European University Institute

DEPARTMENT OF LAW

China's Legal Obligations in the Field of Foreign Investment:

How Trade Agreements Influence the Formation of Investment Agreements?

Yuting Hua

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Florence, 15 June 2017

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Acknowledgement

When finished writing this thesis, I am looking at the blue sky in my home city, Xi'an, and I feel a little bit released. Finish may be another beginning: with hope for a bright future to keep on doing research on international economic law area, I briefly trace out my fantastic long studying journey in Europe.

This thesis is the outcome of my five years research life at the European University Institute in beautiful Florence. I started in September 2011 when I first time arrived in a remote foreign country outside Asia. The exotic cultural atmosphere in Europe, particularly in the Renaissance city, intrigued me and I feel a stirring of curiosity.

After arriving at the beautiful campus of the EUI surrounded by green trees in Fiesole hill, I registered as a research student in the law department. During the following month, I was trying my best to practice public speaking and academic writing by English, although I found it very difficult for me to catch up. I vividly recall that I received a lot of kind understanding and sweet encouragement even sometimes when I felt so embarrassed about my presentation. Because of numerous discussions with my colleagues, I learned a lot from their intelligent knowledge and experience and I can make progress step by step. Also, I benefited a lot from many excellent training classes organized by the library, which guided me how to use databases for selecting materials particularly in the field of international economic law and news.

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Abstract

Since deeper 'open-door' domestic reform in 1992, China has consistently maintained its position as the largest foreign direct investment (FDI) recipient among developing countries. In recent years China is going global (investment abroad) as well. Accompanied with a large amount of outbound FDI, the level of private and public debt is also increasing. Thus it is necessary for China to adopt a sustainable economic development policy and behave based on rules. China needs to work with the world to promote a rules-based investment climate.

At a multilateral level, China joined the World Trade Organization (WTO) in 2001 and promised general and specific obligations on market entry and non-discrimination principles. Bilaterally, only after 2001, China has started negotiating preferential trade agreements (PTAs) with investment chapter. To date, China has signed 130 bilateral investment treaties (BITs). The first part of the thesis analyses China's legal obligations in investment agreements in pre- and post-WTO entry phases. Chapter 1 gives an introduction on China's investment policy before 2001. Chapter 2 clarifies China's commitments on non-discrimination principles under the WTO agreements, especially China's Protocol of Accession. Chapter 3 sources Chinese BITs and PTAs. It begins with a description of the legal rules and economic reasons why countries switch from multilateral rules under the WTO agreements to PTAs. Then it scrutinizes Chinese PTAs concerning the question of how FTA's influence on capital flow is faring in the context of China. This part lastly compares BITs and PTAs with regard to investment principles.

The second part of the thesis concerns interpretation on substantive and procedural provisions. Chapter 4 tries to answer the question of whether and how do tribunals consider jurisprudential concepts developed in the case law of the trade regime when

resolving investment cases. The case law shows that they have done so occasionally only for a very limited set of substantive issues. Trade law may influence *ad hoc* tribunals' interpretation of non-discrimination standards. Chapter 5 examines different remedies in trade and investment agreements. China has had little-publicised cases with investor-state arbitration to date. It is important for China to keep compliance with its commitments in international agreements, otherwise, it would face countermeasures which are highly costly. Also, China can implement competition rules in its domestic market for improving firms' efficiency. Meanwhile, a balancing approach which emphasizes corporate social responsibility is equally important for China's companies going global.

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List of Abbreviations

AAA	American Arbitration Association
ACP	Africa, Caribbean and Pacific (states)
AISCC	Arbitration Institute of the Stockholm Chamber of Commerce
ALI	American Law Institution
APEC	Asian Pacific Economic Cooperation
BIT	Bilateral Investment Treaty
BLEU	Belgium-Luxemburg Economic Union
BOP	Balance of Payment
BOT	Built-Operate-Transfer
CCP	Common Commercial Policy
CJV	Contractual Joint Venture
DTT	Double Taxation Treaty
EC	European Community
ECJ	European Court of Justice
EEC	European Economic Community
EJV	Equity Joint Venture
EP	European Parliament
EU	European Union
FCN	Friendship, Commerce, and Navigation Treaty
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FIP	Foreign Investment Project
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Trade and Tariffs
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for the Settlement of Investment Disputes
JV	Joint Venture
M&A	Merger and Acquisition
MFN	Most-Favoured-Nation
MIA	Multilateral Investment Agreement
MIGA	Multilateral Investment Guarantee Agency
MNEs	Multinational Enterprises

MOFCOM	Ministry of Commerce (of the Chinese Government)
NAFTA	North America Free Trade Agreement
NIEO	New International Economic Order
NT	National Treatment
OECD	Organization of Economic Cooperation and Development
PCA	Permanent Court of Arbitration
PCIJ	Permanent Court of International Justice
PICC	People's Insurance Company of China
PRC	People's Republic of China
PTA	Preferential Trade Agreement
RMB	Renminbi (Chinese Currency)
RTA	Regional Trade Agreement
SEMs	Small and Medium Enterprises
SOEs	State-Owned Enterprises
SPS	Sanitary and Photo-sanitary Agreement
TBT	Technical Barriers to Trade Agreement
TNCs	Transnational Corporations
TRIMs	Trade-Related Investment Measures
TRIPs	Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNCITRAL	United Nations Commission International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WFE	Whole Foreign Owned Enterprises
WGTI	Working Group on Trade and Investment
WTO	World Trade Organization

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William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton & Bilcon Delaware Inc. v. Government of Canada, PCA Case No. 2009-04, Award on Jurisdiction and Liability, 17 March 2015

1 Introduction

A brief look at China's international investment flows reflects the background against which the Chinese investment treaties formed. Since 1993, China has consistently maintained its position as the largest Foreign Direct Investment (FDI) recipient among developing countries and one of the largest in the world. In 2002, China became the largest FDI recipient in the world.[1] By the end of 2007, China had accumulated an FDI stock of over US$768 billion.[2] China became the largest FDI recipient in the world again in 2014.[3] China has also become the largest overseas investor among developing states, with a dramatic surge of outward investment in recent years.[4]

The origin of China's outward investment boom is sourced in its domestic economic development, and is accompanied by trade. China was, for example, a net exporter of rice. Meanwhile, to achieve continued strong growth, China also needs a reliable supply of energy and resources, especially in the long term. As McKinsey's report estimated, by 2030 China will face a water deficit of 25%.[5] The lack of clean drinking water, and even water for agricultural plants in China, has had a severe impact, since China is likely to rely heavily on import products that may be both expensive and vulnerable. Significant industrial and domestic wastewater pollution will make it hard to adjust the quality gap between water supply and demand. This situation will cause deep discontent from civil society and harm the health of the domestic investment environment.

Besides the bright side of the investment boom, the problem caused by rapid increasing of Chinese debt cannot be ignored. It is noted that the high level of debt is only sustainable as long as China's economy keeps on growing rapidly and the repatriate of profits remains high for its investments outside of China. However, since

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1 UNCTAD, World Investment Report 2003: Overview, p. 8.
2 See statistics provided by the Chinese Ministry of Commerce, available at http://www.fdi.gov.cn/pub/FDI_EN/Statistics/FDIStatistics/default.htm.
3 UNCTAD, WIP, 2015, p. 4.
4 UNCTAD statistics show that China was the 18th largest international investor in the world in 2006 with its $16 billion FDI outflow. See UNCTAD, World Trade Report 2007: Overview, pp. 2-3.
5 McKinsey 2009, Charting Our Water Future, Economic Framework to Inform Decision-Making.

China's economy is slowing down, debt levels will become unsustainable and have a high risk of triggering financial difficulty. Also, the difficulty encountered by the current socio-economic decision-making system, to try to keep a balance between economic growth and environmental protection, may make it harder to solve the problem. Thus, a rule-based international investment and technology transfer, including into China, is in need.

This thesis will analyze China's legal obligations in terms of rules in trade and investment treaties, because China needs to support and cooperate with other economic entities, which insist that the 'one belt and one road' (OBOR)[6] plan must be rule-of-law based. If China's investment drive is based on an unsustainable rise in public and private debt, and if China behaves in total absence of rules, it will be difficult for the Chinese government to realize its goal made in the framework of the OBOR.

Chinese investment may impose a positive impact on the local economy of host countries, but a lot of problems still exist. For example, China's firms are required to take certain Corporate Social Responsibility (CSR) and protect the local environment. This thesis focuses on rules under the World Trade Organization (WTO) Agreements,[7] the network of Bilateral Investment Treaties (BITs) and Preferential Trade Agreements (PTAs). China needs to work with the world to promote a *rules-based investment climate*. The EU's European External Action Service (EEAS) for example, states that China needs to fulfill its declared aim of making its OBOR initiative an open platform which adheres to market rules and international norms.[8] This trend requires countries to choose a rule-based path, creating a transparent, level playing field for investment in consideration of human rights, environmental standards, etc.

With regard to these initiatives, China is making efforts to improve its investment treaty network. The number of Chinese investment treaties, including BITs

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[6] China's "one belt, one road" project, is a ribbon of road, rail, and energy projects to help increase trade.

[7] The World Trade Organization's founding instrument is the Agreement Establishing the World Trade Organization, done at Marrakesh, 15 April 1994, 1867 *UNTS* 154, 33 *ILM* 1144 (1994). It entered into force 1 January 1995 (WTO Agreement).

[8] http://eeas.europa.eu/china/docs/joint_communication_to_the_european_parliament_and_the_council-elements_for a_new_eu_stretegy on China.pdf.

and regional treaties, has increased to over 130.[9] Not only has the number of investment treaties grown, but the diversity of treaty partners has also increased. This trend may bring a new level of diversity to the participants in arbitration, both on the claimant and respondent side. China is likely to become involved in more international arbitration cases. Thus, it is worth considering the progress of treaty-making, and how to respond to the challenges ahead.

Other factors in attracting FDI to China include, for example, the country's large and continuously growing market, its export-oriented strategy, the improvement of its economic environment, and the spill-over effects of industrial upgrading in neighboring economies.[10] Accompanied by modern technology lowering the costs of communication and transport, FDI flow is also growing rapidly as well.[11] This trend remarkably promotes the vertical development of the global value chain (on production).[12] In turn FDI, partly as a result of information technology innovation, causes a far-reaching liberalization of FDI policy, especially in developing countries, as well as other domestic (policy and legal) reforms that strongly encourage movement towards a better investment climate.[13] FDI related to production chain may be either horizontal or vertical in nature.[14] Vertical FDI involves the establishment of companies that specialize in certain parts of the value chain, -- in consideration of their location, -- and depending on the comparative advantage of the host country. Horizontal FDI entails a company pursuing an expanding market for its similar goods. The latter implies that FDI and trade may be *substituted* for a multinational enterprise. Vertical FDI often entails offshoring part of the production process to affiliates in other countries with abundant resources or labor-intensive

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[9] See Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policies and Practice*, Oxford University Press, 2009, p. 31.

[10] See OECD Press Release: Reforms Could Boost China's ability to Attract Foreign Investment, posted at: http://www.oecd.org/document/8/0. 2340.en_2649_37467_3240968_1_1_1_37467.00.html.

[11] UNCTAD, "*World Investment Reporter*" (2011) 4, 9. Asian FDI inflows reached USD 300 billion, and outflows reached USD 232 billion in 2010.

[12] UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development,* xix-xx, U.N. Sales No.E.13.II.D.5 (2013).

[13] Bernard M. Hoekman and Michel M. Kostecki, Political Economy of World Trading System: the WTO and Beyond, Oxford University Press, 2009, p 13.

[14] Understanding the determinants of observed differences in FDI inflows, and the magnitude of intra-firm trade versus arms-length outsourcing and offshoring of tasks has become a major focus of research in international economics. See Elhanan Helpman, *Understanding Global Trade*, Cambridge, Mass.; London: Harvard University Press, 2011.

industries. Multinational companies— can also outsource part of production to unaffiliated firms located in other countries, according to vertical FDI. To what extent developing countries can benefit from trade and inward FDI (and knowledge spillovers) depends on their skill levels and capacity to adapt existing technologies.[15] The cost foreign investors may concern is about the ability to implement contracts and protection of intellectual property rights (IPR) in host countries.[16]

China signed up to the Agreements of the WTO in 2001. The lengthy WTO negotiations process, the subsequent amendments to Chinese laws, and regular scrutiny by the WTO are familiarizing the Chinese public with these important legal principles.[17] This process has long-term implications for the development of a much stronger role-of-law in Chinese society.

There have been a lot of studies of the legal aspects of investment treaties. Some research has an awareness of the economic analysis of law, for example, to assess the efficiency of an investment treaty about its liberalization purpose. Some claim that BITs benefit host state economies,[18] while others argue that states receive little benefit from signing BITs.[19]

A few scholars have identified specific circumstances where BITs support investment incentives.[20] Some debate that capital-importing countries seeking to attract foreign investment (rather than the capital-exporting countries) drive the decisions about signing BITs.[21]

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15 Hoekman and Kostecki, *supra* note 13, p.21.

16 *Id.*

17 Esther Lam, *China and the WTO: A Long March Towards the Rule of Law*, Wolters Kluwer, 2009, p. 115.

18 Jeswald W. Salacuse & Nicholas P. Sullivan, 'Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', 46 *Harv. Int'l L.J.* 67, 111 (2005) (concluding that "BITs work to increase FDI into signatory countries substantially").

19 Jason Webb Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence', 51 VA. J. Int'l L. 397, 434 (2011) (arguing that "BITs are not correlated with political risk measures, nor do insurers seem to take BITs into account when deciding insurance terms;" and "limited surveys of in-house counsel for large corporations suggest that companies do not view BITs as playing a majority role in investment decisions"). And Clint Peinhardt & Todd Allee, 'Failure to Deliver: The Investment Effects of US Preferential Economic Agreements,' 2012 *World Economy* 757 (finding that very few countries experience increased investment flows after signing preferential economic agreements, including BITs, with the US).

20 *See, e.g.,* Todd Allee & Clint Peinhardt, 'Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment', 65 *Int'l Org*. 401, 402 (2011) (finding that BITs increase FDI only when the host state is not later challenged before ICSID); Jennifer L. Tobin & Susan Rose-Ackerman, 'When BITs have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties', 6 *Rev. Int'l Org.* 1,2 (2011) (reviewing conditions where BITs are linked with increased investment).

21 See Zachary Elkins et al., 'Competing for Capital: The Diffusion of Bilateral Investment Treaties,' 1960-2000, 2008 *U. ILL. L. Rev.* 246 (noting that host countries tend to sign BITs in clusters, whereas home country signings are more stable over time, and concluding from this pattern that the capital importers decide whether and when to

Investment treaties also referred to as 'international investment agreements' (IIAs), were initially for investors from capital-exporting countries to invest safely abroad and thus created a predictable international legal framework to facilitate and protect those investments.[22] Meanwhile, states have also used the investment treaty as a means to encourage foreign capital flow and market liberalization with their negotiating partners.[23] These objectives are sometimes reflected in the preamble of the treaty, and may also be reflected in the negotiation history.

As the investment treaty is one of the necessary legal instruments to implement economic liberalization policy,[24] we focus on certain substantive and procedural provisions which may facilitate the realization of these purposes. To see a better way for China to conclude investment treaties in the future, we will observe the existing treaty network, where at present the rules are in-built. Meanwhile, we have to retain full awareness of emerging economic problems during the process of forming investment agreements.

The primary purpose of BIT is to protect the interests of foreign investors. By the beginning of the twenty-first century, foreign investors in many countries were protected by international treaties, rather than by customary law alone.[25] The origin of the law on foreign investment lies in the history of efforts made by the US to protect its foreign investments in Latin America.[26] The US argued that responsibility for injuries to the alien arose in the host state when it violated an external standard of treatment (international minimum standard). By contrast, the Latin American

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sign BITs); Kenneth J. Vandevelde, 'A Brief History of International Investment Agreements', 12 *U.C. Davis J. Int'l L. & POL'Y* 157, 177-78 (2005) (suggesting that developing countries turned to BITs largely because, in the 1980s, developed countries reduced their development aid and lending to multilateral development banks, which necessitated seeking private foreign investment); but *see* Salacuse & Sullivan, *supra* note 17, at 73-74 (suggesting that the initial success of BITs was driven largely by negotiation programs promulgated by European states).

[22] This objective is based on the assumption that increased investment will further a country's economic development and prosperity and that foreign sources of capital and technology can contribute to a country's economic advancement.

[23] Investment protection and investment liberalization are distinct concerns. The latter refers to facilitating the entry and operation of foreign investments in the host country. The former refers to protecting the investment, once it has entered the country, from actions by governments and others that would interfere with investor property rights and the functioning of the investment in general.

[24] Kenneth J. Vandevelde, 'Investment Liberalization and Economic Development: the Role of Bilateral Investment Treaties,' 36 *Columbia Journal of Transnational Law* 501 (1998).

[25] *See* M. Sornarajah, *The International Law on Foreign Investment* (Third edition), Cambridge: Cambridge University Press, 2010.

[26] *Id.*

countries argued Calvo Doctrine to counter the American formulations of the law. They claimed that complaints had to first resort to the national courts. If such recourse was impossible, then the responsibility of the respondent state arose on condition that there was a 'denial of justice.'[27] In addition, national courts favored expropriation and provided for weak compensation. Perhaps because of these conflicts, developed countries began to design investment treaties to bring some certainty to the rules on foreign investment relations.[28] BITs originated with Germany (Germany-Pakistan BIT in 1959).[29] Signing a BIT is necessary when the capital importer has a weak protection of property rights. Other OECD states then followed. They concluded bilateral investment treaties with other developing countries. The number of BITs has emerged mainly since then. From a historical perspective, they were *asymmetrical* treaties between a capital exporting country and a capital importing country. Developing countries may adopt high standards of treaty obligations in exchange for a higher inflow of investments which may lead to its economic development. But it is doubtful that these investment treaties have led to increasing investment flows. Investment treaties are also enforced through a mechanism of dispute settlement. The Investor-State Arbitration (ISA) process that underlies the international investment regime grows out of private international law.

Trade and investment are inextricably linked. In theory, they are complements and substitutes. Investment can help circumvent high trade barriers. But trade openness might also lead to more investment.[30] This interactive is reflected not only in economic activities but also in treaty law making. In the earliest days, the friendship, commerce, and navigation (FCN) treaties have incorporated provisions addressing investment-related commitments, e.g., rules on the establishment.[31] Despite these links, the two areas have largely co-existed in parallel, and in different

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[27] See Donald R. Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* 17-20 (1955).
[28] *Id.*
[29] Treaty between Pakistan and the Federal Republic of Germany for the Promotion and Protection of Investments, 25 November 1959, (1963) 457 *UNTS* 23 (1963).
[30] see Bhagwati, J, RA Brecher, E Dinopoulos and TN Srinivasan (1987), 'Quid Pro Quo, Foreign Investment, and Welfare: A Political Economy Theoretic Approach,' *Journal of Development Economics*, 27, 127-138.
[31] See, *e.g.*, W. Alschner, "*Americanization of the BIT Universe: The Influence of Friendship, Commerce and navigation (FCN) Treaties on Modern Investment Treaty Law*," Social Science Electronic Publishing, 2013.

ways. Trade is regulated by multilateral rules (under the WTO), whereas investment is governed through numerous bilateral treaties. However, in recent years, commentators have been concerned with the growing convergence of trade and investment law ('cross-fertilization').[32] In particular, since the late 2000s, trade negotiations have moved away from the multilateral Doha Round and towards free/preferential trade agreements (FTAs/PTAs) built on a bilateral basis.[33] Many PTAs included a chapter on investment. Therefore, the question is, to what extent does international trade influence the forming of investment agreements and through what channels does this occur?

What caused the expansion of FTAs, and those revised obligations China promised in its trade and investment agreements after joining the WTO in 2001? This research will try to find out how trade has a significant influence on forming new Chinese investment treaties.

We divide provisions in IIAs into two categories: substantive provisions and procedural ones. The former includes market access, performance requirements, and non-discrimination treatment (national treatment and most-favored-nation treatment) provisions.[34] The latter includes dispute settlement procedures, namely State-State dispute settlement (SSDS) and Investor-State dispute settlement (ISDS). BITs primarily are referred as investment protection agreements, seeing as a BIT provision may occasionally liberalize or promote investment.[35] Criticisms of BITs have rested on either the claim that the protection standards are too rigorous, or that the necessary regulatory safeguards are lacking. The extent to which BITs play effective roles on free movement of capital has also been questioned.[36] However, liberalization

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32 See Mark Wu, The Scope and Limits of Trade's Influence in Shaping the Evolving International Investment Regime, in Zachary Douglas ed., *The Foundations of International Investment Law*, Oxford University Press, 2014, at 169—209.

33 For the trend of PTAs, see Petros Mavroidis, 'WTO and PTAs: A Preference for Multilateralism?' *Journal of World Trade* 44, no.5 (2010): 1145-1154. Petros B. Mavroidis, Always look at the bright side of non-delivery: WTO and Preferential Trade Agreements, yesterday and today, *World Trade Review* (2011), 10: 3, 375-387. Horn, Mavroidis, Sapir, Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements, *The World Economy*, 2010, p.1467.

34 Distinguish between pre- and post-establishment protection. According to UNCTAD 10% of all BITs grant pre-establishment phase national treatment obligation.

35 Jeswald W. Salacause and Nicholas P. Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', 46 *Harv. Int'l L. J.* 67, 2005.

36 Research on the Effectiveness of BITs, see Mary Hallward-Driemeier, 'Do Bilateral Investment treaties Attract FDI? Only a Bit and They Could Bite', World Bank, Development Research Group, Investment Climate, Policy

provisions are more and more involved in BITs, particularly in investment chapters in PTAs over time.

The content of most Chinese BITs often follows a typical pattern provided by developed capital-exporting countries. Similar provisions often appear in more or less the same order in nearly every BIT. BITs mainly consist of investment protection provisions, which may be categorized as either absolute or relative. Relative clauses define the granted treatment by reference to the treatment provided to any other investment or investor. By contrast, the absolute clauses define the granted treatment without reference to the treatment provided to those comparators.[37] Relative provisions require that covered investment receives treatment no less favorable than the treatment accorded to an investment of investors of any third country, a standard known as most-favored-nation (MFN) treatment. Another relative provision requires that covered investment receives treatment no less favorable than the treatment accorded to investment of investors of the host country, a standard known as national treatment. These two provisions are always followed by a clause making exceptions to the general obligation, mainly for measures relating to taxation or obligations assumed under an economic integration area.[38] This thesis focuses on those relative provisions, which were influenced significantly by trade law.

China's foreign investment policy has changed towards increased liberalization since 2001 (post-WTO entry). Statistics show that FDI in China nearly doubled within the first five years of WTO admission.[39] It reflected that trade could be complementary to investment as it eliminated certain restrictive investment measures, for example, a prohibition on investment measures related to trade (TRIMs), guaranteed non-discrimination, transparency, the rule of law, etc. China's economy

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Research Working Paper No.3121, June 2003; Jennifer L. Tobin and Susan Rose-Ackerman, 'When BITs Have Some Bite: the Political-Economic Environment for Bilateral Investment Treaties,' Rev. Int. Organ. (2011)6:1-32; Axel Berger, Matthias Busse, Peter Nunnenkamp, Martin Roy, 'More Stringent BITs, Less Ambiguous Effect on FDI? Not a Bit!', Economic Letters 112 (2011) 270-272; Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?' World Development, Vol.33, No.10, 1567-1585, 2005.

[37] The absolute treatment provisions means they establish an absolute level of protection that must be accorded by the host state in every circumstance, such as fair and equitable treatment.

[38] See China-Canada BIT, China-Japan-Korea TIA.

[39] See W. Shan, *The Legal Framework of EU-China Investment Relations: a Critical Approach*, Hart Publishing, 2005, P.2. Also see Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policies and Practice*, Oxford University Press, 2009, p.7.

has developed fast since joining the WTO. To test how trade law has had an impact on the form of China's new investment agreements, the first subsections will describe the facts concerning China's signed investment treaties before 2001. It will then analyse China's investment policy in the early years (1980s-1990s) and examine the changed trend of two-way capital flow which reflected new features of investment treaties since the late-1990s. The last subsection will look at procedures of investment dispute settlements in which China has been involved.

1.1 China's Investment Policy Before 2001 (Accession to WTO)

Why did China revise its investment treaties, and involve more economic liberalization clauses? As the experiences of other states has shown, investment treaties may be one of the relevant legal instruments to implement economic liberalization policy.[40] Since the late 1970s China's economy has changed: from a centrally planned system that was largely closed to international trade, to a more market-oriented economy that has rapidly growing private sectors and is a major player in the global economy.[41] Domestic reforms started in 1978 with a phased gradual liberalization of prices, the foundation of a diversified banking system, the rapid growth of non-state sectors, and the opening to foreign trade and investment.[42] In the following sessions we trace a brief history of China's trade and investment policy, then have a look at Chinese BIT program in its early years (before entry to the WTO).

1.1.1 Ancient Times

During the time of the ancient empire, during the Han dynasty (156-87 BC), China was famous for trading its merchandise, such as silk, tea, and porcelain, with the

[40] See Zachary Elkins et al., 'Competing for Capital: The Diffusion of Bilateral Investment Treaties,' 1960-2000, 2008 *U. ILL. L.Rev*. 265, 281-82 (suggesting that "BITs spur foreign direct investment, which in turn spur the creation of more BITs").

[41] But "China is still a developing country with a GDP per capital of around US $6,000 regarding purchasing power parity, compared to the US $48,000 in the case of the US and the US $34,000 in the case of the EU". *See* Rafael Leal-Arcas, *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance*, Edward Elgar Press, 2010. pp.105-107.

[42] *Id*.

world. The "Silk Road," was a commercial path from China's capital city Xi'an, across Central- and Western Asia, to the Mediterranean countries, and finally the city of Rome. Later, during Ming dynasty (1368-1644), China was a strong naval power, and frequently involved in long-distance trade. Captain Zheng He, who led his team with two hundred ships, went across the Pacific Ocean and the Indian Ocean to trade with East Asia countries. This prosperity was centuries before the Europeans' sailed across oceans. But China turned away from the sea in the late fourteenth century when the Ming emperor decided that increased long-distance trade, and the creative destruction that it might bring, would likely threaten their power to control.[43] China was never formally colonized by a European power, but after the Opium Wars (1839 –1842), China had to sign a series of "unequal treaties" and allow the entry of European exports.[44] As China did not take advantage of commercial and industrial opportunities at that time, it lagged behind Western Europe for hundreds of years.

1.1.2 The New Government of P.R. China

From the establishment of China's new government in 1949, until 1978, there was rarely FDI inflow. China's negative experience with the "unequal treaties" of the Western States, had brought large segments of Chinese society to regard trade and investment agreements as "imperialistic impositions", not negotiated but, rather, "imposed".[45] Consequently, in 1950, China negotiated its first treaty with its then closest ally, the Soviet Union, namely the "Treaty of Friendship, Alliance and Mutual Assistance."[46] Eight years later, China and USSR concluded a "Treaty of Trade and Navigation" granting to each other MFN treatment "in all trade, navigation" and

[43] Daron Acemoglu & James Robinson, *Why Nations Fail: the Origins of Power, Prosperity, and Poverty*, Crown Business, 2012, p. 117.
[44] Treaty of Nanking, signed 29 August 1842. Other treaties, including the 1844 Treaty of Wanghia between Qing China and the USA, and the 1844 Treaty of Huangpu with France may be similarly described. See JK. Fairbank, 'Chinese Diplomacy and the Treaty of Nanking, 1842' (1940) 12(1) *Journal of Modern History* 1; Immanuel CY Hsü, The Rise of Modern China, 6th ed, Oxford University Press, 2000, p. 168.
[45] V. Bath, Foreign Investment: The National Interest and National Security: Foreign Direct Investment in Australia and China, in 34 *Sydney Law Review*, 2012, p.5.
[46] Treaty of Friendship, Alliance and Mutual Assistance between the Union of Soviet Socialist Republics and the People's Republic of China, 226 UNTS 3103, Article 5.

"other economic relations."[47] At that time, the "great leap forward" policy had brought the country's economy to the edge of collapse.

1.1.3 After Deng Xiaoping's Reform

In 1978 Deng Xiaoping, the new leader of the country, inaugurated the "open door" policy. He believed that it was time to implement a socialist system with Chinese characteristics, through some changes in the legal framework, at domestic as well as international level. In 1979, the National People's Congress passed the law of China-foreign equity joint ventures. In 1982, the Constitution was amended to include a reference to foreign investments, confirming their protection under Chinese law.[48]

As a result of the 'open-door' policy, China entered into 30 BITs covering most of its principle investment partners[49] in the 1980s. It is evident during this period BITs were concluded with the overwhelming majority of developed European countries (as shown in the table below). For example, in 1982, the Chinese BIT program starts with the signature of the first investment treaty with Sweden.[50] All BITs China entered into during the three subsequent years were with major capital exporters, such as Germany (1983), France (1984) and Italy (1985).

No.	*Party*	*Signature*	*Renegotiation*
1	Sweden	29/3/1982	
2	Romania	10/2/1983	16/4/2007
3	Germany	7/10/1983	1/12/2003
4	France	30/5/1984	26/11/2007
5	Belgium-Lux	4/6/1984	6/6/2005

47 Treaty of Trade and Navigation between the Union of Soviet Socialist States and the People's Republic of China, UNTS 4534, Art 2 (entered into force 25 July 1958).
48 See Article 18 of the Constitution of the People's Republic of China.
49 For example, the list includes Germany, France, Belgium, Luxembourg, Finland, Norway, Italy, Denmark, the UK, the Netherlands, Austria, Singapore, Switzerland, Australia, Japan, and New Zealand, but notably not the U.S.
50 The Agreement did not provide any investor-state dispute resolution mechanism, only state-to-state dispute settlement. See Exchange of Notes Constituting an Agreement between Sweden and the People's Republic of China on the Establishment of Consular Relations, signed 26 June 1955, 228 *UNTS* 3148.

6	Finland	4/9/1984	15/11/2004
7	Italy	28/1/1985	
8	Thailand	12/3/1985	15/8/2009 (Investment Chapter in ASEAN-China FTA)
9	Denmark	29/4/1985	
10	Netherlands	17/6/1985	26/11/2001
11	Austria	12/9/1985	
12	Singapore	21/11/1985	15/8/2009 (Investment Chapter in ASEAN-China FTA)
13	Kuwait	23/11/1985	
14	Sri Lanka	13/3/1986	
15	UK	15/5/1986	
16	Switzerland	12/11/1986	27/1/2009
17	Poland	7/6/1988	
18	Australia	11/6/1988	June 2015 (Investment Chapter in FTA)
19	Japan	27/8/1988	12/3/2013 (Triangle Investment Agreement among Japan, Korea and China)
20	New Zealand	22/11/1988	Apr. 7th, 2008 (Investment Chapter in FTA)
21	Canada	9/9/2012	

Subsequently, while continuing to pursue investment agreements with major capital exporters, China also started to enter into BITs with other developing states. In those BITs with developed states, China sometimes departed from its previous practice of closed-door policy, for example, both the 1986 BIT with the U.K., and the 1987 BIT with the Netherlands allowed for international arbitration as an option. BITs with developed states primarily served the purpose to build its economic infrastructure through inbound investment; conversely, BITs with developing states—whose texts were usually similar to the Chinese model—were primarily aimed at strengthening diplomatic alliances. China’s BITs with developing countries were more focused on investment promotion and encouragement, whilst allowing for flexibility regarding transfers. They featured more specific provisions, such as a definition of investment and the conditions for its admittance, a thorough consultation process, or the exclusive jurisdiction of national courts in questions over the legality of expropriation procedures.[51] In any case, most Chinese BITs signed until the mid-1990s provided for Fair and Equitable Treatment (FET) and MFN treatment, but not national treatment.

China is making an effort to improve its regulatory framework for FDI, including its extensive investment treaty network. In addition, China has substantially revised old versions of treaties and correspondingly updated its domestic laws.

During the period of WTO entry negotiations in the 1990s, China modified old versions of regulations, especially those which promised national treatment, to level the playing field for the investment of both foreign and domestic investors. China was active in entering into BITs, with more than 60 BITs signed during this period (1992-2001), more than twice the number reached in the previous decade. China mainly signed BITs with developing countries at this time.

Previously, Chinese BITs were concluded with industrialized states. From 1985, however, China started to sign BITs with developing countries, while continuing to enter into BITs with other developed states. Whilst the general contents were similar, Chinese BITs concluded with developing countries displayed certain unique features, compared with BITs signed with developed states. First, they were trying to encourage and promote investment, which was reflected not only in the preamble, but also in the specific provisions (e.g., "*definition of investment*"). Second, national *jurisdiction* was emphasized. For example, the China-Singapore BIT requires that investments must be approved by the host state before they can recourse to BIT protection.[52] It seems China has adopted a liberal route following its fast-growing outward investment, in particular in the areas of natural resources and infrastructure in Africa.

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[51] See, e.g., Chinese BITs with Thailand, Sri Lanka, Singapore.
[52] Article 1(1) of China-Singapore BIT (1985).

The ICSID took effect for China in 1993.[53] In accordance with Article 25(4) ICSID Convention, China notified the Centre that it would only consider submitting to ICSID jurisdiction for disputes over compensation for expropriation.[54] Despite this reservation, the accession of China to the ICSID Convention made it possible for investors to make direct reference to ICSID jurisdiction. China later made full reference to ICSID in BITs. For example, the China-Lithuania BIT, signed in November 1993, included such a reference[55]. It stipulates that an ‘amount of compensation’ dispute may be submitted to the Centre for arbitration, if it cannot be settled by negotiation between the parties within six months.[56] The same article also makes it possible for other disputes, as agreed by the parties, to be submitted to the Centre for arbitration. However, not all BITs signed by China since 1993 have followed this model. For example, the China-Uruguay BIT did not make any reference to ICSID jurisdiction, although both parties had signed up to the ICSID Convention at the time of signing the BIT.

1.2 The Features of Early Chinese BITs Due to ‘Open-door’ Policy in the 1980s

As already explained, BITs have their origin in Europe, and the first one was signed between Germany and Pakistan in 1959. China has a different history to that of the West. In certain aspects, however, investment treaties also reflect Chinese attitudes towards international law and international dispute settlement mechanisms.[57] Unlike the developed West, China did not become involved in treaties of Friendship, Commerce, and Navigation (FCN).

After a long period of absence from investment agreements, the first BIT

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[53] See designations and notifications for members on ICSID site, http://icsid.worldbank.org/ICSID/FrontServlet.
[54] “Pursuant to Art 25(4) of the Convention, the Chinese Government would only consider submitting to the jurisdiction of the International Centre for Settlement of Investment Disputes over compensation resulting from expropriation and nationalization.” This reservation can be found at the Centre website: http://icsid.worlbank.org/ICSID/FrontServlet, (visited on 16 July, 2014.)
[55] See China-Lithuania BIT, Art 8(2).
[56] *Id.*
[57] Leon E. Trackman, ‘*China and Foreign Direct Investment: Does Distance Lend Enchantment to the View?*’ Volume 2 No. 1, March 2014, *The Chinese Journal of Comparative Law*, pp. 1-20.

concluded by China with a Western country, was with Sweden in 1982, four years after the introduction of Deng Xiaoping's 'open-door' policy. China finalized a further BIT with the U.K. in 1986, and with the Netherlands in 1987. Since then, China has become active in negotiating treaties for industrial cooperation with other states. Over 130 investment treaties[58] have been concluded by China.

As shown below, the legal structure and the major provisions of existing Chinese BITs signed with developing countries do not differ significantly from BITs concluded with Western, developed states. The uniformity of the Chinese BIT network has been preserved in each of these circumstances.[59] The similarity of the BITs is revealed in certain aspects. Nearly all of the provisions of a typical BIT protect investment, while few BITs include provisions that liberalize investment.[60] BITs rarely contain stringent commitments to induce outbound investment. Rather, the facilitation of investment flow occurs through the guarantee of a secure and stable investment climate. BITs virtually never regulate investment by locking in foreign investors' obligations.[61]

The following part will examine China's purpose in negotiating BITs in the early years, to compete with other developing countries in attracting FDI. Typically, the European countries prepared a model negotiation text that they presented to potential treaty partners as a basis for negotiation.[62] China began concluding BITs with European countries in the early 1980s. More than half of the Chinese BITs entered into in the 1990s followed those European models. In the 1990s, China also signed BITs with other developing countries, although these countries may have been competing with the purpose of attracting private foreign capital, and technology skills

[58] For Chinese BITs data selection, see Norah Gallagher, Wenhua Shan, *Chinese Investment Treaties: Policies and Practice*, Oxford: Oxford University Press, 2009.
[59] The description on using this comparison methodology, see Petros C Mavroidis, 'All Clear on the Investment Front: a Plea for a Restatement,' in Jose E. Alvarez, etc., ed., *The Evolving International Investment Regime: Expectations, Realities, Options*, New York: Oxford University Press, 2011.
[60] *See* C. Fred Bergsten, Gary C. Hufbauer & Sean Miner, '*Bridging the Pacific: Toward Free Trade and Investment between China and the United States,*' Peterson Institute for International Economics, June 2014.
[61] See Peter T. Muchlinsk, "Regulating Multinationals: Foreign Investment, Development, and the Balance of Corporate and Home Country Rights and Responsibilities in a Globalizing World", in *The Evolving International Investment Regime: Expectations, Realities, Options*, Jose E. Alvarez and Karl P. Sauvant, etc. ed, Oxford University Press, 2011.
[62] Leon E. Trakman and Nicola W. Ranieri, 'Foreign Direct Investment: A Historical Perspective', in Leon E. Trakman and Nicola W. Ranieri, ed., Regionalism in International Investment Law, Oxford University Press, 2013.

from developed countries.[63] From 1992 to 1993, China concluded BITs with all five of the Central Asian states.[64] China's BITs with developing countries were often based on existing BITs, already concluded with developed countries. However, these BITs concluded between capital-importing countries could be viewed as part of regional efforts to facilitate capital flow between themselves.[65]

Since private foreign investment has increasingly come to play a significant role in capital-importing countries' development processes, BITs have served to establish the rules according to which such investments could be secured. Earlier BITs, like the China-U.K. BIT (1986) and the China-Netherlands BIT (1987), allowed investors to resort to *ad hoc* international arbitration for dispute remedy. This allowance was an exception to China's standard practice at that point, which involved the provision of settlement for host and home states to resolve investment disputes.[66] However, an updated China-Netherlands BIT (2001) provided for disputes to be submitted to ICSID.[67] As China only became a signatory to the ICSID Convention in 1993, it was unlikely that ICSID would have been an option before that year. A possible alternative would have been to include a conditional consent to investor-state arbitration, as was adopted in the China-Australia BIT (1988), since the condition would have been satisfied when China adopted the ICSID Convention.[68]

Do legal provisions which protect foreign investment influence the foreign investors in their decisions making? In the absence of actual capital flow, legal rules of investment treaties have little meaning to promote host state's economic growth by attracting foreign investment. The legal framework and its positive (or negative) effect on facilitating a particular foreign investment will play a key role in any potential investor's decision-making.

Under this scenario, the existence of a BIT is an essential element in what makes

[63] Andrew T. Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties,' 38 Virginia Journal of International Law 639 (1998).
[64] See, e.g., Chinese 1992 BITs with Kazakhstan, Kyrgystan, Turkmenistan, and Uzbekistan, and with Tadjikistan 1993; Chinese BITs with Lao 1993, and Korea and Viet Nam 1992.
[65] Thomas Hale, 'The *de Facto* Preferential Trade Agreement in East Asia', *Review of International Political Economy*, 18:3, 299-327, 19 Oct. 2010.
[66] China-U.K BIT (1986), Art 7(2).
[67] China- Netherlands BIT (2001), Art 10(3).
[68] China-Australia BIT (1988), Art 12(4).

up a particular country's investment climate. Indeed, the negotiation and conclusion of a BIT involving a developing (capital-importing) country may be intended to send a welcome signal to the international commercial firms, to indicate that the host country will protect foreign investors and their investments.[69]

1.3 A Changed Trend since the Late 1990s: Two-way Capital Flow and New Features of Investment Treaty

In the early1980s, China was predominantly an inward investment destination and not yet a major exporter of capital. It hesitated to embrace a liberalized investment regime at a time when domestic economic reform was ongoing. After 2001, accompanied by a "going abroad" strategy, China's BIT program, has especially focused on outbound investment. Meanwhile, China is currently active as an inward and outward participant at this stage of the global development of BITs.[70]

The challenge of the new treaties' negotiation is that China has still resisted including market access commitments in both the new BIT signed with Canada, and the trilateral investment agreement signed with Japan and South Korea.[71] By not extending the coverage of the national treatment obligations to the pre-establishment phase of investments, China is still preserving its right to regulate the entry of foreign investments. As some scholars argue, China's changed foreign investment policy is not necessarily linked to its evolving status as an outward investing country.[72]

Even though not entirely derived from the U.S. model BIT standards (2010), the provisions of the CJK Triangle Investment Agreement drew comparisons with the

[69] As Peter Egger and Michael Pfaffermayr's analysis of outward FDI stock from OECD countries suggested, merely signing a BIT (between the current OECD economies involve one old and one new OECD member), before implementation actually occurs, has a positive signaling effect. See Peter Egger and Michael Pfaffermayr, 'The Impact of Bilateral Investment Treaties on Foreign Direct Investment,' 32 *Journal of Comparative Economics,* (2004).

[70] There is some evidence of China's vital capacity to conclude more sophisticated BITs with countries across the world, for example with Mexico, Canada, Korea and Japan in the new millennium.

[71] China, Japan, and Korea signed a trilateral investment agreement in May 2012.

[72] James Zhan, Jorg Weber, and Joachim Karl, 'International Investment Rulemaking at the beginning of the Twenty-First Century: Stocktaking and Options for the Way Forward,' in *The Evolving International Investment Regime: Expectations, Realities, Options*, Jose E. Alvarez and Karl P. Sauvant, etc. ed., Oxford University Press, 2011, p. 203.

highest standards of existing Chinese BITs.[73] However, China is willing to grant most-favoured-nation treatment to assist market entry, ensuring that its partner countries' investors benefit from a preferable treatment that China might give third countries in the future.[74]

China's growing participation in foreign investment treaties indicates that to a large extent it is likely to liberalize its investment regime. Since China is making a significant amount of investment abroad, there will be more and more claims provoked by investors against China in the future. However, the benefits may well outweigh the costs. China is going global, and there are at least two trade-offs to be considered: firstly, it could make investment concessions in exchange for the concessions in other areas—i.e., trade; and secondly, the more mutual-commitments implemented, and afforded by, an internal state may be offset by its growing investment interest abroad.

The earliest BITs signed with European countries contained fewer provisions than BITs later updated, for example, the extensively negotiated China-Canada BIT (signed in 2012).[75] Some more complex and detailed provisions were gradually added over time.[76]

Also, notably in the negotiating text of a China-US BIT, more liberalization commitments have appeared than in the past. These guarantee national treatment on the right to establish investment and prohibit the imposition of certain performance requirements as a condition of the establishment of investment. Besides, the provision on the free transfer is much less often subordinated to local law in later BITs than in earlier BITs.

BITs are not reciprocal concessions, but a mutual commitment to certain legal principles. The purpose of trade agreements is to facilitate an escape from a

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[73] Jeffrey J. Schott and Cathleen Cimino, "The China-Japan-Korea Trilateral Investment Agreement: Implications for US Policy and the US-China Bilateral Investment Treaty," in Essays *Toward a US-China Investment Treaty,* Peterson Institute for International Economics, 2015.
[74] *Id.*
[75] J.J. Saulino, 'The Canada-China Investment Treaty—Lessons from a U.S.-China BIT?' *TDM,* Provisional, November 2012.
[76] One clear example is that more particular exception clause added in new BITs, i.e. financial services rules.

terms-of-trade driven prisoners' dilemma.[77] According to the terms-of-trade theory of trade agreements, developing countries stand to gain from reciprocal trade liberalization in cases then they are big enough for foreign exporters to "feel the pain" of their tariffs (i.e. care about access to their markets).[78] While different from the mutual concession in the trade agreements, BITs impose few, if any, commitments on the capital exporting country.

The investment treaty's "asymmetric" characteristic seems "inaccurate" because both parties are equally obliged by a BIT in theory. But the imbalance has became more accurate in practice, to the extent that investment dominantly flows in one-way only between the two parties. In the early years of the BIT programs, the great majority of BITs were between a developed and a developing country, and investment nearly always flowed in only one direction between the two parties, if it flowed at all.[79] Since the 1990s, however, BITs between developing countries have become more familiar, as developing countries seek to increase the stabilizing and signalling effect of their BIT programs or to protect their own outward investment. Traditionally a sense of asymmetry has been argued, due to the disparity in bargaining power between developed and developing countries, though this has gradually diminished over time.[80] In this sense, treaty commitments may be regarded as credits of policies that the capital-importing party should be adopted entirely apart from their effect on particular investments.[81]

China has increasingly become a significant exporter of capital to both developed and developing countries. Thus, the sense of granting strict high standards to inward investment may be offset by giving protection for outside investment.[82] So,

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77 See Henrik Horn, Petros C. Mavroidis, ed., *Legal and Economic Principles of World Trade Law*, The American Law Institute Reporters' Studies on WTO Law, Cambridge University Press, 2013.

78 Kyle Bagwell, Robert W. Staiger, 'Can the Doha Round be a Development Round? Setting a Place at The Table', in Robert C. Feenstra and Alan M. Taylor, ed., *Globalization in an age of crisis: multilateral economic cooperation in the twenty-first century*, the University of Chicago Press, 2014, pp.103-104.

79 See Kenneth J. Vandevelde, 'Investment Liberalization and Economic Development: the Role of Bilateral Investment Treaties,' 36 *Columbia Journal of Transnational Law* 501 (1998); and 'Sustainable Liberalism and the International Investment Regime', 19 *Michigan Journal of Investment Law* 373 (1998).

80 Axel Berger, Matthias Busse, Peter Nunnenkamp, and Martin Roy, 'Attracting FDI through BITs and RTAs: Does treaty content matter?' *Columbia FDI Perspectives*, No.75. July 30, 2012.

81 See Stephan W. Schill, 'Whither Fragmentation? On the Literature and Sociology of International Investment Law', *the European Journal of International Law*, Vol. 22 No.3, 2011; Jason Yankee, 'Controlling the International Investment Law Agency,' 53 H*arv. Int'l L.J. 392* (2012).

82 Leon E. Trakman, *supra* note 53.

what drives China's motivation to pursue investment treaties with different partners? China has concluded their investment agreements, and these treaties often differ in only slight ways from the model offered by developed countries. One important objective for China is to improve its domestic investment climate. Even since the early 1990s, as a major capital-importing country, China has become more likely to incorporate international standards, reflected in treaties, into domestic laws. China exports capital to many other nations in the world. Thus, it must have apply standards to both import and export BITs, which will also help China solidify reforms at home and promote competition its market.

1.4 Investment Claims and China

China has succeeded in attracting massive amounts of FDI over several decades and is expected to further extend its global influence over FDI markets, though there are many criticisms of China's image in relation to foreign investment.[83] There have not been many cases involving China, or Chinese investors registered at ICSID. To date, there appear to be five cases filed by Chinese investors under an investment treaty. There is only one case provoked by a foreign investor against China. Despite China's commitments to consent for *ad hoc* international arbitration, it has had little-publicized experience with investor-state arbitration to date. The following subsections choose six publicized open cases to observe: (1) the risks foreign investors may face in China, and (2) that in other countries' territory Chinese investors pursue investor-state arbitration for their interests.

a) China as a Defendant

The first claim against China is related to construction, timber logging and property development of over 900 hectares in the Hainan province. The rights to leasehold land held by the Malaysian investor were revoked by the local authority, as it claimed that

[83] Vivienne Bath, 'The Quandary for Chinese Regulations: Controlling the Flow of Investors into and out of China,' in Vivienne Bath and Luke Nottage (eds), *Foreign Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge 2011) 25.

the investor had failed to develop the land following local legislation. Ekran[84] filed its claim at ICSID in May 2011. The parties suspended the proceeding in July 2011 and the case was settled in May 2013.[85] No tribunal was ever appointed.

b) China (investor) as Complainant

The first case lodged by a Chinese investor was in *Tza Yap Shum* v. *Peru.*[86] One of the central issues at the jurisdiction stage was whether the investor could avail of the protections of the China-Peru BIT (1994). The tribunal confirmed that an investor from the SAR Co. of Hong Kong was a covered investor under the BIT, and thus entitled to protection for their investment. Nationality is a question of domestic law, as nationality was conferred by a state to a person under its laws. There was no express exclusion in the BIT itself of Chinese nationals resident in Hong Kong nor did Article 25 ICSID require anything more than nationality. Peru's objections on this point were rejected as well as the submission that the transaction was not a covered investment because it was made indirectly through an SPV corporation.

There are some other pending claims by Chinese investors. Two are UNCITRAL arbitrations in accordance with the terms of the relevant BITs: *China Heilongjiang International Economic & Technical Cooperative Corp., et al. v. Mongolia*,[87] which has been withdrawn by the claimant, and in *Philip Morris Asia Limited v. Australia*.[88]

The Philip Morris claim was lodged in 2011, under the Hong Kong-Australian BIT (1993). Article 10 of the treaty provides for arbitration under the UNCITRAL Rules. The basis of the claim relates to the issue of plain-packaging legislation for cigarettes, which Australia argues is part of a "comprehensive government strategy to

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[84] *Ekran Berhad* v. *People's Republic of China* (ICSID Case No. ARB/11/15).

