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Investment Protection Along the Belt and Road

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Abstract
This paper examines the level of investment protection for selected countries along the Belt & Road Initiative (BRI), based on coding the textual content of 17 investment laws and 648 international investment agreements (IIAs). We find substantial heterogeneity in the levels of protection provided in the reviewed laws and IIAs, and consequently along the same BRI corridors and projects. Moreover, the current lack of effective enforcement – as shown by past treaty violations and lack of efficient domestic court systems – poses an additional layer of risk for investors. Substantive improvements and harmonization in standards of treatment and recourse mechanisms in these legal instruments can help reduce investment risks. Given the scale of planned investments, to minimize dispute risks, BRI governments will need to ensure full understanding of their law and treaty commitments and strengthen the capacity to enforce them.

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1. Introduction

The Belt and Road Initiative (BRI), adopted by China since 2013, is a global project aiming to develop physical infrastructure and policy linkages connecting some 70 countries across Asia, Europe, and Africa. The on-going and planned investment amount is large. Some estimates put Chinese investments alone in BRI countries at around $150 billion annually. Given the infrastructure deficit in many BRI economies (ADB 2017) and their long distance from global markets, the BRI has the potential to boost economic growth through improved connectivity for these countries.

One source of direct benefits comes from the reduction in transportation/trade cost. De Soyres et al. (2018) for example, estimate that the planned investments can reduce shipment time and consequently trade costs in BRI countries by between 3.6 and 4.5 percent and 3.2 and 4.0 percent, respectively. Reed and Trubetskoy (2018) study the proposed investments in Asia, Europe and the Middle East and find large potential benefits from increased market access - a trade cost weighted measure of consumers’ income - in high density cities with poor infrastructure. Beyond these direct benefits, many BRI countries expect that improved infrastructure and market access can increase the returns to investments and be a catalyst for investment flows in other sectors. Using a gravity model to calculate the elasticity of FDI inflows to transportation cost, Chen (2018) predicts that China’s infrastructure investments in BRI countries can increase investments in manufacturing and service sectors.

For these gains to materialize however, adequate mechanisms to protect the planned infrastructure investments from political and other risks are necessary. The infrastructure sector presents high risk for investors as projects tend to be large-scale, capital intensive, and with long development timelines. Investors in infrastructure are also particularly vulnerable to regulatory changes that can undermine their profitability (OECD 2015). The existing infrastructure gap in the region despite

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1 We are grateful to Roberto Echandi for his valuable inputs. We thank Rodrigo Polanco for his generous help with sharing the text of investment treaties used in our research; Sarah Hebous for her outstanding assistance with the data cleaning and analysis; Maximilian Philip Eltgen, Cathy Zhou, and Ramprakash Sethuramasubbu for their excellent support in reading and coding of the investment laws and treaties; Siyu Luo for the case studies research; Tristan Reed, Sasha Trubetskoy, and Francoise de Soyes for sharing the spatial data on BRI projects. We are grateful for comments from Tristan Reed, Christine Qiang, Heba Shamseldin, Dongwook Chun, Persephone Economou, Gonzalo Flores, Alexandros Ragoussis and other World Bank workshop participants. Errors are our own.


3 Publicly available information on investor-state disputes indicates the high-risk nature of such activities: out of all known investor-state dispute cases from UNCTAD’s dispute database (http://investmentpolicyhub.unctad.org/ISDS), more than half are in extractives, utilities, construction, and real estate sectors (ISIC Rev. 4 sections B, D, E, F, L).
potential gain are indicative that so far, investors have not been willing to take risks to invest in these countries.

Further, wider economic benefits of the BRI depend on the response of investors to new profit opportunities. Weak protection of property rights makes investors less responsive. There has been a large body of theory and empirical evidence suggesting that investors are deterred by uncertainty (see for example, Dixit 1989, Bloom 2009) and political risks can discourage FDI (see for example Graham 2016). Reducing investment risk can also help BRI countries attract investments in other sectors to fully realize the benefits through their improved infrastructure.

This paper aims to provide an indication of the level of investment protection available in 21 selected BRI countries. It includes an analysis of select legal and practical instruments available in these countries to reduce investment risks, in particular those derived from government conduct.

More specifically, we quantify the (de jure) level of protection based on coding the textual content of domestic investment laws and international investment agreements (IIAs). We follow the convention in the legal and international political economy literature such as in Dixon and Haslam (2016) and UNCTAD (2004) where the level of protection is defined by the extent to which the host countries provide for predictability by (i) limiting the range of arbitrary government interferences and (ii) allowing access to dispute resolution and compensation when their obligations are violated. In effect, our measure of overall level of protection indicates how far countries are from substantively strong protection provisions. The resulting database also allows for disaggregating the overall scores by provision. As such, it can be used to identify specific areas of strengths and weaknesses in the reviewed legal instruments.

While investment protection is determined by a multitude of other legal and regulatory instruments, our reasons for the focus on domestic investment laws and IIAs are two-fold. First, they are the most standardized legal instruments where comparable (text) data are available across all countries. In infrastructure investments, contracts between investors and States (e.g. concession agreements) are common instruments. However, these contracts are specific to individual investors and transactions and are not publicly available. Second, and substantively, protection is one of the core purposes of investment laws and IIAs. Often used as a tool for governments to attract investors, they present the fundamental principles of investment protection within a country’s investment policy regime. Our approach to consider protection provisions in IIAs and investment laws is further rooted in the literature about the impact of IIAs on investment flows. While the evidence about the impact of IIAs is mixed, the majority find a positive association between IIA ratification and FDI inflows at least under some country contexts (Bonnitcha et al. 2016). Several studies found that IIAs have stronger effects in sectors characterized by fixed, large scale investments such as infrastructure and mining, supporting the hypothesis that IIAs help solve the hold-up problem (Guariso 2013, Kerner and Lawrence 2014).

Beyond de jure protection, the paper also considers enforcement mechanisms. This analysis includes: (i) membership of international conventions that provide relatively effective and neutral

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4 To compare protection in BRI countries to the rest of the world will require an analysis of all available laws and treaties globally. It is outside the scope of our paper.
mechanisms for dispute resolution; (ii) the incidence and outcomes of past disputes as they are
informative on how often commitments are violated in practice; and (iii) indicators of the quality
of the domestic legal and judicial system as a broader proxy for the implementation quality of laws
and regulations.

Finally, we attempt to assess potential risks to BRI host countries through a “balance” analysis.
Given the enormous scale of planned BRI investments, it is important to understand the
implications of their commitments to investors in their domestic laws as well as investment
treaties. These include the commitments to the protection of debt, as public debt has been a major
financing instrument for BRI projects. To this end, we include in the textual analysis an
assessment of provisions in the legal instruments which explicitly allow States room for legitimate
regulatory actions.

A few caveats are worth highlighting about our methodology. The purpose of the research is not
to provide a comprehensive risk assessment for investors in BRI countries, nor is it to provide a
comprehensive legal opinion. Rather, we aim to assess the level of investment protection which is
traceable to objective information in select legal instruments that are publicly available, from
which to provide broad, indicative recommendations to address weaknesses in their protection
mechanisms.

Our results show that the strength of protection is uneven across investment laws, investment
treaties, and consequently along the same BRI corridors and projects in our sample. This is driven
by differences both in standard of treatment and availability of recourse mechanisms. Low overall
protection through IIAs can be further due to the small size of the network of IIA partners by BRI
countries. In all investment laws reviewed, one standout finding is the consistently low score on
transparency. Given the lack of clarity on the overall institutional framework governing BRI
projects, this lack of guarantee on transparency can have significant implications for global
investors. Our analysis of enforcement mechanisms further shows that even among countries with
high levels of legal protection – enforcement can be a major obstacle. We observe a high incidence
of disputes involving the very protections guaranteed under the country’s legal framework,
reflecting a general lack of enforcement. Moreover, many BRI countries have inefficient domestic
court systems and generally weak institutions that can prevent effective dispute settlement.

These results suggest several options for BRI countries to improve their investment protection
framework. Unilaterally, countries with weak levels of protection in IIAs/laws can systematically
modernize these instruments. Countries with few IIAs can further expand their network of IIAs
with strategically relevant partners. Greater harmonization between the countries and international
good practices can further reduce transaction costs for investors. In addition, measures to improve

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5 Although there is no official reporting on financing arrangements under BRI projects, various studies and
anecdotal evidence suggest a large amount of investments are financed through sovereign debts with China. In the
prominent case of the Hambantota Port in Sri Lanka for example, the Sri Lanka Port Authority took on debt from the
infrastructure projects of some $87 billion that would be financed through sovereign or sovereign-guaranteed
concessional and commercial loans in 23 BRI countries.

6 Note that our analysis of investment laws relies on UNCTAD’s Investment Laws Navigator, which does not
necessarily provide the most updated version of a country’s investment law.
enforcement are needed for many countries. These include more difficult reforms such as improving domestic courts systems as well as capacity building of government agencies to ensure effective enforcement and provision of effective investor services.

The rest of the paper is organized as follows. Section 2 describes in detail the analytical framework including data sources and scoring methodology. Section 3 presents results from the data analysis. Section 4 discusses enforcement mechanisms. Section 5 concludes.

