

Why Are There So Few Investor-State Arbitrations in China? A Comparison with Other East Asian Economies

Dae Un Hong* & Ju Yoen Lee**

It is not easy to detect East Asia's presence in the field of investor-state dispute settlement (ISDS), despite its large economy. In addition to having less active foreign direct investment (FDI) relative to GDP and fewer investment treaties, East Asian economies and societies seem to possess certain characteristics that have contributed collectively to the dearth of ISDS cases in East Asia. Examples are the short history of international arbitration, the avoidance of litigation, the high proportion of state-owned enterprises in outward FDI from China, and the concentration of FDI in industries in which investor-state disputes are less likely to occur. This trend, however, is likely to change gradually with the ongoing socioeconomic changes in the region, including the increase in both outward and inward FDI, the increasing number of investment treaties, the growing familiarity with international (investment) arbitration among legal experts, the diversification of FDI, and the decreasing fear of administrative litigation.

Keywords: Investor-state Arbitration, East Asia, Foreign Direct Investment, Investment Treaty, Administrative Litigation.

* JSD candidate, Cornell University Law School; Attorney-at-Law (Korea Bar). A.B.(Seoul Nat'l Univ.), J.D.(Hanyang Univ.), LL.M.(Northwestern). ORCID: <https://orcid.org/0000-0002-8970-0497>. The author may be contacted at: dh632@cornell.edu / Address: Cornell Law School Myron Taylor Hall, Ithaca, NY 14853 USA.

** Visiting Scholar at Cornell University Law School; Attorney-at-Law (Korea Bar; Partner at Jinsol LLC). LL.B.(Korea Univ.), LL.M.(Peking / Northwestern), Ph.D.(Hanyang Univ.). ORCID: <https://orcid.org/0000-0002-0190-0030>. The author may be contacted at: jl3435@cornell.edu / Address: Cornell Law School, Myron Taylor Hall, Ithaca, NY 14853 USA.

I. INTRODUCTION

Numerous foreign investors have been interested in the Chinese market¹ since its opening in 1978. To attract foreign investment, China has signed many investment treaties with other countries. Since the International Centre for Settlement of Investment Disputes (“ICSID”) Convention entered into force in China on February 6, 1993, Chinese outward investment has attracted a lot of attention. In this regard, one may assume that many investment arbitrations would have been brought by foreign investors against China or by Chinese investors against other countries. Neither is true, however, despite its large economy (Table 1). Although the total number of known investor–state dispute settlement (“ISDS”) cases has continued to grow, reaching 817 as of July 31, 2017,² China has been the respondent state in only three cases, and Chinese investors have initiated ISDS cases only five times.

Table 1: Population and Gross Domestic Product (GDP) of East Asia

	Population (in thousands, 2016)	GDP (USD billion, 2016)
China	1,403,500.4 (18.8%)	11,382 (14.9%)
Japan	127,748.5 (1.7%)	4,920 (6.4%)
Korea	50,791.9 (0.7%)	1,393 (1.8%)
Taiwan	23,556.7 (0.3%)	529 (0.7%)
Hong Kong	7,302.8 (0.1%)	321 (0.4%)
Macau	612.2 (0.0%)	46 (0.1%)
East Asia	1,613,512.5 (21.6%)	18,590 (24.3%)
World	7,466,964.3	76,349

Sources: UNCTAD STAT³

This phenomenon is not restricted to mainland China; its customs areas such as Hong Kong,⁴ Macao, and Taiwan and other East Asian economies such as Japan and Korea⁵ show similar situations.⁶ Even though China became the world’s largest recipient of foreign direct investment (“FDI”) inflow in 2014,⁷ it is not often addressed in the field of ISDS. More broadly, East Asia accounted for 17.8 percent of the worldwide FDI outflow stock in 2016, second only to Western Europe and North America (Table 2), but investors have been based in this region

in only twelve known ISDS cases (1.3 %). Far more claimants have come from the rest of Asia, Eastern Europe, Latin America and the Caribbean, and Africa, although these regions account for only 6.1 percent, 1.6 percent, 2.1 percent, and 1 percent of the global FDI outflow, respectively.

Table 2: Number of ISDS Cases by Home Region of Investors (As of July 31, 2017)

Regions	Cases	Outward FDI Stock (USD trillion)	Cases per Outward FDI Stock (per USD trillion)
Western Europe	503 (56.3%)	11.41 (41.9%)	44.1
North America	197 (22.1%)	7.60 (27.9%)	25.9
Asia, excluding East Asia	80 (9.0%)	1.66 (6.1%)	48.1
Eastern Europe	53 (5.9%)	0.44 (1.6%)	119.6
Latin America and the Caribbean	31 (3.5%)	0.57 (2.1%)	54.4
Africa	14 (1.6%)	0.27 (1.0%)	52.1
East Asia	12 (1.3%)	4.84 (17.8%)	2.5
Oceania	3 (0.3%)	0.43 (1.6%)	7.0
World outside of East Asia	881 (98.7%)	22.39 (82.2%)	39.3

Sources: Compiled from UNCTAD Investment Dispute Settlement Navigator⁸ (cases) and UNCTAD STAT⁹ (FDI stock)

The same applies to FDI inflow. Although East Asia accounts for 12.4 percent of the global FDI inflow stock as of 2016, again second only to Western Europe and the US (Table 3), East Asian economies have been respondents in ISDS cases only seven times (0.9 percent) - two times per USD 1 trillion in FDI inflow stock. The rate is far lower than the world average when East Asia is excluded (33.3 times) and lower than the average in Western Europe (6.8 times) and North America (5.7 times), where the rule of law is relatively more established and thus regulations are supposed to be less often imposed in an arbitrary manner.

