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East Asian Economies' Cooperation in Cross-border Direct Investment Arrangements

Mary Hui-Yi Hsu

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GOLDEN GATE UNIVERSITY SCHOOL OF LAW

**East Asian Economies' Cooperation in
Cross-border Direct Investment Arrangements**

Mary/Hui-Yi Hsu

**SUBMITTED TO THE GOLDEN GATE UNIVERSITY SCHOOL OF LAW,
DEPARTMENT OF INTERNATIONAL LEGAL STUDIES, IN FULFILMENT
OF THE REQUIREMENT FOR THE CONFERMENT OF THE DEGREE OF
SCIENTIAE JURIDICAE DOCTOR (SJD).**

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March 12, 2010**

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CHAPTER ONE.

INTRODUCTION

1.1 Introduction and background

1.1.1 Trade and foreign direct investment

Foreign direct investment (FDI) is the cross-bordered business activities made by investors, multinational enterprises (MNEs; other terms such as multinational corporations (MNCs) and transnational corporations (TNCs) are also used frequently).

Definitions of foreign direct investment (FDI) are contained in two documents.¹ According to the Balance of Payments Manual: Fifth Edition (BPM5) of the International Monetary Fund (IMF), FDI is “an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor...the investor’s purpose is to gain an effective voice in the management of the enterprise.” According to the third edition of the Benchmark Definition of Foreign Direct Investment (BD3) of the Organization for Economic Co-operation and Development (OECD), “The most important characteristic of FDI, which distinguishes it from foreign portfolio investment, is that it is undertaken with the intention of exercising control over an enterprise.”

A MNE sets its operation, either a branch company or a subsidiary company, making

1 Definitions of FDI are contained in the Balance of Payments Manual: Fifth Edition (BPM5), International Monetary Fund (IMF), 1993, and the Detailed Benchmark Definition of Foreign Direct Investment: Third Edition (BD3), Organization for Economic Co-operation and Development (OECD), 1996. Introduced by the United Nations Conference on Trade and Development (UNCTAD) at <http://www.unctad.org/Templates/Page.asp?intItemID=3146&lang=1> (last accessed on 2009/10/24). See also Duce, Maitena, *Definitions of Foreign Direct Investment (FDI): a methodological note*, Final draft of Banco de España paper, pp. 2-4, July 31, 2003. Available at <http://www.bis.org/publ/cgfs22bde3.pdf> (last accessed on 2009/10/24).

a physical investment in a country or territory other than its home country. They are the major players in the international business activities and play important roles in the international direct investment field.

In order to qualify as FDI, the investment must form the foreign affiliate who is controlled by its parent company or is owed certain percentages of its shares.² However, there is no general definition.³ In this paper, MNEs are investors who have business operations in countries/territories other than their home countries. More details are providing in Chapter Two.

While economic globalization continues to develop, the global economy keeps integrating through increasing trade and FDI. Economies intend to establish closer and more peaceful relationships with their economic partners by promoting not only trade but also FDI.

In addition, FDI plays an important role in intra-regional trade in components and parts.⁴ The increasing relation between FDI and trade has been the result of the growing

2 The definition of a transnational corporation (TNC) made by the UNCTAD:

A transnational corporation is an enterprise that controls assets of other entities in economies other than its home economy, usually by owning a certain equity capital stake. An equity capital stake of 10% or more of the ordinary shares or voting power for an incorporated enterprise, or the equivalent for an unincorporated enterprise, is normally considered a threshold for the control of assets. A foreign affiliate or direct investment enterprise is an incorporated or unincorporated enterprise in which a foreign direct investor, resident in another economy, owns a stake that permits a lasting interest in the management of that enterprise.

Development and Globalization: Facts and Figures, UNCTAD, pp. 32~37, 2004. Available at http://www.unctad.org/en/docs/gdscsir20041_en.pdf (last accessed on 2009/10/24).

3 The definition will be different in various studies areas.

4 Nathalie Aminian, K. C. Fung, Hitomi Iizaka, and Alan Siu, *Foreign direct investment, intraregional*

fragmentation of production combined with the creation of distribution networks spanning across borders.

The increasing important position of East Asia is due to rapid expansion of trade in parts and components among East Asian economies. Trade associated with production fragmentation has been the driving force behind the market-driven integration in the East Asian region.

FDI not only plays an important role in the trend of globalization and liberalization, but also improves the economic and social development of the East Asian region, especially in the last two decades. FDI, has been a driving force of economic integration in East Asia.

The establishment of close and comprehensive industrial production and distribution networks in the East Asian region is mainly driven by FDI cooperation between multinational enterprises (MNEs) and local firms. MNEs have played a key role in promoting vertical intra-industry trade in East Asia by setting up regional and international production networks through FDI.

Under the theory of comparative advantage, MNEs have a comparative advantage⁵

trade and production sharing in East Asia, in Emerging trade issues for the policymakers in developing countries Asia and the Pacific, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25).

5 Theory of comparative advantage:

The theory of comparative advantage predicts that the firms locate relatively labor-intensive segment of the production in the country where labor is abundant and locate relatively capital-intensive segment of the production in the country

in East Asian economies with their differences in size, sources and economic policies. Their efficient economic policies of trade and FDI liberalization include reduction of tariffs and non-tariff barriers.

Investors expect to take the comparative advantages of the host countries when these countries offer various incentives. Most MNEs consider good FDI locations that allow more profits and fewer risks, as parts of their production sharing chain.

Global deployment of MNEs and cross-border direct investment with intra-industrial trade could be the reaction to or strategic impetus for the trend of globalization. MNEs' well-developed international trading and production networks contribute to the expanding trade and FDI.

1.1.2 Three players in foreign direct investment activities

Liberalization of trade and FDI has an important impact on FDI location decisions.

where capital is abundant... It is widely recognized that a significant amount of trade in the global economy is carried out in the form of intra-firm trade, which is symptomatic of the prevalence of FDI-based production networks. But, the dispersed production networks can include both intra-firm and arm's-length transactions. Initially, the development of international production networks may expand the volume of exports from FDI source country to the host country as the reallocation of production site increases exports of intermediate goods as well as capital goods required to engage in production... It may also increase imports of FDI source country as host country increase exports of finished products back to the source country. This trade-creating effect of FDI may change over time if foreign affiliates start sourcing intermediate goods locally or from third-country.

See Nathalie Aminian and K.C. Fung, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp. 1-4, Research Institute of Economy, Trade and Industry, Japan, 2007.

The globalization and liberalization of trade and investment have provided greater freedom to investors for organizing production activities across borders, in accordance with investors' own corporate strategies.

Host countries, primarily developing countries, view FDI as an important method to integrate their economies into international markets and expect it to contribute to their domestic economic development. They liberalize trade and investment rules at either national or international level to promote trade for economic growth and to attract foreign direct investment for economic and social development.⁶

Home countries, often developed countries, applied policies and laws at either the national or international level to protect the rights and security of their nationals, including individuals and MNEs. In addition, they also considered national security issues that are related to foreign direct investment.

Large multinational enterprises, who are the major players in cross-border business activities, usually use their powers to influence governments of either host or home countries to make favorable economic policies and laws for them. However, MNEs would have more risks for their operations in some developing countries where international legal standards of protections are unable to be implemented.

In short, capital-exporting countries will try to protect their nationals and companies overseas, while MNEs seek to gain the most profits from their cross-bordered business activities and to increase their competitiveness. Host countries seek to promote their economic growth and development in order to improve the living standards of their

⁶ See the reports of United Nations Conference on Trade and Development. World Investment Report 2003, FDI Policies for Development: National and International Perspectives, UNCTAD, p. 40, 2003. Also World Investment Report 2004: The shift towards Services, UNCTAD, pp. 39, 49~51, 2004.

people.

Many East Asian economies took liberalization policies and reduced restrictions on trade and FDI. For development objectives, governments are changing policies unilaterally and providing favorable business environment for cross-bordered investors. They are also entering into different forms of international economic agreements or instruments, which may boost investors' confidence and contribute to increased investment flows.

Various policies and measures provided different incentives for investors. MNEs then take the comparative advantages of economies with different levels of development when they make FDI location decisions. MNEs have thus been able to establish the network of international industrial production-sharing chains.

Some high growth of GDP economies with more competitive locations attracted more FDI flow, especially efficiency-seeking FDI. The market-driven economic integration formed in the East Asian region as a result.

Trade and FDI have been the important engines of economic growth and development for the East Asian economies. The role of FDI to the international industrial production network in the region has become a very important factor. Measures of trade liberalization under the WTO framework for closer economic cooperation among economies seem inadequate.

Economies applied various measures by facilitating FDI to strengthen their connections within the production network in the East Asian region. These policies of

FDI liberalization include tax incentives and a more stable and transparent legal and judicial environment provided by the governments of host countries.

The localization of the fragmentation process will also require better institutions such as improved enforcement of intellectual property rights as well as a more impartial and predictable judicial system. In summary, improving the institutions of the East Asian economies will be important policies to expanding and strengthening the production and trade network in East Asia, which, in turn, will strengthen economic integration among the East Asian economies.⁷

In short, in order to enhance their objectives of development, governments of host countries, including developed and developing countries, use various policies and measures, “include the trade and investment policies, monetary policies, and other operational measures” to meet the goals⁸ between MNEs and the host countries. Governments of home countries, which export capital, intellectual property rights, and human resources in some cases, will regulate FDI policies and legal frameworks for the protection and promotion of FDI, and national security.⁹

7 Nathalie Aminian, K. C. Fung, Hitomi Iizaka, and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in *Emerging trade issues for the policymakers in developing countries Asia and the Pacific*, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25).

8 To receive benefits from each other, however, sometimes could be conflicts. See *Foreign Direct Investment and Performance Requirements: new evidence from selected countries*, UNCTAD, pp. 1-2, 2003. available at http://www.unctad.org/en/docs/iteiia20037_en.pdf (last accessed on 2009/8/27).

9 The use of the terms “country” and “countries” follows the Explanatory Notes to Article XVI of the Uruguay Round Agreement Establishing the World Trade Organization, which provides, “The terms ‘country’ and ‘countries’ as used in this Agreement and the Multilateral Trade Agreements are to be understood to include any separate customs territory Member of the WTO.”

There was a consensus to adopt trade liberalization policy unilaterally in most East Asian economies when they concluded bilateral, regional and multilateral trade agreements for promoting trade. Trade liberalization in the form of a reduction in tariff rates and non-tariff barriers created the market-driven integration in East Asia.

Because these economies believed that promoting trade and FDI could benefit their economic growth and development, they reduced restrictions on FDI unilaterally. At the same time, they signed international investment agreements (IIAs) to promote and protect FDI. These IIAs includes bilateral investment agreements (BITs), double tax treaties (DTTs), and preferential trade and investment agreements (PTIAs).

The close link between trade and FDI in the East Asian industrial production sharing chain has been confirmed. There has been competition among the East Asian economies for attracting FDI by reducing barriers and providing incentives.

1.1.3 MNE's FDI activities affect the industrial structure and economic development of economies

Foreign direct investment involves the transfer of tangible or intangible assets from one country (the home country of the investors) into another (the host country) “for the purpose of use in that country to generate wealth under the total or partial control of the owner of the assets.”¹⁰

10 Different from the portfolio investment (FDI stock flows), FDI “requires the physical presence of the foreign investor in the host country and the continuous presence of the foreign investor and his management staff in the host country.” See The international law on Foreign Investment, M. Sornarajah,

FDI involves large capital transfer and movement of persons and property from the home country to the host country. Usually, FDI can have a huge influence on the domestic industrial structure, local market, economic and social development, and nature environment.

FDI might bring capital, create employment opportunities, and create access to foreign markets to the host country. Through training of local workers, it not only transfers technologies, know-how, and knowledge, but also contributes to the development of laborers' skills and local economies. Further, it can help to upgrade the local industrial and social structures.

UNCTAD made the following observation concerning such investment:

FDI can be a vehicle for obtaining foreign technology, knowledge, managerial skills, and other important inputs; for integration into international marketing, distribution and production networks; and for improving the international competitiveness and the economic performance of countries.¹¹

Liberalization of trade and FDI policies increased the international industrial production sharing chain. There has been a close connection between trade and FDI within production networks, especially among the East Asian economies. These host countries have received the benefits of trade and FDI.

It is known that trade in components and parts in general can be tied

Cambridge university press, p. 4, 1994.

11 Foreign Direct Investment and Performance Requirements: new evidence from selected countries, UNCTAD, pp. 1-2, 2003. available at http://www.unctad.org/en/docs/iteiia20037_en.pdf (last accessed on 2009/8/27).

to foreign investment in the host countries or to foreign outsourcing to local producers. In the former case, foreign direct investment (FDI) plays an important role in the formation of the production network; in the latter case, local firms rather than FDI are important in fostering trade in components and parts.¹²

There might be positive and negative effects caused by FDI. These will be discussed further in Chapter Five.

1.2 A shift from market-driven economic integration to institution-driven economic integration in the East Asian region

1.2.1 Unbalanced growth and inequitable development in East Asia, and its over reliance on the North American and European market

The East Asian economic integration started at the industrial production sharing chain. It has been recognized as a “Flying Geese” phenomenon led by Japan, followed by the first tier and second tier Newly Industrialized Economies (NIEs), and then China.

The East Asian economies that adopted export-oriented policies and reduced restrictions on trade, are growing fast in different periods as flying geese primarily led by Japan.

In the 1980s Hong Kong, Singapore, Korean and Taiwan were recognized as the first tier NIEs. In the 1990s the Philippines, Malaysia, Indonesia and Thailand became known

12 Nathalie Aminian, K. C. Fung, Hitomi Iizaka, and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in Emerging trade issues for the policymakers in developing countries Asia and the Pacific, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25)

as the second tier NIEs. China and India in the 2000s are the fastest growing economies in Asia.

The rising intra-industry and intra-firm trade in parts and components make East Asia an important player as the world's factory. The increasing industrial production networks and intra-regional trade have increased the importance of trading position of the East Asian region. It has become an import product source rather than an export destination.

This allows exports to other economies, such as China, whose trade with non-East Asian countries expanded faster than its trade with East Asian economies. The increasingly important position of China in trade is shared by most of the East Asian economies.

While these economies are growing successively, some other economies are still left behind. The East Asian reality is characterized by developmental asymmetries across countries.

Moreover, the East Asian economies, based on export-oriented growth, have been heavily reliant on exports to the world market, especially North America and Europe. East Asian economies exporting final goods still depends on good economic conditions in North American and European markets. This situation brings the risk of over reliance and unbalanced growth between the East Asian factory and the Western markets.

1.2.2 Institution-driven economic integration in the East Asian region

The East Asian regionalism emerged in the late 1990s while the institution-driven European and North American regionalization existed prior to that time. Several East Asian economies are cooperating through signing agreements in order to strengthen the economic relations with others in the region.

The market-driven economic integration thus seems to shift to institution-driven integration.

Free trade agreements in East Asian economies, especially those with WTO-plus elements,¹³ have been promulgated rapidly in recent years.

These agreements not only focus on trade issues but also include investment and other related issues. Trade and investment provisions have often been contained within the same agreements under the consensus of establishing a deeper economic integration among contracting countries in the East Asia and Pacific region.

The Association of Southeast Asian Nations (ASEAN) was designed to promote regional cooperation initially in the East Asian region. ASEAN has not only deepened the sub-regional cooperation among its ten members, but has also negotiated and signed bilateral free trade agreements with WTO-plus elements with some major neighbors, which are recognized as ASEAN plus one.

However, some East Asian economies were left out of the process of negotiating or signing bilateral or regional preferential agreements in such sub-regional and bilateral

¹³ “Free trade agreements with WTO-plus elements” will be discussed in Chapter Five.

attempts for some certain reasons.¹⁴ These economies in fact were excluded, and their investors cannot benefit from the agreements. They stand to lose their comparativeness. Their investors gain less profit with higher costs. This could further the existing economic asymmetries in the Asian region to more unbalanced growth and a more inequitable development situation.

Taiwan is an example. While the East Asia economic alliance is taking shape by cooperation in trade arrangements through signing regional free trade agreements with provisions of investment, Taiwan has been excluded from the institution-driven economic integration in recent years because it is not favored politically. The economic development of Taiwan and those less developed countries (LDCs) might be hurt when they are excluded from the process of the regional economic integration. This might aggravate the unbalanced growth and development problem in the East Asian region.

In short, the process of institution-driven economic integration in East Asia may relocate different types of FDI and industries.

1.2.3 International and domestic rules of FDI

1.2.3.1 International and domestic rules

Developing countries are using the agreements as tools to attract FDI because they believe this might boost investors' confidence and contribute to increased investment

¹⁴ Some economies are unable to participate in the process of the regional institution-driven integration for the reason that they are not favored politically, they cannot afford the costs of many separate negotiations, or because their neighborhood is less open.

flows. The implementation of IIAs and domestic policies and regulations in economies will influence their competitiveness.

Economies intended to establish closer and more peaceful relationships with their economic partners by promoting trade and FDI. They signed international investment agreements (IIAs), which includes bilateral investment agreements (BITs), double tax treaties (DTTs), and preferential trade and investment agreements (PTIAs), including bilateral or regional free trade agreements (FTAs/RTAs) with investment components.

These IIAs are not limited to economies in the same geographical region. They formed “a multilayered and multifaceted network of international investment instruments.”¹⁵ The new IIAs include more specific, complex and sophisticated provisions than before.

Moreover, the number of IIAs between and among developing countries has been increasing rapidly in these twenty years. Although these IIAs, especially those between developing countries, address different development objectives, they work as a mechanism for economic cooperation among contracting parties.

The growth of FDI flow and increasing numbers of IIAs between and among developing countries “may be mutually reinforcing: increasing FDI flows may provide an impetus to strengthen the protection of investment by means of IIAs, while IIAs, in turn, may play a role in promoting and facilitating investment flows.”¹⁶

15 UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, pp. 3-4, 2005.

16 UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on

As a host region for FDI, the East Asian economies have applied more policy changes favorable to foreign investors unilaterally and internationally. While they become capital-exporting countries, they consider these agreements as means to provide protection of investment.

1.2.3.2 The development of IIAs

In the 20th century, most of the developed and developing countries had a common consensus of achieving better living standards of people universe through a fairer distribution of the wealth and advancement within the United Nations structure.¹⁷ However, there were deep differences in expectations and interests between these two groups.

Nevertheless, several documents related to investment and economic development were adopted within the United Nations system. The United Nations General Assembly issued Resolution No. 1803 (XVII) “permanent sovereignty over natural resources”¹⁸ in 1962. It provided sovereign States the principles for nationalization measures and investment agreements. The General Assembly further issued Resolution No. 3201 (S-VI) “Declaration on the Establishment of a New International Economic Order”,¹⁹ Resolution No. 3202 (S-VI) “Programme of Action on the Establishment of a New

International Investment Policies for Development, UNCTAD, pp. 3-4, 2005.

17 In principle, only “sovereign states” are allowed to be UN members.

18 General Assembly Resolution A/RES/1803(XVII), available at <http://www2.ohchr.org/english/law/pdf/resources.pdf> (last accessed on 2010/02/05). It provided recognized the right to nationalize property only for public purposes, security or national interest, subject to the investor receiving “appropriate compensation” in accordance to domestic and international law.

19 General Assembly Resolution A/RES/S-6/3201, available at <http://www.un-documents.net/s6r3201.htm> (last accessed on 2010/02/05). Article 4(e) states that a State has the right to nationalize its resources.

International Economic Order”,²⁰ and Resolution No. 3281 (XXIX) “Charter of Economic Rights and Duties of States”²¹ in 1974.

By the end of the 20th century, many developing countries agreed to enter into bilateral and multilateral agreements to promote themselves as business-friendly, especially investment-friendly, countries. This trend now in the 21st century appears to have moved from BITs towards bilateral and regional PTIAs.

Bilateral investment agreements (BITs) and double tax treaties (DTTs) are the traditional types of international investment agreements. Preferential trade and investment agreements (PTIAs), including free trade agreements (FTAs/RTAs) with investment components have become popular since 2000.

Although the World Trade Organization is mainly concerned with trade, it deals with FDI through its agreements with basic principles and standards, including General Agreement on Trade in Services (GATS), Agreement on Trade-Related Investment Measures (TRIMs), and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Recently negotiated or re-negotiated IIAs can be divided into two groups. First, most recently negotiated or re-negotiated BITs took the form of the new model BITs of the United States and Canada. The second is increasing free trade agreements, which contain

20 General Assembly Resolution A/RES/S-6/3202, available at <http://www.un-documents.net/s6r3202.htm> (last accessed on 2010/02/05).

21 General Assembly Resolution A/RES/29/3281, available at <http://www.un-documents.net/a29r3281.htm> (last accessed on 2010/02/05).

a chapter regarding investment, and these are influenced by the North American Free Trade Agreement (NAFTA).

Provisions of recently negotiated or re-negotiated IIAs have been influenced by recent investment dispute settlement cases between investors and states/governments. The main impact of investor-state dispute settlements (ISDS) cases on the investment rule-making in recent agreements manifested in the substantive and procedural provisions.

The main substantive provisions include definition of investment, standards of treatment, and principles of protection. Transparency obligations of contracting countries are given an importance as well. These IIAs clarify the meaning of provisions and obligations of contracting countries to be in accordance with international law. They also influence the establishment of new international standards.

Some economies, especially those of the Asian Pacific region have recognized that the specific wording of IIA provisions is important to the outcome of an investment dispute. The specific wording of IIA provisions will have an effect on whether the objectives of a country concluding such an IIA will be achieved or not.

Roberto Echandi found that

An increased number of Investor-State dispute settlement (ISDS) cases have generated a growing body of jurisprudence touching upon key procedural and substantive aspects of investment law...international ISDS experience over the last decade has influenced the development of a new generation of IIAs in the

Asia-Pacific Region.²²

1.3 The case of Taiwan and its investors in the East Asian economic integration

1.3.1 Difficulty of legal status for Taiwan to participate in international and regional economic institutions

Taiwan has many typical characteristics of an island economy and is a self-ruling, democratic and market-oriented economic country. It greatly relies on trade and cross-border direct investment in manufacturing, service activities, and sales channels. It plays a dual role in the international industrial production network in the global economy, most notably in the field of electronics and IC wafer production.

However, Taiwan is currently excluded from the process of East Asian institution-driven economic integration because of China's opposition and the legal difficulty due to Taiwan's status in international law.²³ The largest challenge for its government is protecting the rights and interests of its nationals abroad with its weak political capacity.

Taiwan's legal status has been an issue since 1949, while the nation China, Republic of China (1911-1949) in mainland China area, has been divided under two separate governments.²⁴

22 Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 127-144, 2009.

23 For more discuss about the legal status of Taiwan, see Eric Ting-Lun Huang, *The Status of Taiwan under International Law and in a Changing World*, SJD thesis, Golden Gate University, 2002.

24 Eric Ting-Lun Huang, *The Status of Taiwan under International Law and in a Changing World*, SJD thesis, Golden Gate University, pp. 14-19, 2002.

In 1949, the Kuomintang (KMT) government took the name Republic of China (ROC) and moved to the Taiwan island.²⁵ In October 1949, the Communist Party (CCP) established the People's Republic of China (PRC) in Beijing, and took control of mainland China.²⁶

Thereafter the government of Taiwan has been known as ROC on Taiwan officially, or Formosa, Taiwan, or simply Taipei. It has its sovereignty on a defined territory consisting of the islands of Taiwan, Penghu, Kinmen, Matsu, and several islands. The Taiwan Strait divides Taiwan and its surrounding islands from the mainland China area.

Taiwan, ROC, has not been recognized as a sovereign state by most countries in this international community because of the obstruction of China, PRC.²⁷ Taiwan, ROC, has been denied membership in the United Nations and has been unable to develop normal relations with most nation states.²⁸

Manufacturing for foreign investors provided the engine for Taiwan's remarkable

25 The KMT government moved from Nanking to Canton, and then to Taiwan. Chiang Kai-shek and his followers went into exile on Taiwan, about 100 miles off the southeast coast of the mainland, across the Taiwan Strait.

26 In October 1949, the Communist Party (CCP) won a civil war and established the People's Republic of China (PRC) in Beijing. The government of PRC in Mainland area, led by Mao Zedong, announced its sole legitimate sovereignty over whole China. The PRC has been recognized as "China" since 1949 and People's Republic of China supplanted the Republic of China as the "Chinese representative" in the United Nations in 1971.

27 Under China's One China Policy, it insists that Taiwan area is part of China.

28 It makes Taiwan difficultly to participate and contribute to the international community, and receive the respect that people of Taiwan should have earned. Under the UN General Assembly Resolution 2758, the UN General Assembly admitted Beijing (China, PRC) to take the seat and replace Taipei (Taiwan, ROC) in the United Nations and the Security Council. See Eric Ting-Lun Huang, *The Status of Taiwan under International Law and in a Changing World*, SJD thesis, Golden Gate University, pp. 32-35, 2002.

economic growth since the 1960s. During this period, investors of Taiwan manufactured on behalf of foreign investors of developed countries, mainly the United States and Japan. This type of manufacturing was known as original equipment manufacturing (OEM).

Due to the rising labor and land costs, the rise in exchange rates, and increasing concern about environmental protection in Taiwan, Taiwan's industries, especially the labor-intensive manufacturing sectors, have started to migrate to Southeast Asian economies since the 1980s.

Taiwan has been both a capital-importing and a capital-exporting economic entity since the 1980s. In order to enhance its development objectives, the government used various policies and measures, at national and international levels, not only to promote trade and FDI but also to protect rights of its people.

Since the Asian financial crisis in the 1990s, Taiwan has lost its low-cost advantage to China, Vietnam, and other Southeast Asian economies. Many local investors of Taiwan have tried to remain competitive by turning into original design manufacturers (ODM).²⁹ Others have moved their production and operation to low-cost economies.

Some of them thus become large MNEs, and more competitive. Some of these MNEs tried to reap the profits of selling their own products under their own brand names thereafter. They took the "Smile Curve" model and hoped to remain competitive internationally.

²⁹ They enhanced their OEM capabilities with product design services.

Under the trend of globalization, Taiwan has been active in the global economy.³⁰ However, the people of Taiwan have more political and personal risks than others from different sovereign states when they are traveling or doing business across borders because the government of Taiwan has weak capacity to protect their rights and security.

Moreover, because of the difficulty for the government of Taiwan negotiating and signing the IIAs with other countries, investors of Taiwan take the higher risk than those of other countries.³¹

1.3.2 Negative effects of being excluded from governmental international organizations on Taiwan and its people

Because the opposition of its neighbor, China (PRC), Taiwan has been denied not only membership in the United Nations and most international organizations, but also formal relations with major nations.

Taiwan currently is not a member state of the United Nations. It is unable to enjoy the rights and benefits, such as utilizing the functions of the UN system of organizations and UN-affiliated organizations, accorded to member states.

Because it is not a member of the UN, Taiwan is also unable to become a member of the World Bank, the International Finance Corporation, or the International Development Association. As a result, it cannot utilize these organizations' technological assistance,

30 See The Republic of China Yearbook 2008 - CHAPTER 6 Foreign Relations, available at <http://www.gio.gov.tw/taiwan-website/5-gp/yearbook/ch6.html> (last accessed on 2009/10/20).

31 Those BITs and DTTs signed by Taiwan have not been renegotiated yet. The government of Taiwan did conclude FTAs with several countries which have official diplomatic relations. However, there are no IIAs between Taiwan and its major trade and FDI partners, including East Asian economies. Currently, there are negotiations of ECFA between the two sides of the Taiwan Straits.

personnel training, and consultation services.³²

Opportunities for Taiwan to invest in other countries have been negatively affected and reduce its economic competitiveness in the regional production network and global market. Cross-border business activities of its nationals thus have been affected.

The people of Taiwan have tried to survive in such a difficult and competitive world not only attracting FDI inflows but also investing abroad. Taiwan and its investors, both local and overseas, have been playing an important role in the industrial production sharing chain in the East Asian region. Trade and FDI of Taiwan have contributed to the market-driven integration in this region.

Signing investment agreements with Taiwan's major economic partners might be one of the mechanisms to either help Taiwan's investors to expand their business to global markets or build closer economic relations with these countries. The removal of non-tariff barriers, such as investment protection, IP protection, and avoidance of double taxation, could be more important than tariff barriers for Taiwan and its investors while the global economic grows slowly.

However, Taiwan and its investors still face unusual difficulties that might not happen to most countries and their nationals.

The mechanisms for investment disputes settlement are an example. Disputes arising

³² For examples, the interests are in political, social, scientific, educational, health-related, economic, cultural fields. It has alone in preventing and fighting disease, environmental problems, and some other global risks. Taiwan could not exert a powerful stabilizing influence on international finance nor be assisted by related organizations.

from FDI of Taiwan's investors especially in the East Asian economies are common.

However, Taiwan has tried to join the international organizations, includes the World Bank and the International Center for Settlement of Investment Disputes (ICSID), in order to find some better way to protect the interests of the people of Taiwan in their activities across the world, but has not yet succeeded.

Therefore, when international investment disputes arise, Taiwan's investors are unable to use the ICSID's international arbitration mechanism to obtain a fair and reasonable solution. Nor can they take advantage of these binding arbitration decisions in other countries in accordance with the New York Convention.

When more countries are signing new model BITs or re-negotiating BITs, and concluding other new types of investment agreements, Taiwan's current investment treaties are unable to provide international arbitration mechanisms, such as the ICSID, for settling investment disputes.

Although Taiwan, through its many years of economic development, has become a major source of FDI, surveys show that Taiwanese firms, most of them small and medium-sized enterprises (SMEs), are not good at using international arbitration to protect their rights and interests in international investment disputes.

China currently is the largest trade partner and host economy of FDI originating from Taiwan. However, there is no bilateral agreement between Taiwan and China to date.

What the investors of Taiwan did to solve the problems under this situation was to either share the holding of the company with a national of the host country, or with a national of a country with standing under the ICSID to benefit from investment

agreements with China.

Before there is a well-built bilateral agreement concluded, the better way for Taiwan's investors today is making their provisions more detailed in their investment contracts, which include the methods of dispute settlement, before their business relationships begin. However,, there must be some agreements or conventions for the protections of the investors of Taiwan in the future.

Issues of FDI originating from Taiwan will be discussed in Chapter Four.

1.4 The importance and purpose of thesis

In the last two decades, developing countries have become capital-exporting countries due to the trends of globalization and liberalization, as well as their open-door policies. They are actively negotiating and signing IIAs with developed and other developing countries for at least two reasons. One is that they think these agreements could be “tools” to attract trade and FDI flows which would benefit their economic growth and development. The other is that the existence of an IIA could protect investment of home country in the territories of other contracting countries.

The multilateral negotiations of the WTO have been consistently delayed. Some other multilateral economic platforms, including those comprising fewer economies than the WTO, have many of the same issues and complications as its larger cousin. During the same period, there has been an increase in overlapping bilateral and regional free trade agreements, especially in the East Asian and Pacific region. The new IIAs include

more specific, complex and sophisticated provisions than before.

Although these IIAs, especially PTIAs between developing countries, address different development objectives, they work as a mechanism for economic cooperation among contracting parties.

Some of them did not use a good model for their contents. The implementation of IIAs may cause change in the domestic legal systems of individual contracting countries. A well-built bilateral or regional agreement is necessary for domestic legal systems to move towards their respective national development objectives.

Moreover, the form of PTIAs has resulted in several negative effects, such as diversion of trade and FDI, marginalization of some economies/countries, and “spaghetti bowl” problem. Moreover, some East Asian economies were left out of bilateral or regional PTIAs because they are not favored politically, they cannot afford the costs of many separate negotiations, or because their regional neighborhood is less open.

1.5 Structure of the thesis

This chapter sets the framework of the discussion and introduces the background, analyzing the importance of FDI and IIAs in the current global economy and providing an overview of the paper.

In the second chapter, the links between trade and FDI are introduced. This will explain that the economic growth and development of individual economies are mainly the result of regional market-driven economic integration in the East Asian region. There is a shift from market-driven economic integration toward institution-driven economic integration through the rapidly increasing number of bilateral and regional agreements.

The broader scope and complex content of these agreements are not limited to trade, but cover investment and other issues.

Chapter Three will describe the increasing number of IIAs in the process toward regional institution-driven economic integration in the East Asian region. It will analyze the current related international law on foreign direct investment and the recent development of IIAs.

The difficulty for an economy like Taiwan to protect the rights of its investors across borders and maintain its connection to international industrial production networks will be addressed in Chapter Four. Taiwan is an economic entity which is not favored politically due to Taiwan's status in international law and has been left out of the process of negotiating or signing new IIAs with its major economic partners. The thesis suggests that for regional economic growth and development, Taiwan should not be excluded from the current process of institution-driven regionalization.

Chapter Five will discuss the challenges for the current process of institution-driven economic integration in the East Asian region. It presents the difficulties of current IIAs in the region and the impact of current IIAs on some economies, which were left out of bilateral or regional PTIAs.

The last chapter provides a summary of my findings, concluding that the East Asian economies should cooperate in international investment arrangement conforming to international law. This chapter also recommends that, for an economic entity like Taiwan, using the WTO and APEC as models for economic cooperation in reaching investment arrangements in the region is beneficial, and indeed necessary.

CHAPTER TWO.

THE RISE OF THE INTERNATIONAL PRODUCTION SHARING CHAIN AND MARKET-DRIVEN ECONOMIC INTEGRATION IN EAST ASIA

2.1 Introduction

Regional economic integration generally takes two forms. One type is “de facto” and the other one is “de jure.” The former refers to the market-driven integration, natural business cooperation through goods and service trade and the movement of capital and labor. It may be characterized as “regionalization,” which “arises as a result of natural economic developments in that the benefits of agglomeration including economies of scope, scale, and speed outweigh the costs of agglomeration such as congestion.” The latter refers to the institution-driven integration involving institutional arrangement, such as regional trade agreements, and policy coordination of governments. It may be characterized as “regionalism.”³³

The rapid expansion of trade among East Asian economies has been mainly result of industrial cooperation of multinational enterprises (MNEs) and local firms in the form of the production sharing chain combined with the distribution networks. Trade associated with production fragmentation has been the driving force behind the increased economic integration, the market-driven integration, in the East Asian region.

33 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6). See also Tsai-Lung Hong, Associate Research Fellow of Department of International Affairs, Taiwan Institute of economic Research, *East Asian Economic Integration and Taiwan's FTA's Strategies*, a report of Taiwan Institute of economic Research, 2008. available at http://www.ctasc.org.tw/05subject/s_02_56.doc (last accessed on 2009/08/14).

This market-driven integration benefits from trade liberalization in the form of reduction in tariff rates and non-tariff barriers. Several policies promoting exports were adopted unilaterally by East Asian economies while they were capital receivers as host countries. These domestic policies related to FDI had similar effects of trade liberalization that could encourage FDI inflow.

Many East Asian economies reduced restrictions on FDI. Some economies adopted substantial FDI liberalization measures to attract foreign investors. Others introduced incentives, such as tax preferences, to attract FDI inflow. There has been competition among the East Asian economies for attracting FDI by reducing barriers and providing incentives.³⁴

Economies intended to establish closer and more peaceful relationships with their economic partners by promoting trade and FDI. They signed international investment agreements (IIAs), includes bilateral investment agreements (BITs), double tax treaties (DTTs), and preferential trade and investment agreements (PTIAs). The East Asian regionalism emerged in late 1990s while the institution-driven European and North American regionalization existed prior to that time.³⁵

East Asian economies became members of the World Trade Organization (WTO) sequentially with the wish to be successfully active in the world economic community

34 Restrictions on FDI take various forms, including restrictions on market access, most-favored-nation treatment, and national treatment. For example, the method of reducing restrictions on market access includes reducing the number of sectors and industries on the negative list and relaxing the limits on foreign equity ownership. See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

35 The European Union (EU) and the North American Free Trade Agreement (NAFTA).

and create new opportunities for the further development of relations with other members using the WTO framework. WTO, a multilateral trading system formed in 1994, combines rules based on nondiscrimination among trading members.

However, the Asian currency crisis in 1997 hit the East Asian economies seriously, and was a turning point that made people re-think about the weakness and limitation of this region. It made them consider the necessity of strengthening economic integration in East Asia.

At the same period, the WTO could not launch a new round of trade negotiations at the Seattle Ministerial Conference in 1999 and the Early Voluntary Sectoral Liberalization (EVSL) initiative in APEC could not come to a result in trade liberalization. Thus, newly forming, establishing, and re-negotiating regional trade arrangements, includes free trade agreements (FTAs), became a popular issue.

Large MNEs of home countries influence governments by encouraging them to place the policies of deregulation controls and reduction of barriers on trade and FDI onto the agendas of regional and multilateral economic organizations. Some of them influenced forming the contents of domestic policies and regulations and international agreements.

Global Deployment of MNEs and cross-border direct investment with intra-industrial trade could be the reaction to or strategic impetus for the trend of globalization.

2.2 Links between trade and FDI in East Asia

2.2.1 Rapid Expansion of Intra-regional Trade in East Asia³⁶: Vertical Intra-industry or intra-firm trade and trade in parts and components

Since the 1990s, there have been remarkable changes in trade patterns,³⁷ including trading partners and items. These developments were seen as a marked change in considering formal regional cooperation in East Asia. One notable characteristic is a large share of vertical intra-industry trade in intra-regional trade in East Asia. The new development of the expansion of intra-East Asian trade is the international exchange of intermediate goods of different quality and price, which includes parts and components rather than final goods.³⁸

36 This chapter will focus on East Asia includes Southeast Asian economies (ASEAN: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam) and Northeast Asian economies (China, Japan, Korea, and Taiwan).

37 See Global Economic Prospects (GEP) 2005 - Trade, Regionalism, and Development, The International Bank for Reconstruction and Development, The World Bank, pp. 46-49, 2005.

The structure of international trade has changed in three fundamental ways. First exports of manufactured products from developing economies and trade in manufactures among them have become increasingly important. Next, the integration allowed developing economies to specialize the production chains with trade in intermediates. Finally, FDI is playing an ever-increasing role in the integration process. These developments have facilitated the integration of economies that have adopted relatively open trade policies, and have increased the disadvantages for the economies that have segmented from global markets.

Available at <http://siteresources.worldbank.org/INTGEP2005/Resources/gep2005.pdf> (last accessed on 2009/8/12).

38 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006.

Two types of intra-industry trade may be identified. One is vertical intra-industry trade. The other one is horizontal intra-industry trade, where products of similar characteristics in quality and price but with different design and other characteristics are traded. Such trade may occur between the countries with similar

In the finding of Aminian, Fung, Iizaka, and Siu:

This phenomenon results from the emergence of a new form of global production – international fragmentation of production where the production process of a final product is split into two or more steps and each production step is undertaken in different locations across national boundaries.³⁹

The United Nations Commodity Trade Statistics Database (UN COMTRADE)⁴⁰ Broad Economic Categories (BEC) classified the categories of trade as “semi-finished goods, components and parts, capital goods and final consumption goods.” This helps the study of the relation between trade and economic growth in developing countries. It also shows the growing importance of the various modes of trade in East Asia.⁴¹

income levels, where consumers have similar taste but they have demand for variety.”

Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

39 See Nathalie Aminian, K. C. Fung, Hitomi Iizaka, and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in *Emerging trade issues for the policymakers in developing countries Asia and the Pacific*, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. Available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25).

