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CHINESE INTERESTS IN THE GLOBAL INVESTMENT REGIME

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Chinese Interests in the Global Investment Regime

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ABSTRACT: China is rising as a major source of outward direct investment (ODI), but barriers to and protectionism against Chinese investment have been strengthened as well. This situation reflects inherent flaws in the architecture governing international investment. This paper identifies three of China's key interests in the global investment regime: (1) to reduce investment barriers and depoliticize foreign regulatory review processes; (2) to ensure better protection of its overseas investment; and (3) to secure international recognition of its unique identity in terms of institutional characteristics and development strategy. As China shows more and more interest in building the architecture governing international investment, we suggest that improving investment governance at the bilateral, regional, and multilateral levels is the best strategy for China to adopt. Strategies that China should pursue include: (1) accelerating the negotiation and revision of Bilateral Investment Treaties (BITs); (2) promoting regional and sub-regional cooperation; and (3) contributing to the architecture governing global investment.

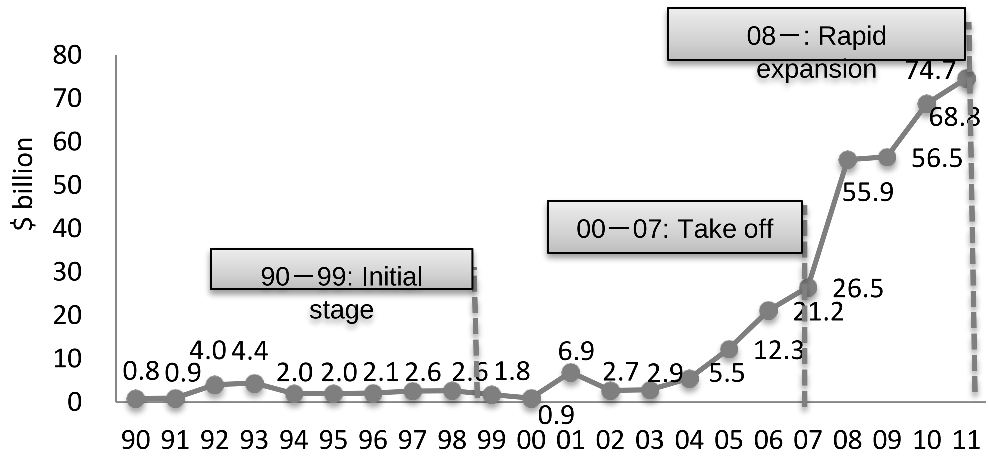
Keywords: China, outward direct investment, international investment governance.

JEL codes: E220, F210, F230.

1. Introduction

China's role in the global economy is changing. Once a major recipient of foreign direct investment, China is now investing in almost every part of the planet. China was the third largest investing nation worldwide in 2012, and the largest among the developing nations (UNCTAD 2013). China's outward direct investment (ODI) has steadily increased in the last two decades, but particularly strong growth only happened after 2004. China's ODI growth had an even stronger momentum after the global financial crisis, which brought about more overseas opportunities for Chinese enterprises (see Figure 1).

Figure 1. China's Outward Direct Investment Flows, 1990-2011



Source: data from 1982 to 2001 are from UNCTAD; data from 2002 to 2012 are from MOFCOM et al. (2012).

Note: data from 2002 to 2012 are all non-financial ODI from China.

But while more Chinese companies are investing overseas, barriers to and protectionism against Chinese investment have also been strengthened. Chinese ODI has caused mixed feelings and raised some concerns. First, state owned enterprises

(SOEs) are the dominant players in Chinese ODI, and are viewed by many foreigners as a threat to fair market competition and even national security. Foreigners often complain that SOEs enjoy unfair competitive advantages through Chinese government support, and question their transparency and true intentions. Secondly, there are worries that Chinese investors may bring technology, resources, and jobs back to China and compete local factories out of the market thereby undermining sustainable development in local communities. Thirdly, many foreigners fear that Chinese enterprises may replicate their domestic misbehavior in host countries, causing detriment to the local environment, labor practices, and competition.

It is fair to say that many of these fears about Chinese ODI are overblown. But these concerns, and the associated adverse treatment of Chinese investors, reflect the inherent flaws in the existing architecture governing international investment. China's ODI will be greater if the rules of the game are clearer and host countries are more hospitable. With its outbound investment increasing, China is showing more and more interest in building the architecture governing international investment.

The active involvement of China could provide momentum for the reform of international investment rules. Traditionally, the major investors have been from developed economies and the current international standards on overseas investment provide them with immense flexibility and are suited to their interests. But the international investment landscape has changed with increasingly significant investors from developing economies like China. As a result, it is necessary to formulate new international rules on investment that consider the interests of emerging economies, not only as recipients of investment but also as sources of investment (Kennedy and He 2013).

This paper seeks to identify key interests of China in the global investment regime. We will first analyze the patterns of Chinese ODI as well as the impediments that it encounters. We think that when it comes to addressing these impediments, direct intervention by the Chinese government is not a good solution as it may further politicize the issue. Instead, we suggest that improving investment governance at the bilateral, regional, and multilateral levels is the best strategy for China to adopt. The strategy should include: (1) accelerating negotiation and revision of Bilateral Investment Treaties (BITs); (2) promoting regional and sub-regional cooperation; and (3) contributing to the architecture governing global investment.

Of course, reforming international investment rules also means that China should reform itself in the first place. China needs to accelerate the reform of SOEs, streamline the regulatory system, further open its services sector to foreign investors, and improve its protection for foreign investors in China. This requires China to be more far-sighted, striking a balance between short and long-term interests, and between the interests of being the overseas investor and the recipient host country. We hope that during this great transformation, China can find better and mutually agreeable ways to maximize its own national interest and influence, while also playing a more active role in the area of global governance.