2. Analytical Framework

Given the scale of the qualitative analysis required, our paper does not cover all 68 BRI countries. We limit our research on countries along the overland corridors which are priority destinations of infrastructure and other investments. We focus on overland corridors as this is where the issue of cross-border protection is most salient, and challenges are likely to arise. Based on existing corridors, these include CPEC (China-Pakistan Economic Corridor), CMREC (China-Mongolia-Russia Economic Corridor), NELB (New Eurasian Land bridge), CCWAEC (China-Central Asia-West Asia Economic Corridor), and CICPEC (China-Indochina Peninsula Economic Corridor). In addition, we include Sri Lanka as a representation of a country along a maritime route. The list of 21 countries in our BRI sample (“BRI Sample”) is included in Table 1. While investment protection is determined by multiple facets of a country’s legal and regulatory framework, we focus only on 2 instruments – international investment agreements and domestic investment laws (“Legal Instruments”), for reasons explained in section 1.

2.1 Elements of Investment Protection

The paper attempts to answer 4 key analytical questions based on qualitative and quantitative analysis. These questions are:

1. If investors opt to invest in BRI countries, are their investments and “terms of contract” protected legally?
2. What are the standards of protection benefiting investors?
3. If there is a problem, in addition to recourse to domestic courts, can investors invoke arbitration? If yes, what type?
4. What is the level of enforcement in these countries? If a dispute goes to arbitration, can arbitration decisions be effectively enforced?

Based on review of legal and regulatory materials, this paper attempts to provide a generalized indication of the level of investment protection available in the BRI sample countries. It should be noted that this paper does not intend to provide a detailed legal opinion on investment frameworks in the sample countries. A full legal analysis can only be provided on a case-by-case basis, taking into account the unique particularities and details of the specific investment, the legal instruments invoked and the overarching legal/regulatory framework of the country (including other international commitments).
Guided by the four questions above, our review includes a textual analysis of the universe of available investment laws and international investment agreements – including bilateral investment treaties (BITs) as well as other agreements with investment provisions - in the BRI sample countries (see section 2.2 for more details). The scoring is based on a standardized questionnaire that includes a series of categorical questions on the content of selected provisions in the laws/treaties. Literal text of the Legal Instruments and well accepted interpretations of the terms used were considered in conducting the review. We discuss the specific variables covered and their substantive implications below.

1. If investors opt to invest in BRI countries, are their investments and “terms of contract” protected legally?

To receive protection under an IIA or domestic investment law of a country, it is imperative that the specific transaction be covered within the definition of “investment”. The review therefore examined the definition of investment- in particular, whether its “asset-based” or “enterprise-based”. An asset-based definition has a wider scope than an enterprise-based definition.\(^7\) It defines investment as “every kind of asset” and typically provides an illustrative list of examples including - movable and immovable property rights; real property rights, including rights to own land; shares, stock, bonds, debentures and other forms of participation in a company or business enterprise; intellectual property rights; contractual and other rights conferred by law. Whether sovereign debt is excluded from the definition of investment was also examined.\(^8\)

2. What are the standards of protection benefiting investors?

The selection of standards of protection reviewed for this paper was based on the centrality of the protections to investment operations,\(^9\) their particular relevance to contract-based investments and standards that are “absolute” in nature (i.e. to be guaranteed to all investments irrespective of the nationality, sector, nature of investment).\(^10\) The standard of protection available to investors in sample BRI countries was measured on basis of quality of provisions on (i) expropriation (ii)

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\(^{7}\) Enterprise- based definition typically requires the setting up of an enterprise.

\(^{8}\) There are other provisions in IIAs and domestic investment laws that can impact the decision on whether a transaction is an “investment”. For example, qualifiers may be included that specify that the investments need to be made in accordance with the host State’s laws and regulations or they wouldn’t enjoy the protection provided under the legal instrument or that they must have the characteristics of investment such as commitment of capital, expectation of profit and assumption of risk (See China-Uzbekistan BIT). Some IIAs specifically list the contractual rights that are protected and others that “may” be protected. For example, the ASEAN-China Investment Agreement specifies that turnkey, construction, revenue sharing contracts or concessions are included while others such as Built Operate and Transfer (BOT) and Build Operate and Own (BOO) projects can be included- alluding to some uncertainty on their inclusion.

\(^{9}\) Expropriation, inability to transfer funds outside the host country, instability in policy and regulatory environment have consistently been identified as critical factors impacting investor decisions to stay and potentially expand operations in a country – See Global Investment Competitiveness Report, 2017. Breach of these standards has led to most international investor-State disputes. - See [http://investmentpolicyhub.unctad.org/ISDSn](http://investmentpolicyhub.unctad.org/ISDSn)

\(^{10}\) For example, the National Treatment standard is a relative standard of treatment under which treatment of foreign investors/investments is assessed relative to the treatment of domestic investors/investment. On the other hand, absolute standards of treatment such as protection from expropriation, fair and equitable treatment are to be guaranteed to all investors, irrespective of their nationality or other characteristics.
The Legal Instruments were reviewed to determine whether protection is explicitly provided against both direct\(^{12}\) and indirect\(^{13}\) expropriation, whether key elements to ensure legality of expropriation were included – that expropriation is done only for public purpose, in a non-discriminatory manner, following due process and against payment of prompt, adequate and effective compensation. These specific conditions for expropriation are a widely accepted legal standard. It was also examined whether investors were guaranteed the ability to freely transfer funds, in a timely manner and in a freely convertible or freely usable currency.\(^{14}\)

Further, it was determined whether a specific provision on FET is included. FET is a composite or a bundle of rights available to investors. While the FET standard has not been precisely defined in IIAs, it has been clarified over the course of time through various decisions of arbitral tribunals. Interpretations of arbitral tribunals, indicate that it is an obligation on states to act in a transparent, consistent, reasonable, proportional manner and respect legitimate expectations of investors generated from written commitments. The FET provision may either be qualified with reference to international law to a list of underlying obligations or may be unqualified.\(^{15}\) Any specific provisions on transparency were also reviewed to determine whether States have any obligation to publish laws and regulations affecting investments and obtain comments from the public.

Specifically, with respect to contracts, in IIAs it was examined whether contract provisions can be given the same level of treatment as treaty provisions, through inclusion of umbrella clauses. Lastly, it was assessed whether in cases where the Legal Instruments conflict with other legal norms (other laws, regulations, IIAs), the more favorable rules apply to investors.

3. If there is a problem, in addition to recourse to domestic courts, can investors invoke arbitration? If yes, what type?

\(^{11}\) Item (vi) only in IIAs.

\(^{12}\) This refers to the direct seizure or taking of property.

\(^{13}\) This refers to cases where actions of the government may tantamount to or have an effect equivalent to taking of the property.

\(^{14}\) Freely usable currency means a currency determined by the International Monetary Fund under the IMF Articles of Agreement (Article XXX(f)) to be a currency that is, in fact, widely used to make payments for international transactions and is widely traded in the principal exchange markets. The US dollar, Japanese Yen, British pound, Euro and Chinese Renminbi are currently determined as freely usable currency.

\(^{15}\) In terms of the text of the IIA per se, an unqualified FET provision provides wider protection since, its interpretation is not bound by principles of international law and neither is it limited to the specifically enumerated rights. It should be noted that the general rules of interpretation, under Article 31 of the Vienna Convention on the Law of Treaties or Article 38 of the Statute of International Court of Justice will continue to apply.
To answer this research question, it was reviewed whether investors have recourse to investor-State dispute settlement (ISDS) and the full scope of such a right. It was assessed whether investors could submit an investment dispute under the International Center for Settlement of Investment Disputes (ICSID) Convention and United Nations Commission on International Trade Law. Provisions on subrogation were reviewed to determine if insurers (covering losses of investors in a host state) can acquire the investor’s right to bring a claim against the host state. It was also reviewed whether investors had recourse to other types of alternate dispute resolution mechanisms, such as mediation or conciliation, either voluntarily or as a mandatory procedure before any adjudicatory procedures (such as arbitration) can begin. In the same vein, it was also examined whether investors had access to domestic courts either as an option alongside other ISDS forums or as a mandatory step prior to submitting a claim to investor-State arbitration. It was also reviewed whether State-State dispute settlement is available. In domestic investment laws, it was assessed whether they provide access to any alternate institutional mechanisms to address investor issues prior to their escalation into legal disputes.

4. What is the level of enforcement in these countries? If a dispute goes to arbitration, can arbitration decisions be effectively enforced?

On enforcement, it was examined whether the sample BRI countries are members of the ICSID and the 1958 Convention for Recognition and Enforcement of Foreign Arbitral Awards (referred to as New York Convention). Membership of ICSID allows investors to pursue arbitration proceedings against the host State under the ICSID Convention, which requires automatic

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16 Disputes emerging from commercial transactions between enterprises are considered commercial disputes and those that arise from intergovernmental relations are considered State-State disputes. Investor-State disputes are disputes between foreign investors and host States. Such disputes are relatively new and a unique feature of international investment law.

17 Whether for example investors are allowed access to investor-State dispute settlement for any disputes relating to investment, or only those disputes involving specific bases for claims other than the treaty such as investment contracts, investment authorizations, or only those disputes involving alleged breach of the treaty. The first case allows investors to submit a very broad range of disputes to ISDS, while the latter 2 cases progressively limit the types of disputes that can be submitted to ISDS.

