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International Third Party Dispute Settlement*

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I. INTRODUCTION

From earliest times, third parties have played an important role in attempting to resolve interpersonal and intergroup conflicts. Indeed, the concept of third-party dispute settlement and roles of judge, arbitrator and mediator pervade all human societies and are closely linked to the emergence of political order and law.

It is not practical in this brief article to review either the long historical experience of international third party dispute settlement or the extensive descriptive and analytical literature it has produced.[1] My purpose

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* This article was originally written as a background paper for the United States Institute of Peace Conference on "Toward the Twenty-First Century: An Investigation of the Roads to Peace," held June 20-21, 1988 at Airlie House, Airlie, Virginia. It will eventually be published in the proceedings of that conference.

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1. This initial note is intended to provide an introductory bibliography of international third-party dispute settlement. Unless otherwise stated, works cited by author in subsequent notes refer to works more fully cited here.

For legally-oriented overviews of international dispute settlement see, *e.g.*, Bilder, *An Overview of International Dispute Settlement*, 1 EMORY J. INT'L DISPUTE RESOLUTION 1 (1986); Bilder, *International Dispute Settlement and the Role of Adjudication*, 1 EMORY J. INT'L DISPUTE RESOLUTION 131 (1987); MERRILLS, INTERNATIONAL DISPUTE SETTLEMENT (1984); INTERNATIONAL DISPUTES: THE LEGAL ASPECTS (H. Waldock ed. 1972); F. NORTHEDGE & M.DONELAN,INTERNATIONAL DISPUTES: THE POLITICAL ASPECTS (David Davies Memorial Institute 1971); O. Schachter, *International Law in Theory and Practice*, 178 RECUEIL DES COURS 10 (1981); Sohn, *The Future of Dispute Settlement*, THE STRUCTURE AND PROCESS OF INTERNATIONAL LAW: ESSAYS IN LEGAL PHILOSOPHY, DOCTRINES AND THEORY 1121 (R. J. MacDonald & D. M. Johnson eds. 1983); D. Bowett, *Contemporary Developments in Legal Techniques in the Settlement of Disputes*, 180 RECUEIL DES COURS 177 (1983); Laylin, *Outlines for Third Parties in International Disputes*, 66 PROC. AM. SOC. INT'L L. 22 (1972); 4 C. DE VISCHER, THEORY AND REALITY IN INTERNATIONAL LAW (Corbett trans. 1968); INTERNATIONAL LAW: CASES AND MATERIALS ch. 13 (L. Henkin, R. Pugh, O. Schachter & H. Smits eds. 1980) [hereinafter Henkin]; H. LAUTERPACHT, THE FUNCTION OF LAW IN THE INTERNATIONAL COMMUNITY (1933); DISPUTE SETTLEMENT THROUGH THE UNITED NATIONS (K. Raman ed. 1977) [hereinafter Raman]; RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES sec. 902 (1988) [hereinafter RESTATEMENT]; Lachs, *Some Reflections on the Settlement of International Disputes*, 68 PROC. AM. SOC. INT'L L. 323 (1974); RANDOLPH, THIRD PARTY SETTLEMENT OF DISPUTES IN THEORY AND PRACTICE (1973); Pechota, *Complementary Structures of Third-Party Settlement in International Disputes* (UNITAR Study P.S. No. 3, 1971). On dispute settlement in particular fields, see Sohn, *Settlement of Disputes Arising Out of the Law of the Sea Convention*, 12 SAN DIEGO L. REV. 495 (1975); Bilder, *The Settlement of Disputes in the Field of the International Law of the Environ-*

is rather to suggest some basic questions and tentative answers which may help to provide a framework for further thinking, discussion and re-

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ment, 1 RECUEIL DES COURS 139 (1975). Hudec, *Reforming GATT Adjudication Procedures: The Lessons of the DISC Case*, 72 MINN. L. R. (1988); R. LILLICH (ed.), THE IRAN-UNITED STATES CLAIMS TRIBUNAL 1981-83 (1984).

Among recent legally-oriented empirical or otherwise less-traditional studies, see *e.g.*, Bailey, *Peaceful Settlement of International Disputes*, Raman, *supra*; T. FRANCK, THE STRUCTURE OF IMPARTIALITY (1968); J. GAMBLE & D. FISCHER, THE INTERNATIONAL COURT OF JUSTICE: AN ANALYSIS OF A FAILURE (1976); G. RAYMOND, CONFLICT RESOLUTION AND THE STRUCTURE OF THE STATE SYSTEM: AN ANALYSIS OF ARBITRATIVE SETTLEMENTS (1980); A. STUYT, SURVEY OF INTERNATIONAL ARBITRATIONS 1794-1970 (1972); F. NORTHEDGE & GRIEVE, INTERNATIONAL DISPUTES: CASE HISTORIES 1945-70 (1973); McGinley, *Ordering a Savage Society*, 25 HARV. INT'L. L. J. 43 (1984); Coplin & Rochester, *The Permanent Court of International Justice, The International Court of Justice, The League of Nations and the United Nations: A Comparative Empirical Survey*, 66 AM. POL. SCI. REV. 529 (1972); and L. PROTT, THE LATENT POWER OF CULTURE AND THE INTERNATIONAL JUDGE (1979).

For recent overviews of international dispute settlement primarily from an international relations or social psychological perspective, see *e.g.*, D.G. PRUITT & J.Z. RUBIN, SOCIAL CONFLICT: ESCALATION, STALEMATE, AND SETTLEMENT (1986); M. PATCHEN, RESOLVING DISPUTES BETWEEN NATIONS: COERCION OR CONCILIATION? (1988); J. BERCOVITCH, SOCIAL CONFLICTS AND THIRD PARTIES: STRATEGIES OF CONFLICT RESOLUTION (1984); W. ZARTMAN, THE 50% SOLUTION (1976); W. ZARTMAN, RIPE FOR RESOLUTION (1985); NEW ISSUES IN INTERNATIONAL CRISIS MANAGEMENT (G. Winham ed. 1988); D.G. PRUITT, NEGOTIATION BEHAVIOR (1981); J.Z. RUBIN, DYNAMICS OF THIRD-PARTY INTERVENTION: KISSINGER IN THE MIDDLE EAST (1981); J.Z. Rubin, *Experimental Research on Third-Party Intervention in Conflict: Towards Some Generalizations*, 87 PSYCHOLOGY BULL. 379 (1980); J.A. Wall, *Third Party Consultation as a Method of Intergroup Conflict Resolution*, 27 J. CONFLICT RESOLUTION 301 (1983). Among many other useful political or social science-oriented works, see *e.g.*, J.Z. RUBIN & B.R. BROWN, THE SOCIAL PSYCHOLOGY OF BARGAINING AND NEGOTIATION (1975); R.L. BUTTERWORTH, MANAGING INTERSTATE CONFLICTS 1945-1974 (1976); MANAGING INTERNATIONAL CRISES (D. Frei ed. 1982); N. CHOUCRI & R. NORTH, NATIONS IN CONFLICT (1976); R.J. RUMMEL, JR., UNDERSTANDING CONFLICT AND WAR (1975); G. SNYDER & P. DIESENG, CONFLICT AMONG NATIONS (1977); J.G. STOESSINGER, WHY NATIONS GO TO WAR (3d ed. 1982); Z. MAOZ, PATHS TO CONFLICT: INTERNATIONAL DISPUTE INITIATION 1816-1976 (1982); S. ROBERTS, ORDER AND DISPUTES (1979); C.R. MITCHELL, THE STRUCTURE OF INTERNATIONAL CONFLICT (1981); D. YOUNG, THE POLITICS OF FORCE (1968); R.N. LEBOW, BETWEEN PEACE AND WAR: THE NATURE OF INTERNATIONAL CRISIS (1981); D. YOUNG, THE INTERMEDIARIES: THIRD PARTIES IN INTERNATIONAL CRISES (1967); R. SMOKE, WAR: CONTROLLING ESCALATION (1977); THE MAN IN THE MIDDLE: INTERNATIONAL MEDIATION IN THEORY AND PRACTICE (S. Touval & I. Zartman eds. 1985); J.W. BURTON, CONFLICT AND COMMUNICATION (1969); J.W. BURTON, RESOLVING DEEP ROOTED CONFLICT (1987); J.R. MITCHELL, THE STRUCTURE OF INTERNATIONAL CONFLICT (1981); CONFLICT IN WORLD SOCIETY (M. Banks ed. 1984); R. FISHER & W. URY, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN (1981); R. JERVIS, PERCEPTION AND MISPERCEPTION IN INTERNATIONAL RELATIONS (1976).

There are also many case studies of third party intervention in particular conflicts or dispute, for example Rubin, *supra* (1981); M. HASTINGS & S. JENKINS, BATTLE FOR THE FALKLANDS (1983); R.L. KENNEDY, THIRTEEN DAYS: A MEMOIR OF THE CUBAN MISSILE CRISIS (1969); J. CARTER, KEEPING FAITH (1982).

Among the leading scholarly journals relevant to these problems are the American Journal of International Law, the Journal of Conflict Resolution, and the Negotiation Journal.

For examples of the recent interesting and sophisticated empirical and theoretical research on dispute processing within domestic societies, and particularly the United States, see *e.g.*, M. Galanter, *Adjudication, Litigation, and Related Phenomena*, LAW AND THE SOCIAL SCIENCES (L. Lipson & S. Wheeler eds. 1986); materials collected and cited in *Special*

search about the potential role of third party intervention.[2]

Several introductory comments may be in order. First, third party intervention is not simply a "legal" means of dispute settlement, but is relevant to many kinds of conflict resolution processes. International lawyers have tended, of course, to look principally at the more formal, institutionalized and "legal" aspects of international third-party dispute settlement—in particular, international adjudication.[3] The International Court of Justice's (I.C.J.'s) recent assertion of jurisdiction and ruling against the U.S. in the *Nicaragua* case[4], and the Reagan Administration's

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Issue on Dispute Processing and Civil Litigation, 15 LAW & SOC'Y REV. 389-928 (1980-81); DISPUTE RESOLUTION, (S. Goldberg, E. Green & F. Sander eds. 1985); DISPUTING IN AMERICA: THE CHANGING ROLE OF LAWYERS (E. Green, J. Marks & F. Sander eds. 1985) *See also* Sander, *Varieties of Dispute Processing*, 70 F.R.D. 111 (1976); and Galanter, *Reading the Landscape of Disputes: What We Know And Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983); C. WITTY, MEDIATION AND SOCIETY (1980); Silbey and Merry, *Mediator Settlement Strategies*, 8 LAW & POL'Y 7 (1987); Kressel & Pruitt, *Themes in the Mediation of Social Conflict*, 41 J. SOC. ISSUES 179 (1985); V. Aubert, *Competition and Dissensus: Two Types of Conflict and Conflict Resolution*, 7 J. CONFLICT RESOLUTION 26 (1963); T. Eckhoff, *The Mediator and the Judge*, 10 ACTA SOCIOLOGICA 158 (1986); O. Fiss, *Against Settlement*, 93 YALE L.J. 1073 (1984); Mather & Ynvesson, *Language, Audience and the Transformation of Disputes*, 15 LAW & SOC. REV. 775 (1980-81); C. Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 UCLA L. REV. 754; S. Merry, *Disputing Without Culture*, 100 HARV. L. REV. 2057 (1987); Fuller, *Mediation—Its Forms and Functions*, 44 So. CALIF. L. REV. 305 (1971); Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353 (1979); Wagatswma & Rossett, *The Implications of Apology*, 20 LAW & SOC. REV. 461 (1980); B. Yngvesson, *Reexamining Continuing Relations and the Law*, 1985 WISC. L. REV. 623; S. Sibley and A. Sarat, Dispute Processing in Law and Legal Scholarship; DPRP Working Paper 8:9 (June 1988) (U. Wis.-Madison Inst. for Legal Studies); D. KOLB, THE MEDIATORS (1985).

On the growing interest among U.S. scholars and practitioners in non-judicial or "alternative" dispute resolution, see references above and, L. KONOWITZ, ALTERNATIVE DISPUTE RESOLUTION: CASES AND MATERIALS (1985).

For interesting discussions of disputes and dispute processing from a broader cross-cultural and anthropological perspective, see e.g., Abel, *A Comparative Theory of Dispute Institutions in Society*, 8 LAW & SOC. REV. 217 (1973); S. ROBERTS, ORDER AND DISPUTES (1979); P. GULLIVER, DISPUTES AND NEGOTIATIONS: A CROSS-CULTURAL PERSPECTIVE (1979); THE DISPUTING PROCESS—LAW IN TEN SOCIETIES (L. Nader & H. Todd eds. 1978); F.G. Snyder, *Anthropology, Dispute Processes and Law: A Cultural Introduction*, 8 BRIT. J. L. & SOC'Y 141 (1981).

2. Certain parts of this paper draw upon my two articles on dispute settlement and adjudication, *An Overview of International Dispute Settlement*, *supra* note 1 and *International Dispute Settlement and the Role of Adjudication*, *supra* note 1.

3. *See, e.g.*, references cited in the first paragraph of *supra* note 1.

4. Case Concerning Military and Paramilitary Activities In and Against Nicargua (Nicar. v. U.S.), 1984 I.C.J. 392 (Judgment of Nov. 26, 1984 on Jurisdiction and Admissibility), *reprinted in* 23 I.L.M. 468 (1984); 1986 I.C.J. 14 (Judgment of June 27, 1986 on Merits), *reprinted in* 25 I.L.M. 1023 (1986). Among the many articles analyzing and discussing the decision and various aspects of the case, see, *e.g.*, articles and comments in 79 AM. J. INT'L L. at 373-405, 423-30, 652-64, and 992-1005 (1985) (dealing with jurisdictional phase), and 81 AM. J. INT'L L. at 77-183 (1987) (dealing with merits); Chayes, *Nicaragua, the United States and the World Court*, 85 COLUM. L. REV. 1445 (1985); Moore, *The Secret War in Central America and the Future of World Order*, 80 AM. J. INT'L L. 24 (1980); Reisman,

related decision to withdraw the declaration made by the U.S. in 1946 submitting to the Court's compulsory jurisdiction, has certainly heightened current interest in the role of international arbitral tribunals and courts.[5] In contrast, however, political scientists and social psychologists have focused their attention primarily on mediation and other non-binding types of dispute-resolution processes; indeed, their writings have largely ignored the role of either law or of formal legal techniques such as adjudication in international conflict resolution.[6]

Clearly, any approach to thinking about international conflict resolution should take into account *all* of the types of factors which may affect the usefulness and success of third party intervention—normative influences, power-political interests, the parties' perceptions and attitudes. Our understanding will best be served by pursuing both legal and social science research and combining a variety of disciplinary perspectives.

Second, third party dispute settlement is only one way of trying to resolve international conflicts, and can be understood only in the context of a general study of dispute-settlement problems and processes. While an exploration of these broad underlying questions is beyond the scope of this paper, they include: first, what do we mean by "conflicts" and "disputes"?; second, what causes conflicts and disputes?; third, do we need to settle conflicts and disputes, and, if so, which ones and why?; fourth, do states have any international obligation to settle their disputes peacefully?; fifth, what kinds of international disputes are there, how frequently do they arise, between or among what states, and involving what kinds of claims?; sixth, do disputes or conflicts follow typical patterns or "life cycles"?; seventh, what techniques or procedures are available in general for settling international disputes?; eighth, when is a dispute "settled"?; ninth, how can disputes be avoided?; and tenth, what is the relevance of law or normative considerations to dispute settlement?[7]

II. WHAT DO WE MEAN BY "THIRD-PARTY DISPUTE SETTLEMENT"?

A "third-party" can be defined as an individual or collective that is external to a dispute between two or more others and that either tries to help the disputants reach a settlement or, in some cases, is authorized on its own to determine a settlement.[8] Thus, a third-party may be another state or group of states (i.e. Algeria in the U.S.-Iran hostage crisis); a governmental international organization (i.e. the U.N. or O.A.S.); an international court (i.e. the I.C.J.) or an arbitrator or arbitration panel (i.e. the

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Has the International Court Exceeded its Jurisdiction? 80 AM. J. INT'L L. 128 (1986).

5. *See* Secretary of State Schultz's letter to U.N. Secretary General, Oct. 7, 1985; Dept. of State statement of Oct. 7, 1985; and Legal Adviser Sofaer's statement of Dec. 4, 1985, all *reprinted in* 86 DEP'T ST. BULL. No. 2106 at 67 (Jan. 1986) and 24 I.L.M. 1742 (1985).

6. *See, e.g.*, the references cited in the third paragraph of *supra* note 1.

7. For a discussion of some of these broader issues, see, e.g., Bilder, *An Overview of International Dispute Settlement*, *supra* note 1.

8. This definition draws on, PRUITT AND RUBIN, *supra* note 1, at 165-66.

U.S.-Iran Claims Tribunal); a non-governmental organization (i.e. the International Committee of the Red Cross); or an individual or group of individuals functioning either in a representative capacity (i.e. a U.N.-appointed mediator) or conceivably in a private capacity. In the interest of impartiality, mediators, arbitrators or judges (or at least most of the judges on an international court) will usually be of a nationality other than that of the disputing parties. However, this need not be the case so long as the third-party is perceived by the disputants as "external" to the dispute and capable of performing impartially and effectively the role of a third-party. For example, the U.S. and Canada have frequently utilized binational panels in dispute settlement roles (i.e. the arbitral panels established under the Jay Treaty, the U.S.-Canada International Joint Commission, and the binational panels which will be set up to review antidumping and countervailing duty determinations under Chapter 19 of the proposed Canada-U.S. Free Trade Agreement).[9]

"Third-party intervention" has, in turn, been defined as "[I]ntervention into a dispute of a person or agency whose purpose it is to act as an instrument for bringing about a peaceful settlement of that dispute, while creating structures whereby the foundations of a lasting settlement may be laid,"[10] or, more broadly, as "[A]ny action taken by an actor that is not a direct party to the crisis, that is designed to reduce or remove one or more problems in the bargaining relationship and, therefore, to facilitate the termination of the conflict itself."[11] International lawyers and others appear to sometimes use the term "third-party dispute-settlement" to refer, not to the broad political processes of third-party intervention but only to the more formalized and regularized structure of norms, institutions, arrangements and procedures which are recognized parts of the international legal order — in particular, techniques and procedures for binding adjudication utilizing arbitral tribunals or the I.C.J. However, I will here use "third party intervention" and "third party dispute settlement" interchangeably. It is important to note that third parties can play an important part in managing, deescalating or damping disputes, even if such efforts do not result in a final resolution of the disputes. That is any enquiry into the role of third parties should appropriately address and encompass their function in "dispute-management and processing," as well as in "dispute resolution and settlement."

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9. *See* Bilder, When Neighbors Quarrel: Canada-U.S. Dispute Settlement Experience (the 1986-87 Claude T. Bissell Lectures, University of Toronto), Inst. for Legal Studies, Univ. of Wisconsin Law School, Disputes Processing Research Program Working Paper 8:4 (May 1987); J.-G. Castel, *The Settlement of Disputes Under the 1988 Canada-United States Free Trade Agreement*, 83 AM. J. INT'L. L. 118 (1989); McDorman, *The Dispute Settlement Regime of the Free Trade Agreement*, 2 REV. INT'L. BUS. L. 303 (1988).

10. BERCOVITCH, *supra* note 1, at 13, citing Harbottle, *The Strategy of Third Party Intervention in Conflict Resolution*, 35 INT'L J. 118, 120 (1979-80).

11. Young, *infra* note 17, at 34.

III. DO STATES HAVE AN OBLIGATION TO SUBMIT THEIR DISPUTES TO THIRD PARTIES EITHER FOR HELP OR FOR BINDING SETTLEMENT?

It is well established that, absent special agreement, states have no obligation to submit their disputes to third parties either for help in achieving settlement or, *a fortiori*, for binding settlement by such third parties.[12] Consequently, the use of most third-party dispute settlement techniques, and in particular resort to arbitration or judicial settlement, depends upon the acquiescence of the disputing parties and cannot occur without their consent.

However, those states that are members of the U.N. (which means, in effect, almost all of the world's nations) have assumed under the Charter treaty obligations to accept at least some limited types of third party intervention, particularly as regards disputes whose continuation "[i]s likely to endanger the maintenance of international peace and security."[13] And, under Art. 33(2) of the Charter, the Security Council shall, when it deems necessary, call upon the parties to settle their dispute by the means (which include third-party means) listed in Art. 33(1) of the Charter.

It is, of course, also open to nations to enter into international agreements with each other which include so-called "compromissory clauses" or other obligations and arrangements to settle their disputes peacefully, and a great number (probably thousands) of such agreements are in effect.[14] Frequently, such agreements will not only include general obliga-

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12. *See, e.g., An Overview of International Dispute Settlement, supra* note 1, at 7-13. *See also* Henkin, *supra* note 1, at 910, "As long as a State does not resort to force, there has been no disposition to find a violation of law in failure to settle disputes peacefully, as by leaving them unsettled."

See also RESTATEMENT, *supra* note 1, sec. 902, comment (e):

> It is well established in international law that no State can, without its consent, be compelled to submit its disputes with other states either to mediation or to arbitration, or to any other kind of pacific settlement. Eastern Carelia (Finland v. Russia), 1923 P.C.I.J., ser. B, No. 5 at 27 (Advisory Opinion of July 23). Consequently, international claims cannot, in the present state of the law as to international jurisdiction, be submitted to a tribunal, except with the consent of the States concerned.

Reparation for Injuries, 1949 I.C.J. Rep. 177-78 (Advisory Opinion of April 11).

As to arbitration, see also the *Ambatielos* case (Greece v. U.K.) 1953 I.C.J. 10, 19 (Judgment of May 19) ("a State may not be compelled to submit its disputes to arbitration without its consent.").

13. *See, inter alia*, U.N. Charter arts.1(1), 2(3), 33, Ch. VI (arts. 33-38) and Ch. VII (arts. 39-51).

14. For example, there are some 250 agreements, bilateral and multilateral, conferring on the I.C.J. jurisdiction over disputes as to the interpretation or application of the agreements. *See* 1983-84 I.C.J.Y.B. 51-56, 92-108 (1984). *See generally*, Sohn, *Settlement of Disputes Relating to the Interpretation and Application of Treaties*, 150 RECUEIL DES COURS (1976) and Morrison, *Treaties as a Source of Jurisdiction for the International Court of Justice*, in THE INTERNATIONAL COURT OF JUSTICE AT A CROSSROADS (L.F. Damrosch ed. 1987) [*hereinafter* Damrosch]. There are many additional agreements containing provisions for dispute settlement by means other than reference to the World Court. *See, e.g.*, Sohn, *supra* note 1, and UNITED NATIONS, A SURVEY OF TREATY PROVISIONS FOR THE PACIFIC SET-

tions of peaceful settlement, but will require, recommend, or provide procedures for the use of specific dispute settlement techniques, such as conciliation, arbitration, adjudication or other third party techniques.

It is an interesting question whether the international community interest in peaceful settlement of disputes suggests the need for expanding the duty of states to resort to at least certain non-binding methods of third-party dispute-settlement, even in the absence of their consent.

IV. WHY DO DISPUTING STATES TURN TO THIRD PARTIES?

Third party dispute settlement is primarily a supplementary means of conflict resolution. Typically, it will be used only when either: (1) the disputing states are unwilling to reach a settlement themselves and wish the help of third parties to do so; or (2) a third party is otherwise authorized or in a position to intervene to affect the settlement or outcome of the dispute. Professor Louis Sohn points out that, "[I]t is an axiom of international diplomacy that the most efficient method of settling international disputes is through negotiations between the two governments concerned, without any meddling of third parties, other states or international organizations," and that "in most instances negotiations lead to a solution."[15] Negotiations are the preferred means of resolving disputes for many reasons. Perhaps the most important is that it is the least risky way the parties can try to resolve their dispute. Thus, negotiation permits each state maximum control over both the dispute settlement process and outcome, since each state always has the option of simply walking away from the negotiation and *not* agreeing. In contrast, any kind of third-party involvement carries a risk of reducing a disputing state's flexibility and freedom to do what it wants, and of somehow trapping it into an undesirable outcome. Some other advantages of negotiation are that negotiation places responsibility for resolving the dispute on the parties themselves, who are in the best position to develop a sensible, workable and acceptable solution. Negotiation works toward a freely agreed rather than imposed solution, which is likely to have maximum acceptability and stability, negotiation favors compromise and accommodation, which is most likely to preserve good long-term cooperative relations between the parties, and negotiation is generally simpler and less costly than alternative dispute settlement methods. So long as disputing states are making some progress towards solving their dispute themselves, they will normally have little reason to turn to third parties, and, conversely, third parties will have little reason to intervene.

Consequently, one would expect disputing states to seek or acquiesce in third-party intervention only when their own efforts to reach a negotiated settlement have been unavailing and are at an impasse, and where neither prefers such a failure to reach agreement to the alternative possi-

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TLEMENT OF INTERNATIONAL DISPUTES, at 1949-62 (1966).

15. Sohn, *supra* note 1, at 1122.

bility of continuing to seek settlement through assistance by, or delegation to, third parties. In this case, both parties may choose to ask third parties for help in their attempts to reach an agreement or, at the extreme, they may simply ask or allow a third party to determine the settlement or outcome.

Presumably, in deciding whether to seek or acquiesce in third-party dispute settlement procedures, each party will weigh what it thinks it may gain from such intervention against the risks and constraints on its control of the situation and outcomes that the particular third party techniques may involve. We would expect that, typically, the party in the more powerful negotiating position might be particularly reluctant to accept third party intervention, since such intervention may have the effect of counterbalancing or neutralizing its bargaining power. But sometimes, even for the stronger party, the risks of conflict, continued dispute, or unfavorable internal or external public opinion may outweigh even substantial risks from third party intervention.

Of course, a state's apparent consent to third party intervention may not in fact be serious or sincere; a state may pretend to agree simply to appeal to internal or external public opinion or seem like a "good citizen," but without any real intention of compromise or cooperation in a good faith effort to settle the dispute. Indeed, both disputing parties may find it useful to appear to be doing something by accepting third party intervention, even though neither really expects such intervention to be successful, or at least to do any more than ratify the outcome that would have occurred anyway. In some cases, for example, agreements may contain nominal obligations, included solely to pacify an internal political constituency of one of the parties, which neither expects to be observed. If and when such "noncompliance" occurs, the party will complain and dispute the matter although it cannot in good faith insist on its position. By resorting to third party dispute settlement techniques, including adjudication, the parties can delay and look as though they are trying to adjust the question while ultimately reaching the outcome they always intended.[16]

In practice, the context of each dispute and conflict is likely to be unique, and many factors may bear upon the willingness of disputing states to seek or accept third party intervention. In the first place, such attitudes obviously will vary depending on the particular circumstances and stakes involved, the type of intervention contemplated, and who the third parties are likely to be. For example, a state may be willing to accept non-binding U.N. mediation but not a binding I.C.J. decision, or accepting fact-finding by neutral State 'A' but not hostile State 'B'. Second, as a threshold condition, disputing states must believe that there are

16. For an interesting discussion of such "latent" functions of adjudication, see Hudec, *Transcending the Ostensible: Some Reflections on the Nature of Litigation Between Governments*, 72 MINN. L. REV. 211 (1987).

things third parties can do that are more likely to be helpful than harmful and they must be willing, at a minimum, to let third parties try. This means that third-party intervention will often have at least two stages or phases: an initial "jurisdictional" phase in which the parties are persuaded to seek or acquiesce in a third party having some role (or the third party otherwise establishes its right to do so); and a substantive or "merits" phase where the third party actually attempts to help settle the dispute. Third, it may not always be easy to say when the disputants are in fact at an "impasse"; for example, a state in a weaker bargaining position may seek third party intervention in hopes of thus obtaining an outcome better than it can obtain itself, even though it is prepared, if its efforts to involve third parties prove unsuccessful, to agree to a less favorable settlement. Fourth, even where states are reluctant to accept third party intervention, they may, as previously noted, have previously undertaken legal obligations to do so under the U.N. Charter, the I.C.J. statute or other international agreements. Indeed, serious problems may arise where a third party, at the request of one party to a dispute, intervenes based on what it construes as the other party's prior consent, but the other party is no longer willing to accept such intervention or claims that it had never given consent. Recent experience, in the *Nicaragua* and other cases, raises questions as to the usefulness or effectiveness of third party intervention in the absence of real and continuing consent on the part of all of the disputing parties.

Finally, third party intervention may occur even in the absence of impasse between disputing states or indeed of real consent by one or both parties. Thus, the third state may have its own interest in promoting or preventing a particular outcome (i.e., helping an ally or hurting an enemy). Indeed, in some situations, the "selfish interest" of the intervening state may be so great that its role is better analyzed as that of a third party to the dispute, rather than as an external third party concerned only with helping the parties resolving the dispute. Or, as often the case, the international community as a whole may have its own interest in resolving conflicts or preventing unjust or unstable settlements which might escalate or spill over to threaten other states. Much of the U.N.'s interventionary authority, under Chapters VI and VII of the Charter, are based on this premise. Indeed, it is worth noting that the international community might wish to intervene even if the disputing states were able themselves to agree easily on a settlement with which they were quite content. For example, the U.N. or third states might wish to intervene in a bilateral settlement of a transfrontier pollution dispute in which the two states agreed to solve the problem by dumping large amounts of the pollutant into the ocean in a way which threatened serious injury to the ocean environment.

V. WHY ARE THIRD PARTIES WILLING TO INTERVENE?

Performing a third-party role in dispute settlement is not an easy task; it can be arduous and costly (i.e., the U.S. role in the various mid-

east crises), dangerous (i.e., the assassination of Count Bernadotte) or unrewarding (i.e., the U.S. role in the Falkland-Malvinas war). Indeed, third parties may run serious risks of becoming caught up in, or blackmailed into, a continuing role in a long-drawn-out dispute or conflict, or of being blamed by one or both of the parties for unfavorable outcomes.

There appear to be various reasons why third parties are willing to intervene, including the following:

First, the third-party may have a legal or institutional responsibility to do so; it may simply be the third party's job or *raison d'etre*. For example, serving as third parties in dispute settlement for which international judges, arbitrators and U.N. Secretary-Generals are paid.

Second, the third party may have a sense of public responsibility, as well as perhaps a desire for the prestige and honor that may accompany a successful third party role. Algeria's role in the Iran Hostages dispute, the Pope's role in the Argentina-Chile Beagle Channel dispute, or the Soviet mediation of the Kashmir dispute may be examples.

Finally, as previously noted, the third party may have its own interests or the interests of an ally at stake, which it believes will be protected or advanced by its intervention and third-party role.

Of course, several of these motives may combine — as may be the case, for example, with U.S. intervention in the Middle East or the "Contadora" states' intervention in the Nicaraguan conflict.

VI. WHAT KINDS OF THIRD-PARTY TECHNIQUES ARE AVAILABLE?

The most usual and accepted list of methods of peaceful settlement of international disputes — and the one most familiar to international lawyers — is that set forth in Article 33 of the U.N. Charter — negotiation, inquiry, mediation, conciliation, arbitration, judicial settlement, resort to regional agencies or arrangements, and resort to the U.N. or other international organization dispute settlement procedures. In essence, this list of methods reflects a spectrum or continuum of techniques ranging from so-called "diplomatic means," which give control of the outcome primarily to the parties themselves, to so-called "legal means" which give control of the outcome primarily to a third party or parties. That is, the principal difference among these techniques is in the extent to which third parties can legitimately participate in helping to bring about or determining the settlement and, conversely, the extent to which the parties can reject a settlement proposed by the third party. In practice, distinctions between these techniques may be more theoretical than real, and a particular process of dispute settlement may combine elements of various techniques. For example, international arbitration or adjudication may often embody compromises reflecting strong elements of negotiation or mediation among the arbitrators or judges, at least some of whom may see their role as safeguarding the interests or representing the point of view of one or the other party. Negotiators will often have to make their

bargaining decisions with the possibility of third party intervention, or perhaps even resort to adjudication, in mind.

The more traditional third-party methods of peaceful settlement, each of which has its own distinctive characteristics, are the following:

Good offices and mediation[17] are techniques in which the parties, unable to resolve a dispute by negotiation, request or agree to limited intervention by a third party to help them break the impasse. In the case of good offices, the role of the third party is usually limited to simply bringing the parties into communication and facilitating their negotiations. In the case of mediation, the mediator usually plays a more active part in facilitating communications and negotiations between the parties, and is sometimes permitted or expected to advance informal and nonbinding proposals of his or her own. President Carter's mediation leading to the Egypt-Israel Peace Treaty is a recent example of successful mediation.

Fact-finding, inquiry and conciliation[18] are methods of settlement in which the parties request or agree to the intervention of a third party, usually on a more formal basis, for the purpose of determining particular facts or otherwise conducting an impartial examination of the dispute and, if the parties so agree, attempting to suggest or define the terms of a mutually acceptable settlement. Like mediation, the report of a fact-finding body or conciliation commission is normally non-binding, although the third party finding or recommendation may exercise an important influence on the settlement. A recent example of a successful use of a formal inquiry procedure is the 1961 "Red Crusader" inquiry into the facts concerning the stopping by a Danish fishery protection vessel of a British trawler off the Faroe Islands. A recent example of successful conciliation is the special commission established by Norway and Iceland to make recommendations concerning their dispute over the apportionment of the continental shelf off Jan Mayen Island; the Commission's Report, recommending joint development of hydrocarbon production, was implemented by the conclusion of a 1981 Norway-Iceland Treaty on the matter.

Arbitration[19] involves the reference of a dispute or series of disputes, by the agreement of the parties to an *ad hoc* tribunal for binding deci-

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17. *See, e.g.*, MERRILLS, *supra* note 1, at ch. 1; Darwin, *Mediation and Good Offices*, in Waldock, *supra* note 1, at 83; Raman, *supra* note 1, at ch. 3. *See generally*, O. YOUNG, THE INTERMEDIARIES: THIRD PARTIES IN INTERNATIONAL CRISES (1967).

18. *See, e.g.*, MERRILLS, *supra* note 1, at chs. 3 and 4; Fox, *Conciliation*, in Waldock, *supra* note 1, at 159; BAR-YAACOV, THE HANDLING OF INTERNATIONAL DISPUTES BY MEANS OF INQUIRY (1974); COT, INTERNATIONAL CONCILIATION (1972); Firmage, *Fact-Finding in the Resolution of International Disputes: From the Hague Peace Conference to the United Nations*, 1971 UTAH L. REV. 421 (1971).

19. *See, e.g.*, MERRILLS, *supra* note 1, at ch. 5; Fox, *Arbitration*, in Waldock, *supra* note 1, at 101; WETTER, THE INTERNATIONAL ARBITRAL PROCESS PUBLIC AND PRIVATE (1979); S. SCHWEBEL, INTERNATIONAL ARBITRATION: THREE SALIENT PROBLEMS (1987); SIMPSON AND FOX, INTERNATIONAL ARBITRATION (1959); Sohn, *The Function of International Arbitration Today*, 1 RECUEIL DES COURS 108 (1963); CARLSTON, THE PROCESS OF INTERNATIONAL ARBITRATION (1946).

sion, usually on the basis of international law. The parties by agreement establish the issue to be arbitrated and the machinery and procedure of the tribunal, including the method of selection of the arbitrator or arbitrators. While arbitration is normally binding, it is open to the parties to provide that the tribunal's opinion will be only advisory. The 1978 U.S.-French Air arbitration over a dispute concerning the interpretation of the U.S.-French Air Agreement is a recent example of a successful arbitration.

Judicial Settlement[20] involves the reference of the dispute, by the agreement or consent of the parties, to the International Court of Justice or some other standing and permanent judicial body for binding decision, usually on the basis of international law. Again, if the rules establishing the court so allow, the parties may agree to an advisory or nonbinding opinion rather than a binding decision, or to a declaratory judgment specifying the principles which the parties should apply in the settlement of their dispute. The *Gulf of Maine* case between the U.S. and Canada is a recent example of successful judicial settlement under the procedures of the I.C.J.

Another method is settlement through the United Nations or other global or regional international organizations or agencies.[21] In some circumstances, the parties may request the assistance of the U.N., a regional organization, or another international organization in settling their dispute, or the U.N. or another organization (for example, a regional organization) may on its own motion legitimately intervene in the dispute, at least for the purposes of trying to bring about a peaceful settlement. Sometimes a third party may ask for the organization's intervention. This assistance may, *inter alia*, take the form of good offices, mediation, fact-finding or conciliation. The rights and obligations of the parties and authority of each organization in these respects are in each case set out in their respective Charters and other constitutive instruments, as well as developed through their practice. The U.N.'s various attempts to deal

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20. *See, e.g.*, MERRILLS, *supra* note 1, at ch. 6; Bilder, *International Dispute Settlement and the Role of International Adjudication*, *supra* note 1, Damrosch, *supra* note 14; T. FRANCK, JUDGING THE WORLD COURT (1986); R. FALK, REVIVING THE WORLD COURT (1986); Bilder, *Some Limitations of Adjudication as an International Dispute Settlement Technique*, 23 VA. J. INT'L L. 1 (1982); Allott, *The International Court of Justice*, in Waldock, *supra* note 1, at 128; S. ROSENNE, THE WORLD COURT (3d ed. 1973); S. ROSENNE, THE LAW AND PRACTICE OF THE INTERNATIONAL COURT (1965); JENKS, THE PROSPECTS OF INTERNATIONAL ADJUDICATION (1964); the excellent collections of articles in THE FUTURE OF THE INTERNATIONAL COURT OF JUSTICE (L. Gross ed. 1976); and JUDICIAL SETTLEMENT OF INTERNATIONAL DISPUTES (H. Mosler & R. Bernhardt eds. 1979); Schachter, *supra* note 1; Sohn, *supra* note 1, and references cited *infra* note 33; and the many additional articles cited in these works. For a listing and brief description of the various present international courts, see Sohn, *supra* note 1, at 1127-30.

21. *See* MERRILLS, *supra* note 1, at chs. 8 and 9; Bowett, *The United Nations and Peaceful Settlement;* Waldock, *supra* note 1, at 179; and Raman, *supra* note 1. Some international agreements empower the organizations established by them to render a binding decision. *See* RESTATEMENT sec. 902, reporter's note 6, at 176. *See also* Sohn, *supra* note 1.

with Middle Eastern, Iran-Iraq, and many other problems are familiar examples of the attempted use of this technique.

The international system has developed a wide variety of institutions, arrangements, procedures and norms through which These kinds of techniques can be invoked and implemented. These include over a hundred international organizations; international courts such as the I.C.J., the Court of the European Communities and the European and American Courts of Human Rights; arbitral tribunals such as the U.S.-Iran Claims Tribunal currently sitting in the Hague; GATT dispute-settlement panels; many binational commissions such as the Canada-U.S. International Joint Commission and so forth.

There are, of course, other sorts of distinctions that can usefully be drawn. For example, two social psychologists, Dean Pruitt and Jeffrey Rubin, suggest the following several broad contrasting types of third-party roles:[22]

- *Formal vs. Informal Role.* Is the third party intervening pursuant to a formal understanding or legal precedents (i.e. under U.N. authorization or the "compromissory clause" of an agreement), or is the intervention informal and without express legitimation?
- *Individual vs. Representative Role.* Is the intervenor acting in a personal capacity, or in a representative capacity (i.e. as a government or international organization official)?
- *Invited vs. Non-Invited Role.* Is the intervenor acting pursuant to an express or implied invitation or with the parties' consent, or on its own or some other third party initiative (or conceivably against the expressed wishes of one or both of the parties)?
- *Impartial vs. Partial Role.* Is the intervenor impartial or neutral, or is it biased in favor of one party or a particular result?
- *Advisory vs. Directive Role.* Is the intervenor's role wholly or primarily advisory, with the aim of helping the parties achieve their own solution, or can the intervenor determine all or part of the settlement or outcome?
- *Content-Oriented vs. Process-Oriented Roles.* Does the intervenor's role focus primarily on the actual content of the dispute (the issues of substance under consideration), or primarily on the process of decision-making (the way in which the discussions are taking place)?

VII. HOW CAN THIRD PARTIES HELP

As indicated, in the case of advisory and non-binding techniques such as good offices, mediation, fact-finding and conciliation, the third party's role is usually limited to helping the parties to negotiate their own settlement of their dispute. In contrast, in the case of directive and binding techniques such as arbitration and judicial settlement, responsibility for settlement of all or part of the issues in dispute is removed from the

22. PRUITT AND RUBIN, *supra* note 1, at 166-69.

parties' direct control and the third party is authorized to decide the matter for them. In each case, of course, the actual - or even potential - presence and activities of a third party may have various effects upon the dynamics of the disputing process and the disputing parties'relationships, some helpful, but some, perhaps not.

How can third parties help the disputants achieve a settlement themselves? A good deal of research has been done to identify the general functions that mediators and other non-directive third parties can perform and the specific kinds of things they can do that are likely to be most useful.

Pruitt and Rubin, for example, describe the type of negotiating impasse which may call for third-party assistance:

> Positions tend towards rigidity because the protagonists are reluctant to budge lest any conciliatory gesture be misconstrued as a sign of weakness. Moreover, the parties may lack the imagination, creativity, and/or experience necessary to work their way out of the pit they have jointly engineered — not because they don't want to but because they don't know how. Thus, for a variety of reasons, disputants are sometimes either unable or unwilling to move toward agreement of their own accord. Under the circumstances, third parties often become involved at the behest of one or more of the disputants, or on their own initiative.[23]

They suggest and discuss a variety of ways in which a third party can help the parties break out of such an impasse.[24] One way is by modifying the physical and social structure of the dispute. For example, the third party can structure communication between the principals; open and neutralize the site in which problem-solving takes place, impose time limits, and infuse resources. Another way is by modifying the issue structure. For example, the third party can assist the disputants to identify existing issues and alternatives; help them to package and sequence issues in ways that lead towards agreement; and introduce new issues and alternatives that did not occur to the disputants themselves. Finally, the third party can increase the disputant's motivation to reach agreement. For example, it can facilitate their making concessions without loss of face, engender mutual trust, encourage their venting and coming to grips with irrational feelings, and respect their desire for autonomy.

Another commentator, Jacob Bercovich, divides third party aims into process objectives and outcome objectives, each of which he in turn subdivides into two categories: (1) information search (i.e., establishing communication, searching for common principles) and, (2) social influence (i.e., persuading the parties to converge on an acceptable outcome). Bercovich sees third party behavior as implemented through certain tactics which he calls (1) reflective behavior (i.e., receiving, transmitting and

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23. *Id.* at 165.
24. *Id.* at 169-79.

interpreting messages and signals reflecting and influencing how the parties perceive their situation); (2) non-directive behavior (i.e., influencing the context and structure of the conflict by controlling publicity, controlling the environment, controlling resources, reducing pressure and recasting issues); and (3) directive behavior (i.e., influencing the parties perceptions and motivation through making proposals, a judicious exercise of power and promises of resources).[25]

Other commentators suggest other types of potential third-party contributions, or classify third-party objectives or functions in a somewhat different way. For example, Oran Young classifies third party objectives as: (1) informational (i.e., offering information or increasing communication); (2) tactical (i.e., offering services); (3) supervisory (i.e., monitoring an agreement); and (4) conceptual (i.e., offering new ideas for a settlement).[26] Indeed, there is now a rich literature suggesting imaginative techniques through which third parties may help parties in an impasse "get unstuck" — for example, by creating a "hurting stalemate," providing "decommitting formulas" or "bypass solutions," "changing or reframing the game," using "single text procedures," and so forth. I have suggested elsewhere that a principal reason why disputing parties may not be able to reach a settlement agreement is that they distrust each other or are otherwise concerned with what they see as very serious risks potentially involved in such an agreement. In this case, third parties can play a crucial role in dispute settlement by helping the parties in a variety of ways to manage these risks - for example, by monitoring or verifying performance, serving as escrow agents, or providing guarantees.[27] Third party risk management devices of this kind may be particularly useful, for example, in facilitating dispute-settlement arrangements in which distrust is a particularly serious obstacle, such as armistice or peace agreements or agreements seeking to resolve complex and emotional racial, ethnic or religious conflicts.

What about more directive techniques of third party intervention such as adjudication, in which third parties have authority themselves to determine how the dispute is to be settled? While we will look at adjudication shortly, two of the most important ways in which this kind of third party technique can help disputing parties can be briefly mentioned here.

First, adjudication can dispose of the matter. It is often more important to the parties that a dispute be settled than that it be settled in a particular way. Where negotiations are unsuccessful, adjudication or other third party disposition of the matter provides an alternative way in which the parties can put the dispute behind them and move on to other things.