The rest of the paper is organized as follows. Section 2 describes the trends and patterns of Chinese ODI, followed by the discussion in section 3 on the impediments that Chinese enterprises meet. Based on the findings in the previous two sections, section 4 identifies what China desires in a global investment regime. Section 5 assesses the existing multilateral investment governance system, while section 6 sets out China's options at the bilateral, regional, and global levels for improving investment governance and satisfying the desires discussed in section 4. The final section offers some concluding remarks.

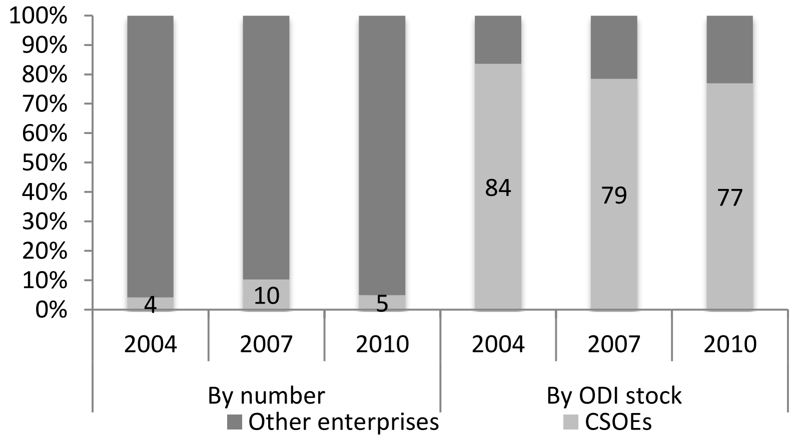
2. Trends and Patterns in Chinese ODI

Chinese ODI has increased significantly in the past decade. Between 2003 and 2011, the total size jumped from US$2.85 billion to US$74.65 billion in terms of flow, and from US$29.9 billion to US$424.8 billion in terms of stock (MOFCOM et al. 2012). This was equal to an average annual growth rate of 39% in terms of stock. Assuming that China's ODI will continue to grow at a pace of 30% annually, the cumulative ODI stock is expected to reach US$4.5 trillion by 2020. This represents a sharp increase of US$4,183 billion from 2010. If the effect of capital account liberalization is taken into consideration, a more bullish forecast puts that figure at US$5.149 trillion by 2020 (He et al. 2012).

SOEs have mainly led this rapid growth. They are still the major players in Chinese ODI, albeit that their relative importance is declining. On closer examination, we can differentiate between two types of SOEs: locally-administered SOEs (LSOEs) and centrally-administered SOEs (CSOEs). Many LSOEs are in the manufacturing sector. They are facing increasing competition from both private companies and other

LSOEs, and have to abide by market discipline. By contrast, CSOEs are small in number but are much more powerful. They face relatively less competition, and are more likely to come from monopolized or highly-controlled industries such as finance, power and utility, petrochemicals and energy, aircraft and telecommunications etcetera. The Chinese central government has always been ambitious to make its CSOEs larger and stronger, and more influential and competitive at the global level. Massive resources have been poured into CSOEs to support their rapid expansion. While CSOEs are outnumbered by other enterprises (they account for merely 5% of China's overseas investors), they contribute nearly 80% of the total investments (see Figure 2). They are the real leaders of Chinese overseas investment.

Figure 2. The Proportion of Non-Financial Chinese ODI by Centrally-Owned SOEs



Source: MOFCOM et al. (2010).

It is not easy to discern where Chinese ODI really ends up. A key reason is that official reports released annually by the Ministry of Commerce of the People's Republic of China (MOFCOM) only identify the first destinations of Chinese ODI. In many cases these are only transit or intermediary destinations. The evidence suggests that in 2011, 64.5% of Chinese ODI went to tax havens, including Hong Kong, the British Virgin Islands, the Cayman Islands, and Luxembourg (see Table 1). Some of the reported Chinese ODI in these tax havens actually returns to mainland China, and in some cases these havens are used as a platform to make further investments in other countries. A good example of how Chinese ODI statistics can prove difficult to interpret is in the area of leasing and business services. This is the largest category of Chinese overseas investment, absorbing 34.4% of total Chinese ODI in 2011 (see Table 1). The exact nature of investments in this category is rather obscure. It is highly likely that a large portion of reported Chinese investments in leasing and business services actually constitutes investment vehicles for manufacturers or mining companies. In other words, the investments might more properly be considered part of the manufacturing or mining sectors despite their official listing within the category of leasing and business services.

Table 1. Top Destinations and Industries for Chinese ODI in 2011

		ODI (US$billion)			ODI (US$billion)	
1	Hong Kong	35.76	47.9%	Leasing and Business Services	25.6	34.3%
2	British Virgin Islands	6.21	8.3%	Mining	14.45	19.4%
3	Cayman Islands	4.94	6.6%	Retail and Wholesale	10.32	13.8%
4	France	3.48	4.7%	Manufacturing	7.04	9.4%
5	Singapore	3.27	4.4%	Finance	6.07	8.1%
6	Australia	3.17	4.2%	Transportation, Storage and Post	2.56	3.4%
7	United States	1.81	2.4%	Real Estate	1.97	2.6%
8	United Kingdom	1.42	1.9%	Electricity, Gas and Water	1.88	2.5%
9	Luxembourg	1.27	1.7%	Construction	1.65	2.2%
10	The Sudan	0.91	1.2%	Agriculture, Hunting, Forestry and Fishing	0.8	1.1%

Source: MOFCOM et al. (2012).