18 This research question focuses on the ease of access to various recourse mechanisms for enforcement of investment protection guarantees in a relatively cost effective and neutral manner. Therefore, while the extensively documented shortcomings of ISDS are well recognized and noted - in particular on transparency of the process- it has not been delved into in detail in this paper. For further information on ISDS, see ICSID, UNCTAD, UNCITRAL.

19 The New York Convention requires the courts of a member State to recognize and enforce an award rendered in another member State. It also limits the grounds on which courts of member states may refuse recognition and enforcement of foreign arbitral awards. Under Article V, the following are some of the grounds - incapacity of the parties to the arbitration agreement, invalidity of the arbitration agreement, natural justice grounds, arbitral authority or procedure was not in accordance with the agreement of the parties, the subject matter of the arbitration cannot be referred to arbitration under the national law of the enforcing country, contrary to public policy of the enforcing country. These exceptions are not easy to establish and therefore countries are rarely able to use them, making the New York Convention a fairly effective means of ensuring enforcement of awards. On the other hand, enforcement of foreign court judgments is available when States have passed a specific law allowing reciprocal enforcement of foreign judgments.

20 Membership of ICSID allows investors to pursue arbitration proceedings against the host State under the ICSID Convention. Non-member States can also pursue arbitral proceedings against host states under ICSID’s Additional
recognition and enforcement of awards by all member states. In addition, assessments were also made based on performance of countries on key enforcement related indicators, outcomes of ISDS cases and recent cases of non-enforcement of arbitral awards to qualitatively determine the level of enforcement in the sample BRI countries.

While this paper is focused on determining - on relatively objective grounds - the level of investment protection in the sample BRI countries, certain aspects were also reviewed to determine the balance in the Legal Instruments, to explicitly allow States room for legitimate regulatory actions. For example, whether transfer of funds can be restricted temporarily in a non-discriminatory manner and in good faith in cases of balance of payments crisis, or on legitimate application of certain national laws. In addition, it was also reviewed whether IIAs include an essential security exception, allowing States to derogate from treaty obligations to protect their security interests. The scope of such a provision was reviewed - whether for example it was limited in application by reference to “in time of war or armed conflict”, “emergency in international relations”, “relating to the traffic in arms” - and whether States could “self-judge” the necessity of invoking such a provision. It should be noted that there are other exceptions that can limit the application of treaty provisions but are not covered in this paper – such as denial of benefits, or specific reference to public order, cultural heritage.

2.2 Data and Scoring Methodology

Our main data set covers the near universe of investment laws and IIAs in force with available text in the 21 sample BRI countries. We review 17 domestic laws, as available from UNCTAD’s Investment Laws Navigator. To cover a more complete set of IIAs, we combine the mapping

Facility Rules- however without the benefit of automatic recognition and enforcement of the arbitral awards. However, Article 19 of the Additional Facility Rules requires that arbitration proceedings conducted under the Rules can only be held in States that are parties to the New York Convention. Therefore, in these cases, the regime under the New York Convention will apply.

This implies that ICSID awards are not subject to any review process by local courts in host States and are automatically enforced. Under Article 53(1) of the ICSID Convention, an arbitral award of the tribunal is binding on all parties to the proceeding. In case of a failure by a party to comply with an award, then under Article 54(1), the other party can seek to have the pecuniary obligations recognized and enforced in the courts of any ICSID Member State as though it were a final judgment of that State’s courts. Typically, if a party informs the ICSID Secretariat about non-enforcement by another party, the Secretariat contacts the non-complying party to request information on steps taken to ensure compliance. See https://icsid.worldbank.org/en/Pages/icsiddocs/ICSID-Convention-Arbitration-Rules.aspx

Specifically, national laws relating to bankruptcy, insolvency, or the protection of the rights of creditors; issuing or trading in securities and other stock market instruments, criminal offences, compliance with orders or judgments in judicial or administrative proceedings, compliance with labor or tax obligations.

The essential security exception is particularly relevant for investments in strategic industries and infrastructure - both of which are likely to be the major investments along the BRI. Over the years through arbitral decisions, it has had implications that go beyond standard defense related activities that it was initially designed for. Its application can potentially be invoked in the context of privatization and increasing possibilities of foreign control over industries such as telecommunications, transportation, energy and other strategic industries. Further, insecurity of States due to the growing role of State owned enterprises, apprehensions of their pursuit of political objectives has further caused gradual increase in inclusion of such an exception. The essential security exception has in the last few decades also been invoked in connection with economic crisis.

http://investmentpolicyhubunctad.org/InvestmentLaws
from UNCTAD’s IIA Mapping Project with IIA texts from the World Trade Institute’s database of investment treaties. The universe of IIAs includes 716 treaties. However, only 648 have English texts across both databases. Of these 648 IIAs, 616 were bilateral investment treaties and 32 agreements with investment chapters. UNCTAD has mapped the content of 534 agreements involving the sample BRI countries. We manually review the remaining 116 agreements and select provisions (that were not mapped by UNCTAD) for all agreements. Our final sample of IIAs reviewed represents more than 90% of the total number of agreements that are in force in the sample BRI countries. Notably, each of the sample BRI countries has signed at least one IIA with China. See Table 1 for more details on the sample by country.

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25 UNCTAD’s IIA mapping project is available at: [http://investmentpolicyhub.unctad.org/IIA/mappedContent#iiaInnerMenu](http://investmentpolicyhub.unctad.org/IIA/mappedContent#iiaInnerMenu). The WTI database is forthcoming.

26 [http://investmentpolicyhub.unctad.org/IIA/mappedContent](http://investmentpolicyhub.unctad.org/IIA/mappedContent)
<table>
<thead>
<tr>
<th>Country</th>
<th>Year investment law enacted</th>
<th>Number of IIAs in force</th>
<th>Number of IIA partners</th>
<th>% of IIAs mapped</th>
<th>IIAs with China mapped</th>
<th>#IIAs in UNCTAD database</th>
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<td>34</td>
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<td>97</td>
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<td>56</td>
<td>111</td>
<td>88</td>
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<td>2003</td>
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<td>82</td>
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<td>100</td>
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<td>44 (36 in force)</td>
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<td><strong>Total</strong></td>
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<td><strong>91</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Using this text data, our methodology to quantify investment protection follows 3 main steps:

**Step 1: Scoring**

The content of each law/treaty is evaluated through 10/11 broad provisions that are aimed to capture (1) the scope application, (2) standards of protection, and (3) recourse mechanisms, as discussed in Section 2, including:

- Definition of investment (1)
- Fair and Equitable Treatment (FET) (2)
- Umbrella clause (IIAs only) (2)
- Full protection and security (2)
- Expropriation and compensation (2)
- Transfer rights (2)
- Non-derogation clause (2)
- Security exceptions (IIAs only) (2)
- Access to SSDS (IIAs only) (3)
- Availability of early grievance management (Laws only) (3)
- Access to ISDS (3)

Each provision is scored using a more detailed set of Yes/No questions which are then added up and normalized to scaled from 0-1, where a higher score indicates a higher level of protection (see Annex 6.1 for examples of questions used to score “Expropriation and Compensation” and “Access to ISDS” in investment laws). It is also worth noting that the scores are meant to be on an ordinal scale as it is impossible to determine the relative importance of each individual question. Our approach shares similarities with earlier work such as Haslam and Dixon (2016) but diverges substantially on how we score the protection provisions. While Haslam and Dixon (2016) assign a four-point scale for each provision-based reading of the text, we use more objective questions to construct the underlying components of each provision. We believe this approach offers a more consistent coding process given the large amount of texts analyzed in this paper.

**Step 2: Aggregating to law/treaty level**

For each law/treaty, the total score is taken as the simple average of all provisions, where a higher score indicates higher protection. In the absence of established theories about the relative importance of each provisions, we use equal weights for simplicity. A key caveat here is that the final results are sensitive to the weights used.

In addition to an aggregate protection score, we also calculate for each law/treaty, a “balance” score which comprises of essential security exceptions and other exceptions to the state’s obligations to investors (see the questions for balance in investment laws in Annex 6.1). The idea
is that there is a balance that needs to be struck between allowing enough flexibility and policy space to governments along with ensuring high levels of investment protection. Our balance score aims to capture explicitly the host country’s flexibility for domestic policy making and the implied obligations they might face should dispute arise.

**Step 3: Aggregating to country level**

For investment laws, the protection/balance scores are readily available at the country level. For IIAs, an additional step is needed to gauge the level of protection offered through all bilateral treaties at the country level.

First, to determine the “relevant” treaty that might apply for an investor in any BRI host country, we consider (i) whether there is a Most-Favored Nation (MFN) provision in their bilateral treaty – if so, the investor enjoys the highest level of protection out of all treaties the host countries have ratified; (ii) if there are multiple treaties in force between 2 countries, the relevant treaty is the one with higher protection level. The idea is to mimic investors’ considerations in practice, where they can take advantage of different treaties in certain cases.

