



Protection of Foreign Investment in China: The Foreign Investment Law and the Changing Landscape

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Abstract

China's foreign investment law regime has experienced significant changes in recent years. A milestone came with the passing of the Foreign Investment Law (FIL) in 2019, replacing the laws and regulations that had governed foreign investment in China for four decades. This article first undertakes a political economic analysis to determine the relevance of internal and external factors contributing to the changes. It then discusses the key characteristics of the FIL and reveals how it is designed to create a liberal, stable, fair, transparent and accountable regime to promote and protect foreign investment. Although the passage of the FIL ushered in a new era of foreign investment in China, many important issues remain unresolved and further actions must be taken to ensure its smooth implementation. To support the sustained development of its foreign investment regime, China must address existing laws and regulations that are incompatible with the new regime, clarify key issues that the new law fails to address, issue clearer guidance on national security, shorten its 'negative list', promote opening up and enhance regulatory transparency.

Keywords Foreign investment law · Foreign investment · Negative list · National security review

1 Introduction

On 15 March 2019, China passed the Foreign Investment Law (FIL)¹ that demonstrated its commitment to providing a level playing field for foreign investors. Entering into force on 1 January 2020, together with its corresponding Implementation

¹ Foreign Investment Law of the People's Republic of China [*Zhonghua Renmin Gongheguo Waishang Touzi Fa* 中华人民共和国外商投资法]. http://www.npc.gov.cn/zgrdw/npc/xinwen/2019-03/15/content_2083532.htm (Accessed 10 Nov 2021).

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Regulation, the FIL put an end to the three primary laws that had governed foreign investment in China for four decades, namely the Sino-Foreign Equity Joint Venture Law, the Sino-Foreign Cooperative Joint Venture Law and the Wholly Foreign-owned Enterprises Law (together, the Three Laws). With unified provisions on market access, investment promotion, investment protection and foreign investment management, the FIL represented a milestone in China's endeavour to open up to foreign investment through the rule of law. The law was promulgated to address international concerns, to summarise the domestic experience and to improve the business environment. In the face of unprecedented uncertainties and rising protectionism in the global economy, the law was intended to create a 'golden age' for foreign investors in China.² Against this backdrop, this article first presents an overview of the development of China's foreign investment law regime, delving into the economic, political and external factors that led to the enactment of the FIL. It then highlights the main features of the FIL. The third part of the article summarises the problems with the law that remain to be resolved and the measures required for its smooth implementation. Specifically, to support the sustained development of its new foreign investment regime, China must revise existing laws and regulations that are incompatible with the FIL, clarify key issues that the FIL fails to address, issue detailed guidance on national security, shorten the 'negative list' to promote opening up and enhance the transparency of the regulatory system.

2 FIL Background

Foreign investment has played a significant role in boosting China's economic development and promoting reforms since the launching of the country's opening up policy. China's attitude towards foreign investment determines the features of its domestic legislation on foreign investment and its practice of international investment law.³ This attitude toward foreign investment is deeply rooted in Chinese economic and political history, but it is evolving with China's changing role in the global economy. For a long time after the adoption of the Sino-Foreign Equity Joint Venture Law in 1979, the first national legislation relating to foreign investment, China maintained a distinct legal system for foreign investors, subjecting domestic and foreign invested enterprises (FIEs) to different laws with different requirements for their establishment and operation.⁴ This regime contrasted with the legal framework in place in many Western states at the time, which imposed the same set of requirements on foreigners as on nationals in company and partnership law.⁵

Before the FIL, foreign investment was regulated on an *ad hoc* basis, which reflected the trial-and-error nature of Chinese economic reform.⁶ This approach had the flexibility to adjust to changing economic situations and thus allowed the

² Kou (2020).

³ Shan et al. (2012), p 122.

⁴ Huang (2009), p 201.

⁵ Shan et al. (2012), p 128.

⁶ Huang (2009), p 203.

government to better administer foreign investment.⁷ However, the parallel system led to conflicts between the Three Laws and other laws, including China's Company Law, thus increasing regulatory costs for the government and compliance costs for foreign investors.⁸ Although the Three Laws provided legal safeguards for foreign investment in China's planned economy, they could not accommodate China's new economic reality and assist in deepening reform and opening up in the modern era. With the development of China's economic legal system, much of the content of the Three Laws, such as the establishment and operation of foreign investments, has been gradually integrated into company law, partnership law, general rules of civil law, property law and contract law. It is unsurprising that China decided to adopt the FIL. This move was the result of a combination of internal and external factors, which are detailed below.

2.1 Internal Factors: Improving the Business Environment and Deepening Reform and Opening Up

The FIL is part of China's effort to establish a unified, open, competitive and orderly market system. The internal factors underpinning the evolution of China's foreign investment law are both economic and political. Economically, China is seeking to further liberalise its market and increase the ease of doing business to promote and protect foreign investment. Politically, as domestic reform is entering into the 'deep water zone', an upgraded and more open foreign investment regime will enhance state government capacity. These economic and political factors are interconnected. Part of foreign investment law covers investment regulation and management. The liberalisation of the foreign investment regime has a direct impact on state governance, in particular it requires a more transparent and law-based environment to be established.

2.1.1 Economic Factor: A More Welcoming Investment Climate

The enactment of the FIL in 2019 illustrated China's determination to promote the healthy development of the socialist market economy and achieve high-quality economic development.⁹ China has been successful in utilising foreign investment, which greatly contributes to its economic growth.¹⁰ According to the United Nations Conference on Trade and Development (UNCTAD), foreign direct investment (FDI) inflows to China reached USD163 billion in 2020, making China the largest FDI recipient worldwide.¹¹ FDI has influenced China's economic development both

⁷ Huang (2009), pp 202–204.

⁸ Huang (2009), p 203.

⁹ Wang (2019).

