The Formulation of Investment Rules under the China-Korea Free Trade Agreement

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Abstract

With the development of economic integrations, the international investment rules have become an essential part of the free trade agreements ("FTAs"), resulting in the co-existence of investment rules both in bilateral investment treaties ("BITs") and in FTAs. China and Korea began the FTA negotiations on May 2, 2012. Investment rules are an important issue in the negotiation process. This article analyzes and discusses the necessity of establishing new investment rules under the China-Korea FTA, the basic principles for negotiations under the investment rules and the design of the specific rules. The author argues that both China and Korea must change the existing conceptions when negotiating about the investment rules under the FTA, so as to attach sufficient importance to the liberalization of investments while emphasizing the protection of investors and their investments. Only through this way can the essence of integration of the FTA be demonstrated.

Key words: Free Trade Agreement (FTA), Bilateral Investment Treaty (BIT), China-Japan-Korea Investment Agreement, Investment rules, Investment protection, Investment liberalization, Investment treatment.

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I. Introduction

Regional trade agreements (hereafter referred to as the "RTAs") are concluded by Contracting Parties with the aim to realize regional economic integration. With the deepening of economic cooperation between different countries, the number of signed RTAs has notably increased since the early 1990s. According to the statistics of the WTO, by January 10th, 2013, GATT/WTO has received 546 reports on RTAs, of which 354 RTAs are currently enforced.[1] Most of these RTAs are free trade agreements (hereafter referred to as the "FTAs") aimed at establishing free trade areas.

In recent years, China and Korea have been active in FTA negotiations and have concluded a number of FTAs with other countries respectively. Early in November of 2004, China and Korea jointly announced the launch of a non-governmental research project for China-Korea free trade area, and in November of 2006, the two countries decided to simultaneously initiate in 2007 the Joint Feasibility Study on the China-Korea free trade in reliance to the cooperative efforts by governments, industries and academic circles. In the May of 2010, the Joint Feasibility Study came to an end. However on May 2, 2012, China and Korea issued a Joint Ministerial Statement, declaring the official launch of the China-Korea FTA negotiations. On May 14, 2012, the two countries held the first round of the FTA negotiations, leading to the creation of a trade negotiation committee, the determination of the scope for agreement and the negotiation guidelines for goods, services, investment, trade rules and for other such areas. International investment, as a significant part of the two countries' economic activities, will be an important issue for the China-Korea FTA negotiations.

As East Asian countries, China and Korea have started indirect trades through Hong Kong and Singapore ever since 1983. Such trades gradually expanded to direct trades in private sectors after 1988.[2] China and Korea established formal diplomatic relations on August 24, 1992. The two countries concluded the Agreement between the Government of the People's Republic of China and the Government of the Republic of Korea on the Promotion and Protection of Investment (hereafter referred to as the "BIT") on Septem-

1. *See* World Trade Org., http://www.wto.org/english/tratop_e/region_e/region_e.htm.
2. Guiyan Yang, *A Study on the China-Japan-Korea Free Trade Area* 17 (China Soc. Sci. Press 2005) (China).

ber 30, 1992. On September 7, 2007, a new BIT was concluded (hereafter referred to as the "China-Korea BIT") in replace of the former agreement. In addition, China, Japan and Korea have concluded the Agreement among their respective governments on the Promotion, Facilitation and Protection of Investment (hereafter referred to as the "China-Japan-Korea Investment Agreement") on May 13, 2012.[3] Once the China-Japan-Korea Investment Agreement goes into effect, there will be two investment agreements between China and Korea. So, is it necessary to design new investment rules during the negotiations of the China-Korea FTA? If so, how should the investment rules be drafted in the China-Korea FTA? Moreover, how should the relationship among these three sets of investment rules be dealt with? The author seeks to present opinions and suggestions in this article on the above issues based on the relevant research conducted.

II. The Feasibility of Formulating New Investment Rules under the China-Korea FTA

In the author's opinion, since China and Korea have concluded the China-Korea BIT and the China-Japan-Korea Investment Agreement, the issue on whether it is necessary to establish new investment rules in addition to the China-Korea FTA depends on several factors, which includes the purpose of the investment rules incorporated in the FTAs, the disparities among the China-Korea BIT, the China-Japan-Korea Investment Agreement and the FTAs' investment rules, the influence of the 2012 U.S. Model BIT on the negotiations of the investment rules under the China-Korea FTA, and the common practices of China and Korea in their negotiations with foreign countries on the FTAs' investment rules. By examining the factors above, the author suggests that it is necessary to establish new investment rules under the China-Korea FTA.

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3. In May, 2007, China, Japan and Korea launched the trilateral negotiation on investment treaty. After thirteen rounds of formal negotiations and a number of informal consultations, the three countries finally concluded negotiations on March, 2012 and concluded the China-Japan-Korea Investment Agreement on May 13, 2012. After signature of this Agreement, all Contracting Parties shall finish the national approval procedure and notify this to other Contracting Parties. This Agreement will take effect 30 days after the receipt of the last approval notice.

A. The Purpose of Investment Rules under FTAs

International investment is an important issue of economic activities for every country. Traditionally, countries usually resort to BITs for the reciprocal investment protection. However, with the expansion of inter-country economic integration from trade field to non-trade field, more and more regional trade agreements incorporate investment rules as supplements or replacements of BITs.[4] According to the statistics of the United Nations Conference on Trade and Development (UNCTAD), a total of 3,164 investment agreements have been concluded by the end of 2011, of which 2,833 were BITs and the other 331 were FTAs, economic partnership agreements and regional agreements with investment rules.[5]

In regional trade agreements, the main objective of the Contracting Parties in their negotiations is to promote the free flow of trade, investment and economic cooperation in other particular areas. For example, most of the RTAs concluded with foreign countries by Korea and some of the RTAs concluded with foreign countries by China set the building of investment liberalization, the reduction or elimination of the barriers to investment and the substantial increase of investment opportunities as part of the main objectives. Particularly, most of Korea's RTAs with other countries specifies a list of measures (i.e. "non-conforming measures") that can be maintained and implemented by contracting parties behind the border and that do not necessarily conform to all the obligations under the agreement.[6] Such agreements require that measures concerning any sectors or matters not listed must fully comply with the obligations under the investment rules under the FTA. It is apparent that, in terms of content, the investment rules under RTAs put particular emphasis on the free flow of investments apart from the promotion and protection of

4. United Nations Conference on Trade and Development (UNCTAD), UNCTAD Series on International Investment Policies for Development, New York & Geneva, 2008, *International Investment Rule-Making: Stocktaking, Challenges and the Way Forward*, U.N. Sales No. E.08.II.D.1 (Oct. 2008), *available at* http://unctad.org/en/Docs/iteiit20073_en.pdf.

