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COMMENTARY

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The National Security Threat to Free Trade

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One of the most challenging issues facing the multilateral trading system is how to address the growing conflict between free trade and national-security concerns. This impacts everything from Chinese direct investment in the United States to the European Union's subsidies for Airbus, as well as barriers to trade in the high-tech sector and agricultural policy in developing countries.

The problem is that most international trade agreements allow member states to ignore their treaty obligations in cases involving national security or other "essential security" interests. But they make no attempt to define what falls within the category of national security, essentially abandoning the matter to the goodwill and judgment of member states.

This might have worked well in the past, especially during the Cold War -- when most signatories to these agreements were Western powers with shared political values and a common concept of what constitutes such security interests. Countries like China and the former Soviet Union, which had far more overarching definitions of national security, were rarely party to such agreements and tended to confine themselves to their own -- Communist-dominated -- economic spheres.

Not so today. Since the collapse of the Soviet bloc, the former Communist economies have become increasingly integrated into the multilateral trading system. China is already a member of the World Trade Organization, while Russia is waiting in the wings. Add in fellow WTO member Saudi Arabia and aspiring entrant Iran and you have a global trading body increasingly full of countries with very different political values. All this means that the clubby agreeable ambiguity that characterized the dominant approach to the relationship between national security and international trade during the Cold War era is unlikely to hold.

Already there are signs it is fraying around the edges -- initially as a result of action by Western nations. The most recent, and high-profile, example was last year's abortive bid by Chinese energy giant Cnooc Ltd. for California-based Unocal Corp.

The outcry in the U.S. Congress that ultimately forced Cnooc to withdraw its bid provided a good example of how a broad interpretation of national-security concerns can be used as an excuse to interfere in what should be the beneficial flow of international trade and investment.

It also shone the spotlight on the role of the Committee on Foreign Investment in the United States (CFIUS), which is charged with vetting the national-security implications of U.S. directed FDI. This committee has the power to review investments after they have been made and order divestment without compensation. As last year's saga showed, the committee's mere existence can deter foreign investment in potentially sensitive areas. Cnooc tried to get CFIUS to agree to an immediate review of its bid to avoid a prolonged period of uncertainty. But this was rejected, leaving Cnooc at a disadvantage to rival bidder Chevron.

In other cases, potential investors simply avoid investing in anything that might be the subject of a CFIUS review. Or they abandon their bids once the CFIUS process is underway. Hutchinson Whampoa did this in 2003 when its bid for Global Crossing led to hostile questions during the CFIUS review about the Hong Kong company's links with the Chinese government.

Of course, the U.S. is hardly alone in using national security as a reason to block foreign takeovers. On Dec. 31, the French government issued a decree allowing it to prevent foreign interests from taking control of French companies in 11 industries. These include not only defense equipment and private corporate security but also -- wait for it -- casinos. Many other countries have legislation allowing them to restrict foreign investments on the grounds of national security including Germany, Italy, Japan, the United Kingdom and Russia. In fact, all the members of the Group of Eight leading nations currently have such restrictions, with the exception of Canada -- which currently has legislation in the works to establish such a screening mechanism. Not surprisingly, Canada's draft bill makes no attempt to define national security.

The fact even Western countries are having trouble agreeing on how and when national security can serve as legitimate grounds for interrupting the free flow of international trade and investment does not bode well for the future. Whatever differences such nations, with their shared political values, have will pale into insignificance compared with the trade and investment disputes likely to arise if the likes of China and Saudi Arabia, and perhaps also Russia and Iran in future, start consistently using their extremely broad definitions of national security as an excuse to avoid honoring WTO commitments.

In China's case, we've already seen examples of just how broad this definition can be. Take, for instance, the citing of national security as a rationale for demanding that foreign Internet companies filter out content critical of the government. From Beijing's perspective, social stability is just another facet of national security. In addition, the specter of security concerns being abused for commercial advantage

was raised by China's 2003 efforts to require all foreign companies selling wireless local area networking equipment in China to use a home-grown proprietary Chinese encryption technology known as WAPI, which would require negotiating a license from Chinese firms designated by the government, instead of using the Wi-fi free global standard. That brought howls of rage from foreign competitors, who claimed this was just a protectionist move designed to benefit domestic companies and help make Chinese proprietary technology the international standard in a market worth billions of dollars. As a result the Chinese government "temporarily" suspended the policy.

Not to be outdone in pushing the boundaries of national security, Pakistan, Uganda and several other developing nations argued during the recently concluded Doha round of trade negotiations that food security is "inextricably connected to national security and political sovereignty" and that "food insecurity" can lead to "internal turmoil and instability." In other words, based on the WTO's national security exemption, they should be entitled to maintain trade barriers against imports of agricultural products in order to prevent their food supplies becoming too dependent on foreign producers.

These examples show just how easily ultra-broad definitions of national security risk undermining the multilateral trading system. Exemptions on the grounds of "essential security" interests can be used as a disguised form of protectionism or trade distortion in everything from investment, imports, and procurement to the extraterritorial application of export restrictions.

The era when it was possible to minimize such problems through informal understandings and bilateral side deals among like-minded nations is over. Instead, there is an urgent need for the major players in the international trading system, from the U.S. to the European Union and China, to try to agree on some common limits on just how far considerations of national security should be allowed to interfere with commercial activity.

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