Table 3: Number of ISDS Cases by Respondents (As of July 31, 2017)

Regions	Cases	Inward FDI Stock (USD trillion)	Cases per Inward FDI Stock (per USD trillion)
Latin America and the Caribbean	228 (27.9%)	2.01 (7.2%)	113.6

Eastern Europe	216 (26.4%)	1.12 (4.0%)	192.2
Asia, excluding East Asia	169 (20.7%)	3.36 (12.1%)	49.4
Africa	92 (11.3%)	0.84 (3.0%)	110.0
Western Europe	61 (7.5%)	8.99 (32.4%)	6.8
North America	42 (5.1%)	7.35 (26.5%)	5.7
East Asia	7 (0.9%)	3.42 (12.3%)	2.0
Oceania	2 (0.2%)	0.67 (2.4%)	3.0
World outside of East Asia	810 (99.1%)	24.33 (87.7%)	33.3

Sources: Compiled from UNCTAD Investment Dispute Settlement Navigator¹⁰ (cases) and UNCTAD STAT¹¹ (FDI stock)

In this research, the authors will try to explain why ISDS has been so rarely utilized in China and other East Asian economies despite their large economy. This article is composed of six parts including an introduction and conclusion. Part two will discuss general factors applicable to both outward and inward FDI. Parts three and four will discuss specific reasons for the dearth of ISDS cases initiated by Chinese and other East Asian investors or brought against China and other East Asian economies. Part five will touch on the signs of change in the future.

II. FACTORS APPLICABLE TO FEW ISDS CASES IN BOTH OUTWARD AND INWARD FDI

A. Less Active FDI

Outward FDI had been relatively inactive in China and other East Asian economies until recently. In 2005, the outward FDI stocks of China, Japan, and Korea accounted for less than 10 percent of their GDPs, far below the average of other economies (Table 4). Although their stocks continued to grow (and more than tripled in 2015), they are still well below the average of other economies. The same applies to the inward FDI stocks of China, Japan, and Korea. Although inward FDI stocks comprise a larger percentage of the GDP in China than in Japan and Korea, this percentage is still well below the average of the

Organization for Economic Cooperation and Development (“OECD”) countries outside East Asia and the world average (excluding China, Japan, and Korea). The low outward and inward FDI activity of these economies has presumably contributed to less utilization of ISDS in East Asia.

Table 4: FDI Stocks as a Share of GDP

Year	Outward FDI Stock as a Share of GDP			Inward FDI Stock as a Share of GDP		
	2005	2010	2015	2005	2010	2015
China	2.8%	5.2%	10.0%	20.6%	25.7%	24.5%
Japan	8.1%	14.6%	28.0%	2.1%	3.8%	4.0%
Korea	4.3%	13.2%	20.7%	11.7%	12.4%	13.0%
OECD, excluding Japan and Korea	31.7%	41.8%	44.4%	27.0%	33.6%	40.1%
World, excluding China, Japan, and Korea	28.3%	35.4%	38.6%	26.9%	34.6%	40.5%

Sources: Compiled by the authors from OECD.Stat¹² and UNCTAD STAT (FDI stock)¹³

B. Relatively Few Investment Treaties,¹⁴ Except in China and Korea

According to the United Nations Conference on Trade and Development (“UNCTAD”), the total number of investment treaties in force reached 2,673 in 2017.¹⁵ Japan has been much less active in negotiating investment treaties than China and Korea, and Taiwan has faced difficulty negotiating treaties with other economies because of its special relationship with mainland China (Table 5). Currently, only twenty-three investment treaties are in force in Hong Kong despite its huge inward and outward FDI. Macau has only four investment treaties.

Table 5: Number of Investment Treaties in Force (As of July 31, 2017)

Rank	Economy	BITs	TIPs	Total
1	Germany	129	56	185
2	France	96	56	152
3	United Kingdom	95	56	151
4	Netherlands	90	56	146
5	Switzerland	112	31	143
8	China	110	19	129
21	Korea	88	17	105

36	Russia	63	6	69
51	Canada	35	17	52
60	Japan	24	19	43
102	Taiwan	17	6	23
102	Hong Kong	18	5	23
135	Brazil	0	13	13
179	Macau	2	2	4

Source: UNCTAD International Investment Agreements Navigator¹⁶

The small number of investment treaties may help to explain why there have been so few ISDS cases brought from or against Hong Kong, Macau, Taiwan, and Japan; fewer investment treaties will generally lead to less protection of investors and, therefore, a small number of ISDS cases. For example, because Brazil did not sign the ICSID Convention and has no bilateral investment treaty (“BIT”) in force,¹⁷ no ISDS case has been initiated by Brazilian investors or brought against the Brazilian government.¹⁸ This explanation, however, has obvious limitations for the cases of China and Korea. For example, Canada and Russia have far fewer investment treaties than China and Korea (Table 5), but they have each appeared in ISDS cases more frequently than all East Asian economies combined. Whereas twelve ISDS cases have been initiated by East Asian investors and seven have been brought against East Asian economies, Canadian and Russian investors have initiated forty-five and sixteen ISDS cases, and twenty-six and twenty-four cases have been brought against Canada and Russia, respectively.¹⁹