[85] The outcome of the proceeding as shown in the ICSID centre: The Secretary-General issues a procedural order taking note of the discontinuance of the proceeding according to ICSID Arbitration Rule 43(1) on May 16, 2013.

[86] *Tza Yap Shum (Investor of Chinese Nationality)* v. *the Republic of Peru,* Decision on Jurisdiction and Competence of the Arbitral Tribunal, ICSID Case No.ARB/07/6, June 19, 2009. The case is under the Peru-China BIT. The claimant is a Chinese national with Hong Kong residency, who provoked the case against Peru for conduct relating to TSG Peru S.A.C., a Peruvian company in the business of producing fish-based food products and export thereof to Asian markets.

[87] *China Heilongjiang International Economic & Technical Cooperative Corp., Beijing Shougang Mining Investment Company Ltd., and Qinhuangdaoshi Qinlong International Industrial Co. Ltd.* v. *Mongolia*, UNCITRAL rules/PCA (Permanent Court of Arbitration), according to China-Mongolia BIT (1991). The dispute arose out of the cancellation of licenses held by the claimants in the Tumurtei iron ore mine in 2012.

[88] Philip Morris Asia's claim against Australia concerns Australia's plain packaging laws. The tribunal ruled (in December 2015) that it had no jurisdiction to decide the claim.

reduce smoking rates in Australia."[89] The Hong Kong-Australian BIT is different in format to the Chinese BITs relied on the previous cases, as it is a broad dispute resolution provision, not requiring the exhaustion of domestic administrative proceedings. Australia also asserted, as a separate argument, that the Hong Kong-Australia BIT only accorded protection to investments that had been 'admitted' by the host state 'subject to its law and investment policies applicable from time to time'.[90]

Another case is an ICSID claim arising out of the financial crisis. The award on jurisdiction has already been released. Ping An, China's second-largest insurance company, filed a complaint against Belgium in September 2012 seeking over $3 billion in damages relating to its ill-fated investment in Fortis which was nationalized by the Belgian Government in 2008. Ping An had bought a stake in Fortis less than a year before. A tribunal was appointed and held its first meeting on procedural aspects in April 2013. It was both the first time a mainland Chinese investor filed a claim against an OECD country at ICSID, and that one of China's new third generation BITs will be considered. The tribunal dismissed Ping An's claim for lack of jurisdiction.[91]

The latest case is *Beijing Construction Company* v. *Yemen*.[92] Claimants alleged that the Yemeni government deprived their assets and contract rights concerning a project for the construction of an airport terminal in Sana'a. The case was registered at the ICSID in 2014. At the time of writing this case is still pending.

Many early Chinese BITs provided a clause to submit the claims to a judicial or

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[89] Australia contended that at the time that the dispute between the parties arose, Philip Morris Asia did not own an interest in the investments that it claims are covered by the investor protection provisions of the Hong Kong-Australia BIT. Australia relied on the fact that Philip Morris Asia only acquired ownership of the related investments in Feb. 2011, almost a year after Australia's April 2010 announcement of its decision to introduce plain packaging legislation.

[90] For the burden of proof, Australia argued that it was up to Philip Morris Asia to prove that "the investments which formed the subject of the dispute met the definition of the 'investment' covered under the BIT." See Article 1(e), Hong Kong-Australia BIT.

[91] Ping An, had submitted the claim by the new investment protection treaty between Belgium and China, which entered into force in 2009. This treaty replaced the old one of 1986. The Tribunal held that it lacked jurisdiction to rule on a dispute that arose before the entry into force of the new Treaty, that was based on an alleged breach of the old 1986 Treaty, about which Ping An had notified Belgium before the entry into force of the new Treaty. According to the 1986 Treaty, the parties only can render the disputes concerning compensation of expropriation for international arbitration.

[92] *Beijing Urban Construction Group Co. Ltd*. v. The *Republic of Yemen*, ICSID Case No. ARB/14/30.

administrative body of the host state.[93] In the absence of an investor-state arbitration clause in BITs, the investor will have no effective means of enforcing their substantive rights under the BIT. For some BITs, arbitration clauses are limited to a quantification of compensation in cases of expropriation (depending on the precise wording of such clauses). Recently, Chinese investors have begun using the BIT to make claims against the host state if governmental measures have negatively affected their overseas investments.

In practice, there are still many questions. China's particular method of liberalizing its BITs is explicable in light of its economic and political development and historical differences from the West.[94] Given China's late participation in BITs, its ideological dissimilarities to the West, and its developing economy, it is unrealistic to expect it to embrace the liberalization of investment that most Western countries themselves did not initially embrace either.[95] As a capital importer, China has had significant historical reasons for regulating inbound capital, including through BITs, domestic laws, administrative regulation, its court system, and commercial arbitration. As a growing capital exporter, China may need to use BITs to protect its outbound investors in BIT partner states. This raises further questions of what commitments China has already promised in its current trade and investment agreements, and if China should take responsibility when involved in world economy activities. Furthermore, it asks what is trade law's influence on the form of new investment agreements?

The structure of this thesis will be as follows: The first part of the thesis will analyse China's legal obligations in investment agreements in the pre- and post-WTO entry phases respectively. After Chapter 1 states China's investment policy before its accession to the WTO in 2001, Chapter 2 clarifies China's commitments in the WTO agreements, especially China's promises under the Protocol of Accession. Recently countries are inclined to negotiate free trade agreements (FTAs) which involved investment agreement as a package deal. Challenge of this trend arises as a large

93 See, for example, Article 8 of the China-Kuwait BIT (1985), and Article 13 of the China-Singapore BIT (1985).
94 *Id.*
95 See Sharon W Mukand, 'Globalization and the "Confidence Game"' (2006) 70(2) *J Int'l Econ*, p. 406.

number of bilateral treaties make the system much more complicated. Chapter 3 describes China's practice in concluding bilateral investment agreements and analyses FTAs and BITs respectively during the post-WTO period. It begins with a description of the legal rules and economic reasons why countries may choose to switch from multilateral rules under the WTO agreements to make promises under PTAs. It will then scrutinize Chinese PTAs, questioning how FTA's influence on capital flow is faring in the context of China. This part lastly makes a comparison between investment provisions in BITs and PTAs.

The second part of the thesis concerns interpretations of substantive and procedural provisions, as trade may influence the formation of investment treaties through the interpretation of substantive commitments by tribunals. Most-Favoured-National (MFN) treatment and national treatment are among core principles in foreign investment law, which can trace their sources from international trade law. Chapter 4 tries to answer the question, whether and how do tribunals consider jurisprudential concepts, developed in the case law of the trade regime when resolving investment cases. The case law shows that they have done so occasionally only for a very limited set of substantive issues. Trade law may influence *ad hoc* tribunal's interpretation of non-discrimination standards. Chapter 5 examines different remedies in trade and investment agreements. China has had few publicized cases of investor-state arbitration to date. It is important for China to maintain compliance with its commitments in international agreements, otherwise, it will face high-cost countermeasures. Finally, Chapter 6 provides an overall conclusion regarding China's openness to foreign investment during the phases of pre- and post-accession of WTO.

2 Investment, Trade and Multilateral Agreements

In the WTO, countries negotiate binding agreements to reduce trade barriers, agree on disciplines for policies affecting international trade, and provide a remedy for dispute settlement mechanisms.[96] The interface defined between trade policy and economic regulations has become more blurred.[97] One difference is that negotiations on regulatory issues may be 'zero-sum games' (i.e., some countries may lose). By contrast, tariff reductions are 'positive-sum' (i.e., all countries gain, even though certain groups in each country will lose unless they are compensated). Another difference, again in contrast to tariffs, is that it can be difficult to agree on what constitutes a non-tariff measure (NTM) — that is to say, what types of policies are trade distorting. Sometimes, it may be indeasible to reduce their negative impact. For many NTMs, all that may be possible is to agree to apply the core principles of transparency, National Treatment (NT), and Most-Favoured-Nation (MFN), and to seek to adopt procedural mechanisms.[98]

Non-discrimination treatment, which is a core principle in investment law, may trace its roots from trade law but has a few differences. Firstly, unlike in international trade law, in international investment law MFN and NT provisions serve the same purpose.[99] They provide foreign investors, and their investments, with an equality of economic opportunity, regarding both the establishment and of treatment. In contrast, in the GATT world,[100] disciplines on regulations were mainly intended to ensure that tariff reductions would not be circumvented through the substitution of domestic

[96] Bernard M. Hoekman and Petros C. Mavroidis, *The World Trade Organization, Law, Economics, and Politics*, 2nd Edition, Routledge Press, 2016.

[97] All regulation affect trade, "The two communities have rarely communicated with each other in the past: the trade and the regulatory community. The report has been aimed to bridge this gap." See Mavroidis, *the E15 Initiative, Policy Options Paper*, 2016.

[98] *Id.*

[99] For the history of investment and trade diversion, see Todd Weiler, *The Interpretation of International Investment Treaty: Equality, Discrimination, and Minimum Standards of Treatment in Historical Context*, Leiden: Martinus Nijhoff Publishers, 2013, p. 435.

[100] The GATT was conceived as a multilateral agreement for the reduction of tariffs. Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, GATT Doc.MTN.TNC/W/FA, dated 20 December 1991.

measures.[101] Non-tariff barriers are addressed by the non-discrimination principle under the GATT. Then, the WTO agreements allow for the TBT and SPS Agreement[102] to integrate markets beyond non-discrimination.[103]

Secondly, by contrast to remedy confronting in trade law, the complainants (private investors) enjoy a direct right to demand compensation for violations. The tribunals in investment arbitration are also different from those in trade law: they are *ad hoc* tribunals. The ICSID Convention is procedural. Most investment treaties are bilateral, representing different internal compromises reached between specific countries. However, some opinions advocate that Most-Favoured-Nation provisions should be interpreted as broadly as possible.[104]

Despite these differences, the non-discrimination commitments of investment treaties that are influenced by trade law, reflect changes in the states' economic activities. Trade and investment can be 'complements' and 'substitutes'. 'Substitutes' refers to the establishment of a foreign subsidiary as a means for delivering goods or services to a foreign market, particularly when high tariffs or high transportation costs have made exports to that market unattractive. However, in a global picture, investment was increasingly seen not as a means of replacing trade, but of promoting it. Foreign subsidiaries, once established, were often links in a large chain of production. Thus, deeper economic integration required lowering barriers both to trade and to investment. As a result, states may negotiate bilateral and regional trade agreements as a package deal, which includes investment-related provisions. The inclusion of investment in a large group of contracts, therefore, may allow parties to offer concessions on investment in exchange for concessions in other areas. This process of deeper economic integration has begun to occur. For example, the founding

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[101] Petros Mavroidis, '*Regulatory Cooperation: Lessons from the WTO and the World Trade Regime,'* ICTSD and World Economic Forum, 2016.

[102] WTO law sets out specific rules on technical barriers to trade in the *Agreement on Technical Barriers to Trade*, commonly referred as the *TBT Agreement*, and the rules of the *Agreement on the Application of Sanitary and Phytosanitary Measures*, commonly referred to as the *SPS Agreement*.

[103] "The TBT and SPS Agreements, which cover a subset of regulatory activity dealing with issues of public health, consumer protection, environmental protection, etc., do not require from WTO members that they adopt first-best policies. They do oblige them, nonetheless, to adopt measures that have the least impact on trade, that are non-discriminatory, and where transparency has been observed." See Petros Mavroidis, '*Regulatory Cooperation: Lessons from the WTO and the World Trade Regime,'* ICTSD and World Economic Forum, 2016.

[104] "The policies underlying investment treaties further justify the broadening of MFN treatment to include the host State's broader consent to investor-State dispute settlement." See Stephan W. Schill, 'Multilateralizing Investment Treaties Through Most-Favored-Nation Clauses,' 27 *Berkeley J. Int'l L.* 496, 554 (2009); Erin O'Hara O'Connor and Susan D. Franck, 'Foreign Investments and the Market for Law,' *University of Illinois Law Review*, No.5, 2014.

of the European Union (EU) and the North America Free Trade Agreement (NAFTA)[105] represent this process. Free trade agreements with investment-related provisions between developed and developing countries have also proliferated in recent years.

This chapter will first give a review of the nexus between trade and investment agreements, then analyse investment-related rules in multilateral trade agreements. Finally, it will move to clarify a few of China's specific commitments in WTO Agreements, and its promises under Protocol of Accession.

2.1 The Nexus between Trade and Investment Agreements

Investment treaties trace their history to Friendly, Commerce, and Navigation (FCN) treaties in the eighteenth century, when Western developed countries aimed to improve trade between themselves.[106] As part of these treaties, the right of access was primarily for the purpose of trade, and persons entering the territory with their property.[107] FCN treaties were primarily trade-oriented agreements, and investment protection did not play an important role in their provisions.[108] However, FCNs did include some obligations to protect foreigners' property, for example, by giving 'special protection' or 'full protection' to the covered property.[109] In addition to the broad terms of property protection clauses, these early treaties developed specific provisions solely covering foreign investors and commercial ownership.[110] Thus, the principle objective of the treaties was to secure minimum international standards of treatment for both investors and investment abroad. According to these early FCNs,

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[105] North American Free Trade Agreement between the Government of Canada, the Government of the United States of Mexico and the Government of the United States of America (NAFTA), 13 December 1993, (1993) 32 *ILM* 289.

[106] The BITs programs as they emerged in the early years are described in: Kenneth J. Vandevelde, U.S. *International Investment Agreements* (2009); Kenneth J. Vandevelde, U.S. Bilateral Investment Treaties: the second wave, 14 *Mich. J. Int'l L.* 621 (1993); Jeswald Salacuse, BIT by BIT: the Growth of Bilateral Investment Treaties and their impact on Foreign Investment in developing countries, 24 *Int'l law* 655 (1990); M. Sornarajah, State Responsibility and Bilateral Investment Treaties, 20 *J. World Trade L.* 79 (1986); Pamela B. Gann, the U.S. Bilateral Investment Treaty program, 21 *Stan. J. Int'l L.* 373 (1985).

[107] See Herman Walker, Jr, 'Modern Treaties of Friendship, Commerce and Navigation', 8 *Minnesota Law Review* 42 (1957): 805-24.

[108] *See* Kenneth J. Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation*, New York; Oxford: Oxford University Press, 2010. p. 22.

[109] *Ibid*., p 23. It is 'absolute' standard because it did not depend upon the level of protection afforded to the property of nationals of other countries.

[110] *Ibid*., p 39.

foreign nationals also enjoyed the right of equal access to domestic courts. Later FCN treaties were extended to prohibit restrictions on the repatriation of profits.

After the Second World War, states endeavoured to set up an international order by negotiating a multilateral trade agreement.[111] The Havana Charter of 1948 would have created the International Trade Organization (ITO).[112] Notwithstanding its focus on international trade, an important objective of the Charter was to encourage economic development, and to foster the global flow of capital for productive investment.[113] The Havana Charter contained some provisions concerning foreign investment, and the relationship between host states and foreign investors.[114] Had the Havana Charter come into force, this would have paved the way for the co-existence of a treaty-based system of bilateral and multilateral treaties on foreign investment, alongside its members' trade obligations.[115]

Following the failure of the Havana Charter to enter into force, the international community was left with the GATT 1947 and its annexed tariff schedules. The GATT 1947 did not contain any provisions on investment.[116] GATT is about tariff reduction, with domestic instruments ensuring that tariff concessions will not be undone through subsequent unilateral action.[117] Should WTO members be obliged to treat domestic and foreign *investors* alike in all respects, because the term "affecting" appearing in Article III.4 GATT and the non-discrimination obligation may extend to any measure

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[111] The first step on the road to post-war economic recovery was the Bretton Woods Conference of 1944, which resulted in the establishment of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). See *Proceedings and Documents of the United Nations Monetary and Financial Conference*, Bretton Woods, New Hampshire, 1-22 July 1944, vol. 1 (Washington, DC: US Department of States, 1947), p. 941.

[112] The Final Act and Related Documents of the United National Conference on Trade and Employment, Havana, Cuba, 21 November 1947-24 March 1948 (Final Act of the Havana Conference), included the draft Chapter for the International Trade Organization (ITO), UN Doc. ICITO/1/4 (1948) (Havana Chapter).

[113] See Havana Charter, Art. 12(1)(d).

[114] Participating States were to "provide reasonable opportunities for investments acceptable to them and adequate security for existing and future investments and to give due regard to the desirability of avoiding discrimination as between foreign investments." Article 12(2) of the Charter.

[115] Mary E. Footer, "International investment law and trade: the relationship that never went away," in Freya Baetens ed., *Investment Law within International Law: Integrationist Perspectives*, Cambridge University Press, 2013, p. 263.

[116] The GATT regulates two types of investment measures: (a) local content requirements (Art.III.5) and (b) export performance requirements (Art. XI). It requires WTO members to abolish these measures. See Douglas A. Irwin, Petros C. Mavroidis, Alan O. Sykes, *The genesis of the GATT*, New York: Cambridge University Press, 2008.

[117] Petros C Mavroidis, *"*Regulation of Investment in the Trade Regime: from ITO to WTO,*"* at Zdenek Drabek and Petros Mavroidis ed., *Regulation of Foreign Investment*, World Scientific Press, 2013, p. 30.

affecting trade?[118] The panel on *Canada—FIRA (Foreign Investment Review Act)* explained the limits of the coverage of investment protection under the GATT 1947:

> "…the purpose of Art. III.4 is not to protect the interests of the foreign investor but to ensure that goods originating in any other contracting party benefit from treatment no less favourable than domestic goods…" "…the national treatment obligations of Art. III of the General Agreement do not apply to foreign persons or firms but to imported products."[119]

Thus according to the award, the non-discrimination obligation does not extend to protection of private investors.

Following the demise of the Havana Charter there have been a number of developments in which investment and trade initially went their separate ways.

Despite restrictions after WWII, some international investment flows did resume, nearly all of which originated in a few Western developed countries.[120] By 1971, the Bretton Woods system was no longer sustainable.[121] The collapse of the Bretton Woods system changed state practice on capital mobility, while the 'impossible Trinity' ('trilemma of international finance') illustrated further capital mobility issues.[122]

Different from US' practice on FCNs, the European BITs were concerned solely with investment protection.[123] However, capital-exporting developed countries shared the same approach to protect investment under either FCNs or BITs. Their joint

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[118] *Id*.

[119] GATT Panel Report, *Canada-Administration of the Foreign Investment Review Act*, L/5504, adopted 7 February 1984, *BISD* 30S/140 (*Canada-FIRA*), para. 5.1, 5.9, 6.5.

[120] See Thomas Cottier, John H. Jackson and Rosa M. Lastra, ed., *International Law in Financial Regulation and Monetary Affairs*, Oxford: Oxford University Press, 2012.

[121] U.S President Nixon took the dollar off the gold standard. States began to allow the exchange rate to float, that is to say, to be set by the market. A country that chooses to allow its currency to float might nevertheless periodically intervene in the market, buying or selling currency in order to raise or lower the exchange rate, and thereby keep it in a certain range. There is a dilemma between a state's monetary policy and its currency stability. The only way to escape this dilemma is to restrict capital movements. States can close the capital account to achieve both purposes, but they will then lose the benefits of foreign investment. Thus many countries have sought to balance all of these considerations, through a compromise, known as a managed float. Under the framework of capital mobility, a country may force a choice between recession and increased debt. The former was attributed to fixed exchange rate, while the latter was as a result of float rate. See Jeffrey A. Frieden, *Global Capitalism*, 2006, p. 63.

[122] It is impossible for a nation to have free capital flows, a fixed exchange rate, and independent monetary policy. A government must choose one side of this triangle, giving up the opposite corner. Paul R, Krugman, *International Economics: Theory and Policy*, (Ninth Edition) Pearson Education (US): Upper Saddle River, 2012. pp.509-510.

[123] In the early 1960s, individual European countries began to negotiate bilateral treaties that were unlike previous bilateral commercial agreements. These new treaties dealt exclusively with foreign investment and sought to create an international legal framework governing investments by the nationals of one country in the territory of another.

economic consideration was to protect investment against a variety of threats from the host state, including discriminatory treatment, exchange controls, and expropriation.[124] The late 1980s witnessed a new phase in the history of the BIT movement. The emerging economies of Eastern and Central Europe, alongside Latin American, African, and Asian countries, sought foreign capital to promote their own country's economic development. Since this time, the number of BITs involving two developing countries, in what one may call 'South-South' BITs, has increased steadily.

After NAFTA was concluded in 1994, it became an important driving force for its member countries to re-examine the BIT negotiating model. One reason was that NAFTA gave rise to claims against the US by foreign investors. The second reason was that BITs were launched in a setting in which investment was increasingly viewed in its relationship to trade.

This subsection will first observe how bilateral investment treaties were successfully emerging in developing countries. It will then analyse the reasons why an endeavour sponsored by many OECD countries for a multilateral investment agreement failed, and assess where it would be possible to build a multilateral investment treaty, in a global scenario.

2.1.1 Developing Countries' Unique Way to Liberalize Investment by Signing BITs

In the 1970s, developing countries suffering debt crises were forced to turn to private foreign investment as a source of capital.[125] The economic integration trend was also reflected in a series of success stories. For example, 'Asian Tigers' and 'Dragon Economies' succeeded because of high rates of private investment and an emphasis on

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[124] For investment treaties' strong protection standards, see Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties*, Kluwer Academic Publishers, 1995. M. Sornarajah, *The International Law on Foreign Investment* (Third edition), Cambridge: Cambridge University Press, 2010. Zachary Douglas, Joost Pauwelyn, Jorge E. Vinuales, *The Foundations of International Investment Law: Bringing Theory into Practice*, Oxford University Press, 2014. August Reinisch, ed., *Standards of Investment Protection*, Oxford University Press, 2008.

[125] See Andrew T. Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties', 38 *Virginia Journal of International Law* 639 (1998); Jeswald W. Salacause, 'From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World', 33 *International Lawyer* 875, 882-886 (1999); Kenneth J. Vandevelde, 'Investment Liberalization and Economic Development: the Role of Bilateral Investment Treaties', 36 *Columbia Journal of Transnational Law* 501 (1998).

production for export. Then in 1989, after the collapse of the Soviet Bloc, the former Soviet countries turned to the free markets, while abandoning central planning.

In addition, the international law on foreign investment was redesigned at this time to adopt rules derived from the neoliberal philosophy.[126] Neo-liberalism advocates the reduction of state control over the economy and the facilitation of individual enterprise. It requires the protection of property rights, including intellectual property rights, the enforcement of contracts, and the effective use of dispute settlement mechanisms.[127]

The combined effect was the emergence of a consensus in the developing world about the desirability of attracting foreign investment through free market policies. Changes in attitude toward foreign investment were accompanied in the 1990s by a revolution in information technology. Starting in the late 1980s, the number of BITs soared. The emergence of these BITs may have been due to the assumption that an increase in FDI would provide interests to investors, while the developing host state would benefit from the capital, human resources and transfer of technology brought by FDI.[128] On the other hand, concluding BITs that guaranteed the safety of foreign investment may have offered a mechanism for signalling a desire to attract these new flows of foreign investment, and to provide a safer climate for investment.

2.1.2 Failed Multilateral Agreement on Investment among OECD Countries

At the multilateral level, it was not until the mid-1990s that the relationship between trade and investment law was revisited. This happened in two related developments. One was the establishment of the WTO in 1995 with new annexed agreements, while the other was an effort at the OECD to negotiate a Multilateral Agreement on Investment (MAI)[129] regulating FDI between states.

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126 Sornarajah, “The Past, Present and Future of the International Law on Foreign Investment”, in W. Shan ed., *China and International Investment Law, Twenty Years of ICSID Membership,* Brill Nijhoff Press, 2014, p. 24.
127 Representing the thinking of “Washington Consensus.”
128 W. Michael Reisman and Robert D. Sloane, ‘Indirect Expropriation and its Valuation in the BIT Generation’, *British Yearbook of International Law*, 74 (2003): 115-50, at p. 116.
129 For the draft MAI, see Organization for Economic Co-operation and Development, Negotiating Group on the Multilateral Agreement on Investment, 22 April 1998, THE MULTILATERAL AGREEMENT ON INVESTMENT DRAFT – CONSOLIDATED TEXT, DAFFE/MAI(98)7/REV1.

Countries made efforts to reconcile trade and investment — in the WTO's TRIMs[130] and in its Working Group on Trade and Investment.[131] At the multilateral level, the WTO has abandoned the negotiating group on trade and investment. As a result, regulations of investment in the WTO are limited to Art.III.5 GATT, TRIMs, Mode 3 under GATS[132] rules and the TRIPs provisions.

a) Negotiations for an MAI

Why did the MAI sponsored by OECD countries fail in 1998, and is a multilateral investment treaty still possible in the future? Or, why negotiate a multilateral treaty in the first place, if an investment agreement cannot promote FDI flow? The prospect of investment capital from certain developed countries, along with other political and economic benefits arising from a bilateral treaty, may make a developing country inclined to conclude a BIT rather than enter into a multilateral agreement.

Developed countries are inclined to think about the competition between their domestic competing-industry and foreign investors. This means that when investment flow is through a "single way", the developed country will prefer to conclude a bilateral treaty with the developing country partner for investment liberalization, because there are few enterprises from the developing country that will invest in the developed country.

There was also skepticism that investment rules actually had any real impact on the pattern of international investment flows. It was asked whether a multilateral agreement would be 'efficient' to attract investment. The MAI contained very high standards for liberalizing investment protection.[133] Unlike most BITs, the MAI

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[130] WTO, Agreement on Trade-Related Investment Measures, Marrakesh, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 143 (1999), 1868 *UNTS* 186.

[131] The Working Group on the Relationship between Trade and Investment was established during the 1996 Ministerial Conference in Singapore to examine the relationship between trade and investment. Also see Decision of the General Council on the work of the Working Group, WT/WGTI/2.

[132] General Agreement on Trade in Services, at Marrakesh, 15 April, 1994, 1869 *UNTS* 183, 33 ILM 1167, entered into force 1 January 1995 (GATS) is taken up in Annex 1B to the WTO Agreement.

[133] Sol Picciotto, 'Linkages in International Investment Regulation: The Antinomies of the Draft Multilateral Agreement on Investment', *University of Pennsylvania Journal of International Economic Law* 19 (1998): 731-68, at pp. 742-3.

purported to cover the pre-establishment phase as well. It included provisions on privatization, the behaviour of monopolies, and the temporary entry and stay of key personnel, such as investors, managers, and experts. The MAI adapted the principle of non-discrimination: first, the MAI parties committed to treat foreign investors and their investments no less favourably than they would treat their own; and second, the MAI parties agreed not to distinguish between investors and investments of other MAI parties. The MAI contained provisions on the cross-border transfer of funds; fair and equitable treatment; and the standard of compensation in case of expropriation. The coverage of the MAI was broad, as FDI, portfolio investment, and rights under contract formed part of its subject matter. It also sought to establish effective dispute settlement procedures, with both state-to-state procedures as well as investor-state arbitration. However, tribunals under inter-state investment dispute settlement, unlike WTO panels, would be allowed to grant direct pecuniary compensation or restitution.

A few reasons may explain why the MAI failed. First, foreign firms can have a huge impact on domestic economic sectors. It can lead to an economic crisis if foreign investors withdraw their investment (especially portfolio investment).[134] Second, multilateral corporations would have employed workers in low-wage countries, with lower labour standards.[135] Third, the NGOs were extremely hostile to the notion of investment negotiations, and they argued that companies would invest in countries with low environmental standards.[136] Also, developing countries were against it since they had not been invited to participate. Thus, while developing countries felt duty-bound to attend negotiations, they could neither actively participate, nor influence the rules-making process.

b) Back to investment in the WTO?

At the Doha Ministerial Conference in 2001, delegations discussed adopting a

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[134] See Razin A, 'Social Benefits and Losses from FDI.' In T. Ito and A. Krueger (Eds.), *Regional and Global Capital Flows,* University of Chicago Press, 2001, pp. 310-325.

[135] Trebilcock, M and R Howse, *International Trade Regulation* (2005), 3rd edition, London, UK: Routledge.

[136] See Graham ED, *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises*. Washington, DC: Institute for International Economics, 2000.

multilateral framework for trade and investment.[137] However, the WGTI could not agree on how to address the concerns of developing country members (who did not want to see their right to regulate investment restricted).[138] The Cancún Ministerial Conference concluded without any consensus on taking the work of the WGTI forward.[139]

2.1.3 A Multilateral Investment Treaty Outside the WTO

Where might a multilateral investment treaty be built? The challenge in answering this lies in exploring the reasons for proposals to address this issue in the WTO. An investment issue may be treated in the WTO if it is trade-related. Therefore, the question is where to draw a fine line: how can an administrative area be negotiated in the WTO? This may extend beyond market access. From an economic perspective, countries are willing to pursue regulatory cooperation which brings gains. One benchmark is to see whether there is a link to the contest of market. If it has a direct bearing on the conditions of competition prevailing on markets, it could be dealt with in the WTO.

The GATT rules apply to trade and trade-related issues, and they do not pertain to government measures that restrict or attract FDI. GATT is also not relevant to policies that affect the operations of foreign firms.

If countries propose to negotiate a multilateral investment treaty, the treaty may include rules on the right of establishment and national treatment for foreign investors and their investment.[140] These issues are largely not included in market access objectives. In many sectors, firms prefer the mode of supplying a market through FDI

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[137] It would secure 'transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment.' See Fourth WTO Ministerial Conference, Doha, 9-14 November 2001, Ministerial Declaration, WT/MIN(01)/DEC, 20 November 2001, para. 20.

[138] Peter T. Muchlinski, *Multilateral Corporations and the Law*, 2nd edn., Oxford University Press, 2007, pp. 669-73.

[139] Fifth WTO Ministerial Conference (Cancún, in September 2003), had no mention being made of the 'investment' issue in the Ministerial Declaration. See Martha Lara de Sterlini, 'The Agreement on Trade-related Investment Measures', in MacRory, Appleton and Plummer (eds), *The World Trade Organization*, pp. 477-8.

[140] See i.e., Stephan W. Schill, 'The Multilateralization of International Investment Law: Emergence of a Multilateral System of Investment Protection on Bilateral Grounds', *Trade Law and Development*, 2(1) (2010): 59-86, at p. 61.

rather than exports.[141]

However, trade and investment are increasingly complementary.[142] A larger share of global trade is intra-firm, involving exchanges between related enterprises. Much of the vertical FDI is export-oriented. Firms will pursue least-cost producers all over the world under global production scenario. Firms are sensitive to investment regulations because they often have to establish joint ventures or affiliates in various locations to ensure profits and quality.

Meanwhile, states could compete with one other to attract FDI by offering incentives — subsidies, taxation, etc. —to foreign investors. But, ongoing competition between developing countries in this way is not efficient from a global welfare point of view. This is because once a capital-exporting party (always developed countries) decides to make an investment, they only consider the exact location, and the total amount of FDI is not affected by tax incentives. The result of competition for FDI costs too much, and reflects a suboptimal level of taxation of capital relevant to other factors of production.

Why is a multilateral investment treaty still possible? If two countries compete for the same investment, why would they want to harmonize competition between them? First, national incentives (i.e., subsidizing foreign firms) may impose negative spillovers on other countries, leading to an inefficient outcome for the world as a whole.[143] Second, an international agreement on investment may be an instrument by which states make commitments, earn credibility, and reduce risk for investors. Third, trade and investment are closely interlinked. Thus, rules may be made for the full set of policies that affect actor's decisions—both trade and investment-related regulations. Lastly, because the GATS already covers FDI, investment rules on (non-services) FDI may be built outside the WTO framework.

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[141] Bhagwati, J, RA Brecher, E Dinopoulos and TN Srinivasan (1987), 'Quid pro quo, foreign investment, and welfare: A political economy theoretic approach,' *Journal of Development Economics*, 27, 127-138. Foreign export-oriented firms may establish import-competing subsidiaries to jump an existing tariff.

[142] See Baltagi, BH, P Egger and M Pfaffermayr (2008). Estimating regional trade agreement effects on FDI in an interdependent world. *Journal of Econometrics*, 145, 194-208. They discuss the relationship between PTAs and FDIs and conclude in an empirical paper discussing the Europe Agreements that the removal of trade barriers can lead to substantial flows of FDI for those participating parties.

[143] See Bernard Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System: the WTO and Beyond*, Third Edition, Oxford University Press, 2009. pp. 584-588.

a) Externalities

If countries are competing for FDI, externalities from this competition may exist. Developing countries are supposed to compete with one another to promote inward FDI through incentives to pursue spill-overs.[144] Thus, countries may need to justify incentives (i.e., taxation advantages) to attract FDI. States may also need to consider whether or not FDI can bring positive externalities, and what forms of domestic regulation will maximize the positive impact of FDI on the host country's economic growth. However, it is very expensive for governments to give foreign investors excessive payments (using tax incentives).

International agreement may play a role in disciplining the use of fiscal incentives. An empirical question is whether fiscal incentives are effective in attracting FDI. If incentives can't influence the FDI flow, there is no need to make an international agreement on efficiency grounds. The evidence on this question has been debated. Some studies say that incentives do not play an important role in changing the global FDI flow;[145] instead, what is more important is the domestic investment climate, including— market size, labour standards, trade facilitation, intellectual property rights, contract enforcement, etc.[146] In contrast, some others argued that incentives do have an effect on location decisions, especially for export-oriented FDI.[147]

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[144] Andrew Guzman argued that whereas developing countries might have been better off negotiating a multilateral investment agreement as a group, individual developing country defected in a prisoners' dilemma situation as each tried to attract the largest possible share of foreign investment by concluding bilateral treaties with developed countries. See Andrew Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties,' 38 *Virginia Journal of International Law* 639 (1998).

[145] Susan Rose-Ackerman takes a global view, finding that 'the marginal impact of BITs is greater in countries that already have relatively effective legal regimes and favourable economic environments.' See Susan Rose-Ackerman, 'The Global BITs Regime and the Domestic Environment for Investment.' In Karl O. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows,* Oxford University Press, 2009, p. 311.

[146] For example, as Luke Eric Peterson and Kevin R. Gray argued, "host states may wish to regulate the economy, including foreign investors embedded therein, in a manner which seeks to promote or protect certain human rights interests…. Where bilateral investment treaties are in place, foreign investors will often enjoy the ability to challenge these human-rights inspired measures through international arbitration." See Luke Eric Peterson and Kevin R. Gray, *"International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration,*" International Institute for Sustainable Development (2003), p. 5.

[147] 'While the stated purpose of DTTs is to address these tax issues, most countries have claimed that, by eliminating excessive taxation, tax treaties can help increase trade and investment between the two treaty signatories.' See Allison Christians, 'Tax treaties for Investment and Aid to Sub-Saharan Africa,' 71 Brooklyn Law Review, 639 (2005), p. 658.

Double taxation treaties (DTTs) help to eliminate double taxation and relieve jurisdictional conflicts. They detail specific allocation rules for different categories of income in both countries. DTTs can also limit transfer pricing, help to combat tax evasion (notably through the exchange of information), provide non-discrimination rules, and outline ways in which tax disputes can be resolved by prescribing specific conflict resolution mechanisms and arbitration procedures.[148] In addition, DTTs can provide remarkable certainty to foreign investors about the tax treatment of their cross-border activities in both the host and the home country.[149] Foreign investors can benefit from DTTs, which determine the maximum rates of taxation (particularly withholding tax rates) that can be imposed by a host country.

Beginning in the 1990s, investment issues have been increasingly addressed in bilateral and regional Free Trade and Investment Agreements (FTIAs).[150] Typical investment provisions of FTIAs include MFN and NT. FTIAs also increasingly address host country responsibilities on labour rights and environmental protection, issues not usually addressed in BITs. This approach allows trade-offs across issue areas (e.g. market access for increased investor protection). In this manner, FTIAs may directly influence FDI flows by opening sectors for investment. They may also indirectly influence FDI flows by enlarging the market, setting standards, and improving a host country's overall investment climate.

In practice, incentives are likely to be most expensive for developing countries that try to *offset* policy-distortions (bad infrastructure, political instability, etc.). Therefore, it is better for states to restrict those distortions *directly*, which means focusing on the fundamental disciplines of the WTO—transparency, NT, MFN and binding of polices—to the investment policy area may be a better choice.

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[148] Karl P. Sauvant and Jorg Weber, eds., *International Investment Agreements: Key Issues* (New York and Geneva: United Nations, 2004), volume II, p. 203.
available at: http://www.unctad.org/en/docs/iteiit200410v2_en.pdf.

[149] Tsilly Dagan illustrates a game theory rationale that explains why many developing countries have opted for relieving source-country taxation in order to attract more FDI. See Tsilly Dagan, 'The Tax Treaties Myth,' 32 *Journal of International Law and Politics* 939, (2000), at 979.

[150] "As of June 2007, 251 FTIAs had been signed—nearly twice as many as five years earlier." See UNCTAD Research Note, "Recent Development in International Investment Agreements," UNCTAD/WEB/ITE/IIT/2007/6, available at: http://www.unctad.org/en/docs/webiteiia20076_3n.pdf.

b) Credibility

Obligations in the investment agreement have played a major role in protecting investment from risks such as expropriation. Many countries that are looking for FDI have made use of a variety of existing, non-WTO credibility-enhancing institutions. These include accepting the arbitration of disputes under the ICSID, by the International Chamber of Commerce (ICC), or by the UN Committee on International Trade Law (UNCITRAL). Investors can choose tribunals. Most BITs involve commitments on dispute settlement mechanisms. Countries can also use existing WTO disciplines to schedule market access policies for services (FDI).

c) Completing the WTO Architecture

The NAFTA adopts regulations that distinguish between trade and investment, with *trade* in goods or services being subject to a set of standard rules, and movement of factors of production (investment) being subject to another set of rules. In other words, NAFTA includes a separate chapter on investment (in goods and services), which is distinct from the rules relating to cross-border trade (in goods and services).

FDI in service is covered by the GATS ("mode 3"). "GATS-inspired" FTAs have separate chapters on investment and services.[151] However, investment in services is covered by both chapters. Liberalization of the supply of services, (including through commercial presence), is governed by the Trade in Services Chapter; whereas the protection of investments in services, (including clauses on expropriation, compensation for losses, investor-state dispute settlement), is located in the Investment Chapter.

The payoff for eliminating entry restrictions for services is high from an economic perspective, as FDI is the main *Mode* of supply. In turn, if it is the high trade barriers that cause the red tape on inward FDI, governments should give priority to trade liberalization. Both can be pursued independently of FDI talks through multilateral liberalization of trade in goods and services. The GATS already covers FDI in services industries and allows commitments on establishment as a mode of supply.

[151] Houde et al. "Interaction between Investment and Service Chapters in RTAs," *OECD Working Paper*, 2007.

Based on this fact, states may prefer to make a multilateral investment agreement outside of the WTO.

The following sections will scrutinize investment-related rules in existing world trade frameworks, with particular focus on China's obligations under multilateral trade agreements, i.e., the GATS. We will also have a look at the Telecoms Reference Paper, which obliges WTO member to impose an agreed set of requirements on their private agents.

2.2 Investment-Related Rules in WTO Agreements

There are some formal mechanisms by which trade directly influences the formation of international investment agreements. First, through provisions within the TRIMS,[152] GATS, and TRIPS Agreements, the WTO contracts place distinct obligations on its members concerning their handling of cross-border investment. Second, through the inclusion of an investment chapter within a PTA, states may choose to subject themselves to further investment-related obligations in exchange for preferential market access for their exports. This subsection will clarify investment-related rules under WTO Agreements, and China's obligations in multilateral trade agreements.

2.2.1 TRIMs

One link between investment and trade is the TRIMs Agreement, which seeks to prevent the trade-restrictive and distorting effects that some investment measures may have on trade in goods. Article 2.1 of the TRIMs Agreement[153] bans any TRIM that is inconsistent with the national treatment standard of Article III of the GATT 1994[154] or the prohibition on quantitative restrictions in Article XI of the GATT 1994.[155] An

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[152] Agreement on Trade-Related Investment Measures, done at Marrakesh, 15 April 1994, 1868 UNTS 186, entered into force 1 January 1995 (the TRIMs Agreement or TRIMs) is taken up in Annex 1A to the WTO Agreement.
[153] TRIMs Agreement, Art. 2.1.
[154] Article III of the General Agreement on Tariffs and Trade 1994 (GATT 1994) is contained in Annex 1A to the WTO Agreement.
[155] GATT 1994, Art. XI.

Illustrative List annexed to TRIMs provides examples of measures that are inconsistent with Art. III or Art. XI GATT. The Illustrative List cites the following examples:

(a) local content requirements;
(b) export performance requirements;
(c) trade balancing requirements;
(d) foreign exchange balancing restrictions, and
(e) restrictions on an enterprise's export or sale for export of products.[156]

Two of the measures [(a), (c)] covered are inconsistent with Art. III.4 GATT. The Illustrative List also reflects three categories of measures that are inconsistent with Art. XI.1 GATT [(b), (d), (e)]. What all these measures share is that they are export-related.

North American countries favour the admission and establishment of FDI on the basis of MFN and national treatment, including pre- and post-establishment.[157] The right of admission may be subject to the right of each party to the BIT to adopt certain exceptions falling within certain sectors. These are listed in a separate annex.[158] The 2012 US Model BIT, for example, also specifically dealt with performance requirements, which are: local purchasing and local content requirements, trade balancing requirements, foreign exchange restrictions and export performance requirements.[159]

2.2.2 "Mode 3" in GATS

As tariffs on goods are reduced, industries must lobby for liberalization and regulatory cooperation in service markets. If service markets are contestable, it may be reflected in the reduced input prices for manufacturing industries. This trend has happened since the 1980s. States also began emphasizing policies affecting trade and investment in services, due to the rapidly growing global market.

[156] TRIMs Agreement, Art. 2.2 and Annex.
[157] i.e., Treaty between the Government of the United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment, 2012, Articles 3 and 4 (2012 US Model BIT), available at: www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf.
[158] 2012 US Model BIT, Art.14.
[159] 2012 US Model BIT, Art.8.

The GATS was created as a major result of the Uruguay Round.[160] It established rules and disciplines on policies affecting access to service markets, and extended the coverage of the multilateral contract. The liberalization of trade in services happened later, as many services had been non-tradable for a long time. Technological innovation made a large number of services tradeable. If trade occurred, the services tended to be embodied in goods, information flows, or people.[161]

Trade in services differs from trade in goods because services tend to be intangible and non-storable. Although some transactions may occur across the border, some services still require that provider and consumer are in the same place at the same time. However, this limitation can be overcome through the physical movement of consumers to the location of the service providers, or via the entry of service providers into the territory of a consumer.

The GATS explicitly applies to the delivery of services, through a 'commercial presence.'[162] One of the 'modes' to supply services outlined in the GATS is that in which a service provider establishes a 'commercial presence' in the host country—i.e., a firm makes an investment to provide a service to the host country ('mode 3' in GATS). In fact, the definition of 'commercial presence' is 'any type of business or professional establishment', which might include either 'the constitution, acquisition or maintenance of a juridical person', including, but not limited to, 'the creation or maintenance of a branch or a representative office' in the territory of a member for the purpose of supplying a service.[163]

Thus, a GATS commitment to allow trade in a particular service sector, through a commercial presence, amounts to a commitment to allow the establishment of foreign investment.

The establishment of a commercial presence in a country—engaging in foreign direct investment (FDI)—is another way of liberalizing services markets. Firms can sell their services in the foreign country by FDI (long-term physical presence) if they

[160] General Agreement on Trade in Services, done at Marrakesh, 15 April, 1994, 1869 UNTS 183, 33 ILM 1167, entered into force 1 January 1995 (GATS) is taken up in Annex 1B to the WTO Agreement.
[161] Hoekman and Kostecki, *supra* note, at 318.
[162] GATS, Art. I:2(c).
[163] GATS, Art. XXVIII(d).

find cross-border exchange or the temporary physical movement of a natural person does not suffice for an exchange to be feasible.

From a balance of payments perspective, ‘a commercial presence’ as a means of delivering international services is a transaction between residents and is therefore *not* recorded as a trade transaction.[164] In this sense, it is much harder to collect data on trade in services compared to those on goods. Part of the reason is that, once established, foreign firms are considered to be residents of the host country, and thus data on sales of services by affiliates does not exist.

2.2.3 TRIPs

Another investment-related WTO agreement is the Agreement on Trade-Related Intellectual Property Rights (TRIPs). The TRIPs agreement obligates the parties to provide certain protections for intellectual property, as a form of investment. As cross-border investments increasingly involve intellectual property, the TRIPs Agreement serves as a guarantee of the minimum standards of protection that such investments will have in WTO member states.

Any violation of these three agreements, as mentioned above, is open to adjudication under the WTO dispute settlement system. However, the WTO agreements governing investment do not include general rules on issues such as restrictions on the transfer of funds related to investment, or the calculation of compensation for expropriation.

2.3 GATS and Interpretation of China’s Commitments

Under traditional trade concepts, questions of access to the distribution system or service facilities is a trade issue, while ownership of the distribution system is an investment issue.[165] While it is necessary for trade negotiating purposes to make a

[164] The reference to ‘a commercial presence’ as a means of delivering international services is an innovation of the GATS, which requires the proximity of the supplier and the consumer. See Mary E. Footer and Carol George, ‘The General Agreement on Trade in Service’, in Patrick MacRory, Arthur Appleton and Michael Plummer (ed.), *The World Trade Organization: Legal, Economic and Political Analysis*, Springer, 2005, p. 825.

[165] ‘The US National Study on Trade in Services, A Submission by the United States Government to the General Agreement on Tariffs and Trade’ 37-39 (1982), in John H. Jackson, William J. Davey, and Alan O. Sykes, Jr.,

distinction between trade issues and investment issues, this does not imply that investment barriers are irrelevant to trade.[166] Indeed, in many cases, the ability to invest in elements of the distribution system or local enterprises can substantially enhance a firm's ability to export its services. BITs cover many areas of services. The General Agreement on Trade in Services (GATS) is the only multilateral agreement that contains legally binding and enforceable rules about measures affecting foreign investments.[167]

2.3.1 Framework of the GATS Commitments

The subject of the general obligations imposed by the GATS on all WTO members includes the MFN obligation (Art. II), transparency (Art. III), obligation to negotiate aspects of domestic regulation (Art. VI), and some competition-related commitments (Art. VIII and IX). The GATS allowed for exemptions from the MFN obligation, provided that these were scheduled at the entry into force of the WTO. Thus, a member can indicate the countries that it does not wish to grant MFN status. The Annex on Art. II of the GATS states that, in principle, such exceptions should not last for more than ten years.

When it comes to specific commitments, the structure of commitments made by WTO members on services takes the form of a positive listing of sectors. These sectors are subject to market access and national treatment obligations. A member has three broad choices: it may schedule "none", meaning that it does not impose any limitation on the supply of particular kind of service; "unbound" implies it is essentially free to regulate as it deems appropriate (no commitment of any kind has been made); or it may introduce specific language to describe its commitment.

The first column of a schedule pertains to Art. XVI GATS (market access). This column lays out six measures restricting market access.[168] The second column of

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Legal Problems of International Economic Relations: Cases, Materials and Text, six edition, WEST Press, 2013, pp1042-1044.

[166] *Id.*

[167] Bart De Meester and Dominic Coppens, '*Mode 3 of the GATS: A Model for Disciplining Measures Affecting Investment Flows?*' at Zdenek Drabek and Petros Mavroidis ed., Regulation of Foreign Investment, World Scientific Press, 2013, pp.99-151.

[168] In sectors where market access commitments are undertaken, the measures which a member may not maintain

each schedule relates to Art. XVII GATS: national treatment. The third column of each schedule relates to Art. XVIII GATS, which allows for "additional commitments."[169]

For a complete picture of sectoral commitments, it is also necessary to consider the "horizontal commitments"—generally applicable provisions and restrictions that apply to all modes of supply, as well as the list of MFN exemptions that each WTO member has deposited to the WTO.

2.3.2 GATS Scope about Investment Measures

The General Agreement on Trade in Services (GATS) has a different approach toward investment: contrary to the GATT, it does not provide a list of impermissible investment measures, but allows for WTO members to contract the parameters of investment protection in their market in the field of services.

The situations of investment that are covered by the GATS are more limited than the cases covered by the OECD benchmark definition.

Article 1.2 of the GATS defines "trade in services" through four modes of supply. A link is made to foreign investment because Mode 3 of service supply is described as "the supply of a service […] by a service supplier of one Member, through commercial presence in the territory of another Member."[170]

The term "commercial presence" is further clarified in Art. XXVIII (d) of the GATS, which reads:

> "commercial presence" means any type of business or professional establishment,

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(unless otherwise specified in its schedule), are defined as:
a) limitations on the number of services;
b) limitations on the total value of service transactions or assets;
c) limitations on the total number of service operations or the total quantity of service output expressed;
d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service;
e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

[169] So far, this possibility has been used comprehensively in the case of telecommunications. The Agreement on Basic Telecommunications includes a "Reference Paper," whereby WTO members agreed on conditions of competition (and the ensuing investment protection) for foreign operators doing business in their national telecoms market.

[170] GATS, Art. 1.2.