A recent study by Wang (2013) tries to track down the final destination and actual industries of Chinese ODI by examining project-level data. It shows that developed countries receive more Chinese investments than developing economies, and mining and manufacturing are the major attractions for Chinese investors. Nearly 60% of Chinese ODI went to developed economies like Australia, Hong Kong, the United States, Germany and Canada (Wang 2013).

Between 2003 and 2011, mining and manufacturing were the two industries that received most Chinese overseas investment. These two industries jointly accounted for approximately 75% of total Chinese ODI: 52% went to the mining sector and 23% went to the manufacturing sector. In terms of the number of projects, 42% went to the manufacturing sector, and 32% went to the mining sector (Huang and Wang, 2013). It is also interesting that overseas investment in the manufacturing sector was mostly made by the private sector and LSOEs, while investment in the mining sector was dominated by CSOEs.

Chinese enterprises 'go abroad' for a variety of reasons. The three most important drivers are resource seeking,[1] technology seeking,[2] and market seeking.[3] Huang and Wang (2013) used two sets of enterprise-level data to examine the motivations of Chinese ODI. As shown in Table 2, for large ODI projects with an average investment of US$173 million, the main objectives are the acquisition of resources and distribution channels, and the purchase of advanced technologies, brands, and other strategic assets. For small and medium enterprise (SME) investors with an average investment of US$1.4 million, the main purposes of ODI are trade-related – there is an especial focus on facilitating China's exports to host

[1] Resource-seeking ODI is directed at exploiting local factor endowments such as oil, gas, mineral, timber and other natural resources.

[2] Technology-seeking ODI is broadly defined, and aims at investing in advanced technologies and brands and improving access to distribution channels and tacit assets with a view to helping the investor fulfil certain long-term strategic objectives.

[3] Market-seeking ODI occurs as the investing firm expands horizontally into markets to secure or defend a market position established through arm's length dealings or to develop a new market previously not served (Buckley et al. 2007).

economies as well as providing after-sale services from China itself. This suggests that for the time being, the main purpose of Chinese ODI is to strengthen domestic production through resource-seeking and trade-promoting ODI and improve investing firms' competitiveness through technology-seeking ODI. But as wages, interest rates, exchange rates, and energy prices continue to rise, cost reduction will become more important in Chinese ODI.

Table 2. Motivations for Chinese ODI

	By number		By value	
	Number	Total share	Value (US$billion)	Total share
Large ODI (with an average investment of US$173 million)				
Market Seeking	49	27.2%	6.9	22.2%
Resource Seeking	61	33.9%	9.9	31.6%
Technology Seeking	63	35.0%	14.2	45.5%
Efficiency Seeking[4]	7	3.9%	0.2	0.7%
ODI by SMEs (with an average investment of US$1.4 million)				

[4] Efficiency-seeking ODI disperses design and production facilities globally, and is undertaken to generate economies of scale and scope and to secure access to cheaper input factors, especially labor.

Trade	982	77.3%	0.6	31.9%
Production (Manufacturing & Processing)	159	12.5%	0.7	39.8%
Construction and Real Estate	36	2.8%	0.1	6.6%
Resource Exploration	32	2.5%	0.2	9.1%
R&D	25	2.0%	0.1	3.6%
Industrial Park	7	0.6%	0.0	2.6%
Other	29	2.3%	0.1	6.5%

Source: Huang and Wang (2013).

3. A Rough Journey

Chinese companies are gearing up to make more ODI in the future, but their journey abroad is by no means smooth sailing. They are facing more and more resistance, especially in developed host countries.

Several major Chinese overseas investments have run into obstacles. High profile cases where Chinese ODI was either effectively blocked or subject to long delays include:

- the 2005 takeover proposal by China National Offshore Oil Corporation (CNOOC) for American oil company, Unocal, which experienced a hostile reaction;
- Chinalco’s failed attempt in 2009 to increase its stake in Rio Tinto, the mining company with extensive Australian assets; and

- several blocked investments by Huawei in the United States since 2008.

Even where Chinese firms finally managed to complete their proposed investments, in many cases hardships were still experienced. For example, both Lenovo's purchase of the IBM personal computer division in 2005 and Anshan Steel's joint venture in a greenfield slab steel project in Mississippi in 2010 experienced an immense amount of difficulty in response to concerns raised by American industry, the security community, and members of Congress.

National security is one of the major pretexts that Western politicians use in order to justify their concerns about Chinese ODI. Foreign ownership of particular assets is viewed as a threat to national security, primarily in four areas where it is thought that it could lead to: control over strategic assets (for example, ports and pipelines); control over the production of critical defense inputs (such as military semiconductors); the transfer of sensitive technology or know-how to a foreign power with hostile intent; and espionage, sabotage, or other disruptive action (Rosen and Hanemann 2011).

Although national security fears over foreign investment are not new, Chinese investors are particularly likely to be put under the spotlight. A key reason is that China adopts a nonalignment policy[5] and is not a military ally of countries like the United States. The role of SOEs as the major players in Chinese ODI has also kindled national

[5] Nonalignment policy is an independent diplomatic policy whereby no alliance is formed with superpowers.

security fears. SOEs are considered to be agents of the Chinese government, and their ODI is usually seen as having political objectives. Foreigners look at these mammoth unfamiliar animals and cannot help ask: is there a hidden agenda?

But national security concerns cannot explain everything. The cases where Chinese ODI has been blocked or subject to delays and other problems are much more complicated. First, blocked and otherwise hampered Chinese investments have a lot to do with the tensions of international relations. When CNOOC met resistance in its proposed takeover of Unocal in 2005, the United States took a tough position. It pressured China over the appreciation of the yuan, and stingingly criticized China for the slow implementation of the promise to further open up that it had made to gain entry into the World Trade Organization (WTO). The failure of Huawei's proposed acquisition in 2010 of 2Wire, a US internet software provider, came at a time in the US mid-term elections when members of Congress were especially sensitive because they were concerned about their prospect of re-election. Scandals over cyber-attacks and data theft sparked fears over internet security.