It is also worth noting that China’s early BITs did not include an investor–state dispute option in line with the treaty practice at that time.²⁰ These BITs tended to define investments narrowly and would only grant foreign investors most-favored-nation treatment.²¹ It was not until the late 1990s that Chinese BITs started providing access to ICSID for all kinds of investor-state disputes.²² In addition, when China became a contracting party of the ICSID Convention, it made a reservation that it “would only consider submitting to the jurisdiction of the ICSID disputes over compensation resulting from expropriation or nationalization.”²³ This practice would have been an obstacle to ISDS claims, although foreign investments in China, especially infrastructure investments, have frequently become subject to forcible takeovers in the name of ‘public interest’ as an alternative to expropriation.²⁴

III. FACTORS APPLICABLE TO FEW ISDS CASES IN OUTWARD FDI: CHARACTERISTICS OF CHINESE AND OTHER EAST ASIAN INVESTORS

A. Characteristics of East Asian Economies as the Home States of Claimants

1. Unfamiliarity with Arbitration among Legal Experts

The rarity of ISDS cases in China and other East Asian economies is partly attributable to a lack of familiarity with the arbitration system in the region. International arbitration as we know it today developed mainly in the West, especially in Europe,²⁵ and it is still not widely used in East Asia. The history of modern arbitration is relatively short in China as the Arbitration Act was first enacted in 1994 and came into force in 1995.²⁶ Although each year approximately 700 cases are filed with the China International Economic and Trade Arbitration Commission, most of which are not domestic but international.²⁷ Arbitration acts were enacted earlier in other economies: first in Japan in 1890 as a part of the Code of Civil Procedure Act²⁸ and then in Korea in 1965. Nevertheless, business disputes, especially domestic ones, are still rarely brought to arbitration in Japan²⁹ and Korea.³⁰ The lack of confidence in the integrity of the arbitration process is a persistent problem in Taiwan, as well.³¹

In China, because no legal education system existed during the Cultural Revolution (the national bar exam was first implemented in 2002), lawyers have not had enough time to develop extensive experience in international litigation or arbitration. In Japan and Korea, the legal market has generally been dominated by a small number of judicial elites³² who are not very interested in international litigation or arbitration. Actually, most major Japanese and Korean law firms did not begin to establish overseas offices until recently, which helps to explain how much they lag behind their Western counterparts in terms of globalization.³³ As a result, there are far fewer arbitrators or arbitration experts in East Asia than in other major developed or developing economies, such as the US, the UK, Argentina, Mexico, and Brazil.³⁴ This situation has resulted in a lack of ISDS experts in the region. In fact, there were no arbitrators from either China or other East Asian economies in the ICSID cases until December 2010.³⁵ Of the 401 arbitrators, conciliators, and ad hoc committee members who participated in the

ICSID cases as of the end of 2016,³⁶ only four were from East Asia: one each from China (although he resigned during the proceedings), Hong Kong, Japan, and Korea.³⁷

Consequently, the relatively short history of arbitration and the resulting lack of arbitration experts in East Asia have prevented many East Asian investors from utilizing ISDS.

2. *Avoidance of Litigation against the Government*³⁸

International investment law deals with situations similar to those under domestic administrative law.³⁹ It is widely agreed that East Asian technocrats have been less subjected to judicial interference than their American and European counterparts. Here, the administration has thus exercised greater power than other branches of society.⁴⁰ In China, the Administration Litigation Law was not implemented until October 1990. Even now, taking local officials to court is still like “throwing an egg against a stone” for victims because administrative malfeasance would not be easily found to be illegal in Chinese courts.⁴¹ Considering that China is still dominated by a single party, it is no surprise that Chinese courts play a complementary role in political-administrative mechanisms for dispute resolution and an even more limited role in the making of key policies, particularly with respect to politically sensitive cases.⁴² Traditionally, in Japan, the administration has been more active than the court,⁴³ so that it is difficult for plaintiffs to prevail in administrative litigation in Japan.⁴⁴ Korea was subject to authoritarian regimes with an imperial presidency for decades until the 1980s through the *de facto* presumption of executive supremacy by the use of various law enforcement offices, such as the police, prosecutors’ office, and intelligence office.⁴⁵ Moreover, there are even legal obstacles to overcome, such as statutes of limitation, for administrative litigation in Japan and Korea.⁴⁶ Similarly, although the Administrative Court and the Administrative Litigation Act had been effective for a long time in Taiwan, bureaucracy was only checked in a limited manner before 1987, when the Martial Law Decree was lifted and political liberalization began.⁴⁷ Because many are still afraid to bring a claim against the state, administrative litigation has not been widely used in East Asia.

Table 6 shows that there exists a huge gap in administrative litigation between East Asia and many other regions. Although the amount of administrative

litigation in China has increased remarkably, only 225,485 cases took place in 2016, which is a relatively small number given China's large population. In Korea, 30,834 administrative cases were filed in all courts in the same year. In Japan, a country with well over 100 million people, only 9,813 administrative litigations were initiated in 2016. In contrast, administrative litigation was much more popular in many other countries, such as France, Poland, and Sweden. In Spain, which is roughly comparable to Korea in terms of population and GDP, there were 191,088 administrative litigations in 2013. In Russia, 563,976 claims were brought against the government in 2011. The Brazilian government was sued in a total of 2,580,232 claims in courts of the first degree and 676,966 times in courts of the second degree in 2009.

