRIMs were restricted by, and focused on, the investment measures related only to trade in goods under the GATT principles. The TRIMs Agreement expressly states that it ‘applies to investment measures related to trade in goods only’, thus limiting the scope of its application.<sup>42</sup> This provision is reinforced by Article 2. Thus, any battle on whether or not a particular investment measure violates the Agreement must be fought within the existing legal framework of the GATT. This is an essential characteristic of the Agreement on TRIMs, which has brought the FDI issues into the regime of the GATT, with qualifications.<sup>43</sup>

The TRIMs Agreement is not meant to be a general agreement on foreign direct investment.<sup>44</sup> But any TRIMs that fulfil the description of the Annex list are *ipso facto* prohibited and there is no permission to establish measures contrary to

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39 Mo, *International Commercial Law* (2nd ed, 1999) 537.

40 UNCTAD, Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI): Characteristics, similarities, and complementarities and differences, policy implications and development impact (15 April 1999) [5].

41 John Mo, ‘China, the WTO Trade Organization, and the Agreement on TRIMs’, 30 *Journal of World Trade* 5 (1996) 89-113, 96.

42 Article 1 of the Agreement on TRIMs.

43 Mo, above n 41, 96-97.

44 Ibid.

GATT Article III (4) and/or XI (1). It is seen that the TRIMs Agreement does not concern investment measures related to trade in services. These are governed by the GATT.

### **Adverse effect of TRIMs on trade**

Does Article 1 mean that the TRIMs Agreement covers those investment measures which are directly applicable to trade in goods, or that it governs the measures which have distorting and adverse effects on trade in goods? If the first meaning prevails, an investment measure that does not apply to trade in goods but has a negative effect on trade in goods falls outside the scope of the Agreement. If the second is preferred, any measure which has the effect of distorting or restricting trade in goods will be covered, whether or not it is directly related to trade in goods.<sup>45</sup>

The latter also called the 'Effect Test', was proposed by US in the Uruguay Round to create a broad concept of TRIMs.<sup>46</sup> The 'Effect Test' approach appears to be largely consistent with the position of the GATT Ministers mentioned above during the negotiations. The 'Effect Test' approach was agreed by the Ministers in the Punta del Este Declaration and at last incorporated in the TRIMs Agreement.<sup>47</sup>

Under the 'Effects Test', a clear causal link would need to be demonstrated between the measure and the alleged effect. If such a link established, the nature and impact on the interests of the affected party would need to be assessed. Then appropriate ways and means would have to be found to deal with the demonstrated adverse effects, including in relation to the treatment accorded when development aspects outweigh the adverse trade effects.<sup>48</sup>

The 'Effect Test' was shown in Article III (4) of GATT 1947 itself by using version of 'affecting their internal sale, offering for sale...or use'. The ordinary meaning of the term 'affecting' has been understood to imply 'a measure that has 'an effect on' the 'internal sale, ...or use' of products and thus indicates a broad scope of application.<sup>49</sup> Then it has been interpreted to cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws,

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45 Mo, above n 39, at 565.

46 Mo, above n 41, at 97.

47 The preamble of the Agreement on Trade-related Investment Measures, para 1.

48 Mina Mashayehki and Murray Gibbs, 'Lessons from the Uruguay Round Negotiations on Investment', (1999) 33 *Journal of World Trade* 6 1-26, 8-9.

49 EC – Banana III, ie EC – Regime for the Importation, Sale & Distribution of Bananas, Report of the Appellate Body (25 September 1997) WT/D27/AB/R, [216]; Canada Automobile, Above n 17, [10.80].

regulations and/or requirements which might adversely modify the conditions of competition between domestic and imported products.<sup>50</sup>

Invoking GATT Article III (4) and XI (1), the TRIMs Agreement at last recognizes that certain measures can restrict and distort trade, no matter whether they are mandatory and act as disincentives or not. The version used in the preamble of the Agreement suggests the victory of the 'Effect Test'.<sup>51</sup> Thus the Agreement merely embodies provisions on outlawing certain investment measures that discriminate against foreigners or foreign products (ie violates National Treatment principle) or lead to restrictions in quantities,<sup>52</sup> which are adverse effects on trade, not on all measures.

### **International minimum standard for investment measures**

The Agreement on TRIMs provides an international minimum standard for trade-related investment measures which clarifies that five types of illegal investment measures applied to enterprises appear on an Illustrative List and all measures inconsistent with the Agreement must be justified, and that Members would not implement such TRIMs.

Although intended to bring TRIMs within the WTO, some scholars believe, the Agreement merely reiterates what was already in GATT 1947, providing no new protections or remedies for foreign investors.<sup>53</sup> Its Illustrative List of prohibited measures addresses only a limited subset of TRIMs (as compared, for example, to the more comprehensive ban on performance requirements found in the investment chapter of NAFTA).<sup>54</sup> Moreover, the Agreement contains no plan or procedural framework for moving toward investment liberalization and shies away from innovation or experimentation. Hardly a 'GATT for Investment'<sup>55</sup> as some had hoped,<sup>56</sup> the TRIMs Agreement is at best a transitional arrangement

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50 Canada Automobile, above n 17, para 10.80; Italian Discrimination against Imported Agricultural Machinery, Report of the Panel (23 October 1958) BISD 7S/60, [12].

51 Mo, above n 41, 98.

52 WTO Trade into the Future: Agreements--Non-tariff Barriers <<http://www.wto.org/tradeintothefuture/agreements.htm>>.

53 Paul Civello, 'The TRIMs Agreement: A Failed Attempt at Investment Liberalization', (1999) 8 *Minnesota Journal of Global Trade* 1 97-126, 97-98.