> including through
> (i) the constitution, acquisition or maintenance of a juridical person, or
> (ii) the creation or maintenance of a branch or a representative office, within the territory of a member for the purpose of supplying a service."[171]

Mode 3 service supply thus apparently involves investment in the sense that "any type of business or professional establishment" will be set up in the territory of another member for the purpose of supplying a service. This test can take the form of a juridical person or of an entity that has no juridical personality (e.g., a branch or representative office). Art. XXVIII (1) defines "juridical person" as:

> "Any legal entity duly constituted or otherwise organized under applicable law, whether for profit or otherwise, and whether privately owned or governmentally owned, including any corporation, trust, partnership, joint venture, sole proprietorship or association."[172]

The legal person may not only involve the creation of a *new* juridical person but may also be created through the acquisition of an *existing* corporation in the host member. Therefore, Mode 3 service provision also covers the "pre-establishment" phase: measures that restrict the possibility to set up a commercial presence (and thus to invest) are within the scope of the GATS.[173]

a) Defining "Owned or Controlled."

Art. 1.2(c) provides that Mode 3 service supply takes place when a service supplier of one member provides services through commercial presence in another member. The service provider of the first member is a juridical person.[174] It is important, however, that the commercial presence in the host member is "owned or controlled" by the natural or juridical person in *another* member.[175] If not, the service provider that

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[171] GATS, Art. XXIII(d).
[172] GATS, Art. XXVIII(1).
[173] See Council for Trade in Services, Mode 3—Commercial Presence. Background Note by the Secretariat, S/C/W/314, April 7, 2010, para. 9.
[174] For most supply, the service supplier is a legal entity, and it must be a company.
[175] The panel addressed this question to define the origin of a service in *China-Publications and Audiovisual Products*, whereby the panel considered whether some Chines measures treated service suppliers from another member less favourably than their own service suppliers, thereby violating China's commitments under Art. XVII of the GATS. The panel needed to determine the origin of the foreign-invested entity and stated: "Recalling the

provides services through a commercial presence would not be a service supplier from another member. In such case, there would not be any cross-border element in the supply, and thus the GATS could not apply.[176] It was therefore necessary to define the situations in which the commercial establishment of a host member can, in fact, be considered to be a "juridical person of another member." Art. XXVIII(m)(ii) of the GATS clarifies:

> "juridical person of another member" means a juridical person which is either:
>
> (i) constituted or otherwise organized under the law of that other member, and is engaged in substantive business questions in the territory of that member or any other member; or
> (ii) in the case of the supply of a service through commercial presence, owned or controlled by:
>
> 1. natural persons of that member;
> 2. juridical persons of that other member identified under subparagraph (i)."[177]

The Panel in *Canada—Autos* stated: "In order to define a 'juridical person of another member', Art. XXVIII(m) of the GATS does not require the identification of the last controlling juridical or natural person: it is sufficient to establish ownership or control by a juridical person of another member, defined according to the criteria set out in subparagraph (i)."[178]

The meaning of "owned" and "controlled" is further specified in Art. XXVIII(n)(i) and (ii) of the GATS:

> (i) 'owned' by persons of a member if more than 50% of the equity interest in it is

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relevant definitions set out in Art. XXVIII of the GATS, we observe that any 'foreign-invested entity' supplying the services at issue in China, and that is owned or controlled by persons of another member, is a service supplier 'of any other member' within the terms of Art. XVII." This point was not appealed before the Appellate Body. See Panel Report, China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/R and Corr.1, adopted January 19, 2010, para. 7,1282.

[176] The definition of the four modes of supply in Article I.2 of the GATS requires each time a cross-border element. The GATS does not apply to purely internal situations. Either the service moves from one member to another (mode 1), or the consumer moves from one member to another to receive the service (mode 2), or the service supplier from one member sets up a commercial establishment in another member where the service is provided (mode 3), or the service supplier that is a natural person moves to another member to provide the service (mode 4).

[177] GATS, Art. XXIII(m)(ii).

[178] Panel Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, adopted June 19, 2000, para. 10,257.

> beneficially owned by persons of that member;
> (ii) 'controlled' by persons of a member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions.[179]

In contrast to the OECD benchmark definition of investment, the definition provided by the GATS would therefore not necessarily consider situations where only 10% of the voting power is at stake as service supply through commercial presence. What needs to be shown is that there is either majority ownership or actual "control", in the sense of power to name a majority of the directors or legally direct their actions. This requires considering the spread of the shareholding, and the influence by other stakeholders in the juridical person.

Art. XVI.2 (f) of the GATS specifies as a prohibited market access restriction, "limitations on the participation of foreign capital in terms of a maximum limit on foreign shareholding or the total value of individual or aggregate foreign investment."[180] It thus seems that the GATS covers measures that limit investment.

b) Defining "investment by service suppliers."

The link with the GATS requires that the investment must be made in order to supply a service in the host member. The connecting factor is the supply of a *service* through Mode 3.

The question is therefore whether the investor must already be a service supplier to be covered by the GATS. For instance, when an investor from one member seeks to acquire a service supplier in another member, but this investor is itself not engaged in the supply of services, would any measures affecting this investment still be covered by the GATS?

Some elements need to be considered in this respect. First of all, Art. I.2(c) of the GATS uses the words "by a service supplier of one member," which may be interpreted as requiring that the investor is *already* a service supplier in that member. However, it could also be argued that the investor becomes a service supplier at the

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[179] GATS, Ar. XXIII(n)(i)(ii).
[180] Art. XVI(2)(f).

moment of investment. Therefore, it is not necessary that the entity which invests in a service sector is itself a service supplier at the moment of making an investment (i.e., setting up a commercial presence to supply a service.)[181]

A second element to be considered in this regard is that Art. XXVIII (m) of the GATS requires that the juridical person that owns or controls the commercial presence is engaged in substantive business operations in the territory of the member where it is constituted or organized, or in any other member. It is noted that no such requirement is applied to natural persons.[182] This requirement prevents that a 'shell company' is set up in a WTO member, while the substantive business operations take place in a country that is not a WTO member. This 'shall company' would be relied on to make use of the GATS, to establish a commercial presence in another WTO member.

There is no further specification of what the 'substantive business operations' must entail. Therefore, the substantive business operations can be in any sector, and do not necessarily need to be in the same sector as the one in which the supply of the service will take place.

Therefore, it can be summarized that the GATS indeed applies to measures affecting investment because of its coverage of Mode 3 –service supply. It involves both pre- (i.e., conditions for making an investment) and post-establishment (i.e., the treatment of investment once made in a host country) investment measures. However, there are some limits to the application of the GATS. First, it is important that the investment is made in a service sector. It must indeed be made in order to supply services by means of a commercial presence. Second, the investment must lead to ownership or control of the commercial presence in the host territory (target country of the investment). Third, the investment must originate in a different *WTO member* then the member in which the investment is made. This investor must not necessarily be a service supplier before it has made the investment, but needs to be engaged in substantive business operations in the WTO member where it was constituted, or in any other WTO member.

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[181] The key in 'Mode 3' is that service is supplied by a juridical, not a physical person.
[182] See Art. XXVIII(m)(ii)(1) of the GATS.

It can already be noted that, even if a measure that affects investment should fall within the scope of the GATS, a number of important obligations in the GATS (market access, national treatment, certain disciplines on domestic regulation) only apply as far as the WTO member in question has made a special commitment to the service sector at stake, and has not inscribed limitations to these commitments such that certain investment measures would remain unaffected.

2.3.3 Commitments on Mode 3 Service Supply

The GATS is a very flexible agreement because it allows members to both specify for certain obligations, and the extent to which they want these obligations to apply to the service sector at stake. For market access (Art. XVI of the GATS), and national treatment (Art. XVII of the GATS), members specify in their "schedules of commitments" what sectors and subsectors are covered by the obligations, and what modes of supply. The member can limit their commitments by explicitly excluding certain measures or reserving themselves the right to adopt new measures (by inscribing the word "unbound" in their schedules.)

a) Market Access

Trade liberalization in the GATS focuses in the first place on allowing suppliers from one WTO member to have access to the market of another member to provide services. To this end, Art. XVI of the GATS prohibits, in sectors where a member has made specific commitments, to take specific measures that restrict market access contrary to these commitments. Art. XVI.2 specifies six types of measures that must not be adopted by the member that has made a commitment. The majority of these measures are of a quantitative nature. Art. XVI.2(f) of the GATS is important for investment, since it prohibits the member to from adopting limitations on the participation of foreign capital regarding maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

Nonetheless, the GATS does not apply to situations where no ownership or control is taken in a local commercial establishment.

As soon as a measure makes it completely impossible to access the market through a mode of supply for which a commitment is carried out without limitations, it is prohibited under Art. XVI of the GATS. Hence, if an investment in a service sector is made impossible because of a particular measure, this measure violates Art. XVI.

Art. XVI.2 of the GATS mentions two types of market access limitations that are of particular relevance for the investment related to Mode 3 service supply.

The first type of market access limitation is that where a WTO member requires the investment to take a particular form. Art. XVI.2 (e) reads:

> measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.[183]

A second type of measure involves quantitative limitations on the participation of foreign capital. Art.XVI.2(f) reads:

> limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.[184]

The latter provision was interpreted in *China—Publications and Audiovisual Products*. The panel held on to the "quantitative nature" of the market access restriction in Art. XVI.2(f).[185] If no clear quantitative limitation can be identified, no such type of market access restriction is at stake.

b) MFN and National Treatment

Two specific provisions set out the obligation of non-discrimination in the GATS.

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[183] GATS, Art. XVI.2(e).
[184] GATS, Art.XVI(2)(f).
[185] See *Panel Report, China—Publications and Audiovisual Products*, paras 7,1376, 7,1388, and 7,1394.

First, Art. II of the GATS prohibits WTO members to treat services and service providers from one WTO member less favourably than those from any other country (most-favoured-nation treatment). WTO members were permitted to list specific exceptions to this obligation in a member-specific Annex on Art. II exemptions. Second, Art. XVII of the GATS obliges each WTO member to accord to services and service suppliers of any other member, treatment no less favourable than that it accords to its own 'like' services and service suppliers (national treatment). This obligation only applies as far as the WTO member in question has made a specific commitment to the service sector and mode of supply at stake, and provided that the member has not specified any limitations to this commitment.

The national treatment obligation of Article XVII:1 of the GATS does not apply to all trade in services. The national treatment obligation applies only to the extent that a WTO member has explicitly committed itself to grant 'national treatment' in respect of a particular services sector.

(i) In applying Article XVII:1, panels must therefore first examine the responding member's Services Schedule to establish whether, and to what extent, that member has made a national treatment commitment on the services sector at issue in the dispute.[186]

In *China-Publications and Audiovisual Products (2010),* the issue arose whether China had made a national treatment commitment on the distribution of sound recordings through electronic means. China argued that the entry 'Sound recording distribution services' under the heading 'Audiovisual Services' (Sector 2.D) in China's Services Schedule, about which it had made a national treatment commitment, does not extend to the distribution of sound recordings through electronic means. According to China, the entry in dispute covers only the distribution of sound recordings in physical form, for example, music embedded on compact discs (CDs). This dispute thus called for an interpretation of China's Services Schedule, and in particular the meaning and scope of the entry 'Sound recording distribution services'.

[186] Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, Third Edition, Cambridge University Press, 2013, pp. 406, 409, 411-413.

After interpreting this entry by Article 31 and 32 of the *Vienna Convention on the Law of Treaties*, the panel concluded that China's commitment in the entry 'Sound recording distribution services' covers physical distribution as well as the electronic distribution of sound recordings.[187] The Appellate Body upheld the panel's finding. After reviewing the panel's reasoning, the Appellate Body concluded that the panel did not err in its consideration of the dictionary definitions of the terms 'sound recording' and 'distribution'.[188] Furthermore, the Appellate Body was persuaded that, on balance, the analysis of a number of contextual elements (such as China's Services Schedule, provisions of the GATS, and the Services Schedules of other members) supported the interpretation of China's commitment to 'Sound recording distribution services' as including the electronic distribution of sound recordings.[189]

(ii) To analyse whether the measure at issue is a measure by a member affecting trade in services, i.e., a measure to which the GATS applies.

A measure affects trade in services when the measure bears 'upon the conditions of competition in the supply of a service'. The panel in *China-Publications and Audiovisual Products (2010)* noted in the context of its assessment of the prohibition on wholesale trading of reading materials that the term 'affecting' is wider in scope than 'regulating' or 'governing', and thus concluded that the measures at issue 'affect' the supply of reading materials distribution services for the purpose of Article XVII:1.[190]

(iii) To ascertain whether the foreign and domestic services or service suppliers are 'like services' or 'like service suppliers'. It is only between 'like service' or 'like service suppliers' that the national treatment obligation applies, and that discrimination within the meaning provided by Article XVII:1 of the GATS may occur.

The GATS does not define terms 'like services' and 'like service suppliers'. The panel in *China-Publications and Audiovisual Products (2010)* noted that:

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[187] See Panel Report, *China-Publications and Audiovisual Products (2010)*, para. 7.1265.
[188] See Appellate Body Report, *China-Publications and Audiovisual Products (2010)*, para. 357.
[189] See *ibid*., para. 387.
[190] Panel Report, *China-Publications and Audiovisual Products (2010)*, para. 7.971.

> [t]he measures at issue distinguish between suppliers that may be permitted to engage in the wholesale of imported reading materials and suppliers that are prohibited from emerging in this service, based exclusively on the suppliers' origin. When origin is the only factor on which a measure bases a difference of treatment between domestic service suppliers and foreign suppliers, the 'like service suppliers' requirement is met, provided there will, or can, be domestic and foreign suppliers that under the measure are the same in all material respects except for origin.[191]

However, the panel observed that, in cases where a difference of treatment is not exclusively linked to the origin of service suppliers, but to other factors, a more detailed analysis would probably be required to determine whether service suppliers on either side of the dividing line are, or are not, 'like service suppliers'.[192] Referring to the considerable body of case law on 'likeness' in the context of Article III of the GATT 1994, the panel first observed that it did not assume that 'without further analysis, [it] may simply transpose' to trade in services the criteria or analytical framework used to determine 'likeness' in the context of Article III of the GATT 1994.[193] The panel noted that there are 'important dissimilarities' between the two areas of trade, such as the intangible nature of services, their supply through four different modes, and possible differences in how trade in services is conducted and regulated.[194]

The panel in *China-Electronic Payment Services (2012)* observed that the dictionary defines 'like' as:

> [h]aving the same characteristics or qualities as some other person or thing; of approximately identical shape, size, etc., with something else; similar.[195]

According to the panel, this range of meanings suggests that:

> for services to be considered 'like', they need not necessarily be exactly the same, and

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[191] *Ibid.,* para. 7.975.
[192] see Panel Report, *China-Publications and Audiovisal Products (2010),* para. 7.975. see also China-Electronic Payment Services (2012), para. 7.697.
[193] *Ibid.,* para. 7.978.
[194] *Ibid.*
[195] Panel Report, *China-Electronic Payment Services (2012),* para. 7.699.

> that in view of the references to 'approximately' and 'similar', services could qualify as 'like' if they are essentially or generally the same.[196]

The panel further noted that the dictionary definition of 'like' made clear that something or someone is 'like' in some respects, such as – in the terms of the definition – the 'shape, size, etc.' of a thing or person. To determine in what respect services need to be essentially the same for them to be 'like', the panel subsequently considered the context of the term 'like services', and, in particular, Article XVII:3 of the GATS. Article XVII:3 clarifies the 'treatment no less favourable' requirement of Article XVII:1, and states that a member is deemed to provide less favourable treatment if it 'modifies the conditions of competition in favor of services of [that] Member compared to like services … of any other Member'. According to the panel, this suggests that:

> Like services are services that are in a competitive relationship with each other (or would be if they were allowed to be supplied in a particular market).[197]

The panel argued that this is so because:

> Only if the foreign and domestic services in question are in such a competitive relationship can a measure of a Member modify the conditions of competition in favour of one or other of these services.[198]

With regard to the 'likeness' of service suppliers, the panel in *China-Electronic Payment Services (2012)* agreed that the fact that service suppliers provide 'like' services might in some cases 'raise a presumption' that they are 'like' service suppliers. However, the panel cautioned that, in the specific circumstances of other cases, a separate inquiry into the 'likeness' of the suppliers may be called for.[199] 'Like service suppliers' determinations should be made on a case-by-case basis.[200]

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196 *Ibid.*
197 Panel Report, *China-Electronic Payment Services (2012),* para. 7.700.
198 *Ibid.*
199 *Ibid.,* para. 7.705.
200 *Ibid.*

(iv) ‘Treatment no less Favourable’

The panel in *China-Electronic Payment Services (2012)* examined the fourth element of the national treatment test of Article XVII:1 in two steps. First, it analysed whether and how the measures under dispute provided for different treatment between domestic services and service suppliers and ‘like’ services and service suppliers of other members. Secondly, it examined whether any different treatment amounts to less favourable treatment. As the panel noted:

> Subject to all other Article XVII conditions being fulfilled, formally identical or different treatment of service suppliers of another Member constitutes a breach of Article XVII:1 if and only if such treatment modifies the conditions of competition to their detriment.[201]

In *China - Publications and Audiovisual Products (2010),* the panel found in the context of its assessment of the prohibition on wholesale trading of reading materials that:

> [s]ince the measures at issue have the effect of prohibiting foreign service suppliers from wholesaling imported reading materials, while like Chinese suppliers are permitted to do so, these measures clearly modify the conditions of competition to the detriment of the foreign service supplier and thus constitutes ‘less favourable treatment’ in terms of Article XVII.[202]

2.4 China’s Commitments on the Non-discrimination Principle under the Protocol of Accession

China acceded to the WTO on 11 December 2001. During the accession process, it accepted scrutiny by WTO members of all aspects of its domestic system relating to trade. The terms of China’s accession to the WTO are set out in the Protocol on the Accession of the People’s Republic of China (the Protocol)[203] and the WTO agreements. With regard to the terms of China’s accession, its market access

[201] *Ibid.*
[202] Panel Report, *China-Publications and Audiovisual Products (2010),* para. 7.996.
[203] ‘The Protocol on the Accession of the People’s Republic of China’, WT/L/432(10 November 2001), available at www.wto.org

commitments are extensive,[204] and there are a large number of specific rules that apply only to trade with China only.[205] While some of these special terms are transitional, with a built-in expiration date, others are of unlimited duration. The China Protocol consists of a main text of 17 sections of substantive provisions, 9 annexes (including China's goods and services schedules), and 143 paragraphs of substantive provisions incorporated by reference from the "Report of the Working Party on the Accession of China."[206] The following subsections will provide an overview of the special terms of China's accession and its post-accession practice to implement those WTO rules.

2.4.1 China's Promise in Line with the 'Non-Discrimination Principle'

It is necessary to identify the commitment articles concerning specific WTO requirements on the Chinese legal system.

This section is concerned with the WTO principle of non-discrimination, most commonly characterized by the notions of MFN and national treatment. China accepted that 'except as otherwise provided for in this Protocol, foreign individuals and enterprises and foreign-forwarded enterprises shall be accorded treatment no less favourable than that accorded to other individuals and enterprises…'[207] In particular, the Accession Protocol guarantees that this treatment is accorded with the procurement of goods and inputs, and the price and availability of goods and services.

a) WTO Requirements and China's Commitments

The WTO China Working Party registers members' concern over 'the application of the principle of non-discrimination to foreign individuals and enterprises', in particular, 'China's practice of conditioning or imposing restrictions upon

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[204] Analysis on the scope and depth of China's market access commitments, see Nicholas R. Lardy, Integrating China into the Global Economy (Washington DC: Brookings Institution Press, 2002), pp.79-80.
[205] Julia Ya Qin, '"WTO-Plus" obligations and their implications for the WTO legal system: An Appraisal of the China Accession Protocol' (2003) 37(3) Journal of World Trade 483.
[206] WPR, WT/MIN(01)/3 (10 November 2001).
[207] Accession Protocol, 3(a)(b).

participation in the Chinese economy based on the nationality of the entity concerned'.[208] Specific to the Chinese legal system, some WTO members expressed concern about 'certain provisions of Chinese laws, regulations, administrative notices and other requirements which could, directly or indirectly, result in less favourable treatment of imported products, in contravention of Article III of the General Agreement on Tariffs and Trade (GATT 1994)'.[209] Most of these requirements relate to product registration and certification; internal taxation; price and profit controls; hugely varying licensing procedures for imports; and distribution or sale of imported goods. Even though some of these requirements apply nominally to Chinese goods as well, WTO members 'reiterated that any *de facto* or *de jure* less favourable treatment of imported goods had to be eliminated in order to ensure full conformity with the principle of national treatment'.[210]

In response, China pledged that it would provide 'non-discriminatory treatment to all WTO members' and 'the same treatment to Chinese enterprises, including foreign-funded enterprises, and foreign enterprises and individuals in China. China would eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China, in comparison to those produced for export'.[211]

Addressing the concern of WTO members over Chinese laws, the government confirmed that 'full respect of all laws, regulations, and administrative requirements with the principle of non-discrimination, between domestically produced and imported products would be ensured and enforced by the date of China's accession unless otherwise provided in the Working Party Report. Furthermore, China undertook, by the time of accession, to 'repeal and cease to apply all such existing laws, regulations and other measures whose effect was inconsistent with WTO rules on national treatment.'[212] This commitment also applies to provisional laws, administrative measures, rules, and notices, or any other form of guidelines.

China confirmed that measures would be taken at both national and regional

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208 Working Party Report, II(1), paras 15-16.
209 Working Party Report, II(1), para. 20.
210 Working Party Report, II(1), para. 21.
211 Working Party Report, II(1), paras 18-19.
212 Working Party Report, II(1), para. 22.

levels, including the repeal or the modification of legislation, to provide full GATT national treatment in respect of laws, regulations, and other measures applying to the internal sale, offering for sale, purchase, transportation, distribution or use of a wide range of products.

The non-discrimination principle, when applied to the right to trade, requires that 'within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China', with some exceptions as agreed in the Accession Protocol. It further requires that 'all such goods shall be accorded national treatment under Article III of the GATT 1994, especially paragraph 4 thereof, in respect of their internal sale, offering for sale, purchase, transportation, distribution or use, including their direct access to end-users'.[213] Also, all foreign individuals and enterprises, including those not investing or registered in China, shall be granted treatment no less favourable than that accorded to companies in China on the right to trade.[214]

b) Case-law

The first case against China in the WTO's Dispute Settlement Body (DSB) further publicized the principle of non-discrimination. Central to the complaint was the alleged violation of the principle of national treatment by the Chinese government in its administration of tariffs on automobiles and car parts. On 15 September 2006, the US, the EU, and Canada submitted separate requests for the establishment of a dispute panel, which would determine whether China violated global trade rules by imposing a tariff surcharge on imported automobile parts.[215] The plaintiffs argued that China violated WTO rules by imposing discriminatory tariffs on imported car parts, which favoured China-based manufactures of car parts. China, in response, maintained that the measures were necessary to stop importers from circumventing higher tariffs by importing automobiles under the guise of car parts.

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[213] Accession Protocol, Art. 5(1).
[214] Accession Protocol, Art. 5(2).
[215] *Measures Affecting Imports of Automobile Parts* (WTO case: DS339, 340, 342).

The panel, established in late October 2006, was the first WTO dispute panel adjudication against China since it joined the WTO.[216] At issue was China's May 2004 *Policy on Development of Automotive Industry* (Order No. 8 of the National Development and Reform Commission (NDRC)), and two subsequent implementing regulations adopted on 1 April 2005. Under these regulations, tariffs on imported car parts were equivalent to the tariff imposed on complete vehicles, if the imported parts exceeded a certain percentage of the completed vehicle's content or its price, or if specific combinations of the imported car parts were used in the finished vehicle. The tariff surcharge sought to encourage car part manufacturers to establish production facilities in China, and to protect the producers already based in China. The complainants contended that the surcharge exceeded the maximum tariff in China's WTO schedule of commitments, and amounted to a discriminatory tax that favoured domestic over imported goods. They also argued that it, in effect, provided a subsidy to those using domestic, rather than imported, car parts.

In late 2008, the WTO Appellate Body ruled against China[217] and upheld the panel's finding that the measures at issue indeed subjected imported auto parts to an internal charge.[218] It also found that these measures were inconsistent with China's obligations under GATT Article III(2).[219]

On 15 August 2009, China implemented the report's findings and withdrew those regulations which were found to be incompliant with its WTO obligations.

2.4.2 Obligations to Eliminate Export Tariffs

While lowering import tariffs is an essential part of the GATT obligations, the WTO has not imposed similar disciplines on export tariffs, although the use of quotas or quantitative restrictions on exports is generally prohibited.[220] The Protocol requires China to 'eliminate all taxes and charges applied to exports' except for those

216 A previous WTO case brought against China over value-added taxes applied to semiconductors, brought by the United States in 2003, was settled before a dispute panel was established.
217 The decision of the WTO Appellate Body in *China-Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R, WT/DS340/AB/R and WT/DS342/AB/R, 15 Dec. 2008.
218 *Ibid*., para. 253(b)
219 *Ibid.*, para. 253(a) & (b).
220 GATT, Art.XI.

specifically provided in Annex 6 of the Protocol.[221] Annex 6 contains a list of eighty-four types of products, with a maximum export duty rate identified for each. China promised not to raise the maximum rates except under exceptional circumstances and, if such circumstances occur, to consult with affected members prior to raising the rates.[222]

There are two cases relevant to China's commitments on "export limitations". The first case, (*China-Raw Materials*), targeted the export duties and quotas that China continued to maintain on various forms of bauxite, coke, fluorspar, magnesium, manganese, silicon metal, yellow phosphorous and zinc.[223] The second, (*China-Rare Earths*), challenged the export duties and quotas imposed on rare earth elements, tungsten and molybdenum.[224] In both cases, China's export duties were found to be in breach of Paragraph 11.3 of China's Accession Protocol, whereas the export quotas at issue were declared inconsistent with Article XI:1 GATT. China's arguments, seeking justification under Article XX (b) and (g) GATT, were dismissed.

The most important reason for this lies in the scope of the China-specific WTO obligations.[225] It remains to be seen whether China will change its defensive strategy for Article XI:1 GATT-inconsistent export quotas (e.g. by invoking other Article XX justifications), although recent WTO case-law seems to leave no room for China to successfully defend the challenged export duties.

2.4.3 Implementation of WTO Rules: China's Practice

There are key constitutional issues apparent in analysing the implications of China's WTO membership for its legal order. One key concern raised by WTO members was how WTO rules would be implemented in China.

The legal status of international treaties is not clearly defined in China's

[221] Protocol, section 11(3).
[222] Protocol, Note to Annex 6.
[223] See Penal report, China- Raw Materials (2012), para. 7.77(for bausite), para. 7.81(for coke), para. 7.85(for fluorspar), para.7.89(for mangnesium), para. 7.93(for manganese), para. 7.98(for silicon metal) and para. 7.101(for zinc).
[224] See Penal report, China-Rare Earths (2014), para.7.150.
[225] See above, China's Protocol, section 3. China has undertaken a general obligation to eliminate export duties in its 2001 Accession Protocol, with the exception of 84 HS 8-digit products listed in Annex 6 to the Protocol.

constitution. During China's WTO accession negotiations, other WTO members requested that it should be clearly stated in the Working Party Report that WTO rules would be directly and automatically applicable in domestic Chinese courts. Long Yongtu, the former negotiator on behalf of China's delegation, rejected these requests, but agreed to include the following paragraph in the report:

> The representative of China stated that China had been consistently performing its international treaty obligations in good faith. According to the Constitution and the Law on the Procedure of Conclusion of Treaties, the WTO Agreement fell within the category of 'important international agreements' subject to the ratification by the Standing Committee of the National People's Congress (NPCSC). China would ensure that its laws and regulations pertaining to or affecting trade were in conformity with the WTO Agreement and with its commitments so as to fully perform its international obligations. For this purpose, China had commenced a plan to systematically revise its relevant domestic laws. Therefore, the WTO Agreement would be implemented by China in an effective and uniform manner through revising its existing domestic laws and enacting new ones fully in compliance with the WTO Agreement.[226]

China undertook a number of special commitments concerning domestic governance, including transparency, judicial review, and the uniform administration of the law. For instance, the Protocol requires China to provide a reasonable period for public comment on 'all laws, regulations and measures' pertaining to WTO matters before their implementation.[227] It is doubtful that China can easily comply with the Protocol requirement that it first publish, in a designated official journal, all of its laws, regulations, and measures pertaining to trade before their implementation. The Protocol secondly requires China to translate all such laws, regulations and measures into one of the three official languages of the WTO within 90 days of their implementation.[228]

With respect to rules-making in the Doha Round, China has been seeking bilateral and regional trade (and investment) agreements outside the Doha multilateral

[226] Working Party Report, para. 67.
[227] Protocol, section 2(c)(2). Exceptions are given to laws and regulations involving national security or publication of which would impede law enforcement.
[228] Working Party Report, para. 334.

forum. The following section will discuss China's economic situation, since China must find a suitable position for negotiating bilateral and regional agreements that meet its requirements for economic (and social) sustainable development.

2.5 Figures Regarding China's Performance in International Trade and Investment

To find the rationale of Chinese FDI policies, and assess the value of investment treaty making, it is necessary to look at China's economic situation.

2.5.1 Export/Import

China's exports are growing rapidly year by year. Many countries have become less inclined to open up their own markets, while simultaneously asking for China's further opening. But this rapid-growth is not in the same situation as before.

Table 1: China's Changing International Trade

		1981		2014	Growth p/a
Exports $ billions		14.6		2,343	16.6%
Imports $ billions		14.6		1,960	16.0%
Fuels and ores as a percentage of:					
	Imports	6.0	*	28.7	
	Exports	25.2	*	2.8	
Reserves $ billions		10.1		3,900	19.8%
As % of imports		69%		199%	

*refers to 1984, not 1981. (Source: *World Development Indicators Online*, 28th Sep. 2015.)

As this table shows, Chinese exports and imports averaged 16% growth for over three decades.[229] In 1981 Chinese trade was more or less balanced, whereas by 2014 exports exceeded imports by about 20%. This means that in 2014 trade between China and its main partners was severely imbalanced.[230] Moreover, China has shifted from

[229] *See* L Alan Winters, "China and the World Trading System: Will 'In and Up' be replaced by 'Down and Out'?", *EUI Working Paper*, RSCAS 2015/82.

[230] But it is noticeable that before the 1978 reform, foreign trade in China was a balancing factor to fill gaps in supply and demand under national plans. The imposition of tariffs was for a revenue-raising purpose. The

being a net exporter of industrial raw materials, to being a large net importer.[231]

Table 2: Main Export and Import Commodities, 2008

Exports			*Imports*		
Item	*Value (100 million USD)*	*Increase over 2007 (%)*	*Item*	*Value (100 million USD)*	*Increase over 2007 (%)*
Automatic data processing machines and components	1,350	9.1	Crude oil	1,293	62.0
Clothes and Clothing Accessories	1,198	4.1	Iron ore	605	79.1
Textile yarns and textile articles	654	16.6	Plastic in Primary forms	341	5.3
Rolled steel	634	43.8	Petroleum products refined	300	82.7
Handheld mobiles and car telephones	385	8.2	Rolled steel	234	14.0
Footwear	297	17.2	Soybean	218	90.1
Furniture	269	21.5	Copper and copper alloys	192	-2.3
Integrated circuit	243	3.3	Edible vegetable oil	90	44.0
Liquid crystal display panels	224	13.9	Paper pulp	67	20.9

pre-reform Chinese trade regime was dominated between 10 and 16 Foreign Trade Corporations with effective monopolies in the import and export of their specified ranges of products. As decentralization of export activities took place and as more and more imports were conducted outside of mandatory planning, trade policy came to play an increasing role in China's economic transition. Average industrial tariff is reduced from 43% in the late 1980s to 40% in 1993, 23% in 1996, 15% in 2001, and 9% by 2006 under the WTO entry conditions. See Prof. G. Giovannetti, *Presentation:* "*China's Role in International Trade and Investments,*" at Executive Training Seminar," Global Governance Program, at the EUI (Florence) (April 2014).

[231] Nature resources, and energy;

Containers	91	3.6	Natural rubber (including latex)	43	32.0
Motor vehicles (including a complete set of spare sets)	89	32.5	Synthetic rubber (including latex)	33	17.5
Coal	52	58.9	Aluminium oxide	18	-9.7
			Cereals and cereal flour	7	37.0

(Source: *Statistical Communiqué of the PRC on 2008*.)

Firstly, from the above table, the presence of primary inducts (i.e., coal, rolled steel, motor vehicles) as the main import to some degree reflects China's role as 'the factory of the world'. Secondly, coal and rolled steel ranked as the first two places for their growth rate in exports, whereas soybeans and refined petroleum products took the first two places for their growth rate in imports.[232] This comparison may show the impact on imports and exports of terms-of-trade changes triggered by the price surge of primary goods. The evidence is that the values of these products went up, yet the quantity went down.

China's debt problem is now a deep concern. Many Western economists argue that China has supported domestic demand through a massive investment boom funded by extensive borrowing.[233] This approach has helped to support aggregate demand, and also substantially reduce the Chinese trade imbalance. But in the long run, it is a big problem.[234]

China affected the world financial crisis in 2008-9, when world demand collapsed, as China's measures stimulated official borrowing and investment.[235]

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[232] Changyuan Luo and Jun Zhang, 'China Trade Policy Review: A Political Economy Approach,' *The World Economy*, 2010, pp. 1390-1413.
[233] "The uncomfortable fact is that China is buying much of its growth through a ballooning issuance of corporate and household debt." See '*Slowing China needs to support its economy,*' Financial Times, 19th Jan. 2016. "Property is used as collateral for 30 to 40 per cent of all banking lending, as Standard & Poor's notes." See Henny Sender, '*Currency risk matters for China's property sector,*' Financial Times, 19th Jan. 2016.
[234] Winters, "This policy made the inevitable cyclical downturn as these positions were unwound deeper and longer and made the climb towards a long-run sustainable growth path even steeper." China growth has started to fall from around 10% p.a. in 2010-11 to around 7% in 20103-2014, and 6.9% in 2015. Considering millions of initial population, China takes percentage of 21.8 of the world population till 1995. (Source from McKinsey) Thus "the combination of a steep cyclical retrenchment with a dramatic change in growth strategy and the population ages poses a significant policy challenge for the Chinese government."
[235] *See* Rajan R, *How Hidden Fractures Still Threaten the Global Economy*, Princeton University Press, Princeton, 2009. Arguing that partly because competitive pressures from China and other low-cost producers constrained real

However, the investment exacerbated Chinese excess capacity in manufacturing, and significantly increased the Chinese stock of huge debt. As already was clear in 2007, this path requires the Chinese economy to move away from investment and exports as the drivers of domestic consumption and innovation.

In spite of these problems, China will still continue to provide a significant impetus to world demand. It is important for China to find a fairly good position for negotiations when considering the quality of the transformation over the last few decades.

China is facing the "impossible trinity"[236] problem now, and it has to choose its RMB and capital regime trade-off.[237] Resolving it, either by means of a devaluation of the RMB or tighter capital controls, will have far-reaching consequences. Western economic thinking recognizes China's trilemma but insists that openness, freer markets, and liberalization are the way forward.

Export growth accelerated from about 2001, partly as China's accession to the WTO drew in FDI especially from other Asia countries. There was also a significant fall in import growth after 2004, mainly as the net import of heavy industrial products fell. This trend partly reflected a build-up of the stock of equipment over the preceding few years, but also the shift in Chinese capabilities so that domestic supplies increased strongly.[238] However, China's exports are slowing. Goods from China only account for around three percent of US expenditure, and hence can have only a small *direct* influence on US aggregate price indices. If China is to have a discernible effect on such indices, it has to be by influencing the prices at which other producers sell.

2.5.2 FDI and Service

wages among less skilled workers, American policy-markets looked to private credit markers to boost their spending power; this, in turn, caused the real estate boom and the stock of toxic mortgages that so burdened the financial system and private portfolios.

[236] Formed by economist Robert Mundell in the late 1960s, this suggests that it is impossible to simultaneously pursue more than two of an independent monetary policy, a fixed exchange rate and free capital movements.

[237] George Magnus, China's trilemma makes it vulnerable to more shocks, FT news, China has a fixed but adjustable exchange rate, plans monetary autonomy, and has promised to liberalize capital transactions.

[238] Winters, (2015).

China is increasingly engaging in outward FDI,[239] implying that it may support negotiating multilateral disciplines on investment. But globally, China's average share in world FDI outflows averaged only 5% during 2010-12, while its share of the world's outward FDI stock was 3% in 2014.[240]

It is still hard to ascertain how the country's FDI is distributed across sectors and geographic regions, as more than two-thirds of China's non-financial sector outflows are channelled via financial centres and tax havens, like Hong Kong, the Cayman Islands, the British Virgin Islands, Luxembourg, and Panama. Thus, it is not known in which countries and sectors they are ultimately invested.

However, it seems likely that services and natural resources are the most important sectors, and that Chinese firms have invested substantially in both developed and developing countries.[241] Trade-supporting FDI is also important, because of the country's leading role in international exports in the past decades. Of further importance is the desire to access markets through direct investment (as opposed to trade).

China moved away from an export-driven, development model towards one that emphasizes domestic consumption and innovation. This change increases interest in service industries if they have much more market access, especially since China's services sector has relatively low added value in an international supply chain.

China has high barriers on service sectors. Nevertheless, China has made great strides in removing policy barriers as part of its WTO accession. Although it is highly open regarding trade outcomes, it still protects internal procedures from foreign competition. For example, China's services sector policies are more restrictive than the average level of restrictiveness of low and middle-income countries. They are additionally much more restrictive than those of the high-income countries in all sectors, including financial, professional service, retail, and telecommunication, with

[239] *Id.* China's outward FDI flows have already almost caught up with China's inward FDI flows: in 2001, outward FDI flows as a percentage of inward FDI flows were 15%; in 2014, they were 90%.
[240] *Id.*
[241] Karl P. Sauvant and Michael D. Nolan, "China's Outward Foreign Direct Investment and International Investment Law," *Journal of International Economic Law*, 2015, 18, 893-934.

transport as the only exception.[242]

The OECD Services Trade Restrictiveness Index notes that many service sectors face FDI restriction. Reflected by the data is that continued restrictions on the entry of foreign firms are an important contributor to the high barriers to service trade in China.[243] Indeed, the OECD scores the barriers to market entry in certain industries in China higher than the OECD overall average barriers to service trade.[244]

2.5.3 BIT's Implication on FDI and Service

For example, completion of a US-China BIT offers an important opportunity for the US and China to increase their trade in services. The US has a comparative advantage in trade in services. China needs to import more services to make its economy more driven by domestic consumer spending, rather than exports.

Given China has relatively high barriers to services trade,[245] the two countries can address some of these impediments in their negotiation for a supposed US-China BIT. Furthermore, FDI can spur Chinese imports of services. The lack of data on the service sector hampers empirical analysis of this sector in China and elsewhere.[246]

Increased trade would improve the level of service in telecommunications, finance, and other business services in China for both businesses and consumers. To move up the value chain in manufactured goods, China will need access to efficient, leading-edge services in engineering, design, development, testing, marketing, advertising, logistics, and distribution. Given the current relatively small size of its business services sector, it seems unlikely that China can become immediately self-sufficient in these activities. Importing these services is an obvious way to provide them.

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[242] See Borchert, Gootiz and Mattoo, '*Restrictions on Services Trade and FDI in Developing Countries,*' *World Bank Working Paper*, 2011. Marchetti, Juan A., and Martin Roy, (2009).

[243] *Bridging the Pacific*, Peterson Institute for International Economics, 2015, p174.

[244] *Id.*, Service industries that have particularly high barriers to foreign firm entry include commercial banking, insurance, road transport, distribution, courier services, broadcasting, and motion pictures—all industries where the US has globally competitive firms. ("FDI in China is governed by rules tailored for each sector. Some sectors are encouraged, some permitted, some restricted, and some prohibited. Many service sectors face restrictions on FDI.")

[245] *Id*.

[246] *Ibid.,* "The core reason is that nearly all the barriers are NTBs and thus regulatory in nature." Three models: (1) Ad valorem equivalents (AVEs); (2) The World Bank's Service Trade Restrictiveness Index (STRI); (3) OECD's Index (Released in May 2014). p. 173.

3 China's Practice of Forming Investment Treaties in Post-WTO Phase

FDI often flow into international competitive sectors. Trade liberalization, accompanied by other policies that encourage investment can have a significant effect on economic development.[247] Both the GATT and GATS have market-access commitments. By requiring reciprocity and MFN treatment, nations attempt to minimize the 'free riding' problem. However, due to the proliferation of bilateral agreements, countries are now negotiating market access for their exporting firms bilaterally. This trend has weakened reciprocity in the multilateral context, as it reduces the incentives for export interests to support liberalization during multilateral treaty negotiations.[248] Other analyses take an opposing view, to argue that PTAs may create political economy forces, which generate support for expanding preferential liberalization to non-members and thus, eventually, multi-liberalization.[249]

In practice, PTAs often include investment chapter as a package deal. This section will give a general description of Chinese BITs and investment chapters in FTAs, respectively. In particular, it will provide a literature review to observe whether signing investment treaties (FTAs and BITs) has any impact on capital flow. It will first analyse the legal rules and their economic rationale, to understand why a state may choose to switch from WTO to Preferential Trade Agreements. Then, it will examine Chinese FTAs to analyse the extent to which China has opened its market in the service sector (FDI) and assess the impact of signing FTAs.

Intra-regional agreements are either part of an organization's deeper economic integration agenda, such as ASEAN's Comprehensive Investment Agreement, entered into force in 2013, or *ad hoc*, like the Trilateral China-Japan-South Korea Investment

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[247] Bernard M. Hoekman and Michel M. Kostecki, *Political Economy of World Trading System: the WTO and Beyond*, Oxford University Press, 2009, p. 21.
[248] *Id*.
[249] Ethier, 2004; Baldwin, 2006.

Treaty, signed in 2012. Regionalism has added a *novel* dimension to investment law due to the vertical overlap of BITs with regional investment agreements.[250] In investment law regionalism may present an opportunity for *coherence*, as multi-party investment agreements can consolidate investment protection provisions.[251]

How do countries deal with vertical treaty overlap? Countries can leave overlapping treaties formally in place. But they can manage treaty interactions in such a way that only one of the treaties defines the relationship. One way is by *incorporation*, which means that one treaty may incorporate another treaty, or parts thereof, in order to avoid duplication. The China-Singapore FTA (2008) incorporates the ASEAN-China Investment Agreement (2009) in Article 84(1).[252] Another way, is by *suspension*, which means the former BIT is suspended when the new FTA enters into force. States can also leave treaties merely in co-existence, rather than consolidating them. Yet another way is by keeping *silence*, which means that there is no language in treaties addressing the issue of overlapping BITs. However, some treaties explicitly affirm the existence of overlapping treaties, as *parallelism*. For instance, Article 25 of the China-Japan-South Korea Trilateral Investment Agreement (2012) states:

> Nothing in this Agreement shall affect the rights and obligations of a Contracting Party, including those relating to treatment accorded to investors of another Contracting Party, under any bilateral investment agreement between those two Contracting Parties exiting on the date of entry into force of this Agreement, so long as such a bilateral agreement is in force.

For the matter of confliction between treaties, the Vienna Convention on the Law of

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[250] ‘Only a few states use regionalism to *de jure* or *de facto* consolidate their investment treaty network, while most countries opt for parallel bilateral and regional treaty layers. This kind of “overlap” raises coordination challenges as parallel treaties may duplicate or contradict each other increasing the risk of parallel proceedings.’ See Wolfgang Alschner, ‘Regionalism and Overlap in Investment Treaty Law: Towards Consolidation or Contradiction?’ Vol17 No2 June 2014, *Journal of International Economic Law*, p. 271.

[251] *Id.*

[252] With the FTA concluded in 2008, China and Singapore, rather than updating their bilateral investment protection regime (based on a 1985 BIT), decided to incorporate the investment agreement at the time still being negotiated, as part of the multi-stage integrated FTA, between China and ASEAN. As Article 84 [Investment] of the China-Singapore FTA states, ‘Recognizing that negotiations on the ASEAN-China Investment Agreement are ongoing, the Parties agree to co-operate to facilitate the early conclusion of that agreement.’

Treaties lays down some principles relevant to aspects of this problem. In the light of these dynamics of treaty making, the Vienna Convention makes a distinction between 'amendment'—namely, the process of changing a treaty in a way which is intended to alter the obligations of all states—and 'modification'—that is, changes proposed to modify the obligations between only some of the parties to a treaty.[253] The details of the Vienna Convention's law of treaties on amendment and modification can be found in Articles 40 and 41 respectively.[254]

Some treaties have explicitly referred to existing agreements more generally, like the ASEAN Comprehensive Investment Agreement (ACIA 2012) in Article 44: "Nothing in this Agreement shall derogate from the existing rights and obligations of a Member State under any other international agreements to which it is a party."[255]

The balance is gradually shifting from bilateral to regional treaty making.[256] Regional investment treaties could add an extra treaty layer to the already existing BITs, which cause the vertical overlap of investment treaties.[257] According to the WTO Regional Trade Agreements (RTA) database,[258] agreements listed there include treaties that have an investment protection component 'substantively equivalent' to those found in BITs.[259] There are also framework agreements which cover only relative (i.e., non-discriminatory) provisions, but not absolute (i.e., expropriation) investment protection standards. An example of this is the China-Switzerland PTA. Relative clauses define the treatment that must be provided, by reference to the treatment provided to any other investment or investor. Absolute clauses describe the

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[253] Richard K. Gardiner, *International Law*, Pearson Education Limited, 2003, p. 93.

[254] Article 41(2) permit that only some of the parties to a treaty can change its terms as between themselves:
- (a) the possibility of such a modification is provided for by the treaty; or
- (b) the modification in question is not prohibited by the treaty and:
  - (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
  - (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole.

[255] Art. 44, ASEAN Comprehensive Investment Agreement.

[256] UNCTAD, *World Investment Report 2012, Towards a New Generation of Investment Policies* (Geneva: United Nations, 2012), p. 86.

[257] UNCTAD's definition of 'other IIAs' comprises a variety of investment-related treaties including PTAs with investment chapters, and also liberalization or framework agreements without substantive investment protection provisions. UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (Geneva: United Nations, 2013), p.101.

[258] Http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx. (visited 2 September 2014) The database lists preferential trade agreements notified to the WTO.

[259] Besides the specific agreements listed, there is investment agreement either concluded as part of the same regional integration project or signed alongside an FTA.

treatment that must be provided without reference to the treatment granted to those comparators. In addition, not all BITs grant Investor-State Arbitration (ISA), while some regional investment treaties also do not provide for such mechanisms, e.g., the Australia-US FTA. Rather, increasingly bi-directional investment flows, coupled with the threat of ISA, have given rise to a new generation of investment treaties. These protect investment abroad, while safeguarding policy space at home through more balanced treaties.[260]

3.1 BITs

Statistics show that China became the largest FDI recipient in the world in 2014.[261] At the same time, multilateral enterprises (MNEs) from developing Asian countries became the world's largest investment group, accounting for almost one-third of the global total.[262] Investment by Chinese MNEs grew faster than inflows into the country, reaching $116 billion.[263]

While imposing certain limitations, China has been by far the most active and open country in pursuing a coherent policy on investment at the international level. Together with a number of domestic reforms, this has resulted in the creation of a better friendlier environment for foreign investors.

China has signed 130 bilateral investment treaties (BITs) that establish rules and proceedings to protect FDI.[264] Over half of them (68 BITs) were entered into force in the 1990s, while others were signed in the 1980s (24 BITs) and the 2000s. Eleven BITs were renegotiated in the 2000s, either in the form of either a new BIT or an amendment protocol. Most of these renegotiated BITs were with European states, which signed BITs with China in the early years and updated the treaties in the 2000s.

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[260] Wolfgang Alschner, 'Americanization of the BIT Universe: The Influence of Friendship, Commerce and Navigation (FCN) Treaties on Modern Investment Treaty Law', 5 *Goettingen Journal of International Law* 455 (2013); S.A. Spears, 'The Quest for Policy Space in a New Generation of International Investment Investments' 13 *Journal of International Economic Law* 1037 (2010); A. Van Asken, International Investment Law between Commitment and Flexibility: A Contract Theory Analysis', 12 *Journal of International Economic Law* 507 (2009).

[261] UNCTAD, World Investment Report, 2015, p. 4.

[262] *Id*., p. 5.

[263] *Id*.

[264] The list of Chinese BITs is on the basis of (1) a list of BITs that have entered into force, which is provided by the Ministry of Commerce of the People's Republic of China; online: (visited on 2 Oct. 2016); (2) the list of Chinese BITs provided by UNCTAD;

Also, China has concluded twelve free trade agreements (FTAs) that contain a BIT-type chapter. The overall structure, and most provisions may appear similar, while the differences—and the changes between one model and the other—reflect special Chinese attitudes towards international law and international dispute settlement mechanisms.[265]

Against the background of China's changing international investment position, its role in the global governance of FDI has attracted more attention. The rationale behind China's FDI policy has been changing from attracting inward FDI to promoting outward FDI. This change in policy priorities is reflected in the shift from a restrictive to a legalized BIT approach, resulting in higher levels of legal protection for foreign investors in China and Chinese investors abroad.[266]

Instead of converging, trade and investment regimes remain largely distinct. The international trade regime seeks to promote trade liberalization through 'reciprocal' advantages directed toward the reduction of tariffs and other barriers to trade. The international investment regime, on the other hand, seeks to promote greater cross-border investment, through mutual protection under an international agreement. Before providing some political economic rationale of including investment provisions in PTAs, the following subsections will first discuss China's BIT program, which serves as a benchmark for evaluating the changed investment rules in China's PTAs.

