U.S.-China Economic and Security Review Commission

Staff Research Report

August 1, 2016

Policy Considerations for Negotiating a U.S.-China Bilateral Investment Treaty

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Executive Summary

A bilateral investment treaty (BIT) is an agreement between two economies that sets forth binding rules on the promotion and protection of foreign investments made in each country's territory.[1] Historically, BITs have primarily served to encourage and expand investment between two countries. Over the past 20 years, however, as the international investment, legal, and developmental practices of many BIT partners have become more similar, some BITs have taken on significance as political and diplomatic instruments to promote regional cohesion and are less often tools designed solely to deepen economic integration.[2]

For the United States and China, a BIT could be a way to expand bilateral investment. There is space to do so—according to official data, China comprised about 2.5 percent of total foreign direct investment (FDI) flows into the United States in 2014, commensurate with the 2 percent U.S. share of FDI flows into China.[3] The U.S.-China BIT, which has gone through 24 rounds of negotiations as of June 2016, is designed to address some of the main obstacles to greater bilateral FDI.

The U.S.-China BIT could also serve as a vehicle for each side to advance its broader international interests. For the United States, the BIT may present an opportunity to address and ban Chinese practices that are out of line with international investment and legal standards, including unclear regulatory and legal enforcement, forced technology transfer, and—most importantly—long-standing market access barriers. For China, the BIT could serve as another commitment to domestic reform of the foreign investment framework as set forth in the 2013 Third Plenum decision. It would impose external obligations, just as China's World Trade Organization (WTO) accession was expected to do, and would signal China's relevance and competitiveness as a destination for investors all over the world.[4] Moreover, with Chinese companies increasingly "going out," China seeks more clarity and reciprocal investment protections.

A number of significant challenges—many of which are unique to China's involvement—complicate the debates around a prospective U.S.-China BIT. The practices U.S. policymakers seek to bar through the U.S.-China BIT are in some cases issues of intense international dispute. Some examples include:

- Restricted market access;
- Performance and localization requirements;
- Discriminatory treatment of foreign investors; and
- Discretionary and opaque national security review mechanism.

This report seeks to summarize briefly each country's history with BITs, identify potential challenges in moving forward with negotiations, and highlight potential implications of the U.S.-China BIT for the United States. Drawing on the 2012 U.S. Model BIT (a model text containing key provisions that acts as a starting point for all U.S. BIT negotiations), the evolution of China's BIT practice, and China's 2012 BIT with Canada, this report identifies a number of questions U.S. policymakers should consider, including:

- *Transparency and availability of information:* Are U.S.-China BIT negotiations transparent and do U.S. policymakers have sufficient knowledge to develop an informed opinion?
- *Reciprocal investor treatment:* Will Chinese regulations favoring domestic companies continue to threaten market access reciprocity?
- *Performance requirements:* Given China's long history of pressuring foreign companies wishing to invest there to transfer technology in exchange for market access—despite its international obligations—how can the interest of U.S. investors be protected?
- *Compliance:* Regardless of how comprehensive and high-standard a final U.S.-China BIT may be, will China actually comply with its commitments?

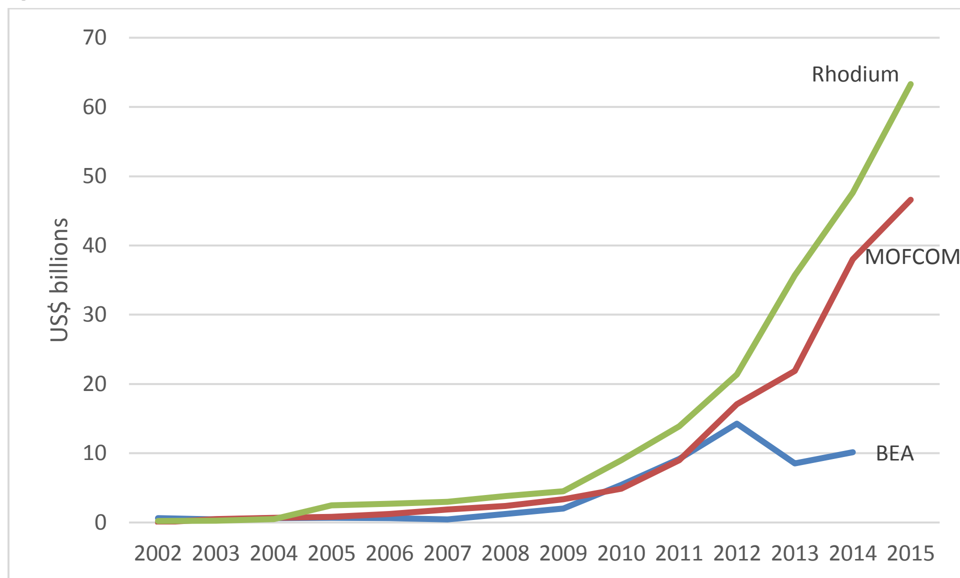
I. Setting the Stage

The United States and China are the world's largest economies and major trading nations. U.S.-China bilateral trade has been rising every year for decades, reaching nearly $600 billion in 2015. Given the size of their trading relationship, however, the level of FDI flows between the two countries is surprisingly small.

Gauging the true magnitude of bilateral investment is challenging because of divergent methodologies, time lags, and lack of reliable data. According to the U.S. Bureau of Economic Analysis (BEA), in 2014 (latest data available) the stock of Chinese FDI in the United States on a historical-cost basis was $10.2 billion.* For the same year, China's Ministry of Commerce (MOFCOM) reported the stock of Chinese FDI in the United States was around $38 billion (see Figure 1). For 2015, MOFCOM reported that stock of Chinese FDI in the United States stood at $46.6 billion.†

Whether one uses the U.S. or Chinese figures, the official estimates usually understate the true volume of investment. There are several reasons for this: One is that official data exhibit a significant time lag. Another is that the official estimates do not account for flows of FDI through Hong Kong and other offshore financial centers, such as the Cayman Islands, which are likely transit points for Chinese money on the way to the real investment destination.[5] Private estimates of Chinese FDI in the United States tend to be significantly higher. For example, according to advisory firm Rhodium Group, in 2015 Chinese firms invested over $15 billion, for a total of $63 billion between 2000 and 2015.[6]

Figure 1: Estimates of the Stock of Chinese FDI in the United States, 2002–2015



Note: BEA data are through 2014 only.
Source: BEA; Rhodium Group; MOFCOM.

Although on the cumulative basis, U.S. FDI in China ($65.8 billion in 2014, according to BEA) continues to dwarf Chinese FDI in the United States, the reverse is true for flows. By most measures, Chinese FDI flows to the United States now exceed U.S. FDI flows to China due to rapid growth in Chinese annual FDI to the United States in the

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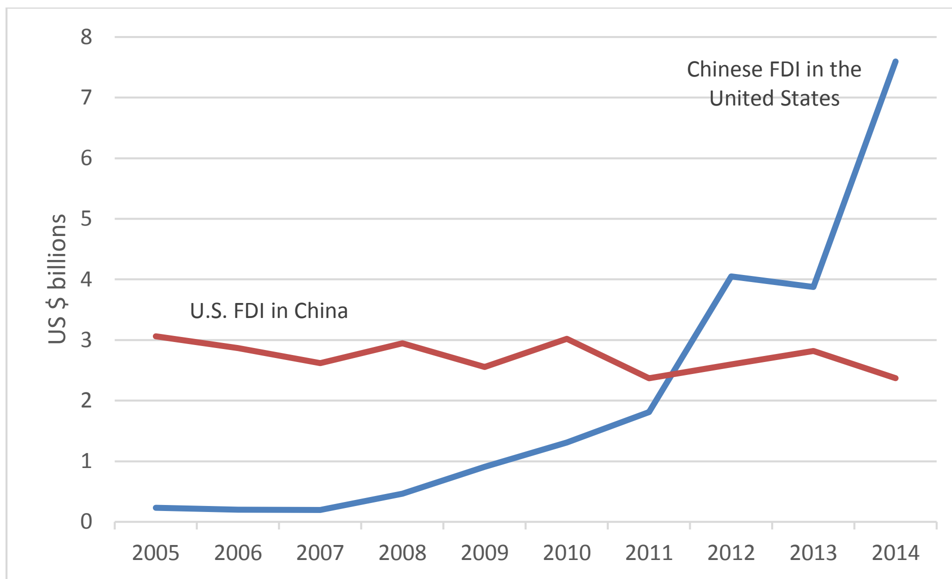
* BEA has two reporting methods for tracking FDI: The standard method, which attributes each investment to the direct purchaser of record, and the "country of ultimate beneficial owner" (UBO) method, which tracks the investment to the actual owner. The $10.2 billion figure is reported on the UBO basis. BEA, "Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data." *http://www.bea.gov/international/di1fdibal.htm*.

† By comparison, cumulative FDI in the United States from top investors is in the hundreds of billions. In 2014, the stock of UK FDI in the United States stood at nearly $450 billion, Japanese FDI at $373 billion, and Canadian FDI at $261 billion. China does rank fairly well among developing countries. For example, in 2014, the stock of Brazilian FDI in the United States was $616 million, and Indian FDI $7.8 billion. Organization for International Investment, "Foreign Direct Investment in the United States," February 19, 2016. *http://ofii.org/resources/fdius-2016-report*.

past five years.[7] In contrast, growth in U.S. FDI in China over the last five years appears to have slowed and even decreased (see Figure 2).

Figure 2: Chinese FDI Flows to and from the United States, 2005–2014



Source: MOFCOM.

The end of 2015 and first few months of 2016 saw an unusually high volume of Chinese bids for U.S. assets. Examples of such deals include China National Chemical Corporation's (ChemChina) $44 billion bid for Syngenta, a Swiss agrochemical company with U.S. assets; Anbang Insurance's withdrawn $14 billion bid for Starwood Hotels; the sale of technology distributor Ingram Micro to Tianjin Tianhai, a Chinese shipping group, for $6 billion; Zoomlion's $3.4 billion bid for U.S. crane maker Terex; property developer Dalian Wanda's $3.5 billion purchase of film production company Legendary Entertainment; and the purchase by Haier, an appliance maker, of General Electric's white goods business for $5.4 billion.[8] The Rhodium Group estimates $30 billion worth of deals announced or pending in the first quarter of 2016 alone.[9] The focus on technology and consumer brands reflects a shift in China's domestic economic strategy as it seeks to rebalance its economy from low-cost manufacturing toward high-tech industries and services. Thilo Hanemann, economist at Rhodium Group said of this development, "They're [China] scrambling to upgrade their technology, they're scrambling to build household brands quickly."[10] Chinese companies are also engaged in brand acquisitions as a way of advancing sales of their products on world markets to consumers who already have confidence in those international brands.

Despite this sustained upward trajectory, the bilateral flow of FDI remains relatively small as a share of the two countries' global FDI inflows and outflows. According to official data, China comprised about 2.5 percent of total FDI flows into the United States in 2014, commensurate with the 2 percent U.S. share of FDI flows into China.[11] Hoping to expand the bilateral investment opportunities, in 2008, the United States and China began negotiating a BIT. The negotiations did not start in earnest until November 2009, when President Barack Obama issued a joint statement with then president Hu Jintao announcing plans to expedite these negotiations.[12] Since then, progress has been in fits and starts, although negotiations appear to have intensified in recent years. As of June 2016, the two sides held 24 rounds of negotiations and exchanged negative lists[*] three times.

For the U.S. government, an enforceable, high-standard,[†] comprehensive BIT with China is an opportunity to expand market access for U.S. firms and address numerous concerns about Chinese policies that disadvantage U.S.

[*] In a BIT context, the negative list includes those sectors where foreign investment will be restricted; all other sectors will be open.