¹⁰ See, for instance, Graham and Wada (2001); Renwald (2006), p 453.

¹¹ UNCTAD (2021).

directly, by increasing capital input, and indirectly, through productivity and knowledge spillover.¹²

In the first two decades after the launching of its opening up policy in 1978, China adopted a quantity-oriented policy to attract FDI, granting foreign investors preferential treatment over domestic companies in areas such as corporate income tax. Since 2006, with China's unprecedented success in utilising foreign capital, its policy on FDI has shifted from quantity-oriented to quality-oriented. This change is demonstrated in the 11th Five-year Plan on Foreign Capital Utilisation.¹³ With the shift in FDI policy, China has taken concrete steps to promote and facilitate foreign investment.¹⁴ Strong evidence of this can be seen in the nationwide unified 'negative list' regime for market access, which was adopted in 2018 after a five-year trial implementation in China's Pilot Free Trade Zones (FTZs).¹⁵

Increased investment liberalisation is welcomed by foreign investors, yet more attention by foreign investors is paid to issues in relation to regulation, communication with the government, equal treatment and the reform of state-owned enterprises (SOEs).¹⁶ Concerns thereover pose challenges to the Chinese government in its effort to maintain economic development as the global economy enters a phase of headwinds. These concerns have also affected China's 'ease of doing business' ranking by the World Bank. For instance, China ranked only 78th in the 2018 report, lagging far behind Singapore, South Korea, Japan and Malaysia.¹⁷ Furthermore, China is facing rising competition from the Association of South East Asian Nations (ASEAN) bloc of economies in attracting FDI. With China's economic growth slowing down, ASEAN is taking advantage of the rising labour costs in China and is emerging as an alternative target for FDI.¹⁸ The Chinese government therefore hopes that the updated FDI regime will respond to the concerns of foreign investors, reassure their confidence and improve the country's ease of doing business.

2.1.2 Political Factor: Deepening Reforms and Opening Up to FDI

Equally important to the FIL are the advanced reforms taking place since 2013, when the Central Committee of the Communist Party of China (CPC) adopted a decision on certain major issues concerning comprehensively deepening the reform.¹⁹ The

¹² Chen (2018), p 604.

¹³ Ministry of Commerce in China (MOFCOM), The 11th Five-Year Plan on Foreign Capital Utilisation [*Liyong Waizi "Shiyiwu" Guihua 利用外资“十一五”规划*], 13 November 2016. <http://www.mofcom.gov.cn/article/zhengcejid/bj/200612/20061204079662.shtml> (Accessed 10 Nov 2021).

¹⁴ See, for instance, MOFCOM, Yearly Overview XVIII for Commerce Work in 2018, 20 January 2019. http://english.mofcom.gov.cn/article/zt_yearlyoverview2018/news/201902/20190202837959.shtml (Accessed 10 Nov 2021).

¹⁵ Seto and Wang (2019).

¹⁶ For instance, see European Chamber of Commerce in China (2019).

¹⁷ World Bank (2018), p 4.

¹⁸ Devonshire-Ellis (2012).

¹⁹ NPC, 'Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform', China.org.cn, 16 January 2014. http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm (Accessed 10 Nov 2021).

new round of reform is termed ‘Reform 2.0’.²⁰ In the decision, the Central Committee decided to give full play to the leading role of economic system reform by focusing on the decisive role of the market in allocating resources. It also established China’s aim to set up fair, open and transparent market rules, to create a business environment by the rule of law and to promote the modernisation of the national governance system and government capacity.²¹

Following the reform agenda, the Chinese government has adopted a series of economic and political measures to optimise market access and to transform government functions. The negative list approach to market access was adopted to liberalise the investment regime since 2013. Pilot FTZs were established as a field in which to conduct experimental economic reform. Currently, there are 21 pilot FTZs serving as pioneers in the reform and opening up; tests of new styles of foreign investment management and the transformation of government functions are conducted in these pilot FTZs before they are implemented nationwide. For instance, after the establishment of the Shanghai FTZ, the Standing Committee of the National People’s Congress (NPC) issued a decision to temporarily adjust the relevant administrative approval items prescribed in the ‘‘Three Laws’’ to accelerate the transformation of government functions.²²

In the meantime, institutional reform has smoothly taken place. Following the opening up, prior governmental approval by the Commerce Department was mandatory for the establishment of and changes to foreign investment in China. This requirement was lifted in 2016, when the Standing Committee of the NPC decided to revise the foreign investment laws to adopt a simpler filing process.²³ In addition, measures were taken by the authorities to reduce institutional transaction costs and otherwise ease burdens for businesses. Efforts were also undertaken to establish a transparent administrative system. At the 3rd Plenary Session in 2013, the Central Committee of the CPC decided to put in place a transparent system wherein the powers of local governments are catalogued to ensure that they are exercised

²⁰ Yang (2013).

²¹ NPC, ‘Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform’, China.org.cn, 16 January 2014. http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm (Accessed 10 Nov 2021).

²² Standing Committee of the NPC, ‘Decision of the Standing Committee of the National People’s Congress on Authorizing the State Council to Temporarily Adjust the Relevant Administrative Approval Items Prescribed in Laws in China (Shanghai) Pilot Free Trade Zone [*Quanguo Renda Changweihui Guanyu Shouquan Guowuyuan Zai Zhongguo (Shanghai) Ziyu Maoyi Shiyanzu Zanshi Tiaozheng Youguan Falv Guiding De Xingzheng Shenpi De Jueding*全国人大常委会关于授权国务院在中国(上海)自由贸易试验区暂时调整有关法律规定的行政审批的决定]’, NPC, 30 August 2013. http://www.npc.gov.cn/zgrdw/npc/xinwen/2013-08/31/content_1805118.htm (Accessed 10 Nov 2021).

