Evolving International Regimes for Foreign Investment in the APEC Region: The Spaghetti Bowl Problem?

Submitted by: ADB
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

Shintaro Hamanaka
Asian Development Bank (ADB)

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).
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 (non Asia-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 a 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

<table>
<thead>
<tr>
<th>Investment treaty</th>
<th>World total</th>
<th>Asia total</th>
<th>Cross-regional</th>
<th>Intra-regional</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2,850+</td>
<td>1,194</td>
<td>1,048</td>
<td>146</td>
</tr>
<tr>
<td>Investment chapter under FTA</td>
<td>200+</td>
<td>61</td>
<td>40</td>
<td>21</td>
</tr>
<tr>
<td>Total</td>
<td>3,000+</td>
<td>1,255</td>
<td>1,088</td>
<td>167</td>
</tr>
</tbody>
</table>

- 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

<table>
<thead>
<tr>
<th>Total IIAs</th>
<th>BITs</th>
<th>FTA with Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRC</td>
<td>135</td>
<td>KyrgyzRepublic</td>
</tr>
<tr>
<td>Korea</td>
<td>97</td>
<td>SriLanka</td>
</tr>
<tr>
<td>India</td>
<td>84</td>
<td>Australia</td>
</tr>
<tr>
<td>Malaysia</td>
<td>70</td>
<td>Japan</td>
</tr>
<tr>
<td>Indonesia</td>
<td>64</td>
<td>Taiwan, China</td>
</tr>
<tr>
<td>VietNam</td>
<td>59</td>
<td>LaosPDR</td>
</tr>
<tr>
<td>Singapore</td>
<td>53</td>
<td>Turkmenistan</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>49</td>
<td>Cambodia</td>
</tr>
<tr>
<td>Pakistan</td>
<td>48</td>
<td>HongKong, China</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>45</td>
<td>NewZealand</td>
</tr>
<tr>
<td>Mongolia</td>
<td>43</td>
<td>BruneiDarussalam</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>42</td>
<td>Myanmar</td>
</tr>
<tr>
<td>Thailand</td>
<td>41</td>
<td>Nepal</td>
</tr>
<tr>
<td>Armenia</td>
<td>36</td>
<td>PapuaNewGuinea</td>
</tr>
<tr>
<td>Philippines</td>
<td>36</td>
<td>Afghanistan</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>31</td>
<td>Vanuatu</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>29</td>
<td>Tonga</td>
</tr>
<tr>
<td>Average</td>
<td>38</td>
<td>0</td>
</tr>
</tbody>
</table>

10
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

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

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-comforming 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)

- 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)

- 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