40 The UN COMTRADE is the pseudonym for United Nations Commodity Trade Statistics Database. It is the largest depository of international trade data. Available at <http://comtrade.un.org/> (last accessed on 2009/8/25).

41 See Nathalie Aminian, K. C. Fung, Hitomi Iizaka, and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in *Emerging trade issues for the policymakers in developing countries Asia and the Pacific*, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. Available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25).

According to several statistics counted by international institutions,⁴² one notable characteristic of East Asian trade in since the 1980s is the rapid expansion of intra-regional trade, which means trade between or among East Asian economies.⁴³

The proportion of intra-industrial trade, with most of vertical intra-industrial trade, has been increased from 32.7% in 1980, 57.5% in 1990, and to 78.6% in 2006. This shows that the different levels of economic growth of East Asian economies has developed a regional network of production sharing chain as East Asia is a factory with various quality and characteristics. Because of the complete network of East Asian industrial production sharing chain, intra-industrial trade, with most intermediate goods, has been rapidly growing.⁴⁴

Another characteristic is the share of intra-regional trade in the East Asian region's overall trade. The share of intra-regional exports and imports in East Asia's overall exports and imports has increased since 1990s.

42 These international institutions include international economic organizations, such as WTO, UNCTAD, World Bank, IMF, regional Development Banks, and academic or private research institutions.

43 Many studies have identified rapid expansion of intra-regional trade in East Asia. For example, Peter A. Petri, *The East Asian trading bloc: An analytical history*, in J.A. Frankel and M. Kahler, eds., *Regionalism and Rivalry: Japan and the United States in Pacific Asia*, Chicago University Press, Chicago, pp. 21-48, 1993; Francis Ng and Alexander Yeats, *Major Trade Trends in East Asia: What are their Implications for Regional Cooperation and Growth?* Policy Research Working Paper No. 3084, The World Bank, 2003; Shujiro Urata, *Emergence of an FDI-Trade Nexus and Economic Growth in East Asia*, in Joseph Stiglitz and Shahid Yusuf, eds., *Rethinking the East Asian Miracle* The World Bank, Oxford University Press, pp. 409-459, 2001, and Masahiro Kawai, *East Asian Economic Regionalism: Progress and Challenges*, *Journal of Asian Economics* Vol. 16, pp. 29-55, 2005.

44 The United Nations BEC classification is utilized to categorize total trade into trade in semi-finished goods, trade in components and parts, trade in capital goods as well as trade in final consumption goods. It shows that the increasing importance of East Asia as a trading region is due at least partially to the rising trade in components and parts.

East Asian economies, including Taiwan and China, enjoy a comparative advantage in labor-intensive industries.⁴⁵ These economies are engaged in assembly of these products, which require labor-intensive rather than high-technology intensive operations. These labor-intensive industries included textiles and garments products in the 1990s, and high-tech products, such as electrical and electronics products, since 2000. This reflects the “inter-process division of labor”⁴⁶ developed in East Asia.⁴⁷

45 According to the finding of Shujiro Urata, Japan and Korea have a comparative advantage in medium- and high-technology products because they have with their well-educated human resource. On the contrary, developing economies in East Asia, including most ASEAN countries China have a comparative advantage in low technology products because they provide low-wage labor. Indonesia and Malaysia have a comparative advantage in natural resource-based products with their abundant natural resources.

[D]ue to the development of inter-process division of labor in East Asia, where labor-intensive process in the production of high technology products is conducted in low-wage developing economies. As we will see later, the main promoter of developing inter-process division of labor is multinational corporations (MNCs) from developed economies such as Japan and the United States and developing economies from Korea, Taiwan and others... Under the triangular trade, parts produced by Japan and the NIES are exported to China and ASEAN countries to be assembled as finished products, which in turn are exported to North America and Europe...

See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, pp. 8-11, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

46 The change of the labor division system has been in both qualitative and quantitative.

47 “Japan and Korea exhibit a similar pattern in that they have a comparative advantage in medium to high technology products. Medium technology products include automotives, chemicals and industrial machinery, while high technology products include electrical and electronics products.” See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

These characteristics demonstrate that East Asia in fact plays an important role as the world's factory. That means that this region manufactures parts and components and has become an import product source rather than an export destination. This allows exports to other economies, such as China, whose trade with non-East Asian countries expanded faster than that with East Asian economies.

The increasingly important position of China in trade is shared by all the East Asian economies. It should be noted that the ASEAN economies and the NIEs have accounted for similar importance in East Asia's trade since 2000.

2.2.2 Foreign direct investment (FDI) plays an important role in the patterns of trade and the phenomenon of Flying Geese in East Asia

Foreign direct investment is defined in the IMF, Balance of Payments Manual, 5th edition, as “investment that involves a long-term relationship reflecting a lasting interest of a resident entity in one economy (direct investment) in an entity resident in an economy other than that of the investor. The direct investor's purpose is to exert a significant degree of influence on the management of the enterprise resident in the other economy.” Both the IMF and OECD recommend a 10% stake for identifying direct investment.⁴⁸

48 See John H. Dunning and Sarianna M. Lundan, *Multinational Enterprises and the Global Economy*, Edward Elgar, p. 7, 2008.

FDI is different from foreign portfolio investment in two important respects. First, the former involves the transfer of a package of assets or intermediate products, which includes financial capital, management and organizational expertise, technology, entrepreneurship, incentive structures, values and cultural norms, and

It is widely recognized that FDI produces economic benefits to the recipient countries by providing capital, foreign exchange, technology, competition and by enhancing access to foreign markets.⁴⁹ Developing countries have opened themselves to FDI, improved the operational conditions and strengthened standards of treatment and protection for foreign investors.⁵⁰

In fact, the developing countries are competing with each other to attract FDI by adopting different promotional policies unilaterally, such as liberalizing trade regimes or establishing special economic zones, and offering other incentives to the foreign investors. They encourage FDI because they take it as a mean an injection of capital, technology, skills, employment, and ultimately access to markets. Developing countries implement policies of trade and FDI liberalization for their economic growth and development.

The developing countries intended to attract FDI, either creating a more favorable investment climate through changing their domestic FDI policy and regulations at the domestic level, or providing a stable and transparent investment climate by including their countries in more IIAs at the regional and/or international level.

access to markets across national boundaries; the last involves only the transfer of financial capital. Second, unlike arm's-length trade in assets and intermediate productions, FDI does not involve any change in ownership; in other words, the power to control decision making over the use of the transferred resources remains in the hands of the investing entity.

49 See Khondoker Abdul Mottaleb, *Determinants of Foreign Direct Investment and Its Impact on Economic Growth in Developing Countries*, p.2, MPRA Paper, No. 9457, posted 05. July 2008, available at http://mpra.ub.uni-muenchen.de/9457/1/MPRA_paper_9457.pdf (last accessed on 2009/06/02).

50 See Karl P. Sauvant and Lisa E. Sachs, *An Overview of "The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows"*, p. 2, Oxford University Press, 2009.

Foreign direct investment flows to East Asia increased rapidly since the mid-1980s. The most important internal domestic factor was the liberalization of both trade and FDI policies. Several notable characteristics, which have implications on trade patterns in East Asia, can be found for the recent FDI inflows to East Asia.⁵¹

FDI is an important driving force in trade associated with production fragmentation in the East Asian region. It is an important factor in explaining trade in components and parts as well as capital goods.

The rising intra-industry and intra-firm trade in components and parts and increasing foreign direct investment production and trade network have increased the importance of trading position of the East Asian region.⁵² The market-driven economic integration is one factor of economic growth in the East Asian region.

East Asia has a relatively short history of growth in development of secondary and tertiary industry. The industrial relocation of Japan's MNEs followed the 1985 Plaza

51 For the external factors such as currencies: "the appreciation of the currencies of the NIEs against the U.S. dollar in the late 1980s promoted FDI outflows from the NIEs to other East Asian countries". See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, p. 11, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

52 "FDI is indeed important in explaining the performance of intra-East Asian import and export trade, particularly in the case of trade in components and parts, followed by trade in capital goods." See Nathalie Aminian, K. C. Fung, Hitomi Iizaka and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in *Emerging trade issues for the policymakers in developing countries Asia and the Pacific*, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. available at <http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25)

Accord for Yen appreciation. The first tier Newly Industrialized Economies (NIEs)⁵³, including Taiwan, have been following Japan, and were tracked by China and the ASEAN economies, especially the second tier NIEs, in their catch-up-with-Japan race. These economies have been following Japan's industrializing process to achieve the most competitive industrial structure as a group of "flying geese."⁵⁴

53 See Thomas M. Leonard, *Encyclopedia of the Developing World*, Taylor & Francis, p. 1130, 2006.

Newly industrialized economies (NIEs) are defined as: the economies of export-led industrialization. The World Bank established a GNP per capita threshold to determine which developing countries belonged to this category. At the beginning of the 1980s, the World Bank used the term "newly industrialized economies" for the first time. The Organization for Economic Cooperation and Development (OECD), however, prefer the term "newly industrialized countries... But the two international organizations converged regarding their explanation of this category: it involves a scheme of development based on a contribution of industry above 25% to GNP, with exports composing the major part of manufactured products; the developing country has high economic growth and the gap with developed countries is closing.

The term "Four Asian Tigers" or "Asian Tigers" refers to the highly industrialized economies of Hong Kong, South Korea, Singapore, and Taiwan. They were relatively poor and had an abundance of cheap labor during the 1960s. But they started their educational reform and established a cheap but productive workforce. Furthermore, they committed to equalitarianism in the form of land reform, to promote property rights and to ensure that agricultural workers would not become disgruntled. These regions were noted for maintaining exceptionally high growth rates and rapid industrialization between the early 1960s and 1990s. In the 21st century, with the original four Tigers are considered "developed" region or areas, attention has increasingly shifted to other Asian economies which are now experiencing rapid economic transformation.

54 "Flying Geese Theory" is first introduced by Kaname Akamatsu in 1935.

The 'Flying geese' pattern was first exemplified by Akamatsu, K (*Trade of Woolen Products in Japan*, Studies of Commerce and Economy 19, 129-212, 1935) before World War II, and later extended and elaborated by Akamatsu himself (*A Historical Pattern of Industrial Developing Countries*, The Developing Economies, March-August, pp. 1-25, 1962), and by Yamazawa, Ippei (*Economic Development and International Trade: The Japanese Model*. Honolulu: East-West 1990), Kwan, C.H. (*Economic Interdependence in the Asia-Pacific Region: Towards a Yen Bloc.*,

Investors of Japan had been active in the East Asian region in various forms since the 1950s. After the 1985 Plaza Accord⁵⁵ and the rapid yen appreciation, investments from Japan in the ASEAN economies grew quickly. Japan entered into a long phase of structural depression in 1990s. Thus investors of Japan sought to cut production costs by developing facilities in different locations in East Asia which offered low-cost labor. This move resulted in supporting the industrial development of East Asia.⁵⁶

In the 1980s, the newly industrialized economies were the first to make the transition to industrialization. The production fragmentation, resulting in huge trade of components and parts among the NIEs in the East Asian region, has brought regional economic integration in East Asia.

The market-oriented economies of the NIEs developed at the beginning of the 1980s

London: Routledge, 1994), Ezaki, Mitsuo (*Growth and Structural Change in Asian Countries*, Asian Economic Journal 9, 113-35, 1995) and Lo, Fu-Chen (*Globalization and Transformation of Southeast Asian Economies*, Third International Conference in Memory of K.S. Liang, Department of Economics, National Taiwan University, 1998), among others.... the sequential rise and fall of the production/exports of a single product among different countries at their different stages of development.

See Yun-Peng Chu, *Trends and Issues in Taiwan: Bringing the Flying Geese Back In*, in Trends and Issues in East Asia 2000, pp. 282-304, Foundation for Advanced Studies on International Development (FASID), available at <http://www.fasid.or.jp/english/publication/research/issues.html> (last accessed on 2009/7/13).

55 Debates about 1985 Plaza Accord, See Arthur M. Whitehill, Japanese management: Tradition and transition, Routledge, p. 202, 1991; and Curtis Andressen, A Short History of Japan: From samurai to Sony, Allen & Unwin, pp. 164-172, 2002. The full text of the Plaza Accord in 1985 is available at <http://www.g8.utoronto.ca/finance/fm850922.htm> (last accessed on 2009/8/11)

56 "Japanese enterprises relocate into Southeast Asia, and established a basic pattern of 'trading triangle' in East Asia. Economic success in Japan, followed by the Four Asian Tigers, has been attributed to the existence of harmonious labor-management relations." See W. Dean Kinzley, *Industrial Harmony in Modern Japan: The Invention of a Tradition*, Routledge, 1991.

and then the intra-regional trade increased at the end of the 1980s. The first tier NIEs included Singapore, Hong Kong, Taiwan, and South Korea, also called as “the four dragons of Asia.” Later, the four ASEAN countries, Thailand, Malaysia, Indonesia, and the Philippines, were classified as the second tier NIEs in East Asia.

However, these economies have met difficulties after they lost their initial competitive edge, cheap productive labor. China, India and some Southeast Asian economies have emerged as fast-growing economies based on cheaper labor. They largely replaced the first tier NIEs. After China joined the East Asian division-of-labor system, East Asian intra-regional trade and economic activities developed rapidly. At the same time, intra- and extra-regional economic integration has also progressed at a faster pace.

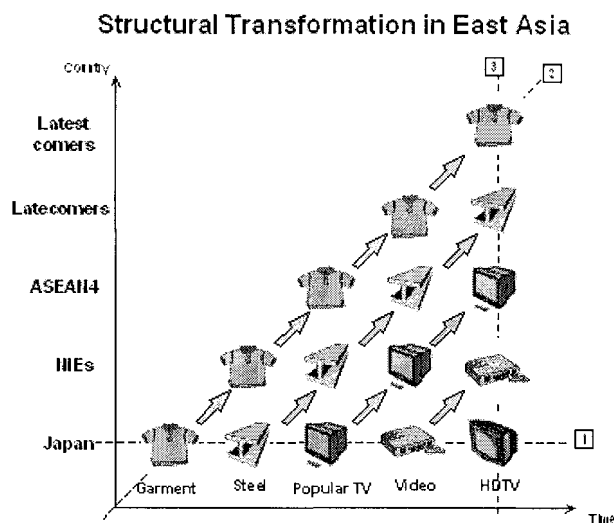
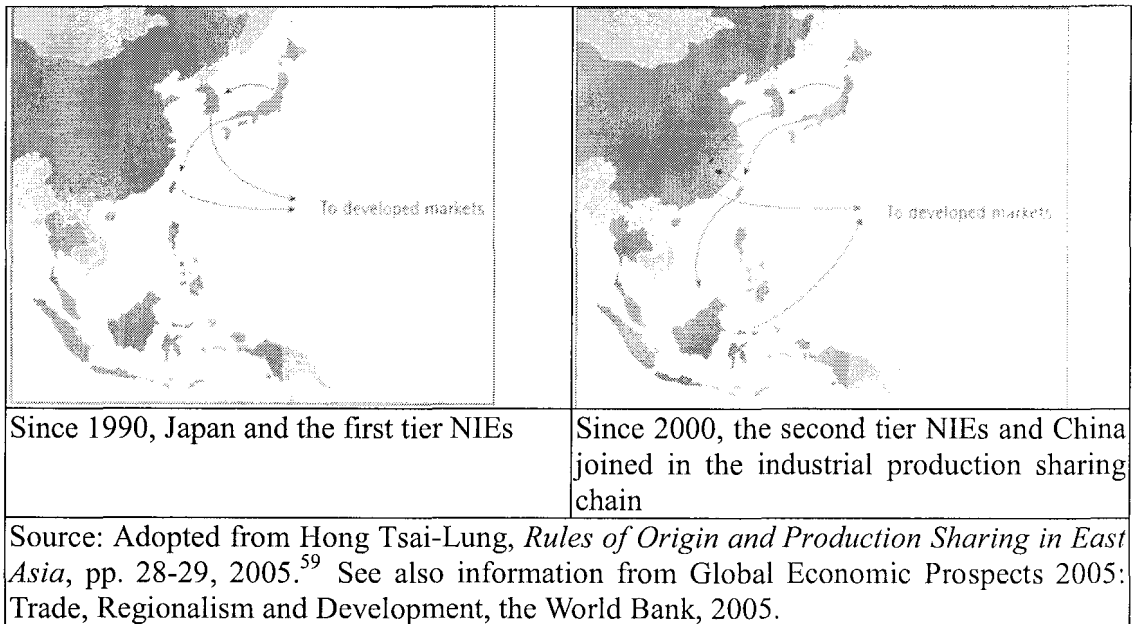
Today, almost every East Asian economy has developed its own industrial identity.⁵⁷ Contrasted with the other East Asian economies, Japan is a large supplier of parts and components⁵⁸ and is recognized as the leader of the flying geese of the East Asian

57 There is a network of “physical distribution for semi-finished goods” in this region. Taiwan developed as a key role within the industrial production chain of electronic and mechanical goods. Korea built its industries on automobiles, steel, heavy industries and electronics. India and Thailand are also cultivating automobile production. China has made itself become a major exporting country of almost every category of final products. Singapore plays a strategic role in transportation and recognized as a financial center and a physical distribution center in this region. Hong Kong plays a similar role as Singapore.

58 See R. W. Jones, H. Kierzkowski and C. Lurong, *What does the evidence tell us about fragmentation and outsourcing*, International Review of Economics and Finance, Vol. 14, pp. 305-316, 2004). MNEs from the United States trade (imports and exports) with East Asia are large enterprises. There is a general belief that these large MNEs from the United States and Japan are responsible for the production network phenomenon in East Asia. See Nathalie Aminian, K. C. Fung, Hitomi Iizaka and Alan Siu, *Foreign direct investment, intraregional trade and production sharing in East Asia*, in Emerging trade issues for the policymakers in developing countries Asia and the Pacific, United Nations and Economic and Social Commission for Asia and the Pacific (ESCAP), 2008. available at

factory. East Asia has been rising as an important trading entity in the world.

The production pattern of IT industry in the East Asia can serve as an example:



Source: <http://www.grips.ac.jp/module/prsp/box/img/geese1.gif>

<http://www.unescap.org/tid/publication/tipub2526.pdf> (last accessed on 2009/8/25).

⁵⁹ Available at http://www.ctasc.org.tw/05subject/s_21_3.pdf (last accessed on 2009/8/25).

Nathalie Aminian and K.C. Fung found that in general

FDI is indeed important in explaining imports and exports of intra-East Asian trade by using an instrumental variable approach. In particular, FDI is particularly important in explaining trade in components and parts, followed by trade in capital goods. This helps confirm that FDI and trade associated with production fragmentation in East Asia are indeed complementary.⁶⁰

2.2.3. The Industrial production sharing chain

The increasing globalization of the world economy and the fragmentation of production processes have changed the economic landscape. International fragmentation of production⁶¹ is a new form of global production. The increasing relation between FDI

60 See Nathalie Aminian and K.C. Fung, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp.36-37, Research Institute of Economy, Trade and Industry, Japan, 2007. Recited, see Busakorn Chantasawat, K.C. Fung, Hitomi Iizaka and Alan Siu, *Foreign Direct Investment in East Asia and Latin America: Is there a People's Republic of China Effect?* Asian Development Bank Institute Discussion Paper No. 17, 2004. available at <http://www.adbi.org/files/2004.11.dp17.fdi.prc.effect.pdf> (last accessed on 2010/1/27).

In terms of the stages of product cycle associated with production fragmentation, we can view fragmentation as having at least two broad phases: one associated with intra-firm trade or trade with other foreign multinationals, a second associated with outsourcing to local firms. Given our results which show that FDI is an important factor in explaining trade in components and parts as well as capital goods, we can conclude that the fragmentation stage of outsourcing to the local firms is still premature for East Asia.

This paper of study also shows that FDI in East Asia and China are complementary.

61 See "Chapter 7" of *From Disintegration to Reintegration - Eastern Europe and the Former Soviet Union* in *International Trade*, World Bank Report, pp340-351, February 2006.

Fragmentation of production offers a unique opportunity for producers in less developed and transition countries to move from servicing small local markets to supplying large multinational firms and, indirectly, their customers all over the world. This phenomenon is accompanied by an evolution in the nature of

and trade has been the result of the growing fragmentation of production combined with the creation of distribution networks spanning across borders.⁶²

The combination of advances in technology and creation of business-friendly environments has spurred a new global division of labor. Investors divided the industrial value chain into smaller functions and moved them to locations where production costs could be lower by setting foreign subsidiaries or branches, or contracting out to independent suppliers across borders. The spread of production across borders has been creating new linkages among economies, which create more opportunities for economies to access the global markets, and result in more competitions for investors.

The global economy has witnessed an increasing trend toward production fragmentation, which has been a key driver of global trade integration. The economic development of the interdependence in the East Asian region is driven by the market. The

competition, with its growing emphasis on customization of products, rapid innovation, flexibility, and fast response to changes in demand. In many cases, managerial and technological skills required to successfully compete in global markets make it impossible to rely on the resources of one country. Under these circumstances, integration into the production and marketing arrangements of the multinational corporations, rather than the pursuit of an autarchic national development strategy, has become the most efficient way of taking advantage of growth opportunities offered by the global economy. Fragmentation of production, however, also means that the multinational corporations have become more sensitive to changes in investment climate. They can relatively easily shift their production from one geographic location to another in response to changes in the cost of production, market access, regulatory conditions, or perceived risks.

Available at <http://go.worldbank.org/6WKTRSQMS0> (last accessed on 2009/8/12).

⁶² “International production and distribution network also known as a global commodity chain, refers to the whole range of activities involved in the design, production, and marketing of a product.” See Jan Winiiecki, *Competitiveness In New Europe: Papers From The Second Lancut Economic Forum*, Routledge, p. 105, 2008.

rapid expansion of trade among East Asian economies has been primarily the result of the industrial cooperation of MNEs and local firms in the form of production sharing chains, combined with the distribution networks. Trade associated with production fragmentation has been the driving force behind the increased economic integration in the East Asian region.

MNEs have a comparative advantage⁶³ in East Asian economies with their differences in the size, sources and economic policies. MNEs split up a production process of the final product into two or more steps. Each production step is undertaken in different locations across national boundaries with the theory of comparative advantage

63 Theory of comparative advantage:

The theory of comparative advantage predicts that the firms locate relatively labor-intensive segment of the production in the country where labor is abundant and locate relatively capital-intensive segment of the production in the country where capital is abundant... It is widely recognized that a significant amount of trade in the global economy is carried out in the form of intra-firm trade, which is symptomatic of the prevalence of FDI-based production networks. But, the dispersed production networks can include both intra-firm and arm's-length transactions. Initially, the development of international production networks may expand the volume of exports from FDI source country to the host country as the reallocation of production site increases exports of intermediate goods as well as capital goods required to engage in production... It may also increase imports of FDI source country as host country increase exports of finished products back to the source country. This trade-creating effect of FDI may change over time if foreign affiliates start sourcing intermediate goods locally or from third-country.

See Nathalie Aminian and K.C. Fung, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp. 1-4, Research Institute of Economy, Trade and Industry, Japan, 2007.

decided by MNEs. Such a phenomenon has been alternatively named “slicing the value chain,” “vertical specialization,” “international production sharing”, and “outsourcing”.⁶⁴

This chapter will use the term “industrial production sharing chain” to discuss this phenomenon in the East Asian region.

MNEs make their FDI location choice in different economies and play a key role in the developing inter-process division of labor forming the industrial production sharing chain. They create international production and distribution networks spanning the world and actively interacting with each other. Their FDI activities deepen intra-regional trade dependency among these economies. They reflect the market-driven economic integration and cooperation. They also result in the growth of intra-industry, intra-firm, or intra-product trade at the expense of traditional inter-industry trade.⁶⁵

64 “Slicing the value chain”: see Paul Krugman, *Growing World Trade: Causes and Consequences*, *Brookings Papers on Economic Activity*, No. 1, pp. 327-377, 1995; “Vertical specialization”: see D. Hummels, J. Ishii and K.M. Yi, *The nature and growth of vertical specialization in world trade*, *Journal of International Economics*, Vol. 54, No. 1, pp. 75-96, 2001. Also see Hildegunn Kyvik Nordas, *Vertical specialization and the quality of infrastructure*, Working Paper ERS2003-04, WTO Economic Research and Statistics Division, WTO, 2003, available at http://www.wto.org/english/res_e/reser_e/ersd200304_e.htm (last accessed on 2009/7/12); “International production sharing”, see Francis Ng and Alexander Yeats, *Production Sharing in East Asia: Who Does What for Whom, and Why?*, in Leonard K. Cheng and Henryk Kierzkowski, eds., *Global Production and Trade in East Asia*, Boston, Kluwer Academic, pp. 63-109, 2001. Also see Hildegunn Kyvik Nordas, *International Production Sharing: A Case for a Coherent Policy Framework*, Discussion Paper No. 11, WTO, 2005, available at http://www.wto.org/english/res_e/booksp_e/discussion_papers11_e.pdf (last accessed on 2009/8/12).

65 *Global Economic Prospects (GEP) 2005 - Trade, Regionalism, and Development*, The International Bank for Reconstruction and Development, The World Bank, p. 49, 2005. available at <http://siteresources.worldbank.org/INTGEP2005/Resources/gep2005.pdf> (last accessed on 2009/8/12).

FDI has been a driving force of economic integration in East Asia as well as trade. Several researchers⁶⁶ found that the East Asian economic integration is mainly driven by FDI through which a close and comprehensive production network has been built.

As tariff barriers have been cut down unilateral by economies, especially in manufacturing, efficiency-seeking FDI divides its production and looks to locate in the lowest-cost site. This form of FDI is associated with the rise in the production sharing chain and trade in components and parts.

In East Asia, the increasing FDI has created relocation and fragmentation of production processes within the region. This form of FDI also promoted the increasing trade in the share of parts and component intermediates of manufactured products in regional exports.⁶⁷

As observed in the World Investment Report 1996,

The issue is no longer whether trade leads to FDI or FDI to trade; whether FDI substitutes for trade or trade substitutes for FDI; or whether they complement each other. Rather, it is: how do firms access resources - wherever they are located - in the interest of organizing production as profitably as possible for the national, regional or global markets they wish to serve? In other words, the issue becomes: where do firms locate their value-added activities? In these circumstances, the decision where to locate is a decision where

66 See Meichu Chen, Specialist Economic Research Department, CEPD. *A Study on Division of Labor and Economic Integration in East Asia*, Economic Research Journal, Vol. 7, Council for Economic Planning and Development (CEPD), Executive Yuan, R.O.C., pp. 235-262, 2007.

67 Global Economic Prospects (GEP) 2005 - Trade, Regionalism, and Development, The International Bank for Reconstruction and Development, The World Bank, pp. 46-49, 2005. available at <http://siteresources.worldbank.org/INTGEP2005/Resources/gep2005.pdf> (last accessed on 2009/8/12).

to invest and from where to trade. And it becomes a FDI decision, if a foreign location is chosen. It follows that, increasingly, what matters are the factors that make particular locations advantageous for particular activities, for both, domestic and foreign investors.⁶⁸

Evidence shows that a variety of labor-intensive industries or sectors have formed their international fragmentation of production globally, including “textiles and apparel, machinery and transport equipment, consumer electronics, toys and furniture.” This phenomenon happened in these sectors for the reason that “such fragmentation could lead to sufficient reduction in production cost.”⁶⁹

Production fragmentation provides local firms, including those of less developed and transition countries, access to global markets, and retrenches the large outlays for advertising and market research. It may also lead to an additional benefit in the form of knowledge spillover. The spread of production across borders has been creating new linkages among economies. It creates more opportunities for economies to access the global markets and more competitions for investors, especially large MNEs.

According to the finding of Aminian and Fung in the RIETI Discussion Paper, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*,

68 World Investment Report 1996 - Investment, Trade and International Policy Arrangements, UNCTAD, p. XXIV, 1996. available at http://www.unctad.org/en/docs/wir1996_en.pdf (last accessed on 2009/08/12)

69 Recent improvements in service links in terms of lower costs of transportation and communication also enhance this trend. See Nathalie Aminian and K.C. Fung, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp. 1-4, Research Institute of Economy, Trade and Industry, Japan, 2007.

Using a gravity model, it evidences that in general FDI is important in explaining imports and exports of intra-East Asian trade. In particular, FDI is especially important in explaining trade in components and parts, followed by trade in capital goods. This helps confirm that FDI and trade associated with production fragmentation in East Asia are complementary.⁷⁰

2.3 Role of Multinational Enterprises for the Economic Growth and Development of Economies

2.3.1 Interests of the three FDI activity players

2.3.1.1 Largest profits of MNEs

Multinational enterprises (MNEs) have had huge impacts on East Asian economies through various forms, including generating production, fixed investment and employment. Among those activities, their impacts on trade and FDI are substantial.⁷¹ MNEs have played a key role in promoting vertical intra-industry trade in East Asia by setting up regional and international production networks through FDI.

A MNE is an enterprise that engages in foreign direct investment and owns or, in some way, controls value-added activities in more than one country. This is the threshold definition of a multinational enterprise and one that is widely accepted in academic and business

70 See Nathalie Aminian and K.C. Fung, the “Abstract” of *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp. 1-4, Research Institute of Economy, Trade and Industry, Japan, 2007.

71 On the impacts of FDI on trade, see Shujiro Urata, *Emergence of an FDI-Trade Nexus and Economic Growth in East Asia*, in Joseph Stiglitz and Shahid Yusuf, eds., *Rethinking the East Asian Miracle*, the World Bank and Oxford University Press, pp. 409-459, 2001; Masahiro Kawai and Shujiro Urata, *Trade and Foreign Direct Investment in East Asia*, in Gordon de Brouwer and Masahiro Kawai, eds., *Exchange Rate Regimes in East Asia*, Routledge Curzon, pp. 15-102, 2004.

circles, by data-collecting agencies such as the Organization for Economic Co-operation and development (OECD), UNCTAD's Division on Investment, Technology and Enterprise Development (DITE), and by most national governments and supranational entities... An MNE qua MNE has, therefore, two distinctive features. First, it accesses, organizes and coordinates multiple value-added activities across national boundaries and, second, it internalizes at least some of the cross-border markets for the intermediate products arising from these activities. No other institution engages on both cross-border production and transaction.⁷²

The ultimate goal of MNEs is to access their largest profits and increase their international competitiveness. They seek methods to meet customers' demand and expand their territory in order to reach that goal.

What an enterprise needs to consider are utilizing the advantageous position of the enterprise and its bargaining power in order to reduce the cost and get a better deal, and re-allocate its internal and external resources in order to get superior efficiency, often by taking advantage of competitive production locations.

Under the trend of globalization, enterprises set up their subsidiaries globally in order to work externally and improve their competitive advantages. When the idea of making cross-border investment or market seeking, due to the diversified characters and conditions of different territories, a suitable location is the first and most important determinant considered by MNEs. The information revolution and new technologies have made it

⁷² See John H. Dunning and Sarianna M. Lundan, *Multinational Enterprises and the Global Economy*, Edward Elgar, pp. 3-6, 2008.

possible for investors to divide an industry's value chain into smaller functions, performed by foreign subsidiaries or branches, or contracted out to independent suppliers.

In the process of making a FDI location decision, it is important for an enterprise to know what resources it has, take the assistance of the network relationship into consideration, and be aware of their motives for doing business cross-border. In order to expand their business scale, most of them are taking advantage of the inter-organization or group network, the intra-industrial network, and the capacities specific to the location.

The FDI location chosen by an enterprise shows not only the characteristic of that enterprise but also the market identity of that host country and industrial production sharing in that region.

2.3.1.2 Economic growth and development of host and home countries

Host countries apply various measures to attract FDI. The measures include the encouragement of inward FDI through deregulation and incentives, and the engagement of bilateral, regional, and multilateral arrangements by the host country. They seek to advance their economic development.

The interests of investors and host countries overlap to a larger extent. On the one hand, cross-border investors can bring a range of tangible and intangible assets, including capital, technology, skills, and access to markets. Investors seek resources that their production needs as well as the markets that firms require in order to sell their goods and services. On the other hand, host countries promote the economic growth through trading with other economies and the economic development by receiving technology, skills

training, and increasing the incomes of their people.⁷³

Home countries establish a closer relationship with their economic partners by promoting trade and FDI. They sign IIAs, includes BITs, DTTs, and PTIAs, with partners and introduce to their investors. They seek to advance their economic growth as promoting gross domestic product (GDP) and establishing peaceful relationships with other countries.

These interests, combined with competition among firms and economies, the liberalization of investment regimes, and advances in communication, transportation and information technologies, have driven the rapid growth of FDI and the rise of cross-border investors, especially MNEs.

2.3.2 Taxation and FDI

The FDI location decisions making by MNEs are usually influenced more by non-legal factors, such as the nature of market and political conditions, than legal factors. However, tax considerations might also play a role, depending on the types of FDI made by MNEs.⁷⁴

The type of market-oriented FDI is normally unaffected by tax considerations because investors seek to gain the profit from the market scale. By contrast, export-oriented FDI is more sensitive to the host-country tax burden because they gain

73 Although globalization and economic openness can bring huge opportunities and benefits to citizens of host countries, there might be problems and challenges, like air pollution, traffic congestion or infrastructure needs, as well.

74 “market-oriented investment is normally unaffected by tax considerations whereas export-oriented FDI is far more sensitive to the host-country tax burden.” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 268, 2007, and cited note 30, *Taxation and Technology transfer: Key Issues*, UNCTAD, p. 20, note 28, 2005.

their profits by spending less on production costs.

Governments, including those of home and host countries, use their domestic tax systems to influence MNEs' FDI locations. MNEs will enjoy the tax avoidance by dealing with a good tax planning on their integrated international business networks. Tax measures that offer friendly tax conditions become important by reducing the barriers to FDI.⁷⁵

The ultimate goal of an enterprise is to gain the most profits after taxation. An enterprise is concerned with gaining the most profits after both collecting revenue on the undistributed profits of the enterprise and the distributions of profits made to shareholders. A domestic enterprise will consider the application of its domestic taxing jurisdiction and laws. A multinational enterprise has to consider not only the law of its subsidiary located at the national level, but also the risk of double taxation among the network of its separate subsidiaries or branches at the international level. "The taxation of MNEs involves further issues arising out of the internationally integrated operations of the firm, the legal relations between its affiliates, and the territorial limits of national revenue laws."⁷⁶

75 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 268, 2007, and cited note 30, *Taxation and Technology transfer: Key Issues*, UNCTAD, p. 20, note 28, 2005, citing Clark, WS, *Tax Incentives for Foreign Direct Investment: Empirical Evidence on Effects and Alternative Policy Options*, *Canadian Tax Journal*, No. 48, pp. 1139, 2000.

76 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 263-306, 2007. Many tax issues are relevant to MNEs. For a full treatment of the taxation of MNEs, see Sol Picciotto, *International Business Taxation*, Weidenfeld and Nicolson, 1992; Alex Easson, *Taxation of Foreign Direct Investment: An Introduction*, Kluwer Law International, 1999. Recited from Muchlinski's book, pp. 263, note 2, 2007.

When MNEs are making the FDI location decisions to operate their international production and distribution networks efficiently, tax considerations become more important. There is also evidence showing that different types of industries and business activities will take the importance of tax considerations differently.⁷⁷

Under the trend of globalization, MNEs holding international business networks and setting up separate subsidiaries or branches with different functions have become very popular. Each firm located in different economies will be a separate taxpayer under the local laws. It will generate revenue on the undistributed profits of the enterprise and the distributions of profits made to shareholders. Thus, there is a risk of double taxation as a subsidiary pays tax on its undistributed profits and then its parent company pays tax on the profits received from it.⁷⁸ This may result the MNE, as a whole, paying taxes on the same profit twice. To avoid this result, governments of different taxing jurisdictions will sign DTTs for encouraging MNEs to set up operations, for either trade or FDI activities, on their territories.

Governments take tax measures as their FDI policies, including inward and outward investment. Offering tax incentives is one measure for host countries to seek to influence

⁷⁷ “Reflecting the relative mobility of the investment and the range of possible locations.” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 268, 2007, and cited note 32. See also Harry Grubert, and John Mutti, *Do tax Influence Where U.S. Corporations Invest?* National Tax Journal, No. 53, p. 825, 2000; OECD *Corporate Tax Incentives for Foreign Direct Investment*, Tax Policy Studies, No. 4, OECD, 2002.

⁷⁸ See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 263-306, 2007.

the inward FDI location decisions made by MNEs. Governments may introduce their domestic enterprises to invest across borders to countries offering a tax exemption system.⁷⁹

These policies and measures influence MNEs' FDI location decisions, as gaining the most profit after taxation is an important ends for MNEs and their shareholders.

According to the report from UNCTAD,⁸⁰

As a broad generalization, it seems that tax considerations play little part in the initial decision to invest abroad, may play a more important role in location decisions, are more important for some types of investment than for others, and are growing in importance.⁸¹

Furthermore, the use of "tax havens" by MNEs becomes popular as well. A tax haven is a country or territory where certain taxes are levied at a low rate or no tax is collected at all.⁸²

79 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 267, 2007.

A foreign tax deduction system will be attractive to a home state that wishes to discourage outward direct investment by its corporations, in that it subjects foreign investment to a higher tax liability than domestic investment. Under this method foreign tax is allowed as a deduction against the profit liable to tax in the home state. Thus the tax paid in the host state is deducted from the tax base of the parent company, unlike under the foreign tax credit system, where foreign tax is credited against the parent company's tax liability on gross profits.

80 See UNCTAD *Taxation and Technology transfer: Key Issues*, UNCTAD, p. 19, 2005. Available at http://www.unctad.org/en/docs/iteipc20059annex_en.pdf (last accessed on 2009/9/11)

81 For more information, see Michael P. Devereux, *The Impact of Taxation on the Location of Capital, Firms and Profit: A Survey of Empirical Evidence*, working paper of Oxford University Centre for Business Taxation, No. 0702, 2007.

82 For more debates about "tax heaven", see Caroline Doggart, *Tax Havens and their Uses*, Economist Intelligence Unit, 2002; Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 299-306, 2007.

Investors, includes individuals and/or corporate entities, take advantage by setting up an offshore company in order to reduced or eliminate taxation levels. MNEs set up and use controlled subsidiaries in tax haven jurisdictions as their global strategy of operating the international business network. This creates tax competition among governments desiring to attract more capital inflow.

2.4 Creating the institutional-driven economic integration of East Asia

The East Asian economic integration started at the industrial production sharing chain. The industrial production sharing chain in the East Asian region has contributed to the economic growth of each economy and the region. It has been recognized as a “Flying Geese” phenomenon led by Japan, followed by the first and second NIEs, and then China.

However, the economic growth of East Asia has been heavily reliant on exports to the world market,⁸³ especially North America and Europe. East Asian economies

83 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

Compared to East Asia and North America, Europe is a self-contained region, where parts are procured and assembled for the production of finished products to be sold inside the region.” “North America, where parts are imported from outside the region to be assembled as finished products, which in turn are sold inside the region.

Europe, which includes a number of small countries with high trade dependency on neighboring countries, tends to show high intra-regional dependency.

exporting final goods still depends on good economic conditions in North American and European markets.

This situation brings the risk of the unbalanced reliance and growth between the East Asian factory and the Western markets. East Asian economies have suffered and learned from the negative effects of un-fully globalization, as their unbalanced economic growth among themselves and over reliance on the North American and European market, in the 1997 currency crisis and the late 2008 financial crisis.