Secondly, Chinese investments tend to fall victim to the domestic politics of host countries. Opposition parties seem to favor using Chinese investments as an easy target to attack the party in government. Anti-China rhetoric is often louder during the lead-up to an election. For example, Chinese private enterprise, Zhongkun Group, proposed to make a US$200 million investment in the Iceland tourism sector in 2011. Of this, US$8 million was to be used to purchase 300 square kilometers of undeveloped land. The investment was welcomed by Iceland's President and Prime Minister, but was stalled by the Interior Minister, a Democrat. When Zhongkun Group was about to abandon the project, Iceland offered a 99 year land lease instead of the previous sale proposal and agreed to sign the contract in October 2012. However, Iceland postponed Zhongku's investment again seemingly because of the election.

Thirdly, commercial interests presumably sometimes lie behind claimed national security concerns. In December 2003, China National Petroleum Corporation (CNPC) planned to buy 61.8% of shares in Stimul, a Russian oil and gas exploration company. Russian gas oligarch, Gazprom, held the remaining stake in Stimul and was determined to regain full control of the company. It seems that the authorities may have rejected the proposal because of a request made by Gazprom. In the case of CNOOC's takeover bid for Unocal in 2005, Member of Congress Richard Pombo from California proposed a bill to defer consideration of all Chinese investments in US oil companies for 120 days. Importantly, Chevron – CNOOC's largest competitor in the bid for Unocal – was headquartered in Pombo's constituency. This coincidence raises some potential concerns about electoral practices and pork barrelling at the expense of Chinese investors. The series of frustrations that Huawei met in the US can at least partly be attributed to opposition from local US telecommunications firms.

Chinese ODI has met with resistance not just in developed countries, but also increasingly in some developing economies. CNPC had to give up an investment in Canadian oil company, Verenex Energy Inc., in 2009 because of an objection by the Libyan government. The main operations of Verenex Energy were in Libya and 86.3% of its oil production belonged to the Libyan government. Several Chinese investments in Mongolia also did not fare well. In 2011, Shenhua Group wanted to acquire 40% of the shares in Tavan Tolgoi, one of the world's largest coal mines. But the transaction was blocked by the Mongolian parliament. Chinalco's investment in Mongolia also encountered setbacks. In 2012, Chinalco decided to invest in SouthGobi Resources, a Canadian mining company operating out of Mongolia. But Mongolian authorities soon suspended SouthGobi Resources' exploration licenses because of national security concerns and Chinalco had to give up on the company.

Many potential deals have fallen through because of political opposition and regulatory obstacles. These hurdles are difficult to overcome through the sheer will of Chinese enterprises alone. There are suggestions that Chinese enterprises should hire local lobbying groups and experienced lawyers to address and reduce entry barriers. But the fact is that many Chinese enterprises have tried this strategy without success. For example, CNOOC hired the famous Washington law firm, Akin Gump, in an attempt to minimize hostility over the proposed Unocal takeover in 2005. During the acquisition of Motorola's wireless network equipment business in 2010, Huawei hired a number of leading US law firms experienced at dealing with sensitive foreign M&As.[6] These efforts did not, however, make their investments any smoother. Importantly, Chinese companies feel frustrated by their attempts to convince skeptical Western countries of their commercial bona fides.

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[6] Firms hired by Huawei included Sullivan & Cromwell LLP and Skadden, Arps, Slate, Meagher & Flom LLP.

Notwithstanding the difficulties experienced by Chinese firms going it alone, direct intervention of the Chinese government might make the situation even worse. It would likely complicate business deals and stir up more Sino-phobic sentiment. China needs a clearer set of international investment rules to address perceived unfairness and to ensure smoother progress of its overseas investments. It is against this background that the reform of the international investment system has become more relevant for China than ever before.

4. China's Desires in a Global Investment Regime

We argue that China should play a more active role in the reform of the global investment architecture. Opposing investment protectionism and creating a new regulatory framework for investment will benefit China in the long run. China has already indicated its strong desire to be involved in the reform of the global investment regime.

First, China wants to reduce investment barriers and depoliticize foreign regulatory review processes in relation to FDI. National security is a real and legitimate concern. It is therefore clear that the common practice of regulating foreign investment that might pose a national security threat to a host country is justified. The United States regulates FDI based on principles of national security through its Committee on Foreign Investment in the United States (CFIUS). In Australia, the Foreign Investment Review Board (FIRB) examines proposed foreign investment to see whether it violates the 'national interest' – this concept encompasses a broad range of matters including both national and economic security.

While genuine national security concerns are legitimate, screening of proposals by Chinese investors is increasingly subject to the threat of politicization. Such screening can also be easily used as a thinly-veiled guise for protectionism. It is understandable that review processes concerning foreign investment must be confidential. However, the highly secretive nature of many reviews and the limited explanations provided for foreign investment decisions often work to create the impression that the process is being influenced by the business competitors of Chinese companies. The risks and benefits of Chinese investment should be assessed objectively based on facts rather than fear.

Huawei's case serves as a good example of this. Huawei's several attempts to invest in the US have all failed because of opposition by the US government, whereas its entry into the European market has been relatively smooth. Huawei has actually secured the cooperation of 45 of the top 50 telecom operators in the world, other than the four American telecom operators: Verizon, AT&T, Sprint and T-Mobile. If Huawei is a real threat to US national security, why has it been generally welcomed in the European market?[7] There is little clarity and consensus at the international level as to the appropriate standards and procedures that target countries should use to measure the

[7] In recent times, Huawei's involvement in the UK market has become more controversial, with a threatened investigation by the UK Security Committee.

national security implications of proposed investments. In these circumstances, the dependence on domestic regulations could lead to the inconsistent application of inherently different rules, thereby increasing political tensions and making mutually beneficial economic cooperation more challenging.