3.1.1 A Time Line

The first generation of Chinese BITs (1982-1992), modelled on the European BIT approach, restricted national treatment, and while its Investor-State Arbitration (ISA) provisions were only concerned with the amount of compensation for expropriation. The second generation of BITs (1992-2001), also modelled on the European BIT

[265] Over time, China has adopted three model BITs. China's State Council drafted the first version of Model BIT in the early 1980s (around 1984). The model was revised in the late 1980s (around 1989). The third version was adopted in the 1990s (around 1997). The last version is the current working text for BIT negotiations. (Gallagher, Shan)

[266] Gallagher and Shan 2009, Schill 2007.

approach, applied national treatment, and adapted full ISDS.[267] National treatment in these BITs was subject either to national law in developing countries,[268] or non-conforming measures in developed countries.[269] The third generation of BITs (post-2001) have been partly modelled on the NAFTA approach. They apply fair and equitable treatment in accordance with customary international law. MFN treatment does not extend to ISDS. But, MFN treatment does apply in pre-establishment phase of building investment.

A fourth period has started since 2006. In 2008, China signed a FTA with New Zealand, featuring an FDI protection regime which has been widely regarded as significant. Since 2006, China has ventured into the territory of FTAs featuring an investment chapter,[270] followed by the stipulation (and completion) of multi-stage integrated FTAs comprising investment agreements.[271] This occurred alongside with gradual shifts in the language and structure of the North American models.[272] The following subsections will outline the evolution of China's policy regarding international investment law.

3.1.2 Geographical Partners

Geographically, Chinese BITs cover most continents including Asia, Europe, Africa, Latin America, Oceania and North America (Canada). The US is not yet covered. The Chinese BIT network is most dense in Asia, covering forty states in the continent. Europe has the second largest number of treaties, with twenty-five members of the European Union being covered by China's BIT network. In Africa, thirty-one states have a BIT with China. The Chinese BIT network also covers four Pacific states, including Australia and New Zealand. In Latin America, Chinese BITs cover thirteen countries. Notably, however, China has not yet signed a BIT with Brazil. The most striking exception to the extensive coverage of the Chinese BIT network is North

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[267] The China-Barbados BIT, signed in July 1998, can be described as a watershed because it was the first treaty to offer foreign investors unrestricted access to international arbitration.
[268] China-Guyana BIT (2003).
[269] China-Germany BIT (2003) and China-Belgium BIT (2009).
[270] China-Pakistan FTA (2006), China-New Zealand FTA (2008), China-Peru FTA (2009)
[271] China-ASEAN Investment Agreement (2009); China-Chile Supplementary Agreement on Investments (2012).
[272] China-Canada BIT (2012) and China-Japan-Korea TIA (2012).

America, notably the US, although negotiation has been proposed. However, China has signed BITs with the other two members of the NAFTA, Canada, and Mexico.

3.1.3 Substantive and Procedural Provisions under BITs

a) National Treatment Provision

China does not reject involving a post-establishment phase of MFN and national treatment in its BITs. National treatment clauses in Chinese BITs with capital-exporting countries—(e.g., with Germany, 2003, and Belgium, 2009)—allow China to maintain only existing non-conforming measures, subject to a “best efforts” rollback promise on the part of China.[273] By contrast, in Chinese BITs with capital-importing countries—(e.g., with Guyana, 2003)—the application of national treatment is limited “without prejudice to its laws and regulations”, thus allowing both states to adopt new non-conforming measures.[274]

b) Investor-State Arbitration Clause

China ratified the ICSID Convention on February 6 1993.[275] When China acceded to the ICSID Convention, only it consented to submit to the Centre’s jurisdiction disputes over the amount of compensation due to expropriation. After that, China updated the model BIT text. One reason for this may have been the surge of outward direct investments from China to the rest of the world, and the growing interest in the protection of Chinese investors in foreign countries using BITs.

The 1997 Chinese model BIT granted consent to international arbitration, including ICSID arbitration, for all Investor-State disputes. The first BIT based on the new model text was the 1998 China-Barbados BIT. It allowed access to ICSID arbitration for *all* Investor-State disputes. Since then, most new BITs have followed

[273] The China-Germany BIT, Art 3. Protocol, Ad. Art.2 and 3.
[274] The China-Guyyana BIT, Art.3(2).
[275] 575 *UNTS* 159. China’s accession entered into force on 6 February 1993. See ICSID homepage, http://icsid.worldbank.org (Accession 5 January 2011).

the new model, and included full access to ICSID jurisdiction. The 1997 China-South Africa BIT was the first in which China accepted investor-State dispute arbitration for all disputes; nevertheless, not being South Africa party to the ICSID Convention, Art. 9 of the BIT featured only *ad hoc* arbitration.

China's initial approach to dispute resolution in the form of Investor-State Arbitration was very restricted. For example, the Australia-China BIT provides for arbitration where the parties agree to it, or 'where the dispute relates to the amount of compensation payable.'[276] In the first arbitration case brought under a Chinese BIT, *Tza Yap Shum v. The Republic of Peru,*[277] the investor was obliged to prove that the terms of the 1994 China-Peru BIT (which is very similar to the Australia-China BIT) allowed the tribunal to consider, not only the amount of compensation due to expropriation, but the question of whether expropriation took place.[278]

The recent BITs, by contrast, represent China's most recent position and allow for submission to ICSID arbitration, or arbitration under UNCITRAL, rules of '*any* legal dispute arising under this [Investment] Chapter,'[279] subject to certain requirements relating to conciliation and administrative review.

Chinese companies investing abroad have to comply both with internal requirements and with the rules of the countries where they propose to invest. In cases of both inbound and outbound investment, the Chinese approval process is not transparent. Thus, it is difficult for a claimant to rebut claims that the application of the system is subject to government influence and protectionism.[280]

3.1.4 A Balancing Approach to New Investment Policies

a) Domestic Policy Relating to Inbound Investment

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[276] Article XII(2)(b).
[277] *Tza Yap Shum v. The Republic of Peru,* Decision on Jurisdiction and Competence, 19 June 2009. ICSID Case No. ARB/07/6.
[278] For the discussion of this case, see Nils Eliasson, 'Chinese Investment Treaties: A Procedural Perspective,' in *Foreign Investment and Dispute Resolution Law and Practice in Asia*, eds. by Vivienne Bath and Luke Nottage, Routledge, 2011, pp. 91-107.
[279] See, for example, the China-NewZealand FTA, Investment Chapter, Article 152.
[280] A Survey by the US-China Business Council (2010) suggests that US businesses are concerned by some factors that relate to equality of treatment, including competition with state-owned enterprises and growing protectionism. See: Areddy, J. (2011) 'US Firms Decry China's Heavy Hand: Alleged Bias by Regulations Is Likely to Be Contentious Issue Between Two Countries.'

Chinese policy towards investment has been amended and modified on numerous occasions since 1979, but the basic objectives have remained consistent.[281] On the one hand, the Chinese government has encouraged foreign companies to invest in China. Incentives (many of which are no longer available) were provided at state level in the form of tax holidays and reductions, a special rate for foreign companies, and customs exemptions for the import of equipment.[282] On the other hand, the Chinese government is keeping a policy that exercises strict regulatory control over both the admission of foreign investment and the scope of operations of foreign investors within China. For example, the primary source of scrutiny over the industries in which foreigners may invest is the 'Catalogue of Industries for Guiding Foreign Investment', the most recent version of which was issued in 2007,[283] which lists activities in which foreign investment is encouraged, restricted or prohibited. Investment in other activities should be permitted.[284]

As part of the preliminary negotiations between China and other countries before China's accession to the WTO in 2001,[285] China opened up a considerable number of sectors to foreign investment and removed from many industries its traditional requirements for the import of technology, and export orientation.[286]

b) Going Global Policy and Outbound Investment

With the adoption of the 'going global' policy in 1999, China increasingly focused on

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[281] Vivienne Bath (2011), p. 69.

[282] For example, Article 7 of the original version of the Equity Joint Venture Law granted income tax holidays and reductions to newly established joint ventures, and Article 71 of the Implementing Regulations of the Sino-Foreign Equity Joint Venture Law of the People's Republic of China (State Council 1987) (Equity Joint Venture Regulations) provided for a waiver of customs duties on certain imported equipment.

[283] The National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), (2007).

[284] Chinese policies have changed from time to time to open up new sectors to foreign investment or to impose additional restrictions. On changes made by the 2007 version of the Catalogue, see OECD (2008), 'OECD Investment Policy Reviews: China 2008', pp. 33-38.

[285] Accession effective 11 December 2001; see Report of the Working Party on the Accession of China, WT/ACC/CHN(01)/3/Add.1, available at www.wto.org/english/thewto_e/acc_e/completeacc_e.htm (accessed 18 January 2011).

[286] Qin, J.Y. (2007) 'The Impact of WTO Accession on China's Legal System: Trade, Investment and Beyond,' *Wayne State University Law School Research Paper*, No. 07-15. Available at: http://ssrn.com/abstract=985321 (accessed 18 January 2011).

outbound investment. With regard to the BIT program, in 2003 China, with Germany, renegotiated the 1983 BIT. In this revised agreement, China agreed to particularly high standards of investment protection. This set the basis for the negotiations of investment discipline featured in Chinese FTAs since 2008, as well as for the BIT with Canada and the Trilateral Investment Agreement with Japan and Korea, both in 2012. Some commentators have described the Chinese BITs since 2006 as a third, more balanced, generation of investment treaties.[287] For instance, the 2006 China-India BIT seeks to clarify indirect expropriation, and the 2008 China-Mexico BIT contains a waiver clause on Investor-State Arbitration. Nevertheless, it appears that such clauses are due more to negotiation bargains with specific states, rather than part of a systemic approach.[288]

This balanced approach is reflected in many recent BITs. Firstly, with regard to investment definition, prior BITs state: 'any investments that are not properly approved by the Government would not qualify as an investment and therefore could not rely on the BIT protections.'[289] The China-German BIT (2003) removed this 'subject to local law' requirement in the definition of investment.[290] However, in the Article on the admission of investments, the treaty provides that each contracting party is required only to 'admit such investment by its laws and regulations.'[291]

Secondly, on the issue of treatment standards, in the earliest model BIT (before the 1990s), China did not include national treatment at all. The BIT with the UK, signed in 1986, was the first BIT where this standard of treatment was included, and even then, it was only a 'best endeavour' clause, requiring the contracting parties to implement it 'to the extent possible'.[292] The BIT with Japan in 1988 was the second such BIT, and its national treatment clause was also substantially qualified by subjecting it to 'the sound development of economy.'[293] More recent BITs, however,

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287 See Gallagher and Shan, 2009.
288 C. Cai, "China-US BIT Negotiations and the Future of Investment Treaty Regime: A Grand Bilateral Bargain with Multilateral Implications," *Journal of International Economic Law*, 2009, n.12, p.462.
289 See old generation of Chinese BITs concluded in the 1980s.
290 See China-German BIT (2003), Art 1(1).
291 *Ibid*. Art 2(1).
292 The China-U.K BIT, Art 3(3).
293 The China-Japan BIT, Art 4 and Protocol, provision 3.

have moved a step further from the current prototype. The German BIT, for example, has removed the 'subject to local laws' limitation in its national treatment clause, though it has replaced it with a 'grandfather clause' [294] for China in its Protocol. This provision allows for the continuation of existing non-conforming Chinese measures that are incompatible with the national treatment standard.[295]

The definition of 'investment' in the China-Japan-Korea Triangle Investment Agreement (CJKTIA) Article 1(5) also does not include the "pre-establishment" phase of investment. As mentioned, China has not conceded pre-establishment rights in its past BITs. Within the China-Canada BIT and the China-New Zealand FTA (with investment chapter), national treatment is afforded only for the 'expansion, management, conduct, operation and sale or other disposition of investments.' In the China-Korea FTA, both sides committed to launch negotiations on pre-establishment national treatment and the negative list mode.[296] However the extent to which China will establish a meaningful precedent in its coverage of pre-establishment rights will depend on the scope of related exceptions (i.e., 'non-conforming measures').

As mentioned above, the CJKTIA establishes non-discriminatory national and MFN treatment for post-establishment investment. In particular, it includes commitments to prohibit performance requirements,[297] enhance transparency,[298] and provide protection for intellectual property,[299] which is progress toward a more transparent climate for Japanese and Korean investors in China. Indeed, the CJKTIA may provide new FDI opportunities for Japanese and Korean firms, as the investment environment in Northeast Asia becomes more liberalized, and investment

[294] See "Grandfather Clause" in European BITs, according to which "an old rule continues to apply to some existing situations while a new rule will apply to all future cases".
[295] The China-Germany BIT, Art 3(2) and Protocol, provision 3.
[296] See MOFCOM web: http://fta.mofcom.gov.cn/topic/enkorea.shtml.
[297] The prohibition of performance requirements in the CJK pact goes only marginally further than obligations already contained in the WTO Agreement on Trade-Related Investment Measures (TRIMs), keeping within China's past BIT practice (Article 7).
[298] The CJK investment pact requires the publication of laws and regulations, and includes some language regarding incorporating "public commentary," but does not specify the means for collaboration with *private* interest groups (Article 10).
[299] The CJK pact dedicates a specific article to IPR (Article 9). Specifically, the pact commits the CJK partners to protect IP rights and "establish and maintain transparent intellectual property rights regimes, and will, under the existing consultation mechanism […] promote cooperation and communications among contracting Parties in the intellectual property field." However, exceptions will likely limit the effective enforcement of ISDS obligations. Specifically, subparagraph 12(a-b) of Article 15 exempts this obligation from all arbitration procedures; instead, disputes in these areas can be subject only to "a competent court of the disputing Contracting Party".

opportunities shift as China moves up the value-added chain.[300] Whether investors will be able to capitalize on any advantages in the Chinese market may hinge on enforcement regarding intellectual property rights and technology transfer provisions.

The most recent Chinese BIT with Canada (ratified in 2013) uses a broad definition of investment, including IPR. The Canada-China BIT does not provide national treatment for the pre-establishment phase of investment, but rather for the "expansion, management, conduct, operation, and sale or other disposition of investments" (Article 6). However, MFN treatment does apply to both pre-establishment and post-establishment phases of investment. This is similar to the investment chapter of the China-New Zealand FTA.

3.2 FTAs

To discover the reasons why states may conclude FTAs, one could start with the legal rules in the WTO agreements. Art. XXIV GATT permits the formation of free trade agreements and customs unions. The formation of a PTA is subject to conditions:

> (1) external trade barriers after integration may not rise on average (Art. XXIV.5 GATT);
> (2) all tariffs and other regulations of commerce must be removed on substantially all intra-regional exchanges of goods within a reasonable length of time (Art. XXIV:8 GATT); and
> (3) PTAs must be notified to the WTO (Art. XXIV.7 GATT).[301]

It is for the WTO Council for Trade in Goods to determine, by a recommendation of the Committee on Regional Trade Agreements (CRTA),[302] whether FTAs meet the criteria reflected in Article XXIV GATT. The language of Article XXIV GATT is unclear on how to define 'substantially all trade', and how to determine whether the external trade policy of a customs union has become more restrictive on average.

Firstly, since the enactment of the 'Transparency Mechanism' in 2006, there is no

300 With increasing wages and production costs among other structural changes, the offshoring of labour-intensive manufacturing to China has slowed as China has seen a shift of investment toward high-technology areas; see UNCTAD (2013).
301 Art. XXIV.5, 7, 8, GATT.
302 The CRTA is the first track to review the consistency of PTAs. It is composed of all WTO representatives and decisions are taken by consensus. The WTO members participating in a PTA must be persuaded that their PTA is WTO-inconsistent for a decision to this effect to be taken.

longer a multilateral review of notified PTAs. The CRTA has evolved into an 'information exchange' system.[303] Parties forming a PTA will respond to questions and provide additional information. Then, a report will be drafted to assess the consistency of the notified PTA with the multilateral rules. Members can always challenge this result before a GATT panel. Compared to the GATT 1947, the WTO clarifies some of the criteria and procedures for the assessment of agreements.[304] There is a ten-year maximum on the transition period for the implementation of an agreement, although exceptions may be allowed. While the definition of the term 'substantially all trade' appearing in Art. XXIV.8 GATT, on the other hand, has not been clarified in WTO practice.[305]

Secondly, to satisfy the external trade policy requirement, a customs union must ensure consistency with Art. XXIV.5 GATT (relevant for both FTAs and CUs). In addition, Art. XXIV.6 GATT (which is pertinent only for the customs union) requires WTO members seeking to increase bound tariff rates upon joining a customs union to enter into renegotiations.[306] If agreement cannot be reached within a reasonable period, the customs union may proceed as it wishes, and affected members may retaliate by withdrawing equivalent concessions.

To see the effect caused by these treaties, it is more important to question the economic rationale of signing PTAs with investment chapter. It remains to be seen if, and how, PTAs can deal with the cost-raising effects of regulatory differences. Furthermore, it has not yet been established whether they will go significantly beyond what is already covered by the WTO, and, if they do, to what extent this will be detrimental to countries that are not PTA members.

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[303] On 14th December 2006, the General Council adopted a decision concerning the Transparency Mechanism for Regional Trade Agreements. Since 2007 the procedures of the transparency mechanism, which calls for consideration of agreements rather than examination as before have been in place. This means that agreements are no longer checked for consistency by the CRTA.

[304] The evaluation of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union is to be based upon "an overall assessment of weighted average tariff rates and of customs duties collected" by the WTO Secretariat, based on import statistics for a previous representative period on a tariff line basis, broken down by WTO member country of origin. See Petros Mavroidis, 'Always Look at the Bright Side of Non-delivery: WTO and Preferential Trade Agreements, Yesterday and Today', *World Trade Review* (2011), 10:3, 375-387.

[305] There is a lack of incentive: "except for complementary products, non-members are better off if they face a less integrated PTA as there will be less trade diversion."

[306] Art. XXVIII GATT is about compensatory adjustment by offering to reduce duties on other tariff lines or to otherwise provide compensation.

One explanation for the formation of PTAs is that they are not only pursued for commercial purposes. PTAs may support the WTO members desire for policy reform, with stronger incentives to enforce agreements. PTAs may also involve disciplines on domestic instruments that are not yet covered by the WTO, and rule-making already started among developed countries.

As shown below, PTAs may divert trade away from the most efficient suppliers in the world to more costly, but preferred, partners, who can sell more in the PTA because they are exempted from duties. Firms within a PTA may create more trade than they divert, by inducing consumers to switch from less efficient local producers to firms in partner countries if they are more efficient. However, PTAs that are beneficial to members may still have a negative impact on those countries that suffer from trade diversion.

Whether or not PTAs slow down multilateral liberalization remains a difficult empirical question. PTAs could be building blocks for multilateral liberalization, if their formation induces excluded countries to pursue WTO negotiations. This can lower the external tariffs of the PTAs to reduce diverting trade potential.[307] Baldwin develops a theory aiming to predict who 'goes preferential' depending on the identity of the 'spoke' and the 'hub' that have already gone preferential.[308]

A trading bloc will normally have more monopoly power in world trade than any of its members alone, which will improve 'terms of trade'.[309] In Saggi and Yildiz, the option to form bilateral FTAs can further the cause of multilateral liberalization by making non-participation *costlier* for reluctant liberalizers.[310]

Winters and Schiff have argued that, it can be assumed that trust can be built and conflict can be avoided through the formation of PTAs.[311] It is assumed that tariff preferences, the quintessence of PTAs in the early GATT years, are not the dominant

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307 See Petros Mavroidis, 'WTO and PTAs: A Preference for Multilateralism?' *Journal of World Trade* 44, no.5 (2010): 1145-1154.

308 Richard Baldwin,'Sequencing and Depth of Regional Economic Integration: Lessons for the Americas from Europe,' *The World Economy* 31 (2008): 5-30.

309 Paul Krugman, 'The Move Toward Free Trade Zones', *Economic Review* November-December (1991): 1-24.

310 See Kamal Saggi & Halis Murat Yildiz, 'Bilateralism, Multilateralism, and the Quest for Global Free Trade', *Journal of International Economics* 80 (2010).

311 Alan Winters & Maurice Schiff, *Regional Integration and Development* (Washington, DC: World Bank and Oxford University Press, 2003).

explanation for some of the more recent PTAs. Freund address this issue head on, and concludes that some Latin American PTAs did not behave as stumbling blocks, that is, their members cut tariffs on MFN basis subsequent to the conclusion of their PTA.[312]

Horn et. al. examine the subject matter of PTAs concluded by two hubs (EU, U.S.) with various spokes, and divide it into WTO+ (tariff cuts beyond the MFN level), and WTOx (issues that do not come under the mandate of the WTO). The WTOx part of the PTAs examined exceeds WTO+ obligations assumed under a PTA. They suggest that the rationale for going preferential should also be searched in WTOx type of obligations.[313]

Lastly, the PTA and WTO-extra issue (the subject matter for which no multilateral rules exist) indicates the problem that no test exists (other than MFN) to measure the consistency of WTO-x provisions with the WTO.[314] The legal framework is important in answering this question. GATT Article XXIV allows deviations from MFN *protection*, but not deviations from MFN *in general*.[315] The problem is that one might proclaim a PTA GATT-inconsistent because it does not meet an agreed definition of the *substantially all trade* requirement, and yet deny PTA participants benefits in the form of FDI, technical assistance in some policies, etc.[316] This does not mean that FDI and PTAs are indissolubly linked. Indeed, one could conclude a BIT without anchoring it in a PTA, as some countries do. However, there could be substantial advantages when negotiating one, instead of two, agreements

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312 Caroline Freund, 'Third-Country Effects of Regional Trade Agreements,' in *Preferential Trade Agreements: A Law and Economic Analysis*, ed. Kyle W. Bagwell & Petros C. Mavroidis (New York: Cambridge University Press, 2010). The authors show that the sample of PTAs examined did not behave as *stumbling blocks* (as opposed to *building blocks* towards global free trade). Bhagwati introduced this term arguing that, besides trade diversion created through the establishment of PTAs, members of PTAs behave as enemies of non-discriminatory trade liberalization, since they are unwilling to cut tariffs on MFN basis for fear of eroding the preferences granted to their PTA partners. See: Jagdish Bhagwati & Arvind Panagariya, 'Preferential trading areas and Multilateralism—Strangers, Friends, or Foes, 33-100', in *Trading Blocks*, ed. Jagdish Bhagwati, Pravin Krishna & Arvind Panagariya (Cambridge, MA: MIT Press, 1999).

313 *See* Horn, Mavroidis, Sapir, "Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements", *The World Economy*, 2010.

314 Petros C. Mavroidis, 'Always look at the bright side of non-delivery: WTO and Preferential Trade Agreements, Yesterday and Today', *World Trade Review* (2011), 10: 3, 375-387.

315 *Id.* According to the GATT discipline, the only permissible form of protection is through tariffs. The term 'other restrictions regulations of commerce' appearing in GATT Article XXIV cannot be understood to encompass domestic instruments, such as environmental protection: such instruments are not meant to be protected (GATT Article III). The content of this term should be narrowed down to border instruments, to elements such as 'other duties and charges' which, at the time when GATT Article XXIV had been agreed were not being negotiated—as the case now is—along with ordinary customs duties. The assumption aims to keep the current WTO mandate constant.

316 *Id.*

(e.g., fixed costs, better enforcement), and disentangling them might be too onerous.[317]

The following parts will analyse the effect of PTAs on capital flow, especially FDI in the service industry, then give a general review of the provisions of Chinese PTAs and BITs respectively.

3.2.1 Economic Significance of FTAs

The state's obligations towards investment treatments are often embodied in BITs, or where they exist, the investment chapters of PTAs. BITs typically contribute to "negative integration", that is, precluding certain policies, rather than requiring policies to actively encourage investment, but they may play an important facilitating role in investment flows.[318] Far more positive in its intent is the common argument that PTAs add credibility to government policies in general, and thus help to raise investment and attract FDI. However, South-South PTAs are unlikely to do this, and may hinder investment if they are not accompanied by trade liberalization with the rest of the world. North-South PTAs, on the other hand, can enhance a Southern country's credibility, but typically only if the PTA is likely to enhance economic performance in its own right, and if the large Northern partner is willing to enforce investment-encouraging rules.

Investment is one of the main objectives of countries in pursuing regional economic integration. The logic is that larger markets and greater competition following trade liberalization, combined with improved policy credibility, will increase the incentives for investment.[319] Investment provisions are now becoming common in PTAs. As well as PTAs, BITs are also concluded *separately* to promote investment flows by providing remedy to international dispute resolution.

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[317] Horn, Mavroidis, Sapir, Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements, *The World Economy*, 2010, p.1467-9701.
[318] L. Alan Winters, Preferential Trading Agreements: Friends or Foe? at Kyle W. Bagwell and Petros C. Mavroidis ed., *Preferential Trade Agreements: A Law and Economics Analysis*, Cambridge University Press, 2011, pp12-14. There are exceptions to this 'negative integration', for instance, if treaties provide for a common expropriation standard.
[319] Bernard Hoekman and Richard Newfarmer, *Preferential Trade Agreements, Investment Disciplines and Investment Flows*, Journal of World Trade 39(5): 949.

In theory, PTAs with investment chapters may help countries improve the *credibility* of an open investment regime.[320] They also may help attract investment by lowering the risk of being confronted with adverse policy changes and regulatory expropriation. However, research shows that 'recent PTAs that include language on investment may do little if anything to increase the flow of investment to developing country partners.'[321]

There are few empirical studies on the impact of PTAs on investment. The strongest evidence for this impact is derived from FDI inflows, as investors from non-member countries confront greater incentives to locate companies within a new PTA.[322] The impact on intra-bloc investment flows is ambiguous. Firms originally located in a member country receive access to the whole market without relocation, and so have less incentive to invest in other members. Firms located in third countries, on the other hand, will have greater incentives to locate new production facilities in a member country, and service the other members of the bloc through intra-PTA (i.e., preferential) exports. This may be termed 'platform investment'.[323] It is widely known that European integration has made member countries more attractive to firms that originate from third countries. The PTAs that result in larger markets attract greater FDI. The interaction between signing a PTA and the expanded market size associated with integrated markets is significant, and positively related to FDI.[324]

PTAs may have a major effect on investment in two ways. One way is through increasing market size, as a consequence of trade liberalization and accompanying legal rules, which eliminate restrictions on market access for foreign investment.[325] The other way is through stronger protection for investors. Since investors will face risks after their investment, such as on the repatriation of their profits, they will consider the protection of investment when making the investment decision.

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320 *Ibid.*, at 951.
321 *Ibid*., at 964.
322 See: Peter Egger and Michael, 'The Impact of Bilateral Investment Treaties on Foreign Direct Investment,' 32 Journal of Comparative Economics 788 (2004); also see: Robert Grosse and Len J. Trevino, 'New Institutional Economics and FDI Location in central and Eastern Europe,' 45 Management International Review 123 (2005).
323 Schiff Maurice and L. Alan Winters, '*Regionalism and Development,*' Washington: World Bank, 2003.
324 *Id.*
325 See Bernard Hoekman, *Supply Chains, Mega-Regionals, and Multilateralism: a Road Map for the WTO*, CEPR Press, 2014. Also see UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development*, United Nations: New York and Geneva, 2013.

Most BITs do not deal with market access restrictions, such as sectoral entry prohibitions, equity limitations, etc., —*per se.* Some do impose disciplines on performance requirements and similar TRIMs, and they also guarantee MFN and national treatment. In some cases, the treatment that is guaranteed to foreign investors is better than that accorded to domestic investors, for example regarding access to foreign exchange or ability to transfer capital outside of the country, and sometimes even concerning investor rights.

Determining the payoffs of the inclusion of investment disciplines in PTAs has become more important, given the failure to include investment at the multilateral level. These PTAs may provide valuable lessons in the future for the potential extension of multilevel agreements to cover investment.

3.2.2 How FTA's Influence on Capital Flow Fares in the Context of China

China is a major recipient of FDI, reaching a new record of US$105.74 billion in 2010.[326] The major investors in China in 2009 were: Hong Kong, Taiwan, Japan, Singapore, the US, South Korea, the UK, Germany, Macau and Canada.[327] The total FDI in 2009 was US$56.5 billion, and much of this investment has been directed to the Asia-Pacific region, with Australia (total stocks of US$5.9 billion at the end of 2009) and Singapore (US$4.9 billion) the largest recipients after Hong Kong (US$164.5 billion).[328] It should be noted that the immense amount of funds which flow in and out of Hong Kong and other tax havens such as the Cayman Islands and the British Virgin Islands make it difficult accurately to access the sources and locations of Chinese outbound FDI.[329]

As previously recounted, under China's open-door policy before 1978, foreign

[326] Vivienne Bath, 'The Quandary for Chinese Regulators: Controlling the Flow of Investment into and out of China,' in *Foreign Investment and Dispute Resolution Law and Practice in Asia*, eds. by Vivienne Bath and Luke Nottage, Routledge, 2011, p. 48.
[327] Fletcher, O. 'Foreign Direct Investment in China Rises 17%, Wall Street Journal, 19 January 2011. Available at: http://online,wsj.com/article/SB10001424052748703396604576088903930134910.html (accessed 20 January 2012).
[328] Xinhuanet, 'China's outbound investment hits $56.5 billion in 2009'. Available at: http://news.xinhuanet.com/english2010/china/2010-09/05/c_13479616.htm (accessed 31 January 2012).
[329] Gugler, P. and Boie, B. (2008) 'The Chinese International Investments: Corporate and Government Strategies,' *NCCR Trade Regulation*, Working Paper No. 2008/25. Available at: http://ssrn.com/abstract=1372013 (accessed 16 February 2012).

trade, investment, and capital flows were all tightly controlled in China. In that year, Chinese leaders decided to adopt the 'reform and open door' policies. After 1990, China formally agreed to adopt a market economy with Chinese characteristics. Furthermore, in 2001, China entered into the WTO, which marked China's engagement in international and regional cooperation. Since 2007, China has established a 'free trade area' strategy for economic development.

Regarding China's performance at the WTO, critics have argued that it only aims to take the benefits of the world trading system, while avoiding the obligations.[330] In the early 1990s, the Chinese reformer Deng Xiaoping brought forward his views on how China should deal with foreign affairs: "observe calmly; secure our position; cope with things calmly; be good at maintaining a low profile; and never claim leadership."[331] However, given China's large impact on the world economy, it can no longer afford to follow Deng's suggestions of assuming a passive role in international relations. The evidence suggests that China continues to be a stubbornly *status quo* oriented country that has learned the rules of the game, and plays within them.[332] Have Chinese strategies therefore preferred the predictability of bilateral relationships to the complexity of multilateralism?

China has demonstrated a significant shift from a relatively protectionist policy on foreign investment to a gradually more liberal view. This change is reflected in the vast number of investment treaties concluded by China in recent years. By December 2016, China had reached 130 BITs,[333] and signed 20 treaties with investment provisions (TIPs).[334]

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[330] See James Scott and Rorden Wilkinson, 'China Threat? Evidence from the WTO', *Journal of World Trade* 47, no.4 (2013): 761-782, 2013.

[331] See Colin B. Picker, 'China's Legal Culture Relationship to International Economic Law: Multiple and Conflicting Paradigms', in Lisa Toohey, Colin B. picker, and Johathan Greenacre ed., *China in the International Economic Order*, Cambridge University Press, 2015, p. 73.

[332] For example, 'having learned the rules of the DSB game, China now manifests a newfound boldness to defend its interest. It is still maintaining the trade system, that is, playing within the established processes of the international trade regime.' See Timothy Webster, 'China's Implementation of WTO Decisions', in Lisa Toohey, Colin B. picker, and Johathan Greenacre ed., *China in the International Economic Order*, Cambridge University Press, 2015, p. 101.

[333] China's list of BITs concluded by 15 March 2017 is available on the UNCTAD website, www.investmentpolicyhub.unctad.org/IIA/CountryBits/42#iialnnerMenu. Accessed on 15th March 2017.

[334] China's list of treaties with Investment Provisions is available on the UNCTAS website, www.investmentpolicyhub/unctad.org/IIA/CountryOtherlias/42#iialnnerMenu. Accessed on 15th March, 2017.

Type of agreement: Treaties with Investment (China)

No.	Short title	Parties	Date of signature	Date of entry into force	Status
1	China-Macao Agreement on Trade in Services	Macau, China SAR	28/11/2015		Signed
2	Australia-China FTA	Australia	17/06/2015	20/12/2015	In force
3	China-Republic of Korea FTA	Korea, Republic of	01/06/2015	20/12/2015	In force
4	China-Switzerland FTA	Switzerland	06/07/2013	01/07/2014	In force
5	China-Iceland FTA	Iceland	15/04/2013	01/07/2014	In force
6	China-Japan-Korea Trilateral Investment Agreement	Japan, Korea, Republic of	13/05/2012	17/05/2014	In force
7	China-Taiwan Framework Agreement	Taiwan Province of China	29/06/2010	01/09/2010	In force
8	China-Costa Rica FTA	Costa Rica	01/04/2010	01/08/2011	In force
9	APTA Investment Agreement (2009)	Bangladesh, Korea, Republic of, Lao People's Democratic Republic, Sri Lanka	15/12/2009		Signed
10	ASEAN-China Investment Agreement	ASEAN (Association of South-East Asian Nations)	15/08/2009	01/01/2010	In force
11	China-Peru FTA	Peru	28/04/2009	01/03/2010	In force
12	China-Singapore FTA	Singapore	23/10/2008	01/01/2009	In force
13	China-New Zealand FTA	New Zealand	07/04/2008	01/10/2008	In force
14	China-Pakistan FTA	Pakistan	24/11/2006	01/07/2007	In force
15	Chile-China FTA	Chile	18/11/2005	01/10/2006	In force
16	Australia-China Framework Agreement	Australia	24/10/2003	24/10/2003	In force
17	China-Macao Partnership Agreement	China; Macao, China Special Administration (SAR)	17/10/2003	01/01/2004	In force
18	China-Hong Kong Partnership	China; Hong Kong, China SAR	29/06/2003	29/06/2003	In force
19	ASEAN-China Framework Agreement	ASEAN (Association of South-East Asia Nations); China	04/11/2002	01/07/2003	In force
20	China-EC Trade and Cooperation	China; EU (European Union)	21/05/1985	22/09/1985	In force
21	RCEP	ASEAN (Association of South-East Asia Nation); Australia; China			In Negotiation

As seen in the table above, China has been increasingly active in its pursuit of regional and bilateral trade agreements. China has 11 PTA partners: the Association of Southeast Asian Countries (ASEAN), Pakistan, Chile, New Zealand, Singapore, Peru, Costa Rica, Iceland, Switzerland, Korea, and Australia. China has signed Closer Economic Partnership Agreements (CEPA) with Hong Kong and Macau respectively, and signed an Economic Cooperation Framework Agreement (ECFA) with Taiwan on 29 June 2010.[335]

China's participation in regionalism can be classified into three types: (i) institutional arrangements, such as the Shanghai Cooperation Organization;[336] (ii) forums; such as the Asia-Pacific Economic Cooperation;[337] and (iii) bilateral arrangements providing for substantial trade and investment liberalization. China has shown particular interest in bilateral arrangements over the past few years. Having concluded Closer Economic Partnership Arrangements (CEPA) with Hong Kong and Macau in 2003, it then signed additional agreements with the two customs territories. China also concluded FTAs with Chile in 2005, and Pakistan in 2006. The China-Association of Southeast Asia Nations (ASEAN) FTA,[338] was launched in 2002 with the conclusion of a framework agreement, which was subsequently expanded by the Goods Agreement in 2004 and the Services Agreement in 2007. China's most important trading partners are East, and Southeast Asia. It has been argued that China's trade policy priority is to create a strong Asian trading area, given

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[335] Cross-Straits Economic Cooperation Framework Agreement
Article 5 [Investment]
1. The two Parties have agreed to conduct consultations on the matters referred to in paragraph 2 of this Article within six months after the entry into force of this Agreement, and expeditiously reach an agreement.
2. Such an agreement shall include, but not be limited to, the following:
(1) establishing an investment protection mechanism;
(2) increasing transparency of investment-related regulations;
(3) gradually reducing restrictions on mutual investments between the two Parties;
(4) promoting investment facilitation.

[336] The Shanghai Cooperation Organization is an intergovernmental organization established in June 2001 comprising China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan. See: http://www.sectsco.org/EN/.

[337] Established in 1989, and currently with twenty-one member economies, the Asia-Pacific Economic Cooperation is a forum for facilitating economic growth, cooperation, trade, and investment in Asia-Pacific region. Unlike the WTO and other multilateral economic entities, it imposes no treaty obligations on its participants. See: http://www.apec.org.

[338] China and the ASEAN first signed the Framework Agreement on China-ASEAN Comprehensive Economic Cooperation in November 2002, and in November 2004 they signed the Agreement on Trade in Goods of the China-ASEAN FTA, which entered into effect in July 2005. In January 2007, the two parties signed the China-ASEAN Agreement on Trade in Services, which entered into effect in July 2007. In August 2009, they signed the China-ASEAN Agreement on Investment. The text of the 2002 China-ASEAN FTA is available at http://www.worldtradelaw.net/fta/agreements/aseanchinafta.pdf. The subsequent agreements are available at http://fta.mofcom.gov.cn/topic/chinaasean.shtml.

China's important position in Asia. By allowing a targeted set of agriculture products phased-in, tariff-free access under an 'early harvest' scheme, China helped allay the fears of ASEAN members. Many of these, which used to view China as a threat, now view China as a *competitor*, and precipitated an ASEAN-China Free Trade Area (ACFTA) goods agreement. China is also making investment and trade deals in infrastructure, agriculture, raw materials, energy, and even tourism, to win over both newer trade partners and prospective FTA partners, and to divert attention away from Chinese manufactured goods exported to those countries.[339]

Going beyond the Asia-Pacific region, China concluded an FTA with Peru in April 2009, which came into force in March 2010.[340] In April 2010, it signed an FTA with Costa Rica, which entered into force at the end of the year.[341] China has also made progress in its talks with Chile to add an investment agreement to their existing FTA framework.

In addition, China has made process with countries seeking economically meaningful FTAs. It has recently signed FTAs with Switzerland (2014), Iceland (2014), and Australia (2015). China is still involved in FTA negotiations with the Gulf Cooperation Council, Norway, and the Southern African Customs Union. It is studying the feasibility of concluding trade and investment agreements with India, Mongolia, and Colombia.

Most of the existing PTAs are bilateral, and most partners are from Asia and belong to developing groups. While China's previously concluded regional trade agreements are mainly with small developing countries, a few agreements have more recently been signed with OECD countries.[342]

A further feature of China's FTAs has been their link to BITs. Investment treaty negotiations typically either anticipate or follow a full FTA as a self-standing bargaining. The China-Japan-Korea Trilateral Investment Agreement (CJKTIA) is a triangle investment treaty dating from before the regional trade agreement among

[339] Qingjiang, Kong, 'China's Uncharted FTA Strategy'. *Journal of World Trade* 46, no. 5 (2012): 1191-1206.
[340] *See* China-Peru FTA, Apr. 28, 2009, at http://fta.mofcom.gov.cn/topic/enperu.shtml.
[341] *See* China-Costa Rica FTA, Apr. 8, 2010, at http://fta.mofcom.gov.cn/topic/encosta.shtml.
[342] For example the China-New Zealand FTA, the China-Switzerland FTA, the China-Australian PTA and the China-South Korea PTA.

these parties. BITs do not traditionally deal with the rules governing investment flow. So, given China's interest now in outward foreign investment, a broader approach would be assumed to fit in with Chinese interest.

3.2.3 Investment Chapters in FTAs

As explained above, China has been establishing its bilateral economic relations through FTAs since 2001. In addition, a number of PTAs have been concluded, while older BITs have been updated. Each of China's eleven FTAs[343] has an investment chapter, except for the 2005 China-Chile FTA, which has an article on the promotion of investment and a commitment to negotiate a future agreement on trade in services and investment.[344] China concluded a trilateral investment agreement with Korea and Japan in 2012, which anticipates the negotiation of a China-Korea-Japan FTA. The chapter on investment in the China-Singapore FTA does not include any expressly stated investment provisions, other than through incorporation by reference to the ASEAN-China Investment Agreement.

In addition to these newly concluded FTAs, China has strengthened its previous FTAs that were primarily concerned with trade in goods. In October 2008, China and Pakistan signed an Amending Protocol to their FTA, with the specific aim of increasing their bilateral investment, and in February 2009, they signed the FTA Agreement on Trade in Services,[345] which entered into force in October 2009. The China-ASEAN FTA was also extended through an investment agreement signed in August 2009, with the expectation that the agreement would be operational by the end of 2010. China is also negotiating FTAs with various other countries and regions, and carrying out feasibility studies on FTAs with India. In addition to the China-New Zealand PTA, another PTA China concluded with a developed country partner is the China-Switzerland PTA.

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343 Chile-China FTA (2005), Pakistan-China FTA (2006), New Zealand-China (2008), Singapore-China FTA (2008), Peru-China (2009), the ASEAN-China FTA (2009), Costa Rica-China FTA (2010), Iceland-China FTA (2014), Switzerland-China FTA (2012), Korea-China (2015), and Australia-China FTA (2015).

344 China signed a supplementary Agreement on Trade in Services with Chile in 2008 and concluded negotiations on investment-related supplementary provisions to the FTA.

345 China-Pakistan FTA FTA on Trade in Services Comes into force on Oct.10.

FTAs are designed and deployed to further increase investment flows between both its members and third countries alike. Many studies on the effectiveness of FTAs in fostering FDI flows have found such a positive relationship. FTAs add market access dimensions and regroup trade and investment provisions under the same agreement signed for an indeterminate period. Thus, they offer a better package of measures for investors.[346] Investment liberalization, that is, granting foreign investors national treatment in the pre-establishment phase, is a case in point. Beyond market access provisions, FTAs also offer the flexibility to include other provisions such as intellectual property rights that go beyond the level of protection enshrined in the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Furthermore, FTAs often include references to sustainable development, human rights protection, investment promotion, and transparency, whereas such innovative treaty language is generally absent from BITs.[347]

China takes three approaches to include rules on investment in FTAs. The first category of PTAs entails provisions in which the contracting parties agree to seek deeper cooperation to promote mutual investment flows (e.g., the China-Chile FTA).

The second group of FTAs mirrors the mainstream BIT approach, by focusing on the protection of investments (e.g., the China-Pakistan FTA). These FTAs establish far-reaching rights for foreign investors, but limit the protection of investments to the post-establishment phase. Standard provisions such as national and most-favoured-nation (MFN) treatment, fair and equitable treatment, expropriation, and transfer of funds only apply to foreign investments that are admitted by the host state. In most cases, foreign investors can have recourse to the ISDS mechanisms to enforce their rights in case of alleged breaches of the agreement by the host state.

The third group of FTAs contains rules on the liberalization of investment flows. This categorization according to the three core elements of FTA practice—cooperation, protection, and liberalization—represents a useful framework that helps to illustrate the evolution of Chinese approaches to integrating investment

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[346] Moroudot 2011

[347] *Id.*

rules into FTAs (e.g. the China-Switzerland FTA).

According to UNCTAD, FTAs that include investment chapters have a stronger impact regarding increased FDI flows than BITs.[348] Consequently, China may join the trend to incorporate the investment discipline into FTAs.

3.2.4 Why FTAs for China?

Most FTAs are promoted by political concerns. Why then has China concluded FTAs? One possible reason is that China needs a steady supply of raw materials and energy. Another is that as most of the agricultural sector in China is not very competitive, China needs to ensure a steady supply of agricultural products to free up its labour from agriculture for manufacturing. This accounts for the pattern of trade between China and its existing FTA partners, which features a flow of raw materials, energy products, or agricultural products to China, and a flow of textile products and electronic products from China. China's FTA partners are probably chosen with these considerations in mind. Moreover, many of the FTAs also include investment provisions, which is another way for China to make sure that it can invest in, and subsequently control, strategic resources.

An even closer examination of China's practice in launching FTA negotiation is needed to answer the question of why these particular partners were selected. Given the list of countries with which China has negotiated or is negotiating FTAs, however, it seems that China's selection is quite random.[349] Firstly, the top three trading partners of China, namely the EU, the US, and Japan, are not on the list. Furthermore, even when the scope is expanded to include the top ten trade partners of China, only three, the ASEAN, Singapore, and Australia, have concluded FTAs with China.

Among the other countries/regions which have concluded or are negotiating FTAs with China, many only have a negligible trade volume. It seems that trade volume is not the most important factor for China in selecting its negotiating partners.

Then, what is the approach by which China selects an FTA partner?

[348] UNCTAD, *World Investment Report*, 2015.
[349] See Qingjiang, Kong, 'China's Uncharted FTA Strategy.' *Journal of World Trade* 46, no. 5 (2012): 1191-1206.

In an interview in May 2007, former vice minister Yi Xiaozhun of MOFCOM suggested some considerations: (1) the country has good political and diplomatic relationship with China; (2) the country's economic structures and trade patterns are complementary with China's; (3) the country either has substantial domestic market, or serves as an FTA hub in a particular region.[350]

First, the political and friendly relationship seems to carry the most weight. For example, Pakistan has been a close ally of China for a long time.

Second, a large portion of China's FTA partners compete with China. These countries share with China an industrial structure that features labour-intensive manufacturing sectors and relies heavily on exports (e.g., in electronics and textile products). Other FTA partners and China are economically complementary, such as Hong Kong, Singapore, New Zealand, Australia, Chile, and Peru. The first two of these partners are highly competitive in services exports, while the latter four countries are very competitive in agricultural industries. In contrast, China is relatively weak in both services and agriculture sectors.

Third, many of China's FTA partners share one thing in common: they are members of other FTAs. While FTAs have been found to have hub-and-spoke effects, the spoke effect seems more important than the market size of the hub country.[351] The domestic markets of these countries are rather small. But almost all of them are relevant FTA hubs. For example, Singapore has FTAs with the US, Japan, Korea and Australia. Chile is an associate Member of Mercosur.[352] Iceland and Norway are members of the European Free Trade Association (EFTA), which has a free trade relationship with EU via the European Economic Area (EEA). Through signing FTAs with these countries, China can potentially enter into the bigger markets created by the FTA agreements already in place, although this is a highly cost-effective way of exploring new markets.

[350] Gao, Shuchao Henry. 'China's Strategy for Free Trade Agreements: Political Battle in the Name of Trade,' (2009). Asian Regional Workship on Free Trade Agreements: Towards Inclusive Trade Policies in Post-crisis Asia, 8-9 December, Bangkok., 1. Research Collection School of Law. Available at: http://ink.library.smu.edu.sg/sol_research/971.
[351] Kong Qingjiang, (2012).
[352] Mercosur, or Common Southern Market, is an economic and political agreement among Argentina, Brazil, Paraguay, and Uruguay.

To sum up, China's overall PTA policy is driven by economic as well as political reasons that are also reflected in the choice of partner countries.[353] The agreements with Taiwan, Hong Kong, Macao, ASEAN, and Pakistan were primarily driven by geopolitical concerns, because China can benefit from a safe and prosperous regional environment. Meanwhile, China has also negotiated PTAs to secure the supply of resources and agricultural products. The agreements with New Zealand, Peru, Chile, Costa Rica, and Australia reflect this resources-seeking strategy. China's economic model during the 1990s was characterized by increasing dependence on exports as a driver of growth. Thus, China might depend on raw materials and intermediary goods from resource-rich countries and tried to secure these inputs through signing PTAs with these countries.

3.3 Investment Provisions in BITs and PTAs: A Comparison

To what extent do Chinese PTAs represent a departure from the previous generation of Chinese BITs? PTAs go beyond the level of investment protection and liberalization usually found in the older BITs.

With investment rules, China has been flexible and responsive to the model texts proposed by its partner countries, as is explained in detail below. The first two, the 2003 Closer Economic Partnership Arrangements with Hong Kong and Macao, do not provide for investment protection (or liberalization). The 2006 China-Pakistan FTA features a chapter on investment, but the text uses the 1997 Chinese Model BIT as a stereotype. Pakistan's government grants specific advantages to Chinese investors. It contains no rules on investment liberalization. With the FTA concluded in 2008 China and Singapore, rather than updating their bilateral investment protection regime (based on a 1985 BIT), decided to incorporate the investment agreement at the time still being negotiated, as part of the multi-stage integrated FTA, between China and ASEAN.

As of the investment chapter in the 2008 China-New Zealand FTA, China agreed

[353] Nakagawa, J. and W. Liang (2001): A comparison of the FTA strategies of Japan and China and the implications for multilateralism, RCCPB Working Paper, October 2011, pp. 17-18.

to conclude new clauses and to change the formulation of those it was already accustomed to. The agreement features post-entry national treatment, a grandfather clause for existing non-conforming measures, MFN for both pre- and post-entry stage, full Fair and Equitable Treatment, conditions for lawful expropriation (with "Hull rule"),[354] and 'a priori' consent to international arbitration for any legal dispute directly concerning investments. Nevertheless, it does not set out the objective of progressive liberalization.

