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Selected Legal Aspects of China's Conduct of Foreign Trade

The Chinese Conception of Law

To better appreciate the distinctive character of the legal aspects of China's conduct of foreign trade, a brief inquiry into the Chinese conception of law, in general, is in order.

In traditional China there was a dichotomization of law into the *li* and the *fa*. The *fa* was the written or positive law. It was essentially a punitive, after-the-fact device operating to control socially unacceptable behavior. The *li*, on the other hand, was an individually internalized device for achieving social control. The *li* was a body of approved behavior patterns to be learned by men so that they might behave properly. It functioned to achieve social differentiation essential to a society based largely on status relationships.¹ The *li* was to be preventive rather than punitive.

Both *li* and *fa* have striking counterparts in contemporary China. These have been referred to as the "external" and the "internal" models of law.² The external model is based on formal, usually written sets of rules defining permissible and impermissible conduct. It is analogous to the *fa*. The internal model posits that proper behavior is to be learned through a continuing educational and socialization process. This model is somewhat consistent with the traditional concept of *li*, as well as with ideological (the mass line principle), economic (underdeveloped economically) and pragmatic (lack of legal specialists) exigencies in contemporary China.³ One difference between the internal model and the traditional *li* is that, rather than functioning to achieve social differentiation based on status, the present internal model is attempting to create a new man, a classless man, in accordance with an ultimate goal of

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¹P. M. CHEN, *LAW AND JUSTICE: THE LEGAL SYSTEM IN CHINA 2400 B.C. TO 1960 A.D.* (New York: Dunellen, 1973) p. 28.

²V.H. Li, *The Evolution and Development of the Chinese Legal System* (J.M.H. Lindbeck, ed.), *CHINA: MANAGEMENT OF A REVOLUTIONARY SOCIETY* (Seattle: U. of Washington Press, 1971).

³*Id.*

achieving a classless society.⁴ For a variety of reasons concerning China's recent development, the internal model is currently ascendant. However, the external model continues to operate and to interact with it.⁵

The Chinese conception of law as an internalized mode of structuring, or at least influencing, behavior has been characterized, by Western legal standards, as reflecting a legal posture ranging from indifference to lawlessness. A moderate view has it that:

(China's) approach to law enforcement and adjudication is not highly "legalistic" in the sense of reliance on statutes and institutional procedures for their application and interpretation. Rather, the party approaches this problem with perspectives derived from its ideology and the Chinese legal tradition, which tend to weaken legal formalities and to shift legal functions away from the specialized structures officially designed to perform them.⁶

The important question, for present purposes, is: to what extent does the Chinese conception of law, as largely informal and unwritten, affect their view of the role and operation of international trade law?

Perhaps the most important effect is that China has no commercial code. The consequences of this are manifold. Principally, when Chinese law is to be applied in a foreign trade dispute, it is extremely difficult to know what that law is. In addition, the near non-existence of a legal profession in China, and the lack of judicial institutions for dispute resolution, probably bear upon the strong preference of the Chinese to resolve foreign trade disputes by negotiation, rather than by arbitration.⁷

One cautionary note, however, is that one should not take the informal Chinese attitude towards the law as an indication of a lack of acumen, on the part of China, when it comes to their actual conduct of foreign trade. It has been said that:

It . . . is quite clear that the Chinese are well informed about the technical aspects of international trade—a fact that is a bit surprising given their de-emphasis of law in domestic matters.⁸

Politics and Trade

Trade is not something conducted in a vacuum or in the abstract. On the contrary, it is an aspect of the overall behavior of a society and reflects the same attitudes and concerns that affect that society's actions in other areas.⁹

⁴CHEN, *supra*, p. 206.

⁵Li, *op. cit.*

⁶J.R. TOWNSEND, *POLITICS IN CHINA* (Boston: Little, Brown and Co., 1974) pp. 315, 316.

⁷James T. Haight, ed., *CURRENT LEGAL ASPECTS OF DOING BUSINESS WITH SINO-SOVIET NATIONS* (Chicago: American Bar Association, 1973) p. 75.