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25. BERCOVITCH, *supra* note 1, at ch. 5, esp. 96-108.

26. Young, *supra* note 1, and Young, *Intermediaries: Additional Thoughts on Third Parties*, 16 J. CONFLICT RESOLUTION 51 (1972).

27. *See* R. BILDER, MANAGING THE RISKS OF INTERNATIONAL AGREEMENT (1981).

Second, adjudication can permit concessions without "loss of face" or bureaucratic risk. Since adjudication involves an impersonal decision by a third party, neither of the governments of the parties (or the officials involved) can be held directly responsible for the outcome. There are probably a number of disputes where governments are relatively indifferent as to the outcome and would normally be willing to negotiate a compromise settlement, but where, for internal political or other reasons, they are unable to concede or even compromise the issue in negotiations. Third-party settlement is a politically useful way by which foreign offices can dispose of such problems without taking direct responsibility for concessions. In effect, they can "pass the buck" for not "winning" the dispute to the third-party tribunal — "Don't blame us, blame the judge!"

VIII. WHICH TECHNIQUES WORK BEST?

A great deal of experience and writing exists concerning the relative advantages and disadvantages of various techniques and when and how each can best be employed.[28] For example, J.G. Merrills, assessing the value of conciliation as a dispute settlement technique, concludes:

> Conciliation has proved most useful for disputes where the main issues are legal, but the parties desire an equitable compromise . . . . In cases of this type, conciliation would appear to offer two advantages over arbitration *ex aequo et bono*, the obvious alternative.
> First, because of the way conciliation is conducted — through a dialogue with and between the parties—there is no danger of it producing a result that takes the parties completely by surprise, as sometimes happens in legal proceedings. Secondly a commissions' proposals . . . are not binding and, if unacceptable can be rejected.[29]

Merrills and others have attempted similar types of assessments of other techniques. Moreover, there is now a considerable body of theoretical and empirical research, historical and political analysis, and biographical and anecdotal reporting concerning such "how to do it" questions as the most appropriate timing of intervention, characteristics of a third party, site selection, the pros and cons of publicity in mediation, and so forth. In this brief overview, however, only a few very broad generalizations can be suggested.

First, different kinds of disputes will obviously call for different methods of settlement. The craft of effective dispute settlement involves judging what method or combination of methods may be most useful in helping to resolve the particular dispute and how and when such techniques can best be employed. Among the factors affecting such a choice will be:

- the subject-matter and characteristics of the dispute (e.g., whether

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28. *See* references in *supra* note 1. For excellent brief evaluations of various techniques from an international lawyer's perspective, see MERRILLS, *supra* note 1.

29. *Id.* at 66.

it involves a dispute about the facts, the law, at the law should be, the terms of a particular allocation, or procedural issues);
- the nature of the relations between the parties, e.g., whether they are "repeat players" having continuing relations with each other or only infrequently have occasion to interact or deal with each other, and whether there is generally friendship and trust or enmity and distrust between them;
- the parties' perceptions and emotional attitudes as to the importance of the dispute (i.e., whether it is considered a matter of "vital interest" or national prestige, or either party feels it "cannot afford to lose");
- the past history of this and other disputes between the parties (i.e., the "stage" of the dispute and extent to which positions have changed or hardened, and precedents as to how the parties have handled such problems in the past);
- the potential effect of the dispute on other states or the international community (e.g., whether it is a matter potentially affecting international peace and security) and the availability or willingness to serve of appropriate third parties and the resources they are able or willing to deploy.

Second, the various techniques are not mutually exclusive, nor are the boundaries between them rigidly drawn. A number of them are usually employed either *seriatim* (although in no mixed order), or in combination to supplement or complement each other. For example, the recent 1982 U.N. Convention on the Law of the Sea and the 1988 Convention on the Regulation of Antarctic Mineral Resource Activities, both of which deploy a variety of techniques to deal with diverse types of disputes that may arise, show how these possibilities can be exploited in an innovative and imaginative way. As Professor Oscar Schachter has pointed out, "Flexibility and adaptability to the particular circumstances are the essential characteristics of these various procedures. There is little to be gained by seeking to give them precise legal limits or procedural rules as a general matter.[30]

Similarly, Judge Manfred Lachs, in his individual opinion in the 1978 *Aegean Sea Continental Shelf* case (Greece v. Turkey) commented:

> There are obviously some disputes which can be resolved only by negotiations, because there is no alternative in view of the character of the subject-matter involved and the measures envisaged. But there are many other disputes in which a combination of methods would facilitate their resolution. The frequently unorthodox nature of the problems facing States today requires as many tools to be used and as many avenues to be opened as possible, in order to resolve the intricate and frequently multi-dimensional issues involved. It is sometimes desirable to apply several methods at the same time or successively. Thus, no incompatibility should be seen between the various instru-

30. SCHACHTER, *supra* note 1, at 205.

ments and fora to which States may resort, for all are mutually complementary.[31]

Third, it is often useful to develop structured institutions and arrangements, such as international courts or fact-finding agencies, and to have them in place, ready for use, and easily available if need should arise. However, in other cases, it may be better to deal with problems as they arise, on a pragmatic, flexible and *ad hoc* basis, rather than to try to force dispute-management efforts onto the Procustean bed of some possibly unsuitable and inflexible already established dispute settlement institution.

Fourth, the choice of techniques and the way they are employed should, where relevant, take into account the particular dispute-settlement experience of the states involved. Every bilateral or other international relationship has its own unique character and environment which shapes both the kinds of disputes that arise and how these particular states tend to deal with them. Some states (i.e. Canada and the U.S.) have developed special dispute management systems - a unique set of practices, procedures, techniques and institutions - to deal with their particular quarrels.

Finally, a specific list of techniques will not exhaust the possibilities. It will always be open to the disputing parties, or to third parties, to modify or adapt most of these techniques (except in the case of judicial settlement by an existing court with established rules), or to creatively develop such additional methods as their needs and ingenuity suggest. Moreover, since every dispute or conflict will be unique, generalizations such as these, or particular "rules" or "formulas," should be applied with caution.

IX. THE ROLE OF ADJUDICATION

In view of current interest regarding the proper role of adjudication as a method of international dispute settlement, particularly in the wake of the World Court's decision in the *Nicaragua* case, some remarks on this technique in particular may be appropriate. Again, it is not practical to review here the very extensive literature analyzing the experience, procedures role and significance of international arbitral tribunals and courts, and more particularly, the I.C.J.[32] However, I would suggest the following general points.

As is the case with respect to any method of dispute settlement, in deciding whether to use adjudication, the parties to a dispute will weigh its potential advantages against its disadvantages.[33] Among the potential

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31. 1978 I.C.J. 52 (Dec. 19, 1978).

32. *See, e.g.*, Bilder, *International Dispute Settlement and the Role of Adjudication*, *supra* note 1, and other references *supra* notes 1 and 20.

33. For discussion of the advantages and disadvantages of adjudication and reasons why states may be reluctant to accept adjudication and, in particular, the compulsory jurisdiction of the I.C.J, *see, e.g.*, Bilder, *International Dispute Settlement and the Role of*

advantages of adjudication, are: (i) it is dispositive, ideally, at least putting an end to the dispute; (ii) it is impersonal, permitting the parties to pass responsibility for unfavorable outcomes to the tribunal; (iii) it is principled and impartial, ostensibly deciding the matter by neutral principles rather than power, bias or whim; (iv) it is serious and demonstrates that the state instituting suit really believes in its claim; (v) it is orderly and can be useful in resolving complex factual and technical disputes; (vi) it can sometimes "depoliticize" a dispute, reducing tensions or buying time; (vii) it can provide rules socially useful for guiding conduct and resolving disputes more broadly; (viii) it can reflect, and educate the com-

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Adjudication, supra note 1, at 144-65; T. FRANCK, *supra* note 20; SCHACHTER, *supra* note 1, at 207-11; Vallat, *Foreword* in Waldock, *supra* note 1; MERRILLS, *supra* note 1, at 107-13; M. NORTHEDGE & DONELON, *supra* note 1, at 321-29; Gross, *Role of International Adjudication*, and Rovine, *The National Interest and the World Court*; Hudec, *Transcending the Ostensible: Some Reflections on the Nature of Litigation Between Governments*, 72 MINN. L. REV. (1987); Higgins, *The Desirability of Third Party Adjudication: Conventional Wisdom or Continuing Truth?*, in INTERNATIONAL ORGANIZATION: LAW IN MOVEMENT 37 (J. Fawcett & R. Higgins eds. 1974); Lachs, *A Few Thoughts on the Independence of Judges of the International Court of Justice*, 25 COLUM. J. TRANSNAT'L L. 593 (1987); Owen, *Compulsory Jurisdiction of the International Court of Justice: A Study of Its Acceptance by Nations*, 3 GA. L. REV. 704 (1969); Shihata, *The Attitude of New States Toward the International Court of Justice* 19 INT'L. ORG. 203 (1965); J. GAMBLE & D. FISHER, THE INTERNATIONAL COURT OF JUSTICE (1975); Dalfen, *The World Court in Idle Splendour: The Basis of State Attitudes*, 23 INT'L J. 124 (1967); Brauer, *International Conflict Resolution: The ICJ Chambers and the Gulf of Maine Dispute*, 23 VA. J. INT'L L. 463, 468-73 (1983); De Visscher, *Reflections on the Present Prospects of International Adjudication*, 50 AM. J. INT'L L. 467 (1956); E. MCWHINNEY, THE WORLD COURT AND THE CONTEMPORARY INTERNATIONAL LAW-MAKING PROCESS (1979); Falk, *The Role of the International Court of Justice*, 37 J. INT'L AFF. 253 (1984); R. FALK, REVIVING THE WORLD COURT (1986); W. JENKS, THE PROSPECTS OF INTERNATIONAL ADJUDICATION (1964); and generally other sources cited *supra* notes 1 and 20. As indicated, explanations of why states are generally reluctant to agree to adjudicative or "legal" techniques of dispute settlement often emphasize states' lack of confidence in the predictability of such procedures and their concern over their loss of control over outcomes. *See, e.g.*, D. Bowett, *supra* note 1, at 180-81:

> [While] specific reasons change from State to State, the basic reason for avoiding legal settlement is simply that States prefer to retain control over the settlement process, so as to ensure that any settlement is acceptable to them, or, if that cannot be achieved, that no settlement is reached. With the political techniques they retain such control — though this is less true when the pressures of United Nations organs are brought to bear — whereas with legal techniques States evidently feel that they lose control.

Some commentators suggest a distinction between so-called "legal" or "justiciable" disputes, on the one hand, and "political," "non-legal" or "non-justiciable" disputes, on the other; the implication is that some disputes have inherent characteristics that make them either particularly appropriate or inappropriate for the use of adjudication as a dispute settlement technique. Others, with whom I agree, are of the view that, while state attitudes towards accepting the risks of adjudication and the usefulness of adjudication will obviously differ in different circumstances, in principle all international disputes are "justiciable." *See, An Overview of International Dispute Settlement, supra* note 1, at 15-17. For discussion, see, *e.g.*, SCHACHTER, *supra* note 1, at 211-15 and Schachter, *Compulsory Jurisdiction in Cases Involving the Use of Force*, in Damrosch, *supra* note 14; Henkin, *supra* note 1, at 829-31; Darwin, *General Introduction* in Waldock, *supra* note 1, at 6-13; RESTATEMENT, *supra* note 1, sec. 903, reporter's note 7; J. GAMBLE & R. FISCHER, *supra* note 1, at 20.

munity as to social values and interests of the international community more broadly, apart from those of the parties alone, and; (ix) it can be system-re-enforcing, supporting respect for and the development of international law.

But, there are also a number of potential disadvantages of adjudication: (i) it involves the possibility of losing; (ii) adjudicative settlement may be illusory or superficial, deciding the "legal" but not the "real" issues in dispute; (iii) it can be inflexible, resulting in a "win-lose" rather than a compromise decision; (iv) it can be judgmental, labeling one party as a "lawbreaker," rather than providing for a shared acceptance of responsibility as a facesaving way out of a conflictual situation; (v) it looks primarily to the past rather than to the future, possibly jeopardizing the maintenance of a useful ongoing relationship; (vi) it is conservative; (vii) its results are unpredictable; (viii) it may not be impartial; (ix) an adjudicative settlement is imposed on the parties; (x) it is adversarial and may escalate the dispute or conflict; (xi) it may freeze the parties' options and discourage settlement; (xii) it can be complex and costly, and; (xiii) there is no assurance that an adjudicative decision will be enforceable.

As previously noted, adjudication has generally played only a rather limited role in the settlement of international disputes. While nations often pay lip-service to the ideal of judicial settlement, in practice they have entrusted relatively few significant disputes to international tribunals. During the period of 1946 through 1985, the International Court of Justice had only 72 cases submitted to it; it rendered 45 judgements in contentions cases and 17 advisory opinions. Moreover, countries have been particularly reluctant to obligate themselves in advance to compulsory binding adjudication of their potential disputes with other countries—particularly disputes concerning issues that may involve what they consider "vital" national interests. In general, they have been willing to do so, at most, only when their commitment to such compulsory jurisdiction is restricted in terms of subject matter or otherwise carefully circumscribed.

In my opinion, this reluctance of states to submit disputes to arbitral or judicial settlement will continue for some time to come. Thus, for the near future at least, the prospects for widespread acceptance of the general compulsory jurisdiction of the I.C.J. under the Optional Clause of Article 36(2) of the Court's Statute do not seem to me bright.[34] In partic-

34. By 1988, only 46 of the 159 members of the U.N. had declarations in effect accepting the Court's compulsory jurisdiction under the optional clause. For comprehensive reviews and analysis of experience respecting the I.C.J.'s compulsory jurisdiction (the so-called "optional clause" of Article 36(2) of the I.C.J. Statute), see, *e.g.*, Damrosch, *supra* note 14; Gross, *Compulsory Jurisdiction Under the Optional Clause: History and Practice*, in DAMROSCH, *supra* note 14, at 19; Merrills, *The Optional Clause Today*, 1979 BRIT. Y.B.I.L. 87 (1979); Giustini, *Compulsory Adjudication in International Law: The Past, the Present and Prospects for the Future*, 9 FORDHAM INT'L L.J. 213 (1985-86); Scott and Carr, *The International Court of Justice and Compulsory Jurisdiction: The Case for Closing the*

ular, I believe that, in the aftermath of the *Nicaragua* case, it is unlikely that the U.S. will soon resume its acceptance of the optional clause, except possibly with very broad reservations—although it is my personal belief that it is in our national interest to do so.[35]

While adjudication may not be the best way of resolving every dispute, there are clearly a number of situations in which adjudication, or at least the availability of adjudication, can perform a very useful dispute settlement function. In practice, most disputes do not involve issues of significant or "vital" national concerns. In these cases, while each party may prefer to win the dispute, the stakes involved are limited and each can afford to lose. Adjudication is one good way in which the parties can achieve their most important objective in these situations — disposing of the dispute. Indeed, to the extent that states can be assured that a commitment to adjudication will be restricted to less vital issues, they will be more willing to agree, even in advance, to adjudication. Thus, nations have frequently been willing to agree to compromissory clauses providing in advance for compulsory jurisdiction over disputes arising out of treaties concerned with specialized matters of clearly defined scope and limited import, such as commercial treaties. The U.S. for example, is party

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Clause, 81 AM. J. INT'L L. 57 (1987). On the Court's jurisdiction under "compromissory clauses," see, *e.g.*, Charney, *Compromissory Clauses and the Jurisdiction of the International Court of Justice*, 81 AM. J. INT'L L. 855 (1987). Morrison, *Treaties as a Source of Jurisdiction, Especially in U.S. Practice*, in DAMROSCH, *supra* note 14, at 58.

35. For recent discussions of U.S. attitudes regarding international adjudication and the Court's compulsory jurisdiction, see in particular Panel Discussion, *Current Developments Concerning the Settlement of Disputes by Arbitration and the World Court*, 83rd Annual Mtg. of Am. Soc. of Int'l L. (Chicago) (April 5-8, 1989) to be printed in 1989 PROC. AM. SOC. INT'L. L. ___; DAMROSCH, *supra* note 14; T. FRANCK, *supra* note 20; *Symposium*, 81 AM. J. INTL. L. 1 (1987). Suggestions have been made for various types of reservations to meet the Administration's concerns and permit resumed U.S. acceptance of the compulsory jurisdiction of the I.C.J. They include reservations excluding from the jurisdiction of the Court matters involving national security or the use of force or matters referred to other dispute-resolution procedures or matters under consideration by the U.N. Security Council; excluding jurisdiction when the applicant party's declaration of acceptance of the Court's compulsory jurisdiction was made for the purpose of filing the individual suit; and providing for the possibility of denunciation of the U.S. acceptance with immediate effect. Suggestions have also been made for modification or elimination of certain U.S. reservations in its 1946 declaration of acceptance, particularly the multilateral treaty (Vandenberg) reservation and the "self-judging" domestic jurisdiction (Connally) reservation. *See, e.g.*, Damrosch, *supra* note 14; Sohn, *Suggestions for the Limited Acceptance of Compulsory Jurisdiction of the International Court of Justice by the United States*, 18 GA. J. INT'L & COMP. L. 1 (1988); D'Amato, *Modifying U.S. Acceptance of the Compulsory Jurisdiction of the World Court*, 79 AM. J. INT'L L. 385 (1985); D'Amato, *The United States Should Accept, by a New Declaration, the General Compulsory Jurisdiction of the World Court*, 80 AM. J. INT'L L. 331 (1986); Gardner, *U.S. Termination of the Compulsory Jurisdiction of the International Court of Justice*, 24 COLUM. J. TRANSNAT'L L. 421 (1986); Morrison, *Reconsidering United States Acceptance of the Compulsory Jurisdiction of the International Court of Justice*, 148 WORLD AFF. 63 (1985); Ende, Comment, *Reaccepting the Compulsory Jurisdiction of the International Court of Justice: A Proposal for a New United States Declaration*, 61 WASH. L. REV. 1145 (1986).

to more than 60 bilateral and multilateral agreements containing such "compromissory clauses."

Among the types of disputes in which adjudication is likely to be particularly useful are: (a) disputes in which governments are indifferent to outcome, but for internal political or other reasons are unable to concede or even compromise the issue in negotiations (i.e., minor boundary disputes or substantively unimportant but emotionally volatile issues of title to small or insignificant areas of territory); (b) disputes involving difficult factual or technical questions in which the parties may be prepared for a compromise solution but where, either because of the complexity of the situation or internal political pressures, they cannot evolve a basis for developing a viable compromise (i.e., again certain complex boundary or maritime, continental shelf, or fishery resource zone delimitation issues); and (c) some particularly awkward or dangerous disputes, in which resort to judicial settlement may be a politically acceptable way of buying time and containing a volatile situation while solutions are sought over time.

Moreover, international tribunals, simply by being available, may help avoid, or induce the settlement of, disputes. Even if states choose only infrequently to invoke the International Court's jurisdiction under the Optional Clause or "compromissory clauses" in relevant agreements, that does not mean such commitments are useless. On the contrary, since each party to a dispute covered by such provisions knows that the other can resort to the Court, a party that wishes to avoid adjudication will have more incentive to reach a negotiated settlement. That is, where the parties have conferred potential jurisdiction on an international tribunal, their decisions and bargaining, like those of parties to domestic disputes, will be more likely to occur "in the shadow of the law." J.G. Merrills comments:

> [T]he value of arrangements for dispute settlement is not to be judged solely by the cases. For a provision for compulsory arbitration by its very existence can discourage unreasonable behaviour and so may be useful even if it is never invoked.[36]

It is also important to note that, for many people throughout the

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36. MERRILLS, *supra* note 1, at 88. In this context, it is amusing to compare an ancient Chinese suggestion that a good way to encourage dispute-settlement by the parties themselves is to provide only very bad courts. The 7th century Emperor K'ang Hsi is reported to have said:

> Law suits would tend to increase to a frightful amount, if people were not afraid of the tribunals, and if they felt confident of always finding in them ready and perfect justice. As man is apt to delude himself concerning his own interests, contests would then be interminable, and the half of the Empire would not suffice to settle the lawsuits of the other half. I desire, therefore, that those who have recourse to the tribunals should be treated without any pity, and in such a manner that they shall be disgusted with law, and tremble to appear before a magistrate.

R. DAVID & J.E.C. BRIERLEY, MAJOR LEGAL SYSTEMS IN THE WORLD TODAY 520 (1978), citing S. VAN DE SPRENKEL, LEGAL INSTITUTIONS IN MANCHU CHINA 77 (1962).

world, international adjudication symbolizes civilized and ordered behavior and the rule of law in international affairs. Whatever the truth may be as to how the international legal system actually works, public judgments as to the relevance and effectiveness of international law are at least in part based on whether the public sees international courts, and particularly the International Court of Justice, as playing a significant role in international dispute settlement. If many states (particularly the important ones) are willing to submit their disputes to impartial settlement and show respect for the International Court, this will be taken by the public as meaning that international law is in itself relevant and worthy of respect, and the public will believe in and support international law. If, on the other hand, important states show indifference or contempt for international adjudication and the Court, the public is likely to conclude that international law is meaningless and withdraw their belief and support. Indeed, these public attitudes may in turn over time reflect back on official and bureaucratic attitudes towards and respect for international law. Consequently, if a state believes that its national interest will be furthered by wider global respect for international law, it will arguably also have an interest in doing what it can to strengthen and support the role of international adjudication.

Finally, even if the role of international adjudication is limited and there is no international court with general compulsory jurisdiction, there can still be effective dispute settlement and a workable international legal order. The international legal order is different in many respects from national legal orders, and need not operate in exactly the same way.[37] Moreover, we are coming to realize that, even in the domestic legal system, adjudication plays a largely supplementary or "back up" role, and that much of the work national courts do is in effect mediation or conciliation.[38]

In sum, since adjudication can be a particularly useful tool in our tool-box of dispute settlement techniques, it is important that it be kept ready at hand, easily available and employed to the fullest whenever its use is warranted. Even if adjudication is not a panacea for problems of world order, it makes sense to do all that we can to strengthen and encourage the greater use of judicial institutions, and to improve their ability to respond in flexible ways to nations' dispute settlement needs.

It is relevant in this respect to note that the Soviet Union's recent apparent change of attitude and new receptiveness towards the compulsory jurisdiction of the World Court, and towards multilateral conflict resolution techniques more generally, at least as stated in Premier

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37. *See* discussion in Bilder, *International Dispute Settlement and the Role of Adjudication*, *supra* note 1; Allott, in Waldock, *supra* note 1, at 128-32; Schachter, *supra* note 1, at ch. III and 207-11.

38. *See, e.g.*, references on dispute processing in the U.S. cited in *supra* note 1, and, particularly, Galanter, *supra* note 1.

Gorbachev's September, 1987 Pravda articles,[39] may represent a unique "window of opportunity" for strengthening international dispute-management institutions, which the U.S. and other western nations ought seriously to explore.

X. SOME LIMITATIONS OF THIRD PARTY DISPUTE SETTLEMENT

While third-party intervention is usually helpful and undertaken for benevolent motives, this may not always be the case. There are some potential drawbacks of third party dispute settlement.[40]

Even well-meaning intervention may get in the way of or discourage the parties' own settlement efforts, making things worse rather than better. This may be true in particular where the intervention is premature or inept, or where the third party is an "officious intermeddler," butting into a situation without invitation and against the parties wishes. But even if intervention is invited, it may be the case that "too many cooks may spoil the soup" or that things somehow go wrong.

Third party intervention will not necessarily produce a fair or stable settlement or outcome. Even where third party intervention is ostensibly "neutral," it may often have the effect of supporting the position and interests of one or another of the parties. Moreover, to the extent intervention by third parties typically produces outcomes differing from those which would have resulted from negotiations based on the effective power of the disputing states acting solely by themselves,the outcomes and "settlements" resulting from intervention may distort rather than reflect real underlying power relationships and be unstable. Indeed, where third parties artificially constrain real pressures, the result may be that over time "the boiler will explode" or "the toothpaste squeeze out of the tube somewhere else," producing even greater problems in the future.

As a corollary to the previous point, the possibility of third party intervention may sometimes lead to or prolong disputes and conflicts by encouraging parties (particularly weaker parties) to be more aggressive or intransigent than they would otherwise normally dare to be. For example, it has been suggested that the Arab states have little reason to refrain from hostile actions against Israel, or to reach a definitive settlement with

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39. Mikhail Gorbachev, *The Realities and Guarantees of a Secure World*, Pravda, Sept. 17, 1987; USSR Mission to the UN, Press Release No. 119 (Sept. 17, 1987), suggesting, *inter alia*, that the International Court's "mandatory jurisdiction should be recognized by all on mutually agreed conditions," that "the permanent members of the Security Council, taking into account their special responsibility, are to make the first step in that direction," and that "the international community should encourage the United Nations Secretary General in his missions of good offices, mediation and reconciliation" (at 11-12). *See also, e.g.*, the Soviet Union's announcement on March 8, 1989, that it would accept the compulsory jurisdiction of the International Court of Justice with respect to disputes concerning five international human rights treaties, N.Y. Times, March 9, 1989, at 1, col. 4; *see also* Lewis, *Moscow Says World Court can Decide Soviet Disputes*, N.Y. Times, Nov. 3, 1988, at 4, col. 7.

40. *See also* PRUITT AND RUBIN, *supra* note 1, at 179-82.

it, so long as they believe from experience that any severe Israeli sanctions or retaliation will always be nullified by U.N. or other third party intervention.

Third party intervention - or even its possibility in the future - can hinder or chill negotiations by encouraging an exaggeration or freezing of the parties' positions. Each will be aware of the tendency of mediators (and even arbitrators and judges) to "split the difference" and seek a compromise; consequently, rather than focusing on settling the matter themselves, they may seek to put themselves in the best position to "win" any third party intervention.

In trying to help resolve a dispute or conflict, third parties can become enmeshed in it, thus widening, complicating and prolonging the dispute. For example, one or another of the disputants may come to perceive the third party as really an ally or an enemy; persuade, coerce or trick it into "taking sides;" or "blackmail" it into a continuing role in the dispute. In this event, the third party may become part of the problem rather than its solution.

Finally, third parties will often have their own interests at stake in intervening in a conflict or dispute, which may distort their settlement efforts or cause them to seek outcomes not in accord with the parties desires or interests. Indeed, sometimes a third party may have a mischievous or malevolent purpose, seeking to prevent the conflict or dispute from being resolved or to "keep the pot boiling" to suit the third party's own purposes.

XI. How Important Is Third Party Dispute Settlement And Does It Really Work?

It is difficult to measure precisely and objectively either the practical significance or success of third party dispute settlement. Clearly, any such judgments will vary with the situation under examination and the perspective of the observer. Moreover, in assessing importance or success, we may have to answer the question "as compared to what?" However, we can probably say at least a few things.

As indicated, most disputes are - and should be - settled through direct negotiations. Thus, third party intervention will usually be less important, effective or efficient than settlement directly by the parties themselves.

However, while precise data is lacking, recent studies suggest that third party intervention in international conflicts often can play a significant role - a result in accord with long human experience and intuition. In particular, there is evidence that, while third party intervention does not always provide a final settlement to a conflict or dispute, it often seems to keep things from getting worse. For example, Bercovitch, analyzing data involving 310 conflicts from 1945-74, found that in 235 of these conflicts, or 82 percent of the total, there was some form of official third-party intervention, primarily by the U.N. and in the form of media-

tion, and that it was useful in at lest abating conflict in a substantial number of these situations.[41] He concludes that third party intervention seems to be an important method for managing international conflict, and that:

> [S]tudies show that institutional third parties can be particularly useful in abating, insulating and restraining international conflict, though not in settling it. We do not know, however, whether conflicts in which the parties accept the intervention of an outsider are more, or less, likely to terminate in a settlement. Nor do we know whether a better, or even a similar outcome could not have been attained and without the participation of a third party. Until we have some answers to these questions, third parties' contributions to successful outcomes should be kept in their proper, and critical, perspective.[42]

Similarly, Pruitt and Rubin conclude that: "In the last analysis, however, it is our view that third parties are enormously helpful and important in the reduction and resolution of differences."[43]

Certainly, there is much to be said for techniques which stop the parties from fighting and keep them talking, even if a definitive solution proves for the moment elusive. Sometimes, if matters can just be put "on hold," time and changing attitudes, interests and circumstances may provide opportunities for settlement not presently apparent.

It is usually assumed, probably correctly, that third party intervention is much more widely used in relatively "unimportant" than "important" types of disputes. But it is also evident that third parties do, at least occasionally, help parties resolve "important" disputes. If third party intervention is in fact useful in resolving a number of less important and even a few important disputes, it would certainly seem to be performing a significant function, even if it cannot help in all disputes.

Finally, regarding adjudication, it seems fair to conclude that despite the relatively small number of these cases — perhaps in all only several hundred intergovernmental arbitrations and less than 85 contentious cases in the World Court (33 in the P.C.I.J. and some 50 in the I.C.J.), many of these cases have involved disputes of considerable significance. Among these important cases are the *Alabama Claims*, *Bering Sea*, *North Atlantic Fisheries*, *Lake Lanoux*, *Island of Palmas*, *Trail Smelter*, *Rann of Kutch*, *Channel Islands* and *Beagle Channel* arbitrations, and the *Gulf of Maine*, *North Sea Continental Shelf* and *Iranian Hostage* cases. Moreover, these decisions have helped to establish principles and rules which have helped resolve or avoid other international disputes.

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41. BERCOVITCH, *supra* note 1, at 92-93 and 113-15 (using data from Butterworth).

42. *Id.* at 113-15.

43. Pruitt and Rubin, *supra* note 1, at 179. For a discussion of the role of third-party dispute settlement techniques in helping nations to manage the risks of their international cooperation and reach international agreements, see Bilder, *supra* note 27, at 56-61.

XII. SOME CONCLUDING REFLECTIONS

What is the proper role of third party techniques in managing international disputes and what can we do to improve their usefulness? In summary, the following are some of my suggestions.

First, we should recognize that the best way of dealing with international disputes is by negotiations between the parties themselves, and the most important and useful thing third parties usually can do will be to supplement and assist this process. Consequently, our efforts should be directed particularly to improving facilitative techniques such as mediation, fact-finding and conciliation. Certainly, we should also encourage the use of more directive techniques such as adjudication, but with awareness that arbitration and judicial settlement are likely to play only a limited role in international dispute settlement for some time to come.

Second, while third party techniques will often be useful, we should not expect more than they can deliver. For example, even the most skilled use of third party techniques usually will not succeed in bringing unwilling parties, who have fundamental differences, to agreement. However, we should also remember that third party intervention can be useful and "successful" simply by restraining or isolating conflict, buying time, or keeping a situation from getting worse, even if it does not bring about a final settlement.

Third, while we should certainly continue to learn more about various methods of third-party intervention, such as mediation, and improve our ability to use them effectively, we should be careful not to overemphasize the importance of mere technique or "gimmicks." There are few secrets and little magic in successful dispute settlement. The most important factor will continue to be whether the parties want — or can be persuaded to want — the dispute settled. The most important qualities of a third party will continue to be traditional "old-fashioned" virtues — common sense, honesty, trustworthiness, patience, integrity, stamina, courage, intelligence, competence, sensitivity to the concerns of others, conscientiousness, impartiality and good will. And luck will always help.

Fourth, we should try to better understand and develop dispute-management systems between or among particular states or groups of states.[44] Dispute settlement is a complex process, in which a variety of techniques may appropriately play a part. Each international relationship exists in a unique environment, and may require its own special approach or "mix." Thus, the U.S. and Canada historically have developed and may be able most appropriately to use one type of dispute-management system, while U.S.-Soviet relationships may most appropriately call for a completely different kind of system.

Fifth, in thinking about dispute settlement, we should not forget the great importance of doing more to avoid disputes. Thus, we should de-

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44. *See* Bilder, *supra* note 9.

velop and improve arrangements and mechanisms designed both to keep disputes from occurring and to permit them to be dealt with at an early stage, before political interests become vested, emotions become involved, or positions harden.[45] Such dispute avoidance measures might include prior agreement on clear rules and workable arrangements; prior notification and consultation, and the establishment of *ad hoc* or permanent binational commissions or joint agencies.

Sixth, we should be sensitive to the possible relevance to any dispute of the particular cultural attitudes and responses towards conflict and dispute-settlement of the parties involved, and take such perspectives into account in deciding on the appropriateness of different approaches or techniques. For example, Chinese, Japanese and certain other non-Western societies appear traditionally to have given particular emphasis to nonadversarial techniques of mediation and mutual accommodation as a way of dealing with disputes, and to have been particularly reluctant to use adjudication or other adversarial or "legally-oriented" methods. Again, different societies may have different perspectives regarding the types of individuals most worthy of respect and trust and most suitable to perform third-party roles; thus, in some cultures, eminent lawyers may be appropriate mediators or dispute resolvers, while in others, political or religious leaders may be more suitable.

Seventh, we should study possibilities for improving old third party institutions and procedures and developing new ones. Clearly, there is much to be said for having institutions or procedures in place, more easily available to parties if they wish to use them — although it is open to question whether new institutions in themselves will make much difference without some change in underlying state attitudes. Certainly, one of the most important things we can do is to foster an international atmosphere in which third-party intervention and efforts to promote peaceful settlement of disputes are considered routine,appropriate, legitimate and acceptable. There are several ideas worth exploring regarding improvements to be made and possible new developments in our dispute management institutions.

One idea is to expand the availability and use of non-binding conciliation processes and of the advisory jurisdiction of international tribunals. As indicated, governments have been reluctant to accept binding judicial settlement since they see legally binding judgments as posing special risks — even though their fears may be unrealistic and unlikely to come to pass. Conciliation and advisory or non-binding adjudication, on the other hand, can offer many advantages of impartial third-party factual and legal determination while reducing some of its most significant risks. In many cases, a recommendation or advisory decision may in fact provide a

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45. *See, e.g.*, Bilder, *An Overview of International Dispute Settlement*, *supra* note 1, at 29-31; R. KIRGIS, PRIOR CONSULTATION IN INTERNATIONAL LAW: A STUDY OF STATE PRACTICE (1983).

mutually acceptable basis for resolution of the dispute; however, each party will have the assurance that, should its worst fears be realized and the decision prove unacceptable, it can legally refuse to comply with it, incurring only limited public relations costs. While binding adjudication may in principle be preferable, non-binding conciliation or adjudication may in some situations be the most that one or both parties will agree to, and in that event, better than nothing. The thus far successful experience of the newly formed Inter-American Court of Human Rights with advisory jurisdiction is suggestive in this respect.[46]

Another idea is to develop a wider, more easily available, and more credible array of international fact-finding, monitoring and verification facilities. For example, proposals have been made in the U.N. for the development of permanent fact-finding institutions, and even for the establishment of International Satellite Monitoring Agency to help verify arms control or similar agreements. I have elsewhere suggested the possibility of establishing an essentially independent and neutral entity (e.g., a "Facility for International Risk Management") outside the U.N. framework and free of direct government control, which would be available to states, at their request and with their sharing of costs, to perform verification, monitoring, escrow or other risk-management functions; such a facility might take, for example, the form of an international corporation, along the lines of EUROCHEMIC, or a nongovernmental organization, such as the International Committee of the Red Cross.[47]

Still another possibility is to explore ways of making international adjudication, and in particular the I.C.J., more acceptable, accessible and flexible.[48] As indicated, any substantial change in the willingness of state's to use international adjudication or the I.C.J. is likely to require a fundamental change in state attitudes and in their willingness to face the

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46. *See, e.g.*, Buergenthal, *The Advisory Practice of the Inter-American Court of Human Rights*, 79 AM. J. INT'L L. 1 (1985). *See generally*, for arguments for more pragmatic, flexible and non-binding types of risk-management and dispute-resolution arrangements, R. BILDER, MANAGING THE RISKS OF INTERNATIONAL AGREEMENT (1981).

47. *See* Bilder, *An Institution to Monitor Treaties*, 18 INT'L PRAC. NOTEBOOK 13 (Apr. 1982) (Amer. Branch, Int'l Law Assoc.) and Milwaukee Journal Mar. 14, 1982, at part 9. On verification, *see generally*, Bilder, *supra* note 46, at 119-39; Trimble, *Beyond Verification: The Next Step in Arms Control*, 102 HARV. L. REV. 885 (1989); M. KREPON, ARMS CONTROL - VERIFICATION AND COMPLIANCE (1987); W. POLLER (ed.), VERIFICATION AND ARMS CONTROL (1985).

48. For recent discussions of the I.C.J. and suggestions for broadening its role, see the references cited in *supra* notes 1, 20, and 33, and also Allott, *supra* note 1, at 134-58; Gross, *supra* note 1; Gross, *The International Court of Justice: Consideration of Requirements for Enhancing its Role in the International Legal Order*, 65 AM. J. INT'L L. 253 (1971); Sohn, *supra* note 1; U.S. DEPARTMENT OF STATE, STUDY ON WIDENING ACCESS TO THE INTERNATIONAL COURT OF JUSTICE (1976), *reprinted in* DIGEST OF U.S. PRACTICE IN INTERNATIONAL LAW 650 (Mcdowell ed. 1976); Murphy, *The World Court and the Peaceful Settlement of International Disputes*, 7 GA. J. INT'L & COMP. L. 551 (1977); Dillard, *The World Court: Reflections of a Professor Turned Judge*, 27 AM. U.L. REV. 205 (1978); Petren, *Some Thoughts on the Future of the International Court of Justice*, 6 NETH. Y.B.INT'L.L. 59 (1975).

risks inherent in binding third-party dispute settlement techniques. But some procedural innovations may be of help. For example, the recent expansion of the availability and use of the I.C.J.'s chamber procedure is one useful step in this direction.[49] Professor Louis Sohn's proposal for step-by-step acceptance of the Court's compulsory jurisdiction — the idea of slicing or fractionating types or degrees of commitment to adjudication into less-risky and more-acceptable packages — is another suggestive and innovative type of approach.[50] Another idea is that the U.S. consider entering into special dispute settlement agreements with the Soviet Union and perhaps other major powers *outside* the Article 36(2) "optional clause" framework - providing for the compulsory submission of carefully specified types of treaty or other disputes to special chambers of the International Court of Justice. Among the various other suggestions which have been made and debated are: permitting wider access to the I.C.J. or other international courts by international organizations, nongovernmental organizations, or even individuals; restricting the types of reservations which can be made to acceptance of the compulsory jurisdiction of the I.C.J. under the "optional clause"; completely discarding the concept of compulsory jurisdiction; expanding the "law" the I.C.J. can draw on under Article 38 of its statute to include U.N. General Assembly declarations; and so forth. We might consider whether at least some of the so-called "alternative dispute resolution" (ADR) techniques, such as "minitrials," currently being discussed and experimented with within the U.S. and some other national legal systems, have possible application to international problems and are worth exploring.

We should also try to strengthen the ability of third parties in appropriate situations to intervene on a temporary basis in disputes and conflicts simply to keep matters "on hold" and from getting worse, while providing time or a "waiting period" in which the disputing states or third parties can seek solutions. Precedents include the power of the I.C.J., under Article 41 of its statute, to indicate, if it considers that circumstances so require, any provisional measures which ought to be taken to preserve the respective rights of either party, as well as the activities of

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49. *See, e.g.*, Schwebel, *Ad Hoc Chambers of the International Court of Justice*, 81 AM. J. INT'L L. 831 (1987). Most of the cases submitted to the Court since 1982 have been under the chamber procedure. There are indications that the State Department strongly favors use of the chamber procedure and, indeed, may contemplate that future submissions to the Court be only to such a panel. *See* 1989 PROC. AM. SOC. INT'L. L., *supra* note 35. Certainly the panel concept has proven popular, and it is arguable that any device which encourages a willingness by states to resort to the Court is for the good. On the other hand, there may be some question whether, if all states choose to use only such specially selected panels, the International Court of Justice will remain in fact a "World Court", rather than simply being a series of *ad hoc* arbitral tribunals sitting at a common seat. That is, to the extent that the extensive use of the chambers procedure tends to erode the concept and integrity of the Court as a global institution, or encourages the attitude that its international judges are inherently biased or untrustworthy, there may be serious reason for concern.

50. Sohn, *Step-by-Step Acceptance of the Jurisdiction of the International Court of Justice*, 58 A.S.I.L. PROC. 131 (1964).

various U.N. peacekeeping forces. We should explore whether there might be additional ways of temporarily restraining and preventing escalation of disputes to permit time and opportunity for settlement.

Also, we should attempt to develop ways of better utilizing national legal systems to implement international dispute-management objectives should be developed. Proposals to allow the I.C.J. to give advisory opinions to national courts on questions of international law would be one interesting step in this direction.[51] Other possibilities might include agreements facilitating access to national courts or agencies by alien individuals, corporations or even foreign governments seeking domestic remedies for particular kinds of transnational problems, such as transfrontier pollution disputes; or an agreement, similar to the N.Y. Arbitration Convention, expressly providing for implementation by a respondent state and third states of the obligation of states under the U.N. Charter to comply with a judgment of the I.C.J.

Eighth, we should give more emphasis and support to innovative research about the international dispute process and techniques of international dispute management and settlement, particularly empirical and interdisciplinary studies.[52] This research should include investigations of the broad underlying questions concerning the causes, characteristics, and "life cycle" of disputes noted at the beginning of this paper. Particular questions relevant to third party dispute-settlement which might merit more attention and additional research including the following:

- What factors influence disputing states' perceptions of the acceptability, authority, and persuasiveness of third parties? What qualities really are most important? In particular, what do we mean by "neutrality," "impartiality" or "lack of bias," how important are perceptions as to the neutrality of third parties to the success of their efforts, and how can we best ensure that third parties are in fact neutral and unbiased? Even though every human being, inevitably, may have biases, can't people still be counted on to conscientiously perform roles which require them to act "neutrally," and how can we strengthen such traditions? What are the pros and cons of utilizing

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51. *See, e.g.*, Schwebel, *Preliminary Rulings by the International Court of Justice at the Instance of National Courts*, 28 VA. J. INT'L L. 495 (1988); Gross, *supra* note 48 ; Sohn, *Broadening the Advisory Jurisdiction of the International Court of Justice*, 77 AM. J. INT'L L. 124 (1983); Goldklang, *House Approves Proposal Permitting ICJ to Advise Domestic Courts*, 77 AM. J. INT'L L. 338 (1983); McLaughlin, *Allowing Federal Courts Access to International Court of Justice Advisory Opinions: Critique and Proposal*, 6 HASTINGS INT'L & COMP. L. REV. 745 (1983).

52. For listings of academic and other study programs and institutes and organizations involved in research relating to conflict resolution and dispute settlement, see INSTITUTE FOR WORLD ORDER, PEACE AND WORLD ORDER STUDIES: A CURRICULUM GUIDE 373-86 (3d ed. 1981). A number of these, such as the Program on Negotiation at Harvard Law School and its Harvard Negotiation Project, expressly adopt an interdisciplinary approach. There is a need, in particular, to integrate the insights of legal and social science research in this respect, and to provide more occasions for lawyers and social scientists interested in these problems to talk and work together.

an international institution, such as the U.N., in a third party role, as contrasted with a state or individual?
- What do we mean by "settlement of a dispute" or an "acceptable outcome" and, in particular, what affects the parties' perceptions as to the "equity" or "fairness" of a particular outcome? Is "fairness" primarily substantive or procedural, against what base lines or by what criteria are the parties likely to judge it, and how can we best achieve it? More generally, how can we best define or measure the "quality" of dispute resolution processes and outcomes?
- Can we say anything about when is the "right time" for various types of intervention? How important are personal interrelations between individual participants in settlement processes? Can nongovernmental organizations play a more useful role in dispute settlement?
- How can disputing parties best protect themselves against improper overreaching or counterproductive interference by a third party? How can a third party best protect itself from becoming enmeshed or blackmailed in the dispute?
- What affects third party perceptions of the legitimacy and persuasiveness of the disputing parties' positions? Is there a difference between the type of argumentation the parties use in negotiation to try to persuade each other, and the type of argumentation they use in third party contexts to try to persuade the third party?
- What role do international law, generalized norms, or general "public opinion" and the attitude of third states play in dispute resolution? What does "social pressure" mean and how does, or can, it affect dispute-resolution processes? Are perceptions of legitimacy relevant only to adjudication or other "legal" techniques of settlement, or do they affect non-adjudicative methods of third-party settlement as well?
- In what kind of cases is it important to successful intervention that the third party be able to provide specific resources, particularly the resources to help the parties manage the risks of potential settlement arrangements,and how can such resources be made more available?
- What do we mean by "face" — the quality of respect or reputation that states (and officials) seem so concerned with "losing" by giving in to settlements, and how can we reduce the obstructive influence of such considerations on settlement efforts?
- What is the effect of "trust" and "distrust" on dispute settlement efforts, and how can third parties help disputing states to overcome or counterbalance distrust?
- Is it desirable or undesirable for a third party to be "powerful" or have some independent basis of influence over the disputing parties? More generally, what is the role of power or force in third party settlement? Can there be anappropriate role for "creative coercion."
- In what respects do mediators or conciliators behave differently from adjudicators or judges, and what makes them act and see their roles as different? What do the parties, or the "general public", ex-

pect of third parties entrusted with these different roles?

