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Overview: Noodle Bowl of International Investment Agreements

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**Capacity Building on Existing International
Investment Agreements in the APEC Region,
Relevance, Emerging Trends, Challenges and
Policy Options to Address Coherence in Treaty
Making**

**Lima, Peru
22-24 February 2016**

Evolving International Regimes for Foreign Investment in the APEC Region:

The Spaghetti Bowl Problem?

Capacity Building on Existing International Investment Agreements (IIAs) in the APEC Region

22-24 February, 2016
Lima, Peru

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Issues

- IIAs are as important as trade liberalization under FTAs.
- The IIA landscape in Asia rapidly changing: TPP, RCEP, US-China BIT
- Noodle bowl syndrome of investment is more serious than trade (in goods).
 - It is not the noodle bowl of FTAs, but that of IIAs that creates serious problems.
 - While a large emphasis on the noodle bowl of free trade agreements (FTAs), little attention has been paid on international investment agreement (IIAs).
 - Investor-state dispute (trade: state-state dispute).

Some Classifications

- IIAs = investment treaties + investment chapters in FTAs
 - Sometimes, both are signed. Sometimes, an investment treaty becomes investment chapter in FTA.
 - Difference: MFN, expire (investment treaty) or not (FTA).
- Investment protection alone vs investment liberalization.
- Bilateral or plurilateral (3 or more parties)
- Regional or extraregional (cross-regional)
- In the past, North-South (nonAsia-Asia) bilateral investment treaty. Now plurilateral FTA with investment chapter involving both developed and developing countries.

Service Chapter and Investment Chapter in FTAs

- Trade in Services (WTO GATS):
 - Four modes:
 - Mode 1: cross border
 - Mode 2: consumption abroad
 - Mode 3: commercial presence – usually entails investment restrictions.
 - Mode 4: movement of natural persons.
 - Positive list
- The majority of Asian FTAs: Service chapter (GATS style service liberalization) + investment chapter
- NAFTA style: investment in service sector is covered by investment chapter. Usually negative list (non conforming measures).

Economic Impact of Various Types of IIAs on FDI

- Not well studied. Methodologically difficult to conduct empirical studies.
 - IIAs are significantly heterogeneous. Dummy variable unsuitable.
 - So many provisions. Mechanism not entirely clear.
 - Investment via third country.
- Investment treaty alone does not seem to have a huge impact on FDI (OECD study).
- Investment chapter in FTA (covering both protection and liberalization) seems to have an impact.
 - Which provision? Unknown, but liberalization likely to have an impact (but not ISD, positive list).
 - But there is a possibility that chapters other than investment in FTA have an impact on FDI: (i) tariff; (ii) trade facilitation.
 - Taxation treaty has an significant impact on FDI.

Historical Perspective: World Level

- Originally, the focus has been on investment protection (not investment liberalization). North-South agreements.
- NAFTA (Chapter 11 Investment) in 1994 (protection + liberalization)
 - The explosion of IIAs.
- In Asia. In the past, nonAsia-Asia bilateral investment treaty. Now plurilateral FTA with investment chapter.
- As of now:
 - There are more than 3,000 IIAs in the world; more than 1,000 IIAs in Asia.
 - There are more than 400 claims/cases based on IIAs.

Historical Perspective: Asia (China)

- Until 1978: Restriction on inward FDI; No BIT
- 1978-1998: 1st generation BITs
 - With industrial countries.
 - Limited investment protection (no or limited NT; no or limited ISD).
- 1998-2007: 2nd generation BITs
 - With African countries.
 - Full NT
- 2007 onwards: 3rd generation BITs
 - More comprehensive investor state arbitration clauses.
 - Pre-establishment NT?