[†] According to the Office of the U.S. Trade Representative (USTR), a high-standard BIT based on the U.S. model provides investors with "improved market access; protection from discriminatory, expropriatory, or otherwise harmful government treatment; and a mechanism to pursue binding international arbitration for breaches of the treaty"; in addition, a high-standard BIT "improves investment climates,

investment, in particular favorable treatment of Chinese domestic firms at the expense of foreign firms (including subsidization of domestic competitors, foreign investment restrictions, unequal and sometimes targeted law enforcement and implementation, weak enforcement of intellectual property (IP) rights, and lack of transparency).[*] U.S. Trade Representative Michael Froman said in a 2015 speech that the U.S.-China BIT negotiations "offer a major opportunity to engage on China's domestic economic reforms and to pursue greater market access, a more level playing field, and a substantially improved investment environment for U.S. firms in China."[13]

Chinese objectives for the BIT are harder to pin down, since China's government has never formally articulated its goals. On the surface, statements from high-ranking officials point to a generic interest in expanding bilateral investment. For example, in the March 2016 Report on the Work of the Government (presented during the rollout of the 13th Five-Year Plan), Chinese Premier Li Keqiang emphasized increased overseas investment as one of government's priorities, stressing in particular that China will work "to make progress in negotiations on investment agreements between China and the United States."[14] A deeper examination of China's objectives highlights additional priorities. The Chinese government perceives the U.S. FDI review mechanism, the Committee on Foreign Investment in the United States (CFIUS), as unfair to Chinese investment, and would like to secure stronger guarantees of fair treatment.[15] The complaint is rooted more in rhetoric than fact—with the exception of a few failed deals, Chinese firms have been extremely successful in investing in the United States even without an investment treaty. In particular, China hopes to secure more protections for its state-owned enterprises (SOEs), which to date have been the biggest investors in the United States and globally (these issues are discussed in greater depth in Part III of this report). Similarly, a U.S.-China BIT may enhance the ability of Chinese companies to acquire U.S. technology and IP or to facilitate exports of U.S. advanced technology to China.[16]

Congress has important legislative and oversight responsibilities for U.S. investment policies: as treaties, U.S. BITs require approval by a two-thirds majority of the Senate in order to be ratified.[17] The goal of this report, therefore, is to provide Members of Congress and other policymakers with an assessment of important issues relevant for consideration of a U.S.-China BIT. The rest of this report is laid out as follows: Part II considers U.S. and Chinese BIT practices, with a particular focus on China's investment treaty with Canada, which provides a useful case study. Part III examines key elements in a prospective U.S.-China BIT, and highlights major areas of controversy. Part IV concludes with a section analyzing issues of relevance for policymakers as they consider the costs and benefits of a prospective U.S.-China BIT.

II. Models for the U.S.-China BIT

Typically, a BIT consists of three parts: (1) provisions defining the scope of the treaty, (2) substantive protections and standards of treatment for foreign investors, and (3) dispute settlement provisions.[18] Often, these protections and the enforcement mechanisms in place to secure them are otherwise unavailable under customary international law.[19] Modern, liberal BITs typically offer the following protections, with individual parties making adjustments to suit their needs:

- *Most favored nation (MFN) treatment:* An MFN[†] clause aims to ensure the host country provides a foreign investor with treatment that is at least as favorable as the treatment provided to other foreign investors under other treaties. MFN clauses are typically general in their wording to allow room for competing interpretations, and sometimes contain specific exceptions.[20] U.S. BITs offer MFN treatment for the full life cycle of the investment (from establishment or acquisition through its management, operation, and expansion, to its disposition).[21] As a result of the increasingly high number of BITs signed—BITs totaled

promotes market-based economic reform, and strengthens the rule of law." Office of the U.S. Trade Representative, *United States Concludes Review of Model Bilateral Investment Treaty*, April 2012. *http://1.usa.gov/299xWZ2*.

[*] For an in-depth assessment of the challenges facing foreign companies doing business in China, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 2, "Foreign Investment Climate in China," in *2015 Annual Report to Congress*, November 15, 2015. *http://1.usa.gov/1Jcwf3h*.

[†] Unless noted otherwise, this paper refers to MFN provisions and relevant treatment in the context of international investment rather than trade. The two concepts are distinct but generally demand that partners not discriminate. In the trade context, MFN means that any special treatment granted by a country to one member of the trade agreement (e.g., under the WTO) must be granted to all members of this trade agreement. In the United States, the "MFN" designation in the trade-related context was changed to "permanent normal trade relations" (PNTR) in 1998. World Trade Organization, "Principles of the Trading System." *http://bit.ly/1PfMaTR*.

2,924 in 2016, an increase of 71 percent since 2000[22]—MFN clauses have become a significant instrument of economic liberalization.[23]

- *National treatment:* The goal of a national treatment clause is to ensure the host country provides a foreign investor with treatment that is at least as favorable as the treatment provided to its own nationals. National treatment clauses aim to prevent discrimination against foreign investors in favor of domestic entities.[24]
- *Limits on expropriation:* Most BITs award compensation to foreign investors if the host government directly or indirectly takes an asset from the investor.
- *Fair and equitable treatment:* Host states must afford foreign investors a basic standard of treatment. Illegal, unreasonable, or arbitrary governmental measures directed at a foreign investor usually are prohibited under this standard.
- *Currency transfer and convertibility:* Nearly all BITs allow for the transfer of investment-related funds without delay into and out of the investor's home country using a market rate of exchange.[25]
- *Investor-state dispute settlement (ISDS):* ISDS provisions allow foreign investors to bring a claim directly against the host state for breaching the terms of an agreement.

U.S. BITs

The United States has fewer BITs than other leading economies. According to the U.S. Department of State, the United States has signed BITs with 49 countries, most recently with Uruguay and Rwanda in 2005 and 2008, respectively (see Appendix 1). Of those 49 treaties, 41 are currently in force.[*] If concluded, the U.S.-China BIT will be only the third U.S. investment agreement signed with a major capital exporting country (after Canada and South Korea).[26] The United States also maintains active free trade agreements (FTAs) with 20 countries.[†] All U.S. FTAs—excluding those with Bahrain and Jordan, with which the United States previously concluded BITs—include investment protection chapters.[27]

U.S. BITs and most other BITs concluded by members of the Organisation for Economic Co-Operation and Development (OECD) provide a broad range of substantive protections for foreign investors, including an expansive definition of "investment" and "investor," national treatment, MFN treatment, fair and equitable treatment, restrictions on performance requirements, free transfer and convertibility of profits and proceeds from sales of assets, flexibility with regard to nationality of management, and protection against both direct and indirect expropriation, among others.[28]

Treatment of investor-state dispute resolution in recent U.S. BIT practice has been shaped by experience with arbitration under the North American Free Trade Agreement (NAFTA), the first U.S. trade agreement to include both an investment chapter and ISDS provisions.[‡] U.S. policymakers have become more cautious about making broad investment rights enforceable through investor-state arbitration due to the high volume and cost of arbitration against NAFTA signatories. As of January 2015, of the 77 known NAFTA ISDS claims, 35 were filed against Canada, 22 against Mexico, and 20 against the United States.[29] Although the United States has yet to lose a NAFTA dispute case, all three governments have incurred tens of millions of dollars in expenses defending themselves against investor claims.[30] Canada has been the target of over 70 percent of all NAFTA claims since 2005, and has already paid damages in excess of $172 million.[31] As a result of the surge in ISDS claims under NAFTA, the most recent U.S. BITs are somewhat more "government-friendly," with narrower criteria for bringing investor claims in some instances, and less "investor-friendly" than many of those BITs concluded by other major capital exporting

[*] For a list of treaties not in force, as well as reasons for their pending status, see U.S. Department of State, "United States Bilateral Investment Treaties." *http://www.state.gov/e/eb/ifd/bit/117402.htm*.

[†] The United States has FTAs with Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore. Office of the U.S. Trade Representative, *Free Trade Agreements*. *https://ustr.gov/trade-agreements/free-trade-agreements*.

[‡] As of 2014, the United States has won all 15 disputes brought against it in the last 30 years under BIT dispute settlement provisions. US-China Business Council, "Bilateral Investment Treaties: What They Are and Why They Matter," June 2014, 2. *http://bit.ly/294xokO*.

countries, according to David Gantz, law professor and director of the international trade program at the University of Arizona College of Law.[32]

2012 U.S. Model BIT

The United States negotiates BITs on the basis of a model text.[33] The early versions of the U.S. Model BIT derived from several sources, including U.S. Treaties of Friendship, Commerce, and Navigation (predecessor to the BIT), BITs negotiated by various European states with less developed countries, and later, U.S. FTA investment chapters.[34] In 2009, the Obama Administration initiated a review of the 2004 U.S. Model BIT "to improve protections for American firms, promote transparency, and strengthen the protection of labor rights and the environment," and after an extended consultation period, produced a revised text in 2012.[35]

The 2012 U.S. Model BIT serves as the starting point for the United States' BIT negotiations with China, and includes innovations that do not exist in any other current U.S. BITs. The revised text features the following changes relevant to U.S.-China BIT negotiations:

- *SOEs:* The actions of SOEs and other entities acting under delegated governmental authority are fully obligated to adhere to the BIT unless specifically excluded. The 2012 U.S. Model BIT clarifies that "delegated governmental authority" includes "a legislative grant, and a government order, directive, or other action transferring to the state enterprise or other person, or authorizing the exercise by the state enterprise or other person of, governmental authority."[36]
- *Performance requirements:* Article 8 of the 2012 U.S. Model BIT bans requirements "to transfer a particular technology, a production process, or other proprietary knowledge to a person in the other's territory," and prohibits a party from requiring investors to "purchase, use, or accord a preference to, in its territory," domestically developed technology to provide an advantage to a party's own investors, investments, or technology.[37]
- *Transparency:* Article 11 of the 2012 U.S. Model BIT requires parties to confer periodically to review their transparency practices with regard to legal and regulatory enforcement and ISDS procedures.[38] In addition, Article 29 of the 2012 U.S. Model BIT requires "transparency of arbitral proceedings"—that is, parties must disclose all documents[*] related to arbitration.[39]
- *Environmental and labor provisions:* The 2012 U.S. Model BIT expands upon environmental and labor standards included in other U.S. BITs.[40] In encouraging the establishment, expansion, or retention of investment in their respective territories, parties must not "waive or derogate" from domestic environmental or labor laws, though this obligation is weakened in that it is conditioned on each party's "right to exercise discretion … with respect to other environmental [and labor] matters determined to have higher priorities."[41]
- *Standards:* Article 11 of the 2012 Model BIT requires parties to allow investors from the other party to participate in the development of standards and technical regulations on terms "no less favorable" than those accorded to their own investors.[42]
- *ISDS:* The 2012 U.S. Model BIT introduces the possibility of establishing a future multilateral appellate mechanism to review awards rendered by investment arbitration tribunals.[43] Moreover, it includes provisions on transparency and public participation comparable to those provided for in existing U.S. ISDS provisions if the aforementioned multilateral appellate mechanism is established in future.[44]

[*] The documents specified in the 2012 Model BIT include the notice of intent; the notice of arbitration; readings, memorials, and briefs submitted to the tribunal by a disputing party; minutes or transcripts of hearings of the tribunal; and orders, awards, or decisions of the tribunal. This article does not require a respondent to disclose or allow access to information it may withhold under articles governing essential security and disclosure of information.

China’s BITs

Overall, China’s BITs contain all the standard provisions found in international BIT practice.[45] Globally, China is second only to Germany in the number of BITs signed. China has concluded 130 BITs*—108 of which are in force—as well as 17 other international investment agreements† (see Appendix 2).

As shown in Table 1, China’s international investment agreement practice has evolved significantly since its first BIT with Sweden in 1982.[46] Due to China’s status as a capital importer (i.e., more focused on investment promotion than investor protection) in the 1980s, China’s early BITs were basic, providing for standard protections like fair and equitable treatment, MFN treatment, restrictions on expropriation, and capital convertibility, but neglecting ISDS and national treatment provisions.[47] China’s reluctance to include liberal national treatment and investor-state arbitration provisions in its early BITs likely stemmed from its preference to retain its sovereignty to screen and regulate FDI and from its development model, which depended heavily on discrimination against foreign investors in favor of domestic industries and companies.[48]

Table 1: Evolution of China’s International Investment Agreement Practice

Phase	Period	Primary Partners	Approach	Approach Characteristics
First	1980s	Western European capital exporters	Restrictive	• Modelled on the European BIT approach • No, or restricted, national treatment • ISDS only concerning the amount of compensation for expropriation
Second	1990–1998	Poor, developing countries		
Third	1998–2008	Poor, developing countries	Legalized	• Modelled on the European BIT approach • National treatment subject to national law • Full ISDS
		Capital-exporting countries		• Modelled on the European BIT approach • National treatment subject to nonconforming measures • Full ISDS
Fourth	2008–ongoing	All types; not divergent by partner country	Incoherent	• Modelled (partly) on the NAFTA approach • Fair and equitable treatment in accordance with customary international law • MFN and national treatment “in like circumstances” • MFN treatment not extended to ISDS • Pre-establishment, MFN treatment • Free transfer of funds except in the case of financial crisis

Source: Axel Berger, “Investment Rules in Chinese Preferential Trade and Investment Agreements,” *German Development Institute*, July 2013, 7. *https://www.die-gdi.de/uploads/media/DP_7.2013.pdf*; Axel Berger, “Hesitant Embrace: China’s Recent Approach to International Investment Rule-Making,” *Journal of World Investment & Trade* 5-6 Special Issue (2015): 843–868.

As China gradually shifted from an FDI-importing economy to an FDI-exporting economy starting in the 1990s, it began to negotiate BITs that are more liberal in pursuance of stronger legal protections for its own foreign investments.[49] For example, in its watershed 1998 BIT with Barbados, China agreed to give foreign investors unrestricted access to international arbitration for investor-state disputes, a measure adopted in almost all of its subsequent BITs.[50] Of note, most of China’s BITs that included comprehensive ISDS provisions during this phase were signed with developing countries—the main destination for Chinese outbound investment at that time.[51]

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* Stated number of BITs and other international investment agreements does not include treaties that have been denounced, terminated by mutual consent, or renegotiated.