⁸V. H. LI, *CHINA'S TRADE WITH THE WEST, A POLITICAL AND ECONOMIC ANALYSIS* (A. Stahnke, ed. 1972) p. 219.

⁹*Id.*, at 226-227.

The preceding statement is particularly apposite to China, where the interplay between politics, society and trade is intimate. Politics and its ideological currents are in constant flow throughout the contemporary Chinese society; their endemic nature being a concomitant of an ongoing socialist revolution or transformation.

As a part of this transformation, foreign trade has come to exist as a state controlled monopoly. In the state controlled foreign trade apparatus, as in the other state run activities, the people who wield effective control of its governmental and non-governmental aspects are members of the Chinese Communist Party (CCP). The party members provide the physical link between politics and trade. In theory, at least, foreign trade is supposed to be run in a manner that will promote, where possible, the ongoing socialist transformation. Politics is to take command over trade.

From the early days of the Chinese Communist regime, the concept of self-reliance has been of extreme importance. Regarding foreign aid, it was said that: "We stand for self-reliance. We hope for foreign aid but cannot depend on it; we depend on our own efforts. . . ."¹⁰ These sentiments applied with equal force to foreign trade. It was thought that independent, self-reliant development, though slower and possibly more arduous than development through foreign trade, fostered desirable political and social values that were more in step with the spirit of the ongoing revolution. Another important reason for the desire for development through self-reliance—a reason perhaps more practical than ideological—was that, prior to the communist take-over, China had been badly misused by foreign countries through grossly unfair trade practices.

The desire for self-reliance did not mean that foreign trade was ignored. The People's Republic of China did engage in foreign trade and began it rather early. Her initial trading partners were members of the Soviet bloc. However, over the years, there has been a shift in orientation away from the Soviet bloc traders to the Western European countries and Japan. This is largely attributable to the estrangement with Russia and, in no small part, to the likelihood that China could get better trading terms with the Western European countries and Japan.

The commitment to self-reliance, though modified in certain respects, continues to this day. Certainly, the rhetoric remains.

China's foreign trade achievements are the results of the policy of building the country independently, through self-reliance, hard struggle, diligence and thrift, consistently followed by the Chinese people.¹¹

¹⁰Mao Tse-tung, *We Must Learn To Do Economic Work*, SELECTED WORKS, VOL. III, (Jan. 10, 1945) p. 241.

¹¹Wang Yao-ting, *China's Foreign Trade*, PEKING REVIEW vol. 17, no. 41 (Oct. 11, 1974) p. 19.

It is fair to say, though, that China's adherence to self-reliance in economic development, while continuing to be espoused as an ideological construct, has become quite "pragmatized." That is, China continues to value the socialist construction advantages inhering in self-reliance, but, at the same time, recognizes the practical, economic advantages of foreign trade. China recognizes that there are some things—technologies and raw materials—that she doesn't have and that she needs. Yet, China wants to obtain these things in a way that respects the commitment to self-reliance. To use a well-worn phrase, China wants to have her cake and eat it too. One way that she keeps from starving while remaining true to her political beliefs is by trading for entire plants, rather than for the things the plants produce.

But it does not stop here. China's interest in foreign trade is not limited to grudgingly entering into trading contracts to obtain technologies or materials to enhance her ability to be self-reliant. China exhibits, if not a zest, at least an enlivened interest in making trade with her more appealing to foreigners. For example, China has shown an interest in "improving packing and packaging and increasing varieties and designs" of her export commodities.¹²

The impact of politics on trade, then, is not so great as it once was, and not even so great as it is claimed to be now. China has become more practical and less political in conducting foreign trade. Nevertheless, because of the fact that party members are largely in control of the trade apparatus, and because China has, in recent years, been highly volatile, politically, a potential for political disruption of trade does exist.