The market-driven economic integration thus seems to shift to institution-driven regionalization. Most of the East Asian economies intended to establish regional preferential agreements on trade and FDI which would lead to further promotion of trade and investment, achieving economic growth and development, and economic cooperation.

Governments considered formal regional cooperation treaties with any types of International Investment Agreements (IIAs) in the East Asian region since the 1990s. The consensus of creating the institutional-driven economic integration of East Asia has strengthened since then.⁸⁴

The form of Free Trade Agreements (FTAs) has gained increasing rapidly. However, there are disadvantages for economies and their national investors outside the region.⁸⁵

84 Economies turned toward regionalism but did not refuse globalism.

85 Such regional integration, for example North American Free Trade Agreement (NAFTA) and European Union (EU) have been willing to reduce barriers within their regions, “can become protectionist and introduce restrictive and discriminatory regulations against the entry and establishment of firms from outside the region”. See Peter Muchliski, *Multinational Enterprises and the Law*, Oxford University

These disadvantages will be reduced under a multilateral legal framework, such as the World Trade Organization. WTO agreements offer several basic standards and measures for members to commit toward global liberalization, which include General Agreement on Trade in Services (GATS), Agreement on Trade-Related Investment Measures (TRIMs), and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). These issues will be discussed in Chapter Three and Five.

2.5 Conclusion

The experience of the East Asian economies indicates that exports could lead to economic growth. The two tier NIEs of East Asia were seen to benefit from export-oriented industrialization. Instead of exporting primary products,⁸⁶ the export of manufactured products is often termed export-oriented industrialization.

The economic growth of East Asia has been better than other regions and has been the main force of the global economic growth. The rapid expansion of extra-regional trade has promoted the economic growth and prosperity of most East Asian economies.

However, the growth of intra-regional trade was not as good as the extra-regional trade since 2005. The trend of trade performance in East Asia shows that it has shifted from intra-regional trade to extra-regional trade. In short, the growth of extra-regional

Press, pp. 262, 2007.

86 See Tim Forsyth, *Encyclopedia of international development*, Routledge, p. 225, 2005. "Though many developing countries are in a position to export primary products, few have grown from such exports (the exceptions being the oil-exporting economies of the Middle East, see OPEC). Primary product exports face many disadvantages including unstable or even secularly declining prices, extreme dependence on world market conditions and a vulnerability to substitution by cheaper synthetic products."

trade has consistently been higher than intra-regional trade in recent years. That means the dependence of East Asian economies' growth on the growth of intra-regional trade has been gradually declining.⁸⁷

Governments consider policies of investment liberalization and promotion both at the level of unilateral measures undertaken by host countries and at the bilateral, regional, and multilateral level. These policies of removing regulatory barriers are aimed at increasing trade and FDI flow liberalization.

East Asian economies intend to reduce the cost of trade and improve their production techniques contributed from MNEs. These economies cooperate by reducing tariffs through the forms of not only domestic free trade areas but also bilateral or regional free trade agreements.

However, the removal of barriers unilaterally or bilaterally might not reach what policy-makers seek. Nonetheless, it is still necessary to reduce cross-border barriers, for either trade or direct investment.

It is sometimes useful for economies to take investment incentives to benefit MNEs. MNEs will consider these locations with more profits and less risks, as parts of their production sharing chain.

The removal of host state controls cannot automatically guarantee adequate levels, or useful kinds, of inward investment. Nor will it

⁸⁷ See Meichu Chen, *A Study on Division of Labor and Economic Integration in East Asia*, Vol. 7, Economic Research Journal, p. 241, Council for Economic Planning and Development (CEPD), Executive Yuan, R.O.C., 2007. Also see Wen-Jung Lien, *The accelerated weakening of the intra-regional trade in East Asia*, Journal of Economic Outlook Bimonthly, Vol. 123, pp. 73-77, Chung-Hua Institution for Economic Research, 2009. (Translated by Hsu, Hui-Yi).

guarantee an equitable international distribution of the benefits of such investment. Furthermore, competition over investment incentives between states may create economic distortion between them with little positive gain to their economies.⁸⁸

Liberalization of trade and FDI and deregulation in various sectors in many economies not only increases competition among MNEs but also promotes their global business operations and activities. MNEs' well-developed international trading and production networks contribute to the expanding trade and FDI.

The leading MNEs of home countries have influenced governments to place the policies of deregulation controls and reduction of barriers on trade and FDI onto the agendas of regional and multilateral economic organizations. Large MNEs had the ability and did try to influence the contents of policies and regulations. They influenced the policies and regulations on FDI toward a liberalized and friendly business environment through either domestic measures or international/regional arrangements.

Aminian and Fung suggested that,

Policymakers who wish to further participate in the network will also need to enact policies that will facilitate FDI. These policies include lower tax rates, a more stable and transparent government and an economy governed with a better rule of law. Localization of the fragmentation process will also require better institutions such as better enforcement of the intellectual property rights and a more impartial and predictable judicial system. To sum up, improving the institutions of the East Asian economies will be important policies to further and deepen the production and trade network in East Asia,

⁸⁸ See Peter Muchliski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 215-262, 2007.

which in turn will deepen the economic integration among the East Asian economies.⁸⁹

There is a marked change in considering formal regional cooperation arrangements, with any types of international investment agreements, in East Asia since the 1990s. Free Trade Agreements (FTAs) have gained increasing usage. Although there are still many problems with the ongoing institution-driven economic integrated East Asia, this kind of economic integration is necessary for growth.

In conclusion, East Asian economies should take their economic cooperation in international investment arrangements towards a flying geese development, instead of competition to each other toward an unbalanced growth situation. Through cooperation in investment arrangements and negotiations, economies are able to negotiate not to produce and export similar or competing products. They could have a negotiation plan to make up the gap among different levels of economic growth and development of East Asian economies, to cover every economy in the production sharing chain, and avoid any of them being left behind by relocated industries following regional transfer of the international production sharing chain.

89 See Nathalie Aminian and K.C. Fung, *Foreign Direct Investment, Intra-Regional Trade and Production Sharing in East Asia*, RIETI Discussion Paper Series 07-E-064, pp.36-37, Research Institute of Economy, Trade and Industry, Japan, 2007.

CHAPTER THREE.

CURRENT INTERNATIONAL INVESTMENT AGREEMENTS IN THE EAST

ASIAN REGION

3.1 Introduction

While they are often seen as alternative economic activities, trade and investment also complement each other in the global economy. An increase in FDI does not replace trade, but promotes it. They are both engines of economic growth and development. Thus, trade and investment provisions are also seen within the same agreements under the consensus of establishing a deeper economic integration among contracting countries.⁹⁰

Most countries believe that FDI can promote their economies. More governments adopt “open door” policies and use measures to promote FDI instead of restricting it. In addition, they believe that cooperation in creating legal frameworks can promote and protect international investment.

The establishment of legal frameworks on investment both at the regional and international levels intends to liberalize investment flows. “They have become instruments of globalization removing barriers to trade and investment...”⁹¹ Thus, a deeper economic integration driven by institutions is now necessary, especially in the East Asian region.

90 See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, pp. 25-26, 2009.

91 See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 27, 2009.

The report of UNCTAD confirms that more investment laws changed to promote greater liberalization. Even though most countries continue to use restrictions on certain industries and sectors for strategies purposes, they believe that greater liberalization of trade and FDI policies could attract more trade and FDI that would benefit their economic growth and development.⁹²

For encouraging FDI, it should be considered not only from the unilateral policies undertaken by host states, but also from inter-state initiatives. At the national level, host countries adopt liberalization as their economic policies. They usually adapt measures to ensure open access and to provide incentives to foreign investors. At the international level; host countries also take bilateral, regional and multilateral initiatives towards liberalization through entering into different forms of international economic agreements or instruments. Governments may offer foreign investors the guarantees for enjoyment of private property and the international minimum standards of treatment under investment provisions of their BITs or FTAs.⁹³

The home countries, capital-exporting countries, intend to remove barriers which may obstruct growth of an integrated global economy. They help and protect the

92 See UNCTAD World Investment Report 2005, UNCTAD, 2005, available at http://www.unctad.org/en/docs/wir2005_en.pdf (last accessed on 2009/9/20).

93 See UNCTAD World Investment Report 2006, UNCTAD, pp. 23-25, 2006, available at http://www.unctad.org/en/docs/wir2006_en.pdf (last accessed on 2009/9/20). Especially those “initiatives for the liberalization of controls over entry and establishment by foreign investors”, will be expressed in various international legal agreements and instruments. Both governments and investors will be bound under these agreements. See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 215, 2007.

international economic activities of their investors and receive the most benefits.

In the friendly economic environment with lower trade and investment barriers, MNEs often provide linkages to form into an international industrial production sharing chain. Within the international industrial production sharing chain, raw materials and parts will be highly traded among industries and firms. Thus, foreign investors will be able to enjoy their rights under applicable domestic laws of host countries and international laws concluded by host and home countries.

3.1.1 Proliferation of International Investment Agreements (IIAs)

An international investment agreement (IIA) is a treaty between/among countries that addresses issues relevant to cross-border investments, usually for the purpose of protection, promotion and liberalization of such investments.⁹⁴ IIAs to date generally fall into three categories, including bilateral investment treaties (BITs), international taxation agreements and double taxation treaties (DTTs), and preferential trade and investment agreements (PTIAs). A series of publications designed to address key concepts and issues relevant to international investment agreements was promulgated since 1999 by the UNCTAD.⁹⁵

Since 1960s, European countries initiated BITs to protect private property of their investors located in developing economies while many of their nationals invested across borders. Until the mid-1990s, IIAs were mostly concluded in the form of BITs and

94 Most IIAs cover FDI and portfolio investment, but some exclude the latter.

95 Available at <http://www.unctad.org/Templates/Page.asp?intItemID=2322&lang=1> (last accessed on 2009/7/9).

DTTs.⁹⁶ They consisted of relatively uniform content and “did not changed markedly since their inception, apart from the introduction of provisions on investor-state dispute resolution in the 1960s.”⁹⁷

BITs and DTTs are strategies of investment promotion for countries. There are several reasons for countries to conclude BITs and DTTs, including primarily to assure that foreign investments are legally protected under international law, to mitigate the possibility of double taxation of foreign entities, and to promote and liberalize foreign investment. These IIAs offer investors of home countries more security and certainty under international law when they invest or set up a business in other contracting countries.

Since the end of the 1990s, the governments in the East Asian region have concluded a number of bilateral Free Trade Agreements (FTAs). The rapid increase of PTIAs has established investment rules and PTIAs became the new development in international investment rulemaking since 2000. This new type of IIAs usually contains liberalization and promotion provisions of both trade and investment components. Provisions of investment protection are also included between the contracting countries.⁹⁸

After NAFTA, more and more agreement began including investment aspects within their trade provisions, especially the agreements between developed and developing

96 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, P22, 2008.

97 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 127-128, 2009.

98 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 129, 2009.

countries.⁹⁹ They covered not only investment issues, “but may also extend to related matters such as trade, services, intellectual property, industrial policies, labor issues, movement of personnel, environmental concerns, and others.”¹⁰⁰ PTIAs, include bilateral and regional free trade agreements (FTAs/RTAs) and other treaties on economic cooperation, are “with substantial investment chapters and regional and multilateral instruments on investment.”¹⁰¹ They are negotiated among countries, “to facilitate the cross border movement of goods, services, capital or people.”¹⁰²

Countries conclude bilateral and regional PTIAs for the creation of preferential market access and other forms of economic integration among the contracting parties.¹⁰³ Many economies in the Asian Pacific region have concluded FTAs/RTAs that not only liberalized trade in goods and services but also contained investment protection

99 As of June 2007, at least 251 preferential trade agreements addressed to the investment-related aspect provision and 89% of them had also been concluded since the 1990s. See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, pp. 25-26, 2009.

100 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, 2008. Available at http://www.unctad.org/en/docs/iteiit20073_en.pdf (last accessed on 2009/0916).

101 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 22, 2008.

102 Usually,

PTIAs are negotiated among countries from the same region for regional economic cooperation or creating a common market... They may involve states at the same or at different levels of economic development... They could be bilateral, plurilateral, regional, inter-regional or multilateral.

See Roberto Ehandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, *Asia Europe Journal*, Vol. 7, No. 1, p. 128, 2009.

103 The list of BITs, DTTs and PTIAs are available at <http://www.unctad.org/ia> (last accessed on 2009/9/09).

provisions.¹⁰⁴ The trend of concluding such PTIAs shows that there is a worldwide process of economic integration among economies/regions.

Furthermore, this new type of IIAs defines procedures for the resolution of disputes. The impact of cases of dispute settlements between investor and states/governments has influenced investment rule-making over the last decade.¹⁰⁵

The number of IIAs negotiated world-wide has increased dramatically since the 1990s (Figure 1 and Figure 2).¹⁰⁶

104 Since 2000, several East Asian countries took NAFTA as a model that contains a chapter on investment, and began to negotiate bilateral or regional free trade agreements (FTAs/RTAs). The rapidly growing agreements include both trade and investment components with three important respects.

First, these agreements included an extensive investment chapter that contained provisions similar to those appearing in BITs... Second, they were often between a developed and a developing country. They went beyond NAFTA in that they often were between countries that were not even in the same region. Third ... included a number of provisions that were more elaborate than those typically found in BITs, especially with respect to investor-State dispute resolution...

See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, Series on International Investment Policies for Development, UNCTAD, p. 19, 2008. Available at http://www.unctad.org/en/docs/iteiit20073_en.pdf (last accessed on 2009/0916).

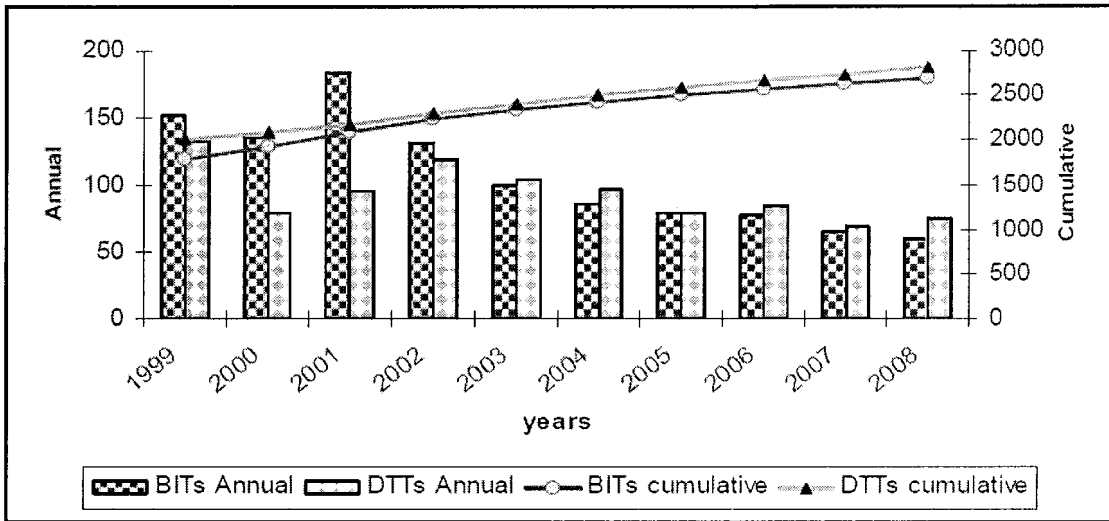
Such treaties have been concluded between the United States and countries such as Singapore and Australia, and have started to be negotiated between the United States and other ASEAN countries such as Malaysia and Thailand.

See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, Regionalism and Regional Trade Agreements in Europe – Asia trade relations, p. 134, 2009.

105 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 127-144, 2009.

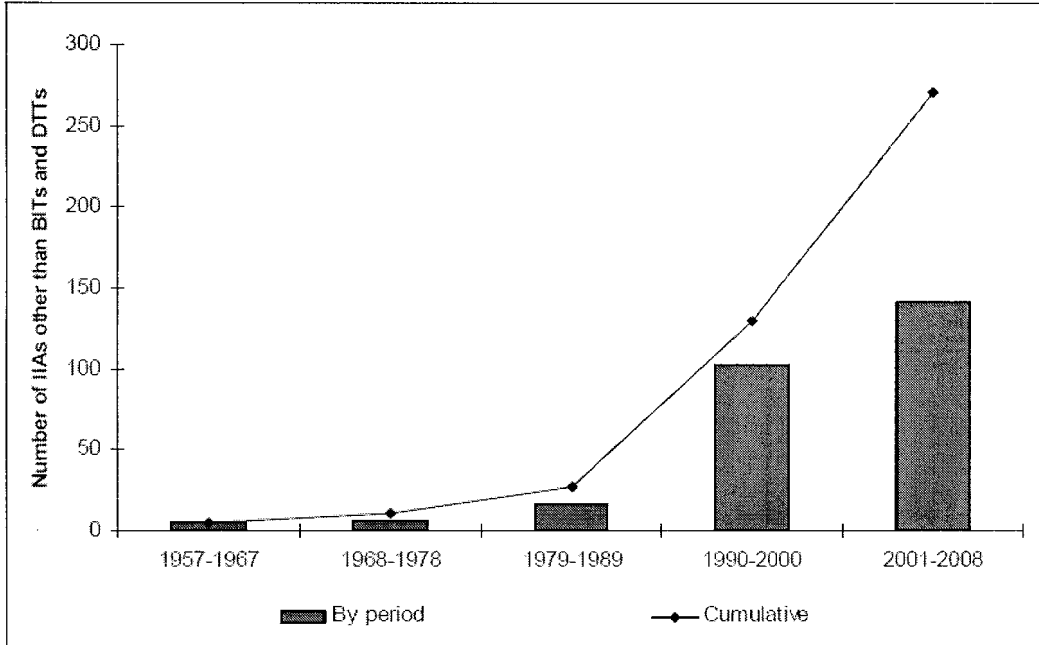
106 Adopted from UNCTAD *Recent developments in international investment agreements (2008–June 2009)*, UNCTAD IIA MONITOR No. 3, p2 Figure 1 and p. 8 Figure 6, UNCTAD, 2009. Available at

Figure 1. Number of BITs and DTTs concluded, annual and cumulative, 1999–2008



Source: UNCTAD (www.unctad.org/ia).

Figure 2. Proliferation of Free Trade Agreements with Investment Provisions: 1960–2008



Source: UNCTAD (www.unctad.org/ia).

http://www.unctad.org/en/docs/webdiaeia20098_en.pdf (last accessed on 2009/09/11).

When the economies in the East Asian region increasingly opened their doors to FDI in the 1980s and 1990s, most of them began to enter into these three types of international investment agreements.¹⁰⁷ Today, these developing economies, with inflow and outflow investments, intended to negotiate and sign investment agreements with either developed countries or developing countries.¹⁰⁸

A substantive increase in the number of IIAs being negotiated has taken place, and some of the existing agreements have been re-negotiated and modified¹⁰⁹ (Figure 3¹¹⁰). IIAs are negotiated not only between developed and developing countries, but also

107 Although the number of BITs negotiated by year has declined since 2003, the total number of these agreements has continued to increase. The number of economic integration agreements, including FTAs and RTAs, worldwide has been growing steadily in recent years.

By June 2007, the Asia Pacific Economic Cooperation (APEC) countries had concluded almost 800 BITs representing about 30% of all agreements negotiated world-wide.

See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, p. 131, 2009.

108 See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 26, 2009.

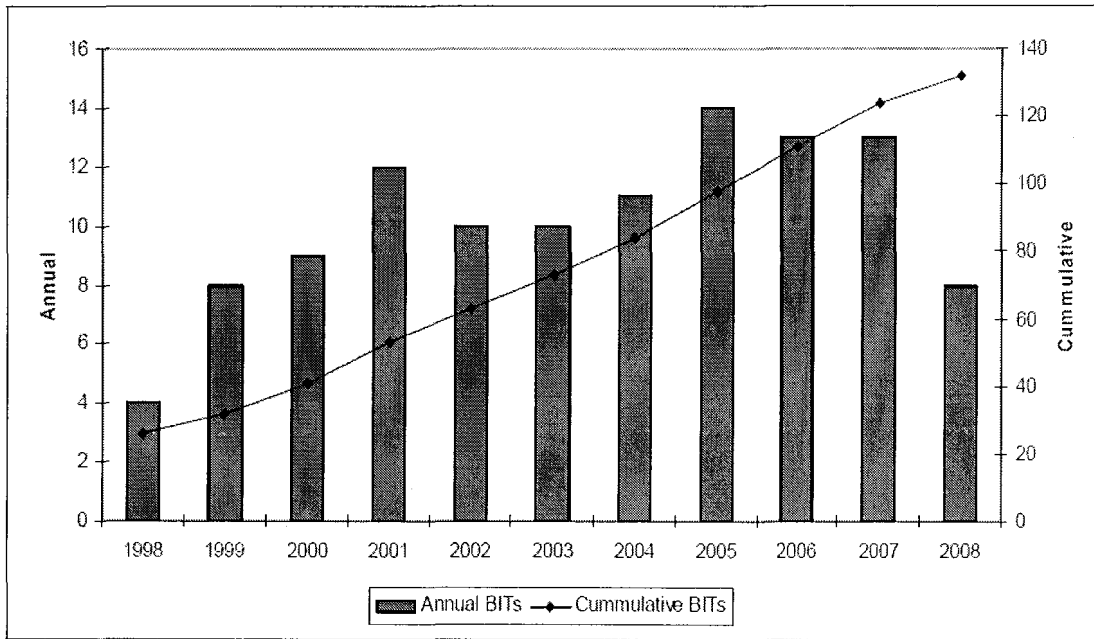
Part of the explanation for this trend was that the old distinction between capital-exporting developed countries and capital-importing developing countries was blurring. A number of developing countries had achieved considerable economic success and were becoming significant exports of capital.

109 The re-negotiated BITs are influenced by the new model BITs of the United States and Canada. See Echandi, Roberto, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, Regionalism and Regional Trade Agreements in Europe – Asia trade relations, p. 134, 2009.

110 Adopted from UNCTAD *Recent developments in international investment agreements (2008–June 2009)*. Number of renegotiated BITs, annual and cumulative (1998–2008), UNCTAD IIA MONITOR No. 3, p.6 Figure 4, UNCTAD, 2009. Available at http://www.unctad.org/en/docs/webdiaeia20098_en.pdf (last accessed on 2009/09/11).

among developing countries.

Figure 3. Number of renegotiated BITs, annual and cumulative (1998–2008)



Source: UNCTAD (www.unctad.org/iaa).

3.1.2 Implementation

Countries are using the agreements as tools to attract FDI. They try to provide a stable, transparent, and friendlier business climate by changing their domestic economic policies and regulations. They have opened themselves to foreign investment, improved the operational conditions for foreign affiliates and strengthened standards of treatment and protection for foreign investors. Governments did so because they believed it would boost investors' confidence and contribute to increased investment flows.

Under the comparative advantage theory,¹¹¹ “location choice” for production,

¹¹¹ It has been described in Chapter Two.

market-seeking, research and development (R&D), and operations headquarters has become very important for FDI. Economies, which concluded IIAs with liberalization of trade and FDI, will modify their domestic policies and laws for the commitment of foreign direct investment. Thus, the production factors have been changed. The position of each economy in the international industrial production sharing chain and its economic competition and advantages then will be affected. It will further result in the transfer of capital flow, technologies, and skilled labor.

The implementation of IIAs and domestic policies and regulations in economies will influence their comparative advantage. The process of institution-driven economic integration in East Asia may relocate different types of investment and industries.

3.2 Changing policies for creating a favorable business environment under the trend of globalization and liberalization of trade and FDI

In order to meet the needs of host countries, home countries, and MNEs, the idea of cooperation in trade and FDI under international laws has been adopted by most countries. Furthermore, liberalization of trade and FDI is recognized as an important element for economies' economic growth and MNEs' development.

International trade and investment rules and standards have been covered in many trade agreements. These agreements, including bilateral, regional, interregional, intraregional and multilateral agreements, contained not only provisions of trade liberalization and promotion, but also liberalization, promotion, and protection of investment. The most important change in the history of IIAs rulemaking with respect to foreign investment was the mixed provision of trade and investment in international

agreements.¹¹²

3.2.1 Liberalization under multilateral framework

After WWII, the major developed countries intended to establish a general multilateral treaty, which included among its provisions the protection of foreign investment; however, those efforts have failed. The Havana Charter of the International Trade Organization¹¹³ which contained a number of provisions relevant to the regulation of foreign investment by corporations in Article 11 and 12, signed in 1948, was an example.¹¹⁴

Relevant sections of the Havana Charter have been covered in the original General Agreement on Tariffs and Trade. The latter was negotiated in 1947 and came into force in 1948. Thereafter, the Uruguay Round¹¹⁵ in 1986, conducted within the framework of the

112 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, p14, 2008.

113 The United Nations Conference on Trade and Employment adopted the Havana Charter for the International Trade Organization (ITO) in 1947. The charter never came into force. However, this charter also contained a list of prohibited business practices in Chapter V. The text of the Havana Charter is available on WTO official website at http://www.wto.org/english/docs_e/legal_e/havana_e.pdf (last accessed on 2009/12/04).

The inclusion of this right, and the absence of any unequivocal provision for compensation in the case of expropriation, caused widespread opposition to the Havana Charter among business interests, and led to its demise when the US and other signatory states did not ratify it.

See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 654-655, 2007.

114 There were also pressures from some private sector bodies, including the ICC and various private groups, with their interests, on governments to conclude a multilateral convention on the foreign investment.

115 It was the 8th round of multilateral trade negotiations under GATT. The OECD Draft Convention on

General Agreement on Tariffs and Trade (GATT), included elements of the original General Agreement on Tariffs, and Trade.¹¹⁶

The Uruguay Round of GATT negotiations also resulted in the creation of the World Trade Organization in 1995 to administer the GATT and the establishment of a stronger dispute settlement mechanism. After the establishment of the Uruguay Round agreements, there was a common consensus of the strong connection between trade and FDI.

3.2.1.1 The WTO Agreements

The Uruguay Round (from 1986 to 1994) of multilateral trade negotiations under the GATT produced major achievements toward liberalizing trade and FDI. It initially introduced investment-related issues into the GATT agenda. The achievements include not only the reduction in tariff rates but also investment-related areas in separate agreements which concerned trade-related services, intellectual property protections and technology transfers and investment measures.¹¹⁷

The new consensus of recognizing the connection between trade and investment and their liberalization during the Uruguay Round of trade negotiations achieved three multilateral agreements in investment-related areas. They are framework agreements on trade in services (GATS), on intellectual property rights (TRIPS) and on trade-related investment measures (TRIMs).

the Protection of Foreign Property was another example. See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 654-655, 2007.

116 Pre-WTO legal texts http://www.wto.org/english/docs_e/legal_e/prewto_legal_e.htm (last accessed on 2009/12/04).

117 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 251, 2007.

The General Agreement on Trade in Services

The General Agreement on Trade in Services (GATS), which was intended to remove barriers to cross-border trade in services, established a mechanism for liberalizing investment in the service sector.¹¹⁸

Regulations in services of host countries have an influence on cross-border direct investments. In order to access to the global markets for their business activities, services-orientated MNEs, which are primarily from capital-exporting countries, need to step into the capital-importing countries through cross-border trade or direct investment. That means MNEs have to establish their operations located in the host countries to offer services locally. As the result, the GATS contains a right of establishment.¹¹⁹

The Agreement on Trade-Related Investment Measures

The Agreement on Trade-Related Investment Measures (TRIMs) prohibits some domestic investment measures that distort trade and violate the principles of national treatment in the provisions of GATT Article III or quantitative restrictions in Article XI.¹²⁰ “The TRIMs provides disciplines for domestic restrictions of members on

118 While trade and direct investment in services have become increasingly significant features of the world economy, trade and direct investment in services issues were considered in the negotiation.

Services trade section at WTO website, available at

http://www.wto.org/english/tratop_e/serv_e/serv_e.htm (accessed on 2009/9/15).

119 “However, the areas in which services enterprises work (eg financial services, insurance, transport, media, tourism) have been among the most highly regulated of business sectors.” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 252-253, 2007.

120 See the description on TRIMs at WTO website, available at

http://www.wto.org/english/tratop_e/invest_e/invest_e.htm (last accessed on 2009/9/15).

Recognizing that certain investment measures can have trade-restrictive and distorting effects, it states that no Member shall apply a measure that is prohibited

foreign investment, such as those designed to protect and foster domestic industries.”¹²¹

The Agreement on Trade-Related Intellectual Property Rights

The Agreement on Trade-Related Intellectual Property Rights (TRIPS) obligates members to provide certain protections for intellectual property against infringement. Members’ domestic laws must meet the standards required in the agreement. It also specifies enforcement procedures, remedies, and dispute resolution procedures.¹²²

MNEs have pressed their home governments to provide the intellectual property rights protection on their technological advantages and knowledge, especially in the field of technology transfer, which had not been respected in some countries. TRIPS offers principles and standards to protect these rights. By application of national treatment standards, MFN and non-discrimination, TRIPS could protect the foreign investors’ rights throughout the world.¹²³

by the provisions of GATT Article III (national treatment) or Article XI (quantitative restrictions).

121 For example,

local equity requirements restricting foreign ownership of investments; licensing requirements and technology transfer rules requiring the transfer of foreign firms’ technology; remittance and foreign exchange restrictions limiting external financial transfers; manufacturing limitations restricting production levels; domestic sales, local content and manufacturing requirements that seek to displace imports; and export requirement seeking to increase the export performance of the host state.

See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 259, 2007.

Also see UNCTAD *Foreign Direct Investment and Performance Requirement: New Evidence from Selected Countries*, UNCTAD, 2003. Available at http://www.unctad.org/en/docs/iteiia20037_en.pdf (accessed on 2009/9/15).

122 Intellectual property rights and the TRIPS Agreement section at WTO website. Available at http://www.wto.org/english/tratop_e/trips_e/trips_e.htm (accessed on 2009/9/15).

123 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 256-258,

TRIMS attempt to minimize the adverse effects and balance the economic structure in the distribution of investment and technology in host countries.

While the East Asian economies became members of the GATT/WTO and were on the way to perform their commitments, trade and FDI liberalization have been promoted in the East Asian region. For example, China liberalized its trade regime and made a dramatic reduction in tariff rates. It committed itself to liberalizing trade in order to join the WTO and further attract trade and FDI.

After the Singapore Ministerial Conference in 1996, the WTO started to discuss the links between international trade and investment¹²⁴, and the influence on economies'

2007.

124 The WTO Singapore Ministerial Declaration was adopted on December 13, 1996. WT/MIN(96)/DEC, December 18, 1996, and is available at http://www.wto.org/english/thewto_e/minist_e/min96_e/singapore_declaration96_e.pdf (last accessed on 2009/11/17). In Paragraph 20, members agreed to set up a working group to study the relationship between trade and investment. See also Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p.669, 2007.

Paragraph 20. Having regard to the existing WTO provisions on matters related to investment and competition policy and the built-in agenda in these areas, including under the TRIMs Agreement, and on the understanding that the work undertaken shall not prejudice whether negotiations will be initiated in the future, we also agree to:

- establish a working group to examine the relationship between trade and investment; and
- establish a working group to study issues raised by Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework....

economic growth.¹²⁵

The first round of negotiations under the WTO, the Doha Development Round (or Doha Development Agenda (DDA)),¹²⁶ started in 2001. Main topics of these negotiations include liberalization in agriculture and services. They also focused on non-agricultural market access. Issues related to cross-border investment were also a major priority in the Doha Ministerial Declaration,¹²⁷ and members agreed on a work program for investment.¹²⁸

In paragraph 20 of the Ministerial Declaration states that:

Recognizing the case for a multilateral framework to secure transparent, stable and predicate conditions for long-term cross-border investment, particularly foreign direct investment that will contribute to the expansion of trade...

In paragraph 21 of the Ministerial Declaration states that:

We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and

125 See Trade and Investment section at WTO website, available at

http://www.wto.org/english/tratop_e/invest_e/invest_e.htm (last accessed on 2009/9/15).

126 Ministerial discussions of the Doha Development Round have taken place in Cancún in 2003, Geneva in 2004, Hong Kong in 2005 and Geneva in 2006 and 2008.

127 The WTO DOHA Ministerial Declaration was adopted on November 14, 2001. WT/MIN(01)/DEC/1, 20 November 2001, and is available at

http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.pdf (last accessed on 2009/11/17).

128 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p.669, 2007.

For more information about the Doha Development Round, available at

http://www.wto.org/english/tratop_e/dda_e/dda_e.htm (last accessed on 2009/12/06).

institutional development...

The WTO system consisted of several substantive agreements on goods and services. It has worked on international investment issues in cooperation with other relevant inter-governmental organizations, including UNCTAD, after the Doha Development Round.¹²⁹ These economic organizations have contributed their works and provided assistance to economies, especially those of developing and less-developed countries.

However, the Doha Declaration did not touch several substantive issues which would be covered under bilateral investment protection agreements. These issues included “the taking of property, incentives, performance requirements and transfer of technology and ... dispute settlement.”^{130,131}

In addition, the four “Singapore issues” include

trade facilitation, investment, government procurement, and competition policy... These four subjects were originally included on the Doha Development Agenda.¹³²

129 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p.669, 2007.

130 The WTO dispute settlement system deals with disputes between states and do not “support for its extension to investor-state disputes.” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 670-671, 2007.

131 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 670-671, 2007.

132 Ministers at the 1996 Singapore Ministerial Conference decided to “set up three new working groups: on trade and investment, on competition policy, and on transparency in government procurement. They also instructed the WTO Goods Council to look at possible ways of simplifying trade procedures, an issue sometimes known as ‘trade facilitation’.” See WTO website, available at http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm (last accessed on 2009/12/6).

However, Ministers were unable to agree and all four Singapore issues were dropped at the WTO Ministerial Conference in Cancun in 2004. Therefore,

WTO-plus agreements and new age FTAs, which are comprehensive FTAs that address the Singapore issues, are becoming more common globally.¹³³

Recent East Asian agreements go beyond the WTO framework¹³⁴ by including the Singapore issues.¹³⁵

133 See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 16-18, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). Also see Roberto Fiorentino, Jo-Ann Crawford and Christelle Toqueboeuf, *The Landscape of Regional Trade Agreements and WTO Surveillance*, in Baldwin, Richard and Patrick Low, eds., *Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009.

134 The WTO framework mainly focuses on goods and services issues.

135 Singapore issues:

These issues were one part of the WTO-Agenda prior to the WTO-Ministerial Conference in Cancun in 2004, where they were taken from the agenda due to a lack of consensus. The highest possible WTO-plus contribution incorporates goods, services, Singapore Issues and cooperation enhancement. The latter includes WTO-plus provisions such as labour standards, IT cooperation, SMEs and environmental issues.

See Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, *Journal of Current Southeast Asian Affairs*, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, p. 77, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04). See also Masahiro Kawai and Ganeshan Wignaraja, *ASEAN+3 or ASEAN+6: Which way forward?*, ADB Discussion Paper No. 77, p. 11, 2007. Also Roberto Fiorentino, Jo-Ann Crawford and Christelle Toqueboeuf, *The Landscape of Regional Trade Agreements and WTO Surveillance*, in Baldwin, Richard and Patrick Low, eds., *Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009.

Moreover, because of the different interests and opinions on the contents in investment and in other areas, the Doha Development Round negotiations became difficult to continue. The different interests and opinions are “not only between developed and developing members but also within the respective groups.”¹³⁶ The multilateral negotiation under the WTO structure had been put off.

Regional economic integration became the major method of expanding economic liberalization and promoting trade and FDI by most economies. Since then, countries turned to negotiating bilateral or regional agreements (FTAs/RTAs) on trade and investment that are currently difficult to negotiate under WTO.

3.2.1.2 The OECD MAI

In the mid-1990s, the OECD countries, developed countries, launched the negotiation of a Multilateral Agreement on Investment (MAI), which would have included the high standards of investor protection and liberalization provisions provided in the draft MAI. The negotiations failed when these protections were opened to developing countries and countries with economies in transition that did not have enough to gain from it.¹³⁷ Furthermore, the OECD Code on Liberalization of Capital Movements required members to liberalize restrictions on direct investment in a broad

136 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

137 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

range of areas.

3.2.2 Liberalization under regional framework

Under the trend of liberalization, trade and FDI play important roles in the rapid economic development of the newly industrializing and developing East Asian economies. These economies started to form international institutions to cooperate and continue such development in the region.

3.2.2.1 The Association of Southeast Asian Nations (ASEAN)

Liberalization of trade and FDI policies has spread out in the East Asian region and has been adopted in regional contexts since the 1990s. The ASEAN members started the ASEAN Free Trade Area (AFTA)¹³⁸ process in 1992, which provided for the liberalization of tariffs and non-tariff measures under the Common Effective Preferential Tariffs (CEPT) Agreement. The CEPT established a schedule for members to reduce their tariff rates on a wide range of products traded within the region¹³⁹. It is recognized as a mechanism to reach the objective of AFTA, “to increase the ASEAN region’s competitive advantage as a production base geared for the world market.”¹⁴⁰ It aimed to promote the members’ economic growth and development together and make ASEAN a competitive

138 The AFTA agreement was signed by six members of ASEAN, including Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, in 1992, in Singapore. Vietnam, Myanmar and Cambodia were required to sign the AFTA when they joined ASEAN later.

139 It only applies to goods originating within ASEAN region.

140 See “*ASEAN FREE TRADE AREA (AFTA): AN UPDATE*”, available at <http://www.aseansec.org/10342.htm> (last accessed on 2009/12/1).

region for not only exports of goods and services but also attracting FDI.¹⁴¹

After the creation of the ASEAN Investment Area (AIA) in 1998¹⁴², which was intended to provide coordinated investment cooperation and facilitation programs, market access, and national treatment of all industries, this agreement would have important implications for investment strategies and production activities in the region.¹⁴³

3.2.2.2 The Asia-Pacific Economic Cooperation (APEC)

The Asia-Pacific Economic Cooperation forum is another regional framework to cooperate on regional trade and investment liberalization and facilitation. It intends to promote economic growth of the Asian and the Pacific region and individual economies

141 Information about AFTA is available at <http://www.aseansec.org/12025.htm> (last accessed on 2009/9/20). Each member may impose tariffs on goods entering from outside ASEAN based on its national schedules; however, members must apply a tariff rate of between 0% and 5% on goods originating within ASEAN.

The AFTA has been in effect among the original five ASEAN members—Indonesia, Malaysia, Singapore, Thailand and the Philippines—since January 2002... By 2010 ASEAN is expected to become a complete free trade area free from tariffs with the exception of CLMV members, which are give later deadlines.

CLMV members are Cambodia, Laos, Myanmar and Vietnam. See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6). Also see The 2nd ASEAN reader, compiled by Sharon Siddique and Sree Kumar, Institute of Southeast Asian Studies, pp. 198-204, 385-389, 2003.