Historical Perspective: Asia (Japan)

- Until mid 1970s: No IIAs
 - Not much FDI outflows = No need to protect investment abroad
 - Restriction on FDI inflows
- The mid 1970s – late 1990s: Old generation IIAs
 - Conservative Approach: the protection of investment outside Japan.
- Mid 1990s: Priority on OECD MAI negotiations rather than BITs.
 - The failure of OECD MAI negotiations (October 1998) resulted in Japan's investment bilateralism: Japan-Korea BIT negotiation started in November 1998.
 - Japan's shift from multilateralism to regionalism/bilateralism started in investment, not trade (Japan-Singapore EPA: negotiations started in December 1999).
 - Japan's emphasis on investment rather than on trade.
- The 2000 onward: New generation IIAs (pre-establishment)

Asia's IIAs

	World total	Asia total	Cross-regional	Intra-regional
Investment treaty	2,850+	1,194	1,048	146
Investment chapter under FTA	200+	61	40	21
Total	3,000+	1,255	1,088	167

- Investment chapters in FTAs play a relatively large role in Asia. The number in FTAs increasing.
- Asian countries prefer comprehensive approach (economic partnership agreement)

Quantitative Analysis

	Total IIAs	BITs	FTAs with Investment		Total IIAs	BITs	FTAs with Investment
PRC	135	129	6	Kyrgyz Republic	28	28	0
Korea	97	92	5	Sri Lanka	28	28	0
India	84	83	3	Australia	28	23	5
Malaysia	70	67	3	Japan	27	18	9
Indonesia	64	63	1	Taipei,China	26	23	4
Viet Nam	59	58	1	Lao PDR	23	23	0
Singapore	53	41	12	Turkmenistan	23	23	0
Uzbekistan	49	49	0	Cambodia	21	21	0
Pakistan	48	46	2	Hong Kong, China	17	15	2
Azerbaijan	45	45	0	New Zealand	11	5	7
Mongolia	43	43	0	Brunei Darussalam	8	6	2
Kazakhstan	42	42	0	Myanmar	6	6	0
Thailand	41	39	2	Nepal	6	6	0
Armenia	36	36	0	Papua New Guinea	6	6	0
Philippines	36	35	1	Afghanistan	3	3	0
Tajikistan	31	31	0	Vanuatu	2	2	0
Bangladesh	29	29	0	Tonga	1	1	0
Georgia	29	29	0				

Intra-Asian IIAs

- PRC (30 intra-Asian IIAs): with almost all Asians (except Nepal)
- India (23 intra-Asian IIAs)
- Korea (22 intra-Asian IIAs)
- Viet Nam (21 intra-Asian IIAs)
- Indonesia (20 intra-Asian IIAs)
- Malaysia (19 intra-Asian IIAs)

Qualitative Analysis of Asian IIAs

- Quality does matter!
- BITsel Index (project of Chinese University of Hong Kong)
 - Coverage: More than 1,500 BITs and more than 100 FTAs with investment chapter.
 - The 11 legal criteria that are used to review IIAs:
 - (1) the definition of investment;
 - (2) admission for foreign investment;
 - (3) national treatment;
 - (4) most favored nation;
 - (5) expropriation and indirect expropriation;
 - (6) fair and equitable treatment;
 - (7) transfer of investment-related funds out of the host state provision;
 - (8) non-economic standards;
 - (9) investor-state dispute mechanism;
 - (10) umbrella clause;
 - (11) temporal scope of application.
 - Indicator between 2.0 (liberal) and 1.0 (restrictive)

Asian Countries' IIAs: Comparison

	PRC	Korea	India	Indonesia	Malaysia
BITsel number of IIAs	84	77	72	61	61
BITsel quality indicator: Average	1.58	1.75	1.82	1.57	1.62
Strongest treaty and coefficient	Germany 1.90	Vietnam 1.90	Switzerland, Mauritius 1.90	Germany 1.90	Saudi Arabia 1.81
Weakest treaty and coefficient	Bulgaria, Mexico, Colombia, Costa Rica 1.36	Indonesia 1.36	Mexico 1.63	Denmark 1.27	Lebanon 1.36
Coefficient of variation	0.31	0.23	0.20	0.30	0.29

Rise of Plurilateral (Regional) IIAs

- Three or more parties in a region
- Investment chapter in a (prospective) region wide FTAs.
- Competing scenarios
 - Investment chapter in TPP
 - ASEAN Comprehensive Investment Agreement (ACIA) – ASEAN Free Trade Area (AFTA)
 - Investment chapter in RCEP
 - China-Japan-Korea Trilateral Investment Treaty (CJK TIT) – CJK FTA?