5. UNCTD, New York & Geneva, 2012, *World Investment Report 2012: Towards a New Generation of Investment Policies*,U.N. Sales No. E.12.II.D.3 (2012), *available at* http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf.

6. Non-Conforming Measures are included in the RTAs concluded respectively by Korea with Chile, Singapore, United States, ASEAN, India and Peru.

investors.[7]

Compared with RTAs, BITs mainly deal with the treatment of foreign investors and their investments.[8] Particularly, BITs, in the early stage, only had regulations for post-establishment treatment and protection, and did not deal with any issues relating to the market access to investments. Because of this, some countries started to promote the liberalization of investment access between the Contracting Parties in reliance to the RTA negotiations. Since most of the RTAs concluded in recent years are usually comprehensive, the content of negotiations involves not only of trade in goods, but also trade in services, investments, environmental protection, labor standards, intellectual property rights and dispute resolutions. Sometimes, the Contracting Parties may undertake "a package of approaches" during negotiations. Under such circumstances, the Contracting Parties can do a comprehensive weighing of each other's bargaining counters, so as to achieve the purpose of liberalizing the market access which cannot be achieved by the BIT negotiations.

By examining the provisions of the China-Korea BIT and the China-Japan-Korea Investment Agreement, it can be noted that both agreements grant only the most-favored-nation treatment (MFN) in terms of investment access, rather than the national treatment. Such an approach apparently cannot adequately reflect the purpose of the investment liberalization. If the China-Korea FTA sets investment liberalization as one of its aims, the issue, as regards to granting a national treatment in the investment access phase, will be unavoidable.

B. The Disparities among the China-Korea BIT, the China-Japan-Korea Investment Agreement and the Investment Rules under FTAs

In the China-Korea BIT, re-concluded in 2007, significant revisions and improvements were made on the original BIT, especially on the provisions relating to the settlement of disputes between Contracting Parties, between

7. UNCTD, New York & Geneva, 2006, UNCTAD/ITE/IIT/2005/10, *Investment Provisions in Economic Integration Agreements, available at* http://unctad.org/en/Docs/iteiit200510_en.pdf.

8. Bernardo M. Cremades, *Promoting and Protecting International Investment*, 3(3) Int'l Arb. L. Rev. 53-58 (2000).

investors and one Party, as well as, those relating to the compensation for losses or damages. In addition, a number of new provisions, such as one on transparency and another on the BIT's relationship with other international agreements, were added. In spite of such significant revisions, the China-Korea BIT still lays particular emphasis on the post-establishment protection of the investors and their investments from the Contracting Parties. The China-Japan-Korean Investment Agreement concluded on May 13, 2012 also failed to provide a national treatment in the market access phase. Nevertheless, on the whole, this investment agreement has raised the level of protection for investors and their investments.

The China-Japan-Korea Investment Agreement contains 27 articles and one additional protocol.[9] It not only includes the provisions seen in the China-Korea BIT,[10] but it also incorporates some foremost provisions seen in the modern FTA investment rules, such as those on intellectual property rights, prohibition of performance requirements, security exceptions, temporary safeguard measures, prudential measures, taxation, denial of benefits and environmental measures.[11] In such cases, do you think it is possible for China and Korea to directly incorporate the China-Japan-Korea Investment Agreement into the China-Korea FTA, but do not renegotiate about investment issues? This question was raised by scholars from both China

9. The main text of this Agreement contains provisions on the following matters: Definition; Promotion and Protection of Investment; National Treatment; Most-Favored-Nation Treatment; General Treatment of Investment; Access to the Courts of Justice; Prohibition of Performance Requirements; Entry of Personnel; Intellectual Property Rights; Transparency; Expropriation and Compensation; Compensation for Losses or Damages; Transfers; Subrogation; Settlement of Investment Disputes between a Contracting Party and an Investor of Another Contracting Party; Special Formalities and Information Requirements; Settlement of Disputes among Contracting Parties; Security Exceptions; Temporary Safeguard Measures; Prudential Measures; Taxation; Denial of Benefits; Environmental Measures; Joint Committee; Relation to Other Agreements; Headings; Final Provisions.

10. The China-Korea BIT includes provisions on the following matters: Definitions; Promotion and Protection of Investment; Treatment of Investment; Expropriation; Compensation for Damages and Losses; Transfers; Subrogation; Settlement of Disputes between Contracting Parties; Settlement of Disputes between Investors and one Contracting Party; Other Obligations; Transparency; Application; Consultations; Entry into Force, Duration and Termination.

11. The Korea-US FTA that went into effect in 2012 incorporated these provisions into its investment rules.

and Korea soon after the China-Korea FTA was concluded.[12] In fact, this approach has already been taken by China in negotiations with other countries. For example, when China and Singapore were negotiating about the FTA, Singapore was a member of ASEAN and China was negotiating with the ASEAN countries about the China-ASEAN Investment Agreement in the free trade area, thus Article 84 of the China-Singapore FTA stipulates that, upon the conclusion of the investment agreement between ASEAN and China pursuant to Article 5 of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and the People's Republic of China (the "ASEAN-China Investment Agreement"), the provisions of that Agreement shall, *mutatis mutandis*, be incorporated into and form an integral part of this Agreement unless the context requires otherwise. Any rights, obligations, restrictions or exceptions contained in the China-ASEAN Investment Agreement that do not relate to either party shall accordingly, be inapplicable under the FTA. In addition, no reformulation of investment rules were conducted under the FTA between China and Costa Rica; instead, the two countries incorporated the BIT between them into the FTA.