- How can third parties better contribute to the settlement of the complex and pervasive internal racial, ethnic and religious strife which increasingly threatens international order (e.g., in South Africa, the Middle East, Cyprus, Northern Ireland, Sri Lanka, and elsewhere)? Clearly, it is becoming increasingly difficult to draw any sharp lines between international (or external) and domestic (or internal) disputes. Do we need to develop new approaches or ways of thinking to help us to deal effectively with these "mixed" or "transnational" kinds of disputes?

Ninth, the international community should be more assertive in insisting that parties accept third party intervention in disputes which threaten international peace and security or, indeed, the international community's general welfare. It is now widely recognized that, for better or worse, the world has become an interdependent community and that serious disputes and conflict are now everyone's business. The idea that states are free to conduct their quarrels however they wish and without regard to the cost to others is outdated and has no place in a nuclear age.

Finally, once again, we should not forget that international third party dispute settlement has a symbolic significance as well as practical importance. The concept that disputes and conflicts within a group are not simply the business of those directly involved but are of concern of every member is at the root of civilized and ordered society. Consequently, third party dispute settlement, and institutions such as the International Court of Justice which implement its use, can encourage growing perceptions of international community and play a crucial role in the development of a more peaceful, just and decent world.

The Law of International Watercourses: Some Recent Developments and Unanswered Questions

STEPHEN C. MCCAFFREY*

The International Law Commission of the United Nations (ILC), a body composed of 34 individuals who serve in their personal capacities, and not as government representatives,[1] is currently engaged in the preparation of drafts on two subjects that relate to transfrontier environmental harm. This work is particularly significant because of the unique nature of the Commission, whose task is "the promotion of the progressive development of international law and its codification."[2] The ILC fulfills

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1. UNITED NATIONS, THE WORK OF THE INTERNATIONAL LAW COMMISSION 6 (4th ed. 1988). Article 2, para. 1 of the Commission's Statute provides that members are to be "persons of recognized competence in international law." *Statute of the International Law Commission* 1, U.N. Doc. A/CN.4/4/Rev.2 (1982) [hereinafter cited as ILC Statute]. Members are elected by the General Assembly unless a vacancy occurs during a five-year term, in which case it is filled by the Commission itself; Article 8 of the Statute provides that "the electors shall bear in mind that the persons to be elected to the Commission should individually possess the qualifications required and that in the Commission as a whole representation of the main forms of civilization and of the principal legal systems of the world should be assured." I.L.C. Statute, at 2.

It is therefore surprising that a recent article should have characterized the Commission as "government-dominated." Allott, *State Responsibility and the Unmaking of International Law*, 29 HARV. INT'L L.J. 1, 2 and 16 (1988). That governments have no power over members of the Commission was demonstrated beyond any doubt when, on several occasions, they have been unsuccessful in efforts to unseat ILC members. *See e.g.*, H. BRIGGS, THE INTERNATIONAL LAW COMMISSION 78-80 (1965) (attempts to remove Shuhsi Hsu (China) in the 1950s); and Schwebel, *The Thirty-Second Session of the International Law Commission*, 74 A.J.I.L. 961, 961-62 (1980) (attempt to unseat Abdul Hakim Tabibi (Afghanistan). A similar attempt to replace a member of Nigerian nationality after a change of government in 1984 was also unsuccessful. Aide-Memoire of 11 May 1984 from the ILC to the Government of Nigeria. "[O]n each occasion, the Commission has politely, but firmly, adhered to the view that its members sit in their personal capacities and cannot be unseated during their term of office by means other than voluntary resignation." I. SINCLAIR, THE INTERNATIONAL LAW COMMISSION 20-21 (1987).

While there may be some justification for the view that the election of Commission members has become increasingly politicized. *See e.g.*, H. BRIGGS at 42; Saunders, *The 1971 Elections of the International Law Commission*, 66 A.J.I.L. 356 (1972)], it has been suggested that this actually enhances the possibility that Commission drafts will be acceptable to governments. *See e.g.*, B. RAMCHARAN, THE INTERNATIONAL LAW COMMISSION 34 (1977); and EL BARADEI, FRANCK AND TRACHTENBERG, THE INTERNATIONAL LAW COMMISSION: THE NEED FOR A NEW DIRECTION 29 (1981). *See generally* I. SINCLAIR at 16-19.

2. ILC Statute, *supra* note 1, at 1. The Commission, in practice, has not drawn a dis-

this mandate by preparing what amount to draft conventions for submission to the United Nations General Assembly. These drafts have often formed the basis of multilateral treaties adopted at conferences convened by the General Assembly.[3] But the Commission's work is of interest even without regard to the final form it may take, since it is the result of efforts to state what the law is (codification) or what it should be (progressive development).[4]

The two subjects on which the ILC is currently working that address problems of transfrontier environmental harm are The Law of the Non-navigational Uses of International Watercourses (International Watercourses) and International Liability for Injurious Consequences Arising out of Acts Not Prohibited by International Law (International Liability).[5] This article will be confined to reviewing recent developments of

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tinction between "codification" and "progressive development," although they are treated as separate exercises in the ILC Statute (*supra* note 1, arts. 15, 16-17 (progressive development) and 18-23 (codification)). I. SINCLAIR, *supra* note 1, at 7; McCaffrey, *Codification and Progressive Development: Law and the World Environment*, 7 HARV. INT'L REV. 8 (1984).

3. *See, e.g.*, the 1958 Geneva Conventions on the Law of the Sea which, in turn formed the basis of much of the 1982 U.N. Convention on the Law of the Sea: Convention on the High Seas, April 29, 1958, 13 U.S.T. 2312, T.I.A.S. No. 5200, 450 U.N.T.S. 82; Convention on the Continental Shelf, April 29, 1958, 15 U.S.T. 472, T.I.A.S. No. 5578, 499 U.N.T.S. 311; Convention on the Territorial Sea and Contiguous Zone, April 29, 1958, 15 U.S.T. 1606, T.I.A.S. No. 5639, 516 U.N.T.S. 205; Convention on Fishing and Conservation of Living Resources of the High Seas, April 29, 1958, 17 U.S.T. 138, T.I.A.S. No. 5969, 559 U.N.T.S. 285. *See also*, the Vienna Convention on Diplomatic Relations, done April 18, 1961, 23 U.S.T. 3227, T.I.A.S. No. 7502, 500 U.N.T.S. 95; the Vienna Convention on Consular Relations, April 24, 1963, 21 U.S.T. 77, T.I.A.S. No. 6820, 596 U.N.T.S. 261; and The Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, 8 I.L.M. 169 (1969).

4. *Supra* note 2.

5. For discussions of the Commission's work on International Liability see, e.g., Magraw, *Transboundary Harm: The International Law Commission's Study of International Liability*, 80 A.J.I.L. 305 (1986); McCaffrey, *The Work of the International Law Commission Relating to the Environment*, 11 ECOLOGY L.Q. 189, 206-211 (1983); *id. An Update on the Contributions of the International Law Commission to International Environmental Law*, 15 ENV. L. 667 (1985); and *id. The Fortieth Session of the International Law Commission*, 83 A.J.I.L. 153, 169-70 (1989).

The Commission has provisionally adopted an article in the context of its work on a third topic, State Responsibility, which also concerns environmental protection. Article 19 of Part One of the Responsibility draft is entitled "International Crimes and International Delicts." It creates a new category of especially serious internationally wrongful state acts called "international crimes". The article provides that an international crime "may result, *inter alia*, from" an act of aggression, the establishment or maintenance by force of colonial domination, a serious and widespread breach of an obligation for the safeguarding of the human being, such as those prohibiting slavery, genocide and *apartheid*, and finally, (d) a serious breach of an international obligation of essential importance for the safeguarding and preservation of the human environment, such as those prohibiting massive pollution of the atmosphere or of the seas. 2 Y.B. INT'L L. COMM'N 95, 96 (1976). The Commission's commentary to article 19 is contained in *id.* at 96-122. For a brief discussion of subparagraph (d), quoted above, see McCaffrey, *The Work of the International Law Commission Relating to the Environment*, 11 ECOL. L. Q. 189, 211-214 (1983). For an in-depth examination of article 19, see generally *International Crimes of State, A Critical Analysis of the ILC's Draft Article 19 on State Responsibility* (J. Weiler, A. Cassese & M. Spinedi eds.

significance in relation to the Commission's work on International Watercourses and examining some of the questions that work raises.

I. OVERVIEW

The General Assembly first recommended that the International Law Commission study the law of the non-navigational uses of international watercourses in 1970.[6] The Commission held general discussions of the topic in 1976 and adopted the first six articles of the draft in 1980. While these articles were later withdrawn at the instance of a new special rapporteur,[7] the Commission in 1987 adopted a fresh set of introductory provisions, as well as the first two articles of Part II, entitled "General Principles."[8] The Commission made further significant progress at its 1988 session, adopting the remaining general provisions as well as Part III of the draft, which concerns procedural obligations in the case of planned measures.[9] At the same session, the Commission discussed a set of articles

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1989).

6. G.A.O.R. Res. 2669 (XXV) (Dec. 8, 1970). For a historical overview of the ILC's work on international watercourses, see UNITED NATIONS, THE WORK OF THE INTERNATIONAL LAW COMMISSION 100-105 (4th ed. 1988).

7. Stephen M. Schwebel resigned from the Commission in 1981 upon his election to the International Court of Justice (ICJ). He was succeeded by Jens Evensen, who was appointed in 1982. In 1985 the Commission appointed the present author special rapporteur after Evensen had himself been elected to the ICJ. Schwebel was in fact the second rapporteur for the topic, having succeeded the original rapporteur, Richard Kearney, in 1977. Since the Commission accords special rapporteurs wide latitude in deciding how work on a topic should proceed, and because it discusses topics only on the basis of reports submitted by the rapporteurs, changes in rapporteurships can result in significant delays in the ILC's work.

8. *See Report of the International Law Commission on the Work of its Thirty-Ninth Session*, 42 U.N. GAOR Supp. (No. 10), U.N. Doc. A/42/10 at 53-88 (1987) [hereinafter 1987 ILC Report], which also contains the Commission's commentaries to these articles. The titles of the articles forming Part I, Introduction, are as follows: Article 1, "[Use of terms]" (action on this article was deferred until a later stage of the Commission's work; *infra* note 10); Article 2, "Scope of the present articles;" Article 3, "Watercourse States;" Article 4, "[Watercourse] [System] agreements;" and Article 5, "Parties to [watercourse] [system] agreements." The articles of Part II, General Principles, adopted in 1977 are Article 6, "Equitable and reasonable utilization and participation," and Article 7, "Factors relevant to equitable and reasonable utilization."

9. The remaining articles of Part II, General Principles, adopted in 1988 are: Article 8, "Obligation not to cause appreciable harm;" Article 9, "General obligation to co-operate;" and Article 10, "Regular exchange of data and information." Part III, Planned Measures, also adopted in 1988, contains the following provisions: Article 11, "Information concerning planned measures;" Article 12, "Notification concerning planned measures with possible adverse effects;" Article 13, "Period for reply to notification;" Article 14, "Obligations of the notifying State during the period for reply;" Article 15, "Reply to notification;" Article 16, "Absence of reply to notification;" Article 17, "Consultations and negotiations concerning planned measures;" Article 18, "Procedures in the absence of notification;" Article 19, "Urgent implementation of planned measures;" Article 20, "Data and information vital to national defence or security;" and Article 21, "Indirect procedures." These articles, together with the Commission's commentaries thereto, are contained in the *Report of the International Law Commission on the Work of its Fortieth Session*, 43 U.N. GAOR Supp. (No. 10), U.N. Doc. A/43/10 at 83-139 (1988) [hereinafter 1988 ILC Report].

proposed by the special rapporteur on environmental protection and pollution. Some of the more controversial issues raised by these articles will be examined after a brief discussion of the general obligations that form their basis.

II. EQUITABLE UTILIZATION AND THE OBLIGATION NOT TO CAUSE APPRECIABLE TRANSFRONTIER HARM

The twin cornerstones of the entire watercourses draft are Articles 6 and 8. They provide as follows:

Article 6: Equitable and reasonable utilization and participation —

1. Watercourse States shall in their respective territories utilize an international watercourse [system][10] in an equitable and reasonable manner. In particular, an international watercourse [system] shall be used and developed by watercourse States with a view to attaining optimum utilization thereof and benefits therefrom consistent with adequate protection of the international watercourse [system].

2. Watercourse States shall participate in the use, development and protection of an international watercourse [system] in an equitable and reasonable manner. Such participation includes both the right to utilize the international watercourse [system] as provided in paragraph 1 of this article and the duty to co-operate in the protection and development thereof, as provided in article [9].[11]

Article 8: Obligation not to cause appreciable harm —

Watercourse States shall utilize an international watercourse [system] in such a way as not to cause appreciable harm to other watercourse States.[12]

The obligations embodied in Articles 6 and 8 are firmly rooted in the practice of states.[13] Article 6 obligates states to use international water-

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10. The term "system" appears in brackets as a result of a Commission decision to postpone until a later date the precise definition of the scope of the draft. The basic question is whether the draft should apply to the concept of an "international watercourse *system*," which would include not only tributaries but also such watercourse components as groundwater and glaciers, or to the potentially much narrower concept of an "international watercourse" which, in the view of some ILC members, would include only the main stem of a river. *See* 1987 ILC Report, *supra* note 8, at 54.

11. 1987 ILC Report, *supra* note 8, at 69-70. The Commission's commentary to article 6 is contained in *id.* at 70-82.

12. 1988 ILC Report, *supra* note 9, at 83. The Commission's commentary to article 8 is contained in *id.* at 83-101.

13. *See* the Commission's commentaries to article 6, 1987 ILC Report, *supra* note 8, at 70-82; and article 8, 1988 ILC Report, *supra* note 9, at 83-101. *See also* the authorities surveyed in S. McCaffrey, *Second Report on the Law of the Non-navigational Uses of International Watercourses*, U.N. Doc. A/CN.4/399 44-81, and *id.* at Add.1, 1-52 (1986) [hereinafter McCaffrey, Second Report]; and S. Schwebel, *Third Report on the Law of the Non-navigational Uses of International Watercourses*, [1982] 2 Y.B. INT'L L. COMM'N 65, 75-87 (1982) [hereinafter Schwebel, Third Report].

courses in a manner that is "equitable" viv-a-vis other states using the same watercourse. "The scope of a State's rights of equitable utilization depends upon the facts and circumstances of each individual case, and specifically upon a weighing of all relevant factors, as provided in article 7."[14] Article 8 "is a specific application of the principle of the harmless use of territory, expressed in the maxim *sic utere tuo ut alienum non laedas*, which is itself a reflection of the sovereign equality of States."[15]

In the view of many specialists, the most fundamental principle of international water law is that of equitable utilization. Thus, for example, a downstream state that was first to develop its water resources could not foreclose later development by an upstream state by demonstrating that the later development would cause it harm; under the doctrine of equitable utilization, the fact that the downstream state was "first to develop" (and thus had made prior uses that would be adversely affected by new upstream uses) would be merely one of a number of factors to be taken into consideration in arriving at an equitable allocation of the uses and benefits of the watercourse.[16] These observers believe that if the "no harm" principle took precedence over that of equitable utilization the effect would be to freeze the development of many riparian states to international watercourses ("watercourse states").

The approach of the International Law Commission to this problem is illustrated in the following excerpt from the commentary to Article 8:

> *[P]rima facie*, at least[,] utilization of an international watercourse [system] is not equitable if it causes other watercourse States appreciable harm. . . . The Commission recognizes, however, that in some instances the achievement of equitable and reasonable utilization will depend upon the toleration by one or more watercourse States of a measure of harm. In these cases, the necessary accommodations would be arrived at through specific agreements.[17]

This solution will probably not be completely satisfying to adherents of

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14. 1987 ILC Report, *supra* note 8, at 73.

15. 1988 ILC Report, *supra* note 9, at 83. Compare Principle 21 of the Stockholm Declaration on the Human Environment, adopted by the United Nations Conference on the Human Environment on June 16, 1972 which provides as follows:

> States have, in accordance with the charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.

Report of the United Nations Conference on the Human Environment, at 325 U.N. Sales No. E.73.II.A.14.

16. *See* text *supra* note 14. *See* the indicative list of factors contained in Article 7, *adopted by* the ILC in 1987. 1987 ILC Report, *supra* note 8, at 82. *See also* Article V of the Helsinki Rules on the Uses of Waters of International Rivers, adopted by the International Law Association (ILA) it its fifty-second Conference held in Helsinki in 1966, ILA, *Report of the fifty-second Conference, Helsinki, 1966*, 484 (1967) [hereinafter Helsinki Rules].

17. 1988 ILC Report, *supra* note 9, at 84.

the school of thought referred to above. Several points must be recognized in its defense, however. First, the ILC's approach affords a measure of protection to the weaker state that has suffered harm. It is not open to the stronger state to justify a use giving rise to the harm on the ground that it is "equitable." A second, and related, point is that it is far simpler to determine whether the "no harm" rule has been breached than is the case with the obligation of equitable utilization. Thus, primacy of the "no harm" principle means that the fundamental rights and obligations of states with regard to their uses of an international watercourse are more definite and certain than they would be if governed in the first instance by the more flexible (and consequently less clear) rule of equitable utilization. And finally, the "no harm" rule is preferable in cases involving pollution and other threats to the environment. While a state could conceivably seek to justify an activity resulting in such harm as being an "equitable use," the "no harm" principle would — at least *prima facie*[18] — require abatement of the injurious activity.

Irrespective of whether primacy is accorded to the "no harm" principle, however, the question remains whether it is enough for an injured state to show that it has been harmed by another state's use of a shared watercourse. That is, is the standard of responsibility for breach of Article 8 a strict one, or is responsibility based on the "fault" of the source state? The Commission side-stepped this important issue. It decided to determine the extent to which a state could be held strictly liable (i.e., liable for the injurious consequences of an act not prohibited by international law) in the context of its work on the International Liability topic. Within the context of the ILC's overall program of work,[19] this decision can be defended as a means of avoiding duplication of effort. But those who look to the Commission's work-product for guidance in dealing with problems relating to international watercourses would doubtless have welcomed some treatment of the standard of responsibility in the context of the watercourses draft itself. The Commission's discussion of this issue will be reviewed in part IV, below.

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18. The extent to which other states would tolerate harm so long as the source state was taking reasonable measures to abate it is discussed in S. McCaffrey, *Fourth Report on the Law of the Non-Navigational Uses of International Watercourses*, U.N. Doc. A/CN.4/412/Add.2, 12-13 (1988) [hereinafter McCaffrey, *Fourth Report*]; and J. LAMMERS, POLLUTION OF INTERNATIONAL WATERCOURSES, 349 (1984) [hereinafter LAMMERS]. *See infra* note 67.

19. There are seven substantive items on the Commission's active agenda. They are: state responsibility, Jurisdictional immunities of states and their property, status of the diplomatic courier and the diplomatic bag not accompanied by diplomatic courier, the Draft Code of Crimes against the Peace and Security of Mankind, the law of the non-navigational uses of international watercourses, international liability for injurious consequences arising out of acts not prohibited by international law, and relations between states and international organizations (second part of the topic). 1988 ILC Report, *supra* note 9, at 3-4.

III. THE OBLIGATIONS OF NOTIFICATION, CONSULTATION AND NEGOTIATION CONCERNING PLANNED MEASURES

A survey of the ILC's work on International Watercourses relating to the environment would not be complete without at least a brief mention of the articles adopted at the Commission's 1988 session on procedural obligations in the case of planned measures relating to an international watercourse.[20] Such provisions are indispensable to any scheme of prevention. Their aim is to provide an "early warning" of potentially adverse changes in the regime of an interantional watercourse so that the states concerned will have an opportunity to effect any necessary adjustments in advance, before human and financial resources are irrevocably committed and positions become entrenched.

The provisions on prior notification and consultation concerning planned measures are contained in Part III of the watercourses draft.[21] That chapter begins with Article 11, a general article requiring states riparian to an international watercourse to "exchange information and consult each other on the possible effects of planned measures on the condition of the watercourse. . . ."[22] Unlike the other articles in Part III, Article 11 requires the exchange of information concerning all potential effects of planned measures, whether they be positive or negative. This will facilitate planning by affected watercourse states and may help to avoid problems associated with unilateral interpretations of whether a new project will have negative or beneficial impacts.

Articles 12 and following establish a system of prior notification concerning planned measures that may adversely affect other watercourse states and procedures for resolving any disputes that may arise concerning those measures. The Commission's commentary explains that the expression "planned measures" includes "new projects or programmes of a major or minor nature, as well as changes in existing uses of an international watercourse. . . ."[23] The obligation to notify is triggered by the criterion that the contemplated measures may have "an appreciable adverse effect" upon other watercourse states.[24] It is therefore incumbent upon

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20. The titles of these articles are set forth in *supra* note 9. The articles themselves, together with the Commission's commentary thereto, are contained in 1988 ILC Report, *supra* note 9, at 114-139.

21. *Id.*

22. Article 11, *Information concerning planned measures*, 1988 ILC Report, *supra* note 9, at 114.

23. 1988 ILC Report, *supra* note 9, at 115 (para. (4) of commentary to Article 11).

24. Article 12. 1988 ILC Report, *supra* note 9, at 115. The meaning of the expression "appreciable adverse effect" is discussed in para. (2) of the commentary to article 12. *Id.* at 115-116. As there explained, "[t]he threshold established by this standard is intended to be lower than that of 'appreciable harm' under article 8." *Id.* The purpose of using a different standard is to encourage notification in order to allow bilateral determinations of whether a project (or change in an existing use) will have harmful consequences in other watercourse states, without forcing the notifying state to admit that it is planning measures that may give rise to a violation of article 8.

the state planning the measures to undertake its own assessment of the impact of the project upon other states using the watercourse. This evaluation would include possible effects upon the environment of other states; it would thus function as a "transfrontier" environmental impact assessment.

The system established by Part III functions in the following manner: After a state has received a notification of the kind described above it has six months (unless another period is agreed upon) within which to evaluate the potential effect of the project upon it and to communicate its findings to the notifying state (Articles 12 and 13). The notifying state may not proceed with the implementation of its plans during this period without the consent of the notified state (Article 14). If the latter state determines that implementation of the plans would put the notifying state in violation of Articles 6 (equitable utilization) or 8 (no appreciable harm), and so informs the notifying state within the 6-month period, Article 17 requires that the states enter into consultations and negotiations with a view to arriving at an equitable resolution of the matter. Implementation of the project must be suspended for an additional 6 months if the notified state so requests, in order to permit meaningful discussions (Article 17). If, on the other hand, the notifying state does not receive a "negative" reply within the initial 6-month period, it may go forward with the implementation of its plans (Article 16).

Of course, it may happen that the state in whose territory the measures would be implemented (for convenience, the "planning state") provides no notification at all. This would presumably be due to a finding by that state that the planned measures would have no appreciable adverse effect upon other watercourse states. If another state nonetheless learns of the plans and wishes information concerning them, it may set in motion the procedures outlined above by requesting the planning state to apply the provisions of Article 12 (Article 18, para. 1) — i.e., to determine whether the plans could have an appreciable adverse effect upon other watercourse states. If the planning state answers this question in the negative, but that determination is not accepted by the other state, the states are required to enter into consultations and negotiations (Article 18, para. 2). Once again, implementation of the plans is to be suspended for 6 months, at the request of the potentially affected state, to allow meaningful talks (Article 18, para. 3). It goes without saying that even if no information is provided to other states before the plans are actually implemented, the state permitting the implementation remains bound to comply with its obligations under Articles 6 and 8.

These articles represent acceptance by the Commission of the principles of prior notification, consultation and negotiation in relation to new watercourse uses or modifications of existing ones. While the procedures they establish are quite general, they provide a framework within which states sharing international watercourses can develop specific regimes tailored to their particular needs and to the characteristics of the watercourse and the uses being made of it. The articles cover all potentially

adverse effects of planned measures, including environmental impacts. The particular obligations of watercourse states in relation to pollution and environmental protection were the subject of articles proposed by the special rapporteur in 1988. These articles, and some of the issues they raise, are the subject of the following section.

IV. ENVIRONMENTAL PROTECTION AND POLLUTION

A. *The Articles Proposed by the Special Rapporteur*

In 1988, the special rapporteur for international watercourses proposed a set of three draft articles (initially submitted as Articles 16-18[25] on the subtopic of "Environmental protection, pollution and related matters." At the rapporteur's suggestion the Commission focused its discussion upon draft Articles 16 and 17; action on draft Article 18 was postponed until the ILC's next session. The latter article, entitled "Pollution or environmental emergencies," will not be discussed further in this paper.[26] The Commission ultimately decided to refer draft Articles 16 and 17 to the Drafting Committee. That body attempts to produce formulations of draft articles, on the basis of proposals submitted by the rapporteurs, that take into account points of view expressed in the Commission's debates. The Committee was unable to take up the two articles at the 1988 session for lack of time. It will presumably examine them during the course of the ILC's 1989 session.

Draft Articles 16 and 17, which would be contained in a separate chapter, provide as follows:

Article 16 - Pollution of international watercourse[s] [systems] —

1. As used in these draft articles, 'pollution' means any physical, chemical or biological alteration in the composition or quality of the waters of an international watercourse [system] which results directly or indirectly from human conduct and which produces effects detrimental to human health or safety, to the use of the waters for any beneficial purpose or to the conservation or protection of the environment.

2. Watercourse States shall not cause or permit the pollution of an international watercourse [system] in such a manner or to such an extent as to cause appreciable harm to other watercourse States or to the ecology

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25. These articles will eventually be renumbered to conform to the numerical sequence of the articles already adopted.

26. The special rapporteur suggested deferring detailed discussion of the article so he would have an opportunity to incorporate it into a more general article on water-related hazards and dangers. 1988 ILC Report, *supra* note 9, at 54. After defining the term "pollution or environmental emergency," the draft article requires the state in whose territory such an incident has occurred to notify immediately all potentially affected watercourse states and to provide them with all available data and information relevant to the emergency. It further obligates that state to take immediate steps to prevent, neutralize or mitigate the danger or damage to other watercourse states resulting from the incident. McCaffrey, *Fourth Report*, *supra* note 18, at 23.

of the international watercourse [system].

3. At the request of any watercourse State, the watercourse States concerned shall consult with a view to preparing and approving lists of substances or species, the introduction of which into the waters of the international watercourse [system] is to be prohibited, limited, investigated or monitored, as appropriate.[27]

Article 17 - Protection of the environment of international watercourse[s] [systems] —

1. Watercourse States shall, individually and in co-operation, take all reasonable measures to protect the environment of an international watercourse [system], including the ecology of the watercourse and of surrounding areas, from impairment, degradation or destruction, or serious danger thereof, due to activities within their territories.

2. Watercourse States shall, individually or jointly and on an equitable basis, take all measures necessary, including preventive, corrective and control measures, to protect the marine environment, including estuarine areas and marine life, from any impairment, degradation or destruction, or serious danger thereof, occasioned through an international watercourse [system].[28]

The three paragraphs forming Article 16 contain a definition of pollution, a core obligation not to cause appreciable pollution harm to other watercourse states, and a requirement that watercourse states consult, on request, with a view to agreeing upon lists of substances or species which, due to their especially dangerous qualities, should be subjected to special regulation. A summary of the Commission's discussion of this article is contained in its report to the General Assembly.[29] Only its most controversial aspects will be considered here. Draft Article 17 begins by requiring watercourse states to protect the environment of the watercourse. This affirmative obligation of protection goes further than the "no appreciable harm" rule of draft Article 16, since it requires the taking of positive steps; such steps may be necessary even if no pollution harm would be caused to other states. The obligation is mitigated, however, by the qualification that a state need only take "all *reasonable* measures" to protect the watercourse environment. While such qualifications weaken the rule to which they pertain and are thus generally undesirable, in this case the term "reasonable" is intended to reflect the nascent character of the obligation itself.[30] Equivalent language is employed, perhaps for the same reason, in the environmental provisions of the Law of the Sea Conven-

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27. McCaffrey, *Fourth Report*, *supra* note 18, at 2; 1988 ILC Report, *supra* note 9, at 57; *supra* note 49.

28. McCaffrey, *Fourth Report*, *supra* note 18, at 20; 1988 ILC Report, *supra* note 9, at 69; *supra* note 61.

29. 1988 ILC Report, *supra* note 9, at 57-69.

30. *See* the authorities surveyed in McCaffrey, *Fourth Report*, *supra* note 18, at 8-57 (A/CN.4/412/Add.2).

tion.[31] Paragraph 2 of draft Article 17 addresses the increasingly serious problem of harm to the marine environment resulting from watercourse pollution. Like paragraph 1, it lays down an affirmative obligation of protection. In the case of paragraph 2, the duty is based on the Law of the Sea Convention[32] and other, regional agreements that proscribe pollution damage to the marine environment from land-based sources.[33] In some respects this provision seems to go further than paragraph 1, in that it requires that "all measures *necessary*" (rather than "all reasonable measures") be taken, and specifies that these are to include "preventive, corrective and control measures." In employing the expression "on an equitable basis," however, paragraph 2 may seem to be softening the obligations of watercourse states in the case of actual or threatened harm to the marine environment. But the expression is used here for a different purpose, namely, to indicate that while a watercourse state is not internationally responsible for harm to the marine environment caused by pollution originating in another state, all states riparian to the watercourse share an obligation to cooperate with each other in developing and establishing arrangements designed to avoid such harm. The intent of the provision is that the costs and other burdens of such arrangements be shared equitably among the riparian states.

It may be said immediately that paragraph 2 of article 16 provoked a more lively debate within the Commission than any other paragraph of either article. This may be because it contains the "hardest" obligation of any of the five paragraphs. It may also be due in part to questions raised as to the standard of responsibility the paragraph entails. But it is at least somewhat ironic that an obligation which is found in numerous treaties, dating from the middle of the last century,[34] proved more controver-

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31. 1982 U.N. Convention on the Law of the Sea on the Protection of Marine Environment, Art. 194, ¶1 (1982) (states shall use "the best practicable means at their disposal and in accordance with their capabilities") [hereinafter 1982 U.N. Convention on the Law of the Sea]. *Id.* at 70.

32. *Id.* Art. 194(1) & (3)(a) & Art. 207.

33. *See, e.g.*, Convention for Cooperation in the Protection and Development of the Marine and Coastal Environment of the West and Central African Region, March 23, 1981, Natural Resources/Water Series No. 13, *supra* note 13, p. 2; 1974 Convention on the Prevention of Pollution from Land-Based Sources, 13 I.L.M. 352 (1974); 1974 Convention on the Protection of the Marine Environment of the Baltic Sea Area, 13 I.L.M. 546 (1974); 1976 Convention on the Protection of the Mediterranean Sea Against Pollution, 15 I.L.M. 290 (1976); 1978 Kuwait Regional Convention for Cooperation in the Protection of the Marine Environment from Pollution, 17 I.L.M. 511 (1978).

34. One study identifies 88 different international agreements "containing substantive provisions concerning pollution of international watercourses." LAMMERS, *supra* note 18, at 124. Early agreements containing provisions on water pollution include the 1868 Final Act of the Delimitation of the International Frontier of the Pyrenees between France and Spain, sec. I, clause 6, *reprinted in Legislative Texts and Treaty Provisions concerning the Utilization of International Rivers for other Purposes than Navigation*, 674, 676, U.N. Sales No. 63.V.4 (1963)(Treaty No. 186)[hereinafter *Legislative Texts*]; *see also* the following conventions in *Legislative Texts*: 1887 convention between Switzerland and the Grand Duchy of Baden and Alsace-Lorraine, art. 10, at 397 (Treaty No. 113); the 1904 Convention between

sial than one which has been recognized only recently.[35]

B. *Salient Issues*

The Commission's discussion of Article 16 revealed differences of views on several important issues,[36] three of which will be the focus of this section: (1) The question whether the draft should contain a strict obligation concerning transfrontier water pollution harm; (2) the criterion of "appreciable (pollution) harm;" and (3) the standard of responsibility for breach of the article. These points, all of which relate to paragraph 2 of Article 16, will be taken up in turn.

1. The Strictness of the Obligation

Most members of the Commission who addressed the issue agreed that the draft should contain a strict obligation not to cause transfrontier water pollution harm, along the lines of Article 16, paragraph 2. Some of these members believed the principle to be so important that it deserved to be placed in a separate article; in the view of others, the obligation was sufficiently central to warrant its inclusion in Part II of the draft among the other general principles.[37] Not all members believed that such emphasis should be given to prohibiting pollution, however. Thus it was suggested that the obligation not to cause transfrontier water pollution harm was actually only an aspect of the more fundamental duty to cooperate in the equitable utilization of international watercourses. According to this view, international cooperation was the best means of controlling pollution. It was therefore proposed that paragraph 2 of Article 16 could provide as follows: "Watercourse States shall co-operate to prevent, reduce

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France and Switzerland for the Regulation of Fishing in their Frontier Waters, art. 17, at 701, 706 (Treaty No. 196); the 1906 Agreement between Switzerland and Italy Establishing Provisions in Respect of Fishing in Frontier Waters, art. 12, at 839, para. 5, (Treaty No. 230); and the 1909 Boundary Waters Treaty between Canada and the United States, art. IV, at para. 2, 260, 36 Stat. 2448, T.S. 548, 12 Bevans 319, (Treaty No. 79).

35. A number of relatively recent international agreements contain provisions on the protection of the environment of international watercourses. *See, e.g.* the 1975 Statute of the Uruguay River, especially arts. 36, 37 and 41 *reprinted in* URUGUAY, MINISTERIO DE RELACIONES EXTERIORES, ACTOS INTERNACIONALES URUGUAY-ARGENTINA, 1830-1980, 600-602 (Montevideo, ed. 1981); the Accord de 1977 portant creation de l'organisation pour l'amenagement et le developpement du bassin de la Riviere Kagera (Burundi, Rwanda, Tanzania and Uganda), art. 2, para. 1, Natural Resources/Water Series, No. 13, U.N. Doc. ST/TCD/4, 32 (1987); and the 1978 convention relating to the Status of the River Gambia (Gambia, Guinea and Senegal), art. 4, Natural Resources/Water Series No. 13, at 39. For a more general view, see the provisions of the 1982 United Nations Convention on the Law of the Sea, *supra* note 31 at 70-73 (arts. 192, 194 and 207). U.N. Sales No. 83.V.5, 70-73 (1983)(Article 207 specifically addresses pollution from land-based sources, "including rivers, estuaries, pipelines and outfall structures").

36. For a summary of the Commission's discussion of Article 16, see 1988 ILC Report, *supra* note 9, at pp. 57-69.

37. *Id.* at 61.

and control pollution of international watercourse[s] [systems]."[38]

There is nothing objectionable about such a formulation, as far as it goes. Indeed, cooperation among all states sharing an international watercourse system is essential not only to the maintenance of acceptable water quality but also to the smooth functioning of procedural rules and the very development of the resource.[39] The problem is that the proposed language, by itself, does not go far enough. It is a general principle that must be implemented through specific obligations. It could therefore complement, but should not replace, a concrete prohibition of transfrontier pollution harm. "Soft law"[40] may be useful for certain purposes, such as paving the way for the development of new norms.[41] But a "soft" obligation such as the one proposed, standing alone, lacks the "determinacy,"[42] or "ability . . . to convey a clear message,"[43] necessary for states to take it seriously, if indeed they are able to ascertain from its text exactly what it requires them to do or refrain from doing. It is a classic example of a norm "whose substance is so vague, so uncompelling, that *A*'s obligation and *B*'s right all but elude the mind."[44] Thus its value as a deterrant of state caused or permitted transfrontier pollution harm would be slight. And since it would be difficult to determine whether such a general obligation had been violated, the proposed provision would provide only a very slender reed of support for a state claiming to have suffered harm as a result of another state's breach of an obligation to prevent pollution of an international watercourse. Finally, substituting an obligation to cooperate in controlling harmful pollution of international watercourses for a prohibition of such pollution seems out of line with treaty practice. This is important for the following reasons: Even though the Commission's draft on watercourses is foreseen as a "framework agreement,"[45] one of its chief purposes is to clarify the fundamental obli-

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38. *Id.*

39. *See* the discussion of the importance of cooperation in the use and development of international watercourse systems in S. McCaffrey, *Third report on the law of the non-navigational uses of international watercourses* 7-34, U.N. Doc. A/CN.4/406 and Corr.1 (1987) [hereinafter McCaffrey, *Third Report*].

40. *See generally* Weil, *Towards Relative Normativity in International Law?*, 77 A.J.I.L. 413, 414 (1983) ("alongside 'hard law,' made up of the norms creating precise legal rights and obligations, the normative system of international law comprises . . . more and more norms whose substance is so vague, so uncompelling, that *A*'s obligation and *B*'s right all but elude the mind. One does not have to look far for examples of this 'fragile,' 'weak,' or 'soft law,' as it is dubbed at times: . . . a recent Advisory Opinion of the International Court of Justice includ[ed] obligations 'to co-operate in good faith' and 'to consult together' among the 'legal principles and rules' governing the relations between an international organization and a host country.").

41. *See* 1988 Annual Meeting of the American Society of International Law (April 20-23, 1988) *to be published in Proceedings* of the Society (1988) (remarks of Professor Dupuy during panel discussion).

42. *See* Franck, *Legitimacy in the International System*, 82 A.J.I.L. 705, 713 (1988).

43. *Id.* at 713.

44. Weil, *supra* note 40, at 414.

45. *See, e.g.*, [1986] 2(2) Y.B. INT'L L. COMM'N 63, ¶ 242; [1980] 2(1) Y.B. INT'L L.

gations of states with regard to the non-navigational uses of international watercourses.[46] These obligations may be distilled, in part, from similar provisions in a wide range of international agreements.[47] Many such agreements, some of which are quite venerable,[48] contain prohibitions of harmful transfrontier water pollution.[49] It seems unwise to ignore the lessons of this treaty practice, especially in this era of increasing pollution and environmental problems. Moreover, retreating from a specific obligation that states have demonstrated a willingness to accept, to a more general and vague obligation whose contours are blurred at best, would do little to promote clarification of the rights and obligations of watercourse states — one of the chief purposes of the draft. For these reasons, it is submitted that the first question identified above should be answered in the affirmative, i.e., the draft should contain a strict obligation concerning transfrontier water pollution harm, such as that contained in paragraph 2 of draft article 16.

2. The "Appreciable Harm" Criterion

The second issue concerns the criterion of "appreciable (pollution) harm." The standard of "appreciable harm" was first considered in relation to article 8, set out above.[50] The Commission accepted the special rapporteur's proposals that (a) the purely factual standard of "harm" was preferable to the legal concept of "injury" because of its greater clarity; and (b) some qualifier was necessary so that the article would not be interpreted to proscribe all harm, no matter how minor.[51] These factors are

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COMM'N 161, ¶ 11 (The idea of a "framework agreement" is that "the Commission should produce a set of articles which would provide a legal framework for the negotiation of treaties to govern the use of water of individual watercourses by the watercourse States.").

46. [1986] 2(1) Y.B. INT'L L. COMM'N 94-95 ¶ 32, ("[S]ince political relationships and disposition to co-opeate among riparian States varied greatly, the general rules included in a framework agreement should be precise and detailed enough to safeguard the rights of interested parties in the absence of specific agreements." Summarizing comments made in the Sixth [Legal] Committee of the General Assembly).

47. L. HENKIN, R. PUGH, O. SCHACHTER & H. SMIT, INTERNATIONAL LAW 87 (2d ed. 1987) (This is especially true when, as in the case of the non-navigational uses of international watercourses, the agreements "deal with matters generally regulated by international law," as opposed to "treaties which deal with matters which are clearly recognized as within the discretion of the states . . . ."). *See also* 1 HACKWORTH, DIGEST OF INTERNATIONAL LAW 17 (1940); and 1 HYDE, INTERNATIONAL LAW 10-11 (2d ed. 1945).

48. *See, e.g.*, agreements cited in *supra* note 35.

49. *See* the agreements surveyed in McCaffrey, *Fourth Report*, *supra* note 18, at 8-18.

50. *See* text *supra* note 12. The adjective "appreciable" is also employed in articles 4 and 5 of the watercourses draft.

51. 1988 ILC Report, *supra* note 9, at 85. McCaffrey, *Second Report*, *supra* note 13, U.N. Doc. A/CN.4/399/Add.2 at 1-3. Another approach to the problem of formulating a general criterion is found in the newly adopted Antarctic Minerals Convention, which employs the standard of "significant adverse effect." ("significant adverse effects on air and water quality"). Convention on the Regulation of Antarctic Mineral Resource Activities, 27 I.L.M. 868, 871 (1988)(Art. 4, para. 2 (a)). The Convention also incorporates the expression "damage to the Antarctic environment or dependent or associated ecosystems." *See, e.g., id.* at

recognized in a number of agreements, which employ the expression "appreciable harm" or its linguistic counterpart.[52]

Some members of the Commission nevertheless expressed doubts as to the "appreciable harm" criterion, either because it was too subjective or on the ground that it was a potential obstacle to industrial development. The adjective "substantial" was proposed as being preferable to "appreciable." In the end the Commission seemed to agree with the special rapporteur that an expression should be employed that provided as factual and objective a standard as could be formulated in the context of a framework agreement. Since the criterion of "appreciable harm" has already been employed in Article 8, it seems likely that the same standard will be used to measure the permissible limits of transfrontier water pollution.

3. Standard of Responsibility

The final issue to be discussed here is that of the standard of responsibility for breach of the obligation not to cause appreciable pollution harm to another watercourse state. The Commission also confronted this issue with regard to the more general obligation of Article 8. In that case it was ultimately decided not to address the point in the commentary,[53] presumably on the ground that the problem should be dealt with in the context of the Commission's work on other topics on its agenda more directly concerned with issues of responsibility, viz., State Responsibility and International Liability.[54] It is likely that the Commission will follow the same approach with regard to draft Article 16.[55] But because the ILC's work on these two topics may never provide a clear answer to the question of the standard of responsibility in the specific case of transfrontier water pollution, brief consideration of the issue here seems appropriate.

During the Commission's consideration of draft Article 16, a number of members addressed the issue of standard of responsibility. As one might expect, opinion in the Commission was divided between those that favored a strict standard and those that would apply a more flexible

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art. 1 (15), at 869-70.

52. *See* the agreements cited in 1988 ILC Report, *supra* note 9, at 86-87.

53. The Commission deleted a paragraph of the draft commentary to Article 8 which developed the proposition that a breach of that article would engage the international responsibility of the watercourse state in question, thus in effect deciding not to address the issue. *Provisional Summary Record of the 2092nd Meeting of the International Law Commission, 28 July 1988*, U.N. Doc. A/CN.4/SR.2092 at 11 (Oct. 3, 1988).

54. In its discussion of the issue of standard of responsibility in the context of draft Article 16, para. 2 (prohibition of appreciable pollution harm), the Commission seemed to agree that the matter was best left to be resolved in the context of its work on the two other topics. 1988 ILC Report, *supra* note 9, at 69, para. 168. It is reasonable to infer that this was also the motivation for not dealing with the issue in the commentary to Article 8, since the latter was considered after the Commission's discussion of draft Article 16.

55. *See id.*, and accompanying text.

test.[56] In his report, the special rapporteur had stated that "the obligation set forth in paragraph 2 [of Article 16] is proposed as one of due diligence to see that appreciable harm is not caused to other watercourse States or to the ecology of the international watercourse [system]."[57] A number of members agreed with this approach, noting that since the concept of due diligence was well rooted both in domestic tort law and in the law of state responsibility it would be easy for states to apply. Moreover, these members believed that it was the appropriate standard in the specific case of responsibility for transfrontier water pollution harm.

