

NEPAL: THE BIT-LESS HOLDOUT AMONG INDIA'S  
BELT-AND-ROAD NEIGHBORS

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by

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## **ABSTRACT**

Despite its formal engagement in the Belt-and-Road Initiative and significant interest in attracting foreign direct investment, Nepal does not have a bilateral investment treaty with China, unlike all of India's other contiguous neighbor states who are participating in the Belt-and-Road. Utilizing interviews with scholars and lawyers based in South Asia and other literature on China's engagement in South Asia, this thesis examines the reasons why Nepal does not have a bilateral investment treaty with China. I argue that the Nepali government's lack of movement on proposing a BIT with China stems neither from its internal bureaucratic mechanisms nor its historic ties to India thwarting such attempts, but its adoption of a soft-law approach with all of its neighbor-investors. This is not outright resistance against the investor-state regime, as seen in some jurisdictions around the world, but rather a novel approach to redefining the rules of investment dispute resolution to soft law mechanisms on a state-to-state level.

## **BIOGRAPHICAL SKETCH**

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This thesis is dedicated to my wife, Sadichchha Dhakhwa, who inspired my academic interest in Nepal. It is also dedicated to my father, Rob, brother, Greg, and sister-in-law, Cynthia, for all of their emotional support while I was writing during a difficult time. Lastly, I dedicate this thesis to my mother, Victoria, who passed away while I was writing. Even as a quadriplegic, retired teacher, she taught me how to be persistent in my academic work, no matter what life throws at you.

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## INTRODUCTION

### (a.) The puzzle of Nepal in South Asia's Investor-State Regime

The “investor-state regime” refers to the international network of bilateral relationships between states and international organizations that promote signing bilateral investment treaties (BITs) to foster foreign direct investment (FDI). Nepal occupies a curious position in this regime. While Nepal has ratified international investment treaties in the past, they were very few compared to those of its neighbors.<sup>1</sup> Even Nepal's treaty with its neighbor and greatest trading partner, India, was cancelled unilaterally by India as a reaction against its own experience with the international regime. Nepal's Ministry of Foreign Affairs also expressed a clear interest in encouraging investment from Chinese corporations by issuing a Joint Communique with China during Xi Jinping's 2019 visit to Kathmandu, but even as the Nepali government increased ties with China by officially joining the Belt-and-Road Initiative (BRI) in 2017, it has neither ratified nor drafted a treaty with its northern neighbor. What is more puzzling is that India's other contiguous neighbors participating in the BRI (Pakistan, Sri Lanka, and Bangladesh) maintain BITs with China that were ratified decades ago.

The Permanent Forum of China Construction Law (2019), a panel of Chinese and international legal counsel who advise China-based firms operating abroad, made the following recommendations on choosing a dispute resolution method: 1. Determine if the host state is both a member of the United Nations Convention on the Enforcement of Foreign Arbitral Awards (the New York Convention) and the Settlement of Investment Disputes between States and Nationals of Other States Convention. 2. If yes, did the host state make any reservations while signing

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<sup>1</sup> According to the United Nations Conference on Trade and Development (UNCTAD), Nepal has only 4 ratified BITs (not counting its terminated BIT with India or its signed-but-never-ratified BIT with Mauritius) compared to 32 for Pakistan, 24 for Bangladesh, 24 for Sri Lanka. These 4 are exclusively with developed economies: the UK, France, Germany, and Finland, unlike the other three South Asia states, which ratified BITs with developed and emerging market economies throughout the past three decades

either convention? 3. Determine any obstacles to enforcing arbitral awards under a host country's legal system. These aspects represent China's growing emphasis on protecting its investors abroad, making it more puzzling why Nepal, amid growing investment, does not have an investment treaty to assure Chinese investors.

States have consistently signed BITs with emerging market economies like China in the hopes of assuring and attracting larger investment from abroad. Taking this fact into consideration alongside the Nepali government's apparent lack of movement on drafting a BIT, I explore the reasons why this is the case in Nepal's relationship with China and the implications it has for the investor-state regime worldwide. My thesis looks at the investment-regimes from two eras: The first is the late twentieth century, specifically 1986 to 1997 when Nepal and other South Asian states were ratifying BITs with China or other states. The second is from 2011 to the present when India was reacting against the investor-state regime and China was promoting the Belt-and-Road Initiative.

I argue that the Nepali government's lack of movement on proposing a BIT with China stems neither from its internal bureaucratic mechanisms nor its historic ties to India thwarting such attempts, but its adoption of a soft-law approach with all of its neighbor-investors. This is not outright resistance against the investor-state regime, as seen in some jurisdictions around the world, but rather a novel approach to redefining the rules of investment dispute resolution to soft law mechanisms on a state-to-state level.

### **(b.) Outline of Thesis**

Section I provides a general summary of the investor-state regime, the role of BITs in promoting foreign investment, the actors responsible for negotiating these treaties, and states' prospects for attracting investment. Section II describes Nepal's ambiguous position in two categories of academic literature: those concerning investor-state regime and the BRI as well as

those concerning the impact of BITs on FDI. Section III describes the BIT adoption strategies of China, Sri Lanka, Pakistan, Bangladesh, and Nepal, focusing on the late twentieth century period while incorporating some context from the BRI era. Section IV introduces China's BRI and India's Model BIT strategy and explains Nepal's position in both contexts. Section V discusses BIT-sanctioned arbitration cases that China and Nepal have been involved in and explains how it informs their present-day attitudes towards BITs. My thesis concludes with remarks on the reasons for Nepal's ambiguous position on a BIT with China and this relationship's future trajectory. It also discusses future areas for research.

