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Give BIT a Role in Handling Investment Disputes between China and America

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Two recent events indicate an increase in frustration between China and America in handling mutual corporate investment activities. The developments are another reminder of the need for the existence of dispute resolution mechanisms that do not automatically invoke each side's domestic political processes. Among the various tools floated, one instrument has yet to receive its due share of attention: a Bilateral Investment Treaty (BIT).

In mid-February, the Chinese telecommunications equipment company Huawei decided to bypass the recommendation of the Commission on Foreign Investment in the United States (CFIUS) that it not proceed with a deal and instead moved to seek a final judgment by President Barak Obama. Huawei is a veteran of sorts in dealing with the CFIUS, dating back to 2001, when the company started its first US operation. CFIUS is meant to function as an advisor to the U.S. President in assessing national security implications of foreign investments. Thus, for Huawei to move over the head of CFIUS amounts to evidence of a high degree of frustration on one hand on the part of the company. On the other hand, the incident also demonstrates a prevailing determination on the part of the U.S. government to leave no stone unturned when it comes to probing possible challenges to America's "national security'', however loosely defined the term.

As if in response, in the same week, China announced the establishment of a ministerial joint committee to undertake national safety reviews of foreign mergers and acquisitions by domestic firms. In a structural sense, such a committee, which has its roots in an anti-monopoly law enacted in 2008, marks a step forward in providing a clearer road map for evaluating possible impact on Chinese definitions of its national security. International media commentary, instead, warned against a future of Chinese government agencies competing to use the review process to block an increase in foreign investments. Foreign companies continue to ask, for instance, how a couple of years back Coca-Cola's attempted take-over of Huiyuan, a Chinese fruit juice producer, should have been rejected on "national security'' or "national competitiveness'' grounds.

The irony is that such maneuvers are occurring against the backdrop of both the government of China and the administration of the United States working to create one regularized high-level dialogue mechanism after another, each tasked to iron out differences as they arise. Over four dozen bilateral dialogue mechanisms, managed by

officers of deputy ministerial rank and above, are in place and an overwhelming majority of these are mandated to deal with concrete and technical disagreements.

China and America are both complex societies whose internal dynamism across all spectrums of social and political life seems to complicate solutions that seem obvious. So much so that there are now increasingly louder assessments of the Strategic and Economic Dialogue, the most comprehensive of all such mechanisms, that continues to be useful but is simultaneously less effective than it was originally intended to be. Still, cynicism, despair, and/or no action cannot be an acceptable option.

For dispute resolution, if it is becoming increasingly clear that another dialogue mechanism is not the wisest proposition to advocate, two structural approaches come readily to mind: a free-trade agreement (FTA) and a bilateral investment treaty (BIT). Given the ongoing reality of the low-levels of trust the two societies have of each other, the two propositions risk being ridiculed as text-bookish. But a BIT is less so than an FTA.

The negotiation process of an FTA forces one negotiating party to undergo a thorough review – between government and industry as well as among industry “losers’’ and “winners”– of its own economic setup and future landscape to accommodate the needs of the other party invited to the same negotiating table. The purported goal is to enlarge the pie of economic activities so that in aggregate terms both will benefit.

It is little wonder that the United States has shown more liking for an FTA as an instrument of investment dispute resolution (i.e., by giving preferential treatment and therefore removing many barriers that would otherwise be in place to cause dispute) with its immediate neighbors Canada and Mexico, the decade-long history of NAFTA negotiations notwithstanding. Likewise, as soon as China warmed up to an FTA as a trade/investment promotion instrument, it gave priority to completing FTA deals with the ten-member Association of Southeast Asian Nations economies, all its immediate neighbors.

Given the vertical nature in the division of labor between the American and Chinese markets, a Sino-American FTA would benefit China more quickly and tangibly than it would America. If the ups and downs in South Korea’s negotiation of an FTA with the U.S. are an indicator, it is simply too wishful thinking to advocate a China-US FTA. The American polity/society is not ready for getting into, effectively, a wealth-sharing scheme through an FTA with China. Panama and Columbia are already on the U.S. FTA agenda. Not China. To be fair, it remains to be tested how positively the idea of an FTA with America would fly in China.

A Sino-American Bilateral Investment Treaty (BIT), by contrast, is already on the agenda of governmental-level negotiation. In 2007, negotiating toward conclusion of a BIT became a standard reference in the Strategic Economic Dialogue between the two governments. The joint communiqué issued upon President Hu Jintao’s state visit to the United States in January this year also refers to concluding a BIT as an agenda item. What is lacking is the political push to make it actually happen, and faster.

To start with, China has signed 119 BITs, covering most of its trade/investment partners among the developed economies, including Japan, South Korea, Germany, the Netherlands, and Finland. The United States is a party to over 45 BITs. In other words, a BIT as an instrument for investment dispute resolution is by no means unfamiliar to either party.

Here it must be emphasized that skeptics – a good number of whom are among China's intellectual elite – miss the point when they cite the non-existence of a BIT between Japan and the U.S. as evidence against the desirability of a Sino-American BIT. The point is that those two economies have such a long history of mutual learning, involvement, and economic/political systematic compatibility, among other fundamentals, that they do not have the same types or numbers of disputes among their corporations. China is not Japan, simple as that.

Specific contents of a BIT are subject to negotiation. But the core protections are generally the same. According to the China Chapter of the American Chamber of Commerce, a successfully concluded Sino-American BIT would include the following essential protections:

Enhanced and non-discriminatory market access for investments, including elimination of equity caps, capital requirements, and restrictions on corporate structure

Non-discriminatory treatment of foreign investments after they have been established

Transparent laws and regulations, and a guarantee of due process for foreign investors in administrative and judicial proceedings

A prohibition against forced divestment or adoption of regulations that undermine the value of an investment, without payment of compensation to the investor

Allowing the transfer of funds related to the investment at any time and in freely convertible currency

A prohibition against local content, technology transfer and other performance requirements

Enforcement by private investors, who may seek to resolve disputes with the host government through international arbitration and seek monetary damages for breaches of the treaty.

The fundamental difference between a BIT and an agreement reached under the current dialogue mechanisms is that a BIT requires ratification by the domestic legal apparatus of each country. Along with ratification comes establishment of a domestic legal process – one that is obliged to function without being pressured by initiation of complaint by a foreign government – that makes dispute resolution according to established legal principles and norms a habit, not something to bargain for or barter with.

Among other things, without a BIT in place, much to the dismay of those Chinese who criticize American businesses as seeking extra-territorial benefits, there is little incentive or cost for such practices, assuming such accusations are substantively true, to change. For American companies operating in China, then, there will be less of a need to wait for a senior-level government dialogue to take place before its grievance can be heard. The court system in China, under the scenario of a BIT, would have an automatic obligation to rule based on a set of principles already agreed upon between the two governments.

To the best of my knowledge thus far, BIT discussions between China and the United States take place among a rather selected circle of government officials and associates. This does not have to be the case. Secrecy breeds misinformation. After all, a treaty is one that's meant to have all the rest of the society to abide by. For that reason, the discussions should be inclusive, to the extent possible; in order to generate smooth business activity once a BIT is agreed upon.

It is high time for discussions, including Track II or Track 1.5 ones, to highlight early conclusion of a BIT as a priority between the two governments. The societies of China and America are just beginning to move from a purely trade-based relationship to one that includes two-way flow of investment. Having a BIT in place should be one effective way to get the investment route right. Give a BIT a role to play.

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