THE US-CHINA BUSINESS COUNCIL
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Bilateral Investment Treaties: What They Are and Why They Matter

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What is a bilateral investment treaty (BIT)? Why do we need them? Who benefits from them?

Understanding what BITs do and don't do is important. The United States and China—the world's two largest economies—are currently negotiating a BIT, making the issue particularly relevant today.

What is a BIT?

A BIT is an agreement between two countries that sets up "rules of the road" for foreign investment in each other's countries. BITs give US investors better access to foreign markets—and on fairer terms. The United States currently has BITs with 42 countries.

What would a BIT do for American investors?

When countries enter into a BIT, both countries agree to provide protections for the other country's foreign investments that they would not otherwise have. A BIT provides major benefits for American investors in another country, including national treatment, fair and equitable treatment, protection from expropriation and performance requirements for investments, and access to neutral dispute settlement. Although Chinese investments in the US are already granted most of these rights under US law, such as the right to due process and protection from expropriation, the BIT would give Chinese investors a few additional benefits, such as access to neutral investor-state dispute settlement.

How would American investors be treated under a BIT?

A BIT ensures that foreign governments will treat American investors the same as domestic companies; this right is known as "national treatment." BITs also guarantee that American investors are given the same types of preferences that other foreign investors are given in a market, also called "most-favored nation" treatment. Under a strong US-China BIT, the Chinese government would treat US companies the same as Chinese companies, as well as companies from New Zealand, Germany, and Korea -- countries that already have investment agreements with China.

The promise of equal treatment applies to investments made prior to the time the BIT enters into force and to new investments in the market. That means that BITs bar foreign governments from using investment restrictions, like ownership caps, to prevent American companies from investing in their markets. This is particularly important in China, which currently restricts investment in over 100 industry sectors, ranging from manufacturing to services to agriculture. By contrast, the United States restricts foreign investment outright in only five sectors, and maintains 24 mostly minor conditions or restrictions that would be removed if the US is given reciprocity in China's market.

Under a BIT, governments also commit to treating American investors on a "fair and equitable" basis in accordance with international law. America already grants foreign investors these benefits, so a BIT would primarily serve to better protect American investors in China.

How would a BIT help protect companies from unfair government actions?

A BIT would ensure US companies would not have to meet unfair investment requirements, like licensing requirements, that Chinese companies are not required to meet. Currently, US investors often face difficulties—and at times discrimination—when applying for business licenses in China.

BITs also protect investors in several other ways. For example, BITs limit foreign governments' ability to take over US investments in their country. If such an expropriation does happen, BITs ensure governments compensate investors in a fair and timely manner. BITs also curb a government's ability to require that American investors meet burdensome conditions to operate in their markets. For example, under a BIT, governments cannot create rules mandating companies to use locally-made materials in their products or to transfer technology to a domestic company as a condition of investment. Finally, BITs ensure that American investors can move capital freely in and out of the country in which they have invested, as businesses do every day in the United States.

Would a BIT give US companies recourse when treated unfairly?

BITs give American investors access to a neutral, third-party arbitrator when a problem arises with another investor or the host government. This provision can be extremely helpful for investors in countries where the legal system is not mature or well-established. Notably, the dispute settlement provisions do not give foreign investors more rights than those already established in US law, thanks to America's mature legal system, but the benefits for American investors in China would be significant.

Dispute-settlement provisions are already in place in the 42 BITs that the United States has with other countries. Only 15 disputes have been brought against the United States over a 30 year period, and the United States has won each case.

Does a BIT address intellectual property rights protection and enforcement?

BITs are tools to break down market access barriers and give American companies greater protections overseas, but they can't address every problem that companies face abroad. For example, American companies in China face challenges in protecting and enforcing their intellectual property rights (IPR). A BIT would not fix those problems directly.

Indirectly, however, a BIT would help US companies protect their IPR in China. The BIT would remove ownership restrictions that force US companies in some sectors to partner with Chinese firms in order to invest. Without these restrictions, companies are in a better position to protect their IPR because they can own 100 percent of their operations instead of sharing their IPR with a partner.

What about government subsidies to Chinese companies and preference in government procurement? Will foreign companies be treated equally?

A BIT wouldn't address government subsidies to Chinese companies or give equal access to government procurement markets. Those issues must be addressed under separate initiatives, either bilaterally or by getting China to join the World Trade Organization's (WTO) Government Procurement Agreement.

A BIT would, however, bar the Chinese government from granting preferential treatment to state-owned enterprises (SOEs) and private Chinese companies. In addition, a BIT would obligate SOEs to treat US investors fairly. This requirement would help protect US companies in China from unfair treatment, as some SOEs are given authority to regulate aspects of an industry (*de facto* or formally), even though they act as a commercial competitor in that industry. In these situations, the BIT would ensure that US companies' competitors do not have the ability to regulate in their own favor.

A BIT cannot address all SOE-related issues, like the share of dividends paid out or governance structure. These can and should be addressed through appropriate channels that compliment a BIT. However, there is no reason not to conclude a BIT with China, even if those issues are currently outside of the BIT's scope.

Finally, it's important to remember that the Obama administration spent three years revising the US "Model BIT," which is used as a basis from which the US negotiates its BIT agreements. In that process, the US made important modifications that effectively address concerns about SOEs, among other issues.

What is the process for approving a BIT in the United States?

At the time of writing, the United States and China are in the early stages of negotiating the BIT. When the BIT text is final and ready for government consideration, the treaty will be submitted to the Senate and referred to the Committee on Foreign Relations. Once considered, the Committee may report the treaty to the full Senate favorably, unfavorably, give no recommendation, or choose not to act it at all. When a treaty has been reported to the Senate, it will be added to the Executive Calendar and considered in executive session. Two-thirds of the Senate must vote in favor of the BIT, via a resolution of ratification, in order for it to pass.

Takeaways

A high-quality US-China BIT would give American companies better access to China's market, and equal rights as Chinese firms. These guarantees would provide American companies with a better opportunity to expand in China – the world's second largest economy, with a middle class that will soon be larger than the population of the United States. US companies overwhelmingly invest in China to reach these customers– not export back to the United States. In fact, according to US government statistics, American companies in China sell only 7 percent of goods they make in China back to the United States – the rest is sold in China or other foreign countries.

In addition, a BIT with China would also help bring more foreign investment to America and create new opportunities here for American workers. US government analysis shows that foreign investment not only supports 5.6 million jobs in the United States – one-third of which are in the manufacturing sector – but that US companies with foreign investments pay employees more on average than their counterparts without overseas investments.

Chinese investment in the United States remains relatively small compared with investments from other foreign countries. In fact, USCBC analysis shows that the United States and China have less than a 5 percent share of investment in each other's markets. Since these are the two largest economies in the world, that means there is significant room for growth.

A BIT is an essential tool for facilitating this growth, making the United States more competitive internationally, and creating a stronger economy here at home. A BIT also represents the most important single tool we have to address many of the level-playing field issues US companies face in China.