The author holds the opinion that if both China and Korea are inclined to promote investment liberalization by the China-Korea FTA, it is not advisable to follow the provisions above in the China-Singapore FTA. The reasons are as follows: (i) although the China-Japan-Korea Investment Agreement is an independent agreement in formality, it is, in fact, an agreement aimed at accelerating the negotiation process for a China-Japan-Korea free trade area; (ii) the China-Japan-Korea Investment Agreement is formed on the basis of balancing three Parties' interests, and its requirements for investment liberalization are not completely appropriate for the specific circumstances in China and Korea. Both China and Korea should create investment rules that suit their national conditions according to their own situations; (iii) the China-Korea FTA may follow the examples of other FTAs by including general provisions on transparency, intellectual property rights, general exceptions, security exceptions and safeguard measures. In such event, the relevant provisions of the China-Japan-Korea Investment Agreement

12. At the International Seminar on Legal Issues concerning China-Korea FTA convened by the Korean Law Research Center of China University of Political Science and Law in May, 2012, scholars from both China and Korea present at the seminar explored the possibility and necessity of the two countries conducting negotiations about investment rules under the China-Korea FTA.

will become redundant; and (iv) if both Parties generally incorporated the China-Japan-Korea Investment Agreement into the China-Korea FTA and excluded the provisions that have nothing to do with them, this would lead to uncertainty in the enforcement of investment rules under the China-Korea FTA.

Although the China-Japan-Korea Investment Agreement, as a whole, raised the level of protection under the China-Korea BIT, gaps still exist between this Agreement and the investment rules under Korea's FTAs with other countries. As previously mentioned, most of Korea's FTAs with other countries specify a list of Non-Conforming Measures that can be maintained, and provide for National Treatment obligations in the investment access phase and the post-establishment phase. These provisions will become unavoidable issues when China and Korea negotiate about investment rules under the FTA.

Undoubtedly, if the treatment accorded to investors and their investments of these two countries, in accordance with the investment rules under the China-Korea FTA, were more favorable than that under the China-Japan-Korea Investment Agreement, Japanese investors and their investments in both China and Korea would fall into a disadvantageous position, which would undermine the benefits that Japanese investors would receive under the China-Japan-Korea Investment Agreement.

C. The Influence of the 2012 U.S. Model BIT on the Negotiations of Investment Rules under the China-Korea FTA

It is worth noting that, in terms of the content of the investment rules, many developed countries were influenced by the United States when concluding the RTAs with other countries, as well as Korea. International investment is a significant driving force for economic growth, employment and export in the United States. For the convenience of negotiation, the United States started drafting its model BIT in 1984 and has been constantly revising it. Since February of 2009, the Office of the United States Trade Representative and the U.S. Department of State have jointly launched the revision procedure of the 2004 Model BIT, so as to ensure that the BITs concluded between the U.S. and other countries comply with the public interests and the executive's overall economic plan. Although revisions on the model BIT do not need the approval of the Congress, each specific BIT would need

approval from two thirds of the Senate. During the revision, the executive holds a number of consultations and receives massive suggestions from the Congress, corporations, business associations, labor groups, environmental and other non-governmental organizations, as well as academic circles. These suggestions are perceived in the final version of the BIT.

Comparing with the previous version, the 2012 U.S. Model Bilateral Investment Treaty includes revisions and improvements in the following aspects: the expansion of the scope of performance requirements that Contracting Parties shall not conduct, further clarification of state-dominant economic entities, the use of domestic technology by these entities, the right of foreign investors to participate in the design of technical standards, the position of state-owned enterprises as representatives of the state, improvement and revision of the provisions on transparency, investment and environment, investment and labor, and financial services. On the whole, the new model BIT continues to provide strong legal protection to investors, while at the same time, enhancing the government's administrative power over issues relating to the public interests. This model BIT has embodied the high level of protection for international investments and reflected the development trend of international investment protection, which will generate significant influences on negotiations of the China-Korea FTA investment rules.

D. The Common Practices of China and Korea in their Negotiations with Foreign Countries on the Investment Rules under FTAs

From China's and Korea's FTAs with other countries, it can be seen that none of China's FTAs with other countries provide a national treatment to the other party's investors and their investments during the investment access phase, while most of Korea's FTAs with other countries apply a national treatment in the investment access phase and include a detailed list of non-conforming measures. Moreover, some FTAs concluded by Korea with other countries also contain provisions on the environment within the investment rules. In general, FTAs concluded by Korea with other countries demonstrate a relatively higher level of investment liberalization. Therefore, whether a national treatment during the investment access phase should be incorporated into the investment rules under China-Korea FTA will be a critical issue for negotiation. Although China has been officially implementing the "Going

Global" strategy since 2001,[13] China's investment towards Korea is far less than Korea's investment towards China. If the treatment of access of Chinese investors and their investments to Korea is to be improved through the implementation of the investment rules under China-Korea FTA, it would be conducive to the expansion of China's investments in Korea.

III. The Basic Principles for Formulating Investment Rules under the China-Korea FTA

Since international investment is of crucial relevance to the industrial security of a country, negotiations about investment rules under FTAs are far more sensitive and complicated than those about the trade in goods. In the author's view, both China and Korea should adhere to the following basic principles when negotiating about investment rules.

A. Equal Emphasis on Investment Protection and Investment Liberalization

Looking at the content, the regulative objects of recent BITs have become more and more specialized, the standards for investment protection increased higher and higher, the solutions to disputes more and more diversified and the scope of the jurisdiction of host countries over foreign investment gradually narrowed down.[14] However, the principal aim of most BITs is to reduce the risks faced by investors, rather than creating a free investment system.[15]In contrast, the main objective of FTAs or other forms of economic integration agreements is to achieve economic integration, including the liberalization of trade in goods, trade in services and of investments, through regular negotiations or mutual concessions. As a result, the purpose of FTAs lies in the market access.

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13. In March, 2011, the "Going Global" strategy has been formally written into the 10th Five-Year-Plan for National Economic and Social Development.

14. Sun Liu, *A Brief Analysis on the Latest Development of BITs and Their Influences: Taking the American BITs as Objects of Research*, 6 J. Hunan Pol.-Legal Cadre C. 31-33 (Dec. 2002).

15. Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 Harv. Int'l L. J. 469 (2000).