### **(c.) Methodology**

This research will be one component to my larger Ph.D. project in subsequent years, which will explore states' endorsements of various investment dispute mechanisms and corporate actors' responses to those endorsements. I consulted a large amount of legal and social science scholars' general works on investor-state dispute resolution and states' reactions to the international regime. For information on investment treaties and international arbitration cases, I utilized the UN Commission on Trade and Development's (UNCTAD) Investment Agreements Navigator and Investment Dispute Settlement Navigator online databases. For information on specific countries' approach to investment treaties over the past few decades, I interviewed scholars and lawyers from Nepal, Sri Lanka, Bangladesh, and China via email, messaging apps, and video conferencing.<sup>2</sup> It was pure coincidence that the Nepali journalist Amish Raj Mulmi published his book on China's burgeoning engagement in Nepal last year (2021), and I have supplemented my thesis with his anecdotal evidence.

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<sup>2</sup> For Pakistan's government, I decided that Lauge Poulsen's interviews of relevant officials (2015) was sufficient for my research on that country.affairs and commerce. Because of the limited amount of time that I had to complete my masters program, I decided to communicate with more accessible scholars and lawyers who have experience interacting with these individuals.

#### **(d.) Challenges to Research**

I was originally planning to travel to Kathmandu over the recent winter break to interview lawyers familiar with Chinese corporations' engagement in Nepal. However, due to personal immigration circumstances and the current pandemic, I had to cancel my plans and communicate with individuals over Zoom, WhatsApp, and email.

One of the most immediate challenges with conducting research on state-to-state or state-to-corporation negotiations is communicating with individuals who have first-hand experience with these processes, particularly CEOs and personnel from governments' ministries of foreign affairs and commerce. Because of the limited amount of time that I had to complete my masters program, I decided to communicate with more accessible scholars and lawyers who have experience interacting with these individuals.

## **(I.) DEFINING THE INVESTOR-STATE REGIME, THE ROLE AND NEGOTIATORS OF BITS, AND PROSPECTS FOR ATTRACTING FOREIGN INVESTMENT**

### **(a.) The Investor-State Regime**

The investor-state regime (sometimes referred to as the investment treaty regime) has attracted the attention of many legal and political science scholars over the past decade with the widespread ratification of BITs and other kinds of investment treaties across the globe.

Bonnichta et al. (2017, p. 3) describe this regime's three components: The first is investment treaties that are either concluded between two states as BITs or multilateral treaties. The second is the set of international treaties, rules, and institutions governing investor-state arbitration. These treaties are the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). The former compels domestic courts to decline to hear disputes that parties have already agreed to resolve through arbitration and enforce the judgements of arbitral tribunals. The latter establishes the International Centre for Settlement of Investment Disputes (ICSID) for conducting arbitrations initiated by foreign investors against states.<sup>3</sup> The third component is decisions of arbitral

Investors in the regime can either be natural persons or legal entities (corporations). While the foreign direct investment that these treaties hope to attract span many different industries, ICSID tribunals in cases such as *Salini v. Morocco* and *Bayindir v. Pakistan* have defined investment as a contribution, of a certain duration over which the project is implemented, which involves the sharing of operational risks, and a contribution to the hosting state's development (Bonnitcha et al. 2017, p. 52). Along with investors setting up projects in a host

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<sup>3</sup> China, Nepal, Pakistan, Sri Lanka, and Bangladesh are all signatories and contracting states of both treaties. While India is in this category for the New York Convention, it has never signed the ICSID Convention. tribunals applying and interpreting investment treaties, particularly from ICSID-constituted tribunals.

country, they also are hoped to foster global value chains in which local companies can make contracts with the foreign investor and citizens can be employed.

### **(b.) The Role of BITs**

Bilateral investment treaties are binding documents meant to protect investors of other states' assets in foreign countries. Ofofile (2013, p. 159-160) describes the key features of China's BITs with other states:

A broad asset-based definition of investments; absolute standards of treatment clauses (for example, fair and equitable treatment) clauses; relative standards of treatment (for example, National Treatment and Most-Favored Nations) clauses; protection against expropriation; protection against wars, riots and related disturbances; state-state dispute settlements as well as investor-state dispute settlement procedures; subrogation clauses; and clauses guaranteeing the right of investors to freely transfer funds.

Because China has been increasing its investment in South Asia long before the implementation of the BRI, it has developed much experience with negotiating investment treaties since its first diplomatic foray in the region with the 1986 Sri Lanka BIT.

The arbitration articles in BITs are typically devised to both resolve disputes between the contracting states and resolve disputes between a contracting state and an investor from the other contracting state. The investor is usually a company contracted by the receiving state's government to develop a project in its energy, transportation, mining, or communications sector. Sometimes the investor in a dispute is an individual representative of a greater company. The arbitration articles try to encourage the resolution of disputes via negotiations between the parties. If agreement between the parties cannot be reached, the article outlines the procedure for arbitration.

One party must notify the other in writing of its intent to commence arbitral proceedings in a timely fashion, and some arbitration articles in BITs set limits on the number of years that an arbitration claim is valid. Both parties will hire legal counsel either from their home country or from international law firms. When a tribunal is selected and convenes, it must decide whether it has jurisdiction to decide a case, even if the BIT explicitly grants the tribunal venue jurisdiction, because some treaties' articles limit arbitral proceedings to certain transactional disputes or specific forms of expropriation of assets. A tribunal can take several years to determine jurisdiction alone. If the tribunal decides that it has the authority to hear the case, it will take as much time as necessary to hear the merits of each side's argument. Usually, these merits are areas of dispute that each require their own decision. A decision is reached by a majority vote and the arbitrators usually decide to dismiss certain merits or demand appropriate compensation to a party. The BIT will state that the decision of the tribunal is binding on both parties and should be enforced by both states' judiciaries. It will also determine how the parties will pay for the costs of the three arbitrators' services.