142 ASEAN Ministers signed the Framework Agreement on the ASEAN Investment Area (AIA) on 7 October 1998, in Manila.

143 Information about AIA is available at <http://www.aseansec.org/6480.htm> (last accessed on 2009/9/20).

in this region.¹⁴⁴

The central objective of APEC is to improve the economic growth and development of the region by promoting economic integration and cooperation, as well as to strengthen the Asia-Pacific community. It provides policies and programs encouraging cross-border transfers of goods, services, capital, and technology. It seeks to reduce the barriers of trade and FDI to cross-border business activities among members “without diverting economic activity away from other economies.”¹⁴⁵

APEC members agreed to prepare and implement individual action plans, set up liberalization measures and make significant progress toward freer trade and FDI regimes.¹⁴⁶

In addition, the 1994 APEC Investment Principles provides rules for investment as a whole, including non-discrimination and national treatment. However, they are non-binding principles.¹⁴⁷

APEC has 21 member economies, including not only economies in East Asian region

144 Website of APEC is available at <http://www.apec.org/> (last accessed on 2009/9/20).

145 See Kenneth A. Reinert, Ramkishen S. Rajan and Amy Joycelyn Glass eds., *The Princeton Encyclopedia of the World Economy*, Vol. Two, Princeton University Press, pp. 81-84, 2008.

146 See *Individual Action Plans Keeping APEC Economies on Track*, APEC Newsletter, Issue 3, APEC, August 2004. Available at http://www.apec.org/apec/enewsletter/aug_vol3/onlinenews.html (last accessed on 2009/9/20). See also Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

147 The 1994 APEC Non-Binding Investment Principles available at http://www.apec.org/apec/apec_groups/committee_on_trade/investment_experts.MedialibDownload.v1.html?url=/etc/medialib/apec_media_library/downloads/committees/cti/pubs/1994.Par.0001.File.v1.1 (last accessed on 2009/9/20).

but also economies in North and South America and Oceania.¹⁴⁸ One important characteristic of APEC is that it includes China and Taiwan as members.¹⁴⁹ APEC, WTO, and the Asian Development Bank are the only international economic forums in which both China and Taiwan pursued trade and FDI liberalization as members.

In short, before establishing the international investment framework at a multilateral level, “APEC” could be the best choice at regional level for economic cooperation in Asian and the Pacific region.

Free Trade Area of the Asia-Pacific (FTAAP)

Countries began signing PTIAs when the Doha round of WTO negotiations stalled. This resulted in the “spaghetti bowl phenomenon” of IIAs,¹⁵⁰ which included similar provisions and conflicting elements of free trade agreements between members, especially in the East Asian region. To address this problem, in 2006, APEC Leaders identified the Free Trade Area of the Asia-Pacific (FTAAP) as a possible long-term goal and agreed to seriously consider negotiating a FTAAP.

148 List of APEC member economies is available at http://www.apec.org/apec/member_economies.html (last accessed on 2009/9/20).

149 However, Taiwan, the Republic of China (ROC), which is represented under the name of “Chinese Taipei”, was excluded from the annual APEC Economic Leaders’ Meeting. The annual APEC Economic Leaders’ Meeting are attended by the heads of government from all member economies, but Taiwan is represented by a ministerial-level official.

150 The term was first used by Jagdish Bhagwati in *U.S. Trade Policy: The Infatuation with Free Trade Agreements*, in Jagdish Bhagwati and Anne O. Krueger, *The Dangerous Drift to Preferential Trade Agreements*, AEI Press, 1995. The “spaghetti bowl phenomenon” is often used to describe a problem of overlapping free trade agreements (FTAs) with different rules of origin, especially those concluded by the East Asian economies in recent years.

They hope the establishment of FTAAP could be a way to overcome the “spaghetti bowl” effect, but also to create a union with economic expansion in trade and FDI for the promotion of economic growth and development in the region. However, it is also affected by political factors among member economies.¹⁵¹

Trans-Pacific Strategic Economic Partnership Agreement (TPP)

The Trans-Pacific Strategic Economic Partnership Agreement (TPP), also known as the “P4” agreement, is a multilateral free trade agreement between the countries of Brunei, Chile, New Zealand and Singapore, which was signed in 2005 and came into force in 2006.¹⁵² However, this agreement is not an APEC initiative.¹⁵³

On September 2008, the United States announced it was entering negotiations to join the group.¹⁵⁴ The first round of negotiations was scheduled to take place in March

151 Information will be updated in APEC newsletter which is available online at

http://www.apec.org/apec/news__media/enewsletter.html (last accessed on 2009/9/30). For more discussion about FTAAP, see Charles Edward Morrison and Eduardo Pedrosa, *An APEC trade agenda? the political economy of a free trade area of the Asia-Pacific*, APEC Business Advisory Council and Pacific Economic Cooperation Council, 2007.

152 Sources of the Trans-Pacific Strategic Economic Partnership Agreement Available at include Office of the United States Trade Representative <http://www.ustr.gov/>, New Zealand Ministry of Foreign Affairs and Trade <http://www.mfat.govt.nz/>, and The Hon Simon Crean MP, Australian Minister for Trade <http://www.trademinister.gov.au/> (last accessed on 2009/9/30).

153 The original Trans-Pacific Agreement negotiations were launched by Chile, New Zealand and Singapore at the APEC leaders’ summit in 2002, but it does not fall within the APEC agenda. For more discussion about TPP of P 4 or P5, see Charles Edward Morrison and Eduardo Pedrosa, *An APEC trade agenda? the political economy of a free trade area of the Asia-Pacific*, APEC Business Advisory Council and Pacific Economic Cooperation Council, pp. 222-223, 2007.

154 On September 22, 2008, USTR Susan Schwab, along with Ministers from the current member countries, announced the launch of negotiations for the United States to join the Trans Pacific Partnership. See *United States to Negotiate Participation in Trans-Pacific Strategic Economic Partnership*, Trade

2009, but has been on hold due to the changing of the presidential administration of the United States.¹⁵⁵

TPP is a free trade agreement covering the major areas found in most FTAs that includes trade in goods, rules of origin, trade remedies, sanitary and phytosanitary measures, technical barriers to trade, competition policy, intellectual property, government procurement and trade in services. Article 1.1 states that “this agreement covers in particular the commercial, economic, financial, scientific, technological and cooperation fields.”¹⁵⁶ This agreement would help facilitate trade and promote investment among contracting countries, resulting in increasing economic growth and development. Contracting countries hope it will enhance the competitiveness of the countries.

Moreover, Article 20.6 states that the agreement is open to accession “on terms to be agreed among the parties, by any APEC economy or other state.” This shows that the Trans-Pacific Agreement, a RTA, intends to attract new members. It strengthens the goal of promoting regional economic integration of APEC. It could be a RTA model for the Asia-Pacific region towards the Free Trade Area of the Asia Pacific.¹⁵⁷

Facts, Office of the United States Trade Representative, Sep. 2008. Available at http://www.ustr.gov/sites/default/files/uploads/factsheets/2008/asset_upload_file660_15116.pdf (last accessed on 2009/9/25).

155 The US Administration needs time to conduct a general review of US trade policy.

156 Text of TPP is available at

<http://www.mfat.govt.nz/downloads/trade-agreement/transpacific/main-agreement.pdf> (last accessed on 2009/9/26).

157 The context of the Trans-Pacific Strategic Economic Partnership Agreement is available online at

<http://www.mfat.govt.nz/downloads/trade-agreement/transpacific/main-agreement.pdf> (last accessed on

Same idea appeared in the document of the Office of the United States Trade Representative:

This initiative will support other priority trade initiatives.

- A successful conclusion of the Doha negotiations remains a top priority for the United States and the TPP countries; the Agreement's high standards will support a high level of ambition in the WTO Doha negotiations.
- It could provide a foundation for and build momentum towards a Free Trade Area of the Asia Pacific.¹⁵⁸

3.2.3 Regional institution v. bilateral agreements of individual countries

Countries decide to conclude FTAs for economic and/or political reasons. The economic benefits of FTAs can vary depending on the scope and the content of each agreement. They will have an interactive effect on industrial structures of contracting countries. There will be binding of market access for goods, and perhaps services as well. Foreign direct investments would be "triggered." Moreover, contracting countries may gain greater competition in regional markets through their growth of trade and FDI. Another benefit for governments to implement these FTAs would be gains from trade and factor flows and welfare gains from harmonization of national economic policies and

2009/9/30).

158 The last paragraph of United States to Negotiate Participation in Trans-Pacific Strategic Economic Partnership, Trade Facts, the Office of the United States Trade Representative, September 2008. Available at http://www.ustr.gov/sites/default/files/uploads/factsheets/2008/asset_upload_file660_15116.pdf (last accessed on 2009/9/30).

regulation.¹⁵⁹

A FTA is a discriminatory trade agreement favoring the contracting partner and violating the basic principles of non-discrimination under the multilateral trade frameworks of the General Agreement of Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). However, under GATT Article XXIV, free trade agreements are permitted as an exception to its non-discrimination principles, with several conditions.¹⁶⁰

The surge in RTAs has continued to increase since the early 1990s as a feature of the Multilateral Trading System (MTS). According to the WTO data up to December 2008, 421 RTAs have been reported to the GATT/WTO with 230 agreements in force, including 324 RTAs reported under Article XXIV and Ad Art. XXIV of the GATT 1947¹⁶¹ or¹⁶², 29

159 See Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp.72-73, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04). Also see Peter Lloyd, *New bilateralism in the Asia-Pacific*, in Peter Lloyd and Chris Milner eds., *The World Economy, Global Trade Policy 2002*, Blackwell publishing, pp. 83-100, 2003. First published as *The World Economy*, Vol. 25, No. 9, pp. 1279-1296, 2002. Also see Aggarwal, Vinod K., *Bilateral Free Trade Agreements in the Asia-Pacific*, in Vinod K. Aggarwal and Shurijo Urata eds., *Bilateral Trade Agreements in the Asia-Pacific*, Routledge, pp. 8-9, 2006.

160 Texts of GATT Article XXIV and Ad Art. XXIV are available at http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#articleXXIV and http://www.wto.org/english/docs_e/legal_e/gatt47_03_e.htm#adarticleXXIV (last accessed on 2009/9/22).

161 Article XXXVIII of The General Agreement on Tariffs and Trade (GATT 1947) is available at http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#articleXXIV; Ad Article XXIV of the GATT 1947 is available at http://www.wto.org/english/docs_e/legal_e/gatt47_03_e.htm#adarticleXXIV (last accessed on 2009/12/06). “Paragraphs 4 to 10 of Article XXIV of GATT (as clarified in the Understanding on the Interpretation of Article XXIV of the GATT 1994) provide for the formation and operation of customs unions and free-trade areas covering trade in goods.”

RTAs reported under the Enabling Clause¹⁶³, and 68 RTAs reported under Article V of the GATS¹⁶⁴. There are almost 400 RTAs, including those which are “in force but have not been notified, those signed but not yet in force, those currently being negotiated, and those in the proposal stage,” which are scheduled to be implemented by 2010. Over 90% of these RTAs are free trade agreements (FTAs) and partial scope agreements.¹⁶⁵ The agreements that have either been reported, or for which an early announcement has been made to the WTO, can be found in the database of the WTO Regional Trade Agreements Information System (RTA-IS).¹⁶⁶

The nature of an FTA could be recognized as a form of regional integration. These agreements generally start with the type that only remove tariff and non-tariff barriers, with lesser coverage of economic activity among the members and toward a deeper integration, including economic and political integration. A “preferential trade agreement” provides preferential access to certain products by reducing trade tariffs from contracting countries. A “free trade agreement” removes tariff and non-tariff barriers on

162 1994 Understanding is available at http://www.wto.org/english/docs_e/legal_e/10-24.pdf (last accessed on 2009/12/06).

163 Enabling Clause “allows derogations to the most-favored nation (non-discrimination) treatment in favor of developing countries”. For example, the 1979 Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries (the 1979 GATT decision) allows preferential trade in goods among developing countries. Available at http://www.wto.org/english/docs_e/legal_e/enabling_e.pdf (last accessed on 2009/12/06).

164 Text of GATS Article V which governs the conclusion of RTAs in the area of trade in services is available at http://www.wto.org/english/docs_e/legal_e/26-gats.pdf (last accessed on 2009/12/06).

165 Source from WTO website Regional Trade Agreements Section http://www.wto.org/english/tratop_e/region_e/region_e.htm (last accessed on 2009/01/17).

166 The Regional Trade Agreements Information System (RTA-IS) database is available at <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx> (last accessed on 2009/9/25).

trade among the members. A “customs union” is a deeper integration that is composed of a free trade area and adopts common external tariffs on non-members. A “common market” could be recognized as a customs union status plus providing free movement of labors and capitals among members. Finally, an “economic union” is a common market status which also provides harmonization of fiscal and monetary policies among members.¹⁶⁷ The European Union is an economic and political union with a more complex RTA toward a common market status. The North American Free Trade Agreement (NAFTA) is a FTA with far less intensive cooperation among the United States, Canada, and Mexico.

The rapid growth of free trade agreements led to the rise of regionalism which related to the competition for attracting FDI in developing countries. Several countries began to negotiate bilateral free trade agreements (FTAs) similar to NAFTA, which includes trade and investment provisions.

Until recently, East Asian countries started to participate in the formation of regional trade agreements (RTAs). Moreover, many East Asian economies began to negotiate and sign FTAs with the economies not only in the region but also outside the region.¹⁶⁸

¹⁶⁷ See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

¹⁶⁸ Ralph A. Cossa and Akihiko Tanaka eds., *An East Asian Community and the United States*, CSIS Press, pp. 57-60, 2007.

In light of these developments, one can detect the change in the characteristics of regionalization in East Asia around the turn of the century from market-driven to institution-driven regionalization as the main driver of regionalization is changing from the market forces unleashed by trade and FDI liberalization to regional and bilateral institutions such as FTAs.¹⁶⁹

Not only ASEAN but also its members individually have become active in FTA negotiations with other countries in recent years.

ASEAN as a group has discussed FTAs with economies in either its neighborhood or other regions. ASEAN has concluded free trade agreements with China¹⁷⁰, Korea¹⁷¹, Japan¹⁷², Australia and New Zealand¹⁷³, and India¹⁷⁴. FTAs between ASEAN and these six economies are called as the ASEAN plus six. In addition, ASEAN is currently negotiating free trade agreement with the European Union.¹⁷⁵

169 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

170 Information about the ASEAN - China Free Trade Area, available at <http://www.aseansec.org/19105.htm> (last accessed on 2009/09/25).

171 Information about the ASEAN - Republic of Korea Free Trade, available at <http://www.aseansec.org/22557.htm> (last accessed on 2009/09/25).

172 Information about the ASEAN - Japan Free Trade Area, available at <http://www.aseansec.org/22572.htm> (last accessed on 2009/09/25).

173 Information about the ASEAN - Australia New Zealand Free Trade Area, available at <http://www.aseansec.org/22258.htm> (last accessed on 2009/09/25).

174 Information about the ASEAN - India Free Trade Area, available at <http://www.aseansec.org/22563.htm> (last accessed on 2009/09/25).

175 Information about ASEAN-European Union relations, available at <http://www.aseansec.org/4970.htm> (last accessed on 2009/09/25).

Several ASEAN members have become active in establishing bilateral FTAs. For example, Singapore is a frontrunner in FTAs negotiations among ASEAN members. It enacted many FTAs with countries such as New Zealand, Japan, Australia, the United States, the European Free Trade Association (EFTA), and India.¹⁷⁶ Thailand is also active in concluding FTAs with Australia, New Zealand, and India.¹⁷⁷ It is currently in negotiations with the United States, Japan and many others. Malaysia signed an FTA with Japan and began to negotiate with several countries including the United States.¹⁷⁸

Concerned with the negative impacts of being excluded from the trade agreements, the Northeast Asian economies, including China, Japan, and Korea, decided to change their policy and become very active in FTAs in recent years.

China concluded FTAs with the ASEAN, Hong Kong, Macau, and several other countries. It is negotiating FTAs with over 20 countries either within or beyond the East Asian region.

Since its first FTA with Singapore, Japan started to establish FTAs with the ASEAN economies actively.¹⁷⁹ Korea is the most active Northeast Asian economy in negotiating

176 Information about Singapore's RTAs from RTA-IS database, available at

<http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?enc=bUbyxPA3Wob5pG8+pdmN/1N67wFoVNQFKxmtOWfwqPo=> (last accessed on 2009/09/25).

177 Information about Thailand's RTAs from RTA-IS database, available at

<http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?enc=BGNDAo9i1u5NEK0fWo0Yn7xPElauDRnW1ZiU+Cl9bKA=> (last accessed on 2009/09/25).

178 Information about Thailand's RTAs from RTA-IS database, available at

<http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?enc=bUbyxPA3Wob5pG8+pdmN/6RMoHoWosnmSAr03A/4Pkk=> (last accessed on 2009/09/25).

179 See Katsuhide Takahashi and Shujiro Urata, *On the Use of FTAs by Japanese Firms: Further Evidence*, RIETI Discussion Paper Series, 2009. Available at

FTAs with other economies.

Taiwan also wished to participate in FTAs with its neighbors and has started the process of forming regional economic integration; however, there have been diplomatic objections from China.¹⁸⁰

3.2.4 Unilateral Liberalization

3.2.4.1 Policy of trade liberalization

Reduction of tariff rates and the removal of non-tariff barriers are two forms of trade liberalization frequently undertaken by governments. Other domestic measures adopted by East Asian economies have had similar effects on trade liberalization with respect to promoting exports.

For example, the duty drawback system is an important measure used in the export-oriented economies for the production of exports. The producers of exported products are able to receive the returned tariffs that have paid on the imported parts and components. They receive the same benefits as a consequence of free trade.

Establishment of Export Processing Zones (EPZs), Special Economic Zones (SEZs) or Free Trade Zones (FTZs), is another important measure used by East Asian developing economies. Trade barriers, such as tariffs and quotas, are eliminated by governments in

<http://www.rieti.go.jp/jp/publications/dp/09e028.pdf> (last accessed on 2009/09/25). As of March 2009, Japan has enacted nine FTAs with Singapore (2002), Mexico (2005), Malaysia (2006), Chile (2007), Thailand (2007), Indonesia (2008), Brunei (2008), ASEAN (2008) and the Philippines (2008). It is negotiating a number of new FTAs including ones with Australia and India.

180 Siew calls for pragmatic approach to ASEAN ties, Taipei Times Newspaper, Oct 12, 2008, available at <http://www.taipetitimes.com/News/taiwan/archives/2008/10/12/2003425653> (last accessed on 2009/09/25).

these special areas in order to attract export-oriented FDI. Investors who set up their operations or corporations in the zone may receive tax breaks as an additional incentive, especially exporters or producers of export products can take advantage of free trade on imported raw materials or components.

Learning from the success of using EPZs, SEZs, or FTZs in Taiwan and Korea in the 1960s and 1970s, many East Asian economies, in particular China, undertook the same policies and measures in the 1980s and 1990s.¹⁸¹

Under this export-oriented policy, trade liberalization in these East Asian economies has promoted FDI inflow.¹⁸²

3.2.4.2 Policy of FDI liberalization

Since the 1980s, many economies opened themselves to foreign investment, improved the operational conditions for foreign affiliates and strengthened standards of treatment and protection. In fact, developing countries now actively encourage FDI. They believe the contribution of inward FDI can bring capital, technology, skills, employment, and market access. It promotes their economic growth and development. FDI thus has grown rapidly with the liberalization of the FDI regulatory framework, combined with advances in information and communication technologies.

181 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

182 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

Some developing economies deregulate FDI in specific ways, including conditions of entry, ownership of MNEs, privatization policies, or other benefits associated with inward investment. Furthermore, the creation of EPZs, SEZs, or FTZs for export-orientated investment is the method for liberalization of both trade and FDI. A ‘one-stop’ investment agency may help the process of investment approval more simplified and concentrated.¹⁸³ All of these measures help to promote FDI.

3.3 Current IIAs on FDI in East Asia

3.3.1 BITs

3.3.1.1 An expansion in the numbers of BITs

The increasing international investment agreements have been accompanied by the rapid growth of FDI after WWII. BITs are still the most common type of IIAs.¹⁸⁴ BITs were initially signed between developed and developing countries (called North-South treaties)¹⁸⁵, and these agreements began in the 1960s.¹⁸⁶ A growing number of BITs have been negotiated and signed between developing countries (called as South -South treaties) in the 1990s in particular.

The increasing in the number of BITs occurred in the 1990s because of the failure of

183 Governments may also establish domestic laws in favor of foreign investment which would be attractive to foreign investors’ interests, “such as planning regulations, corporate disclosure requirements or labor relations” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 215, 2007.

184 UNCTAD has established the database system of BITs, available on its website at <http://www.unctad.org/iaa>. See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 674, 2007.

185 These developing countries were mainly colonies of these developed countries.

186 The first BIT was concluded between Germany and Pakistan in 1959.

multilateral attempts for an investment agreement. Countries turned to bilateral and regional agreements. The Asian and Pacific region concluded the most BITs between developing countries.¹⁸⁷ This reflects the trend of cooperation between South-South countries and the stronger role of some developing countries as capital exporters, such as China.

IAs continue to increase, however new BITs have been signed slowly over the last few years, while countries continue to enter into PTIAs and economic integration treaties with provisions of trade and investment.

BITs usually cover private foreign investments made by MNEs or individuals of home countries in the territory of host countries. The purpose BITs is to promote and attract FDI for the capital-importing country and to protect investors of the capital-exporting country and protect them from risks, including political risks. This is the reason that BITs were originally signed between developed and developing countries while FDI usually flows from developed countries to developing countries.

Traditional BITs primarily and typically deal with the admission of entry, treatment, protection and security, and free transfer of means of foreign investment. BITs could be recognized as an assurance between contracting countries providing compensation for expropriation, fair, equitable and non-discriminatory treatment. New BITs further provide broader terms to observe investment contracts between states and private investors, and other investment-related obligations.

¹⁸⁷ See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, pp. 23-24, 2008.

Traditional BITs exclusively focused on the reciprocal promotion and protection of investments by nationals and companies of their home countries in the host countries. The United Nations Conference on Trade and Development (UNCTAD) defines BITs as “agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other’s territories by companies based in either country.”¹⁸⁸

The renegotiation of existing BITs is a recent development of IIAs in the 2000s.¹⁸⁹ Several countries are questioning the existing traditional BITs with broadly drafted investor protections that limit the ability of host countries to regulate.¹⁹⁰ The evolution of investment rule-making on BITs has been greatly influenced by cases of dispute settlement between investors and states/governments.¹⁹¹ There is increasing awareness causing countries to revise their existing BITs to add new concerns related to environmental and social issues, and national security. The host country’s right to regulate is also included.

Kenneth J. Vandavelde explained the explosion in the numbers of BITs since the late 1980s in the East Asian region as seemingly having two major causes, “the victory of market ideology” and “a loss of alternatives of foreign investments as a source of

188 available at: http://www.unctadxi.org/templates/Page___1006.aspx (last accessed on 2009/9/16).

189 See UNCTAD *Recent developments in international investment agreements*, UNCTAD Research Note, available at: http://www.unctad.org/sections/dite_dir/docs/webiteiit20051_en.pdf (last accessed on 2009/9/16).

190 The texts of new BIT model contain a balance between protection of investors and policy space of host countries.

191 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia–Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 127-144, 2009.

capital.”¹⁹² These result from the domestic policies of unilateral trade and FDI liberalization. The success of economic growth of several East Asian economies thus developed and integrated as “flying geese” through the industrial production chain driven by the market.

While the trend of liberalization continues to affect economies, these countries believe that having multilateral, bilateral or even regional trade agreements would help lead to deeper integration, especially in the investment-related aspects of trade.¹⁹³ They believe that deeper integration could lead to economic growth and development for individual economies, regions, or the globe.

3.3.1.2 The content of BITs

Because they mainly promise foreign investors nondiscriminatory treatment and give them specific additional rights, BITs have become popular.¹⁹⁴ BITs, as one of

192 The success of economic growth of several East Asian economies is related to their domestic import substitution policies. It brought the high rates of private FDI and the production goods for exports. In the late 1980s, these economies created a favorable environment for FDI.

Developing countries rushed to attract foreign investment by demonstrating their support for market capitalism in general and a secure investment offered a mechanism for signaling a desire to attract foreign investment by providing a more secure environment for such investment.

See Kenneth J. Vandevel, *A Brief History of International Investment Agreements*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, pp. 21-22, 2009.

193 See Kenneth J. Vandevel, *A Brief History of International Investment Agreements*, in Sauvant, Karl P.; Sachs, Lisa E. eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 23, 2009.

194 “Clearly, some governments have thought them worthwhile. Yet, empirical studies of the impact of BITs on FDI have had mixed results.” See Tim Buthe and Helen V. Milner, *Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis*, in Karl P. Sauvant and Lisa E. Sachs eds., *The*

effective means made by contracting countries, are often expected to provide credible and long term guarantees to foreign investors, and hence create FDI flow.

The procedural provisions provided by host countries are the most important guarantee. BITs give assurance to foreign investors that they will be well-treated during the lives of their investments. If there is breach by favorable treatment covered by the substantive provisions, foreign investors have rights against the host countries to enforce the unilateral initiate via international arbitrations.¹⁹⁵

The common provisions of most IIAs, especially in BITs¹⁹⁶, covered four major parts as common contents. First, the “Preamble” introduces the general objects and purposes of treaty partners. Second, they contain “Provisions Defining the Scope of Application of the Treaty” by covering subject matter (what), persons and entities (who), territory (where), and temporal effect (when), which is usually negotiated by the partners. Next, the most important section, “Standards of treatment,” is divided into two types. One is General Standards of Treatment, which includes Fair and Equitable Treatment, National Treatment, and Treatment of Most-favored-nation (MFN); the other type is Specific Standards of Treatment with treatments often considered as free transfer of

Effect of Treaties on Foreign Direct Investment, Oxford University Press, p. 171, 2009.

195 See Yackee, Jason, *Do BITs Really Works? Reviting the Empirical Link Between Investment Treaties and Foreign Direct Investment*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, pp. 380-381, 2009.

Many BITs, for example, guarantee investors access to the International Center for the Settlement of Investment Disputes (ICSID), a World Bank-associated organ that has emerged as the most important institutional enforcer of investment-treaty rights. ICSID arbitration can proceed even absent host countries participation, and any resulting award can be legally enforced against host-country assets in domestic courts the world over.

196 Including other IIAs with investment provisions.

payments, compensation for losses due to armed conflict or internal disorder, compensation for expropriation, and others. Finally, “Dispute Settlement Clauses” can be divided into those dealing with disputes between contracting countries and those between contracting countries and private investors. This section is a key provision related to MNEs’ rights of protection and security.¹⁹⁷ The arbitration institutions like International Centre for Settlement of Investment Disputes (ICSID) and the International Chamber of Commerce (ICC) are the most popular options in the investment agreements.¹⁹⁸

3.3.2 DTTs

The importance of tax treaties can be shown as the number of DTTs rapidly increased from 100 in 1960 to more than 2,500 today. By the end of 2007, the shares of DTTs by country show that 38 per cent of all DTTs have been concluded between developing and developed countries, 24 per cent were between developed countries, and 16 per cent were concluded between developing countries. Countries in the Asia and the Pacific region are the most active. Among developing countries, as of 2007 China had

197 See Peter Muchlinski, *The Framework of Investment Protection: the Content of BITs*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, pp. 37-71, 2009.

198 “Recently, the principle of non-discrimination against foreign investors at the pre-entry and the post-entry phase can be found in the models of BITs concluded by the US and Canada.” See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp.238-239, 674, 2007. Also see the UNCTAD Series on Issues in International Investment Agreements (IIAs) published between 1999 and 2004. All volumes addressed key concepts and issues relevant to international investment agreements and are also available at <http://www.unctad.org/iia> and <http://www.unctad.org/Templates/Page.asp?intItemID=2322&lang=1>. Also see UNCTAD Investment Provisions in Economic Integration Agreement, UNCTAD, 2006, available at http://www.unctad.org/en/docs/iteit200510_en.pdf (last accessed on 2009/12/07).

concluded the most of these agreements.¹⁹⁹

The growing international trade and FDI under the trend of globalization may increase the conflict of tax revenue between tax jurisdictions if there is no arrangement between countries. Today, there are no international restrictions or regulations for tax jurisdiction or rights to tax collection.

In general, these tax issues are still recognized as matters of national sovereignty. By the application of different theories and definition, various principles of income source and residence, and accounting and income recognition rules by countries, one income may receive situation of double taxation or tax exemption.

Jurisdictional conflicts can be, and often are, relieved unilaterally under both international investment agreements (IIAs) and double tax treaties (DTTs). The bulk of such arrangements are represented by bilateral agreements dealing exclusively with tax matters.²⁰⁰

Governments use bilateral tax treaties as one means to divert investment flows and influence MNEs decisions regarding FDI locations in their territory.²⁰¹

199 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, P26, 2008.

200 UNCTAD Taxation, Series on Issues in International Investment Agreements, UNCTAD, 1999. available at http://www.unctad.org/en/docs/iteit16_en.pdf (last accessed on 2009/9/30).

201 Governments use tax policies to

affect the rates of return on capital, provide public goods, or simply capture part of the profits that would otherwise be repatriated to other countries... These Treaties adjust the tax environment for investment between treaty partners by specifying the applicable tax base, the withholding tax that can be applied, and other measures

Current DTTs are all based on the Organization for Economic Co-operation (OECD) model or the UN (United Nations) model. Most of the treaties by developed countries are based on the model convention from the OECD, while the less-developed countries rely primarily on the UN model.²⁰²

These DTTs primarily deal with the issue of double taxation in international financial activities, such as regulating taxes on income, assets or financial transactions.²⁰³ The rules apply to govern income taxation of cross-border transitions. “Two primary goals of bilateral tax treaties are the elimination of double taxation of cross-border activities and the prevention of tax avoidance and evasion.”²⁰⁴

In short, DTTs play an important role in the international tax regime.

affecting the taxation of FDI.

See Bruce A. Blonigen and Ronald B. Davies, *Do Bilateral Tax Treaties Promote Foreign Direct Investment?* in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 461, 2009. Also see Claudio M. Radaeli, *The Politics of Corporate tax in the European Union*, Routledge, Research in European Public Policy, 1997.

202 See Peter Egger, Mario Larch, Michael Pfaffermayr and Hannes Winner, *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Empirical Evidence*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 513, 2009.

203 OECD Commentary Art.1, Para.7,

The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion.

204 See Peter Egger, Mario Larch, Michael Pfaffermayr and Hannes Winner, *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Empirical Evidence*, in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 537, 2009.

Under DTTs, a credit is usually allowed against the tax levied by the country in which the tax payer resides for taxes levied in the other treaty country, and as a result the tax payer pays no more than the higher of the two rates.

3.3.3 PTIAs

3.3.3.1 An expansion in the numbers of PTIAs

Over the last few years, countries have preferred to conclude PTIAs, including FTAs and other treaties on economic cooperation with investment provisions. These treaties are not limited to investment issues drafted in the case of BITs, but also deal with related matters, such as trade, services, competition, intellectual property, and government procurement.

Because multilateral negotiations under the WTO structure have been put off, regional economic integration has become the major method of expanding economic liberalization and promoting trade and FDI by most economies. Since then, countries turned to negotiate bilateral or regional free trade agreements (FTAs/RTAs) which are economic agreements originally dealing with trade issues²⁰⁵ and extending to investment issues.²⁰⁶ Compared to the number of BITs, the total number of PTIAs is still small. There has been rapid growth in the number of such agreements in the 2000s.

The establishment of international investment rules covered by preferential trade and investment agreements (PTIAs) is a new development in international investment rule-making since 2000. PTIAs are international investment agreements other than BITs and DTTs.

205 They mainly focus on reducing tariffs and restrictions on trade between two or more nations within a certain region.

206 Investment issues are currently difficult to negotiate under WTO

They are basically forms of bilateral or regional free trade agreements (FTAs/RTAs). They could be named as, for example, Economic Partnership Agreements (EPA),²⁰⁷ Closer Economic Partnership Agreements (CEPAs),²⁰⁸ Closer Economic Relations (CERs), Regional Economic Integration Agreements (REIs), Strategic Economic Partnership Agreement (SEPs), or framework agreements on economic cooperation.²⁰⁹

3.3.3.2 The content of PTIAs

PTIAs are agreements among countries on cooperation in economic and trade areas and typically include provisions that are more specific, complex and sophisticated. They show more variation in their scope and content and cover a broader range of issues. International investment rules have increasingly been adopted in recent FTAs.

Usually they cover a complex and broader set of issues. These new types of FTAs typically include not only trade liberalization in traditional FTAs, but also facilitation of foreign trade, liberalization and facilitation of FDI, economic and technical cooperation, and competition policy.²¹⁰ Some PTIAs contain investment promotion and protection

207 For example, the EPA between Japan and Singapore.

208 For example, the CEPA between China and Hong Kong, CEPA between China and Macao.

209 See UNCTAD International Investment rule-making stocktaking, challenges and the way forward, UNCTAD Series on International Investment Policies for Development, UNCTAD, p26, 2008.

210 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, pp. 129, 2009.

Recent FTAs tend to encompass a broader range of issues that in the most comprehensive agreements may include not only investment protection and liberalization, but also trade in goods and services, intellectual property rights, competition policy, government procurement, temporary entry for business persons, transparency, the environment, and labor rights.

Also See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research,

commitments similar to those found in BITs.

These agreements primarily deal with trade but include an expanded range of issues related to investment.²¹¹ For example, such agreements include the 1992 North American Free Trade Agreement (NAFTA) among Canada, Mexico and the United States,²¹² the Agreement on the Promotion and Protection of Investments, adopted by the ASEAN countries in 1987, the Energy Charter Treaty (ECT), concluded among some 50 countries in 1994, and other agreements, especially those concluded by the United States.

Many countries, such as Canada and Japan, also include provisions of investment liberalization similar to those found in the BITs concluded by the United States. The 1998 ASEAN Framework Agreement on the ASEAN Investment Area, and some other FTAs also added liberalization as an obligation of contracting countries.²¹³

Furthermore, some PTIAs only establish a framework for economic cooperation between the contracting parties. One such agreement was the Trade and Investment

Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

211 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

212 The NAFTA aims at the closer integration of the economics of North America, including the US, Canada and Mexico by means of a single trilateral FTA

It entered force on 1 January 1989. This agreement is notable as it contained a specific chapter on investment protection and acted as a model for the investment provisions of NAFTA.

See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p.239, 2007.

213 See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

Framework Agreement (TIFA) concluded in 2006 between the United States and ASEAN. Such agreements specify that there will be future negotiations on investment liberalization and/or protection.

Moreover, some recent agreements only contain “general principles with respect to further investment liberalization, promotion and protection, and pave the way for the future creation of a free trade and investment area.”²¹⁴

In addition, some agreements include regional initiatives for increased economic integration and investment liberalization.²¹⁵

In short, PTIAs, with their various combinations of contents on trade and investment, are the mainstream of institutional-driven economic integration in the East Asian region. Such economic integration and cooperation aims to create favorable conditions for encouraging trade and FDI flows, and further to promote the economic growth and development of individual economies and the region.

3.4 The development of current IIAs in the East Asian region

The current IIAs are more specific, complex and sophisticated than before. The development of current IIAs in the last two decades has changed the objectives, structure, substantive provisions and implementation provisions of these agreements.²¹⁶

214 For example, the ASEAN Framework Agreements with China and India (2002 and 2003, respectively).

See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, No. 1, Regionalism and Regional Trade Agreements in Europe – Asia trade relations, p. 130, 2009.

215 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p.238, 2007.

216 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series

3.4.1 Objectives and scope

Most IIAs indicate an objective of development among contracting countries in their preambles or specific declaratory clauses. Members recognized that they are in different stages of economic development. However, there is recognition toward the more effective integration through economic cooperation among members.

For example, the preamble of the 2002 China-ASEAN Framework Agreement indicates that it is made

Recognising the different stages of economic development among ASEAN Member States and the need for flexibility, in particular the need to facilitate the increasing participation of the newer ASEAN Member States in the ASEAN-China economic co-operation and the expansion of their exports, including, inter alia, through the strengthening of their domestic capacity, efficiency and competitiveness.²¹⁷

Some new IIAs address a broader scope of issues which include not only promotion and liberalization of FDI but also protection of FDI individuals and companies.

on International Investment Policies for Development, UNCTAD, pp. 36-46, 2005. Also see UNCTAD World Investment Report 2003 - FDI Policies for Development: National and International Perspectives, FDI Policies for Development: National and International Perspectives, UNCTAD, pp. 145-154 Chapter V, 2003.

217 Framework Agreement on Comprehensive Economic Cooperation between the Association of South East Asian Nations and the People's Republic of China, also call as China-ASEAN FTA: framework agreement available at <http://www.aseansec.org/13196.htm> (last accessed on 2009/9/25). For more discussion about China-ASEAN Framework Agreement, see *China-ASEAN investment agreement negotiations*, Frontiers of Law in China, Vol. 1, Higher Education Press, co-published with Springer-Verlag GmbH, pp. 423-431, 2006.

Contracting countries agree to use international or domestic techniques to achieve the “balance between investment protection and other public policy objectives.” These issues have been either put in the preamble of the agreements, incorporated into specific provisions in the investment chapter, or covered in “side agreements.”²¹⁸

3.4.2 Structure

These new IIAs allow signatories to make reservations and exceptions for necessary domestic development-oriented policies, such as public security or public health considerations.²¹⁹ Such provisions provide flexibility for contracting countries with different levels of economic development.

3.4.3 Substantive provisions:

3.4.3.1 Definition of investment

Some IIAs with the purpose of FDI protection “provide for a broad definition in

218 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia–Pacific region*, Asia Europe Journal, Vol. 7, Springer Berlin / Heidelberg, pp. 139-140, 2008.

The protection of health, safety, the environment, and the promotion of internationally recognized labor rights are areas where new IIAs include specific language aimed at clarifying that the investment promotion and liberalization objectives of IIAs must not be pursued at the expense of these other key public policy goals.

219 For example, the ASEAN-China Framework Agreement contains provisions that allow for exceptions on grounds of public security or public health considerations or for the protection of the environment and animal wildlife.

See Article 10, available at <http://www.aseansec.org/13196.htm> (last accessed on 2009/9/25).

the protection of its national security or the protection of articles of artistic, historic and archaeological value...the protection of public morals, or for the protection of human, animal or plant life and health.

their coverage.” For example, the 1987 ASEAN Agreement for the Promotion and Protection of Investment “tends to retain a measure of host country control over the admission.”²²⁰

Other agreements limit their coverage to a narrow definition. These IIAs address more details in the definition of investment, which includes the method of the “closed-list” definition of “investment.”

The “closed-list definition”

originally envisaged as an “enterprise-based” definition used in the context of the U.S.-Canada Free Trade Agreement, this approach evolved towards the definition used in article 1,139 of NAFTA. Subsequently, the “closed-list” approach has been frequently used by several APEC member countries in the definition of “investment” included in their IIAs.²²¹

An example is Article 2 of the 1998 Framework Agreement on the ASEAN Investment Area.²²²

This Agreement shall cover all direct investments other than:

- (a) portfolio investments; and
- (b) matters relating to investments covered by other ASEAN Agreements, such as the ASEAN Framework Agreement on Services.

220 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 41, 2005. The context of the 1987 ASEAN Agreement for the Promotion and Protection of Investment is available at <http://www.aseansec.org/12812.htm> (last accessed on 2009/9/29).

221 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, Springer Berlin / Heidelberg, pp. 135-137, 2008.

222 The context of the 1998 Framework Agreement on the ASEAN Investment Area is available at <http://www.aseansec.org/7994.pdf> (last accessed on 2009/9/29).

3.4.3.2 treatment and protection of foreign investors

These new IIAs tend to clarify the meaning of several substantive provisions, especially the principles and standards of protection that the contracting countries have an obligation to undertake.