† “Other international investment agreements” includes various types of investment treaties that are not BITs. Three main types of other international investment agreements can be distinguished: (1) broad economic treaties that include obligations commonly found in BITs (e.g., an FTA with an investment chapter); (2) treaties with limited investment-related provisions (e.g., only those concerning establishment of investments or free transfer of investment-related funds); and (3) treaties that only contain “framework” clauses, such as the ones on cooperation in the area of investment and/or for a mandate for future negotiations on investment issues. UN Conference on Trade and Development, “International Investment Agreements Navigator.” *http://bit.ly/29cP28y*.

From 2000 to 2008, China increasingly included qualified national treatment provisions designed to be minimally effective in its BITs with capital-importing, developing countries, according to Axel Berger, political scientist at the German Development Institute.[52] In these BITs, national treatment was conditioned on the host country's laws and regulations, marking a less stringent national treatment provision effectively reduced to a best-effort clause.[53] Mr. Berger argues the legal reservation to grant national treatment "without prejudice to its laws and regulations" limits the effectiveness of the national treatment clause in China's BITs with developing countries through the following treaty operations:

- First, BITs with this reservation only provide for national treatment if the host countries' laws and regulations already grant national treatment. Most of China's developing partner countries during this period have already granted national treatment to foreign investors in BITs with OECD countries.[54]
- Second, through the "free rider" phenomenon (also known as the "multiplier effect"), a country can—through the operation of the MFN clause—obtain the benefits of any commitments made by its treaty partner to third countries without offering strong commitments in exchange.[55] Because every Chinese BIT includes an MFN clause, national treatment will be awarded to Chinese outbound FDI by default; however, because China has never offered pre-establishment national treatment in its BITs, it effectively does not have to offer reciprocal national treatment to inbound foreign investment.[56]

In its BITs with developed countries during this phase, China's national treatment provisions were stronger than those in its BITs with developing countries primarily because the agreements included a commitment from China to gradually remove the "nonconforming measures" (i.e., China's treatment of foreign investors that is incompatible with national treatment), thereby allowing its laws and regulations that promote discriminatory treatment of foreign investors to remain in effect.[57]

Mr. Berger characterizes China's investment agreement strategy since 2008 as "incoherent," referring to China's adoption of a flexible negotiation strategy.[58] Among China's 17 investment agreements—including 13 BITs—signed since 2008, some adopt an early Chinese approach modeled on European BIT practice (i.e., providing investment protection in the post-establishment phase only and incorporating vague and open-ended treaty language), while others adopt a NAFTA-like approach.[*] [59] Those that adopt the European approach tend to diverge by partner country—post-2008 BITs with developing country partners (e.g., Mali and Libya) resemble earlier developing country partner BITs, and those with developed partners (e.g., Switzerland and Malta) resemble earlier iterations of BITs with developed country partners.[60] China's post-2008 BITs (e.g., New Zealand, Peru, the Association of Southeast Asian Nations [ASEAN], Canada, and Tanzania) that take a NAFTA-like approach, however, incorporate balanced provisions with developing and developed countries alike.[61] This is a result, argues Mr. Berger, of China's tendency to negotiate on the basis of partner model texts except where partner countries do not present their own model texts, in which case China uses its own more traditional model.[62]

Despite its overall adherence to international BIT practice, China has not yet achieved the high-standard BIT U.S. negotiators aspire to conclude. To date, China has limited its provision of national treatment in international investment agreements to the post-establishment phase of investment, with carve-outs for existing nonconforming measures.[63] In addition to falling short of U.S. standards in handling national treatment for the pre-establishment phase of investment, China's BITs feature less stringent measures relating to labor, environment, transparency, and SOEs.[64]

2012 Canada-China Foreign Investment Protection Agreement

In contrast to U.S. practice, China does not use its own model text as a basis for negotiations, but rather tends to negotiate based on partner countries' model texts, as was the case with the 2012 Canada-China Foreign Investment Protection Agreement (FIPA, the Canadian term for a BIT).[65] The Canada-China FIPA is the most relevant of China's BITs for assessing a U.S.-China BIT for several reasons: First, the United States and Canada share similar legal systems and experience as respondents under NAFTA Chapter 11, which governs investment provisions including national treatment, MFN treatment, performance requirements, and ISDS, among others.[66] Second,

[*] China's shift toward a NAFTA-like BIT practice is characterized as more "government-friendly" and less "investor-friendly," mimicking the approach of NAFTA countries who took this approach in response to costs associated with an increasing number of ISDS cases.

Canada's Model FIPA closely resembles the 2004 U.S. Model BIT, and like the United States, Canada strives for high-standard investment agreements.[67] Third, like the United States in its BIT negotiations with China, Canada sought primarily to increase its foreign investor protections and expand market access in China through the FIPA.[68]

While much of the Canada-China FIPA is in line with international practice, it is remarkable for its nonreciprocal elements.[69] Several noteworthy departures from Canada's usual FIPA practice include:

- *National treatment:* Under the Canada-China FIPA, national treatment applies to the "expansion, management, conduct, operation, and sale or other disposition" phases of investment, but not the pre-establishment phase.[70] Moreover, "expansion" of investments to receive national treatment is limited to "sectors not subject to a prior approval process under the relevant sectoral guidelines and applicable laws, regulations, and rules in force at the time of expansion."[71] These carve-outs mean existing discriminatory measures faced by Canadian investors will remain in place, even after China grants Canadian investors market access.[72]
- *Transparency:* The Canada-China FIPA stipulates that ISDS arbitration tribunals are only required to publish their ultimate decisions, while the party defending a claim will have the unilateral power to make arbitration documents available to the public if deemed by that party to be in the public interest.[73]
- *MFN treatment:* MFN treatment in the Canada-China FIPA requires both parties to offer each other's investors no less favorable treatment than investors from third countries.[74] However, Canada has given market access to foreign investors through pre-establishment national treatment clauses in other FIPAs, while China has not. As a result, through the extension of national treatment at the pre-establishment phase in other FIPAs and the granting of MFN treatment to China, Chinese investors automatically get the right to market access in Canada, while China—having never granted market access rights to foreign investors at the pre-establishment phase—does not have to reciprocate.[75] Moreover, the China-Canada FIPA stipulates that MFN treatment "does not encompass the dispute resolution mechanisms."[76] As a result, under the FIPA, Canadian investors cannot pursue MFN treatment violation claims through ISDS procedures.
- *Performance requirements:* Restrictions on performance requirements are limited to those in the WTO Agreement on Trade-Related Investment Measures (TRIMs), a departure from Canada's Model FIPA and all of Canada's FIPAs and trade agreements, which prohibit performance requirements.[77]
- *SOEs:* The Canada-China FIPA obligations apply to "any entity," including SOEs. Elsewhere, however, the FIPA affords SOEs a "significant exemption" from minimum standard of treatment, MFN, and senior management obligations, according to Professor Gantz.[78] In practice, SOEs and governmental entities are exempt from any measures adopted after the FIPA that impose limitations on state control, management, or nationality of Chinese firms.[79]
- *Expropriation:* The Canada-China FIPA expropriation clauses apply to indirect as well as direct expropriation, a stronger commitment than China has made in past BITs.
- *FDI screening:* While the Canada-China FIPA gives each party a carve-out to block investments by the other's investors on a case-by-case basis, the carve-out for China is broader than that for Canada. The FIPA allows the Canadian federal government to screen Chinese investments only in accordance with the Investment Canada Act, limiting investments that can be blocked to those involving the takeover of a Canadian business valued at more than approximately $247 million, or those constituting national security threats.[*] [80] China, on the other hand, retains the right to review FDI under any of its "laws, regulations and rules relating to the regulation of foreign investment," giving China more flexibility to block Canadian investments.[81] While only Canada's federal government can block a Chinese takeover of a Canadian company under the FIPA, any level of government in China—central, provincial, municipal, or local—can block a Canadian investment.[82] Moreover, investment screening decisions cannot be pursued in ISDS.[83]

[*] Under the Investment Canada Act, Canada's federal government can block foreign investments involving the takeover of a Canadian company, but not an investment involving the startup of a new business, known as a greenfield investment. Expansion of an existing Chinese company in Canada also does not fall under the scope of the Act. Gus Van Harten, *Sold down the Yangtze: Canada's Lopsided Investment Deal with China*, James Lorimer & Company, August 2015, 44–47.

In addition to these departures from Canada's usual treaty practice, its FIPA with China is unusual in that it has the longest lock-in period of all Canada's FIPAs (as with the Egypt FIPA).[84] Most of Canada's FIPAs have no minimum term and allow for termination of the FIPA on one year's notice with a 15-year survival clause for existing foreign investments, creating a 16-year minimum lifespan. In contrast, the Canada-China FIPA has a minimum term of 15 years, including a 15-year survival clause for existing investments with one year's notice of termination, creating a 31-year minimum lifespan—double that of most FIPAs.[85]

In Canada, the FIPA with China received heavy criticism from sources in the government and the public, so much so that Canada took more than two years after signing to ratify the agreement. The Canada-China FIPA's departures from international practice—which, according to some critics, amount to the Canadian government "selling out" to Chinese corporations[86]—are problematic for several reasons. First, the FIPA does not adequately protect Canadian investors in China from discrimination.[87] The failure to cover national treatment in the pre-establishment and establishment phases of investment in China is particularly troublesome given that Canada grants market access to Chinese investors without any restrictions. (Importantly, under the MFN clause, pre-establishment treatment may be granted to Canadian investors at a future time if such protection is granted in the U.S.-China BIT or the China-European Union BIT.)[88] Second, failure to prohibit performance requirements puts Canadian investors at a "significant disadvantage" if China forces them to disclose their technology or use domestic inputs to invest.[89] Finally, in addition to the lack of reciprocity in market access for Canadian investors, ISDS mechanisms also lack reciprocity such that decisions on investments at the subnational level in China are exempt from arbitration, as are decisions on national security reviews of investments in China.[90]

III. Structural Components of a U.S.-China BIT

Pre-Establishment National Treatment

The breadth of national treatment coverage is expected to be one of the most challenging topics for U.S.-China BIT negotiations. Under pre-establishment national treatment, U.S. firms in China would enjoy market access equal to that afforded to Chinese firms—that is, all investments would be permitted except those explicitly excluded in a negative list. Investments identified in the negative list would be subject to administrative approval by the host country. Adopting the negative list approach to investment would mark a reversal of the current positive list framework governing foreign investment in China, under which regulators categorize sectors as either "encouraged," "restricted," or "prohibited" to foreign investors based on their strategic importance to the Chinese economy. The opaque, onerous, and sometimes overlapping laws and regulations supporting China's current approach to market access—and inconsistent enforcement thereof—have earned China the designation of most restrictive FDI regime,[*] according to the OECD's FDI Regulatory Restrictiveness Index.[91]

At the 2013 Strategic and Economic Dialogue (S&ED), China committed to negotiate a BIT with the United States that will provide "national treatment at all phases of investment," including the pre-establishment phase, with a negative list approach to prohibited or restricted sectors.[92] For U.S. officials, the key to negotiating pre-establishment national treatment provisions in a high-standard BIT with China lies in shortening the negative list to include only narrowly crafted exceptions in a few essential sectors.[93] China has never granted pre-establishment rights to investors in past BITs; indeed, in the Canada-China FIPA, China only committed to include an extensively qualified form of national treatment that does not cover the pre-establishment or expansion phases of an investment in unapproved sectors.[94]

Negative List Approach

For the United States, whittling down the number of sectors on the negative list—a determinant of market access under pre-establishment national treatment—is a key challenge for successful BIT negotiations. To date, the two

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[*] Among OECD economies and non-OECD member economies. The OECD FDI Regulatory Restrictiveness Index is based on four main indicators: "equity restrictions, screening and approval requirements, restrictions on foreign key personnel, and other operational restrictions (such as limits on purchase of land or on repatriation of profits and capital). The discriminatory nature of measures is the central criterion to decide whether a measure should be scored." Blanka Kalinova, Angel Palerm, and Stephen Thomsen, "OECD's FDI Restrictiveness Index: 2010 Update," *OECD Working Papers on International Investment* 03 (2010): 6. *http://bit.ly/292VgCK*.

sides exchanged negatives lists three times: first in June 2015, then in late September ahead of Chinese President and General Secretary of the Chinese Communist Party Xi Jinping's U.S. state visit, and again after the June 2016 S&ED. Although officials have not publicly discussed the contents of China's BIT negative list, Ambassador Froman said China's latest offer was a "serious effort," but "still a fair distance from being acceptable" to the United States.[95] A USTR spokesperson said, "China will need to demonstrate the substantial liberalization of its investment market, ensure that U.S. firms can compete on a level playing field, and address other key priorities to facilitate the progress and successful conclusion of a mutually beneficial and high standard BIT."[96] Myron Brilliant, international vice president of the U.S. Chamber of Commerce, told the *Wall Street Journal* the list should be narrowed down to a "few sectors on a single piece of paper."[97]