### **(c.) Nepal and China's Actors in BIT Negotiations**

When examining the BITs that were concluded by the Nepali government in the late twentieth century, the representatives signing the documents change from the 1980s onward. France and Germany's BITs with Nepal (1985, 1986) were signed by the Minister of Foreign Affairs. Nepal's Minister of Finance signed the state's BITs with Mauritius (1999) and Finland (2009). Nepal's Minister of Industry signed the state's now-cancelled BIT with India (2012). This rotation of officials indicates that these treaties are not only negotiated by several different departments but reflects Nepal's changes in governmental functions during four eras: as an absolute monarchy (1959-1990), a constitutional monarchy (1990-2006), an interim republic (2006-2015), and today's parliamentary republic. A lawyer familiar with the negotiation process

confirmed to me (2022) that nowadays a team of officials from both the Ministry of Foreign Affairs and the Ministry of Industry would be involved in negotiating the draft of an investment treaty. While the prime minister's office could also be involved, the prime minister himself is rarely involved. The treaty is then ratified by a two-thirds majority in both houses of the Parliament (Constitution of Nepal 2015, Article 279). This contrasts with China's negotiating team, which according to Chinese lawyers familiar with the process (2022) has always been under the complete purview of the Ministry of Commerce.

#### **(d.) Prospects for Attracting Foreign Investment**

Bilateral investment treaties were usually signed with the expectation that they would attract foreign direct investment. Andrew Guzman made one of the earliest analyses on why so many developing countries were concluding BITs in the last two decades of the 20th century. He determined (1998, p. 678-679) that BITs introduced a mechanism through which developing countries could compete for investment among each other by reassuring foreign investors that an expropriation of their assets would amount to a violation of international law and could be remedied through binding arbitration.

Lauge Poulsen's interviews with Pakistani officials (2015) corroborates Guzman's conclusions. One official involved with that country's BIT negotiations over the past few decades recounted how in the late twentieth century (p. 129) 'Pakistan was looking for FDI...so there was a climate that since we are providing the protections and liberalizing everything, why not add some confidence to the investors with BITs?' In Nepal's case, the UN Commission on Trade and Development's 2003 Nepal Investment Policy Review also reflects Guzman's findings by advising (2003, p. 31) the Nepali government to develop a wider BIT network to assure foreign investors of their national treatment, non-discrimination, protection from expropriation, and efficient settlement of disputes.

Even in more recent years, states have entered into investment agreements for similar reasons. Vietnam has signed BITs and multilateral agreements over the past fifteen years and reformed its domestic laws to alleviate investors' concerns about domestic courts inefficiently enforcing awards made by arbitral tribunals (Malesky and Milner 2021, p. 454). The efforts of these states and international organizations to assure investors of their protection under BITs demonstrates that governments perceived (and some still believe) that BITs will attract more foreign direct investment.

## **(II.) PLACING NEPAL'S SITUATION IN THE LITERATURE**

### **(a.) Within Investor-State Regime and BRI Scholarship**

Claire Cutler (2020) has argued for a critical reimagining of the relationships between state sovereignty and new constitutional governance by corporate entities and global value chains. She categorized various reactions against the loss of autonomy among local governments and societies by the investor-state regime into three types: resistance against law through termination of investment agreements, resistance through means of law by engaging in treaty-sanctioned arbitration proceedings, and resistance through redefinition of the law. The Nepali state's limited experience with the investor-state regime has not fit perfectly into any of these categories as it has neither terminated agreements unilaterally nor insisted that foreign investors submit to domestic laws. Even in the midst of China-based corporations' increasing engagement in Nepal, the state has still maintained this ambiguous position.

Lampton et al. describe (2020, p. 86) two spectra of internal attributes to differentiate states' responses to China's infrastructure development overtures: (1) development-based legitimation, which defines the degree to which ruling political elites can legitimize their domestic rule, and (2) power pluralization, which defines how much political power is distributed across the ruling class and different segments of society. These authors' devised a table (p. 91) to demonstrate the power pluralization spectrum with China's engagement in Southeast Asia.

**Relative Degree of Development-based Legitimation**  
**(vs. identity-based legitimation)**

		Low	High
<b>Degree of Power</b>	High	Quadrant 3  Selective & flexible engagement (Thailand)	Quadrant 2  Receptive, with cyclical recalibration (Malaysia)
	Low	Quadrant 4  Limited involvement (Vietnam)	Quadrant 1  Enthusiastic embrace (Laos)

**Pluralization**  
**(vs. power concentration)**

Nepal’s engagement with China has adopted a similar approach as Thailand’s. Lampton et al. describe this state’s engagement (p. 99) as follows: “Thailand buys submarines from China, but simultaneously cooperates in US naval exercises. Similarly, Bangkok rejects Beijing’s rail financing and right-of-way development proposals but awards rail contracts to Beijing.”

Thailand’s strategy with accepting Chinese developmental aid despite close military ties to the United States corresponds to Nepal’s approach with India and China. However, instead of balancing between two states with a BIT on one end, Nepal has been balancing between China and India without these treaties for most of the past four decades.

The particular reasons why not every state participating in the BRI has an investment treaty with China has also been explored by legal scholars such as Wang Jiangyu in his comparative study of China’s BRI-sanctioned Memorandums of Understanding (MoUs) with the

Philippines and New Zealand (2019). Wang describes MOUs as a form of “soft law” that is easier to achieve than binding, hard law because it allows states to avoid public perceptions of having their “sovereignty directly challenged” by hard law. It also helps avoid uncertainty over the impact of hard law over time. It also facilitates compromises via “mutual and beneficial cooperation.” Any state participating in the BRI that does not have a BIT with China probably prescribes to the same views, but, surprisingly, no state with an existing BIT attempted to revise their treaty when signing an MOU. Given the increase in international investment in the twenty-first century and new advancements in dispute resolution, it is worth exploring why Nepal has not signed a BIT with China despite being an active participant in the BRI, unlike its South Asian counterparts.