²³ Standing Committee of the NPC, Decision of the Standing Committee of the National People’s Congress on the Revision of Four Laws Including the Law on Wholly Foreign-Owned Enterprises [*Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Xiugai ‘Zhonghua Renmin Gongheguo Waizi Qiye Fa’ Deng Sibufalv De Jueding*全国人民代表大会常务委员会关于修改《中华人民共和国外资企业法》等四部法律的决定], 3 September 2016. http://www.npc.gov.cn/zgrdw/npc/xinwen/2016-09/03/content_1996747.htm (Accessed 10 Nov 2021).

based on the rule of law. In 2015, the Chinese central authorities issued a guideline requiring local governments at all levels to implement a ‘power list’ system to define the boundaries of their powers.²⁴ This power list must be publicised on the governments’ official websites to invite public supervision. In addition, local governments are urged to cancel any administrative powers with no legal basis or conflicting legal bases.²⁵

Discussing foreign investment in particular, President Xi Jinping stated in 2017 that China should ‘create a stable, fair, transparent and predictable business environment, and speed up bids to build an open economy in a bid to promote the sustainable and healthy development of the Chinese economy’, adding that China should create a new basic law governing foreign investment and that rules that contradict the principles of opening up should be abolished.²⁶ In his report, delivered at the 19th National Congress of the CPC in October 2017, he reaffirmed that China will ‘adopt policies to promote high-standard liberalisation and facilitation of trade and investment’, ‘implement the system of pre-establishment national treatment plus a negative list across the board, significantly ease market access, further open the service sector, and protect the legitimate rights and interests of foreign investors’. To this end, all businesses registered must be treated equally in China.²⁷ President Xi’s report appears to have set the tone for the FIL and demonstrated political support for its passage in 2019.

2.2 External Factors: Bilateral Investment Treaty Negotiations with the US and the EU and China–US Trade Talks

Along with the internal economic and political factors discussed above, external factors, including the Bilateral Investment Treaty (BIT) negotiations between China and the US and the EU respectively, and the China–US trade talks, have significantly motivated China to push forward with the FIL.

The distinction between international law and domestic law is becoming blurred in the regime of foreign investment law.²⁸ The BIT negotiations have had spill-over effects on China’s domestic legal system, as they have pushed China to conform to the framework set up by the BITs.²⁹ The opening up policy has similarly driven internal reform.³⁰ The pre-establishment national treatment and negative list initially

²⁴ See also Shan and Chen (2016), p 244.

²⁵ General Office of the CPC, ‘Central Committee and General Office of the State Council, Guiding Opinions on the Implementation of the Power List System of the Departments of Local Governments at All Levels [Zhongban Guoban Yinfa ‘Guanyu Tuixing Difang Geji Zhengfu Gongzuo Bumen Quanli Qingdan Zhidu De Zhidao Yijian’ 中办国办印发《关于推行地方各级政府工作部门权力清单制度的指导意见》]’, People’s Daily [Renmin Ribao 人民日报], 24 March 2015. <http://politics.people.com.cn/n/2015/0325/c1001-26744385.html> (Accessed 10 Nov 2021). See also Gao and Tyson (2018).

²⁶ Chinadaily (2017).

²⁷ Xi (2017).

²⁸ Dolzer and Schreuer (2012), p 12.

²⁹ Schill (2007), p 117.

³⁰ Shan and Chen (2016).

arose as China's economic policy in the context of the China–US BIT negotiations. In 2013, China agreed to negotiate an investment treaty based on pre-establishment national treatment with a negative list.³¹ This policy was implemented on a trial basis in the Pilot FTZs and promoted nationwide in 2018, before it was written into the FIL.

The China-EU Comprehensive Agreement on Investment (CAI), negotiations on which were concluded in principle in December 2020, also contains rules on market access commitments. Market access was one of the central themes in the 35 rounds of negotiations. For instance, China and the EU provided their formal feedback on their respective market access offers in the 19th round of negotiations held in October 2018.³² The CAI accelerates China's steps to further liberalise its domestic market, in particular in the sectors of manufacturing, the automotive sector, health, computer services and financial services.³³

Meanwhile, China–US trade talks have played an important role in the revision of China's foreign investment regime to address issues such as technology transfer,³⁴ intellectual property rights and equal treatment. The subject of technology transfer has been one of the primary issues fuelling China–US trade frictions over the past years. As the requirement of technology transfer creates market barriers, the US launched an investigation in 2017 into whether China's policies and practices related to technology transfer are unjustifiable.³⁵ Following the investigation, the Trump administration took a series of actions against China in 2018, including raising tariffs on selected products from China. China retaliated by imposing tariffs on imports from the US, and several more rounds of retaliatory tariffs followed. This type of trade confrontation is economically harmful to all parties involved.³⁶ It also significantly hampers global trade and economic growth.³⁷ However, improvements in the US–China relationship became evident following a meeting between the presidents of the two countries in December 2018. Shortly after the meeting, the final draft of the FIL was submitted to the Standing Committee of the NPC for deliberation.³⁸

While the US–China trade talks certainly exerted pressure on China to adopt the FIL, they were not a decisive factor. Rather, economic and political factors were the fundamental determinants of the process of the FIL. China's move to revise its

³¹ MOFCOM, 'MOFCOM Spokesman Shen Danyang Comments on China and US to Promote Energetically [sic] Negotiations on Bilateral Investment Agreement, 6 July 2013. <http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201307/20130700200566.shtml> (Accessed 10 Nov 2021).

³² European Commission (2018).

³³ European Commission (2020).

³⁴ Technology transfer has been used by many countries, including China and India, as a performance requirement imposed on foreign investors to foster domestic capacity. Yet, as demanded by developed countries, prohibitions on technology transfer requirements are contained in some of the most recent international investment agreements. See Cosby (2015).

³⁵ White House, 'Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation', 22 March 2018. <https://www.whitehouse.gov/presidential-actions/presidential-memorandum-actions-united-states-related-section-301-investigation/> (Accessed 10 Nov 2021).