Secondly, China is also seeking better protection of its overseas investment. China is a newcomer in the international investment arena. Most Chinese companies, including the big giants, are inexperienced and find it easy to ignore the potential risks in overseas markets. Some Chinese companies – including SOEs as well as private enterprises – are accustomed to building close connections with juntas, local strongmen, and powerbrokers, but do not know how to communicate with the local community and its people. China invested heavily in politically vulnerable countries and regions like Afghanistan, the Sudan, Iran, Iraq, Libya, Venezuela and North Korea. Chinese investments in these 'unstable' areas consisted of about 11.4% of its total ODI stock in 2011 (MOFCOM et al. 2012). Chinese investment is likely to become a target and suffer heavy losses wherever there is political turmoil, terrorist attacks, civil wars and sudden regime changes.

Losses that Chinese companies incurred as a result of the Libyan unrest were huge. Chinese investors and workers have been robbed, kidnapped, and even killed in Africa. The unfolding of political changes in the Middle East, North Africa, and South America is certain to trigger more turbulence and instability in these regions and may also create a ripple-effect that impacts on the rest of the world as well. China and foreign investors from other nations share the same concerns and need to guard against potential risks when investing abroad. It is not surprising to see that China is asking the host nations to its investments for policy transparency, good governance, and property protection – the very same list that Western countries handed to China when they started their investment there two decades ago.

Thirdly, China wants to secure international recognition of its unique identity. China is still a developing country. China is not Chad. True, but it is not a developed country either. It boasts a rapidly expanding economy, but its per capita GDP still remains at a relatively low level. It is a newcomer in the arena of international investment. It is understandable that when negotiating with developed countries, China wants to have room to maneuver. This has more to do with China's lack of experience and confidence than its so-called 'hidden agenda'.

China's development strategy is also quite unique. It does not follow the orthodox 'Washington Consensus',[8] but sticks to the kind of prudent pragmatic realism embodied in the Chinese proverb about 'crossing the river by toughing the stones'.[9] From the perspective of many Westerners, China's growth and rising influence is a conundrum. China is like the student in class who never does his homework but always outperforms other students in examinations. To be frank, China itself does not have a

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8 The Washington Consensus is a set of policy proposals by the International Monetary Fund (IMF) and the World Bank to reduce government intervention and promote trade and financial liberalization.

9 'Crossing the river by toughing the stones' means that there is no fixed mode to follow. Rather, progress is made incrementally by feeling the way forward step by step.

clear vision of what the 'China Model' is. Since its opening up in 1978, China has lacked the universal ideological aspirations evident in the US. But the success of China's economic growth and its increasing ODI will inevitably lead to suspicions and fears among some Westerners, and may also provide other developing countries with encouragement and the hope that they can follow suit. It requires China and other international players to adjust to this changing global economic landscape.

In the area of global investment, China does not want to be wrongly labeled as pursuing 'state capitalism'. It is true that China continues to emphasize the importance of state ownership for a number of reasons. The Chinese government still relies on the revenue generated by SOEs because China does not yet have a well-functioning income tax system. China still relies on SOEs for job creation and the provision of welfare, both of which are crucial to the government's goal of maintaining social stability. For now, the Chinese government continues to intervene in the market directly because (at least in the short run) administrative measures often prove to be more effective than available alternatives. But it is fair to say that the issue of state ownership has been overestimated. What really matters is market structure, not ownership per se. A local SOE producing color TVs, for example, behaves almost in the same manner as its private competitors because it is part of a competitive market. Large SOEs with monopoly powers, like the behemoth oil and telecommunication companies, are the real concerns. Even in the case of these huge monopolist SOEs, it is quite difficult to judge whether in investing abroad they act as agents of the Chinese government or simply as profit-seeking economic beasts like any other company.

5. The Existing Multilateral Investment Governance System

There is the WTO in the international trading regime and the International Monetary Fund for the international financial system, but so far no comprehensive and binding international investment agreement supported by a similar institution has been created. The Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID), both of which are members of the World Bank, are part of the institutional structure for the very few binding multilateral investment arrangements. Also contributing to these arrangements are two investment provisions – the Agreement on Trade-Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS) – both of which fall under the WTO framework. There is also the Energy Charter Treaty (ECT), a multilateral framework in energy arena.

These multilateral arrangements have resulted in a certain degree of investment-related liberalization and protection. But they are quite limited and lack comprehensiveness. Thus there is an absence of widely accepted and applied global rules that aim to both facilitate and regulate foreign investment.

5.1. Investment Guarantee Agency: MIGA, Member of the World Bank.

The MIGA (the Multilateral Investment Guarantee Agency) was established on 12 April 1988 and provides political risk insurance guarantees to investors and lenders in the private sector. Such guarantees help investors protect foreign direct investments against political and non-commercial risks in developing countries. The main covered risks include currency transfer, expropriation, breach of contract, war, and civil disturbance.[10] The MIGA is a member of the World Bank Group, but operates as a legally separate and financially independent entity.

5.2. Disputes Settlement Agency: ICSID, Member of the World Bank.

The ICSID (the International Centre for Settlement of Investment Disputes) was established in 1966 after the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (Washington Convention) was concluded. It is an international arbitration institution for the settlement of legal disputes between international investors and countries. The ICSID is a member of the World Bank Group and receives its funding from the World Bank, but is formally autonomous.