Many other IIAs are influenced by the investor-state dispute settlement provisions in NAFTA. Recent IIAs negotiated among APEC economies also include such provisions.²²³

The content and scope of the minimum standard of treatment and protection in new IIAs are greatly influenced by the experience of investor-state dispute settlement cases, especially with regards to expropriation issues. These investor-state dispute settlement cases not only play a role as guidance for future cases, but also influence the provisions in further IIAs negotiations.

Expropriation remains the most important issue, especially the issue of regulatory or indirect expropriation, in the claims made by investors in recent investor-state dispute settlement cases. Most of them affected IIAs negotiations and became the grounds for principles of “national treatment” or “standards of fair or equitable treatment”²²⁴.²²⁵

223 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, Springer Berlin / Heidelberg, pp. 141-142, 2008.

224 Host countries often agree to have the obligation of providing “fair and equitable treatment” in the provisions of the FDI protection their IIAs. However, the standard remains uncertain and interchangeable. See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 635-637, 2007. For more discussion, see *Fair and Equitable Treatment*, UNCTAD Series on issues in international investment agreements, 1999. Available at <http://www.unctad.org/en/docs/psiteiid11v3.en.pdf> (last accessed on 2009/9/30). Also see *International Investment Law: A Changing Landscape, A Companion*

In general, most IIAs include treatment provisions, such as national treatment and most favored-nation (MFN) treatment²²⁶, and involve some exceptions as well. Usually, they are international minimum standard of treatment in accordance with customary international law. They include the principles of fair and equitable treatment and full protection and security.²²⁷ However, some IIAs signed by China²²⁸, for example, did not include the principle of national treatment.

Principle of national treatment not only offers stronger standards of protections for foreign investors, but also guarantees the minimum standard of protection under international law. In order to secure full protection and security of investment for attracting more FDI inflow, contracting countries, especially host states, will usually apply the principle of national treatment in their IIAs, especially BIT and PTIAs. However, this has not been recognized as a principle under customary international law.²²⁹

Volume to International Investment Perspectives, OECD, pp. 81-103, 2005; *Fair and Equitable Treatment Standard in International Investment Law*, Working Papers on International Investment, OECD, 2004. Available at <http://www.oecd.org/dataoecd/22/53/33776498.pdf> (last accessed on 2009/9/30).

225 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 621, 2007

226 UNCTAD Most favored-nation treatment, UNCTAD Series on Issues in International Investment Agreements, UNCTAD, 1999. available at <http://www.unctad.org/en/docs/psiteiid10v3.en.pdf> (last accessed on 2009/9/30).

227 See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, Springer Berlin / Heidelberg, pp. 137-139, 2008.

228 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 42, 2005.

229 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 621-628,

By the application of national treatment, foreign investors will be treated as the same as nationals of host countries or receive no less favorable treatment than investors from host countries when they are operating in similar business activities. The purpose is to prevent discriminations and promote equal opportunities for competition in host countries.

Furthermore, the host countries have to offer international minimum standard treatment to foreign investors, even if the treatment of nationals under the domestic law is lower than international minimum standard.²³⁰

Protection of foreign investors' rights is generally covered in protection provisions, such as transfer of funds, expropriation and compensation, and mechanisms of dispute settlements.²³¹

Many recent developments of these protection standards have been based on the decisions of investor-state dispute settlement cases. These decisions review the domestic administrative actions related to the foreign investment made by contracting countries. They will result in creating an improved investment climate for both the investor and the host country.²³²

Some recent new IIAs covered "more detail investor-state dispute settlement

2007. For more discussion and further examples of national treatment provisions, see UNCTAD National Treatment, UNCTAD Series on issues in international investment agreements, UNCTAD, 1999. available at <http://www.unctad.org/en/docs/psiteiitd11v4.en.pdf> (last accessed on 2009/9/30).

230 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 621-622, 2007.

231 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 42, 2005.

232 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 651, 2007.

procedures, providing greater guidance, both to the disputing parties and tribunals, with respect to the conduct of the arbitration proceedings.” NAFTA’s chapter 11 is the first IIA that regulated investor-state dispute settlement, including arbitration proceedings.

3.4.4 Implementation of IIAs

Countries conclude IIAs for various objectives of development. However, these objectives would be never reached if a country only signed an IIA and did not fully implement it domestically.

In order to attracting more trade and FDI, countries take steps to create business climate favorable to foreign investors implementing their IIAs in various ways.

At the international level, some IIAs create institutional frameworks. An institutional framework will directly set up a committee, which is responsible for the commitment of agreements and further negotiating processes. “Institutional setups can allow for the evolution of an agreement in light of the (developmental and other) experiences that it brought about.” Some others would provide “an indirect link through referring to the implementation of the agreement in question as a whole.” The ASEAN Investment Area Council²³³ is an example that “shall ‘supervise, co-ordinate and review the implementation’ of the Agreement and assist the ASEAN economic ministers in all matters relating to it.”²³⁴

Many IIAs include provisions as guidelines or as hortatory statements and

233 NAFTA is an example that greatly effected by those claims of expropriation issues. See Article 16

“Institutional Arrangements” of Framework Agreement on the ASEAN Investment Area (AIA), available at <http://www.aseansec.org/7994.pdf> (last accessed on 2009/9/30).

234 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 42-43, 2005.

suggestions to domestic policy measures. In order to reach their goals of economic growth and development, capacity building programs and technical assistance are often agreed by contracting countries and contained in the new IIAs.²³⁵

At the national level, there are various domestic measures adopted by contracting countries. These domestic measures are intended to create friendly business environments for foreign investors. Examples of domestic measures, which are provided by governments of host countries and would affect FDI location decisions, are “general policy pronouncements, information, financial and fiscal incentives, and investment insurance”²³⁶

Most of these provisions related to Implementation issues are found in Asian IIAs.²³⁷

Recent IIAs include provisions of greater transparency obligations in the process of domestic rulemaking. The purpose of involving such provisions is the exchange of information between contracting countries. These obligations include publication of laws and regulations, which relate to rights and obligations of investors and governments. Further, the transparency obligations in the domestic process of rulemaking would

235 Schedule II “Promotion and Awareness Programme” of “The Framework Agreement on the ASEAN Investment Area is an example for more operational policy measures, setting up a detailed promotion and awareness programmes.” See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 43-44, 2005.

236 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 43, 2005.

237 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 44, 2005.

“enable interested investors to participate in investment rulemaking.”²³⁸

3.5 Conclusion

The successfully concluded Uruguay Round of the GATT initiated the development of adopting economic policies of liberalization on cross-border economic activities, especially by developing countries. The East Asian region has thus gained economic importance by increasing intra-regional trade and exports to industrialized markets.²³⁹

In the last two decades, several developing countries have become capital-exporting countries²⁴⁰ due to the trends of globalization and liberalization, as well as their open-door policies. They are actively negotiating and signing IIAs with developed and developing countries for at least two reasons. One is that they think these agreements could be “tools” to attract trade and FDI flows that would benefit their economic growth and development. The other is that the existence of an IIA could protect investment of home country in the territories of other contracting countries.

238 Governments

attempt to use transparency as an instrument to promote the principle of due process and a tool to enable interested persons to participate in the process of investment-related rulemaking. Thus, in addition to enabling investors to know and understand the applicable rules and disciplines affecting their investments.

See Roberto Echandi, *The new generation of international investment agreements: recent developments in the Asia-Pacific region*, Asia Europe Journal, Vol. 7, Springer Berlin / Heidelberg, pp. 140-141, 2008.

239 Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp. 74-79, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

240 For information about the value of merchandise exports and imports of East Asian countries, check the data provided by “IMF Direction of Trade Statistics.” Available at <http://www.imfststatistics.org/DOT/> (last accessed on 2009/12/8).

The new IIAs include more specific, complex and sophisticated provisions than before. Although these IIAs, especially those between developing countries, address different development objectives, they work as a mechanism for economic cooperation among contracting parties.²⁴¹

However, the multilateral negotiations of the WTO have been putting off. At the same period, the increasing of overlapping bilateral and regional IIAs has resulted in the “spaghetti bowl” problem. Moreover, some East Asian economies were left out of bilateral or regional PTIAs because they are not favored politically, they cannot afford the costs of many separate negotiations, or because their neighborhood is less open.

This chapter provides general introduction for the development of IIAs in East Asia. Through cooperation in regional or multilateral investment arrangements under modern international law, economies could be able to obtain resolutions to promote their economic growth and development, and improve the living standard of people.

241 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 45, 2005.

CHAPTER FOUR.

THE CASE OF FDI ORIGINATING FROM TAIWAN AND ECONOMIC COOPERATION IN FDI WITH ITS NEIGHBORS

4.1 The role of Taiwan and its cross-border direct investment in the production sharing of East Asia

4.1.1 The development of Taiwan's economic and political events are influenced and shaped by its geographical position.

Taiwan, a small island located at the heart of the Asia-Pacific region, links Northeast Asia and Southeast Asia from its position off the southeast coast of China, with which it shares language and cultural ties. Its closest neighbors are predominantly large countries with growing economies. To its west lies China, which is a country of various natural resources, with the third largest landmass in the world, and representing a full 20% of the world's population with over 1.3 billion people in 2008. To the north, there is Japan, one of the top economically developed countries both in terms of economic size and its standard of living. To the east, across the Pacific Ocean, there is the United States, with the fourth largest landmass in the world and a total resident population of 306 million, and one of the top economically developed countries as well. In addition to the three great powers, there are ASEAN countries such as Singapore²⁴², Indonesia, Malaysia, the Philippines, and Thailand.²⁴³

242 As a city country cooperated with other countries, especially its neighbors, in economic affairs, positively

243 For more information related to economic history of Taiwan and the relations with its neighbors, see Frank S.T. Hsiao and Mei-Chu W. Hsiao, *Taiwan in the Global Economy: Past, Present, and Future*, in Peter C.Y. Chow eds., *Taiwan in the Global Economy: From an Agrarian Economy to and Exporter of*

The Taiwan Straits between Taiwan and China serves as an essential passageway for major transportation routes in East Asia.

4.1.2 Taiwan's economic growth and development are connected to its extensive involvement in international trade and investment.

Taiwan has many typical characteristics of an island economy. It greatly relies on trade and cross-border direct investment in manufacturing, and service activities, and sales channels.

The recordkeeping of development of Taiwan's economic history started in the Age of Discovery. The Europeans, such as the Dutch and Spanish Empires, realized that Taiwan was located on the strategic cusp between the East and Southeast Asia. Taiwan became an intermediate destination for trade between Western European empires and East Asia states in the seventeenth century. The history of Taiwan as an important point of commerce to the Dutch Empire, Qing China, and Empire of Japan between 1630 and 1945 was based heavily on economics. "Before the mid-1980s, Taiwan's pattern of industrialization, outward direct investment, and trade was similar to that of Japan in the 1960s and 1970s."²⁴⁴

High-Tech Products, Praeger, pp. 161-222, 2002.

244 See Steven A. Y. Lin, *Roles of Foreign Direct Investments in Taiwan's Economic Growth* in Peter C. Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 82, 2002. It is important to assess the formation of Taiwan's colonial economic structure as well as its effect on the success of industrialization as NIEs as a colony of Japanese imperialists in the prewar period of about fifty years. See Teruzo Muraoka (Jaw-Yann Twu), *Colonization and NIEs' lization of Taiwan's Economy Blending with Japan's Globalization: A Global Perspective*, in Peter C. Y. Chow eds., *Taiwan in the Global Economy: From a Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 223-240, 2002.

As an agrarian colony of Japan prior to the end of World War II (1895-1945), Taiwan's major exports in the 1950s were rice, sugar, and other primary commodities. Since the early 1960s, Taiwan has been trading heavily with Japan and the United States, which has transferred technology, expertise, and skills to Taiwan and has been the major market for the products made in Taiwan.²⁴⁵

During the Cold War period when the labor force of those developing countries was blockaded, Singapore, Hong Kong, South Korea and Taiwan took the export substitute policy to produce the goods and exported the final goods to the developed countries of North America and Europe.²⁴⁶ With large markets and few competitors, these four economies, also called as the four Asian little dragons, took the chance with highly

245 The government of Taiwan did not adopt the "dependency theory" as its development strategy.

The main thesis of dependency theory – that due to unequal distribution of power and resources between the 'core' (the developed countries) and the 'periphery' (the developing countries), a peripheral country like Taiwan has to be self-reliant so as not to become dependent on the 'core' countries – was not adopted by the Taiwanese government.

The author focused on the development path, which shifted Taiwan's role from dependency to independency. He argued that Taiwan's development different from the conventional core-peripheral model. It offered an alternative development model for late industrialization. Taiwan has exemplified itself as an intermediate between the core, such as Japan, the United States, and European Union, and the peripheral countries, such as the ASEAN economies. See Peter C.Y. Chow, *From Dependency to Interdependency: Taiwan's Development Path toward a Newly Industrialized Country*, in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 241-278, 2002. The author added on page 271, note 2: "It is noted that in the 'less static zero-sum model,' Wallerstein (1979, 76-81) pointed out that peripheral countries could take three strategies to become semi-periphery, which is sandwiched between the core and periphery. The three strategies are, in addition to self-reliance, multinational corporations and aggressive state actions when internal and external opportunities exist." See Immanuel Wallerstein, *Dependence in an Interdependent World: the Limited Possibilities of Transformation within the Capitalist World-Economy*, in Immanuel Wallerstein eds., *Capital World Economy*, Cambridge University Press, pp. 76-81, 1979.

246 These four economies led by Japan worked as a factory to the market of North America and Europe.

economic growth and became the first-tier NIEs.

The trend of globalization and liberalization of trade and investment advanced the fragmentation of production processes and the outsourcing of parts and components, especially in the East Asian region. The major source, especially some high-tech and services sectors of international trade and investment, are transferred from MNEs from the developed economies. Taiwan has become an important player in the world market by teaming up with many MNEs, mostly from the Organization for Economic Co-operation and Development (OECD) economies.²⁴⁷ The rapid expansion of trade brought Taiwan a high speed of economic growth. In 1979, economists of the OECD recognized Taiwan as one of the newly industrializing economies. Taiwan became one of the first-tier NIEs in 1980s.²⁴⁸

247 See Tain-Jy Chen and Ying-Hua Ku, *Offshore Sourcing Strategies of Multinational Firms in Taiwan*, in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 95-108, 2002. Members of OECD is available at http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last accessed on 2009/8/20)

248 See Miyagawa Noriyuki, "Abstract" of *NIEs in the International Situation: A Case Study of Taiwan*, 1988.

Taiwan's economic development process is focused on in terms of development strategy, domestic balanced growth, direct foreign investment and trade structure. Firstly, success of primary export substitution, that is export of labor-intensive manufactured goods, is stressed. That strategy was adopted in the sixties and contributed to Taiwan's higher growth rate very much in the sense that it made balanced growth between agriculture and manufacturing successful. Secondly, the processing zone for export which attracted direct foreign investment especially from developed countries was of great importance. Finally, Taiwan's trade structure is analyzed. Since first oil crisis, she has adopted second import substitution, that is displacement by domestic industry for production of capital-intensive manufactured goods, and second export substitution, that is export of capital-intensive ones, mixed with liberalization policy. As a result, diversification

Taiwan's economy had not only become more globalized, it had also shifted from a recipient to a provider of foreign direct investment during the period 1960-1980. After the late 1980s, there was simultaneous flow of both outward FDI from and inward FDI to Taiwan,²⁴⁹ and this resulted in Taiwan's economic and industrial structure advancing.²⁵⁰

Due to the rising labor and land costs, the rise in exchange rates, and increasing concern about environment protection in Taiwan, Taiwan's industries, especially the manufacturing sectors, have started to migrate to Southeast Asian economies on a large scale²⁵¹ in order to seek cost advantages by engaging in offshore productions overseas through outward FDI since the 1980s.²⁵²

After the government of China began its open door policy in 1979 and the government of Taiwan legally allowed its people to visit their relatives in China in 1987, Taiwan's investors used Hong Kong as the relay station to invest in China. By the early 1990s, Taiwan had become the fourteenth largest trading economy in the world, and the

of trade structure is being brought about. However, export of labor intensive goods in which Taiwan has comparative advantage is still dominant in it.

available at <http://ci.nii.ac.jp/lognavi?name=nels&lang=en&type=pdf&id=ART0000550119> (last accessed on 2009/7/13).

249 Taiwan's economy growth was contributed by the export-led policy and boosted by the inflows of FDI in the 1960s and 1970s. For more details, see Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan's economic Growth*, in Peter C. Y. Chow eds., *Taiwan in the Global Economy: From a Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 79-94, 2002.

250 It was a fascinating phenomenon of globalization in the late-industrialized country.

251 Taiwan's FDI flows to Southeast Asia have been slowed down when the financial crisis happened since Aug. 1997.

252 However, these changes are evidences of Taiwan's economic development and upgrade. Taiwan has played an important role in the production sharing chain as a capital and technology acceptant benefited from foreign direct investment.

third largest economy of IT²⁵³ products and other high-tech sectors.²⁵⁴

In 1991, the government of Taiwan began allowing its people to invest in China officially. Part of the cross-border direct investment originating from Taiwan has been a shift from Taiwan and Southeast economies to China.

Since 1970s, the manufacturing industries of Taiwan, especially traditional low-tier processing manufacturing sectors, have migrated to the labor-intensive Southeast Asian economies and China with less production costs while they started to join the international production and trading system under the trend of globalization. Hence, Taiwan transformed itself from a recipient to a provider of outward FDI.

With the economy and industry structure upgraded, another manufacturing industry of Taiwan, led by the information and communication technologies (ICT) and high-tech sectors, started to migrate to these labor-intensive economies. The second tier Asian NIEs, ASEAN-4 (Indonesia, Malaysia, the Philippines, and Thailand), and China are the major recipient economies (host countries) for Taiwan's outward FDI, and Taiwan has become one of the largest investors in many Southeast Asian economies.

Taiwan has become a key player, in the East Asian industrial production sharing chain, with roles in both supply and demand. Taiwan relied on the key technology and components supplied by Japan on the one hand, and on the other hand offered the intermediate products and components to Southeast Asia and China for their final

253 The information technology (IT) industry.

254 For more information related to Taiwan's information industry, source available at <http://www.itis.org.tw/> (last accessed on 2009/7/21).

products to export.

The increasing trade and investment flow between Taiwan and Southeast Asian economies and China boosted economic growth in these economies and increased their rate of industrialization. The drive towards the globalization of Taiwan has contributed to regional economic integration and development, as Taiwan is one of the key players in the East Asian group.

4.1.3 SMEs of Taiwan and their location choices:

98% of all businesses in Taiwan are small and medium enterprises (SMEs), which are the backbone of its economic development.²⁵⁵ “The emergence of Taiwan’s SMEs is closely related to the economic, social and educational policies adopted by the government in the past.”²⁵⁶

255 For more information about the Statistics of SMEs in Chinese, source from Small and Medium Enterprise Administration, Ministry of Economic Affairs, ROC, available at <http://www.moeasmea.gov.tw/lp.asp?ctNode=220&CtUnit=140&BaseDSD=7&mp=1> (last accessed on 2009/07/29).

256 See Taiwan’s Economic Development, reported by the Small and Medium Enterprise Administration, Ministry of Economic Affairs, Ministry of Economic Affairs, ROC.

The ‘Land to the Tiller’ program and the Economic Construction Plan, the implementation of which began in 1953, the beginning of compulsory education in 1968, and the Ten Major Construction Projects plan, which began to be implemented in 1973, along with other measures adopted in the areas of economic development, manpower resources, social stability and public construction, have all provided SMEs with an excellent environment in which to grow and develop. In particular, following the outbreak of the Asian financial crisis in the late 1990s, Taiwan's SMEs won international acclaim for the way in which they stood up to the impact of the crisis. As Taiwan's economy has developed, so have Taiwan's SMEs.

available at <http://www.moeasmea.gov.tw/ct.asp?xItem=72&CtNode=263&mp=2> , updated in 2007, (last accessed on 2009/7/29).

According to the definition of SMEs (revised and issued by Ministry of Economic Affairs, ROC, on July 5, 2005) is:

A SME shall refer to an enterprise that has completed company registration or business registration in accordance with the requirements of the law, and which conforms to the following criteria: (1) In the manufacturing, construction, mining and quarrying industries, a paid-in capital of NT\$80 million (US\$2.42 million) or less. (2) In the agriculture, forestry and fisheries, water, electricity and gas, commercial, transportation, warehousing and communications, finance, insurance and real estate, industrial and commercial services or social and personal services industries, sales revenue of NT\$100 million (US\$3.03 million) or less in the last year.²⁵⁷

In 2006, there were just over 1,244,000 SMEs, accounting for 97.77% of the 1,273,000 enterprises in Taiwan.²⁵⁸

Most of them are independent in their industries. Through inward FDI, Taiwan's

²⁵⁷ Article II of Standard for SMEs Definition, available at

<http://www.moeasmea.gov.tw/ct.asp?xItem=70&CtNode=261&mp=2> (last accessed on 2009/7/29).

²⁵⁸ See *The SMEs' Status in Taiwan*, reported by the Small and Medium Enterprise Administration, Ministry of Economic Affairs, Ministry of Economic Affairs, ROC.

Although the SMEs' share of all enterprises in Taiwan fell slightly due to a pronounced increase in the number of large enterprises, for other indicators—including total sales, domestic sales and export sales—SMEs displayed higher growth rates than large enterprises, and as a result SMEs' shares of total sales, domestic sales and export sales all rose... This slight decline was due to the pronounced increase (2.93%) in the number of large enterprises.

available at <http://www.moeasmea.gov.tw/ct.asp?xItem=770&CtNode=331&mp=2>, updated in 2007, (last accessed on 2009/7/29).

SMEs have not only received technology and management skills from foreign MNEs, but also benefited from the foreign investors' networks to the global market.²⁵⁹

As the economy keeps developing, the capital stock of Taiwan accumulated fast. With the regulations of Foreign Direct Investment legalized in 1962 in Taiwan,²⁶⁰ cross-border direct investment became possible for investors of Taiwan while capital was relatively abundant. Since then, local enterprises were allowed to hire foreign worker in order to utilize relatively abundant capital by the economic policy of the Taiwan government.

Because Taiwan's SMEs have less capacities of globalization, they have considered that lowering the costs is the best way to gain more profile. The government of Taiwan recognized the disadvantages and difficulties of operating business, marketing, R&D, and financing that its SMEs were facing and gave them assistance for promoting their capacities and competitiveness.²⁶¹ Taiwan's firms also engaged in "strategic alliances" with some MNEs of developed economies and stimulate their businesses in developing economies by trade and cross-border direct investment.

Taiwan's SMEs are unable to become big MNEs if they only enter this limited market on this small island. These SMEs seek a large market and intend to extend their

259 See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan's Economic Growth* in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 79-81, p. 93 note 2, 2002. The author cited reference book with the analysis of the impacts of inward FDI on productivity growth of Taiwan's industries. See S. Okuda, *Taiwan's Trade and FDI Policies and their Effect on Productivity Growth*, *The Developing Economies*, Vol. 32, pp. 452-463, 1994.

260 However, it did not include investment between Taiwan and China.

261 However, there is little success.

economic scale in order to reach their ideal profits.

Investors of Taiwan's started to capitalize on the deepening division of labor in the mid-1980s in the East Asian region. Next, they shifted production of labor-intensive products to Southeast Asian economies and China.²⁶²

In order to improve their export competitiveness Taiwan's SMEs expanded scope and depth of the international division of labor to lower their costs of production. "They stepped into the original design manufacturing (ODM) stage from original equipment manufacturing (OEM) or simple contract manufacturing." They set up production platforms with outward FDI in different locations with different incentives offered by local governments in order to improve their export competitiveness. The host economies were initially ASEAN countries and later China. The final goods were then exported to global markets, usually the United States. SMEs who technologically upgraded to the higher technology industries also expanded their business activities, "especially the logistic management aspects of marketing... Taiwan's SMEs were offered the opportunity to extend their supply chain to global logistic management."²⁶³

Some of Taiwan's investors in high-tech industries followed the traditional manufacturing industries and started to move to these developing countries in these two

262 "However, unlike South Korea, Taiwan was unable or willing to build the heavy industries and conglomerates." See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan's Economic Growth* in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 82, 2002.

263 See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan's Economic Growth* in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 83, 2002. Cited the reference report: "Industrial Technology Information Services, 1997. ROC: "Republic of Computers – Taiwan", Report #9707, Taipei, Taiwan."

decades. A hollowing-out of some labor-intensive and higher-technology industries of Taiwan was observed due to the cross-border investment flows to China directly or indirectly.²⁶⁴

The strategy of global deployment and cross-border direct investment with intra-industrial trade could be the reaction to or strategy for the trend of globalization for Taiwan's SMEs. The FDI location decision, include the flexible and elastic composition, could be recognized as an innovation of Taiwan's cross-border direct investors. Not all investors, especially SMEs, from every economic entity have the ability or willingness to do so.²⁶⁵

After its great amount of FDI flowed toward Southeast economies and China, some of these SMEs sprouted to become medium-to-big enterprises. Cross-border direct investment made by Taiwan's SMEs brought Taiwan to such a position as an important role in the industrial production sharing chain, especially in the East Asian region. The investment from Taiwanese firms has formed a complete supply chain system in East Asia.²⁶⁶

264 Indirect investment through a third party.

265 Compared with the SMEs of Italy, Taiwan's SMEs have more ability and willingness to invest across borders.

266 See Yun-Peng Chu, *Trends and Issues in Taiwan: Bringing the Flying Geese Back In*, in *Trends and Issues in East Asia 2000*, pp. 282-304, Foundation for Advanced Studies on International Development (FASID).

There are over one million of them (SMEs), accounting for more than half of the exports and 78 per cent of employment. Each year about 42,000 of them disappear, while another 45,000 are newly born. Of the surviving SMEs, 24.8 per cent have

Following are the characteristics of the FDI activities originating from Taiwan:²⁶⁷

Most of the investors locate their operation center in Taiwan. Most Taiwanese investors in Southeast Asian economies and China used to keep the business relationships closely held, either with their mother companies or companies in their industrial supply chain during the past two decades.

The majority of these investors obtained export orders²⁶⁸ in Taiwan and produced more in China than in Taiwan, Southeast Asian economies, or other regions. At least 86% of the technological sources for Taiwan's cross-border economic activities came from Taiwan. Only 21% of research and development (R&D) was produced by the overseas centers themselves.

However, the trade effects of FDI, which is the intra-industry or intra-firm trade of

been in business from 10 to 20 years, and 13.1 per cent have been in business for more than 20 years. Many 'graduated' and became medium-to-big enterprises... In effect, Taiwanese firms are hard pressed to upgrade themselves following the sudden and monumental appreciation of the domestic currency in 1987... On the positive side (of view of how successful the transition has been), a study shows that the percentage share of the technology-intensive products (measured in terms of the ratio of high-grade manpower to total employment) in total production of the manufacturing sector rose from 28 per cent in 1988 to 40 per cent by 1998. On the negative side, many firms in the traditional sector have either given up production in Taiwan completely or are struggling very hard to survive.

available at <http://www.fasid.or.jp/english/publication/research/issues.html> (last accessed on 2009/7/13).

267 Wu Shyon Chen, *Strategy of Global Layout for Taiwanese Businessmen's Investment*, Chinese

National Federation of Industries, ROC, 2006. Available at

<http://www.cnfi.org.tw/kmportal/front/bin/ptdetail.phtml?Part=magazine9510-439-2> (last accessed on 2009/7/22)

268 For new official information updated and offered by the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. Available at

http://2k3dmz2.moea.gov.tw/gnweb/english/e_new.aspx (last accessed on 2009/7/25).

raw materials, component, and semi-manufactured goods, has been weakened for the reason that some investors have localized their business operations, hired local management staffs, and extended business functions from production to R&D and marketing locally.

The equal prices of economic activities' elements have made investors of Taiwan relocate their capitals, resources, and even the whole private entities overseas in order to pursue higher profits.

4.1.4 Taiwan's Economic Indicators

Statistics of FDI from Taiwan:

According to the official statistics of Taiwan²⁶⁹ approved outward investments to China total USD 77,110,264.71 (USD1,000 per unit) from 1991 to May 2009; investment in the other countries was USD 60,711,728.0389 from 1952 to May 2009. Counting the amount of FDI from Taiwan to ASEAN countries, the outward investment to ASEAN countries was USD 63,665.82 million from 1959 to December 2008.

Taiwan is the largest investor in Vietnam, the third-largest investor (just behind Japan and the United States) in Thailand and Malaysia, the third-largest investor (just behind Malaysia and China) in Cambodia, and the seventh- and eighth-largest investor in the Philippines and Indonesia respectively.

However, a great deal of investment originating from Taiwan went through third parties, and was officially uncounted. In the past ten years, the outward FDI from Taiwan has mainly located in the Asian region and was especially highly centralized in China,

²⁶⁹ Source from the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. Available at <http://www.dois.moea.gov.tw/asp/relation3.asp> (last accessed on 2009/7/25).

followed by the American region.²⁷⁰

At present, China is still the main location of the industrial value chain of Taiwan's manufacturing industries. Until Oct. 2007, Taiwan's investment in China was more than 50% of its total FDI, and it is increasing. After Hong Kong, Taiwan is the country most dependent on its close economic ties with China.²⁷¹

Statistics of FDI in Taiwan:

The officially approved amount of overseas Chinese and foreign investment in Taiwan is 103,823,954 from 1952 to April 2009 (USD 1,000 per unit).²⁷²

The top three countries or territories of Overseas Chinese Investment in Taiwan are the United States, Philippines, and Hong Kong. The top four countries or territories of foreign investment to Taiwan are the United States, the Netherlands (many investors originating from Taiwan in Europe took the advantages of the DTTs between Netherlands and Taiwan), the Caribbean Sea, and Japan.

Statistics of Trade:

The United States used to be the largest exporting market of Taiwan but it was replaced by Hong Kong in 2002. The degree of reliance on the United States market of Taiwan has declined from 40% to 20% in 2003.

270 Only took minority in Europe.

271 See Research on the Migration of Industry Value Chain (of Taiwan) - An Example of (Taiwan's) Industry Value Chain across (Taiwan) Straits, Chia-Yan Yang and Hui-Ping Lee, Taiwan Institution of Economic Research, 2007.

272 Source from the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. Available at http://investintaiwan.nat.gov.tw/en/env/stats/fdi_area.html (last accessed on 2009/7/25).

However, both the import amount from Japan and the export amount to Hong Kong and China have been increasing. The increasing amount of imports from Japan has great relevance to the increasing amount of exporting to China as intra-industry or intra-firm trade of Taiwan's investment in China.

The United States became the third-largest exporting market of Taiwan, and Taiwan is the eighth-largest trading partner of the United States. In 2006, Japan and China were Taiwan's top two trading partners²⁷³ while Taiwan plays a double role in the East Asian industrial production sharing chain.

Taiwan has been well known as a major economic player in the world, as the world's fourteenth largest trading country and ranked sixteenth on the UNCTAD list of the world's 100 largest economic entities in 2000.²⁷⁴ It was the world's sixteenth largest trading and the world's eighteenth largest economic entities in 2006. It has been playing a double role within the industrial production sharing chain in East Asian region with its investors bringing many benefits through trade and cross-border direct investment for the East Asian host economies.

However, the proportion of total global trade value of Taiwan to East Asian economies has continued to decline from 9.1% in 2000 to 6% in 2008. The proportion of total intra-regional trade value of Taiwan to East Asian economies has declined from 9.4% in 2000 to 6.7% in 2008. Taiwan's trade performance in East Asia has been poor in recent years.

The closer economic relationship and the increasing trade rate across Taiwan-Straits

273 Source from Directorate General of Customs, Ministry of Finance, ROC.

274 According to a survey of the world's top 100 economic entities of 2000 by UNCTAD.

seem to indicate failure for improving Taiwan's economic growth and trade in the East Asian region in recent year. It means the role of Taiwan in the East Asian industrial production sharing chain is not as important as before. It could result in the phenomenon of marginalization of the Taiwanese economy.²⁷⁵

4.2 FDI originating from Taiwan in China, which is the first trading partner of Taiwan and host country of Taiwan's outward FDI

When the government of China instituted the "open door policy"²⁷⁶, there was virtually no legal structure acting as a regulatory mechanism. There were also virtually no codified laws or regulations pertaining to foreign commercial enterprise ventures or investments.²⁷⁷

Since the Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures,²⁷⁸ enacted in 1979, the fundamental piece of legislation dealing with foreign investment in China, the Chinese government has passed over 200 laws and regulations relating to FDI in China.²⁷⁹ For example, foreign joint ventures, offshore oil exploration, foreign economic contracts, mediation and arbitration proceedings, and Special

275 See Wen-Jung Lien, *The accelerated weakening of the intra-regional trade in East Asia*, Journal of Economic Outlook Bimonthly, Vol. 123, Chung-Hua Institution for Economic Research, pp. 73-77, 2009. (translated by Hsu, Hui-Yi).

276 This was done by way of the December 1978 meeting of the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party.

277 See Kui Hua Wang, *Chinese Commercial Law*, Oxford University Press, pp.83-84, 2000.

278 Available at <http://tradeinservices.mofcom.gov.cn/en/b/2001-03-15/2591.shtml> (last accessed on 2009/8/20).

279 Available at <http://www.fdi.gov.cn/ltlawpackage/index.jsp?currentPage=1&category=02&app=1&language=en> (last accessed on 2009/7/31).

Economic Zones have all been specifically addressed by Chinese law.

Since then, China voluntarily opened its doors to foreign investment. The legal thinking and methods of civil law and common law has been incorporated.

The relations of trade between Taiwan and China, and cross-border direct investment originating from Taiwan in China, have developed rapidly since China initiated economic reform and liberalization policies. After a deregulation policy of Taiwan in 1991, trade and investment have led to mutual dependence between the two sides and influenced their respective economic development. China has become a key trading partner of Taiwan, and a major host country for cross-border direct investment.²⁸⁰

When the government of China announced, “Enterprises with investment of Taiwan compatriots shall enjoy preferential treatment in accordance with the relevant provisions of the State Council on encouraging investment of Taiwan compatriots,” investors with huge Taiwan’s capital exported to China because of the cheap labor and resources and the large market.

After the entry into the WTO, China has kept making its laws at least not inferior to the standards of WTO regulations. During this period of time, a new economic world order took effect with the advent of China being admitted into WTO on November 10, 2001. A large proportion of Taiwan’s traditional manufacturing industries moved to China.

280 It is difficult to figure the actual amount of direct investment originating from Taiwan in China because many investments go unreported to the government. See the official reports “Cross-Strait Economic Statistics Monthly”, available at <http://www.mac.gov.tw/english/english/csexchan/rpt/>, includes documents from No. 141 to the last. Mainland Affairs Council, Executive Yuan, R.O.C. Also see the official reports “Statistics of FDI in Southeast countries and China”, Available at <http://www.dois.moea.gov.tw/asp/relation3.asp>, Department of Investment Services, Ministry of Economic Affairs, R.O.C. (last accessed on 2009/7/1).

They are investors mostly of capital-intensive and labor-intensive industries.

As Taiwan is playing the double role in the East Asia production sharing chain, it exports the intermediate goods and components to China, and China exports the final goods to the other countries. The industry and economy of Taiwan has great reliance on the Chinese economy.²⁸¹

40% of Taiwan's exports go to China, covering the industries of electronics, mechanical equipment, and raw materials and products. This is the trading efficiency of intra-industry or intra-firm trade resulting from the cross-border direct investment originating from Taiwan.

However, the cross-strait trade growth rate has declined since 2005; Taiwan still barely relied on trade with China, while China did not. The proportion of trade with Taiwan has declined compared with China's total amount of trade.

Since October 2007, the proportion of Taiwan's FDI in China is 50% stronger than in other economies, and it keeps increasing. According to a survey conducted in 2006 on cross-border direct investment of Taiwan's manufacturing investors, 81.18% of them chose China as their favorite FDI location. The proportion of these investors has been increasing, especially in electrical machinery industry, metal products industry, and plastic products industry, due to not only the cheaper labor costs, but also the similar

281 For more details, see Hui-Ping Li and Chia-yen Yang, Research on the Movement of Taiwan's Industrial Value Chain: *The case study of the Industrial Value Chain across Taiwan Straits*, Taiwan Institution of Economic Research, 2008. (Translated by Hsu, Hui-Yi).

languages and culture across the Taiwan Straits.²⁸²

The FDI location of Taiwan's investors has extended from the Pearl River Delta to the Yangtze River Delta for two decades, and then toward the north and mid-west in recent years. 90% of the direct investment originating from Taiwan located in the Yangtze River Delta with mainly high-tech industries and the Pearl River Delta with mainly traditional industries.²⁸³

The increasing of Taiwan's FDI, made by big companies, flowed to China and has made the whole industrial chain move to China. These investors formed the industry clusters in these regions in China, such as the electrical machinery industry clusters located in the Yangtze River Delta (32% of Taiwan's investors located in Jiangsu Province), and the textile industry cluster, leather industry cluster, and toy industry cluster are located in the Pearl River Delta (25% of Taiwan's investors located in Guangdong Province).²⁸⁴

However, for the reason that China's industrial structure has become more complete, and resources easier to receive than before, Taiwan's investors have started to localize their business operations in China and their industrial clusters have settled more

282 See Wu Shyon Chen, *Strategy of Global Layout for Taiwanese Businessmen's Investment*, Chinese National Federation of Industries, ROC, 2006. Available at <http://www.cnfi.org.tw/kmportal/front/bin/ptdetail.phtml?Part=magazine9510-439-2> (last accessed on 2009/7/22).

283 See document and handout presented to the conference of "Taiwan's Overseas Investors Invest Back to Taiwan Symposium in Year-2008", on September 1, 2008, in Taipei. (Translated and testimony of Hsu, Hui-Yi).

284 Information is from Investment commission, Ministry of Economic Affairs, ROC, and Ministry of Commerce, PRC in the document presented in the conference of "2008 Invest back to Taiwan from overseas Taiwan's investors Symposium in Year-2008", on September 1, 2008, in Taipei.

completely in recent years. During the migrations of these whole industrial clusters from Taiwan to China, they duplicated the experience of Taiwan's economic development to China and formed a unique industry network of firms of industrial clusters originating from Taiwan.

Some of the changes in cross-border investment in China originating from Taiwan in the last ten years include:

- (1) diversification by industries, expanding from traditional manufacturing to service industries (such as insurance, tourism, and business service) and shifting from labor-intensive (such as export-processing activities) to capital- and technology- intensive industries (such as high-tech);
- (2) diversification by location choice, extending from investment in coastal areas to interior (such as Beijing, Sichuan and Northeastern region). They are also adjusting their developmental strategy as fragmentation of production in other economies.²⁸⁵

In August 2008, the growth rate in exports from Taiwan to China grew 13.9%, setting a new growth record. At the same time, the export growth rate from the United States to China grew 14.82%, while Chinese-to-America exports grew by a record 15.39% in a single month.

However, the export growth rate of Taiwan to China was -16.3% in September 2008,

285 However, due to the change of policies and regulations on trade and FDI by the government of China in recent years, some of Taiwan's firms are thinking of migrating and relocating again as they did in 1980s in Taiwan.

just as the financial crisis happened in the United States. The export growth rate of China to the United States was 12.44%, -6.13%, 4.14% and the export growth rate of Taiwan to China was -19.9%, -38.5%, -54.0% in the following three months²⁸⁶.