³⁶ Nicita (2019).

³⁷ Baliño (2019).

³⁸ Li (2018).

foreign investment law started as early as 2015, when the Ministry of Commerce (MOFCOM) released a draft FIL to solicit public comments. Later, the National Development and Reform Commission (NDRC) proposed a different version of the draft. Draft FILs were also listed in the 2018 legislative plans of both the State Council and the Standing Committee of the NPC, which had been separately released earlier in 2018.³⁹ Thus, before the final draft was submitted to the NPC for deliberation in 2018, extensive consensus-building had been performed.⁴⁰

3 Highlights of the FIL

The FIL was adopted by an overwhelming majority at the closing meeting of the Second Session of the 13th NPC in March 2019. To implement the FIL, the State Council adopted the Regulation on the Implementation of the Foreign Investment Law⁴¹ (Implementing Regulation) in December 2019. In the same month, the Supreme People's Court issued the Interpretation on Certain Issues Regarding the Application of the Foreign Investment Law⁴² (Interpretation on Certain Issues). All of these took effect on 1 January 2020.

The FIL reaffirms China's basic policy of opening up to foreign investment, encourages foreign investment in China, implements policies on higher-level investment liberalisation and proclaims a commitment to building a stable, transparent, reliable and fair market environment.⁴³ Under these guidelines, the FIL comprises six chapters with a total of 42 articles covering the areas of investment promotion, investment protection, investment administration and legal liability.

3.1 Scope of Application

Article 2 of the FIL prescribes that the law applies to foreign investment within the territory of China. 'Foreign investment' is defined to include direct or indirect investment by a foreign natural person, enterprise or other organisation, including establishing a foreign-invested enterprise either individually or jointly with any other investors; acquiring shares, equities, property shares or any other similar rights

³⁹ The State Council, State Council Releases Legislation Plan for 2018, 14 March 2018. http://english.www.gov.cn/policies/latest_releases/2018/03/14/content_281476077645036.htm (Accessed 10 Nov 2021); NPC Observer, NPC Standing Committee Releases 2018 Legislative Plan, 27 April 2018. <https://npcobserver.com/2018/04/27/npc-standing-committee-releases-2018-legislative-plan/> (Accessed 10 Nov 2021).

⁴⁰ Kong and Ding (2019).

⁴¹ Regulation on the Implementation of the Foreign Investment Law of the People's Republic of China [*Zhonghua Renmin Gongheguo Waishang Touzi Fa Shishi Tiaoli* 中华人民共和国外商投资法实施条例]. http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm (Accessed 10 Nov 2021).

⁴² Interpretation of Certain Issues Regarding the Application of the Foreign Investment Law of the People's Republic of China [*Zuigao Renmin Fayuan Guanyu Shiyong 'Zhonghua Renmin Gongheguo Waishang Touzi Fa' Ruogan Wenti De Jieshi* 最高人民法院关于适用《中华人民共和国外商投资法》若干问题的解释]. <http://courttapp.chinacourt.org/zixun-xiangqing-212921.html>.

⁴³ FIL, Art. 3.

and interests of a domestic enterprise; investing in a new project either individually or jointly with any other investor; and making an investment in any other way provided by other laws, regulations or the State Council. The Implementing Regulation specifies that the term 'any other investors' includes national persons,⁴⁴ thus allowing Chinese nationals to establish FIEs or to invest in new projects jointly with foreign investors. Previously, both the Sino-Foreign Joint Venture Law and the Sino-Foreign Contractual Joint Venture Law had provided that only Chinese companies, enterprises or other economic organisations could establish joint ventures or contractual joint ventures with foreign investors.⁴⁵

The FIL is silent as to whether it applies to investment from the Hong Kong Special Administrative Region (SAR), Macau SAR and the Taiwan Area. This issue was raised by certain deputies in the deliberation of the law.⁴⁶ Investment from these three areas is characterised as special domestic investment, not foreign investment. Yet these three areas are separate customs territories, and it has been prescribed in the State Council's administrative regulations, department rules and other relevant normative documents that investment from these three areas is regulated with reference to rules on foreign investment.⁴⁷ The Constitution and Legal Committee of the NPC considers it appropriate and feasible not to make specific provisions for the application of the FIL to investment from these three areas and to continue following the previously established arrangements.⁴⁸ Following this logic, the Implementing Regulation specifies that unless otherwise provided by laws and regulations, investment from Hong Kong SAR and Macau SAR is covered by the FIL and the Implementing Regulation. Investment from the Taiwan Area is subject to the PRC Law on the Protection of Investments by Taiwan Compatriots and the corresponding Implementing Regulation on the Protection of Investments from the Taiwan Area. Matters not covered by these are subject to the FIL and the Implementing Regulation.⁴⁹ Article 48 of the Implementing Regulation also allows Chinese citizens residing abroad to invest in mainland China in accordance with the FIL and its Implementing Regulation.

⁴⁴ Implementing Regulation, Art. 3.

⁴⁵ Sino-Foreign Joint Venture Law, Art. 1; Sino-Foreign Contractual Joint Venture Law, Art. 1.

⁴⁶ Constitution and Law Committee of the 13th NPC, 'Report on the Deliberation on the Foreign Investment Law of the People's Republic of China (Draft) [*Di Shisanjie Quanguo Renmin Daibiao Dahui Xianfa He Falv Weiyuanhui Guanyu 'Zhonghua Renmin Gongheguo Waishang Touzi Fa (Caoan)' Shenyi Jieguo De Baogao*第十三届全国人民代表大会宪法和法律委员会关于《中华人民共和国外商投资法(草案)》审议结果的报告]', 15 March 2019. <http://www.npc.gov.cn/npc/c30834/201903/d211271623a64dc0bcc192447bcb5fdb.shtml> (Accessed 10 Nov 2021).

