

Dynamics of investment negotiations between China and Japan : the China-Japan-Korea trilateral investment treaty and beyond

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August 2016

Abstract: The investment agreement relationship between China and Japan is complex. The many intersecting and overlapping agreements can rightly be described as a “noodle bowl of agreements.” The 1989 bilateral investment treaty (BIT) between China and Japan still stands. Japan can also free-ride on the negotiation outcome of China’s BITs and free trade agreements (FTAs) with other countries by using the most-favored-nation (MFN) provision in the 1989 China-Japan BIT, which does not contain regional economic integration organization (REIO) exception rules. However, because the China-Japan BIT does not have investor-state dispute settlement (ISDS), it may face implementation problems. The China-Japan-Korea trilateral investment treaty (CJK TIT), in force since 2014, made improvements upon the 1989 BIT, but Japan is not entirely satisfied with the outcome. For Japan, pre-establishment national treatment (NT) and prohibition of various types of performance requirements are the most important negotiation items, but the CJK TIT insufficiently addressed those problems. Moreover, because the CJK TIT has MFN provisions with an REIO exception rule, better access to investment markets brought about by future FTAs such as the China-Korea FTA and the EU-China FTA cannot be imported into CJK TIT. Hence, in the long run, Japan needs to pursue an FTA investment chapter with China that covers both MFN and ISDS.

Keywords: bilateral investment treaty (BIT), China-Japan-Korea Trilateral Investment Treaty (CJK TIT), US-China BIT, most-favored nation (MFN)

JEL classification: F15, F53, F55

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Abstract

The investment agreement relationship between China and Japan is complex. The many intersecting and overlapping agreements can rightly be described as a “noodle bowl of agreements.” The 1989 bilateral investment treaty (BIT) between China and Japan still stands. Japan can also free-ride on the negotiation outcome of China’s BITs and free trade agreements (FTAs) with other countries by using the most-favored-nation (MFN) provision in the 1989 China-Japan BIT, which does not contain regional economic integration organization (REIO) exception rules. However, because the China-Japan BIT does not have investor-state dispute settlement (ISDS), it may face implementation problems. The China-Japan-Korea trilateral investment treaty (CJK TIT), in force since 2014, made improvements upon the 1989 BIT, but Japan is not entirely satisfied with the outcome. For Japan, pre-establishment national treatment (NT) and prohibition of various types of performance requirements are the most important negotiation items, but the CJK TIT insufficiently addressed those problems. Moreover, because the CJK TIT has MFN provisions with an REIO exception rule, better access to investment markets brought about by future FTAs such as the China-Korea FTA and the EU-China FTA *cannot* be imported into CJK TIT. Hence, in the long run, Japan needs to pursue an FTA investment chapter with China that covers both MFN and ISDS.

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1. Introduction

Relations between China and Japan are central to economic cooperation in Asia, particularly when negotiating regional economic agreements. For both China and Japan, investment has been the central issue among all negotiation items in economic agreements, rather than trade and tariffs. The principal reason why Japan joins these agreements is not trade liberalization, but to secure non-discriminatory investment liberalization, including by prohibiting various performance requirements. In contrast, China remains cautious in allowing investment liberalization such as pre-establishment national treatment (NT) because it may hinder its national industrial policy (Berger 2013). Given these divergent investment goals, coming to an agreement on the international rules to govern country investment policy is difficult. The differences in the negotiating stances of the two countries concerning investment will likely be the greatest obstacle to current and future negotiations for economic agreements in Asia.

China and Japan have already spent much time negotiating international investment agreements (IIAs).¹ The Investment Protection Treaty between China and Japan was originally signed in 1989. However, unlike other Chinese bilateral investment treaties (BITs), this treaty has not been renegotiated. In addition, the China-Japan-Korea Trilateral Investment Treaty (CJK TIT) was signed in 2012 and became effective in 2014, despite the fact that the 1989 BIT remains in force. There are other current and future negotiations for IIAs that involve or will involve both China and Japan. In 2014, negotiations for a China-Japan-Korea Free Trade Agreement (CJK FTA) were launched, with investment as one of its core chapters. Moreover, negotiations started in 2012 to establish a Regional Comprehensive Economic Partnership (RCEP) among the ASEAN+6 members² that includes an investment chapter. The Trans-Pacific Partnership (TPP), which includes Japan, was agreed to in 2015. Whether or not China joins the TPP in the future is an important item on the regional economic agenda. The TPP includes a significant investment chapter that is largely based on the North America Free Trade Area (NAFTA) model, but also incorporates modifications based on the United States (US) post-NAFTA experience (Hodgson 2015).

This paper reviews the evolution of investment negotiation dynamics between China and Japan. It considers the future prospects for IIAs in Asia given the negotiation dynamics between the two largest economies in the region. In particular, we will closely examine the CJK TIT, which is one of few plurilateral investment treaties in Asia.³ Interestingly, the CJK TIT is one of the few relatively “Americanized” investment treaties signed by China, even though the US is not a contracting party (Chi 2015). The CJK TIT provides some insight into the prospect of future Asian IIAs involving the two countries, including negotiations on the proposed CJK FTA investment chapter.