#### **(b.) Within the Scholarship Concerning BITs’ Ambivalent Impact on FDI**

Allee and Peinhardt (2011) have discussed the effects of BIT-sanctioned disputes on FDI flow to states involved in ICSID arbitrations. They determine that when an investor brought a claim against the host state to ICSID, the state’s FDI decreases even if the case is pending or unresolved. If a state appears to be losing an arbitration or loses the arbitration’s final award, it loses an even greater amount of FDI. If a state loses a dispute, it will lose an annual average of \$663.8 million over the next five years following the decision. Even pending ICSID disputes result in states losing an average of \$31.57 million each year while the case is still being decided. These outcomes may explain Nepal’s hesitance to sign a BIT with China in the last twelve years, especially in light of India and its neighbors reassessing the impact of BITs. However, it does not explain why Nepal did not sign a BIT with China in the 1980s and 1990s when this data on the impact of arbitrations on FDI was not available.

Given that the number of ICSID cases has dramatically increased over the last twelve years, Kerner and Pelc (2021) have expanded on Alle and Peinhardt's research to examine the types of claims brought against states and their effects on FDI flows originating from the United States. They concluded that claims of direct expropriation result in a slowdown in fixed capital investments by American multinational corporations. However, cases involving other claims showed no equivalent effect. In terms of these authors' focus on multilateral relations, they only focus on states that have signed BITs and their investors. They do not pay attention to states that have no BITs like Nepal.

Economists have also examined the relationship between host states' involvement in investment arbitrations and subsequent FDI flows. Aisbett et al. (2018) examined the dispute-related reactions of investors from both BIT partner countries and non-partner countries and the effects on FDI flows. They determined that FDI flows from BIT-partners fall to a greater degree when at least one investor-state dispute involves the host state.<sup>4</sup> While this is crucial for disputes in ICSID, seeing as these arbitrations are almost always brought before this institution in accordance with a BITs provisions, it does not account for states' involvement in other multilateral initiatives such as the BRI.

### **(III.) CHINA AND SOUTH ASIA'S BIT STRATEGIES IN THE LATE 20<sup>TH</sup> CENTURY AND BRI ERAS**

#### **(a.) China**

China pursued a policy of opening up to the rest of the world throughout the 1980s and 1990s. Among the vast range of Asian and European countries with which it signed BITs, those of Bangladesh, Pakistan and Sri Lanka were also concluded in this time. From 1982 to 1999, the Chinese state concluded BITs with both capital-exporting and capital-importing countries to attract inward investment and promote China's outward FDI (Li and Bian 2020, p. 505).

China did not join the ICSID Convention until 1993. The UK's experience with negotiating its own BIT with China in 1986 reveals China's position on arbitration before it joined the Convention (Denza and Brooks 1987, p. 920-921):

Several countries with which the UK has [BITs] are not parties to the Convention though, in all cases, they have been persuaded to agree to submit such disputes to arbitration under the rules of other reputable bodies such as the International Chamber of Commerce and the UN Commission on International Trade Law...While the Chinese accepted the principle of arbitration, they wished to see arbitration of such disputes submitted to an ad hoc tribunal set up in accordance with detailed provisions specified in the [BIT]. This was the solution adopted in all previous Chinese [BITs]. The Chinese also took the view that, given that a foreign investor-individual or -company does not have the same status as a State, the investor's recourse to arbitration should remain much more limited. This was a point on which they remained immovable.

This observation indicates the approach China took with Sri Lanka, Pakistan, and Bangladesh for their BITs. It was not until the late 1990s that Chinese officials included consent to investor-state arbitration in BITs. Poulsen explains (2015, p. 158) that this change occurred because China needed BITs to protect its growing outward investment.<sup>4</sup>

In my interview with Dilini Pathirana (2022), a law professor from Sri Lanka who focuses on China's legal and FDI engagement in Sri Lanka, she explained that although Chinese investors' approach has been to resolve dispute through state-to-state diplomacy over the past decades, Chinese investors have been increasingly utilizing the investor-dispute resolution mechanism, as in Huawei's ICSID dispute with Sweden (Huawei Technologies Co., Ltd. v. Kingdom of Sweden). While this change has yet to result in disputes between Chinese investors and South Asian states, it is likely that investors familiar with this mechanism will utilize this in the future. The Chinese state has also been including broader protections for investors in its free trade agreements with Pakistan and Sri Lanka, both of which contain investment dispute provisions .

### **(b.) Sri Lanka**

Sri Lanka signed its BIT with China in 1986 and both sides ratified it the next year. The treaty was ratified during a decade when Sri Lanka was signing treaties with several Asian and European states. Pathirana (2020, p. 383) states that China and Sri Lanka linked up with their shared desire to open to foreign investment in the 1980s. The two states also had geopolitical

<sup>4</sup> In spite of this new drive, the Belt-and-Road Initiative has not encouraged states to sign or update investment treaties with China. Turkey remains the only state to have signed or ratified a BIT with China since the Initiative began in 2013 (UNCTAD).

considerations, with China seeking to curb India's influence in the region and Sri Lanka curbing India's intervention in Sri Lanka's civil war.