There is a huge potential for China and Korea to expand in bilateral trade and investment. In respects to foreign trade, the volume of bilateral trade between China and Korea was only 5 billion USD when they established their diplomatic relations in 1992. By 2012, the trade volume between China and Korea had skyrocketed to forty times the trade volume of 1992. China has become Korea's largest trading partner, while Korea became China's third-largest trading partner. In terms of investment, Korea started to make investments in China in the early 1990's, mainly in labor-intensive manufacturing, and expanded into the service sector thereafter. Korea's investment in China has grown rapidly since 1992. From 1992 to 2005, the number of Korean investment projects in China increased from 1,650 to 6,115, with the Korean share in total FDI projects in China rising from 1.33% to 13.89%.[16] In 2011, the value of Korea's investment contracts in China was 6.08 billion USD,[17] and the total investment amount reached 50 billion USD. Korea has become China's seventh-largest country of investment source, while China became Korea's second-largest investment destination. China began investing in Korea in the late 1990's, mainly in the areas of trading and services, and expanded into the industrial sector after 2002.[18] In 1992, the amount of China's investment in Korea was only 1,056 million USD.[19] In 2011, China's non-financial foreign direct investment in Korea amounts to 73.97 million USD,[20] and the total investment amount to 3 billion USD. Thus it can be seen that China's direct investment in Korea is significantly less than Korea's investment in China. Therefore, laying equal emphasis on the investment protection and liberalization by the investment rules under the China-Korea FTA is not only consistent with the purpose of the FTAs, but also satisfies the practical needs. Especially for China, with further increase in its foreign trade, the introduction of foreign capital and foreign exchange reserve, and the "Going Global" strategy will be a long-term national policy. However,

16. Joint Study Committee, *The Joint Study Report for China-Korea FTA*10, 96 (June 2010), *available at* http://fta.mofcom.gov.cn/enarticle/enkorea/enkoreanews/201006/2759_1.html.
17. Ministry of Commerce of the People's Republic of China, *2012 Country-Specific Report on Trade and Investment Environment* (2012)(China).
18. *The Joint Study Report for China-Korea FTA*, *supra* note 16, at 10.
19. Investment Promotion Agency of Ministry of Commerce, P.R. China (CIPA), *2011 Country/Region-Specific Report Series on China's Foreign Investment Promotion: INVEST IN KOREA* (2011)(China).
20. *2012 Country-Specific Report on Trade and Investment Environment*, *supra* note 17.

investment liberalization and protection should be based on the two countries' economic development levels and practical situations. While determining the scope of access to the investment market, the two countries should give sufficient considerations to complement their industrial structures and should be allowed to make certain reservations. Only in this way can both Contracting Parties achieve a win-win result. Looking at the aspect of the industrial situation, Korea's manufacturing industry has competitive advantage. Korea's economy is mainly based on heavy chemical industry, with its shipbuilding industry holding a dominant position in the world, and its car, textile, steel and chemical production ranking the world's fifth. Its electronic industry is based on high and new technology-intensive products and for this, it has become one of the top ten countries in the electronic industry. Korea has also seen the rapid development of its semiconductor integrated circuit, and thus, it has maintained the leading position for years in the areas of semiconductors, liquid crystal displays and other such products. Korea's service industry, especially the financial system, is also comparatively more advanced. However, there is a lack of competitiveness in Korea's agriculture, forestry and fishery.[21] If the investment policies in the area of agriculture are to be opened up, the agriculture of Korea will probably suffer from some pressure. China's competitive advantage is manifested in the agricultural products, light industrial products, commercial services and the new energy industry; but in such areas as financial services, car manufacturing, electronic industry and high and new technology, China is relatively backwards. Thus, the opening up of such industries will certainly have impact on China. Consequently, while negotiating about the investment rules under the FTA, China and Korea must take the protection of sensitive areas into adequate consideration.

B. Taking the China-Korea BIT and the China-Japan-Korea Investment Agreement as the Basis for Negotiations

Unlike BITs, FTAs and other types of economic integration agreements do not adopt a uniform structure or consistent approach in the investment provisions.[22] However, the investment rules under FTAs have been largely influenced by BITs, WTO agreements and other investment agreements. As

21. CIPA, *supra* note 19.

22. *Investment Provisions in Economic Integration Agreements*, *supra* note 7.

regards to the United States, its model BIT is taken as an important reference for its negotiations with other countries regarding the FTA investment rules. Take NAFTA for an example, its investment provisions are similar to the provisions of the U.S. BITs with other countries in both scope and content.[23] Similarly, both China and Korea, respectively, refer to a large part of the BITs and other relevant agreements they have concluded with foreign countries when in negotiating with other countries about the investment rules under the FTAs. Therefore, in negotiations of investment rules under the China-Korea FTA, the China-Korea BIT and the China-Japan-Korea Investment Agreement must be employed as the basis of negotiation, with particular emphasis on the China-Japan-Korea Investment Agreement, as it provides a higher level of protection.

C. Taking the Investment Rules under FTAs as Reference

When China and Korea are in the middle of negotiations about investment rules under the FTA, the investment rules included in their FTAs with other countries can also be taken as references. It is because these rules reflect the common practices of China and Korea in negotiations of their investment rules under the FTAs.

Up until now, both China and Korea have concluded a number of FTAs with other countries. Since December 11, 2001, when China entered into the WTO, to the December of 2012, China has successively concluded the FTAs with the ASEAN countries, Chile, Pakistan, New Zealand, Singapore, Peru and Costa Rica. Mainland China has also reached the Closer Economic and Partnership Arrangements (CEPA) with the Hong Kong Special Administrative Region and the Macau Special Administrative Region respectively. In addition, Mainland China has signed the Economic Cooperation Framework Agreement with the Taiwan District in 2010. All the above-mentioned FTAs have included the investment rules. Korea concluded its first FTA in 2003. By the December of 2012, Korea has successively concluded FTAs with Chile, Singapore, EFTA, ASEAN, United States, India, European Union and Peru, all of which contain investment rules.[24] However, China

23. *Id.*

24. The FTA between Korea and European Union does not provide any uniform rules on investment but instead has provisions on investment in the service sector.

and Korea are both Contracting Parties of the Asia-Pacific Trade Agreement, which nevertheless does not contain any investment rules.[25]

Of the FTAs concluded by China and other countries, the China-Pakistan FTA has similar investment rules with those in the China-Pakistan BIT; while China's FTAs with ASEAN, Chile, New Zealand and Peru all incorporate new provisions in the investment rules on the basis of the existing BITs. These new provisions are related to the non-conforming measures, denial of benefits, general exceptions, security exceptions, other obligations, transparency, measures to safeguard the balance of payments and taxation measures. Overall, investment rules under Korea's FTAs with other countries are relatively more comprehensive in content. In addition to the traditional provisions, such as, those on scope and coverage, national treatment, most-favored nation treatment, minimum standard of treatment, losses and compensation, expropriation and compensation, transfers, subrogation and settlement of disputes between a party and an investor of the other party, new provisions on performance requirements, reservations and exceptions, exceptions and safeguard measures, special formalities and information requirements, relation to other chapters, denial of benefits, and environmental measures, are also generally included.