Due to the industrial transition and economic reform, the gap of the products competitiveness has narrowed between Taiwan and China. The intra-industrial or intra-firm trade across the Taiwan Straits, which is due to the substitution and induction effects,²⁸⁷ has great impact on the industrial structures and economic development of Taiwan.

The ratio of manufacturing industry in GDP and the growth rate in labor productivities have decreased, FDI flowed out more than it flowed in, and the unemployment rate climbed up. Not only Taiwan's downstream industries invested in China, but also high-tech goods and technologies exported from Taiwan have been gradually replaced by China's local operations.²⁸⁸

In short, the efficiency of trade creation of Taiwan's FDI in China declined in recent years. The trading efficiency of intra-industry or intra-firm trade declined in 2007 and became almost non-existent after the financial crisis in late 2008.

Taiwan's advantage of traditional manufacturing industry has been mostly replaced by China. "By 1995, China already replaced Taiwan as one of the top-five suppliers to the United States of the following labor-intensive products: apparel and other textile products,

286 See Editorial: *Pay Attention to the Issue of Taiwan's Industrial Structure after the Financial Crisis*, Taiwan Economic Research Monthly, Vol. 32, No. 3, Taiwan Institute of Economic Research, pp. 6-7, 2009 (translated by Hsu, Hui-Yi).

287 For more information, see Jien-chun Wu, *The Comparison between the Competitiveness of Investment for the Taiwan Businessmen across the Taiwan Strait*, thesis of the author's Master degree, 2006.

288 The attractiveness of the China was not defined as the only effective factor.

leather and leather products, miscellaneous plastic, and so on.”²⁸⁹

4.3 Taiwan’s current engagements to agreements related to FDI (with the Asian and Pacific economies): BITs, DTTs, PTIAs

Two legal determinants of FDI location choice concerned by MNCs or SMEs are not only national laws which include cooperation law, income and business tax law, and statutory right of taxation, but also international laws which include bilateral, regional, and multilateral investment treaties, double tax treaties, and preferential trade and investment agreements.

Besides the economic and market factors of the host countries, tax issues and investment protection are factors that SMEs originating from Taiwan take very seriously. According to the Survey of Taiwan’s investors in China in 2005 made by Chinese National Federation of Industries, ROC, 64% of the investors urged the government to sign a BIT and DTT with China.

Because of the high competition of global industries, investors have to invest more but receive less profit than before. Governments’ income distribution of profits has declined as well. In order to increase revenue, governments become more stringent with their taxation and inspection on indirect tax, which includes tariff duties and business taxes (such as value added tax and consumption tax).

289 See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan’s Economic Growth* in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, pp. 87, 2002. Cited the reference book: “Feenstra, R., W. Hai, W. Woo, and S. Yao. 1998, June. “The U.S. – China Bilateral Trade Balance.” NBER Working Paper #6598.”

The reaction of investors or enterprises is to enhance the efficiency of management on operations and logistics/supply chain to reduce operating costs and indirect taxes. Especially for SMEs originating from Taiwan, these two legal determinants are important for them. The following are agreements related to investment signed by Taiwan or under negotiation.

4.3.1 BITs:

With the trend of globalization, bilateral investment agreements become one of the major channels of dealing with cross-border direct investment issues. FDI plays an important role in the global economy and governments take it seriously, signing BITs in order to protect the rights and benefits of their people and investment in other countries. BITs affect the national legal system as well as MNEs' economic activities, directly or indirectly.

The government of Taiwan has been negotiating and tried it best to sign BITs with other countries, especially those are major trading and investment partners of Taiwan. At present, Taiwan has signed bilateral investment promotion agreements and protection agreements with twenty-seven countries. However, these agreements did not cover major topics of modern common contents,²⁹⁰ such as the provision of dispute settlements.²⁹¹

290 For details, see Huai-Shing Yen, *Agreements of Investment protection and an Analysis of Common disputes on international investment*, Journal of e-focus on global Taiwan's businessmen, Vol. 105, 2008/6/10, Department of Investment Services, Ministry of Economic Affairs (MOEA), Executive Yuan, ROC, 2008. Available at <http://twbusiness.nat.gov.tw/epaper/y08/06/105-101.htm> (last accessed on 2009/7/22). The majority bilateral or multilateral investment agreements covered two topics as the

In fact, some of these agreements signed in the early time that could not protect the rights and benefits of Taiwan's investors or give them a fair relief treatment while disputes occurred. Most of them have to be re-negotiated.

Taiwan already has agreements related to investment protection with 27 countries,²⁹² including BITs with India (2005), six ASEAN countries (effective between years of 1990-1996),²⁹³ nine countries of Central and South America (effective between years of 1992-2004),²⁹⁴ six countries of Africa (effective between years of 1994-2003),²⁹⁵ and other countries.²⁹⁶

It also has other types of investment-related agreements which includes the

common /contents. The first one is Standard of investment treatments, which includes the principle of national treatment, fair and equitable treatment, full protection and security treatment, and Most-favored-nation treatment. The other one is provision of investment protection, which includes Dispute settlements between contracting countries or between contracting countries private investor. The arbitration institutions as International Centre for Settlement of Investment Disputes (ICSID) and International Chamber of Commerce (ICC) are most popular choices in the investment agreements. (Translated by Hsu, Hui-Yi).

291 Because Taiwan is not a member of the World Bank who can settle the international investment disputes under ICSID, Taiwan's investors either share the holding of the company with a nationality with his own country is a member of ICSID or incorporate the company in the ICSID contracting member.

292 Source from the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. Available at http://www.dois.moea.gov.tw/asp/relation1_1.asp. See the agreements in details, available at http://www.dois.moea.gov.tw/asp/relation1_1_2.asp (last accessed on 2009/7/14)

293 Singapore (effective in 1990), Indonesia (1990), Philippines (1992), Malaysia (1993), Vietnam (1993), Thailand (1996).

294 Panama (effective in 1992), Paraguay (1992), Argentina (1993), Nicaragua (1993), El Salvador (1997), Honduras (1998), Guatemala (2001), Costa Rica (2004); Belize (signed in 1999)

295 Nigeria (effective in 1994), Swaziland (1998), Malawi (1999), Senegal (1999), Liberia (2000), Burkina Faso (2003).

296 Marshall Islands (effective in 1999), Macedonia (1999), Dominican Republic (2002).

“Agreement Dealing with the Guaranty of American Investment of Private Capital in Taiwan (1952)” and the “Memorandum of Understanding between the Ministry of Economic Affairs in Taipei and the Ministry of Finance and National Economy in Riyadh for the Promotion and Protection of Investment (2001)”.

The main purpose for the government of Taiwan re-negotiating and signing the modern investment protection agreements is to lower the political risk of host countries for contracting parties’ investors, and hopefully to solve these problems at the intra-governmental level.

The contents in general contains definitions, applicability, promotion of investments, treatment of investments which includes principle of non-discrimination, national treatment and most-favored-nation treatment, exceptions, expropriation, compensation for losses, transfer of capital and return, subrogation, investment dispute settlements which includes the dispute between investors and host country and between contracting parties.

4.3.2 DTTs:

DTTs are arrangements between two countries not to re-tax the repatriated income that a firm or person domiciled in one country earned in (and paid taxes on in) the other.

Taxation is one of the most important legal determinants of location choice of MNEs. Because Taiwan is a small island with limited economic scale, Taiwan and its firms have to take the “capital-exporting” policy for their development.

The principle of international taxation is important to Taiwan’s SMEs and multilateral group enterprises. Either multilateral group enterprises or multilateral SMEs

consider the difference of taxation at the national level and international level in determining where and in what operation centers to locate.

However, the government of Taiwan faced more difficulties in signing agreements with other countries due to either the absence of diplomatic relations with major trading partners or the government of China obstructing such an agreement. Taiwan's firms have been doing business activities overseas with more risks of being identified as the "Permanent Establishment (PE)" and levied a tax on profits, while few DTTs signed with Taiwan. Therefore, the domestic tax regulations of host countries have become serious factors considered by Taiwan's firms for competitiveness.

Taiwan already has some DTTs, which including Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect of Taxes on the Income with 16 countries (effective from 1982-2005),²⁹⁷ and DTTs on the international operation of either ships or aircraft with 12 countries (information updated to 2006).²⁹⁸

The government of Taiwan signs such agreements to avoid double taxation and prevent fiscal evasion with respect to taxes on income.

The cross-border investors originating in Taiwan consider these tax agreements and

297 Includes Singapore (1982), Indonesia (1996), South Africa (1996), Australia (1996), New Zealand (1997), Vietnam (1998), Gambia (1998), Swaziland (1999), Malaysia (1999), Macedonia (1999), The Netherlands (2001), UK (2002), Senegal (2004), Sweden (2004), Belgian (2005), Denmark (2005).

298 For more information, see the list of DTTs signed by Taiwan, ROC, Source from the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. available at http://www.dois.moea.gov.tw/asp/relation1_2.asp and Source from the e tax Portal, Ministry of Finance, available at <http://www.etax.nat.gov.tw/wSite/ct?xItem=25735&ctNode=10785> (last accessed on 2009/7/14).

domestic tax regulations of host countries as the legal factors of FDI location choice decision making. Thus, investors, usually the multinational group enterprises, could take the new transaction mode of the international logistics supply chain and relocate their business centers by different functions in different countries. For example, an investor would like to set up its operational headquarter in a place with no or less withholding tax on capital gains, set up its R&D center in the place with less withholding tax on royalties, and set up its manufacturing center in a industrial park with preferential treatment on tax.

Taxation of Taiwan: The maximum rate of corporation tax is 25%. A 20% withholding tax is levied on dividends, interest, royalties and fees. Progressive personal income tax rates are in the 6-40% range. The other two important regulations that apply to direct investment in Taiwan are “Statute for Encouraging Investments” and “Statute for Upgrading Industries.” There is a research program reported by National Science Council, ROC.²⁹⁹

299 For more discussion about the influence of taxation in Taiwan, see Mao-Zong Huang, Tax Exemption and Economic Development in Taiwan, research program No. NSC95-2414-H002-012 of National Science Council, ROC, “The first 4 chapters are about “Statute for Encouraging Investments” and “Statute for Upgrading Industries”, including reviewing and analyzing their enforcement, statute structures, and application procedures. Chapter 1 uses the structure of Income Act, distinguishing tax subject as resident (divided ad individuals and enterprises) and none-resident. Chapter 1 also introduces the conditions and measures of the tax incentives in the period of those two statutes, as well as briefly illustrates the Taiwan economic tax law history. Chapter 2 uses Sun Ke-Nan, Yang Ya-Hwei, Wang Jiann-Chyuan's empirical research to review the impact of those tax incentives on Taiwan economic developments. Chapter 3 focuses on the R&D tax incentives valued and used much by the enterprises, analyzing from the theories and practical situations, in order to evaluate R&D policy rationales, definitions. Chapter 4 introduces the application procedures of “Statute for Encouraging Investments” and “Statute for Upgrading Industries”.

4.3.3 PTIAs³⁰⁰

Free Trade Agreements (FTA):

Taiwan has been actively seeking the opportunities to sign bilateral free trade agreements with countries with who have diplomatic relationships and have great amount of trade and FDI. However, it is hampered in this effort by its status vis-a-vis China.

At present, Taiwan has FTAs with Panama (effective in 2004), Guatemala (2005), Nicaragua (2007), El Salvador (2008) and Honduras (2008).

The government of Taiwan emphasizes Central American countries as FTA partners for the reason that the government hopes to assist its investors in gaining access to and rapid response to the demand of the North American market under the North American Free Trade Agreement (NAFTA) and the Central American Free Trade Agreement (CAFTA). It is also a step to the global deployment of investors from Taiwan. At the same time, it could promote a closer relationship with these countries through trade and investment.

It is negotiating with Dominican Republic and Paraguay. Additionally, it hopes to negotiate further deals with Costa Rica, Swaziland, Japan, the United States, Korea, Singapore and Mexico.

The main chapters/topics that Taiwan values in its FTA include:³⁰¹

(1) initial provisions (2) general definitions (3) national treatment and market access

300 International investment agreements other than BITs and DTTs which include, for example, closer economic partnership agreements, regional economic integration agreements or framework agreements on economic cooperation.

301 Take the example of FTA between Taiwan and Panama.

for good (4) rule of origin (5) customs procedures (6) safeguard measures (7) unfair trade practices (8) sanitary and phyto. Measures (9) measures on standards, metro, and author. procedures (10) investment (11) cross border trade (12) financial services (13) telecommunication (14) temporary entry for business persons (15) competition policy, monopolies, and state enterprises (16) intellectual property (17) transparency (18) administration of agreement(19) dispute settlement (20) exceptions (21) final provisions.

Chapters three to nine are topics related to access to market and tariff reduction that take the standard of WTO regulations and add more preference. Chapters ten, eleven, and fourteen are the topics necessary in every agreement. Chapters twelve and thirteen are depending on the contracting parties' requests.

Agreements on Promotion of Investment or Economic Cooperation:

Taiwan already has such agreements, “memoranda of understanding”, or “declarations of intention” with seventeen countries signed between 1989 and 2007³⁰².

The purpose of signing such agreements with these countries is to create a favorable investment environment and the promotion of economic cooperation. The contracting parties exchange information and provide a favorable investment environment to potential investors from the other party. Governments take the necessary steps to assist

302 Taiwan has agreement/Memorandum of Understanding/Declaration of Intention of economic cooperation with countries or states Includes: Agreements with Dominican (signed in 1989), five States of German (1980 and 2002), Ireland (1980), South Africa (1991), three Regions of Belgium (1993), Mexico (1993), Czech (1995), and Lithuania (1997). It has Memorandum of Understanding (MOU) with Vietnam (1993) and Australia (1993), the United States (1995), Hungary (1999), Peru (2006), Canada (2007). Declaration of Intention with Israel (1998), Sweden (2002), and Switzerland (2004). Source from the Department of Investment Services, Ministry of Economic Affairs, Executive Yuan, ROC. Available at http://www.dois.moea.gov.tw/asp/relation1_3.asp updated in Feb. 2009. (last accessed on 2009/7/30).

the development of these investors. The contracting parties set up the economic office or agency and associate with each other for maintaining relations.

4.3.4 Under negotiated ECFA with China:

In addition, the investors originating from Taiwan have been suffering from a great number of investment disputes in China, who has been the major trading partner and host country of direct investment with Taiwan. However, there is no bilateral promotion or protection agreements between them.

There are the “Law of the People’s Republic of China on the Protection of Investment of Taiwan Compatriots” and “Rules for The Implementation of Law of the People’s Republic of China on the Protection of Investment of Taiwan Compatriots,” which are still domestic laws of China, and do not protect the investors’ rights and benefits as BITs do.

Most of the investors originating from Taiwan in China hope the government of Taiwan could sign a bilateral investment protection agreement with China. However, it was unable to do so because of the political tensions across Taiwan Straits, and it is still unable to do so for the reason that both governments are more interested in negotiating the opening of markets, capital flows, and other issues rather than investment protection.

There is a controversy now concerning the possibility of FTA with China.³⁰³ The controversy surrounding the negotiation of an economic cooperation framework

303 More information is available at http://www.bilaterals.org/rubrique.php?id_rubrique=99 (last accessed on 2009/7/29).

agreement (ECFA) with China has been highlighted since April 2009 in Taiwan.

The possibility of signing the economic cooperation agreement across Taiwan Straits is now being negotiated between current governments of Taiwan (Kuomintang government) and China. Whatever the result, the provisions of investment protections, includes dispute settlements, should at least meet the standards and principles under current international investment law.

The legislature has also called upon the government to strengthen Taiwan's relationships with Japan and the United States, in order to balance Taiwan's deepening ties with the economy of China.

4.4 The difficult position of Taiwan and recommendations

4.4.1 Policy and legal environment mold the economy and industry structure of Taiwan

Exporting manufacturing industries have been the main strength of Taiwan's economic and industrial growth for more than twenty years. Under the manufacturing-oriented policy, its legal system has regulated favored manufacturing industries, emphasized the tax incentive on direct investment with assets. However, the service industries have been unable to receive similar treatment.³⁰⁴

304 The text of Statute for Encouraging Investments (abolished on Jan. 30, 1991) (in Chinese) is available at <http://law.moj.gov.tw/Scripts/NewsDetail.asp?no=1J0040010&KeyWordID=287&KCDate=2009-7-30&FL=>. The text of Statute for Facilitating Upgrade of Industries (in Chinese) is available at <http://law.moj.gov.tw/Scripts/NewsDetail.asp?no=1J0040016&KeyWordID=151&KCDate=2009-7-30&FL=> (last accessed on 2009/7/29).

The past advantages of first-tier NIEs no longer exist, consequently economic development has slowed, industries relocate to developing economies, and wage level stagnates. However, Taiwan's economy and industry has not shifted from manufacturing industries to service sectors or other industries successfully.

Thus, these migrations of industries will still impact the economic development and local economy of Taiwan. It has been causing a rapidly diminishing comparative advantage of the home supply-base.

Moreover, the rapid expansion of cross-border direct investment to China has heavily affected the domestic production system and labor market of Taiwan. These migrations have affected the industrial structure and development of Taiwan that brought two impacts on Taiwan's economy. For one, the prosperity of OEM in Taiwan no longer exists. Additionally, a high unemployment rate exists due to manufacturing industries migrating abroad.³⁰⁵

4.4.2 Difficulties

4.4.2.1 Difficulties at domestic level

It appears that cross-border direct investment in China originating from Taiwan has promoted the cross-Strait economic integration. However, Taiwan's expansionary investment in China has caused a hollowing-out of industries in Taiwan. For example, employees in manufacturing sectors and their job-creation capacity have shown a trend of decrease since 1990s.

If the industries of Taiwan are moving overseas and the government has not

305 The major findings are discussed in the IEMBA thesis of Shen-Ming Chen. See Shen-Ming Chen, *A Study of Manufacturing Industries for Taiwan Since 1990*, 2008.

established any new industries to fill vacancies, negative results will include economic stagnation, income stagnation, and a drop in the employment rate.

4.4.2.2 Difficulties at international/regional level, to avoid “Marginalization”

Because of the political pressure from China, Taiwan has been difficult to establish official political and economic relationship with most countries. Taiwan was unable to participate in the wave of regional integration activities, recognized as the ASEAN Plus.

Taiwan was excluded from the process of institution-driven regional integration in East Asia, and thus it has been limited in its pursuit of trade or economic cooperation in the region. Taiwan’s nonparticipation may affect the willingness of either investors choosing Taiwan as an investment location or traders dealing the intermediate product transaction amount and shares in import countries with Taiwan.

This process of institution-driven regional integration involving Taiwan’s major international outsourcing partners may affect Taiwan’s trade and investment development. Furthermore, it may affect Taiwan’s economic growth and development.

Taiwan may yield its role in international trade and production sharing chain in the long term. The argument of whether “Taiwan is facing the crisis of been marginalized in East Asia” due to its exclusion from ASEAN Plus continues.

The current challenge for Taiwan is how to upgrade its local industries, create high added value and introduce new industries that suffer less damage from inability to tear down the tariff barriers under the institution-driven integration in East Asian region. Taiwan needs to make up for being left behind by relocated industries following regional

transfer of the international outsourcing value chain.

4.4.2.3 Risks faced by Taiwan's SMEs in their host developing countries

Some of these risks are common to investors from all countries; others are unique to Taiwan investors because of the lack of diplomatic relations. Taiwan's investors in China are facing various risks and difficulties beyond those of investors from other countries.³⁰⁶

4.4.3 Recommendations

For the economic growth and development of Taiwan, the government of Taiwan still has several methods can do rather than just stepping on the difficulty of signing bilateral, regional, or international agreements with other countries. Its investors still has several mechanisms to promote their competitiveness rather than just lowering costs.

4.4.3.1 Establishing a favored business environment of Taiwan and assisting its SME's to promote their competitiveness

The policy and legal environment of Taiwan should be modified toward a favored environment for promoting the service industries, which includes those currently

306 1. Market risks: (1) Changes in governmental policies and economic environment. (2) Competition from local private business companies that are improving, growing, and expanding. (3) Piracy and lack of intellectual property protection.

2. Financial Risks: (1) Banking systems not easy to fully access. (2) Lack of integrity, poor credit system, unreliable financial statements. (3) Foreign exchange control.

3. Operational Risks: (1) Logistic problems. (2) Tax problems. (3) Legal problems. (4) Shortage of electricity and water.

4. "Physical Risks" include increasing number of incidents occurred during the last ten years. "Incidents" include physical harm, missing persons, and deaths.

5. Political Risks with China.

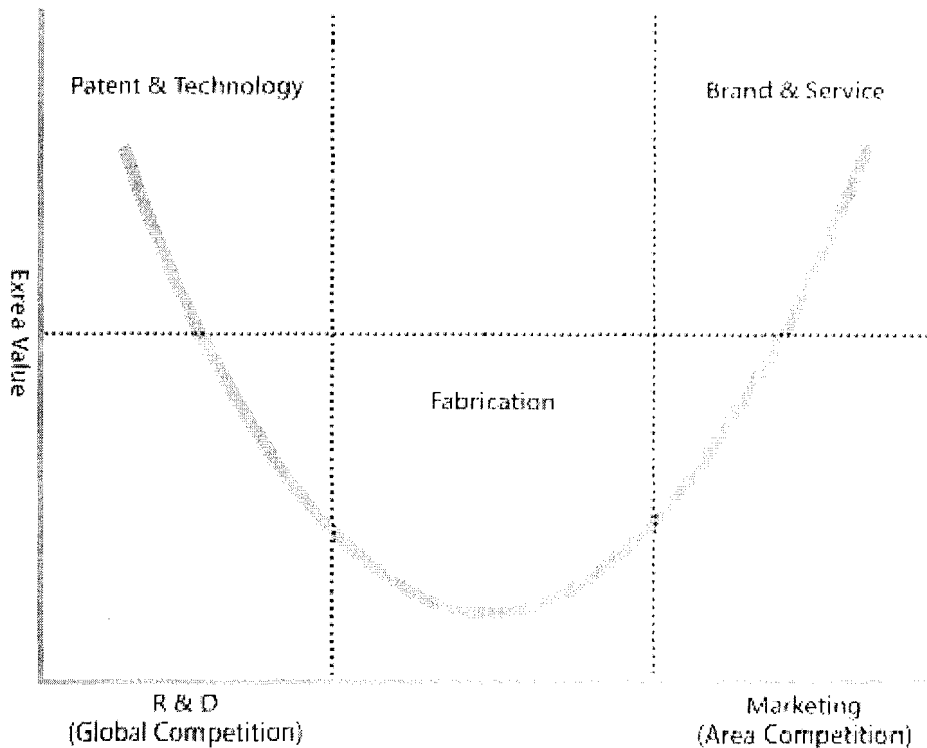
controlling sectors, such as transportation, financial services, medical care, and education.

Taiwan should seek the non-trade wealth that businessmen are unable to trade or move, as the specific characteristic of Taiwan. This non-trade wealth includes the public wealth, such as land, public construction, and education; the living environment, such as water and electricity supply, air quality, water quality, hygiene; the public security; and the legal system and administrative efficiency, which is a standardized system that is transparent and guarantees peoples' rights equally and fairly.

Taiwan's investors and their products must promote competitiveness through better quality. Lowering costs and gaining more profit might not be the only way for the development of investors. Moreover, in order to cope with the risk of hollowing-out due to expansionary China-bound direct investment, Taiwan's manufacturing sectors needs to adopt a strategy to move toward higher value sectors in the division of labor with China's economy.

In this sense, Taiwan's business and academic circles recently designed the "Smile Curve" model³⁰⁷ of division of labor with China. In this model, Taiwan manufacturing industries intensely develop two-pronged higher value sectors on the Smile Curve of value chains; the lower value sector, located on the mid-stream of the value chain of the Curve, is to be carried out in China.

307 The "Smile Curve" model was introduced by Stan Shih, the founder of Acer computer group, an IT company of Taiwan, in his book "Re-creation of Acer: creation, growth and challenges" (translated by Hsu, Hui-Yi), initial published in 1992 and republished by Book Zone (Taiwan) in 2004. It is an illustration of value-adding potentials of different components of the value chain in an IT-related manufacturing industry.



The “Smile Curve” model

4.4.3.2 Cooperation with its host neighbor countries in establishing industry clusters.

Beachheads and industry clusters are defined as the geographic concentrations of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field that are present in a nation or region. Clusters arise because they increase the productivity with which companies can compete.³⁰⁸

308 The term “Industry cluster”, also known as a “business cluster”, “competitive cluster”, or “Porterian cluster”, was introduced by Michael E Porter, in *The Competitive Advantage of Nations*, The Free Press, 1990. Republished with a new introduction in 1998. Also see his article, *Clusters and the New Economics of Competition*, in *Harvard Business Review*, November-December 1998. Moreover, the importance of economic geography, or more correctly geographical economics, was also brought to

Taiwan has been in top position as the rating of “State of Cluster Development” in the past three years, part of various ratings conducted by the World Economic Forum (WEF) in the Global Competitiveness Report.³⁰⁹ Industrial clusters have been a locomotive of Taiwan’s development in terms of innovation and productivity, and existing clusters include the high-tech sector and the traditional manufacturing sector, powered by unique local handicraft skills.

Although Taiwan’s traditional manufacturing or high-tech industry clusters, especially the labor-intensive sectors, have relocated and become hollowed out to China³¹⁰ and ASEAN countries, its local SMEs enhance their competitiveness through “industrial clusters” in Taiwan to promote their industrial core value and become more innovative. The government of Taiwan keeps holding programs to help SMEs, who have fewer resources and R&D capacities than large enterprises or groups, to cooperate with governmental and academic institutions in order to improve their productivity and competitiveness.

Taiwan consistently ranks first in a worldwide rating of the “state of cluster development” by the World Economic Forum. The continuous efforts of the government of Taiwan, includes the Council of Economic Planning and Development (CEPD) and the Small and Medium Enterprises Administration (SMEA), and the innovative spirit of the

attention by Paul Krugman, in his book, *Geography and Trade*, MIT Press, Cambridge, 1991. Cluster development has since become a focus for many government programs.

309 In the Global Competitiveness Report, WEF ranks the Competitiveness of Industrial Clusters for economies.

310 These investors formed the industry clusters in these regions in China, such as the electronic electrical machinery industry clusters located in the Yangtze River Delta (32% of Taiwan’s investors located in Jiangsu Province), and the textile industry cluster, leather industry cluster, and toy industry cluster are located in the Pearl River Delta (25% of Taiwan’s investors located in Guangdong Province).

private sectors allows everyone to benefit from a dense collaborative network.³¹¹

The role of the government is to promote the clustering of related SMEs and to connect different clusters to create more business opportunities through innovation. Taiwan promotes its clusters as in the high-tech industries and traditional industries, such as local culture, handicrafts, and art.

Referring to a geographic concentration of interconnected businesses, suppliers and associated institutions in a given field, clustering is a targeted approach that improves economic development activity by leveraging resources in the direction with the greatest potential return. Economists believe that clustering is the most efficient way to increase makers' productivity, with which they can compete domestically and globally.³¹²

WEF Ranking of the Competitiveness of Industrial Clusters

311 The Ministry of Economic Affairs, ROC, has announced plans to invest \$20 million in infrastructure development in an effort to add 90 more industrial clusters between 2008 and 2011. The additional clusters will cover innovative sectors such as tourism technology, biomaterial applications, health care and leisure, and LEDs and intelligent lighting control.

312 See *Taiwan to invest \$20 million in 90 business clusters*, Computer product OEM & ODM service News, 2008/12/17, available at <http://www.globalsources.com/gsol/1/Computer-product/a/9000000102669.htm>. (last accessed on 2009/7/1). "Over 70 clusters spread throughout the island" introduced that "Taiwan has more than 70 industry clusters of various sizes in operation. One of the major manufacturing clusters is the Hsinchu Science Park, which is located in the northern part of the region. The hub gathers most of the region's semiconductor and optoelectronic industries. One cluster in Central Taiwan is where precision machinery and tooling industries are congregated. Steel and petrochemical companies, on the other hand, are mainly based in the southern part of the island. Other domestic industries that benefit from clustering include bicycles and musical instruments in Taichung, glassware in Changhua, automotive parts in Tainan and yachts in Kaohsiung. The Taipei Artist Village and the Huashan Creative and Cultural Industry Center, both located in Taipei City, serve as the region's cultural and creative center."

	2008-2009		2007-2008		2006-2007		2005-2006	
	Global Ranking	Score	Global Ranking	Score	Global Ranking	Score	Global Ranking	Score
Taiwan	1	5.6	1	5.7	1	5.52	1	5.39
United States	2	5.6	2	5.3	2	5.22	4	5.19
Singapore	3	5.3	4	5.1	7	4.92	6	5.15
Italy	4	5.3	21	4.5	85	3.9	5	5.16
Japan	5	5.2	12	4.7	27	4.33	1	5.46
Finland	6	5.2	11	4.8	3	5.07	3	5.33
Hong Kong	7	5.0	14	4.7	12	4.75	11	4.68
South Korea	8	5.0	3	5.1	31	4.19	21	4.38

Source: Ratings conducted by the World Economic Forum (WEF) in the Global Competitiveness Report

In order to meet the global trends in competition and changes in Asia's industrial division of labor, Taiwan will not only continue cultivating technology industry clusters but will also speed up the development of traditional local industry clusters so as to enhance domestic regional economic growth and create job opportunities.

Such experiences on building industry clusters and promote the economic growth could be introduced to developing countries and less developed countries, as a mechanism of cooperation in investment arrangements of Taiwan with other economies.

This mechanism has been brought to the economic cooperation of the Republic of Korea and the Philippines. The governments of these two countries have just signed a Memorandum of Understanding on the Feasibility Study on the Multi-Industry Cluster (MIC) Program in May 2009.

According to the statement of Berna Romulo Puyat, undersecretary of the Department of Agriculture (DA), the Philippines, the Multi-Industry Cluster Program

(MIC)

is envisioned to serve as a catalyst for the establishment of major industries through high-level cooperation between major actors in the agriculture sector... The MIC aims to create synergy among major industries like manufacturing and services to drive economic growth... It also seeks to address the underdeveloped sectors in the country by putting up investments in areas such as agriculture, labor, and manufacturing.³¹³

4.5 Conclusion

Taiwan has been an active member in such international economic organizations as the Asian Bank, APEC, and WTO³¹⁴, by using titles other than its official designation.³¹⁵

313 A government-to-government agreements, a Memorandum of Understanding (MOU) on this MIC feasibility study was signed by Secretary Alberto Romulo of the Department of Foreign Affairs (DFA) on behalf of the Philippines and Minister Yu Myung-hwan of Korea's Ministry of Foreign Affairs and Trade (MOFAT) during the official visit of President Arroyo to the Republic of Korea last May 30-31, 2009. "Manila and Seoul are undertaking a feasibility study on a proposed program initiated by Korea that aims to generate investments in Philippine agriculture and other sectors in the country through a multi-industry cluster approach." ROK is one of the Philippines most dynamic partners with bilateral trade at around US\$5.06 billion and Korean investments in the Philippines at over US\$3 billion. Annually, 600,000 Korean tourists take the largest share of the visitor arrivals to the Philippines. They also signed other agreements at the same time which includes These include the Memorandum of Understanding (MOU) for Employment Permit System (EPS), MOU on Labor and Manpower Development Cooperation, Notes on the Grant Aid for Rice Processing Complexes (RPCs), and MOU on Agricultural Scientific and Technical Cooperation. Information is from the government of the Philippines. Available at http://www.gov.ph/index2.php?option=com_content&do_pdf=1&id=2000782 (last accessed on 2009/7/31).

314 Taiwan has joined these International organizations. Source is adopted from Department of Investment Services, Ministry of Economic Affairs, R.O.C. Available at <http://www.dois.moea.gov.tw/asp/relation.asp> (last accessed on 2009/7/1).

315 Taiwan, ROC, has been a member of the Asian Development Bank since 1966 as the name of the "Taipei, China". It has been a member of APEC since 1991 as the name of the "Chinese Taipei". It .has

However, it is still excluded from the UN organization and its specialized financial agencies, includes the IMF and the World Bank, the two major international financial institutions.³¹⁶

Because of the trend of globalization and liberalization, the international economic environment is changing all the time. Taiwan became a full member of WTO on January 1st 2002 with the wish to be successfully active in the world economic community and create new opportunities for the further development of relations across the Taiwan Straits by using the WTO framework. Since then, investors and industries of Taiwan have faced increasingly fierce competition from foreign companies.

Taiwan's accession to WTO in 2002 caused the necessary institutional and policy changes that involved further local economy and industry being upgraded as well as financial and other service sectors reformed.

Moreover, it resulted in the formation of more modern Taiwanese firms with new management and operation models for local and cross-border economic activities. Advancements in formation technology in information technology, biotechnology, biomedical and special chemical industries in recent years have facilitated Taiwan's

been a member of WTO since January 1, 2002, as the name of the "Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (called 'Chinese Taipei')".

316 For more information, see Eric Ting-Lun Huang, *Taiwan's Status in a Changing World: United Nations Representation and Membership for Taiwan* in Prof. Sucharitkul, Sompong, Prof. Sylvester, Joe H, and Prof. Okeke, Christian N., eds., *Annual Survey of International & Comparative Law*, Vol. IX, Spring 2003, Golden Gate University, School of Law, p. 93, note 121, 2003. Under the political pressure from China, Taiwan is not a formal member of the OECD, IMF, and the World Bank. It has fulfilled the criteria of OECD member and been qualified to join the OECD as Korea did in 1996. Also see Peter C.Y. Chow, *From Dependency to Interdependency: Taiwan's Development Path toward a Newly Industrialized Country*, in Chow, Peter C.Y. eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 243, 2002.

efforts in lifting itself onto a higher level of economic growth and development.

It has been expected that strategic inward and outward cross-border direct investment coupled with appropriate economic reforms could provide the means of this transformation.

MNEs, especially from Japan and the United States, brought Taiwan into the East Asian industrial production chain since the 1960s. “Inward FDI played a key role in integrating Taiwan into the foreign multinationals’ international division of labor and aiding in the transference of technology and management skills to Taiwanese firms.”³¹⁷

Taiwan’s SMEs have been the mainstay of Taiwan’s export-led economy since the 1960s as Taiwan was a capital and technology receiver. In the 1980s, Taiwan’s SMEs have been the mainstay of Taiwan’s economic growth while it started to expand its capital

317 “Firms from advanced developed countries had been more willing to license their technology to Taiwan’s small-sized firms... They also benefit from the multinationals’ marketing networks, and superior market information. Taiwan needs to selectively attract more inward FDI and encourage the formation of more strategic alliances between its firms and foreign business.” See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan’s Economic Growth* in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 81-93, 2002; and also H. Pack, *New Perspectives on Industrial growth in Taiwan*, in Gustav Ranis Boulder eds., *Taiwan: From Developing to Mature Economy*, Westview Press, pp. 73-120, 1992. “By importing the appropriate manufacture intermediates and technological goods and targeting the ‘right customers’ (export destination) in the world market, Taiwan has been enjoying favorable gains from trade... Taiwan had continually changed the structure of commodity composition of its exports and shifted its trade orientation to other growing Asian countries. As a highly open economy, Taiwan not only has developed more and more intra-industry trade with the rest of the world but also has become interdependent with OECD countries through strategic partnership.” See Peter C.Y. Chow, *From Dependency to Interdependency: Taiwan’s Development Path toward a Newly Industrialized Country*, in Peter C.Y. Chow eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 270, 2002.

and technology to neighbors, or in 2009 when it suffered from the financial crisis.

The economic growth and development driving force of Taiwan has highly relied on exports. Export to China has become an important source of developing engine of Taiwan; on the contrary, exports to the North American and European markets have declined in recent years. Nevertheless, the United States, Japan, Europe, ASEAN economies, and China are still major economic partners of Taiwan.

Enterprises, not only those invested overseas, but local ones, have to acquire new knowledge and develop new technology. Moreover, innovations are constantly takes place in the area of business management, product lifespan is getting shorter, and customers' demands are becoming more and more diverse. Enterprises also have to enhance the added value of their products and services. These factors have brought more challenges for Taiwan's SMEs who have less resources, capacity of finance, and capacity of R&D.

Furthermore, Taiwan is a capital-exporting economy with its limited, small-scale economy. The Principles of International Taxation become especially important for its SMEs doing cross-border economic activities.

Globalization has also created economic and business opportunities for SMEs who are carefully managed. The Small and Medium Enterprise Administration is an official institution established by the government of Taiwan for helping its SMEs.

In order to help SMEs to become more competitive, the Small and Medium Enterprise Administration assists companies in traditional industries to upgrade and transform themselves, works to promote innovation and R&D, helps to raise the level of technology used in SMEs and the level of product design, promotes computerization to increase speed and efficiency, and implements measures to help SMEs create high added value. The goal is to enhance the overall competitiveness of Taiwanese industry.³¹⁸

Taiwan and its investors, both local and overseas, have been playing an important role in the industrial production sharing chain in East Asia for a long time. However, as WTO negotiations have been blocked and WTO members turned to process bilateral or regional free trade agreements with their economic partners positively. Taiwan has been excluded from the institution-driven economic integration in recent years because it is not favored politically, while the East Asia economic alliance is taking shape by cooperation in trade arrangements through signing regional free trade agreements (RTAs).

318

The Administration (Small and Medium Enterprise Administration) also provides assistance to newly-established SMEs, helping them to undertake innovative research and promoting the development of knowledge-based industries. Technomart mechanisms are used to establish platforms for the exchange of capital and technology, and to encourage the widespread adoption of technology in both the manufacturing and service sectors. The aim is to create an environment beneficial to entrepreneurial activity, helping new start-ups to become a new source of motive power for Taiwan's economic development.

Its key operational areas are including creating a Healthy Environment for the Development of SMEs, strengthening the SME's Management Guidance Function, building a Platform for Enterprise Start-up and Incubation, and integrating the SME Financing, Mechanism. Available at <http://www.moeasmea.gov.tw/ct.asp?xItem=76&CtNode=318&mp=2> (last accessed on 2009/7/29).

The economic development of Taiwan and those less developed countries might be hurt when they are excluded. It might aggravate the unbalanced growth and reliance problem in the East Asian region.

Because of the difficulty for the government of Taiwan negotiating and signing the IIAs with other countries, SMEs of Taiwan take the higher risk than those of other countries. For example, the operational risks includes logistic problems, tax problems, and legal problems, the incidents which includes physical harm, missing persons, and deaths, and the political risk which related to the ambiguous legal status of Taiwan.

What investors and people of Taiwan urged its government to do is only to protect their fundamental human rights either within its territory or overseas. Signing free trade agreements with Taiwan's major economic partners might be one of the mechanisms to either help Taiwan's investors to expand their business to global markets or build closer economic relations with these countries.

Moreover, it might result in economic growth and development of Taiwan and the Asian region. A mechanism for removing the tariff barriers will have the expected effect when there are more demands in the global markets. The removal of non-tariff barriers, such as investment protection, IP protection, and avoidance of double taxation, could be more important than tariff barriers for Taiwan and its investors while the global economic grows slowly.

Taiwan must try to keep up with the ongoing institution-driven regional integration in East Asia, either the one initiated by the ASEAN economies or the one discussing in the APEC. The government must maintain Taiwan's position as an indispensable section

of the industrial value chain, and seek the mechanisms of cooperation in international industries and cross-border direct investment arrangements.