54 Article 1106 of the North American Free Trade Agreement between the Government of Canada, the Government of United Mexico States and the Government of the United States of America (1992, as effective on 1 January 1994).

55 Paul M Goldberg & Chales P Kindleberger, 'Toward a GATT for Investment: A Proposal for Supervision of the International Corporation', 2 *Law & Policy: International Business* 295 (1970)- proposing a GATT-like treaty for FDI.

56 Patrick Low & Arvind Subramanian, 'TRIMs in the Uruguay Round: An Unfinished Business?', presented at the Uruguay Round and the Developing Economies, A World

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

that may serve, at least, as a sign that future trade negotiations will have to address FDI.<sup>57</sup>

In addition, while the 'Effect Test' appears to be self-evident, its application may lead to ambiguities and confusions.<sup>58</sup> The precise scope of the prohibited TRIMs is left yet to be ascertained and developed.<sup>59</sup>

Therefore, it is noticeable that the Agreement on TRIMs is just functioning as supplying a general international standard, but is really not a detailed legislative code.

Notwithstanding this, the TRIMs Agreement, in fact, contains a variety of procedural and substantive obligations. Article 2 of the Agreement, formally, lays down an obligation which is distinct from the obligation contained in GATT III.<sup>60</sup> So the Panel Report noted in *Indonesian Car Programmes*, the Agreement is not an 'Understanding to GATT 1994', unlike the six Understandings which form part of the GATT 1994.<sup>61</sup> If the purpose of the TRIMs Agreement were to refer to Article III as applied in the light of other (non Article III) GATT rules, there would be no need in Article 3 to refer to such general exceptions.<sup>62</sup> Moreover, it has to be recognized that the TRIMs Agreement in Article 4 and 5, in addition to interpreting and clarifying the provisions of Article III where TRIMs are concerned, has introduced special transitional provisions, and notification requirements.<sup>63</sup> This reinforces the conclusion that the TRIMs Agreement has an

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Bank Conference, (26-27 January 1995) 5. US which proposed the original negotiating agenda for the TRIMs Agreement, had hoped for such a 'GATT for investment'.

57 Civello, above n 53, at 97-98.

58 Mo, above n 39, at 566.

59 Ibid, 569.

60 Above n 9, [6.84].

61 The General Agreement on Tariffs and Trade 1994 ('GATT') is defined as to consist of: (a) the provisions in the General Agreement on Custom duties and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement; (b) the provisions of a series of the legal instruments (protocols and decisions) set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement; (c) six Understandings on the interpretation of provisions of GATT 1994; and (d) the Marrakesh Protocol to GATT 1994.

62 A similar drafting technique was used with the TRIPs Agreement which cross-refers to provisions of other international treaties.

63 In *Indonesia Car Programme*, Indonesia put emphasis on a particular statement of the Bananas III panel concerning the relationship between Article III of GATT and the TRIMs Agreement. The Panel considered that that statement had to be understood in the particular context of that dispute between two developed countries (no transition

autonomous legal existence, independent from that of Article III GATT 1994.<sup>64</sup> So that the argument by Indonesia that the Agreement was not *lex specialis* to any dispute<sup>65</sup> is not correct, the Panel concluded the TRIMs Agreement applied to the case.

The criteria adopted in the TRIMs Agreement appear to deviate little from the adherence of GATT ministers to trade in goods. Perhaps considering this, the Agreement permits its members to determine whether a particular TRIM is inconsistent with the principles of GATT 1994, and requires the Council for Trade in Goods, within 5 years after the WTO Agreement effective, to review the operation of the Agreement and, as appropriate, propose amendments to its text complemented by provisions on investment policy and competition policy.<sup>66</sup>

Despite the above shortcomings, the Agreement has made a number of useful contributions. Chiefly among them are:

- (i) the incorporation of specific investment-related disciplines in the multilateral trading system;
- (ii) the transparency that is to result from the obligation to notify existing conforming TRIMs, an obligation that would automatically extend TRIMs added in future to the Illustrative List;
- (iii) the legal certainty provided by the obligation to eliminate notified TRIMs the end of agreed transition periods; and
- (iv) the acknowledgement that heightened policy interrelations in the fields of investment and competition will likely warrant more encompassing work on investment and competition policy within the multilateral trade system.<sup>67</sup>

Although the TRIMs Agreement could not be regarded as perfect, within its framework, Members are obliged to abolish and remove the use of harmful trade related investment measures as described in the Illustrative List, in order to open up more opportunities for foreign investment. At least, the Agreement has introduced one of the most important rules of international law in the world economy system to date.

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period was therefore applicable) where the panel had already reached a conclusion that the measure at issue violated Article III:4 of GATT. Therefore there was no need to further discuss the TRIMs Agreement since any action to remedy the inconsistency found under Article III:4 of GATT would necessarily remedy inconsistencies under the TRIMs Agreement. In the present case, the Panel addressed the legal relationship between these two agreements.

64 Above n 9, [14.62].

65 Ibid, [6.56].

66 Article 9 of the Agreement on TRIMs.

67 Pierre Sauve, 'A First Look at Investment in the Final Act of the Uruguay Round', (1994) 28 *Journal of World Trade* 5 5-16, 7-9.