Some U.S. investors and industry groups expect China's BIT negative list to mirror the negative list in place in its pilot free trade zones (FTZs) located in Shanghai, Guangdong, Fujian, and Tianjin, which were established to test incremental economic reforms for expansion nationwide.[98] China first adopted a negative list approach for regulating foreign investment in the Shanghai FTZ in September 2013 amid high investor expectations, and has continued to whittle down the negative list incrementally. The list of restrictions and prohibitions, referred to as "special management measures," fell from 190 items in 2013 to 139 in July 2014, and finally to 122 across 50 sectors in April 2015.[*] [99]

Although the FTZ negative list has been shortened, "many industries and sectors [on the list] have been merely re-grouped" instead of removed, according to the European Chamber of Commerce in China.[100] For example, the 2015 negative list largely maintains foreign investment restrictions in sectors where Western firms hold a significant competitive advantage over Chinese firms, including production and publication of broadcasting and television programs and films, telecommunications, and banking and asset management.[101] In a joint submission to China's State Council, U.S. business groups wrote that the revisions reflect "a streamlining of the negative list with other national regulations guiding foreign investment rather than a significant liberalization of the investment environment."[102] Ambassador Froman warned, "A negative list that echoes the lists of the Shanghai Free Trade Zone … would be a major disappointment and a departure from China's stated ambition to use the BIT as a vehicle for economic reform and opening."[103]

Concurrent with BIT negotiations, Chinese authorities are testing the negative list approach through several distinct initiatives ahead of planned reforms of the foreign investment regime. On October 19, 2015, China's State Council announced its intention to explore a negative list system to be replicated nationwide in 2018[104] after piloting the approach in some regions between December 1, 2015 and December 31, 2017.[105] Pre-establishment national treatment toward foreign investment in unlisted sectors was also proposed in China's draft foreign investment law, published for public comment in January 2015.[106] Upon its enactment, the law would replace the three laws currently governing foreign investment in China with a unified set of regulations. It is unclear whether those lists under consideration for adoption nationwide will resemble China's BIT negative list.

National Security Review

China's National Security Review

During President Xi's U.S. state visit in September 2015, both he and President Obama committed to limit the scope of their respective national security reviews "solely to issues that constitute national security concerns," not to include "other broader public interest or economic issues."[107] Moreover, the two committed to apply "the same rules and standards under the law" regardless of country of origin in each investment reviewed, and to evaluate national security risks "as expeditiously as possible."[108] Seemingly in response to ongoing Chinese complaints that CFIUS unfairly blocks Chinese investment, the United States reaffirmed during President Xi's visit that it maintains an "open investment environment for Chinese investors, including state-owned enterprises."[109]

China's commitment to limit the scope of review appears to conflict with its existing national security review provisions, codified in the July 2015 National Security Law, which governs reviews only within China's four FTZs,

[*] For more information on China's FTZs, see U.S.-China Economic and Security Review Commission, *Monthly Analysis of U.S.-China Trade Data*, May 5, 2015. *http://1.usa.gov/1qpO2B6*.

and in a 2011 Circular that governs reviews conducted on investments outside the zones.[110] Guidance issued in the 2011 Circular allows regulators to consider national economic stability, social order, and research and development capacity for key technologies related to national security in reviews of proposed mergers and acquisitions (M&As).[111] Given that President Xi's commitment to limit the scope of review contradicts existing laws and practices in China that favor an expansive definition of national security, it is unclear whether this commitment will result in any meaningful change. Moreover, national security is a much broader concept in China that incorporates the economic and social well-being of its people as well as "traditional" national security concepts, which leaves the question of if and how these concepts would be handled in the national security review.

Under the FTZ review, a foreign investor must file notice with China's MOFCOM for certain kinds of investment, including investment into sensitive agricultural products, key natural resources and energy, strategic infrastructure, transport capabilities, technology and information technology (IT), and near military facilities.[112] During review, the National Development and Reform Commission (NDRC) and MOFCOM will take into consideration the following factors: (1) impact on national security, including China's capacity to provide essential goods and services to that end; (2) impact on the stability of the economy; (3) impact on basic social order; (4) impact on culture and social morality; (5) impact on Internet security; and (6) impact on sensitive technology for use in national defense.[113]

The draft foreign investment law expands the definition of a "foreign investor" to include instances where the person or entity with "actual control"[*] over the company making the investment is foreign, even if the company itself is domestic.[114] This shift in focus from foreign equity to foreign control will allow Chinese authorities to treat variable interest entities (VIEs), a prevalent investment structure for foreign investors in restricted sectors of China's economy, with increased scrutiny and administrative discretion.[115]

China introduced a formal national security review process for reviewing foreign investments in its draft foreign investment law, which was published in January 2015 for public comment and will abolish the three existing laws governing foreign investment in China. China's State Council put forth more specific provisions for the national security review in April 2015 when it announced foreign investments in sensitive areas will be subject to the new national security review.[116] When China's new foreign investment law is implemented—expected sometime after 2016—it will establish a nationwide, unified national security review mechanism for foreign investments, replacing the 2011 Circular.[117]

Because China's formal national security review procedures are only in the pilot phase in its FTZs and are still under consideration in the draft foreign investment law, the degree to which review mechanisms in the FTZ and foreign investment law will resemble China's BIT review is not clear. But in a jointly issued statement, three prominent business associations—the U.S. Chamber of Commerce, the American Chamber of Commerce (AmCham) in China, and AmCham in Shanghai—expressed their "deep concern" about the implications of China's "overly broad" definition of national security, which they describe as "heavily skewed in favor of protecting national interests that fall outside the widely accepted scope of essential national security concerns" and "likely to have a significant adverse impact on the flow of foreign investment into China."[118] Specifically, that China's national security definition includes economic security criteria "raises fundamental questions about whether future commitments by China to open its markets to foreign investment will produce the intended results," and further "may also be inconsistent with principles of non-discrimination, fairness, and openness that are embodied in a high-standard BIT," at the risk of undermining the ongoing BIT negotiations.[119]

[*] The draft law defines "control" as follows: (1) directly or indirectly holding 50 percent or more of the shares, equity, property shares, voting rights, or other similar rights and interests of an enterprise; (2) despite holding less than 50 percent of the shares, equity, property shares, voting rights, or other similar rights and interests of an enterprise, (a) being entitled to directly or indirectly appoint at least half of the members of the board or a similar decision-making body, (b) being able to ensure that its nominees obtain at least half of the seats on the board or a similar decision-making body, or (c) being able to exert a material impact on the resolutions of the shareholders' meetings or the directors' meetings; or (3) being able to exert a decisive influence on such matters as the operations, finance, personnel, and technology of an enterprise through contracts, trusts, or other means. Joseph W.K. Chan, Ling Chen, and Calamus Huang, "China Set to Overhaul Foreign Investment Law," *Sidley Austin LLP*, February 26, 2015. *http://www.sidley.com/news/02-26-2015-china-update*.

Chinese Perceptions of the Committee on Foreign Investment in the United States

For China, the biggest perceived obstacles to increased Chinese investment in the United States are political opposition and CFIUS review.[120] While then Chinese commerce minister Chen Deming estimated in 2013 that only one-third of intended Chinese investment in the United States is approved,[121] in reality only a small number of Chinese investments have not been approved under the CFIUS process. A U.S.-China BIT could provide much-needed clarity on the national security review for both parties.

CFIUS is an is an inter-agency committee authorized to review all "covered"[*] foreign investments to determine if an investment presents national security concerns, if a foreign government controls the foreign entity making the investment, or if the investment would result in control of critical infrastructure that could impair national security.[122] Notifications to CFIUS are voluntary, but foreign transactions not notified to CFIUS still fall within its purview and may be investigated and subject to divestment or other actions at any time.[123] "Greenfield," or start-up investment, is not covered, and therefore not reviewed by CFIUS.[124] In 2015, nearly 12 percent of Chinese investment in the United States was considered a greenfield investment, according to Rhodium Group.[125]

Under this system, a small number of Chinese investments have not been approved for national security reasons. China and its state-run media have portrayed these CFIUS decisions as discriminatory to Chinese firms, contributing to a "Chinese perception of operating at a disadvantage" when investing in the United States.[126] On the sidelines of China's National People's Congress in March 2013, Minister Chen expressed his hope that "CFIUS can be more open and transparent, because companies never know whether their bid meets the requirements or not."[127] Minister Chen said "clearer guidelines on what conditions might violate U.S. security" could help "reduce disappointment and the cost of failed bids."[128] In short, China's government has made it clear that the CFIUS process is a key point of concern in the bilateral investment relationship.

Yu Jiantuo, director of the China Development Research Foundation under the Development Research Center of the State Council, argues CFIUS's investigations are open to abuse because its definition of national security is too ambiguous and its decision-making process is opaque.[129] Chinese BIT negotiators are concerned that Chinese SOEs in particular are vulnerable to rejections.[130] With more mixed-ownership SOEs "going out" and investing abroad, Chinese negotiators will look to the BIT to provide a "clear and practical definition of SOEs" that would alleviate the perceived discrimination and signal to Chinese investors how to best avoid the review, according to Mr. Yu.[131] During the 2014 U.S.-China S&ED, the United States reiterated that its reviews are conducted "without regard to the investor's country of origin," and reaffirmed its commitment to "maintain an open investment environment for Chinese investors, including SOEs."[132]

Despite China's dissatisfaction with CFIUS's broad power, "a U.S.-China BIT is unlikely to change the CFIUS process because of the difficult political climate," according to a report from the Peterson Institute for International Economics.[133] However, the report argues, there is room to increase transparency by allowing greater disclosure of unclassified evidence, arguments, and allegations considered in deliberations to better aid Chinese firms in responding to CFIUS reviews and decisions.[134] For example, after CFIUS blocked an attempt by Ralls, a Chinese-owned company, to purchase wind farms near a naval base in Oregon, the company successfully sued the U.S. government and President Obama to acquire unclassified but withheld evidence that motivated CFIUS to block the investment.[135] The U.S. Court of Appeals ruled that "the Presidential Order deprived Ralls of its constitutionally protected property interests without due process of law" by not providing access to the unclassified evidence on which the decision was made.[136] The court ordered the government to disclose to Ralls information that led President Obama to block the transaction, after which CFIUS would issue a revised assessment of the investment. However, the U.S. government and Ralls reached a settlement in October 2015, which made the disclosure and subsequent reassessment unnecessary; the details of the settlement have not been publicly shared.[137]

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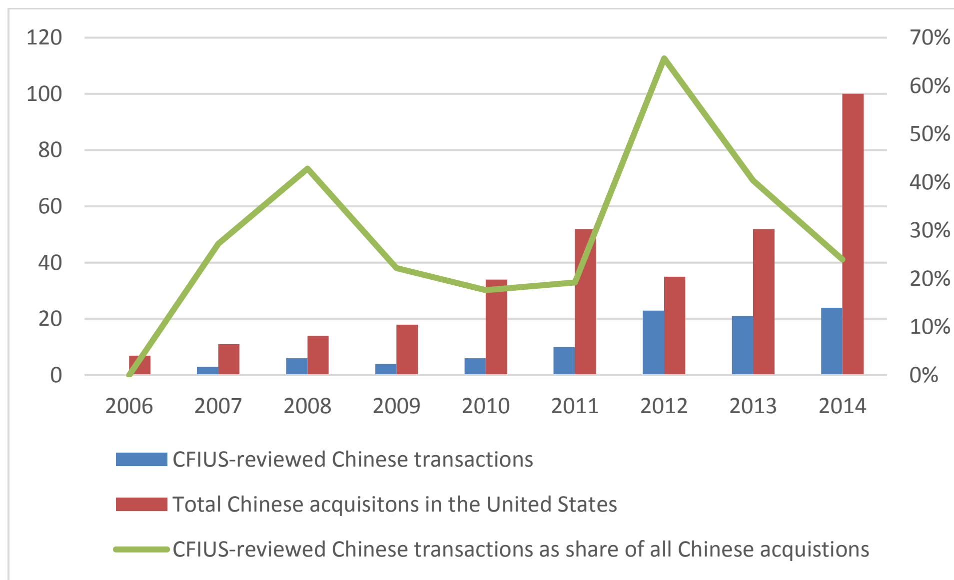
[*] A covered foreign investment transaction is defined as any merger, acquisition, or takeover that results in "foreign control of any person engaged in interstate commerce in the United States." Control is defined by the U.S. Department of the Treasury as "the power, direct or indirect, whether or not exercised, and whether or not exercised or exercisable through the ownership of a majority or a dominant minority of the total outstanding voting securities of an issuer, or by proxy voting, contractual arrangements or other means, to determine, direct or decide matters affecting an entity." James K. Jackson, "The Committee on Foreign Investments in the United States (CFIUS)," *Congressional Research Service*, March 6, 2014, 13–15. *https://www.fas.org/sgp/crs/natsec/RL33388.pdf*.