The Machinery of Trade

The foreign trade of China does not just happen. It is, instead, conducted as a state monopoly by established organs in accordance with a central or master plan. Speaking metaphorically, it could be said that the Chinese have built a foreign trade machine. From time to time, the government (which receives direction from the party) decides what it needs to get from this machine, makes the proper adjustments and settings, and hopes that it produces the desired results. Being a machine, it is made up of a number of component parts working together to produce foreign trade. The most important parts are: the Ministry of Foreign Trade, the state trading corporations, the China Council for Promotion of International Trade, and the Canton Trade Fair.

The Ministry of Foreign Trade

The Ministry of Foreign Trade is the government entity possessed of the "official" capacity for the conduct of China's foreign trade. The Ministry for-

¹²*Id.* at 19.

mulates and submits annual import and export plans to the State Council for its approval. Once the plans are approved, the Ministry is charged with supervising their implementation. Some of the responsibilities of the Ministry include: the development of trade relations with other countries; the negotiation of trade agreements; and the supervision of the Chinese Customs Administration and the China Commodity Inspection Bureau. The Ministry does not actually do the trading. That is done by the state trading corporations, which operate under licenses issued by the Ministry.

The Ministry, then, through its official administrative, supervisory and licensing functions, exercises near total control over the international trade environment of China. A resultant characteristic of this control is an extreme centralization of the trade process. An interesting aspect of this extreme centralization, from the perspective of China's trading partners, is that by dealing only with the official, centralized trade apparatus, the foreign sellers do not have direct contact with the end users of their products. Consequently, a seller is able to obtain only an inexact and incomplete picture of who the intended user is and of what the product will be used for.

State Trading Corporations

The actual business of trading is carried out by the state trading corporations, organized and existing under licenses from the Ministry of Foreign Trade. These corporations are the sole importers and exporters in China, and it is with them, ultimately (there are companies outside of China that act as go-betweens), that foreign traders must deal in negotiating and concluding contracts. The state trading corporations are organized along mutually exclusive lines to trade in particular commodities. At present, there are eight such corporations:¹³

China National Machinery Import & Export Corporation

China National Chemicals Import & Export Corporation

China National Metals and Minerals Import & Export Corporation

China National Textiles Import & Export Corporation

China National Cereals, Oils and Foodstuffs Import & Export Corporation

China National Light Industrial Products Import & Export Corporation

China National Native Produce and Animal By-Products Import & Export Corporation

China National Technical Import Corporation

The state trading corporations possess independent juridical personality enabling them to enter into contracts with foreigners. Accordingly, they can sue and be sued on their contracts. However, they can be held liable only to the

¹³*China Trade Guide* (New York: First National City Bank, 1975) p. 6.

extent of the capital appropriated to them by the Ministry of Foreign Trade. For example, during any given year, the Ministry might capitalize a particular corporation, say the China National Chemicals Import & Export Corporation, with an amount of money thought to be sufficient to enable the corporation to carry out its part of the overall trade plan. Should the trading corporation be sued in damages for breach of one of its contracts, its liability would be limited to the capital appropriated to it by the Ministry. In essence, then, the state trading corporations possess the juridical capacity to contractually bind themselves to the extent of their assets, but they cannot bind the other trading corporations or China as a government.

China Council for Promotion of International Trade

Whereas the Ministry of Foreign Trade is the "official" governmental trade body, the China Council for Promotion of International Trade (CCPIT) is billed as the "unofficial," non-governmental component of China's foreign trade machine. It can be likened to a chamber of commerce that operates at the international level. Though the CCPIT is ostensibly an independent body, it, in fact, works closely with the Ministry of Foreign Trade in furtherance of China's trade program.