## Removal of TRIMs under amendments of Chinese FDI law

In Chinese FDI Law, there were some provisions requiring foreign investment enterprises (FIEs) to satisfy export-performance requirements, foreign-exchange balancing requirements and local content requirements. Bilateral and multilateral negotiations on China's accession pushed China to offer to eliminate legal references to them by the year 2000.<sup>68</sup>

To keep its promises, the Standing Committee of National People's Congress, China amended the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures* (CJV Law) and the *Law of the People's Republic of China on Wholly Foreign-Owned Enterprises in China* (WFOE Law) on 30 October 2000. The National People's Congress (NPC), China amended the *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures Law* (EJV Law) on 15 March 2001. Accordingly, the State Council revised the *Detailed Rules for the Implementation of the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises in China* (WFOE Implementation Rules) on 12 April 2001 and the *Implementation Regulations of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures* (EJV Implementation Regulations) on 22 July 2001.

These amendments covered the following three areas:

### Local purchase requirement

Article 9 of the previous *EJV Law* (1979) provided:

...in its purchase of required raw and semi-processed materials, fuels, auxiliary equipment, etc., an equity joint venture shall give first priority to Chinese sources, but may also acquire them directly from the international market with its own foreign exchange funds.

Article 57 of the 1983 *EJV Implementation Regulations* went further:

...in its purchase of required machinery, equipment, raw materials, fuel, parts, means of transport and things for office use, etc., a joint venture has the right to decide whether it buys them in China or from abroad. However, where conditions are the same it should give first priority to purchase in China.

The requirement that an equity joint venture (EJV) 'shall give first priority to Chinese sources' or 'should give first priority to purchase in China' underlined that a policy of purchasing domestic products prevailed. It would be likely to constitute 'the purchase or use by an enterprise of products of domestic origin or

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68 The United States-China Business Council, *China and the WTO: Critical Issues and Objectives*, (June 1998) <<http://www.uschina.org/press/wto.html>>.

from any domestic source',<sup>69</sup> and to make import products from abroad at the position less advantageous than the domestic products. Therefore, it would fall within the term of 'local content requirement' and was obviously contrary to Article III (4) GATT 1994, so it should be removed.

According to the amendments, wholly foreign-owned enterprises (WFOEs) and contractual joint ventures (CJVs) may purchase raw materials, fuel and some fixtures and fittings in China or overseas, replacing the former stipulations that 'priority should be given to the Chinese market.'<sup>70</sup>

### **Foreign exchange balancing requirement**

These amendments also abolished the requirement for the balance of foreign exchange receipts and payments in order to conform to the TRIMs Agreement.

Article 20 of the previous *CJV Law* (1988) stated:

Contractual Joint Ventures shall solve by themselves the balance of foreign exchange receipt and payments. If they cannot, they may apply for aid from concerned departments in accordance with the State regulations.

This provision was deleted. Due to the same reason, paragraph 3 under Article 18 of the 1986 *WFOE Law* was deleted as well.<sup>71</sup>

The former *EJV Implementation Regulations* (1983) requested EJVs keeping foreign exchange balance. Its Article 75 said:

A joint venture shall in general keep a balance between its foreign exchange income and expenses. When a joint venture whose products are mainly sold on domestic market under its approved feasibility study report and contract has an unbalance of foreign exchange income and expenses, the unbalance shall be solved by the people's government of a relevant province, an autonomous region or a municipality directly under the central government or the department in charge under the State Council from their own foreign exchange reserves, if unable to be solved, it shall be solved through inclusion into plan after the examination and approval by the Ministry of Foreign Economic Relations and Trade together with the State Planning Commission of the People's Republic of China.

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69 Item (a) of Paragraph 1 of Illustrative List of the Annex to the TRIMs Agreement.

70 See Article 15 of the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises in China (2000 revision), Article 19 of the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (2000 revision). Also see 'New rules lure foreign money into China', *China Daily* (27 October 2000); <[http://www.chinadaily.com/chinabusiness/cb-inves\\_a27.htm](http://www.chinadaily.com/chinabusiness/cb-inves_a27.htm)>.

71 *Zhongguo Xinwen She*, As WTO looms, China tweaks 3 key foreign investment regulations (24 October 2000) <<http://www.chinaonline.com/topstories/001024/1/c00102302.asp>>.

This article was removed by the amendment of the State Council in 2001.

### **Export ratio requirements**

There was an export ratio requirement in paragraph 7 of Article 14 in 1983 *EJV Implementation Regulations*. It stated:

The joint venture contract shall include the following main items:

(7) The ways and means of purchasing raw materials and selling finished products, and the ratio of products sold within Chinese territory and outside China.

Under Chinese FDI Law, restrictive measures on the WFOEs seemed greater than the EJV and CJVs. WFOEs must either (a) use advanced technology and equipment, develop new products or upgrade existing products, produce import substitutes, or economize in the use of energy and raw materials; or (b) export more than 50% of their products.<sup>72</sup> Although these criteria were presented in the alternative, some local administrations might attempt to require WFOEs to commit to a minimum export level even if they satisfy the other criteria. Various export requirements also existed in other provisions in the previous *WFOE Implementation Rules (1990)*, i.e. Article 45-48 relating to such restriction.

Article 45, to take an example, stipulated:

In selling products in the Chinese market, a wholly foreign-owned enterprise shall follow its approved sale ratio.

In case a wholly foreign-owned enterprise intends to sell more of its products than the approved sale ratio in the Chinese market, an approval is required from the examination and approval authority.

Paragraph 2 of Article 48 went further:

The prices for products sold in the Chinese market by a wholly foreign-owned enterprise in line with the approved sale ratio shall follow the provisions of the price control regulations in China.