Over the past decade, Sri Lanka has also balanced Indian and China investment overtures. Despite joining the Belt-and-Road Initiative and permitting Chinese companies to develop its ports, Sri Lanka has still permitted Indian companies to hold stakes in the same industry. In my conversation with Pathirana (2022), she explained that protests against foreign investment in Sri Lanka do not appear focused on one origin. They are instead centered around projects that the Sri Lanka stakeholders could have developed themselves but the government awarded to foreign investors. The most recent example was the Sri Lankan government permitting the India-based Adani Group to develop the western sector of Colombo Port despite local labor unions arguing that they had sufficient means to develop the port themselves. The Indian government strongly desired to hold a stake in Sri Lanka's ports to counter China's growing influence, which motivated the Sri Lankan state to compromise with a joint venture project between Adani and Sri Lanka's largest listed company John Keells Holdings, and the Sri Lanka Ports Authority (SLPA). In spite of this competition and the existence of BITs, Sri Lanka has managed to avoid investment disputes with both Chinese and Indian investors.

### **(c.) Pakistan**

Poulsen (2015, p. 129-130) interviewed Pakistani diplomatic officials and consulted periodicals from the country's corporate sector to determine that Pakistan's main reason for concluding BITs was the expectation that they could help the country attract much-needed capital. Almost every visit with between Pakistani and foreign officials involved recommending that the two states sign a BIT. It was not until 2009 that the officials began to examine the efficacy of these treaties as the government became subject to international arbitration claims.

Despite these claims brought by investors from other states, Pakistan still maintains its BIT with China.

Another dimension to Pakistan's BIT with China is that it continues to remain in force despite the existence of the China-Pakistan Economic Corridor (CPEC), which started in 2015 to complement the Belt-and-Road Initiative. As one scholar explains (Sayed 2019, p. 126), "Every project in the CPEC has different terms and conditions as each is executed by a different Chinese state-owned enterprise (SOE) and is independent from other CPEC projects." The existence of multiple agreements raises an important question regarding the redundancy of a bilateral investment treaty that was concluded decades before the BRI. However, Pakistan's maintenance of this BIT raises an even greater question about why other states like Nepal would not want to conclude a treaty when other states participating in the BRI do not appear to be in any rush to terminate a seemingly-redundant treaty with China.

#### **(d.) Bangladesh**

Despite promulgating the Foreign Private Investment Act in 1980, Bangladesh's government still signed BITs with other states to assure foreign investors of their protection from expropriation. China was among the countries that signed a BIT with Bangladesh in the 1990s. Rumana Islam, a law professor who focuses on Bangladesh's BIT program, explains (2021, p. 2746) that Bangladesh BITs largely reflect the features of investor protectionism at the cost of national and public interest. Unlike other developing countries with a large number of BITs, investors' claims against Bangladesh are rather low. There has only been one international arbitration against it, *Saipem v. Bangladesh* in 2005, compared to twenty-six against India, ten against Pakistan, six against China, and five against Sri Lanka (UNCTAD Dispute Settlement Navigator). While the reasons for this low number remain unclear, it does help assure the

Bangladesh government that it can maintain these treaties with little conflict, no matter how unfounded those assurances may be.

In my correspondence with Rumana Islam (2022), she recounted that the personnel of government ministries responsible for signing BITs, such as those for foreign affairs and commerce, knew very little or nothing about the BITs signed before 2010. This discovery could indicate that Bangladesh's BIT program was very disorganized and it was not until after that year that the country developed a strategy for BITs when creating the Bangladesh Investment Development Authority.

#### **(e.) Nepal in the Late Twentieth Century**

Nepal displayed all of the same elements conducive to signing a BIT with China as Pakistan, Sri Lanka, and Bangladesh: The promulgation of the 1992 Foreign Investment and Technology Transfer Act demonstrated the Nepali government's willingness to attract foreign investment. However, during this period the Nepali state never signed a BIT with an emerging market economy in Asia, including China.

China did not pay attention to infrastructure development along its Tibet-Nepal border until 1999 when President Jiang Zemin announced the *xibu da kaifa* ("Open up the West") campaign (Mulmi 2021, p. 141). This lack of motivation on the Chinese side to bring investment into Nepal throughout the 1990s, especially at a time when Nepal was still signing BITs with other countries, thwarted any aspirations Nepali officials may have held for improving the country's ties to China. A Nepali law firm familiar with the government's BIT strategy over the past few decades confirmed to me (2022) that there was no initiative from the Chinese government to promote good economic relations during this time. By the time China was able to

develop Tibet's land border with Nepal, the Nepali state was deeply embroiled in a civil war that preoccupied its government from the late 1990s until its conclusion in 2006.

## **(IV.) NEPAL IN THE CONTEXT OF CHINA’S BRI AND INDIA’S MODEL BIT**

### **(a.) China and the BRI**

The BRI is China's two-pronged, multilateral strategy for international cooperation and economic development (Green Finance & Development Center 2021). It was introduced in September 2013 during President Xi Jinping's visit to Kazakhstan (Ministry of Foreign Affairs 2013). Officially, the priorities of the BRI projects are within the borders of countries that lie along the historic Silk Road and China's fifteenth-century maritime trade routes. In these terms, Sri Lanka and India’s state of Kerala should be China's priorities on the Indian subcontinent because their ports were visited by Chinese maritime voyages six centuries ago.<sup>5</sup> However, China has invited all states from across five continents to join the BRI network.

While the infrastructure projects of the BRI usually consist of roads, railways, hydroelectric power, and ports, some states have agreed to digital infrastructural development such as subsea fiberoptic cable networks and facial recognition technology.<sup>6</sup> The states agree to these projects by signing memorandums of understanding (MOUs). These MOUs are non-binding, bilateral documents that convey both parties' intent to work on development

<sup>5</sup> See Jung-pang Lo, *Zheng He: Chinese Explorer*, ENCYCLOPEDIA BRITANNICA (Jan. 1, 2021) <https://www.britannica.com/biography/Zheng-He> (displaying a map of voyages by the Chinese admiral, Zheng He, from 1405 to 1433).