Second, we compute a protection score at the country level for BRI economies using a weighted average of the “relevant” treaty’s scores. The weights are the share of their partner countries’ GDP as a share of world GDP. This weighting reflects the following assumptions: all else equal, the level of protection (i) increases with the number of IIA partners and (ii) increases with the size of the partners’ economies. There are opposing views in the literature about the marginal effects of additional BITs in attracting FDI. On the one hand, if BITs are pure signaling devices about a host country’s commitment to protect investors, then there is decreasing returns to additional BITs (Bubb and Rose-Ackermann 2007). On the other hand, Montt (2009) argues that BITs have increasing returns as investors could expect a more predictable and efficient jurisprudence to evolve with the size of the BIT network. Given these possible opposing effects, we follow a simple rule in which the level of protection increases linearly with the number of partner countries.

In notations, the score at the BRI country level $p_i$ is aggregated from the bilateral treaty protection scores $p_{ij}$ as follows, where $w_j$ is the partner country’s share in world GDP:

$$p_i = \sum_{j \in IIAs \text{ w/o MFN}} w_j \times \max_{t} \{p_{ijt}\} + \sum_{j \in IIAs \text{ w/MFN}} w_j \times \max_{k} \{p_{ik}\}$$

The resulting datasets include (i) a BRI country level database with aggregate protection and balance scores in investment laws and IIAs, and (ii) a law/treaty level database including both

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27 Multinationals can also make use of different treaties through investing from a 3rd country. We sidestep this issue as not all investors can take advantage of restructuring to the same extent. Another caveat is that MFN data is incomplete for the sample as we were only able to use the mapping from UNCTAD. Further, the scoring only takes into account inclusion of a MFN provision and not any specific exceptions regarding regional integration agreements, ISDS procedural provisions or phase of application that may be included in treaties and may change the applicable treatment on a case by case basis.

28 This weighting rule implies that the maximum possible score for protection is 1, where the country has investment treaties with the rest of the world, and each treaty has the highest level of protection.
aggregate scores for law/treaty as well as individual questions and provisions. This data allows us to look at the overall strength of investment protection as well as how it is driven by specific provisions within the laws/treaties.

3. Results: Legal Protection of Investments
3.1 An Overview of Results
3.1.1 Trends and Patterns of IIAs

Figure 1 presents the trends in the number of IIAs signed by BRI countries and their level of protection and balance over time. As with the rest of the world, the bulk of treaties were signed in the early to mid-1990s, with two other significant waves around 2000 and 2010. The content of these IIAs has changed over the years, as indicated by the pattern of protection and balance. The average level of treaty protection increases between 1980 and 2000 and decreases after 2010. At the same time, investment treaties have increasingly included more exceptions, reflected by increasing balance scores. The peak in the protection score appears to be in the treaties signed in the 1970s, a period when IIAs globally included a greater number of unqualified and broad-based protection standards, and fairly limited interpretational explanations or exceptions. The trend on the balance score also aligns with the global trend of gradual increase in inclusion of interpretational guidance as well as exceptions in the 2000s.

Figure 1 – Number of IIAs in BRI Sample Countries and Level of Investment Protection and Balance over Time

A particular feature of the investment treaty regime is that most countries have ratified treaties that are highly similar in content (Bonnitcha et. al 2018). Nevertheless, we find meaningful heterogeneity in the constructed protection score across the sample treaties, where it ranges from 0.15 to 0.805 (Figure 2). Part of this variation is driven by timing – we have observed changes in the level of protection and balance over the years. However, year effect only explains less than 10% of variations in the score. The majority of this heterogeneity comes from the parties themselves.
Another interesting pattern is the difference between BITs and other treaties with investment provisions in their content and level of protection (see Figure 15 and Figure 16 in Appendix 6.3). On average, BITs offer higher level protection and fewer exceptions (low balance). Using a Principal Component decomposition on the individual scores of all questions under each protection provision, we also see a distinct clustering of the content - based on the first two principal components – of other types of treaties compared to BITs. This is consistent with the fact that BITs focus more explicitly on investment protection.

### 3.1.2 Overall Protection Levels in Investment Laws and IIAs

Figure 3 presents the correlations between our measures of protection levels in investment laws and IIAs. We find that countries with high protection levels in investment laws generally have higher protection in IIAs, with a few exceptions. These include Myanmar, with low IIA protection but high protection in its investment law, and Turkey on the opposite end.
In the rest of the paper, our results are disaggregated by legal instrument rather than aggregated into a composite measure of protection. This is an important caveat as investment laws and treaties are complementary – an investor would often draw on both instruments to their advantage. Nevertheless, there are several reasons to consider them separately in our quantitative framework. First, the application of international treaties is strongly influenced by national law and legal institutions of both host and home countries (Salacuse 2013). Hence, creating a composite measure of protection would require considerations of other legal instruments. Yet, investment law is but one element of the national law framework. In fact, 4 out of 21 countries in our sample do not have an investment law. Second, the duration of application of these instruments might differ as investment laws may be more susceptible to change with changing government. IIAs, on the other hand, typically provide for a relatively more stable device to restrain arbitrary government conduct (Salacuse 2013).
3.1.3 Legal Protection and the Perception of Risks

While an analysis on the effect of investment protection in IIAs on signaling and investment attraction is outside the scope of this paper, we examine their correlations with other measures of risk and the quality of a country’s business environment. If legal protection indeed has an impact on signaling a better investment climate or on investment attraction, then we should expect that a higher level of legal protection is associated with lower perception of investment risks in the country.

Table 2 presents the simple pair-wise correlations of our constructed protection levels in investment laws and IIAs with different measures of risks at the country level. Since Myanmar is an outlier case, the correlation pattern is driven by whether it is included in the sample or not. Excluding Myanmar, we find that the level of protection in investment laws is generally increasing in business environment quality - as proxied by the Doing Business overall distance to frontier score - and the perception of risk – as indicated by higher International Country Risk Guide (ICRG) political risk rating and lower expropriation risk premium. This might be partly driven by the fact that richer countries in the sample also tend to have better protection levels in their investment laws. Similarly, despite the small sample of 21 countries, we find that IIA protection level is increasing in country’s income per capita and a higher level of IIA protection is predictive of higher overall business investment quality and a lower perception of risk.

Table 2 – Correlations with Business Environment and Risk Indicators

<table>
<thead>
<tr>
<th></th>
<th>Law protection score</th>
<th>Law protection score without Myanmar</th>
<th>IIA protection score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Log GDP per capita</td>
<td>-0.2934*</td>
<td>0.3337*</td>
<td>0.4092*</td>
</tr>
<tr>
<td>DB DTF score</td>
<td>0.0503</td>
<td>0.4209*</td>
<td>0.5336*</td>
</tr>
<tr>
<td>ICRG political risk rating</td>
<td>0.0595</td>
<td>0.1773</td>
<td>0.2821*</td>
</tr>
<tr>
<td>Credendo expropriation risk premium</td>
<td>-0.0489</td>
<td>-0.3028*</td>
<td>-0.3116*</td>
</tr>
</tbody>
</table>

Note: Data on DB DTF scores and risk are for 2016, GDP per capita data are for 2015.

3.2 Investment Protection in BRI Countries

3.2.1 A Typology of Investment Protection and Investment Patterns

Based on the analysis of protection levels in investment laws and IIAs, we construct a typology of countries based on their protection levels and BRI investment profiles. Figure 4 presents the positions of BRI countries by protection level and the amount of Chinese BRI investments.
Figure 5 is similar, but instead of investment amount, we show the position of countries based on their expected gain in land value due to improved market access, as estimated in Reed and Trubetskoy (2018).

These results show that there exist substantial variations in overall protection of IIAs at the country level. Across the sample BRI countries, two interesting groups of countries emerge:

1. Those with a high level of investments and expected benefits but low protection levels in both laws and IIAs: Pakistan, Iran, Laos, and to a lesser extent Russia.

2. Those that have relatively high legal protection as well as high levels of investments and expected benefits: Kazakhstan and Uzbekistan.

For the first group of countries, there is scope to improve investor protection through improving the levels of legal protection in their investment laws and IIAs. We discuss the specific areas of strengths and weaknesses in existing investment laws and IIAs in section 3.2.2 and 3.2.3 below.

For the second group of countries, the priority would be to ensure the effectiveness of enforcement mechanisms to safeguard the benefits of investments. We discuss this further in Section 4.

**Figure 4 – Investment Protection and On-Going/Pipeline BRI Investments by China**

Note: BRI investment is from the WIND database based on publicly available project-level information. High and low protection in investment law indicates protection below and above the median in the sample, respectively. The red dotted lines represent the median values of investment and existing investment protection level in IIAs.
Figure 5 – Investment Protection and Expected Benefits from BRI

Note: Estimates of expected gains in land value are from Reed and Trubetskoy (2018). The red dotted lines represent the median values of expected investment and existing investment protection level in IIAs.

3.2.2 Protection in Investment Laws

Figure 6 provides a breakdown of protection levels by broad sections of the law – scope, standard of treatment, and recourse. The results show that there are significant variations in how the sample investment laws provide for legal protection across countries. For example, while Turkey and Russia have generally low levels of protection across all provisions, Turkmenistan, Iran and Pakistan have particularly weak protection in recourse mechanisms. Both Kazakhstan and Myanmar perform particularly well on recourse, on account of inclusion of specific institutional mechanisms for handling investor grievances prior to their escalation into full-fledged legal disputes. Of note is Myanmar’s domestic investment law’s performance on strength of protection score as well as balance. Enacted in 2016, Myanmar’s Investment Law is one of the most recent of all the investment laws reviewed. Applying to both domestic and foreign investment, the law has a broad scope. It defines “investment” to include both tangible and intangible property. On standards of treatment, it includes a comprehensive set of provisions on expropriation and transfer of funds. It is the only investment law from the sample to include an explicit provision on fair and equitable treatment standard.