Table 6: Number of Administrative Litigations per 1,000 People by Economy

Regions	Year	Administrative Cases	Population	Administrative Cases per 1,000 People
Brazil ⁴⁸	2009	3,257,198	194,895,996	16.71
Sweden ⁴⁹	2014	133,161	9,689,376	13.74
Lithuania ⁵⁰	2013	22,748	2,997,334	7.59
Spain ⁵¹	2013	191,088	46,697,052	4.09
Russia ⁵²	2011	565,332	143,263,988	3.95
France ⁵³	2014	237,564	66,418,986	3.58
Poland ⁵⁴	2015	102,165	38,265,226	2.67
Taiwan ⁵⁵	2016	25,741	23,556,706	1.09
	2012	12,064	22,928,526	0.53
Macau ⁵⁶	2016	632	612,167	1.03
	2008	219	514,348	0.43
Korea ⁵⁷	2016	30,834	50,791,919	0.61
	2008	23,389	49,218,985	0.48
China ⁵⁸	2016	225,485	1,403,500,365	0.16
	2008	108,398	1,344,415,227	0.08
Japan ⁵⁹	2016	9,813	127,748,513	0.08
	2008	8,571	128,550,508	0.07
Hong Kong ⁶⁰	2012	159	7,106,399	0.02

Sources: UNCTAD STAT⁶¹ (population)

Moreover, state-owned enterprises (“SOEs”) account for a significant portion of the Chinese and Taiwanese economies. SOEs and entities directly controlled by SOEs comprise more than 40 percent of China’s non-agricultural GDP.⁶² Including the contributions of indirectly controlled entities, urban collectives, and public township and village enterprises, approximately 50 percent of GDP is owned and controlled by the state.⁶³ Taiwanese authorities control many SOEs in various sectors, as well.⁶⁴ In general, SOEs are not likely to bring administrative action against the government because they are supposed to share many common interests with the government and generally act in alignment with it.

In short, limited experience with bringing a legal claim against the government has likely contributed to East Asian investors’ hesitation to initiate an ISDS case.

3. Legal Culture

In many aspects, Confucian societies such as China, Japan, and Korea demonstrated a preference for resolving interpersonal conflicts outside the court.⁶⁵ Legal sanctions were used only when no alternative existed or the gains were thought to outweigh the costs of compromised relations and trust.⁶⁶ In general, informal mechanisms rather than formal legal rules were used to resolve most civil disputes.⁶⁷

Based on Confucianism, Chinese⁶⁸ and Japanese⁶⁹ societies are still reluctant to litigation. In a dispute about transnational energy pipelines, a Chinese scholar claimed that the best way to settle a dispute was through diplomatic or political means, such as negotiation and consultation, and that legal methods should always be a last resort.⁷⁰ In general, Japanese investors are risk-averse and prefer to take a long-term view when disputes arise. Therefore, they have not yet directly availed themselves of the ISDS provisions provided in any Japanese treaty, even those with developing countries.⁷¹ Japanese investors tend to negotiate amicable settlements directly with the host state or through the informal good offices of their own government.⁷²

In brief, the traditional Confucian preference for amicable resolution⁷³ of disputes through moral persuasion rather than legal processes in China, Japan, and Korea⁷⁴ appears to be an important factor affecting the number of ISDS cases.

4. High Portion of SOEs in Outward FDI from China

According to the People’s Republic of China (“PRC”) Ministry of Commerce,

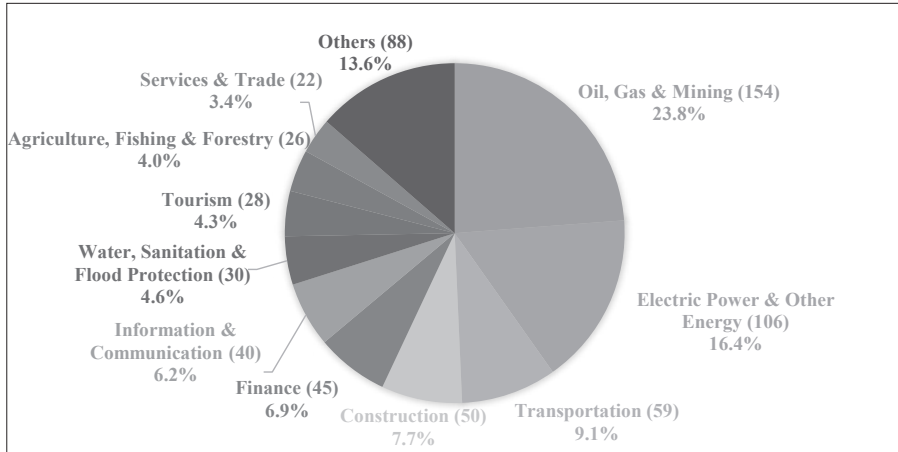
outward FDI from China's SOEs accounted for 69.2 percent of total outward FDI stock at the end of 2009, whereas private firms accounted for only 1 percent of total outward FDI stock.⁷⁵ In addition, all the top thirty firms, ranked by overseas assets and overall firm size, are SOEs.⁷⁶ The proportion of SOEs involved in outward FDI is estimated to be higher if other types of companies under the Chinese government's influence are included.⁷⁷

Chinese investors have emerged from a strongly state-led economic model featuring a high level of state ownership in national enterprises.⁷⁸ As China's corporate engagement is based on its diplomatic strategy,⁷⁹ SOEs may be discouraged from initiating an ISDS claim due to the diplomatic concerns of their home state, although Beijing's control mechanism may not always be direct or effective.⁸⁰ For example, China relies heavily on the coordination of a complex array of corporations and government bureaucracies to achieve its policy objectives in Africa.⁸¹ Moreover, a conventional moral hazard problem may prevent Chinese SOEs from initiating ISDS cases. They may feel free to act in a fiscally irresponsible manner by relying on China's state-controlled banks for financial support regardless of their economic performance.⁸² In China, because SOEs are the primary source of outward FDI, Chinese investors initiate few ISDS claims.