Fortunately, these articles had been amended or abolished under the amendments. Now the State encourages the founding of WFOEs whose products are export-orientated or involved in the high-tech field, the new law states. It is instead of the former wording which said, 'wholly foreign-owned enterprises in

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<sup>72</sup> Article 3 of the Detailed Rules for the implementation of the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (1990).



China are required by existing laws to export all or most of their products, or failing that, must use high-tech and advanced equipment."<sup>73</sup>

### **Further examination of Chinese FDI Law against the TRIMs agreement**

As requested in the Protocol on China's Accession, upon its accession, China must comply with the TRIMs Agreement, and eliminate and cease to enforce trade and foreign exchange balance requirements, local content and export or performance requirements made effective through laws, regulations or other measures.<sup>74</sup> Just before its accession, China revised three key laws and their implementation rules or regulations on FDI in China. It seems that Chinese FDI Law, at the national level, was revised in accordance with the rules of the WTO and pledges China had made to other countries.<sup>75</sup>

Would the revisions of three key FDI laws be enough for China to eliminate all the TRIMs under the Chinese FDI Law? Could people say that Chinese FDI Law has already complied with the WTO Agreement and the Protocol of China's Accession? Now in Chinese FDI Law, does any TRIM the Agreement on TRIMs concerned exist?

To answer these questions, it is necessary, first, to view Chinese FDI Law under the international standard of the TRIMs Agreement.

#### **Identification: a TRIM or a subsidy**

TRIMs are usually not very easily identified. Disincentive measures would be likely to be found in them, but incentives are not.

TRIMs are government measures that require private investors to do specific business, like performance requirements, as well as encourage specific behavior by private investors,<sup>76</sup> like investment incentives. For example, a government may require that an investor who manufactures goods in the country purchase a minimum percentage of inputs from domestic sources. This is known as a local content requirement. *Canada FIRA*<sup>77</sup> is an example. The trade balancing

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73 Article 3 of the Law of the People's Republic of China on Wholly Foreign-owned Enterprises (1986).

74 Above n 6, para 3, Section 7, Part I.

75 Zhongguo Xinwen She, above n 71.

76 Robert H Edwards, JR & Simon N Lester, 'Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures', (1997) 33 *Stanford Journal of International Law* 169-214, 170.

77 Above n 8, Canada - Administration of the Foreign Investment Review Act, Report of the Panel (7 February 1984) GATT L/5504 - 30S/140.

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

requirements may be disincentive as well, like *India Car Sector* case where the manufacturers were required to sign an MOU to keep their trade balancing so that they could gain the right to apply for the import licence.<sup>78</sup> Alternatively, the government may give the investor an incentive to purchase from domestic sources by granting a subsidy for such a purchase, *Indonesia Car Programme*,<sup>79</sup> for instance. So a comprehensive study of investment in ASEAN countries noted:

Regulations specifying a minimum level of local content, a minimum proportion of production that must be exported, and a minimum amount of technology transfer have largely been dismantled by the ASEAN countries. . . . [I]nstead of rules specifying minimum levels, incentives are granted to firms that produce goods with a certain local content ratio, firms that export a specific proportion of their output, and/or firms that transfer advanced technology.<sup>80</sup>

No matter what form they take, the disincentive requirements and incentives described above might aim to promote domestic production to the disadvantage of foreign producers or suppliers.

However, it should be aware that certain incentives might constitute subsidies under the Agreement on Subsidies and Countervailing Measures (SCM), TRIMs under the TRIMs Agreement as well. Because of that, under the WTO, one measure may fall within the discipline of TRIMs as well as the discipline of subsidy.

Investment incentives and TRIMs tend to be closely related policy instruments. Where the latter exist, they might be often linked to the former: firms agree to comply with certain performance requirements in exchange for an incentive to invest in a particular location. These linkages have led to calls for developing a coherent set of disciplines in both areas so as to mitigate and progressively eliminate their potentially distortive effects on trade, investment and corporate decisions.<sup>81</sup> So it sometimes would be confusing whether a conduct by enterprises to obtain an advantage or an incentive measure constitutes a TRIM or a subsidy, or both. In this regard, *Indonesian Car Programmes* is an example. Clearly, the Panel pointed out that the two agreements designed to prohibit different measures. However, if a Member were to apply a TRIM (in the form of local content requirement) as a condition for the receipt of a subsidy, the measure would continue to be a violation of the TRIMs Agreement if the subsidy element

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78 See India – Measures Affecting the Automotive Sector, Report of the Panel (21 December 2001) WT/DS146/R, WT/DS175/R.

79 Above n 9, Indonesia – Certain Measures Affecting the Automobile Industry, Report of the Panel (2 July 1998) WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R.

80 Janis Togashi & Pearl Imada, 'The Legal Framework for Investment in ASEAN' *Investment Regulations and Incentives* 3 (1993) 19.