The paper is structured as follows. Section 2 briefly reviews the IIA policies of China and Japan and explains how they have evolved over time. Section 3 reviews two investment treaties signed by China and Japan: the China-Japan BIT in 1989 and the 2012 CJK TIT. We compare the quality of the CJK TIT with China-Japan BIT in 1989, the China-Korea BIT in 2007, and the Japan-Korea BIT in 2003. This section also reviews the original positions of

¹ In this chapter, IIAs refers to both investment treaties and investment chapters in free trade agreements (FTAs).

² ASEAN+6 includes the 10 ASEAN members plus China, Japan, Korea, Australia, New Zealand and India.

³ Plurilateral investment treaties have three or more signatories.

China and Japan on critical CJK TIT investment points such as pre-establishment NT and examines whose preference prevailed. Section 4 examines the current negotiations over the CJK FTA investment chapter. It also touches on the current negotiations for a US-China BIT, China-Korea FTA, and European Union (EU)-China BIT and FTA, given that these IIAs impact China-Japan negotiations and IIAs in Asia. The final section concludes the paper.

2. IIA Policies of China and Japan

2.1. China's IIA Policies

Until 1978, China restricted inward foreign direct investment (FDI). The notion of private property was rejected under the planned economic system. China wanted to establish its own controlled economic development system rather than relying on foreign capital. Except for a limited number of joint ventures with former Soviet Union states, foreign investment was not allowed. Naturally, during this period, China did not sign any IIA to attract FDI or to give protection to the limited investments made by foreign entities.

Economic reform started in late 1978 when a “socialist system with Chinese characteristics” was adopted. China began to understand how inward FDI could benefit economic development so its stance toward inward FDI also changed. China signed its first BIT with Sweden in 1982 and during this “first phase”, which lasted until 1998, it signed around 70 BITs. The majority of these BITs were with developed countries. These agreements opted for limited investment protection through narrowly defined investor-state arbitration clauses (Fan 2015). China's first model BIT (formulated in 1984) did not include any NT provisions. Dispute resolution was either not included or only allowed for consideration of the amount of compensation. The second model BIT (formulated in 1989) made some improvements, such as the inclusion of NT provisions, but their scope was extremely limited. However, China's first-phase BITs did include post-establishment (investment protection) most favored nation (MFN) status.

By the late 1990s, a second phase for IIAs evolved as the Chinese government started to encourage outward investment, thereby significantly increasing investment outflows. In particular, China began investing heavily in resource sectors in developing countries, especially in Africa. Further, China became the then-largest investment recipient in the world. Naturally, Chinese IIA policies became more proactive. Accordingly, a third model BIT was formulated in 1997, including a comprehensive NT clause. Also, the model's dispute settlement provisions were improved. Between 1998 and 2007, China signed around 40 BITs. During this period, the majority of BITs with developed countries signed between 1982 and 1998 were also renegotiated and replaced with new ones, with the notable exception of Japan. Some BITs with developed countries included standstill commitments to non-conforming measures, meaning China would not increase discrimination toward foreign investors.

A third phase began after 2007 as China moved from being a prime destination for inflows to becoming a massive capital exporter. Chinese firms with strong political support and incentives began investing abroad and found the need to protect their investments (Berger 2008). Third-generation IIA provisions are more detailed and balanced. Chi (2015, p. 379) calls this the “Americanization” of Chinese IIAs. While China had previously followed European formats, it began signing American-style IIAs that included detailed provisions, broader coverage, a more self-contained structure and greater enforceability. For example, for investor-state arbitration, third-generation Chinese IIAs often include provisions concerning statutes of limitations, the constitution of tribunals, and consolidation (Fan 2015). However, at the same time, recent Chinese IIAs still have some restrictive language regarding the definition of investors. They often cite “substantial business rules,” meaning that incorporation (without substantial operations) in a partner country is insufficient to fall under the scope of an IIA. Moreover, pre-establishment NT remains excluded from third-generation IIAs, although pre-establishment MFN is covered. Table 1 summarizes the evolution of Chinese IIAs throughout the three phases of development.

Table 1: Evolution of Chinese IIAs

	National treatment (NT)	Most favored nation (MFN)	Investor-state dispute settlement (ISDS)
First Phase (1980s-1990s)	<ul style="list-style-type: none"> No NT or restricted NT. 	<ul style="list-style-type: none"> Post-establishment MFN. 	<ul style="list-style-type: none"> No ISDS or ISDS limited to the amount of compensation.
Second Phase (2000s)	<ul style="list-style-type: none"> BITs with developing countries: No NT or NT subject to national laws. BITs with developed countries: (i) full post-establishment NT; (ii) standstill commitment to non-conforming measures. 	<ul style="list-style-type: none"> Post-establishment MFN. 	<ul style="list-style-type: none"> Full ISDS.
Third Phase (after 2007)	<ul style="list-style-type: none"> Pre-establishment NT not covered. 	<ul style="list-style-type: none"> Pre-establishment MFN. MFN not extended to ISDS. 	<ul style="list-style-type: none"> Detailed ISDS provisions.

Source: Compiled by author based on Berger (2013).