The investment chapter in the 2009 China-Peru FTA may resemble, at first glance, that of the China-New Zealand FTA (overall architecture of dispositions); but a more careful analysis shows that some provisions depart from this template and draw from the parties' respective backgrounds.[355]

The 2009 Agreement on Investment between China and ASEAN (CAIA), as part of a multi-stage FTA, displays remarkable similarities with the ASEAN Agreement on Investment of the same year. The CAIA also features commonalities with both the China-New Zealand FTA as well as the China-Peru FTA. In 2010, the China-Costa Rica FTA operated a *renvoi* to the 2007 BIT between the two states. The text of China-Costa Rica BIT is entirely drawn from the 1997 Chinese BIT model.

In 2012, the Supplementary Agreement on Investment (SAI) between China and Chile, as part of the multi-stage integrated FTA signed back in 2005, replaced the 1994 China-Chile BIT which was itself entirely drawn from the 1984 Chinese model text.

Underlying the geopolitical rationale of the agreement, the 2013 FTA with Iceland, simply operates a *renvoi* to the 1994 BIT between the parties (featuring the text of Chinese 1989 Model BIT). The FTA with Switzerland from the same year does not cover investment protection at all. Chapter 9 of the FTA, limited to 'investment promotion', features only two generic provisions.[356] The investment matter between

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[354] Require 'full, adequate, and prompt' compensation for legally expropriation.

[355] It is different from China 1997 model BIT, and is not similar with the US-Peru FTA 2006 either.

[356] Article 9.1 [Investment Promotion]

The Parties recognize the importance of promoting cross-border investment and technology flows as a means for achieving economic growth and development. Cooperation in this respect may include:

(a) identifying investment opportunities;

(b) exchange of information on measures to promote investment abroad;

the parties is thus left to the 2009 BIT which replaced the 1986 agreement in a move from the Chinese model to Swiss model. In 2015, the China-Australia FTA was signed, and came into force at the end of the same year.

Regarding the coverage of China's FTAs in general, it is evident that the earlier FTAs usually merely dealt with trade in goods, and focused on traditional trade issues such as reducing tariffs, eliminating barriers, remedies, and other trade facilitation measures. The later FTAs have gradually covered trade in services and investment. Evidently, China has now become more inclined to conclude package agreements that include investment matters.[357]

Compared with China's BITs— FTAs show some *new* characteristics. For example, in defining 'investment', China's recent FTAs have included more and broader provisions. In contrast to most BITs, which usually require investment to be made 'in accordance with the laws and regulations' of the host country, recent FTAs such as the China-New Zealand FTA do not require foreign investment 'to be made by following the host country's law'. Almost all of China's FTAs—(such as the China-New Zealand and China-Peru FTAs, as well as the China-ASEAN Investment Agreement)—provide national treatment to investors from the partner countries.[358] The following subsections will discuss some innovations shown in FTA investment chapters, namely national treatment, social responsibility clauses, and dispute settlement remedies.

3.3.1 Revise National Treatment Provision

China maintains a very prescriptive approach to the admission and establishment of investments.[359] The 1988 China-Australia BIT states, '[E]ach Contracting Party …

(c) exchange of information on investment regulation;
(d) assistance of investors to understand the investment regulations and the investment environment in both Parties; and
(e) the furthering of a legal environment to increase investment flows.

[357] Wang Guiguo, 'China's FTAs: Legal Characteristics and Implications', *The American Journal of International Law*, vol.105, No3 (2011), p496. Also see Francis Snyder, 'China, Regional Trade Agreements and WTO Law,' *Journal of World Trade* 43, no. 1 (2009), p.500.

[358] China-New Zealand FTA, Art.138; China-Peru FTA, Art.129; China-ASEAN Agreement on Investment, Art.4.

[359] The United Nations Conference on Trade and Development (UNCTAD 1999) distinguishes between admission (the right to enter or be present in a jurisdiction) and establishment (the right to enter or be present in a jurisdiction)

shall, in accordance with its law and investment policies from time to time, admit investments'.[360] The 2015 China-Australia FTA, which refers to national treatment, is limited to 'management, conduct, operations, maintenance, use, enjoyment or disposal' of investment, and the responsibility of the host state is qualified by being limited to treatment no less favourable than that accorded, in like circumstances, to its own investors.[361] Similar to the China-New Zealand FTA, Article 139 of the China-Australia FTA goes further, by according to investors of each party 'treatment no less favourable than that accorded, in like circumstances, to the investments and associated activities by the investors of any third country with respect to *admission*, expansion, management, conduct, operation, maintenance, use, enjoyment and disposal.' A provision granting MFN treatment to the admission and establishment of investments is also included in the ASESN-China Investment Agreement.[362]

3.3.2 Added Social Responsibility Clauses

Another new feature is that a few PTAs added provisions safeguarding the right to regulate for sustainable development. For example, they contain exceptions to transfer-of-funds obligations or prudential carve-outs.

The China-New Zealand FTA (2008) is China's first FTA that contains a binding Environment Cooperation Agreement and a binding Memorandum of Understanding on Labour Cooperation. It is also the first Chinese investment agreement (as a package deal of FTA) that explicitly prohibits the use of performance requirements by incorporating the WTO Agreement on Trade-Related Investment Measures.[363]

To take the China-ASEAN FTA for example, its transfer clause includes a number of exceptions, including the right to impose capital controls in the case of a serious balance of payment crisis.[364] Additionally, it includes chapters on general

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and establishment (the right to set up a particular type of entity). For the purpose of this chapter, the terms are used primarily to refer to the question of admission of investments.

360 Article II (1).

361 The China-Australia 2015 FTA, Art. 138.

362 Article 5(1).

363 Also, see the China-South Korea BIT (2007), Art. 2(3) states that the contracting parties shall not 'impose unreasonable or discriminatory measures on investments by investors of the other Contracting Party concerning local content, technology transfer or export performance requirements.'

364 China-ASEAN PTA, Art. 10(5).

exceptions and security exceptions, as well as a chapter on transparency requirements. A novel feature of the China-ASEAN FTA is that its chapter on the promotion and facilitation of investment originates from the ASEAN Comprehensive Investment Agreement, and also reflects the original objectives written down in the Framework Agreement. China and ASEAN countries have committed in the Framework Agreement to strengthen cooperation and to 'progressively liberalize and promote trade in goods and services as well as create a transparent, liberal and facilitative investment regime.'[365]

3.3.3 Limited Application of Investor-State Arbitration

China's FTAs usually contain friendly and conflict-avoiding methods for dispute settlement. As can be found in most of China's FTAs, the objective of dispute settlement is 'to encourage the Parties at all times to endeavour to reach a mutually satisfactory resolution of the dispute arising under this Agreement through cooperation and consultations; and … the Parties may, at any time, reach a mutually satisfactory resolution of any matter through consultations.'[366] If the dispute cannot be settled through amicable negotiations and consultations within a period (usually six months), the parties may resort to other means, such as conciliation, mediation, or arbitration (namely, Investor-State Arbitration).

Most of China's recent FTAs provide for Investor-State Arbitration, with the purpose of investment protection. On the other hand, they cautiously regulate investor-state dispute settlement by limiting treaty provisions that are subject to investor-state dispute resolution.

Under the China-Pakistan FTA, for example, disputes may be submitted to a competent domestic court of the host country, or for arbitration by the ICSID.[367] However, once a local court is chosen, that choice will exclude the possibility of submitting the same dispute to the ICSID for arbitration. The China-New Zealand

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[365] The Framework Agreement, Art. 1(b).
[366] See China-New Zealand FTA, Art 163(1).
[367] China-Pakistan FTA, Art 54(2).

FTA also allowed investors to submit disputes to ICSID for arbitration, but before that can occur, a condition of six months' notice is required.[368] The purpose of this provision is that it allows the host country to require that the investor concerned must go through the administrative review procedures. The laws and regulations of the host country often define these procedures. The China-New Zealand FTA also has detailed rules on arbitration procedures, which have the effect of modifying the domestic laws of the parties and the ICSID regulations governing dispute settlement.[369] One such modification is that the time limit for the submission of disputes is set at no longer than three years from "the time at which the disputing investor became aware, or should reasonably have become aware, of a breach of obligation" by the host country that has caused loss or damage to the investor, or its investments.[370] Also under Chinese law,[371] when the provisions of an international treaty concluded by China are in conflict with those of national laws, the treaty provisions prevail.

Although China has renegotiated several of its first-generation BITs, many investments in China and Chinese overseas investments remain covered by them. The Peru-China BIT (1994) is one example of a first-generation BIT which is still in force.

Tza Yap Shum v. Peru[372] is the first case brought under a Chinese BIT. The case concerned alleged breaches of the Peru-China BIT (1994). Mr. Tza Yap Shum made an investment in TSG Peru S.A.C (TSG), a Peruvian Company in the business of producing fish-based food products and their subsequent exports to Asian markets. In 2004, the Peruvian Tax Administration started a number of actions, which the claimant Shum alleged destroyed TSG's business operations and economic viability.

Shum claimed that Peru had violated a few articles in the China-Peru BIT, including 'no expropriation without compensation' (according to Article 4 of China-Peru BIT). Peru objected to the jurisdiction of the Tribunal, and argued that the claims brought by Mr. Shum did not fall within the scope of the arbitration clause in

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[368] China-New Zealand FTA, Art 153(1).
[369] China-New Zealand FTA, Art 153(4), states that the FTA's provisions on dispute settlement prevail over the arbitration and conciliation procedures of both ICSID and the UN Commission on International Trade Law.
[370] *Id.*, Art. 154(1).
[371] See Chinese Civil Procedure Law, Art. 238.
[372] Mr Tza Yap Shum v. The Republic of Peru, ICSID Case No. ARB/07/6 Decision on Jurisdiction and Competence, 19 June 2009.

the Peru–China BIT. However, the tribunal found that the expropriation claim was within the jurisdiction of the Tribunal.

Peru defended that, according to Article 8(3) of the Peru-China BIT, *disputes involving the amount of compensation for expropriation* may be referred to arbitration under the ICSID Convention. Other disputes may only be referred to arbitration following a separate agreement between the investor and the state accepting the investment. However, the tribunal did not accept Peru's argument that the *expropriation* claim was outside its jurisdiction. The tribunal held that:

> The BIT uses the word 'involving' which, according to the Oxford Dictionary means 'to enfold, envelope, entangle, include.' A bona fide interpretation of these words indicate that the only requirement established in the BIT is that the dispute must 'include' the determination of the amount of a compensation, and not that the dispute must be restricted thereto. Obviously, other wording was available, such as 'limited to' or 'exclusively', but the wording used in this provision reads 'involving'.[373]

The Tribunal concluded that to give meaning to all the elements of the article; it must be interpreted that the words:

> Involving the amount of compensation for expropriation includes not only the mere determination of the amount but also any other issues normally inherent to an expropriation, including whether the property was actually expropriated in accordance with the BIT provisions and requirements, as well as the determination of the amount of compensation due, if any. In the opinion of the Tribunal, a contrary conclusion would invalidate the provision related to ICSID arbitration since according to the final sentence of Article 8(3), turning to the courts of the State accepting the investment would preclude definitely the possibility of choosing arbitration under the ICSID Convention. Consequently, since the Claimant has filed a prima facie claim of expropriation, the Tribunal, pursuant to Articles 25 and 41 of the ICSID Convention and Rule 41 of the Arbitration Rules, considers that it is competent to decide on the merits of the expropriation claim filed by Claimant.[374]

However, there have also been awards concluded which state the tribunal's jurisdiction is limited to the quantification of damages. The different result may depend on the wording of the arbitration clauses in different BITs. In another case, the

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[373] *Ibid.*, para. 151.
[374] *Ibid.,* para. 188.

Chinese financial services company Ping An, filed an international arbitration against Belgium under the China-Belgium BIT.[375] The 1984 BIT limited investors to pursuing *ad hoc* arbitration only in relation to 'disputes over the amount of compensation owing in cases of expropriation or nationalization.'[376] The tribunal rejected the Chinese investor's claim on the jurisdiction.[377]

To sum up, Chinese PTAs and revised BITs are influenced by a new investment policy that seeks a better balance between the protection of foreign investors and host countries' regulatory rights. Although China may have been defensive about commitments that go beyond the level of investment liberalization found in Chinese BITs, China is willing to grant MFN treatment in the pre-establishment phase. PTAs do not depart from previous BITs, as they maintain the high standards granted to foreign investors for their interests. However, PTAs could have a balancing function to give the host country some regulatory space concerning foreign firms' social responsibility.

3.4 A Cross-Issue Link: Investment and Service in PTAs

Services are similar to goods with regard to the economic effects of removing barriers to trade. The overall result is to allow greater competition from foreign firms. Inefficient firms face the risk of exiting the market if they fail to improve their performance. This contest will finally lead to resource re-allocation, although someone may confront adjustment costs and losses. But, if there are economies of scale, and greater foreign participation with more competition, there will be a larger scale of activity. However, different from trade in goods in terms of their 'cross-border' economic impact, the 'import' of services are often locally produced. If foreign participation merely substitutes for domestic production, and the sector does

375 Ping An v. *Kingdom of Belgium,* ICSID Case No. ARB/12/29.

376 Article 10 (3) of China-Belgium-Luxembourg Economic Union BIT (1984).

'… [a] dispute which *arises from* an amount of compensation for expropriation, nationalization or other similar measures and has not been settled within six months from the date of notification may, as the investor prefers referred for settlement either to:

(1) a judicial body of the Contracting Party accepting the investment, or,

(2) an international arbitration without resort to any other means.' (Emphasis added)

377 The claimants file a counter-memorial on jurisdiction on May 12, 2014.

not expand, then there may be no positive growth impact.

Empirical research finds that there is a positive link between service liberalization and inward FDI in service; the firms that use services from FDI have greater productivity growth.[378] Policy reform on service markets may face more or less opposition. Some industry sectors may support the policy as they have an interest in a wider market entry for service inputs. Consumers may oppose liberalization because of concerns about quality, or the geographical supply of certain services, such as health, education, transport, and telecommunications etc. Governments have to evaluate these interests to implement reforms. One way to overcome some constraints and support reform is by signing international trade agreements. In services, this depends on where exports' interests exist.[379]

Exports interests of services may learn the way from exports of goods. If firms can access to service inputs with a high-quality and competitive price, it will help their exports of goods. Meanwhile, it is important to obtain information and assess the impact of *status quo* services policies. FDI is one of the modes of supplying services. Therefore, foreign investors may have a high 'export' interest and thus support the multilateral negotiation. A business that would benefit from higher quality and lower priced services is more inclined to support service liberalization. In practice, those countries which first implement liberalization will obtain a strategic advantage. Consequentially they will have further incentives to pursue domestic reforms. Therefore, narrow reciprocity, in the form of equivalent concessions between trading partners, is less of a priority for those countries.[380] By contrast, countries are always willing to 'mutually' liberalize further merchandise trade.

Given the severe investment restrictions that exist in service industries, this is the area where PTA-based market access can have a significant beneficial impact on investment flows. Foreign investment in the service sector is mainly market seeking.

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[378] FDI in service promotes industry's production. The logic is that i.e. they find a positive relationship between policy reforms in banking, telecommunications, and transport and the productivity of Indian firms in manufacturing industries. *See* Hoekman and Kostecki (2001), p.328.

[379] Bernard M. Hoekman and Aaditya Mattoo, "Liberalizing Trade in Services: Lessons from Regional and WTO negotiations," *EUI Working Paper* RSCAS 2013/34.

[380] Hoekman and Messerlin (2000).

The services concerned require the commercial presence of affiliates, branches, or offices to deliver the service. Barriers to entry into services markets usually take the form of regulatory restrictions on the entry of foreign markets, foreign equity ownership limitations, quotas on outputs and requirements or restrictions on the legal form of establishment.

The NAFTA was the first regional agreement to combine BIT-like disciplines with comprehensive trade in services standards. Through the GATS the WTO brought the supply of services into the realm of multilateral trade rules for the first time. These two important developments have expanded the landscape of regional agreements and the possible types of interaction between investment and service disciplines.

The granting of preferential access could make foreign firms with higher costs gain a competitive advantage relative to investors from outside the region, because preferential mover advantages and barriers to entry (for outsiders) make it difficult for those lower cost suppliers from other countries to enter the regional market.[381] This is one of the reasons why MFN matters.[382] In addition, the rules of origin (ROO) that are included in PTAs for investors in services (and other industries), will identify the extent to which intentions are discriminatory or not.

Multilateral, explicitly MFN-based liberalization, is likely to produce even larger gains than preferential regional agreements. This is also because multilateral liberalization opens the market to the largest number of competitors, and maximizes consumers' choices. Another way of assessing the likely impact of PTAs, is to ask to what extent they go beyond the GATS in the elimination of discrimination in service markets. As with the GATT, the GATS does not preclude members from entering into a preferential agreement with other members, nor does it prevent members from granting one another mutual recognition of their regulatory standards and certification requirements.[383]

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381 Trade diversion.
382 The extent to which such discriminatory policies are applied to services in the PTA context is difficult to know.
383 While GATS applied a positive list approach to schedule commitments for services trade, the plurilateral pact (Trade in Services Agreement (TiSA)) is moving toward a hybrid approach: members will still schedule market access commitments under the positive list approach, but national treatment obligations will be handled under a negative list approach, in which members commit to national treatment in all sectors except those where an exception is scheduled.

This part will give a review on the liberalization commitments previously scheduled in the WTO/GATS and two Chinese FTAs (with Costa Rica, and Chile for example).[384] The normative text and most of the contents of China's services schedules are similar in these two agreements. The FTAs that China has negotiated with partners in Asia, particularly ASEAN, have been less ambitious and contain less comprehensive sectoral coverage.

China made several commitments in its WTO Accession Protocol (2001). The difference between the GATS and the new bilateral agreements is most striking for China in mode 3 (FDI), where Chinese FTAs have scheduled greater opening for direct investment.

China has preferred to negotiate the services component of its FTAs under the positive list format. Under this approach, restrictions that could affect services and investment are set out differently than under a negative list approach. Measures affecting the entire economy are listed under the horizontal limitation section, while measures affecting individual service sectors are listed according to the 12 main sectors and 157 subsectors, which the WTO has defined in Classification List W/120.[385] Most-Favoured-Nation-Treatment limitations are listed at the end of the Schedule.

These two FTAs (with Costa Rica and Chile respectively) have built on China's GATS schedule, which was considered to be very comprehensive at the time of China's accession to the WTO (2001), particularly for infrastructure services such as telecommunications, financial services, distribution, and transport.[386]

a) Horizontal Measures Affect Services Trade and Investment.

China has maintained the same horizontal commitments in its FTAs that it set out in

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[384] Service barriers come in many flavours, are deeply embedded in regulatory practices, and are not eliminated nearly as easily as tariffs. World Bank's Services Trade Restrictiveness Index (STRI) is a method for measuring service barriers. China's barriers in 18 service sectors were more restrictive than the average scores for 40 other developed and developing economies.

[385] The Service Sectoral Classification List is WTO document MTN.GNS/W/120.

[386] Sherry M. Stephenson, "Service Barriers," at *Bridging the Pacific*, Peterson Institute for International Economics, 2015. pp.185-186.

its GATS Services Schedule, 2002. Limitations in this section apply to two areas: FDI (mode 3) and labour movement (mode 4). In FDI, China imposes a minimum equity of 25% for Joint Ventures and no horizontal equity ceiling, though ceilings are special for individual sectors. There is no guarantee that foreign firms can establish branches in China, unless indicated for specific sectors. As land is state-owned in China, foreign firms cannot purchase land but must lease, and leases have specific term lengths: 70 years for residential use, 50 years for industrial, and only 30 years for commercial, tourist, and recreational purposes. Foreign firms in several enumerated sectors—including audio-visual, aviation, and medical—as well as in new service sectors cannot obtain subsidies.

b) Sectoral Measures Affecting Services Trade and Investment

Most of the restrictions by sector are found in mode 3 (commercial presence, usually FDI). In legal advisory services, foreign law firms can provide legal services only in the form of representative offices and international conventions.[387] Joint ventures are required for professionals in the areas of taxation, medical and dental services, market research activities, photographic services, convention services, environmental services, business services (i.e., those incidental to agriculture, forestry, hunting, fishing, and mining), and oil and gas exploration.[388] In the construction sector, China imposes a restriction on the types of construction activities that foreign investors can undertake, limiting these essentially to those funded by foreign sources, or those in which Chinese expertise is limited.[389] Regarding distribution, in the area of retail sales, China imposes restrictions on the number of retail outlets to less than 30. Additionally, no wholly foreign-owned retailers are permitted for chain stores. An education requirement calls for the establishment of joint schools. The areas of telecoms,[390]

[387] See Report of the Working Party on the Accession of China, Addendum, Schedule CLII-The People's Republic of China, *Part II—Schedule of Specific Commitments on Services List of Article II MFN Exemptions*, WT/ACC/CHN/49/Add.2, 1 October 2001.
[388] *Id.*
[389] *Id.*
[390] Information and communications technology (ICT) firms must get approval (for operation) from the Chinese Ministry of Industry and Information Technology (MIIT). In 2013 MIIT released an updated catalogue of

transport,[391] and financial services[392] operate under limits on FDI.

Despite the requirement that China imposes on investors to establish a joint venture in many service sectors, there is nonetheless no equity limit for many of these activities, and 100 percent equity participation is often possible. Wholly foreign-owned enterprises are permitted for most professional services. Relatively few equity ceilings remain in China's FTA schedules on service activities. Wholly foreign-owned subsidiaries are also allowed in the travel and tourism sector for hotels, restrictions, and tour operators, except those which deal with trips to Hong Kong, Macao, and Chinese Taipei. There are no restrictions on recreational, cultural, and sporting services activities for cross-border trade, or FDI.

Most PTAs negotiated since the early 1990s include provisions on services. Although many PTAs do not go much beyond the GATS, some recent agreements have tended to have a higher level of ambition when measured by sectoral coverage. The substantive rules that are included in many PTAs are similar to those in the GATS, i.e., the depth of the associated commitments often does not go much beyond what PTA members committed to under the WTO.

In these areas (services in FTAs) it seems easier for governments to agree to common rules and disciplines in the WTO/GATS context.[393] One of the exceptions is

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telecommunication services, *subjecting four new categories to licensing requirements*: long-term evolution (LTE) 4G, wire access infrastructures services, satellite-based fixed communication services, and mobile resale. *Foreign firms doing business in these categories will need a license from MIIT to operate in the named subsectors and must use a joint venture with no more than 50 percent foreign ownership*.

[391] In the area of transport services, China's FTAs exclude passenger transport. There are no restrictions on rail or road transport in China's schedule, and wholly owned foreign subsidiaries are permitted, though maritime transport and air transport are restricted. Less than 49 percent equity participation in FDI is allowed in maritime shipping as well as in auxiliary services for maritime, and ships can operate only under China's national flag. Shipping on inland waterways by foreign vessels is not permitted.

[392] China did not include updated financial services commitments in its FTAs with Chile and Costa Rica. The baseline accordingly reflects China's WTO schedule of commitments, in effect since 2002. Several areas of China's financial services sector seem relatively open according to its WTO commitments. There are no equity limits, geographical limitations, or clientele limitations on FDI in insurance lines—with the overriding exception of life insurance, while licenses must be obtained for nearly all financial activities, they are issued without quantitative restrictions, but they require compliance with prudential standards, which states flexibly interpret.

[393] The WTO deals with investment policies only through the GATS (insofar as a member decides to make mode 3 commitments for a service sector). *Investment disciplines lodged in RTA services chapters are usually based on the GATS* (Investment is covered in the narrower form of a "commercial presence". MFN treatment and Transparency are the general obligations. Obligations on market entry and national treatment arise to the extent liberalization commitments are listed in separate schedules. Domestic regulation issues are also addressed. Avoidance of restrictions on international payments and transfers is the only significant 'protection' provided by the trade in services chapters, and even so, only in sectors where liberalization commitments are scheduled.) Houde, et al. *Survey some PTAs on the comparison between the schedules of commitments in the RTAs and GATS commitments in Mode 3*, "Interaction between Investment and Service Chapters in RTAs," *OECD Working Paper*, (2007) (suggesting that all those agreements are WTO-plus.)

in investment protection. Several PTAs have disciplines on investment protection, and some even provide for arbitration in the case of investor-state dispute.[394] Often these are general and not services-specific, but services are covered. The level of investment protection is determined by the scope and coverage of the investment protection provisions.

To sum up, the liberalization of investment in services in FTAs.[395] goes further than in the GATS.[396] Regional agreements are supposed to provide a higher degree of liberalization to be consistent with WTO rules (GATS Article V). The regional trade agreement is intended to create a degree of mutual reciprocity in the commitments, particularly in agreements between developed and developing countries (the latter have made fewer commitments under the GATS). Chinese RTAs may promote further investment liberalization in services.

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[394] Today's RTA investment chapters typically provide broad investment coverage, strong protection and non-discrimination commitments and recourse to investor-state arbitration. *The level of investment protection is determined by the scope and coverage of the investment protection provisions*, such as on expropriations, transfers, compensation for losses or investor-State dispute settlement.

[395] *e.g.*, Chinese RTAs with Chile, Costa Rica.

[396] *See e.g.,* In Telecom services, "China's services schedule for telecoms in its FTA with Costa Rica is considerably *simpler* than its WTO GATS schedule of a decade earlier; …and a simplified schedule that encompasses all telecom activities is a useful innovation…" Sherry M. Stephenson, "Service Barriers", at *Bridging the Pacific*, Peterson Institute for International Economics, 2015. p.188.

4 Interpretation on Substantive Investment Provisions in FTAs and BITs

A new generation of investment treaties look very different today than they did in the last century. The texts are longer and more complex, with substantive obligations in greater detail, and increasingly they contain reservations, carve-outs, exceptions, explanatory notes, schedules, and so on.[397] While they may still be a long way from a multilateral investment agreement, the provisions of BITs nowadays have developed a great deal of similarities by referring to one another in model BITs.[398] In this way, states are slowly developing an increasingly coherent and predictable discipline of international investment law and procedure.[399]

Trade and investment regimes already share some common substantive provisions in their standard baseline treaties.[400] The principle of non-discrimination is at the heart of investment neutrality.[401] Trade law may influence the interpretations of *ad hoc* tribunals on national treatment standards.

How frequently do investment tribunals consider jurisprudential concepts developed in the case law of the trade regime, when resolving their cases? To date, they have done so only on select occasions, for a very limited set of substantive issues. Most instances are confined to the issue of national treatment, a fundamental concept of non-discrimination shared across the two regimes. The basic principle is that governments are obliged to treat foreign and domestic entities indiscriminately. Critical to this analysis is the issue of identifying proper comparators—a question

[397] For example, the MFN provision in the recent signed China-Japan-Korea Trilateral Investment Agreement states that the obligation to accord MFN treatment to investors and their investment does not include treatment accorded by provisions concerning the settlement of investment disputes.

[398] Meg Kinnear, "ICSID and International Investment Treaty Arbitration: Progress and Prospects," in W. Shan ed., *China and International Investment Law, Twenty Years of ICSID Membership,* Brill Nijhoff Press, 2014.

[399] *Id.*

[400] Despite this, international investment treaties, have traditionally contained only specific and, not general exceptions.

[401] Investment flows, under the principle of investment neutrality, should be allocated by market forces rather than by political intervention. See Kenneth J. Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation,* Oxford University Press, 2010, p. 337.

which was considered by both WTO panels and investment tribunals. However, while investment tribunals may consider what the relevant WTO jurisprudence has to offer on this matter, they have rejected, with regularity, the tests developed by WTO panels and the Appellate Body. Rather than borrow from WTO case-law, investment tribunals have chosen instead to formulate and apply their own tests.

4.1 National Treatment (NT)

In the past, national treatment was considered to apply to foreign investors only after their investments were made, or after their entry into the market. For example, the 2012 Trilateral Investment Agreement between China, South Korea, and Japan, Article 3, provides that: "Each Contracting Party shall in its territory accord to investors of another Contracting Party and to their investments treatment no less favourable than that it accords in like circumstances to its own investors and their investments with respect to investment activities."[402] Some recent BITs, however, contain NT provisions that apply to pre-entry activities.[403]

Another feature of NT provision is that sometimes the BIT provides such treatment separately for investments and investors. It is also sometimes the case that NT and MFN treatment are stipulated within the same provision. Still, other BIT provisions require that whichever — (NT or MFN treatment)— is more favourable should apply. For example, Article 10(7) of the Energy Charter Treaty (ECT)[404] states that 'Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other

[402] See Agreement among the Government of the People's Republic of China, the Government of the Republic of Korea and the Government of Japan for the Promotion, Facilitation, and Protection of Investment entered into on May 13, 2012; text available at http://www.mofa.go.jp/announce/announce/2012/5/pdfs/0513_01_01.pdf.

[403] According to an UNCTAD report, such BITs are typically the ones "entered into by Canada and the United States (apart from the Friendship Commerce and Navigation ("FCN") treaties of the United States), [which] have extended national treatment to the pre-entry stage so as to ensure market access for foreign investors on terms equal to those enjoyed by national investors." See UNCTAD, Report on National Treatment 1999 (hereafter "UNCTAD Report"), UN Doc. UNCTAD/ITE/IIT/11, Vol. IV, p. 4.

[404] Final Act of the European Energy Charter Conference: 69/5-69/114. See Peter D. Cameron, *International Energy Investment Law*, the Pursuit of Stability, Oxford University Press, 2010, p. 153.

Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.'[405] The exceptions to the NT and the MFN clauses are limited in scope, number, and duration, while being clearly known and transparent at the time of signature.[406]

The purpose of NT is to ensure non-discrimination against foreign investments and investors. From the following parts on the review of treaty practice, it is clear that, as an extension of treatment standards on trade, NT in the case of investments is only applicable 'in like circumstance', as opposed to for 'like products' in the case of trade. The most important question is how to establish 'like circumstances' and 'less favorable' treatment, because the language of many BITs does not contain the words 'like circumstance', or similar references. A related question is whether the *intent* of the host state to discriminate against foreign investors is required or whether a discriminatory *effect* is sufficient. The third question is whether precedents arising from trade tribunals, such as the panels and Appellate Body of the WTO, can serve as a reference for settling investment disputes.[407]

As will be explained in following sections, tribunals consider competition as a relevant condition for 'like circumstances'. But should competition be as a *necessary* condition for 'like circumstance'? In *SD Mayer v. Canada*, the tribunal instead determined 'likeness' from a 'business perspective.'[408] In its view, the 'likeness' test requires an inquiry into the competitive relationship between domestic and foreign investors. It stated that to establish whether less favourable treatment is accorded to a foreign investor, the foreign investor and the comparable domestic investor must be in the same sector, which "has a wide connotation that includes the concepts of 'economic sector' and 'business sector.'"[409] The *S.D. Myers* Tribunal then concluded that, from a business perspective, "SDMI and Myers Canada were in 'like circumstances' with Canadian operators" because they "all were engaged in providing

[405] Art. 10(7) ECT.
[406] Peter D. Cameron, (2010), p. 157.
[407] For a comparison between the two fields, see: J. Kurtz, *The WTO and Investment Law: Converging Systems*, Cambridge University Press, 2016.
[408] *S.D Myers v. Canada*, First Partial Award (November 13, 2000), para. 251.
[409] Ibid., para. 250.

PCB waste remediation service."[410] The rationale the tribunal gave is that SDMI was in a position to attract potential customers from the Canadian operators.[411] The *S.D. Myers* Tribunal's decision was in essence based on its establishment of the competitiveness of the claimant and domestic comparators.

This section will first examine how the national treatment standard on cross-border trade has evolved in the context of investment, followed by how investment tribunals have applied the standard.

4.1.1 WTO Case Law

The role of national treatment is to ensure that liberalization concessions are not offset through the imposition of domestic taxes and similar measures. A WTO member claiming that its goods, have been treated discriminatorily might need to establish the origin of its goods since MFN is relevant to goods of (some) WTO origin.[412] The WTO Agreement does not contain a harmonized benchmark for conferring origin. WTO members can choose their standard for conferring origin but then have to apply it in a non-discriminatory way to domestic and imported 'like' goods.[413]

Policy choices on economic variables, both at home and abroad, as well as government evaluation of the effects of their policies, decide the scope for beneficial trade contracts.[414]

When unilaterally making tax policy, a government may be tempted to pursue the 'beggar-thy-neighbour' policies. Therefore, trade agreements are reciprocal exchange concessions.[415] NT works against the protectionist use of domestic policy instruments to circumvent tariff bindings.[416]

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[410] Ibid., para. 251.
[411] Ibid., para. 251.
[412] Mavroidis and Hoekman, *The World Trade Organization: Law, Economics, and Politics*, 2nd edition, Routledge Press, 2016, p. 36.
[413] *Id.*
[414] 'Unilateral policy choices are likely to be inefficient when evaluated from the perspective of the world as a whole.' See Gene M. Grossman and Henrik Horn, 'Why the WTO? An Introduction to the Economics of Trade Agreements,' in Horn and Mavroidis, (ed.), *Legal and Economic Principles of World Trade Law*, Cambridge University Press, 2013, p. 15.
[415] The final property of design of trade agreements is that they entail reciprocal reductions in tariffs, and other trade barriers. See *ibid*., p. 35.
[416] NT is meant to outlaw the protectionist use of domestic instruments. See: Gene M. Grossman, Henrik Horn, and Petros C. Mavroidis, 'National Treatment', in Horn and Mavroidis, (ed.), *Legal and Economic Principles of*

The following part will discuss how panels test the application of NT provisions and detect the protectionist purpose of government measures.

a) The Coverage of the National treatment obligation

With regard to domestic instruments, Art. III. 1 GATT stipulates an extremely broad coverage by referring to

> "…internal taxes and other internal charges, and laws, regulations, and requirements… having the effect of
> …affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions…."[417]

The same broad approach is continued in Art. III.2 GATT, which states that exports of a member shall not be subject,

> "…directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products…"[418]

Similarly, Art.III.4 requires no less favourable treatment of imported products with respect to

> "… all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."[419]

Art. III GATT covers direct taxes on goods (Art. III.2 GATT), as well as indirect taxes and non-fiscal impositions (Art. III.4 GATT). A fiscal imposition on goods affects trade by modifying the price of the goods concerned. This explains why Art. III.2 GATT (which covers fiscal measures) does not include the words *affecting* trade, whereas these words are found in Art. III.4 GATT (which covers non-fiscal

World Trade Law, Cambridge University Press, 2013, p. 205. They explore an economic analysis to find that the extent to which the GATT achieves its purpose (in the preamble) depends on how the regulations it imposes affect the working of markets. p. 206.

417 Art. III.1 GATT

418 Art. III.2 GATT

419 Art. III.4 GATT

measures).

Art. III GATT does not enumerate one by one the domestic instruments to which it applies, except in the case of local content requirements that are explicitly mentioned in Art. III.5 GATT. Two policy measures have been explicitly exempted from the coverage of the NT obligation by Art. III.8 GATT: subsidies and government procurement.

b) Establishing a Violation of National Treatment

The language in GATT Art. III.2 (fiscal measures) and Art. III.4 (other internal policies) is divergent. The legal test for seeing the consistency of measures is different. WTO Case-Law reflects that Art. III.1 GATT discourages the protectionist use of domestic legislation irrespective of whether fiscal or non-fiscal measures are used.

The national treatment obligation requires a double comparison as the treatment of foreign goods may not be less advantageous than that accorded to domestic 'like' goods. The MFN on subjective measures accorded to one foreign product must immediately and unconditionally be accorded to all 'like' foreign products. As a result, the treatment accorded to domestic products must be accorded to *all* foreign 'like' products.

For a violation of Article III GATT to occur, a successful complainant must establish that a WTO member has intervened through regulatory means 'so as to afford' protection to domestic competing 'like' products. Hence, the complainant must persuade the WTO adjudicating body that the product pair at hand (domestic-foreign) is *like* and that the measure being challenged treats the domestic product in a more advantageous manner.

Relevant GATT/WTO case law has clarified three criteria for *likeness* to be determined: first, demand-side factors are relevant; second, econometric or other indicators may be used; and third, all 'like' products have to be directly competitive or substitutable. "Some criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar'": to test the product's end-uses in a given market;

consumers' tastes and habits, which change from country to country; the product's properties, nature, and quality.”'[420]

The AB reports on *Japan-Alcoholic Beverages II* and on *Korea-Alcoholic Beverages* excluded supply-side criteria in establishing likeness and limited the relevant criteria to the demand side in the marketplace. The first reported attempts to apply standard economic criteria, such as the cross-price elasticity, in determining likeness,[421] while the second report allowed complainants to use other criteria such as physical characteristics, consumer preferences, and end-uses.[422]

For products to be ‘like’ they have to share some properties beyond what any two directly competitive or substitutable products share. The AB report on *Japan-Alcoholic Beverages II*, states that “two directly competitive or substitutable products which come under the same HS classification are considered to be like.”[423]

In *Philippines-Taxes on Distilled Spirits*,[424] the EU and the US each brought forward a complaint, with respect to the WTO-consistency of the Philippines excise tax on distilled spirits. In the appeal, the Appellate Body upheld the Panel's finding that, ‘through its excise tax, the Philippines subjected specific types of imported distilled spirits to internal taxes in excess of those applied to like domestic spirits of the same type made from designated raw materials in violation of Art. III:2, first

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[420]. ‘Like’ products is a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all ‘directly competitive or substitutable’ products are ‘like’. The AB in its report on *Korea-Alcoholic Beverages* held that *like* products is a subset of *DCS* products: if two products are like, they are, by definition, DCS as well. (ξ 118) see Appellate Body Report, *Korea-Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.

[421] The AB, in its report on *Japan-Alcoholic Beverages II* provides its understanding of DCS products. This dispute arose because of a Japanese taxation scheme which, while neutral on its face-value, subjected predominantly Western products to a heavier taxation than predominantly Japanese products. As a result, sochu (an alcoholic beverage predominantly produced in Japan) was subjected to less burdensome taxation than, inter alia, whisky (an alcoholic beverage predominantly produced in Europe and the US). Europe and the US protested, arguing that all of the products concerned (with the exception of vodka that was deemed to be a ‘like’ product to sochu) were DCS products. The AB upheld the panel's findings in this regard. In its review, (a) physical characteristics; (b) common end-users; and (c) tariff classification, are appropriate elements to take into account when defining whether two products are *DCS*. Upholding the panel's findings in this regard, the AB made it clear that the test to define whether two products are DCS is in the marketplace, in the sense that, it is *consumers* who will ultimately decide whether two products are indeed in competition with each other. To this effect, “*econometric indicators* (for instance, the *cross-price elasticity*) are relevant to define whether two products are indeed in competition with each other.” For comments on this case, see: Horn and Mavroidis, (eds.) *Legal and Economic Principles of World Trade Law*, Cambridge University Press, 2013, pp. 253-4.

[422] *Korea-Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999.

[423] Appellate Body Report, *Japan on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

[424] *Philippines - Taxes on Distilled Spirits*, DS396. DS403 (adopted on 20 January 2012).

sentence.'[425] The Appellate Body, however, reversed the Panel's additional finding that all distilled spirits at issue in the dispute, irrespective of their raw material base, and their origin or type (brandy, whisky, rum, gin, vodka, tequila, and tequila-flavoured spirits), were 'like products' within the meaning of Art. III:2, first sentence.[426] "Likeness" was not necessarily confined to goods with high substitutability between them.

c) 'Application of NT to Afford Protection'

A key condition for a measure to violate national treatment is that it has the *effect* of affording protection. Many adjudicating bodies use proxies to establish whether protection has indeed been accorded through regulation.

With respect to fiscal policies, Art. III.2 GATT requests that foreign products (i) should not be taxed in excess of 'like' domestic products[427] whereas, (ii) they should not be taxed in a manner that affords protection to domestic directly competitive or substitutable products.[428] The key term in (i) is 'in excess'. This has been equated in Case-Law to a pure arithmetic difference in taxation, irrespective of the margin (i.e., for a violation to occur, the more burdensome taxation must be imposed on the foreign products).[429] For a violation of (ii) to occur, the tax differential must be more than *de minimis* (with this to be determined on a case-by-case basis).[430]

The Appellate Body's conclusion in the *Chile–Alcoholic Beverages* case

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[425] *Philippines – Taxes on Distilled Spirits*, DS403, adopted on 20 January 2012. ξξ 120-122.
[426] *Id.*, ξξ148.
[427] "With respect to *like* products, taxation in excess should be understood as an instance of a measure operating applied so as to afford protection precisely because the imported product was taxed higher than the domestic like good." Appellate Body Report on *Japan-Alcoholic Beverages II*, pp.18-19.
[428] "Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such protective application… Most often, there will be other factors to be considered as well." *Appellate Body Report on Korea—Taxes on Alcoholic Beverages*, (ξ 150).
[429] The AB has stated that even a *minimal* tax differential suffices to satisfy the in-excess criterion. See: Appellate Body Report on *Japan-Alcoholic Beverages II*, p. 23.
[430] For comments on Appellate Body's Report on *Japan-Alcoholic Beverages II*, "Regulatory intent can, consequently, be an issue in the limited case where two products are DCS, and the tax differential is not large enough, keeping in mind that case law has not provided a *quantitative* benchmark to decide what large actually means." See: Horn and Mavroidis, (eds.) *Legal and Economic Principles of World Trade Law*, Cambridge University Press, 2013, p. 260.

illustrates the need for rethinking the interpretation of Art. III.[431] The national treatment obligation was originally designed as an instrument for non-discrimination and not as a tool for de-regulation, since the over-arching function of Art. III GATT is to combat "protectionism."[432]

When it comes to non-fiscal measures, Art. III.4 GATT imposes an obligation not to accord to imported products less favourable treatment than that accorded to domestic like products. To establish whether a regulation operates in a protectionist manner, a complainant does not have to show either protective effects[433] or protective intent.[434]

The TBT[435] and SPS[436] Agreements reflect more elaborate understandings of the non-discrimination obligation. A domestic regulation can simultaneously fall under Art. III GATT, the TBT, and the SPS Agreements. According to the TBT Agreement, a WTO member enacting a technical regulation or standard must respect the national treatment (assuming no relevant international standard exists, which must be followed according to Art. 2.4 TBT). Furthermore, a state will have to ensure that its legislation is *necessary* for it to achieve its unilaterally set regulatory objective.

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431 The AB first held that the tax differential across the two categories of lower and higher alcoholic content drinks was more than *de minimis.* (ξξ 44ff) The AB then asked the question of whether the dissimilar taxation supported the conclusion that it was ASATAP to the domestic product. (ξξ 62-66) The AB agreed that, as a matter of fact, most of the alcoholic drinks hit by the higher taxation were of Chilean origin. However, it dismissed the relevance of this observation for the interpretation of the 'applied so as to afford protection' requirement in the following terms (ξ 67): "This fact does not, however, by itself outweigh the other relevant factors, which tend to reveal the protective application of the New Chilean System. The relevant proportion of domestic versus imported products within a particular fiscal category is not, in and of itself, decisive of the appropriate characterization of the total impact of the New Chilean system under Article III:2, second sentence, of the GATT 1994. This provision, as noted earlier, provides for equality of competitive conditions of *all* directly competitive or substitutable imported products, in relation to domestic products, and not simply, as Chile argues, those imported products within a particular fiscal category. The cumulative consequence of the New Chilean System is, as the Panel found, that approximately 75 percent of all domestic production of the distilled alcoholic beverages at issue will be located in the fiscal category with the lowest tax rate, whereas approximately 95 percent of the directly competitive or substitutable imported products will be found in the fiscal category subject to the highest tax rate." Appellate Body Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000.

432 "Protectionism" here means a policy that causes negative international externalities, for example, when a tariff exceeds the (international) *efficient* negotiation level.

433 In *US-Superfund (1987)*, the US. response was that the difference was so minimal that it could not reasonably have had an impact on the prices in the US market. The GATT panel dismissed the U.S. argument. In this view, the fact that the effects on the market were negligible was a nonissue: Art. III GATT should be constructed and understood as a mechanism protecting legitimate expectations as to the quality of competitive conditions. (ξ 5.1.9). see: GATT Panel Report, United States – Taxes on Petroleum and Certain Imported Substances, L/6175, adopted 17 June 1987.

434 WTO panels did not totally exclude the relevance of an intent test. Case law state that the *subjective* intent of the legislator does not matter. In the Appellate Body's report on *Chile-Alcoholic beverages*, it brought *objective* regulation purpose, that is, the purpose as revealed through the design and architecture of the measure, within the analysis of the 'applied so as to afford protection' criterion. (ξξ71-72).

435 Technical barriers to trade (TBT) Agreement.

436 Sanitary and phytosanitary (SPS) Agreement.

The necessity test means that WTO members can pursue any objective they think proper, while simultaneously choosing the means that will have the least possible negative impact on international trade. 'Necessity' requirement does not oblige WTO members to target this objective by using the most efficient method to realize a social preference. For instance, the SPS Agreement obliges WTO members to base their interventions on scientific evidence and a process of risk assessment, as well as to ensure some coherence in their health and environmental policies.[437]

d) Exception Clause

Trade liberalization, market access, and non-discrimination rules may conflict with other important societal values and interests.[438] General exception clauses allow members, under specific conditions, to adopt and maintain legislation and measures that promote or protect other important societal values and interests, even though this legislation or these measures are inconsistent with the substantive disciplines imposed by the GATT 1994 or the GATS. These exceptions clearly allow members, under specific conditions, to give *priority* to certain societal values and interests *over* trade liberalization, market access and non-discrimination rules.[439]

General exceptions may exclude certain measures from the scope of the application of the 'national treatment' obligation in the GATT.

Art. XX GATT contains a list of grounds that justify deviations from the GATT obligations. The GATT/WTO case law has clarified a few points on how to interpret this provision. First, it is the WTO member invoking Art. XX GATT that carries the burden of proof.[440] The burden of persuasion varies across the various sub-paragraphs included in Art. XX GATT. Second, Art. XX GATT contains an exhaustive list of policy objectives that may serve as grounds for an exception from

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[437] Article 5.5 SPS Agreement.
[438] Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, Cambridge University Press, 2013, p. 544.
[439] Ibid., p. 545.
[440] The respondent has the burden of proof to establish eligibility for an Art. XX GATT exception.

other obligations in the GATT.[441] Third, the conformity of an otherwise GATT-inconsistent measure must be established by using one of the sub-paragraphs of Art. XX GATT as a benchmark. The legal standard for compliance is not the same in each and every sub-paragraph of Art. XX GATT. For example, whereas sub-paragraph (b) requires that measures used are necessary (that is, are not more trade restrictive than what is required to achieve the stated objective) to reach a goal, sub-paragraph (h) requires that measures are simply relating to the attainment of the objective. Therefore, sub-paragraph (h) is a substantially less demanding standard, equivalent more or less to an appropriateness test (i.e., it establishes if a particular measure is appropriate to reach a certain goal, independently of whether it is the least restrictive option).

Once substantial conformity has been satisfied, WTO members must ensure that they apply their measure in a manner consistent with the chapeau of Art. XX GATT. Hence, there is a dichotomy between the subparagraphs and the chapeau. The former are relevant so long as substantial conformity is concerned; whereas the latter is relevant only when the application of an otherwise WTO-consistent measure is concerned.

Case-law on the 'two-tier' test under Article XX of the GATT 1994 is reflected in *US-Gasoline (1996).*[442] Also, the Appellate Body in *US–Shrimp (1998)* further clarified that, to determine whether a measure can be justified under Article XX, one must always examine, first, whether this measure can be provisionally justified under one of the specific exceptions listed in paragraphs (a) to (j) of Article XX; and, if so, whether the application of this measure meets the requirements of the chapeau of Article XX.[443] Hence, an analysis under Article XX must first focus on the measure at issue itself, before then concentrating on the application of that measure.

The following subsections will discuss one of the specific exceptions, and its requirements, provided for in paragraphs (b) of Article XX: as Article XX(b) concerns measures which are 'necessary to protect human, animal or plant life or

441 Horn and Mavroidis, (eds.) *Legal and Economic Principles of World Trade Law*, Cambridge University Press, 2013, p. 319.
442 Appellate Body Report, *US-Gasoline (1996)*, para. 22. See also Appellate Body Report, *Brazil – Retreated Tyres (2007)*, para. 139.
443 See Appellate Body Report, *US-Shrimp (1998*), paras. 119-20.

health.'[444] It sets out a two-tier test to determine whether a measure is *provisionally* justified under this provision: (1) the policy objective pursued by the measure is the protection of the life or health of humans, animals or plants; and (2) the measure is *necessary* to fulfil that policy objective.