In fact, Taiwan is ready and has a strong desire and compatibility to contribute and be responsible for its obligations³¹⁹ in the regional or multilateral integrated economic community. Hopefully, signing a PTIA with China (currently recognized as an ECFA between the governments of Taiwan and China) would initiate Taiwan's PTIAs with other major partners.

Upgrading Taiwan's industries to the next level faces greater resistance from firms in advanced industrial countries. Further advances in science and technology depend on Taiwan's abilities in research and development. Taiwan could double its efforts in fostering an environment that encourages private firms to compete in the research and development of new products and processes.³²⁰

This is an integrated, globalized, interdependent global economy. For the global economic development and balanced growth, each economy, includes the rich and the poor countries, the developed, developing, and least developed countries, the capital exporting and importing countries, should cooperate in economic activities, not only trade but also international direct investment.

319 Available at http://2k3dmz2.moea.gov.tw/gnweb/english/indicators/e_indicators.aspx?menu=2 Last Modified on 2009/07/09 (last accessed on 2009/7/18).

320 The author also suggested to government in the conclusion that "In addition Taiwan needs to continue diversifying its investments beyond the semiconductor industry and to leapfrog into additional high-tech industries in order to moderate the adverse impacts of wild business fluctuations as well as facilitating further economic growth." See Steven A.Y. Lin, *Roles of Foreign Direct Investments in Taiwan's Economic Growth* in Chow, Peter C.Y. eds., *Taiwan in the global Economy: from an Agrarian Economy to an Exporter of High-Tech Products*, Praeger, p. 92, 2002.

CHAPTER FIVE.

CHALLENGES

5.1 Introduction

5.1.1 Emergence of the global factory: production networks in the developing East Asian region

Globalization brings great opportunities for economies and MNEs. Under the trend of globalization and liberalization, most East Asian economies are taking export-oriented policies following a similar path of growth as the first and second tier NIEs. Moreover, FDI made by MNEs has been a force for economic globalization. MNEs contribute to most world trade flows from their international production networks.

The East Asian economies undertook trade liberalization policies unilaterally, bilaterally and regionally. The international industrial production networks have been very complete, and intra-regional trade³²¹ has increased rapidly in the region.

The increasing important position of East Asia is due to rapid expansion of trade in components and parts among East Asian economies.³²² Trade-related FDI plays an important role in intra-regional trade in components and parts. Trade associated with

321 They are intra-industry and intra-firm trade of intermediate goods and complements. Intra-regional trade grew faster than global trade during the period 1990–2006. See *Asia and Pacific Regional Economic Outlook 2007*, International Monetary Fund (IMF), 2007.

322 “Accordingly, trade within Asia increased significantly from 37% of total trade to 54% between 1980 and 2007, led by trade in parts and components.” See ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*, Asian Development Bank (ADB), 2008. available at http://aric.adb.org/emergingasianregionalism/pdfs/Final_ear_chapters/final%20report.pdf (last accessed on 2009/11/8).

production fragmentation has been the driving force behind the market-driven integration in the East Asian region. In short, East Asian economies have grown substantially based on the growth of FDI and trade.

The establishment of close and comprehensive industrial production and distribution networks in the East Asian region is mainly driven by FDI cooperation between multinational corporations (MNEs)³²³ and local firms³²⁴. FDI investors take the comparative advantage of economies and set their operations and productions in the most cost-effective locations.³²⁵ They segment their production process into smaller steps in order to reach improved efficiency.

East Asian production networks have built a closer economic relationship among these economies and deepened regional integration.³²⁶ East Asian economies rely on

323 Lots of FDI are also originated from developed countries, like Europe, the United States, and Japan.

324 “They were also geographically close to an expanding high-income Japan, with efficient multinational corporations (MNCs) seeking to relocate production to less costly locations in East Asia.” Both local firms and SMEs invested cross-bordered “acquired the requisite technological capabilities to either compete internationally or become suppliers to MNCs.” See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 4-5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

325 “Rising factor costs in core production locations were a prime driver... Falling regional trade barriers and logistics costs, as well as technological progress, spurred the decentralization of production networks to the most cost-effective locations.” See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 4-5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

326 Fukunari Kimura, *International Production and Distribution Networks in East Asia: Eighteen Facts, Mechanics, and Policy Implications*, Asian Economic Policy Review, Vol. 1, Issue 2, pp. 326–344, 2006.

intra-regional trade in intermediate goods and complements. The economic interdependence among the East Asian economies is notably high.

5.1.2 Export-oriented growth in East Asia and unsustainable imbalances in the global economy

Products are manufactured in the East Asian economies within the advanced production networks in this region. The final goods are then exported from certain East Asian economies, such as China, to the developed countries, such as Europe, the United States, and Japan. Hence, the East Asian region works as a factory and the East Asian economies become much more dependent on external trade than economies of other regions.

After market-driven expansion of trade and FDI for almost fifty years, the East Asian region became the global factory, a process initiated by the labor-intensive policies of East Asian developing economies, which provided productive and cheaper labor.³²⁷ The East Asian region, based on export-oriented growth, became the most dynamic region, with extremely high shares of exports to GDP in the global economy based on demand.

Also see ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*, Asian Development Bank (ADB), 2008. available at http://aric.adb.org/emergingasianregionalism/pdfs/Final_ea_chapters/final%20report.pdf (last accessed on 2009/11/8).

327 “Generous foreign aid flows also favored outward-oriented growth in Asia.” See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 4-5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). See also Stiglitz, Joseph, *Some Lessons from the East Asian Miracle*. *World Bank Research Observer*, Vol. 11, Issue 2, pp. 151–77, 1996.

The economic interdependence, especially trade interdependence, between the developed markets³²⁸ and the Asian factory has rapidly increased in recent years. The economic growth of East Asia is much affected by the market conditions of the European and the North American markets and much dependent on demand. Thus, when there is a decline in the demand for the exports of East Asia, the growth of East Asian economies will suffer.

5.2 Multilateralism and WTO-plus provisions of PTIAs in the East Asian region

5.2.1 Multilateralism:

Although there are arguments in economic literature about the relationship between bilateral/regional agreements and FDI flow, there is general agreement that trade and FDI liberalization is positively related to economic growth and development in the long term. There is also widespread recognition by the governments of developing countries that measures of trade and FDI liberalization could be the means to achieve their development goals.³²⁹

The East Asian economies with their comparative advantage in manufacturing have benefited from trade negotiations on the reduction of tariffs in manufacturing governed

328 Especially the European and the North American markets.

329 Trade liberalization in the multilateral WTO has produced positive effects especially on the East Asian region which “is held up as the model of successful development combining good institutions, trade liberalization, and economic growth.” See Brigid Gavin and Alice Sindzingre, *EU trade relations with Emerging Asia: identifying the issues*, Asia Europe Journal, Springer Berlin / Heidelberg, Vol. 7, No. 1, p. 13, 2009. available at <http://www.springerlink.com/content/x053351g2v377434/fulltext.html> (last accessed on 2009/10/25). See also Dani Rodrik, *Feasible globalizations*, Harvard University, 2002. available at <http://ksghome.harvard.edu/~drodrik/Feasglob.pdf> (last accessed on 2009/10/25).

by multilateral GATT/WTO rules. The East Asian economies also supported the work of the Asia–Pacific Economic Cooperation (APEC), the “premier forum for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region,”³³⁰ by their unilateral liberalization policies.³³¹

Multilateralism through the WTO framework and its predecessor, the GATT, and open regionalism through APEC strengthened the cooperation of East Asian economies toward the goals of promoting regional and global trade and investment.

However, the capacity of the WTO for effective trade governance and further negotiations of related issues at the multilateral level has declined in the 2000s. Although the East Asian economies expressed their support for the multilateral trade system under WTO as the preferred approach for governing global trade, they turned to conclude bilateral and regional negotiations actively when the WTO negotiations in the Doha Round failed. They turned to bilateral and regional negotiations for deeper integration and the discussion of wider issues, including investment.

5.2.2 Bilateral agreements:

From the 1990s until the early 2000s, developing countries increasingly concluded IIAs, particularly in the form of BITs, with each other and also with developed countries in the hope of encouraging FDI flow. BITs became one of the major channels of dealing

330 The APEC official website explains what Asia-Pacific Economic Cooperation is, which is available at http://www.apec.org/apec/about_apec.html (last accessed on 2009/12/31).

331 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 4-5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

with FDI issues. BITs are strategies of FDI protection and promotion used in the negotiations between many East Asian economies and developed countries, while there are a number of policy instruments from which to be chosen.³³²

Aiming to protect and promote FDI, BITs provide cross-border investors guarantees relating to non-commercial risks. They guarantee foreign investors non-discriminatory treatment. The provisions usually include a standard of fair and equitable treatment for investors and “most-favored-nation” commitments.

In such agreements, issues related to investors’ rights will usually become rules governing the restrictions of contracting countries. These issues include expropriation, funds transfer and repatriation of profits. In the latest agreements, mechanisms for resolving disputes over investment matters would be established which covered investor-state/government dispute settlement procedures.

DTTs and international tax rules are important factors in FDI location choices of MNEs. Until the mid-1990s, many countries have also negotiated BITs and DTTs to mutually reduce withholding taxes on MNEs based in the other country.³³³ Home countries reducing double taxation on their MNEs can have quite different implications

332 BITs “are one of the most popular policy initiatives undertaken by low- and middle- income countries in the race to attract a larger share of global FDI.” See Emma Aisbett, *Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation* in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 421, 2009.

333 For example, the OECD has taken BITs as a way to enhance FDI across members. Others took BITs with tax section mainly for sharing tax information across countries in order to deter tax evasion and to reduce administrative costs. See Bruce A. Blonigen, *Foreign Direct Investment Behavior of Multinational Corporations*, NBER Reporter Winter 2005-2006, pp. 11-14, available at <http://www.nber.org/reporter/winter06/winter06.pdf> (last accessed on 2009/12/31). Also see T. Dagan, *The Tax Treaties Myth*, *New York University Journal of International Law and Politics*, Summer 2000, pp.939-996.

for FDI activity.³³⁴

Concluding new bilateral agreements has slowed down, and governments have found that their public policy decisions would be bound by international arbitration, especially in investor-state/government investment dispute settlement cases. Furthermore, many studies failed to definitively prove a relationship between signing bilateral agreements and FDI inflows.

Some developed countries, such as the United States and Germany, still negotiate or renegotiate modern BITs with other countries. Modern BITs could protect FDI of home countries in host countries where investors' rights are not already protected through existing agreements, such as free trade agreements not including FDI-related issues. It could encourage host countries to transition their economies toward a more market-oriented domestic market, which could have more guarantees to private investment for an open, transparent, and non-discriminatory environment.

In the 2000s, the new type of IIAs, many taking the form of preferential FTAs with investment rules, became the most popular agreements dealing with trade and investment related issues and problems. At present, developing countries prefer to engage in PTIAs. At the same time, there is an increase in FDI flow among them.

PTIAs, mostly in the form of free trade agreements (FTAs), have become formal institutions that manage mainly trade issues and economic cooperation. Trade and

334 The methods could be allowing credits or deductions, and so on. See M.A. Desai, C.F. Foley, and J.R. Hines, *Foreign Direct Investment in a World of Multiple Taxes*, NBER Working Paper No. 8440, August 2001, available at <http://www.nber.org/papers/w8440> (last accessed on 2009/12/31).

investment provisions have often seen contained within the same agreements under the consensus of establishing a deeper economic integration among contracting countries. These provisions of FTAs qualify them as a “persistent and connected set of formal and informal rules that prescribe and behavioral roles, constrain activity, and shape expectations.”³³⁵

The East Asian economies began emphasizing FTAs as a trade policy instrument in the late 1990s. They concluded PTIAs with provisions that include not only liberalization of trade in goods and services, but also protection of FDI. Some of these agreements will further contain liberalization of FDI provisions in order to promote FDI flow. The region became the most active one to conclude FTAs.³³⁶

Due to the increase in FDI leads and the signing of IIAs, the implementation of agreements may cause a change in domestic policies and measures in the host countries.³³⁷ IIAs affect not only the domestic legal system of individual countries, but

335 Robert O. Keohane, *Neoliberal Institutionalism: A Perspective on World Politics*, in Robert O. Keohane, ed., *International Institutions and State Power: Essays in International Relations Theory*, Westview, pp. 1-20, 1989.

336 See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 5-6, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). See Tubagus Feridhanusetyawan, *Preferential Trade Agreements in the Asia-Pacific Region*, IMF Working Paper WP/05/149, International Monetary Fund (IMF), 2005. available at <https://www.imf.org/external/pubs/ft/wp/2005/wp05149.pdf> (last accessed on 2009/11/8). Also see Roberto Fiorentino, Jo-Ann Crawford and Christelle Toqueboeuf, *The Landscape of Regional Trade Agreements and WTO Surveillance*, in Richard Baldwin and Patrick Low, eds., *Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009.

337 See Emma Aisbett, *Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus*

also choices of FDI location and business strategies of MNEs. In short, the implementation of agreements in a domestic economy is more important.

5.2.3 Increasing WTO-plus provisions in the East Asian PTIAs

The significant difficulties in building multilateral rules under multilateral legal frameworks like the WTO, or regional legal frameworks like ASEAN and APEC, created the demand for bilateral legal institutions.

Until the mid-1990s, IIAs were mostly concluded in the form of BITs and DTTs. Since the late 1990s, countries have shown a preference for concluding the new type of IIAs, PTIAs with provisions related to investments. These investment treaties may be bilateral or regional, stand-alone or folded into broader free trade agreements.

The current IIAs include more specific, complex and sophisticated provisions than before. Although these IIAs, especially FTAs between developing countries, address different development objectives, they currently work as a mechanism for economic cooperation among contracting parties.³³⁸

Some of the modern FTAs in East Asia have gone beyond trade in goods and services issues. They

have tended to be more comprehensive in terms of coverage and of the building bloc rather than the stumbling bloc type, though there are

Causation in Karl P. Sauvant and Lisa E. Sachs eds., *The Effect of Treaties on Foreign Direct Investment*, Oxford University Press, p. 422-423, 2009. “the potential for reverse causality, where a higher growth rate of FDI leads to increased probability of a BIT being formed... Finally, I undertake a graphical event study that shows clearly that BITs are formed during times of increasing bilateral FDI flows, but it shows no evidence of an increase in flows after the BIT is ratified.”

338 See UNCTAD South-South Cooperation in International Investment Arrangements, UNCTAD Series on International Investment Policies for Development, UNCTAD, p. 45, 2005.

some (minor) exceptions in terms of certain components...With a few exceptions, Asian economies are increasingly favoring WTO-plus agreements rather than narrowly limited agreements.³³⁹

According to Table 1: Scope of Concluded FTAs in Integrating Asia³⁴⁰, Japan, Korea, and Singapore concluded most FTAs with more WTO-plus elements.

This table shows the various scope of FTAs concluded the new Asian economy. The scope of these IIAs could be divided into four degrees, from narrow agreements primarily dealing with good and/or services to broad agreements with many WTO-plus elements.³⁴¹

Most East Asian FTAs between developed and developing countries cover the WTO-plus elements, especially agreements with the United States and Japan. Moreover, “some existing FTAs are gradually being expanded to have WTO-plus coverage...The inclusion of WTO-plus provisions, particularly the four Singapore issues, would be desirable in all future Asian FTAs.”³⁴²

339 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 16-18, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). See also See Plummer, Michael, *Best Practices in Regional Trade Agreements: An Application to Asia*, World Economy, Vol. 30, No. 12, p.1775, 2007. The author suggested a set of best practices to guide future FTAs.

340 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 32-33, Appendix Table 5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

341 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 16-18, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

342 See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*,

The four Singapore issues, such as investment provisions and competition policy, will be put in the sections of agreements for promotion of FDI and the development of production networks. Trade facilitation and logistics development issues will be put in the sections for increasing trade by lowering transactions costs. These PTIAs will also include cooperation issues, especially technical cooperation, which would increase technology transfer and industrial competitiveness. Technical cooperation provisions in these PTIAs generally follow the line of the APEC economic and technical cooperation³⁴³ (ECOTECH).³⁴⁴

In conclusion, for various objectives, the scopes of East Asian FTAs are different; however, several subjects are generally considered. The trade cooperation of East Asian

Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 16-18, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). For more discussion about The WTO-plus provisions in Asian FTAs, see Masahiro Kawai and Ganeshan Wignaraja, *Multilateralizing Regional Trading Arrangements in Asia*, in Richard Baldwin and Patrick Low, eds., *Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009. Also see Masahiro Kawai and Ganeshan Wignaraja, *ASEAN+3 or ASEAN+6: Which Way Forward?* This paper was presented at the Conference on Multilateralising Regionalism in Geneva, on September 10-12, 2007, available at http://www.wto.org/english/tratop_e/region_e/con_sep07_e/kawai_wignaraja_e.pdf (last accessed on 2009/11/09).

343 “ECOTECH is the APEC schedule of programs designed to build capacity and skills in APEC Member Economies to enable them to participate more fully in the regional economy and the liberalization process”. See the information Available at http://www.apec.org/apec/news__media/fact_sheets/esc__ecotech.html (last accessed on 2009/12/18).

344 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 16-18, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

economies in the form of new PTIAs are consistent with WTO norms.³⁴⁵

345 Howard Loewen, *WTO Compatibility and Rules of Origin - Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp. 79-80, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

Table 1: Scope of Concluded FTAs in Integrating Asia³⁴⁶

Country	Goods	Goods + Services	Goods + Services + Singapore Issues*	Goods + Services + Singapore Issues + Cooperation Enhancement**
ASEAN	ASEAN–Korea FTA	ASEAN–China FTA	AFTA	ASEAN–Japan FTA ASEAN–Australia and New Zealand CER
Brunei Darussalam	ASEAN–Korea FTA	ASEAN–China FTA	AFTA	ASEAN–Japan FTA; Transpacific SEPA; ASEAN–Australia and New Zealand CER
Cambodia	ASEAN–Korea FTA	ASEAN–China FTA	AFTA	ASEAN–Japan FTA; ASEAN–Australia and New Zealand CER
China (PRC), (People’s Republic of China)	APTA; China–Thailand PTA; China–Chile FTA; China–Pakistan FTA	ASEAN–China FTA; China–Hong Kong, China CECA; China–Macau, China CECA	China–Singapore FTA	China–New Zealand FTA; China–Peru FTA
Hong Kong, China		China (PRC)–Hong Kong, China CECA		
Indonesia	ASEAN–Korea FTA	ASEAN–China FTA	AFTA	
Japan			Japan–Chile FTA; Japan–Mexico FTA	ASEAN–Japan FTA; Japan–Singapore EPA; Japan–Mexico FTA;

346 Adopted from Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 32-33, Appendix Table 5, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

				Japan–Philippines EPA; Japan–Thailand EPA; Japan–Brunei Darussalam FTA; Japan–Indonesia EPA; ASEAN–Australia and New Zealand CER
Korea, (Republic of Korea)	APTA; ASEAN–Korea FTA		Korea–Chile FTA; Korea–EFTA FTA	Korea–US FTA; Korea–Singapore FTA
Lao PDR, (Lao People’s Democratic Republic)	ASEAN–Korea FTA; Lao PDR–Thailand PTA	ASEAN–China FTA	AFTA (1)	ASEAN–Japan FTA; ASEAN–Australia and New Zealand CER
Malaysia	ASEAN–Korea FTA; PTA Group of 8 Developing Countries	ASEAN–China FTA	AFTA; Japan–Malaysia FTA	ASEAN–Japan FTA; Malaysia–Pakistan FTA; ASEAN–Australia and New Zealand CER
Myanmar	ASEAN–Korea FTA	ASEAN–China FTA (1)	AFTA	ASEAN–Japan FTA ; ASEAN–Australia and New Zealand CER
Philippines	ASEAN–Rep. of Korea FTA (1)	ASEAN–China FTA (1)	AFTA	ASEAN–Japan FTA; Japan–Philippines EPA; ASEAN–Australia and New Zealand CER
Singapore	ASEAN–Korea FTA	ASEAN–China FTA	AFTA; Singapore–EFTA FTA; New Zealand–Singapore FTA;	ASEAN–Japan FTA; US–Singapore FTA; Korea–Singapore FTA; Singapore–Australia FTA;

			India–Singapore CECA; Singapore–GCC FTA	Singapore–Jordan FTA; Singapore–Panama FTA; Transpacific SEPA; China–Singapore FTA; Singapore–Peru FTA; ASEAN–Australia and New Zealand CER
Taiwan (ROC), (Taipei, China)			Taiwan–Panama FTA; Taiwan–Guatemala FTA; Taiwan–Nicaragua; Taiwan–El Salvador–Honduras FTA	
Thailand	China–Thailand PTA; Lao PDR–Thailand PTA	ASEAN–China FTA	AFTA	ASEAN–Japan FTA; Japan–Thailand EPA; Thailand–Australia FTA; Thailand–New Zealand FTA; ASEAN–Australia and New Zealand CER
Viet Nam	ASEAN–Korea FTA	ASEAN–China FTA	AFTA	ASEAN–Japan FTA; ASEAN–Australia and New Zealand CER; Japan–Viet Nam EPA

* Singapore issues include trade facilitation, investment, government procurement, and competition policy.

** Cooperation enhancement includes such provisions as intellectual property, ICT and e-commerce, labor standards and mobility, environment, and SMEs.

Source: ADB's Asia Regional Integration Center (ARIC) FTA Database (www.aric.adb.org); data as of June 2009.

5.2.4 Current bilateral and regional PTIAs concluded by the major East Asian economies

In the 2000s, more governments of East Asian countries are interested in negotiating PTIAs with the main objective of economic cooperation and integration instead of BITs. Protection and promotion of FDI and taxation issues could thus be negotiated under such a framework.

Regional institution-driven integration carried out the regionalism of East Asia. Economies are concluding PTIAs in a recent trend that is becoming increasingly important. Bilateral and regional free trade agreements are the major form.

“FTA activity in Asia over the last decade has given rise to a classic hub and spoke arrangement.”³⁴⁷ As Table 2: Geographical Orientation of Concluded FTAs in Integrating Asia³⁴⁸ shows, Japan, Singapore, Korea, and China have become key hubs

347 See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 6-9, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29). See also Gary Clyde Hufbauer and Jeffrey J. Schott, *Fitting Asia-Pacific Agreements into the WTO System*, in Baldwin, Richard and Patrick Low, eds., *Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009; this paper was presented at the Conference on Multilateralising Regionalism in Geneva, on September 10-12, 2007, available at http://www.wto.org/english/tratop_e/region_e/con_sep07_e/hufbauer_scott_e.pdf (last accessed on 2009/11/8).

348 “Integrating Asia here includes Brunei Darussalam, Cambodia, People’s Republic of China, Hong Kong, India, Indonesia, Japan, Korea, Lao, Malaysia, Myanmar, Philippines, Singapore, Taiwan, Thailand, and Viet Nam”. For basic economic statistics of the economies in Integrating Asia see Masahiro Kawai and Ganeshan Wignaraja, Appendix Table 1 of *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, p. 27, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

of FTA activity with more FTAs under negotiation. Other smaller economies, excepting Taiwan, have emerged as spokes in the East Asian region. Furthermore, China (PRC), Korea, Singapore, and Taiwan (ROC; Taipei, China) have concluded many cross-regional FTAs with economies in other regions.³⁴⁹

Japan

Japan is the first developed economy in the East Asian region. It has the strongest base of top MNEs involved in the regional industrial production networks and supply chains.

Japan, as a supporter of multilateralism, was a latecomer to FTAs. The government took multilateral negotiations as a means of opening up global markets to its MNEs' interests until the late 1990s.

However, it was increasingly suffering the loss of market share while its neighbors engaged in bilateral and regional free trade agreements with more preferential offers. In order to continue its status in the regional industrial production networks and supply chains and the competitive capacity of its MNEs, the Japanese government engaged in FTAs.

Japan concluded PTIAs that could provide a market-friendly and predictable regional business environment for its MNCs.

349 See Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 6-9, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

Singapore

Singapore is a preferred location choice for the regional headquarters of many leading MNCs.

It is strategically located in the midst of a fast growing resource-producing region and the key regional markets, such as China, the ASEAN countries, and Australia. It is also the most active Asian economy to conclude PTIAs with countries both in the East Asian region and outside the region.

The government of Singapore is seeking access to overseas markets, particularly for services and investments.

Korea

Korea was also a latecomer to FTAs. It is actively negotiating and concluding FTAs with its major trading partners. To present, it not only engaging in FTAs with major economies in the Asian-Pacific region, including the ASEAN³⁵⁰, but also expandg to Europe³⁵¹ and the United States³⁵².

China

China is the biggest emerging economy in the East Asian region with its potential

350 The text of the ASEAN-Korea FTA is available at <http://www.aseansec.org/18063.htm> (last accessed on 2009/12/15).

351 The EU-Korea Free Trade Agreement “is the first of the new generation of FTAs launched in 2007. It has been initialed in Brussels on 15th October 2009.” Available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=443> (last accessed on 2009/12/15).

352 The United States-Korea Free Trade Agreement (KORUS FTA) was signed on June 30, 2007. Available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta> (last accessed on 2009/12/15).

markets and huge natural resources.

In order to reduce the impact of anti-dumping retaliation against China, as the main exporter of final goods for the Asian factory, under WTO, the government actively negotiated and engaged in bilateral and regional FTAs.

China is engaging in bilateral agreements with countries mainly in the Asia-Pacific region. It is using FTAs to ensure market access for goods and to expand outward investment, especially in the East Asian region.

Furthermore, the government of China has also signed bilateral closer economic partnership agreements (CEPAs) with Hong Kong and Macau. Hong Kong³⁵³ and Macau³⁵⁴ are both “Special Administrative Region of the People’s Republic of China” and are also contracting parties of the GATT/WTO.

Taiwan

Taiwanese investors covered China and the Southeast economies within the East Asian production sharing chain and integrated its access to the global market. At the meantime, Taiwan played its dual role in the production network of the region.

Taiwan prefers a multilateral approach, such as the WTO negotiations, to negotiating

353 “Hong Kong, then a British Crown Colony became contracting party of GATT on 23 April 1986... became an original Member of the WTO.” See WTO news of 17 September 2001, *WTO successfully concludes negotiations on China's entry*, available at http://www.wto.org/english/news_e/pres01_e/pr243_e.htm (last accessed on 2009/12/15).

354 “Macau became a contracting party of the General Agreement on 11 January 1991 and was a founding member of WTO, which was established on 1 January 1995. On 20 December 1999 Macau continued to be a member of the WTO using the name of ‘Macau, China’.” See WTO news of 17 September 2001, *WTO successfully concludes negotiations on China's entry*, available at http://www.wto.org/english/news_e/pres01_e/pr243_e.htm (last accessed on 2009/12/15).

new rules for deep integration in the global economy. However, it was seriously suffering the loss of industrial competitiveness while its neighbors engaged in bilateral and regional free trade agreements with more preferential offers.

Taiwan has tried to establish bilateral agreements with other countries. It concentrated its efforts on bilateral agreements with countries with which Taiwan has diplomatic relations.

It has been trying but failed for an FTA with the United States.³⁵⁵ To present, Taiwan successfully concluded FTAs with only four countries in the Central American region in order to access the US market.

In order to keep its dual status in the regional industrial production network in East Asia, it has been trying unsuccessfully for an FTA with the ASEAN or its individual members. However, the current government of Taiwan turned to negotiate a FTA, recognized as the Economic Cooperation Framework Agreement (ECFA), with China. To present, there have been several talks on forming such an FTA.

The current government of Taiwan hopes to reduce the impact of falling behind in the East Asian regional economic integration through setting up the Taiwan-Mainland ECFA.³⁵⁶

355 “The US is reluctant to sign any deal with Taiwan as it could upset US relations with China.

Washington has consistently blocked talks on a TIFA, a first step towards an FTA, on the grounds of Taipei’s poor record in protecting US intellectual property rights in Taiwan.” See *Overview of bilateral free trade and investment agreements*, Background paper prepared for the “Fighting FTAs” international strategy workshop organized by FTA Watch in cooperation with bilaterals.org, GRAIN and MSF in Bangkok on 27-29 July 2006, Revised for public release as of 1 October 2006. Available at <http://www.twinside.org.sg/title2/FTAs/info.service/fta.info.service039/777158075453899d75cc70.pdf> (last accessed on 2009/12/13).

356 Until the end of 2009, the necessary pre-meeting arrangements and preparations have been underway

Cross-border direct investors originating from Taiwan hope FDI related issues, which are usually covered in BITs and DTTs, would be negotiated under the Taiwan-Mainland ECFA. Some hope such a friendly action could initiate negotiations of PTIAs between/among Taiwan and other major economic partners like the United States, Japan and the EU. Foreign Affairs Minister Timothy Chin-tien Yang said, “Taiwan’s bid to join international organizations requires support from other countries, as well as the goodwill of China.”³⁵⁷

The Association of Southeast Asian Nations (ASEAN)

ASEAN itself has the oldest trade agreements among member countries. It is also a major regional hub linking ASEAN members with other economies in the region. It enacted individual FTAs with China, Japan, and Korea that were recognized as “ASEAN Plus One.” The “ASEAN Plus Three” Cooperation has broadened and deepened many areas of cooperation among the ASEAN China, Japan and Korea.³⁵⁸

The ASEAN then concluded negotiations on bilateral agreements with India, Australia and New Zealand. The ASEAN is negotiating an FTA with the EU, however, they agreed to halt ongoing talks³⁵⁹ in 2009.³⁶⁰

by the four rounds of SEF-ARATS³⁵⁶ talks on an Economic Cooperation Framework Agreement (ECFA).

357 News: *SEF-ARATS talks should include international organization issues*, The China Post (Taiwan) December 16, 2009. available at <http://www.chinapost.com.tw/taiwan/foreign-affairs/2009/12/16/236831/SEF-ARATS-talks.htm> (last accessed on 2009/12/30).

358 “ASEAN Plus Three Cooperation” is available at <http://www.aseansec.org/16580.htm> (last accessed on 2009/12/15).

359 Mustaqim Adamrah, News: *ASEAN-EU FTA talks frozen*, THE JAKARTA POST, 2009/5/7. Available

Less-developed and medium-developed ASEAN member countries, such as Cambodia, Lao PDR, Myanmar, Viet Nam, the Philippines and Indonesia relied heavily on the ASEAN for FTAs with other countries or regions.

“The development of FTA hubs and spokes in Asia can be related to several factors, including economic size, per capita income, levels of protection, economic geography, and the production network strategies of MNCs.”³⁶¹

In short, bilateral and regional FTAs are the most popular type of IIAs for the governments of the East Asian economies in recent years. These FTAs have been set up toward a regional economic integration. Several economies are trying to position themselves as hubs for the new trade and investment flows.

However, some economies were left out of the process of negotiating or signing PTIAs with economies in the region, either because they are not favored politically, because they cannot afford the costs of many separate negotiations, or because their neighborhood is less open.

at <http://www.thejakartapost.com/news/2009/05/07/aseancu-fta-talks-frozen.html> (last accessed on 2009/12/15).

360 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 6-9, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29)

361 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 6-9, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

Table 2: Geographical Orientation of Concluded FTAs in Integrating Asia³⁶²

Country	Within Integrating East Asia	North and South America	Europe	Rest of South Asia	Others
ASEAN	ASEAN FTA, ASEAN–Korea FTA, ASEAN–China FTA, ASEAN–Japan FTA (these four agreements= “all ASEAN FTAs”)				ASEAN–Australia and New Zealand CER
Brunei Darussalam	all ASEAN FTAs; Japan–Brunei Darussalam EPA				Transpacific SEPA; ASEAN–Australia and New Zealand CER
Cambodia	all ASEAN FTAs				ASEAN–Australia and New Zealand CER
China (PRC), (People’s Republic of China)	ASEAN–China FTA, China–Thailand PTA, China (PRC)–Hong Kong, China CECA, China (PRC)–Macau, China CECA, China–Singapore	China–Chile FTA; China–Peru FTA		Asia–Pacific Trade Agreement (APTA) ³⁶³ China–Pakistan FTA	China–New Zealand FTA

362 Adopted from Kawai, Masahiro and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 29-30, Appendix Table 3, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

363 The Asia-Pacific Trade Agreement (APTA), previously known as the Bangkok Agreement, was signed in 1975. It is a preferential tariff arrangement between developing countries in the Asia-Pacific region. Members of APTA are Bangladesh, China, India, Korea, Lao PDR and Sri Lanka. APTA is open to all developing members of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). The information of the Asia-Pacific Trade Agreement is available at <http://www.unescap.org/tid/apta.asp>. It’s first agreement, the Bangkok Agreement, is available at <http://www.unescap.org/tid/BKK.asp> (last accessed on 2009/12/30).

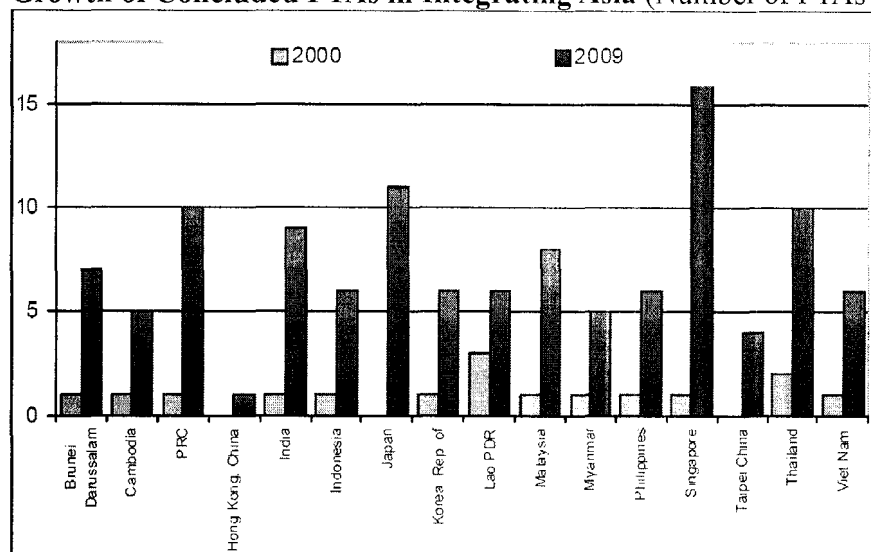
	FTA				
Hong Kong, China	China (PRC)–Hong Kong, China CECA				
Indonesia	ASEAN FTAs, Japan–Indonesia EPA				ASEAN–Australia and New Zealand CER
Japan	ASEAN–Japan; bilateral FTAs with Singapore, Brunei Darussalam, Indonesia, Malaysia, Thailand, Philippines, and Viet Nam	Japan–Mexico FTA, Japan–Chile FTA	Japan–Switzerland FTA		
Korea, (Republic of Korea)	ASEAN–Korea FTA, Korea–Singapore FTA	Korea–US FTA, Korea–Chile FTA	Korea–EFTA FTA	Asia–Pacific Trade Agreement (APTA)	
Lao PDR, (Lao People’s Democratic Republic)	all ASEAN FTAs, Lao PDR–Thailand PTA				
Malaysia	all ASEAN FTAs, Japan–Malaysia EPA			Malaysia–Pakistan FTA	PTA Group of Eight Developing Countries; ASEAN–Australia and New Zealand CER
Myanmar	all ASEAN FTAs				ASEAN–Australia and New Zealand CER
Philippines	all ASEAN FTAs, Japan–Philippines EPA				ASEAN–Australia and New Zealand CER
Singapore	all ASEAN FTAs, Japan–Singapore EPA, Korea–Singapore FTA, China–Singapore FTA,	US–Singapore FTA, Singapore–Panama FTA, Singapore–Peru FTA	Singapore–EFTA FTA		India–Singapore CEC, Transpacific SEPA, Singapore–New Zealand FTA, Singapore–Australia FTA, Singapore–Jordan FTA; ASEAN–Australia and New

					Zealand CER; Singapore–Gulf Cooperation Council (GCC) FTA
Taiwan (ROC), (Taipei, China)		Taiwan–Panama FTA; Taiwan–Guatemala FTA; Taiwan–Nicaragua FTA; Taiwan–El Salvador–Honduras FTA			
Thailand	all ASEAN FTAs, Japan–Thailand EPA, China–Thailand PTA, Lao PDR–Thailand PTA				Thailand–Australia FTA; Thailand–New Zealand FTA; ASEAN–Australia and New Zealand CER
Viet Nam	all ASEAN FTAs, Japan–Viet Nam EPA				ASEAN–Australia and New Zealand CER

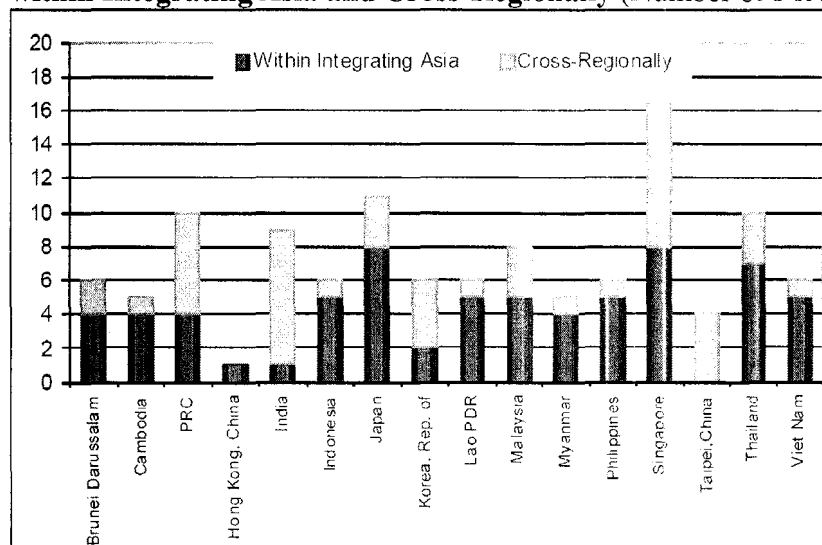
ADB = Asian Development Bank;
 AFTA = ASEAN Free Trade Area;
 ASEAN = Association of Southeast Asian Nations;
 CECA = Comprehensive Economic Cooperation Agreement;
 CER = Closer Economic Relations;
 EFTA = European Free Trade Area;
 EPA = economic partnership agreement;
 FTA = free trade agreement;
 Mercosur = Common Market of the South;
 PTA = preferential trade agreement;
 SAFTA = South Asian Free Trade Area;
 TA = trade agreement.

Source: ADB's Asia Regional Integration Center (ARIC) FTA Database (www.aric.adb.org); data as of June 2009.

Growth of Concluded FTAs in Integrating Asia (Number of FTAs by Country)³⁶⁴



Geographical Orientation and Share of Concluded FTAs in Integrating Asia—FTAs within Integrating Asia and Cross-Regionally (Number of FTAs)³⁶⁵



Source: ADB's Asia Regional Integration Center (ARIC) FTA Database (www.aric.adb.org), data as of June 2009.

364 Adopted from Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, p. 7, Figure 1, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

365 Adopted from Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, p. 9, Figure 2, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29)

5.3 Challenges in managing the existing IIAs and the Problems of ongoing institution-driven integration in East Asia

5.3.1 Introduction: impacts of IIAs on FDI and development

Although IIAs may bring benefits to contracting countries, several possible negative impacts have been observed.³⁶⁶ Usually, FDI recipients can receive not only the capital from FDI, but also efficient technologies, know-how and other benefits.