Countries other than China and Korea also mostly incorporate investment rules in their foreign FTAs and add new provisions to those traditional ones on investment. These investment rules are important sources for reference in the design of investment rules under the China-Korea FTA.

In conclusion, the author holds the view that China and Korea should take the China-Japan-Korea Investment Agreement as a chief source for reference in negotiations of investment rules under the FTA, while also taking the investment rules under the China-Korea BIT and China's and Korea's respective FTAs with other countries and other FTAs into consideration.

IV. The Formulation of Investment Rules under the China-Korea FTA

The FTAs concluded, respectively, by China and Korea with other coun-

25. It was previous known as the Bangkok Agreement, which was concluded on July 31, 1975. Its current Member States are China, Bangladesh, India, Laos, Republic of Korea and Sri Lanka.

tries, investment norms are mainly presented in three modes. The first one is the mode of a separate chapter. Most of the FTAs concluded by China and Korea with other countries contain a separate chapter entitled "Investment" for the investment rules. Most of the FTAs notified to the WTO also adopted such an approach. The second one is the mode of a separate agreement attached to the main text, like when China and Korea respectively concluded an investment agreement with ASEAN in addition to the framework agreement.[26] Another example is when China and Chile concluded the Supplementary Agreement on Investment to the China-Chile FTA. The third one is the mode of a special provision. The Korea-EFTA FTA simply provides principles on investment issues with only one provision. In the author's opinion, the China-Korea FTA should follow the example of most FTAs, i.e., using the mode of a separate chapter. Incorporating investment rules in the main text of the FTAs is beneficial to the supplementary application of the investment rules and other such rules as provisions on settlement of disputes, exceptions and transparency under the FTAs. While there is the absence of investment rules, the general rules under FTAs may be applied.

Both investment rules under BITs and FTAs contain provisions on the scope of application, investment treatment, expropriation or similar measures, losses and compensation, transfers, subrogation, settlement of investment disputes, performance requirements, non-conforming measures, measures to safeguard the balance of payments, denial of benefits, general exceptions, security exceptions, transparency, taxation measures, environmental measures and intellectual property rights, etc. In the view of the author, if the China-Korea FTA provided a separate chapter on investments, it would be unnecessary to set forth rules on measures to safeguard the balance of payments, environmental measures, intellectual property rights, transparency, general exceptions, security exceptions and taxation measures in this chapter. The reason being that once Contracting Parties agree to negotiate about the above issues, they usually will agree on some general provisions regarding the issues and agree to apply them to all parts of the agreement. Thus, the focus in negotiations about investment rules under the China-Korea FTA remains under the rules involving the vital interests of both Parties. The author

26. Most of the economic integration arrangements between ASEAN and other countries adopt the approach of a framework agreement attached with a separate agreement (including investment agreement).

thinks that the China-Korea FTA should include revisions and improvements on the following provisions on the basis of the China-Japan-Korea Investment Agreement.

A. Investment Treatment

Treatment of foreign investors and their investments in a host country is the core of all international investment agreements. From the aspect of investment phases, the investment treatment of foreign investors and their investments includes both treatment in the pre-establishment phase, which is the market access of investments, and treatment in the post-establishment phase. Regarding the types of standards, investment treatment involves the most-favored nation treatment, the national treatment and the fair and equitable treatment. If the three types of treatment are provided simultaneously and reciprocally by the Contracting Parties, foreign investors and their investments will definitely obtain comprehensive non-discriminatory treatment in the host country.

With regard to the situations in China and Korea, most BITs concluded by China with other countries before 2000, only required the Contracting Parties to provide the most-favored-nation treatment mutually, while only a few BITs were required both the most-favored-nation treatment and the national treatment.[27] After 2000, most BITs concluded between China and other countries attach more importance to the comprehensiveness of non-discriminatory investment treatment, requiring the Contracting Parties to provide, not only the most-favored-nation treatment, but also the national treatment and the fair and equitable treatment. Most investment rules under BITs and FTAs concluded by Korea with other countries provide the three types of treatment above simultaneously. The China-Japan-Korea Investment Agreement also provides for the above-mentioned three types of treatment, though it is relatively conservative in terms of the national treatment.

1. National Treatment

In accordance with the national treatment, foreigners engaged in the same

27. *See* Agreement between People's Republic of China and Japan Concerning the Encouragement and Reciprocal Protection of Investment, China-Japan,art. 3, 1998.

activities shall receive the same treatment as those of nationals of the host country.[28] National treatment is included without exception in the China-Korea BIT, the China-Japan-Korea Investment Agreement and the FTAs concluded by China with the ASEAN countries, Chile, Pakistan, New Zealand and Peru. However, national treatment in these agreements only applies to the post-establishment phase rather than the access phase. By contrast, national treatment is applied in both phases in most of Korea's FTAs with other countries. Thus, investment rules under the Korea's FTAs with other countries provide a higher level of protection to investors and their investments. As national treatment is designed to prevent the host country from imposing certain requirements on foreign investors, so as to leave them in a position of competitive disadvantage compared with national investors,[29] whether national treatment should be applied in the investment access phase on the basis of China-Japan-Korea Investment Agreement will be the focus of debate for China and Korea.