⁴⁷ In practice, in the statistics collected by MOFCOM, investment from these three areas is considered to be foreign investment. See, for instance, MOFCOM, News Release of National Assimilation of FDI From January to October 2018, 22 November 2018. <http://english.mofcom.gov.cn/article/statistic/foreigninvestment/201812/20181202815485.shtml> (Accessed 10 Nov 2021).

⁴⁸ Constitution and Law Committee of the 13th NPC, Report on the Deliberation on the Foreign Investment Law of the People's Republic of China (Draft) [*Di Shisanjie Quanguo Renmin Daibiao Dahui Xianfa He Falv Weiyuanhui Guanyu 'Zhonghua Renmin Gongheguo Waishang Touzi Fa (Caoan)' Shenyi Jieguo De Baogao*第十三届全国人民代表大会宪法和法律委员会关于《中华人民共和国外商投资法(草案)》审议结果的报告]', 15 March 2019. <http://www.npc.gov.cn/npc/c30834/201903/d211271623a64dc0bcc192447bcb5fdb.shtml> (Accessed 10 Nov 2021).

⁴⁹ Implementing Regulation, Art. 48.

3.2 Investment Promotion

The section of the FIL on investment promotion covers both pre-establishment and post-establishment.

The FIL establishes the pre-establishment national treatment plus the negative list as the basic policy. Although this particular policy came into existence in China in 2013, the FIL defines the term ‘pre-establishment national treatment plus the negative list’ for the first time. Definitions were not covered in the first draft of the law but were provided in the second draft.

Under the FIL, China accords to foreign investors and their investments no less favourable treatment than that which it accords to its national investors and their investments with respect to the stage of entry, unless the negative list provides otherwise. The ‘negative list’ refers to special administrative measures for foreign investment in specific fields as provided by the State Council. The FIL also emphasises that where an international treaty to which China is a party contains provisions for more favourable treatment of foreign investors and their investment at the stage of entry, those provisions may prevail. Most of the BITs concluded by China do not contain provisions on pre-establishment national treatment. This position has recently changed, as both the Regional Comprehensive Economic Partnership (RCEP) and the EU–China Comprehensive Agreement on Investment include provisions on pre-establishment national treatment and market access. This arrangement in the FIL maintains the flexibility to allow foreign investors to rely on more favourable treatment provided either by the domestic law or the BITs.

A list of measures to promote foreign investment is also included in the FIL, providing that China will treat foreign investment and domestic investment equally and fairly with respect to the application of national policies on supporting the development of enterprises,⁵⁰ the formulation of standards and the application of compulsory standards,⁵¹ as well as bids for government procurement.⁵²

Furthermore, Chapter II of the section on investment promotion incorporates the principle of transparency by requiring that the government shall consult foreign investment enterprises when formulating laws and regulations on foreign investment,⁵³ provide timely public normative documents and documents of legal judgments,⁵⁴ provide consultation and other services to foreign investors and publish foreign investment guidelines for their convenience.⁵⁵

The FIL adds that investment promotion and facilitation could be granted to foreign investors and their investments through the establishment of a special economic area⁵⁶

⁵⁰ FIL, Art. 11.

⁵¹ FIL, Art. 15.

⁵² FIL, Art. 16.

⁵³ FIL, Art. 10.

⁵⁴ FIL, Art. 10.

⁵⁵ FIL, Art. 19.

⁵⁶ FIL, Art. 13.

and by allowing local governments at the county level or above to formulate related policies within their capacity.⁵⁷

3.3 Investment Protection

Chapter III of the FIL sets out a list of measures to protect foreign investment in five respects, detailed below.

First, Article 20 of the FIL stipulates that investments by foreign investors are not generally subject to expropriation. However, under special circumstances and for the public interest, such investments may be subject to expropriation or requisition pursuant to statutory procedures and providing fair and reasonable compensation in a timely manner. The Implementing Regulation further requires that expropriation be conducted in a non-discriminatory manner and that the compensation be based on the market value of the expropriated investment.⁵⁸ These provisions are in line with the provisions of expropriation included in most of China's recent BITs.⁵⁹

Second, given that conditions for the transfer of funds are of central concern for both foreign investors and the host state,⁶⁰ Article 21 of the FIL ensures that foreign investors can freely transfer funds into and out of China in Chinese currency or a foreign currency.

Third, the FIL attempts to enhance intellectual property protection to mitigate foreign investors' concerns on this issue. China's weak protection and enforcement of intellectual property rights are frequently criticised by foreign investors. 'Forced technology transfer' is a central issue in the China–US trade talks.⁶¹ Article 22 of the FIL clarifies that cooperation on technology should be based on freewill and business rules, and it prohibits governmental departments and their staff from forcing any transfer of technology by administrative means. Article 23 of the Implementing Regulation further specifies that stronger efforts will be made to increase punishment for infringements of intellectual property rights, to promote the establishment of a rapid collaborative protection mechanism and to improve the diversified settlement mechanism for intellectual property rights. Article 24 of the Implementing Regulation forbids administrative authorities from directly or indirectly forcing foreign investors to transfer technologies in any administrative procedures. Additionally, Article 23 of the FIL requires that government departments and their staff do not disclose or unlawfully provide to others any trade secrets that they are made aware of at work.

Fourth, to enhance the credibility and accountability of governments, Article 24 of the FIL requires that governments and their departments formulate normative documents concerning foreign investment pursuant to the laws and regulations.

⁵⁷ FIL, Art. 18.

⁵⁸ Implementing Regulation, Art. 21.

⁵⁹ See for instance, Art. 10 of the 2012 China–Canada BIT.

⁶⁰ Dolzer and Schreuer (2012), p 208.

⁶¹ Sykes (2021).