CFIUS Reviews of Chinese Investment

According to the CFIUS 2014 Annual Report to Congress, issued in February 2016, China accounted for the largest number of cases reviewed from 2012 to 2014, with 68 of the 358 reviewed transactions, followed by the United Kingdom with 45, Canada with 40, and Japan with 37.[138] Though the number of Chinese transactions under CFIUS review has grown in absolute terms, it has actually decreased as a share of all Chinese acquisitions. For example, in 2014, the latest year for which data are available, CFIUS reviewed 24 Chinese transactions—the most to date (Figure 3).[139] However, as reported by Rhodium Group's China Investment Monitor, 2014 also saw at least 100 Chinese mergers and acquisitions in the United States—almost double the number in 2013.[140] As a ratio of total Chinese acquisition deals, the number of CFIUS-reviewed Chinese transactions has decreased every year since 2012.[141]

Figure 3: Chinese CFIUS-Reviewed Transactions and Total Chinese Acquisitions in the United States, 2006–2014



Source: Thilo Hanemann and Daniel Rosen, "Don't Misread Old Tealeaves: Chinese Investment and CFIUS," *Rhodium Group*, February 24, 2016. *http://rhg.com/notes/dont-misread-old-tealeaves-chinese-investment-and-cfius*.

Alternatively, Chinese investors displeased with a CFIUS ruling could use ISDS mechanisms and MFN or national treatment clauses in a U.S.-China BIT to claim before an international tribunal that an SOE's investment was discriminatorily blocked.[142] A tribunal could override a U.S. ruling on the national security threat of a given Chinese investor, although the national security exemption clause appears broad enough to allow U.S. regulators sufficient bandwidth to protect its essential security interests.[143] U.S. government officials have not publicly commented on the possibility of amending the CFIUS review process in response to BIT negotiations.

Performance Requirements

When China joined the WTO in 2001, it committed to cease the enforcement of trade and foreign exchange balancing requirements, local content and export performance offsets, and technology transfer requirements under its TRIMs obligations.[*] [144] China also committed to enforce only those technology transfer rules that do not violate WTO standards on IP and TRIMs.[145] In response to complaints from WTO members, China has revised a number

[*] The TRIMs agreement "prohibits investment measures that violate GATT [General Agreement on Tariffs and Trade] Article III obligations to treat imports no less favorably than domestic products or the GATT Article XI obligation not to impose quantitative restrictions on imports." Office of the U.S. Trade Representative, *2014 USTR Report to Congress on China's WTO Compliance*, December 2014, 87. *https://ustr.gov/sites/default/files/2014-Report-to-Congress-Final.pdf*.

of investment measures to eliminate explicit requirements relating to export performance, local content, foreign exchange balancing, and technology transfer, but some of the revised measures continue to encourage such practices without formally requiring them, particularly at the local, municipal, and provincial levels.[146] For example, although China lowered tariffs on the import of whole automobiles upon WTO accession, it penalized manufacturers for using imported auto parts in the manufacture of vehicles for sale in China—in violation of TRIMs.[147] After a WTO panel in 2008 ruled in favor of the complaining parties, China repealed its discriminatory rules on automobile parts in 2009.[148]

As described earlier, the 2012 U.S. Model BIT bans requiring foreign investors to adhere to performance requirements like technology transfer and other localization requirements designed to benefit local suppliers. U.S. negotiators may insist on ISDS procedures to handle violations of the ban on performance requirements. For the U.S. investors, however, the main question is whether any provisions regarding performance requirements would be enforceable, or at least more enforceable, under international tribunals than under the WTO. This is a nontrivial concern, since despite its WTO commitments, China continues to make technology transfers, local content requirements, and other performance requirements factors in granting foreign companies access—though on an informal rather than de jure basis.[149] Chinese officials often pressure foreign companies to "voluntarily" transfer technology in return for gaining approval for investment or support of specific projects. For example, AmCham China noted in a 2015 paper on the investment environment in China that "companies continue to report both direct and indirect requests for technology transfers as a requirement for their investment approvals."[150] AmCham's 2015 White Paper went into greater detail:

> *The relatively opaque nature of inbound FDI approval procedures enables China's investment approval authorities to favor domestic competitors over foreign investors, should they so desire, without leaving a paper trail of discriminatory written regulations that could clearly breach China's WTO obligations or otherwise violate the principle of "national treatment." Vaguely worded or unpublished rules or requirements are often applied in ways that impede foreign participation in a given sector without expressly stating this goal in writing. ... The relative opacity of the approval process and the broad discretion granted to the authorities foster an environment where government authorities can impose deal-specific conditions beyond any written legal requirements, often with the intent to force technology transfer as a condition of market access or support industrial policies and the interests of local competitors.*[151]

Resolving the problem of such informal or unofficial performance requirements would require an enforceable commitment from the Chinese government not only to outlaw them, but also to create an investment environment where U.S. and other foreign companies subjected to such requirements could bring legal cases against Chinese authorities without fear of retaliation—something that appears far beyond the scope of a BIT.

State-Owned Enterprises

The Chinese government has a number of preferential policies designed to favor domestic companies—especially, but not exclusively, SOEs—with the aim of developing national champions and protecting them from international competition.[152] This is particularly true in industries designated by the government as strategic (examples include aerospace, clean energy, and biotechnology[*]) and selected for special promotion through subsidization or other concessions. Although the number of SOEs has been steadily declining, many have been strengthened through consolidation, and continue to maintain monopolistic control over certain industries (including oil, telecommunications, and railways), which grants them outsized influence over China's economy.[153] In 2015, there were approximately 150,000 SOEs in China: 112 are central SOEs directly under government control,[†] while the municipal or provincial governments own the rest.[154] Though most are small, some sub-central SOEs have global standing (examples include Lenovo, a technology company, Haier, a white goods manufacturer, and Goldwind, a wind turbine maker).

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[*] For a list of China's key industries, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 163. *http://1.usa.gov/1TAf2cF*.

[†] The Chinese central government fully owns 112 SOEs, but it also has over 277 majority-owned, large SOEs listed in the Shanghai and Shenzhen stock exchanges. Shu Zhuang and Matthew Miller, "China Plans Mergers to Cut Number of Big State Firms to 40–State Media," Reuters, April 27, 2015. *http://www.reuters.com/article/china-soe-idUSL4N0XO4FD20150427*.

In an effort to make its domestic enterprises more internationally competitive and allay international criticism over the slow pace of investment liberalization, the Chinese government simultaneously promotes (1) a "going out" strategy to encourage private and state-owned Chinese companies to invest abroad, and (2) an SOE reform plan to encourage a "mixed-ownership" model of SOE privatization.[155] The increase in Chinese state-owned and mixed-ownership enterprises "going out" reflects the shift in the Chinese government's BIT negotiating strategy from investment promotion to investment protection. In addition, many scholars attribute China's liberalization of ISDS mechanisms in its BITs to the increase in Chinese companies "going out."[*] [156]

As more Chinese SOEs invest abroad, the United States will seek to "ensure they compete on a commercial basis when they compete against private firms," according to Ambassador Froman.[157] To that end, it is currently the intention of U.S. negotiators that all obligations under the U.S.-China BIT would effectively apply to SOEs. For U.S. firms operating in China, the United States will lobby for an end to discrimination in favor of Chinese entities, be they SOEs or private companies. However, some experts assess "a prohibition of continuing government discrimination in favor of SOEs against foreign investors would be difficult for China to accept in view of the fact that they have not accepted the requirement in prior BITs."[158]

In contrast, China wants to secure a more transparent and politically stable operating environment for the increasing number of SOEs in the United States. For the Chinese government, the U.S. process for determining whether an SOE's acquisition of a U.S. company threatens national security is a main concern in negotiating the U.S.-China BIT; the process is widely perceived by Chinese officials and scholars as discriminatory against Chinese SOEs (see "National Security Review" earlier in the paper).[†] Through the operation of ISDS and MFN or national treatment clauses in a potential U.S.-China BIT based on the 2012 U.S. Model BIT, China could feasibly claim an SOE's investment was discriminatorily blocked directly before an international tribunal, potentially overriding a U.S. ruling on the national security threat of a given Chinese investor.[159]

The Chinese government's active role in promoting overseas investment, coupled with robust subsidization programs for state-owned or state-invested companies, raises the question of whether investment is undertaken with a nod to Chinese industrial policy goals, such as acquisition of valuable technology to enhance industries designated by the Chinese government as strategic, rather than motivated by pure economic interest.[‡] More worryingly, U.S. law does not comprehensively address potential unfair trade practices by a state-owned or -controlled enterprise. For example, if a Chinese company exported to the United States goods at a price below the cost of production or that have been subsidized, the United States could apply antidumping or countervailing duties. Such trade remedies, however, are only applied at the border and not to goods produced domestically.[160] This leaves open the possibility of a Chinese enterprise circumventing U.S. regulations by sourcing subsidized components for assembly in the United States or utilizing state-subsidized capital to fund its operations with no domestic recourse for the anticompetitive impact.

Competition Policy

In 2013 and 2014, China's Anti-Monopoly Law (AML) enforcement against high-profile foreign companies garnered international attention from industry, government, and media actors. According to the U.S. Chamber of Commerce, although Chinese authorities have used the AML to protect competition and prevent monopolistic conduct in line with international legal practices, "China has also employed [the AML] both domestically and extraterritorially to pursue objectives that have no place in a free, open, and fair market-based economy."[161] More than 80 percent of companies surveyed by the US-China Business Council (USCBC) in 2014 said they were

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[*] Other scholars argue that China began testing open access to international arbitration in its BITs with small developing countries starting in 1998 to prepare for future negotiations with developed countries that expected access to arbitration. Amos Irwin, "Crossing the Ocean by Feeling for BITs: Investor-State Arbitration in China's Bilateral Investment Treaty," *Boston University Global Economic Governance Initiative Working Paper*, May 2014, 19.

[†] Several examples are provided in David Dollar, "United States-China Two-Way Direct Investment: Opportunities and Challenges," *Brookings Institution*, January 2015, 15–16.

[‡] Economic and national security concerns related to Chinese investment in the United States are discussed in U.S.-China Economic and Security Review Commission, *2013 Annual Report to Congress*, November 2013, 98–103. *http://1.usa.gov/1PG12sj*.

concerned about China's competition enforcement activities.[162] The most prevalent criticisms related to China's AML enforcement include:

- Consideration of industrial policy and other noncompetition factors;
- Lack of transparency in publication of arbitration and penalty decisions;
- Lack of due process and pressure to admit guilt;
- Restricted access to foreign counsel;
- Application of the AML to gain access to foreign IP at lower-than-market rates;
- Discrepancies in enforcement between different regional/local/national offices; and
- Lack of appeals process.

Due to a lack of transparency, it is not possible to assess conclusively whether the Chinese government is targeting foreign companies in these campaigns; however, a sampling of case information covering 80 percent of China's AML enforcement undertakings indicates "either there is too much leniency granted to big [SOEs], or there is too rigorous enforcement for foreign brands," such that "the consequent penalties inflicted on similar circumstances [differ] substantially."[163] For example, all M&A transactions blocked or conditionally approved between 2008 and 2014 by China's MOFCOM under the AML have involved foreign companies.[164] Based on the aforementioned sampling of case information, 29 of 48 cases, or 60 percent, involved foreign companies.[165]

China's AML investigation and enforcement activities have slowed since the 2014 Asia-Pacific Economic Cooperation (APEC)[*] summit, partly in response to a stream of criticism from members of the business community and U.S. officials. In December 2014, for example, White House National Security Council Spokesman Patrick Ventrell said, "The United States government is concerned that China is using numerous mechanisms, including anti-monopoly law, to lower the value of foreign-owned patents and benefit Chinese firms employing foreign technology"; President Obama also raised this issue with President Xi when they met in Beijing in November 2014.[166]

The U.S. government continues to raise concerns about China's investment restrictions and discriminatory competition policies[†] at the highest levels, including in bilateral fora such as the Joint Commission on Commerce and Trade (JCCT) and the S&ED. Regarding China's AML enforcement, U.S. officials from the Federal Trade Commission and the Department of Justice have consistently engaged in consultation, training, and exchanges with Chinese antitrust officials. For example, at the 2014 JCCT, U.S. official engagement resulted in Chinese commitments of increased ability of counsel to attend meetings with the AML enforcement agencies, more transparent penalty procedures, and competition-based remedies.[167] China's commitments at the JCCT and S&ED, however, have not fundamentally allayed concerns about its competition policy enforcement.[168] (The status of China's compliance with these commitments is not known.)