29 For example, the Investment Ombudsman in Kazakhstan.
Figure 6 - Protection Level by Broad Areas of the Investment Law

![Figure 6 - Protection Level by Broad Areas of the Investment Law](image)

Note: Estimated scores for broad areas of the law (scope, standard of treatment, recourse) are shown on the dotted line for each country. Higher scores (closer to 1) indicate stronger protection.

Figure 7 provides further details on specific provisions on select standards of treatment. The most significant variation is seen in the provisions on expropriation and transfers. Kyrgyzstan and Myanmar stand out on their guarantee on expropriation – due to inclusion of an explicit provision on indirect expropriation and a requirement of non-discrimination to ensure legality of expropriation. On the other end of the spectrum is Cambodia, which does not include an explicit provision on payment of compensation for expropriation, a feature included in other investment laws. Kazakhstan and Turkmenistan investment laws do not include explicit provisions guaranteeing free transfers and thus fare low on that standard. The complete list of recommendations is provided in Annex 6.2, Table 3.

Notably, most laws appear to fare relatively consistently on transparency and FET. This is not because they include specific provisions on these aspects - in fact most investment laws reviewed do not include explicit provisions on these aspects – but because transparency and FET standards are reflected in varying degrees in other parts of the country’s legal framework. All investment laws reviewed, other than Lao, Vietnam and Cambodia, include at least one of the FET components (i.e. transparency and accessibility, rule of law and due process and stability and predictability).

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30 For example, the 2013 Law on Making Legislation in Lao mandates that all laws should be available online on the official gazette website, [www.laoofficialgazette.gov.la](http://www.laoofficialgazette.gov.la). Draft bills should also be available for public comment through the official gazette website. In practice however, not all bills are posted for comment and the provinces in particular, very rarely post their local legislation per the requirement of the law.
Of particular importance is the consistently low score on transparency across all investment laws reviewed. Given the lack of clarity on the overall institutional framework governing BRI projects, this lack of guarantee on transparency can have significant implications for global investors.

Figure 7 – Protection Level by Specific Provisions on Standard of Treatment

Note: Estimated scores for 5 selected provisions within Standard of treatment (FET, Full protection, Expropriation, Transparency, Transfer rights) are shown on the dotted line for each country. Higher scores (closer to 1) indicate stronger protection.

Finally, it is interesting to note that the richest countries in our sample (Singapore, Malaysia) do not have an investment law. This is perhaps due to the fact that these countries generally have better investment climates and hence lower payoffs to use the instrument.31

31 There are a few reasons that can motivate countries to enact investment laws. First, as a single instrument capturing all the most important guarantees for foreign investors, it may have an important signaling effect on the country’s openness to investment and reform. Second, it can substantively complement the standards of treatment already available under the existing legal framework of the country. Third, it can serve as an opportunity to reflect in the domestic legislation core international commitments of a country under its IIAs. Fourth, it can be an opportunity to level the playing field between all investors ensuring that all are equally protected. Finally, it can also allow for unifying, consolidating diverse set of legal instruments currently in force in the country.
3.2.3 Protection in Investment Treaties

Strength of Protection in IIAs with China

Analyzing the broad areas of IIAs shows that all IIAs of the sample BRI countries with China have a broad scope (Figure 8). They include asset-based definition of investment and do not explicitly exclude public debt from the definition of investment. It is also important to note that none of the reviewed IIAs with China expressly exclude state-owned or controlled entities. This is of particular relevance to BRI investors, since a large number of those are likely to be made by Chinese SOEs. In fact, the ASEAN-China Investment Agreement further clarifies that ‘governmentally owned or controlled’ investors are protected by the agreement.32

Turkmenistan’s IIA performs lowest on recourse since it does not provide for any type of investor-State dispute settlement mechanism. Georgia’s IIA also fares relatively low on recourse, since it doesn’t provide any alternatives to arbitration and doesn’t explicitly list any available forums for arbitration.

Figure 8- Protection Level by Broad Areas of the IIA with China

Note: Estimated scores for broad areas of the IIA (scope, standard of treatment, recourse, exceptions) are shown on the dotted line for each country. Higher scores (closer to 1) indicate

32 Further, in Beijing Urban Construction Group Co Ltd v Republic of Yemen (ICSID Case No. ARB/14/30), the investor is a wholly state-owned enterprise. The tribunal decided that SOEs are investors for the purpose of BITs, unless they are acting as an agent for the government or discharging an essentially government function. In this case, the investor made the investment (construction of an airport terminal) as a commercial enterprise and after participating in a competitive tender. It was not held to discharge a PRC governmental function. Also see Sanum Investments Limited v. Lao People’s Democratic Republic (II) (ICSID Case No. ADHOC/17/1).
stronger protection. Four IIAs with China by Kyrgyzstan, Kazakhstan, Tajikistan, and Belarus cannot be analyzed due to the lack of available English text.

Figure 9 presents the results on specific standards of treatment provisions. There is consistency in performance of the treaties on the expropriation standard, with Pakistan marginally falling behind due to absence of any indication on the adequacy or valuation of compensation in case of expropriation. The variation in scores on FET in ASEAN countries and the rest of the sample is due to inclusion of a “qualified FET” clause in the ASEAN agreement and an “unqualified FET” in the others. There also appears to be significant variation on the transfers standard. Countries like Azerbaijan, Turkmenistan and Mongolia do not specifically guarantee transfers in a freely convertible or usable currency. Though Turkey’s IIA appears to be performing relatively well on the variables shown in Figure 9, it falls short in the other areas that are part of the scoring, such as transparency. For contract investments, an umbrella clause can help bring the terms of these contracts within the umbrella of IIAs. Turkey, Turkmenistan, Georgia, Mongolia, Azerbaijan, Iran, Russia and Pakistan do not include such a clause.

Figure 9 - Protection Level by Selected Provisions on Standard of Treatment in IIA with China

Note: Estimated scores for 4 selected provisions within Standard of treatment (FET, Umbrella clause, Expropriation, Transfer rights) are shown on the dotted line for each country. Higher scores (closer to 1) indicate stronger protection.
**Strength of Protection in IIAs for all Investors**

As discussed in section 3.2.1, there are substantial variations in the overall levels of protection provided by the BRI countries’ network of IIAs. There are a number of drivers for these differences. The main driver of the low protection score for some countries is due to the small network of IIA partners that they have. For example, Myanmar, Laos, and Cambodia have the lowest number of ratified IIAs and resulting IIA partners (see Table 1). The small size of their IIA network offsets the relatively high levels offered in their IIAs, as seen in Figure 10.

Analyzing the number of IIA partners (Table 1) and the distribution of IIA level scores across countries (Figure 10) offers further explanations for why some countries have relatively weak or strong overall investment protection. On one hand are countries with higher overall levels of protection: Mongolia has a concentration of high protection IIAs and a moderate number of IIAs while Azerbaijan and Turkey have medium level of protection but many partners. On the other hand, low overall protection in countries such as Iran and Pakistan is driven by a large share of low protection treaties. Pakistan’s case stands out as it has an almost complete lack of high protection treaties – 75% of all treaties has a protection score of around 0.5 and below.

Finally, another notable pattern from Figure 10 is the high variance in the level of protection across treaties in several countries such as Russia and Kyrgyzstan. Even in cases where aggregate protection is relatively high such as Azerbaijan, the differing levels of investment protection depending on partner countries can be a challenge for a subset of investors. Varying levels of legal protection might create an uneven playing field for investors and a cause for potential inefficient allocation of resources.

**Figure 10 – Boxplot of Protection Levels in IIAs Ratified in BRI Sample Countries**

![Boxplot of Protection Levels in IIAs Ratified in BRI Sample Countries](image)

*Note: The boxplots present the distribution of protection levels – including the 25th percentile, median, the 75th percentile - in all IIAs by each BRI country.*
Given these results, our policy recommendations to improve the overall quality of investment protection in IIAs can be summarized as follows:

- Increasing the network of IIAs in countries with few IIA partners such as Myanmar, Laos, and Cambodia – especially with more strategically relevant partners such as large economies.

- Harmonize the levels of investment protection in countries such as Russia and Kyrgyzstan with high degree of variance in protection.

- Broad based reforms of a set of lower quality IIAs in countries such as Iran and Pakistan. Pakistan is a stand-out case in which 90% of BITs are "older generation" treaties from before 2000. Improving protection in IIAs would require reforms of even their “better” existing treaties.

### 3.3 Balance

Until recently, the use of carve-outs or exceptions in IIAs has been rare. It is estimated that only around 10 percent of existing investment treaties include exceptions (Bonnitcha et al. 2018). We find a slightly higher incidence of exceptions from the analysis of IIAs where around 17 and 24 percent of the sample treaties include any essential security exceptions and exceptions to transfer rights, respectively. Out of the 17 sample IIAs with China, only 7 include any exceptions. The incidence of similar exceptions in investment laws are even lower, with all but 2 countries not including them. Myanmar and Uzbekistan’s laws include exceptions to transfer guarantee. Myanmar goes a step further and includes an explicit exception for balance of payments situations. While these exceptions reduce the scope of protection by increasing balance - qualitatively they bring about greater clarity and certainty on factors that can potentially limit the available protection to investors.