81 Pirre Sauve, 'Qs and As on Trade, Investment and the WTO', (1997) 31 *Journal of World Trade* 4, 59-60.

were replaced with some other form of incentive. By contrast, if the local content requirements were dropped, the subsidy would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the SCM Agreement might be affected.<sup>82</sup> The Panel concluded that the TRIMs Agreement and the SCM Agreement might have overlapping coverage in that they might both apply to a single legislative act, but they had different *foci*, and they imposed different types of obligations.<sup>83</sup>

Normally, in the case of the SCM Agreement, what is prohibited is the grant of a subsidy contingent on use of domestic goods, not the requirement to use domestic goods as such. In the case of the TRIMs Agreement, what is prohibited are TRIMs in the form of local content requirements or others, not the grant of an advantage, such as a subsidy.<sup>84</sup> One action, however, may violate two different WTO disciplines but the SCM and TRIMs Agreements could not be in conflict, as they cover different subject matter and do not impose mutually exclusive obligations.<sup>85</sup>

### **Criteria: the TRIMs Agreement and the Protocol on China's Accession**

It must be admitted that accurate statistics on the use of TRIMs are difficult to gather because defining and identifying TRIMs is a complex and idiosyncratic process.<sup>86</sup> The difficulties somewhat in isolating the effects of specific TRIMs from complex packages of government rules have resulted in a relative paucity of empirical studies on the impact of these measures.<sup>87</sup> As Moran and Pearson note, there is incomplete empirical evidence of the extent and characteristics of performance requirements and even less analysis of their economic effects.<sup>88</sup>

Nevertheless, no matter how hard it is to sort out all TRIMs while reviewing Chinese FDI Law, the general standard of interpretation will be used to check them strictly and identify them from the number of Chinese legislative documents and legal practice. The basic criteria are the provisions under the TRIMs Agreement, at least the Illustrative List as such.

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82 Above n 9, [14.51].

83 Ibid [14.52].

84 Ibid [14.50].

85 Ibid [14.52].

86 United Nations, *The Impact of Trade-related Investment Measures on Trade and Development*, at 12, UN Doc ST/LTL/120, UN Sales No E 91.II.A. 19 (1991); also see generally Oliver Morrissey & Yogesh Rai, 'The GATT Agreement on Trade-related Investment Measure: Implications for Developing Countries and Their Relationship with Transnational Corporations', (1995) 31 *Journal of Development Study*, 702.

87 Stephen E Guisinger & Assoc (ed), *Investment Incentives and Performance Requirements: Patterns of International Trade, Production and Investment* (1985) vii.

88 Theodore H Moran & Charles S Pearson, 'Tread Carefully in the Field of TRIP Measures', (1988) 11 *The World Economy* 119, 124.

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

Under Article 2 of the TRIMs Agreement, there is an Annex, containing an Illustrative List of measures that are inconsistent with GATT 1994 Article III (4) or Article XI (1). The agreement reaffirms and clarifies existing GATT disciplines by specifically applying them to the investment area.

The Illustrative List in the Annex to the TRIMs Agreement covers:

- two measures which require particular levels of local procurement by an enterprise ('Local Content Requirements') and
- three measures which restrict the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exports ('Trade Balancing Requirements').<sup>89</sup>

Under paragraph 1, the Annex provides examples of TRIMs that are inconsistent with the obligation of National Treatment in Article III.4 of the GATT 1994. These TRIMs relate to:

- local content requirement (subparagraph (a)), and
- import limitation and export requirement (subparagraph (b)).<sup>90</sup>

Under paragraph 2, the Annex provides examples of TRIMs that are inconsistent with the obligation in Article XI.1 of the GATT to eliminate quantitative restrictions. This paragraph applies generally to:

- import restrictions and trade-balancing requirements (subparagraph (a)),
- trade balancing through foreign-exchange restrictions (subparagraph (b)), and
- various export restrictions (subparagraph (c)).<sup>91</sup>

In addition, the Protocol of China's Accession goes further. Besides those within the Illustrative List, the Protocol extends the elimination of TRIMs to other performance requirements, such as distribution of import licences, quotas, tariff-rate quotas, the conduct of research, the transfer of technology, so long as they are used as conditions to permission of the right of importation or investment.<sup>92</sup> Permission to invest, import licences, quotas and tariff rate quotas should be granted without regard to the existence of competing Chinese domestic supplies.<sup>93</sup>

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89 Legal Texts: the WTO agreements—A Summary of the Final Act of Uruguay Round, <<http://www.wto.org/wto/documents/legaltexts.html>>.

90 Ibid.

91 Ibid.

92 Above n 6, para 3, Section 7 Non-tariff Measures, Part I.

93 The Working Party on the Accession of China, Report of the Working Party on the Accession of China, WT/ACC/CHN/49, 1 October 2001, Restricted, [203], Section D. 5, Part IV.

## **Identification of TRIMs existing in Chinese FDI Law per the TRIMs Agreement**

China has started to revise its FDI Law, and the amendments of three FDI laws are examples. However, it is still at the first stage. There still remains a number of TRIMs in administrative regulations and local regulations. It needs to continue to identify and justify all TRIMs in existence in Chinese FDI Law by assessment under the TRIMs Agreement and the Protocol on China's Accession.

### **Measures inconsistent with national treatment**

Through the examination, several provisions and requirements have been found in Chinese FDI Law, both at the state level and local level, which are in relation to some TRIMs inconsistent with the Agreement on TRIMs, for instance, local-content requirements.

There are certain measures, including local content requirement and import limitation and export requirement under Chinese laws and regulations, particularly under administrative regulations as well as local regulations, which may be construed not consistent with National Treatment principle under the TRIMs Agreement.

The requirement that an investor who manufactures goods in the country purchase a minimum percentage of inputs from domestic sources is known as the local content requirement. There is an automotive industrial policy designed to foster development of a modern automobile industry in China. The policy explicitly calls for production of domestic automobiles and automobile parts as substitutes for imports, and establishes local content requirements, which would force the use of domestic products, whether comparable or not in quality or price.<sup>94</sup> Some local content requirements are found in *Provisional Regulations of the State General Administration for Industry and Commerce on Automobile Trading Market Control* (Issued by the State Administration of Industry & Commerce in 1985), and other rules and regulations. Although there is a transition period needed for elimination of TRIMs in the industrial policy for the automotive sector,<sup>95</sup> the wording of the Illustrative List of the TRIMs Agreement makes it clear that a simple advantage conditional on the use of domestic goods is considered to be a violation of Article 2 of the TRIMs Agreement even if the local content requirement is not binding as such.