Other members, however, opposed the use of a due diligence test. For some, it was simply too vague and subjective to serve as a standard of responsibility. Others maintained that such a criterion could place,

> [t]oo heavy a burden on the victim State since only the source State would have access to the means of proving whether or not it had exercised due diligence to prevent appreciable harm from being caused to another watercourse State. It was suggested in this connection that the burden of proving due diligence should be placed on the source State.[58]

Some members went so far as to label the due diligence standard "dangerous" on the ground that "it made responsibility rest on wrongfulness rather than on risk and that States would be tempted to evade responsibility simply by trying to prove that they had complied with their obligation of due diligence."[59] According to this view, responsibility for breach of paragraph 2 should be strict. These members went on to urge that, in any event, the question of responsibility should be tackled within the framework of the International Liability topic rather than that of International Watercourses.

This tendency to treat the standard-of-responsibility question as such a hot potato is unfortunate, even if it is understandable. It is unfortunate because it leaves an important question in this field unanswered, robbing the "no harm" rule of much of its "determinacy" and thus undermining its "legitimacy."[60] For in an actual case, whether the injured state will be legally entitled to relief will often come down to how the responsibility of the source state must be established. If the standard is a strict one, responsibility is established by showing appreciable harm that resulted from, e.g., pollution emanating from the source state. If a lower standard is applied, there may be no final determination of responsibility as a practical matter, in the absence of agreed dispute settlement machinery, especially if the burden of proof rests entirely upon the victim state.

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56. *See* 1988 ILC Report, *supra* note 9, at 64-66.

57. McCaffrey, *Fourth Report*, *supra* note 18.

58. 1988 ILC Report, *supra* note 9, at 66.

59. *Id.*

60. As explained by Professor Franck, the "legitimacy" of a rule of international law is largely dependent upon its "determinacy," or the clarity of the obligation it creates. Franck, *supra* note 42, at 713. *See* text at *supra* note 39.

Instead, the question will be left to be resolved, as so many are, through negotiations between the governments concerned. And since it will be very difficult for the victim state to prove, e.g., that the source state failed to comply with its obligation of due diligence, the outcome for it will probably be less than satisfactory. This situation would be ameliorated, but not eliminated, if the burden of proving due diligence shifted to the source state upon a prima facie showing by the victim state of harm caused by water pollution emanating from the former state.[61]

Side-stepping the standard-of-responsibility question is, however, understandable in the context of the ILC's program of work as a whole. The very fact that it is a pivotal issue means that much time and energy would have to be expended before it was resolved; even then, the likelihood is that the "resolution," like most compromises, would not be definitive. The question is, then, whether the resources that would have to be dedicated to the effort would be worth an end result that would likely be inconclusive. Two considerations suggest a negative answer to this question: first, taking on this issue could prevent the Commission from attaining its objective of completing the provisional adoption of the entire watercourses draft by 1991;[62] and second, examining this issue in the context of watercourses, at the same time it is being studied in the context of two other topics, would entail an undesirable duplication of effort. All things considered, therefore, it may be advisable for this issue to be left to river basin states to be resolved in specific agreements. As a practical matter, however, the states concerned may be unable to reach agreement on the question or simply may not address it. The remainder of this section therefore considers the standard that would apply under rules of general international law.

In the absence of any agreement on the standard of responsibility, the question would be governed by general rules of state responsibility or possibly, where "ultrahazardous activities" are involved, the regime being developed by the Commission in its work on International Liability.[63] In the ordinary case of transfrontier water pollution, a breach of paragraph 2 of draft Article 16 (or, more generally, Article 8) would engage the international responsibility of the source state. In requiring watercourse states not to cause appreciable pollution harm to other watercourse states, paragraph 2 lays down an "obligation of result" in the sense of Article 21[64]

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61. This technique was suggested by some members of the Commission. *See* text at *supra* note 54.

62. 1988 ILC Report, *supra* note 9, at 281.

63. *See generally* Magraw, *supra* note 5.

64. Article 21 provides as follows:

> Article 21. Breach of an international obligation requiring the achievement of a specified result:
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> 1. There is a breach by a State of an international obligation requiring it to achieve, by means of its own choice, a specified result if, by the conduct adopted, the State does not achieve the result required of it by that obligation.
>
> 2. When the conduct of the State has created a situation not in conformity

and, in particular, Article 23[65] of the ILC's articles on State Responsibility. Article 23 provides as follows:

Article 23 - Breach of an international obligation to prevent a given event —

When the result required of a State by an international obligation is the prevention, by means of its own choice, of the occurrence of a given event, there is a breach of that obligation only if, by the conduct adopted, the State does not achieve that result.[66]

Both Article 8 and paragraph 2 of draft Article 16 require watercourse states to prevent a given event, namely, appreciable harm in another watercourse state. Whether there had been a breach of those provisions would therefore be determined by applying Article 23. If, by whatever means it chooses, the state fails to prevent the occurrence of appreciable (pollution) harm to another watercourse state, it will have breached the two articles. The Commission's commentary to Article 23 states that it even applies to "cases where the result aimed at by the obligation is the prevention by the State of an event caused by factors in which it plays no part [such as] ensur[ing] the result of preventing individuals or third parties from committing certain acts, or of preventing disasters, whether naturally or artificially caused (such as flooding or pollution), from taking place."[67]

This sounds very much like strict responsibility. Indeed, although opinion is not uniform, the prevailing view today would seem to be that there is no general requirement of international law that a state be at "fault" — in the sense of culpable negligence (*culpa*) or malicious intent (*dolus*) — in order to be internationally responsible.[68] Under this "objec-

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with the result required of it by an international obligation, but the obligation allows that this or an equivalent result may nevertheless be achieved by subsequent conduct of the State, there is a breach of the obligation only if the State also fails by its subsequent conduct to achieve the result required of it by that obligation.

[1977] 2(2) Y.B. INT'L L. COMM'N at 18-19.

65. [1978] 2(2) Y.B. Int'l L. Comm'n at 81.

66. *Id.*

67. *Id.* at 82. Article 21, on the other hand, covers obligations "requiring a result in whose achievement or non-achievement only action by the State is involved."

68. *See, e.g.*, I. Brownlie, *Principles of Public International Law* 436-441 (3d ed. 1979), canvassing the authorities: "It is believed that the practice of states and the jurisprudence of arbitral tribunals and the International Court have followed the theory of objective responsibility as a general principle (which may be modified or excluded in certain cases). . . . A considerable number of writers support this point of view, either explicitly, or implicitly. . . ." Similarly, according to Starke, international law does not contain "a general floating requirement of malice or culpable negligence as a condition of responsibility." Starke, *Imputability in International Delinquencies*, 19 BRIT. Y.B. INT'L L. 114, 115 (1938). *See also* Sohn and Baxter, *Convention on the International Responsibility of States for Injuries to Aliens (Final Draft with Explanatory Notes), reprinted in* RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURY TO ALIENS 135, 169 (Garcia-Amador, Sohn & Baxter eds. 1974). *See generally* the survey of "doctrine" concerning the "fault

tive theory" of responsibility, it is the content of the obligation itself (in the ILC's parlance, the "primary rule")[69] that is crucial. Where the obligation requires the state to prevent the occurrence of a given event (such as pollution harm), no amount of diligence will eliminate responsibility if the event occurs.[70] On the other hand, if the obligation merely requires the state to exercise due diligence to prevent the occurrence of the event, the occurrence of the event will not give rise to responsibility if due diligence has been exercised.

As presently worded, Article 8 and paragraph 2 of draft Article 16 contain no due diligence requirement. Without any contrary indication in the commentary to those provisions, they would presumably be interpreted as falling under Article 23 of the State Responsibility draft, with the consequences described above. This would leave no room for a source state to claim that it had made its best efforts, or had used the best available technology, to prevent extraterritorial pollution harm. While this result might seem rather harsh (and possibly out of line with the reality of state practice),[71] Article 23's strictness could be mitigated, in appropriate cases, in two ways. The first has to do with what the ILC has termed "circumstances precluding wrongfulness." In all cases governed by the law of State Responsibility under the Commission's draft, certain circumstances may operate to preclude what the ILC terms the "wrongfulness," or unlawfulness, of the conduct in question. "The circumstances usually considered to have this effect are consent, countermeasures in respect of an internationally wrongful act, *force majeure* and fortuitous event, distress, state of emergency [necessity] and self-defence."[72] If one of these

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theory" and the "objective theory" of international responsibility in "Force majeure" and "fortuitous event" as circumstances precluding wrongfulness: Survey of State practice, international judicial decisions and doctrine, study prepared by the U.N. Secretariat, U.N. Doc. A/CN.4/315, *reprinted in* [1978] 2(2) Y.B. INT'L L. COMM'N 61, 188 (1978).

69. The Commission decided in 1970 that, in order to enable it to make progress on the State Responsibility draft, it would not undertake to define

> [t]he rules of international law which . . . impose particular obligations on States, and which may, in a certain sense, be termed 'primary,' as opposed to the other rules — precisely those covering the field of responsibility — which may be termed 'secondary,' inasmuch as they are concerned with determining the consequences of failure to fulfil obligations established by the primary rules.

[1970] 2(2) Y.B. INT'L L. COMM'N 179. Using this terminology, the "secondary rules" of international responsibility contain no "fault" requirement; fault may, however, be required by a specific "primary" rule. To this effect see, *e.g.*, L. HENKIN, *supra* note 47, at 528-529; and B. SMITH, STATE RESPONSIBILITY AND THE MARINE ENVIRONMENT 16-17 (1988).

70. *See* the passage of the commentary to article 23, *quoted in* text at *supra* note 67.

71. *See* LAMMERS, *supra* note 18, at 349, noting that if source states take the best practicable measures to abate pollution, "victim States do not appear to be much inclined to hold those States internationally responsible, demanding either the *immediate* effective termination of the causing of substantial harm or compensation for the harm caused or both." (emphasis in original).

72. [1979] 2(2) Y.B. INT'L L. COMM'N 106 (commentary to Chapter V of the articles on State Responsibility).

circumstances were present, the conduct of the State of origin could not be characterized as "wrongful;" the State would thus not be in breach of the relevant obligation (e.g., draft Article 16(2)). For example, under Article 33, "*State of Necessity*," a state would not be in breach of draft Article 16 if it could show that its "sole means of safeguarding an essential interest threatened by a grave and imminent peril is to adopt conduct not in conformity with what is required of it by [Article 16]."[73] While this kind of situation is certainly not a common one, the availability of exculpating circumstances such as a state of necessity provide potential escape routes for polluting states; if the "primary rule" requires strict prevention, source states can be expected to look closely to see whether one of these circumstances might be present.[74]

The second way in which Article 23's strictness might be mitigated has to do with the consequences that would ensue from the international responsibility of the source state. In the words of Jimenez de Arechaga, "a State discharges the responsibility incumbent upon it for breach of an international obligation by making reparation for the injury caused. . . . The forms of reparation may consist in restitution, indemnity or satisfaction,"[75] indemnity being "the most usual form."[76] It has long been recognized that the amount of indemnity, or compensation, may in appropriate cases be determined by taking into account the degree of "blameworthiness" of the state's conduct.[77] That is, even if the standard of responsibility is strict under the applicable primary rule, its effect may be softened by a reduction in the monetary extent of responsibility where the source state's conduct was not particularly "blameworthy." Thus, a source state might be found to have breached draft Article 16 but, because the harm occurred notwithstanding its proper use of the best available technology, the amount of compensation owing to the injured state might be mitigated. Such a reduction in the extent of responsibility may well be viewed as being inconsistent not only with the "Polluter Pays Principle,"[78] but

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73. [1980] 2(2) Y.B. INT'L L. COMM'N 34.

74. It must be noted, however, that even if there is an applicable circumstance precluding wrongfulness, the Commission does not exclude the possibility that compensation might be payable. Article 35 of the State Responsibility draft provides that "Preclusion of the wrongfulness of an act of a State . . . does not prejudge any question that may arise in regard to compensation for damage caused by that act." [1980] 2(2) Y.B. INT'L L. COMM'N 61.

75. de Arechaga, *International Law in the Past Third of a Century*, 159 Recueil des Cours 285 (1978-I). *See also* The Chorzow Factory Case (Ger. v. Pol.), 1927 P.C.I.J., Ser. A, No. 9, at 21 (the leading judicial decision on the point).

76. The Chorzow Factory Case, 1927 P.C.I.J., Ser. A, No. 17, at 27.

77. In the 1872 *Alabama* arbitration, Great Britain took the position, which the United States did not dispute, that the amount of compensation should be in proportion "not only to the loss incurred as a consequence of a wrong (act or omission), but also to the gravity of the wrong itself." The *Alabama* Claims Arbitration (U.S. v. U.K.), Moore, 1 *Arbitrations* 495, at 623 (1898). *See also* SCHWARZENBERGER, INTERNATIONAL LAW 661 (3d ed. 1957). *See generally* the authorities surveyed in B. SMITH, *supra* note 69, at 58.

78. This Principle is contained in the Annex to Recommendation C(72)128, adopted by

more fundamentally with the concept that one conducting an activity should be responsible for any harm it causes.[79] Yet the fact remains that relative culpability has been considered by international tribunals in assessing damages[80] and, in the specific context of water pollution, injured states have shown a willingness to allow source states some flexibility where the latter are taking all reasonable steps to terminate the harmful water pollution.[81]

While these considerations could introduce a small measure of flexibility into what would otherwise appear to be a rather strict regime, they are not likely to provide much comfort to source states inasmuch as they go only to the extent, not the existence of responsibility. Thus, there is all the more reason for states sharing international watercourses to enter into specific agreements that take into account the characteristics of the watercourse, the types and extent of its uses by the respective states, and any special circumstances such as the levels of development of the states concerned.

V. CONCLUSION

The recent strides made by the International Law Commission in its work on International Watercourses pave the way for completion of the draft in the near future. Important issues remain to be addressed, however. The Commission will resolve some of these when it adopts articles on environmental protection and pollution. It is uncertain at this stage of the work on Watercourses whether that draft will deal with the issue of standard of responsibility. The Commission may wish to revisit this issue prior to completing the provisional adoption of the draft as a whole or when giving the articles a "second reading."[82] A model that the Commission might consider is provided by the 1982 United Nations Convention

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the Council of the Organization for Economic Cooperation and Development (OECD) on 26 May 1972, *reprinted in* OECD, *OECD and the Environment* at 23, 24 (1986).

79. This idea is implicit in the maxim, *sic utere tuo ut alienum non laedas*, which was in turn stated by the Commission to be the basis of the rule expressed in Article 8 of the Watercourses draft. 1988 ILC Report, *supra* note 9, at 83. It is also expressed in Principle 21 of the Stockholm Declaration on the Human Environment, which provides in pertinent part that "States have . . . the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction." *Report of the United Nations Conference on the Human Environment*, U.N. Pub., Sales No. E.73.II.A.14, at 325. *See supra* note 15.

80. *See* the decisions collected in B. SMITH, *supra* note 69, at 58.

81. *See, e.g.*, the finding of Professor Lammers quoted in *supra* note 18.

82. When the Commission completes work on a draft, it is provisionally adopted and sent to the General Assembly and to governments for their comments. The Commission then gives the articles a "second reading" on the basis of governmental observations and the special rapporteur's recommendations in response thereto. When the Commission has adopted a final draft, it is submitted to the General Assembly with a recommendation concerning further action (e.g., that a conference be convoked to conclude a convention on the basis of the Commission's draft). *See* ILC Statute, *supra* note 1, Art. 16, paras. (g)-(j); and THE WORK OF THE INTERNATIONAL LAW COMMISSION, *supra* note 1, at 14.

on the Law of the Sea. Article 94 of the Convention measures the performance of a flag state by whether it conforms to "generally accepted international regulations procedures and practices."[83] The recently revised Restatement of U.S. Foreign Relations Law generalizes this standard and applies it to a source state's obligation to take measures to prevent extraterritorial environmental harm. Thus, under section 601 of the Restatement:

> (1) A state is obligated to take such measures as may be necessary, to the extent practicable under the circumstances, to ensure that activities within its jurisdiction or control
> (a) conform to generally accepted international rules and standards for the prevention, reduction, and control of injury to the environment of another state or of areas beyond the limits of national jurisdiction . . . .[84]

In the parlance of the Commission's articles on State Responsibility, this section expresses the obligation of the source state as one of conduct,[85] rather than one of result. This may be the course that would prove most broadly acceptable to states since "[i]n general, the applicable international rules and standards do not hold a state responsible when it has taken the necessary and practicable measures."[86]

Even if the Commission does not ultimately address the standard of responsibility for water pollution harm to other states, the draft will still have made a significant contribution to the development of international environmental law. As is true of any general codification effort, however, the real test of its effectiveness will be whether states apply it in concrete cases.

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83. 1982 U.N. Convention on the Law of the Sea, *supra* note 31, at 32 (art. 94, para. 5).

84. 2 RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 601, at 103 (1987) [hereinafter RESTATEMENT].

85. Obligations of conduct are governed by Article 20 of the State Responsibility draft. That article provides: "There is a breach by a State of an international obligation requiring it to adopt a particular course of conduct when the conduct of that State is not in conformity with that required of it by that obligation." [1980] 2(2) Y.B. INT'L L. COMM'N 32.

86. RESTATEMENT, *supra* note 84, at 105. While the Restatement provides an interesting model, it is to be hoped that the Commission's final product will avoid language such as "to the extent practicable under the circumstances," in the interest of establishing an obligation whose content is clear to both the obligor and the obligee state. Such language could be considered necessary in relation to an obligation of result, but it does not seem justified when a mere obligation of conduct is involved.

China's Tax System: An Evaluation*

JINYAN LI**

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* It is important for the reader to know that most of the references and citations within the text's footnotes have been translated from Chinese by the author.

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Very little has been written in the West about the Chinese system of taxation as a whole, even though the appearance of numerous publications dealing with taxation of foreigners in China reflects the obvious interest of Western writers in this area. Taxation, however, is central to the current reform of China's entire economic system and, as such, merits greater attention. This article attempts to provide a concise overview and evaluation of the tax system, explaining its evolution, in the hope that this might stimulate comment and discussion among Western observers.

I. THE EVOLUTION OF THE CHINESE TAX SYSTEM[1]

The tax system in China has developed with the evolution of the political and economic structure of the country. As the latter predetermines the fiscal structure, the fiscal systems of the various historical periods reflect the economic situation and the interests of the governing body. In the course of several thousands of years of feudal society, the feudal dynasties derived most of their revenue from compulsory levies, land taxes and various excise taxes on items like salt, tea, liquor and iron. Taxation of commercial activities was only commenced in the Song Dynasty (960-1279) when a class of merchants started to appear and commercial transactions became popular.[2] Direct taxes in the modern sense were first introduced by the Guomindang Government in 1936. By the end of the Guomindang Era (1912-1949), there existed about eighteen taxes, including land tax, contracts tax, income tax, profits tax, inheritance tax, business tax, stamp tax and excise taxes[3].

The tax system of the Guomindang Government was abolished by the Communist Government with the promulgation of the "Principal Rules for Implementation of the National Tax Administration" in January 1950[4]. The Principal Rules instituted a new unified tax system and designated the different categories of taxation. Apart from the existing agriculture tax, fourteen taxes were introduced: the commodity tax, industrial and commercial tax, salt tax, custom duties, stamp tax, transaction tax, slaughter tax, house property tax, land tax[5], special consumption tax, vehicle and vessel license plate tax, interest income tax, salary or remuneration tax and inheritance tax. The two last mentioned taxes, however, were never implemented.

From the beginning, the most important tax was the industrial and commercial tax which comprised a business income tax and a business turnover tax imposed on business entities temporary commercial enter-

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1. For a more detailed discussion, see A.J. Easson and Li Jinyan, *The Evolution of the Tax System in the People's Republic of China*, 23 STAN. J. INT'L L. 399 (1987); WANG KUN, GUOJIA SHUIFA GAILUN (A GENERAL INTRODUCTION OF THE NATION'S TAX LAW) 57-82 (1985) (Chinese version); LIULONGHENG, ZHONGGUO SHUIFA GAILUN (A GENERAL INTRODUCTION OF CHINA'S TAX LAW) 1-52 (1986) (Chinese version); and ZHAO WEIJIN & YIN ZHONGXIN, ZHONGGUO SHUIWU XUE (CHINESE TAXATION) 81-96 (1987) (Chinese version).

2. *See generally* Zhongguo Caizheng Jinrong Xueyuan Caizheng Jiaoyan Shi (The Teaching and Research Group of the Finance Department of China's Fiscal and Financing Institute), ZHONGGUO CAIZHENG JIANSHI (A BRIEF HISTORY OF CHINA'S FINANCE) 107 (1980) [hereinafter CAIZHENG SHI]; ZHOU BODI, ZHONGGU CAIZHENG SHI (CHINA'S FINANCE HISTORY) (1981) (Chinese versions); and R. HUANG, TAXATION AND GOVERNMENTAL FINANCE IN SIXTEENTH-CENTURY MING CHINA (1974).

3. CAIZHENG SHI, *supra* note 2, at 264.

4. Principal Rules for the Implementation of the National Tax Administration, *adopted by* the Government Administration Council on January 27, 1950 [hereinafter "Principal Rules"].

5. The house property tax and land tax were combined into an Urban Real Estate Tax, the regulations of which were promulgated in 1951.

prises and street-traders. A contract tax and a cotton-yarn monopoly sales tax were introduced soon afterwards. Despite the Korean War, economic recovery from the years of the anti-Japanese war and the civil war was quite rapid and tax revenue doubled in two years. The state sector of the economy had also commenced to grow and this facilitated the simplification of the tax system which occurred in 1953. The number of taxes was reduced to thirteen,[6] with a number of the specific taxes either disappearing or being merged into a single commodity circulation tax. This reform was carried much further in 1958, when the number of taxes was reduced to eleven. The simplification, however, may have been more apparent than real, except from an administrative point of view, since the new Consolidated Industrial and Commercial Tax,[7] which replaced four existing taxes, preserved many of the previous categories and grew in complexity and multiplicity of rates and schedules.

The chief effect of the consolidation was to bring together a variety of commodity, excise, sales and turnover taxes, leaving the tax on business income as a separate item — the Industrial and Commercial Income Tax.[8] Another achievement of the 1958 reform was that a new national Agriculture Tax was introduced.[9] A further reform took place in 1973 when the Consolidated Industrial and Commercial Tax was merged with a few other taxes levied on state enterprises, such as the urban real estate tax, the vehicle and vessel license plate tax and the slaughter tax, and the name "Consolidated" was dropped. As a result of the simplification, state enterprises became liable only to the Industrial and Commercial Tax, whereas collective enterprises were liable to the Industrial and Commercial Income Tax as well as the Industrial and Commercial Tax.[10]

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6. The taxes that were reduced were the commodity circulation tax, commodity tax, industrial and commercial taxes, stamp tax, salt tax, customs duties, livestock transaction tax, slaughter tax, urban real estate tax, entertainment tax, vehicle and vessel license plate tax, interest income tax and contracts tax; *see* LIU, *supra* note 1, at 11. For a further discussion of the tax system between 1950 and 1956 in China, see GE ZHIDA, GUODU SHIQI DE ZHONGGUO YUSUAN (CHINA'S BUDGET IN THE TRANSITION PERIOD) (1957).

7. Consolidated Industrial and Commercial Tax (Draft), *adopted by* the Standing Committee of the National People's Congress on Sept. 11, 1958, *promulgated* for trial implementation by the State Council on Sept. 13, 1958.

8. Until 1980, this was the only tax on business profits. Introduced in 1950 as one of four components of the industrial and commercial taxes, it was imposed upon the income of all industrial and commercial enterprises operated for profit. Since 1980, new legislation has been adopted to tax enterprises with foreign investment and various types of domestic enterprises.

9. Agriculture Tax Regulations of the People's Republic of China, *promulgated by* the 96th Session of the Standing Committee of the National People's Congress on June 3, 1958 [hereinafter Agriculture Tax Law].

10. In 1950, regulations were adopted which exempted most publicly-owned enterprises from income tax. *See* Ministry of Finance Notice on Payment of Industrial and Commercial Tax by Public Enterprises, *issued* Mar. 17,1950; and article 5 of the Provisional Regulations on Industrial and Commercial Tax, *adopted* Jan. 27, 1950. *See also* H. Chao and Yang Xiaoping, *Private Enterprises in China: the Developing Law of Collective Enterprises*, 19 INT'L L. 1215, at 1236 (1985); and GE, *supra* note 6, at 67.

That, essentially, was how the Chinese tax system stood at the beginning of 1980. With the launching of the "Four Modernizations" programme in 1978, two years after the death of Chairman Mao Zedong and the end of the "Cultural Revolution", a new set of economic policies was adopted by the Chinese Government. The new policy was composed of two parts: the opening to the outside world and the reforming of the domestic economic system.

The "open to the world" policy called for more international cooperation, and foreign enterprises were invited to invest in China bringing with them capital, skills and technology. Fiscally, this had two major implications. First, if foreigners were to be encouraged to do business in or with China, they might also be expected to contribute to the Chinese economy by paying taxes on their profits. Second, if a tax regime for foreign investment was to be introduced, it was necessary that the system be differentiated from the domestic tax system. These differentiations were necessary as these investments would not form part of the central economic plan. The government promised the autonomous management of these foreign investment enterprises. As a consequence, the first major amendments to the Chinese tax laws since 1950 were those which concerned foreign business and investment in China.[11]

On the domestic scene, the reform was initiated in rural areas in 1979 and expanded to urban areas soon afterwards. The introduction of the "household responsibility system" in the countryside, leading to the virtual dismantling of the People's Communes which had been set up in the 1950s, had enormous economic consequences but little impact on the agricultural tax system. As a deliberate policy, agricultural taxes have not increased in line with production and the main consequence of the rural economic reform has been an increase in the payment of taxes in cash rather than in kind.

Reform of domestic industry has been a different matter. The ownership structure of the industrial sector has been changed from the previous state-owned to a multiple structure of ownership whereby collectively-owned and privately-owned enterprises coexist with the state enterprises. State enterprises themselves have been given much more autonomy to operate as independent economic entities through experimentation with various responsibility systems. The orthodox central planning of the economy is being replaced with a state-guided market economy. The fiscal reforms have been equally significant. Whereas state enterprises were formally required to turn in all their profits to the state, experiments were began as early as 1979 to allow those enterprises to keep part of their profits to expand production and to issue bonuses and awards to workers. This experiment proved generally successful, with the growth

11. The Individual Income Tax Law and the Joint Venture Income Tax Law, both of Dec. 14, 1980 and the Foreign Enterprise Income Tax Law of Dec. 13, 1981. These tax laws will be discussed further below.

rates of those enterprises chosen for the experiments averaging three to four times that of the average state enterprises. Based on the experience drawn from the experiments, a further reform took place in 1983 to make state enterprises subject to income taxes — a reform which is commonly referred to in Chinese as *li gai shui.*

The first stage of *li gai shui* commenced in 1983 in accordance with the Provisional Regulations on Levying Income Tax on State Enterprises.[12] By the end of 1983, over 90 percent of profitable state enterprises were paying income tax.[13] At this stage of *li gai shui*, state enterprises were still required to deliver their "extra" after-tax profits to the state. The purpose of the reform was to give enterprise managers greater independence and control over the allocation of funds and with regard to investment decisions and, by permitting a substantial part of the profit to be retained, to provide an incentive for greater efficiency and promote competition between enterprises. There was, however, a major obstacle to this. Due to the distortions caused by price controls and the unbalanced allocation of natural resources and capital investment, the level of after-tax profits among state enterprises does not necessarily reflect the level of management and productivity. Therefore the second stage of *li gai shui* was instituted in October 1984,[14] requiring all taxable state enterprises only to pay income taxes and removing the obligation to deliver profits to the state. Enterprises were thus permitted to retain all their after-tax profits. The second stage of *li gai shui* also implemented a new turnover tax system which replaced the former Industrial and Commercial Tax with four new taxes — a product tax, a value-added tax, a business tax and a salt tax. Regulatory taxes on resources and state enterprise profits and other taxes were introduced to complete the substitution of tax payment for profit delivery for state enterprises so that, in the end, taxation became the primary means by which the state shares in the profits made by enterprises.[15]

The re-birth of collective and private enterprises also necessitated the introduction of new taxes on business profits generated in these enterprises.[16]

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12. Provisional Regulations on Levying Income Tax on State Enterprises, *adopted by* the Ministry of Finance on April 29, 1983.

13. Yan Zhensheng, *Stage Two of the Substituting Taxation for Profit Delivery for State Enterprises*, Zhengfa Luntan (Political and Legal Forum), 1985, No. 3, 53 (Chinese version).

14. Pursuant to the Trial Measures concerning Stage Two of the Substitution of Taxation for Profit Delivery of State Enterprises, *adopted by* the State Council on Sep. 18, 1984.

15. Subsequently, however, there has been a move to adopt the "contract management responsibility system," under which a contract is made by the state with the management to require the latter to turn over a prescribed amount each year out of profits, thus reintroducing a form of profit delivery.

16. The Collective Enterprise Income Tax of Oct. 26, 1985, the Urban and Rural Individually-Owned Industrial and Commercial Households Income Tax of Jan. 7, 1986, and the Private Enterprise Income Tax Law of June 25, 1988.

Consequently, the current tax scene in China bears very little resemblance to that which existed at the beginning of 1980. There have been changes in the Agriculture Tax, especially in the method of payment. An entirely new system of taxation has been installed to deal with foreign enterprises and investment. An individual income tax has been introduced for the first time. Commodity and product taxes have been radically revised. State enterprises now pay tax on their profits instead of accounting for them to the state. Private and collective enterprises have been revived and are subject to wholly new taxes. Some new local taxes have been introduced. Not only has a complete new tax system been created but taxation has assumed a new importance: whereas in the period 1958-1978, tax revenue accounted for only 40 percent of state revenue, by 1985 this proportion had risen to approximately 95 percent.[17]

II. THE CHINESE TAX STRUCTURE

Currently in China, there are taxes levied on commodities and services, taxes imposed upon personal and business income, as well as taxes charged by local governments. Several "penalty" taxes are also levied by the government in order to implement certain state policies, such as the bonus taxes and construction tax. Each of the main taxes will be briefly described and commented on in the following section of this paper.

A. *Turnover Taxes*

Turnover taxes are those taxes levied on the basis of business revenue derived from the sales of products and the provision of services. Ever since the eighth century B.C., this type of tax has been an important and reliable source of government revenue in China.[18] Before 1984, these taxes were levied under the Industrial and Commercial Tax Law, the greater part of which was collected from state enterprises which would eventually account to the state for their profits in any event. Thus the collection of the tax really represented little more than a bank transfer from the enterprise to the tax office at the time that sales receipts were realized.[19] Nevertheless, turnover taxes were simple to administer and ensured a prompt and regular cash flow for the exchequer.[20] This liquidity advantage has become far more important with the change from profit delivery to profit taxation.

Additionally, turnover taxes operate as a form of "buffer" between the cost of production and the eventual price paid by the consumer. In

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17. Cong Shuhai, *An Analysis of the Establishment of China's Tax System*, Caijing Yanjiu (Finance Study), 1986, No. 5, at 26 (Chinese version).

18. DING WEN, SHUISHOU YU CAIWU SHOUCE (TAXATION AND FINANCIAL AFFAIRS HANDBOOK) 30-1 (1987); and Wei Zuhou, *A Brief Introduction of Commodity Tax During the National Period*, Zhongguo Shuiwu, 1988, No. 5, 60 (Chinese versions).

19. G. ECKLUND, FINANCING THE CHINESE GOVERNMENT BUDGET 69 (1966).

20. Zhan Wu, Gong Qifang and Chen Deyan, *Several Questions on the Reform of the Taxation System*, Renmin Ribao (People's Daily), March 14, 1984, at 5 (Chinese versions).

most tax systems it is assumed that the burden of indirect tax will be shifted forward to the consumer in the form of higher prices. But in China the majority of prices, especially of goods produced and services supplied by state enterprises, are regulated by the state. Consequently, turnover taxes have a greater effect upon the level of profit of the enterprise; since, in most cases, the tax cannot be passed forward. It is shifted back to the supplier.[21] Before *li gai shui*, when enterprise profits accrued to the state, the precise level of tax was relatively unimportant since the more tax the state collected on transactions, the less it received in the form of profit delivery. All this, of course, was changed once enterprises became responsible for their own profits or losses and private businesses were allowed to operate.

As will be discussed below, the relationship between taxation and pricing ensures that turnover taxes have a special role to play in regulating the economic activities of enterprises in China. Due to irrational pricing, enterprises producing high-priced goods or services will enjoy a greater after-tax income than those producing low-priced goods and services. This unbalanced "sweet and sour" situation became more obvious when enterprises were required to pay income taxes and were allowed, subject to certain restrictions, to dispose of their retained earnings. Although pricing policy is being reformed, this will inevitably be a lengthy process so that, in the meantime, the reform of the turnover tax system is necessary to regulate the effect upon profits of "irrational" pricing.[22] The new rates of tax have been established by reference to the fixed price and to the average cost of production, leaving a reasonable margin of profit for the producing enterprise. Further, by regulating the profitability of particular types of goods and services, the new taxes may operate as economic levers to stimulate the production of those articles which are at present in short supply. Regulating profitability may also operate to reduce production of those articles where the supply is excessive due to high profit levels.[23]

Under the current system, the following turnover taxes are imposed:

1. Product Tax (Chanpin Shui)

The product Tax is imposed on enterprises and individuals engaged

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21. For a discussion of the shifting of tax burden in China, see Cao Erdong, *A Brief Discussion of Shifting of Tax Burden*, Caijing Yanjiu (Finance Study), 1985, No. 6, 24; and Xu Jianguo, *Whether Shifting of Tax Burden Exists in Socialist Tax System*, Zhongguo Shuiwu (Chinese Taxation), 1987, No. 6, 26 (Chinese versions).

22. The State Council made it clear that changes in turnover taxes were not to involve any price change, but must be absorbed by the paying enterprise. *See* State Council Circular on the Approval and Circulation of Finance Ministry Report on the Second Phase of Substitution of Tax Payment for Profit Delivery in State Enterprises: State Council Bulletin No. 23 of Oct. 10, 1984, at 796.

23. *See* Dai Yuanchen, *Substituting Tax Payments for Profit Delivery is a Decisive Step in the Economic System Reform*, Jingji Yanjiu (Economic Study), Sept. 20, 1984, at 17, (Chinese version).

in manufacturing taxable industrial products and purchasing taxable agricultural products, as well as on importers of foreign goods.[24] Under the Product Tax Law, there are 270 taxable items, of which 260 are industrial products and 10 agricultural, taxable at 26 different tax rates ranging from 3 percent to 66 percent. Necessities and industrial raw materials are taxed at lower rates, whereas luxury goods (such as top-grade cigarettes and electric appliances) are subject to high tax rates. The broad tax base and multiple rate structure make this tax a useful means for the state to control the price level of a product and the profit level of a producer by manipulating the tax rates.

The tax is payable by manufacturers on gross sales revenue when they sell taxable products to wholesalers or retailers. Products manufactured by an enterprise and used in its continuous production are not taxed, with the exception of products subject to high tax rates such as liquor, sugar, leather and silk.[25] Purchasers of agricultural products are liable for the Product Tax on the purchase price when the purchasers are state or collective enterprises. If such a purchaser is an individual or other type of entity, it is the seller who is liable to pay the tax.[26] A taxpayer importing taxable goods is subject to the tax, but the tax is normally paid to Customs upon importation together with import duties.[27]

The Product Tax is levied only once on a taxable product, either on the manufacturer, purchaser or importer. However, the Business Tax may be levied again on the turnover of these products in the hands of wholesalers or retailers.

To encourage exports, goods are exempted from the tax if they are exported directly by manufacturers, or a rebate is given if they are exported through a foreign trading corporation. Gold and contraceptive products are also exempted whether they are exported or not. New products listed in the State Plan for trial production, and products which use waste residue, waste liquid or waste gas, may be granted a reduction of, or exemption from, the tax for a period of time. Certain products manufactured in minority nationality regions to meet the special needs of the minority people may also be exempted or receive a reduction of tax where there is difficulty paying the tax. Reduction or exemption can be granted in other special circumstances.[28]

Since 1984, when the Product Tax was introduced, it has become one of the most important taxes in China. It provides about 40 percent of the total tax revenue of the country and 50 percent of the tax payment by

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24. Regulations of the People's Republic of China on Product Tax (Draft), *promulgated* Sept. 18, 1984 by the State Council (hereafter Product Tax Law). The Implementing Rules for the Regulations of the People's Republic of China on Product Tax (Draft) were *promulgated* Sept. 28, 1984.

25. *Id.* at art. 3.

26. *Id.* at art. 4.

27. *Id.* at art. 5.

28. *Id.* at art. 7.

state enterprises to the state.[29] More importantly, because of its comprehensive tax base and numerous tax rates, this tax is considered to be an efficient economic regulator used in conjunction with pricing policy to adjust the supply and demand of the market.

2. Value Added Tax (Zengzhi Shui)

The Value Added Tax (VAT), a new tax in China,[30] was introduced on a trial basis in 1979 in some industrial cities including Shanghai, Liuzhou and Xian. From July 1, 1982, VAT was experimented with across the country.[31] During this period, VAT applied only to five chosen items which had been cumulatively taxed under the existing Industrial and Commercial Tax. Regulations concerning VAT were formally adopted in 1984[32] in the second phase of *li gai shui*, together with the Product Tax and Business Tax.

Pursuant to the 1984 VAT Law, the scope of VAT was restricted to two categories comprising twelve items of industrial products including machines, machinery and spare parts (covering mechanical equipment for general and specified use, motor vehicles, motorized ships, bearings and farm implements), steel products, billet, bicycles, sewing machines, electric fans, printed and dyed silks and western medicines. These products were taxed at six different rates ranging from 6 percent (on farm implements) to 16 percent (on electric fans). Two methods of calculating VAT liability were adopted: the *tax credit* method applying to "simply structured" goods, such as steel products, bicycles, electric fans, printed silk and western medicines; and the *sales subtractive* method applying to machines and machinery products.[33] Deductible items were limited to the cost of purchase and taxes paid on materials, fuels, power and packaging materials purchased from outside and used to manufacture the taxable products.[34]

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29. WANG, *supra* note 1, at 98 and DING, *supra* note 18, at 184.

30. For a discussion of VAT in China, see Li Jinyan, *People's Republic of China: Value Added Tax*, 42 BULL. INT'L FISCAL DOCUMENTATION 17 (1988).

31. This was conducted in accordance with the Provisional Measures on Value Added Tax, *issued by* the Ministry of Finance, *Cai Shui Zi*, No. 343. For further information, see GUO HONGDE, WANG WENDING AND HAN SHAOCHU, ZENGZHI SHUI GAISHUO (A GENERAL TALK ON VALUE ADDED TAX) (1984) (Chinese version).

32. Regulations of the People's Republic of China on Value Added Tax (Draft), *promulgated on* Sept. 18, 1984 by the State Council [hereainafter VAT Law]. The Implementing Rules to the Regulations of the People's Republic of China on Value Added Tax (Draft) *issued on* Sept. 28, 1984 by the State Council.

33. For further, *see* Li, *supra* note 30, at 19-20; Yan Zengzu, *A Talk on VAT Administration*, Zhongguo Shuiwu, 1986, No. 3, 33 (Chinese version).

34. Arts. 5 and 6 of VAT Law, *supra* note 32. Capital goods are not deductible because most capital investment is planned by the state and the government encourages labour-intensive investment. Moreover, the unbalanced existing capital structure of enterprises makes it difficult to set a uniform level of depreciation. The purpose of introducing VAT in China is to eliminate the unfair tax burden caused by cumulative taxation. Capital inputs are not considered a contributing factor.

As is well known, a VAT works ideally only if there is a single tax rate, or at most two rates, a comprehensive tax base, and the tax credit method is adopted. In China, VAT has been proved to be a superior tax to the Product Tax for the elimination of cumulative taxation of a product, and for the encouragment of enterprises to compete on a fair basis, whether they are comprehensive or specialized manufacturers. At present, VAT co-exists with Product Tax due to the particular political and economic situation in China. The role of government in direct regulation of the market through pricing policy and taxation, the traditional use of the product tax, and the unbalanced development level between regions, industrial sectors and enterprises make it impossible, for the moment, to completely substitute VAT for the Product Tax. Moreover, the government has used the Product Tax quite efficiently to control and regulate the supply and demand of the market by increasing or decreasing the tax rates applicable to specific products. Therefore, in maintaining the regulatory function of the Product Tax, efforts have been made to reduce the unfair tax burden on enterprises by increasing the scope of VAT while at the same time reducing that of the Product Tax.[35] By the end of 1987, there were 24 categories and some 120 items of industrial products subject to VAT and taxable at eleven tax rates and the tax credit method was adopted as the proper way of calculating VAT liabilities.[36] Consequently, although the categories of taxable products were increased by about ten times, the number of tax rates was merely doubled indicating the intention of the government to adopt a VAT system which not only accommodates the existing multi-rate structure of the turnover tax system but which is also easily administered and enforced. However, compared to the VAT system adopted in other countries, the Chinese VAT has too many tax rates and too restricted a scope of taxable products. To fully take advantage of the tax system, China's VAT needs to be further expanded in scope and simplified in rate structure.[37]

3. Business Tax (Yingye Shui)

The Business Tax was one of the four components of the Industrial and Commercial Tax of 1950, and was incorporated into the Consolidated

35. The Ministry of Finance made it very clear that products which have been brought within the scope of VAT shall no longer be taxed under the Product Tax Law. *Cai Shui Zeng Zi*, No. 037 (July 13, 1987). *See also Cai Shui Zi*, No. 026 (Feb. 4, 1986); *Cai Shui Zi*, No. 009 (Jan. 27, 1987); *Cai Shui Zeng Zi*, No. 013 (March 26, 1987).

36. *See* Certain Regulations on Perfecting the Rules on Value Added Tax Administration, *issued by* the Ministry of Finance (March 20, 1987); *Cai Shui Zi*, No. 042. For an English translation of the taxable items and applicable rates, see LI, *supra* note 30 at 22. *See also* Ministry of Finance Notice, *Cai Shui Zi*, No. 242 (October 13, 1987).

37. For further comments on the Chinese VAT, see Li Shengjun, *Our Country's VAT Needs to be Further Perfected*, Zhongguo Shuiwu, 1987, No. 2, 16; Wang Pingwu, *To Actively and Steadily Implement VAT*, Zhongguo Shuiwu, 1987, No. 4, 6; Yan, *supra* note 33 at 33; Chen Jijiang and Lou Jiwei, *An Inquiry on the Question of Fully Implementing VAT System*, CAIMAO JINGJI (FINANCE, TRADE AND ECONOMY), 1987, No. 11, 17 (Chinese versions).

Industrial and Commercial Tax in 1958, and subsequently the Industrial and Commercial Tax in 1972. It became a separate tax in 1984 and was imposed upon individuals and entities which were engaged in commerce, the supply and sale of commodities, transportation, construction and installation, financial and insurance services, post and communications, public utilities, publishing, entertaining, processing and other service industries.[38] Unlike the Product Tax and VAT, the tax rates of Business Tax are applied in accordance with the type of activity, and not with the type of product or service. Enterprises providing services closely related to people's everyday life, such as retailing, postal services, telecommunications, public transportation, publishing and entertaining are taxed at lower rates; whereas those activities which are normally highly profitable are subject to higher rates, the highest of which being petrol pipe transportation and railway cargo transportation.[39]

The Business Tax is levied when a taxpayer receives business income and is payable on the gross amount of revenue. Wholesale businesses are taxed at 10 percent on the difference between purchase and sale prices.[40] Since industrial enterprises do not pay this tax, sales income realized by these enterprises is not taxable under the Business Tax Law, but sales revenue realized by wholesalers and retailers is taxable and service industries will be taxed on income derived from using these products. As a result, double or multiple taxation still exists in the system.

Exemptions are granted to entities selling grains and edible oil at state-planned prices. Incomes from export sales, agricultural insurance, medicare, and childcare, are also exempted.[41]

4. Salt Tax (Yan Shui)

Salt tax in China is almost as old as the country itself. References to the first salt tax in China are recorded during the Warring Period (710-221 BC).[42] The salt tax was retained as one of the fourteen taxes introduced in 1950 and regulations on the tax were promulgated in 1984 during the second stage of *li gai shui*.[43] However, the revenue importance of

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38. Art. 1 of the Regulations of the People's Republic of China on Business Tax (Draft), *issued by* the State Council on September 18, 1984 [hereinafter Business Tax Law]. The Implementing Rules for the Regulations of the People's Republic of China on Business Tax (Draft), *promulgated by* the Ministry of Finance on September 28, 1984.