Figure 11 shows the overall balance scores in investment laws and IIAs across the sample countries. As the only countries including any security exceptions in the laws, Myanmar and Uzbekistan have the highest levels of balance in the law. Averaging across all IIAs, Iran and Pakistan stand out as two countries with relatively low levels of balance in their investment treaties.
From the FDI host country’s perspective, there is a need to consider the implications of the balance between the state regulatory autonomy and protecting investor rights. Until recently, developing countries have often overlooked the potential costs of these agreements. With the rise in investment treaty arbitration however, they are increasingly aware of the potential costs and binding nature of these agreements (Bonnitcha et al. 2018).

In the sample BRI countries, debt obligations can become a source of future disputes. A study by the Hurley, Morris, and Portelance (2018) estimates that 8 BRI countries, including Tajikistan, Kyrgyzstan, Laos, Pakistan, and Mongolia, have a heightened risk of default due to BRI borrowing. Pakistan, in particular, has received around $62 billion in investments from China. Among those, one concession guarantees Chinese power plants annual returns of up to 34 percent for 30 years, all backed by the government. This case demonstrates the high risk of contract violations considering that Pakistan’s 10-year government bond yields have generally fluctuated between 8 and 9 percent over the past year. Yet, out of all BRI sample countries, Pakistan has the lowest balance (fewer exceptions) in both law and IIAs (see Figure 11).

Debt can be included within the definition of investment under various categories - securities including debentures, loans, claims to money or to any performance under contract having a

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financial value. In all of these cases, debt is protected as “investment”. Some IIAs may explicitly exclude public debt. None of the IIAs between BRI sample countries and China explicitly make such an exclusion. Yet, in several of the well-known BRI projects, government owned and controlled entities are set up as investment vehicles.

In the event of a default, investors may oppose State debt restructuring strategies (such as reduction in rate of interest payable or principal amount) based on guarantees provided in IIAs. Given the benefits of investor-State arbitration over national courts, it may become a strong alternative that creditors prefer using. To ensure greater flexibility in the sovereign debt restructuring processes (SDR) and prevent abuse of the dispute settlement process, a relatively new innovation in IIAs is the inclusion of an annex which limits the host state’s obligations with respect to public debt. None of the IIAs with China reviewed for the purpose of this paper included such an annex.

### 3.4 Investment Protection Across Borders

The “corridor” nature of BRI projects exemplifies investment risks. An investor is faced with a different legal and regulatory framework whenever their project crosses borders. Figure 12 illustrates this: the level of investment protection in IIAs can vary significantly within the same corridors. The Samarkand-Mashad rail upgrade project under the CCWAEE for example, passes through Uzbekistan, Turkmenistan, and Iran, whose protection levels range from low to medium. Where the success of a corridor depends on the successful completion of the full network, improving investment protection is only fully effective if it addresses the weakest countries in the corridor.

Further, in addition to varying levels of protection, investors still need to navigate disparate and complex laws, rules, and regulations shaping the business environment in each country. Nikkei (2018) for example documents the delay of the Jakarta-Bandung rail project due to permit problems and sluggish land acquisition. Beyond direct impacts on project returns, delays due to government action/inaction can be grounds for indirect expropriation claims and costly disputes. Complementary reforms that increase general policy transparency and predictability to reduce investment risk will be a key determinant of the economic returns on BRI investments. Moreover, effective reform requires not only good practice policy formulation but also implementation and enforcement (see further discussion on enforcement of investment protection mechanisms in Section 4).

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34 Tribunals have provided some guiding principles. In *Fedax v. Venezuela*, ICSID Case No. ARB/96/3, the tribunal regarded promissory notes issued by Venezuela and assigned by another company to Fedax as an “investment” on the basis that promissory notes are evidence of a loan and not “volatile capital”. In *Poštová Banka, A.S. and Istrokapital, SE v. Hellenic Republic*, the tribunal made a distinction between bonds circulated on the secondary market and loans involving contractual privity between lender and debtor. The tribunal decided that public bonds would not qualify as ‘claims to money or to any performance under contract having a financial value’, because of the absence of a contractual relationship, and thus would not be treated as “investment”.


36 See for example, Annex G, US-Uruguay BIT

Note: IIA protection is the protection score aggregated over all partner countries. Low, medium, and high protection levels are defined by the 33rd and 67th percentiles protection scores in the sample.

4. Enforcement Mechanisms

This section looks at the mechanisms to enforce investment protection in BRI countries through three questions. First, do states follow through with their commitments in investment laws/treaties? In other words, do we observe treaty violations in practice? Second, in cases where such violations arise, what are the available mechanisms for dispute resolution? Third, where arbitration decisions are made, do they get enforced in practice? The rationale for our focus on investor-state dispute cases is due to the argument that reputational effect is what forces government to comply with their commitment to investors and reason why IIAs have can resolve the hold-up problems (Bonnitcha et al. 2018). Empirical evidence about this is still limited. Nevertheless, some evidence
by Minhas and Remmer (2018) suggests that with increasing access to information about disputes, dispute cases can have a negative impact on the perception of risk about host countries.

Lack of enforcement of legal frameworks (laws, regulations, contracts), can ultimately culminate into disputes. Most BRI countries in our sample have experienced some cases of international investor-State disputes – indicating that violations of obligations to investors do happen in practice (Figure 13). 38 12 of the 21 countries have at least 4 or more disputes. While sample BRI countries in Central Asia have on average been respondents in almost 10 disputes, countries in Southeast Asia have been respondents in about 2 disputes. 39 Relative to their FDI stock, with 24, 17, 13 and 10 cases respectively, Russia, Kazakhstan, Kyrgyzstan and Turkmenistan have had fairly high numbers of investor-State arbitration disputes (Figure 13). 40

**Figure 13 - Number of ISDS Cases – Normalized by FDI Inward Stock**

![Bar chart showing number of ISDS cases normalized by FDI inward stock]

*Source: UNCTAD Investment Dispute Settlement Navigator (http://investmentpolicyhub.unctad.org/ISDS)*

38 Lack of enforcement is reflected in any disputes between investors and State- be it in international arbitration or domestic arbitration of domestic courts. In this section we focus on international investor-State disputes due to ease of access to information on these.

39 This also aligns with the distribution of ICSID cases as of June 2018- Eastern Europe and Central Asia 26%, followed by 23% involving South American States. South and East Asia and Pacific States are involved in about 7% of all cases. 40% of all cases registered in 2018 involved Eastern Europe and Central Asian States. See https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202018-2%20(English).pdf
In addition, Chinese investors have registered 5 investor-State arbitration disputes, of which 1 was won by the investor, 2 are pending and 2 by the respondent States. Of these 5 disputes, 2 were registered against sample BRI countries- Lao and Mongolia.

40 In fact, to address this issue of non-enforcement of legal frameworks, the Kazakhstan government established an Investment Ombudsman in 2013. According to the Ministry of Investment and Development, during 2015-16 the Investment Ombudsman successfully addressed 60 investors’ requests. However, despite these efforts 6 of its total 17 international investor-State arbitration cases were registered 2013 onwards. (See US Department of State, Investment Climate Statement: http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2018&dlid=281702)
Most of the dispute cases are in utilities and mining – sectors often characterized by high fixed costs or concession contracts that are sensitive to regulatory changes: 64 percent of these disputes are in the tertiary sectors (such as electricity/gas supply, construction, telecommunication, financial services) followed by 26 percent in the primary sector (such as mining and quarrying) with the remaining in the manufacturing sector. The largest number of cases are in the electricity, gas, steam and air conditioning supply sub-sector, followed by extraction of crude petroleum and natural gas sub-sector.

UNCTAD data on international investor-State disputes shows that most cases are based on alleged violations of core protection standards such as FET and protection from indirect expropriation (Echandi 2018, UNCTAD). This pattern is also reflected in ISDS cases involving the BRI Sample countries. Our analysis of the UNCTAD database on disputes shows that majority of the cases in which the investor prevailed (on which there is publicly available information) have been based on violation of FET, closely followed by indirect expropriation. A high incidence of claims involving the very protections guaranteed under the country’s legal framework reflects a general lack of enforcement.

Where investors face such situations of lack of enforcement, it is important that they have access to effective recourse. Only 13 of the sample BRI countries are members of ICSID and 20 are members of the New York Convention – limiting investors’ access to international arbitration. Using domestic courts to resolve disputes can be costly as many of the sample BRI countries have slow court systems that lack independence, as indicated by the World Governance Indicator’s Rule of Law index (Figure 14). Seven of our sample BRI countries fall below the 20th percentile, followed by another seven at or below the 40th percentile. This is consistent with the view expressed, for example, by the US Commercial Guides which assess that in many of the sample countries, a weak judicial system often fails to act as an independent and efficient arbiter in investment disputes.