The CCPIT is made up of state trading corporation representatives and experts in economics, trade and law. Its functions include: arranging trade exhibitions, sending exploratory trade missions abroad, and entertaining trade missions in China. The major undertaking of the CCPIT is that of arranging and conducting the Canton Trade Fair twice each year. Consequently, the CCPIT plays a major role in establishing trade with non-communist countries that don't have diplomatic relations with China. In addition, the CCPIT is responsible for settling disputes through its Foreign Trade Arbitration Committee and Arbitration Tribunal, and for registering trademarks. The CCPIT is viewed as having independent legal personality. It can, and does, make trade agreements—as distinguished from trade contracts, which are made by the trading corporations—in its own name.¹⁴

Canton Trade Fair

The Canton Trade Fair, conducted semi-annually in the spring and fall, has been the principal forum for conducting foreign trade. As noted, it is run by the CCPIT. As much as 50 percent of the total foreign trade for certain years has been conducted at the Fair. It is at the Fair that contracts are negotiated and often concluded. Attendance is limited to those who have been invited by

¹⁴A. H. Smith, *Standard Form Contracts in the International Commercial Trade Transactions of the People's Republic of China*, 21 I.C.L.Q. 133 (1972).

the Chinese. The manners and methods of negotiating at the Fair are fascinating and should be looked into.¹⁵

The importance of the Fair as a forum for trade may be expected to decline in the coming years. This is because more and more foreign traders are finding it possible to deal directly with the state trading corporations and bypass some of the formalities and delays of the Fair. However, the Fair should continue to be of importance to those first attempting to trade with China. This is because the Chinese are concerned about developing a good overall trade relationship. Fleeting affairs are not sought. The initiation of a lasting relationship cannot be hastened, but will continue with the slow, "feeling each other out" atmosphere of the Fair.

Contracts

In General

Recognizing the difficulties with generalizing, but being unable to resist, a few modest generalizations are set out below.

1. In spite of the seeming indifference with which the Chinese regard law domestically, they take foreign trade contracting with utmost seriousness.
2. Where possible, the Chinese use their own standard form contracts for buying and selling.
3. Modification of the terms of China's form contracts, while not often easy, is, nonetheless, possible.
4. In practice, the Chinese behave reasonably under contracts that, by their terms, seem to favor China.
5. An English-speaking trading partner can expect to have the contract drawn up in English, or English and Chinese, often accompanied by a statement that both languages are of equal authenticity.
6. Contracts contain no mention of the legal system that will govern performance.¹⁶
7. Where China is the buyer the contracts often contain a fairly detailed quality guarantee clause.¹⁷ Such a clause is generally absent from contracts where China is the seller.

Shipping Documents and Terms

Almost all of the import contracts of China are F.O.B. In short, F.O.B. means that the seller of goods to China will be responsible for delivery of those goods on board a vessel at the port of shipment specified, the seller assuming

¹⁵M. F. Klingenberg, *The Canton Trade Fair: The Initiation of United States-Chinese Trade*, 13 VA. J. INT'L L. 63 (1972).

¹⁶DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA (Hong Kong: Business International, 1973) p. 68.

¹⁷Smith, *supra*, p. 147.

all risks relating to the goods until the goods are so delivered or tendered for delivery. Note that the contracts won't necessarily employ the term F.O.B. but, rather, the wording will be consistent with the usual understanding of the term.

The export contracts of China are generally C.I.F. In short, C.I.F. means that the Chinese seller will be responsible for chartering space on a vessel, loading the goods, and paying freight and insurance. The seller assumes all risks until the goods are delivered within a specified time.

In practice, when China is the purchaser, the seller must provide detailed shipping and other documents. However, when China is the seller, reference to shipping documents may be omitted or discussed in vague, general terms.¹⁸ Where China is the exporter, the standard form contract permits transshipment and partial shipment. However, where China is the importer, transshipment may be specifically prohibited.¹⁹ Finally, the contracts often go into detail on shipping and packing instructions.