Exceptions to national treatment are another issue for China and Korea to discuss during the negotiations of investment rules under the China-Korea FTA. This issue would become more important if national treatment were to be applied in the investment access phase. The China-Korea FTA, China-Japan-Korea Investment Agreement and investment rules under most of the FTAs concluded respectively by the two countries with other countries all contain such exceptions, including those of non-conforming measures, specific groups, specific sectors, government procurement and subsidies. When dealing with such exceptional circumstances, the Contracting Parties are not obliged to provide the national treatment. Of the exceptions to the national treatment, those in non-conforming measures constitute the main part. Non-conforming measures concerning national treatment refer to the measures that have been implemented by a Contracting Party under its laws and regulations but do not conform to its obligation of the national treatment at the time when the investment agreement or the investment rules are in effect. Although the China-Japan-Korea Investment Agreement and other FTAs con-

28. Jian Zhou, *National Treatment in Foreign Investment Law: A Comparative Study from A Chinese Perspective*,10Touro Int'l L. R. 39 (2000).

29. Calvin A. Hamilton & PaulaI. Rochwerger, *Trade and Investment: Foreign Direct Investment through Bilateral and Multilateral Treaties*,18 N.Y. Int'l L.R. 1 (2005), *available at* http://www.hamiltonabogados.es/downloads/publications/2005_New_York_Intl_Law_Review.pdf.

cluded by China with other countries provide for non-conforming measures concerning national treatment, none of these agreements requires a list of specific non-conforming measures. In this case, investors from one Contracting Party cannot accurately know about the specific non-conforming measures of other Contracting Parties, which leads to a great reduction on the transparency of national treatment. Nevertheless, most of the FTAs concluded between Korea and other countries provide detailed lists of non-conforming measures. Thus, the author recommends that in order to ensure the transparency of national treatment, the China-Korea FTA should require a detailed list of non-conforming measures from both Parties respectively.

2. Fair and Equitable Treatment

There are some views that fair and equitable treatment is an independent and self-regulated norm.[30] For this reason, many FTAs and BITs concluded in recent years put this treatment in an independent provision. However, fair and equitable treatment makes a disputable issue of arbitrations in cases concerning investors and host countries.[31]

Although most BITs between China and foreign countries, including the China-Korea BIT, provide for fair and equitable treatment, few elaborate on its meaning. Some of China's FTAs with other countries only provide a simple interpretation. For example, Article 7.1 of the Agreement on Investment of the Framework Agreement on Comprehensive Economic Co-operation between China and ASEAN interprets the fair and equitable treatment as that each Party shall accord to the investments of investors of another Party a fair and equitable treatment, full protection and security. Some agreements require that each Party accord fair and equitable treatment in accordance with the widely-accepted international law principles or customary international law. For example, Article 143 of the China-New Zealand FTA provides that investment of investors of each Party shall at all times be accorded fair and equitable treatment and shall enjoy the full protection and security within the territory of the other Party in accordance with commonly accepted rules of international law, and that the fair and equitable treatment includes the obligation to ensure that, regards to general principles of law,

30. Hamilton &Rochwerger, *supra* note 29.

31. *Id.*

investors are not denied justice or treated unfairly or inequitably in any legal or administrative proceedings affecting the investment of the investor. Article 132 of the China-Peru FTA stipulates: Each Party shall accord fair and equitable treatment and full protection and security in accordance with customary international law in its territory to investment of investors of the other Party. The concepts of "fair and equitable treatment" and the obligation of "full protection and security" do not require additional treatment to that required under the minimum standard of treatment of aliens in accordance with the standard of customary international law of Contracting Parties. The breach of another provision of this Agreement or another international agreement does not imply that the minimum standard of the treatment of aliens has been breached. "Fair and equitable treatment" also contains the prohibition against the denial of justice in criminal, civil, or administrative proceedings in accordance with the general accepted principles of customary international law.

FTAs concluded between Korea and other countries provide for the "minimum standard of treatment", which is similar to the fair and equitable treatment and is basically based on customary international law. For instance, Article 10.5 of the Korea-Chile FTA provides that each party shall accord to the investments of the investors from the other Party, treatment in accordance with the customary international law minimum standard of treatment of aliens; thus including fair and equitable treatment and full protection and security. Also, that the concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. In addition, new provisions on the access to judicial proceedings are added into both the Korea-India FTA and the Korea-ASEAN FTA. The Korea-Singapore FTA gives an explanation on the minimum standard of treatment granted to foreigners under the customary international law. Article 10.5 of the Korea-Singapore FTA stipulates: Each Party shall accord to investment of investors of the other Party treatment in accordance with the customary international law minimum standard of treatment, including fair and equitable treatment and full protection and security. The concepts of "fair and equitable treatment" and the obligation of "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law's minimum standard of treatment of aliens, and also, do not create additional substantive rights. The obligation to provide "fair and equitable treatment" includes the obligation not to deny

justice in criminal, civil or administrative adjudicatory proceedings. The obligation to provide "full protection and security" requires each Party to provide the level of police protection required under customary international law. The "customary international law minimum standard of treatment of aliens" refers to all customary international law principles that protect the economic rights and interests of aliens.

The China-Japan-Korea Investment Agreement contains "general provisions on investment treatment" which are similar to the fair and equitable treatment. Article 5.1 of this Agreement provides: Each Contracting Party shall accord to investment of investors of another Contracting Party fair and equitable treatment and full protection and security. The concept of "fair and equitable treatment" and the obligation of "full protection and security" do not require treatment in addition to or beyond any reasonable and appropriate standard of treatment in accordance with generally accepted rules of international law. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not *ipso facto* establish that there has been a breach of this paragraph.

The author maintains that it is not appropriate for the above-mentioned provisions to be adopted in the fair and equitable treatment rules under the China-Korea FTA. The reason is that, up to now, there has been no international consensus on the standards of customary international law or general principles of international law on international investment. Therefore, the China-Korea FTA can interpret the fair and equitable treatment in the same way as Article 143 of the China-New Zealand FTA is interpreted, i.e., as an obligation to ensure that, giving regard to general principles of law, investors are not denied justice or treated unfairly or inequitably in any legal or administrative proceedings affecting the investments of an investor. A breach of any other provision under the investment chapter does not constitute a breach of the fair and equitable treatment. Moreover, the China-Korea FTA should also provide a non-exhaustive list of circumstances in breach of the fair and equitable treatment, so as to prevent broad interpretations of the fair and equitable treatment.