39. Business Tax Law, *supra* note 38, art. 2; Schedule of Taxable Items and Tax Rates of the Business Tax annexed to the Business Tax Law.

40. Business Tax Law, *supra* note 38, art. 3(2). The purchase price includes Product Tax paid on the product.

41. Business Tax Law, *supra* note 38, art. 6.

42. WANG, *supra* note 1 at 138. *See also* SHAO-KWAN CHEN, THE SYSTEN OF TAXATION IN CHINA IN THE TSING DYNASTY, 1644-1911 (1914), reprinted in (1970).

43. Regulations of the People's Republic of China on Salt Tax (Draft), *issued by* State Council on Sept. 18, 1984 [hereinafter Salt Tax Law]; Implementing Rules for the Regulations of the People's Republic of China on Salt Tax (Draft), *adopted by* the Ministry of Finance on Sept. 28, 1984.

the tax has decreased from 5 percent of total tax revenue in 1950 to 1.2 percent in 1983.[44]

The tax is levied upon salt producers, which are mainly state or collective enterprises, and upon salt importers and marketing agencies, on a per quantum basis.[45] The tax rates rage from 40 yuan to 160.80 yuan per ton depending on the area of production and the quality of salt. It is exempted on salt for export and reduced for salt used for leather manufacturing, soap and animal feed industries, farming, fishing and animal husbandry.[46]

5. Consolidated Industrial and Commercial Tax (Gongshang Tongyi Shui)[47]

When the Consolidated Industrial and Commercial Tax (CICT) Law was promulgated in 1958, it was made to apply to all enterprises and individuals, Chinese and foreign alike, which were engaged in the production of industrial products, the purchasers of agricultural products, the importation of foreign goods, commercial retailing, communication and transportation, and all other service trades.[48] The 1972 tax reform consolidated the CICT and three local taxes into the Industrial and Commercial Tax. Since the Industrial and Commercial Tax was applicable only to domestic enterprises and individuals, foreign businesses in China continued to be subject to the CICT Law. The further reform which took place in 1984 likewise did not affect the application of CICT to foreigners.[49] This tax may, however, be repealed in the near future, so that foreign enterprises will be subject to the turnover taxes applicable to domestic businesses.[50]

Altogether, CICT applies to over 100 categories of goods or transactions and prescribes some 42 different rates, ranging from 69 percent on top-quality cigarettes to 1.5 percent on certain basic necessities. Retail sales are taxed generally at 3 percent and the provision of services at

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44. DING, *supra* note 18 at 70.

45. Salt Tax Law, *supra* note 43, art. 1.

46. Salt Tax Law, *supra* note 43, art. 6.

47. *See* A.J. Easson and Li Jinyan, *Taxation of Foreign Business and Investment in the People's Republic of China*, 7 NW. J. INT'L L. & BUS. 666, 668-9 (Fall-Winter, 1986); GONGSHANG TONGYI SHUI JIANGHUA (A TALK ON THE CONSOLIDATED INDUSTRIAL AND COMMERCIAL TAX) (First Department of the General Tax Bureau of the Ministry of Finance, ed., Beijing, 1964 Chinese version).

48. Art. 1, Regulations of the Consolidated Industrial and Commercial Tax of the People's Republic of China (Draft), *adopted in principle* Sept. 11, 1958 by the 101st Meeting of the Standing Committee of the National People's Congress [hereinafter CICT Law]. The Detailed Rules and Regulations for the CICT Law were adopted by the Ministry of Finance on Sept. 13, 1958 [hereinafter CICT Rules].

49. It was decided by the Chinese government that to avoid the de-stability of taxation applying to foreign investors and businesses, the current tax reform should only affect Chinese enterprises. *See* Decision of the Standing Committee of the National People's Congress Authorizing the State Council to Promulgate Tax Reform Regulations *issued on* Sept. 18, 1984.

50. Renmin Ribao (Haiwai Ban), July 7, 1988 at 3.

rates between 3 and 7 percent. It is this tax on services which is of primary interest and concern to foreign businesses.

Exemptions and reductions are specifically granted to enterprises with foreign investment on the exportation of taxable goods (with the exception of crude oil, petroleum products and products covered separately by state regulations) and on importation of raw materials, machinery and equipment used in the business.[51] Further exemptions and reductions are available to those enterprises operating in the Special Economic Zones (SEZs), Hainan Province and the Economic and Technological Development Zones (EDTZs) established in the 14 Coastal Cities, where special policies are adopted to offer preferential treatment to foreign enterprises.[52]

6. Urban Maintenance and Construction Tax (Chengshi Weihu Jianshe Shui)

The Urban Maintenance and Construction Tax is a new local tax levied on taxpayers of Product Tax, VAT and Business Tax for the purposes of urban maintenance and construction.[53] Though the tax is not strictly perceived as a turnover tax, the rate is expressed as a percentage of the amount of tax payable by enterprises under the Product Tax, VAT or Business Tax. This is normally 7 percent in cities, 5 percent in county towns and 1 percent in other areas. The tax is payable at the same time as the three turnover taxes are paid though revenue from the tax is required to be used specifically to maintain or construct urban utilities.

This tax has been criticized by some commentators as not equitable

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51. *See* Regulations on the Supervision and Control of and Levying of or Exemption from Duties and Taxation on Goods Imported or Exported by Chinese-Foreign Equity Joint Ventures, jointly *promulgated by* the General Administration of Customs, the Ministry of Finance and the Ministry of Foreign Economic Relations and Trade on April 30, 1984; Regulations concerning the Levy and Exemption of Customs Duties and Consolidated Industrial and Commercial Tax on Imports and Exports of Goods for Chinese-foreign Cooperative Petroleum Exploitation of Offshore Petroleum, *promulgated on* April 1, 1982 by the General Administration of Customs and the Ministry of Finance; State Council Regulations Concerning Encouragement of Foreign Investment, *promulgated on* Oct. 11, 1986.

52. The four Special Economic Zones (SEZs) are Shenzhen, Zhuhai, Shantou (in Guangdong Province) and Xiamen (in Fujian Province); and the 14 coastal cities are Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhangjiang, and Beihai. The tax incentives in these areas are granted under the Provisional Regulations on Reduction and Exemption of Enterprise Income Tax and the Consolidated Industrial and Commercial Tax for the Special Economic Zones and the 14 Coastal Cities, *promulgated by* the State Council on Nov. 15, 1984; Regulations on Encouraging Investment and Development on Hainan Island, *adopted by* the State Council on May 4, 1988 [hereinafter Hainan Regs.]; Interim Provisions of the Ministry of Finance Concerning the Reduction of and Exemption from Enterprise Income Tax and Consolidated Industrial and Commercial Tax for the Encouragement of Foreign Investment in the Open Coastal Economic Zones, *issued on* June 15, 1988.

53. Art. 1 of the Provisional Regulations of the People's Republic of China on Urban Maintenance and Construction Tax, *promulgated on* Feb. 8, 1985 by the State Council.

because enterprises which are exempted from the Product Tax, VAT or Business Tax benefit from urban public utilities without contributing to the fund and enterprises manufacturing heavily taxed products have to pay more tax than taxpayers paying lower rates of tax even if they do not benefit from the public utilities at all.[54]

B. *Income Tax*

Historically, income taxes have played a relatively insignificant role in the public finances of China. At various times over the past fifty years attempts have been made to levy taxes on income, generally with little success.[55] In 1950, when the new tax system was established, income tax on business activities formed a part of the industrial and commercial taxes, although a wages and salaries income tax was also proposed. The only independent income tax was the Interest Income Tax,[56] chiefly payable by former capitalists whose businesses had been transferred to public ownership in return for bonds. This tax was paid until 1959 when it was discontinued and interest rates were correspondingly reduced.[57]

The present income tax system dates from 1980, with the introduction of the Joint Venture Income Tax Law and the Individual Income Tax Law. In 1981, the promulgation of the Foreign Enterprise Income Tax Law completed the income tax system regarding foreign individuals and enterprises doing business in China. Between 1983 and June 1988, four more business income taxes were promulgated which applyied to state enterprises, collective enterprises, individual households and private businesses. Another two personal income tax laws were passed in September 1986 and June 1988 which were applicable only to Chinese citizens. As a consequence, the revenue importance of income taxes has greatly increased and now constitutes about 40 percent of total tax revenue.

Before discussing the various income taxes, some initial comments should be made regarding income tax in China. First, the law distinguishes between the urban and rural sectors. Income from agriculture is not treated in the same way as income from other forms of business activ-

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54. Guo Hongde, *Suggestions on Improving the Principles on Levying the Urban Maintenance and Construction Tax*, Zhongguo Shuiwu, 1986, No. 6, 15 (Chinese version).

55. Although a short-lived progressive personal income tax was imposed as early as 10 A.D., the first income tax in the modern sense was introduced, (without ever being enforced), in 1913. In 1936, an income tax law was formally promulgated by the Guomindang Government. This law was based on the British schedular system and divided income into three categories: business income, employment income and income from securities and deposits. In 1938 and 1943, the Government introduced "excessive income tax during the Anti-Japanese War Period" to collect revenue for waging the war. *See* Yang Zukun, *Wang Mang First Introduced Income Tax*, Zhongguo Shuiwu, 1988, No. 6, 64; WANG, *supra* note 1 at 184-5 (Chinese versions).

56. Interim Regulations on Interest Income Tax, *issued on* Dec. 29, 1950 by the Administrative Council.

57. *See* Xu Zenghong, *Major Developments of Our Country's Income Tax System*, Zhongguo Shuiwu, 1987, No. 3, 22 (Chinese version).

ity. Second, the tax system is essentially a schedular one. Although some of the taxes are progressive, most income is taxed at a flat rate. There is no general system of aggregation whereby the eventual tax burden of an individual is computed by reference to his or her total income. In particular, a basic distinction is drawn between income from business and income from other sources. Third, different types of business organizations are subject to different rules based on the ownership of the enterprises. Finally, an obvious feature of the system is that it is divided into two parts. Taxes on foreign individuals and businesses are distinct from taxes on citizens and domestic enterprises. Foreigners and foreign businesses are generally taxed more favorably when compared to Chinese nationals and enterprises.

1. Personal Income Taxes

When it was introduced in 1980, the Individual Income Tax Law[58] applied to both foreigners and Chinese citizens, although the main target was the growing community of foreigners working in China.[59] Another tax, the Individual Income Regulatory Tax[60] was introduced in 1986, and from the beginning of 1987 has applied to Chinese citizens resident in China. In June 1988 a separate regulatory tax on private investors' income from private enterprises[61] was adopted to adjust the income level between these investors and ordinary wage earners.

(a) Individual Income Tax (Geren Suode Shui)

As a general rule, residents of China are taxed on world income while non-residents are taxed only on income from sources within China. There is no precise definition of "residence," but taxpayers are subject to different tax treatment based upon the period of time spent in China. Individuals who stay in China for more than five years are liable for Individual Income Tax ("IIT") on their world income with a foreign tax credit avail-

58. Individual Income Tax Law of the People's Republic of China, *adopted by* the 3rd Session of the 5th National People's Congress on Sept. 10, 1980 [hereinafter IIT Law]; Detailed Rules and Regulations for the Implementation of the Individual Income Tax Law of the People's Republic of China, *approved by* State Council on Dec. 10, 1980, *promulgated by* Ministry of Finance on Dec. 14, 1980 [hereinafter IIT Regs.].

59. It was estimated at the time that no more than 20 Chinese citizens would initially have to pay the tax. N.Y. Times, Sept. 3, 1980, at 1. By 1985, it was reported that there were 1,318 in Shanghai alone paying the tax. Wang Xiaochun, *Why the Shanghai Tax Bureau's 1985 Personal Income Tax Receipts Increased Rapidly*, Zhongguo Shuiwu, 1985, No. 6 at 15.

60. Provisional Regulations of the Individual Income Regulatory Tax of the People's Republic of China, *adopted by* the State Council on Sept. 25, 1986 [hereinafter IIRT Law]; Detailed Rules and Regulations for Implementing the Provisional Regulations of the Individual Income Regulatory Tax of the People's Republic of China, *adopted by* Ministry of Finance on Dec. 10, 1986 [hereinafter IIRT Regs.].

61. The State Council Regulations Concerning the Levy of Individual Income Regulatory Tax on Private Investors' Income from Private Enterprises, *adopted by* State Council on June 3, 1988, *promulgated on* June 25, 1988 [hereinafter Private Investors IIRT Law].

able for taxes paid in other countries. Individuals who reside in China for a year or more, but less than five years, are taxable on foreign-source income only to the extent that it is remitted to China. In practice, however, foreigners working in China for non-Chinese enterprises who do not intend to become permanent residents in China are not taxed on foreign source income at all.[62] Individuals residing in China for less than a year are taxed only on income gained within China.[63] The regulations further provide that remuneration paid by employers outside China for individuals whose continuous or cumulative residence in China does not exceed 90 days in a calendar year is exempted.[64] Individuals not resident in China at all are taxed on the total amount of their income obtained from personal services, royalties, rental income, and upon interest and dividends received from Chinese sources.

Taxable income under the IIT is divided into six categories: wages and salaries; compensation for personal services; royalties; interest, dividends and extra dividends; income from the lease of property; and other kinds of income specified as taxable by the Ministry of Finance.

(i) Employment Income

Only income from wages and salaries is taxed at progressive rates. A monthly deduction of 800 yuan is allowed with the excess taxed at rates rising from five percent to forty-five percent, the top rate being payable on earnings in excess of 12,000 yuan per month. From August 1, 1987, the tax on wages and salaries of foreign personnel working for non-Chinese enterprises in China was reduced by half.[65]

(ii) Compensation for Personal Services

This type of income includes compensation received for providing personal services, such as designing, installation, drafting, medical practice, law practice, accounting, consulting, lecturing, news reporting, broadcasting and entertaining.[66] It is taxed at a flat rate of 20 percent. A deduction is allowed for expenses of 800 yuan if the amount received in a single payment for a piece of work is less than 4,000 yuan For payments of 4,000 yuan or more, a deduction of twenty percent is allowed.[67] The remainder is taxed at twenty percent. Rents and royalties received by a

62. Notice of the General Tax Bureau of the Ministry of Finance, *Cai Shui Zi*, No. 62 (March 7, 1983).

63. This includes income from work and personal services performed in China and dividends, royalties and interest from Chinese sources, whether or not the place of payment is in China. IIT Regs., *supra* note 58, art. 5.

64. Art. 5 of IIT Regs. *as amended by* Ministry of Finance (Feb. 13, 1988).

65. Interim Provisions of the State Council of the People's Republic of China Concerning the Reduction of Individual Income Tax on the Income from Wages and Salaries Derived by Foreign Personnel Working in China, *issued on* Aug. 8, 1987.

66. IIT Regs., *supra* note 58, art. 4(2).

67. IIT Law, *supra* note 58, art. 5(2).

non-resident are taxable in full without any deduction.

(iii) Interest and Dividends

Income from interest, dividends and extra dividends is taxed at a flat rate of twenty percent without deduction.[68]

(iv) Exemptions and Reliefs

Certain categories of income are exempted from tax, notably: prizes and awards for scientific, technological or cultural achievements, interest from deposits in state banks, welfare benefits, certain pensions or severance pay, and salaries of foreign diplomatic and consular officials.[69]

(b) Individual Income Regulatory Tax (Geren Shouru Tiaojie Shui)

When the IIT Law was introduced in 1980, it was intended primarily to satisfy the needs of the "open" policy and was designed mainly to tax foreigners living and working in China. Within a few years of the economic reform it became apparent, however, that an appreciable number of Chinese citizens were receiving substantial incomes without paying tax. Basic exemption limits, which appeared to be quite reasonable for foreign executives having to live in scarce and expensive apartments or in hotels, were nevertheless many times higher than the average Chinese wage or salary. The large difference between average incomes and the incomes of this newly emerging wealthy class necessitated regulation, and a new personal tax was thus introduced in September 1986.[70]

The Individual Income Regulatory Tax (IIRT) applies to Chinese citizens who have a residence in China[71] and obtain personal income.[72] It differs from the IIT Law in two important respects: tax rates are more steeply progressive and there is some aggregation of the different categories of income.

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68. IIT Law, *supra* note 58, art. 3(2).

69. *Id.* at art. 4. For further discussion, see O.E. Bell, *People's Republic of China — Personal Income Tax*, 11 GA. J. INT'L & COMP. L. 373 (1981); Easson and Li, *supra* note 47, at 683-92; M.H. Byres and A. Shum, *Individual Income Tax in the PRC*, TAX PLAN. INT'L REV., 16 (March 1986); R.D. Pomp, T.A. Gelatt and S.S. Surrey, *The Evolving Tax System of the PRC*, 16 TEX INT'L L.J. 11 (1981); and Wang Desheng, *A General Talk on Our Country's Individual Income Tax System*, FAZHI JIANSHI (LEGAL CONSTRUCTION), No. 3, at 54 (1987) (Chinese version).

70. *See* Li Jinyan, *People's Republic of China: The New Regulatory Tax on Individual Income*, 41 BULL. FOR INT'L FISCAL DOCUMENTATION 167, 168 (1987); Editorial Notes in Zhongguo Fazhi Bao (Chinese Jurisprudence Newspaper), Dec. 12, 1986 (Chinese version).

71. "Chinese citizens who have a residence in China" is defined as a Chinese citizen who has Chinese nationality, a household registration and actually stays in China. *See* IIRT Regs., *supra* note 60, art. 2.

72. IIRT Law, *supra* note 60, art. 2.

(i) Taxable Income

The IIRT adds a new category of taxable income, namely "income from contractual and sub-contractual fees."[73] These fees are earned by individuals who contract with a state enterprise, a collective enterprise or a joint enterprise to manage the business, or some part of the business, and to be responsible for the profit or loss thereof.[74] Additionally, the IIRT has two categories of "royalty" income; income from transferring patent rights and providing non-patented technology, and income from writing and translating.[75]

(ii) Tax Rates

Unlike the IIT Law, the IIRT Law provides for a measure of aggregation of the various types of income. The two types of royalty income are taxed at a flat rate of 20 percent, after an expense deduction similar to that under the IIT Law.[76] Dividend and interest income is taxed at twenty percent on the gross amount received. However, employment income, income from contractual fees, remuneration for personal services and rental income are aggregated monthly and are taxed under an elaborate progressive rate schedule.[77] Tax becomes payable, at a rate of twenty percent, when the individual's monthly income exceeds four times the "basic regional taxable amount"[78] and increases to a rate of sixty percent on the excess above eight times that amount. Consequently, the effective rate varies from region to region.[79] The overall effect is that a Chinese citizen living in Beijing will pay the highest rate of sixty percent, on income in excess of 800 yuan per month, whereas this amount is the same as that at which a foreigner begins to pay the lowest, 2.5 percent, rate under the IIT Law. As with the IIT Law, a number of categories of income are exempted.

The introduction of the IIRT Law has led to a considerable increase in the number of Chinese citizens, particularly artists, athletes, writers, business managers, and scientists, who are liable to pay personal income tax and to a great increase in the tax burden upon those who already were paying IIT. In Shanghai, for instance, there were 300,000 individuals

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73. *Id.* at, art. 3(ii).

74. IIRT Regs., *supra* note 60, art. 4(ii).

75. IIRT Law, *supra* note 60, art. 3(v) and (vi).

76. *Id.* at, art. 7(i).

77. *Id.* at, art. 5.

78. The "basic regional taxable amount" ("BRTA") ranges from 100 to 115 yuan. The starting point for tax is consequently 400 yuan, or 460 yuan in regions with the highest BRTA.

79. The BRTA is determined by reference to wages and price levels in the different regions. It appears to have a built-in incentive to encourage workers to go to the remote regions. The BRTA tax is heaviest in the capital, Beijing, and least heavy in areas such as Tibet and Xinjiang. *See* LI, *supra* note 70, at 169.

who paid IIRT in the 1987 taxation year.[80]

(c) Private Investors Individual Income Regulatory Tax (Siying Qiye Touzizhe Geren Shouru Tiaojie Shui)

This tax was introduced in June 1988 together with the Private Enterprise Income Tax.[81] Individual investors in private enterprises are liable to IIRT on their wages or salaries paid by the enterprises. If the private enterprise distributes income to its investors out of its after-tax profits, the investors are taxed under the Private Investors IIRT Law. The enterprise is required, however, to put aside not less than 50 percent of its retained earnings in a production development fund. The investor is exempted from tax on his reinvestment in the production development fund. He must, however, pay the tax at 40 on the amount distributed to him for personal consumption. Where the investor takes funds out of the production development fund, or gets funds by disposing of enterprise business assets for personal consumption purposes, he will also be liable for the regulatory tax at 40 percent of the amount.[82]

2. Business Income Taxes

In contrast to personal income taxes, there are six or seven separate taxes imposed upon business income, depending on the type of business entity being taxed. Two of these taxes are levied on enterprises with foreign investment, and the rest are imposed on domestic enterprises.

(a) Income Taxes on Enterprises with Foreign Investment

(i) Joint Venture Income Tax (Heying Qiye Suode Shui)

A foreign company intending to do business in China must choose between establishing a "branch"[83] operation, or forming a subsidiary by setting up a joint venture with one or more Chinese co-venturers or incorporating a wholly foreign-owned enterprise.[84] A distinction is commonly drawn between equity joint ventures[85] and cooperative joint ventures.

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80. Renmin Ribao, Jan. 15, 1988, at 1 (Chinese version).

81. Provisional Regulations of the People's Republic of China on Private Enterprise Income Tax, *adopted* June 3, 1988 and *promulgated* June 25, 1988 by the State Council [hereinafter PEIT Law].

82. Private Investors IIRT Law, *supra* note 61, art. 3. *See* Li Jinyan, *People's Republic of China: Taxation of Private Business and Private Investors*, 42 BULL. FOR INT'L FISCAL DOCUMENTATION, 415, 417-8 (1988).

83. Generally, it is not possible for a foreign enterprise to establish a branch plant operation. But it may open a representative office which is permitted to transact business in a limited way. In addition, a contractual joint venture is treated in a manner similar to that of a branch.

84. Under the Law on Enterprises Operated Exclusively with Foreign Capital, *adopted* April 12, 1986.

85. An equity joint venture can be established in accordance with the Law on Joint Ventures Using Chinese and Foreign Investment, *adopted by* the 2nd Session of the 5th

Prior to 1988, a cooperative joint venture created no separate legal entity and the relationship of the parties resembled that of a partnership. All this has been changed since the promulgation of the Cooperative Joint Venture Law in April, 1988.[86] Under this law, a cooperative joint venture can choose whether to take the form of a partnership or that of a Chinese legal person. Under the existing tax system, a cooperative joint venture is normally not regarded as a taxable person, the profit of the venture is divided among the participants in accordance with the contractual stipulation and is taxed in the hands of the participants. Thus, the Chinese party may pay the State Enterprise Income Tax or Collective Enterprise Income Tax while the foreign party pays the Foreign Enterprise Income Tax.[87]

By contrast, an equity joint venture is a separate legal person, incorporated under Chinese law and taxed under a separate tax statute.[88] The Joint Venture Income Tax (JVIT) is levied on income of Chinese-foreign joint ventures from production, business and other sources, including the income from branches inside and outside China.[89] Taxable income is defined as "the excess of gross income in a tax year over its deductible costs, expenses and losses".[90] Tax is charged at a flat rate of 30 percent, in addi-

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National People's Congress on July 8, 1979 [hereinafter JV Law]; and the Detailed Rules and Regulations for the Implementation of the Law on Joint Ventures Using Chinese and Foreign Investment, *adopted by* the State Council on September 21, 1983.

86. Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures, adopted at the 1st Session of the 7th National People's Congress on April 13, 1988, promulgated and effective on the same date [hereinafter Cooperative Joint Venture Law].

87. At present it is unclear how a cooperative joint venture which chooses to be constituted as a legal person, under the Cooperative Joint Venture Law, will be treated. It seems that the party can agree to share after-tax profits, rather than before-tax profits, and it may be that in such a case the venture will be taxed in the same way as are equity joint ventures.

88. Income Tax Law concerning Joint Ventures with Chinese and Foreign Investment, *adopted by* the 3rd Session of the 5th National People's Congress on September 10, 1980 [hereinafter JVIT Law]; Detailed Rules and Regulations for the Implementation of the Income Tax Law concerning Joint Ventures with Chinese and Foreign Investment, *promulgated by* the Ministry of Finance on December 14, 1980 [hereinafter JVIT Regs.]. For further discussion of the law, see EASSON and LI, *supra* note 47, at 672-76; D.R. Simon, *Taxation of Joint Ventures in China: A Legal Analysis in the Context of Current Chinese Economic and Political Conditions*, 15 VAND. J. TRANSNAT'L L. 513 (1982); T.A. Gelatt and R.D. Pomp, *Tax Aspects of Doing Business with the People's Republic of China*, 22 COLUM. J. TRANSNAT'L L. 21 (1984); H.J.F. Bloomfield, *Legal Aspects of Joint Ventures in China*, 14 INT'L BUS. LAW. 327 (1986).

89. JVIT Law, *supra* note 88, art. 1. "production" and "business" are defined as "operations in industry, mining, communications and transportation, agriculture, forestry, animal husbandry, fishing, poultry-farming, commerce, tourism, catering, service trades and other lines of business." "Other income" is defined as "income from dividends, extra dividends and interest income, and income from the lease or transfer of tangible property, patent rights, proprietary technology, trademark rights, copyrights and other property": JVIT Regs., *supra* note 88, art. 2. Note that capital gains are also taxed as "other income": *see* Ministry of Finance Ruling, (87) *Cai Shui Wai Zi*, No. 033 (Feb. 22, 1987).

90. JVIT Law, *supra* note 88, art. 2. Profits of joint ventures must be computed and accounts drawn up, in accordance with the Accounting Regulations for Joint Ventures Using Chinese and Foreign Investment, *promulgated* March 3, 1985 by the Ministry of Finance.

tion to which a local income tax of 10 percent of the assessed tax is payable, bringing the effective rate to 33 percent.[91] For joint ventures established in the Special Economic Zones, or other special development areas, the rate is commonly reduced to 15 percent, with no additional local income tax. A special dividend withholding tax of 10 percent is also payable on profits remitted outside China.[92] By contrast, when a participant in a joint venture reinvests its share of the profits in China for a period of not less than five years, the participant is eligible for a refund of 40 percent of the central tax paid by the joint venture in respect of the reinvested amount.[93] A participant who withdraws reinvested funds within the five year period must repay the amount refunded.[94] A joint venture to which the JVIT Law applies is taxed on its world income, but foreign tax paid on income from non-Chinese sources may be credited against tax due under the JVIT Law.[95]

Certain tax holidays are provided in legislation to encourage foreign investment in joint ventures. For instance, newly established ventures scheduled to operate for ten years or more may be exempted from the JVIT in the first two profit-making years and are allowed a 50 percent reduction in the following three years. Joint ventures engaged in certain low-profit operations, in particular farming and forestry, or located in remote or under-developed regions, may be allowed a further reduction for up to ten years.[96] Joint ventures which are "export-oriented enterprises"[97] or "technologically advanced enterprises"[98] will continue to enjoy the 50 percent reduction after the expiry of the normal tax holiday period, in the case of a technologically advanced enterprises for an additional three years, and in the case of an export-oriented enterprise for as long as it continues to qualify as such.[99]

Art. 9 of the JVIT Regs. expressly prohibits certain deductions in the computation of profits, notably interest on capital, losses covered by insurance, donations other than those for public welfare in excess of 1% of gross business income. Capital expenditures are not deductible, but depreciation or amortization is permitted normally on a straight line basis over prescribed periods corresponding to the estimated useful life of the asset in question: arts. 10-17 of the JVIT Regs., *supra* note 88.

91. JVIT Law, *supra* note 88, art. 3.

92. *Id.* at, art. 4. This tax is commonly exempted in Special Economic Zones, Economic and Technological Development Zones and other open coastal areas.

93. JVIT Law, *supra* note 88, art. 6.

94. *Id.*

95. *Id.* at art. 15.

96. *Id.* at art. 5.

97. These are enterprises whose output value of exported products amounts to more than 70 percent of the total output. *See* art. 8 of the Provisions of the State Council for the Encouragement of Foreign Investment, *adopted and promulgated on* October 11, 1986 [hereinafter Foreign Investment Provisions].

98. *Id.* at art. 9. The certification procedures, for both "export enterprises" and "technologically advanced enterprises", are set out in the Implementing Measures of the Ministry of Foreign Economic Relations and Trade on the Confirmation and Examination of Export-Oriented Enterprises with Foreign Investment, promulgated on Jan. 27, 1987.

99. Qualifying enterprises located in the SEZs, where the normal tax rate is reduced to

(ii) Foreign Enterprise Income Tax (Waiguo Qiye Suode Shui)

A foreign enterprise that carries on business in China in any form except that of an equity joint venture is liable to the Foreign Enterprise Income Tax (FEIT) on income earned in China by that enterprise.[100] The FEIT consequently applies to wholly foreign-owned enterprises incorporated in China, to the foreign participant in a cooperative joint venture, and to foreign enterprises doing business in China through a representative office, branch or other establishment. For the purposes of the legislation, "foreign enterprise" means a foreign company, enterprise or other economic organization having an establishment in China engaged in independent business operations or cooperative production or joint business operations with Chinese enterprises.[101] Foreign enterprises which do not have establishments in China are subject to a flat-rate withholding tax of 20 percent on income from dividends, interest, rentals, royalties and other sources in China, which tax must be withheld by the paying unit.[102]

A foreign enterprise having an establishment in China is taxed on income earned there at progressive rates ranging from 20 percent on the first 250,000 yuan of taxable income for the year to 40 percent on income in excess of one million yuan.[103] A local income tax of an additional 10 percent is also levied, bringing the total rate to a maximum of 50 per-

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15 percent, pay a reduced rate of 10 percent rather than receiving a 50 percent reduction: *see* the Implementing Measures for the Preferential Taxation Provisions of the State Council Provisions for the Encouragement of Foreign Investment, adopted by the Ministry of Finance on January 31, 1987. In most of China's tax treaties, these tax holidays are accorded "tax sparing" treatment. *See* EASSON and LI, *supra* note 47, at 693-4.

100. Income Tax Law of the People's Republic of China concerning Foreign Enterprises, *adopted by* the 4th Session of the 5th National People's Congress and promulgated on Dec. 13, 1981 [hereinafter FEIT Law]; Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China concerning Foreign Enterprises, *promulgated by* the Ministry of Finance on February 21, 1982 [hereinafter FEIT Regs.]. For further discussion of the tax, *see* Li Jinyan and A.J. Easson, *Taxation of Foreign Investment in China*, GUOJI MAOYI WENTI (INTERNATIONAL TRADE JOURNAL), 1987, No. 1, 27 (Chinese version), P.D. Reynolds, *Doing Business with the People's Republic of China: Tax Considerations*, 14 INT'L LAW. 49 (1980); J.Horsley, *Comments on Laws and Legal Developments Affecting Foreign Investment in China*, 3 CHINA LAW REP. 175 (1986); T.A. Gelatt and E. Theroux, *Tax Treatment in China*, CHINA BUS. REV. 22 (Jan.-Feb. 1984); and A. Ness and S.J. Mitchell, *Taxing US Offices in China*, CHINA BUS. REV. 36 (Sept.-Oct. 1986).

101. FEIT Law, *supra* note 100, art. 1. A foreign individual who carries on business in China may be regarded as an "enterprise" for the purposes of the FEIT Law: *see* Ministry of Finance Ruling (82) *Cai Shui Wai Zi*, No. 99, Aug. 2, 1982.

102. FEIT Law, *supra* note 100, art. 11. Certain types of interest and royalty income are exempted or taxed at reduced rates. Interest on loans to the Chinese government, to the state banks or to the National Offshore Oil Corporation are entirely exempted and a reduced rate of 10 percent is charged on interest on loans made between 1983 and 1990 and on income from leasing equipment to Chinese concerns: see rulings from the Ministry of Finance, (82) *Cai Shui Zi*, No. 326, Dec. 13, 1982; (83) *Cai Shui Zi*, No. 348, Jan. 7,1983; and (86) *Cai Shui Zi*, No. 1, Jan. 6, 1986.

103. FEIT Law, *supra* note 100, art. 3.

cent.[104] Consequently, except in the case of small operations, an equity joint venture will pay less tax on its profits than will a branch operation or cooperative joint venture, though there will be an additional tax of 10 percent on profits remitted outside the country by the joint venturers. Foreign enterprises operating in SEZs or other special areas and enterprises which are "export-oriented" or "technologically advanced" are taxed at the same preferential rate as equity joint ventures.[105]

The term "establishment" is interpretated to mean "organizations, places or business agents established in the Chinese territory by foreign enterprises and engaged in production and business operations,"[106] which mainly include "management offices, branches, representative offices, factories and places where natural resources are exploited and where contracted projects of building, installation, assembly and exploration are operated."[107] The definition is, on its face, fairly broad. Nonetheless, in practice, the word seems to correspond to the notion of "permanent establishment" used in the tax treaties signed so far by China.[108]

As in the case of joint ventures, the Chinese authorities provide tax holidays to attract foreign investment. Enterprises scheduled to operate for a period of ten years or more in farming, forestry, animal husbandry or other low-profit activities may be exempted from tax in the first profit-making year and allowed a fifty percent reduction in the following two years, with further reduction for an additional period of up to ten years.[109]

(iii) Draft Law on Income Taxation of Enterprises with Foreign Investment

A draft version of the Income Tax Law of People's Republic of China on Enterprises with Foreign Investment (Draft) (the "Draft Tax Law") has been under review by the State Council and might become law sometime in 1989. The draft law consolidates the JVIT Law and FEIT Law, lowers the general tax rates and offers more incentives to foreign investors. The Draft Tax Law will apply to all enterprises with foreign investment, including equity joint ventures, cooperative joint ventures, wholly foreign-owned enterprises, as well as foreign enterprises which have an establishment in China. The tax rate will be either 25 percent with an additional 5 percent local tax, or 30 percent with a 3 percent local tax.

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104. *Id.* at art. 4. It should be noted that this local rate is not, unlike that under the JVIT Law, expressed as a percentage of the tax otherwise payable. The local tax authorities may reduce or waive this tax.

105. Foreign Investment Provisions, *supra* note 97, art. 8.

106. FEIT Regs., *supra* note 100, art. 2.

107. *Id.*

108. *See* EASSON and LI, *supra* note 47, at 677-9; and Li Jinyan, *A Discussion of Tax Agreements*, JINGJI YU FALU (ECONOMICS AND LAW), 1987, No. 4, 7 (Chinese version).

109. FEIT Law, *supra* note 100, art. 5. These concessions are also accorded "tax sparing" treatment in China's tax treaties, except that with the U.S.

Enterprises established in the Special Economic Zones and Economic and Technological Development Zones will be taxed at 15 percent and productive enterprises established in the open coastal areas will be taxed at 20 percent. The tax reductions and exemptions provided under the JVIT Law and FEIT Law will be maintained. Business losses will be allowed to be carried forward forever. The Draft Tax Law also includes a new provision which authorizes the tax authorities to reasonably adjust the amount of income where a taxpayer does not deal at arm's length with its affiliated companies.

(b) Income Taxation of Domestic Enterprises

(i) State Enterprise Income Tax (Guoying Qiye Suode Shui)

Despite the recent impressive growth in the number of foreign enterprises, joint ventures, collective and private enterprises, the Chinese economy remains dominated by state enterprises.[110] The growth in the importance of tax revenue, from less than half of the total budget revenue a few years ago to the present over 90 percent, is due to the substitution of tax payments for profit delivery by state enterprises. The main purposes of *li gai shui* are to maintain a proper balance between state interest and that of enterprises. The *li gai shui* establishing a system whereby enterprises are responsible for profits and losses after tax, and enables them, under the guidance of state macroeconomic planning, to have motivation and become more vital, so that they will be able to perform their roles as relatively independent commodity producers.[111]

State Enterprise Income Tax (SEIT) is charged in accordance with the State Enterprise Income Tax Law and Regulations.[112] The tax is imposed upon the profits of state enterprises engaged in industry, commerce, transportation and communications, construction and installation, finance and insurance, catering and services, culture, education, public health, supply and marketing of goods, urban utilities and other work.

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110. By the end of 1985, there were approximately 833,000 state enterprises, 3,347,000 collective enterprises, and around 17 million people engaged in individually-owned businesses, the number of which is variously estimated at from 5.8 to 11 million. The key industries and sectors of the economy are in the hands of state enterprises. *See* China Daily, Jan. 27, 1986 and Oct. 23, 1986.

111. For further comments, see the Tianjin Investigation Team on Substituting Taxes for Delivery of Profits, *The First Stage in Substituting Taxes for the Delivery of Profits*, Jingji Guanli (Economic Management), 1984, No. 1, 20; Xu Riqing and Li Liangru, *A Brief Discussion on the Question of the Role of Substituting Tax Payment for Profit Delivery for State Enterprises*, Jingji Wenti (Economic Issues), 1984, No. 1, 38; and Tian Jiyun, *Several Questions on Improving the System of Substituting Tax Payment for Profit Delivery*, Jingji Ribao (Economic Daily), Jan. 12, 1984 (Chinese versions).

112. Regulations of the People's Republic of China on State Enterprise Income Tax, *promulgated by* the State Council on Sept. 18, 1984 [herineafter SEIT Law]; and the Detailed Rules and Regulations for the Regulations of the People's Republic of China on State Enterprise Income Tax, *issued by* the Ministry of Finance on Oct. 18, 1984 [hereinafter SEIT Regs.].

Not all state enterprises, however, are taxed under the SEIT Law. Those enterprises which are not the subject of *li gai shui*, such as some military enterprises, enterprises engaged in postal and telecommunications, civil aviation enterprises, foreign trade corporations and agriculture, etc., are not subject to the SEIT Law. They still deliver all their profits to the state.[113]

Under the SEIT Law, only those enterprises which keep independent economic accounts are considered to be taxpayers. Therefore, joint corporations which are formed by several enterprises in order to enjoy economies of scale are not necessarily taxpayers of the SEIT as such. If a separate legal and accounting entity is established, the joint corporation pays the tax as an independent taxpayer. If no such entity is formed, especially those established among state enterprises and collective or private enterprises, each participating enterprise remains liable for tax on its share of profits.[114] For certain nation-wide corporations formed by enterprises in the same industry, the joint corporation may pay the income tax as an independent taxpayer and receive a credit for taxes paid by its subsidiaries.[115]

The taxable income of a state enterprise includes net income from production, transportation, commerce, services and other income. "Other income" is interpreted as dividend income received from a joint corporation or other enterprise, interest income on bonds (except state bonds) and other non-business income.[116] In calculating taxable income, the following deductions are specifically permitted: profits and dividends distributed to its shareholders by a joint corporation before paying the SEIT; certain interest payments on loans approved by the Ministry of Finance; losses incurred in previous years; and some prescribed deductions, such as net profits from utilizing waste liquid, gas or materials, profits from processing for a foreign enterprises, etc.[117] The following items are not deductible: wages, bonuses or subsidies paid out of a after-tax fund (such as wage-increase fund, bonus fund); payments of bonus tax, construction tax and purchasing state bonds.[118]

A state enterprise is taxed on its world income. Income from a foreign-source must be computed separately from domestic income and a reduced rate of 20 percent is applicable to the foreign income.[119] Taxes

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113. *Ding*, *supra* note 18, at 229-30.

114. Arts. 2 and 9 of the SEIT Law, *supra* note 112 and art. 4 of the SEIT Regs., *supra* note 112, and arts. 24-27 of the Decision of the State Council on Questions Regarding Further Improving the Horizontal Economic Cooperation of Enterprises, March 23, 1986 by the State Council.

115. *See* DING, *supra* note 18, at 230-1; and Zhang Lianshun, *A Brief Discussion of the Question of Levying Income Tax on Joint Enterprises*, Zhongguo Shuiwu, 1985, No. 8, 26 (Chinese version).

116. SEIT Regs., *supra* note 112, art. 9.

117. *Id.* at art. 10.

118. *Id.* at art. 11.

119. Arts. 1 and 4 of the Interim Regulations on the Levy of State Enterprise Income

paid in foreign countries are deductible in calculating taxable income.[120] A company incorporated for the purposes of carrying out contracting businesses in foreign countries is exempted from income tax for the first five years from its incorporation, and further reductions in tax may be available subject to approval by the tax authorities.[121]

State enterprises are divided into two categories for tax purposes. Large and medium-sized enterprises pay a flat rate of 55 percent on their profits. Small enterprises,[122] food servicing enterprises and enterprises in the hotel business pay an eight-grade progressive tax, which rises from 7 percent to 55 percent. Certain industries are subject to the 55 percent rate regardless of the size of the enterprise. These include enterprises engaged in publishing, construction and installation, finance and insurance, wholesaling, trading centres, friendship hotels,[123] petroleum stores (including gas stations), overseas shipping companies.[124]

The distinction also applies to the treatment of after-tax profits. Small enterprises and enterprises paying the progressive rates assume sole responsibility for profits and losses and, after payment of taxes, the state generally makes no further appropriation. Only those which have a large amount of "extra" profits are required to pay a contractual or leasing fee to the state.[125] As for the large and medium-sized enterprises a number of experimental systems have been tried. Initially, a further part of the profit was turned over to the state under specially negotiated contractual arrangements. However, for many enterprises this system has been superseded by a separate regulatory tax which seeks to address the wide disparities in the profitability of different enterprises which may reflect circumstances other than the efficiency of management, such as geo-

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Tax on State Enterprises Engaging in Contractual Projects in Foreign Countries, adopted by the Ministry of Finance on March 11, 1985: (85) *Cai Shui Zi*, No. 058.

120. It should be noted that it is a *deduction* method instead of credit method which is adopted here.

121. (85) *Cai Shui Zi*, No. 058, *supra* note 120. *See* Zhang Lianshun and Sun Wushan, *Comments on Levying Income Tax on State Enterprises' Income from Contracting Projects in Foreign Countries*, Zhongguo Shuiwu, 1985, No. 5, 32 (Chinese version).

122. "Small enterprises" are defined as those whose fixed assets, profits and workers do not exceed a certain level which varies from region to region. In Beijing, Shanghai and Tianjin, the three largest cities in China, a small industrial and transportation enterprise is one whose fixed assets do not exceed 4 million yuan, annual profits do not exceed 0.4 million. In other regions, a small enterprise is one whose fixed assets do not exceed 3 million yuan and annual profits do not exceed 0.3 million yuan. Small enterprises in commerce in Beijing, Shanghai and Tianjin are defined as those whose number of workers does not exceed 60 and annual profits do not exceed 0.2 million. *See* art. 15 of the SEIT Regs., *supra* note 112.

123. In China, special stores are designated as "friendship stores" to serve the needs of foreigners and overseas Chinese. Generally, local currency is not accepted in these stores and the goods are normally not easily available in local shops.

124. SEIT Regs., *supra* note 112, art. 15.

125. The amount of the leasing fee is determined by local government. *See* Tao Shengyu, *The Contents of Policies in the Second Phase of Li Gai Shui*, Qiye Guanli (Enterprise Management), No.10 and 16, at 17 (1984) (Chinese version).

graphical location, availability of natural resources, level of previous capital investment, the condition and age of the plant and machinery and the state pricing policy. A resource tax is also levied as a form of excess profits tax on large and medium-sized enterprises, aimed at eliminating disparities between enterprises brought about by different physical conditions.

(ii) State Enterprise Income Regulatory Tax (Guoying Qiye Tiaojie Shui)

This tax is imposed on large and medium-sized state enterprises whose after-tax profits exceed a "reasonable" amount of retained profits. This amount is equated to the reasonable amount of retained profits of an enterprise in 1983, after paying the SEIT and the State Enterprise Income Regulatory Tax (SEIRT).

Unlike other income taxes, there are no tax rates provided in the SEIRT Measures.[126] The SEIRT Measures do, nonetheless, provide that the appropriate rate is determined according to the following formula:

$$\text{Tax rate} = \frac{\text{Base Year Profit} \times (1\text{-}55\%) - \text{1983 Retained Profit}}{\text{Base Year Profit}} \times 100\%$$

The "base year profit" refers to the amount of profits realized by an enterprise after deducting payments of Product Tax, VAT, Business Tax and Resource Tax.[127] Once the tax rate is determined, it is valid for seven years, commencing from 1985, to ensure that subsequent increases in profitability in response to the new incentives are not nullified by the tax. Enterprises whose current year profits exceed that of the base year can enjoy a 70 percent reduction in the regulatory tax on the excess amount.