Insurance

Standard form contracts almost invariably provide that China will insure the transacted goods, whether China is the buyer or the seller. This situation is, of course, a concomitant of the fact that China normally buys F.O.B. and sells C.I.F. One possible explanation for the Chinese willingness to arrange for insurance is the existence of the People's Insurance Company of China. The People's Insurance Company handles international trade and maritime risk insurance and writes all common forms of insurance, including war risk.²⁰ When China is the seller, the goods are usually insured at 110 percent of their invoice value.²¹ Additional coverage may be had by paying an additional premium.²²

Inspection of Goods

China does not recognize any international inspection organizations. Instead, its contracts provide for the inspection and testing of goods by the China Commodity Inspection Bureau. The Bureau has offices in China's major ports and industrial and transportation centers. It is responsible for ensuring that imports and exports meet the required standards.²³

The usual inspection process for imports is as follows: the goods arrive at the port of destination; the party applies to the China Commodity Inspection

¹⁸*Id.* at 144.

¹⁹*Id.* at 145.

²⁰*Id.* at 144.

²¹DOING BUSINESS . . . , *supra*, p. 70.

²²*China Trade Guide, supra*, p. 10.

²³S. LUBMAN, PRIVATE INVESTORS ABROAD—PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1973 (Virginia S. Cameron, ed.) (New York: Matthew Bender, 1973) p. 137.

Bureau for inspection of quality, quantity, specifications, and weight of the goods; and the Bureau issues the appropriate certificate.²⁴ If there are any discrepancies, China has the right to reject the goods or claim against the seller. A party dissatisfied with the result of the inspection may apply for a re-inspection. If still dissatisfied, the party may petition for review by the government agency having jurisdiction over the Bureau. However, the dissatisfied party may be held liable for the re-inspection expenses and for costs resulting from the delays.²⁵

The Chinese inspectors are known to be extremely meticulous and uncompromising in applying the standards that the goods must meet. They may reject goods for the slightest non-conformity.²⁶ Since inspections are so rigorous and rejections a real possibility, great care should be taken to ensure that the description contained in the documents relating to the goods is exact. This is because in conducting the inspections the inspectors rely on the descriptions contained in the accompanying documents. An example of where an inexact description resulted in a rejection that could have been avoided was where a company shipped goods containing improvements made since the contract was concluded, and failed to correct the old description.²⁷

An important legal consequence of the inspection requirement is that the contract may appoint the China Commodity Inspection Bureau the final arbiter of whether or not goods conform. That is, the inspection certificates are used as conclusive and irrebuttable evidence by the Chinese in pressing claims arising from non-conforming goods.²⁸ This arrangement is somewhat at odds with what most Western lawyers would be comfortable with. However, it may be necessary to accept such a provision, and European experience suggests that Chinese corporations insist on the finality of the Bureau's certificate.²⁹

Force Majeure

The meaning and content given to *force majeure* clauses may differ according to the legal systems of individual countries. That is, each country will attempt to determine, for itself, what circumstances should be *force majeure* for contract purposes.

In the case of China, not all contracts have *force majeure* clauses and, when they do, what constitutes *force majeure* is not always spelled out.³⁰ In general,

²⁴J. A. COHEN, CHINA TRADE PROSPECTS AND U.S. POLICY (Alexander Eckstein, ed.) (New York: Praeger, 1971) p. 151.

²⁵*Id.* at 151.

²⁶LUBMAN, *supra*, p. 139.

²⁷DOING BUSINESS . . . , *supra*, p. 69.

²⁸G. C. Reghizzi, *Legal Aspects of Trade with China: The Italian Experience*, 9 HARV. INT'L L. J. 85, 138 (1968).

²⁹LUBMAN, *supra*, p. 126.

³⁰*Id.* at 128.

it would include war and natural disasters, but apparently not strikes or labor disruptions.³¹ In any event, it seems clear that when an event would be considered *force majeure*, there is an obligation on the party seeking to invoke the clause to seasonably notify the other party. At present, Western experience under Chinese *force majeure* clauses is very limited.

An interesting question is whether modification by Chinese authorities of a state trading corporation's ability to perform its contractual obligations would qualify as *force majeure*. For example, what if the Ministry of Foreign Trade modified its import and export plans so as to make performance on an outstanding contract impossible for a state trading corporation? Could that corporation rely on a *force majeure* clause to escape its obligations?