Since import substitution has been a longstanding Chinese trade policy designed to foster development of a modern automobile industry in China, it explicitly calls

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94 Inventory of Foreign Trade Barriers 1998: China, <<http://www.ustr.gov/reports/nte/1998/contents.html>>.

95 Above n 93, [204]-[207], Section D.5, Part IV .

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

for production of domestic automobiles and automobile parts as substitutes for imports, and establishes local content requirements, which would force the use of domestic products, whether comparable or not in quality or price.<sup>96</sup> So some measures of import substitution have been dealt with in *Regulations of the Shanghai Municipality for the Encouragement of Foreign Investment in the Pudong New Area* (1990)<sup>97</sup> and *Implementing Provisions for Encouraging Foreign Investment in Guangdong Province* (1987).<sup>98</sup>

The following table shows some legislation against the obligation of National Treatment.

**Figure 1: Examples of measures inconsistent with the obligation of national treatment**

Title	Local Content Requirement	Import Limitation & Export Requirement
<i>Formal Policy on Development of Automobile Industry (1994)</i>	Article 34.2 Local content	
<i>Measures relating to the Import Substitution by Products Manufactured by Chinese-Foreign Equity Joint Ventures and Chinese-Foreign Cooperative Ventures (1987)</i>		Article 8 and 9 Requiring import substitution

96 Above n 94.

97 The Regulations of the Shanghai Municipality for the Encouragement of Foreign Investment in the Pudong New Area (Promulgated by Shanghai Municipal People's Government on 10 September 1990).

Article 20. Foreign-invested enterprises may sell certain quantities of their products manufactured as substitutes for imports on domestic markets on approval of the relevant competent department and after paying customs duties and consolidated industrial and commercial tax according to relevant regulations. A portion of foreign currencies may be obtained when necessary.

98 The Implementing Provisions for Encouraging Foreign Investment in Guangdong Province (promulgated by the People's Government of Guangdong province on 26 April 1987 and went into effect on the same day).

Article 13. Production acceptable as import-substitutes shall be encouraged. Chinese enterprise shall buy from foreign investment enterprise if the latter's products have satisfied the following requirements: i) That their quality and specifications have reached the required international standards of similar import; ii) That their prices are competitive, and iii) That the foreign investment enterprise can deliver its products at the required time. Under such an arrangement, the production and sale by the foreign investment enterprise will be considered as having met its export obligations, and purchase by the Chinese enterprise, its import needs.

**Figure 1 cont**

<b>Title</b>	<b>Local Content Requirement</b>	<b>Import Limitation &amp; Export Requirement</b>
<i>Resolution of the Standing Committee of the National People's Congress Approving the Regulations on Special Economic Zones in Guangdong Province (1980)</i>	Article 17 Requiring preferential price offer locally	
<i>Several Regulations of Beijing Municipal People's Government on the Implementation of the State Council Regulations concerning Encouragement of Foreign Investment (1986)</i>		Article 12 Requiring import substitution

### **Measures inconsistent with elimination of quantitative restrictions**

Under the TRIMs Agreement, measures of quantitative restrictions are 'TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994,' which require import restriction and trade-balancing requirement, trade balancing through foreign-exchange restriction and various export restriction.<sup>99</sup>

Measures of quantitative restrictions are usually 'mandatory or enforceable under domestic law or under administrative rulings', but sometimes they would be in the form of 'compliance with which is necessary to obtain an advantage'.<sup>100</sup>

In Chinese laws and regulations, both at State level and at local level, there are certain measures including requirements for volume or value of exports and restriction on balance of foreign-exchange earnings and payments fallen within the category of measures of quantitative restrictions under the TRIMs Agreement.

Import licences used by MOFTEC to exercise an additional, nationwide system of control over some imports. Many products have been subject to both quotas and import licensing requirements. For these products, after permission has been granted by other designated agencies for its importation, MOFTEC must decide whether to issue a licence.

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99 Illustrative List of the Annex to the TRIMs Agreement, [2].

100 Ibid.

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

Notwithstanding this, there is a preferential provision for FIEs. Import by FIEs on machinery and equipment, vehicles used in production, raw materials, fuel, bulk parts, spare parts and components, machine component parts and fittings (including imports restricted by the State), are not required to apply for examination and approval and are exempt from the requirement for import licences. But there is, as well, a condition that those goods are needed by FIEs to import in order to carry out their export contracts.<sup>101</sup> In addition, there is another requirement that 'the imported materials and items mentioned above are restricted to be used by the enterprise itself only and may not be sold on the domestic market.'<sup>102</sup> 'If they are used in products to be sold domestically, then they are required to go through the import procedures retroactively in accordance with the provisions and the taxes shall be made up according to the governing stipulations.'<sup>103</sup> These conditions and requirements may constitute quantitative restrictions.

In this regard, there are also other measures of quantitative restrictions. Import restriction and trade-balancing requirement appears in *Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises* (1991)<sup>104</sup> and others regulations. They may restrict the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports.<sup>105</sup>

In addition, there are various export restrictions in other regulations. They may restrict the exportation or sale for export by an enterprise of products, whether

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101 The Regulations of the State Council on Encouragement of Foreign Investment (promulgated by the State Council on 11 October 1986), [1], Article 13.

