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A China – US bilateral investment treaty: A template for a multilateral framework for investment?

by
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China is the largest foreign direct investment (FDI) host and home country among emerging markets, the United States among developed countries. As host countries, both seek to maintain policy space to pursue their own legitimate public policy objectives; as home countries, both seek to protect their investors' outward FDI. The development of their bilateral investment treaties (BITs) over the past decade reflects this: Chinese BITs have become more protective of investors, US ones more respectful of host country interests. If agreement is reached between both, it would provide a template for future investment agreements.

The two governments began negotiating a BIT in June 2008. With the new US Model BIT released in April 2012 and a May 2012 cabinet-level agreement between the two governments to intensify negotiations, discussions resumed in October 2012. So far, it appears likely (based on publicly available documents) that agreement can be reached that all investors (including state-controlled entities) are covered; the MFN clause applies to substantive provisions only; fair and equitable treatment corresponds to the customary international law minimum standard of treatment; the indirect expropriation clause is circumscribed; and treaty benefits can be denied under certain circumstances.

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Differences are more pronounced regarding performance requirements (the US seeks to expand the TRIMs list, China not; reaffirming China's WTO accession commitments to leave the use of certain requirements to the parties to a given investment might solve this matter); labor and environment standards (the US desires strong language; side agreements of the China-New Zealand free trade agreement reaffirming commitments already made in other fora and providing for purposeful cooperation between the parties in these areas suggest a compromise); and investor-state dispute settlement (where one could build, in the framework of general agreement, on the September 2012 Canada-China BIT regarding transparency).

Not surprisingly, the most difficult issue concerns the phase of investment to which national treatment (NT) applies: host countries typically want to maintain flexibility relating to when and where they allow FDI into their economies (including given industrial policy considerations), while the US business community seeks strong market-access commitments. Accordingly, the US government seeks pre-establishment national treatment (PENT) with a "negative list" approach (which lists sectors to which NT does not apply), while China has limited its agreements to date to post-establishment NT with carve-outs for existing non-conforming measures. This key architectural question has profound implications for market access.

Perhaps a compromise could be a negative list approach for NT regarding post-establishment and a positive list approach (which lists sectors to which NT applies) regarding pre-establishment (China's Guidance Catalogue and the US exceptions in BITs may constitute starting points as they identify sectors). In a hybrid approach, the two governments would (1) list the broad sectors to which *NT applies pre-establishment* (positive list) and (2), within each broad sector, list all sub-sectors to which *NT does not apply pre-establishment* (negative list).

Either approach would be a major concession by the parties and would require a political decision. This could be facilitated (and hence limit the concession) by grandfathering existing non-conforming measures (including a narrowly defined national security review); agreeing a standstill on new restrictions (to provide transparency, predictability and stability, but perhaps with the flexibility that new restrictions for future investments need to be offset by negotiated new openings) and a commitment to remove non-conforming measures progressively. One could also carve out particularly important sectors and agree on a tailored approach for them. Or one could grant pre-establishment MFN but not PENT (as per the Canada-China BIT). There are many approaches to protect the essential interests of both sides.

US concerns as a host country seem to become more pronounced, reflected in the more active screening of certain incoming investments (see e.g. President Obama's September 2012 veto, on national security grounds, of a Chinese investment, the first such veto in 22 years), while China has introduced its own FDI national security review (which includes economic security and conceivably also industrial policy) -- making investment entry less predictable. Moreover, China's outward FDI is rising rapidly and, with it, the desire to protect it. Hence, both countries should be interested in concluding their BIT negotiations, to put their bilateral investment relationship on a predictable footing. In particular, a BIT would increase the protection that investors from both countries would receive in each other's territory, provide a mechanism for dispute resolution and likely improve market access.

More generally, a China-US BIT would provide a solution to the challenge of balancing the interests of a given country in its capacity as a (capital-importing) *host* country with its interests in its capacity of a (capital-exporting) *home* country. Meeting this challenge would represent a historic compromise between the traditionally quite diverging host and home country positions and (together with other important negotiations, e.g. involving the European Union, Japan, India, and a Trans-Pacific Partnership Agreement) might well become a platform on which, sooner or later, a multilateral framework could be built. These negotiations are therefore of crucial importance not only for the economic relations of the world's two largest economies, but also for the evolution of the international investment law regime.

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