Should the relevant laws and regulations not be available, the government and its departments shall not impair the legitimate rights of foreign investors or impose any additional obligations. Article 25 requires local governments to fulfil their commitments to foreign investors and to perform the contracts entered into with them in accordance with the law. If the commitments or contractual terms must be amended in the national or public interest, compensation should be made for any loss incurred.

Fifth, the FIL provides for a complaint mechanism to detect and resolve disputes between foreign investors and the government.⁶² Article 26 of the FIL states that a foreign-invested enterprise may send a request to solve a problem through the complaint mechanism if it deems that its legitimate right has been infringed by a government department. Article 26 also clarifies that sending a request through the complaint mechanism does not prevent that same request from being submitted for administrative review or administrative litigation. Article 29 of the Implementing Regulation further requires that a complaint mechanism be established by local governments above the county level in accordance with the principles of openness, transparency, efficiency and convenience.

At the central level, an inter-ministerial joint meeting mechanism is to be established to coordinate and promote complaints by FIEs. In March 2020, MOFCOM issued a draft of Working Rules for the Foreign Investment Complaint Mechanism for FIEs to solicit public opinions.⁶³ This draft aims to improve the efficiency, transparency, accountability and fairness of the complaint mechanism. In August 2020, MOFCOM adopted the Rules on Handling Complaints of Foreign-Investment Enterprises.⁶⁴ It consists of five chapters and 33 articles that further refine the relevant requirements provided in the new FIL and the corresponding Implementing Regulations. Under the Rules on Handling Complaints of Foreign-Investment Enterprises, FIEs and foreign investors may apply to complaint agencies for solutions if their legitimate rights and interests are infringed by administrative acts. The complaint system may also be used to report issues concerning the investment environment and to suggest improvements to relevant policies and measures. However, given that local complaint centres are encouraged to establish their own detailed procedures, there are concerns that foreign investors will face complex and inconsistent mechanisms. There are also doubts as to whether the system will be applied fully and consistently. Notably, it is unclear whether the complaint mechanism will consider intellectual property-related complaints.⁶⁵

The complaint mechanism is helpful in settling foreign investment disputes through alternative dispute resolution (ADR). Following the relevant provisions,

⁶² FIL, Art. 26.

⁶³ Department of Foreign Investment Administration of MOFCOM, 'Notice of MOFCOM on the Public Solicitation of the 'Complaint Mechanism for Foreign Investment Enterprises' (Exposure Draft)' [*Shangwubu Guanyu 'Waishang Touzi Qiye Tousu Gongzuo Banfa (Zhengqiu Yijiangao)' Gongkai Zhengqiu Yijian De Tongzhi* 商务部关于《外商投资企业投诉工作办法（征求意见稿）》公开征求意见的通知], 22 March 2020. <http://wzs.mofcom.gov.cn/article/n/202003/20200302947902.shtml> (Accessed 10 Nov 2021).

⁶⁴ MOFCOM, MOFCOM Order No. 3 of 2020 on Rules on Handling Complaints of Foreign-Invested Enterprises, 31 August 2020. <http://english.mofcom.gov.cn/article/policyrelease/aaa/202008/20200802997073.shtml> (Accessed 10 Nov 2021).

⁶⁵ Giolzetti (2011).

Beijing and Shanghai have separately taken the initiative to set up compliant mechanisms. It should also be noted that ADR has gained increasing attention on the international stage. In the ongoing discussion regarding the reform of the Investor–State Dispute Settlement held by the United Nations Commission on International Trade Law (UNCITRAL), significance is attached to mediation and ADR by many states, including China.⁶⁶

3.4 Investment Management

Article 28 of the new FIL does not allow foreign investors to invest in the prohibited fields on the negative list. Foreign investors are required to comply with the specified requirements when investing in restricted industries on the list. Where a foreign investor invests in prohibited fields on the negative list, the relevant competent government shall either order the investor to cease its investment activities or take other measures. Any illegal gains shall be confiscated.⁶⁷ According to the ‘Interpretation of Certain Issues’, where a foreign investor invests in a prohibited field on the negative list and a party claims that the investment contract is void, the People’s Court shall uphold the claim.⁶⁸ However, in cases where a foreign investor invests in a field that is no longer prohibited due to the adjustments made to the negative list before the People’s Court renders an effective judgment and a party claims that the investment contract is valid, the People’s Court shall uphold such a claim.⁶⁹

In terms of the corporate governance of FIEs, their organisational forms, governing structures and standards of conduct are subject to the provisions of China’s Company Law, the Partnership Enterprise Law and other applicable laws.⁷⁰ For FIEs formed before the implementation of the FIL, a five-year transition period is granted to enable them to retain their original organisational forms.⁷¹ After adjusting their organisational forms and structures to comply with the FIL, these FIEs can continue to apply the methods for equity or equity transfer, income distribution and the distribution of surplus assets as agreed upon by the original parties to the equity or contractual joint ventures.⁷² If the necessary adjustments to the organisational form or structure are not completed by an FIE within the provided transitional period, Article 44 of the Implementing Regulation provides that the State Administration for Market Regulation (SAMR) will not deal with the registration matters applied for by the enterprise and will publicise the situation. Furthermore, under Article 33 of the FIL, foreign investors that merge with or acquire enterprises in the territory of China

⁶⁶ UNCITRAL (2020).

⁶⁷ FIL, Art. 36.

⁶⁸ Interpretation on Certain Issues, Art. 3.

⁶⁹ Interpretation on Certain Issues, Art. 5.

⁷⁰ FIL, Art. 31.

⁷¹ FIL, Art. 46.

⁷² Interpretation on Certain Issues, Art. 46.

or participate in a concentration of undertakings must submit to an anti-monopoly review under the Anti-Monopoly Law.