The answer is unclear. One author has argued that there should be no escape from liability.³² He reasons that such an application of *force majeure* is not traditionally recognized and that each party should bear the risks inhering in its own government's behavior. In support of this view, it could also be argued that an act of the Ministry of Foreign Trade is not an act external to the state trading corporation (because of state control over the trade apparatus), hence, not *force majeure*. However, in *Jordan Investments Ltd. v. Soiuznefteksport*, English translation in 53 Am. J. Int'l L. 800 (1959), the Soviet Ministry of Foreign Trade cancelled an export license, thereby preventing a Soviet state trading corporation from performing on its contract. The Arbitration Commission held that the *force majeure* clause was broad enough to excuse the corporation from liability.

Payment Terms

International trade contracts with China are of the type known as documentary transactions. Under them, payment is not made against the goods, but against documents evidencing the legal right to possession of the goods by the holder of the documents. The usual international practice in documentary transactions is by an irrevocable letter of credit against the presentation of a sight draft and shipping documents. The Chinese practice has some notable differences.

The first is that in sales by China the letter of credit must reach the seller (China) before the date of shipment and remain valid until fifteen days after expiration of the shipment date. This produces the seemingly unsettling situation where the buyer has committed his letter of credit but may, for a period of time, be without either the goods or the documents. Yet, while this is theoretically unnerving, there have been no reports of serious problems arising from this situation.

³¹R. Starr, *Developing Trade with China*, 13 VA. J. INT'L L. 13, 20 (1972).

³²Reghizzi, *supra*, p. 108.

Another important difference is one resulting from the inclusion of inspection clauses in the contracts. The clauses condition acceptance of the goods on a satisfactory inspection. When this condition is viewed together with an F.O.B. sale to China, there is a peculiar result. An F.O.B. sale should mean that the risk of loss passes, and the buyer's liability arises, upon delivery of the goods on board the vessel. This is when the irrevocable letter of credit should be irrevocable. Yet, acceptance and payment is conditioned upon a satisfactory inspection which doesn't take place until the goods are in China. In a theoretical sense, the inspection clause operates to transform what is supposed to be an irrevocable letter of credit into a conditional promise to pay. Again, it does not appear that this has caused serious problems.

Another difference concerns the use of confirmed letters of credit. It is the usual practice in international trade to use confirmed letters of credit. A regular letter of credit, *inter alia*, is irrevocable and issued by a financing agency of good international repute. A confirmed letter of credit has these characteristics and, in addition, carries the direct obligation of the confirming agency. As a general rule, China, while requiring its trading partners to deal in confirmed letters of credit, will not do so itself. It is thought that to insist on China's use of confirmed letters would imply doubt about the credit standing and good faith of the country. Not wishing to offend China and, thereby, possibly damage the trading relationship, trading partners do not ordinarily insist. Another reason for going along with the practice is that China has, in fact, a very good payment record, making confirmed letters generally unnecessary.

China often insists that letters of credit in its favor be transferable, but they don't appear to be, in fact, transferred, at least not outside the country.³³ Finally, letters of credit are negotiated by the Bank of China and may be opened only through certain third country banks having correspondent relations with the Bank of China.³⁴

The currency used in international trade transactions with China has included most Western European currencies, the Japanese yen, and the U.S. dollar. Since 1970, there appears to have been an effort by China to have its own currency, the renminbi (RMB), used more frequently. When the RMB is used for payment, it must be purchased from the Bank of China.

For years, contracts for sales to China had been based on cash payments exclusively. More recently, however, the Chinese have indicated a willingness to purchase on credit. Examples are the purchases of ethylene and butadiene plants from the Tokyo Engineering Corporation of Japan, a vinylon plant from Kurary, and a third plant from Mitsubishi. The terms are said to provide

³³Smith, *supra*, p. 141.

