

Inside US-China Trade

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Unions, NGOs Tell Senate Staff To Be Wary Of U.S.-China Investment Pact

By Scott Otteman

A group of labor unions, non-governmental organizations and U.S. legal scholars warned Senate staff last week that the Obama administration should not accelerate the negotiation of a bilateral investment treaty (BIT) with China unless fundamental adjustments are made in the U.S. negotiating position.

They argued that pursuing a traditional BIT with a major capital exporter such as China runs the risk of destabilizing the Chinese financial system at a delicate global juncture by rapidly lifting restrictions on capital controls. They also said that the existing model BIT would extend preferential investment protections to subsidized, state-owned enterprises (SOEs) and sovereign wealth funds (SWFs) that are poised to invest China's surplus reserves in the United States.

According to the group, U.S. negotiations on a BIT with China should only continue if the U.S. tamps down its standard demands for an immediate and complete liberalization of China's state-dominated financial system. In addition, the U.S. should make sure that investments made by Chinese SOEs and SWFs don't receive better protections or expedited appellate procedures than U.S. firms and individuals investing in the U.S.

During his mid-November trip to China, Obama and Chinese President Hu Jintao publicly agreed to "expedite" BIT negotiations, which were begun during the last year of the Bush presidency but have been limited to technical exchanges. The administration has been engaged in reviewing the U.S. negotiating stance, known as the "model U.S. BIT," and had targeted the end of this year for conclusion.

A knowledgeable government official said this week that he was "reasonably hopeful we won't miss that target by a significant amount" and that the process would finish in a matter of weeks rather than months.

Members of the group engaged in the Senate briefing helped prepare an advisory report on BIT policy for the State Department, which has been helping coordinate the interagency BIT review. The group made its case for reform at a Dec. 10 Senate staff briefing sponsored by the office of Sen. Sherrod Brown (D-OH).

Because BITs are treaties, they must be ratified by the Senate but do not have to be approved by the House of Representatives.

Speaking at the briefing were Linda Andros of the United Steelworkers; Owen Herrstadt of the International Association of Machinists and Aerospace Workers; Matthew Porterfield of Georgetown Law School's Harrison Institute for Public Law; Kevin Gallagher of Boston University's Global Development and Environment Institute, and Sarah Anderson of the Institute for Policy Studies (IPS). Their views, which go beyond the consensus Sept. 30 report prepared for State by its Advisory Committee on International Economic Policy (ACIEP), were included as an annex to that report.

Circumstances have changed since the post-World War II era, when investment treaties were first drawn up to protect U.S. multinationals as they expanded their operations into developing countries. "They wanted to be able to bypass the judicial systems, which they thought would be corrupt," Andros said.

As a result, the demand for an investor-state arbitration mechanism that allows investors to demand private arbitration of investment disputes with governments became part of the U.S. model BIT. But inclusion of that provision, which U.S. corporations still avidly support, has not helped promote reform of developing countries' judicial systems, she said.

Instead, it has saddled the U.S. with a negotiating position that rewards foreign investors with a means to bypass the U.S. judicial system, a option that U.S. citizens do not have when the value of their investments in the U.S. is threatened.

Instead, the group argued, local remedies, including domestic legal procedures, should be exhausted, as is common practice under international legal practice, before foreign investors can resort to the expedited dispute settlement system under a BIT. If corruption of the local process can be demonstrated, the use of an investor-state mechanism could be allowed, according to Georgetown's Porterfield.

The preferential treatment offered by an investor-state dispute mechanism has thus far had a limited impact on the United States because the 51 countries that have signed BITs or free trade agreements with the U.S. include only one other major capital-exporting nation: Canada.

According to the IPS's Anderson, virtually all disputes involving investment in the United States -- 15 to date -- have been brought by Canadian firms under the North American Free Trade Agreement's BIT-like investment chapter.

But that could radically change if a BIT is negotiated with China, she insisted, because China has become a major capital exporter in recent years and is currently the U.S.'s biggest foreign creditor.

As China seeks to diversify away from U.S. financial instruments and into U.S. assets, "that changes all the winners and losers and political alignments that we are going to have here," predicted Georgetown's Gallagher. "This is about major investments that will be made here in the U.S. under a set of rules that don't coincide with our domestic rules."

Whereas U.S. corporations may back new BIT measures aimed at limiting the powers of SOEs in China so that they can compete on an even footing in that market, their representatives on the ACIEP were not keen on restricting general investors' rights, which would be open to SOEs who are invested in the U.S., said Andros.

"They want a BIT as fast as they can get it [to battle with SOEs for investment opportunities in China]," said Andros. "But we have to be mindful that in the 21st century investment will be coming this way... How will that be affecting our work force and standards of living" in the U.S.?"

In terms of the model BIT, U.S. business representatives appear to have "both a fear of getting locked out of the China market" and a fear over "the treatment they will get once they get in there," said Porterfield.

The unduly rapid liberalization of China's state-run financial system required by the model BIT would pose another major danger, according to Boston University's Gallagher. "If we force them to have the [free capital] transfer provisions in our model BIT, we are implementing shock therapy, and China is 'too big to fail' for the world economy," he said. By contrast, the BIT China has struck with Germany does not require China to completely liberalize its capital account, he noted.

Moreover, neither the China-Germany BIT nor any of the other 125 investment treaties signed by China allocates pre-establishment rights to the parties. Pre-establishment, which is a market access measure that calls for national treatment and other aspects of the BIT to be applicable to the process for competing for new investments (instead of only extending them to existing investments), is a standard element in the U.S. model BIT.

Because China has not agreed to pre-establishment with other nations, corporate arguments that describe a failure to negotiate a BIT with China as putting U.S. firms at a disadvantage in competing for investment there are misleading, said Anderson.