B. Performance Requirements

Performance requirements mainly refer to the regulation of foreign

investments in the post-establishment phase.[32] Traditional BITs generally do not limit the host countries' performance requirements for foreign investors. Since 1980s, BITs concluded by the United States with other countries have established the rule of prohibition on the performance requirements for foreign investors, which significantly weakens the host countries' jurisdiction over foreign investments.[33] The 2012 U.S. Model BIT retains the rule of prohibition on the performance requirements and includes further revisions and improvements on the basis of the previous model.

Most of China's BITs, including the China-Korea BIT, have no provisions on the performance requirements. Of China's FTAs, only the China-New Zealand FTA has explicit performance requirements. However, this FTA merely prohibits the Contracting Parties from implementing the performance requirements under the WTO's Agreement on Trade-Related Investment Measures (TRIMs). In contrast, almost all of Korea's FTAs with other countries have provisions on the performance requirements, and the scope of the prohibited performance requirements extends far beyond those under TRIMs. For example, the Korea-New Zealand FTA contains eight provisions on the prohibition of performance requirements.

The China-Japan-Korea Investment Agreement adopted a compromise on the prohibition of performance requirements, extending the prohibited performance requirements from provisions in TRIMs to the area of technology transfer. Article 7 of this Agreement provides that the provisions of the Agreement on Trade-Related Investment Measures in Annex 1A to the WTO Agreement are incorporated into and made part of this Agreement, *mutatis mutandis*, and shall be applied with respect to all investments under this Agreement. No Contracting Party shall, in its territory, impose unreasonable or discriminatory measures on investments by investors of another Contracting Party concerning the performance requirements on export or transfer of technology.

In the author's opinion, in order to reduce investment barriers, the China-Korea FTA should expand the scope of prohibition on the performance requirements based on the China-Japan-Korea Investment Agreements. This

32. Alireza Falsafi, *Regional Trade and Investment Agreements: Liberalizing Investment in a Preferential Climate*, 36 Syracuse J. Int'l L. & Com. 43 (2008).

33. Hao Du & Sun Liu, *A New Trend in the Development of BITs*, 2 Law & Soc. Dev. 122-125 (2002).

is because the prohibitions under TRIMs are only limited to investment measures that distort trade in goods. At the same time, while expanding the scope, the host country's control over foreign investments must be fully respected, just as emphasized in the 2012 U.S. Model BIT.

V. The Relationship among the China-Korea FTA Investment Rules, the China-Korea BIT and the China-Japan-Korea Investment Agreement

Presently, the China-Korea BIT and the China-Japan-Korea Investment Agreement co-exist between China and Korea. If new investment rules are established under the China-Korea FTA, a third set of investment rules will take effect between the two countries. Under such circumstances, how can the relations among these sets of three investment rules be dealt with?

A. Approaches by China and Korea

From the perspective of the BITs and FTAs concluded respectively by China and Korea with foreign countries, the following approaches are usually adopted to address this issue.

1. Prior application of the agreement with a higher level of treatment

This approach is adopted by the China-Korea BIT and most FTAs concluded by China and Korea, respectively, with other countries. For example, Article 10.1 of the China-Korea BIT provides that if the legislation of either Contracting Party or international obligations, existing at present or established hereafter between the Contracting Parties, result in a position entitling investments by investors of the other Contracting Party to a treatment more favorable than is provided for by the agreement, such position shall not be affected by this Agreement. This provision means that, even though the China-Korea BIT contains provisions on the investment treatment, if more favorable provisions on the investment rules are included in other agreements between China and Korea, then such favorable provisions shall be applied in the host country. The advantage of this approach is

that the most favorable agreement will be applied, even though there exist various sets of investment rules. Nevertheless, this approach also has some deficiencies. It does not provide the criteria for determining which agreement is more favorable, and thus, confer more flexibility on the host government.

The FTAs concluded by United States with most other countries[34] adopt the same approach in effect, though using different expressions. For instance, Article 1.2 of the U.S.-Korea FTA provides, "For greater certainty, this Agreement shall not be construed to derogate from any international legal obligation between the Parties that provides for more favorable treatment of goods, services, investment, or persons than that provided for under this Agreement." It is evident that this provision has imposed the obligation on both contracting parties to apply the more favorable agreement.

2. Establishment of a consultation mechanism for dispute settlement

Of China's and Korea's FTAs, the China-New Zealand FTA and the Korea-Singapore FTA adopt this approach, and so do the FTAs between Australia and Singapore, Australia and Thailand, and that between Japan and Singapore. For example, Article 3.2 of the China-New Zealand FTA provides that in the event of any inconsistency between this Agreement and any other agreement to which the Parties are a Party, the Parties shall immediately consult with each other with a view to finding a mutually satisfactory solution in accordance with the customary rules of interpretation of public international law. The advantage of this approach is that relevant problems are solved jointly on the basis of mutual respect, instead of being decided by one party on its own. However, this approach also has distinct disadvantages. It puts the treatments of investors and their investments in a state of indeterminacy. Even if a more favorable investment agreement is concluded or more favorable investment provisions are incorporated by two countries after tough consultations, the result will likely lead to the inadequate application of the more favorable treatment, and thus, investors and their investment interests will not receive their promised protection. Moreover, when no agreement is reached through consultation, the issue in dispute still may not be settled. In such a case, any Contracting Party may claim that the other has violated one of the rules and thus, may submit the dispute to the dispute settlement mechanism,

34. Such countries are South Korea, Australia, Singapore and Jordan.

which can lead to different results.[35]

3. Termination of the application of previous investment agreements due to the entry into force of FTAs

This approach is adopted by the FTAs concluded by Korea, respectively, with Chile and Peru, as well as, the Supplementary Agreement on Investment of the Free Trade Agreement between China and Chile. For example, Article 21.4 of the Korea-Chile FTA provides, "Both Parties agree that 'The Agreement between the Government of the Republic of Chile and the Government of the Republic of Korea on the Reciprocal Promotion and Protection of Investment' (BIT), signed in Santiago, Chile on September 6, 1996, shall no longer be in effect upon the entry into force of this Agreement, as well as all the rights and obligations derived from the BIT." This approach in fact establishes the exclusive position of the FTAs. Its advantage is its operability, with no difficulties in the application of law. However, it also has defects in terms of the revision of investment rules. The reason is that it will force the revision of investment rules to be made under the framework of the relevant FTA, but the amendment procedure of an FTA is very complicated, and usually, closely related to other chapters. Therefore, the complete abolition of existing BITs will deprive contracting parties of the flexibilities in the investment policies.