<sup>6</sup> See Anna Gross et al., *China’s Tech Groups Shaping UN Facial Recognition Standards*, FINANCIAL TIMES (Dec. 1, 2019), <https://www.ft.com/content/c3555a3c-0d3e-11ea-b2d6-9bf4d1957a67>; see also *The Digital Side of the Belt and Road Initiative is Growing*, THE ECONOMIST (Feb. 6, 2020), <https://www.economist.com/special-report/2020/02/06/the-digital-side-of-the-belt-and-road-initiative-is-growing>.

cooperation. The areas of cooperation outlined in MOUs with China vary widely from joint transportation, infrastructure development, and establishment of sister-city networks to investment promotion, financial cooperation, and collaboration in regional initiatives.

Out of the 138 states who have officially signed MoUs, 41 of them do not have a ratified BIT with China (Li and Bian 2020, p. 524). Li and Bian explain why not having a BIT can be problematic (p. 526-527): As more and more Chinese investors commence projects under the auspices of host states participating in the BRI, a dispute with the host state becomes more likely. In the event of a dispute with one of these states, a Chinese investor would have to approach a domestic court, engage in commercial arbitration, or both states' governments would have to resolve the dispute. A domestic court could be unreliable in resolving the dispute, especially when enforcing an award or behaving impartially to both parties. An international commercial arbitration tribunal may be unable to bring a claim against a state due to sovereign immunity. Both governments resolving a dispute through diplomatic channels may exacerbate accusations that China's government is trying to exert its economic influence on BRI states and gain negotiating leverage.

Cotula et al. (2016, p. 49) conducted surveys of Chinese corporate actors on their attitudes towards conducting business in African states:

Company interviewees raised concerns about access to business opportunities, corruption, and unfair competition. They have developed strategies to deal with investment disputes, with a strong emphasis on alternative dispute resolution (ADR). Existing China-Africa BITs have little to say about these issues and strategies, which seems to create a misalignment between law and practice.

This approach may suggest that Chinese corporate actors do not push for investment treaties, which the Nepali state has taken to heart. A Nepali law firm familiar with China's FDI in the country confirmed to me (2022) that few of their counterparts from China have actually inquired about the possibility of an investment treaty between the two countries and that such discussions have only occurred on a governmental basis.

### **(b.) Nepal in the BRI Era**

Even before Nepal had officially joined the Belt-and-Road Initiative, imports from China had skyrocketed from \$300 million at the end of Nepal's civil war to \$1.1 billion in 2010 and has fluctuated between that figure and \$2 billion over the past decade (Observatory for Economic Complexity). The major imports that Nepal has received from China during this period are textiles, machines, and metals, many of which Nepal also receives from India.

As of 2019, firms in China became the second largest holders of foreign direct investment stock in Nepal after those in India (UNCTAD 2019, p. 5). Mulmi reports (2021, p.185) in September 2019, the chief ministers of six provinces in Nepal<sup>7</sup> pitched for Chinese investment at a forum set up by the Chinese embassy and a Chinese business committee. Nepal's Department of Industry reported that of the 227 FDI projects approved in the 2020 fiscal year, 176 were backed by Chinese investors, particularly in construction, cargo handling practices, software development, and manufacturing (Mulmi 2021, p. 185-86).

In 2019, the governments of Nepal and China issued a joint statement discussing the MOUs that have been signed and further avenues for cooperation. Article 5 of the document emphasizes the main objective of this new partnership, stating,

<sup>7</sup> There are only seven provinces in Nepal.

The two sides agreed to intensify implementation of the Memorandum of Understanding on Cooperation under the Belt-and-Road Initiative to enhance connectivity, encompassing such vital components as ports, roads, railways, aviation and communications within the overarching framework of trans-Himalayan Multi-Dimensional Connectivity Network. . .

The article proceeds to advance specific commitments made in MOUs that were signed in 2018 and 2017. Two such commitments were agreements to conduct a feasibility study on launching the Cross-Border Railway and bring into full play the Joint Implementation Mechanism on Nepal-China Cooperation in hydropower, wind power, and solar power. Another was the establishment of a working group on investment cooperation led by secretary and vice-minister-level officials. China already is investing heavily in Nepal's hydroelectric power sector with the construction of projects by two state-owned enterprises: China Water and Electric along the Rasuwaghadhi River and GeZhouBa along the Trishuli River (Murton et al. 2016).

### **(c.) Framing China's Investment in Nepal**

Mulmi reflects (2021, p. 189-190) on the presence of Chinese investment in Nepal:

Chinese investment today is most visible to the average Nepali in SMEs [small and medium enterprises] that form the largest share of FDI in the country. The hotels and restaurants in Thamel and other tourist districts, agro-businesses...and the many stores that sell to the Chinese tourist and expatriates—these enterprises shape the interactions and perceptions of Nepalis towards China, its companies and its people. But that brings separate challenges.

While its low-cost production methods are a boom to the Nepali consumer because of low prices, the scale of Chinese investments—even at SME levels—can overwhelm the Nepali entrepreneur. It is also apparent that Chinese companies have

a tendency to remain as silent partners in private ventures while orienting the business to Chinese nationals. In Thamel, for example, I visited a traditional ayurvedic medicine store that marketed to the Chinese tourist: the prices were in RMB, most of the salespeople were Chinese and even the billing system was in Mandarin, I asked the Nepali cashier, who had only joined a month ago and was visibly struggling with the computer's Mandarin user interface, about the company. She told me the products were Indian, the investment was Chinese but the owner was a Nepali...

Such an enterprise raises questions about outward capital flow and the loss of state revenue through the circumventing of local taxation systems. At the moment, there is little regulatory oversight, especially over digital payment mechanisms.