2.2. Japan's IIA Policies

While Japan is known as a major investor in many parts of the world, especially in Asia, it had a surprisingly cautious attitude to investment inflows until very recently. Until the mid-1970s, inward investment was heavily restricted via the Foreign Capital Law. After joining the Organisation for Economic Co-operation and Development (OECD) in the mid-1960s, investment deregulation started, but progress was slow. The Foreign Capital Law was only abolished in 1980.

Japan signed several BITs between the mid-1970s and the late-1990s (first phase). However, Japan was not as keen to sign BITs and most agreements were proposed by its counterparts (Fan 2015). Through 2001, Japan had signed only nine BITs, with the majority of partners being small economies such as Egypt (1977), Sri Lanka (1982) and Bangladesh (1998), with the notable exception of China (1989). Japan's BITs during this period covered only post-establishment NT. But even post-establishment NT provisions were often restrictive. Japan did not have a model BIT and had no preference regarding the specific wording of NT provisions. In other words, it was "flexible" enough to accommodate partner's concerns. Moreover, Japanese BITs during this period did not include clauses on fair and equitable treatment (FET).

One reason Japan did not have a strong interest in BITs, even after it became one of the world's leading investors, was that it had a strong preference for multilateral investment regimes. An OECD ministerial meeting in May 1995 agreed to begin negotiating a Multilateral Agreement on Investment (MAI). The MAI was expected to cover both pre-establishment and post-establishment. A leaked draft of the MAI suggests it would be a comprehensive and binding investment agreement, consisting of 12 sections.⁴ Although the MAI negotiations were initially conducted among OECD countries, it was expected that non-OECD members would later join the agreement. The Japanese government and industry was a strong proponent of the MAI. In fact, a report prepared in April 1996 by Keidanren, the largest business association in Japan, emphasized two systemic issues relating to the MAI.

⁴ The sections included in the MAI were the following: (i) general provisions; (ii) scope and application; (iii) treatment of investors and investments; (iv) investment protection; (v) dispute settlement; (vi) exceptions and safeguards; (vii) financial services; (viii) taxation; (ix) country-specific exceptions; (x) relationship to other international agreements; (xi) implementation and obligations; and (xii) final provisions.

First, the report argued that MAI should be open for accession by non-OECD members and that Japan should play an important role in bringing in Asian economies, as Japan was then the only Asian country in the OECD. Second, the relationship between the MAI and existing regional and bilateral investment treaties was underscored. Keidanren felt that violations of MFN rules in the MAI by signing bilateral or regional investment treaties should not disrupt the interests of non-treaty members. This example well illustrates Japan's pro-multilateralism approach to investment. However, in December 1998, a formal decision to terminate MAI negotiations was made at an informal OECD meeting.⁵

The failure of the MAI pushed Japan to pursue second generation BITs. In fact, in November 1998 Japan began negotiating a Japan-Korea BIT (signed in 2002), the very first IIA categorized as second generation. Interestingly, the Japanese Ministry of Economy, Trade and Industry felt the Japan-Korea BIT was "equivalent" to the MAI.⁶

Some may argue that Japan's engagement in economic partnership agreements (EPAs) came resulted from the abandonment of its multilateralism-centric *trade* policy in the late 1990s. This argument implies that the shift in Japan's IIA policy was merely a side effect of the shift in trade policy because an investment chapter is only one of many components of an EPA. However, it is important to note that Japan's active bilateral and/or regional economic policy began with investment rather than trade. Negotiations on the Japan-Korea BIT started before negotiations began on its first FTA (the Japan-Singapore EPA). In fact, some argue that investment, not trade, is the core component of Japanese EPAs (for example, see Hatch 2005).

2.3. Comparative Analysis of China and Japan

A comparison of the evolution of Chinese and Japanese IIAs is summarized in Table 2. Several important observations can be drawn from the comparison.

Table 2: Summary of the Development of IIAs of China and Japan

China	Japan
No BIT (1949-1978) <ul style="list-style-type: none"> Restrictions on foreign direct investment (FDI) 	No BIT (1950s-mid 1970) <ul style="list-style-type: none"> Restrictions on FDI
First Generation (1978-1998) <ul style="list-style-type: none"> Reform and opening up; Aimed to attract FDI Growth in BITs, but conservative approach (FDI importer perspective) 	First Generation (1976-2001) <ul style="list-style-type: none"> Expansion of FDI inflows and large declines in FDI outflows Passive negotiators in BITs, restrictive approach (BITs mainly proposed by the counterparty)
Second Generation (1998-2007) <ul style="list-style-type: none"> 'Going global' strategy; began to become FDI exporter, more liberal view on investment protection; Pro-investor BITs (FDI exporter perspective) 	Second Generation (2002-onward) <ul style="list-style-type: none"> FDI exporting country Pro-investor IIAs (FDI exporter perspective)
Third Generation (2007-onward) <ul style="list-style-type: none"> Characteristics of both inflow and outflow of FDI More balanced and more detailed BITs and FTAs 	

Source: Compiled by author.

⁵ Several salient reasons for the failure of MAI negotiations included criticism from non-governmental organizations (NGOs) that the MAI paid little attention to labor and environmental issues; criticism from developing countries that MAI reflected only the views of developed countries; and concerns over the capital flow liberalization triggered by the 1997/98 Asian financial crisis.