Investor-State Dispute Settlement

Early U.S. BITs included provisions for state-to-state arbitration in the event of a treaty dispute, but lacked a mechanism for investor-state arbitration until the 1990s, when procedures for binding third-party arbitration of investment-related disputes between investors and nations were established.[169] Prior to the inclusion of ISDS provisions in BITs, foreign investors had to work their grievances through the host country's legal system or rely on their home country to impose diplomatic, military, or economic sanctions if the host country treated their investments unfairly.[170] An agreement between countries consenting to ISDS (usually a BIT or a free trade agreement containing an investment chapter) is necessary before any claim can be brought; in other words, in most

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[*] APEC's 21 member economies are the United States, Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, South Korea, Taiwan, Thailand, and Vietnam.

[†] For more information on China's Anti-Monopoly Law and related law enforcement, see U.S.-China Economic and Security Review Commission, "Foreign Investment Climate in China," *2015 Annual Report to Congress*, November 2015, 79–139. *http://1.usa.gov/1Jcwf3h*.

cases no foreign investor can challenge the host state absent a formal agreement between countries allowing ISDS.[171] U.S. investors seeking redress against anticompetitive actions by a foreign government have another avenue available to them: Section 301 of the Trade Act of 1974, which empowers the U.S. government to "impose trade sanctions on foreign countries that either violate trade agreements or engage in other unfair trade practices."[172] Though Section 301 does not give U.S. investors an independent right to initiate legal proceedings, investors can petition the USTR for help (the USTR can also self-initiate).[173] In the event of a petition by an investor, the USTR has broad discretion on whether to accept the petition and take subsequent action.[174]

In practice, once ISDS provisions have been agreed to, arbitration can take many forms and investors can take their claims to a number of international arbitration institutions. The two leading institutions are the International Centre for Settlement of Investment Disputes (ICSID),[*] of which China became a member in 1993, and the UN Commission on International Trade Law (UNCITRAL).[†] [175] Typically, before pursuing a claim, investors must wait through a three- to six-month "cooling off" period starting from the date either party requested settlement to allow for the possibility of resolving the dispute through consultation or negotiation.[176] Under the Canada-China FIPA, investors must wait six months before submitting a claim to arbitration; additionally, investors must first withdraw any existing claims in Chinese courts before pursuing third-party arbitration.[177]

ISDS is controversial. Some members of the U.S. public and elected officials have strongly criticized ISDS provisions over concerns they grant foreign investors special protections that threaten state and local laws. A letter to Trans-Pacific Partnership (TPP) negotiators signed by 100 U.S. state legislators expressed concern about "the way that investor-state disputes in bilateral investment treaties and free trade agreements are being used to challenge domestic legal processes, including processes and decisions of national courts."[178] Lori Wallach, director of Public Citizen's Global Trade Watch, argues a U.S.-China BIT would "invite a wave of attacks on our domestic laws by Chinese corporations through a system of private foreign tribunals that are a threat to our sovereignty and solvency."[179] Specifically, she warns that SOEs doing business in the United States would be granted investor rights that are more expansive than those granted under the WTO. Some ISDS critics allege that investors could sue a host country even in the event that "expected future profits" are lost (e.g., due to tighter labor or environmental standards).[180] Other critics are concerned the threat of corporate litigation may produce a "chilling effect" on public policy, which can "deter governments from acting in the public interest or distort policy choices towards options that are more amenable to foreign commercial interests."[181]

Critics have also expressed concern that the treaty arbitration process suffers from a lack of transparency. China's shortcomings in legal transparency and the absence of a transparency requirement for Canadian investor disputes against China in the Canada-China FIPA could heighten this concern during consideration of a U.S.-China BIT.[182] (As described above, under the FIPA, the Canadian government will be able to make public any ISDS documents and hearings when Canada is the respondent, while the Chinese government can choose to keep private any proceedings brought by a Canadian investor against China.) This concern is not unfounded. While ICSID arbitrations are public, UNCITRAL arbitrations conducted under the ad hoc rules are not.[183]

Proponents of ISDS argue that although companies could use the ISDS mechanism to challenge legitimate state regulations, a number of safeguards are in place to minimize the risk of abuse. For one, BITs do not grant arbitral panels the authority to overturn domestic laws or regulations.[184] Most BITs, including the 2012 U.S. Model BIT, explicitly limit arbitral panels to monetary compensation for a treaty breach.[185] The rare instances where an ISDS claim has challenged a government's legislative or regulatory power have been unsuccessful, though on several occasions governments changed or rescinded regulations as part of a negotiated settlement in ISDS disputes.[186] Moreover, under U.S. investment provisions, "no government can be compelled to change its laws or regulations,

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[*] Brazil, Canada, Mexico, Russia, Thailand, and Vietnam are not parties to the ICSID Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention); despite that, all but Brazil have concluded numerous BITs. David A. Gantz, "Challenges for the United States in Negotiating a BIT with China: Reconciling Reciprocal Investment Protection with Policy Concerns," *Arizona Journal of International & Comparative Law* 14-03 (January 2015): 212.

[†] Of all known BIT ISDS claims worldwide, about 63 percent were brought under ICSID, and 28 percent were brought under UNCITRAL. David A. Gantz, "Challenges for the United States in Negotiating a BIT with China: Reconciling Reciprocal Investment Protection with Policy Concerns," *Arizona Journal of International & Comparative Law* 14-03 (January 2015): 211.

even in cases where a private party has a legitimate claim that its basic rights are being violated and it is entitled to compensation."[187]

Within the context of the U.S.-China BIT, however, the U.S. government might not be prepared to pay the costs of undergoing international arbitration—let alone pay compensation—with a major Chinese SOE backed by unlimited state funds. The U.S.-China BIT will likely contain traditional ISDS mechanisms, enabling Chinese SOEs with investments in the United States to bring arbitration claims directly against the U.S. government for violations of the BIT.[188] Indeed, defending against a growing number of investor-state arbitration claims has prompted the governments of Venezuela, Argentina, and Bolivia to "reevaluate the relative costs and benefits of BITs."[189] Recent BIT ICSID proceedings have included decisions against the governments of the Czech Republic ($350 million), Lebanon ($266 million), and Ecuador ($70 million).[190]

The status of SOEs in ICSID procedures is ambiguous. At issue is the question of whether an SOE is a state entity (therefore falling within the scope of state-to-state disputes) or a commercial entity (therefore falling within the scope of investor-state disputes). Under Article 25(1) of the ICSID Convention, ICSID jurisdiction extends to investment disputes between "a Contracting State … and a national of another Contracting State."[191] Further, Article 25(2)(b) provides that a legal entity subject to foreign control may be considered a "national of another Contracting State."[192] For claims submitted to ICSID arbitration, tribunals have consistently found that SOEs meet the "national" requirement and can be subject to investor-state disputes rather than state-to-state disputes; in fact, "[ICSID] claims arising from foreign investments by SOEs are not uncommon."[193] In the only instance where a tribunal examined the distinction between SOEs as states and SOEs as investors, the panel determined claims brought by SOEs constitute investor-state disputes as long as the activities of the SOE are commercial, "even if the entity engages in activities that are 'driven by' State governmental policies and is controlled by the State such that it is 'required' to do the State's 'bidding.'"[194]

While Chinese investors have been increasingly active in pursuing ICSID arbitration under China's BITs—ICSID shows three Chinese investor claims under a BIT since the first one was made in 2007—Chinese SOEs are not yet known to have pursued ICSID arbitration.[*] (The status of claims made in confidential, ad hoc proceedings is unknown.)[195]

If the U.S.-China BIT contains liberal ISDS mechanisms, U.S. entities with investments in China will likewise be able to bring arbitration claims directly against the Chinese government—including for action by local governments in China's provinces—for BIT violations.[196] Only two arbitration proceedings have been initiated against China at ICSID. Most recently, in a November 2014 case, a Korean company alleged that Chinese local government entities "interfered with the company's investment in a country club and golf course by failing to transfer all of the land needed for the construction of the project and by failing to prevent the construction of a nearby unlicensed golf club," resulting in the company being forced to sell the property at a significantly reduced value—a violation of the 2007 China-Korea BIT.[197] As of July 2016, that case is still pending.[198] The first claim against China, initiated by a Malaysian construction company in 2011, was discontinued on unknown terms in 2013.[199]

Notwithstanding concerns that ISDS provisions potentially grant state-owned investors power, BIT-protected investors have not often pursued ISDS claims. According to research published by the Center for Strategic and International Studies, over 90 percent of the nearly 2,400 BITs in force have operated without a single investor claim of a treaty breach.[200] While the number of ISDS claims filed over the past ten years has increased, it has done so in proportion to the overall rise in outward foreign capital stock.[201] About a third of ISDS cases are settled in advance of a ruling, but in disputes that ended in an arbitral decision, states won about twice as often as investors did.[202] Even successful investor claims resulted in awards worth a small fraction of the initial claim—on average, less than one-tenth.[203] Low awards, high expenses for filing a claim, length of time required (3.5 years, on average), low likelihood of prevailing, and the risk that filing a claim presents to future operations usually dissuade investors from pursuing ISDS.[204] It remains to be seen whether Chinese SOEs backed by potentially unlimited state funding would balk at these deterrents.

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[*] Records pertaining to ICSID proceedings can be searched on the World Bank Group's ICSID website. *https://icsid.worldbank.org/apps/ICSIDWEB/Pages/default.aspx*.

IV. Considerations for U.S. Policymakers

A U.S.-China BIT is unique among other existing BITs insofar as it will have to balance the interests of two world powers that are both capital-importing and capital-exporting nations. It will not only determine future investment relations between the world's two biggest economies, but will also set the precedent for U.S. investment relations with other major developing countries. One legal scholar assessed that "if the United States departs significantly from its high-standard-of-investor-protection with China, it will not likely be able to return to this model in future negotiations with other BRICS [Brazil, Russia, India, China, South Africa] or Vietnam."[205] While a U.S.-China BIT could potentially unlock sizable benefits, there are a number of potential concerns derived from China's recent BIT practice that policymakers should weigh when considering the treaty.

Potential Benefits of a U.S.-China BIT

Increased bilateral investment. Assuming BITs in general successfully promote the expansion of bilateral investment,[*] and given the comparatively low proportion of bilateral investment between the United States and China to each country's total outbound FDI, a U.S.-China BIT that addresses the primary obstacles to increased bilateral investment could potentially yield large gains,[206] though no official estimate is publicly available. Capitalizing on shared economic interests is one way to bolster ongoing negotiations.

Leveled playing field. The BIT presents the most significant opportunity since China's WTO accession for U.S. companies to address long-standing Chinese investment barriers.[207] With the 2012 U.S. Model BIT as its foundation, the core text of an ambitious U.S.-China BIT would attempt to level the playing field for U.S. firms, allowing them to compete better with domestic enterprises. Such a BIT, if enforceable, aims to guarantee that U.S. firms in all industries—except those exempted by a short negative list—enjoy the same treatment Chinese firms do at all stages of investment, would prohibit the Chinese government from imposing discriminatory industrial policies and other laws and regulations on U.S. firms, and would allow U.S. companies to better protect their rights through an independent dispute resolution mechanism. A high-standard BIT would also reinforce U.S. business priorities like transparency and rule of law in China, and could possibly abolish technology transfer requirements.

Increased market access. Arguably, the most critical benefit for U.S. companies under a progressive BIT is expanded access to the Chinese market. A short negative list with narrowly defined exemptions would significantly lift market barriers for U.S. companies in the nearly 100 sectors and industries where foreign investment is currently restricted or prohibited.[208] China's service sector, for example, was worth more than $4.9 trillion in 2014—equivalent to 48.2 percent of its gross domestic product—but remains effectively closed to foreign investors in many instances, according to AmCham in China.[209] Lifting market access barriers in service sectors such as finance, telecommunications, health, education, media, and logistics—sectors where U.S. firms are globally competitive—could markedly boost the profitability of U.S. firms and overall U.S. investment in China.[210] Insofar as having a commercial presence in a market is important for the supply of services there,[†] increasing U.S. firms' access to the China market through a U.S.-China BIT is an important precondition for facilitating greater services trade with China.[211] Opening the service sector to foreign investment is mutually beneficial: China's current reform agenda identifies service sector liberalization as conducive to moving up the value-added chain and promoting a higher level of domestic consumption of services.[212]

China's domestic reform. Beyond increasing bilateral trade and investment, and improving the access of U.S. companies to the Chinese market, a comprehensive, deeply liberalized BIT has the potential to address many of the most pressing concerns the United States has when it comes to the U.S.-China economic relations, including the Chinese government's role in the economy and lack of transparency. A BIT with far-reaching provisions—faithfully

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[*] Evidence is mixed on the correlation between the presence of a BIT and increased FDI. One report concluded BITs do have a causal positive impact on FDI flows, but only for hosts who have not had a BIT claim brought to arbitration. Emma Aisbett, Matthias Busse, and Peter Nunnenkamp, "Bilateral Investment Treaties Do Work: Until They Don't," *Kiel Working Paper* 2021 (January 2016): 16. *http://www.econstor.eu/bitstream/10419/125937/1/846070405.pdf*. A number of additional studies analyzing this relationship can be found in Shayerah Ilias Akhtar and Martin A. Weiss, "U.S. International Investment Agreements: Issues for Congress," *Congressional Research Service*, April 29, 2013, 16–17. *https://www.fas.org/sgp/crs/row/R43052.pdf*.