Although declared temporary, the regulatory tax is criticized from Chinese writers. They claim that it retains vestiges of the former profit delivery system and, by penalizing success, is like "beating the fast running cow."[128] Due to the existence of those factors causing disparities of profitability among enterprises, the SEIRT is likely to remain in order to allow the state to appropriate the amount of profits realized by enterprises which benefit from advantageous factors and to encourage enterprises to improve their technology by reducing the SEIRT payable.[129]

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126. State Enterprises Income Regulatory Tax Collecting Measures, *promulgated by* the State Council on Sept. 19, 1984 [hereinafter the SEIRT Measures].

127. *Id.* at art. 6.

128. *See* Chen Lanying, *Should Not Undervalue the Historical Function of the Regulatory Tax*, Zhongguo Shuiwu, No. 6 at 30 (1986); and Tang Sheng, *Is the Regulatory Tax Beating the Fast Running Cow?*, Zhongguo Shuiwu, No. 3 at 18 (1987) (Chinese versions).

129. *See* Tao Shengyu and Lu Bing, *To Actively Create Conditions for Enliven Large and Medium-Sized Enterprises by Doing a Good Job in Reducing Regulatory Tax*, Cai Zheng (Finance), No. 5 at 15 (1986). As a matter of fact, many state enterprises enter into contracts with the state to "promise" to hand in a certain amount of taxes, including SEIT and SEIRT, to the state for a number of years in accordance with the Interim Provisions concerning the Financial Affairs of Large and Medium-Sized State Enterprises which Implement Contractual Responsibility System, *issued by* the Ministry of Finance on August 21,

(iii) Collective Enterprise Income Tax (Jiti Giye Suode Shui)

Collective enterprises had been subject to the Industrial and Commercial Income Tax until 1985 when a separate tax law — the Collective Enterprise Income Tax Law ("CEIT Law")[130] was promulgated. The tax applies to all collective enterprises engaged in industry, commerce, service trades, construction, installation, communications, transportation and other fields of work, which have independent accounting systems. Collective enterprises in China take a variety of forms, ranging from small partnerships to relatively large concerns which are incorporated and, in some cases, have made public offerings of stock.[131] The essence of a collective is that it is collectively-owned, rather than state-owned, and is "non-governmental." The collective's production plan is not incorporated directly as part of the State Economic Plan and it does not account to the state for its profits. Due to the rapid development of collective enterprises in urban and rural areas, the percentage of national industrial revenue contributed by the collective sector increased from 6.8 percent in 1978 to 15 percent in 1984 and collectives also generate 43.7 percent of national revenue from light industry.[132] The number of collective enterprises far exceeds that of state enterprises.[133]

Collective Enterprise Income Tax ("CEIT") is levied upon total income after deduction of expenses, according to an eight grade progressive

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1987, (87) *Cai Gong Zi*, No. 407. This saves the problem of calculating the SEIRT for each year but it may cause confusion of profit delivery and tax payment. For further discussions, see Xu Jingan and Zhou Shaohua, *Remodel the State Economic Management Pattern*, Shijie Jingji Daobao (World Economic Herald), Nov. 31, 1987, at 15; Wang Shaofei, *Contractual Responsibility System and Tax Reform May Promote Each Other*, Renmin Ribao, Feb. 5, 1988, at 5; Xia Yang, *The Defects of Signing a Contract with Guaranteed Tax Payments*, Guangming Ribao, Dec. 5, 1987, at 3; and Renmin Ribao, March 14, 1988, at 1 (Chinese versions).

130. The Interim Regulations of the People's Republic of China on Collective Enterprise Income Tax, *promulgated by* the State Council (April 11, 1985) [hereinafter CEIT Law], and the Detailed Rules for the Interim Regulations of the People's Republic of China on Collective Enterprise Income Tax, *adopted by* the Ministry of Finance (July 22, 1985) [hereinafter CEIT Regs.].

131. At present, collective enterprises are the only type of domestic enterprises which are officially permitted by the government to issue stocks: *see* Zhongguo Fazhi Bao, April 4, 1987 (Chinese version). *See further* Chen Huiren, *The Practice of Stock System of Zhongxingcun and Inspiration therefrom*, Jingji Gaige (Economic Reform), No. 1, at 43 (1987) (Chinese version); Zhang Hong, *Certain Questions on the Shareholding System of Collective Enterprises*, Jingji Gaige, No.1, at 47 (1987)(Chinese version); and *China Tries out Shareholding System* written by the Investigation and Research Group of the State Commission for Economic Restructuring, BEIJING REV. 22, Oct. 5, 1987.

132. Wang Chuhong, *Collective Economy Shall be The Basis of our Country's Ownership System*, Guangming Ribao (Guangming Daily), Feb. 7, 1987, at 3 (Chinese version).

133. By the end of 1985, there were 833,400 state enterprises, and 3,347,000 collective enterprises. *See* Renmin Ribao (Haiwai Ban), July 11, 1986. Rural township collectives have been developing rapidly since the late 1970s and the gross revenue therefrom exceeded the gross revenue from agriculture in 1986 for the first time: Renmin Ribao (Haiwai Ban), Nov. 14, 1986.

scale, as is the case with small state enterprises. However, income from agriculture is not taxed under this tax.[134] Profits and dividends received from other enterprises are deductible in computing taxable income. Nonetheless, the deduction of the following items are specifically prohibited: losses from previous years; payments of wages and bonuses paid to workers;[135] penalties; Construction Tax; government bonds; and dividends to shareholders.[136]

The tax is levied annually, and must be prepaid monthly or quarterly.[137] Special reductions or exemptions are given for certain types of enterprises, especially those enterprises ancillary to agriculture, village and township collectives established in minority-inhabited areas or remote and border areas.[138]

As in the case of small state enterprises, collective enterprises are free to dispose of retained profits after payment of the income tax subject to the following conditions: not less than 55 percent of the retained profits must be allocated to the production development fund, and not more than 20 percent to the workers' welfare fund, not more than 10 percent to the workers' bonus fund and not more than 15 percent to the dividend account.[139]

(iv) Individual Industrial and Commercial Household Tax (Geti Gongshangyehu Suode Shui)

Since the introduction of the economic reforms and the open policy in 1979, private businesses have been revived and have become an inseparable part of the national economy.[140] By the end of 1987, there were more than 13 million individually owned businesses employing more than 20 million people conducting industrial, commercial and service activities.[141] Like collectives, individual households were until recently liable to pay the Industrial and Commercial Income Tax. A new tax, introduced in 1986,[142] now applies to all industrial and commercial households engaged

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134. CEIT Regs., *supra* note 130, art.9.

135. Payment of wages and bonuses to workers by collectives in accordance with the specified standard are treated as a cost of production and therefore deductible. Payments beyond the standard must be paid from retained earnings: art. 28(1) of the Financial Administrating Measures on Urban and Township Industrial Collective Enterprises, *adopted by* the Ministry of Finance (Dec. 31, 1986) [hereinafter Collective Enterprise Financial Measures].

136. CEIT Regs. *supra* note 130, art.12.

137. *Id.* at art.6.

138. *Id.* at art. 4.

139. Collective Enterprise Financial Measures, *supra* note 135, art. 4(3). The exact percentage is for the enterprise to decide.

140. *See* Gao Jikang, *A Summary of Discussions on Legal Questions Regarding Private Economy*, Zhongguo Fazhi Bao, Oct. 28, 1986, at 3 (Chinese version).

141. Renmin Ribao (Haiwai Ban), Dec. 30, 1987; and Zhongguo Fazhi Bao, Sept. 5, 1986 (Chinese versions).

142. Interim Regulations on Income Tax concerning Urban and Rural Individually-operated Industrial and Commercial Households, *promulgated by* the State Council (Jan. 7,

in industry, commerce, service trades, construction and installation trades.

The Households Income Tax is levied on profits after deducting costs, expenses, salaries and losses.[143] The deductible amount of salaries payable to employees, the number of which may not exceed seven, shall be in line with the amount payable to workers in state enterprises in the same industry and the same region.[144] The net profits are taxed according to a ten-grade progressive scale which rises from 7 percent to 60 percent. In addition, a surtax of from 10 to 40 percent is imposed on taxable income in excess of 50,000 yuan a year. Since most individual households operate on a small scale,[145] the surtax is only applicable to a few households to effectively regulate the profit level of those enterprises.

Special reductions in the tax are accorded to the childless elderly, handicapped and those providing badly needed services requiring high labour intensity.[146] Individual doctors, dentists and veterinarians are exempted from the tax on income earned through private practice if the fees charged are reasonable.[147] Households engaged in farming activities or water transportation are also exempted.[148]

(v) Private Enterprise Income Tax (Siying Qiye Suode Shui)

As of July 1, 1988, individuals are officially allowed not only to conduct business in the form of individual households but also through private enterprises registered under the Private Enterprise Law[149] in the form of a sole proprietorship, a partnership or a corporation with limited liability.

Private enterprises established under the Private Enterprise Law are currently taxed under the Private Enterprise Income Tax Law (PEIT

1986) [hereinafter Households Income Tax Law]. Unlike other tax laws, the implementing rules will not be promulgated by the Ministry of Finance, but by local governments: art. 16 of the Households Income Tax Law.

143. It should be noted here that, in contrast, losses in previous years are not deductible for collective enterprises. *See* art. 12 of the CEIT Regs., *supra* note 130.

144. Art. 4 of Certain Policy Regulations concerning the Urban and Rural Individually-operated Industrial and Commercial Households Income Tax, *adopted by* the Ministry of Finance, (86) *Cai Shui Zi*, No. 091 (April 18, 1986)[hereinafter Households Tax Policies].

145. Households are restricted to hire more than seven employees. *See* Renmin Ribao (Haiwai Ban), March 12, 1988, at 1; Meng Qingyaun, *Several Questions on Private Economy*, Zhongguo Fazhi Bao, Aug. 27, 1984, at 3; State Council Interim Regulations on Individually-operated Industrial and Commercial Households in the Countryside, *issued on* Feb. 27, 1984: (1984) *Guo Fa*, No. 26; and the Provisional Regulations on the Management of Individual Industrial and Commercial Households in Urban and Rural Areas, *issued by* the State Council (Aug. 5, 1987) (Chinese versions).

146. Households Income Tax Law, *supra* note 142, art. 5.

147. Households Tax Policies, *supra* note 144, arts. 6 and 9.

148. *Id.* at art. 7.

149. The Provisional Regulations on Private Enterprise of the People's Republic of China, *adopted by* the State Council (June 3, 1988), *promulgated on* June 25 and *effective as of* July 1, 1988 [hereinafter Private Enterprise Law].

Law) on their profits derived from engaging in industry, construction, transportation, commerce, catering or other service industries. The tax is imposed on profits after deducting costs, expenses, turnover taxes and non-business expenses allowed by the State.[150] Unlike the Households Income Tax, a flat rate of tax of 35 percent is charged on the taxable amount and no surtax is levied.[151] Moreover, business losses incurred by a private enterprise can be carried forward for three years.[152]

Exemptions and reductions are granted if a private enterprise manufactures goods by using waste water, gas or materials, or where the taxpayer is in financial difficulty due to storm, fire, flood, earthquake or other natural disaster.[153]

As previously explained, profits distributed by a private enterprise are taxed again, in the hands of the investor, at a flat rate of forty percent.[154] Consequently this provides a measure of integration of the taxation of enterprises and investors and creates a system not unlike the "classical" system of corporation tax employed in the United States and some other Western countries.

C. *Agriculture Tax*

Agriculture taxes existed in China, in one form or another, for at least four thousand years. This is not surprising considering that China always has been mainly an agricultural country. Whether to classify these taxes as taxes on income is questionable. At some times — for instance with the "nine-square" system — the tax resembled the medieval European "tithe" and could be considered to be a tax on production or on income.[155] At other times, the assessment was based upon the value or area of the land itself, approximating a property, or annual wealth, tax. The system, in force since 1949, is based upon the estimated yield of the average harvest for the land in question, and might therefore be described as a sort of hybrid property and income tax.

The agriculture tax is of major importance not only because of its antiquity but also because it affects some eighty percent of the population of the People's Republic. However, its budgetary importance gradually diminished over the past three decades as the degree of industrialization increased. Even in the predominantly agricultural areas, it has ceased to be a major source of tax revenue.[156] That does not mean that

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150. PEIT Law, *supra* note 81, art. 2. For a discussion of the tax, see Li, *supra* note 82, at 417.

151. *Id.* at art. 3.

152. *Id.* at art. 6.

153. *Id.* at art.4.

154. Under the Private Investors IIRT Law, *supra* note 81.

155. *See* Easson and Li, *supra* note 1, at 429.

156. According to one study in a primarily agricultural county, the agriculture tax had accounted for thirty-two percent of the total tax revenue in 1957, but for only nine percent in 1983. *See* Zheng Jiaju and Ye Shaokun, *Thoughts on Reforming Agriculture Taxes*,

the contribution by peasants to the national revenue has decreased, since the state also secures its share of agricultural income through a "concealed tax" — compulsory procurement.

The first agriculture tax law in the People's Republic was promulgated in 1950.[157] The tax was assessed on the basis of the average annual harvest for land of the particular type and levied on a progressive scale according to the total production of the household owning the land. By 1958, with the formation of mutual-assistance groups and then the communes, there was no longer a need for a progressive tax system and a new flat-rate system was introduced.[158] This is the system which, with some modifications, remains in force today.

As under the previous system, tax is charged on all units and individuals deriving agricultural income from the production of grain, varieties of potatoes, cotton, hemp, tobacco, sugar and oil-bearing crops, as well as income from horticultural crops and cash crops.[159] The tax is assessed on the basis of the estimated average annual yield of the land. The assessment usually remains in force for five years. This has the advantage of providing an incentive to increase production as the taxpayer has a complete tax holiday on the increment in output over the normal level until the date of the next assessment of normal output.[160] The tax rates vary from thirteen to nineteen percent in different regions, with a national average of 15.5 percent.[161] Local governments may impose an additional local surcharge of up to fifteen percent (in the case of grains) or thirty percent (in the case of cash crops) of the basic tax.[162] A ten to fifty percent surtax may also be levied upon income derived by individual farmers.[163] The amount of tax is calculated in monetary terms based on the price paid by the state for medium-quality grains when it buys from the production unit. However, until recently the tax was normally paid in kind and was collected twice a year following the summer and autumn harvests.

The Agriculture Tax has failed to keep pace with crop yield and with rising rural incomes. Since Liberation (1949), despite some setbacks, agricultural production has risen steadily. By 1978, total output value stood at 3.63 times that of 1949, and the vital grain output had risen by 270

NONGYE JINGJI WENTI (AGRICULTURAL ECONOMIC ISSUES) April 23, 1985, at 36-8 (Chinese version).

157. Interim Regulations on Agriculture Tax in Newly Liberated Regions, promulgated by the 9th Session of the Central People's Governmental Committee (Sept. 5, 1950).

158. Regulations on Agriculture Tax of the People's Republic of China, adopted by the Standing Committee of the National People's Congress (June 3, 1958) [hereinafter Agriculture Tax Law].

159. *Id.* at arts. 3 and 4.

160. *See* A.R. Khan, *Taxation, Procurement and Collective Incentives in Chinese Agriculture*, 6 WORLD DEV. 827, 829 (1978).

161. Agriculture Tax Law, *supra* note 158, art. 10.

162. *Id.* at art. 14.

163. *Id.* art. 13.

percent.[164] Production rose still more sharply following the introduction of the "responsibility system" in 1978.[165] In contrast, tax assessments rose barely, with the result that an average nominal tax rate of fifteen percent amounted in reality to a real rate of three percent or less.[166] Consequently, in the past few years, pressure has been mounting for a major reform of the Agriculture Tax in line with the tremendous changes which have taken place in rural China. The "responsibility system" has meant that the state has considerably relaxed its control over agriculture. Until 1985, the state almost totally monopolized grain supplies; taxes were mostly paid in grain and the remainder of the state needs were met by quota deliveries at state-fixed prices.[167] This policy has been changed. The state now obtains most of its grain requirements on a contract basis. In more backward areas, tax continues to be paid in kind, but elsewhere the current policy is cash payment.[168] Peasants, in turn, have greater freedom to determine what shall be grown on the land leased to them. Many have switched from grain production to cash crops which yield higher incomes;[169] stories abound of a new generation of 10,000 yuan-a-year peasants. To reduce the difference between growing grains and cash crops, new regulations were adopted in 1983 [170] to levy a five to fifteen percent tax on income from producing fruits, natural rubber, silkworm and other cash products.[171]

The agricultural tax system designed for conditions existing thirty years ago is no longer suitable for modern conditions, and is under attack

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164. Zhang Yulin, *Readjustment and Reform in Agriculture*, in CHINA'S ECONOMIC REFORMS 124 (eds. Lin Wei and A.Chao 1985).

165. *See*, R.Delfs, *Growing Troublesome: China's Rural Reforms Have Produced Some Unexpected Results*, FAR EASTERN ECONOMIC REVIEW, Feb. 18, 1988, at 66. For a general discussion of the rural economic reform, see also, Keith Griffin and Kimberley Griffin, *Institutional Change and Income Distribution*, and A.K. Ghose, *The New Development Strategy and Rural Reform in Post-Mao China* in INSTITUTIONAL REFORM AND ECONOMIC DEVELOPMENT IN THE CHINESE COUNTRYSIDE, (K. Griffin, ed., 1984), 20 and 253 respectively.

166. Ministry of Finance, *Great Achievements in Finance Adminstration in the Past 35 Years*, CAI ZHENG, (FINANCE) 1984, No. 10, at 1.

167. *See*, Cai Nong, *Several Questions on the Collection and Accounting of Agriculture Tax*, CAI ZHENG, 1987, No. 11, at 36 (Chinese version).

168. The method of calculating the tax has also been changed to reflect the new procurement policy. It is now set in the "reverse ratio of 3:7," that is to say, 30% of the price component is the price formerly set for the state monopoly purchase of grain while the remaining 70% is based on the purchase price for grain surplus to the production quota: *see*, *Guo Fa*, No. 71; and Cai Nong, *To Pay in Cash rather than in Kind is a Major Reform in Agriculture Tax Collection*, CAI ZHENG (Finance), 1985, No. 6, at 19 (Chinese versions).

169. For example, citrus crops yield three-and-a-half times as much income as a double crop of rice due to the lowly state-fixed purchasing price for grains. See, Zhang and Ye, *supra* note 156.

170. Measures concerning the Collection of Agriculture Tax on Income Derived from the Specialized Products of Rural Households, adopted by the State Council (Nov. 12, 1983).

171. *Id.* at arts. 2 and 4. For further comments, see *Collection of Taxes on Rural Specialized Products*, CAI ZHENG, No. 1, at 11 (1984); and Cai Nong, *Agriculture Tax Rates*, CAI ZHENG, No. 4, at 45 (1985) (Chinese version).

by many writers in China.[172] It is likely that, before long, a whole new system, an income tax with progressive rates, will replace the present Agriculture Tax.[173]

1. The Concealed Agriculture Tax

Direct agricultural tax is not the only contribution made by the agriculture sector to the state revenue. It also makes a contribution through sales to the state if prices are below those which might otherwise have been obtained. After the founding of the People's Republic, the Government commenced an industrialization program to catch up with developed countries. Due to the nature of an agricultural state, capital was hard to obtain internally and more difficult externally because of the trade embargo imposed by the United States and its western allies. The only source available for China to raise capital was from the contributions of the peasants. There were two possible means of acquiring revenue from the agricultural sector by the state: direct taxation and compulsory purchase by the state at artificially low prices. By using the latter method, the state was able to procure raw materials from the agricultural sector at low prices and allocate them to industry, or sell them to urban workers at low prices, to keep down the cost of production of industrial enterprises and then to collect profits and taxes from these enterprises. As the basis of the economy, the agricultural sector has made a tremendous contribution to the nation's industrialization process by contributing 600 billion yuan in the form of "concealed tax"[174] and 96.5 billion yuan in the form of Agriculture Tax between 1953 and 1983.[175]

Before 1985, there were two types of procurement of agricultural products.[176] A lower price was paid on a basic quota which had to be fulfilled by all collective units; this was called *gongliang* (public grains). Over and above the compulsory quota, all production units were free to sell additional quantities to the state; this was commonly referred to as *yuliang* (additional grains). On such voluntary sales the units received a price which was approximately 30 percent higher than the price received from compulsory sale.[177] The units sold *yuliang* voluntarily to the state because it was an honorable obligation of each citizen or unit to contrib-

172. Su Ting and Huang Zhengang, *Discussions on Reforming the Agriculture Tax System*, CAIJING YANJIU, No. 1, 13 (1985); Zhao Yong, *An Attempt to Discuss the Agriculture Tax Reform*, CAI ZHENG, No. 7, 26 (1984); and Zhao Ganqi and Cai Jianhua, *To Readjust the Agriculture Tax Burden and Implement Rural Economic Policies*, CAI ZHENG, No. 11, 37 (1987) (Chinese version).

173. China Daily, Oct. 22, 1986, at 2; and Yan Chu, *A Summary of Discussions at the 1986 Seminar on Tax Theories*, ZHONGGUO SHUIWU, No. 4, 22, at 23 (1987) (Chinese version).

174. Zhou Qiren, Dai Shaojing, *Peasants, Market and Bringing Forth New Ideas*, JINGJI GUANLI, No. 1, 3, at 5 (1987) (Chinese version).

175. *Id.*; Ding, *supra* note 18, at 971.

176. *See*, R. ALLEY AND W. BURCHETT, CHINA: THE QUALITY OF LIFE 26 (1976).

177. A.R. Khan, *supra* note 160, at 829.

ute to the national development, and also because there were hardly any buyers except the state during that period.

Under the new purchase system inaugurated in 1985, peasants sign quasi-voluntary contracts with the state to supply grain to the state-marketing system. The state pays the base-procurement price for twenty to thirty percent of the contracted amount and a higher, above-quota price for the remaining seventy to eighty percent. The exact proportions vary in different areas and for different grains.[178] The state purchases about 50 million tons of grains, and sells it to urban residents at low, fixed, retail prices. Peasants sell another 50 million tons in further negotiated sales to the state and in free markets. The latter are mainly in rural areas, though some premium quality grain is sold in cities. The rest of the crop is retained by the peasants for their own consumption, reserves and seed. As a result of this procurement system, the state controls eighteen to twenty percent of total grain production, three-quarters of the market supply and nearly all urban grain trade.[179]

D. *Additional Taxation of After-Tax Profits*[180]

In addition to income taxes levied on state and collective enterprises, taxes are also imposed upon certain retained profits to allow the state to participate in the allocation of funds, guide and supervise the use of those profits, control the overall investment level and prevent excessive increase in consumer consumption. This type of tax is not uncommon in other state-planned economies.[181]

1. Construction Tax (Jianzhu Shui)

The Construction Tax[182] was introduced to curb the country's increasing capital construction expenditure, to readjust the investment structure, and to direct its limited capital to key projects. The tax is imposed on state enterprises, collective enterprises, private enterprises, and other organizations, which undertake investment in: (1) capital construction, (2) investment in construction as part of a technology renovation project; or (3) investment in construction not listed in the State's Fixed Assets Investment Plan by using the following funds; (a) capital funds outside the state budget, (b) local reserve funds and bank loans (including foreign exchange loans) and (c) various private funds of an enterprise

178. R. Delfs, *How the System Works*, FAR E. ECON. REV. 68 (Feb. 18, 1988).

179. *Id.*

180. This title may seem self-contradictory but the taxes covered in this part are levies payable by enterprises with their retained earnings.

181. DING, *supra* note 18, at 257.

182. The tax is levied under the Provisional Rules of the People's Republic of China on Construction Tax, (June 25, 1987) by the State Council [hereinafter Construction Tax Law]. The Construction Tax Law replaced the Interim Measures on Collecting Construction Tax and their detailed implementing rules, promulgated by the State Council on Sept. 20, and Nov. 18, 1983, respectively.

or public institution; or other self-raised funds.[183]

This tax is charged at 10 percent on investment made by state enterprises or public institutions in a capital construction project or investment in construction as part of a technology renovation project which is a project listed in the state plan;[184] and on an investment in a construction project in urban areas by collective or private enterprises.[185] The tax rate is twenty percent on an investment in a project not listed in the state plan, and 30 percent on constructing a hotel, guest house, convalescent hospital, theatre, auditorium, conference hall, office building or exhibition centre which is not listed in the state plan.[186]

The Construction Tax is exempted on investment in constructing facilities for the development of energy resources, communication facilities, educational facilities for a school, hospital or scientific and research facilities. The tax is also exempted on investment in a project financed with a loan provided by an international financial institution or a foreign government, or donations from abroad, as well as investment in a social welfare project or a pollution control and environment protection project.[187]

To make the Construction Tax more effective, the tax must be paid with self-raised funds and is not deductible in calculating taxable income.[188] Taxpayers are not permitted to pay the tax with funds allocated to them by the state or from bank loans. The tax payments cannot be counted as part of the cost of the fixed assets and therefore cannot be amortized.

2. State Enterprise Wages Regulatory Tax (Guoying Qiye Gongzi Tiaojie Shui)

This tax is only imposed upon those state enterprises which have adopted a floating-wage system whereby the level of wages floats with the economic efficiency of the enterprise.[189] It is levied on the portion of

183. Construction Tax Law, *supra* note 182, at art. 2. Individuals constructing houses for commercial use in urban areas are also liable for the tax. *See* ZHONGGUO SHUIWU, No. 10, at 41 (1985) (Chinese version).

184. A "project listed in the state plan" refers to construction investment which is organized by a provincial, autonomous region, directly-administered municipal planning commission, economic commission or one of the various State Council departments in charge, in accordance with the annual plan of the State Planning Commission on self-raised investment in capital construction or investment in construction as part of a technology renovation project, and relevant regulations. *See* art. 4 of the Construction Tax Law, *supra* note 182.

185. Construction Tax Law, *supra* note 182, arts. 3(i), 3(iii).

186. *Id.* arts. 3(ii), 3(iv).

187. *Id.* art. 5; Ministry of Finance Notice (87) *Cai Shui Zi*, No. 234 (Oct. 6,1987).

188. *See* SEIT Regs., *supra* note 112, art. 11(3); CEIT Regs., *supra* note 131, art. 12(4).

189. The "economic efficiency of an enterprise" refers to the amount of taxes and profits paid to the state, which includes SEIT, Product Tax, VAT, Business Tax, Resource Tax, SEIRT and Urban Maintenance and Construction Tax. *See* art. 3 of the Detailed Rules for the Implementation of the Provisional Regulations on State Enterprise Wages Regulatory Tax, *promulgated* September 18, 1985 by the Ministry of Finance [hereinafter SE Wages

wages exceeding the specified amount.

Prior to the current economic reform, wage levels were generally set by the state and enterprises had no power to increase the amount of wages to their workers. Honorary awards or awards in kind were normally granted to "model workers." As part of the urban economic reform, the wage system is undergoing reform, and various methods are being implemented which are aimed at giving workers more incentives and to breaking the system of "everybody eating from the same pot." For certain large and medium-sized state enterprises, wages float with the economic achievement of the enterprise. As a result, the more profitable an enterprise, the more after-tax profits can be retained and the more money is available for the "wage increase funds."[190] For other state enterprises and public institutions, the basic wage level was maintained, but they could increase the renumeration to workers and staff by granting bonuses. Consequently, enterprises tended to use up all their funds to increase wages or bonuses to their employees and certain enterprises operating at a loss were unable to do so. In order to limit the wage increase to a reasonable level, to regulate the wage difference between enterprises and to ensure that wages increase at an appropriate speed to avoid a "demand-pull" inflation, the Wages Regulatory Tax and Bonus Tax (explained in next section) were introduced in 1985.

The State Enterprise Wages Regulatory Tax is charged only on the amount of wages that exceeds the amount of wages specified by the state for the previous year by seven percent.[191] The amount of wages includes various forms of wages, salaries, bonuses, subsidies, allowances and awards in kinds.[192] Where the increase is not more than seven percent, no tax is payable. The rate ranges from thirty percent to 300 percent for the 1985 tax year[193] and 20 to 200 percent for the 1987 tax year.[194] The amount of tax payable in the previous year is not included in the speci-

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Regulatory Tax Regs.].

190. A steel manufacturing enterprise in Hubei Province adopted this system upon approval by the provincial government in 1981. Under the system, the enterprise "promised" to increase its profitability by not less than seven percent based on the 1983 level and wages were to increase by 0.75 percent for every one percent extra increase in profits. *See* Wuhan Iron and Steel Corporation, *To Link Wages with Profits and Taxes, the Enterprise Increases its Vitality by Times*, Qiye Guanli, 1987, No. 1, at 17 (Chinese version).

191. Art. 4 of the Provisional Regulations on State Enterprise Wages Regulatory Tax, *promulgated by* State Council on July 3, 1985 [hereinafter SE Wages Regulatory Tax Law].

192. SE Wages Regulatory Tax Regs., *supra* note 189, art. 6.

193. 193 For 1985, the tax was levied at thirty percent for an increase between seven percent and twelve percent; one hundred percent for an increase between thirteen percent and twenty percent; and three hundred percent for an increase of more than twenty percent. *See* Appendix to the SE Wages Regulatory Tax Law, *supra* note 191.

194. The tax rate was cut in 1987 to twenty percent for an increase between seven and twelve percent; fifty percent for an increase between thirteen and twenty percent; one hundred percent for an increase between twenty one and twenty seven percent; and two hundred percent for an increase of more than twenty seven percent. *See* Jingji Ribao (Economic Daily), Feb. 24, 1987 (Chinese version).

fied amount of that year and thus does not form part of the basis for the following year.

3. State Enterprise Bonus Tax (Guoying Qiye Jiangjin Shui)

Those state enterprises which have not implemented the floating-wage system are subject to the State Enterprise Bonus Tax on bonuses paid to workers.[195] It should be noted that this tax, as well as the State Enterprise Wages Regulatory Tax, is levied on the enterprise rather than on the workers. Workers are taxed according to the Individual Income Regulatory Tax on their monthly income received that exceeds four hundred yuan.

The tax rates vary in accordance with the amount of the bonus that exceeds the amount of four month's standard wages.[196] The standard monthly wage amount is sixty-seven-and-one- half yuan or more, depending upon the skill and experience of the worker and the regional wage.[197] If the total yearly bonus exceeds four months wages but is not more than six months, the tax rate is 30 percent. The top rate under this tax is three hundred percent where the yearly bonus amount exceeds the standard wage amount by six month's wages.[198]

The tax is exempted on bonuses paid to employees as invention awards, awards for rational proposals on technical transformation, awards for speed unloading of foreign freighters, and bonuses issued to workers working in mining, transportation, construction, or oil and gas exploitation.[199]

4. Collective Enterprise Bonus Tax (Jiti Qiye Jiangjin Shui)

All collective enterprises are liable for the Collective Enterprise Bonus Tax on bonus payments to their employees in accordance with the rules provided in the State Enterprise Bonus Tax Law.[200] The taxable bonus includes all payments made from the workers's award reserves and bonus reserves, as well as wages, subsidies, labour dividends and stock

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195. Art. 2 of the Provisional Regulations on State Enterprise Bonus Tax, *adopted by* the State Council on June 28, 1984 and amended and *promulgated on* July 3, 1985 [hereinafter SE Bonus Tax Law]. This tax was imposed on all state enterprises in 1984 before the SE Wages Regulatory Tax Law was introduced.

196. SE Bonus Tax Law, *supra* note 195, at art. 3.

197. Ministry of Finance Notice, (86) *Cai Shui Zi*, No. 082 (April 2, 1986).

198. *Id.* In 1987, the rates were reduced to 20% and 200%. *See* Ministry of Finance Notice, (87) *Cai Shui Zi*, No. 010 (Feb. 17, 1987).

199. SE Bonus Tax Law, *supra* note 195, at art. 6. For further discussion of the tax, see Yan Zhiping & Yu Leigui, *Certain Questions on Taxing Bonuses*, Gongren Ribao (Workers Daily), May 5, 1984 (Chinese version).

200. Arts. 1 and 2 of the Provisional Regulations on Collective Enterprise Bonus Tax, *promulgated by* the State Council on Aug. 24, 1985 [hereinafter CE Bonus Tax Law]; and arts. 2 and 3 of the Detailed Rules for Implementing the Provisional Regulations on State Enterprise Bonus Tax, *promulgated by* the Ministry of Finance on Nov. 2, 1985 [hereinafter CE Bonus Tax Regs.].

dividends that exceed the standard amount.[201] "Labour dividend" is a form of renumeration made by a collective to its workers at the end of the year to allow them to share in the profits of the enterprise. This payment is taxable only if the amount of the labour dividend is more than one month's standard salary.[202] "Stock dividends" are dividends declared and paid by a collective which has issued stock to its employees. These stock dividends are taxable if the amount paid is more than fifteen percent of the paid-in capital.[203] Food subsidies and price subsidies granted to workers by collective enterprises by referring to those given by state enterprises [204] are not taxable. If a collective enterprise pays wages under the standards set by the state for state enterprises, the taxable bonus is computed in the same way as for a state enterprise. If wages are paid according to other standards, the monthly wage is calculated based on sixty yuan per worker.[205]

Tax rates and exemptions are similar to those applicable to state enterprises except that collectives engaged in agricultural activities are exempted from the tax.[206]

E. *Resource Taxes*

1. Resource Tax (Ziyuan Shui)

The Resource Tax, introduced in 1984,[207] was aimed at eliminating profit disparities brought about by favorable physical conditions and encouraging an efficient use of the natural resources of the country. This tax is now being levied on units and individuals engaged in exploiting crude

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201. CE Bonus Tax Law, *supra* note 200, at art. 5.

202. *Id.* at art. 7.

203. *Id.* at art. 8.

204. In China, wages are only a part of the workers' actual income received from state enterprises. A greater part of their renumeration is in the form of labour insurance and price subsidies. Labour insurance and welfare payments are about 37% of the basic wage bill in state enterprises. All employees in state and collective enterprises enjoy free medical care. Because of the price policy on agricultural and sideline products, the government has to purchase cereals, oil crops, eggs, pork and coal, etc., and sell them to city residents at a loss in order to keep the wage level down. State enterprises may also give certain food subsidies to their employees in various forms. From early 1988, the "hidden" food subsidy became apparent in Beijing by paying a 10 yuan food subsidy to each qualified person (such as workers and university students) per month in return for allowing the market to decide the price of vegetables, eggs, sugar and pork. In addition, houses in cities are built and distributed by government departments and enterprises according to an overall plan, and rents are artificially low. The total cost of these subsidies makes up 85% of the renumeration in state enterprises of which 70% consists of subsidies for housing. *See* Yu Haitao, *Difference in Wage Systems*, BEIJING REV., Jan. 18-24, 1988, at 25-26.

205. CE Bonus Tax Law, *supra* note 199, at art. 10. There have been some complaints about this standard monthly wage amount being too low. *See* Shijie Jingji Daobao (World Economic Herald), Dec. 28, 1987, at 2.

206. CE Bonus Tax Law, *supra* note 200, at art. 13.

207. Regulations of the People's Republic of China on Resource Tax (Draft), *promulgated* Sept. 18, 1984 by the State Council [hereinafter Resource Tax Law].

oil, natural gas, coal, metal and non-metal products.[208] The progressive tax rates are calculated according to the sale profit rate of the taxable products.[209] The higher the sale profit rate, the higher the Resource Tax rate. The basic sale-profit rate is 12 percent, and the tax is only imposed if the profit rate is higher than the basic rate. For each 1 percent increase in the sale-profit rate, the rate is .5 percent of the sales income of the product if the profit rate is between 12 to 20 percent. The tax rate is .7 percent for each 1 percent increase on the excess portion where the sales-profit rate exceeds 25 percent.[210] Products consumed by the taxpayer are deemed to be sold at the stipulated prices for the purpose of the tax.[211] Small-scale mining businesses can be granted a 50 percent reduction in tax. Other taxpayers may also be entitled to an exemption from or reduction in the tax if special encouragement is deemed appropriate by the government.[212] The payment of this tax is deductible when computing the taxable income of the taxpayer.

2. Special Tax on Burning Oil (Shaoyou Debie Shui)

This tax was introduced in 1982[213] to restrict domestic oil consumption in order to encourage the domestic use of coal, thereby increasing the export of petroleum abroad.

Enterprises which burn crude oil or heavy oil for boilers, industrial kilns and furnaces are subject to this tax based on the amount of oil burned.[214] The tax is levied at the rate of 40 to 70 yuan per ton on crude oil and 70 yuan per ton on heavy oil.[215]

F. *Local Taxes*

Considering China's size, both in terms of geography and population, its tax system and legal system are highly centralized. Local government

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208. *Id.* at art. 1. Foreign enterprises and Chinese-foreign joint ventures are not currently subject to this tax. Tax on metal and non-metal products has been postponed. *See* art. 1(1) of the Provisions on Several Questions of Resource Tax, in Ministry of Finance Notice, (84) *Cai Shui Zi*, No. 296.

209. The "sales-profit rate of a taxable product" calculation is:

$$\frac{\text{Sale profit of the product}}{\text{Sale income of the product}} \times 100\%$$

Resource tax = sale income of the product × tax rate

210. Resource Tax Law, *supra* note 207, at art. 2.

211. *Id.* at art. 4.

212. *Id.* at art. 7. For a discussion of the tax, see Guo Hongde and Yang Yimin, *The Status of Implementing the Resource Tax and Ideas for Perfection of the Tax*, Zhongguo Shuiwu, 1986, No. 4 (part 1), 13-5. and No. 5 (part 2), 11-2; and Hong Chu, *The Deep Meaning of Start Levying Resource Tax*, Zhongguo Shuiwu, 1985, No. 1, at 18 (Chinese versions).

213. Trial Regulations on Levying of Special Tax on Oil Burning, *promulgated by* the State Council on April 22, 1982 [hereinafter Oil Burning Tax Regs.].

214. *Id.* at art. 1.

215. *Id.* at art. 3.

authorities derive their taxing powers from the central government so that the taxes that they are empowered to levy, and the maximum rates of such taxes, are prescribed by the central government.[216] However, local governments have extensive powers to promulgate implementing rules with respect to the local tax laws promulgated by the central government. The local government also may have powers to grant reductions or exemptions from local taxes.

Taxes designated as local taxes by the central government include Real Estate, Urban Land Use, Farmland Use, Vehicle and Vessel Use, Slaughter, Stamp and Banquet.[217]

1. Real Estate Tax (Fangdichan Shui)[218]

An Urban Real Estate Tax was imposed in China in 1951 on both buildings and land.[219] It was replaced in 1986 by the Real Estate Tax,[220] but the 1951 version still applies to foreign individuals and enterprises with foreign investment. The Real Estate Tax is levied in cities, counties and townships. This tax is payable in respect of houses or buildings owned by units or individuals. It is charged at 1.2 percent of the residual value of a property if the taxpayer is also the property owner. The "residual value" is usually between 70 and 90 percent of the original cost of the property, the exact percentage being determined by the local government.[221] If the property is leased, the tax is imposed at 12 percent of the rental income from the property.[222] Properties owned by government agencies, armed forces, and individuals for non-business purposes are exempt from the tax. Temples, parks and historical places are also exempt.[223]

2. Urban Land Use Tax (Chengzhen Tudi Shiyong Shui)

The Urban Land Use Tax was introduced in July 1988 and became

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216. The Principal Rules of 1950 provided that tax legislation which is within the jurisdiction of a county, municipality or province must be submitted to the central authorities for approval. In practice, most local tax legislation is promulgated by the central government in the first place. They are referred to as local taxes because the revenue accrues to the local governments and the local governments have the right to promulgate implementing rules.

217. *See* Regulations concerning the Implementation of a Fiscal Administration System of Delineating Taxes, Checking and Ratifying Revenue and Holding Different Levels of Government Responsible, *issued by* the State Council on March 21, 1985.

218. The term "real estate" does not include land as all land in China remains the property of the state under the CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, art. 10 (*adopted on* Dec. 4, 1982, by the 5th Session of the 5th National People's Congress).

219. *See* Provisional Regulations Governing the Urban Real Estate Tax, *promulgated* Aug. 8, 1951 by the Administrative Council.

220. Provisional Regulations of the People's Republic of China on Real Estate Tax, *issued by* the State Council on Sept. 15, 1986 [hereinafter Real Estate Tax Law].

221. *Id.* at art. 3.

222. *Id.* at art. 4.

223. *Id.* at art. 5.

effective as of November 1, 1988. All units and individuals who use land located in cities and towns are subject to the tax.[224] The tax rates vary from 0.5 to .10 yuan in large cities to between 0.3 and 0.6 yuan in county towns and mining areas, the exact rate of which is determined by the local government.[225] The tax is not imposed on land used by the government agencies, armed forces, temples or parks, or used for the purposes of constructing energy, transportation and water facilities.[226]

3. Farmland Use Tax (Gengdi Zhanyong Shui)

The Farmland Use Tax was introduced in 1987.[227] It was aimed at encouraging citizens and businesses to make better use of land resources, strengthen land control, and protect farmland.[228]

Any unit or individual that occupies farmland to build a house or engage in other non-farm business is a taxpayer and is liable for the tax at rates ranging from one to 10 yuan per square meter, depending on the location of the land. The exact rate of the tax is determined by the people's government of the province, autonomous region, or municipality directly under the Central Government.[229] These rates may be raised by not more than 50 percent in the Special Economic Zones and other areas open to foreign investment.[230] Land is also exempt from tax if it is used for such things as military purposes, railways and airports, schools, kindergartens and hospitals.[231]

4. Vehicle and Vessel Use Tax (Che Chuan Shiyong Shui)[232]

This tax was levied on units and individuals using motor vehicles and motor boats of most types, plus some types of non-motored transport. It is within the jurisdiction of the province, autonomous region or municipality directly under the Central Government, and is normally paid yearly as a form of license fee.

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224. Art. 2 of the Interim Provisions of the People's Republic of China on Urban Land Use Tax, *adopted by* the State Council on July 12 and effective as of Nov. 1, 1988 [hereinafter Urban Land Use Tax Law].

225. *Id.* at arts. 4 and 5.

226. *Id.* at art. 6.

227. Provisional Regulations of the People's Republic of China on Farmland Occupation and Use Tax, *promulgated* by the State Council on April 2, 1987 [hereinafter Farmland Use Tax Law].

228. "Farmland" is defined to be land used for growing crops. *See id.* at art. 2.

229. *Id.* at art. 5.

230. *Id.*

231. *Id.*

232. This tax was previously called Vehicle and Vessel License Plate Tax under the Provisional Regulations Governing the Vehicle and Vessel License Plate Tax, *promulgated* Sept. 13, 1951 by the Administrative Council of the Central People's Government. On Sept. 15, 1986, a new law was issued by the State Council based on the 1951 law — the Provisional Regulations of the People's Republic of China on Vehicle and Vessel Use Tax. The 1951 law still applies to foreigners and foreign businesses in China.

5. Slaughter Tax (Tuzai Shui)

The Slaughter Tax is charged when pigs, sheep and cattle are slaughtered. The tax is imposed at a rate fixed by the local government in accordance with the Slaughter Tax Regulations.[233]

6. Stamp Tax (Yinhua Shui)

A stamp tax was levied from 1950 until 1958 when it was incorporated into the Consolidated Industrial and Commercial Tax. A new Stamp Tax Law was passed in June, 1988, and became effective October 1, 1988.[234] Under the Stamp Tax Law, all individuals and entities who write or obtain a specified document are liable for the tax. The "specified documents" include: (1) contracts for; (a) purchases and sales, (b) undertaking of processing work, (c) construction projects, (d) leasing property, (e) transportation of goods, (f) storage and custody, (g) lending funds, (h) insuring property and technology; (2) conveyances; (3) business accounts books; (4) registration certificates for rights and licenses; and (5) other documents determined taxable by the Ministry of Finance.[235] Tax rates vary in accordance with the nature of the documents. For example, purchase and sales contracts are taxed at 0.003 percent of the sale price, while construction and installation contracts are taxed at 0.003 percent of the fee charged; contracts for the undertaking of processing work and transportation of goods are taxed at 0.005 percent.[236] Taxpayers are required to pay the tax at the applicable rate by purchasing and affixing tax stamps which must be pasted on the taxable document.[237] The tax is not levied on duplicates or manuscript copies of documents on which the stamp tax has already been paid, nor on instruments written by the owner of property when such property is donated to the government, a social welfare entity, or a school.[238]

7. Banquet Tax (Yanxi Shui)

A Banquet Tax was introduced in September 1988, to guide reasonable consumption and discourage waste.[239] Entities and individuals who hold banquets in restaurants, hotels and other catering places are subject

233. Provisional Regulations on Slaughter Tax, *issued by* the Administrative Council on Dec. 19, 1950.

234. Provisional Regulations of the People's Republic of China on Stamp Tax, *adopted by* the State Council on June 24, 1988, and effective as of Oct. 1, 1988 [hereinafter Stamp Tax Law].

