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Updated January 12, 2018

A U.S.-China Bilateral Investment Treaty (BIT): Issues and Implications

Over the past three decades, U.S.-China commercial ties have expanded significantly. In 2017, China was the United States' largest trading partner (with total merchandise trade estimated at $633 billion), while the United States was China's largest trading partner. Yet the level of bilateral foreign direct investment (FDI), while growing, is relatively small. In 2008, the United States and China launched negotiations for a bilateral investment treaty (BIT), an agreement that typically contains provisions to encourage and provide reciprocal investment protections in order to enhance bilateral commercial ties. In 2013, China agreed to negotiate a "high standard" BIT with the United States, which would include opening new sectors to FDI and generally treating U.S.-invested firms in China the same as Chinese firms. The two sides were unable to reach an agreement by the end of the Obama Administration's term, and the Trump Administration has not shown interest in restarting the talks. Many analysts contend that a BIT could significantly boost bilateral FDI and trade flows.

What Is a BIT?

U.S. BITs address six core principles or issues for investors, including national treatment and most-favored nation (MFN) treatment at all stages of investment, rules on expropriations and compensation if this occurs, ability to transfer funds in and out of the country, limits on performance requirements (such as domestic content targets or mandated technology transfer), neutral arbitration of disputes, and freedom by investors to appoint their own senior officials. To take effect, BITs must be approved by the U.S. Senate by a two-thirds vote (see CRS In Focus IF10052, *U.S. International Investment Agreements (IIAs)*, by Martin A. Weiss and Shayerah Ilias Akhtar).

Economic Theoretical Benefits of a BIT

BITs are intended to improve the investment climate among the partners, promote free market policies, and expand commercial ties. FDI inflows can boost a country's economy by creating (or sustaining) jobs, generating tax revenues, enhancing domestic research and development and access to technology, increasing domestic competition, and expanding the types of goods and services available to consumers. FDI outflows abroad may help firms become more competitive by boosting their overseas sales of goods and services, generating exports from the home country, and expanding a firm's access to foreign talent.

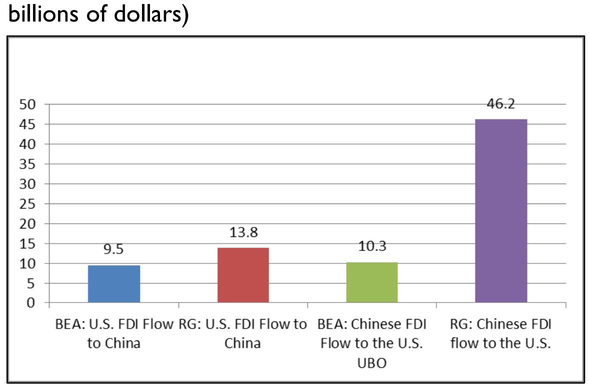
U.S.-China FDI Flows: Different Estimates

FDI is generally the most commonly used measurement of international investment flows, although some contend such measurements do not cover all investments. According to the *U.S. Code of Federal Regulations*, FDI is defined as the ownership or control, directly or indirectly, by one foreign person of 10% or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated business enterprise, including a branch.

The U.S. Bureau of Economic Affairs (BEA) is the main U.S. federal agency that collects and reports data on U.S. FDI outflows and inflows. It reported that Chinese FDI flows to the United States in 2016, based on an ultimate beneficiary owner (UBO) measurement, were $10.3 billion, while U.S. FDI in China was $9.5 billion. BEA further reported that the stock of Chinese FDI in the United States on a historical-cost (book value) basis through 2016 was $58.2 billion (UBO), while the stock of U.S. FDI in China was $92.5 billion.

Some analysts contend that BEA's data do not reflect the full value of Chinese FDI in the United States. They note, for example, that many of acquisitions of U.S. firms do not appear to be reflected in BEA's FDI in the year the deal was completed. They further contend that BEA data often attribute the source of the FDI inflows according to where the funds originated from, such as offshore financial centers, which may not reflect the nationality of the actual investor. The Rhodium Group (RG), a private consulting firm, has sought to calculate its own estimates of U.S.-China FDI flows, based on the value of completed transactions by Chinese-owned firms. Using this method, it estimates Chinese FDI flows to the United States in 2016 at $42.6 billion (which was 4.5 times BEA's estimate) and U.S. FDI in China at $13.8 billion (34% higher than BEA's data).

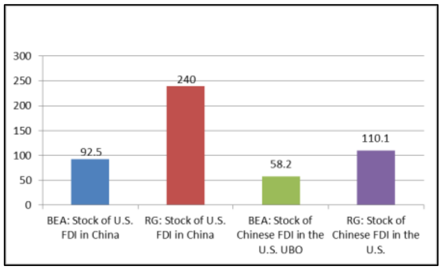
Figure 1. Estimates of U.S.-China FDI Flows in 2016
(in billions of dollars)



Sources: BEA and the Rhodium Group.