⁶ See: http://www.meti.go.jp/policy/trade_policy/asia/s_korea/html/jkbia_gaiyo.html

First, several commonalities between the two countries can be seen. Each country's IIA policy evolved over time. Basically, both countries began at the "No BIT" stage with FDI highly restricted and only restrictive IIAs were signed early on. More recent IIAs are more liberal. Changes occurred by stage or phase rather than as a steady or constant development. In other words, IIAs signed during the same stage are more or less similar. The change in stage is more evident in China, which used model BITs. But Japan also shows clear phases in the evolution of its IIAs.

Second, while more recent China and Japan IIAs are more liberal, the restrictiveness of IIAs differs significantly. For example, both China and Japan started to engage in BITs in the mid-1970s upon partner requests. However, the first Japanese BITs were more liberal than those involving China. This has an important implication. Since preferred restrictions vary across Northeast Asia, bilateral or regional IIA negotiations between or among them tend to be challenging. In fact, as we will see later, the 1989 China-Japan BIT was never renegotiated.

It is interesting that what triggered more liberal IIAs varies among countries. The investment position (whether FDI importer or exporter) is critical for determining IIA policy because more investment security is needed for FDI exporting countries. If a country wants to protect investments in partner countries, it should offer reciprocity. China's shift to second generation IIAs clearly came once it started to invest abroad, especially in Africa. The external environment also affects IIA policies. The MAI failure made Japan realize that an alternative to the multilateral approach was necessary. For Japan, even as it massively invested in Asia in the 1990s, multilateral investment negotiations were more important than BITs.

3. IIAs between China and Japan

3.1. The 1989 China-Japan Investment Protection Treaty

Negotiations for the China-Japan Investment Protection Treaty started in 1982 with the BIT signed on August 27, 1988, and entered into force on May 14, 1989. Both China and Japan IIA policy were in their respective first phases when this treaty was negotiated. While Japan was already an active player in international investment by the 1980s, especially after the 1985 Plaza Accord, its IIA policy was not proactive.

Naturally, the 1989 BIT was not ambitious. Since first-generation IIAs of the two countries did not usually include pre-establishment NT, it was not covered in the BIT. Post-establishment NT was included, but policies inconsistent with NT are permitted for purposes relating to maintaining public order, national security or sound development of the national economy. But again, both China and Japan's first-generation IIAs included restrictive language when outlining post-establishment NT. Perhaps the two countries held different views on investor state dispute settlement (ISDS). While Japan's first-generation IIAs included ISDS and often mention the International Centre for Settlement of Investment Disputes (ICSID), Chinese first-generation IIAs seldom included ISDS. Since the scope of ISDS under the China-Japan BIT is limited to the amount of compensation, Chinese preference prevailed, possibly because China was not a part of the ICSID convention at that time.

Article 15 of the 1989 BIT provides for the agreement to be in effect for 10 years, although it "shall continue in force" unless terminated. Either party could request renegotiation toward the end of the period, though such a request never materialized. Apparently, neither country wanted the agreement terminated because the investment protection was valued. This is in sharp contrast with the Chinese BITs with Western European countries from the 1980s, which were replaced by new ones in the early 2000s (for example, the 1983 China-Germany BIT was replaced with a new BIT in 2003). The 1989 China-Japan Investment Protection Treaty remains in force, despite the CJK TIT becoming effective in 2014 (see following section).

Meanwhile, the original BIT between China and Korea was signed in 1992. It was initially effective for 5 years, but has been extended on an annual basis ever since. While the 1992 BIT was not particularly ambitious, it was replaced by a new BIT in 2007 after successful renegotiations. While only the amount of compensation can be submitted for dispute settlement under the old BIT, there is no such restriction under the 2007 BIT. FET was also included in the new BIT. However, the new agreement does not cover post-establishment NT. Again, Chinese preference prevailed.

In short, many Chinese BITs signed in the 1980s and 1990s were renegotiated and replaced by new BITs, with the Chinese BITs with Western European countries and the BIT with Korea being renegotiated. In contrast, the 1989 China-Japan BIT was not renegotiated and remains in effect. As shown in Table 3, the treatment Japan received was not on par with that of other countries such as Korea. In particular, major concerns for Japan included (i) the lack of a prohibition of performance requirements, (ii) the possible introduction of restrictions subject to domestic regulations and laws (such as expropriation, restrictions on transfers), and (iii) limited access to an investor-state dispute mechanism. Naturally, by the time the new China-Korea BIT came into effect, Japan felt it was necessary to improve its BIT with China. Because of Japan's large amount of investment assets in China, the business sector in Japan was particularly intent on improving the agreement.

Two things stand out concerning the MFN provisions in the 1989 China-Japan BIT. First, the MFN provision does not include a regional economic integration organization (REIO) exception clause.⁷ When the MFN provision in an investment treaty includes an REIO exception, only provisions in other investment treaties can be imported; provisions in other FTAs cannot be used (United Nations Conference on Trade and Development [UNCTAD] 2004). The China-Japan BIT can conveniently import both provisions from other investment treaties and the investment provisions in FTAs signed by either China or Japan with other partners. Second, the MFN provisions in the China-Japan BIT cover both post- and pre-establishment NT (see Table 3). The treatment accorded nationals and companies of the other contracting party regarding investments, returns and business activities in connection with investment shall have MFN status. This implies that better market access under the provisions of others IIAs such as provisions on investment liberalization and prohibition of performance requirement can be imported into the China-Japan BIT using the MFN provisions. It also applies to judicial access, administrative tribunals and agencies (domestic remedies). However, the scope of international disputes and access to ICSID is not covered by MFN provisions.