235. *Id.* at art. 2.

236. *See* Table of Tax Rates for Stamp Tax Items annexed to the Stamp Tax Law.

237. Stamp Tax Law, *supra* note 234, arts. 5 and 6.

238. *Id.* at art. 4.

239. Interim Regulations of the People's Republic of China on Banquet Tax, *adopted by* the State Council on Sept. 9, 1988, and *promulgated* Sept. 22, 1988 [hereinafter Banquet Tax Law].

to this tax.[240] The tax is charged at fifteen to twenty percent of the banquet price exceeding 200 to 500 yuan, the exact amount of which is subject to determination by the local government.[241] The owner or manager of restaurants and hotels which provide the banquet are required to withhold the tax from the price charged.[242]

8. Market Transaction Tax (Jishi Jiaoyi Shui)[243]

This is a tax imposed on individuals or entities (mainly farmers) selling domestic animals, meat, fruits, local products and home-made handicrafts. The rate is generally 10 percent of the sale price and local governments are empowered to impose the tax at lower or higher rates.

9. Livestock Transaction Tax (Shengchu Jiaoyi Shui)[244]

Entities or individuals purchasing cattle, horses, donkeys, mules and camels are liable to this tax. The tax rate is 5 percent of the purchase price. The tax is payable to the local tax office and accrues to the province, autonomous region or municipality directly under central control. Enterprises with foreign investment may also be liable to this tax if they purchase taxable livestock for business purposes.[245]

III. AN OVERALL EVALUATION OF THE CHINESE TAX SYSTEM

Despite its long historical antecedents, China's present tax system is the creation of the past eight or nine years and is the result of the new economic policy. Although further major changes and reforms can certainly be expected, the basic structure of the system now seems to be complete. Because China is both a developing and a socialist country, the criteria which would commonly be applied in assessing a Western capitalist economy may be inappropriate in evaluating China's recent achievements.

A. *Functions of Taxation in China*

Taxation in China performs not only the function of raising revenue for the government, but also acts as an economic regulator to implement the state economic plans and various state policies. Since 1980, when the Joint Venture Income Tax Law was promulgated, taxation also has played an important role in attracting foreign investment.

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240. *Id.* at art. 2.

241. *Id.* at art. 3.

242. *Id.* at art. 5.

243. The tax is charged under the Interim Regulations on Market Transaction Tax, adopted on April 16, 1962 by the State Council.

244. It is levied under the Interim Regulations on Livestock Transaction Tax, issued on Dec. 13, 1982 by the State Council.

245. *Cai Shui Wai Zi*, July 19, 1984, No. 130 (Ruling by the General Tax Bureau of the Ministry of Finance).

1. Raising Revenue

As in any other system, taxation in China performs the function of raising revenue and reallocating income. Taxes are levied on the "principle of using what is taken from the people in the interest of the people."[246] Since the establishment of the People's Republic, more than 800 billion yuan has been collected in the form of taxation, and this has played an important role in promoting socialist construction. Prior to the recent tax reform, tax revenue accounted for only 40 to 55 percent of state revenue while the rest came from profits delivered by state enterprises.[247] In 1986, this figure had been increased to over 90 percent.[248] This function of raising revenue is considered to be the primary function of taxation in China.[249]

2. Regulating the Economy

Another function of taxation is to regulate the economy. In China, numerous "economic levers" are used to implement the state economic plans, including controls on prices, credit, interest rates, wages and profits, as well as taxation. The most important of these at present are pricing and taxation. The state uses taxation to guide and control the production and consumption of products and to fulfill various planned targets by stipulating different tax rates, tax base and exemptions to suit various requirements.[250] Frequently, however, taxation is used in combination with price controls to regulate the economy.

Taxation is also used as means of readjusting differences in income among enterprises caused by various "objective factors," such as fixed prices, quality of existing equipment, availability of resources and the locality of the enterprise. By levying taxes on profits earned from taking advantage of favorable conditions, the state can make enterprises compete on a equal basis.[251]

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246. Commentator's article, *Fundamental Ways to Increase Tax Revenue*, Renmin Ribao, April 14, 1984, at 1 (Chinese version).

247. Wang Kun, *supra* note 1, at 20.

248. *See* Jin Xin, *The Principles and Practice of Constructing China' Tax System*, ZHONGGUO SHUIWU, No. 12, at 4 (1987).

249. *See* Liu Zuo, *The First Function of Socialist Taxation Is Organizing Fiscal Revenue*, ZHONGGUO SHUIWU, No. 6, at 23 (1986); and Xu Jianguo, *Functions of Socialist Taxation*, ZHONGGUO SHUIWU, No. 12, at 17 (1986). Agriculture Tax is not very important in providing revenue, but it does secure the supply of grains to the state. *See* Cai Nong, *Characteristics, Functions and Policy of Our Country's Agriculture Tax*, CAI ZHENG, No. 2, at 37 (1985) (Chinese version).

250. *See further* Wang Ruichang, *A Brief Discussion of the Characteristics of the Economic Lever Function of Taxation*, ZHONGGUO SHUIWU, No. 1, at 16 (1986); Deng Ziji, *A Brief Discussion of Taxation Lever*, ZHONGGUO SHUIWU, No. 4, at 24 (1986); and Lu Renzhi, *The Comparison and Choice of Public Debt Lever and Taxation Lever*, CAIMAO YANJIU, No. 11, at 60 (1986) (Chinese version).

251. Yuan Zhenyu, *Functions of Socialist Taxation*, ZHONGGUO SHUIWU, No. 4, at 33 (1985); and Tang Tengxiang, *From Economy to Finance*, ZHONGGUO SHUIWU, No. 11, at 42

(a) Prices Versus Taxes

China used to have a highly centralized, planned economic system. The overwhelming majority of commodities and services were controlled by the state pricing management organs, and principal aim of pricing policy had been to maintain the stability of market prices.[252] Since the late 1970s, when new economic policies were adopted, China has been experimenting with a combination of market forces and state planning in order to regulate the economy. By the end of 1987, the degree of central planning of the economy reduced from 100 percent to about 55 percent.[253] Two new pricing systems also were adopted in addition to the previous system. Under these systems the state stipulated a single price known as state stipulated prices." These two systems are "state guided prices" and "market adjusted prices." The term "state stipulated prices" refers to prices of products and rates of service fees determined by the Commodity Price Department and the competent departments of local governments. "State guided prices" are commodity prices and service fee rates determined by enterprises within the guidelines prescribed by the Commodity Price Departments and the competent departments of local government by setting a basic price fluctuation range, a rate differential, a profit rate, a ceiling price or a minimum reserve price.[254]

State stipulated prices are determined as not only the same as the value of the commodity, reflecting supply and demand conditions, but also to meet state policy requirements.[255] Prior to 1979, most goods and services were subject to state price control. State policy required that agricultural products, raw materials and necessities be priced artificially low in order to reduce the cost of industrialization; by contrast, luxury goods and some industrial products were priced very high.[256] Consequently, enterprises producing highly-priced goods, such as watches and bicycles, were profitable whereas those producing lowly-priced products suffered losses or made little profit no matter how well they were managed.[257]

Since price reform commenced in 1979, goods subject to state stipulated prices decreased from more than three hundred categories to twenty-six by the end of 1987. However, basic production materials listed

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(1986) (Chinese version).

252. HE JINMING, JINGJI GONGZUO SHOUCE (ECONOMIC WORKING HANDBOOK) 455 (1984) (Chinese version).

253. Renmin Ribao (Overseas Edition), Nov. 9, 1987, at 1 (Chinese version).

254. Regulations of the People's Republic of China on Price Control, art. 8, *promulgated* Sept. 11, 1981 by the State Council [hereinafter Price Control Regs.].

255. *Id.* art. 7.

256. It is argued by some writers that whenever prices are set above marginal costs, the part of price over the marginal costs can be deemed as an indirect tax on the product payable by the purchasers. *See* R.H. Floyd, *Equivalence of Product Tax Changes and Public Enterprise Price Changes*, 28 IMF Staff Paper 338 (1981).

257. For a discussion of the disparities caused by the previous price policy, see Wang Zhenzhi and Wang Yongzhi, *Epilogue: Prices in China*, CHINA'S ECONOMIC REFORMS 220 (1982).

in the state plan, such as petroleum, natural gas, electricity, acid and coal, are still uniformly priced by the state. The majority of industrial products are, however, subject to the state guided prices and some goods are totally priced by market forces. Certain products may be subject to three different prices, depending upon whether they are inside or outside the state plan. In most cases, the stipulated price is lower than the guided price, which is lower than the market price.[258] Enterprises used to be indifferent to their profits, since they accounted for all their profit and loss to the state and everyone ate from the "same big pot." The current economic reform requires these enterprises to be economically independent and responsible for their own profits and losses. Although the price reform has rationalized the pricing system, the reform cannot be completed within a short period of time due to various existing problems. Further, inflation is too high to allow further readjustments.[259]

To balance the "bitter and the sweet" among enterprises manufacturing different products, Product Tax and Value Added Tax (VAT) were introduced in 1984.[260] The tax rates of these two taxes were designed on the assumption that price levels would be relatively unchanged.[261] Where prices are higher than the value of products,[262] profits made by enterprises from the price over the actual value should be handed over to the state in the form of tax, whereas enterprises that suffer losses due to the price being set below the value should be granted financial subsidies in the form of lower tax rates or special tax exemptions. Therefore, tax rates are high for products which are sold at high prices and where the govern-

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258. For example, rice is subject to three type of prices. When state purchases rice pursuant to a contract signed with peasants, the price is state stipulated. Where peasants sell extra amounts to the state, they can sell it at the state- guided price. If the rice is sold on the market directly, peasants can get whatever price they can determined by supply and demand. *See* Bao Xiansen, *A Discussion of the Effect of Li Gai Shui on Price Factors*, CAIMAO YANJIU, No. 3, at 27 (1985) (Chinese version).

259. An obvious difficulty of rationalizing the price system is how to increase prices for previously lowly priced goods, (mainly raw materials, agricultural products and necessities) without causing a cost-push inflation. The inflation rate in 1987 was 7.3 percent, in general, but around 20 percent for non-staple foods in cities. *See* Ge Wu, *Prices and Economic Situations*, Beijing Review, March 7-13, 1988, at 4; and Song Yangyan, Wang Haidong and Du Duanhua, *Reflections on and Designs of Price Reform*, JINGJI LILUN YU JINGJI GUANLI (ECONOMIC THEORY AND ECONOMIC MANAGEMENT), No. 3, at 21 (1987) (Chinese version).

260. The ICT performed similar functions as these two taxes but on a smaller scale.

261. *See* Liu Deming, *A Brief Discussion of the Relationship between Price Lever and Tax Lever*, ZHONGGUO SHUIWU, No. 3, at 8 (1985) (Chinese version).

262. The value of a product equals the cost of production plus wages and average social profit which is the average profit made by all enterprises manufacturing the same products. *See* CHEN GONG, HOU MENGHUA AND YUAN ZHENYU, CAIZHENG JIAOCHENG (TEACHING MATERIALS ON FINANCE) 155 (1985) (Chinese version). The price of a product theoretically equals the value of the product plus Product Tax or VAT. The amount of the Product Tax or VAT is not shown on price tags and consumers do not know how much tax they pay when they purchase goods. Normally, when taxes are increased, prices are not increased at all, or are increased by a smaller amount, depending upon whether the state intends to maintain the price level of the product or not. Thus, increased taxes are borne by producers.

ment does not intend to encourage over-production of these products. Lower tax rates or exemptions are applied to products which are lower priced, and the production of which is necessary and needs to be encouraged. To influence consumption of taxable goods, higher rates are applied to those the consumption of which needs to be limited due to limited supply or social policy. Conversely, lower rates are set for products of which the government encourages the consumption and for products receiving financial subsidies, such as foods and other necessities.[263] This explains why the Product Tax has as many as 26 tax rates applicable to 270 taxable products.

It should be noted that, as long as the state controls prices, taxes will be used to regulate supply and demand. However, it has been recommended that when prices are rationalized, i.e., prices equal the true value of products, taxes should be "neutral".[264]

3. Attracting Foreign Investment

The Chinese government believes that lower tax rates will attract foreign investment to China and that taxing foreign investment in a favorable way will do no harm to the creation of a suitable environment for foreign investors. Therefore, tax incentives are offered to foreign enterprises and Chinese-foreign joint venture enterprises. These enterprises are taxed at very low rates — 10 percent in Special Economic Zones for export-oriented enterprises, whereas state enterprises are taxed at 55 percent and individual households are taxed at 60 percent or more. Foreign individuals working in China are also taxed at nominal rates compared to those applicable to Chinese citizens.

B. *Equity*

Before discussing the equitability of China's tax system, it should be mentioned that the equity dimension of tax policy, highly important in capitalist countries, is less important in China. Despite the fact that a rich class of citizens is emerging in China due to the flexible economic policies, large disparities of income are unlikely to appear in the near future because of the public ownership of land and means of production and state control over wage increases. The communist party and the government maintain a host of instruments other than income taxation to influence the distribution of incomes in the society. The government maintains these controls because of the communist philosophy and tradi-

263. *See* Dai Yuanchen, *A Discussion of the Relationship between Price and Public Finance, Taxation, Credit, Wages and other Economic Levers*, CAIMAO YANJIU, No. 1, at 9 (1986); He Zhaoqi and Tang Shunlu, *To Properly Use the Price and Taxation Levers to Promote and Speed up a Commodity Economy*, ZHONGGUO SHUIWU, No. 9, at 8 (1986); and Xu Riqing and Qian Wei, *A Study on Several Questions relating to the Socialist Tax Lever*, CAIMAO YANJIU, No. 1, at 14 (1986).

264. Xu Jianguo, *Relationship between Prices and Taxes*, ZHONGGUO SHUIWU, No. 5, at 19 (1987).

tional Chinese values which emphasize equal levels of income and wealth.

1. Vertical Equity

Marx and Lenin both called for a heavily progressive income tax in socialist states in order "to ensure that the incidence of taxation falls on those individuals best able to pay."[265] Although China's Individual Income Tax (IIRT) is not heavily progressive, the recent Individual Income Regulatory Tax and the Private Investors Individual Income Regulatory Tax make it more so for Chinese citizens. Passive investment income is taxed at a flat rate of 20 percent. With the basic deductions permitted, the effective top marginal rate on royalties is a mere 16 percent for Chinese citizens. At first sight, China's system of taxing earned income more heavily than unearned, and taxing workers more heavily than the self-employed, seems contrary to socialist principles. Such an evaluation, however, is superficial. Employees do not begin to pay tax until their wages or salaries are several times greater than average Chinese monthly earnings. Even under the IIRT, tax becomes payable only when income exceeds approximately four times average monthly earnings. Employment income would have to exceed seven times the average before the total tax burden equals that of the flat-rate tax on interest and dividends.

For Chinese citizens, the IIRT aggregates income from employment, professional services and rents, with the two latter items now being taxed at progressive rates. In addition, business income of individuals, whether operating through private enterprises or individual households, is taxed at progressive rates, though technically it is the enterprise which pays the tax. In any event, it could be argued that a progressive income tax is not needed in China for purposes of redistributing income, since redistribution has already been achieved by other means. The relatively even distribution of income and wealth in China, and the absence (as yet) of any substantial class of "rich" individuals, reduces the need for a steeply progressive income tax.

A further possible cause of vertical inequity is the fact that personal income tax plays, at least for the present, an insignificant role in public finance. Heavy reliance is placed upon taxes on goods and services, which are generally considered to be regressive in nature. Taxes on essential items, such as the Salt Tax, clearly are regressive. In general, however, the structure of indirect taxes seems to be mildly progressive, with low rates applying to basic necessities and higher rates to luxuries, tobacco and alcohol. Further, in an economy where the prices of many commodities are controlled, the conventional view that indirect taxes are necessarily shifted to the consumer is no longer valid. Currently, Chinese officials feel that these taxes operate as taxes on enterprise profits, since they cannot be passed on in the form of higher prices. In the case of state enterprises this may make little difference, but as competition among different

265. M. NEWCITY, TAXATION IN THE SOVIET UNION 361 (1986).

types of enterprises increases in China, it may be legitimate to regard indirect taxes, at least in part, as being imposed upon the profits of private and collective businesses.

2. Horizontal Equity

In terms of horizontal equity, the present system stands up to scrutiny less well. A major reason for this is the essentially schedular nature of income taxation in China due to the state policy of taxing earned and unearned income differently, though the IIRT may be viewed as a step towards the eventual introduction of a comprehensive income tax since it introduces a measure of aggregation of the various sources of income. At present, however, there is a mixture of flat-rate and progressive taxation: an individual with a large salary may pay more tax than another individual with the same total income where that income is derived from dividends or interest, or from a combination of salary and investments. Since different types of income are taxed differently — rents and royalties on the one hand and dividends and interest on the other — distortions are inevitable and opportunities for tax planning and avoidance arise.[266] Another potential cause of inequity is the taxing of certain types of income, notably rents, royalties and professional income, on the basis of gross receipts less a standard deduction, rather than upon actual profit.

C. *Neutrality*

Inequities will arise in the taxation of business income as well. Seven different taxes — eight if one includes the Agriculture Tax — are imposed on profits, depending upon whether the business is foreign-owned, a joint venture, a state enterprise, collectively owned, individually or privately operated. Each type of business pays tax according to its own rules and schedule of rates. Since these different types of business are in competition with each other, there is a risk that differences in tax burdens may cause distortions.[267] Unfortunately, this situation may stay until a complete reform of the business income tax system has taken place. In any event, in a socialist state, the difference in ownership predetermines the difference in fiscal liability of enterprises towards the state. The difference will remain if the government adopts different policies towards

266. Little is known about the Chinese attitude toward tax avoidance. Tax evasion, by contrast, appears to be widespread and a serious problem. *See, e.g.*, Renmin Ribao, May 13, 1985 (Chinese version); China Daily, Oct. 8, 1986. Nor is it a new problem. Ecklund records a massive campaign against tax evasion in 1955, and notes that of 2,071 firms audited in Wuhan, 1,760 were found to have evaded tax. G. Ecklund, *supra* note 19, at 41.

267. Different tax treatment, of course, may be designed to promote competition and to compensate for other factors which cause distortions. Nevertheless, some consequences may be unintended; for example, a large collective enterprises (in terms of profit) pays more tax than a small one, although, when profits are shared among the individual members each receives the same. Similarly, there are significant differences in the rates of tax applicable to contractual fees earned by an individual under the IIRT, and by a private business under the CEIT or Household Tax.

each type of enterprise.

Distortions also exist in the indirect tax system, due to the partially cumulative effect of the Product Tax and Business Tax. This leads one to wonder whether the value-added tax might eventually be expanded to replace those taxes. It should be noted, however, that some of the distortions are intended by the state to encourage or discourage the production and consumption of certain products or to use taxation as an economic lever to control the economy. Neutrality of the tax system is not yet one of the main criteria to evaluate the Chinese tax system.

D. *Complexity*

At first glance the Chinese tax system appears to be excessively complex. Where, in many Western countries, there is a single comprehensive income tax, or two taxes (one on individuals and one for corporations), China has nine or ten. Similarly, where other countries manage with two indirect taxes — a sales tax or value-added tax and an excise duty — China has four or five. Nevertheless, these differences are more apparent than real. Frequently, a country will have a single income tax code, commonly of considerable length, which treats various types of activity and income differently. Western tax codes are, at least, as complex as the multiplicity of separate tax laws in China. The number of separate taxes, therefore, is not important unless they are administered separately. Nevertheless, the existence of so many categories and rate schedules, both of direct and indirect taxes, inevitably gives rise to "grey" areas and to uncertainty, which in turn may give rise to disputes between taxpayers and authorities.

Simplification of China's tax system seems a distinct possibility. There has already been a substantial move towards VAT in the turnover tax system, but simplification cannot really take place until the pricing system is totally reformed. Taxes on enterprises may be, at least in part, integrated. A single income tax law on all enterprises with foreign investment has been drafted.[268] The State Enterprise Income Regulatory Tax may be repealed due to the pressure from both academics and enterprises and we may eventually see a single enterprise income tax system in China in the future.[269] The Individual Income Regulatory Tax has moved a step further in aggregating personal incomes.

IV. CONCLUDING REMARKS

As the current tax system is mainly a product of the new economic polices adopted in the late 1970s, it is bound to be reformed along with the further development of the economic and political reform in China.

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268. Renmin Ribao (Haiwai Ban), July 7, 1988, at 3 (Chinese version).

269. Cao Ruitian and Zhou Caifeng, *To Organize Tax Revenue and to Regulate the Economy — a talk by Jin Xin, Director of the General Tax Bureau of the Ministry of Finance*, Renmin Ribao (Haiwai Ban), June 21, 1988, at 3 (Chinese version).

To a certain extent, in fact, the tax system has already lagged behind the development of the economic reform. For instance, the replacing of Product Tax with VAT has been very slow and has not taken into account the results of the pricing reform by amending and simplifying the rate structure when the price of more and more commodities are subject to market determination; the income taxation of domestic enterprises cannot completely meet the requirements of urban economic reform, which generates some new forms of business entities, such as corporate groups, formed by mergers among state enterprises, collectives or private enterprises, which are not at present clearly subject to any tax laws; and there have been tax laws providing for the taxation of enterprises and individuals where state enterprises are contracted, leased or sold to collectives or individuals. The existing tax system, also has many deficiencies in itself. The income taxes levied on business income cause unfair competition among different types of enterprises. Large and medium-sized state enterprises, which are the backbone industrial enterprises of the Chinese economy, are subject to heavy taxation and are short of funds for investment.[270] The multiple-rate structure of the turnover tax system and the separate tax on each type of enterprise cause confusion among taxpayers and difficulty in administration. Tax evasion has already become a big problem and concern of the government.[271] Annual national tax inspections have been called to investigate serious tax evasion cases and penalize tax evaders.

To accommodate the economic reform and create an equitable and simple tax structure which fits in the socialist economy, the existing tax system needs to be reformed and perfected. It is anticipated that the future reform may be conducted in the following manner. The turnover taxes and income taxes will remain the two important components of the system, and neither of which can become the leading tax. In the turnover tax system, VAT will gradually replace product tax and, probably, business tax and an excise tax will be levied on some specific products. In the income tax system, income regulatory taxes may be abolished, various tax laws may be integrated, and progressive tax rates adopted. An agricultural tax may stay and be reformed to regulate the rural sector of the

270. *See* Zhou Shaoyun and Liu Jin, *The Problems Existed in the Current Income Tax System and Thoughts on Further Reform*, CAIJING YANJIU, No. 2, at 40 (1988) (Chinese version).

271. It has been reported that, in certain areas of the country, about 50 percent of state enterprises avoid tax and about 90 percent of individual households try to pay no tax at all. Tax evasion is becoming a commonplace. *See* Renmin Ribao (Haiwai Ban), May 4, 1986, at 1; Han Shaochu, *To Administrate Law with Law Is the Material Requirement of Taxation*, ZHONGGUO SHUIWU, No. 12, at 20 (1985); and *To Implement National Tax Law and to Guarantee State Tax Revenue*, ZHONGGUO SHUIWU, No. 1, at 17 (1988) (Chinese version).

economy. Local taxes may be further defined to make sure that the central government receives adequate revenue.[272]

272. *See* Jin Xin, *Principles and Practice for the Development of China's Tax System*, ZHONGGUO SHUIWU, No. 12, at 3 (1987); Xu Jianguo, *Principles for the Establishment of our Country's Tax System*, ZHONGGUO SHUIWU, No. 4, at 21 (1987); Ji Kan, *A Brief Discussion of the Reform of our Country's Fiscal System*, JINGJI GAIGE, No. 2, at 25 (1987); Xu Riqing, Du Yanshuang and Zhao Kaitai, *An Inquiry on the further Reform of our Country's Socialist Tax System*, CAIJING YANJIU, No. 5, at 8 (1985); Liu Liqun and Shi Xiaomin, *Reflections on and Choices of Tax Reform*, CAIMAO JINGJI, No. 6, at 26 (1987); Shen Liren, *Comments on "to eat from separate kitchens" and to Delineate Central and Local Taxes*, CAIMAO JINGJI, No. 11, at 24 (1987); Cai Xiuguo, *Several Ideas on the Third Stage of Li Gai Shui*, CAIJING YANJIU, No. 7, at 62 (1986); Sui Zongyan, *Theoretical Basis and Guiding Principles for Reforming and Perfecting our Country's Tax System*, ZHONGGUO SHUIWU, No. 5, at 20 (1986); Gao Wancong, *A Summary of Views of Discussions at a Seminar on Perfecting the Tax System and Tax Models*, ZHONGGUO SHUIWU, No. 2, at 27 (1987); and Xu Riqing, *Thoughts on the Develop Strategy of Our Country's Tax System*, ZHONGGUO SHUIWU, No. 6, at 21 (1988) (Chinese version).

LEONARD v.B. SUTTON AWARD PAPER*

The 1987 Soviet Joint Venture Law: New Possibilities for Cooperation and Growth in East - West Relations

DAVID M. BOST**

I. INTRODUCTION

In May of 1985 more than 400 American businesspeople attended meetings in Moscow with Soviet trade officials as part of a conference sponsored by the U.S. - U.S.S.R. Commercial Commission. The Soviets hoped to accomplish a double purpose by hosting these meetings: demonstrate to Western nations that it was willing to do business, and encourage Western governments to reciprocate by relaxing trade barriers.[1] One year later, Soviet trade officials met in New York with U.S. trade leaders to explore what forms would best facilitate Soviet-American business relationships. After expressions of interest by Monsanto, Occidental Petroleum, Singer Sewing Machine, and other companies,[2] Soviet officials announced a new Soviet Joint Venture Law in January of 1987.[3] Within

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* The Leonard v.B. Sutton Award is presented each year in recognition of excellence in international legal writing. The award is endowed by the Honorable Leonard v.B. Sutton. Judge Sutton is a former Chief Justice of the Colorado Supreme Court, the former Chairman of the Foreign Claims Settlement Commission of the United States, and an internationally renowned scholar and attorney.

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1. Rogers, *Glasnost and Perestroika: An Evaluation of the Gorbachev Revolution and Its Opportunities for the West*, 16 DEN. J. INT'L. L. & POL'Y 209, 211 (1988). The Soviet description of the Commission's goals is: to search for ways of improving cooperation between the Soviet Union and United States' economies through seminars, symposiums, marketing, joint scientific research, joint ventures and technology transfers. USSR TRADE SUPPLEMENT, J. of Comm., Dec. 8, 1986, at 10.

2. Aronson, *The New Soviet Joint Venture Law: Analysis, Issues, and Approaches for the American Investor*, 19 LAW & POL'Y. INT'L BUS. 851 (1987). Among other interested companies which have recently entered into negotiations with the Soviets are: RJR Nabisco, Mercator Corp., Chevron, Eastman Kodak and Johnson & Johnson. *See Breakthrough: a Journalist's Report From Moscow*, THE NEW YORKER, April 17, 1989, at 30.

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months the Soviets received over 200 proposals from interested Western businesspeople.[4]

Although there have been joint venture laws in the Eastern Bloc for some time,[5] this Western access to the Soviet economy is new and reflects a changing Soviet Union, in terms of *perestroika* and *glasnost* as well as the desire to integrate its economy with the more prosperous West. This change of attitude has spread throughout Soviet society and politics, and is confirmed by other recent events such as the relaxation of controls on information, the historic agreement between the U.S. and U.S.S.R. to eliminate intermediate range nuclear missiles,[6] and a number of domestic and foreign reforms.

Some observers and experts on Soviet affairs have remained skeptical of Soviet attempts to become involved with the free market, while holding reservations about Soviet intentions in the joint venture realm.[7] However, the new joint venture law conforms to the realities of *perestroika* and *glasnost*, and reveals remarkable flexibility by conforming to Western investors' needs.

The joint venture law can bring about more than the establishment of many small ties for profit. Partnerships based on common economic goals will allow communist and capitalist enterprises to encounter and assimilate each other. This interdependence will require the creation within a given venture of structures for developing shared interests and resolving conflicts, as well as harmonizing what may be considered a new communist - capitalist economic culture.

Because the joint venture law does not operate in a void, these many small ties will implicate numerous social, economic, and political realities. The venture's resolution of inevitable conflicts arising under the law due to differing ideologies, will be paramount to the partnership's viability. It is through this mutual resolution of problems that larger processes for conflict resolution are created: a process for resolving conflicts in the

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U.S.S.R. AND THE ACTIVITIES OF JOINT ENTERPRISES WITH THE PARTICIPATION OF SOVIET ORGANIZATIONS AND FIRMS OF THE CAPITALIST AND DEVELOPING COUNTRIES, 26 I.L.M. 750 (1987)[hereinafter JOINT VENTURE LAW].

4. Wall St. J., April 6, 1987 at 20 (the 200 proposals were counted as of April 1987).

5. There exist East-West joint ventures in Poland, Bulgaria, Hungary, Czechoslovakia, and Yugoslavia. *See* Scriven, *Co-operation in East-West Trade: the Equity Joint Venture*, 10 INT'L BUS. LAW. 105, 109 (1982).

6. Agreement was signed Dec. 9, 1987.

7. It is no secret that the Soviet Union desires to attain the same advantages given member states of the General Agreement on Tariffs and Trade (GATT). Consequently, it has been hinted that the Soviets believe their democratization of certain government powers through *Glasnost* may lead to admission to GATT. Rogers, *supra* note 1, at 227. Speculation operates in the idea that the new joint venture law stems from the Soviet desire to gain admission to GATT. One means of broadening the base of Soviet export earnings and a prominent role in world trade can be linked to joint ventures as the proving ground for more of the open free trade principles found in GATT. *See* Aronson, *supra* note 2, at 856-867. Arguably, the Soviet joint venture law may be a stepping stone for Soviet inclusion to GATT.

larger context of East-West relations.

II. BACKGROUND

It is apparent that the Soviet Union no longer represents a compelling ideal to the third world, or even to its own society. As one commentator recently observed, "[S]ince Communism is becoming an evident failure at home, it is increasingly difficult for the Soviets to sell it as the wave of the future to third world and other countries."[8] In an attempt to stabilize and modernize the Soviet economy, the U.S.S.R. has found it necessary to expand its role in the world market by implementing what looks remarkably similar to capitalist reform. If so, this would not be the first time the Soviets have found certain Western reform advantageous, since as far back as the 1920's Lenin implemented many free-market reforms in times of crisis.[9] In fact there is an economic crises in the U.S.S.R. today and, as one author has determined, the programs the Soviets are implementing to correct its problems "[a]rise from the new Soviet consciousness that its economic system is not working and that if it wishes to keep pace economically and culturally with the rest of the world, [it] must make 'significant changes.' "[10]

Before the enactment of one such change — the joint venture law — foreign investment in the Soviet Union was limited to Industrial Cooperation Agreements (ICA's),[11] which required a Western investor to furnish the Soviets with the capital, equipment, and technical expertise essential to make the *Soviet run operation* function. Without any real say in the operation of the ICA or in managing the operations, Western investors were left only with the hope they could recoup the cost of their original investment.[12] This conformed to the reality of the U.S.S.R.'s centrally planned economy, controlled and administered entirely by a rigid and entrenched bureaucracy bent solely on state ownership of all means of production, prohibiting the private use of hired labor, and private management: a virtual ban on private business for profit.

The joint venture law is a stark contradiction to past Soviet policies on foreign investment. Joint ventures are a creative form of business relationship, existing in many forms, and managed by their respective partners. A joint venture is simply, "[A]n economic entity comprised of two or more partners which combine their assets, and expertise, and agree to share the profits and losses resulting from their jointly managed enterprise."[13]

The desire to implement a joint venture law in the Soviet Union

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8. Rogers, *supra* note 1, at 211.

9. *Id.* at 239.

10. *Id.*

11. Dunn, *The New Soviet Joint Venture Regulations*, 12 N.C. J. OF INT'L & COMM. REGS. 171, 174 (1987).

12. *Id.* at 175.

13. Aronson, *supra* note 2, at 855.

came partly from the knowledge that joint ventures provide their host country with great opportunities in research and development. These benefits were made obvious by China's success with its joint venture law.[14] The Chinese experience, and the fact that joint ventures between capitalist countries have also been successful,[15] has improved the Soviets' receptivity to joint ventures.

III. THE JOINT VENTURE LAW - GENERAL PROVISIONS

A. *The Venture Proposal*

The first step for parties interested in creating a joint enterprise is to submit a proposal to the Soviet partner's local ministry. The proposal is to reflect an interested investor's tentative plans for a business activity with a Soviet partner. After being processed through the Soviet bureaucracy, the U.S.S.R. Council of Ministers decides whether to accept or deny the proposal.[16] The Council has wide discretion in making its decision. This discretion is limited only by such considerations as the Soviet Union's need for raw materials, foodstuffs, new technology and management techniques, a desire to enhance the value of the ruble, increase imports of foreign exchange, and expand the export base of the U.S.S.R..[17]

B. *Structure of the Joint Venture*

The structure of the joint venture is determined by a number of mandatory and permissive provisions in the joint venture law. In the original 1987 law, a Soviet partner was to own not less than fifty-one percent interest in the joint venture; however, the law has since been changed permitting Western partners *more* than fifty percent ownership.[18] The venture is to be considered an individual entity, self-financing and with its own balance sheet. That is, the enterprise must "sink or swim" on its own.[19]

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14. China has permitted an "open door policy" to Sino-Foreign partnerships in the form of joint ventures for 10 years. These have brought China over 6 billion dollars in foreign investment from over 7,000 foreign investors. *See* Yuquing, *Like Bamboo Shoots After a Rain: Exploiting the Chinese Law and New Regulations on Sino-Foreign Joint Ventures*, 8 N. W. J. INT'L L. & BUS. 59, 118 (1987).

15. Since 1978 a number of industrial nations focused on joint ventures as a progressive business. Most of those countries were high profit residence states such as the United Kingdom, United States, Japan, France, and West Germany. KAREN J. HLADIK, INTERNATIONAL JOINT VENTURES 6 (1985).

16. 16 JOINT VENTURE LAW, *supra* note 3, at 750, secs. 1 & 2.

17. *Id.* at 750-751, sec. 3.

18. Telephone interview with Harold E. Rogers, Jr., International Attorney and Author on U.S. - Soviet business transactions (April 10, 1989). For a view of the old forty-nine percent rule see *id.* at 751, sec. 5.

19. With a view of the past, this provision is startling to most observers because it allows soviet business to run itself for the first time, and allows joint ventures to set production limits and goals free from government control. *See* Dunn, *supra* note 11, at 174. What M.S. Gorbachev has stated as the key to the new Soviet economic and social reform is, "[t]o

The venture will conclude contracts on its own, acquire property, and have the right to sue and be sued.[20] Each venture is to have a board with Soviet citizens as the Chairman and General Director. Participants of the venture have the right, by mutual consent, to transfer their share of ownership to third persons. However, the Soviet partner has a first right of purchase and any transfer must be approved by the Council of Ministers.[21]

The joint venture must employ a labor force that is made up primarily of Soviet citizens,[22] thus the venture may enter into contracts with Soviet labor organizations. The venture must pay its workers wages, social security and pensions at a rate determined by Soviet law. All disputes between the partners, and between the venture and other businesses, may be settled either in the Soviet courts or by a Soviet arbitration tribunal.[23] Finally, the joint venture must create a charter and file it with the Council of Ministers. The contents of the Charter must include the purposes of the venture, its location, composition of ownership, the stated amount of each partner's capital contributions, and a statement of the Charter fund composition.

The composition of the charter fund includes a statement of the amount of foreign currency, as opposed to the rubles brought into the venture. The value of each partner's property (capital contribution) is to be determined by its conversion into rubles.[24] This valuation is the determining factor of ownership interest and profit allocation between the partners.

The duration of the venture may be perpetual; it is limited solely by the Charter.[25] The Charter may also include any other provisions which allow the partners to further define their duties and relationship to one another. Thus, having a Soviet Chairman and General Director does not necessarily eviscerate a foreign partner's voting and decisionmaking rights. Structures and rules for inter-venture decision making may be defined by agreement between the partners and incorporated into the ven-

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carefully prepare, within the year 1987, and to implement in the U.S.S.R. law on State Enterprises. To extend its action to all enterprises in 1988 and 1989, and make them completely self accounting and self financing." Pravda, June 27, 1987, col. 1.

20. JOINT VENTURE LAW, *supra* note 3, at 751, sec. 6.

21. *Id.* at 752, sec. 16.

22. *Soviet Council of Ministers Decision on Joint Ventures with Western Firms*, 4 INT'L TRADE REP. 358, 361 (BNA) (Mar. 11, 1987).

23. JOINT VENTURE LAW, *supra* note 3, at 753, sec. 20.

24. *Id.* at 752, secs. 11-12.

25. *Id.* at 751, sec. 8. This is a very positive provision because many communist nations limit their ventures' duration. Both Poland and Bulgaria place a 15-year maximum on the length of the venture. Other socialist countries have similar principles. One problem associated with limitations on joint venture duration is that foreign partners must accept the exploitation of their capital and technology by sacrificing their capital to the government when exiting the partnership. *See* Şcriven, *supra* note 5, at 109.

ture charter.[26] In many respects the charter operates in a manner similar to partnership agreements in the Western legal world.[27]

C. *Venture Operations*

For its operations the joint venture may create branch offices within the Soviet Union.[28] It may purchase raw materials from the Soviet Union;[29] however, all the venture's purchases and sales in the Soviet domestic markets must be transacted in rubles.[30] The venture's cash assets must be deposited in a Soviet State Bank, with foreign currency to be immediately converted at an exchange rate determined either by world money market rates or a procedure established by the State Bank.[31]

The venture may import and export goods as necessary, but it must do so through a Soviet Foreign Trade Organization (FTO).[32] Any foreign currency expenditures flowing from the venture must be transacted with the actual foreign currency brought in by the venture's export sales. The foreign partner's repatriation of profits is similarly limited to the currency brought in by the venture's net export receipts.[33]

IV. THE LAW'S INHERENT PROBLEMS AND POSSIBLE SOLUTIONS

The new joint venture law presents ample opportunities for profit, expanded trade, and improved foreign relations. Yet, because the law does not operate in a void, it also presents problems that must be resolved. Major difficulties exist in regard to the law's provisions on foreign exchange. There are, as well, the existing trade regulations promulgated by the Soviet Union and Western nations: these alone present significant obstacles. Finally, the absence of Soviet legal precedent in partnership and contract law may well be the most daunting problem for joint

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26. JOINT VENTURE LAW, *supra* note 3, at 753, sec. 21. Without a foreign partner having the ability to make major management and production decisions, the entire purpose of the Joint Venture law would be destroyed. The Soviets desire to learn Western decision processes and without flexibility in the charter agreements the Soviet partners could dominate the venture.

27. *Id.* at 751, sec. 7. This provision allows the partners to make specific contractual obligations between themselves, thus minimizing disputes in the future.

28. *Id.* at 753, sec. 19.

29. There exist a number of incentives making it less likely that the venture will contract for raw materials outside the country. Large tax breaks are given to ventures that purchase their materials within the country. Extra taxes can be levied on raw materials that are imported, even while available within the Soviet Union. For a more in depth review of the tax consequences to the Joint Venture, see UNION OF SOVIET SOCIALIST REPUBLICS: EDICT CONCERNING TAXATION OF JOINT ENTERPRISES IN THE SOVIET UNION AND DISPUTE RESOLUTION OF JANUARY 13, 1987, 26 I.L.M. 759 (1987)[hereinafter DISPUTE RES. LAW].

30. JOINT VENTURE LAW, *supra* note 3, at 754, secs. 25 & 26.

31. *Id.* at 754-755, sec. 29.

32. *Id.* at 754, sec. 24. This seems necessary because the Soviet's wish to prevent the importation of undesirable commodities.

33. *Id.* at 755, secs. 30-32.

venturers.

These problems can be solved and, in many cases, aspects of the law which appear to be obstacles are in fact opportunities in disguise. The process of problem solving is as important as the solutions to individual problems. The joint venture law provides the Soviet Union and Western nations with an opportunity to develop common approaches to problems in circumstances where shared goals are clearly defined.

A. Foreign Exchange and Currency Problems

Foreign currency reserves are critical both to nations and joint ventures. Using the foreign currency it has acquired, a nation can invest in activities and products from abroad and enhance the state's ability to compete in the world market. Not surprisingly, states are quite restrictive in controlling the foreign currency that enters and leaves their economies. International law also reflects this attitude: there is no bilateral treaty anywhere in the international business world that allows a venture to import or export domestic or foreign exchange freely.[34] A state's regulation of foreign exchange is explicitly recognized as an act of sovereignty.[35]

Some countries are less concerned with the acquisition of foreign currency than others. Its importance depends on a country's relative economic status in the world. Thus, "While the acquisition of foreign exchange may be a high priority of the investment policy of the Sudan, it is certainly not as important for Saudi Arabia, which seeks particularly to acquire new technology."[36] Without question, the Soviet Union wishes to acquire both foreign currency and new technology. In fact, the Soviet need for foreign currency reserves is as great as that of Sudan; Soviet currency has very little practical worth in the Western market.[37] In its trade with Western countries, the U.S.S.R. must use the currency of its trading partners. Foreign currency is so important to a joint venture's successful operation that it has been described as "the mother's milk of joint venturing abroad."[38]

The new Soviet joint venture law's foreign exchange provisions also present major difficulties for joint ventures. The law inhibits a joint venture's ability to obtain needed currency simply because the law is geared toward increasing the Soviet acquisition of foreign exchange. The Soviets have organized their joint venture law in a manner that makes joint ventures a conduit for bringing in foreign currency. The law inhibits the venture from sending foreign currency out of the country once it has received

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34. Salacuse, *Host Country Regulation of Joint Ventures*, in JOINT VENTURES ABROAD 103 (1985).

35. *Id.*

36. *Id.* at 106.

37. Aronson, *supra* note 2, at 863. Of course, the Soviets need foreign currency to trade with other countries and foreign businesses.

38. Salacuse, *supra* note 34, at 118.

it.[39] Provision 25 of the joint venture law limits the joint venture's use of foreign exchange to the currency it earns through its own exports.[40] The venture is also precluded from obtaining currency subsidies and from borrowing currency outside the U.S.S.R.[41] This forces joint ventures to concentrate their activities more in the area of exporting goods rather than selling in the Soviet domestic market where payment would be in rubles.[42]

The biggest risk a venture faces when dealing with these restrictions is that its exports might fail or fall short. It would then be unable to pay its foreign creditors and repatriate the profits for its foreign partner.[43] "In substance, the new law's express 'guarantee' of the right to take of profits in foreign exchange . . . will apparently apply only when the necessary foreign exchange has been earned."[44] Under Soviet law, if the venture's foreign currency runs out, it must make all its expenditures in rubles.[45] Many capitalists will be discouraged from entering joint ventures if the pot of gold they seek exists only in rubles.

B. Foreign Exchange Rate - The Ruble

The essential problem of foreign exchange is the valuation process of the ruble: all foreign currency and capital originally contributed or brought in through exports must be deposited in a Soviet State Bank and then converted to rubles.[46] The State Bank of the U.S.S.R. determines for itself the official exchange rate.[47] Such a one-sided determination of ex-

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39. Although seeming harsh, such is not unusual in Eastern Bloc states, nor in China. Yuquing, *supra* note 14, at 100.

40. JOINT VENTURE LAW, *supra* note 3, at 754, sec. 25.

41. *Id.* at 860-861.

42. As long as a joint venture decides to concentrate on selling its products exclusively within the Soviet domestic market there would be little concern over foreign exchange since the entire process can be accomplished in rubles. However, because foreign currency is required for making outside purchases and repatriating profits, a foreign partner benefits more by using its Soviet facilities to manufacture its products for export to its previously established Western markets. As witnesses in China's international joint venture law, foreign investors have geared toward primarily export oriented ventures, Yuquing, *supra* note 14, at 100. *See also*, Salacuse, *supra* note 34, at 106 (Soviet law has forced many to accept export as the *quid pro quo*). It may indeed be more beneficial to Western partners if they set up primarily export oriented joint ventures since it is likely the Soviets will go along with proposals which give the Soviets some competitive advantage in the manufacture or sale of a product. This is expecially true when the foreign partner lacks a great foreign marketing operation and could benefit from such activity. If a foreign partner does have an extensive marketing operation throughout the world, he receives little incentive to enter a Soviet joint venture because start-up costs override the low wages found in the U.S.S.R.