His observation reveals two aspects: First, the public's awareness of China's investment on an ambiguous, small-scale level hinders the creation of a shared consensus toward China-Nepal economic relations. Second, the arrangement of these enterprises gives insight as to why the Nepali government may not be enthusiastic for pushing for a BIT with China: It is hesitant to sign an investment treaty that could give Chinese investors a legal avenue to challenge the Nepali state if it chose to regulate these investments in the future.

#### **(d.) India's Influence on Nepal's Model BIT**

Like Pakistan, Sri Lanka and Bangladesh, India pursued a similar strategy of signing BITs with many countries including its neighbors. However, this approach changed drastically when the state lost a major arbitration case in 2011 to an Australian investor (*White Industries v. India*), in which a tribunal ruled against India's courts for setting aside a previous arbitral award

granted to White Industries. This case sparked a major reassessment of BITs in the Indian government.

Prabhash Ranjan interviewed Indian government officials from the ministries of commerce and finance, who recounted (2019, p. 267) that “many in the Indian government didn’t expect that a BIT claim would be brought against India for the actions of the Indian judiciary.” Ranjan also notes (p. 269) that another critical indicator of the Indian government’s change in attitude toward BITs were “the noticeably critical discussions carried out in Parliament since the *White Industries* award as against the period from 1994-2010. Opposition political parties have questioned BITs on the floor of the house, a phenomenon evident only after the *White Industries* case.” This led to a unilateral termination of India’s BITs with Sri Lanka and Nepal in 2017 and the BIT with China in 2018. However, the Bangladesh-India BIT survived because both governments were able to agree on signing the Joint Interpretive Note that clarifies (Press Information Bureau) the definition of investor, definition of investment, exclusion of taxation measures, Fair and Equitable Treatment (FET), National Treatment (NT) and Most Favoured Nation (MFN) treatment, expropriation, essential security interests and Settlement of Disputes between an Investor and a Contracting Party. India’s government also issued a model BIT in 2016.

In July 2019, Nepal’s government released a draft model BIT. The Investment Arbitration Reporter observed (2019) that the treaty closely resembles the prominent model treaty released by India, even going so far as to copy the same definition of investment with the same word missing: “‘An enterprise. . . [that] has the characteristics of an investment’ according to criteria of contribution, risk, duration, expectation of profit, and significance for host state development.” In terms of arbitration articles in the model BIT, Nepal would require investors

to pursue local litigation for at least three years before turning to international arbitration. While three years does not seem like a long time in the course of an investor-state dispute (this duration is even scaled-down from India's five-year requirement), requiring investors to go through domestic proceedings for that long could be detrimental to the state's ability to ensure reasonable access to courts and its system of appeals. While the influence of India's post-*White-Industries* approach on Nepal is very clear, it is also important to note that Nepal has not publicly incorporated this model treaty into any major treaty negotiations yet, even with China.

In regard to relations with India, even Sri Lanka and Bangladesh, who maintain close ties to India to this day, concluded BITs with many Asian states years before signing one with India. This indicates that India's influence on its neighbors cannot be the reason for the Nepali state's unwillingness to sign a BIT with China. However, there is the possibility that Nepal's government would prefer not to ratify an investment treaty with China until it makes a new treaty with India. There are two historical precedents for Nepal's government putting India before China: In the March 1989 India-Nepal border crisis, the Nepali state decided that, despite the Indian government closing off most of the border points, it could not afford to circumvent trade with India and harm this relationship in exchange for China's minimal support (Mulmi 2021, p. 139-140). Another instance occurred during the internal deliberations leading up to Xi Jinping's 2019 visit to Kathmandu, in which Nepali officials explained to the local press that there would be discussions with Chinese officials about extraditing criminals only because India's extradition treaty with Nepal was also being discussed at the same time (Ghimire 2019). Even in these two instances, it is important to note that the Nepali government took this approach on its own accord and was not influenced by any efforts by the Indian government to influence its negotiations with China.

## (V.) CHINA AND NEPAL IN BIT-SANCTIONED ARBITRATIONS

So far, the Chinese state has not entered into any publicized arbitration disputes with a South Asia state or investor.<sup>8</sup> However, analyzing the international arbitration disputes that involve Chinese investors can determine whether China and its investors had any issue with their arbitration articles and whether they honored their treaty agreements. After looking at three cases in which Nepal was not involved, we will turn to Nepal's only experience with international arbitration. It can reveal the Nepali government's concerns toward signing a BIT despite welcoming a large amount of Chinese investment.

### (a.) *Tza Yap Shum v. Peru* (2007)

One of the earliest examples is *Tza Yap Shum v. Peru* (2007), in which the state of Peru argued that ICSID did not have jurisdiction for two reasons: First, because Article 8(2) established the Peruvian courts' ability to adjudicate courts before proceeding to arbitration. Second, because Article 8(3) of the Peru-Chinese BIT only limits arbitration to considering the "amount of compensation for expropriation," not whether expropriation occurred in the first place (para. 61-62). However, the tribunal disagreed, citing Article 8(2) that not only stipulates their authority to determine the amount but also the occurrence of expropriation. As for the Peruvian courts' priority, the tribunal explained that the ICSID Convention permits investors to proceed to arbitration before courts (*Ibid.*). The arbitral tribunal's procedural decision on circumventing domestic courts can pose a problem for any South Asia state that is a party to the ICSID Convention because the option to approach a domestic court can be circumvented, unless

<sup>8</sup> See generally *Investment Dispute Settlement Navigator: China*, UNCTAD INVESTMENT POLICY HUB, <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/42/china> (last accessed April 8, 2022) (demonstrating that China has no current or prior publicized disputes with South Asian states).

explicitly stated in a treaty that domestic options must be exhausted first. The ruling also implicitly suggests that a domestic court should be approached first to avoid this kind of dispute. With this ruling in mind, Nepal's officials may be concerned about having its domestic courts circumvented.