The FIL proposes to establish China's first foreign investment information reporting system. Foreign investors and FIEs are required to submit relevant information to competent commerce departments through the enterprise registration system and the enterprise credit information publicity system.⁷³ The content and scope of the foreign investment information report are determined under the principle of necessity. Violations of information reporting are subject to a fine of up to 500,000 RMB.⁷⁴ In December 2019, MOFCOM and the SAMR adopted the Measures for Reporting Foreign Investment Information, which confirm that the investment reporting system is not a precondition for foreign investors or FIEs to process business registration or other business matters.⁷⁵ Together with the Measures for Reporting Foreign Investment Information, MOFCOM issued the Notice on Matters Related to Foreign Investment Information Reporting, providing detailed guidance on the required content of such information reports.⁷⁶

In addition, a national security review system has been established to determine whether a foreign investment affects or may potentially affect national security. Any decision following a security review is final.⁷⁷ Previously, various regulations provided for a national security review of foreign investment, and they were only applied to monitor foreign investors' mergers and acquisitions.⁷⁸ The FIL now extends its application to the review of greenfield investment.⁷⁹ This is confirmed by the Measures for the Security Review of Foreign Investment (the Measures) jointly adopted by the NDRC and MOFCOM in December 2020. The Measures set out the sectors of foreign investment that are subject to a national security review; the operational mechanism, scope and procedures for the security review; enforcement supervision; and penalties for non-compliance. Accordingly, investment activities directly or indirectly conducted in China by foreign investors that will or may affect national security are subject to a national security review. An operational mechanism was established to organise, coordinate and guide security reviews of foreign investment. The office of the operational mechanism has been set up under the NDRC and is headed by both the NDRC and MOFCOM. The Measures also cover investment by investors from the Hong Kong SAR, Macau SAR and the Taiwan Area.

⁷³ FIL, Art. 34.

⁷⁴ FIL, Art. 37.

⁷⁵ MOFCOM, 'Heads of Related Departments of MOFCOM and the State Administration for Market Regulation Addressing Media Questions on the Measures for Reporting Foreign Investment Information', 3 January 2020. <http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/202001/20200102931510.shtml> (Accessed 10 Nov 2021).

⁷⁶ MOFCOM, Notice on Matters Related to Foreign Investment Information Reporting [*Guanyu Wai-shang Touzi Xinxi Baogao Youguan Shixiang De Gonggao* 关于外商投资信息报告有关事项的公告], 31 December 2019. <http://www.mofcom.gov.cn/article/b/f/201912/20191202927046.shtml> (Accessed 10 Nov 2021).

⁷⁷ FIL, Art. 35.

⁷⁸ Shan et al. (2012), p 131.

⁷⁹ Cui and Cai (2019), p 21.

Overall, the FIL represents China's efforts to build a sophisticated, liberal and balanced regime for foreign investment in China. It also indicates China's attempt to maintain consistency between the practice of domestic law and that of international law.

4 The Road Ahead: Implementation of the FIL

The FIL reveals China's commitment to overhauling the legal regime for foreign investment in China. Nonetheless, many important issues raised by foreign investors, including restrictions on key economic factors, remain unresolved. Moreover, certain provisions of the FIL are vaguely drafted and leave room for discretionary interpretation.⁸⁰ The Implementing Regulation fails to fully address the doubts held by foreign investors.⁸¹ For these reasons, foreign investors and the wider foreign community remain cautious.⁸² Significant work remains to be done to put the FIL fully into practice and to fulfil its objectives. Such work includes rescinding or amending laws, regulations and policies that are not compatible with the FIL, clarifying key issues, elaborating further implementation rules, further liberalising the domestic market and enhancing regulatory transparency.

4.1 Addressing Laws and Regulations Incompatible with the New FIL

As mentioned above, China previously maintained an *ad hoc* approach to regulating foreign investment, resulting in a complex network of laws, regulations and policies.⁸³ By referring to the principle of 'high-level law overriding lower-level law and new law overriding old law', the Implementing Regulation makes it clear that the FIL and the Implementation Regulation shall prevail in the case of inconsistencies between them and any provisions on foreign investment formulated before 1 January 2020. MOFCOM, the NDRC and the Ministry of Justice have taken concrete measures to clean up the related laws, regulations and policies. They have also persuaded sub-national governments and authorities to abolish or revise any regulations, departmental rules and normative documents that are in conflict with the FIL.⁸⁴

These efforts were initiated soon after the adoption of the FIL. For instance, draft amendments to the Administrative Licensing Law, Trademark Law, Construction

⁸⁰ Zhou (2019); USCBC, US-China Business Council comments on the Draft Foreign Investment Law of the People's Republic of China, 24 February 2019. https://www.uschina.org/sites/default/files/uscbc_comment_on_chinas_draft_foreign_investment_law_en_-_february_24_2019_0.pdf (Accessed 10 Nov 2021).

⁸¹ Lowe (2020).

⁸² Zhang (2020), p 232.

⁸³ Huang (2009), p 203.

⁸⁴ MOFCOM, 'Officials of the Ministry of Justice, MOFCOM, and the NDRC answer questions from journalists on issues related to the Implementation Regulation on Foreign Investment Law of the People's Republic of China', MOFCOM, 1 January 2020. <http://english.mofcom.gov.cn/article/newsrelease/significantnews/202002/20200202940323.shtml> (Accessed 10 Nov 2021).