[†] As established in the General Agreement on Trade in Services, which identifies having a commercial presence as one of four modes for supplying services.

implemented—could act as a sign of Chinese government's commitment to domestic reform, encouraging competition in many sectors of the economy and supporting China's rebalancing from an investment- and export-led economy to one driven by services and consumption.

Future trade and investment liberalization. U.S.-China BIT negotiations could serve as an important predecessor to other bilateral and multilateral investment agreements, including the EU-China BIT, the Regional Comprehensive Economic Partnership (RCEP), and the Transatlantic Trade and Investment Partnership (TTIP), and are therefore of crucial significance to the convergence of the international investment law regime.[213] C. Fred Bergsten, senior fellow and director emeritus of the Peterson Institute for International Economics, wrote in 2015 that the U.S.-China BIT negotiations will also influence and be influenced by other ongoing international economic negotiations, including "the extension and update of the Information Technology Agreement (ITA II), the Trade in Services Agreement (TISA), and the new effort to reduce barriers to trade in environmental goods, the Environmental Goods Agreement (EGA)," and well as "perhaps most importantly" a potential Free Trade Area of the Asia Pacific (FTAAP), which could include all APEC member economies.[214]

Potential Concerns Raised by a U.S.-China BIT

Data limitations. As laid out in this paper and elsewhere, there are significant gaps in reporting on Chinese FDI in the United States. This absence of reliable data and case studies analyzing the impacts of Chinese FDI on the U.S. economy and national security can impede the ability of U.S. policymakers to shape a prospective BIT with China.

Role of the Chinese government. The Chinese government continues to play an important role in the Chinese economy, including in promotion and approval of outbound FDI. This prompts questions about the extent to which Chinese FDI in the United States could be motivated by the pursuit of Chinese government's objectives rather than economic interest. Although Chinese regulations on outbound investment have been significantly liberalized, many deals continue to require filings and potential review by the government before they can proceed (e.g., projects of $1 billion or more).[215] Because the Chinese government continues to exert significant influence in the sectors it views as strategic (e.g., telecommunications and autos),[216] this leaves open the possibility that a Chinese company, even a nominally-private one, may be making an investment to further the government's goals.

Economic impact. The potential economic impacts of a U.S.-China BIT on U.S. employment are not well studied. Would a BIT—if successful in increasing bilateral investment flows—create jobs in the United States or lead to greater outsourcing of jobs and production? The impact on U.S. employment from China's WTO accession sets a troubling precedent. Before the United States granted China Permanent Normal Trade Relations (PNTR) status, enabling it to join the WTO in 2001, China's MFN treatment needed to be reauthorized by Congress every year. Justin Pierce, senior economist, Federal Reserve Board of Governors, and Peter Schott, economist at the Yale School of Management, argued in 2012 that the uncertainty over this reauthorization discouraged U.S. companies from investing and setting up export platforms in China.[217] However, after PNTR was granted, this uncertainty was eliminated, leading to a surge of offshoring.[218] More recent research has linked the surge in imports from China following China's WTO accession to significant job losses in the United States.[*]

Sufficiently high standards. One obvious risk facing U.S. investors—embodied by the Canada-China FIPA—lies in whether the BIT is high-standard enough. The FIPA falls short of U.S. ambitions for market access reciprocity, pre-establishment national treatment, transparency, the scope of ISDS arbitration, performance requirements, and SOE treatment. Critics argue a U.S.-China BIT that compromises on any of these key principles in the interest of concluding the treaty under the Obama Administration is not worth negotiating. Derek Scissors, resident scholar at U.S. think tank American Enterprise Institute, argues that without meaningful restrictions from Beijing on SOEs and discriminatory competition policies, "a bilateral investment treaty is a bad idea."[219] The AFL-CIO, the umbrella federation for U.S. unions, opposes BIT negotiations with China, arguing the 2012 U.S. Model BIT does not offer

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[*] According to David Autor, David Dorn, and Gordon Hanson (MIT, University of Zurich, and University of California, San Diego, respectively), between 1999 and 2011, the United States lost up to 985,000 manufacturing jobs (and up to 2 million jobs in the entire economy) due to import competition from China. David Autor et al., "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade," NBER Working Paper No. 21906, National Bureau of Economic Research (February 2016), 28. *http://www.ddorn.net/papers/Autor-Dorn-Hanson-ChinaShock.pdf*.

strong enough protections for fundamental labor rights—including freedom of association, collective bargaining, and freedom from forced labor—to serve as the basis for U.S.-China BIT negotiations.[220]

Treatment of SOEs and scope of coverage. The Chinese government's controlling presence in many aspects of the economy, and continued preferential treatment of domestic companies—state-owned, state-invested, or private but operating in strategic sectors—raises important questions about the ability of a BIT, even a high-standard one, to truly level the playing field for U.S. companies. First, many of the measures favoring domestic Chinese companies at the expense of their foreign competitors are informal in nature, and therefore difficult to prove from a legal standpoint.[221] Regardless of the tools available to them, companies may be unwilling to bring a case against the Chinese government over unfair treatment for fear of retaliation.

Second, it is not clear how the provisions of the BIT would apply to sub-central government authorities and SOEs. The central government in Beijing, which relies extensively on sub-central governments to carry out its initiatives, has been reluctant to include sub-central SOEs or governments in international commitments. In practice, this means local governments have a great deal of discretion when carrying out enforcement actions or complying with government regulations.[222] For example, China continues to fail its commitment to accede to the WTO's Agreement on Government Procurement (GPA) because, among other things, it refuses to extend the scope of coverage of entities subject to GPA's provisions to include all of its SOEs and all 22 provinces, five autonomous regions, and four municipalities.* The Canada-China FIPA serves as a cautionary example, since SOEs and governmental entities were granted significant exceptions from minimum standard of treatment, MFN, and other obligations. Finally, China lacks an independent judiciary, which leaves open the possibility that BIT provisions notwithstanding, courts will not enforce regulations fairly or consistently, especially in cases where the government interest favors a Chinese domestic company.[223]

The scope of coverage issue is also relevant for the United States. Though there are questions about whether Chinese sub-central governments or entities would be subject to the BIT's provisions, no such uncertainty exists in the United States: State and local governments are subject to agreements reached by the federal government and trade partners can challenge state and local laws.† (State and local governments have no standing in international tribunals, such as WTO or ICSID, and would be represented by the federal government in any disputes arising under trade or investment agreements.[224]) Some critics of international trade or investment agreements argue that the federal government does not give sufficient opportunities for state and local governments to provide feedback,[225] or may otherwise undermine the protection accorded to U.S. states.[226]

Reciprocal investor treatment. One lesson for the United States that can be drawn from the Canada-China FIPA is that market access reciprocity should not be threatened by the interaction between the MFN treatment clause and the national treatment clause. On the basis of the U.S. Model BIT, both parties have agreed to negotiate pre-establishment national treatment for investors in sectors not identified on the negative list. Having never granted pre-establishment national treatment in its other BITs, China would be required through the operation of the MFN treatment clause to extend pre-establishment national treatment to all third-party countries with which a BIT including MFN treatment was signed—a seemingly enormous concession.[227]

Similarly troubling, the Canada-China FIPA contains major carve-outs in the general obligation to provide national treatment. In essence, either country is permitted to continue to discriminate in favor of domestic investors based on existing discriminatory measures, meaning that only new discriminatory measures are disallowed.[228] If similar exceptions were permitted in a prospective U.S.-China BIT, Chinese investors would not face much difficulty because the United States has one of the most liberalized investment climates in the world. The reverse would not be true. U.S. and other foreign investors in China face an extremely discriminatory environment. China's unequal

* For more on the details of China's latest GPA accession offer, see U.S.-China Economic and Security Review Commission, *Monthly Analysis of U.S.-China Trade Data*, January 7, 2015. *http://1.usa.gov/1Sff2JQ*.

† There are some exceptions. For example, individual U.S. states can choose whether to be covered by the WTO's GPA, and the degree of coverage varies on a state-by-state basis. For a list of U.S. state government procurement covered under GPA, see "Appendix I, Annex 2: Sub-Central Government Entities which Procure in Accordance with the Provisions of this Agreement," October 16, 2000. *https://www.wto.org/english/tratop_e/gproc_e/usa2.doc*.

treatment of foreign investors has been extensively documented.* Most recently, 77 percent of U.S. companies surveyed in the AmCham China's 2016 Business Climate Survey felt foreign businesses are less welcome in China.[229] Assuming that China's investment environment does not improve dramatically in the near term—a safe bet given growing complaints from businesses—a BIT with China could lock the United States into de jure nonreciprocity.

***Scope of FDI screening provisions*.** During President Xi's U.S. state visit in September 2015, he and President Obama committed to "limit the scope of their respective national security reviews of foreign investments (for the United States, the CFIUS process) solely to issues that constitute national security concerns, and not to generalize the scope of such reviews to include other broader public interest or economic issues."[230] While this concession, if enforceable, signals China's commitment to BIT negotiations, other forthcoming Chinese laws—like the draft cybersecurity law and the draft foreign investment law—may apply the concept of national security differently and could complicate the regulatory environment for foreign investors in China, casting doubt on China's intentions to limit its expansive interpretation of national security. Ambassador Shaun Donnelley, vice president for investment and financial services of the U.S. Council for International Business, concludes that if China believes FDI "needs to be limited, screened, restricted, and subjected to forced localization, then real BIT negotiations will, unfortunately, not succeed."[231]

***Scope of ISDS provisions*.** A BIT that features the ISDS provisions included in the 2012 U.S. Model BIT could limit the ability of the United States to block or unravel Chinese investments.[232] Under the ISDS provision, a foreign investor (e.g., a Chinese SOE) can directly bring an action in an international arbitration tribunal rather than resorting to litigation in the domestic legal system of the host state. In addition, the MFN clause in the 2012 U.S. Model BIT would require that all FDI be given equal treatment, while the national treatment clause mandates that foreign companies be treated the same as U.S. companies. As a result, if a Chinese SOE's investment is blocked while that of a different SOE or U.S. company is approved, the Chinese SOE could argue that the United States acted discriminatorily, and bring the claim directly before ICSID.[233] ICSID awards are final and binding, and the United States is obliged under U.S. law to give ICSID awards the same "full faith and credit as if the award were a final judgment of a court of general jurisdiction" in the United States.[234] Though uncommon, ISDS provisions may also result in multimillion-dollar arbitration decisions levied against U.S. government entities at the national and state levels. Furthermore, it is unclear whether adverse CFIUS determinations could be subject to an ISDS challenge. According to Daniel C. K. Chow, law professor at Ohio State University, Article 18 of the 2012 U.S. Model BIT includes a security exception clause that is "broad enough" for CFIUS and the president to review investment transactions considered necessary for the protection of its essential security interests.[235] However, this principle has never been tested in practice, leaving the question unresolved.