5. Concentration of Outward FDI in the Japanese, Korean, and Taiwanese Manufacturing Industries

Industry-specific analysis is appropriate because investor-state disputes are more likely to occur in some industries (*e.g.*, oil exploration) than in others (*e.g.*, light industry).⁸³ For instance, it is hardly expected that a foreign investor in a T-shirt factory would be concerned about the kind of mistreatment of investors unambiguously outlawed by BITs.⁸⁴ Indeed, of the 648 cases in which the economic sector was identified by ICSID on December 10, 2017, investor-state disputes were most frequent (23.8 percent) in the oil, gas, and mining sectors, followed by the energy sector (Figure 1). Manufacturing is one of the least litigated industries in ISDS and belongs to other industry.

Figure 1: ICSID Cases by Economic Sector (As of July 31, 2017)



Source: ICSID⁸⁵

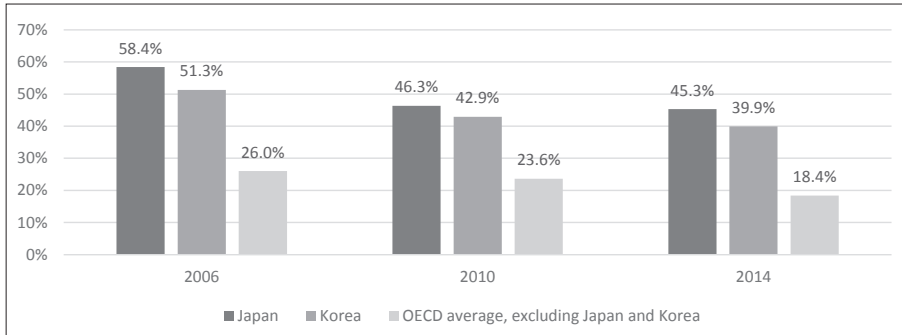
East Asia has highly manufacturing-oriented economies. The percentage of the GDP produced by the manufacturing industries in China (incl. Taiwan) and Korea is higher than double the average in non-East Asian economies (Table 7).

Table 7: Manufacturing as a Share of GDP

Taiwan (2016)	Korea (2015)	China (2015)	Japan (2015)	World outside of East Asia (2015)
30.3%	29.8%	29.4%	20.5%	13.4%

Sources: Compiled from World Bank (China, Japan, Korea, and world)⁸⁶ and Statista.com (Taiwan)⁸⁷

This economic structure has resulted in an unusually high degree of concentration of outward FDI in manufacturing, at least among the OECD members, although the degree of concentration has decreased in recent years (Figure 2). The same applies to Taiwan. By the end of 1995, 65.9 percent of Taiwanese outward investments were directed at manufacturing activities,⁸⁸ and manufacturing was the target industry of about half of Taiwan’s outward investment flow in 2013.⁸⁹

Figure 2: Portion of Outward FDI Stocks in the Manufacturing Industry

Source: Compiled from OECD.Stat⁹⁰

To sum up, outward FDI from Japan, Korea, and Taiwan is concentrated not in the resource extraction and energy sectors (where ISDS is most frequently used) but in the manufacturing industry (where ISDS is very rarely used). This seems to have contributed to the dearth of ISDS cases initiated by investors from those economies.

IV. FACTORS APPLICABLE TO FEW ISDS CASES IN INWARD FDI: WHO INVESTS IN EAST ASIA, AND WHERE DO THEY INVEST?

As mentioned above in Table 3, East Asian economies have been respondents in ISDS cases far less often than other economies, including their counterparts in Western Europe and North America. What brought East Asia to this dearth of claims against their economies?

A. Investments from East Asia

The characteristics of East Asian economies, as discussed in Part III - unfamiliarity with arbitration, avoidance of litigation (against the government), and the predominance of investment in the manufacturing industry - are still applicable to inward investment because East Asian economies themselves are the primary sources of foreign investment in East Asia (Table 8). For example, FDI from Hong

Kong accounted for 70 percent of China's inward FDI for a long period.⁹¹

Table 8: Intra-region FDI Stocks in East Asia in 2012

Invested Economy	Investing Economy	Inward FDI Stock from East Asia (USD billion)	Total Inward FDI Stock (USD billion)
China	Hong Kong (44.1%), Japan (6.5%), Taiwan (4.2%), Korea (3.9%), Macau (0.8%)	799.8 (59.5%)	1,343.6
Hong Kong	China (37.0%), Japan (1.8%), Korea (0.9%), Taiwan (0.7%)	502.8 (40.4%)	1,244.6
Macau	Hong Kong (25.9%), China (12.2%), Japan (0.2%), Korea (0.1%)	7.3 (38.3%)	18.9
Korea	Japan (26.8%), Hong Kong (2.1%), China (1.3%), Taiwan (0.2%)	47.4 (30.4%)	156.1
Taiwan	Japan (14.3%), Hong Kong (5.0%), Korea (0.8%)	24.3 (20.0%)	121.4
Japan	Hong Kong (2.8%), Korea (1.4%), Taiwan (1.2%), China (0.3%)	11.7 (5.7%)	205.8
Total		1,393.3 (45.1%)	3,090.5