4. Incorporation of a BIT into an FTA

The China-Costa Rica FTA that concluded in 2010 adopted this approach. Since China and Costa Rica had just concluded a bilateral investment treaty in 2007, they did not renegotiate about investment issues; instead, Article 89 of the China-Costa Rica FTA provides, "The Parties reaffirm their commitments under the Agreement between the Government of the People's Republic of China and the Government of the Republic of Costa Rica on the Promotion and Protection of Investment, signed in Beijing, on 24th October 2007." Such an approach has helped to avoid the overlap of the application of law, but appears too conservative, because the FTA has failed to expand the liberalization of investments or to increase the protection standards for

35. *Investment Provisions in Economic Integration Agreements*, supra note 7.

investors and their investments on the basis of the previous BIT.

5. No influence of the investment rules under FTAs on the legal force of the previously-concluded investment agreements

The China-Japan-Korea Investment Agreement is actually the investment rule under the China-Japan-Korea FTA regarding negotiations. This investment agreement has quite different provisions on its relationship with other agreements. Article 25 of this Agreement stipulates that nothing in this Agreement shall affect the rights and obligations of a Contracting Party, including those relating to the treatment accorded to investors of another Contracting Party, under any bilateral investment agreement between those two Parties existing on the date of entry to the force of this agreement, so long as such a bilateral agreement is in force. The note of this provision further provides that it is confirmed that, when an issue arises between an investor of one Party and another, nothing in this Agreement shall be construed as to prevent the investor from relying on the bilateral investment agreement between those two Contracting Parties, which is considered by the investor to be more favorable than this Agreement.

It can be seen from the above-mentioned provisions that this agreement makes no discrimination between the legal force of investment rules under the FTAs and that of the BITs and thus, does not grant a force of prior application directly to the more favorable agreements. This gives discretionary power to the competent authorities on investment of the Contracting Parties, i.e., the competent authority on investments of the host country has the power to decide the investment rules of which agreement to apply. However, the note of this provision implies that investors can invoke the BIT which they deems more favorable than the FTA when investment disputes occur. This is in fact indirectly conferring a position of prior application on the FTAs, unless investors can demonstrate that the rules under the BITs are more favorable. By this token, such an approach differs greatly from the first approach. Its deficiency is that it does not directly confirm the prior application of agreements, which puts investors and their investments in a state of indeterminacy; namely, when investment disputes occur, only when investors make claims, can they receive more favorable treatment.

6. The FTAs only declaring acceptance of the rights and obligations under other international agreements

This approach is adopted by the FTAs concluded by Chile, respectively, with the U.S. and Australia. For example, Article 1.3 of the U.S.-Chile FTA provides, "The Parties affirm their existing rights and obligations with respect to each other under the WTO Agreement and other agreements to which both Parties are party." It is obvious that this approach does not clearly establish the application sequence of various international agreements, but recognizes only their independence. This gives the competent authorities on investment of the host country a high level of flexibility, which will put the treatment for investors and their investments in a state of indeterminacy.

7. Prior application of FTAs when FTAs conflict with other international agreements

The North American Free Trade Agreement (NAFTA) and the U.S.-Israel FTA adopted this approach. The NAFTA does not address the application problems of different international investment rules in Chapter 11, which regulates investment problems. However, Article 103 of the NAFTA makes a uniform provision on this issue. It provides, "The Parties affirm their existing rights and obligations with respect to each other under the General Agreement on Tariffs and Trade and other agreements to which such Parties are party. In the event of any inconsistency between this Agreement and such other agreements, this Agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement." From this provision, it can be seen that the NAFTA does not have absolute force of the prior application. Only when the NAFTA conflicts with other international agreements, can it be applied preferentially. This approach has effectively consolidated the outcome of FTA negotiations, but will impede the implementation of more favorable agreements concluded in the future.

B. The approach which should be adopted by the China-Korea FTA

In accordance with the general theory of law of treaties, if an international

agreement does not stipulate its relationship with other international agreements, and there is overlap in content, usually, the application should be determined based on the principle of "a later statute takes away the effect of a prior one".[36]

The author suggests that the China-Korea FTA should specify its relationship with other international agreements. If no specification is made, then the principle of "a later statute takes away the effect of a prior one" shall apply. In such a case, if the treatment granted by a later law to investors and their investments is lower than that granted by a prior law in certain aspects, the investors and their investments will not be able to enjoy the investment treatment which may be beneficial to them. For this reason, in order to sufficiently protect investors and their investment interests, it is the proposal of the author that the China-Korea FTA should adopt the same approach as taken in Article 10 of the China-Korea BIT, namely, the prior application of the most favorable rules when several sets of investment rules co-exist between the Contracting Parties. Only in this way, can the Contracting Parties be encouraged to fulfill their high-standard commitments. Besides, the China-Korea FTA should also make further definitions on the word "favorable", by specifying that the word "favorable" concerns a specific treatment instead of various treatments as a whole.

VI. Conclusion

From the above analysis, the author believes that even if there have been the China-Korea BIT and the China-Japan-Korea Investment Agreement between China and Korea, it is still necessary to negotiate about the investment rules under the framework of the China-Korea FTA. During the negotiation process, both Parties should resort to the China-Japan-Korea Investment Agreement as the chief source, give equal emphasis on investment protection and investment liberalization, and take the investment rules under FTAs concluded respectively by China and Korea with other countries, as well as those under the FTAs of other countries, as reference; thus, to formulate investment provisions that suit the national situations of both countries. Meanwhile, the relationship between the China-Korea FTA investment rules

36. Haopei Li, *TiaoYueFaGaiLun* [*Introduction to Law of Treaties*] (Law Press 2003) (Chi.).

and other investment agreements should also be defined, with the establishment of the principle of prior application of more favorable rules, thereby, consolidating the outcome of high-standard liberalization and protection of investments through investment negotiations.

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