5.3. Investment Provisions in the WTO Framework: TRIMs Agreement and GATS.

The WTO came into existence as a result of the General Agreement on Tariffs and Trade (GATT) after the conclusion of the Uruguay Round of negotiations in 1994. The WTO presides over two major agreements that directly address investment issues: the Agreement on Trade-Related Investment Measures (TRIMs) and the General

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[10] In addition, under certain conditions the covered risks extend to other specific non-commercial risks, but in no case to the risk of devaluation or depreciation of currency.

Agreement on Trade in Services (GATS).[11]

The TRIMs Agreement requires countries to phase out trade-related investment measures that impinge on foreign investors. The most commonly used TRIMs are requirements to do with local content, trade and foreign exchange balancing, export performance, joint venture or equity participation, manufacturing limitations and remittance restrictions (Ferrarini 2003). Developing countries were granted a prolonged phase-out period for existing TRIMs and temporarily deviate from the agreement for balance of payments purposes.

The TRIMs Agreement deals exclusively with investment measures related to trade in goods (not in services). The GATS is the general agreement on trade in services. FDI is covered in the GATS since it represents a mode of supply of services through 'direct commercial presence' in a member state (Ferrarini 2003). The GATS adopted the so-called 'positive-list' approach, which allows member countries to offer national treatment exclusively in sectors they decide to open up to foreign investments.

5.4. Energy Charter Treaty (ECT).

The ECT is an international agreement that establishes a multilateral framework for cross-border cooperation in various aspects of commercial energy activities including trade, transit, investments, and energy efficiency. In the area of investment, the

[11] The WTO administers another three agreements that arguably have indirect effects on investment: the Agreement on Subsidies and Countervailing Measures (ASCM), Trade Related Intellectual Property Rights (TRIPs), and the Government Procurement Agreement.

provisions of the ECT protect foreign investors and their investments from political risks such as discrimination, expropriation, nationalization, breach of contract, damages due to war etcetera. The legally binding nature of the ECT makes it the only multilateral framework for energy-related matters. China is not a member of the ECT, but has been an observer since 2001.

The above multilateral arrangements have to some degree provided a global mechanism for investment-related liberalization and protection. But they are quite limited and lack comprehensiveness. The TRIMs Agreement applies exclusively to investment measures related to trade (and only trade in goods, not services). It also relates exclusively to trade-distorting restrictions – trade-promoting investment measures are not covered. The TRIMs Agreement has also been criticized as a failed attempt to codify investment issues within the WTO framework – it has been argued that it merely clarifies the application of existing GATT provisions (Bora 2002). The GATS and the ECT are also not widely applicable to investment. The GATS is confined to investment-related trade in services through the 'direct commercial presence' requirement, while the ECT is an international multilateral agreement that applies exclusively in the energy sector.

6. Improving Investment Governance: China's Options at the Bilateral, Regional and Global Levels

To better protect Chinese ODI interests and reduce investment barriers, the best strategy for China to adopt is to improve investment governance at the bilateral, regional and multilateral levels.

6.1. Accelerate Negotiation and Revision of Bilateral Investment Treaties (BITs)

BITs were originally signed to help developed countries guard against the threat of expropriation and other non-commercial risks in developing countries. Developing countries used the BITs as a strategic instrument to attract foreign investments. Since the first BIT with Sweden in 1982, China has concluded BITs with 131 countries (100 of which have already come into force).

These BITs have, however, been playing a limited role in protecting Chinese overseas interests and need substantial revisions. Most of the existing BITs were concluded in the 1980s and 1990s, and thus reflect Chinese interests as the recipient of foreign capital. They therefore require substantial revision to account for increasing Chinese interests as a major source of FDI. The China-Canada BIT, which was signed in September 2012 after 18 years of negotiations, is so far the concluded BIT with the most comprehensive content. It contains all of the key substantive protections – i.e., national treatment, most favored nation treatment (‘MFN’), fair and equitable treatment, compensation for expropriation, full protection and security – as well as an investor-state dispute settlement mechanism.

In addition to revising existing BITs to better position China as a source of FDI, China should also push ahead with bilateral BIT negotiations with the US. The two countries have held nine rounds of negotiations between September 2008 and June

2013. But so far, the progress has been quite limited. Negotiations have not entered an essential phase: the United States is still explaining its BIT Model to China, while China has not proposed its own negotiation text. One reason for the slow progress is that Sino-US BIT negotiations were held up because of the 2004 Model BIT revision in the US from the end of 2009. The negotiations did not resume until October 2012 in Beijing. The new model (the 2012 Model BIT) attaches greater importance to environmental protection, labor practices, SOE discipline, as well as transparency of laws and regulations in the host country. The more important reason for slow progress on the proposed BIT between China and the US is that there are several sources of disagreement in the negotiations, including:

(1) Market access: in particular, whether the parties should commit to pre-establishment national treatment for investments and thereby narrow the scope for considering industrial policy and national security goals;

(2) Fair competition: the question has been what standards, if any, should be set with regard to SOEs, labor practices, and the environment;

(3) Investor protection: there has been debate over the liberalization of capital flows, customary international law, performance requirements, and the transparency of law and regulations; and

(4) Dispute settlement: discussions have centered on the extent to which arbitration is governed by the Convention on Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention/Washington

Convention) and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

Generally speaking, the US has pursued BITs that facilitate market access by lowering barriers to investment, whereas Chinese BITs have focused largely on protecting investment assets and dispute settlement.[12] Reaching an agreement does not require the resolution of all these differences since some can be exempted through exceptional arrangements and other legislative techniques. But both sides will have to make major concessions. China has taken the lead in making a major concession. During the fifth Sino-US strategic and economic dialogue in July 2013 in Washington, China for the first time promised pre-establishment national treatment for investments. This breakthrough is likely to bring the Sino-US BIT negotiations into an essential phase. Negations will be complicated and drawn out. It took 18 years for China to establish a BIT with Canada. We do not expect a Sino-US BIT deal to be reached anytime soon, but negotiations are helpful in themselves in promoting a healthy Sino-US investment environment.