⁷ The absence of REIO exception in the 1989 China-Japan BIT is partly because both China and Japan had not signed any FTA or REIO by that time.

Table 3: Comparative Analysis of Investment Treaties in Northeast Asia

	China-Japan BIT (1989)	Japan-Korea BIT (2003)	China-Korea BIT (2007)	CJK TIT (2012)
NT (pre-establishment)	No	Yes	No	No
NT (post-establishment)	Yes (discrimination possible for public order, etc.)	Yes	Yes	Yes
MFN (pre-establishment)	Yes	Yes (REIO exception)	Yes	Yes (REIO exception)
MFN (post-establishment)	Yes	Yes (REIO exception)	Yes	Yes (REIO exception)
Negative list	No	Yes	No	No
FET	Yes (limited scope)	Yes	Yes	Yes
Umbrella clause	No	No	Yes	Yes
Expropriation and Compensation	Yes (subject to laws; limited to MFN for compensation for damages)	Yes	Yes	Yes
MFN and NT due to armed conflict, etc.	Yes (limited to NT)	Yes	Yes	Yes
Transfers	Yes (restriction possible based on domestic regulations)	Yes	Yes	Yes
ISDS	Yes (limited to the amount of compensation)	Yes	Yes	Yes
State-State Dispute	Yes	Yes	Yes	Yes
PR (export restriction)	No	No	No	Yes
PR (local procurement requirement)	No	Yes	Yes (limited)	Yes
PR (local content requirement)	No	Yes	No	Yes
PR (export-import balance requirement)	No	Yes	No	Yes
PR (export requirement)	No	Yes	No	Yes (limited)
PR (domestic sale restriction requirement)	No	Yes	No	No
PR (local senior management requirement)	No	Yes	No	No
PR (local employment requirement)	No	Yes	No	No
PR (regional headquarters requirement)	No	Yes	No	No
PR (R&D requirement)	No	Yes	No	No
PR (technology transfer requirement)	No	Yes	Yes (limited)	Yes (limited)
PR (monopolistic supply requirement)	No	Yes	No	No

PR = performance requirement prohibited

Source: Compiled by author.

3.2. China-Japan-Korea Trilateral Investment Treaty (CJK TIT)

At the China-Japan-Korea trilateral summit meeting in October 2003 in Bali, Indonesia, the three leaders agreed to launch a joint study group of business, government and academia to examine the feasibility of a CJK TIT. The report was finished in September 2004. By then, the differences in preferences between China and Japan over the modality of a possible trilateral investment treaty became clear. As summarized in Table 4, Japan, together with Korea, felt that strong rules on investment were necessary, while China wanted to maintain some policy space, given its status as a developing country. It is interesting that both Japan and Korea insisted that the Japan-Korea BIT should be the basis of a CJK TIT. As discussed above, the 2002 Japan-Korea BIT was a turning point in Japan's IIA policies and marked the beginning of Japan's second-generation BITs. The treaty covers both pre-establishment and post-establishment. It employs negative lists, and almost all critical IIA elements are included, except for an umbrella clause. Further, all major performance requirements are prohibited, other than export restrictions (see Table 3). In contrast, China insisted that existing regimes such as the World Trade Organization (WTO) and the 1989 China-Japan BIT had been working well. Due to differences, the launch of official treaty negotiations was delayed. In 2005 and 2006, no formal negotiation was launched, though several low-key intergovernmental meetings were held.

Table 4: Negotiation Positions for CJK TIT

Issues	Position of Japan and Korea	Position of China
Transparency	The principle of transparency as contained in the recently concluded investment arrangements, including the Japan-Korea Investment Treaty should be incorporated and further strengthened as much as possible.	The rules for transparency as contained in the relevant rules and provisions in the World Trade Organization should serve as reference.
Prohibition of Performance Requirements	Provisions that prohibits performance requirements in recently concluded investment arrangements, including the Japan-Korea Investment Treaty should be the basis for future deliberation.	The prohibition of performance requirements could be researched further in the future.
Dispute Settlement	The dispute settlement mechanism in recently concluded investment arrangements, including the Japan-Korea Investment Treaty could be good models for the possible investment arrangement.	The dispute settlement mechanism established by China-Japan, China-Korea and Japan-Korea BITs works effectively. The existing mechanism can be strengthened and fully utilized in dealing with disputes concerning investment.
Pre-establishment National Treatment	Pre-establishment national treatment is essential to the arrangement, as many recently concluded investment arrangements contain this principle and the possible arrangement of the three countries should have the same principle. The differences in economic development should be duly considered and accommodated in a practical manner, e.g., making use of exception clauses in the arrangement.	It is premature for pre-establishment national treatment to be included in the possible arrangement due to the differences in the development stages of the three countries.