First, the policy objective of a measure was for the protection of the life or health of humans, animals or plants. In *China-Raw Materials (2012)*, China submitted regarding the export restrictions on certain raw materials at issue in this case that these export restrictions were:

> Part of a comprehensive environmental protection framework whose objectives are pollution reduction for the protection of health of the Chinese population.[445]

However, the respondents in this case (the EU, the US and Mexico), argued that China's export restrictions were not designed to address the health risks associated with environmental pollution, and that China's invocation of environmental and health concerns was 'merely a *post hoc* rationalization developed solely for purposes of this dispute'.[446] The panel found that China was unable to substantiate that the export restrictions at issue 'were part of a comprehensive programme maintained in order to reduce pollution. Thus, this cast serious doubts over whether the policy objective pursued by the export restriction was for the protection of the life or health of humans, animals or plants.[447]

Second, the 'necessity' requirement is much more complex than the first element. In its report on *Brazil – Retreaded Tyres* (2007), the Appellate Body summed up how the 'necessity' requirement of Article XX(b) is currently being interpreted and applied, as follows:

> [I]n order to determine whether a measure is 'necessary' within the meaning of Article XX(b) of the GATT 1994, a panel must consider the relevant factors, particularly *the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective,* and *its trade restrictiveness*. If this analysis yields a preliminary conclusion that the measure is necessary, this result must be confirmed by comparing the measure with possible alternatives, which may be less trade restrictive while

444 GATT, Art. XX(b).
445 Panel Reports, *China-Raw Materials (2012)*, para. 7.498.
446 *Ibid*., para. 7.499.
447 *Ibid*., para. 7.516.

> providing an equivalent contribution to the achievement of the objective. This comparison should be carried out in the light of the importance of the interests or values at stake. It is through this process that a panel determines whether a measure is necessary.[448]

The Appellate Body emphasized that the 'weighing and balancing' required to determine whether a measure is 'necessary' is a 'holistic operation that involves putting all the variables of the equation together and evaluating them in relation to each other after having examined them individually, in order to reach an overall judgment.'[449]

When considering the 'weighing and balancing' process applied to determine whether an otherwise GATT-inconsistent measure is 'necessary,' the third factor is the restrictive impact of the measure at issue on international trade. In *Brazil–Retreated Tyres (2007)*, the Appellate Body clearly suggested with regard to this factor, that the more restrictive the impact of the measure at issue is on international trade, the more difficult it is to consider that measure 'necessary'.[450] The panel then assessed the existence of less trade-restrictive alternative measures.

With regard to the contribution of the achievement to the value or policy objective pursued, the Appellate Body ruled in *Brazil–Retreated Tyres (2007)* that a measure contributes to the achievement of the objective 'when there is a genuine relationship of ends and means between the objective pursued and the measure at issue.'[451] Furthermore, the Appellate Body held in *Brazil–Retreated Tyres (2007)* that a measure must bring about a material contribution to the achievement of its objective; and that whether a measure brings about such a contribution can be demonstrated either by evidence that the measure: (1) has already resulted in a material contribution; or (2) is opted for produce a material contribution.[452]

Another case law example on the 'necessity' requirement of Article XX(b) is the

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[448] Appellate Body Report, *Brazil – Retreated Tyres (2007)*, para. 178. Emphasis added.
[449] Appellate Body Report, *Brazil – Retreated Tyres (2007)*, para. 182.
[450] See Appellate Body Report, *Brazil – Retreated tyres (2007)*, para. 150.
[451] Appellate Body Report, *Brazil – Retreated tyres (2007)*. In this case, the Appellate Body rejected the European Communities' argument that the contribution of the measure at issue to the achievement of its objective must be quantified by a panel. It held instead, that either a quantitative or a qualitative evaluation is permissible. What is required is 'a genuine relationship of ends and means between the objective pursued and the measure at issue'.
[452] See *ibid*., para. 151.

reports of the panel in *China–Raw Materials (2012).*[453] The panel examined whether the objectives of the export restrictions were for the protection of health and the environment.[454] The panel concluded that China had not demonstrated that the export restrictions at issue were 'necessary' within the meaning of Article XX(b).[455] China did not appeal this finding of the panel.

Lastly, the chapeau of Article XX of the GATT 1994, with regard to measures provisionally justified under one of the paragraphs of Article XX, imposes:

> the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.[456]

The Appellate Body in its report on *US–Shrimp,* expressed the view that it is the language of the chapeau that makes it clear that all exceptions appearing in Art. XX GATT are limited and conditional.[457]

This section will conclude by briefly summing up the understanding of case-law about NT. Firstly recall that the role of NT is to prevent countries from pursuing internationally inefficient (beggar-thy-neighbour) policies.[458] Interpretation of the terms applied in Art. III GATT disputes, can become consistent with the rationale of the provision. Art. XX GATT provides a hierarchy between trade commitments and national social preferences. Public morals, the protection of human health, etc., which

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[453] On the availability of Article XX to justify export restrictions inconsistent with Article XI:1 of the GATT 1994, as opposed to the unavailability of Article XX to justify export duties inconsistent with China's Accession Protocol.

[454] The panel did not examine the importance of the policy objective pursued. It noted that, in the Appellate Body Report in *Brazil – Retreated Tyres (2007)*, it was stated that 'few interests are more "vital" and "important" than protecting human beings from health risks, and that protecting the environment is no less important. See Panel Reports, *China – Raw Materials (2012)*, para. 7.482.

[455] The Panel also considered: 'whether the export restrictions at issue already made, or were apt to produce, a material contribution to the achievement of the policy objective pursued; what was the impact of the export restrictions on trade; and whether there were WTO-consistent or less trade-restrictive alternative measures that could be used instead of applying export restrictions.' See: Panel Reports, *China – Raw Materials (2012)*, para. 7.615. The Panel found – assuming *arguendo* that Article XX was available to justify export duties inconsistent with China's Accession Protocol – that China had not demonstrated that these export duties were 'necessary' within the meaning of Article XX(b). See: Panel Reports, *China–Raw Materials (2012)*, para. 7.616.

[456] Art. XX, GATT.

[457] Appellate Body Report, *United States–Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998. ξ157.

[458] 'The general objective of the regulation of domestic instruments in the GATT is to limit the use of domestic instruments for protectionism, while allowing legitimate use of such instruments, even if this causes adverse consequences for trading partners by shielding import-competing products from foreign competition.' Horn and Mavroidis, (eds.) *Legal and Economic Principles of World Trade Law*, Cambridge University Press, 2013, p. 301.

are listed in this provision, are more important than trade commitments.[459]

The previous section presented interpretations of Art. III GATT and Art. XX GATT based on the case-law. These interpretations may affect the determinations in other cases. The next section will switch to the area of international investment law to examine how investment tribunals apply the national treatment principle.

4.1.2 Investment Case-Law

In the investment context, the basic function of NT is to protect foreign investors from internal regulations which afford more favourable treatment to domestic investors. What does one mean by 'granting NT' or, in other words, prohibiting discrimination based on the nationality of the investor (or investment)? In addition, if a measure has a detrimental impact (or adverse effect) on foreign compared to domestic investors, can it be said to discriminate even though, on balance, is it a sensible measure? To answer these two related questions, it is essential to delineate two basic features of the NT standard: 'nationality discrimination' and 'public policy justification.'

The relationship between discrimination and the policy justification underlying the measure at issue may change depending on what one means by 'discrimination'.[460] Furthermore, when the NT principle is extended to cover national measures which have a detrimental impact on foreign investors, the test of the principle is not about the detrimental impact *per se*, but about whether the measure (with detrimental impact) is related to a legitimate regulatory purpose.[461] The fact that the national measure has a detrimental impact becomes a 'threshold' question,[462] where the justification analysis is the real key test.

The first step in a national treatment case involves identifying the appropriate

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[459] Trade thus is not elevated to the supreme common value that all Members must observe at any cost. *Ibid.*, p. 303.

[460] Federico Ortino,'Non-Discriminatory Treatment in Investment Disputes', in Pierre-Marie Dupuy, Francesco Francioni, and Ernst-Ulrich Petersmann, (ed.), *Human Rights in International Investment Law and Arbitration*, Oxford University Press, 2009, p. 351.

[461] 'What matter most is not the position of [foreign and domestic] investments in relation to each other in the market (competition test), but rather the factual support for the government's distinction between the two when taking regulatory action (regulatory context test).' See DisMascio and Pauwelyn, at 81.

[462] 'The idea that competition has a natural role to play in the likeness inquiry relates to its ability to against possible instances of protectionism.' See Jürgen Kurtz, *The WTO and International Investment Law*, Cambridge University Press, 2016, p. 96.

domestic comparator against which the treatment accorded the allegedly injured investment (or investor) can be measured. A second step requires the identification of treatment that was less favourable than that given to the domestic comparator. Finally, tribunals have to consider whether the host government had legitimate reasons that justified the difference in treatment.[463]

This analysis is not always undertaken in separate steps or in the order suggested above. In practice, tribunals have recognized that the type of treatment at issue is not necessarily separate from the 'like circumstances' inquiry.[464]

a) Nationality Discrimination

The jurisprudence applying the NT standard focuses on the following two key elements: 'like circumstances' and 'less favorable treatment.

"*Like Circumstances*":

Identification of the appropriate comparator is a key step in testing national treatment standards, because the outcome in most cases depends on whether the more favourable treatment was accorded to an entity 'in like circumstances'. If the allegedly favoured entity is not in 'like circumstances', the inquiry ends. In rare cases, there may be no actual comparator. In the case of *de facto* national treatment violations,[465] a claimant has to demonstrate that an ostensibly neutral measure has discriminatory effect for the claim to prevail. However, it is hard to show a

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[463] See C. Mclachlan, L. Shore, and M. Weiniger, *International Investment Arbitration: Substantive Principles* (2007), pp 253-254.

[464] Dean Cass noted that 'one might determine that two entities are not in like circumstances because of the different treatment they receive, rather than because there were legitimate reasons for structuring the differential treatment. For example, a State might apply different pollution control regimes to high pollution areas of the country such that different companies in the same economic sector could be affected differently. In such a situation the treatment accorded—a stricter regulatory regime—might affect the like circumstances determination such that only factories in the affected areas are deemed to be in like circumstances with respect to the implementation of pollution control measures.' See *United Parcel Service of America Inc* v *Canada (NAFTA),* Separate Statement of Dean Cass, 24 May 2007, paras 49-50.

[465] 'There are laws or regulations that do not explicitly differentiate on nationality grounds. They may pose a greater adverse burden on the foreign investor and thereby may be considered illegitimate as constituting *de facto* discrimination.' See *Merrill & Ring Forestry L. P.* v. *Government of Canada*, UNCITRAL, ICSID Administrated, Award, 31 March 2010, para. 94.

discriminatory effect if no other entity receives any treatment whatsoever. By contrast, in the case of *de jure* measures, one need not show that a domestic entity has received any treatment.[466]

The manner in which tribunals have approached identifying the comparator has varied. It is fair to say that the approach is flexible, and varies according to both the circumstances of the investment (or investor) and the treatment at issue. One formulation was borrowed by the *S.D. Myers v Canada* tribunal from WTO practice: 'the accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied.'[467] According to the *Pope & Talbot v Canada* tribunal:

> […] [b]y their very nature, 'circumstances' are context dependent and have no unalterable meaning across the spectrum of fact situations […] the concept of 'like' can have a range of meanings, from 'similar' all the way to 'identical.'[468]

The 'like circumstances' analysis involves considering whether the appropriate comparison is between the like-circumstanced investments (or investors), and the like-circumstanced treatment. This means that the comparison can take into account the regulatory context, in addition to the relationship between the investments (or investors). In fact, many tribunals do so when determining the appropriate comparators.[469] It is also consistent with the placement of the modifier in many treaties. The US Model BIT, for example, provides that: 'Each Party shall accord to investors of the other Party *treatment* no less favourable than that it accords, in like circumstances, to its own investors […]'.[470] In a related vein, the existence of a competitive relationship between the comparator and the claimant is not seen as

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466 A. Newcombe, L. Paradell, and D. Krishan, 'National Treatment,' *The Law and Practice of Investment Treaties*, 2008, 35, discussing possible breach if preferential tax treatment is given only to qualified domestic investments.

467 *S.D. Myers Inc v Canada* (NAFTA), Partial Award, 13 November 2000, para. 244, citing *Japan—Alcoholic Beverages*, WT/DS38/AB/R, paras 8.5 and 9.

468 *Pope & Talbot Inc v Canada* (NAFTA), Award on the Merits of Phase 2, 10 April 2001, para.75.

469 For example, in *Corn Product v. Mexico*, the tribunal channeled the political economy of host state policy to foreign investment, stating: 'the fact that economic competitors have—and lobby for—different interests is not at all surprising. On the contrary, it is a fact of economic and political life which may be observed in any open society…[I]t is precisely where the interests of foreign investors and domestic investors are in conflict that the principle of non-discrimination becomes most important.' See *Corn Products International Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, para. 135.

470 Article 3(1) US Model BIT 2012 (emphasis added).

irrelevant to a finding of 'like circumstances', but is considered as well.[471] In an investment case, the protection which a measure apparently gives a competing entity may give rise to an inference of nationality-based preference.[472]

Most early arbitral cases embrace competition as a condition of likeness between foreign and domestic investors in a national treatment inquiry. In *SD Myer v Canada*,[473] to decide whether SD Myers was in 'like circumstances' with Canadian polychlorinated biphenyls (PCB) waste-disposal companies, the tribunal awarded that generally comparisons should be made between firms operating in the same sector (which included both business and economic sectors).[474] The tribunal considered not only environmental concerns, which justified treating companies differently to protect the public interest, but also obligations to avoid trade distortions, not justified by environmental concerns.[475]

It finally awarded that the claimant and its investment in Canada were in 'like circumstances' with the Canadian PCB remediation companies, and highlighted their competitive relationship when ruling:

> 'It was precisely because SDMI [S.D. Myers International, the Canadian corporation deemed to be an investment] was in a position to take business away from its Canadian competitors that [they] lobbied the Minister of the Environment to ban exports when the US authorities opened the border.'[476]

In *Occidental* case, by contrast, the tribunal suggested that 'like situations' were not limited to situations where the investor was competing with a domestic enterprise in the same sector.[477] Ecuador permitted certain exporters, including those dealing

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[471] Jürgen Kurtz, 2016.
[472] Andrea K. Bjorklund, 'National Treatment', in August Reinisch, edited, *Standards of Investment Protection*, Oxford University Press, 2008, p. 39.
[473] The question was whether Canada's closing of the border to the export of polychlorinated biphenyls (PCB) waste violated Canada's obligations by unduly affecting SD Myers; a US company which aimed at competing with Canada for contracts to process PCB waste at its Ohio remediation facility. See *S.D. Myers v. Canada,* Partial Award, paras 248-250.
[474] *S.D. Myers Inc v Canada*, para. 250.
[475] *Ibid*., paras. 247, 250.
[476] *Ibid.*, Para. 251.
[477] For example, the *Occidental Exploration and Production Co. v Ecuador* tribunal found two entities to be in 'like circumstances' despite the lack of any competitive relationship between them. See *Occidental Exploration*

with flowers, mining, and seafood products, to claim a refund of VAT on all exports, but exclude Occidental from a claim for VAT refund on exports of oil. Thus Occidental claimed a violation of the NT obligation according to the Ecuador-US BIT.[478] However, the tribunal rejected Ecuador's arguments. It held that the purpose of the national treatment obligation is to protect foreign investors and that it would be inappropriate to address '[…] exclusively the sector in which that particular activity is undertaken',[479] furthermore, exporters should not be placed at a disadvantage in foreign markets because they had to pay more taxes in their country of origin.[480] It suggested that 'like situations' were not limited to situations where the investor was competing with a domestic enterprise in the same industry.

The *Occidental* tribunal's award was quite different from previous cases. It depends on the situations of a particular case for the 'like circumstances' determination, whereas the lack of any competitive relationship between the comparators would generally be a difficult hurdle to overcome. In fact, the tribunal's decision is not surprising to the extent that it reflected an assessment that 'VAT refunds were denied to the oil exploration sector because it was dominated by foreign competitors.'[481] Therefore, the policy considerations underlying the treatment could remarkably affect the outcome.

In *Pope & Talbot v Canada*, another NAFTA Chapter 11 case, a US investor that owned three lumber mills in British Columbia, challenged Canada's implementation of the US/Canada Softwood Lumber Agreement.[482] The claimant did not challenge

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and Production Company v Republic of Ecuador, LCIA Case No. UN3467, Final Award, 1 July 2004, paras 175-176.

[478] Ecuador argued that the VAT refund was not available to *any* exporters of oil, including Petro-Ecuador, the state-owned oil company, and that there was thus no evidence of any attempt to discriminate against foreign companies. See *Occidental Exploration and Production Company v Ecuador*, para. 60.

[479] *Ibid*. para.175.

[480] *Id.*

[481] Ecuador moved to set aside the award, but its petition was denied. See SD Franck, 'International Decision: Occidental Exploration & Production Co. v. Republic of Ecuador,' 99 *American Journal of International Law* (2005) 675,679-680.

[482] Under the Softwood Lumber Agreement, Canada agreed to limit the export of softwood lumber from the four 'covered' provinces—Alberta, British Columbia, Quebec, and Ontario —that had historically been the largest exporters of softwood lumber to the United States. In return, the US would not institute any unfair trade remedies cases against Canadian softwood lumber exporters, for the five years that the Agreement remained in effect. Under the Agreement up to 14.7 billion board feet of lumber could be exported free of charge; exports between 14.7 and 15.35 billion board feet would be charged a duty at the rate of US$50 per board foot; and exports in excess of 15.35 billion board feet would be charged a duty at the rate of US$100 per board foot. Lumber exports from the non-covered provinces were not limited. In each of the covered provinces, Canada allocated a quota among

the Softwood Lumber Agreement itself, but only the manner in which Canada had implemented it. It claimed a violation of Article 1102, NAFTA's national treatment provision, because lumber producers in the non-covered provinces were not subject to the quota, and were thus accorded more favourable treatment than lumber producers in the covered provinces.[483] It also claimed that it was treated less favourable than certain other producers in the covered provinces, including producers in British Columbia and Quebec.[484]

Thus, the first question for the *Pope & Talbot* tribunal was whether the claimant was in 'like circumstances' with lumber producers in other non-covered provinces. In effect, the tribunal approached this question of 'like circumstances' with whether the government offered a rationale for the difference in treatment. It then awarded that the first order of business was to determine whether the foreign investor was in 'like circumstances' with the allegedly more favourably treated domestic investor, which required merely establishing that the two entities, operating in the same economic sector, received differential treatment.[485] If the claimant could make a *prima facie* case, the burden of proof then shifted to the respondent to show that certain legitimate government objective justified the differential treatment and thereby demonstrate that the two were not indeed in 'like circumstances': '[…] once a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances?'[486]

The tribunal concluded that the foreign investor's investments in British Columbia were not in 'like circumstances' with any of the allegedly more favourably treated investments. It considered the policy reasons which Canada, the respondent, was able to offer to explain the differences in treatment. First, the tribunal considered that the manner in which Canada implemented the Softwood Lumber Agreement—limiting exports only from the four covered provinces—was rational

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Canadian lumber producers based on their historic levels of export to the US. See *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, 10 April 2001, para. 18.

[483] *Id.*

[484] *Id.*

[485] *Ibid.*, para. 78.

[486] *Ibid.*, para. 79.

given the historical background of the case.[487] The US had never imposed duties on products in these non-covered provinces, and thus, limiting exports from only the covered provinces was '[…] reasonably related to the rational policy of removing the threat of CVD [countervailing duty] actions'.[488] Secondly, the tribunal determined that the allegedly more favourable treatment granted to producers in Quebec than to producers in British Columbia was also justified.[489] Canada had set aside some quotas, to allocate to new entrants into the lumber industry, but most of those new entrants were in Quebec, therefore, British Columbian producers were not in 'like circumstances' with Quebecois new entrants; but in any event, Pope & Talbot was not a new entrant.[490]

Some tribunals have been confronted with cases in which the question is of discriminatory *effect*, but there are few comparators against which to compare the treatment accorded. For example, *Feldman v Mexico* involved a challenge to a Mexican tax rebate law by the investor in a Mexico enterprise, CEMSA, that resold and exported cigarettes from Mexico.[491] Feldman claimed that Mexican laws, though neutral at face-value, discriminated against his company because the rebates were available only to exporters who were also producers of cigarettes, rather than to resellers of cigarettes alone. However, there were very few potential firms in 'like circumstances'.

The *Feldman* tribunal concluded that CEMSA was not in 'like circumstances' with the producers/exporters, as it noted that Mexico had a rational basis for treating producers differently from resellers, including '[…] better control over tax revenues, discouraging smuggling, protecting intellectual property rights, and prohibiting grey market sales'.[492]

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[487] *Ibid*. para. 87.
[488] *Id*.
[489] *Ibid*. para. 93.
[490] *Id.* Also, *Pope & Talbot v. Canada* Award on the Merits of Phase 2 notes that application of the standard will require evaluation of the entire fact setting surrounding the genesis and application of the regime as well as the overall legal context. See *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, 10 April 2001. paras. 75-78.
[491] Marvin Roy *Feldman v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award on Merits, 16 December 2002.
[492] *Ibid.*, para. 170. Also, this case demonstrates that the burden of proof will shift if the claimant makes out a *prima facie* case of discrimination. *Ibid*., paras 76-78.

Methanex Corp v United States involved the challenge brought by a Canadian producer of methanol against California's ban on methyl tertiary-butyl ether (MTBE), a gasoline additive for which methanol is a feedstock.[493] MTBE is an oxygenate added to gasoline to help it burn more cleanly; high-pollution areas in the US are required to sell only oxygenated gasoline in order to improve air quality. The only effective competitor of MTBE is ethanol, because other oxygenates are not yet commercially viable. The claimant argued, *inter alia*, that California banned MTBE in order to assist the US-dominated ethanol industry.[494] In order to prevail on its national treatment, Methanex had to demonstrate that it was 'in like circumstances' with producers of ethanol, who received the more favourable treatment, rather than with producers of methanol, or producers of MTBE. As the *Methanex* tribunal stated, this was a difficult hurdle to overcome because,

> […] it would be as perverse to ignore identical comparators if they were available and to use comparators that were less 'like', as it would be perverse to refuse to find and to apply less 'like' comparators when no identical comparators existed.[495]

The tribunal concluded that because Methanex was found to be in 'like circumstances' with other producers of methanol, all of whom were affected in the same manner by the ban on MTBE, it could not prevail on its national treatment claim.[496]

"*Less Favourable Treatment*":

In addition to identifying the appropriate comparator, a claimant alleging a national

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493 *Methanex v United States of America*, UNCITRAL, Final Award, 3 August, 2005. Part IV, Ch. B.
494 See Loukas Mistelis, Confidentiality and Third Party Participation: UPS v. Canada and Methanex Corp v. USA.' in Todd Weiler, eds., *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, 2005, CAMERON MAY, p.186.
495 *Ibid.*, para. 17.
496 *Ibid.*, para. 28.

treatment obligation must demonstrate that the treatment is less favourable than that accorded to the domestic comparator. As in the case of the ‘likeness’ criterion, arbitral tribunals have differed in the tests adopted for establishing whether a measure affords ‘less favourable treatment’ to the foreign investor.

National treatment obligations preclude *de jure* or *de facto* discrimination by nationality. One of the strongest statements of the nationality-based discrimination approach can be found in the *GAMI* decision.[497] The *GAMI* tribunal disposed of any suggestion that mere differential treatment could result in a successful national treatment claim. There was no question in *GAMI* that some sugar mills had not been expropriated, but that the US investor’s mills had been. They were thus in receipt of less favourable treatment than had been some Mexican-owned mills.

Two separate issues may be identified in this regard. First, arbitral tribunals have differed regarding whether the arguable measure’s adverse effect on foreign investors is sufficient to establish less favourable treatment, and on whether discriminatory intent is also an indispensable element in the national treatment equation. Several investment tribunals seem to rely on the measure’s effects only, excluding the relevance of the measure’s intent. In *Myers*, the NAFTA tribunal stated as follows:

> “Intent is important, but protectionist intend is not necessarily decisive on its own. The existence of intent to favour nationals over non-nationals would not give rise to a breach of Chapter 1102 of the NAFTA if the measure in question were to produce no adverse effect on the non-national complainant. The word ‘treatment’ suggests that practical impact is required to produce a breach of Article 1102, not merely a motive or intent that is in violation of Chapter 11.”[498]

The second issue surrounding the ‘less favourable treatment’ test is whether nationality discrimination is established simply by showing that *one foreign* investor has been treated less favourably than at least one domestic investor in ‘like circumstances’, or whether a broader ‘nationality imbalance’ needs to be established by the claimant (i.e., to show that foreign investors as a whole are treated less

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497 *GAMI Investment Inc* v *Mexico* (NAFTA), Final Award, 15 November 2004, paras. 113, 115.
498 *S.D. Myers*, at para. 254.

favourably than similar domestic investors as a whole).

In *Pope & Talbot*, for example, the tribunal noted that a breach of NAFTA, Article 1102 is presumptively established, 'once a difference in treatment between a domestic and a foreign-owned investment is discerned'.[499] Canada had argued in its defence that in cases of alleged *de facto* discrimination, a violation of the NT obligation can be found only if the measure in question 'disproportionately disadvantages' the foreign-owned investments or investors.[500] The tribunal rejected Canada's 'disproportionate disadvantage' approach. The tribunal noted that 'the recognition that the NT obligation can be violated through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skilful or evasive drafting' and that such a 'result would be inconsistent with the investment objectives of NAFTA, in particular Article 102(1)(b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities'.[501] Furthermore, the Tribunal emphasized the 'practical implications' of Canada's suggestion,[502] how 'unwieldy' it would be to show disproportionate disadvantage, and 'how it would hamstring foreign-owned investments seeking to vindicate their Article 1102 rights.'[503]

b) Justification on Public Policy Grounds

Analysis under the NT standard does not necessarily end with a finding of nationality

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499 *Pope & Talbot, Inc v The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, 10 April 2001, at para 79.

500 According to Canada, the tribunal must determine 'whether there are any Canadian-owned investments that are accorded the same treatment as the Investor… Then, the size of that group of Canadian investments must be compared to the size of the group of Canadian investments receiving more favourable treatment than the Investment. Unless the disadvantaged Canadian group (receiving the same treatment as the Investor) is smaller than the advantaged group, no discrimination cognizable under Article 1102 would exist.' See *Pope & Talbot*, at para. 44.

501 *Pope & Talbot*, paras 69-70.

502 The investor would need 'to ascertain whether there are any other American owned lumber producing companies among the more than 500 softwood lumber quota holders operating in Canada. If so, the treatment accorded those companies as a whole would have to be measured and then weighed against the predominant treatment, whatever that might mean, accorded Canadian companies operating in like circumstances. A violation of Article 1102 could then only be found if the differing treatment between the class of American investments and their Canadian competitors in like circumstances is "disproportionately" in favour of the domestic investments, whatever that might mean'. See *Pope & Talbot*, at para. 71.

503 Ibid.

discrimination. In cases where such a finding is based on the adverse effect on the foreign investor, it may be justified on public policy grounds. The justification may be expressly provided for in the ‘general exceptions’ provisions of investment treaties, usually formulated on the basis of GATT, Article XX. However, since the use of these general exceptions provisions in international investment treaties is not common, tribunals have given relevance to public policy justifications even when no such general exceptions provision was included in the text of the underlying treaty.

NAFTA tribunals have interpreted the ‘in like circumstances’ language in Article 1102 as a *de facto* public policy justification mechanism. Accordingly, if the less favourable treatment afforded to a foreign investor vis-à-vis a domestic one may be justified on the basis that such differentiation is related to a legitimate public policy, then there is no violation of the NT obligation. This may be viewed as the second function of the phrase ‘in like circumstances’ in NAFTA, Article 1102 (the first one being the determination of the relevant comparator). In *Myers*, for example, the tribunal expressly noted that ‘the assessment of “like circumstance” must also take into account circumstances that would justify governmental regulations that treat them [i.e., a foreign investor and a domestic investor competing in the same business sector] differently in order to protect the public interest’.[504]

Clayton/Bilcon v. Canada Award on Jurisdiction and admissibility finds that if a prima facie case is made under the three-part *UPS v. Canada* test,[505] the host State can still show that there is no breach, because the discriminatory treatment identified is somehow justified, or that the discriminatory treatment is not sufficiently linked to nationality, but merely an incidental effect of the reasonable pursuit of domestic policy objectives, as the tribunal viewed that,

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[504] According to the tribunal, such interpretation conforms with the general principles emerging from the legal context of the NAFTA, including both its concern with the environmental concerns. *See* Myers, at paras 247-250.

[505] ‘The Tribunal notes that three distinct elements which an investor must establish in order to prove that a Party has acted in a manner inconsistent with its obligations under article 1102. These are: a) the foreign investor must demonstrate that the Party [Canada] accorded treatment to it [the claimant or UPS Canada] with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disquisition, expansion, management, conduct, operation, and sale or other disposition of investment. b) The foreign investor or investment must be in like circumstances with local investors or investments: and c) The NAFTA Party must treat the foreign investor or investment less favourably than it treats the local investors or investments.’ See United Parcel Service of America, Inc. v. Canada, UNCITRAL/NAFTA, Award on the Merits, Separate Statement of Dean Ronald A. Cass, 24 May 2007, para. 83.

> '… once a prima facie case is made out under the three-part UPS test, the onus is on the host state to show that a measure is still sustainable within the terms of Article 1102. It is the host state that is in a position to identify and substantiate the case, in terms of its own laws, policies and circumstances, that an apparently discriminatory measure is in fact compliant with the "national treatment" norm set out in Article 1102.'[506]

To sum up, national treatment is a viable and important cause of action in investment treaty cases. Notwithstanding the apparent simplicity of the concept, however, it can be difficult to apply. The majority of tribunals agree that the national treatment obligation is directed at measures that distinguish on the basis of nationality.

Moreover, it is well established that a claimant need not establish discriminatory *intent*, but that discriminatory *effect* will suffice to sustain a claim.[507] Deciding whether a state has violated its national treatment obligation in a given case, however, requires an often-difficult assessment of whether it is appropriate to treat the allegedly less favoured entity differently.[508] This assessment usually requires consideration of the kind of treatment accorded, in addition to analysing the competitive relationship between the two entities.[509] The existence of a competitive relationship could be helpful for a national treatment claim, since most of the time the aggrieved entity will be in competition with the more favourable treatment entity.

4.1.3 Trade Law's Influence on Tribunal's Interpretation of National Treatment

As explained in previous sections, trade law's focus on market access makes NT as one corn principle in the GATT, on efficiency concerns, namely preventing tariff concessions from circumvention. GATT national treatment ensures equal competitive opportunities. In contrast, investment law is about protecting investors, and its NT

[506] *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton & Bilcon Delaware Inc. v. Government of Canada*, PCA Case No.2009-04, Award on Jurisdiction and Liability, 17 March 2015, para. 723.
[507] Tribunals holding that it is not necessary to prove an intent to discriminate, but evidence of such intent will be considered. For example, in ADM v. Mexico, the Tribunal finds that 'both the intent and effects of the measure show the discriminatory nature of the measure.' See *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5, Award, 21 November 2007, para. 209-210. Similarly, *S.D. Mayers v. Canada* Partial Award holds that 'intent to discriminate in favour of nationals over non-nationals will not give rise to a breach if the measure in question were to produce no adverse effect on the non-national complainant.' See *S.D. Myers v. Canada*, Partial Award, 13 November 2000, para. 254.
[508] Andrea K. Bjorklund, 'National Treatment', in August Reinisch, ed., *Standards of Investment Protection*, Oxford University Press, 2009, p. 58.
[509] *Id.*

principle is to provide security and fairness to private foreign investors for their business operations.

NAFTA Chapter 11 has been the most fertile source of decisions regarding national treatment obligations. As case-law decided by arbitral tribunals plays an important role in formulating international investment law, this section will be devoted to scrutinizing the often-different awards.

As mentioned before, the most quoted method for discovering nationality-based discrimination was first suggested by the tribunal in the NAFTA case *S.D. Myers v. Canada*. The tribunal turned to WTO jurisprudence to examine the meaning of the word 'like' as it applied to the national treatment obligation found in NAFTA Article 1102.[510] The tribunal also highlighted language from the WTO Appellate Body's ruling in *Japan-Alcoholic Beverages* that the 'likeness determination' is a 'discretionary decision' whose definition is shaped by the legal *context* in which the phrase appears.[511] Yet, the Tribunal chose not to borrow from the 'likeness' test developed by the WTO Appellate Body, which evaluates such claims on the basis of a multi-factor test. In rejecting the WTO's approach, the Tribunal emphasized contextual differences between the treaties governing the WTO regime and the investment regime.[512]

The tribunal in the *Pope & Talbot v. Canada* dispute subsequently refined the analysis from S.D. Myers into a coherent 'like circumstances' test.[513] Similarly, it is another case that shows the contextual differences between trade and investment regimes. In this case, Canada argued that in evaluating a claim of a *de facto* national treatment violation, an investment tribunal formed under NAFTA Chapter 11 ought to apply a 'disproportionate advantage' test.[514] After analysing two WTO decisions

[510] 'In considering the meaning of "like circumstances" under Article 1102 of the NAFTA, it is similarly necessary to keep in mind the overall legal context in which the phrase appears.' See Partial Award dated November 13, 2000 at para. 245.
[511] 'The tribunal addresses that legal context first and then turns to the other facts of this case.' *Ibid.*, para. 247.
[512] *Corn Products v. Mexico* Decision on Responsibility cites *Myers* and *Pope & Talbot* in finding that it is necessary to consider the entire factual and legal context. See Corn Products International Inc. v. United Mexican States, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, para. 118.
[513] *Pope & Talbot v. Canada*, Award on the Merits of Phase 2, 10 April 2001, paras 75-77.
[514] *Ibid.*, para. 71.

(*EC-Asbestos*,[515] and *US-Malt Beverages*[516]), the tribunal concluded that Canada misread the applicable WTO case law. In its ruling, the tribunal emphasized the vindication of the rights of individual entities within the investment regime and the lack of an emphasis on modifications to the conditions of competition.[517] Consequently, it rejected Canada's proposal for the incorporation of a WTO jurisprudential concept.

In subsequent cases, the arbitral tribunal continued to identify the different reasons for rejecting borrowing from WTO case law. In evaluating the national treatment claim in *Occidental v. Ecuador*, the tribunal suggested that 'like situations' were not limited to situations where the investor was competing with a domestic enterprise in the same sector. A key reason, the tribunal stressed, was because the WTO's concern is with comparing 'like products' whereas the US-Ecuador BIT at issue in the case required a comparison of 'like situations'. This textual difference, the tribunal concluded, required that it perform a broader analysis than that applied under WTO law.[518] However, the *Occidental* tribunal's understanding of GATT/WTO law was inadequate. There are national treatment norms that apply to services and intellectual property, and not only to goods, and this suggests a broader purpose for the national treatment obligation in the GATT/WTO system than reflected by the tribunal.[519]

A year later, in the *Methanex* dispute, an investment tribunal again considered the question of whether it ought to turn to WTO jurisprudence when evaluating a national treatment claim. The tribunal declared that, 'it would be unwarranted for a

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[515] The Appellate Body stressed that finding less favourable treatment of imports is not simply a matter of identifying one single imported product that is banned and one like domestic product that is permitted. See Appellate Body Report, *European Communities—Measures Affecting Asbestos*, para. 99, WT/DS135/R (adopted 5 April 2001).

[516] Panel Report, *United States—Measures Affecting Alcoholic and Malt Beverages*, DS23/R-39S/206 (adopted 19 June, 1992). Rarely, it moved away from a strictly objective evaluation of likeness. The panel used an evaluation of a regulation's "aim and effect" within the like-products analysis.

[517] *Pope & Talbot v. Canada*, Award on the Merits of Phase 2, 10 April 2001, para. 78.

[518] Since "the purpose of national treatment in this dispute … is to avoid exporters being placed at a disadvantage in foreign markets because of indirect taxes paid in the country of origin," the tribunal held that "no exporter ought to be put at a disadvantageous position as compared to other exporters." The tribunal rejected the business or economic sector test within the regulatory context of VAT refunds. See *Occidental Exploration and Production Company v. Republic of Ecuador*, LCIA case No. UN3467, Final Award, 1 July 2004. Para. 175-176.

[519] See: Jürgen Kurtz, 'The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and its Discontents', *EJIL* (2009), Vol. 20 No. 3, 749-771.

tribunal interpreting the provision to act as if they had, unless there were clear indications elsewhere in the text that, at best, the drafters wished to do so, or at least, that they were not opposed to doing so'.[520] The award reads,

> In any event, the drafters did not insert the above italicized words in Article 1102; and it would be unwarranted for a tribunal interpreting the provision to act as if they had, unless there were clear indications elsewhere in the text that, at best, the drafters wished to do so or, at least, that they were not opposed to doing so. In fact, the intent of the drafters to create distinct regimes for trade and investment is explicit in Article 1139's definition of investment.[521]

Therefore, although parties to investment disputes have invoked WTO jurisprudence, the investment tribunals apply a national treatment test that is significantly different from that applied by the trade regime.

In addition, the extent to which tribunals recourse to WTO case-law, may vary according to the interpretative challenges they face, regarding the specific investment instruments they are applying.[522] In a regional trade agreement (e.g., NAFTA), investment provisions are set within a broader scope of economic integration; whereas it is different situation when a tribunal faces a BIT between states of different levels of development or different political and economic systems.[523] Under the Vienna Convention on the Law of Treaties, Article 31 and 32, the first duty of the treaty interpreter is fidelity to the treaty regime it is interpreting, including the context of that particular regime, the *acquis* of practice, and, to some extent, its negotiating history.[524]

Lastly, this diversity in interpretation also provides an immensely useful learning ground, for policy makers aiming to improve the content of investment treaties. In this sense, within the investment context, there is a strong dialectic between the arbitral

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520 See e.g., Joel Trachtman, 'FDI and the Right to Regulate: Lessons from Trade Law,' in UNCTAD, *The Development Dimensions of FDI: Policy and Rule-making Perspectives,* 189, UN Doc.UNCTAD/ITE/IIA/2003/4 (2003), at 193, suggesting 'caution regarding any efforts to transplant constraints on domestic regulation from the field of international trade law to the field of foreign investment law.' Tribunal in *Methanex v. United States,* Jurisdiction and Merits (Aug. 3, 2005), referred to textual differences.

521 *Methanex Corporation v. U.S.,* UNCITRAL, Final Award, 3 August, 2005. (Part IV, Chapter B, Paragraph 35.)

522 Robert Howse and Efraim Chalamish, The Use and Abuse of WTO Law in Investor-State Arbitration: A Reply to Jürgen Kurtz, *The European Journal of International Law*, Vol. 20 no. 4, 2009. p. 1089.

523 *Id.*

524 *Id.*

jurisprudence on one hand, and political/legislative arm on the other. It indicates that states may learn from the jurisprudence and make changes to their investment policies and treaty-making.

4.1.4 National Treatment Provision in Chinese BITs

The BITs signed by China in recent years include relative standards (NT and MFN) and absolute standards (fair and equitable treatment).[525] For instance, the 1986 China-UK BIT was the first BIT signed by China that included NT. Its Article 3(3) stipulates that "either Contracting Party shall, to the extent possible, accord treatment in accordance with the stipulations of its laws and regulations to the investments of nationals or companies of the other Contracting Party the same as that accorded to its own nationals or companies."

Since 2002, however, most of China's new and renegotiated BITs have included provisions for *full* national treatment. Consider the BITs signed by China with Germany and France as examples. The early BITs, signed in 1983 and 1984, respectively, only provided MFN treatment for investors and activities relating to investment, while the 2003 China-Germany BIT and the 2007 China-France BIT include both MFN treatment and NT.

In the newest BITs, the scope of MFN treatment and NT has also been expanded. In the 2003 China-Germany BIT, MFN treatment and NT are to be provided for "investments and activities associated with such investments".[526] For NT, the "activities associated with such investments" are defined in the Protocol to the BIT to include "more particularly, but not exclusively… the management, maintenance, use, enjoyment and disposal of an investment,"[527] whereas those activities for which MFN treatment shall be applicable are nowhere defined. In comparison, the 2004

525 In practice, the expressions "relative standards" and "absolute standards" are not used by BITs, but only reflect academic usage. In general, the difference between them is that relative standards focus on ensuring that each contracting party grants treatment to investments of nationals and companies of the other party on a basis relative to how it treats the investments of its own nationals and companies or those of a third country, while absolute standards focus on ensuring that treatment provided by either contracting party is consistent with the requirements of international law.

526 See: 2003 China-Germany BIT, Article 3(2) and (3).

527 See *ibid.*, Protocol, para. 4(a).

China-Finland BIT explicitly provides that NT is applicable to "the operation, management, maintenance, use, enjoyment, expansion, sale or other disposal of investments that have been made,"[528] whilst MFN treatment applies to "the establishment, acquisition, operation, management, maintenance, use, enjoyment, expansion, sale or other disposal of investments."[529] The 2004 China-Finland BIT and the 2009 China-Switzerland BIT also stipulate that investors have the right to enjoy whichever is the more favourable of NT or MFN treatment.[530]

One of the trends in the contemporary development of bilateral investment protection is the extension of the application of NT and MFN treatment to the pre-establishment phase of investment.[531] Previously, BITs usually provided that they did not protect the investors' interests in the pre-establishment phase, and that the host country could authorize foreign investments; set up the requirements for their establishment; or reserve some industries for domestic investors or those from a third country; without violating any obligations to provide NT and MFN treatment.[532] However, most contemporary BITs exclude these rights of the host country, which levels the playing field for foreign investors and domestic investors with regard to market access. In practice, China has extended the application of MFN treatment to the pre-establishment phase,[533] but this is not yet the case for NT.

In addition, there are restrictions on the application of NT provisions. These include: (1) existing non-conforming measures; (2) the continuation and amendment of non-conforming measures, provided that such amendments do not increase the

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528 Agreement between the Government of Finland and the Government of the People's Republic China on the Promotion and Reciprocal Protection of Investment, Article 3(2).

529 *Ibid*., Article 3(3).

530 *Ibid*., Article 3(4); Agreement between the Swiss Federal Council and the Government of the People's Republic of China on the Promotion and Reciprocal Protection of Investment, Article 4(3).

531 For example, Article 3 and 4 of the 2012 US Model BIT extend NT and MFN treatment, respectively, "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory."

532 This was mainly due to the different levels of economic and technological development of individual countries. Compared with those from developed countries, enterprises in developing countries usually have lesser or no international competitiveness. In such a situation, according foreign investment NT for the market access phase may result in their superior status, and domestic industries will not be effectively protected. See Yu Jinsong, "Issues on national treatment for foreign investment of the market access phase in China's development", Jurist Review, Vol. 6, 2004 (in Chinese).

533 Article 3(3) of the 2004 China-Finland BIT and Article 4(3) of the 2009 China-Switzerland BIT are examples of this. Article 5(1) of the 2009 China-ASEAN BIT is even more explicit, extending MFN treatment to "admission, establishment, acquisition, expansion, management, conduct, operation, maintenance, use, liquidation, sale, and other forms of disposal of investments."

degree of non-conformity; and (3) measures that would not fall into the NT obligations of an existing BIT that a party has concluded.[534] This having been stipulated, the parties are under an obligation to progressively remove the non-conforming measures.[535]

4.2 Most-Favoured-Nation (MFN) Treatment

The MFN principle has applied to all the WTO Agreements covering trade in goods, trade in services, intellectual property, and non-tariff barriers. With regard to international investment, the MFN clause can be found in literally every BIT and FTA, as well as in the treaties and agreements on intellectual property. The MFN is embodied in international treaties and agreements. However, its interpretation is sometimes divergent. According to the publication by the UN's International Law Commission of the Draft Articles on MFN clauses, MFN treatment is defined as follows:

> "Most-favoured-nation treatment is treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State."[536]

In the WTO, the scope of MFN is wider: customs themselves are covered and any measures *affecting* trade are covered.

The MFN provision is a generalizing provision. If a country has guaranteed a particular kind of treatment to investment in any of its BITs, then, at least in the case of substantive treatment it has guaranteed that treatment to investment covered by any BIT with an MFN treatment provision.[537]

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[534] China-New Zealand FTA, Article 141.
[535] The China-New Zealand FTA does not provide specifically what may constitute a non-conforming measure. It instead incorporates the provisions of the WTO Agreement on Trade-Related Investment Measures mutatis mutandis. See *id*.
[536] Article 5 of UN Report of the International Law Commission, Draft Articles on Most-Favoured-Nation Clause, July 1978. "Granting State" means a state which has undertaken to accord MFN treatment while "beneficiary State" means a state to which a granting state has undertaken to accord such status.
[537] Some tribunals have held that the term 'treatment' in the MFN treatment provision does not apply to procedural provisions in BIT. See Kenneth J. Vandevelde, p. 350.

If a country has entered into an economic integration agreement and hopes to extend special preferences to investments from other members, it can address this wish through a specific exception to the MFN treatment provision.

One difficulty presented by an MFN treatment provision is that it potentially creates the 'free-rider problem'. One way to address the free rider problem, apart from specific exceptions to limit the range of agreements, is to adopt a conditional MFN treatment provision. Under a conditional MFN treatment provision, a country enjoys benefits granted by its treaty partner to third countries only if that country grants the same benefits to its treaty partner. Such a provision, however, reduces to some degree the generalizing effect of an MFN treatment provision. BITs rarely use conditional MFN treatment provisions.

In the Multilateral Agreement on Investment (MAI), the OECD Member States agreed to the suspension of the negotiations in 1998 to include the MFN and NT standards in the Draft Agreement as follows:

> […] each Contracting Party shall accord to investors of another Contracting Party and to their investments, treatment no less favourable than the treatment it accords [in like circumstances] to investors of any other Contracting Party or of a non-Contracting Party, with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposition of investments.[538]

Despite it being the very common practice throughout the 19th century to include MFN treatment in treaties relating to bilateral economic relations, there is no customary obligation on states to grant MFN treatment according to the predominant position.[539] Economic theory, especially in the field of trade, has shown that liberalization, even unilaterally, is more likely to lead to increased welfare and hence often recommends *unconditional* MFN treatment. Conditional MFN treatment, therefore, is a right to obtain the more favourable treatment upon the condition to do the same (reciprocity). MFN clauses found in new BITs are unconditional, but they may be limited in scope and subject to exceptions.

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538 MAI draft.

539 Kenneth J. Vandevelde, *Bilateral Investment Treaties*, Oxford University Press, 2010, p. 351.

4.2.1 Defining 'Unconditional' MFN

Article I:1 of the GATT 1994 requires that any advantage granted by a WTO member to imports from, or exports to, any country must be granted 'immediately and unconditionally' to imports from, or exports to, all other WTO members.

According to the Panel in *Indonesia—Autos (1998)*, the requirement to accord an advantage 'unconditionally' means that such advantage:

> cannot be made conditional on any criteria that [are] not related to the imported product itself.[540]

The Panel in *Canada—Autos (2000)* rejected the interpretation of Article I:1 advocated in this case the complainant, Japan. According to Japan's interpretation the term 'unconditionally' in Article I:1 must be interpreted to mean that subjecting an advantage to conditions not related to the imported product itself is *per se* inconsistent with Article I:1.[541] The panel in *Canada—Autos (2000)* ruled that:

> Whether conditions attached to an advantage granted in connection with the importation of a product offend Article I:1 depends upon whether or not such conditions discriminate with respect to the origin of products.

In another panel report, the reports on *Colombia—Ports of Entry (2009)*, the panel explicitly referred to the interpretation of the term 'unconditionally' in the panel report on *Canada—Autos (2000).*[542] The panel in *Colombia—Ports of Entry (2009)* stated:

> [T]he panel reiterates the view expressed in *Canada –Autos* that conditions attached to an advantage granted in connection with the importation of a product will violate Article I:1 when such conditions discriminate with respect to the origin of products.[543]

4.2.2 Applying MFN Clause in Investment Treaties

The clauses relating to MFN treatment in BITs have only recently raised certain questions (in the 20th century), concerning the scope of the MFN; that is, whether the

[540] Panel Report, *Indonesia—Autos (1998)*, para. 14.143.
[541] See Panel Report, *Canada—Autos (2000)*, para.10.29.
[542] See Panel Report, *Colombia—Ports of Entry (2009)*, paras. 7.362-7.366.
[543] Panel Report, *Colombia—Ports of Entry (2009)*, para. 7.366.

clause also applies to procedural rights (dispute settlement). The following section will try to classify the existing awards and opinions relating to the proper application of MFN clauses in investment agreements.

The MFN clause was rediscovered in the context of international investment arbitration, following the decision of an arbitral tribunal in the case of *Maffezini v Spain* in 2000.[544] Since then, a number of tribunals have had to address the issue of the correct application and interpretation of the MFN clause.[545] The following provides a very short overview of the most relevant cases with respect to their contribution to the discussion on MFN.