102 Ibid [2], Article 13.

103 Ibid.

104 The Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (Issued by the State Council of China on 30 June 1991).

Article 75. The relevant regulations promulgated by the State Council before the entry into force of this Law mentioned in Article 8 Paragraph 2 of the Tax Law refer to the following regulations concerning the exemption and reduction of enterprise income tax promulgated by the State Council:

7. Export-oriented enterprises with foreign investment may, upon the expiration of the tax exemption and reduction period as provided for in the Tax Law, further enjoy a 50% reduction in enterprise income tax based on the rate stipulated by the Tax Law, if the value of their export products of the year exceeds 70% of the total value of products of the year. But for the Special Economic Zones and the Economic and Technological Development Zones and other export-oriented enterprises where income tax has already been reduced to 15% and the above requirements are met, the enterprise.

105 Item (a) of Paragraph 2 of Illustrative List of the Annex to the TRIMs Agreement.



specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.<sup>106</sup>

Such export restrictions exist in the *Provisional Regulations on Direction Guide to Foreign Investment*. For restricted sub-category A projects that are included in part 1 of Article 6, when export sales account for more than 70% of their total sales, the projects can be raised to the kind of being allowed upon an approval, and therefore are no longer bound by restrictions laid down in Article 9.<sup>107</sup> That means no requirement that an EJV engaged in project of the restricted categories should have a definite operation term; that for projects of restricted sub-category B, fixed assets put in by the Chinese side should come from the own capital or assets of the Chinese investors.<sup>108</sup> Such a stipulation obviously restricts the exportation or sale for export by an FIE of products.

There is another table to figure certain measures inconsistent with the General Elimination of Quantitative Restrictions.

**Figure 2: Examples of measures inconsistent with general elimination of quantitative restrictions**

Title	Import Restriction & Trade Balancing Requirement	Trade Balancing through FE Restriction	Various Export Restriction
<i>Implementation Measures for the Administration on Import by Foreign-funded Enterprises (1995)</i>	Article 3 Import licence requirement		
<i>Regulations of the State Council concerning the Balance of Foreign Exchange Income and Expenditure by Sino-Foreign Equity Joint Ventures (1986)</i>		Article 2 Keeping foreign exchange balance	
<i>Provisions of the State Council on the Encouragement of Foreign Investment (1986)</i>			Article 2 Import & export ratio
<i>Implementing Provisions for Encouraging Foreign Investment in Guangdong Province (1987)</i>	Article 10 Export licence & quotas restriction		

106 Item (c) of Paragraph 2 of Illustrative List of the Annex to the TRIMs Agreement.

107 The Provisional Regulations on Direction Guide to Foreign Investment (1995), Article 11.

108 Ibid. Article 9.

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

**Figure 2 cont**

Title	Import Restriction & Trade Balancing Requirement	Trade Balancing through FE Restrictio n	Various Export Restriction
<i>Measures of Shanghai Municipality Governing Commodity Purchasing Product Sales by Foreign Investment Enterprises (1989)</i>		Article 11.2 Requiring FE balance	
<i>Provisions of Fujian Province for Encouragement of Foreign Investment in Agriculture (1991)</i>			Article 5 Export licence & quotas restr's

There are still other measures left to sort out.

Special note should be taken when classifying and identifying TRIMs. It is crucial to make sure that all TRIMs included in notification documents are identified correctly, precisely and appropriately, and that they are notified properly. In *Indonesian Car Programmes*, the Indonesian government used to report to the TRIMs Committee that its 1993 Incentive System was a TRIM under Article 5.1 of the TRIMs Agreement.<sup>109</sup> On 28 October 1996, Indonesia notified the TRIMs Committee that it was 'withdrawing' its notification related to automobiles because it considered that its car programme was not a TRIM (G/TRIMS/N/1/IDN/1Add.1), and made another notification with respect to its 1993 and 1996 Car Programmes to the SCM Committee.<sup>110</sup> Such commitments put Indonesia into a particular disadvantageous position in the case.

### **Why TRIMs should be prohibited under the TRIMs agreement**

Nowadays most countries and regions in the world have taken and still take, to some different extent, certain encouragement and/or restrictive measures on foreign investment. They have made and still make relevant policies and laws with these TRIMs as well.<sup>111</sup>

109 G/TRIMS/N/1/IDN/1, 23 May 1995.

110 G/SCM/N/16/IDN, 28 October 1996; Also see Indonesia – Certain Measures Affecting the Automobile Industry, above n 11, [2.44].

111 Edwards et al, above n 76, at 180.

Local content requirements, for instance, will mandate that an investor source more inputs locally than the investor would have absent the requirement. If other things are equal, this will result in a decrease in imports into the country applying the TRIM.<sup>112</sup> Certain TRIMs may have an uncertain impact on trade flows. For instance, it is difficult to predict *ex ante* how a restriction on the remittance of profits may affect trade flows. If profits cannot be remitted, they may be used either to purchase more local goods, or to purchase foreign goods as inputs for the manufacturing process (which leads to an increase in imports).<sup>113</sup>

Considering this, in *FIRA*, the Panel recognized that:

Purchase requirements may reflect plans which the investors would have carried out also in the absence of the undertakings; that undertakings with such provisos as 'competitive availability' have an adverse impact on imported products only in those cases in which imported and Canadian goods are offered on equivalent terms; and that the undertakings are enforced flexibly. ... However, understanding GATT practice, a breach of a rule is presumed to have an adverse impact on other contracting parties (BISD 26S/216), and the Panel also proceeded on this assumption.<sup>114</sup>

Since there is a broad variety of forms of government of action that can be effective in influencing the conduct of private parties,<sup>115</sup> it very important to assess whether there is a condition upon which a TRIM exists. For instance, if the allocation, permission or rights for importation and investment is conditional upon performance requirements set by national or sub-national authorities, or subject to secondary covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs or the transfer of technology,<sup>116</sup> it would be regarded as a TRIM under the Protocol on China's Accession.