Source: The Report of the Joint Study on the Possible Modality of Trilateral Investment Arrangements among China, Japan, and Korea (Available at: http://www.mofa.go.jp/mofaj/gaiko/investment/jck/pdfs/jck_kaigo_04e.pdf)

Japan had a strong interest in the trilateral investment treaty, given that renegotiating its bilateral treaty with China was unlikely. This was especially true when the new China-Korea BIT came into effect in 2007. Japan wanted to create a level playing field with Korean industries in the Chinese market. Korea also expected that, by collaborating with Japan, a trilateral treaty could lead to a stronger treaty than its BIT with China. In fact, as we will see later, the position of Japan and Korea were almost the same on various issues covered by BITs; the two formed a coalition in regards to China. Finally, in January 2007, official negotiations for the CJK TIT began. However, progress was slow. This was mainly due to China's reluctance to accept pre-establishment NT to treat national and foreign companies equally under governmental regulations (Yoshimatsu 2014). After nearly 10 years since the trilateral summit, the CJK TIT was signed in May 2012 and came into effect in May 2014.

The CJK TIT reflects Japan's preferences to a certain degree. In particular, while the focus of dispute settlement was limited to the amount of compensation under the 1989 China-Japan BIT, this limitation was removed in the CJK TIT. Moreover, the CJK TIT sets very clear ISDS procedural guidelines, minimizing the ambiguity of dispute settlement procedures. These provisions cover a wide range of issues from initiation of arbitration to award enforcement, which makes the CJK TIT "Americanized" (Chi 2015). However, this was no longer controversial for China because the majority of third-generation Chinese IIAs have full and detailed ISDS provisions (see Table 1).

Overall, however, Japan was unsatisfied with the CJK TIT. First, it covers only post-establishment, not pre-establishment NT. And, unlike the Japan-Korea BIT, it does not use a negative list approach. Second, the transparency provision was strengthened compared with the China-Japan BIT (Article 10). Signatories must provide a reasonable opportunity for public comments on regulations related to investment and consider them before adoption. However, the interval between the announcement of a new regulation and its implementation was not clearly specified and is dependent on the best efforts of the nation creating the regulation (i.e., the country "shall endeavor" to provide a reasonable period for public comment). Third, performance requirements prohibited under the CJK TIT remained limited (Article 7). In addition to the measures listed in WTO Trade-Related Investment Measures (TRIM),⁸ only two measures are prohibited by CJK TIT: export requirements and technology transfer. Moreover, prohibition is limited to imposing unreasonable or discriminatory measures concerning the two. Hence when a "reasonable" technical transfer request is imposed in a non-discriminatory manner, it would be acceptable as far as the CJK TIT is concerned. As seen in Table 3, the Japan-Korea BIT included a much longer list of prohibited performance requirements.

The only reason why Japan eventually signed the CJK TIT was that it was still better than the 1989 BIT with China. The prolonged negotiations for the CJK TIT did not benefit Japan, as it had to rely on the old BIT. Japan preferred concluding the prolonged CJK TIT negotiations and beginning a new negotiation on the CJK FTA investment chapter. In fact, by 2012, the joint study on CJK FTA was already launched (see below).

The relationship between CJK TIT and previous BITs between the three countries requires a careful assessment. It is important to note that the old BITs remain in force. Article 25 (Relation to Other Agreements) of the CJK TIT says

Nothing in this Agreement shall affect the rights and obligations of a Contracting Party, including those relating to treatment accorded to investors of another Contracting Party, under

⁸ When IIAs cover pre-establishment, the prohibition of performance requirements is powerful. This is because the performance requirement is usually imposed when companies decide to make new investment. However, the effectiveness of the prohibition of performance requirement is unclear when IIAs cover only post-establishment. If a host government attempts to impose a performance requirement upon the expansion of existing investment (post-establishment), provisions other than the prohibition of performance requirement, such as FET provisions, seem to be effective enough to prevent the implementation of such performance requirement policies.

any bilateral investment agreement between those two Contracting Parties existing on the date of entry into force of this Agreement, so long as such a bilateral agreement is in force.

Note: It is confirmed that, when an issue arises between an investor of a Contracting Party and another Contracting Party, nothing in this Agreement shall be construed so as to prevent the investor from relying on the bilateral investment agreement between those two Contracting Parties which is considered by the investor to be more favorable than this Agreement.

One possible reason why the old BITs, especially the 1989 China-Japan BIT, remain in place is the effectiveness of their MFN provisions. As mentioned previously, the earlier BIT and the 2007 China-Korea BIT do not have an REIO exception, unlike the CJK TIT (Article 3.4 (a)) and the 2003 Japan-Korea BIT (see 4.2 for details).

4. Future Prospects for China-Japan Investment Negotiations

4.1. Negotiations between China and Japan over a China-Japan-Korea Free Trade Agreement (CJK FTA)

China, Japan and Korea are currently negotiating a CJK FTA, which also includes an investment chapter. At a trilateral summit in October 2009, the leaders of the three countries agreed to launch a joint study group comprising business, government and academia (Hamanaka 2014).