Sources: Compiled from UNCTAD Bilateral FDI Statistics 2014,⁹² OECD.Stat,⁹³ and UNCTAD STAT (FDI stock)⁹⁴

In the case of China, “round-tripping” must be mentioned. In the past, it was a rather common practice for Chinese companies to set up so-called special purpose vehicles (“SPVs”) abroad for reinvestment on the Chinese mainland.⁹⁵ Before 2008, one of the main goals of Chinese round-trip investment structures was to utilize special FIE tax holidays.⁹⁶ Although the 2008 reform of China’s enterprise income tax system abolished this opportunity, “round-tripping” is still used to gain access to overseas financing and to avoid regulatory as well as practical problems with onshore listings.⁹⁷ As a result, some speculate that inward FDI in China may be overstated by between 25 and 50 percent.⁹⁸ Such high portion of intra-region FDI would thus prevent foreign investors in East Asia from bringing their claims to ISDS.

B. Investments from Outside of East Asia

1. Concentration of Inward FDI in the Manufacturing Industry in China, Japan, Korea, and Taiwan

As mentioned above, investor–state disputes are most likely to occur in the resource extraction and energy sectors but have little likelihood of occurring in the manufacturing industry. FDI in the primary sector (mostly the extraction industry) has been quite sluggish in East Asia as a whole. Comparing the composition of FDI inflow into China to that of FDI inflow into other economies, foreigners invest in more the secondary sector (mostly manufacturing) than the primary sector in China. Indeed, China’s mining industry received only 0.5 percent of the total inward FDI stock, far below that of many other economies (Table 9). The share is even lower in Japan and Korea. In comparison, the primary sector in Latin America and the Caribbean received 23 percent of FDI inflows in 2005,⁹⁹ and the primary sector accounted for nearly 50 percent of FDI inflows between 1996 and 2000 in twenty-four African economies.¹⁰⁰

Table 9: Portion of FDI Stocks in the Mining Industry (2014)

China ¹⁰¹	Japan	Korea	OECD average, excluding Japan and Korea
0.5%	0.03%	0.03%	7.3%

Source: Compiled from OECD.Stat (Japan, Korea, and other OECD economies)¹⁰²

By contrast, 70 percent of the FDI in China was concentrated in the manufacturing field before 2002,¹⁰³ partly due to the supply of cheaper labor and the relatively lower cost of materials.¹⁰⁴ Inward FDI is highly concentrated in the manufacturing industry in Japan and Korea as well (Table 10). In Taiwan, 61.5 percent of inward FDI flowed into the manufacturing industry in 2016.¹⁰⁵

Table 10: Portion of Inward FDI Stocks in Manufacturing Industry (2014)

China ¹⁰⁶	Japan	Korea	OECD average, excluding Japan and Korea ¹⁰⁷
54.2%	40.6%	38.2%	20.4%

Source: Compiled from OECD.Stat (Japan, Korea, and other OECD economies)¹⁰⁸

Although China is rich in natural resources, it has either discouraged or banned

foreign investment in many areas of the extraction industry. Since 1995, the Chinese government has promulgated the Catalog for Industry Guidance of Foreign Investment (hereinafter the Catalog), which addresses the primary source of control over the industries in which foreigners may invest.¹⁰⁹ The Catalog is divided into three parts: (1) encouraged industry; (2) restricted industry; and (3) prohibited industry.¹¹⁰ For example, the 2011 Catalog restricted foreign investment in ten categories of mining and prohibited foreign investment in three categories of mining.¹¹¹ Therefore, it is no coincidence that the three ISDS cases brought against China were outside the extraction industry (Table 11).

Table 11: ISDS Cases Brought Against China (As of July 31, 2017)

Name	Industry	Status
Hela Schwarz GmbH (Germany) v. People's Republic of China (ICSID Case No. ARB/17/19)	Manufacturing (food products)	Pending
Ansung Housing Co., Ltd. (Korea) v. People's Republic of China (ICSID Case No. ARB/14/25)	Real estate development	Decided in favor of State
Ekran Berhad (Malaysia) v. People's Republic of China (ICSID Case No. ARB/11/15)	Construction	Settled

Source: ICSID¹¹²

Unlike those of China, the mining industries of Japan, Hong Kong, Korea, and Taiwan are not attractive to foreign investors. Because natural resources are scarce and labor costs are high in all of these countries, their mining industries do not play a significant role in their economies. Japan's mining sector did not account for more than 0.2 percent of the GDP during any year from 1994 to 2013.¹¹³ In Hong Kong, the primary industry, including the mining and quarrying sectors, accounted for 0.1 percent of the GDP from 2012 to 2016.¹¹⁴ In Korea, mining and quarrying activity accounted for just 0.2 percent of GDP in 2013 and 2014.¹¹⁵ In Taiwan, the mining and quarrying sectors accounted for 0.1 percent of GDP in 2014.¹¹⁶

To sum up, the concentration of inward FDI in the manufacturing industry and lack of inward FDI in the resource extraction industry, where ISDS is most likely

to be used, appear to have contributed to the dearth of ISDS cases brought against East Asian economies.