³⁴DOING BUSINESS . . . , *supra*, p. 70.

for a 20 percent down payment with the remainder payable with interest at 6 percent over a five-year period.³⁵

Terms Relating to Breach

The standard form contracts of China usually do not contain provisions covering a possible breach by China. This situation is not the result of an oversight on China's part. Nor is it likely the result of intentional, underhanded maneuvering to gain an unfair advantage over the other party. Rather, it is probably the result of an attitude that refuses to put into question the potential bad faith or bad acting of China towards its contractual obligations.

On the other hand, China's standard form contracts commonly contain provisions relating to breach by the foreign trading party. These provisions include, *inter alia*, the right to compensation or penalties for late delivery or defects, and the right to terminate upon breach. Compensable damages include the loss of future profits.³⁶ The inclusion of penalties as a possible recovery for breach is not a universally popular idea. What makes penalties so harsh is that, even when they are paid, they don't necessarily release the breaching party from the obligation to perform or from payment of damages.³⁷ In practice, the Chinese insistence that penalties be paid has varied.³⁸

Another interesting factor is China's strong preference for specific performance over money damages as a remedy for breach. This attitude results, in part, from the fact that China's foreign trade exists as an integral part of the nation's overall economic plan. Consequently, there often exists a crucial relationship between a particular foreign trade contract and the implementation of a carefully thought out domestic economic project. Since the fulfillment of economic plans is a matter of primary importance to the Chinese government, money damages are often a poor substitute for the performance of a contract. Foreign traders can expect, then, that China will strongly insist on the often more drastic remedy of specific performance.

Disputes Settlement

The most important thing to stress in the area of dispute settlement is that the Chinese are extremely reluctant to resort to arbitration despite the fact that dispute settlement by arbitration is a well-established practice in international commercial law. The Chinese prefer, instead, to settle contractual disputes through negotiation.³⁹

³⁵LUBMAN, *supra*, p. 134.

³⁶Smith, *supra*, p. 150.

³⁷Reghizzi, *supra*, p. 105.

³⁸LUBMAN, *supra*, p. 135.

³⁹Smith, *supra*, p. 138.

The preference for negotiation can be explained in terms of both traditional and contemporary attitudes. Traditionally, the Chinese did not favor litigation as a means of settling disputes. This disfavor is reflected in the proverb: "It is better to die of starvation than to become a thief; it is better to be vexed to death than to bring a lawsuit."⁴⁰ Instead, the Chinese favored mediation and compromise. This is because they sought a means of dispute resolution that would not adversely affect the overall relationship between the parties, the overall relationship being highly valued in Confucian thought. The *li/fa* dichotomy also comes into play here. *Li* stresses that reasonable men should deal with their opponents with propriety and tolerance to produce a spirit of compromise. Where *fa*, the formal law, is resorted to, the implication is that the party failed to behave as a reasonable man would have. Hence, the desire to avoid formal litigation.

In addition, there are contemporary ideological reasons for preferring mediation over arbitration or litigation. In terms of Maoist-Marxist-Leninist thinking, civil disputes (and this would include commercial disputes) are thought to belong to what are called "contradictions among the people."⁴¹ Contradictions among the people, unlike some other types of contradictions, are not suited to be suppressed. Consequently, all or nothing adjudicatory procedures are inappropriate. Resolution through negotiation and compromise is to be preferred.⁴²

Finally, the preference for negotiated settlement derives, in part, from economic considerations. As already noted, specific performance is preferred over damages when there is a breach of contract. The possibility of obtaining performance, even if only partial, is likely to be increased through amicable negotiations. Resort to arbitration will tend to freeze the parties to their respective positions following the alleged breach.

One further point to make in this regard is that, because disputes are settled through negotiation, it doesn't mean that decisions are reached in disregard of understood principles of law. It would be careless to jump to the conclusion that negotiated resolution is unprincipled or mere serendipity. In an account relating to the use of mediation at the domestic level in China, it was said:

[W]e must guard against the phenomenon of using imagination instead of policy. . . . The view that mediation can be on the sole basis of the willingness of the parties without paying attention to policy and law is wrong and harmful.⁴³

⁴⁰*Id.* at 138.