The question is whether or not conclusion of the CJK TIT makes future investment negotiations in Asia easier. Some argue the CJK TIT can form the basis for future investment negotiations involving both China and Japan, including the CJK FTA. Under this view, the investment chapter in the CJK FTA can replicate the CJK TIT with limited improvements. However, it is also possible that the CJK TIT could make the negotiations for a CJK FTA investment chapter even more difficult, because some changes and additions are required to justify a new agreement.

From China's perspective, the investment agreement has been completed and authorities believe any investment chapter to an FTA should basically follow what was agreed to in the trilateral investment treaty. From Japan's perspective, however, it is pointless to sign a trilateral FTA given its strong interests in investment issues unless the investment chapter shows a significant improvement. In fact, according to the March 2012 Joint Study Report for the FTA, Japan argued that

The three countries should conclude as soon as possible the trilateral investment agreement which is being negotiated but far less ambitious in its substance than what the investment chapter of a CJK FTA is expected to be and should then launch negotiations on the investment chapter of a CJK FTA in terms of a high level of investment liberalization, building on the concluded trilateral investment agreement.

The report also underscores the disagreement between the two governments (Table 5). Interestingly, Japan and Korea again formed a coalition against China in the negotiations. Japan wants the CJK FTA investment chapter to go far beyond the existing agreements—including the CJK TIT and WTO TRIM. It prefers a negative list approach, meaning all sectors will be liberalized unless there are specific reservations. China wants policy flexibility and emphasizes investment facilitation and promotion (such as information exchange) over investment liberalization. It wants to follow TRIM, meaning only “trade related aspects of investment” should be covered with investment liberalization itself not specifically on the agenda. While the formal intergovernmental negotiations for the FTA started in November 2012, it remains unclear how far China will move from what was agreed to in the CJK TIT.

Table 5: Negotiation Position for a CJK FTA Investment Chapter

	Position of Japan and Korea	Position of China
The level of ambition	<p>The essential elements to be covered by the CJK FTA include national treatment (NT) and most favored nation (MFN) at the pre- and post-establishment phases, investor-state dispute settlement (ISDS) procedures with a wide ranging scope, prohibition of performance requirements (PR) beyond the Trade-Related Investment Measures (TRIM) level, a negative list approach integrated with the services chapter, and any other facilitating elements in a future CJK FTA.</p> <p>The investment chapter in a future CJK FTA should surpass protections and liberalizations in the BITs among the three countries, including the CJK TIT.</p>	<p>The CJK FTA should seek an investment chapter that provides better protection, greater transparency and a more effective dispute resolution mechanism, and any other facilitation and promotion elements that could further promote intra-investment flow, including information exchange on investment opportunities and information sharing on laws and regulations in the field of investment.</p> <p>Investment promotion and liberalization depend much more on the specific needs of individual countries, their state of economic and legal maturity, and their own development strategies. In future negotiations on the investment chapter, more flexibility should be given to China for adaption and modification in its liberalization process.</p>
Scope and Coverage	<p>The investment chapter of a CJK FTA should cover all industry sectors, including services sectors, and measures adopted or maintained not only by central governments but also by regional and local governments.</p>	<p>The scope and coverage of the investment chapter should be discussed at the negotiation stage being consistent with TRIM, including possible approaches adopted for the negotiations.</p>

Source: Joint Study Report for an FTA among China, Japan and Korea.
 Available at: http://www.mofa.go.jp/mofaj/press/release/24/3/pdfs/0330_10_01.pdf

4.2. China’s Other IIAs: Can Japan Free-ride on Others?

As seen, three elements are critical for Japan’s IIA negotiations: (i) pre-establishment NT; (ii) detailed ISDS procedures; and (iii) prohibition of performance requirements. Among these, pre-establishment NT is the issue where there is a serious disagreement between Japan and China. So far, China has not signed any IIAs that cover pre-establishment NT. In the recently concluded China-Canada BIT, NT is afforded only for “expansion, management, conduct, operation and sale or other distortion of investment” (Schott and Cimino 2015). Moreover, the liberalization commitment by China and Canada under the BIT is not reciprocal (Harten 2014). However, China’s treaty practice may change in the near future. Three ongoing negotiations require careful examination.

United States (US)–China BIT. Negotiations over a proposed US-China BIT is likely to affect Japan’s attitude toward investment negotiations vis-à-vis China. While negotiations are ongoing, it is likely that investment liberalization (pre-establishment NT) is included in the BIT (Miner and Hufbauer 2015).

Japan does not want to fall behind the US by signing a CJK FTA or RCEP with a poor quality investment chapter. This would be similar to the 2007 experience where the China-Korea BIT was improved, while the China-Japan treaty was not. Japan does not seem to have large bargaining power vis-à-vis China in investment negotiations because, for example, it does not have an investment screening process for Chinese investment, unlike the US.

Both the CJK TIT and the China-Japan BIT have MFN provisions. Hence, any improvement in market access given to the US by China under a future US-China BIT, including pre-establishment NT, should be given to Japan (and Korea) as well. In this sense, Japan can “free ride” on the US-China BIT using the MFN in BIT and TIT with China.