43. Aronson, *supra* note 2, at 863.

44. Smith, *U.S. - Soviet Joint Ventures: A New Opening in the East*, 43 INT'L BUS. LAW. 79, 84 (1987).

45. JOINT VENTURE LAW, *supra* note 3, at secs. 25-29.

46. Section 20 of the joint venture law dictates that the foreign currency acquired by the venture must be deposited in a Soviet Bank for conversion into rubles.

47. JOINT VENTURE LAW, *supra* note 3, at sec. 29.

change rates can result in an inflated valuation of the Soviet partner's initial contribution and, eventually, the share of profit that partner receives.[48] Thus, a partner's profits could vary at the whim of state policymakers.[49]

While this discussion may lead one to believe that the future for joint ventures is doubtful, it is still quite possible under the present law for ventures to resolve the foreign exchange problems and reap sufficient profits.[50] The establishment of a fair exchange rate is more likely than it seems. The Soviet Union has strong incentive to build up the international integrity of its currency:

> Gorbachev may represent the last chance of better integrating the Soviet Union into the world economy. There it would come under pressure to behave like a Western Country, competing for capital . . . lowering the barriers to foreign investment and even making its currency convertible.[51]

It is in the strong mutual interest of both Soviets and joint venture's to establish a fair exchange rate for the ruble.[52] Moreover, the joint venture can protect itself from unreasonable exchange rates by agreement within the venture charter. Both partners can agree as to the value of their respective contributions and ownership interests.[53]

The Soviets have recently reacted to this dilemma of poor ruble marketability by considering a new type of "special ruble" for international trade purposes. This limited edition ruble, if approved, will be available to Western partners, and backed by gold and hard currency reserves.[54] This type of consideration enforces the idea that the Soviets view the new law as both flexible and accommodating to Western needs.[55]

C. *Import Substitution*

Another way of relieving a venture's foreign exchange problems is through import substitution. If a venture is producing certain products which the Soviets need to import from abroad, it is much more economi-

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48. Aronson, *supra* note 2, at 864.

49. *Id.* at 866.

50. Smith, *supra* note 44, at 84.

51. TIME, July 27, 1987, at 11.

52. There exist a number of obvious and not so obvious reasons for enhancing the value of the ruble: 1) Since unfair rates will discourage foreign investors, the Soviets will be apt to set a rate which encourages entrance into joint ventures; 2) The more joint ventures that exist in the Soviet Union, the more the ruble is spread around the world community, and it follows that this alone may enhance the integrity of the ruble in the free market; 3) The more inflated the ruble becomes, the less likely it will ever be respected in the international market.

53. Smith, *supra* note 44, at 89.

54. *Soviet Union Considering Special Ruble to Lift Trade*, Wall St. J., April 4, 1989, at A17, col. 4.

55. Thus, we might consider this type of flexibility as a precursor to even greater Soviet receptability to Western investors' needs.

cal for the Soviets to trade with the venture and avoid the costs associated with importation, shipping, and excise taxes. If the Soviets pay the venture for its products in rubles, they need not touch their foreign exchange reserves; however, the venture will be left with an excessive surplus of unconvertible rubles.

Import substitution allows the venture to utilize a greater amount of foreign currency than it could if limited solely to the currency it acquired through its exports.[56] The amount of rubles the venture receives from the Soviets is valued at its worth in foreign currency, and the venture then receives the right to borrow or withdraw foreign currency from abroad — or even within the Soviet Union — up to the amount of the valuation. This allows a joint venture to utilize needed foreign currency above and beyond the limits of its export income, as well as repatriate profits and pay foreign creditors.

The benefits of import substitution are reciprocal. The venture receives a higher limit on its foreign currency transfers, and the Soviets reduce their foreign currency expenditures on goods from abroad.[57] The use of import substitution is only one example of how the Soviets and joint ventures can meet their needs by resolving problems in respect to their shared interests.

D. Countertrade

Countertrade offers further solutions to the joint venture law's limitations on foreign exchange. Countertrade is trade with an eye on avoiding the exchange of money. One form of countertrade especially useful to joint ventures is barter. Barter is the direct exchange of goods or commodities of equal or near equal value without the use of currency.[58]

Although barter encompasses only 4% of all countertrade transactions worldwide,[59] its practicality presents an obvious advantage for joint ventures and the Soviets. A joint venture can trade the goods it produces for the products of a foreign company. The goods received by the venture may be divided up among the venture's partners according to their percentage of ownership. A foreign partner can avoid the harshness of the Soviet controls on foreign exchange by having its share of the booty sent to an FTO outside the Soviet Union. Thus, the FTO can sell the Western partner's share of goods in exchange for convertible currency. The profits from such can be deposited into a foreign account, thus allowing the partner to repatriate its profits. Of course, the Soviet Union also profits in this transaction — it acquires the goods received by the Soviet partner, new trading partners in the free market, and increases exports of Soviet

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56. Yuqing, *supra* note 14, at 102.

57. Aronson, *supra* note 2, at 861.

58. Rowberg, *Countertrade as a Quid Pro Quo*, in JOINT VENTURES ABROAD 211, 213 (1985).

59. *Id.* at 211.

made goods.

Since it is often impossible to get immediate delivery of goods as payment for outgoing goods, another more widely used form of countertrade (counterpurchase) may be utilized. Counterpurchase, or "buy-back," is the exchange of goods for goods and is performed through reciprocal contracts. Each party pays for the other's goods in an escrow type account upon receiving delivery of the goods, while guaranteeing by promissory note that the other party will pay the same amount back into the account upon receiving a reciprical delivery of goods.[60] This avoids foreign exchange problems because the currency never really leaves the possession of the Joint Venture.[61]

The Soviets should be very receptive to countertrade because of its popularity and its benefits. Countertrade today encompasses over five percent of all world trade, while some sources put it as high as thirty percent.[62] At least 88 countries, including socialist, developing, and developed states, require some form of countertrade in certain transactions.[63] China has the same restrictions on foreign exchange as do the Soviets,[64] and for them countertrade has been a great success.[65] Even greater benefits have been realized in the Slavic Communist nations. Western joint venture partners in Yugoslavia have profited through countertrade, and Yugoslavia has been able to afford the import of previously unattainable goods from costly Western markets. Also, other Eastern Bloc countries have also experienced a greater influx of needed consumer goods, a noticeable rise in their exports, and a growth in their domestic industries.[66] The utility of countertrade strikes a balance between the needs of partners and the Soviet state. By recognizing the interests both desire from trade, the joint venture and Soviet Union can develop a dialogue conducive to their separate and shared interests, therefore, shaping both Soviet law and a future Soviet-Capitalist economic culture.

E. Review by Soviet Foreign Trade Organizations

Although the joint venture law gives the Soviet venture the right to import and sell goods in the domestic market,[67] a Soviet Foreign Trade Organization (FTO) must review and approve all transactions to deter-

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60. Park, *Countertrade Requirements in East - West Transactions*, 10 INT'L BUS. LAW. 122, 123 (1982).

61. The venture can use the same lump sum of currency in a number of successive transactions since only its presence in the account is important. For a more detailed description of countertrade transactions, see Atrisien & Buckley, *Joint Ventures in Yugoslavia: Comment*, 18 J. WORLD TRADE L. 163 (1984). *See also* Rowberg, *supra* note 58, at 211.

62. BARTON & FISHER, INTERNATIONAL TRADE AND INVESTMENT 80 (1986).

63. Rowberg, *supra* note 58, at 214.

64. Yuquing, *supra* note 14, at 100.

65. *Id.* at 96.

66. Atrisien & Buckley, *supra* note 61, at 166.

67. JOINT VENTURE LAW, *supra* note 3, at 754, sec. 24.

mine if the goods are appropriate for Soviet domestic consumption.[68] The venture is not free to deal directly with Soviet citizens until approval is granted. Therefore, if the Soviet FTO is motivated to promote exports over domestic sales, or to protect Soviet industry from competition, a joint venture oriented toward sales in the U.S.S.R. will seldom succeed.[69]

One of the most problematic aspects of the Soviet Union's desire to regenerate its ailing economy is the introduction of unplanned goods into their planned economy.[70] Because the Soviets fear an introduction of goods that are "too new too soon," they require a FTO to approve all joint venture goods designed for domestic sale.[71] Another potential problem exists. It is not entirely clear whether the Soviets will require foreign partners to bring the newest and most modern machinery and tools into the joint venture. Some Eastern Bloc countries and less developed countries require a foreign investor to supply its venture with the most up-to-date technology available.[72]

The potential for resolving conflicts associated with FTO's is promising. We must not forget the benefits host countries seek through their joint ventures: increased foreign exchange, increased employment, public revenue, the development of local resources, management experience, technology, and improved quality in domestic goods.[73] These benefits are not always realized by a host country, and there is a danger that a venture can backfire, causing greater harm than good.[74] Nonetheless, the Soviet desire for obtaining the resulting benefits from joint ventures may be motivation enough for allowing many previously unacceptable goods to be sold domestically.[75] It is important to note that although FTO's are legal entities, they are integral parts of the Soviet Ministry of Trade and, therefore, representative of Soviet policy.[76] Without the newest skills and technology, the Soviets could neither compete in the world market nor

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68. Smith, *supra* note 44, at 82.

69. *Id.* at 85. This situation might never arise if the joint venture states at the outset what types of goods it plans to bring into the country. If this plan is approved by the Council of Ministers, it seems unlikely an FTO could override Ministry approval.

70. Dunn, *supra* note 11, at 177.

71. Smith, *supra* note 44, at 85. There exists a possibility that if goods are designed primarily for export or destined for other communist nations, the FTO might be more willing to approve the venture's sale within Russia. Thus, a foreign partner should always seek ministry approval of domestic sales before manufacturing.

72. Salacuse, *supra* note 34, at 15. The requirement provides a host country numerous benefits, including: the examination of the newest technology around, modern equipment which is less likely to break down and, low cost replacement parts. Likewise, these contributions on the part of foreign investors demonstrate their intentions to remain and make a venture work.

73. *Id.* at 106.

74. These risks include foreign domination (both political and economic), as well as the destruction of local competition, negative impact on foreign exchange reserves and, in the communist world, adverse social effects from the introduction of undesirable consumer goods. *Id.* at 107.

75. This is another example of how ideology must often accommodate practical need.

76. Dunn, *supra* note 11, at 174.

improve their local industries.[77] From the Soviet perspective, joint ventures are the way these benefits can be obtained.[78] There are a number of steps joint ventures can take to prevent struggles with Soviet FTO's. FTO's have discretion in how they deal with parties. They do not necessarily have the same policies or negotiation techniques as their brother organizations.[79] Thus, foreign partners should learn as much as possible about the FTO they will work with. The investor should determine beforehand whether it wishes to sell its products in the Soviet domestic market and whether permission to do so can be obtained from the FTO.

F. Foreign Regulation of Technology Transfers

A determination as to what technology may be brought into the Soviet Union is not exclusive of the FTO's. Capitalist states have an even greater say in what types of products and technological know-how may enter the U.S.S.R. from the West. Technology transfers are heavily monitored and regulated by most of the industrialized nations through their membership in the Coordinating Committee on Multilateral Export Controls (COCOM).[80] COCOM is designed to prevent militarily useful technology from being transferred by capitalist businesses and governments to Communist nations. COCOM has the ability to prevent transfers through political and economic pressures, including threats, and embargoes.[81] COCOM often enforces its purpose by committing its member states to use their domestic law to punish those who export military technology to the Eastern Bloc. The states themselves may determine if a certain transfer fits the definition of "militarily useful." COCOM has effectively blocked a number of transfers, as well as applied sanctions against violators.[82]

The COCOM vision is to enable all capitalist nations to exchange important technology freely, without the fear of having important technological information fall into the wrong hands. Ironically, this vision is inherently self - defeating: this paranoia held by Capitalist nations blocks the flow of technology between industrialized nations.

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77. Aronson, *supra* note 2, at 856.

78. *Id.* at 856. The newest advancements from Japan and South Korea are also a necessity for Soviet competition. Asian countries may also enter Soviet joint ventures since the law is open to all "Capitalist Countries." JOINT VENTURE LAW, *supra* note 3, at 750, sec. 1.

79. Smith, *supra* note 44, at 86.

80. COCOM includes Japan and all the North Atlantic Treaty Organization countries, with the exception of Iceland.

81. Aronson, *supra* note 2, at 888.

82. Wall St. J., Jan. 27, 1988, at 17, col. 1. France arrested 4 people charged with selling electronic measuring and communications equipment. This was done under the authority of COCOM using French anti-espionage laws. N.Y. Times, Jan. 27, 1988, at 32, col. 5. Pressure was also exerted through sanctions against the Toshiba Corporation and Norway's Kongsberg Vaapenfabrikk for selling equipment to the Soviets which they could use to develop quiet submarine propeller systems. N.Y. Times, Jan. 24, 1988, at 26, col. 4.

Many Western businesspeople feel the inclusion of certain items on the COCOM embargo list is unwarranted. They feel that such inclusions not only inhibit trade, but harm political relations as well.[83] More Western businesses are entering the joint venture arena and the pressures they alone can exert on their governments may result in a relaxation of export controls.

Moreover, certain actions taken by states in the name of COCOM have been assailed. One such challenge is reflected in an ongoing debate within COCOM. On January 29, 1988, the European Committee (EC) protested the United States' attempts at passing a Senate Trade Bill that barred the importation of products from foreign corporations that the U.S. determined had violated COCOM's Export Controls List. The EC (which includes many COCOM members) complained that the legislation interfered with the purposes of COCOM and was nothing less than an "extraterritorial application of United States law."[84] These accusations, as well as other pressures from COCOM members, may cause COCOM to shorten the list of banned items.[85]

G. Domestic Policies of the Capitalist States

Further restrictions on technology transfers are made by the individual nations. The United States, for example, has export control laws which restrict transfers of high technology. The Jackson Vanick Amendment[86] limits the extension of most favored nation status to countries that have taken noticeable steps to improve human rights. The Soviet Union has been excluded from this status because of its restrictions on emigration.[87] Strategically, the Soviets have taken a number of positive steps in improving their emigration policies and the U.S. may soon act to lift the Soviet's restricted status.[88]

The United States' Export Administration Act of 1979 also restricts the export of goods and technology which *could* contribute to the military

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83. N.Y. Times, Jan. 24, 1988, at 26, col. 4.

84. N.Y. Times, Jan. 30, 1988, at 18, col. 5. Such protest by Western members of many international trade agreements and committees is pressure which enables export standards to be re-evaluated, and modified to the benefit of business.

85. *Id.*

86. 19 U.S.C. sec. 2432 (1982).

87. If the Soviets believe a most favored nation status would help improve its trade relations and economy, it may find it advantageous to change its domestic policies even more.

88. Charles A. Vanik, the co-author of the 1974 Jackson-Vanik Amendment, recently stated, "With the Soviet levels of immigration, and its dynamic effort to relax its regulations on religion and culture, why should the U.S.S.R. be denied most-favored nation under a Jackson Vanik waiver. . . ." *quoted in* T.L. Friedman, *U.S. Gets Appeal for Freer Trade With the Soviets*, N.Y. Times, May 5, 1989, at A5, col. 3. The statement was made in a speech before the American Committee on United States-Soviet relations. Secretary of State James A. Baker was present and hinted that a waivor might soon be issued to the Soviets as a method of testing the new thinking of the Soviets. *Id.*

potential of countries viewed as a threat to U.S. national security. The Act was invoked in 1982 after Western European governments and firms began exporting American pipeline technology and equipment to the Soviet Union in exchange for natural gas. Fearing that Western Europe might become overly dependent on the Soviet gas, President Reagan issued an executive order aimed at preventing further exports. The U.S. used political pressure and the threat of embargoes to persuade its allies that the venture was unacceptable.[89] To bolster its right to engage in these activities, the U.S. cited a provision of the act:

> No person in the United States or in a foreign country may export or re-export to the U.S.S.R. foreign products directly derived from United States technical data relating to machinery utilized for the exploration, [and] production . . . of natural gas. . . .[90]

The European Community protested that the U.S. actions were in contravention of "territoriality principles" accepted by all nations, including the U.S.[91]

As tensions mounted between Europe and the U.S., the incident was resolved, though not completely in favor of East-West trade.[92] The ultimate decision as to what actions will be taken under the act is within the discretion of the President.

Laws such as these place a great burden on the Soviets and their foreign partners: neither can be absolutely sure whether necessary capital and technology will be available to them. However, businesses that are interested in joint venturing, or that are already involved in a joint ventures, can exert pressure on their governments to ameliorate especially harsh restrictions.[93]

V. IRREGULARITIES IN SOVIET LAW - PECULIARITIES IN APPLICATION

An important aspect of joint venturing in the Soviet Union involves the venture's use of the Soviet court system.[94]

The joint venture law permits partners in the joint venture to con-

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89. The embargo list included oil and gas equipment as well as a general ban on certain licensing issuances. *See* 83 DEP'T. ST. BULL. 28 (1983).

90. Export Administration Act of 1979, 50 U.S.C. § 6(b) *as amended* by § 379.8 (1982).

91. *European Communities: Comments on the U.S. Regulations Concerning Trade with the U.S.S.R.*, 21 I.L.M. 891 (1982).

92. Through economic and political compromise, the U.S. agreed that all present contracts with the U.S.S.R. should be recognized. The Europeans agreed they would not continue the venture, and would instead seek alternate Western sources for their natural gas needs. *Resolution of the East-West Trade Regulations and the Soviet Pipeline Sanctions*, 83 DEP'T. ST. BULL. 28 (1982).

93. For a much more detailed look at U.S. tranfers of technology to the Soviet Union, see G. Armstrong Jr., *Transferring U.S. Technology to the Soviets: Some Practical Legal Problems*, 16 INT'L. LAW. 737 (1982).

94. DISPUTE RES. LAW, *supra* note 29, at 759 (allowing the venture access to the Soviet courts).

tract with each other and with outside entities.[95] Yet the Soviets have only now begun to deal significantly with joint ventures. There is very little applicable contract and partnership law in the Soviet Union.[96] Contract rights, until recently, were allocated to a small minority of government entities, even though the Soviet Constitution provides its citizens with such rights[97] Soviet legislation places some limitations on contractual freedom,[98] but there has been very limited litigation of contract rights in the Soviet Union.[99]

Not only is there a lack of substantive law in the areas of partnership and contracts, but the joint venture law itself is in its infancy. Most of its provisions still await an interpretation of law. As one author has suggested, the law is written broadly and resembles a "moving target."[100] Neither side can know exactly how the provisions will be applied in a given set of circumstances.

This "naked" law could lead one to believe that resolution of a joint venture's conflicts might be best achieved elsewhere. However, the dearth of applicable law should not be regarded as an obstacle, but viewed as providing a blank slate on which Western attorneys and Soviet lawmakers can write laws that will enable the ventures to prosper.

Because a joint venture is the mutual assimilation of each partner toward creation of a new entity, there will be a number of interests common to both partners as a unit. A venture strives to profit from its undertakings and both partners will want to test and change laws that inhibit the venture's ability to grow and profit. Simply stated, "[i]t is through the recognition of these goals by each partner that the necessary mutuality of interests is created."[101]

One area the joint venture will surely explore is the extent to which partners may determine their respective duties and powers. For example, the preliminary guidelines of the joint venture law do not specify how much control a foreign partner may have in selecting management and labor.[102] Thus, the venture's charter agreement is one means of testing,

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95. JOINT VENTURE LAW, *supra* note 3, at 751, sec. 6.

96. Salacuse, *supra* note 34, at 115. The Soviets use a wide range of legal entities which encompass their joint venture law. Their past use of agencies and ministries to monitor and determine the outcome of disputes in their domestic realm must give way to dispute resolution in their courts. It is this change of legal supervision which provides the West an opportunity to integrate necessary laws into the system.

97. *Id.* at 113.

98. Article 234 of the Russian Soviet Federated Socialist Republic Code provides that changes in the Soviet National Plan may lead to a cancellation of contracts. Dore, *Plan and Contract in the Domestic and Foreign Trade of the U.S.S.R.*, 8 SYR. J. INT'L. L. & COM. 29, 32 (1980)

99. Smith, *supra* note 44, at 82. *See also id.*

100. Rogers, *supra* note 1, at 853.

101. Scriven, *supra* note 5, at 106.

102. The termination of employees under current Soviet law can be accomplished only under the most extreme circumstances. Aronson, *supra* note 2, at 874. Yet because poor

defining, and developing the limits of newly enacted Soviet law.

Of course, there still exists the problem of what law should apply in a given conflict. That there is virtually no Soviet law to apply to joint ventures may well be the greatest benefit to the West. The U.S.S.R. has a number of incentives for absorbing western style contract principles and partnership law. First, the Soviets wish to acquire and integrate Western technology and management techniques into their industrial sector.[103] Adopting established and workable Western contract and partnership law will expedite this process. Second, the Soviets would benefit from adopting Western law simply because of the difficulty involved in adapting existing Soviet law to cover the disputes unique to joint ventures. Finally, Soviet receptivity to Western law will encourage greater Western investment.

Western attorneys will need to use creative legal argument to protect both partners' investment and define the boundries of newly established law. "This transitional period of reform provides an opportunity for U.S. lawyers to help shape the new Soviet legal and economic structure in a way which would make it most advantageous for Western investment."[104] This need for Western legal knowledge is already evident as one New York law firm has established an office in Moscow.[105]

The greatest obstacle to Soviet assimilation of Western law is the effect such developments might have on Soviet ideology and policy. After all, Western law comes replete with such democratic principles as voting rights, equality, and the right to profit. In theory, at least, the problems with ideology can be solved, since these problems are the subject of recent Soviet reforms. In fact, General Secretary Gorbachev has titled the reform process as "The Democratization of the Economy."[106] Though the Soviets will have to compromise some ideology to receive the benefits of joint ventures, this compromise would be minimal. Simply enacting a joint venture law was an enormous sacrifice of Marxist ideology: the Soviet Constitution has always prohibited the ownership of industrial enterprises by anyone but the government.[107] Before recent changes, the law permited a foreign partner to own only forty-nine percent of the venture. However, the Soviets have recently made a dramatic change in the law by allowing foreigns partner an unprecedented fifty percent or more of the

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labor performance will effect the quality of products and diminish a foreign partner's invesment interest in a venture, the Soviets might be persuaded to initiate change in the area of labor law.

103. HLADIK, *supra* note 15, at 40.

104. Aronson, *supra* note 2, at 853.

105. This is an annex of the New York firm Coudert Brothers. N.Y. Times, Jan. 16, 1988, at 32, col. 6.

106. ON THE PARTY'S TASKS IN FUNDAMENTALLY RESTRUCTURING MANAGEMENT OF THE ECONOMY, Report by General Secretary Mikhail Gorbachev at the June 25, 1987 Plenary Meeting of the CPSU Central Committee, *reprinted in* Moscow News (Supp.) No. 27, at 4 (1987)[hereinafter GORBACHEV ADDRESS].

107. KONST. SSSR art. II.

venture's ownership.[108] Furthermore, and for the first time in history, Soviet business (including the joint venture) may run itself with very limited government control.[109] If the Soviet Union was willing to sacrifice ideology in enacting the joint venture law, it might easily do the same to ensure their joint ventures retain that viability and attractiveness to the West. One author has remarked, "[h]aving identified the need to engage in joint ventures in order to advance, . . . the Soviet government will not be restrained by conflicting statutory provisions. Once again, ideology will be forced to accommodate practical need."[110] Thus, the Soviets may well sacrifice more Marxist doctrine in order to incorporate existing Western law. This ideological flexibility is a virtual precondition to Soviet attempts at reviving their domestic business sector with modern Western practices.[111]

VI. CONCLUSION

The benefits that flow from the new Soviet Joint Venture Law have yet to be fully realized. As joint ventures proliferate and mature, all parties will be able to take full advantage of the law's provisions. Those provisions allow expanded trade between communist and capitalist states. The Soviets will enjoy access to their Western partners' established business connections in the free market; likewise, Western partners will gain access to a vast Eastern Bloc market alliance.[112]

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108. Insiders originally acknowledged that the Soviet desire for knowledge, expertise, and technology possessed exclusively by some firms might give the Soviets a reason to allow these firms even equal or majority ownership of the venture. Aronson, *supra* note 2, at 872. Obviously their hypothesis has been fulfilled in a manner most surprising to even them. *See* Interview, *supra* note 18. It is the power of the Soviet Regime which allows it to do whatever it wishes with its own Constitution, and as the past has shown us, the Soviet Constitution is often compromised; for example, freedom of the press and freedom of speech are guaranteed in the Soviet Constitution. The fact that foreigners, can now own Soviet based businesses may be the Soviets' most capitalistic compromise.

109. Dunn, *supra* note 11, at 174. This is the first time that such has been permitted without government control. Combined with the fact Westerners may receive majority control over Soviet based property, the right to run the business end of the venture seems natural, yet incredible when realizing these rights are available to capitalists in the U.S.S.R.

110. *Id.* at 178.

111. Gorbachev has repeatedly emphasized the need to change existing management philosophy in the Soviet business strata to engender the efficiency of the West. As Gorbachev has stated: "The sum of the Nation's substance of the fundamental reshaping of the Nation's economy control is the switch over . . . from an excessively centralized system of management to democratic, promoting self-management." CONCLUDING SPEECH OF M.S. GORBACHEV TO THE CPSU CENTRAL COMMITTEE, June 25, 1987, *reprinted in* Moscow News (Supp.) No. 3276, at 4 (1987). The Soviets have always believed in a production enterprise operating under one-man management, with all responsibility for administration held by a single director. In contrast, capitalism frequently operates with co-equal decision making, done by a majority of ideas and votes. Aronson, *supra* note 2, at 874.

112. Section 24 of the Soviet Joint Venture law grants joint ventures the freedom to trade and transact business in the markets of COMECON member countries. JOINT VENTURE LAW, *supra* note 3, at sec. 24. The Council of Mutual Economic Assistance (COMECON) was established on Jan. 30, 1949 and includes the nations of the Soviet Union,

The joint venture law also presents other historic opportunities. Although there are problems that must be solved, the problems *can* be solved. In fact, the chance to resolve difficulties together in an atmosphere of mutual interest may be the greatest benefit of all.

> As these East-West trading relationships have evolved from simple once - off sales and purchases into the complicated transactions existing today, the partners . . . have had to pay more attention to the mutuality of interest which is inherent in any long-term commercial relationship.[113]

Resolving these problems will result in formal structures for problem solving. Structures such as an evolving Soviet commercial law, will lead to enhanced understanding and cooperation, as well as the establishment of a new Communist-Capitalist economic culture. More importantly, the structures will be a way of perpetuating this understanding and cooperation between nations. General Secretary Gorbachev recognized as much when stating,

> Comrades, not one state in the world of today can regard itself isolated from others in the economic respect. Our country is no exception. International commercial and financial relations of countries and the latest technological ideas invariably have an impact on our own economy. . . . In other words, restructuring of the Soviet economy will promote broad international cooperation and, hence, better world relations.[114]

Poland, Hungary, Czechoslovakia, East Germany, Bulgaria, North Korea, Vietnam, and Cuba. Its goals include the exchange of economic experience, technical aid, material assistance in foodstuffs, raw materials, machines, and technology. Scriven, *supra* note 5, at 105. COMECON began as an alliance between communist nations (under Soviet hegemony) to help war-torn Marxist regimes re-establish growth in their own economic systems and to encourage the sharing of modern technological information.

113. *Id.* at 106.

114. GORBACHEV ADDRESS, *supra* note 106, at 10.

BOOK REVIEWS

Association International De Droit Penal

*Reviewed by Edward Kwakwa**

INTERNATIONAL PROTECTION OF VICTIMS (M.C. Bassiouni, ed.); Siracusa, Italy, 1988; pp. 470.

The concept of basic human dignity has gained increased contemporary significance in the conduct of inter- and intra-state relations. Despite this welcome trend, however, the international community has probably placed undue emphasis on penalizing the perpetrators of crime and abuse of power. In the process, there has been a corresponding de-emphasis on protecting or adequately compensating the victims of such crime and abuse of power. The publication of *International Protection of Victims*[1] is a timely event to help reverse this trend of ignoring or not adequately alleviating the severe physical, psychological and financial harm suffered by victims of crime and abuse of power.

International Protection of Victims is essentially a combination of studies, commentaries and documents pertaining to the United Nations Resolution of Declaration of Basic Principles of Justice for Victims of Crime and Abuse of Power.[2] Divided into four sections, the text initially

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1. INTERNATIONAL PROTECTION OF VICTIMS (C. Bassiouni ed. 1988) [hereinafter BASSIOUNI].

2. In December 1985, in a landmark pronouncement by the United Nations on the rights of victims of crime and abuse of power, the General Assembly of the United Nations adopted Resolution 40/34 which included an annex on the "Declaration of Basic Principles of Justice for Victims of Crime and the Abuse of Power."

The Declaration files the lacunae in the definition of "victims" by including not only persons harmed by ordinary or conventional crimes, but also those harmed or injured by abuse of power. Paragraphs 1-17 of the Declaration define "victims" of crime, provide standards for access to justice and fair treatment, restitution from the offender, as well as compensation from the state and assistance toward recovery. Paragraphs 18-21 define "victims" of abuse of power and call upon states to incorporate into their national law proscriptions on abuse of power provisions for remedies to victims of such abuses. For a text of the Declaration, see Resolution Adopted by the General Assembly: Declaration of Basic Principles of Justice for Victims of Crime and Abuse of Power, U.N. Doc. A/Res/40/34 (Dec. 11, 1985), *reprinted in* BASSIOUNI, at 201-05.

gives a brief historical conspectus of events leading to the establishment of the Declaration. Part II contains the core of the study. It includes studies and commentaries by distinguished experts, many of whose reports were presented at a World Society for Victimology meeting held in Dubrovnic, Yugoslavia. The third part of the book is a collection of all the relevant United Nations documents pertaining to the Declaration, and the redundant final part discusses some regional and national approaches taken in pursuit of the rights of victims of crime and abuse of power.

There is much to recommend to *International Protection of Victims*. It demonstrates an acute sensitivity to the plight of victims of crime and abuse of power. As succinctly put by Bassiouni, victims of crime and abuse of power are by the very fact of their victimization persons whose basic human rights have been violated. A growing realization of the preeminence of individual and collective human rights should therefore serve as an incentive for scholars and international legal practitioners to draw attention to the problems faced by victims of crime and abuse of power. The studies and commentaries in *International Protection of Victims* serve as a useful guide in this respect.

All of the essays, without exception, are scholarly, instructive and thought-provoking. Kerrigan provides a detailed paragraph-by-paragraph analysis of the United Nations Declaration.[3] He rightly concludes that victims of abuse of power may need greater attention. This follows from the obvious defects in Part B of the Declaration dealing with victims of abuse of power, which suffers from serious ambiguity in terminology.

The second essay by Professor Lamborn[4] suggests an "internally consistent and rational way"[5] of reconciling these ambiguities. In his view, paragraph 19's reference to "norms proscribing abuses of power" should be construed to mean "internationally recognized norms relating to human rights."[6] Paragraph 21's "acts that constitute serious abuses of political or economic power," *pace* Lamborn, is also a reference to "those [acts] in violation of internationally recognized norms relating to human rights."[7] In this reviewer's opinion, such a teleological interpretation of the Declaration serves a useful purpose. To be sure, it is the only way in which the inconsistent paragraphs of the Declaration can be reconciled. It is also the most effective way of giving effect to the aims and purposes of the Declaration. A reference to "internationally recognized dimensions and effects of acts taking place within an otherwise domestic setting.

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3. Kerrigan, *Historical Development of the United Nations Declaration*, in BASSIOUNI, *supra* note 2, at 91.

4. Lamborn, *The United Nations Declaration on Victims: The Scope of Coverage*, in BASSIOUNI, *supra* note 2, at 105.

5. *Id.* at 112.

6. *Id.* at 113.

7. *Id.*

Dr. Van Dijk's essay *Priorities for Policy Makers*[8] will be of genuine interest to scholars of law and policy. More significantly, it should be of great value to government officials and policy makers who are genuinely concerned about improving the condition of crime victims. Dr. Van Dijk reminds us that the criminal justice system does not treat victims of crime with respect. He therefore makes an eloquent plea to police officers, prosecutors and judges for better treatment of crime victims.

Professor Waller addresses implementation of the Declaration.[9] He provides the reader with a comparative study of implementation measures adopted in various legal systems. No less important are his additional recommendations on adoption, application, review and dissemination of the Declaration.

Marco Sassoli's thesis on the victim-oriented approach of International Humanitarian Law[10] is probably the most detailed as well as the most important contribution. Armed conflicts undoubtedly produce the greatest number of victims. The point bears emphasis; as lucidly put by Sassoli, situations of armed conflict "represent the most intense form of victimization in the contemporary world."[11] Sassoli rightly points out that the United Nations Declaration covers only victims of violations of domestic criminal law and internationally recognized norms relating to human rights.[12] In effect, the Declaration treats violation of a norm as the *conditio sine qua non* for the existence of a "victim." This is in contradistinction to the position of the "victim" in international humanitarian law. The laws of armed conflict protect both combatants and non-combatants, and not only those affected as a result of a violation of the laws of war.

Sassoli clearly and cogently demonstrates that International Humanitarian Law is victim-oriented. Indeed, he succeeds in establishing that International Humanitarian Law is more victim-oriented than International Human Rights Law.[13] "The writer observes that the best way to improve the situation of victims is to prevent their being victimized. This leads him to the self-evident statement that "the best way to prevent victimization by armed conflicts is to prevent armed conflicts."[14] Unfortunately, however, this is the one area in which International Humanitarian Law is unable to play a direct role. Sassoli does not seem troubled by this; in his opinion, there exist "other branches of international law, with their own implementing procedures and bodies, intended to prevent armed

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8. Van Dijk, *The United Nations Declaration on Crime Victims: Priorities for Policy Makers*, in BASSIOUNI *supra*, note 2, at 117.

9. Waller, *Rights of Victims of Crime and Abuse of Power: From Rhetoric to Realization*, in BASSIOUNI, *supra* note 2, at 127.

10. Sassoli, *The Victim-Oriented Approach of International Humanitarian Law and of the International Committee of the Red Cross*, in BASSIOUNI, *supra* note 2, at 147.

11. *Id.* at 148.

12. *Id.* at 150.

13. *Id.*

14. *Id.*

conflicts."[15] He might have added that the conclusion to be drawn from this scenario is stark and plain — International Law in general, and International Human Rights Law in particular, are not as victim-oriented as International Humanitarian Law would have them be.

The final commentary by Bassiouni is on the protection of "collective victims" in international law.[16] The "criminal conduct, goals, and outcome in the case of "collective victims" are predicated on the fact that the victim belongs to an identifiable group or collectivity."[17] Bassiouni's essay provides the reader with a sophisticated overview of a complex subject. It gives a carefully reasoned distinction between individual and collective victims, discusses the sources of international law applicable to collective victims, and delineates an extensive list of international crimes as well as categories of collective victims protected under international human rights instruments. Bassiouni's discussion leads him to four troubling conclusions: first, there are several categories of collective victims who are victimized in spite of the protections granted them by national and international law; second, there are very limited or ineffective means to adequately prevent such victimization; third, the modalities for the protection or compensation of collective victims are inadequate; and finally, objective scientific study of the problems of collective victims are being hindered or stalled because of concerns about the politicization of the issues involved.[18]

International Protection of Victims is not without blemish. A close reader is likely to get bored and frustrated with the book — this is because a certain amount of material overlaps throughout the book. In fairness to the editor, this could be explained by the fact that the studies and commentaries are all based on the same United Nations Declaration. The fourth part of the book could however have benefited from a less Europocentric concentration and a more representative coverage of regional and national approaches to the problems of victims of crime and abuse of power. Out of the nine essays, there are five on Europe, and one each on North America, South Australia, India and Nigeria. Above all, *International Protection of Victims* suffers from patently obvious typing errors in some crucial areas. For example, Part II of the table of contents refers to "The United Declaration of Victims" [sic], in an apparent reference to the United Nations Declaration. An even more fundamental objection could be made to page 148 of the book, which refers to "the four Geneva Conventions of 1943" (emphasis added).

Nevertheless, these errors do not detract from the essence of *International Protection of Victims*. It is a very timely publication which will

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15. *Id.* at 183.

16. Bassiouni, *The Protection of "Collective Victims" in International Law*, in BASSIOUNI, *supra* note 2, at 181.

17. *Id.* at 191-92.

18. *Id.*

serve as a useful introduction to the intricate but often overlooked issues pertaining to victims of crime and abuse of power.

International Criminal Law: A Guide to U.S. Practice and Procedure

Reviewed by Edward Kwakwa

INTERNATIONAL CRIMINAL LAW: A GUIDE TO U.S. PRACTICE AND PROCEDURE (Ved Nanda and Cherif Bassiouni, eds.) New York: Practicing Law Institute, 1987. Pp xiv, 546.

What sources of law can a United States practitioner turn to when faced with a case that has international criminal ramifications? What are some of the procedural aspects of criminal law issues most likely to be encountered by the international business transactions practitioner? Which areas of international judicial assistance in criminal matters are of interest to a United States attorney? Where does he find the relevant laws on extradition, diplomatic and consular immunity? Above all, what judicial remedies are available in United States courts for breaches of internationally protected human rights? These ubiquitous and important questions are the focus of inquiry in Ved Nanda and Cherif Bassiouni's *International Criminal Law: A Guide to U.S. Practice and Procedure.*[1]

The book is a combination of essays by several distinguished practitioners and academicians. It is appropriately divided into six subject areas: jurisdiction, mutual assistance and judicial cooperation, extradition, immunities, constitutional limitations and judicial remedies. It is not possible, within the confines of this review, to adequately summarize and appraise in sufficient detail the various and varied essays in *International Criminal Law.* The variation in attention or length of review given to a particular essay should therefore not be construed as a judgment on its quality.

The first part of *International Criminal Law* is a very useful introduction by the editors. The introduction is essentially a discussion of the reasons for, and scope of coverage of the book. Part II deals with the subject of jurisdiction. Professor George gives a comprehensive discussion of United States Federal anti-terrorist legislation, with particular emphasis on the Comprehensive Crime Control Act of 1984.[2] His discussion has been given greater relevance by the ongoing trial of several terrorists in United States federal courts.

Theodore Banks also addresses the issue of international activities and criminal considerations under United States antitrust laws. His principal concern is with the Sherman Act, a task for which he draws upon

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1. INTERNATIONAL CRIMINAL LAW: A GUIDE TO U.S. PRACTICE AND PROCEDURE (V. Nanda & C. Bassiouni, eds. 1987) [hereinafter INTERNATIONAL CRIMINAL LAW].

2. *See* Pub. L. No. 98-473, 98 Stat. 1976 (1984).

his experience as corporate counsel. For the international business practitioner concerned with antitrust laws, the issue of which practices violate the antitrust laws is inextricably tied to the question of jurisdiction under the Sherman Act. Banks' discussion of such landmark cases as *American Banana*,[3] *Timberlane*,[4] and *Mannington*,[5] as well as subsequent developments in the case law, will be of invaluable assistance to the interested practitioner. Following up on the theme of jurisdiction, Professor Herman addresses issues pertaining to the extraterritorial application of United States securities laws. He presents a summary of criminal provisions in United States securities laws, surveys some of the leading cases on extraterritorial application of the United States securities laws, and concludes that the test of "reasonableness," rather than the "conduct and effects" test, will more appropriately facilitate a determination of the extraterritorial reach of U.S. securities laws and any criminal prosecution brought under those laws.

In his chapter on tax crimes and extraterritorial discovery, David Pansius argues that if one accepts the need for broad powers possessed by the government in the domestic setting, then one must *a fortiori* give United States discovery powers the broadest construction in the international setting. Any contrary position, he insists, would permit foreign-based individuals or wealthy Americans to evade taxes through foreign transactions in jurisdictions that have secrecy laws. The chapter also discusses conflict of laws problems that arise in two different situations - those in which there is a tax treaty in force between the United States and the foreign jurisdiction, and those in which there is no such treaty. The section on jurisdiction ends with Reed Kathrein's essay on criminal enforcement of the Export Administration Act, Francis Higgins' chapter on procedural aspects of anti-boycott laws and regulations, and that of Robert Gareis and Paul McCarthy on the Foreign Corrupt Practices Act and related statutes.

The third major section of *International Criminal Law* is on the subject of mutual assistance and judicial cooperation. Prominent among the essays in this section is Cherif Bassiouni's examination of issues arising from bilateral treaties that allow for the transfer of convicted criminal offenders. Parts IV, V land VI of the book cover the areas of extradition, immunities and constitutional limitations, respectively. The final chapter of the book is on judicial remedies. Written by Professor Nanda, the chapter is, as is to be expected, penetrating and incisive. Professor Nanda's discussion provides a variation on the dominant theme by shifting attention from domestic law limitations to international law limitations. The focus of inquiry is on the remedies available to a plaintiff who invokes norms of international human rights law in United States court. Professor Nanda asserts that the international community has success-

3. 213 U.S. 347 (1909).
4. 549 F.2d 597 (9th Cir. 1976).
5. 595 F.2d 1287 (3d Cir. 1979).

fully established norms of international human right law in the post-1945 era. Unfortunately, however, the achievements in prescribing norms "have not been matched by availability of remedies to the victims of the violations of those norms."[6] The chapter also discusses the interface between international criminal law and international human rights, and examines the treatment of treaties and customary norms of international human rights law United States courts. Professor Nanda ends the book on an optimistic note by predicting that conventional and customary international human rights law will eventually find their proper place in United States courts.

International Criminal Law is a major contribution to international scholarly literature. As far as this reviewer knows, it is the first of its kind that has brought together so many essays by such distinguished experts on international criminal law and how it impacts on United States practice and procedure. The book is extensive in scope — it covers some of the most important and crucial aspects encountered on an everyday basis by the international legal practitioner. The individual essays are all concisely written, lucid in style and very well documented. The book also provides the reader with an extensive table of authorities, as well as an index.

The editors state at the outset that the book is meant to provide an international law practitioner with a useful set of materials; it is their hope that the book proves to be useful for those practicing in the international criminal law area. Professors Nanda and Bassiouni skillfully succeed in performing the task they set out to do with the publication of *International Criminal Law*. But they do more than that — the book will be of invaluable assistance not only to international law practitioners, but also to teachers, students and even government officials involved in substantive and procedural aspects of international criminal law in United States practice. Professors Nanda and Bassiouni deserve congratulations for adding *International Criminal Law* to their already extensive list of publications.

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BOOK NOTES

SANDS, P., CHERNOBYL: LAW AND COMMUNICATION; Grotious Publications Limited, Cambridge, England (1988); $57.00; ISBN 0-949009-22-9; 312pp.; index, bibliography, map section.

This publication brings together in a single volume some of the more significant materials needed to examine the legal issues and ramifications arising out of the Chernobyl accident. Moreover, likely developments in this area are also considered. Twenty four texts, each commencing with a personal note by the author make up this publication which successfully studies the legal issues relating to nuclear accidents which have international effects

BINDMAN, G., SOUTH AFRICA AND THE RUKE OF LAW; Printer Publisher, London and New York (1988); $37.50; ISBN 0-86167-919-8; 159pp.; index.

This report, conducted by four lawyers both from practical and academic backgrounds focuses on "legislation" in South Africa. The report takes into account legislation regarding areas such as freedom of speech and expression, education, children, the right of personal freedom and the legal stuctures of Apartheid. It is premised upon the notion that the South African government has undermined all human rights of the black and colored people. Moreover, the report suggests that South African legislation has made a mockery out of it's legal system. This mission rejects claims that human rights violations are justified by security reasons. Report takes into account developments up to the end of February 1988.

JOHNSON, S.P., WORLD POPULATION AND THE UNITED NATIONS; Cambridge University Press (1987); cloth $59.50, paper $22.95; ISBN 0-521-32207-3 hard cover, ISBN 0-521-31104-7 paper back; 357pp.; charts and index.

This book overviews four decades of United Nations involvement regarding the world's population dilemma. The author particularly emphasizes on the post 1969 period. The book primarily focuses on the creation of the U.N.'s Fund for population activities (UNFPA), and deems it as the major instrument for United Nations for resolving the problem. Actual accomplishments with regard to the population problem have been studied. Furthermore, major sections of the book are devoted to the two international conferences on population which have been held during the periods under consideration.