Taking another example, in *India Car Sector*, under Public Notice No. 60, the signing of an MOU was therefore in itself a condition, including indigenization and trade balancing, to obtaining a licence.<sup>117</sup> The MOUs themselves also contained the same conditions, including the indigenization condition, whose acceptance as legal obligations by the signatories was necessary in order to obtain the right to import the restricted kits and components under licence.<sup>118</sup> Therefore, the Panel found that the indigenization condition, as contained in Public Notice

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112 Ibid.

113 Ibid.

114 Above n 8, [6.4].

115 Ibid.

116 Above n 93, [203], Section D. 5, Part IV.

117 Above n 32, [7.188].

118 Ibid [7.189].

CRITERIA TO IDENTIFY TRADE-RELATED INVESTMENT MEASURES IN CHINESE  
FOREIGN INVESTMENT LAW

No 60 and in the MOUs signed thereunder, constituted a 'requirement' within the meaning of GATT Article III (4).<sup>119</sup> Such conclusion was equally applicable to the trade balancing requirement, obligation which was, like the indigenization requirement, one of the conditions provided for in Public Notice No. 60 and to be accepted by MOU signatories as a condition for obtaining the advantages of a licence. Thus the Panel concluded that it was a requirement as well.<sup>120</sup> It 'has an effect' adversely on either the internal purchase, offering for sale etc of the product or the imported product.<sup>121</sup>

Nonetheless, investment liberalization provisions may be used as one of criteria to examine the key investment-related elements in the WTO Agreement, whose aim is to promote and secure non-discriminatory treatment.<sup>122</sup> Local content requirements on the other hand, like *FIRA* and *Indonesia Car Programmes*, distinctly accords less favorable treatment to these imported products than to like products of domestic origin, within the meaning of Article III (4) of GATT 1994. That is to say, they are inconsistent with the non-discrimination principle. Under the WTO, members should provide MFN and National Treatment to other members, which means a state should provide at least national treatment for foreign investors. Local content requirements lead to a decline in imports and results actually in unfair competition between nationals and foreign investors, and may aim to promote domestic production to the disadvantage of foreign producers,<sup>123</sup> but are inconsistent with National Treatment. So in *Canada Automobile*, the Panel noted that the CVA requirements accorded less favourable treatment within the meaning of Article III (4) to imported parts, materials and non-permanent equipment than to like domestic products because, by conferring an advantage upon the use of domestic products but not upon the use of imported products, they undermined the equality of competitive opportunities of imported in relation to like domestic products.<sup>124</sup> Such measures of the host country concerned shall be deemed as investment measures against the obligation of National Treatment under the Agreement.<sup>125</sup> From this angle, TRIMs also demonstrate somewhat direct and significant restrictive and adverse effects on trade or investment. It is the reason that certain TRIMs are inherently distorting trade or investment why they should be prohibited outright.

The National Treatment principle is a fundamental tenet of the WTO/GATT under which each Member treat goods from each other Member on a level comparable to those produced in its own territory for the purposes of internal sale.<sup>126</sup> Under the

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119 Ibid [7.193].

120 Ibid [7.303].

121 Ibid [7.305].

122 Sauve, above n 67, at 6-7.

123 Ibid.

124 Above n 17, [10.85].

125 Sauve, above n 81, at 60.

126 Article III of GATT 1994.

TRIMs Article 2, any breach of the rule 'is presumed to have an adverse impact on other contracting parties'. The preamble of the TRIMs Agreement shows that the Punta del Este Ministerial Declaration which launched the Uruguay Round included the subject of TRIMs as a subject for the round through a carefully drafted compromise:<sup>127</sup>

Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.

## Conclusion

TRIMs may be defined, in general, as certain investment measures relating to trade provided for investors in respect of the laws, regulations, policies and/or administrative actions of the host countries, which apply to certain conditions, or are adopted in special areas. TRIMs include not only mandatory measures but also those measures which are not mandatory but create advantages if observed.<sup>128</sup>

Upon accession, China must eliminate and cease to enforce trade and foreign exchange balancing requirements, local content and export or performance requirements made effective through laws, regulations or other measures.<sup>129</sup> Although China amended its three FDI laws before its WTO accession, there still remain a number of TRIMs in administrative rules and local regulations. To comply with the WTO rules, it needs to further review Chinese FDI Law. Since TRIMs exist, they must be eliminated. China must not enforce provisions of contracts imposing TRIMs inconsistent to the TRIMs Agreement.<sup>130</sup>

To do such work, China needs to identify TRIMs correctly, precisely and appropriately. The criteria are the TRIMs Agreement, which provides an international minimum standard for investment measures in relation with trade in goods and the Protocol on China's Accession, which provides China's commitments to perform its obligations under the WTO agreements. The rules apply both to measures affecting existing investments and to those governing new investments.<sup>131</sup>

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127 The Preamble of the TRIMs Agreement.

128 Above n 93, [122], Section B.8, Part IV.

129 Above n 6, [3], Section 7 Non-tariff Measures, Part I.

130 Ibid.

131 Above n 93, [122], Section B.8, Part IV.