6.2. Promoting Regional and Sub-Regional Cooperation

China actively participates in regional investment cooperation, perhaps demonstrated

[12] China's approach, consistent with BITs adopted by European countries, is known as the 'admission model' whereas the US approach is known as the 'pre-establishment model' (Berger 2011). As of the end of 2011, there were 2,833 BITs worldwide (UNCTAD 2012).

by the fact that 61% of China's outward FDI flowed to Asia in 2011. In addition to bilateral investment negotiations, China should advance regional and sub-regional cooperative platforms to better express and secure its interests in overseas investment.

Currently, the main platforms for regional investment cooperation are the Association of South East Asian Nations (ASEAN)–China Investment Agreement and the Greater Mekong Sub-Region (GMS) Strategic Framework. The Shanghai Cooperation Organization (SCO) is also an avenue for greater regional collaboration if its mission can be expanded beyond counterterrorism. Under the pressure of the current Trans-Pacific Partnership (TPP) negotiations, China is likely to be more active in pushing for the utilization of these regional and sub-regional cooperative arrangements.

China concluded an investment agreement under the Free Trade Area (FTA) with the ASEAN in August 2009. This investment agreement – which for the first time creates unified regional investment protection rules in the ASEAN-China FTA – is conducive to removing barriers to Chinese investment in the ASEAN as well as promoting regional investment. But the conclusion of the ASEAN-China Investment Agreement has not led to the termination of the nine existing effective BITs between individual ASEAN countries and China.[13] Instead of the ASEAN-China Investment Agreement simplifying the situation and introducing greater consistency, its co-existence with BITs between individual ASEAN countries and China complicates

[13] China has signed BITs with all 10 ASEAN countries. Other than the China-Brunei BIT, all the other BITs have come into force.

the legal context of regional investment and probably leads to overlaps and inconsistencies.

Bound together by the Mekong River, China and five other countries signed the GMS Strategic Framework in 1992.[14] The Asian Development Bank (ADB) provided financial and technical support. Recognizing the huge economic potential and strategic significance of this region, other countries including the US, Japan and Australia have shown their interest and contributed funds to the GMS Strategic Framework.

The GMS Strategic Framework has gradually been translated into a plan of action and has been backed by various investment programs in areas such as transportation, energy, telecommunications, the environment, and tourism.

The GMS Strategic Framework (2012-2022) was agreed on at the fourth GMS Summit in December 2011 in Myanmar. To ensure that this framework is well implemented, GMS member states decided to formulate the Regional Investment Framework (RIF) through which a batch of investment projects would be identified. A preliminary list of projects[15] has already been confirmed with a total investment of US$9 billion.[16] The projects are to have a particular focus on basic infrastructure such

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[14] The five countries are Cambodia, Laos, Myanmar, Thailand and Vietnam. In China, the focus of the GMS Strategic Framework is on Yunnan province and the Guangxi Autonomous Region.

[15] See http://www.adb.org/projects/36630-012/details for details.

[16] The investments will increase substantially during the finalization of the RIF in the first quarter of 2013.

as water and sanitation, transport, power and telecommunications. In addition to its focus on infrastructure achievements, the plan for the GMS Strategic Framework has also put more emphasis on governance, the environment and social impacts.

The SCO is also a potential platform that could be used to protect Chinese overseas interests and promote Chinese overseas investments in Central Asia. The SCO was founded in 2001. There are six member countries and five observer states.[17] The SCO is currently preoccupied by security issues, and focuses exclusively on counterterrorism cooperation. China is rapidly increasing its investment in the SCO member countries and observer states, with a large portion of investments in risky and controversial areas such as energy and trans-boundary water resources. If a permanent organization is established within the SCO for economic cooperation – or if an investment agreement is concluded within the SCO just like the ASEAN-China Investment Agreement – the SCO will become another essential mechanism to promote and secure the safety of China's investment in the region.

China's involvement in these regional and sub-regional cooperation mechanisms is likely to be intensified in light of the threat posed by the Trans-Pacific Partnership Agreement (TPP) negotiations. The TPP is a comprehensive free trade agreement in the Asia-Pacific region. Led by the United States, other member states include Chile, Peru, Vietnam, Singapore, New Zealand, Brunei, Australia, Malaysia,

[17] Members are China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan. Observers are Afghanistan, India, Iran, Mongolia, and Pakistan.

Japan, Mexico and Canada. The TPP Agreement is expected to establish a highly liberalized investment chapter to facilitate cross-border investment within the member states. Because it excludes China, once concluded such an investment chapter will put Chinese investors at a disadvantage. Hence China is likely to be more active in contributing to, and pushing for the utilization of, regional and sub-regional cooperative arrangements such as the ASEAN–China Investment Agreement, the GMS Strategic Framework, and the SCO to defend its overseas investment interests.

6.3. Contributing to the Architecture Governing Global Investment

China's ODI plays a positive role in stimulating the global economy. When investment from the developed world withdrew in some countries because of the recent global financial crisis, to a certain extent China's increasing ODI alleviated the impact of this. Between 2007 and 2011, ODI from developed countries dropped by 32% while China's grew by 189% (UNCTAD 2012). Chinese ODI plays an active role in promoting stability and prosperity in the world economy. It offsets the decline of overseas investment by developed countries. American scholar, Deborah Brautigam (2010), highlighted the three 'gifts' that Chinese investors bring to Africa: China's own experience that aid is not central to development; putting infrastructure at the center of Chinese aid and investment; and creating a new image of Africa with hope and opportunities.