Maffezini v Spain: An Argentinian investor in Spain requested the application of the MFN clause contained in Article IV(2) of the Spain-Argentina BIT to benefit from the allegedly more favourable provision in the Chile-Argentina BIT (This stipulated for no waiting period of 18 months until an arbitral tribunal could be seized). The tribunal rejected Spain's argument that the application of the MFN clause was limited to substantive matters or material aspects of the treatment granted to investors, and therefore did not cover procedural or jurisdictional questions.[546]

In *Tecmed v Mexico*, a Spanish investor tried to overcome jurisdictional limitations *ratione temporis* by invoking a MFN clause in the Mexico-Spain BIT (1995), and then borrowing the more generous clause of temporal scope in the BIT between Mexico and Austria (1998). The ICSID Tribunal did not allow the retroactive application of substantive standards as contained in this treaty with a third party

> "[…] because it deemed that matters relating to the application over time of the Agreement […] due to their significance and importance, go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties."[547]

In *MTD v Chile*, a Malaysian company had invoked the MFN clause contained in

[544] *Maffezini v Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, 25 January 2000, paras 53.
[545] For an overview of the case law see M. F. Houde and F. Pagani, 'Most Favoured Nation Treatment in International Investment Law,' in OECD (ed.), *International Investment Law: A Changing Landscape—A Companion Volume to International Investment Perspectives* (2005), Chapter 4.
[546] See P. Acconci, 'Most-Favoured Nation Treatment and International Law on Foreign Investment', in P. Muchlinski, F. Orrino, and C. Schreuer (eds), *The Oxford Handbook of International Investment Law*, Section 1.
[547] *Técnicas Medioambientales Tecmed, S.A. v the United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 69.

the Chile-Malaysia BIT in order to benefit from two other BITs concluded by Chile with Denmark and Croatia. These contained more detailed treaty language on fair and equitable treatment. The tribunal agreed to incorporate the provisions of the Croatian and Danish treaties into the Treaty between Malaysia and Chile by the 'wide scope' of the latter treaty's MFN clause,—and further deemed this importation to be 'in consonance with' the purpose of the Chile-Malaysia BIT.[548]

In *Siemens v Argentina*, the investor, the German company Siemens, invoked the more favourable terms of a bilateral investment treaty between Argentina and Chile, (which permitted the absence of a waiting period of 18 months before an arbitral tribunal could be seized), through the MFN clause contained in the Argentina-Germany BIT. Argentina argued that Siemens failed to exhaust the 18-month period, set out in the Argentina-Germany BIT, for recourse to local courts, before turning to international arbitration. The arbitral tribunal determined that the relevant MFN clause allowed the investor to choose more favourable dispute settlement provisions from various other agreements.[549]

Salini v Jordan: The Italian investor invoked the MFN clause in the BIT between Jordan and Italy to benefit from more favourable dispute settlement provisions in the BITs with the US and the UK. In the view of the claimant, the US and UK treaties contained a dispute settlement clause 'which is more favourable than that contained in Article 9 of the Jordan-Italy BIT', by its supposed inclusion of contractual breaches. The relevant MFN clause was silent on the question of the application of MFN to the dispute settlement process; accordingly, the tribunal rejected the claimants' contention that the MFN clause should be interpreted so as to apply to procedural matters.[550]

The dynamic nature of the MFN clause is intended to operate only in situations where a treatment occurs in 'like situations' or 'like circumstances'. When it comes to the application of the MFN clause in the basic treaty to invoke the application of a

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548 *MTD Equity Sdn. Bhd and MTD Chile S.A v Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, para. 103.
549 *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004, para. 120.
550 *Salini Costruttori S.p.A and Italstrade S.p.A v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, 29 November 2004.

specific treatment provision in a third party treaty, this principle is normally referred to as the '*Ejusdern Generis*' principle.[551] It is normally understood to mean that the third party must, in principle, regulate the same subject-matter as the basic treaty, otherwise the specific treatment standard would be taken out of its context and thus not be accorded in 'like circumstances'. No other rights can be claimed under an MFN clause than those falling within the limits of the subject matter of the clause.

Some MFN clauses are very general in scope. A typical example is the clause in the Spain-Argentina BIT, as it was at stake in the *Maffezini* decision. Article IV(2) of the Argentina-Spain BIT is relatively open or unspecific with regard to the exact scope of the MFN clause:

> "In all matters subject to this Agreement, this treatment shall not be less favourable than that extended by each Party to the investments made in its territory by investors of a third country."[552]

Certain MFN clauses go further in their explicitness to define the types of situations in which the treatment is subject to the MFN standard. For example, the NAFTA includes not only the 'management, conduct, operation, and sale or other disposition of investments', but also their 'establishment, acquisition, expansion', and thus extends MFN treatment to market access or establishment, (i.e., rights normally related to the pre-establishment phase of foreign direct investment). The extension of the MFN clause is limited to certain operations (including pre-establishment rights) and only applies in 'like situations'.

It is possible to include an additional MFN standard in a specific treaty provision thereby limiting the scope of this particular provision to the specific standard. Some BITs, such as certain treaties negotiated by the UK, clearly specify that their MFN treatment clauses are to be also applied to dispute settlement. The ICSID tribunal in *Maffezini v Spain* noted, however, that such clear intention, explicitly mentioned in the text, was not very common as far as investment treaties were concerned.[553] As a

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[551] Andreas R. Ziegler, Most-Favored-Nation (MFN) Treatment, in August Reinisch, (ed.), *Standards of Investment Protection*, Oxford University Press, 2008, P. 10.
[552] Argentina-Spain BIT, Art. IV(2).
[553] *Maffezini v Spain*, para. 42.

consequence, several states have started to prefer to clearly state, in the negotiating history or in the agreement itself, what should be exempted from the application of an MFN clause.

4.3 Market Access

Investment treaties have dealt with the entry of foreign investment from a home to a host country using one of two models. The ‘admission’ model—also sometimes referred to as the ‘investment-control’ model—is found in traditional BITs initially concluded by European countries and followed by the vast majority of developing countries.[554] Over 90 per cent of the BITs concluded to date follow the admission model approach. Under this model, the host country does not grant positive rights of entry and establishment to investors from the other contracting party. It may apply any admission procedures for foreign investment and determine the conditions under which foreign investment will be allowed to enter and operate in the country.

The other approach that has been used consistently by counties seeking to liberalize conditions for the entry and operation of their investors, in addition to ensuring their protection, is the ‘pre-establishment’ or ‘combined National Treatment and Most-Favoured-Nation’ treatment model.[555] Under this model, foreign investors are granted NT (‘treatment no less favorable than that accorded to nationals engaged in the same line of business as the foreign investor’) and MFN treatment (‘treatment no less favorable than that accorded to other foreign investors in the same line of business’) regarding the entry and establishment of the investment. This approach is found in BITs concluded by Canada and the US.

a) Admission Model

Treaties following the admission model encourage the parties to promote favourable investment conditions between them, but leave the conditions of entry and establishment up to the discretion (i.e., laws and regulations) of each country. Foreign

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[554] Anna Jobin-Bret, Admission and Establishment in the Context of Investment Protection, in August Reinisch (ed.), *Standards of Investment Protection*, Oxford University Press, 2008, p. 10.
[555] E.g., Articles 10.3, 10.4 Peru-United States Trade Promotion Agreement (2006).

investors will face risk and uncertainty, since the laws and regulations relating to the entry of foreign investment may change over time. There is no guarantee as to a certain level of entry conditions, or to the elimination of discriminatory regulations which affect the establishment of foreign investment (unless the BIT states otherwise).

However, once admitted, foreign investment is granted full national treatment and MFN treatment. Treaties using the admission model do not contain specific exceptions (closed sectors, operational conditions, entry requirements, etc.) to MFN and National Treatment, as the entry and establishment of foreign investment is at the complete discretion of the host country, there is no need for such exceptions.

b) MFN only

Some BITs, despite containing an admission clause, also provide some rights, namely MFN treatment, to investors at the pre-establishment state. For example, the BIT between China and Finland grants no right of entry beyond rights included in the domestic legislation of the parties but grants MFN in the pre-establishment phase.

c) Pre-establishment Model

National Treatment and MFN treatment are granted at all stages of the lifespan of an investment: establishment, acquisition and expansion, management, use, conduct, operation, sale, and other disposition of the investment. The term ‘establishment’ or ‘acquisition,’ is defined in the pre-establishment phase, when the investor is still *seeking* to make, or in the process of making, investments. It is also defined in some cases where ‘expansion’ requires special approval procedures.

Essentially, under this model, each host state accepts, to a certain extent, a limit on its sovereignty to regulate foreign investment. However, this is subject to the right of host states to adopt or maintain exceptions to this general commitment. Thus, in contrast to the admission model, BITs using the pre-establishment model include lists of exceptions (‘negative lists’) to National Treatment and MFN treatment. A variation of this is the ‘positive list’ approach, whereby National Treatment and MFN are only granted for certain enumerated sectors or activities.

4.3.1 "In accordance with domestic laws" Provision in Investment Treaties

The question here is whether the protection afforded by a BIT is subject to the admission requirements in accordance with the laws and regulations of the host country. First, the reference to the laws and regulations of the host state may also be found in some treaties in the articles on 'Definitions' or on the 'Scope of application.' For example, the BIT between China and Luxemburg states that:

> "[t]he term investment means every kind of assets invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the latter, …"[556]

In some treaties, a reference to the laws and regulations of the host country can also be found in a separate article defining the scope of the application of the treaty. For example, the China and Peru BIT states:

> "This Agreement shall apply to the investments which are made prior to or after its entry into force by investors of either Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the Latter."[557]

Similarly, the China-Mexico BIT states:

> This Agreement shall apply to investments made after the entry into force of this Agreement by investors of one Contracting Party in the territory of the other Contracting Party, as well as to investments made in accordance with the applicable laws of the Contracting Parties and existing at the entry into force of this Agreement. However, the provisions of this Agreement shall not apply to claims arising out of events which occurred, or to claims which had been settled, prior to its entry into force.[558]

a) Definition of Investment in Chinese BITs: the Illustration List

In all Chinese BITs, the general definition of investment is supplemented by an

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[556] Article 1(2), China-Luxemburg BIT.
[557] China-Peru BIT, Article 11.
[558] China-Mexico BIT, Article 29 [Application of the Agreement].

illustrative list of particular assets covered by the BIT. Typically, Chinese BITs include five categories: investment, namely movable and immovable property; interests in companies; contractual rights; intellectual property rights; and business concessions. The exceptions to the illustrative list are the China-Poland BIT and China-Bulgaria BIT, which include the first four categories of investment but exclude business concessions.

Article 135 of the China-New Zealand FTA (2008) makes progress in trying to draw a distinction between investment and trade debts. The FTA lists '…(f) bonds, including government issued bonds, debentures, loans and other forms of debts, and rights derived therefrom'[559] as a separate category of investment, parallel to normal company participation in the form of shares and stocks. It continues clarifying this loan and debts clause by adding in a footnote that:

> "Loans and other forms of debt, which have been registered with the competent authority of a party, do not mean trade debts where the debts would be non-interest earning if paid on time without penalty."[560]

This qualification, therefore, helps to avoid certain unintended claims to be brought under the protection of a BIT. The China-Gabon BIT defines investment to include every kind of investment invested directly or indirectly by the investors of one party in the territory of the other party, in accordance with its laws and regulations.

The revised China-Germany BIT (2003) also refers to 'invested directly and indirectly' but omits the 'in accordance with its laws and regulations' requirement. Moreover, the BIT includes an explanation on 'invested indirectly', which reads:

> "…invested indirectly' means invested by an investor of one Contracting Party through a company which is fully or partially owned by the investor and having its seat in the territory of the other Contracting Party."[561]

This treaty thus clarifies that investment made by foreign investment enterprises

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[559] China-New Zealand FTA, Article 135.
[560] *Id*.
[561] The Protocol to the 2003 Germany BIT, *Ad* Art 1.

in China that are fully or partially *owned* by German investors are also investments covered by the BIT. The China-Portugal BIT (2005) also adopts the concept of 'investment invested directly and indirectly' in the definition of investment but does not further define the meaning of investment indirectly. The China-Spain BIT (2005) does not refer to 'investment invested directly and indirectly', but nevertheless has a provision which effectively covers 'indirect investment', as defined in the 2003 Germany BIT. The provision reads:

> 'Investments made in the territory of one Contracting Party by any company of that same Contracting Party which is actually owned or *controlled* by investors of the other Contracting Party shall likewise be considered as investments of investors of the latter Contracting Party if they have been in accordance with the laws and regulations of the former Contracting Party.'[562]

The introduction of the 'foreign control' test serves to expand the coverage of the BIT.

Most Chinese treaties, however, do not have a separate clause dealing with the scope of application of the treaty. They will define investment, investors, and the other key terms of the treaty, whereas the admission clause is the only substantive provision which both describes the laws and regulations of the host state, and gives them a determining role to permit investment.

Many North American treaties use the denial of benefits clause to precisely deny the benefits of the treaty to certain categories of investments. Alternatively, the same can be achieved by the reference to laws and regulations of the host state in the *admission model* BIT, where the protection does not need to be denied because it must be granted positively. In the admission model approach, it is only after the admission of the investment that the investor will enjoy the full benefits of the BIT.

The relevant question is to identify the laws and regulations that are referred to in the treaties, relating to admission of investments by foreign investors. Almost all countries have legislation specifically addressing investments by foreign investors, in the form of investment laws, exchange control regulations, and specific procedural requirements such as permits, licenses, authorizations, and registrations.

[562] China-Spain BIT (2005), Art 1(1). Emphasis added.

In addition, to the specific, substantive, and procedural rules and conditions to the quality, entry, and operation of a foreign investor, all the laws and regulations of the host country will apply to the investor, as they would to any other economic actor in the host country. Foreign investors will be subjected to the general legal framework consisting of tax laws, environmental laws, and intellectual property laws, etc. They have to abide by these laws and regulations like any other national economic operator.

b) Domestic Legislation on Foreign Investment (in China)

In order to choose the proper 'category' of investment, a foreign investor may check China's domestic legislation on foreign investment in China. The two key documents are "the Guidance on the Direction of Foreign Investment" (Investment Guidance) and its attached "Guiding Catalogue of Industries for Foreign Investment" (Guiding Catalogue). The Department of Treaty and Law of China's Ministry of Commerce (MOFCOM)[563] first issued the Investment Guidance in 2002 and the Guiding Catalogue in 2007 (updated in 2012).

The Guidance and the Catalogue classify all the foreign investment projects into four sub-catalogues: Encouraged, Restricted, Prohibited, and Permitted. The Encouraged, Restricted and Prohibited industries are specifically defined while all others are classified as Permitted industries by default. Foreign Investment Projects (FIPs) in the Encouraged Catalogue may enjoy taxation incentives.[564] By contrast, FIPs in the Restricted Catalogue are subject to certain restrictions, sometimes depending on the modes of investment.

There are three modes of foreign investment in China: Equity Join-Ventures (EJVs)[565], Contract Join Ventures (CVJs)[566], and Wholly Foreign-Owned Enterprises

563 Department of Treaty and Law of China's Ministry of Commerce [hereinafter MOFCOM], taking charge of Chinese investment treaty's negotiation.

564 Their imported equipment can continue to enjoy the exemption of import duties and import VAT, and their purchase of domestically produced equipment can enjoy rebate of VAT.

565 A joint venture, may be an Equity Joint Venture, under which the rights and obligations of the JV partners are divided in accordance with the equity (shares) they possess. See: The Law of Sino-Foreign Equity Joint Ventures, adopted on 1 July 1979.

(WFEs)[567]. This section will explore how China has revised these laws.

An Equity Joint Venture (EJV) is a joint venture set up by foreign firms in conjunction with Chinese firms within the territory of China. The joint venture agreement, a contract between the joint investors, which is subject to approval by the government, is the legal basis of the venture that stipulates the rights and obligations of the parties. An EJV takes the legal form of a Limited Liability Company (LLC). Each party can contribute capital in cash, or, in industrial or property rights. There is no ceiling on the proportion of foreign investment, but there is a minimum capital contribution requirement consisting of twenty-five percent of the registered capital. The parties share the profits, risks, and losses in proportion with their respective contribution to the registered capital. The Board of Directors, the Chairman of which may be Chinese or foreign, shall decide all the major policies in the venture, while the day to day operations are under the charge of its general manager. The features of an EJV are: a joint contribution of investment; joint management; and a share of risks, profits and losses in proportion to capital contributions.

A Contract Joint Venture (CJV) is another form of a joint venture in China. It is established jointly by a Chinese partner and a foreign partner by contributing cash, materials, industrial property, and know-how, or other kinds of investment, though these contributions are not necessarily represented by shares.[568] Consequently, the partners do not have to share the profits and losses in precise proportion to their contributions as in an EJV, but they agree on a way of sharing in their contract[569]. Also, there is no minimum or maximum requirement of foreign investment proportion. If it is qualified to be a judicial person, it may take the form of a limited liability company. Otherwise, it could carry out the co-operation on an individual basis, with unlimited liability.[570]

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566 A Contract Joint Venture, may be a contractual joint venture, under which everything is defined by the JV contract between the partners. See: The Law of Sino-Foreign Joint Ventures, adopted on 13 April, 1988.

567 A wholly foreign-owned enterprise (WFE) is an enterprise established in China with capital solely invested by one or more foreigners. WFEs are excluded or restricted in certain fields, as stipulated in the Investment Guidance and the Guiding Catalogues. See Art. 2, the WFEL. The Law of Wholly Foreign Owned Enterprises was adopted on 12 April 1986, and last revised on 12 April 2001.

568 The Chinese –Foreign Contractual Joint Ventures law (CJVL), Article 2 & 8,

569 *Ibid*, Art. 22.

570 *Ibid.* Art. 2

Moreover, the decision-making body of the joint venture may be a joint management committee or a Board of Directors with the Chairman being either a Chinese or foreign partner[571]. Alternatively, the joint ventures might entrust a third party to manage the joint venture.[572]

A Wholly Foreign-Owned Enterprise (WFE) is an enterprise established in China, with capital solely invested by one or a few foreigners, excluding branches or offices which foreign enterprises, or other organizations, have in China.[573] A WFE is required to be beneficial to the development of the Chinese Economy and to be able to achieve remarkable economic consequences.[574]

Furthermore, WFEs are excluded or restricted in certain fields, as stipulated in the Investment Guidance[575] and the Guiding Catalogues. Once a WFE is approved and established, it can enjoy an autonomy of management according to its approved Articles of Association, free from any intervention.[576]

4.3.2 China's Opening Market: Adopt a "Negative List" in Shanghai Free Trade Zone

In the Shanghai Free Trade Zone, China has practiced a unilateral market opening model by adopting a "negative list". This policy is to grant national treatment at the pre-establishment stage of an investment. China has agreed to switch from a positive list (where permitted investments are exhaustively enumerated), to a negative list (where only the sectors where foreign investment is prohibited are listed, the rest being *libera terra*).

China had used a positive list for decades, according to its Catalogue of Industries for Guiding Foreign Investment ('Catalogue'), which delineated the sectors where foreign investment was encouraged, allowed, and prohibited. This positive list system was coupled with a post-establishment national treatment protection— (i.e.,

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571 *Ibid.* Art. 12
572 *Ibid.*
573 Art. 2, the WFEL.
574 *Ibid.* Art. 3
575 Art 8, *Investment Guidance*.
576 Art.11, the WFEL.

NT only after approval by the Chinese administration).

Before, China directed more of its attention to the role of the host country, while currently, in China, it has become more acceptable to have a higher-level protection for investors and for reducing limits on access. China adopted the Negative List Approach in the Shanghai Pilot Free Trade Zone in September 2014. China has a range of laws and regulations that govern FDI, including basic laws and one Guiding Directory.

In 2001, China made a radical commitment to liberalize services in its accession to the World Trade Organization. This commitment caused a change of FDI in the 2000s, from manufacturing to service industries. China's WTO accession commitment still adopted a Positive List Approach (GATS model) that included limits on sectors and regions, which was included and reflected later in the revised Guiding Directory. The current (2015) version of the Guiding Directory lists three catalogues (encouraged, restricted and prohibited). The last three decades have witnessed China's efforts to shorten the restrictive and prohibited lists, and to facilitate administration procedures by decentralizing approval powers; eliminating or simplifying documents and other measures.

Although China has attempted to streamline foreign investment administration, the substantive general requirements for approval have not been modified. All of the deregulation attempts by the government have been mainly concerned with delegating some approval authority to the local governments because the revision of the Guiding Directory did not result in any major liberalization. For example, the 2015 Negative List retains the same eighteen industrial sector categories that were restricted or prohibited from foreign investment in the 2013 List.[577]

4.4 Performance Requirements

[577] That is: agriculture/forestry/animal husbandry/fishery, mining, manufacturing, electricity/heating/gas and water production and supply, construction, wholesale and retail, transportation/warehousing/postal service, information transmission/software/information technology (IT) services, finance, real estate, leasing and business services, scientific research and technology services, water conservation/environmental/public facility management, education, health and social work, and culture/sports/entertainment.

Related to the issue of the entry or establishment of investment is the ability of the host country to impose conditions on that entry. One type of condition that host countries often impose is a ‘performance requirement’ on an investment project. As a condition of entry, such requirements on an investment project may include: exporting a certain proportion of its production; restricting its imports to a certain level; or purchasing a minimum quantity of local goods and services. Although most investment treaties have not dealt with the question of performance requirements, the NAFTA specifically provides that no NAFTA party may impose any one of seven defined performance requirements in connection with the ‘establishment, acquisition, expansion, management, conduct or operation of an investment…’[578]

The Investment Chapter of the China-New Zealand FTA (2009) is the first Chinese investment agreement that explicitly prohibits the use of performance requirements by incorporating the WTO Agreement on Trade-Related Investment Measures.

As Article 9 [Performance Requirements] in the China-Canada BIT (2012) states,

> “The Contracting Parties reaffirm their obligations under the WTO Agreement on Trade-Related Investment Measures (TRIMs), as amended from time to time. Article 2 and the Annex of the TRIMs are incorporated into and made part of this Agreement.”

In a similar vein, Article 7 [Prohibition of Performance Requirements] in the China-Japan-Korea TIA states that,

> “1.The provision of the Agreement on Trade-Related Investment Measures in Annex 1A of the WTO Agreement are incorporated into and made part of this Agreement, *mutatis mutandis* and shall apply with respect to all investments under this Agreement.
>
> 2. No Contracting Party shall, in its territory, impose unreasonable or discriminatory measures on investment by investors of another Contracting Party concerning performance requirements on export or transfer of technology.”

Countries permit foreign investment to access their domestic markets as they regard

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578 Article 1106 of the NAFTA,

foreign investment capable of bringing prosperity to their economy.[579] For example, FDI can bring new technology and expertise into the host state; FDI can also develop trade links, particularly for exports, which will generate foreign exchange and balance of payments. By contrast, many countries are sceptical about FDI and thus impose certain requirements, often known as performance requirements, on foreign investment as a condition of granting access to their economy. These requirements are intended to ensure that foreign investment operates in a way that contributes to economic development and prosperity.

A small number of BITs contain prohibitions on performance requirements. Typically, no definition of the term "performance requirements" appears in a BIT. Prohibited performance requirements usually are host-state restrictions on the use of inputs and outputs by investments. Examples include local hiring requirement, domestic content requirements, import restrictions, technology transfer requirements, and export requirements. BITs that prohibit performance requirements most often prohibit only those requirements that are included in an exhaustive list. Those performance requirements not on the list are permitted.

Two justifications will be addressed to understand the reasons why prohibitions on performance requirements exist. The first is that such requirements interfere with the investor's control of the investment.

For foreign direct investment, one key difference from the portfolio is that the former provides control over the enterprise to the investor. Performance requirements represent a limited diminution of that control.

Some investors accept performance requirements in exchange for some incentives (e.g., tax incentives). The investor has thus bargained away control. The investor will calculate the cost of the performance requirements and conclude that the benefits received from the incentives exceed the costs imposed by the requirements. However, some BITs prohibit certain performance requirements, even though investors might sometimes accept that particular requirement. Thus, the loss of

[579] Kenneth J. Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation*, Oxford University Press, 2010, p.419.

control is not the sole justification for a performance requirement prohibition.

A second justification for the prohibition on performance requirements is that they are trade distorting. Performance requirements can restrict international trade since they often regulate the source or use of inputs, or the destination of outputs. Performance requirements thus have an impact, not merely on the covered investment, but on international trade flows.

As a result of their trade distorting character, certain performance requirements are also prohibited by the TRIMs. The TRIMs agreement applies to performance requirements that are inconsistent with the obligation of national treatment or the prohibition on quantitative restrictions in the GATT.

The 2012 US Model Negotiating Text, at Article 8, prohibits certain performance requirements whether imposed on investment or accepted by the investment in exchange for a benefit. Such performance requirements include local content requirements, restrictions on imports, and restrictions on local sales.

In addition, the 2012 model prohibits export requirements and technology transfer requirements, when imposed by the government, but allows them if accepted as a condition of receiving a benefit. The 2012 US Model BIT also includes a number of exceptions in the text and allows the parties to reserve the right to maintain or adopt other exceptions, by specifying them in an annex to the treaty.

The performance requirements provision has been the subject of very few international arbitrations. All three publicly available awards involving the performance requirements provision were issued in cases arising under the NAFTA. These awards suggest that tribunals are giving a literal reading to the performance requirements provision, applying it only to requirements that are explicitly included in the exhaustive list.

Given that the list in the NAFTA is exhaustive and given the specific nature of the language, a literal approach would seem appropriate. In *Pope & Talbot v. Canada*,[580] the claimant challenged a Canadian measure that required payment of a

[580] *Pope & Talbot v. Canada*, Interim Award on Merits – Phase one, 26 June 2000, pp.22-27. http://www.naftaclaims.com/disputes_canada_pope.htm.

fee for softwood lumber exports that exceeded the exporter's assigned quota. The measure had been adopted by Canada pursuant to an agreement with the US to limit softwood lumber exports. The tribunal found the measure not to fall within the terms of any of the prohibited performance requirements. More specifically, the measure did not require the claimant to export a given level or percentage of its product. In fact, the measure limited exports. It also did not restrict the claimant's sales in Canadian territory.[581]

In *SD. Myers v. Canada*,[582] the claimant, a US company, sought to export toxic substances known as polychlorinated biphenyls (PCBs) from Canada to the US, where it had a facility engaged in the business of disposing of PCBs. Canada imposed a ban on the export of PCBs in order to preserve the business of PCB disposal for Canadian companies. The claimant argued that this prohibition, in substance, amounted to a violation of the NAFTA's prohibition on performance requirements[583] to utilize domestic content or purchase local goods or services. The tribunal held, however, that an export ban clearly was neither a domestic content requirement, nor a requirement to purchase local goods or services.[584]

In *ADF Group v. US.*,[585] the US conceded that its law requiring that the steel used in federally funded highway construction projects be of US origin was a domestic content performance requirement under the NAFTA. Nevertheless, the tribunal found, as the US argued, that the requirement did not violate the performance requirement provision of the NAFTA because the NAFTA contains an exception to the performance requirements prohibition for measures relating to government procurement.

4.5 Exception Clauses

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[581] Pope & Talbot v. Canada, Interim Award on Merits – Phase one, 26 June 2000, para.77-80.
[582] Partial Award on the Merits, 13 November 2000, pp.67-68, http://www.naftaclaims.com/disputes_canada_sdmyers.htm.
[583] NAFTA, Article 1106(1)(b)(c), Article 1106(3).
[584] Also see Separate, Concurring Opinion, 13 November 2000, para.188-201, http://www.naftaclaims.com/disputes_canada_sdmyers.htm.
[585] Final Award, 9 January 2003, Case No. ARB(AF)/00/1, pp.74-83. http://www.naftaclaims.com/disputes_us_adf.htm.

The exceptions to the application of the national treatment and MFN standards also affect the scope of the relevant non-discrimination obligations. Many specific exceptions are potentially applicable to both standards, but further specific exceptions are required to limit MFN treatment, with its possibility to create 'free rider' situations. Systematic exceptions include, usually, the Regional Economic Integration Organization exception, and exceptions with respect to taxation, which are designed precisely to avoid such free-riding. There may also be country-specific exceptions which may restrict access to specific sectors of the economy or grandfather non-conforming measures, though these exceptions can very much depend on whether the relevant standards are also supposed to cover the pre-establishment stage of the investment.

General exceptions may exclude certain measures from the scope of application of the non-discrimination standard, and other standards of treatment, along the lines of general exceptions in the GATT and the GATS. However, the inclusion of such general exceptions is relatively rare.

4.5.1 Essential Security Interests Exception

Some BITs include an exception for measures necessary to preserve a party's essential security interests.[586] Such provisions may contain limitations that state, for instance, that any measures should be reasonable and non-discriminatory,[587] or that the exception shall not apply to expropriation or to war and civil disturbance provisions.[588] An essential security exception appeared in the GATT.[589]

The essential security interests exception is a limitation on the scope of the obligations in the BIT.[590] This means host state conduct that falls within the essential security interests exception does not violate the BIT. Such conduct is not wrongful and does not result in liability for compensation.[591] The essential security interests

[586] e.g., Australia-India BIT, Art. 15; United States-Argentina BIT, Art. XI; Finland-Armenia BIT, Art. 14(1).
[587] e.g., Australia-India BIT, Art. 15.
[588] e.g., Finland-Armenia BIT, Art. 14(1).
[589] General Agreement on Tariffs and Trade, Art. XX(b).
[590] Kenneth J. Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation*, Oxford University Press, 2010, p. 181.
[591] *Id.*

exception has been invoked by Argentina in a number of cases involving measures taken by Argentina to address an economic crisis that occurred in 2001 and 2002.[592]

One issue that has arisen is the relationship between the essential security interests exception and the 'necessity rule', codified in Article 25 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts. The rule of necessity in Article 25 of the ILC Articles, can be relevant to the subject matter of an investment treaty:

> 1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) is the only means for the State to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.
>
> 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if: (a) the international obligation in question excludes the possibility of invoking necessity, or (b) the State has contributed to the situation of necessity.

In *CMS v Argentina*,[593] the respondent pleaded the defence of necessity, but the tribunal found that the conditions for its applications were not met:

> [T]he Tribunal is persuaded that the situation was difficult enough to justify the government taking action to prevent a worsening of the situation and the danger of total economic collapse.[594] […] A different issue, however, is whether the measures adopted were 'the only way' for the State to safeguard the interests. This is indeed debateable. […] The International Law Commission's comment to the effect that the plea of necessity is 'excluded if there are other (otherwise lawful) means available, even if they may be more costly or less convenient,' is persuasive in assisting this Tribunal in concluding that the measures adopted were not the only steps available.[595] […] The second limit is the requirement for the State not to have contributed to the situation of necessity. […] The Tribunal observes that government policies and their shortcomings significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties they do not exempt the Respondent from its responsibility in the matter.[596]

Therefore, the tribunal considered that an economic crisis might give rise to a plea of

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592 See Andrea K. Bjorklund, 'Emergency Exceptions: State of Necessity and Force Majeure,' in Peter Muchlinski, Frederico Ortino, and Christoph Schreuer, (ed.), *The Oxford Handbook of International Investment Law* , 2008.
593 *CMS v Argentina*, Award, 12 May 2005, 44 ILM (2005) 1205.
594 Ibid., para. 322.
595 Ibid., para. 323- 324.
596 Ibid., para. 328- 329.

necessity in principle. But it found that two requirements for a finding of necessity were not met in the particular case: the measures taken by Argentina were not the only way to cope with the situation, and Argentina itself had contributed to the situation.

4.5.2 Taxation Exception

Many BITs include an exception to the MFN and national treatment provisions for tax matters. Some BITs exempt taxation measures from certain BIT's provisions. The US 2012 Model BIT has applied only selected provisions to measures of taxation, (e.g., expropriation, performance requirements, and disputes provisions applied to matters of taxation).[597] Also, the Canadian 2003 model BIT authorizes Investor-State Arbitration of claims with respect to taxation measures, only if the claim is either that the measure breaches an agreement between the investor and the host state or that the measure constitutes an expropriation.[598]

A few BITs grant to the taxation authorities of the two parties, the power to decide whether certain measures violate the BIT. For example, the Canada-Uruguay BIT provides that a tax measure shall not be considered to contravene an agreement between the investor and the host state or to constitute an expropriation if the taxation authorities jointly so determine.[599] Many US BITs provide that a tax measure shall not be considered an expropriation if the taxation authorities of the two parties jointly so decide.

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[597] US Model BIT 2012, Article 21 [Taxation]

1. Except as provided in this Article, nothing in Section A shall impose obligations with respect to taxation measures.
2. Article 6 [Expropriation] shall apply to all taxation measures, except that a claimant that asserts that a taxation measure involves an expropriation may submit a claim to arbitration under Section B only if:

the claimant has first referred to the competent tax authorities of both Parties in writing the issue of whether that taxation measures involves an expropriation; and

within 180 days after the date of such referral, the competent tax authorities of both Parties fail to agree that the taxation measure is not an expropriation.

3. Subject to paragraph 4, Article 8 [Performance Requirements] (2) through (4) shall apply to all taxation measures.
4. Nothing in this Treaty shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Treaty and any such convention, that convention shall prevail to the extent of the inconsistency. In the case of a tax convention between the Parties, the competent authorities under that convention shall have sole responsibility for determining whether any inconsistency exists between this Treaty and that convention.

[598] 2003 Canadian Model BIT, Art. 16.

[599] Canada-Uruguay BIT, Art. XVI(3)-(4).

The NT and MFN obligations exclude the application of tax advantages or privileges granted to investors of a third state pursuant to a tax treaty or economic integration agreement. Also, the non-conforming provision seeks to preserve any existing tax laws and regulations, and measures that are otherwise inconsistent with the treaty.

Recent arbitral jurisprudence reflects that a taxation measure may constitute an expropriation. The tax filter is a mechanism through which parties are to submit the dispute to the taxation authorities. A very distinctive feature of the regulation of tax measures in an investment treaty is the 'joint tax consultation' (sometimes amounting to a 'joint tax veto' by the two tax authorities).[600]

In *EnCana v. Ecuador*, the tribunal required: for indirect expropriation, that a tax law had been 'extraordinary, punitive in amount, or arbitrary in its incidence.'[601]

In *Occidental v. Ecuador*, the tribunal was much more reticent than the *EnCana* tribunal, with respect to the quality of the 'tax refund right' to constitute an 'investment' protected against expropriation. It did not separate the tax refund from the overall investment, consisting of a bundle of property rights, but rather looked at the economic effect, which indicated that the overall investment was doing well; thus no 'substantial economic deprivation' took place.[602]

The tribunal's restrictive approach towards indirect expropriation was perhaps facilitated by the fact that it was not precluded from accepting the claim for a breach of national treatment commitment.

In Chinese BITs, the MFN provision excludes international agreements and domestic laws on taxation. For example, some BITs especially refer to 'international treaties for the avoidance of double taxation',[603] whereas others refer only to 'any international agreement or arrangement relating to taxation'.[604] The updated China-Germany BIT (2013) refers only to international taxation agreements and

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[600] Art. 21(2), US 2012 Model BIT.
[601] *EnCana Corporation v. the Republic of Ecuador*, LCIA Case No. UN 3481, February 2006, para. 177.
[602] *Occidental v. Ecuador*, administration case no. UN3467 decision of 1 July 2004, http://ita.uvic.ca/documents/Oxy-EcuadorFinalAward_001.phf, paras 86-9.
[603] See e.g. China-Indonesia BIT, Art 2(3).
[604] See e.g. China-Korea BIT 1992, Art. 3(4).

arrangements in the treaty text. However, the protocol adds a further exemption confirming that a state does not have to extend to foreign investors any ‘tax privileges, tax exemptions and tax reductions which according to its tax laws are granted only to investors resident in its territory’.[605]

[605] China-Germany BIT (2003), *Ad* Art. 3(b). Other recent BITs also contain this exclusion for investor residents. See China-Portugal BIT and China-Spain BIT Protocols (both 2005).

5 A Comparative Study on Dispute Settlement Mechanisms in Trade and Investment Agreements

Investment arbitration has been created from the decisions of states to get out of the constraints of diplomatic protection.[606] Investment treaties help to switch investment disputes from inter-state settlement to a credible depoliticized dispute settlement mechanism. This mechanism also interacts with other concepts, (e.g., trade and human rights laws), when dealing with the Investor-State Arbitration (ISA) to balance the rights of the host state and the rights of the citizens of this host country.

Investment arbitration also corresponded with an economic imperative; to facilitate the flow of world trade and investment by settling the disputes which would arise along the way.[607] However, the ISA process provokes some questions. For example, tribunals may lack of consideration of the public policy of the host state, such as the legitimate imposition of taxation. Or, the arbitration simply may not give full remedy to a suffered investor.

Most investment treaties provide for two distinct dispute settlement mechanisms: one for disputes between the two contracting states, and another for disputes between a host country and an aggrieved foreign investor. As to the former, investment treaties usually stipulate that in the event of a dispute over the interpretation or application of the treaty, the states concerned will first seek to resolve their difference through negotiation and then, if that fails, through *ad hoc* arbitration.[608]

As to the ISA, the trend among more recent investment treaties is to provide a separate international arbitration procedure, often under the auspices of the ICSID, which is for disputes between an aggrieved foreign investor and an offending host

[606] Jacques Werner, Limits of Commercial Investor-State Arbitration: The Need for Appellate Review, in Pierre-Marie Dupuy, Francesco Francioni, and Ernst-Ulrich Petersmann, ed., Human Rights in International Investment Law and Arbitration, Oxford University Press, 2009, p. 115.

[607] *Ibid.*, p. 116.

[608] See e.g., China-UK BIT (1986) Art. 8(1)(2); China-Korea BIT (1992) Art. 10(1)(2); China-Netherlands BIT (2001) Art. 9(1)(2).

country government. By agreeing to an investment treaty, a state often simultaneously gives their consent to submit any future investor-state dispute to the ICSID or another arbitration forum.[609] Although the investor may have to first try to resolve the conflict through negotiation and may also have to exhaust local remedies, the investor can ultimately invoke a compulsory arbitration in order to secure a binding award. The WTO does not give a remedy to private persons injured by trade law violations.

In the case that a state fails to pay the compensation (under an award), the ICSID Convention requires each ICSID member state to recognize such '…award… as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.'[610] Non-ICSID awards rendered under investment treaties are enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention').[611] This chapter will explore investment arbitration proceedings by looking at the WTO.

5.1 WTO Dispute Settlement Mechanism

The WTO's dispute settlement system is unique in international law and institutions, both at present and historically.[612] It embraces mandatory exclusive jurisdiction and virtually automatic adoption of dispute settlement reports, which is extraordinary for an institution with such broad-ranging competence and responsibilities as the WTO.

In *US—Section 301*, the EC claimed that Section 304 of the US Trade Act mandated the UETR to make a unilateral decision regarding whether another member was acting inconsistently with the WTO Agreement. The EC further argued that a USTR determination under Section 304, in the situation where a panel or Appellate

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[609] One of the most predicts for investment treaty arbitrations involves the need to establish party consent in the treaty, foreign investment law, and contracts. See Y. Shany, 'Consolidation and Tests for Application: Is International Law Relevant?', 21 *ICSID Review* (2006) 135.

[610] The ICSID Convention, Art. 54(1).

[611] The New York Convention, 330 UNTS 3, UNCITRAL, 'Status.' www.uncitral.org/uncitral_Texts/arbitration/NYConvention_status.html.

[612] John H. Jackson, *Sovereignty, the WTO, and Changing Fundamentals of International Law*, Cambridge University Press, 2006, p. 134.

Body report had not yet been adopted by the DSB violated DSU Article 23.2(a).[613]

The Panel noted that, under the statute, the USTR maintained the discretion to determine that US rights under the WTO were not being denied. However, in addition, it recognized that, under Section 304, the USTR also had the discretion to find that another member's actions were in fact inconsistent with the *WTO Agreement*.[614]

The Panel then examined and reached certain general observations regarding Article 23 of the DSU. First, the Panel noted that the purpose of Article 23, as indicated by its title, is the 'strengthening of the multilateral system' and further considered that this provision was designed to prevent members from unilaterally resolving WTO disputes.[615]

The Panel then examined Articles 23.1 and Article 23.2 and found they contained three requirements that members must respect in resolving disputes.[616] On this basis, the Panel found that it was for the WTO through the DSU process, and not an individual WTO member, to determine whether a measure is inconsistent with WTO obligations.[617]

Finally, the Panel recognized that striking down a domestic law under WTO rules, based solely upon the risk of inconsistent action, 'should not be done lightly'…'[i]t depends on the specific WTO obligation at issue, the measure under consideration and the specific circumstances of each case.'[618] Nonetheless, in the instant case, the Panel found support for its decision 'in the context of Article 23 and the DSU in the overall WTO system.'[619]

The Panel's preliminary conclusion was that Section 304 constituted a *prima facie* violation of Article 23.2(a), 'by mandating a determination before the adoption

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613 Panel Report, *United States—Section 301-310 of the Trade Act of 1974*, WT/DS152/R(27th January, 2000) para. 7.29.
614 *Ibid*. para. 7.31.
615 *Ibid*. para. 7.35.
616 It includes the requirement that members are not to make a determination that a violation had occurred 'except through recourse to dispute settlement.' As Art. 23.2(a) in DSU reads: "…2. In such cases, Members shall: (a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;..."
617 *Ibid*. paras. 7.37-7.40.
618 *Ibid*. para. 7.93.
619 *Ibid*.

of DSB findings and statutorily reserving the right for this determination to be one of inconsistency.'[620]

Before reaching a final decision on this matter, however, the panel recognized that it must also consider other institutional and administrative features of Section 304 that affected the implementation of the statute. The Panel concluded that the US had, in fact, already lawfully removed the *prima facie* violation of Section 304.[621] The Panel then concluded that Section 304 was 'not inconsistent' with US obligations under *DSU* Article 23.2(a).[622]

This case reflects the extent to which DSU Article 23 precludes unilateral action by WTO members. Each side claimed victory—the US because it technically won; the EU because the US had firmly committed to always use WTO procedures before retaliation—and neither appealed.[623]

The WTO has a remarkable system for settling disputes between WTO members concerning their rights and obligations under the WTO agreements.[624] The WTO dispute settlement system, which has been in operation since 1 January 1995, is not an entirely novel system. On the contrary, this system is based on and has taken on board, almost fifty years of experience in the resolution of trade disputes in the context of the GATT 1947.[625] The GATT 1947 contained only two brief provisions on dispute settlement,[626] which neither explicitly referred to 'dispute settlement' nor provided for detailed procedures to handle disputes.

The WTO Dispute Settlement Understanding (DSU), which is Annex 2 to the WTO Agreement, provides the core treaty text, of about twenty-five pages, which governs the WTO DS process. This process consists primarily of four major stages, and the Dispute Settlement Body has the overall responsibility for supervising the

[620] *Ibid*. paras. 7.96-7.97.
[621] *Ibid*. para. 7.131.
[622] *Ibid*. para. 7.135.
[623] See William J. Davey, 'The WTO Dispute Settlement System: the first Ten Years', 8 JIEL 17 (2005), in John H. Jackson, William J. Davey, and Alan O. Sykes Jr., ed., *Legal Problems of International Economic Relations, Cases, Materials and Text, West Press*, 2013, pp. 321-324.
[624] Peter Van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization*, third edition, Cambridge University Press, 2013, p. 157.
[625] 'Members affirm theri adherence to the principles for the manegement of disputes heretofore applied under Articles XXII and XXIII of GATT 1947 and the rules and procedures as further elaborated and modified herein.' Article 3.1, DSU.
[626] Art. XXII and Art. XXIII, GATT1947.

process. First, the parties must attempt to resolve their differences through consultations. The WTO member should exercise restraint. Second, if that fails, the complaining party may demand that a panel of independent experts be established to rule on the dispute. Third, and new under the DSU, is the possibility of an appeal by any party to the dispute to the Appellate Body. Finally, if the complaining party succeeds, the DSB is charged with monitoring the implementation of its recommendations. If the recommendations are not implemented, the possibility of negotiated compensation or authorization to withdraw concessions arises. The DSU also provides for voluntary mediation[627] at any time (an option which never is used), and for an alternative procedure of arbitration,[628] which is used only once. The DSU provides for compulsory referral of all disputes regarding the ‘covered agreements’ (WTO-related, as listed or implied in the DSU text) to the procedures set forth.[629] This is obviously a very powerful measure of “compulsory jurisdiction,” which, when combined with the virtually automatic adoption of a DS report (panel or appellate) is even more powerful.[630]

5.1.1 Scope of the Jurisdiction

The WTO dispute settlement system thus has jurisdiction *ratione materiae* over disputes between WTO members arising under the ‘covered agreements’.[631] The covered agreements, referred to in Appendix 1 to the DSU, include the WTO Agreement, the GATT 1994 and all other multilateral agreements on trade in goods; the GATS; the TRIPS Agreement; the DSU; and the plurilateral Agreement on Government Procurement. It is clear that the scope of jurisdiction of the WTO dispute settlement system is very broad. It ranges from disputes over measures regarding customs duties, disputes regarding sanitary measures, disputes regarding subsidies,

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[627] Art. 5, DSU
[628] Art. 25, DSU
[629] Arts 1 and 23, DSU.
[630] John H. Jackson, *Sovereignty, the WTO, and Changing Fundamentals of International Law*, Cambridge University Press, 2006, p. 152.
[631] With regard to dispute which subject to WTO dispute settlement, Article 1.1 of the DSU states, in relevant part: The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the ‘covered agreements’).

disputes regarding measures affecting market access for services, to disputes regarding intellectual property rights enforcement measures.[632]

5.1.2 Different Methods of Dispute Settlement

The WTO dispute settlement system provides for several dispute settlement methods. In Article 4 of the DSU, it provides for consultations (i.e., negotiations) between the parties. Articles 6 to 20 of the DSU provide for adjudication by a panel and the Appellate Body. The WTO dispute settlement system also provides for other dispute settlement methods, in particular: arbitration, conciliation, and mediation. Pursuant to Article 25 of the DSU, parties to a dispute arising under a covered agreement may decide to resort to arbitration as an alternative means of binding dispute settlement, rather than have the dispute adjudicated by a panel and the Appellate Body.[633] When parties opt for arbitration, they have to agree on the procedural rules that will apply to the arbitration process, and explicitly agree to abide by the arbitration award.[634] Arbitration awards need to be consistent with WTO law,[635] and must be notified to the DSB, where any member may raise any point relating to them.[636] The DSU also provides for arbitration in Articles 21.3(c) and 22.6. These arbitration procedures concern specific issues that may arise in the context of a dispute, such as the determination of the reasonable period of time for implementation[637] and the appropriate level of retaliation.[638]

5.1.3 Remedy for Breach

The DSU provides for three types of remedy for breaches of WTO law. One is the

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632 Peter Van den Bossche and Werner Zdouc, (2013), p.163.

633 Article 25.1 of the DSU, ‘Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties.’

634 Articles 25.2 and 25.3 of the DSU.

635 Article 3.5 of the DSU.

636 See Article 25.3 of the DSU. In 2001, The United States and the European Communities resorted to arbitration under Article 25 to resolve a dispute on the appropriate level of compensation due by the United States after it failed to comply with the panel report in *US – Section 110(5) Copyright Act (2000)*. Award of the Arbitrators, *US – Section 110(5) Copyright Act (Article 25) (2001)*, recourse to Arbitration under Article 25 of the DSU, WT/DS160/ARB25/1, adopted on 9 November 2001.

637 Article 21.3(c), DSU.

638 Article 22.6, DSU.

withdrawal (or modification) of the WTO-inconsistent measure.[639] The other two are temporary remedies, including compensation and suspension of concessions or other obligations (commonly referred to as 'retaliation'). The DSU makes clear that compensation and the suspension of concessions or other obligations are not alternative remedies.[640] They are remedies which members may want to apply instead of withdrawing (or modifying) the WTO-inconsistent measure.

Compensation as defined by Article 22 of the DSU is voluntary, which means the complainant is free to accept or reject compensation. It is also forward-looking. For instance, the compensation concerns only the nullification or impairment that will be suffered in the future. Moreover, compensation has to be consistent with the covered agreements.[641]

As is explicitly stated in Article 3.7 of the DSU, the suspension of concessions or other obligations, commonly referred to as 'retaliation', is a measure of 'last resort'.[642] When the 'reasonable period of time for implementation' has expired and the parties have not been able to agree on compensation, the original complaining party may request authorization from the DSB, to retaliate against the offending party by suspending concessions or other obligations with respect to that offending party.

The following sections will focus on dispute settlement mechanisms explored in current investment agreements. They have very different features compared with the dispute settlement system under the WTO.

5.2 The State-State Dispute Settlement (SSDS) for Investment Issues

Most investment treaties provide for two distinct dispute settlement mechanisms: one

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[639] Article 3.7, fourth sentence, of the DSU states: In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.

[640] Article 22.1 of the DSU explicitly states: Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.

[641] e.g. In *Japan – Alcoholic Beverages II (1996)*, the parties agreed on compensation which took the form of temporary, additional market access concessions for certain products of export interest to the original complainants.

[642] Article 3.7, last sentence, of the DSU.

for disputes between the two contracting states, and another for disputes between a host country and an aggrieved foreign investor. Regarding the former, current investment treaties usually stipulate that in the event of a dispute over the interpretation or application of a treaty, the states concerned will first seek to resolve their differences through negotiation and then, if that fails, through *ad hoc* arbitration.

Typically, all BITs contain a State-State Dispute Settlement provision for binding arbitration of disputes between parties, with only minor variations among them. These provisions apply to any dispute concerning the interpretation or application of the BIT.[643] As in the Chinese Model BIT, the text states that:

> "Section IV: State-State Dispute Settlement [Application]
> 1. This Section applies to the settlement of disputes between the Contracting Parties arising from the interpretation or application of the provisions of this Agreement."[644]

In practice, states rarely recourse to the SSDS procedure to solve their disputes. But, foreign investors frequently provoke Investor-State Arbitration according to the Investor-State Dispute Settlement provision, which applies to *any* dispute concerning an investment.