Another important consideration is the extent to which investor-state arbitration, if included in a U.S.-China BIT, would be truly neutral. Given the involvement of the Chinese state in many aspects of China's economy, it is difficult to imagine that a Chinese enterprise, particularly state-owned or –controlled, would purse ISDS without clear sanction of the Chinese government or on its behalf.[236] Any such claim would become, in essence, a state-to-state dispute. José Alvarez, who teaches international law at the New York University School of Law, noted that

> *to the extent sovereign investors make use of investor-state dispute settlement, that arbitral mechanism is transformed from an alternative to politicized diplomatic espousal to itself a form of interstate dispute settlement not unlike diplomatic espousal itself*.[237]

While the United States seeks to protect the exclusive sovereignty of its national courts, China wants to preserve its "bilateral sovereignty"—that is, the power to sign BITs without ceding international tribunals space to broadly interpret the BIT provisions.[238] China aims to prevent tribunals from establishing a precedent that would allow all of its partners open access to arbitration, and has so far done so by adopting the same capital exporter-friendly protections used in U.S. BITs.[239] This dynamic may well push both sides to exclude access to international

* For an in-depth assessment of the challenges facing foreign companies doing business in China, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 2, "Foreign Investment Climate in China," in *2015 Annual Report to Congress*, November 15, 2015. *http://1.usa.gov/1Jcwf3h*.

arbitration from the MFN clause. Moreover, investor-state arbitration is rare in China, and there is minimal precedent where Chinese courts have recognized and enforced foreign court decisions.[240]

***Compliance*.** Regardless of how comprehensive and high-standard a final U.S.-China BIT may be, China's compliance with its commitments remains a paramount concern for U.S. officials and companies. One of the main criticisms of China's WTO accession—at the time hailed by many as pivotal for China's transition to a market-based economy and integration into the international trade regime—is that it did not deliver on U.S. expectations that it would contribute to a lower U.S. trade deficit, impose the WTO trading order on China, and meaningfully enforce Chinese commitments to phase out trade barriers.[241] The USTR tracks China's WTO compliance and reports on it in an annual report to Congress. In its latest report, published in December 2015, the USTR noted that although China has been a WTO member for 14 years, "a wide range of Chinese policies and practices continued to generate significant concerns among U.S. stakeholders."[242] These include

> *serious problems with intellectual property rights enforcement in China, including in the area of trade secrets; the Chinese government's wide-ranging use of industrial policies favoring state-owned enterprises and domestic national champions in many sectors; troubling agricultural policies that block U.S. market access; numerous continuing restrictions on services market access; and inadequate transparency.* [243]

The Chinese government's continuing promotion of "indigenous innovation" policies exemplifies this trend. Indigenous innovation refers to an array of Chinese government policies that bolster China's homegrown high-technology industries through forced technology transfer and by favoring the products of Chinese companies over imports.* In its 2015 Report to Congress on China's WTO Compliance, the USTR found that policies aimed at promoting indigenous innovation remained in place despite a number of high-level commitments from the Chinese government to discontinue them at the central and subnational level, including a 2011 notice from the State Council.[244] A 2015 report by the US-China Business Council found that some sub-central governments have not eliminated indigenous innovation requirements; more troubling, many sub-central government agencies "have released new policies and regulations" promoting indigenous innovation.[245]

In a recent report on China's WTO commitments published by the Information Technology & Industry Foundation, Robert Atkinson and Stephen Ezell argue one of China's motivations for entering the WTO was not necessarily to support domestic reform, but rather to gain protection against other nations that might pursue unilateral trade enforcement measures against it.[246] Disappointment in China's compliance with WTO obligations coupled with minimal, managed, and incremental reforms to its foreign investment framework cast doubt on its motivations and intentions for negotiating a progressive BIT with the United States.

* For more information about China's "indigenous innovation" policies, see U.S.-China Economic and Security Review Commission, "Indigenous Innovation and Intellectual Property Rights," in *2011 Annual Report to Congress*, November 2011, 70–87. *http://1.usa.gov/1VxOCsj*.

Appendix 1: U.S. BITs

Party	Date Signed	Date of Entry into Force	Status
Panama	10/27/82	05/30/91	In force
Senegal	12/06/83	10/25/90	In force
Haiti	12/13/83		Signed*
Democratic Republic of the Congo	08/03/84	07/28/89	In force
Morocco	07/22/85	05/29/91	In force
Turkey	12/03/85	05/18/90	In force
Cameroon	02/26/86	04/06/89	In force
Egypt	03/11/86	06/27/92	In force
Bangladesh	03/12/86	07/25/89	In force
Grenada	05/02/86	03/03/89	In force
Congo	02/12/90	08/13/94	In force
Poland	03/21/90	08/06/94	In force
Tunisia	05/15/90	02/07/93	In force
Sri Lanka	09/20/91	05/01/93	In force
Czech Republic	10/22/91	12/19/92	In force
Slovakia	10/22/91	12/19/92	In force
Argentina	11/14/91	10/20/94	In force
Kazakhstan	05/19/92	01/12/94	In force
Romania	05/28/92	01/15/94	In force
Russia	06/17/92		Signed
Armenia	09/23/92	03/29/96	In force
Bulgaria	09/23/92	06/02/94	In force
Kyrgyzstan	01/19/93	01/12/94	In force
Moldova	04/21/93	11/26/94	In force
Ecuador	08/27/93	05/11/97	In force
Belarus	01/15/94		Signed
Jamaica	02/04/94	03/07/97	In force
Ukraine	03/04/94	11/16/96	In force
Georgia	03/07/94	08/10/99	In force
Estonia	04/19/94	02/16/97	In force
Trinidad and Tobago	09/26/94	12/26/96	In force
Mongolia	10/06/94	01/04/97	In force
Uzbekistan	12/16/94		Signed
Albania	01/11/95	01/04/98	In force
Latvia	01/13/95	12/26/96	In force
Honduras	07/01/95	07/11/01	In force
Nicaragua	07/01/95		Signed
Croatia	07/13/96	06/20/01	In force
Jordan	07/02/97	06/12/03	In force
Azerbaijan	08/01/97	08/02/01	In force
Lithuania	01/14/98	06/13/04	In force
Bolivia	04/17/98	06/06/01	Terminated†
Mozambique	12/01/98	03/03/05	In force
El Salvador	03/10/99		Signed
Bahrain	09/29/99	05/30/01	In force
Uruguay	11/04/05	11/01/06	In force
Rwanda	02/19/08	01/01/12	In force

Source: UN Conference on Trade and Development, "United States Bilateral Investment Treaties." *http://investmentpolicyhub.unctad.org/IIA/CountryBits/223#iiaInnerMenu*; U.S. Department of State, *United States Bilateral Investment Treaties*. *http://www.state.gov/e/eb/ifd/bit/117402.htm*.

* A status of "Signed" signifies the BIT is not in force.

† The Government of Bolivia delivered notice to the United States on June 10, 2011, that it was terminating the *Treaty between the Government of the United States of America and the Government of the Republic of Bolivia Concerning the Encouragement and Reciprocal Protection of Investment*. As of June 10, 2012 (the date of termination), the treaty ceased to have effect, except that it will continue to apply for another ten years to covered investments existing at the time of termination.

Appendix 2: China's BITs

Party	Date Signed	Date of Entry into Force	Status
Sweden	03/29/82	03/29/82	In force
Germany	10/07/83	03/18/85	Terminated
	12/01/03	11/11/05	In force
France	05/30/84	11/06/99	Terminated
BLEU*	06/04/84	10/05/86	Terminated
	06/06/05	12/01/09	In force
Finland	09/04/84	01/26/86	Terminated
Norway	11/21/84	07/10/85	In force
Italy	01/28/85	08/28/87	In force
Thailand	03/12/85	12/13/85	In force
Denmark	04/29/85	04/29/85	In force
Netherlands	06/17/85	02/01/87	Terminated
	11/26/01	08/01/04	In force
Austria	09/12/85	10/11/86	In force
Singapore	11/21/85	02/07/86	In force
Kuwait	11/23/85	12/24/86	In force
Sri Lanka	03/13/86	03/25/87	In force
United Kingdom	05/15/86	05/15/86	In force
Switzerland	11/12/86	03/18/87	Terminated
	01/27/09	04/13/10	In force
Poland	06/07/88	01/08/89	In force
Australia	07/11/88	07/11/88	In force
Japan	08/27/88	05/14/89	In force
Malaysia	11/21/88	03/31/90	In force
New Zealand	11/22/88	03/25/89	In force
Pakistan	02/12/89	09/30/90	In force
Bulgaria	06/27/89	08/21/94	In force
Ghana	10/12/89	11/22/91	In force
Russia	07/21/90	07/26/91	Terminated
	11/09/06	05/01/09	In force
Turkey	11/13/90	08/20/94	In force
Papua New Guinea	04/12/91	02/12/93	In force
Hungary	05/29/91	04/01/93	In force
Mongolia	08/25/91	11/01/93	In force
Czech Republic	12/04/91	12/01/92	Terminated
Slovakia	12/04/91	12/01/92	In force
Portugal	02/03/92	12/01/92	Terminated
	12/09/05	07/26/08	In force
Spain	02/06/92	05/01/93	Terminated
	11/14/05	07/01/08	In force
Uzbekistan	03/13/92	04/12/94	Terminated
Bolivia	05/08/92	09/01/96	In force
Kyrgyzstan	05/14/92	09/08/95	In force
Greece	06/25/92	12/21/93	In force
Armenia	07/04/92	03/18/95	In force
Philippines	07/20/92	09/08/95	In force
Kazakhstan	08/10/92	08/13/94	In force
Korea, Republic of	09/30/92	12/04/92	Terminated
	09/07/07	12/01/07	In force
Ukraine	10/31/92	05/29/93	In force
Argentina	11/05/92	08/01/94	In force
Moldova	11/06/92	03/01/95	In force
Turkmenistan	11/21/92	06/04/94	In force
Viet Nam	12/02/92	09/01/93	In force
Belarus	01/11/93	01/14/95	In force

* Belgium-Luxembourg Economic Union

Party	Date Signed	Date of Entry into Force	Status
Lao	01/31/93	06/01/93	In force
Albania	02/13/93	09/01/95	In force
Tajikistan	03/09/93	01/20/94	In force
Georgia	06/03/93	03/01/95	In force
Croatia	06/07/93	07/01/94	In force
United Arab Emirates	07/01/93	09/28/94	In force
Estonia	09/02/93	06/01/94	In force
Slovenia	09/13/93	01/01/95	In force
Lithuania	11/08/93	06/01/94	In force
Uruguay	12/02/93	12/01/97	In force
Azerbaijan	03/08/94	04/01/95	In force
Ecuador	03/21/94	07/01/97	In force
Chile	03/23/94	08/01/95	In force
Iceland	03/31/94	03/01/97	In force
Egypt	04/21/94	04/01/96	In force
Peru	06/09/94	02/01/95	In force
Romania	07/12/94	09/01/95	In force
Jamaica	10/26/94	04/01/96	In force
Indonesia	11/18/94	04/01/95	In force
Oman	03/18/95	08/01/95	In force
Morocco	03/27/95	11/27/99	In force
Israel	04/10/95	01/13/09	In force
Cuba	04/24/95	08/01/96	In force
Serbia	12/18/95	09/13/96	In force
Saudi Arabia	02/29/96	05/01/97	In force
Mauritius	05/04/96	06/08/97	In force
Zimbabwe	05/21/96	03/01/98	In force
Lebanon	06/13/96	07/10/97	In force
Zambia	06/21/96		Signed
Cambodia	07/19/96	02/01/00	In force
Bangladesh	09/12/96	03/25/97	In force
Algeria	10/17/96	01/28/03	In force
Syrian Arab Republic	12/09/96	11/01/01	In force
Gabon	05/09/97	02/16/09	In force
Nigeria	05/12/97		Signed
Sudan	05/30/97	07/01/98	In force
Macedonia	06/09/97	11/01/97	In force
Cameroon	09/10/97		Signed
Democratic Republic of the Congo	12/18/97		Signed
South Africa	12/30/97	04/01/98	In force
Yemen	02/16/98	04/10/02	In force
Qatar	04/09/98		Terminated
Cape Verde	04/21/98	01/01/01	In force
Ethiopia	05/11/98	05/01/00	In force
Barbados	07/20/98	10/01/99	In force
Qatar	04/09/99	04/01/00	In force
Bahrain	06/17/99	04/27/00	In force
Congo	03/20/00		Signed
Botswana	06/12/00		Signed
Iran	07/22/00	07/01/05	In force
Brunei Darussalam	11/17/00		Signed
Cyprus	01/17/01	04/29/02	In force
Sierra Leone	05/16/01		Signed
Mozambique	07/10/01	02/26/02	In force
Kenya	07/16/01		Signed
Nigeria	08/27/01		Signed
Jordan	11/15/01		Signed
Myanmar	12/12/01	05/21/02	In force
Bosnia and Herzegovina	06/26/02	01/01/05	In force

Party	Date Signed	Date of Entry into Force	Status
Trinidad and Tobago	07/22/02	12/07/04	In force
Côte d'Ivoire	09/30/02		Signed
Guyana	03/27/03	10/26/04	In force
Djibouti	08/18/03		Signed
Benin	02/18/04		Signed
Latvia	04/15/04	02/01/06	In force
Uganda	05/27/04		Signed
Tunisia	06/21/04	07/01/06	In force
Finland	11/15/04	11/15/06	In force
Dem. People's Rep. of Korea	03/22/05	10/01/05	In force
Equatorial Guinea	10/20/05		Signed
Namibia	11/17/05		Signed
Guinea	11/18/05		Signed
Madagascar	11/21/05	06/01/07	In force
Czech Republic	12/08/05	09/01/06	In force
Vanuatu	04/07/06		Signed
India	11/21/06	08/01/07	In force
Seychelles	02/10/07		Signed
Costa Rica	10/24/07		Signed
France	11/26/07	08/20/10	In force
Mexico	07/11/08	06/06/09	In force
Colombia	11/22/08	07/02/13	In force
Mali	02/12/09	07/16/09	In force
Malta	02/22/09	04/01/09	In force
Bahamas	09/04/09		Signed
Chad	04/26/10		Signed
Libya	08/04/10		Signed
Uzbekistan	04/19/11	09/01/11	In force
Democratic Republic of the Congo	08/11/11		Signed
Canada	09/09/12	10/01/14	In force
Tanzania	03/24/13	04/17/14	In force

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