The implement of IIAs may cause a change in the domestic legal system of individual contracting countries. Although there is no strong evidence showing that IIAs create new FDI flow, these would have positive impacts on their economic growth and development.

Many countries have opened their markets to FDI by applying more liberalized trade and investment regimes; however, not all of them are attracting as much FDI as expected. Only a few economies with high economic growth, such as China, India and some ASEAN countries, are successful in attracting FDI.³⁶⁷

IIAs may affect choices of FDI location and business strategies of MNEs. Because of rules of origin in bilateral and regional agreements, the preferential offers may cause

³⁶⁶ PTIAs may bring benefits to members in the form of trade expansion. Several possible negative impacts³⁶⁶ have been pointed out. See Shujiro Urata, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

³⁶⁷ See World Investment Report 2004: The shift towards Services, UNCTAD, pp. 39, 49~51, 2004.

trade creation or distortion. They may also cause diversion effects on trade and FDI.

The economies with strong dependence on cross-border trade and FDI would like to conclude more such agreements. If such an economy were unable to participate in these agreements, it might lose the competitiveness for its economic growth and development.

The principle of non-discrimination is the heart of the postwar trade architecture, which is established under the multilateral WTO framework. However, the spread of PTIAs in the absence of multilateral rules could increase costs for non-participating countries and might bring the risk of marginalization to these countries.³⁶⁸

In addition, the stalled multilateral negotiations under the DDA made the WTO members turn to PTIAs for liberalization. This could result in a negative impact on multilateral WTO negotiations.

There is one common argument that PTIAs “endanger the multilateral World Trade Organization (WTO) system. Various rules of origins of overlapping PTIAs have caused noodle-bowl...” In addition, these preferential offers may bring trade-distorting effects and investment-diverting effects that may disadvantage non-contracting economies.³⁶⁹

368 The impact of trade diversion and FDI relocation on non-participating countries of the NAFTA is an example. See Brigid Gavin and Alice Sindzingre, *EU trade relations with Emerging Asia: identifying the issues*, Asia Europe Journal, Springer Berlin / Heidelberg, Vol. 7, No. 1, p. 15, 2009, available at <http://www.springerlink.com/content/x053351g2v377434/fulltext.html> (last accessed on 2009/10/25). The impact of trade diversion and FDI relocation on Taiwan, a non-participating economy of the ASEAN plus is another example.

369 See Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian

According to the speech of Pascal Lamy, Director-General of the WTO, in 2007, the proliferation of RTA “...is breeding concern — concern about incoherence, confusion, exponential increase of costs for business, unpredictability and even unfairness in trade relations.”³⁷⁰

5.3.2 Implementation problems

The implementation of IIAs may cause a change in the domestic legal system of individual contracting countries.

Although there is no strong evidence showing that BITs create new FDI flows in earlier studies, with different methodological and different assumptions, the majority of recent studies confirm a positive effect of BITs on FDI. For example, Eric Neumayer and Laura Spess indicated a positive effect of BITs on FDI, especially for developing countries.³⁷¹

by signing more BITs with developed countries, particularly those that are major FDI exporters, developing countries give up some of their domestic policy autonomy by binding themselves to foreign investment protection, but could expect to receive more FDI in exchange.³⁷²

Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp.69-81 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

370 Pascal Lamy, *Proliferation of regional trade agreements “breeding concern*, Speech in opening the Conference on “Multilateralizing Regionalism” on September 10, 2007 in Geneva, available at http://www.wto.org/english/news_e/sppl_e/sppl67_e.htm. (Last accessed on 2009/12/18).

371 See Eric Neumayer and Laura Spess, *Do bilateral investment treaties increase foreign direct investment to developing countries?* World development, Vol. 33 No. 10, pp. 1567-1585, 2005.

372 Section of “Interview with Eric Neumayer” in News: *Do Bilateral Investment Treaties Lead to More Foreign Investment?* Investment treaty news (ITN), International Institute for Sustainable Development (iisd), 2009. Available at

Many countries have opened their markets to FDI by applying more liberalized trade and investment regimes; however, not all of them attracting as much FDI as was expected.

These objectives of agreements would be never reached if a country only signed an IIA and did not fully implement it domestically.³⁷³ Furthermore, countries concluding low quality agreements³⁷⁴ would not have the expected effects, and may bring problems if these provisions do not comply with international law or international standards.

To date, only a few economies with high economic growth, such as China, India and some ASEAN countries, have been successful in attracting FDI.³⁷⁵

5.3.3 Rules of Origin

Rules of Origin (ROO) are measures³⁷⁶ which determine where a product comes

<http://www.investmenttreatynews.org/cms/news/archive/2009/04/30/do-bilateral-investment-treaties-lead-to-more-foreign-investment.aspx> (last accessed on 2010/1/3). Eric Neumayer's research also showed that "the effect was possibly more pronounced in countries with weak domestic institutions, i.e. in countries for which the confidence and credibility-inspiring signal to foreign investors following the signing of BITs was most important."

373 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, pp. 698, 701, 2007. For the "East Asian miracle", see Stiglitz, Joseph, *Some Lessons from the East Asian Miracle*. *World Bank Research Observer*, Vol. 11, Issue 2, pp. 151-77, 1996.

374 Some FTAs that are established in East Asia are of low quality in that a substantial number of commodities and/or important commodities are excluded from trade liberalization. See Urata, Shujiro, *A Shift from Market-Driven to Institution-Driven Regionalization in East Asia*, Stanford Center for International Development (SCID), Stanford Institute for Economic Policy Research, Working Paper No. 303, p. 21, Nov. 2006. Available at <http://scid.stanford.edu/publicationsprofile/1043> (last accessed on 2009/8/6).

375 See World Investment Report 2004: The shift towards Services, UNCTAD, pp. 39, 49-51, 2004.

376 Including laws, regulations and administrative procedures.

from or was made. ROO also define which goods will have preferential bilateral tariffs.³⁷⁷ In order to take the advantage of preferential tariffs, investors would relocate their FDI locations. This results in trade deflection and FDI diversion.

ROOs are another potentially challenging aspect of Asian FTAs. “Rules of origin are important in implementing such trade policy instruments as anti-dumping and countervailing duties, origin marking, and safeguard measures.”³⁷⁸ Foreign economic policies may thus discriminate between exporting countries by those measures.³⁷⁹

Globalization and international industrial production networks increase the complexity of product processing,³⁸⁰ and further increase the importance of ROO issues.

377 Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp. 77-79, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04). See also Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 13-14, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

378 See *Introduction to rules of origin in the WTO*, available at http://www.wto.org/english/tratop_e/roi_e/roi_e.htm (last accessed on 2009/12/19).

379 Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp. 77-79, 2009. Available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04). The study of rules of origin by Antoni Esteveadcordal and Kati Suominen presents a global mapping of the existing ROO regimes and analyzed economic effects of ROO on manufactured goods.³⁷⁹

380 Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp. 77-79, 2009. Available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

5.3.4 Diversion effects of trade and FDI under PTIAs and “Marginalization” of some economies/countries

Generally, globalization and liberalization of trade and FDI could bring advantages and disadvantages to economic growth and development. Inward FDI is the major effect of trade, particularly on the export-oriented host country. One major effect of trade on the exports of a home country is outward FDI.

However, several applications of national measures and international agreements to some countries may sometimes lead to economic inefficiency. The economic inefficiency could result from the process of diversion and distortion effects of trade and FDI. Such agreements fell in the exceptions as free trade agreements that make the principle of non-discrimination, which is at the very heart of the WTO, difficult to achieve.

The case of the electronics industry is an example in the East Asian region. It is an export-oriented industry. Electronics MNEs are the type of efficiency-seeking FDI which seeks FDI locations where their production can be performed at low cost.

Electronics investors took the competitive advantages theory to make their FDI location decisions. Japanese electronics investors hold the efficient technologies and know-how. In the mid-1980s,³⁸¹ many Japanese electronics firms set up their production base in the first NIEs, such as Korea and Taiwan, in order to maintain their price competitiveness. In the late 1980s, Korea and Taiwan³⁸² lost the advantages of low cost production compared to the second NIEs, such as Thailand and Malaysia. By the early

381 Mainly because the yen appreciated drastically in Japan.

382 The exchange rates appreciated in Korean and Taiwan could be the main reason. The labor wages increased could be another reason.

1990s, these ASEAN countries³⁸³ were unable to attract efficiency-seeking MNEs who looked for cost-saving FDI locations. The low-cost manufactured MNEs shifted their FDI locations to China, where low-wage labor was available.

Although different types of FDI could be affected by different factors, some factors may be important for all types of FDI, such as protection of investors' rights, treatment and standards. Moreover, each economy has its specific objectives and economic growth and development that could promote the living standards of its people, the ultimate goal for each government.

In short, a well-functioning legal system covering these general factors and issues is needed in the host territory. Government may take various measures unilaterally, bilaterally, and multilaterally in order to offer a stable and transparent business environment.

IAs may affect choices of FDI location and business strategies made by MNEs. From an investor's point of view, a BIT is an important legal institution to protect assets and rights; a DTT is a tool for tax planning; and an FTA could reduce tariffs and thus lower costs.

However, some East Asian economies were left out of bilateral or regional PTIAs for some certain reasons.³⁸⁴ The spread of PTIAs in the absence of multilateral rules

383 Wages increased and public infrastructure was waiting for establishment.

384 Some countries were left out because they are not favored politically. Some other countries could not participate because they cannot afford the costs of many separate negotiations or their neighborhood is

Some articles argue that the rapidly increasing FTAs with different rules of origin are likely to give rise to the spaghetti bowl effect. Some of these PTIAs include similar provisions and conflicting elements that would reduce trade volume by creating obstructions to trade.³⁸⁷

A “noodle bowl” problem of criss-crossing agreements that potentially distort trade toward bilateral channels, excessive exclusions and special treatment in FTAs, and the possibility that the multilateral trading system may be progressively eroded.³⁸⁸

On the contrary, some others argued that Asian FTAs may be creating an order of a different sort by building the foundation for a stronger regional trading system³⁸⁹ or

387 Kotera Akira, *What is the “Spaghetti Bowl Phenomenon” of FTAs?* Research Institute of Economy, Trade and Industry (RIETI), 2006. available at http://www.rieti.go.jp/en/columns/a01_0193.html (last accessed on 2009/11/13). “The obstructive nature of mixed rules of origin might harm trade flows and elevate the noodle-bowl effect.” Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, p. 79-80, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

388 See Richard Baldwin, *Multilateralizing Regionalism: Spaghetti Bowls as Building Blocks on the Path to Global Free Trade*, The World Economy, Vol. 29, No. 11, pp. 1451–1518, 2006. See also Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*, Oxford University Press, 2008. Bhagwati concluded that PTAs also are serving as stumbling blocks, instead of building blocks, for the objective of reaching multilateral free trade. Also Kawai, Masahiro and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 3-4, 2009. Available at <http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

389 Masahiro Kawai and Ganeshan Wignaraja, *Asian Free Trade Agreements: Trends and Challenges*, Asian Development Bank Institute (ADBI) Working Paper, No. 144, pp. 13-14, 2009. Available at

regional economic integration.

Some scholars have argued that the positive effects of WTO-plus elements of PTIAs in East Asia “do not fully confirm the distortion thesis” and these PTIAs are given positive record of notification³⁹⁰ to the WTO.

However, they all agree that these overlapping PTIAs with various rules of origin in East Asia “may lessen the multilateral effectiveness of interregional FTAs.”³⁹¹

To date, nearly all WTO members have concluded at least one free trade agreement. These bilateral or regional agreements include not only tariffs and rules of origin regulating trade in goods, but also services, investments, technical barriers to trade, and competition rules. Some of them covered issues not directly related to trade.

Governments take different types of free trade agreements into more comprehensive, regional, interregional, and even multilateral agreements. They would make these agreements as tools for economic growth and development. The growth of regional FTAs, such as ASEAN-Plus, and intra-regional agreements, such as Trans-Pacific Economic

<http://www.adbi.org/files/2009.08.04.wp144.asian.fta.trends.challenges.pdf> (last accessed on 2009/10/29).

390 RTAs falling under Article XXIV of GATT, Article V of GATS, and the Enabling Clause must be noticed to the WTO. For more information about the notification, see *Transparency Mechanism for RTAs of WTO*, available at http://www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm (last accessed on 2009/12/19).

391 Howard Loewen, *WTO Compatibility and Rules of Origin - Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, pp.69-81, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

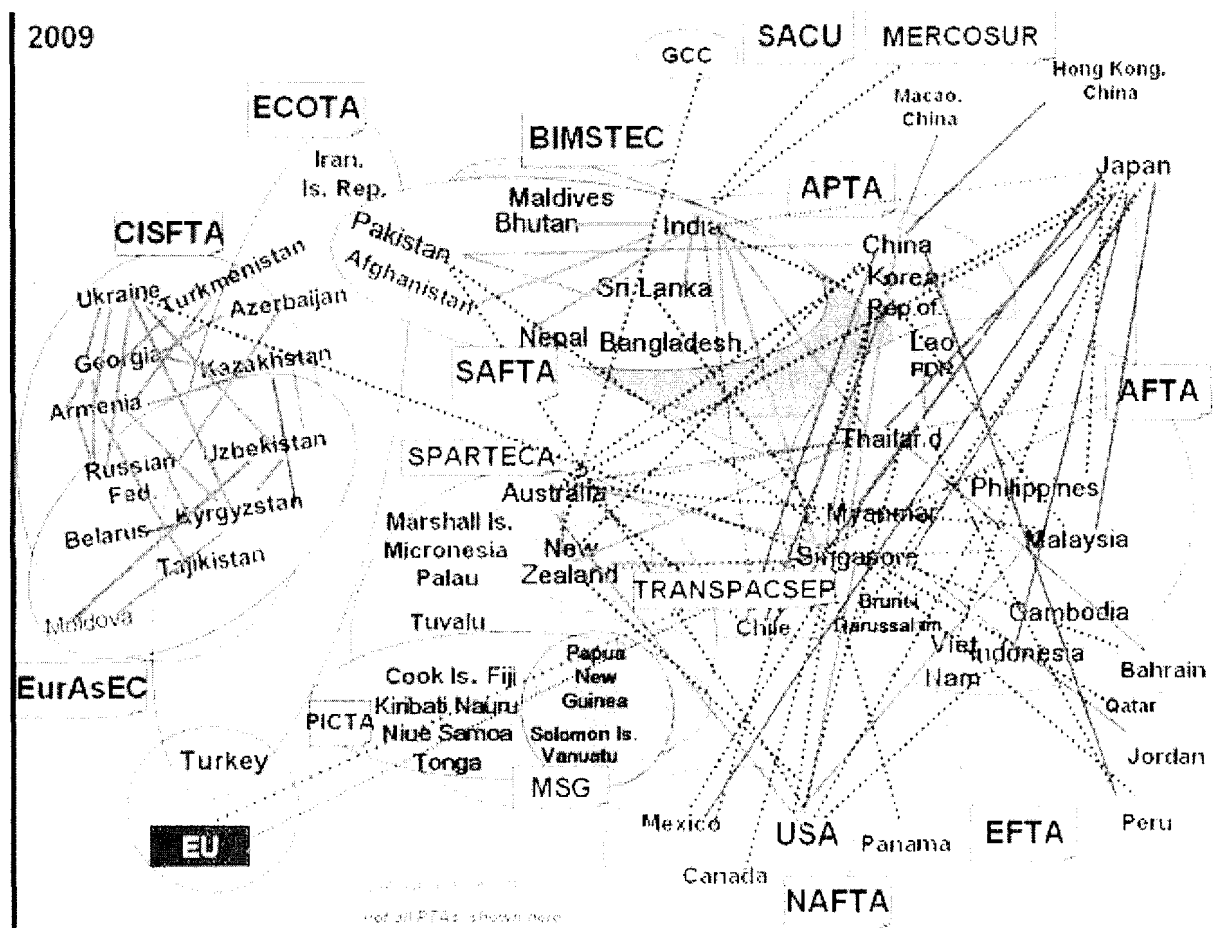
Partnership, have thus become a trend.³⁹²

Therefore, “Multilateralizing Regionalism” was the title of the WTO conference held in Geneva, 10-12 September 2007. Participants discussed the “Spaghetti Bowl” problems posed for the multilateral trade system and contributed some ideas on how to adapt these overlapping agreements.³⁹³

392 Howard Loewen, *WTO Compatibility and Rules of Origin – Assessing Bilateral Trade Agreements between Latin America and East Asia*, Journal of Current Southeast Asian Affairs, Institute of Asian Studies at German Institute of Global and Area Studies (GIGA), Hamburg, Vol. 28, No. 1, p. 79-80, 2009. available at <http://hup.sub.uni-hamburg.de/giga/jsaa/article/download/5/5> (last accessed on 2009/11/04).

393 Information is available on WTO website, Conference on “Multilateralising Regionalism”, at http://www.wto.org/english/tratop_e/region_e/conference_sept07_e.htm (last accessed on 2009/12/30). See Richard Baldwin and Patrick Low, eds., *Introduction of Multilateralizing Regionalism: Challenges for the Global Trading System*, Cambridge University Press, 2009. Available at http://www.wto.org/english/res_e/booksp_e/multila_region_e.pdf (last accessed on 2009/11/3). See also Antoni Esteveordal, Jeremy Harris and Kati Suominen, *Multilateralizing Preferential Rules of Origin around the World*, this paper was presented at the Conference on Multilateralising Regionalism in Geneva, on September 10-12, 2007, available at http://www.wto.org/english/tratop_e/region_e/con_sep07_e/estevadeordal_harris_suominen_e.pdf (last accessed on 2009/11/8). Also Philippe De Lombaerde and Luis Jorge Garay, *Preferential Rules of Origin and the Multilateral Trading System: Pro-Development Policy Options*, Intereconomics, Vol. 42, No. 5, Springer Berlin / Heidelberg, pp. 260-266, 2007.

The Noodle-Bowl of FTAs in the World, 2009³⁹⁴



Source: Asia-Pacific Trade and Investment Agreement database, Trade Agreements Database Trade and Investment Division, UNESCAP.

394 Adopted from Asia-Pacific Trade and Investment Agreement database, Trade Agreements Database Trade and Investment Division, UNESCAP. available at <http://www.unescap.org/tid/aptiad/pillar.aspx> (last accessed on 2009/11/04).

5.4 Conclusion

FDI is an engine to development, especially to economic and social development. FDI benefits host countries by expanding productive capacity, driving job creation and economic growth, promoting innovation and trade, and ensuring essential infrastructure. FDI has also become an increasingly important source of finance for development and economic growth.³⁹⁵

Recent studies have found that there is a link between the quality of the investment climate and the quality of productive investment. A quality investment climate could provide greater security, certainty and opportunities for FDI from capital-exporting country. At the same time, it ensures that the capital-receiving country is a desirable destination for foreign investors.

Bilateral agreements, including trade agreements and investment agreements, can play an important role toward liberalization in reducing regulatory barriers to cross-border trade and investment. Then they may able to improve investment climates and bring the benefits that come with FDI.

Compared to multilateral negotiations and agreements, bilateral agreements have fewer conflicts, which are difficult to resolve, between contracting countries. These agreements can more easily address the unique needs of the relationships between contracting countries.

When multilateral measures are incomplete or slow to develop, bilateral agreements can be a mechanism to provide foundational rules and ensure that progress in improving

395 See the "Opening remark" of Supachai Panitchpakdi, Secretary-General of UNCTAD, at the Global Forum on International Investment (GFI-7), March 27, 2008, OECD Conference Centre.

the global environment for FDI continues. They could be stepping-stones to the multilateral system.

However, negotiating multiple trade or investment issues in PTIAs has become a trend, especially in the East Asia and the Asian Pacific region. Those countries which are excluded and cannot participate because they are not favored politically, who cannot afford the costs of many separate negotiations, or whose neighborhood is less open, have been in fact excluded from such economic cooperation and integration. For regional and global development, these countries or economies should not be excluded.

In addition, several developing countries have succeeded in attracting FDI, including China, which is currently the second-largest FDI recipient in the world. To date developed and developing countries are not as divided as the rich and the poor countries. Some reasons for opposing the multilateral framework on investment are not important or no longer exist. Furthermore, some FDI issues that current rules under WTO do not cover have become important to both developed and developing countries.

To participate in a regional or multilateral framework for economic cooperation would be the best method for these countries.

Although some scholars oppose the “multilateral investment rules” as an issue under the WTO negotiations in the late 1990s and the early 2000s, the international economic condition has changed, and it could be the time to negotiate investment rules under a multilateral platform. This thesis suggests that the APEC, which takes the open

regionalism policy,³⁹⁶ is a good framework for the regional platform, and the WTO with its dispute settlement body would be a good framework for this multilateral platform.

Moreover, there is also a need for greater international coordination of tax policies. Muchlinski³⁹⁷ discussed several taxation problems surrounding the activities of MNEs. He concluded that MNEs try to gain the most profit through international tax planning.

396 Open regionalism allows benefits from trade liberalization undertaken by members to accrue not only to APEC members but to non-APEC members as well. For more discussion about “open regionalism”, see C. Fred Bergsten, *Open Regionalism*, Working Paper 97-3, Peterson Institute for International Economics, 1997. Available at <http://www.iie.com/publications/wp/wp.cfm?ResearchID=152> (last accessed on 2010/01/03).

397 See Peter Muchlinski, *Multinational Enterprises and the Law*, Oxford University Press, p. 261-306, 2007.

CHAPTER SIX.

CONCLUSION

6.1 Development and linkage of trade and FDI

This thesis focuses on two core elements of strategies aimed at reducing the degree of unbalanced growth and development and unbalanced reliance, and achieving sustainable, long-term economic growth and development for all economies. The first is the need to promote economic growth and development in each economy and the whole region by the cooperation in international direct investment arrangements among economies in the East Asian region, and further around the world. Second is the need to improve investment environments by implementation of investment rules under international law in individual economies.

This thesis began with the importance of trade and foreign direct investment in East Asia. The successful economic growth and development in the region, especially in certain economies, have resulted from active involvement of MNEs in foreign direct investment and trade.³⁹⁸

MNEs took advantage of business opportunities arising from a more liberal trade and FDI environment in East Asian economies. MNEs fragmented production processes

398 There is some evidence suggesting increased trade by itself does not ensure economic development. Trade and FDI are both engines for economic development. See Ram Upendra Das, *Imperatives of Regional Economic Integration in Asia in the Context of Developmental Asymmetries: Some Policy Suggestions*, ADBI Working Paper, No. 172, 2009. available at <http://www.adbi.org/files/2009.12.07.wp172.regional.economic.integration.asia.pdf> (last accessed on 2010/1/7).

into two or more steps for sub-processes and located the sub-processes in economies where MNEs could gain most efficiently. As a result of fragmentation strategy by MNCs, international industrial production and distribution networks have been established in East Asia.

The rapid expansion of intra-regional trade in the East Asian region has primarily resulted from industrial cooperation by multinational enterprises (MNEs) and local firms in the form of the international industrial production and distribution networks under liberalized market conditions, and efficient communications and transportations systems in recent years. Composition of trade in machinery products, electronic products³⁹⁹ and electric products increased their importance.

The pattern of intra-industry trade expanding faster than inter-industry trade results from trade in parts and components rather than final goods. It reflects the increasing extent of division of labor inside East Asia in which MNEs take their comparative advantages. In addition, intra-regional trade expanding faster than extra-regional trade results in an increase in intra-regional dependency. East Asia has become a factory for the world. Such development has been driven by MNEs' cross-border business activities and is described as market-driven economic integration.

However, unbalanced economic development carries risks for the East Asian economies. The Asian Financial Crisis beginning in mid-1997⁴⁰⁰ and the global

399 They mainly are office and telecommunication equipment products.

400 For more information about the 1997 Asian Financial Crisis, see *The IMF's Response to the Asian Crisis*, A Factsheet of IMF, January 1999, available at <http://www.imf.org/external/np/exr/facts/asia.HTM>; also Steven Radelet and Jeffrey Sachs, *The East Asian Financial Crisis: Diagnosis, Remedies, Prospects*, Harvard Institute for International Development,

economic crisis since mid-2008 are examples. All of the three major types of FDI (market-seeking, efficiency-seeking, and resources-seeking) will be impacted.

Market-seeking FDIs located in developed countries are the most affected due to the decreased local demand. Efficiency and resource-seeking FDI that located in developing and emerging economies and aimed at exporting to advanced markets were depressed due to the low demand of advanced markets.⁴⁰¹ MNEs from developed countries might pull back their investment and re-consider their FDI locations in developing countries during the global economic crisis.

Liberalization of trade and FDI might be the best policy for economic welfare for all the economies in the world. Trade and FDI are both driving forces for economic growth and development. Moreover, economic development has great influence on improving the living standards of people. It is important to make sure that existing and future international trade and investment rules are consistent with modern international law and basic human values.

Economies' cooperation in international direct investment could be the first step to narrow current development gaps toward regional and multilateral development cooperation strategies.

6.2 The three approaches of IIAs, bilateral, regional and multilateral approaches

1998, available at <http://www.cid.harvard.edu/archive/hiid/papers/bpeasia.pdf> (last accessed on 2009/10/25).

401 See *Assessing the impact of the current financial and economic crisis on global FDI flows*, A note issued by UNCTAD, for the "International Enterprises" programme, pp1-2, January 2009. available at www.unctad.org/en/docs/webdiaeia20091_en.pdf (last accessed on 2010/1/20).

6.2.1 Bilateral approaches

The bilateral approaches are mainly BITs and bilateral free trade agreements with investment provisions (bilateral PTIAs). These agreements mainly provide protection for cross-border direct investment at the international level.

Countries are able to choose the contracting partners, especially their major economic partners. This allows each agreement to be negotiated separately for requirements under specific situations. It is flexible for countries to set up their networks of IIAs.

However, some countries with weak bargaining power are unable to conclude certain provisions that their contracting partners do not like. In addition, less favorable countries usually have few opportunities to conclude agreements. Moreover, the increasing number of bilateral investment agreements with different rules and standards would be costly for MNEs and administrators.

6.2.2 Regional and interregional approaches

Regional agreements, which combine investment and trade provisions, are usually in the form of PTIAs. They seek to receive the benefits of larger markets through liberalization of both investment and trade, and investment protection and promotion as well.

These agreements go beyond traditional international trade rules, to include regional rules on investment, competition, environment and labor. Recent agreements further provide a regulatory framework for improving the overall investment climate in the region.

These agreements provide some exceptions, reservations, and transition periods for individual countries at different levels of development.

Countries concluding regional arrangements with the objectives of economic growth and development are seeking a deeper and closer economic integration and cooperation. Countries concluding such agreements are often concerned not just with economic outcomes, but political outcomes as well. However, this often results in discrimination to non-members. Countries that are excluded from the regional institution-driven integration are hurt by the diversion of FDI and diversion of trade.

Yet, an open and non-discriminatory rule-based regional PTIA could be a step toward greater openness for a multilateral system.

6.2.3 Multilateral approaches

A multilateral approach usually aims at both protection and liberalization. It should be an open and non-discriminatory rule-based framework that would include even less politically favored countries.

This could provide a platform for members to negotiate international measures and standards together for improving individual, regional and even the global economy toward a better living standard for all.

However, it is difficult to come to a conclusion among countries with different or conflict interests.

6.2.4 Conclusion

The form of trade agreements entered into by a country depends on many factors, including its objectives and the structure, substantive provisions, and implementation processes of the proposed agreements.

For a country like Taiwan, trying to survive in the process of regional and global economic integration, it is very important for it to participate in an open and non-discriminatory rule-based framework at either the regional or the multilateral level.

6.3 Multilateral or regional legal frameworks for foreign direct investment

6.3.1 A multilateral legal framework for foreign direct investment

This is an integrated, globalized, interdependent global economy. For the global economic development and balanced growth, each economy, including the rich and the poor countries, the developed, developing, and least developed countries, the capital exporting and importing countries, should cooperate not only in trade but also in international direct investment arrangements.

To date, there is an open and non-discriminatory rule-based multilateral trade system under the World Trade Organization (WTO) framework dealing with issues of trade and some measures for trade-related investment. The GATT/WTO agreements provide international basic standards for cross-bordered activities of trade in goods and services, trade-related investment and the transfer of intellectual property rights among members.

However, there has been no multilateral legal framework on investment like the WTO for multilateral trade systems. Although there is an open and non-discriminatory rule-based multilateral trade system, the closer connections of this global economy

require further reaching frameworks.

It is time to establish an open and non-discriminatory rule-based multilateral framework on international direct investment in order to secure higher standards of living for all people through economic integration and cooperation.

A multilateral investment legal framework could combine functions of international institutions that deal with investment matters separately nowadays, such as UNCTAD, IMF and World Bank, and regional Development Banks.

This could resolve the problems of the current mechanisms for international investment dispute settlement. Provisions of mechanisms for investor-state dispute settlement are important in investment agreements. ICSID and UNCITRAL are currently the major mechanisms for investor-state dispute settlement.

During the first decade of the twenty-first century, the International Centre for Settlement of Investment Disputes (ICSID) was the most “referred to” arbitration facility for disputes under BITs⁴⁰² with its own set of rules and procedures. Provisions on ICSID arbitration are commonly found in investment contracts between governments of member countries and investors from other member countries. Today, ICSID is considered to be the leading international arbitration institution devoted to private investor-state dispute settlement.⁴⁰³

402 Most of these agreements refer present and future investment disputes to the ICSID and it received substantially increased FDI cases.

403 International Centre for Settlement of Investment Disputes (ICSID) is an autonomous international institution established in 1966 under the “Convention on the Settlement of Investment Disputes between States and Nationals of Other States” (also called as the Washington Convention) linked to the World Bank. The primary purpose of ICSID is to provide facilities for conciliation and arbitration of

The United Nations Commission on International Trade Law (UNCITRAL), drafted 30 years ago to address private commercial disputes, provides the second most-used set of rules in investor state arbitration. Disputes claimed by cross-border private investors against states under many FTAs and BITs are arbitrated according to UNCITRAL rules. However, the Rules do not address the public interest implications of investor-state disputes.⁴⁰⁴

This thesis then suggests that the WTO would be the better model for setting up rules for international direct investment. One reason for this is that the WTO is one of very few international organizations in which Taiwan and China are both members.

6.3.2 Cooperation in international direct investment arrangements for a deeper regional economic integration in East Asia and the Pacific region

The conscious efforts towards avoiding over reliance by export-oriented East Asian economies on developed markets, and narrowing unbalanced growth and development gaps, has led some East Asian economies to seek closer economic cooperation and integration with other economies, not limited to their neighbor countries. They are even inter-continental. The rapidly spreading bilateral and regional agreements involve

international investment disputes between member countries and individual investors who qualify as nationals of other member countries. The official website is available at www.worldbank.org/icsid/ (last accessed on 2010/1/18). ICSID Convention, Regulations and Rules (2006) is available at http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf (last accessed on 2010/1/6).

⁴⁰⁴ The United Nations Commission on International Trade Law (UNCITRAL) is the core legal body within the United Nations (UN) to harmonize and unify international trade law. The official website is available at <http://www.uncitral.org/> (last accessed on 2010/1/18).

strategic considerations of regional security or regional balance.

WTO members turned to process bilateral or regional free trade agreements including investment provisions with their economic partners positively because they think several issues would be difficult to meet their needs under multilateral negotiations. These sensitive issues include investment and agriculture conflicts between/among members. The increasing number of bilateral and regional PTIAs includes such provisions, which are usually covered in BITs. There is then a shift from market-driven economic integration to institution-driven economic integration.

The increasing number of bilateral and regional PTIAs steps in investment issues that used to be consisted in BITs. However, these PTIAs in fact might create discrimination against non-members and increase costs for MNEs and economies.

Many agreements have the effect of trade diversion. The PTIAs with high external border protection and low tariffs among members discriminate against efficient, low-cost suppliers in non-member economies. They might cost the economy more in lost trade revenues than they earn. In addition, Different agreements, providing different rules of origin, different tariff schedules, and different periods of implementation, will take a longer time to process goods cross-customs. Longer processing times increase the cost of trade.

An open and non-discriminatory rule-based regional economic integration framework with schemes that optimally deploy the region's industrial, financial, natural, human, and technological resources could narrow developmental gaps among economies.⁴⁰⁵ It could help less-developed countries to participate in regional industrial

405 See Ram Upendra Das, *Imperatives of Regional Economic Integration in Asia in the Context of*

production networks and give them access opportunities to global market. Furthermore, it could not only cover economic issues but also other related issues, such as labor, competition, developmental and environmental issues.

Some argue that the sub-regional and bilateral attempts, ASEAN and ASEAN plus one,⁴⁰⁶ could be a base for a broader regional framework for economic cooperation. ASEAN with major Asian countries are now building a complex network of free trade arrangements linking ASEAN members and the contracting countries for deeper regional economic integration. However, this network of FTAs in fact might create discrimination against non-members.

This thesis suggests that open regionalism and non-discrimination APEC would be the better model for regional economic cooperation. One of the reasons is that both China and Taiwan are members of APEC.

APEC is a forum for twenty-one 21 member economies in Asia and the Pacific region with objective to enhance economic growth and wealth in the region. It intends to strengthen the Asia-Pacific community by cooperation on regional trade and investment liberalization and facilitation among members.⁴⁰⁷

Developmental Asymmetries: Some Policy Suggestions, ADBI Working Paper, No. 172, 2009. Available at <http://www.adbi.org/files/2009.12.07.wp172.regional.economic.integration.asia.pdf> (last accessed on 2010/1/7).

406 Ten member countries of ASEAN plus one are bilateral agreements with individual country of Japan, China, South Korea each. The three plus-one-countries plus agreements with India, Australia and New Zealand are recognized plus six.

407 APEC was established in 1989. To enhance economic growth and prosperity for the region and to strengthen the Asia-Pacific community are its purpose and goals. The information about APEC is

Furthermore, the APEC Economic Leaders created the APEC Business Advisory Council (ABAC) in 1995 with the objective of providing advice on the implementation of the Osaka Action Agenda to achieve the Bogor Goals and on other specific business sector priorities. ABAC provides an annual report to APEC Economic Leaders that includes recommendations to improve the business and investment environment on specific areas of cooperation in the Asia-Pacific region and responds to APEC's request for information about business-related issues.⁴⁰⁸

ABAC involves the participation of the "private sector," an important player in international economic activities other than economies/countries. Each economy appointed up to three members of the private sector, including small and medium enterprises, by their respective Leaders to ABAC. It is the only non-governmental organization on the official agenda of the APEC Economic Leader's Meeting.

In addition, there has yet been no formal regional economic integration agreement concluded by every economy or country in East Asian and the Pacific region. However, a broader regional framework for deeper economic cooperation and development in East Asia will become necessary in the future.

The form of a regional economic integration agreement could be a mechanism reducing regional unbalanced growth and inequitable development. It could create conditions and opportunities for all economies to participate. It could be a platform to

available at its official website at <http://www.apec.org> (last accessed on 2010/1/11). These goals were adopted by Leaders at their 1994 meeting in Bogor, Indonesia.

408 The information about ABAC is available at its official website at <https://www.abaconline.org> (last accessed on 2010/1/11).

bring economies together for economic development. Those economies lacking the capacity to negotiate and implement regional economic integration schemes would not be left behind.⁴⁰⁹

6.4 Standing at the point of view of Taiwan and its local and cross-border direct investors

Compared with large MNEs, SMEs have less capacity to influence policies of home countries and host countries. They need more assistance from governments of home countries and host countries.

Most Taiwan's investors are SMEs, both local and overseas. They especially need assistance from the government of Taiwan in economic, political, and security areas when they are doing business across borders.

Cross-border direct investment in China is an example. China is the top host country of FDI originating from Taiwan. Protection of FDI is an important subject that has not been negotiated by the governments of Taiwan and China.

Although there is a political issue between Taiwan and China, there are mutual interests in their economic cooperation together with other the East Asian economies.⁴¹⁰ In order to promote regional economic growth and development, Taiwan should not be

409 Ram Upendra Das, *Imperatives of Regional Economic Integration in Asia in the Context of Developmental Asymmetries: Some Policy Suggestions*, ADBI Working Paper, No. 172, 2009. Available at <http://www.adbi.org/files/2009.12.07.wp172.regional.economic.integration.asia.pdf> (last accessed on 2010/1/7).

410 Taiwan and China have their mutual interests in economic cooperation. See Huang, Eric Ting-Lun, *The Status of Taiwan under International Law and in a Changing World*, SJD thesis, Golden Gate University, pp. 283-286, 2002.

excluded from the process of East Asian institution-driven economic regionalization.⁴¹¹

The government must maintain Taiwan's position as an indispensable section of the industrial value chain. It has to seek better mechanisms of cooperation in international industries and cross-border direct investment arrangements in East Asia. Taiwan must try to keep up with the ongoing institution-driven regional integration in East Asia, either the one initiated by the ASEAN economies or the one discussed in the APEC.

In conclusion, although there is opposition to regulate the international investment rules in the multilateral system of WTO, in Taiwan's view, it is a good mechanism to protect the investment originating from Taiwan because Taiwan and China are both members of WTO. However, the multilateral negotiations of the WTO have been delayed for several years.

Taiwan is excluded from the process of the regional economic integration initiated by the ASEAN. The APEC could be the ideal platforms for regional economic cooperation for the reason that both Taiwan and China are members of the APEC.⁴¹²

6.5 Conclusion

The new type of IIAs, the form of PTIAs, works as a mechanism for economic cooperation among members. However, along with their positive effects, current or ongoing negotiated international investment agreements would cause negative effects on members. They could also have negative impacts on non-members.

411 While there is a consensus of forming a regional economic integration in the East Asia region, the government of Taiwan can do little for its people when it is excluded from the process.

412 Taiwan and China are both members of the WTO, the APEC, and the Asian Bank.

What content of such agreements consist and their implementation would lead to further economic cooperation, growth and development become very important. The possible negative impacts on economies that have not been included in the process of institution-driven economic integration are important to governments as well.

In the last two decades, several developing countries have become capital-exporting countries due to the trends of globalization and liberalization, as well as their open-door policies. Investors from developing countries with more competitiveness have more abilities to set their operations in different countries and territories.

FDI flows originating from, and going to, developing countries are growing rapidly. FDI-related issues that used to be only the concern of developed countries have become important to developing countries.

It is the time to establish a multilateral legal framework for cooperation in international investment arrangements. While multilateral negotiations are still difficult, an open and non-discriminatory rule-based regional framework, covering trade and investment liberalization, toward economic integration, could be the first step toward a multilateral legal framework for further integration.

Economies should work together to fit their policies together and facilitate implementation. They should be accompanied by complementary development policies including not only trade but also investment. The benefits from FDI, especially in infrastructure, education, and research and development (R&D), would narrow the gaps of unbalanced development in the region. Each economy then could take advantage of economic opportunities in global markets by increasing its development capability.

Economies should not be left out of the institution-driven economic integration, either because they are not favored politically, because they cannot afford the costs of many separate negotiations, or because their neighborhood is less open.

The East Asian economies should take their economic cooperation in international investment arrangements towards a flying geese development, instead of competition with each other. No one can fly too high, if a goose flies by its own wings. When every goose claps its wings, other geese will catch and follow up and the whole group of geese starts to rise into the air. When one goose is sick or injured, other two will fly to the one to protect it and keep it company until the injury has recovered. They will catch up the original group thereafter. Economies would achieve their objectives of development through cooperation with different advantages for each member, just like the flying geese.

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