ACIA

- Signed in 2009.
- Consolidated other agreements:
 - ASEAN Agreement on Promotion and Protection of Investment in 1987
 - ASEAN Investment Area (AIA) in 1998
 - However, the majority of service investment is covered by ASEAN Framework Agreement on Services (AFAS).
- Not only FDI but also portfolio investment (AIA: FDI only)
- Foreign owned ASEAN-based investment is covered.
- Dispute settlement mechanism:
 - (i) clear and detailed investor-state dispute procedures; Alternative dispute settlement mechanism (conciliation, consultation and negotiation)
 - (ii) state-state dispute.

CJK TIT/FTA

- China-Japan BIT in 1989 (no renegotiation)
- China-Korea BIT in 1992 (re-negotiated in 2007)
- Japan-Korea BIT 2002 (high quality)
- CJK Trilateral Investment Treaty (TIT)
 - Joint study started in 2003; negotiation started in 2007 and concluded in 2012.
 - Pre-establishment not covered. Limited coverage of PR.
 - For Japan, not ideal but better than the 1989 BIT.
- CJK FTA
 - Negotiation started in 2012.
 - Investment chapter is critical elements
 - China: Done deal. Emphasis on development, WTO TRIM.
 - Japan: CJK TIT+ is necessary. Negative list. Longer list of prohibited PR.

TPP Investment Chapter

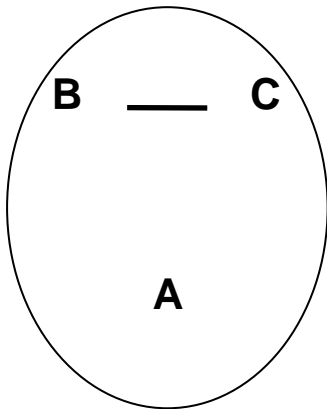
- Members: Australia, Canada, Japan, Malaysia, Mexico, Peru, United States, Vietnam, Chile, Brunei, Singapore, New Zealand
- Very comprehensive: 52 pages
- Basically, NAFTA style, but building upon post-NAFTA US experiences.
 - Investment chapter covering services
 - No GATS style service commitment
 - Negative list; Non-conforming measures.
- Exclusion of tobacco

Other IIAs

- Regional Comprehensive Economic Partnership (RCEP) among ASEAN+6, another IIA including China and Japan.
 - Original idea: China's East Asian FTA (EAFTA) among ASEAN+3 <goods centric> and Japan's Comprehensive Economic Partnership in East Asia (CEPEA) <investment centric>.
- Transatlantic Trade and Investment Partnership (TTIP) – EU and the US
- US-China BIT
 - Pre-establishment NT?
 - Japan may simply wait and see the result of US-China BIT, rather than concluding CJK FTA/RCEP.
 - Canada-China BIT concluded. Non-reciprocal pre-establishment NT (Canada to open its economy to Chinese investors, while allowing China to retain a closed economy and to keep discriminating against Canadian investors)