⁴¹T.W. Huang, *Reflections of Law and the Economy in the People's Republic of China*, HARV. INT'L L. J. 261, 278 (1973).

⁴²See J. Cohen, *Chinese Mediation on the Eve of Modernization*, 54 CAL. L. REV. 1201 (1966); and S. Lubman, *Mao and Mediation*, 55 CAL. L. REV. 1284 (1967).

⁴³Huang, *op. cit.*, p. 279.

Negotiation, then, is strongly preferred. However, most trade contracts with China do make provision for arbitration in the event that a settlement cannot be reached through negotiation. The terms of the arbitration agreement are not always the same but depend upon the bargaining power of the parties, and the nature of the commodity traded.⁴⁴ In general, the arbitration clauses exhibit a preference for arbitration in China. However, the Chinese have accepted clauses providing for arbitration in the defendant's country or a third country, such as Switzerland or Sweden.⁴⁵

If a dispute is referred to arbitration, the Foreign Trade Arbitration Committee (FTAC), the likely arbiter, will provide the procedural and substantive rules. The FTAC has twenty-one members. Each party to the dispute may choose one arbitrator from the members. The two arbitrators (assuming two disputants) then select a third arbitrator from the remaining members to act as a referee. In lieu of the foregoing selection procedure, the parties may agree on a single arbitrator. The parties may be represented by lawyers, though Chinese is the official language of the Committee. The meetings are open, unless a party requests that they be closed. When handing down the decision the reasons behind it must be stated. The decision unless a party requests that they be closed. When handing down the decision the reasons behind it must be stated. The decision is final.

The subject matter jurisdiction of the FTAC includes disputes "as may arise from contracts and transactions in foreign trade."⁴⁶ Personal jurisdiction may be exercised only on a voluntary basis, and upon written application of one of the parties to the dispute.⁴⁷

There is a question as to what substantive law would be applied in arbitration, as the contracts do not state the legal system that governs performance.⁴⁸ Presumably, choice of law will be left up to the forum state. But since China is usually chosen as the forum state, and since China has no substantive body of rules on choice of law in private international commercial disputes, foreign traders can only guess what law will be used.

In fact, disputes rarely, if ever, go to arbitration. The Chinese preference for negotiation is well known to China's trading partners. There is a widespread feeling among them that an insistence on arbitration (though permitted by contract) would severely jeopardize future trade. In practice, what generally happens when the CCPIT receives a complaint is that one person, a "foreign

⁴⁴V. H. Li, *Legal Aspects of Trade With Communist China*, 3 COLUM. J. TRANS. L. 57, 63 (1974).

⁴⁵Smith, *supra*, p. 139.

⁴⁶Article I of the Provisional Rules of Procedure of the Foreign Trade Arbitration Committee of the China Council for the Promotion of International Trade, adopted March 31, 1956.

⁴⁷*Id.*, Art. II.

⁴⁸Smith, *supra*, p. 138.

trade expert," is selected who may or may not be a FTAC member. This person investigates and proposes a compromise solution.⁴⁹ Regarding the actual settlement of claims, the Chinese prefer to settle them through future business dealings, rather than by money payments.⁵⁰

Conclusion

The legal aspects of China's conduct of foreign trade are, in a number of ways, unique. In general, trade is conducted in a highly unilateral fashion. This is something uncommon in today's world of international trade. Both traditional and contemporary notions of law interact to affect China's legal approach to trade. Politics, while continuing to be of importance, does not impact on trade the way it once did. The practical advantages of trade are being given increasing recognition. As time passes, barring major political disruption, it can be expected that China will begin to adopt some of the more common approaches to structuring the legal relationships involved in foreign trade. In the meantime, her "uncommon" approach to conducting foreign trade needs to be recognized and dealt with accordingly.

⁴⁹LUBMAN *supra*, p. 127.

⁵⁰Haight, *supra*, p. 71.