In terms of the stock of Chinese FDI in the United States through 2016, RG's estimate, at $110.1 billion, was 89% larger than BEA's UBO estimate, while RG's estimate of the stock of U.S. FDI in China, $240 billion, was 159% larger than BEA's data.

Figure 2. Estimates of the Stock of FDI Flows between the United States and China through 2016 ($billions)



Sources: BEA and the Rhodium Group.

China's Investment Climate

According to the United Nations, China was the third-largest destination of FDI in 2016 (at $134 billion). BEA estimates sales of foreign affiliates of U.S. firms in China totaled $482 billion in 2015. Over the past few years, foreign-invested firms in China have reported that the business climate in China is becoming increasingly challenging. For example, a 2017 survey by the American Chamber of Commerce in China of its members found that 81% of recipients stated that they "felt less welcomed than before." Unclear laws, inconsistent regulatory enforcement, and preferences given to domestic Chinese firms over foreign firms are often cited as obstacles for U.S. FDI.

According to the U.S.-China Business Council, China imposes ownership barriers on nearly 100 industries. To a great extent, China's FDI restrictions appear to be linked to industrial policies that seek to promote the development of sectors identified by the government as critical to future economic development. For example, since the early 1980s, the Chinese government has encouraged foreign auto companies to invest in China, but has limited FDI in that sector to 50-50 joint ventures with domestic Chinese partners. In addition, the central government maintains a "Guideline Catalogue for Foreign Investment," which lists FDI categories that are encouraged, restricted, or prohibited. U.S. firms also raise concerns about FDI regulations that discriminate against foreign firms, condition investment approval to certain performance requirements (such as technology transfers), and extend preferential policies (e.g., subsidies) to Chinese firms.

Progress Toward a High-Standard BIT with China

During the July 2013 session of the U.S.-China Strategic and Economic Dialogue (S&ED), China agreed to negotiate a high-standard BIT with the United States that would include all stages of investment and all sectors, commitments U.S. officials described as "a significant breakthrough, and the first time China has agreed to do so with another country." A press release by the Chinese government stated that China was willing to negotiate a BIT on the basis of nondiscrimination and a negative list, meaning the agreement would identify only those sectors not open to foreign investment on a nondiscriminatory basis (as opposed to a BIT with a positive list, which would list only sectors open to foreign investment).

During the July 2014 S&ED session, the two sides agreed to a broad timetable for reaching agreement on core issues and major articles of the treaty text and committed to initiate the "negative list" negotiation early in 2015. During BIT negotiations held in June 2015, each side submitted their first negative list proposals, and later agreed to submit a revised list in September 2015. During the July 2015 S&ED, the two sides also reaffirmed that reaching a BIT remained a high priority and pledged to intensify negotiations and exchange improved "negative list" offers.

While some progress was reportedly made in the September 2015 BIT talks, a breakthrough was not achieved in time for President Xi's summit visit to the United States. *The Wall Street Journal* on September 18, 2015, reported that China's latest negative list contained 35 to 40 sectors. On September 22, 2015, then-U.S. Trade Representative Michael Froman stated that, although progress had been made over the past 20 months to reach a BIT, there was "a substantial distance from the kind of high standard agreement necessary to achieve our mutual objectives." During the September 2015 U.S.-China summit, the two sides said they were "committed to intensify the negotiations and to work expeditiously to conclude the BIT." However, no breakthrough was achieved by the end of the Obama Administration's term.

While the Chinese government has indicated its support for continuing BIT negotiations, the Trump Administration has been less clear on its position. U.S. Secretary of Treasury Steven Mnuchin was quoted by the publication *Inside Trade* in June 2017 as follows:

> It's on our agenda; I wouldn't say it's at the very top of our agenda. I think what we're looking for is, opposed to just negotiating a large agreement, we're looking to negotiate very specific issues that deal with market issues today, deal with market fairness today, deal with opening their markets to the same extent that our markets are open, and that's really our focus.... Once we can make progress in that we can turn to the bilateral investment treaty.

Implications of a BIT Agreement

Many analysts believe that a high-standard U.S.-China BIT could have a significant effect on boosting bilateral commercial relations, such as by increasing U.S. exports to China. As noted by one former Treasury official, a BIT "could be a game changer in terms of unlocking new opportunities and leveling the playing field for U.S. firms and investors." Some view China's willingness to negotiate such an agreement as an indicator that it is serious about implementing comprehensive new economic reforms, although whether or not it can commit to such reforms on paper remains unclear. Some analysts have raised concerns over whether China could be relied on to fully implement the agreement, especially in regards to preferences it gives to many state-owned or controlled firms. Some critics question why China is negotiating a high-standard BIT with the United States while at the same time seeming to impose new FDI restrictions. It is unclear to what extent a BIT would boost Chinese FDI in the United States.

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