2. Preference for Informal Dispute Settlement with the Chinese Government

Not only Chinese individuals but even foreigners in China would generally see administrative litigation as hopeless, costly, and dangerous to their relationship with the government.¹¹⁷ Only a handful of foreign litigants have directly challenged the Chinese state in court, mainly in regard to patent or trademark litigation initiated by multinational companies.¹¹⁸ Conversely, these companies would regularly challenge government actions in the courts of the US, the EU and developing economies such as Mexico, Brazil, and India.¹¹⁹ For foreign companies in China, ‘tread carefully’ continues to be the mantra of lawyers and businesspersons alike.¹²⁰

Foreign investors in China - both from Asia and the West - have often relied on *guanxi*, special relationships with the relevant government agencies, to do business in China.¹²¹ They are often advised to hire local consultants who can provide information about the internal workings of the Chinese government. The local consultants, who are usually former government officials, may have *guanxi* that are useful in setting up and coordinating meetings.¹²² These local government relations staff will always want to resolve such disputes by negotiation,¹²³ not through a legal process (e.g., administrative litigation or arbitration). Even a prominent foreign lawyer who has practiced in China for decades will strongly advocate for a non-confrontational resolution of disputes with government agencies.¹²⁴

V. SIGNS OF CHANGE: WHY WE ARE LIKELY TO SEE MORE INVESTOR-STATE ARBITRATIONS IN EAST ASIA IN THE FUTURE?

It will become increasingly easier for both East Asian investors and foreign investors in East Asia to invoke investment treaties. As mentioned above, since the late 1990s, Chinese BITs have provided access to ICSID for all kinds of investor-state disputes, not just those arising from expropriation. In addition, there has been

competition among East Asian economies to sign more investment treaties. For instance, the Japanese government aims to increase more than double the number of its investment treaties by 2020.¹²⁵

On the claimants' side, it is likely that more East Asian investors will avail themselves of ISDS in the future for the following reasons. First, there have been fast and steady increases in outward FDI from East Asia, especially from China because its outward FDI stock grew by more than 1,800 percent from 2005 to 2015 (Table 12). This number is far above that of the EU (80.0 %) and the US (65.1 %). Chinese companies have increased outward FDI because domestic markets have become increasingly competitive and saturated, especially after 2000.¹²⁶ Such a trend is likely to continue for the foreseeable future because China's outward FDI stock still accounts for a far smaller portion of its GDP than the world average (Table 4). Outward FDI stock from the rest of East Asia has substantially grown as well, more than quadrupling from 2005 to 2015. In contrast, outward FDI stock from the rest of the world has grown only 88.9 percent during the same period.

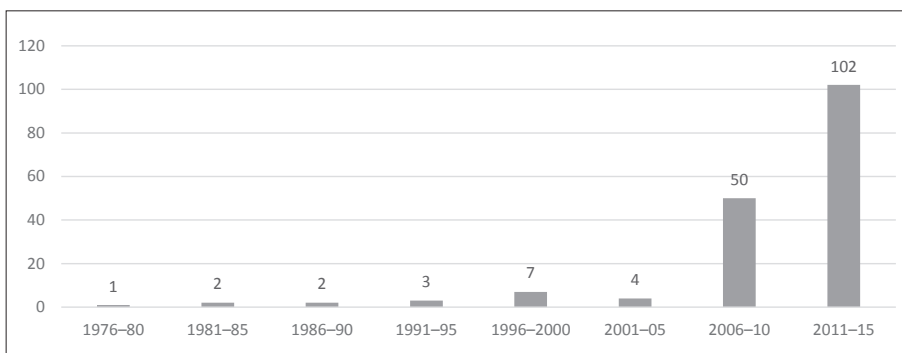
Table 12: Outward FDI Stock Growth Rate (2005-15)

Regions	2005	2010	2015	Growth Rate (2005–2015)
China	57.2	317.2	1,097.9	1819.2%
Hong Kong	476.2	943.9	1,531.4	221.6%
Japan	386.6	831.1	1,226.6	217.3%
Korea	38.7	144.0	285.9	639.2%
Macau	0.5	0.5	3.1	536.1%
Taiwan	103.3	190.8	303.1	193.3%
East Asia	1,062.5	2,427.6	4,448.0	318.6%
European Union	5,060.7	9,138.9	9,110.7	80.0%
United States	3,638.0	4,809.6	6,005.7	65.1%
World outside of East Asia	10,840.0	18,511.6	20,477.2	88.9%

Source: Compiled from UNCTAD STAT¹²⁷

Second, international (investment) arbitration is becoming a more viable option for East Asian investors. The Chinese and Korean arbitration communities are becoming increasingly familiar with the ICSID proceedings,¹²⁸ as the Chinese and the Korean governments have been promoting international arbitration. For example, the Chinese government has increased its legal diplomacy efforts in Africa to promote joint dispute arbitration mechanisms by establishing the China Africa Joint Arbitration Centre.¹²⁹ Meanwhile, the Korean government played a key role in establishing the Seoul International Dispute Resolution Center in 2013 and enacting the Arbitration Industry Promotion Act in 2016. As Chinese lawyers are becoming more professional,¹³⁰ arbitration has been increasing steadily in China.¹³¹ The capacity of corporate legal departments in Japan and Korea is improving partly due to the emergence of staff members who are practicing lawyers.¹³² In addition, more international law scholars in this region are studying and teaching ISDS. For example, only two scholarly articles on ISDS were published in Korean academic journals in 2005, but the number jumped to sixteen in 2010 and has been more than twenty each year since 2012 (Figure 3). Moreover, it is now much easier than before for future lawyers in the region to obtain international arbitration experience, including ISDS, by participating in international competitions based in East Asia, such as Vis Moot (East), which started in 2004¹³³ and FDI International Arbitration Moot Asia Pacific Regional Round, which started in 2009.¹³⁴

Figure 3: Number of Academic Journal Articles on ISDS in Korea



Source: Compiled from RISS¹³⁵

Third, administrative litigation has been increasing in East Asia (Table 6). Compared to 2008, the number of administrative litigations per capita in 2016 increased by 99.3 percent in China. During the same period, this number went up to 15.2 percent in Japan, 27.7 percent in Korea, and 142.5 percent in Macau. In the case of Taiwan, the number of litigations has increased by 107.7 percent since 2012. This trend suggests that East Asian investors will be more willing to sue foreign governments in the future.