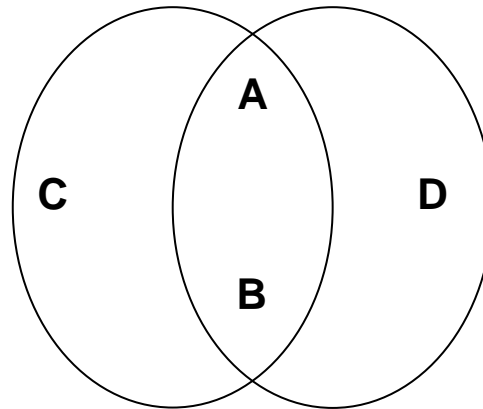
Noodle Bowls: Three Scenarios

Nested Agreements



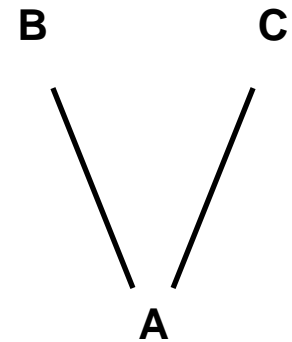
B-C bilateral
A-B-C trilateral

Overlapped Agreements



A-B-C trilateral
A-B-D trilateral

Intersected Agreements

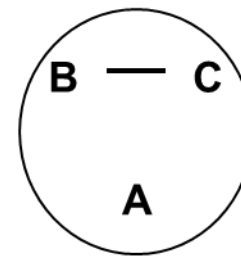


A-B bilateral
A-C bilateral

Investment and Trade: Comparison

- MFN
 - Trade: MFN tariff for WTO Members
 - Investment: The “best” agreement (no “World Investment Organization”)
- Preference
 - Trade: Tariff preference can be eliminated by lowered MFN tariff
 - Investment: Preference cannot be eliminated
- Dispute
 - Trade: state-state
 - Investment: investor-state

Nested Agreements (A-B-C versus B-C)

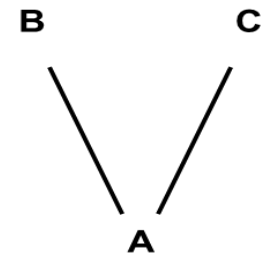


B-C bilateral
A-B-C trilateral

- In the case of trade in goods, this basically gives more options for traders.
- In the case of investment, one could similarly argue that having more options (of claim) is better.
 - However, if procedures for ISDS are inconsistent, such may cause a problem (domestic, ICSID).
 - One treaty - “fork on the road”
 - In addition, the difference between substantive rules of nested IIAs would lead to uncertainty of applicable rules, at an early stage (before the decision on ISDS is made).

Intersected Agreement (A-B versus A-C)

Intersected Agreements



A-B bilateral
A-C bilateral

- It is simply too natural that different rules are applicable to different economic relations.
- Any problem for different rules for different economic relations?
 - Treaty shopping: Best treaty is chosen! What's the point of having different rules?
 - Unexpected use of agreement (use of agreement by unexpected party).

Intersected Agreement: Goods vs. Investment

- In the case of goods:
 - The risk of treaty shopping is not that serious, because of established ROOs (country A firm's use of B-C agreement is rare).
 - Unexpected usage of FTAs (leaky ROOs) is welfare enhancing.
- In the case of investment:
 - Treaty shopping problem is serious, because (1) the origin of investor is ambiguous; and (2) investors are “mobile”.
 - MP case: HK-Australia BIT
 - Unexpected usage of provision leads to unexpected ISDS initiated by an unexpected party.

Possible Solutions

- The noodle bowl problems become serious because two “factors” are mobile:
 - 1. Investors: Investors change location to be best protected by the IIA.
 - 2. Provisions: Provisions in IIAs can be “imported” using MFN
- If one factor can be mobile, the noodle bowl problem can be mitigated.
 - “Membership”. Open membership for IIA.
 - If non-member can join, there is no need to use a third party’s IIA.
 - TPP open membership; separating investment from trade (open membership for TPP Investment Chapter) .
 - Korea, Taiwan, Philippines, Thailand, Indonesia, Columbia, costa Rica
....
- Multilateral Regime on investment?

Conclusion

- It can be said that:
 - So many IIAs.
 - Various types of IIAs; The quality of IIAs varies.
 - Rise of Plurilateral IIAs.
 - Noodle bowl of IIAs could be problematic.
 - Open membership?

Further information

- Chaisse and Hamanaka (2013) “Investment Version of Asian Noodle Bowl, *Working paper on Regional Economic Integration*. No. 128
- Chaisse and Hamanaka (2015) “Chapter 5 Asian Noodle Bowl of IIAs: How to mitigate the problems?”, in *Current Issues in Asia Pacific Foreign Direct Investment*, The Australian APEC Study Centre.
- Hamanaka (2013) “A note on detecting biases in assessing the use of FTAs”, *Journal of Asian Economics* 29: pp 24-32.