As discussed in Part 5, there is no comprehensive and binding multilateral investment agreement (MIA) in existence. But in the last two decades, overseas investment has increased substantially with the participation of new investors like China. The number of BITs has grown rapidly, warranting an international standardized set of rules for FDI (Aslund 2013).

Present organizations such as the WTO, the Organization for Economic Cooperation and Development (OECD), the United Nations Conference on Trade and Development (UNCTAD) and the World Bank are all possible candidates that could administer a MIA. Alternatively, a new platform or institution could be created to host a MIA. The most important thing is to initiate negotiations, set a clear timetable, and involve relatively few countries at the beginning to maximize the prospect of securing agreement on core issues.

The establishment of the WTO as a global trade governance organization provides an experience of building the architecture governing global investment. At the Bretton Woods conference in 1944, in addition to creating the International Monetary Fund (IMF) and the World Bank, the creation of an International Trade Organization (ITO) was discussed. But the ITO was not established since it was deemed too ambitious and did not receive support from the US. Instead, three years later in 1947, the GATT was concluded in Geneva. Compared with the ITO, the GATT involved fewer countries and followed a bottom-up approach through negotiations among member countries. If a unified and high standard MIA cannot be built overnight, maybe we can start with a less ambitious agreement and use it as a stepping stone for a fully-fledged MIA.

The European Union (EU) and the US are the leaders of global investment governance negotiation. The two economies announced their shared principles for international investment in April 2012.[18] The seven principles are:

- Competitive neutrality: governments should ensure a level playing field for SOEs and private commercial enterprises;
- National treatment: governments should provide an open and non-discriminatory investment climate, specifically, broad market access to foreign investors;
- Strong protection for investors and investments: governments should provide the highest possible level of legal certainty and protection to all investors and investments in their territories;
- Fair and binding dispute settlement: governments should provide access to effective dispute settlement procedures and ensure that such procedures are open and transparent, with opportunities for public participation;
- Robust transparency and public participation: governments should ensure the highest levels of transparency and public participation in the development of domestic laws and other measures relating to investment;
- Responsible business conduct: governments should urge that multinational enterprises operate in a socially responsible manner; and

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[18] See http://www.ustr.gov/callout/us-eu-shared-principles-international-investment for details.

- Narrowly-tailored reviews of national security considerations: governments should ensure that their reviews, if any, of the national security implications of foreign investments focus exclusively on genuine national security risks.

These seven principles reflect a unified stance by the EU and the US on international investment principles. The two major economies have ostensibly proposed their standards so as to strategically dominate the direction of MIA development.

By contrast, China is falling behind and has not yet voiced its attitude towards the global investment principles or proposed its own. China is the world's third largest ODI investor, and its overseas investments have encountered massive impediments. At the multilateral level, China may use the G20 summit or band together with the other four BRICs countries to express international investment principles from the perspective of developing countries that are both recipients of FDI as well as promising major sources of investment.

When it comes to investment agreements, there are at least two challenges for China. One is the regulation and treatment of SOEs and the other is the reciprocal opening up of Chinese markets and the protection of foreign investors in China.

The dominant players of Chinese ODI are still SOEs. In the future, it is probable that China's SOEs will continue to be quite active in international investment. A clear statement on the rights and obligations of SOEs should be included in investment agreements. This will help rectify the misinterpretation of, and prejudice against, SOEs and will also help to establish better rules that facilitate investment by SOEs and serve the interests of both investors and recipients of FDI. Such a statement of rights and obligations may also help facilitate reform of SOEs in China. At the same time, foreign investment review processes in host countries should be more transparent in order to offset investment protectionism and barriers.

Investment agreements are binding on all contracting parties. This suggests that in addition to China's appeal for a more open environment and protection of its overseas investments, the country itself should also offer greater access to its own markets and better protection of foreign investments in China. There are complaints about the deteriorating investment environment in China. Some of these complaints are unfounded, as the so-called deteriorating environment mainly reflects a changed economic landscape in China that includes rising production costs, slowing profit growth, improved competitiveness of domestic enterprises, as well as weakened external demand. But some of the complaints are reasonable to an extent. Entry barriers still exist in some sectors, especially the services sector. The protection of intellectual property rights also needs to be improved. These are not only demands made by foreign investors, but are also increasingly the expectations of Chinese domestic private enterprises.

6. Concluding Remarks

China has become an important overseas investor in recent years. But Chinese enterprises are facing mounting risks and obstacles when investing abroad. This situation makes it imperative for the Chinese government to improve the investment environment and governance at the bilateral, regional and multilateral levels in order to facilitate and protect its overseas investment. The best approach to achieve this is China's more active participation in negotiating and concluding investment agreements at various levels.

As the second largest economy in the world, it is inevitable and highly desirable for China to play a larger role in international affairs and make a greater contribution to global economic governance. China is showing more and more interest in issues like reforming the international financial system, advancing cross-regional collaboration that is exemplified by BRICs, supporting regional integration, and establishing a new type of partnership between major powers.

To accelerate its domestic reform, China needs to upgrade its opening up policy. A likely breakthrough will be in the negotiation of BITs, especially the Sino-US BIT. Resolving all the differences – including on market access, fair competition, investor protection, and dispute settlement – in the Sino-US BIT negotiations requires China to deepen the reform of its foreign investment regulatory framework, its financial and judicial systems, and its mechanisms of administrative management. Its importance for China's economic reform is to some extent equivalent to the role played by China's entry into the WTO. A more ambitious mission is to establish a comprehensive and binding architecture to govern global investment. This process requires China to take a more forward looking attitude, striking a balance between short and long-term interests and between the interests of being the overseas investor and the recipient host country.

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