5.2.1 The SSDS according to BITs

a) General Texts

From a historical perspective, the SSDS clause appeared in the first BIT (Germany-Pakistan, 1959), and has changed relatively little in the fifty years since. This BIT provided that, in the event of a dispute concerning the interpretation or application of the treaty, the parties *shall* enter into consultations for the purpose of finding a solution.[645] If no such solution is reached, the dispute shall be submitted to arbitration or, if both parties agree, to the International Court of Justice.[646]

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643 i.e., Australia-India BIT, Art. 13(1); Netherlands-Ethiopia BIT, Art. 12.
644 See Shan and Gallagher, Chinese Investment Treaties, 2009. p. 408.
645 Germany-Pakistan BIT, Art. 11(1).
646 *Id.*

The approach adopted in the Germany-Pakistan BIT was followed closely by other BITs with some variations, typically in the form of additional clauses. In one respect, most other early BITs were less detailed than the Germany-Pakistan BIT, since they did not refer to ICJ adjudication as an alternative.

The SSDS provision commonly begins with a statement that any disputes within the scope of the provision should be settled through negotiation if possible. Sometimes it also specifies a certain period of time (i.e., six months) that must have passed before the dispute may be submitted to binding arbitration.[647]

Some BITs include an entirely separate provision requiring each party, at the request of the other, to *consult* on matters concerned in the treaty.[648] This 'provision in kind' may be used to resolve disputes. But its presence in a treaty is a way of indicating the importance that the parties place on the *amicable* resolution of disputes. This provision may therefore be used as a means of facilitating the implementation of the treaty.

If the dispute can't be settled through negotiations, the SSDS provision provides for arbitration before an *ad hoc* tribunal of three arbitrators.[649] Typically, the prescribed procedure in a treaty for the formation of the tribunal is that each party appoints one arbitrator, after which the two party-appointed arbitrators choose a third arbitrator who serves as the chair of the tribunal.[650]

BITs often state that the tribunal shall determine its own procedure.[651] For example, the Australia-India BIT specifies that a particular set of rules be used, either the International Law Commission's model rules of arbitral procedure or the UNCITRAL rules.[652] Other BITs do not include a choice of law clause, but commonly require that international law is applied.[653] The SSDS often provides that any award shall be final and binding. It may be noticed that similar language also

647 See e.g., Australia-India BIT, Art. 13(2).
648 See, e.g. Netherlands-Ethiopia BIT, Art. 11.
649 i.e., Australia-India BIT, Art. 13(2); Netherlands-Ethiopia BIT, Art. 12(1).
650 BITs also conditon the appointment of the chair on the approcal of the two disputing parties, and generally requrie that the chair be a national of a third state. See Australia-India BIT, Art. 13(2).
651 Australia-India BIT, Art. 13(8).
652 One common clause specifies that decisions of the tribunal shall be by a majority vote. See Australia-India BIT, Art. 13(6).
653 i.e., Netherlands-Ethiopia BIT, Art. 12(5).

often appears in investor-state disputes provisions.

The last issue addressed in most state-state disputes provisions is the payment of the costs of arbitration. One common approach is to provide that each party shall bear the costs of its own representation and of the arbitrator that it appoints, but that the remaining costs shall be *shared* by the two parties.[654] An alternative is to provide that each party shall bear the costs of its own representation, but that all costs of the tribunal shall be paid *equally* by the parties.[655] Still other BITs allow the tribunal, at its discretion, to impose a greater share of the costs on one party than the other.[656]

b) The Relationship between SSDS and ISDS

BITs often provide that Investor-State Arbitration may not be submitted to state-state arbitration unless the tribunal declined jurisdiction or the host state failed to comply with the award. The Chinese BIT model includes a similar clause, as the text states that:

> "Section IV: State-State Dispute Settlement [Application]
> …
> 2. A Contracting Party may not initiate proceedings in accordance with this Section with regard to a dispute concerning the violation of the rights of an investor, unless the other Contracting Party fails to abide by or comply with a final award rendered in a dispute that such investor may have submitted pursuant to Section III [Investor-State Dispute Settlement]. In this case, an Arbitral Tribunal established in conformity with this Section may render, upon request of the Contracting Party whose investor was a party in the dispute:
> (a) a statement that the failure to abide by or comply with the final award is inconsistent with the obligations set forth in this Agreements; and
> (b) a recommendation that the other Contracting Party abide by or comply with the final award."[657]

This rule in BITs can trace its origins to the ICSID Convention. According to Article 27 of the ICSID Convention,

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654 i.e., Australia-India BIT, Art. 13(7).
655 i.e., Mexico-Iceland BIT, Art. 22.
656 i.e., India-Indonesia BIT, Art. 10(5).
657 Chinese Model BIT, Section IV.

> "(1) No Contracting State shall give diplomatic protection, *or* bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.
> (2) Diplomatic protection, for the purpose of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute."[658]

The reference to an international claim is represented by the word '*or*' from the phrase dealing with diplomatic protection. It indicates that an international claim in this context is different from diplomatic protection. This opens the possibility of two different arbitration procedures arising from the same claim: one under ICSID between the investor and the host state, the other between the two States based on the alleged violation of the investment treaty.[659] This may cause parallel proceedings, which involve different parties. To avoid the conflict, some BITs carve out inter-state arbitration where ICSID arbitration has been instituted or is available.[660] In the absence of such a provision in a BIT, a tribunal in an inter-state arbitration may decline jurisdiction if the claim is in conflict with Article 27 of the ICSID Convention. However, the mere existence of a valid consent to ICSID arbitration is not sufficient to exclude a claim from inter-state arbitration. In fact, a claim can be brought by the investor's home state on the condition that the state hosting investment has failed to abide by the ICSID award.[661]

Article 64 of the ICSID Convention provides that disputes between Contracting Parties concerning the interpretation or application of the Convention are to be referred to the International Court of Justice (ICJ).[662] However, in order to prevent conflicts with the activities of ICSID tribunals, the Report of the Executive Directors

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[658] ICSID Convention, Art.27. Emphasis added.
[659] See Broches, A., The Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 136 Recueil des Cours 331, 376 et seq. (1972-II), in Christoph H. Schreuer with Loretta Mlintoppi, August Reinisch, and Anthony Sinclair, The ICSID Convention: A Commentary, second edition, Cambridge University Press, 2009, pp. 420-421.
[660] See i.e., US-Turkey BIT (1985), Art. VII(7). Also See Dolzer and Stevens, Bilateral Investment Treaties, p. 249.
[661] ICSID Convention, Art.27.
[662] ICSID Convention, Art.64.

(in the course of drafting the Convention) clearly establishes that Art. 64 must not be used to undermine or circumvent consent to ICSID arbitration.[663]

c) Set Up a Joint Committee for Deciding Certain Cases?

In recent years, some states have called for expanding the scope of applying State-State Dispute Settlement.[664] While maintaining the overall structure of ISDS, the renovation is to apply SSDS to disputes on certain issues. Like using filters, a BIT may provide for a joint committee to decide on these disputes. For example, a committee may decide whether a measure is a prudential measure aimed at safeguarding the integrity and stability of the financial system; or whether a taxation measure constitutes a fiscal expropriation. In this situation, the ISDS proceeding is suspended until the state-to-state tribunal renders its decision. The SSDS award will be binding on the ISDS tribunal. The China-Canada 2012 BIT has adopted this approach.[665]

It is supposed that SSDS, in the form of arbitration, may be better suited for sensitive issues, such as those relating to the integrity and stability of the financial system, tax matters, or public health, etc. The following section will explore investment Case-Law, to have a look at the analyses of tribunals in Inter-State Arbitration concerning the issues mentioned above.

5.2.2 Case-Law

a) Define the 'Dispute'

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663 The Report specifically states that Art. 64 does not '… empower a State to institute proceedings before the Court in respect of a dispute which one of its nationals and another Contracting State have consented to submit or have submitted to arbitration, since such proceedings would contravene the provisions of Article 27, unless the other Contracting State had failed to abide by and comply with the award rendered in that dispute.' See Christoph H. Schreuer with Loretta Mlintoppi, August Reinisch and Anthony Sinclair, The ICSID Convention: A Commentary, second edition, Cambridge University Press, 2009, p. 422.

664 UNCTAD, World Investment Report, 2015, p. 149.

665 China-Canada 2012 BIT, as Art. 14 [Taxation] states: (4) The provisions of Article 10 [Expropriation] shall apply to taxation measures. (5) No claim may be made by an investor pursuant to paragraph 4 unless: (a) the investor provides a copy of the notice of claim to the taxation authorities of the Contracting Parties; and (b) six months after receiving notification of the claim by the investor, the taxation authorities of the Contracting Parties fail to reach a joint determination that the measure in question is not an expropriation.

In the *Chevron Corporation and Texaco Petroleum* v *Republic of Ecuador* case,[666] the tribunal regarded that Ecuador had breached the US-Ecuador BIT. After receiving the award, Ecuador tried to provoke another procedure for state-state arbitration against the US. In Ecuador's view, the existence of the SSDS process is confirmed by "the [US]'s refusal to respond to Ecuador's request regarding the *interpretation* of the provision concerned."[667] Ecuador argued that the "mere denial" of the interstate arbitration by a respondent state does not prove its non-existence.[668]

The US did not respond to Ecuador's claim, since the US regarded that it had not breached any BIT provision (even allegedly) and was not a party to the disagreement about interpretation.

The majority of the tribunal considered whether there was a *dispute* at all, regarding 'positive opposition' by the US of Ecuador's claims.[669] They took the view that the US's silence on its preferred interpretation of the treaty could not be taken to mean that it rejected Ecuador's stated view.[670] However, the US had given another reasonable explanation for its silence, namely that— it wished to avoid interfering with a prior tribunal's decision.[671]

Another arbitral proceeding was initiated by Peru against Chile in 2003. Peru provoked the SSDS claim in response to an earlier-initiated investor-state claim brought by the Chilean investor.[672] The interstate arbitration provision was designed to resolve a disagreement between the two parties as to the proper interpretation of the Peru-Chile BIT. However, this state-state arbitration was abandoned, because the tribunal in the separate investor-state arbitration declined to suspend their own proceedings so that the state-to-state procedure could be pursued.

b) Relationship between Diplomatic Protection and SSDS

[666] *Chevron Corporation and Texaco Petroleum* v *Republic of Ecuador,* PCA Case No. 34877, UNCITRAL Arbitration Rules, Partial Award on the Merits, March 30, 2010.
[667] Ecuador's Counter-Memorial on Jurisdiction, para. 64.
[668] *Ibid*., para.65
[669] Jarrod Hepburn & Luke Eric Peterson, US-Ecuador Inter-State Investment Treaty Award Released to Parties; *IA Reporter,* (Oct 30, 2012).
[670] *Id*.
[671] *Id*.
[672] *Empresas Lucchetti, S.A. and Lucchetti Peru, SA v Peru* (ICSID Case No. ARB/03/4), Award, February 7, 2005.

A different type of state-state arbitration was initiated pursuant to a BIT in 2003 when Italy espoused various claims in a dispute with Cuba. The dispute originated in injuries that a group of Italian companies, operating in a range of industry sectors, claimed to have suffered as a consequence of a series of acts attributable to Cuba.[673] In order to exercise diplomatic protection of these companies, Italy invoked Article 10 of the Italy-Cuba BIT, which provides for *ad hoc* arbitration for the settlement of "disputes between the Contracting Parties concerning the interpretation and application of the treaty."[674]

Cuba's first objection was with Italy's right to pursue its diplomatic protection claim. Cuba did not contest that Italy could make claims concerning the interpretation and application of the BIT. However, it did object to Italy's resort to the interstate dispute settlement clause for the purpose of the diplomatic protection claim.[675] In the tribunal's view, as long as the investor had not consented to international arbitration with the host state or submitted the dispute for arbitration, it could request diplomatic protection from its home state.[676] However, if the investor had already brought a claim before an investor-state tribunal or given its advance consent to such dispute settlement, the home state would be prevented from espousing the claim.[677]

The way in which the two dispute settlement remedies were coordinated demonstrated the method provided in Article 27 of the ICSID Convention. This method prohibits diplomatic protection once the investor has submitted or consented to submit the dispute to ICSID arbitration. Thus, in the tribunal's view, the absence of a similar provision in the Italy-Cuba BIT could not prevent the application "by analogy" of the principle in Article 27.[678] Therefore, Italy had the right to resort to diplomatic protection within the BIT's interstate arbitration framework, provided that

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673 See Michele Potestà, Republic of Italy v. Cuba, the American Journal of International Law, Vol. 106, No. 2 (April 2012), pp. 341-347.
674 *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Interim Award, March 15, 2005.
675 *Ibid*., para. 47.
676 *Ibid*., para. 65.
677 *Id*.
678 Interim Award, para. 65

the other jurisdictional requirements set forth in the treaty were met.[679]

c) SSDS Tribunal's Decisions on Market Access

In the *Cross-Border Trucking Services* case, Mexico claimed that the US had denied its new application for trucking services. The US had previously permitted the gradual allowance its services in exchange for the US's own services in Mexico.[680] In contrast, the US defence primarily rested on the argument that the delay was both prudent and consistent with US obligations under the NAFTA, because of Mexico's inadequate safety regulatory system.[681]

Responding to the obligations of national and MFN treatment under the NAFTA, the US stressed the importance of the "regulatory environment" in the US and Canada compared to that in Mexico.[682] As a result of these differences, the US argued that "the 'circumstances' relevant to the treatment of Mexican-based trucking firms for safety purposes are not 'like' those applicable to the treatment of Canadian and US carriers."[683]

As to the issue of investment, the Panel considered the relevant inquiry as "whether the failure by the US government to take appropriate regulatory actions to eliminate the moratorium on Mexican investments constitutes a breach of Articles 1102, 1103, and 1104 of NAFTA."[684] Applying the required allocation of burden of proof,[685] the Panel found that Mexico satisfied its *prima facie* burden.[686] Finally it

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679 Id., paras 65-67.
680 In the matter of Cross-Border Trucking Service, Secretariat File No. USA-MEX-98-2008-01, Final Report, para. 21, at 6 (Feb. 6, 2001), available at http://www.ustr.gov/enforcement/trucking.pdf [hereinafter Cross-Border Trucking Service Final Report], para.146, at 31.
681 *Id.*, para.153, at 33.
682 *Id*. paras. 169-73, at 37-38.
683 *Id.* para. 174, at 38-39 (quoting the US Counter-Submission at 49).
684 *Id*. para 279, at 75.
685 For the burden of proof: Mexico must establish that the actions (and inaction) of the US are inconsistent with the schedule for implementation of NAFTA, whileas the US bears the burden of proving that its actions and inactions in connection with Chater Eleven are authorized by an exception to NAFTA. (para. 285. at 77-78.)
686 See *id*. paras 286, 291, at 78, 80. Even though Mexico did not produce a specific investor, the Panel found that an application would be pointless in light of the US policy. (para. 286, at 78.)

regarded that the US had not defended on the point of investment.[687]

The *Cross-Border Trucking Services* case was settled by an inter-state arbitration between two states. The dispute concerned market access obligations under the NAFTA. The tribunal allowed for a case-by-case review, in place of a blanket restriction (on market entry), thereby allowing the US to impose its safety standards on Mexican operations 'as long as they are made in good faith with respect to legitimate safety concerns and conform to all relevant NAFTA provisions.'[688]

5.3 Investor-State Dispute Settlement (ISDS) Provisions in Investment Treaties

The trend among more recent investment treaties is to provide a separate international arbitration procedure, e.g., under the ICSID, for disputes between a foreign investor and a host country government. By concluding an investment treaty, a state sometimes simultaneously gives the consent required to establish an ICSID or other arbitral tribunal for any future dispute between one contracting state and a national of another contracting state.

Although sometimes the investor must first try to try to resolve the dispute through negotiation, and may also have to exhaust local remedies, the investor can ultimately invoke compulsory international arbitration in order to secure a binding award. For example, with the exception of the Australia-US PTA, all of the US investment agreements contain an investor-state dispute resolution provision that permits investors to take foreign governments to dispute resolution, for violation of the treaty's national treatment, non-discrimination, or expropriation provisions, among others.[689]

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687 'In essence, the United States has effectively conceded that the safety concerns, which are the claimed basis of the US refusal to implement its cross-border service obligations, are not applicable to investment.' See id., para. 289, at 79.

688 See Stephen T. Weusweaver, 'International Trade: Partners, Politics, and Promises: An Analysis of the North American Free Trade Agreement's Arbitral Panel Decision Concerning the United-Mexico Trucking Dispute', 32 New Mexico Law Review, 482 (2002).

689 See Bernard Hoekman and Richard Newfarmer, 'Preferential Trade Agreements, Investment Disciplines and Investment Flows,' *Journal of World Trade* 39(5): 949-937, 2005.

5.3.1 Investor-State Dispute Settlement (ISDS) according to Chinese Investment Treaties

The first BIT entered into by China, in 1982 with Sweden, did not include a provision for investor-state dispute resolution. The China-Sweden BIT, Article 6, provides that disputes between the contracting parties on the interpretation and application of the treaty shall be referred to a three-member *ad hoc* tribunal.[690] The China-Thailand BIT (1985) also has no investor-state provisions.

States giving consent to arbitration in any future disputes will fall under the jurisdiction of treaties. The Chinese BITs have also evolved in this respect and have moved from a limited right to arbitrate (quantum only) to an unqualified right to arbitrate. This right of an investor to arbitrate all disputes is subject only to the obligation that they resort to the domestic administrative review process. The investor now has the right of direct recourse for an international arbitration for which the state must respond. Resort to the national court is no longer the only option.

All of China's BITs include provisions on state-state dispute resolution. They are substantially similar, and provide that disputes on the interpretation or application of the BIT can be referred to *ad hoc* arbitration with a tribunal.

The following part will review the different types of dispute resolutions in the Chinese BITs. It will first look at the choice of arbitrations made in China's treaties, ICSID, *ad hoc*, or other arbitration rules. It will then continue by reviewing the two main types of investor-state dispute resolution clauses in China's BITs. These clauses are either restrictive—where by the BIT permits international arbitration of disputes on the amount of compensation for expropriation only—or more liberal or expansive—which allows access to international arbitration for all disputes between the investor and host state. It will then consider a topic of particular interest right now for investors and potential investors in China; the application of the MFN clause to dispute resolution. Finally, it will look at the applicable law for dispute settlement and the requirement to exhaust domestic remedies.

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[690] The original Sweden BIT 1982 was subsequently amended by a Protocol on 27 September 2004.

a) Arbitration Options

The majority of BITs signed by China provide for *ad hoc* arbitration, usually in accordance with the UNCTRAL Arbitration Rules. Overwhelmingly, Chinese BITs have consented to arbitrate under the auspices of ICSID. The incorporation of ICSID arbitration is not exclusive to China's new BITs. Several of the older BITs that are restrictive in nature provide for disputes to be referred to ICSID. For example the China-Chile BIT[691] and the China-Iceland BIT[692], both signed in 1994 (the year after China ratified the ICSID Convention) refer quantum disputes to ICSID or *ad hoc* arbitration.[693] These clauses also allow the parties, by 'mutual agreement', to refer any dispute concerning other matters to *ad hoc* arbitration.

Other BITs make reference to the ICSID for ancillary matters. In the China-Cambodia BIT, for example, disputes on quantum are to be referred to *ad hoc* arbitration. In the event of default in the appointment process, 'either party to the dispute may invite the Secretary General of [ICSID] to make the necessary appointment.'[694] This clause continues to deal with arbitral procedure, which will be determined by the tribunal. However, the tribunal may take as guidance the ICSID arbitration rules.[695] Though the China-New Zealand BIT has a slight variation, whereby the appointing authority is the president of the World Bank, and the arbitral procedure can still be determined by the tribunal with reference to the ICSID Convention.[696] The China-Singapore BIT is slightly different, in that the arbitral procedure can be decided by reference to the ICSID Convention, but the appointing authority is the Chairman of the Stockholm Chamber of Commerce.[697]

The more recent treaties give the parties a choice of international arbitration in

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691 China-Chile BIT, Art. 9(3).
692 China-Iceland BIT, Art. 8(3).
693 According to Article 9(3) of the China-Korea 1992 BIT, the treaty refers quantum disputes to a conciliation board or an arbitration board, to be established with reference to the ICSID Convention.
694 See Chinese BITs with Cambodia, Qatar, and Iran.
695 See also Chinese BITs with Algeria, Azerbaijan, Croatia, Ecuador, Georgia, Indonesia, Jamaica, Lao, Oman, Mongolia, Uruguay, Vietnam.
696 China-New Zealand BIT Art.13(5).
697 China-Singapore BIT, Art 13(5).

what has been called a 'cherry-picking' approach. This approach is not limited to the BITs that permit arbitration of *all* disputes. For example, the China-Ethiopia BIT (1998) which is restrictive in scope provides that, 'if a dispute involving the amount of compensation for expropriation cannot be settled within six months after resort to negotiations…it may be submitted at the request of either party to an *ad hoc* arbitral or arbitration under the auspices of …ICSID.'[698] Some of China's BITs provide for ICSID arbitration as an alternative to a competent local court.[699]

b) Restrictive and Expansive Dispute Resolution Clause

Some older Chinese BITs permitted international arbitration only for the 'amount of compensation'. All other disputes had to be settled in the appropriate national courts of the host state.[700]

The first BIT to grant open access to international arbitration of any dispute was the Barbados BIT, (1998). It allows 'any investment dispute' to be referred to ICSID or *ad hoc* arbitration under the UNCITRAL Arbitration Rules.[701]

This clause is broad in nature as it covers 'any dispute' between an investor and host state. There are no longer any restrictions *ratione materiae*. Some of the liberal BITs mention an 'investment dispute' being referred to arbitration,[702] while others refer to 'legal disputes',[703] reflecting the language in Article 25(1) of the ICSID Convention.

c) Application of MFN Clause on Jurisdiction

Some MFN provisions cover both pre-establishment and post-establishment phases of

[698] China-Ethiopia BIT, Art 9(3).
[699] See for example, the China-Uganda BIT which provides at Article 8(2) that, 'if the dispute cannot be settled through negotiations within six months from the date it has been raised by either party to the dispute, it shall be submitted by the choice of the investor: (a) to the competent court of the Contracting Party that is a party to the dispute; (b) to International Centre for Settlement of Investment Dispute (ICSID).
[700] See e.g., China-Albania 1993 BIT, China-Iceland1994 BIT.
[701] See e.g., China-Finland BIT, China-Germany BIT, China-Belgium-Luxembourg BIT, and China-the Netherlands BIT.
[702] China-Guyana BIT.
[703] China-Jordan BIT.

investment, although this is quite a recent development. The China-New Zealand FTA has a reference to 'admission' in the MFN clause. BITs were primarily conceived as investment protection agreements that applied once an investment was made and not to deal with the pre-investment phase. The China-Finland BIT is an exception, which covers 'establishment' in its MFN provision.[704]

The China-Ethiopia BIT links the MFN provision to fair and equitable treatment and full protection and security protections.[705] It does not cover any other provision of the BIT; since in some treaties, the MFN clause applies only to certain aspects of the treaty, while others have a wider application to all of the treaty protections. There are specific exclusions from the MFN treatment, for example, double taxation treaties, or customs unions.

There is uncertainty on whether the MFN treatment should extend to dispute resolution. It would not be possible to rely on an MFN clause to provide more favourable investor-state dispute provisions, if the agreement itself specifically excludes it. The China-New Zealand FTA (2008) confirms that the MFN obligation does 'not encompass a requirement to extend to investors of the other Party dispute resolution procedures other than those set out in this Chapter.'[706]

d) Exhaustion of Local Remedies

The Chinese BITs require an investor seeking arbitration to have already gone through the appropriate domestic administrative review process in the national courts. Nearly all Chinese BITs that permit arbitration of all disputes include this local remedy proviso.[707]

China insists on an obligation to exhaust local remedies. In the Protocol of the China-Russia BIT, *Ad* Article 9 confirms that before submitting a dispute to

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[704] Art. 3(3) of the China-Finland BIT.

[705] Art. 3(2) of the China-Ethiopia BIT provides that, 'the treatment and protection referred to in Paragraph 1 [fair and equitable treatment] of this Article shall not be less favourable than that accorded to investments and activities associated with such investments of investors of any third state.'

[706] Art. 139(2) of the China-New Zealand FTA (2008).

[707] *See, e.g.,* Chinese BITs with Jordan, Guyana, Djibouti, Cote d'Ivoire, Brunei, Botswana.

arbitration 'the Contracting Party involved in the dispute may require the investor concerned to go through domestic administrative review procedures specified by the laws and regulations of that Contracting Party'. Ad Article 9(2) confirms that such review procedures shall not take more than ninety days. The time limit of three months appears in the majority of these BITs.[708] However, the China-Iran BIT does not include any reference to domestic review procedures as a precondition to arbitration.

5.3.2 Case-Law: a Chinese Perspective

Several claims have been arbitrated (or threatened) pursuant to Chinese investment treaties. Such claims include a pending claim by a Chinese investor against Peru, a potential claim by a major Chinese financial services company against Belgium, and a claim by Chinese mining investors against Mongolia.

a) *Ping An Life Insurance Company of China, Limited and Ping An Insurance (Group) Company of China* v. *Belgium*[709]

In 2012, the Chinese financial services company Ping An filed an international arbitration dispute against Belgium under the China-Belgium BIT. This case was the first known treaty claim by a mainland Chinese investor.[710] The case also marked the first where Belgium has been sued pursuant to a BIT. The underlying dispute arose out of the alleged destruction of Ping An's investment in the Belgian-Dutch bank, Fortis. Ping An complained it had sustained losses of US＄2.3 billion of its investment in Fortis, in the early days of the 2008 crisis when it was dismantled and nationalized.[711]

[708] *Similarly, e.g.,* Chinese BITs with Belgium and Luxembourg, Finland, Germany, Latvia, the Netherlands, Portugal, Spain, and Sweden.
[709] Ping An v. *the Kingdom of Belgium,* ICSID Case No. ARB/12/29.
[710] Ping An made a decision to file a formal arbitration claim against Belgium. This is the first mainland Chinese company to do so. Previously a Hong Kong investor brought a claim against Peru to the World Bank's arbitration centre.
[711] See IA Reporter, (Sep. 2012).

Disputes: Previously Ping An Co. had a major stake in Fortis financial service company. It was the largest shareholder in Fortis, a massive Belgian-Dutch financial institution when Fortis nearly collapsed in 2008. Following a government bailout of Fortis, authorities engineered the sell-off of various assets of the company despite the strenuous objections of Ping An and a minority of other smaller shareholders.[712]

The details of its arbitration request have not yet been made public. In 2009 the Belgian government decided to sell control of Fortis' Belgian banking operations to the French company BNP Paribas.[713] Ping An, which held almost 5 percent of Fortis, voted against the sale. Fortis shareholders lost up to 90 percent of their investments after the bank was expropriated by the Belgian and Dutch governments.

Application of the BIT: Given that the case was filed at the ICSID—a forum not offered in the 1984 China-Belgium investment treaty—it would appear that the claim was made under an updated China-Belgium treaty that was signed in 2005 but only came into force in December 2009. The 1984 treaty that was in force during the bail-out and break-up of Fortis in 2008 and 2009, was a much less investor-friendly agreement. It limited investors to pursue *ad hoc* arbitration only in relation to a single cause of action; disputes over the amount of compensation owed in cases of expropriation or nationalization.[714]

By contrast, the 2005 treaty, which is now in force, offers ICSID arbitration in case of a wide range of potential claims, including when an investor has been denied "fair and equitable treatment" by its host country, or suffered discriminatory treatment at the hands of authorities. The 2005 China-Belgium treaty also provides for the right to compensation in cases of nationalization or expropriation. Finally, the tribunal

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[712] It was widely reported in the international press at that time, that Ping An had engaged the assistance of the Chinese Government to help lobby Belgium for compensation as a result of the alleged mishandling of the Fortis crisis by Belgian authorities.

[713] Fortis' s problem began in April 2007 when the Belgium financial group was forced to raise cash to pay for the 24billion Euro takeover of ABN Amro, the Dutch bank. The acquisition of ABN stretched Fortis's balance sheet at a time when global liquidity retreated because of the subprime crisis. The Belgium and Dutch governments were later forced to nationalize the group's banking operations in October 2008 to avoid the collapse of their respective banking sectors, a move that was firmly opposed by shareholders. See *FT news*, 24 September, 2012.

[714] If any move to arbitrate dispute had been taken at the time of the crisis, the old treaty might have applied. According to Article 10.2 of the China-Belgium 2005 BIT, any formal effort to *judicialize* or *arbitrate* a dispute while the older treaty was in place could have led to the dispute being relegated to resolution under the old treaty, rather than permitting it to be taken up under the new treaty once it was in force.

rejected Chinese investor's claim on the jurisdiction.[715]

b) *China Heilongjiang International Economic & Technical Cooperative Corp. and others v. the Republic of Mongolia*

This case brought by a trio of Chinese investors against Mongolia has been withdrawn prior to the final hearings scheduled for February 2013. Following the cancellation of a license in 2009, three Chinese investors in the Tumurtei iron ore mine provoked the arbitration. The claimants contend that Mongolian authorities have breached protections contained in the 1991 China-Mongolia investment treaty, as well as the terms of a Mongolian investment protection statute. The arbitration is a purely *ad-hoc* proceeding (rather than a claim brought under institutional arbitration rules, such as those of the ICSID or the SCC).

c) Ekran Berhad v. *People's Republic of China*[716]

A financially-embattled Malaysian construction and development company has brought an arbitration claim against China at the ICSID. This is the first time that China has been sued in an ICSID arbitration. The Malaysian investor, Ekran, is claiming the rights to 900 hectares of land for reconstruction in China.

Dispute: The arbitration by Ekran is the first claim logged against China at the ICSID.[717] However, scrutiny of the company's financial statements indicates that a Chinese subsidiary of the company, Sino-Malaysia Culture & Art Co. Ltd., held an ownership stake in lease-holdings for three parcels of land totalling 900 hectares in

[715] The claimants file a counter-memorial on jurisdiction on12 May, 2014.
[716] ICSID case No. ARB/11/15.
[717] According to Malaysian business press reports, the company's Chairman Tan Sri Ting Pek Khiing enjoyed close ties to the former Malaysian Prime Minister Mahatir Mohamad, and the company had worked on several major projects, including a large hydroelectric dam and the development of hotel resorts in Malaysia and abroad. According to the same Malaysian business press reports, the company struggled in more recent years to pay debts. Trading of its shares was suspended in October 2008, and the company was de-listed from the Kuala Lumpur stock exchange in January 2010.

China's Hainan province. Ekran company records show that the leases were granted in the early 1990s and were to run for 70 years. However, in 2004, the company's financial records disclosed that local authorities in Hainan province were moving to revoke the leasehold rights due to the company's failure to move forward with its development plans. An important charge was recorded in Ekran's books in 2004. The following year, Ekran's financial records confirm that the company's rights to the Chinese landholdings were revoked as a result of the failure of a subsidiary "to develop the land as stipulated under the local legislation."

In subsequent years, Ekran's Annual Reports have disclosed that its Chinese subsidiary, Sino-Malaysia Culture & Art Co. Ltd has been deconsolidated from the company's financial statements. Notwithstanding the company's 70% equity stake in SMCAC, Ekran no longer exercises control over the company. The company's publicly available records do not clarify the reasons why Ekran lost control over the Chinese company through which its Chinese assets were held. Ekran's publicly available financial records do not disclose whether the company took legal action in the Chinese courts following the loss of the property leases. However, on 24 May 2011, the ICSID arbitration facility disclosed that the company had filed the arbitration against China.

Procedure: The proceeding has been suspended, pursuant to both parties' agreement. The parties filed a request for the discontinuance of the proceeding pursuant to ICSID Arbitration Rule 43(1). In addition, the Secretary-General issued a procedural order taking note of the discontinuance of the proceeding pursuant to ICSID Arbitration Rule 43(1).

To conclude, recently updated Chinese BITs have revised procedural provisions, including consent to the jurisdiction of Investor-State Arbitrations (ISA) for *all* disputes, although transparency in dispute settlement proceedings is still in need. It is not unusual for a BIT to require investor-state parties to first attempt to resolve their differences amicably through negotiations, before resorting to arbitration. In the only ISA case that has been taken against China so far, *Ekron Berhad v. China*, investor-state negotiations did not take place in a transparent fashion.

5.4 A Comparison between Different Remedial Actions

International trade theory is based on comparative advantage,[718] as developed by David Ricardo. Since Ricardo formulated this theory, there has been a shift in the focus of trade theory from a country-, to industry-, to firm-specific analysis.[719] Openness to foreign trade and investment, coupled with complementary reforms, typically leads to fast growth. In particular, developing countries that do not have access to world markets are far worse off than those that do. Therefore, trade requires a broader context to achieve a full community between different countries.

In this context, the fundamental rights related to globalization include the rule-of-law, good governance, institution building, and press freedom, etc. Traditionally, WTO members have been free to unilaterally decide their domestic policy, but they do not discriminate against imported products.[720] It is up to the WTO members to determine the extent to which they are representing the corporate interests that are reflected in WTO dispute settlement.

5.4.1 Firm's Lobbying

Firms can strongly lobby governments. In the *China—X-Ray Equipment* dispute, two firms (one European, the other Chinese) took the lead in pressing for antidumping measures in their respective home markets.[721] The imposition of antidumping duties in this manner triggered a reveral of dynamics set forth in Krugman (1984), and the home market of the embattled incumbent (EU company) is now closed to the new

[718] "Comparative advantage' is determined by the opportunity cost of producing a good, rather than the amount of resources committed to its production". See Paul R. Krugman, Maurice Obstfeld, Marc J. Melitz, *International Economic: Theory and policy*, Tenth Edition, Pearson, 2015.

[719] See P. Mavroidis, *The Regulation of International Trade*, Volume 1, GATT, the MIT Press, 2016. p23.

[720] Horn and Mavroidis ed., *The Economic and Legal Principle in World Trade Law*, Cambridge University Press, 2013.

[721] Many of the US claims were similar to those raised in several previous WTO dispute brought by the US against China: *China—GOES*, and *China—X-Ray Equipment*, and in *China—Broiler Products*. (antidumping cases)

entrant (a Chinese company).[722] This case implied that the antidumping measures may emerge because of firm-led initiatives calling for the government to take action to counter and/or support industrial policy.[723] It is more complicated than the traditional government-led model.

In this picture of China's participation in investor-state arbitration (ISA), so far, there are few decided cases in which China was the respondent. But there have been some cases provoked by Chinese investors. As mentioned above, a Malaysian firm previously tried to file a case against China in the ICSID. The Malaysian investors complained that the local authority denied them the opportunity to renew the license for a real estate project in China's Hainan Island, but later the case was withdrawn according to arbitration's procedure. The process of an investor filing an ISA claim is ordinarily done confidentially.

In the ICSID, claims by Chinese investors overseas against foreign governments are appearing, including a claim for RMB22.8billion brought by China's Ping An insurance company against Belgium. However, there are few publicized documents concerning Chinese investor-state disputes.

As well as the transparency challenge, China has been reproached for imposing rigid constraints on foreign investors, notably a 'one-by-one' method of approving applications for FDI.[724] This practice is sometimes criticized for leading to a selective investment entry process, through which Chinese regulatory authorities evaluate each FDI project, in apparent order, before approaching them.[725] But, are these criticisms of China's alleged approach towards foreign investment are overstated? China may have adopted a 'dual-track' policy. On one hand, it concluded BITs with developed states primarily to build its economic ties through both inbound and outbound

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[722] "Government could protect a domestic firm in a sector with increasing economies of scale." Paul Krugman, "Import Protection Act as Export Promotion: International Competition in the Presence of Oligopoly and Economies of Scale," in H. Kierzkowski (ed.), *Monopolistic Competition and International Trade,* Oxford: Clarendon Press, 1984.

[723] For the detailed analysis of this case, see Michael O. Moore and Mark Wu, "Antidumping and Strategic Industrial Policy: Tit-for-Tat Trade Remedies and the China-X-Ray Equipment Dispute", *EUI working paper*, RSCAS 2015/51.

[724] Lee G. Branstetter and Robert C. Feenstra, "Trade and Foreign Direct Investment in China: A Political Economy Approach", *NBER working paper* No. 7011, April 1999.

[725] See Axel Berger, 'Investment Treaties and the Search for Market Access in China' Investment Treaty News (26 June 2013) http://www.iisd.org/itn/2013/06/26/investment-treaties-and-the-search-for-market-access-in-china/ 15Aug.2013

investment. On the other hand, China signed BITs with developing countries primarily to strengthen diplomatic alliances and to gain its resource demands.[726]

When China's early BITs permitted disputes to proceed to arbitration was dependent on the amount of compensation for expropriation and not on whether China had been involved in expropriation.[727] The underlying assumption was that China's regulation of foreign investment was not subject to legal challenge.

China could use *de facto* retaliation measures against those that resist claims if China considers that the treatment of its outbound state enterprises is unduly harsh.[728] A further question will ask whether, and to what degree, China is likely to intervene, diplomatically or otherwise, on behalf of private outbound investors.[729] In the Chinese *Ping An v. Belgium* case,[730] the alleged economic loss of investment interest has exceeded US $22billion. In choosing whether to intervene diplomatically, the Chinese government could adopt a "cost-benefit analysis"[731] to weigh the benefits of defending a prominent outbound investor, against the cost of antagonizing the government of a foreign state.

5.4.2 Prospective and Retroactive Remedies

The remedies described in the GATT/WTO are strictly prospective. In GATT/WTO dispute settlement proceedings, the claimant states have regularly requested only withdrawal of the illegal act without demanding reestablishment of the *status quo ante*

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[726] See Susan Ariel Aaronson, 'A fresh Approach to International Investment Rules', *Institute for International Economic Policy*, May 2014; Jennifer Tobin and Susan Rose-Ackerman, 'Foreign Direct Investment and the Business Environment in developing Countries: the Impact of Bilateral Investment Treaties', Yale Law School, Center for Law, *Economics and Public Policy Research Pape*r No.293, 2005.

[727] (Shaun) Zhang-Hui Wu, 'International Arbitration for Chinese-Foreign Disputes: Emerging Choices in 2012', *International Law News* Vol.41No.2, Spring 2012.

[728] Susan d. Frank, 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law,' 19 *Pac. McGeorge Global Bus. & Dev.L.J.* 337, 2006.

[729] For investor-state arbitration and diplomatic protection in comparison, see: E.U. Petersmann, Introduction and Summary: 'Administration of Justice' in International Investment Law and Adjudication?/Constitutional Theories of International Economic Adjudication and Investor-state Arbitration, in P.M. Dupuy, F. Francioni, and E.U. Petersmann, *Human Rights in International Investment Law and Arbitration*, Oxford; New York: Oxford University Press, 2009.

[730] *Ping An life Insurance Company of China, limited and Ping An Insurance (Group) Company of China, Limited* v. *Kingdom of Belgium* (ICSID Case No. ARB/12/29)

[731] 'We learn that for everything we have to give up something else, and we are taught to set the advantage we gain the other advantage we lose, and to know what we are doing when we elect.' Oliver Wendell Holmes (1897), 'the Path of the Law,' 10 *Harvard Law review* 474.

or of the situation that would have existed in the absence of the illegal act.[732]

Under the WTO system, any compensation or retaliation can thus only be taken to induce future compliance. The reason for this prospective remedy is that GATT/WTO rules prescribe minimum standards for the non-discriminatory treatment of traded goods and, in GATT jurisprudence, are construed to protect ‘expectations on the competitive relationship between imported and domestic products’ rather than ‘expectations on export volumes’. Moreover, it is often impossible to recreate retroactively the ‘lost trade opportunities’ or to calculate, and make good for, ‘lost trade volumes’.

Prior to the *Australia-Automotive Leather* implementation report, it was widely accepted by WTO members that the WTO did not provide for retrospective remedies. The multilateral trading system was about a balance of rights and obligations with WTO remedies to preserve further trading opportunities rather than redress past injury.[733] However, the *Automotive Leather* implementation panel found that to ‘withdraw the subsidy’ under Article 4.7 of the Agreement on Subsidies and Countervailing Measures (the SCM Agreement) required retrospective repayment of past subsidies.

The issue of retrospective remedies has been considered in three subsequent disputes.[734] In the *Aircraft Subsidies* implementation disputes, both Canada and Brazil criticized the *Automotive Leather* findings on ‘withdraw the subsidy’ and emphasized they were not seeking a retrospective remedy. They implementation panel in *Canada-Aircraft Subsidies* concluded that:

> [W]e consider that Brazil does not, in fact, want us to make any finding along the lines of Australia-Leather Article 21.5. The same is more obviously true of Canada. As noted above, we consider that a panel’s findings under Article 21.5 of the DSU should be restricted to the scope of the ‘disagreement’ between the parties. In the present case, therefore, we do not consider it necessary to make any finding as to whether Article 4.7

[732] Won-Mog Choi, The Investor-State Dispute Settlement Paradigm, In William J Davey and Hohn Jackson ed. *The Future of International Economic Law*, Oxford University Press, 2008, pp. 269-309.
[733] WTO Article 21.5 Panel Report, Australia-Subsidies Provided to Producers and Exporters of Automotive Leather (‘Automotive Leather’), WT/DS126/RW, adopted 11 February 2000.
[734] Gavin Goh and Andreas R. Ziegler, Retrospective Remedies in the WTO after Automotive Leather, Journal of International Economic Law 6(3), pp. 548-549.

> of the SCM Agreement may encompass repayment of subsidies found to be prohibited.[735]

Similarly, the implementation panel in *Brazil-Aircraft Subsidies* noted:

> We recall that, under Article 3.7 of the DSU, the aim of the dispute settlement mechanism is to secure a positive resolution to a dispute, and that our role under Article 21.5 is to render a decision 'where there is disagreement' as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations or rulings of the DSB. Accordingly, we shall address only claims that are put before us. Our silence on issues that are not before us should not be taken as expressing any view, express or implied, as to whether or not a recommendation to 'withdraw' a prohibited subsidy may encompass repayment of that subsidy.[736]

The Appellate Body in that dispute stated: 'In our view, to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".'[737]

The cases highlight the marked reluctance of complainants – given the potential implications of their own measures in a subsequent dispute—to claim retrospective withdrawal.[738]

In the *United States — Foreign Sales Corporations* implementation dispute, the EC claimed that the United States' revised FSC scheme provided subsidies contingent upon export performance and accordingly, the United States had failed to comply with the recommendations and rulings of the DSB to withdraw the subsidy. The EC did not claim that the United States had failed to recall past subsidies provided under the original FSC scheme.[739]

In contrast, the Investor-State Dispute Settlement (ISDS) mechanism is based on the retroactive remedy rule. For example, NAFTA stipulates that arbitral tribunals may award only 'monetary damages and any applicable interest', 'restitution of property', and/or 'costs'. If restitution is awarded, 'the disputing party may pay

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735 WTO Article 21.5 Panel Report, Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/RW, adopted 4 August 2000, para 5.48.

736 WTO Article 21.5 Panel Report, *Brazil—Export Financing Programme for Aircraft,* WT/DS46/RW, adopted 23 August 2001, fn 17.

737 *Ibid*., para 45. The Appellate Body did not rule, however, on whether non-recall of past subsidies would also constitute a failure to 'withdraw' subsidies.

738 Gavin Goh and Andreas R. Ziegler, p. 549.

739 WTO Article 21.5 Panel Report, *United States—Tax Treatment for 'Foreign Sales Corporations,'* WT/DS108/RW, adopted 29 January 2002, para 3.1.

monetary damages and any applicable interest instead of restitution'.[740] Such retroactive remedies in the ISDS system are indispensable because the primary purpose of investment rules is to give an *ex post* reparation of damages illegally inflicted upon a private investor.

However, retroactive remedies alone are not sufficient. It must be noted that many investment rules, including provisions on national treatment and most-favoured-nation treatment, also play a role in protecting 'expectations on the competitive relationship' between investors. Although one particular investor's interest is usually at issue, an arbitral panel's award is keenly observed by many current or potential investors. In this light, prospective remedies announced by an arbitral panel can greatly contribute to bringing about both stabilization and predictability in shaping future investment decisions. In this sense, the cessation of illegal acts and guarantees of non-repetition in addition to any retroactive damage awards, may be effectively introduced into the ISDS remedy system.

[740] NAFTA Chapter 11.

6 Conclusion

New generation IIAs, do not only provide for investment protection, but also gradual liberalization. Globalization makes trade and investment more interrelated. Following the GATS, an increasing number of FTAs have expanded their scope to market access for service sectors and non-service sectors.

The global picture of investment flows has been changing, with the industrializing states of the South (i.e., China, Singapore, South Korea) becoming massive exporters of capital. China is expanding its foreign investment, especially in the energy sector. This is one reason why China is willing to involve high standards for protecting its own investment overseas. Meanwhile, many developed countries are changing course to conserve regulatory space. Many NGOs (committed to specific sectors, like the environment, human rights, and labour standards) have argued against inflexible investment protection on corporations.

New regional treaties contain wide defences to states' regulatory space. Tribunals often rely on the Vienna Convention on the Law of Treaties for the interpretive techniques which are used. From a tribunals' point of view, the agreement is given effect on the grounds that foreign investment cannot move unless parties respect the obligations to which they promised.

When interpreting a treaty, the first objective may be the protection of foreign investment. Sometimes, tribunals also examine the 'public interests' of the state in taking measures which are allegedly violating the treaty.

Chinese investment treaties have undergone some subtle changes since China entered into the WTO in 2001. Besides self-standing BITs, China has started to negotiate FTAs with investment chapter. The language of investment treaties has become longer and more complex. They describe substantive obligations in more detail and contain more exceptions. Many BITs borrow the language 'in like circumstances' from trade agreements as one of the benchmarks in triggering national treatment commitments.

In order to preserve sufficient regulatory discretion, host states may limit the access provisions of the BIT, reserving the right to screen investors, or to place conditions on the entry of investment. This is the approach adopted by most early BITs.

A changed approach allows the host state to keep a broad definition of investment, (i.e., permitting the treaty to apply to new forms of investment), while limiting the actual scope of the treaty's application. That is, host states limit the scope of market access, but make deeper commitments to nondiscrimination, transparency and rule-of-law principles. These principles under trade law have a significant influence on the formation of new BITs/PTAs.

Investment treaties encourage host states to admit more foreign investment, while simultaneously retaining a greater right to regulate the investment once established. This approach allows the state to grant a broad right of access to foreign investment, but to also adopt more carefully calibrated substantive provisions. Therefore, if the state is concerned with the volatility of portfolio investment, rather than excluding portfolio investment from the definition of investment or imposing limitations on the admission of portfolio investment, it can draft the currency transfers provision with exceptions for exigent economic circumstances. Similarly, if the host state is concerned with the ability of local enterprises to compete with foreign investment in certain sectors of the economy, the host state may reserve the right to derogate from the obligation of national treatment in those sectors, at least for some particular period of time. In investment treaties, these principles exist as a subtle way to circumvent certain provisions.

In recent years, developed OECD countries have already sought to achieve a balance between investors' interests and the regulatory measures of the host state. In the future, states will be more careful in sculpting their substantive obligations, including the use of more specific language and the provision for more exceptions; and will create for their BIT partners a role in predicting the proceedings of investment dispute settlements.

The new BITs also tend to include more procedure rules. One innovation of the BIT movement is the inclusion of provisions in the treaties for investors to bring claims against host states to an international arbitration tribunal. Many new investment treaties have included advance consent from the state for an aggrieved investor to commence Investor-State Dispute Settlement (ISDS). Most of China's recent FTAs provide for Investor-State Arbitration as well.

The balance is also gradually shifting from bilateral to regional treaty making. Trade liberalization, accompanied by investment policy, has had a significant impact on economic development. Only after China joined the WTO, did it start to conclude PTAs. Most BITs do not deal with market access restrictions *per se*, (i.e., sectoral entry prohibition), although some impose discipline on performance requirements (and similar TRIMs).

BITs also guarantee MFN and national treatment. Chinese PTAs and recent BITs are influenced by a new investment policy that seeks a better balance of the protection of foreign investors and host countries' regulatory rights. Although China may have been defensive with regard to commitments that go beyond the level of investment liberalization found in Chinese BITs, China is willing to grant MFN treatment in the pre-establishment phase.

China joined the trend to incorporate the investment discipline into FTAs. PTAs go beyond the level of investment protection and liberalization usually found in old BITs. China's overall PTA policy is driven by economic as well as political reasons. A few PTAs have added provisions safeguarding the right to regulate for sustainable development. They contain exceptions to transfer-of-funds obligations or prudential carve-outs; and cautiously regulate Investor-State Dispute Settlement by limiting treaty provisions that are subject to Investor-State Arbitration.

Lastly, the case-law reflects that although parties to investment disputes have invoked WTO jurisprudence and tribunals have given it consideration, it is hard to detect the actual influence of the trade regime's jurisprudence on national treatment. Consequently, the investment tribunals apply a national treatment test that is significantly different from that applied by the trade regime. China is learning how to improve transparency, for example through increasing access to hearings by non-parties.

It is particularly important for China to highlight its compliance with investment treaties' commitments, including the implementation of the rules. China should implement its commitment to the WTO, otherwise, it will face countermeasures. China should also implement competition rules in its own markets to improve firms' efficiency.

Through its 'silk road', China can help improve the economic development of countries along the way. The development of the Chinese 'Belt and Road' strategy, into an actual two-way street with traffic regulation is through the *rule-of-law*. Current rising tensions and long term existential vulnerabilities – particularly in China – may thus be overcome without resort to the threat of violence.

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