China-Korea FTA. As discussed previously, the 2007 China-Korea BIT does not cover pre-establishment NT (see Table 3). Meanwhile, the China-Korea FTA came into force in December 2015. While its investment chapter does not cover pre-establishment NT, an important agreement was made in the annex on “guidelines for subsequent negotiations” (Annex 22-A). Based on this, the two shall start subsequent negotiations not later than 2 years following the FTA taking effect and the negotiations are expected to conclude within 2 years. The Annex states that “the subsequent negotiation will be conducted based on a negative list approach covering pre-establishment phase of investment and trade in services in mode 3”. Hence, it is natural to infer that pre-establishment NT will be covered in the renegotiated FTA between China and Korea.

The question is whether Japan can free-ride on the future China-Korea FTA investment chapter. There is no FTA covering both Japan and China at this stage. Therefore, Japan cannot import provisions using its FTA MFN provisions. However, as discussed, the 1989 China-Japan BIT in has MFN provisions without REIO exception. Hence, arguably, Japan can free-ride on the China-Korea FTA investment chapter based on its old 1989 BIT, which is still in place after the launch of CJK TIT.

European Union (EU)-China BIT/FTA. There are currently 26 BITs between China and EU members. However, the Lisbon Treaty recognizes EU competence over investment issues. This means that Brussels, not each capital, should negotiate investment treaties. Hence all 26 BITs will be replaced by a single EU-China BIT. Negotiations continue, but pre-establishment NT will likely be covered, just like in the the US-China BIT (Garcia-Gallardo and Jin 2015).

While the immediate goal of the two sides is to sign stand-alone treaties on investment rather than an FTA (Tams 2015), it seems that China has a strong interest in negotiating an EU-China FTA for geo-political considerations (Zhang 2015). The proposed BIT can be a stepping stone to an FTA, but China may be more willing to commit to substantial investment liberalization under an FTA. Either way, Japan can free-ride, because the 1989 BIT has an MFN clause without REIO exception.

In summary, when new or renegotiated Chinese BITs have better investment market access provisions, Japan can import them into CJK TIT, using its MFN provision. When a new or renegotiated Chinese FTA has a better investment market access provisions, Japan can import them into 1989 China-Japan BIT, using its MFN provision (without REIO exception). One important reservation is that the 1989 BIT does not cover ISDS (domestic remedies only) and its MFN scope is also limited to domestic remedies. This implies that there is no guarantee that a better investment market access in other IIAs such as pre-establishment NT is actually given to Japan due to the lack of an enforcement mechanism.

5. Conclusion

The investment agreements between China and Japan are complex and form a typical example of the “noodle bowl” of IIAs that exist in Asia (Chaisse and Hamanaka 2014). The 1989 BIT between China and Japan is still in effect and continues to affect negotiations and agreements between the two countries. The CJK TIT, in force since 2014, makes improvements upon the 1989 BIT, but Japan was not entirely satisfied about the outcome. For Japan, pre-establishment NT and prohibition of various types of performance requirements are the most important negotiation items, but the CJK TIT insufficiently addressed those problems. However, because CJK TIT has MFN provisions (with an REIO exception rule), a better outcome for market access may result from future BITs (not FTAs) such as US-China BIT and China-EU BIT, the provisions of which can be imported into the CJK TIT.

So far, China has not signed any IIA that covers pre-establishment NT. However, there are several important ongoing IIA negotiations involving China, including with the US and EU, that will likely cover pre-establishment NT. While the December 2015 China-Korea FTA does not cover pre-establishment NT, it has an important annex that stipulates guidelines for

subsequent negotiations. These will be based on a negative list approach covering pre-establishment NT and shall be conducted within 2 years. Therefore, it is likely that the China-Korea FTA will have pre-establishment NT by 2017 or 2018.

Japan does not have a strong incentive to conclude an FTA investment chapter with China (such as a CJK FTA and RCEP) in a hasty way, because the country can already free-ride on the negotiation outcome of not only BITs but also FTAs signed by China with others, using the MFN provision in the 1989 China-Japan BIT that does *not* contain an REIO exception rules. In other words, while the substance of the original BIT is poor, its MFN clause is of use. In a long run, however, Japan needs a FTA investment chapter with China that covers both MFN⁹ and ISDS for two reasons. First, the 1989 China-Japan BIT has MFN without the REIO exception rules, but it does not include ISDS, which is not covered under MFN provisions. Hence, even though the 1989 China-Japan BIT can import better market access provisions from other BITs/FTAs, it may face implementation problems. Second, the CJK TIT is not effective in importing investment provisions from other FTAs such as those in China-Korea FTA and China-EU FTA because of the REIO exception rule. The timing of when a future FTA investment chapter between Japan and China will likely be after the conclusion of China's BIT negotiations with the US and Europe, because, then, Japan can request that an investment chapter better than those agreements be included in the FTA.

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⁹ The fact that an FTA investment chapter has pre-establishment MFN provisions is more important than the substance of the chapter. In this case, non-conditional or automatic MFN is necessary for Japan. Some Chinese IIAs have conditional MFN provisions, which means that more favorable treatment could be given to future treaty partners. Whether this is extended to previous IIA partners is subject to negotiations. For example, see Article 5 paragraph 2 in Agreement on Investment of the Framework Agreement on Comprehensive Economic Co-operation between China and ASEAN.

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