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China Chomps at the BIT

An investment treaty would help U.S. firms and Chinese reform.

For those who wonder whether China's new leader Xi Jinping will follow through on promises to restart economic reforms, an important indicator passed almost unremarked last month. At the Strategic and Economic Dialogue talks with the U.S., the Chinese made two key concessions that should make it possible to fast-track a bilateral investment treaty, or BIT.

BITs are usually ho-hum affairs that focus on the minutiae of dispute resolution, but this one is important because it is "all about market access," according to John Frisbie, the president of the U.S.-China Business Council. The last big opening of the Chinese market was in 2001, when then Premier Zhu Rongji negotiated China's entry into the World Trade Organization. That required a raft of domestic reforms which made possible the country's impressive growth spurt from 2003-08.

China has since rested on its reform laurels. The last supreme leader, Hu Jintao, spent his decade-long term catering to the needs of large state-owned enterprises at the expense of private companies, domestic and foreign. So a BIT deal that reprises the WTO opening would represent a major breakthrough for reform.

European Pressphoto Agency

A view of China Strategic and Economic Dialogue at the State Department in July.

The U.S. is pressing China for better access for services, especially in finance, as a way to bring down the bilateral trade deficit. While the fixation on that number is unhealthy, a BIT is certainly a more responsible way to boost American exports than putting pressure on Beijing to revalue the yuan.

American firms manufacture and sell more goods in China than the U.S. exports to that market, making it a big source of corporate profits that in turn support American jobs. The negotiations will include a range of barriers American firms face, including limits on foreign ownership, advantages given to state-owned enterprises and pressure to transfer technology.

The goal in the BIT, as it was with WTO, is to extend the principle of "national treatment"—foreign firms are treated the same as domestic ones—to the greatest possible extent. In China's WTO accession agreement, that goal was met with a list of industries in which national treatment would apply. Beijing's biggest concession last month was to switch to a "negative list" approach. This stronger approach allows only the businesses specified in the treaty to be exempted, making it less likely that an American company would be blindsided by new regulations designed to put them at a disadvantage.

Another important concession was Beijing's acceptance in principle of a pre-establishment clause. That means national treatment will apply to American firms as they go through the process of setting up new China units. The North American Free Trade Agreement pioneered this principle.

Of course Beijing wants something in return, and it's no coincidence that the logjam over a potential BIT was cleared as Chinese firms are emerging as global players. The acquisition of Smithfield Foods by Shuanghui has attracted negative scrutiny in the U.S. Congress and a second review from the Committee on Foreign Investment in the U.S. A BIT would smooth the way for such deals so that they become routine.

However, as with the WTO the greater opening will be on the Chinese side. That is especially true because other nations that have negotiated BITs with China that include a "most favored nation" clause will benefit from the new concessions the U.S. is securing.

It dovetails with rumored reforms that could be unveiled in the fall at the new Central Committee's third plenum meeting. According to Chinese media, the plans under discussion include further privatization of state-owned companies, securitization of loans and liberalization of interest rates. If these materialize, the BIT could be a stepping stone to Chinese entry into the Trans-Pacific Partnership Agreement.

A lot of things would have to go right for that to happen. Beijing gets undeserved credit for decisive policy-making from some Western pundits, whereas many Chinese call the 2000s a "lost decade" in reform. It's natural the technocrats would use an approach that worked in the past and reach for an international treaty to help push through their domestic program. The U.S. can help by not dropping the ball on negotiations so that Beijing's market opening can gain momentum.

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