**(b.) *Beijing Urban Construction v. Yemen (2014)***

The second ICSID case established the precedent of state-owned enterprises acting as investors and not as representatives of states. In *Beijing Urban Construction v. Yemen (2014)*, the state of Yemen argued that the claimant was a state-owned enterprise and could not be considered an investor under the BIT (para. 13). The tribunal ruled against this interpretation because the claimant was not a representative of China's government. Essentially, all South Asian states that are party to the ICSID Convention would need to acknowledge Chinese state-owned enterprises as investors in an ICSID dispute, unless they agree with China to define these corporations as representatives of the state in the treaty. This case also confirmed the procedural ruling of *Tza Yap Shum*, by allowing the tribunal to determine both the existence of liability and the amount of compensation (para. 29-30).

**(c.) *Ansung Housing v. China (2014)***

Another ICSID case that challenged the arbitration articles of a Chinese BIT is *Ansung Housing v. China (2014)*. The claimant was a South Korean real estate company that was disputing the Jiangsu provincial government's actions in the construction of a country club (para. 36). The tribunal analyzed the South Korea-China BIT's Article 9(7) to determine that the investor first learned it had incurred a loss over three years ago, which time-barred the claim and

rendered it meritless (Ibid.). The clause appears advantageous to the contracting state, should an investor take too much time to initiate arbitral proceedings.

**(d.) *Axiata and NCell v. Nepal (2019)***

The Nepali state has only been involved in one ICSID case: *Axiata and NCell v. Nepal*. Although Nepal and Malaysia do not have a BIT, the Malaysian telecoms group Axiata is relying on its subsidiaries in the UK, Ncell and Axiata Investments, to bring Nepal to arbitration under the Nepal-UK BIT (Dahlquist 2019). While this case is still pending, it is one example of how a BIT with one state could have unforeseen consequences with disputes brought by multinational corporations. Even if this case were to be decided in the Nepali government's favor, its officials would be justifiably concerned about signing an investment treaty with China that could allow multinational corporations with China subsidiaries to circumvent its domestic courts.

## CONCLUSION

Unlike Pakistan, Bangladesh, and Sri Lanka in the 1980s and 90s, Nepal did not pursue a BIT strategy with emerging market economies like China or India. At that time, China was also not in a position to instigate heavy investment in Nepal because Tibet, the main conduit between both states, was not a developmental priority. Despite Nepal's government formally declaring its interest in attracting foreign investment with the 1992 Foreign Investment and Technology Transfer Act, it only ratified BITs with European states up until its treaty with India. It also lost the initiative to link up with China's Tibet development plans in the late 1990s when it became embroiled in a civil war that lasted for an entire decade. As Nepal recovered from the conflict and China increased FDI in the region, the detrimental outcomes of BIT-sanctioned arbitrations became more pronounced to Nepal's South Asia neighbors, even prompting the Nepali government to copy India's reactionary Model BIT. At the same time, China became more focused on taking a soft law approach through the BRI by complementing increased trade and investment with MoUs. While Nepal and China did express their mutual interest in promoting investment in 2019, there has been no movement towards drafting an investment treaty.

The Nepali government has prioritized its relations with India over China in past situations when its northern neighbor made major diplomatic overtures, but this strategy was motivated by Nepali officials' own fears of harming their ties to India instead of a concerted effort by India's government and its corporations to influence the Nepali government's foreign policy. The implication of this observation is that the Indian government cannot stop Nepal from signing a treaty with China. As is the case in Sri Lanka, it can only counter China's follow-up investment (if any) with its own investment.

### **(a.) Areas for Future Research**

One of the best ways to expand this research would be to interview Nepali officials familiar with a hypothetical BIT negotiation process. Even if Chinese officials are less willing to divulge these discussions, their Nepali counterparts may be able to share what Chinese personnel have discussed with them on this topic.

A second critical aspect to pursue is the perspectives of corporate actors in Nepal and their Chinese counterparts. Their thoughts on the importance of an investment treaty, and whether they actively advocate for their home states to sign one, would reveal the extent to which these entities influence their governments' decisions. Although it appears that treaty negotiations have not been subject to much corporate lobbying over the past decade and corporate actors seem to place little importance on the existence of BITs as a condition for their engagement, Chinese corporations have become more willing to approach international tribunals sanctioned by their state's BITs since 2020, thus indicating that these entities are paying more attention to the legal avenues offered by these treaties. Over the next few years, corporations in China and other emerging market economies may become much more active stakeholders in their states' treaty negotiations and thus their perspectives on such processes will become more valuable.

### **(b.) A Nepal-China BIT Prognostication**

It may be that both governments have lost interest in pursuing a BIT for the time being, but China's changes in its BIT strategy over the past four decades at the onset of increased outward investment has indicated that the government can be swayed by domestic corporate interests. The increasing number of Chinese corporations engaging in BIT-sanctioned arbitration may encourage the Chinese government to revisit their BITs. The fact that China has maintained

BITs with Bangladesh, Sri Lanka, and Pakistan for decades without any arbitration disputes would assure personnel at China's Ministry of Commerce that there is little harm in promoting new or updated BITs to other states participating in the BRI. Even in that scenario, it is doubtful that the Nepali government would accept a BIT from China in that situation given its current dispute with Axiata and the dispute settlement avenues that might open to foreign investors in its wake. One avenue towards signing a BIT would entail Nepal's Ministry of Industry convincing China's Ministry of Commerce to accept the text of its model BIT. Otherwise, Nepal will continue with its own approach to investment dispute resolution through soft-law mechanisms on a state-to-state level.

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