Fourth, the legal culture has been changing in this region. Today, Confucianism are weakening, while individualism is getting stronger among younger generations in China.¹³⁶ The same applies to Japan,¹³⁷ Korea,¹³⁸ Taiwan,¹³⁹ and other East Asian societies although the degree of individualism may differ from region to region.

Fifth, SOEs in China held over 80 percent of total overseas investment stock in 2006 but only 55 percent in 2013.¹⁴⁰ According to the MOFCOM, outbound investments by private enterprises would eventually surpass those by SOEs.¹⁴¹ This will likely result in more ISDS claims by Chinese investors because Chinese private companies will be less hesitant to resort to confrontational dispute resolution measures.

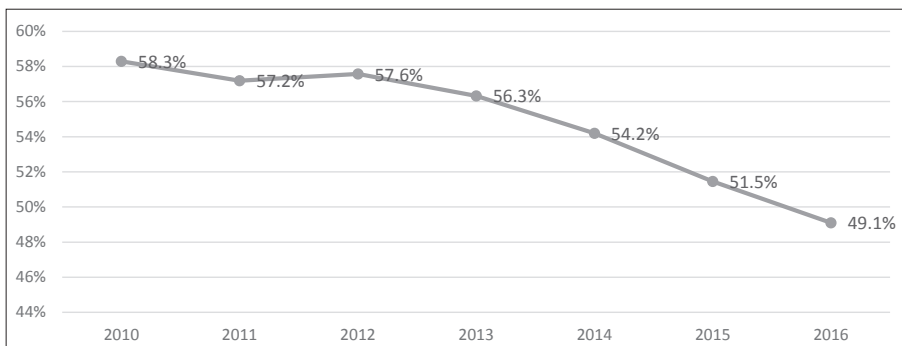
Sixth, outward FDI is becoming increasingly diversified and less concentrated in the manufacturing industry in Japan and Korea (Figure 2). This means that the more frequently ISDS is used, the more investments will be in these sectors.

On the respondent's side, more ISDS cases are likely to be brought against East Asia. First, the primary and energy sectors - where investor-state disputes are most likely to occur - in East Asia are increasingly open to foreign investment. China has recently decided to open many areas of the primary sector to foreign investors. For example, special administrative measures applied by the 2015 Catalog to exploration and development of unconventional oil and gas resources, such as oil shale, oil sands, and shale gas, were removed from the 2017 Catalog.¹⁴² In the energy sector, China relocated "construction and operation of power grids" from the restricted category to the encouraged one. Several types of power plants have also become a part of the encouraged category in the 2015 Catalog.¹⁴³ In addition, the 1994 Energy Charter Treaty (hereinafter 1994 ECT), the most frequently invoked treaty in ISDS cases,¹⁴⁴ has been expanding to East Asia.¹⁴⁵ Although Japan is the only East Asian member country of the 1994 ECT, China and Korea signed the 2015 International Energy Charter, a nonbinding set of

principles for international energy cooperation that was intended as the first step toward accession to the legally binding 1994 ECT.¹⁴⁶ Moreover, Japan's electricity and gas markets were liberalized in 2016 and 2017, respectively, decades behind efforts in the EU and the US.¹⁴⁷

Second, inward FDI in East Asia is becoming increasingly diversified, in accordance with fundamental changes in the economic structure of the region. International experience has demonstrated that the services sector becomes more attractive to foreign investment as an economy matures.¹⁴⁸ Today's East Asia has the limited potential for further growth of the manufacturing sector.¹⁴⁹ Moreover, there is a general perception that a weak service sector is less productive than a strong, internationally competitive manufacturing sector.¹⁵⁰ China's service sector is lagging behind that of other economies at a similar stage of development.¹⁵¹ FDI in China is moving away from low-cost processing sectors to more value-added services.¹⁵² The year 2015 marked the third consecutive year of this trend, with 61.1 percent of total inward FDI going to the service sector.¹⁵³ As a result, the portion of FDI stock in the manufacturing industry has been steadily declining in recent years (Figure 4). This trend is likely to continue as Chinese policies attempt to direct more investment to the service sector.¹⁵⁴ Similar situations have been observed in other East Asian regions. The share of the service sector in the market has been steadily increasing in Japan.¹⁵⁵ In Korea, there has been a recent shift toward the service industry, which still has great potential for development.¹⁵⁶ In Taiwan, industrial production declined from more than 50 percent in 1986 to 24.78 percent in 2009 of GDP.¹⁵⁷

Figure 4: Portion of Inward FDI Stocks in China's Manufacturing Industry



Source: MOFCOM¹⁵⁸

VI. CONCLUSION

To conclude, many of the characteristics of East Asia have contributed to the dearth of ISDS cases. These factors, however, are changing, although the degree of change may differ from region to region. The differences between East Asian and international investors appear to be decreasing, as are differences in the industry structure between East Asia and many other parts of the world. This trend will lead Chinese and other East Asian economies to use ISDS more in the future.

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5. 'Korea' refers to South Korea in this paper.
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