The Kumtor Gold Mine case involving Kyrgyzstan is a notable one. The gold mine began production in 1997. The Canadian company, Centerra Gold, whose local subsidiary Kumtor Gold operated the mine was forced to renegotiate the terms of their investment more than 3 times, on the insistence of the government. In 2016, law enforcement officials raided the Bishkek headquarters of the company on accusations of financial irregularities and prevented expatriate officials from exiting the country. Further, a local court also issued an injunction to stop the company from making financial transfers to its Canadian holding company and subsequently also fined Kumtor nearly $98 million in alleged environmental damages. This case was finally brought to international arbitration. See: http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2018&dlid=281702

https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements

41 The Kumtor Gold Mine case involving Kyrgyzstan is a notable one. The gold mine began production in 1997. The Canadian company, Centerra Gold, whose local subsidiary Kumtor Gold operated the mine was forced to renegotiate the terms of their investment more than 3 times, on the insistence of the government. In 2016, law enforcement officials raided the Bishkek headquarters of the company on accusations of financial irregularities and prevented expatriate officials from exiting the country. Further, a local court also issued an injunction to stop the company from making financial transfers to its Canadian holding company and subsequently also fined Kumtor nearly $98 million in alleged environmental damages. This case was finally brought to international arbitration. See: http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2018&dlid=281702
42 https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements
Yet another challenge is the enforcement of an arbitral award itself, once a dispute is decided. To analyze more granular information on enforcement, this section focuses on the experience of Kazakhstan and Kyrgyz Republic. Both of these are interesting cases, especially since they fare relatively well on protection scores (which is based on the de jure frameworks and not de facto enforcement). Though there is limited publicly available information on status of enforcement of arbitral awards, secondary research shows that both Kazakhstan and Kyrgyz Republic have had cases of non-enforcement, despite being members of the New York Convention. The *Rumeli v Kazakhstan* and *Sistem v Kyrgyz Republic* cases are illustrations of such lack of enforcement (See Box 1). Information from the Investment Arbitration Reporter indicates that in the *Sistem* case, enforcement proceedings failed in Canada and Switzerland and are currently underway in the US. Notably, inefficiency of local courts in enforcing arbitral awards has in itself, in recent times been the basis for countries losing investor-State arbitration cases.

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*Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16

*Sistem Muhendislik Sanayi Ve Ticaret A.S. v. Kyrgyz Republic*, ICSID Case No. ARB(AF)/06/1

*Sistem* sought to attach around US$11.7 million, held by the Geneva-based International Air Transport Association in the name of Kyrgyzaeronavigatsia, a Kyrgyz state company. This was refused by the Geneva Debt Collection Office, on account of Swiss state immunity of law (that prevented seizure of foreign state property used in exercise of sovereign authority). *Sistem* also targeted Kyrgyzstan’s assets in the Canadian gold mining company Centerra Gold, owned by state owned KyrgyzAltyn. In April 2014 the Ontario Superior Court decided that the Kyrgyz Republic had an interest in these shares and that they may be subject to arbitral award’s enforcement. Publicly available resources indicate that these efforts to have the award enforced still remain unsuccessful and a debt of more than US$12 million is stated to remain outstanding to Sistem. Source: [https://www.iareporter.com/](https://www.iareporter.com/)

For example, *White Industries v India*, UNCITRAL, Award (Nov. 30, 2011)). White Industries Australia Limited concluded a supply contract with a State-owned company, Coal India, for the provision of equipment and technical
Box 1- Cases of Non-Enforcement of Arbitral Awards

Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan

Rumeli and Telsim had 60% shareholding in KaR-Tel and won a bid to hold a license to operate a second mobile telephone network in Kazakhstan. In October 1998, KaR-Tel started negotiating new investment incentives with the Kazakh Investment Committee (KIC) which ultimately led to an investment contract between KaR-Tel and KIC. Differences arose between the parties, culminating into the unilateral termination of the investment contract by KIC. Rumeli and Telsim commenced arbitral proceedings in July 2005. In July 2008, ICSID arbitral tribunal ruled in favor of the investor awarding $125 million in damages, finding that Kazakhstan breached FET standard and had expropriated the claimants’ property. Kazakhstan’s request for annulment of the award failed. Thereafter, per publicly available sources, a 30-day deadline lapsed without the Kazakhstan making payment on the large arbitral award.

Sistem Muhendislik Sanayi Ve Ticaret A.S. v. Kyrgyz Republic

Sistem, a Turkish company entered into a joint venture agreement with a Kyrgyz company to construct and operate a hotel in Bishkek (Pinara). Shortly after the completion of the construction in 1995, Sistem was excluded from participation in the management of the hotel. In 1999 the Kyrgyz company went into bankruptcy. Thereafter, based on several agreements guaranteed by the governments of Turkey and Kyrgyzstan, Sistem acquired the Kyrgyz company’s interest in Pinara. In 2005, there was a change in government, as a result of the revolution. Shortly after that, the hotel was taken over by a group of armed men and the Turkish employees of the hotel operating company were ordered to leave the premises. After a few months, the Kyrgyz courts also reversed the earlier decisions declaring the Kyrgyz company bankrupt and invalidated the purchase of its share in the hotel by Sistem. Subsequently, Kyrgyz authorities clarified that the Kyrgyz company was the sole owner of the hotel.

Sistem brought arbitral proceedings against Kyrgyz Republic. The tribunal, highlighting the various circumstances of the case, ultimately decided that the Kyrgyz court’s decisions resulted in Sistem being deprived of its assets- that the actions of the courts are attributable to Kyrgyz Republic and constituted expropriation. Since 2009, Sistem has been trying to enforce the arbitral award against the Kyrgyz Republic in Switzerland, Canada and most recently in the US.

services for a mining project. A dispute arose under their contract and was referred to an ICC tribunal. The award was in favor of White Industries and it applied for enforcement in the Indian courts. In parallel, Coal India requested setting aside of the order. Over the next several years, the cases were transferred across courts. Unable to get recognition of the ICC award, White Industries decided to register an investor-State arbitration case. The tribunal ruled that the award itself constituted an investment. While the claims for denial of justice were not successful (acts did not demonstrate “shocking a sense of juridical propriety”). Relying on the MFN clause from the India-Australia BIT, White Industries used the “effective means” standard from the India-Kuwait BIT. The nine-year period during which the proceedings to set aside the award could not be completed (in fact still remained at jurisdiction phase) and demonstrated the respondent’s inability to ensure effective protection of rights.
BRI Initiatives for Dispute Settlement

Ultimately, without effective enforcement of laws, regulations, contracts and awards, de jure legal provisions are merely promises on paper. Access to effective mechanism for dispute settlement, perhaps even dispute prevention mechanisms can be instrumental in improving the general level of enforcement in countries.

In this regard, over the past year, several initiatives on investment related dispute settlement mechanisms dedicated to BRI have been explored, mostly covering commercial arbitration. BRI may generate a broad range of disputes – between private enterprises (including individuals), investor-State and State-State. On January 23, 2018 President Xi issued a circular stating that the Supreme People’s Court will set up courts for resolving BRI disputes. Following issuance of this opinion, on July 1, 2018, the Supreme People’s Court issued the "Supreme People's Court Regulations on Certain Issues in Establishing an International Commercial Court" ("ICC Regulations"), focused on commercial disputes (not investor-State).

Three such courts have been established – one each in Shenzhen (covering the maritime route), Xian (covering the land portion) and Beijing (headquarters of the courts). The objective is to have a "one stop shop" for international commercial dispute resolution services, including mediation, arbitration, and litigation. Initial research indicates that the court will have 8 judges (with each bench comprising 3 judges), all from China, selected based on their experience in international commercial disputes and bilingual capabilities (Chinese-English). There will also be an International Commercial Expert Committee, comprised of twelve Chinese and twenty non-Chinese legal professionals who will further provide expert knowledge on mediation, arbitration, and litigation. There remain several open questions - some of which will likely be clarified in subsequent procedural rules. Most importantly, there is lack of clarity on whether and how investor-State disputes will be covered.

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47 See https://eng.yidaiyilu.gov.cn/. The circular emphasized that the settlement of international business disputes will follow four principles - jointly discussing, developing and sharing of the mechanism, handling disputes in a fair, efficient and convenient way, respecting the autonomy of the will of the parties, as well as diversifying methods of dispute resolution. It also calls for efforts to actively promote international cooperation within the BRI, settle business disputes in accordance with the law, protect the legal rights and interests of parties and create an equal and fair environment for doing business.


49 Article 3 of ICC Regulations provide that cases can be submitted to the international commercial court, essentially where one or both parties are foreign, the domicile of one or both parties lies outside the PRC, the object of the dispute lies outside the PRC, or legal facts producing, changing, or destroying commercial relations in dispute occur outside the PRC.

50 For example – (i) the commercial courts will be bound by Chinese law and will have limited jurisdiction to develop their own judicial precedents- in that sense it comes across as a court with limited jurisdiction, functioning within the existing hierarchy of Chinese courts; (ii) under Article 2 of the ICC Regulations, for any commercial dispute valued at RMB 300 million or more, the commercial courts will have first instance jurisdiction. It is unclear however if the courts will have exclusive jurisdiction and whether parties can opt out and choose another forum; (iii) while the requirement to have bilingual judges is clear, the language for conducting procedures in the courts has not
Alongside these courts, the China Council for the Promotion of International Trade will also establish a “Belt and Road International Dispute Management Center,” which will assist existing arbitration centers (such as the one set up in Qianhai). Other initiatives include the International Academy of the Belt and Road (Hong Kong)’s fairly comprehensive proposal on the Blue Book issued in 2017- providing a new set of rules covering conciliation, arbitration and appeal procedures (including transparency rules and code of conduct for conciliators, arbitrators and appellate body Members) applicable to all types of disputes. Much emphasis is placed on conciliation. It incorporates the UNCITRAL Conciliation Rules and UNCITRAL Model Law on International Commercial Conciliation (Wang 2005), makes mediation a prerequisite for arbitration and incorporates several transparency dimensions. For the investor community broadly -both conciliation and mediation have had limited value as effective means of dispute resolution – partly for reasons of non-binding nature of the decisions.

Even in country specific corridors, various dispute settlement options are being considered. For example, the Lahore-based Center for International Investment and Commercial Arbitration has entered an MoU with the Hanzghou Arbitration Commission, to serve as an arbitration center for disputes arising in the China-Pakistan Economic Corridor. Similarly, the China Africa Joint Arbitration Centre was established in 2015 to resolve investment disputes between Chinese and African entities. The rationale provided for these initiatives is avoiding local courts and arbitration institutions. The center has been set up both in China (Shanghai) and South Africa (Johannesburg). Other examples include the memorandum of understanding between Singapore International Mediation Centre and the China Chamber of International Commerce Mediation Centre to resolve BRI cross-border disputes and Hong Kong’s justice department’s initiative on an online dispute resolution tool for major BRI infrastructure projects.

Disputes in BRI will involve a diverse set of country laws and regulations, different legal traditions (civil or common law), and multiple court systems of varying levels of effectiveness and capacities. In this context, having some clarity and consistency in the dispute settlement

been specified – further under Article 240 of the PRC Civil Procedure Law, trials touching on foreign elements, must be in Chinese.
See https://www.asil.org/insights/volume/22/issue/11/china-international-commercial-court-prospects-dispute-resolution-belt
51 International Academy of the Belt and Road, Dispute Resolution Mechanism for the Belt and Road (October 2016)
52 On the basis that conciliation has a long history in the East. “...the necessity of avoiding conflict, observing proper rules of behavior, and relying on the social group to resolve differences, which are in conformity with Confucian standards and values” (Wang 2005).
53 Mediation may terminate by: (a) parties reaching a settlement agreement; (b) the mediator(s), after consulting the parties, declaring to terminate the mediation; and (c) one or both parties deciding to terminate mediation.
54 Until June 2018, only 11 conciliation cases were registered under the ICSID Convention and Additional Facility Rules (9 and 2 respectively), representing 1.6% of ICSID’s total caseload. In 83% of the cases in which a conciliation report is issued (which is in 75% of all cases, in the rest the conciliation proceedings are discontinued), parties fail to reach an agreement. See ICSID (2018) on proposed new rules and amendments to existing rules to improve conciliation and mediation frameworks.
55 BRI includes the Anglo-American common law, European civil law, Islamic law and a range of other customary and local rules.
mechanisms available to investors may be helpful. The question is should a new comprehensive, over-arching mechanism be created, or should there be greater consistency and harmonization in using the already available mechanisms (for e.g. arbitration forum, rules). As the BRI community further explores this area, some aspects need to be kept in mind. To ensure credibility, BRI would need dispute resolution mechanisms that are effective, suitable for the investor community as well as recognized internationally. Under the existing mechanisms, parties have freedom of choice on courts/forum, procedural rules, laws and languages- it needs to be ensured that any special mechanisms for the BRI do not conflict with such fundamental contractual freedoms or illustrate unequal bargaining power of the entities involved.

5. Conclusion

Investments along the BRI are prone to political, legal, and regulatory risk by their very nature- largely cross border infrastructure projects that are capital intensive, with long gestation periods and complicated structures. Investors will need to navigate a diverse set of country laws and regulations, legal traditions, and court systems of varying levels of effectiveness and capacities. There are also no confirmed plans for creating a legal framework or even a systematic institutional framework to govern investments along the BRI. In this context, unilateral efforts of host countries to strengthen their investment protection frameworks will contribute to enhancing their attractiveness as investment destinations. Greater harmonization between the countries and international good practices can further reduce transaction costs for investors.

Our paper contributes to the understanding of the quality of investment protection frameworks in BRI countries. Using a unique database developed based on the textual content of laws and IIAs, we find substantial variations in the levels of legal protection in the sample countries. In addition, the database enables us to identify specific areas of the strengths and weaknesses of investment protection provisions in the laws and investment agreements across countries and across partners within the same country.

Our results suggest that countries can improve the level of protection in several ways. With respect to IIAs, countries with fewer IIAs may consider negotiating more treaties with strategically relevant partners (large economies). Countries with old generation IIAs and dated investment laws may consider systematically modernizing these instruments. Substantively, provisions on transparency need to be strengthened across the board in both laws and treaties. Given the lack of clarity on the overall institutional framework governing BRI projects, inadequate inclusions of guarantee on transparency can have significant implications for global investors.

Alongside strengthening the protection levels provided in the Legal Instruments, all sample BRI countries should consider explicit provisions to give themselves some policy and regulatory flexibility. For some countries, given both the pipeline for BRI projects (not yet materialized) as well as high reliance on debt financing, it is important for the country to upgrade its investment protection frameworks, while also systematically ensuring sufficient balance.

Cases of Kazakhstan and Kyrgyzstan are only illustrative of a more pervasive challenge on enforcement. Measures to address this challenge should be implemented- such as access to effective dispute resolution mechanisms through improved courts systems and membership of
international conventions, institutional strengthening and capacity building of government agencies to ensure effective enforcement and provision of effective investor services.

With regard to recent discussions on BRI specific dispute settlement mechanisms, it is important that any new mechanism that is considered should be effective, suitable for the investor community as well as recognized internationally. Under the existing mechanisms, parties have freedom of choice on courts/forum, procedural rules, laws and languages- it needs to be ensured that if any special mechanisms for the BRI are considered- they do not conflict with such fundamental contractual freedoms or illustrate unequal bargaining power of the entities involved.

Whether a common investment protection regime for BRI investments will facilitate investment will depend on the quality of this regime. However, softer initiatives like information sharing platforms and publishing guides on applicable laws and regulations can help bridge information asymmetry and bring about more clarity and predictability for investors.
References

ADB. 2017. *Meeting Asia's Infrastructure Needs*. Manila


6. Annex
6.1 Examples of Questions for Scoring Investment Laws

This section shows the examples of the questions used to score investment laws in 3 specific provisions. In general, for the purpose of this paper, the legal provisions were assessed on basis of the broad level of protection provided to investors and does not cover aspects such as precision in legal drafting, transparency in arbitral proceedings or other similar considerations. In scoring domestic investment laws, a distinction was made between provisions that are typically included as standard good practice (e.g. protection against expropriation) and those that should be included as good practice but have still not become standard practice and may in fact be found in other legal instruments of the country (e.g. transparency).

Expropriation and Compensation Provisions

1. Does the act cover direct expropriation?
2. Does the act explicitly cover indirect expropriation?
   a) If yes, does the act define indirect expropriation (using tests or criteria to be met for a given measure to be considered indirect expropriation)?
3. Does the act clearly state that expropriation will be carried out only when there is a public purpose?
4. Does the act clearly state that expropriation will be carried out in a non-discriminatory manner?
5. Does the act clearly state that expropriation will only be carried out in accordance with due process of law?
6. Does the act clearly state that expropriation will only be carried out against compensation?
   a) Compensation must be prompt (paid in timely manner)
   b) Compensation must be adequate (fair market value)
   c) Compensation must be effective (Method or mode of payment)?
7. Does the act have carve-outs (exceptions) for legitimate regulatory measures?

Access to ISDS provisions

1. Does the act state that ISDS is available for any dispute relating to an investment, arising between home State and investor?
2. In the event of a dispute, does the act require that parties first attempt to resolve it through consultation or negotiation (so called “amicable settlement”)?
3. If the answer to above is yes, is there a time limit specified in the act for such amicable settlement attempt?
4. Does the act require investors to exhaust local remedies (local courts) before referring the dispute to arbitration?

5. Does the act provide express consent to arbitration?

6. Does the act expressly mention the arbitration forum (or fora) which can be used?

**Balance**

1. Does the act have carve-outs (exceptions) for legitimate regulatory measures?

2. Does the act include any exceptions to free transfer of currency?

**6.2 Main areas of Weakness in Investment Laws**

**Table 3 - Main areas of weaknesses in investment law**

<table>
<thead>
<tr>
<th>Country</th>
<th>Main areas of weakness in investment law for the bottom 10 countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iran</td>
<td>Access to ISDS</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>Transfers rights</td>
</tr>
<tr>
<td>Cambodia</td>
<td>FET, expropriation provisions, Access to ISDS</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>FET, full protection</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Access to ISDS</td>
</tr>
<tr>
<td>Russia</td>
<td>Scope of application</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>Scope of application, Transfer rights, Access to ISDS</td>
</tr>
<tr>
<td>Turkey</td>
<td>Scope of application</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Scope of application</td>
</tr>
<tr>
<td>Vietnam</td>
<td>FET</td>
</tr>
</tbody>
</table>
6.3 Content of Investment Treaties by Treaty Type

Figure 15 – Protection and balance in BITs and other Treaties with Investment Provisions

Figure 16 – Clustering of content in BITs and Treaties with Investment Provisions