Law and Electronic Signature Law were passed by the State Council in April 2019. In line with the objectives of the FIL, it was suggested that the principle of non-discrimination be included in the Administration Licensing Law and that the amount of compensation for an infringement of the exclusive right to use trademarks be substantially increased.⁸⁵ In November 2020, the State Council adopted a decision to amend and repeal certain administrative regulations, thereby amending 22 administrative regulations that were inconsistent with the FIL.⁸⁶ However, a large number of inconsistent ancillary regulations and policies remain. To ensure a smooth transition to the new foreign investment regulation regime, clarifications and explanations of issues arising from the implementation of the FIL are expected to be made by the relevant authorities.⁸⁷

4.2 Clarifying Key Issues of Foreign Investment and IP Penalties

The FIL does not provide a clear definition of ‘indirect investment’ in Article 2, thereby introducing doubts as to whether the nationality of an investor is determined by the investor’s ultimate controller or the investor itself. Although Article 47 of the Implementing Regulation confirms that the FIL and the Implementing Regulation apply to reinvestment by FIEs, the SAMR maintains a different approach in practice, only designating direct subsidiaries of FIEs as ‘invested by FIEs’; any subsidiaries from that level downward are treated the same as domestic enterprises. Whether this practice will change in the implementation of the FIL and the Implementing Regulation requires further clarification.⁸⁸ The characterisation of ‘indirect investment’ also closely relates to the implementation of the negative list, as regulators must consider how to prevent foreign investors from circumventing the negative list management through various indirect investment approaches.

Another term requiring a further definition is that of ‘investment to initiate a new project’ in Article 2 of the FIL. It is not clear whether this covers any investment project in which a foreign investor does not set up or acquire an enterprise in China as these two forms are already provided for in separate paragraphs, or whether it only refers to an investment project that a foreign investor carries out through such contractual arrangements as natural resources exploration and exploitation

⁸⁵ Hua (2019).

⁸⁶ State Council, Decision of the State Council to Amend and Repeal Certain Administrative Regulations (Order No. 732 of the State Council of the People’s Republic of China) [*Guowuyuan Guanyu Xiugai He Feizhi Bufen Xingheng Fagui De Jueding* 国务院关于修改和废止部分行政法规的决定], 29 November 2020. http://www.gov.cn/zhengce/content/2020-12/11/content_5568885.htm (Accessed 10 Nov 2021).

⁸⁷ Xu et al. (2020a).

⁸⁸ Id. Some bilateral investment treaties concluded by China include provisions on the definition of indirect investment. For instance, the Protocol of the 2003 China-Germany bilateral investment treaty defines the term ‘invested indirectly’ as being invested by an investor of one contracting party through a company that is fully or partially owned by the investor and having its seat in the territory of the other contracting party.

concessions.⁸⁹ It is suspected that the Supreme People's Court will issue judicial interpretations on a case-by-case basis to clarify the types of project that are considered to be 'new projects' under the new law and regulations.⁹⁰

The FIL and the Implementing Regulation are also silent on the variable interest entity (VIE), which is a contractual arrangement used by foreign investors to make investments in industry sectors which would otherwise be subject to restrictions on foreign investment. The VIE structure has mainly been used by China's tech companies, including Alibaba and Tencent.⁹¹ The VIE structure gives rise to legal uncertainties, as it serves as an efficient tax avoidance tool and a vehicle to engage in unfair transfer pricing.⁹² The Draft Foreign Investment Law prepared by MOFCOM in 2015 attempted to tackle this issue by providing that any domestic companies that are controlled contractually through the VIE structure are classified as foreign investors and are therefore subject to foreign investment restrictions.⁹³ However, these provisions were dropped in the FIL and the Implementing Regulation. Given that there is no clarification of the term 'indirect investment' in Article 2 of the FIL and the Implementing Regulation, it remains unclear whether the VIE structure falls within the scope of the FIL. This reflects China's prudential attitude towards the VIE structure, particularly considering the large number of Chinese enterprises currently taking advantage of it. In this respect, the 'catch-all' provision in Article 2, which refers to 'investment in any other way stipulated by laws, administrative regulations or provisions of the State Council', leaves room for future legislation to address the VIE structure issues if necessary.⁹⁴

In May 2021, China's State Council issued the Implementation Rules for the Law for Promoting Private Education, which contains a provision prohibiting the use of mergers and acquisitions or contractual control arrangements to control private schools of compulsory education or to control non-profit, private pre-schools.⁹⁵ This signals a tightening of control over foreign investment through VIE in certain prohibited and restricted sectors.⁹⁶ The government's moves against Didi Chuxing, a ride-hail company, in July 2021, including an investigation prompted by data security concerns soon after its initial public offering (IPO) on the New York Stock Exchange, reveals China's intention to discourage listings of Chinese technology companies in the US.⁹⁷ The China Securities Regulatory Commission was reported to have amended the overseas listing rules requiring enterprises structured

⁸⁹ Elen (2020).

⁹⁰ Dong and Stone (2020).

⁹¹ Schumpeter (2017).

⁹² Larson (2018), p 240.

⁹³ Foreign Investment Law (Exposure Draft), Art. 11. See also Practical Law China, Draft Foreign Investment Law open for comment until 17 February 2015, 19 January 2015. [https://uk.practicallaw.thomsonreuters.com/9-596-4525?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/9-596-4525?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1) (Accessed 10 Nov 2021).

⁹⁴ Sun (2019).

⁹⁵ Implementation Rules for the Law for Promoting Private Education, Art. 13.

⁹⁶ Morre et al. (2021).

⁹⁷ Lemert and Runde (2021).

through VIE to seek approval before IPOs in the US.⁹⁸ However, it seems that China intends to ban companies with large amounts of sensitive consumer data from going public in the US.⁹⁹ In light of these developments, the US Securities and Exchange Commission now requires offshore issuers associated with China-based operating companies to prominently and clearly disclose VIE-related information before their registration statements will be declared effective.¹⁰⁰ Although such developments indicate tighter control over the VIE structure, some are optimistic that this will result in greater clarity concerning the scope of the FIL from regulators.¹⁰¹

Another concern expressed by stakeholders about the FIL lies in the fact that it does not clarify the criminal penalties to be imposed on government personnel under Article 39 in cases of abuse of powers or negligence in performing duties, nor does it state whether these provisions extend to non-officials.¹⁰² This may lead to foreign investors' concerns over ministries' and local officials' regulatory discretion, including the ability to retaliate against foreign companies.¹⁰³

4.3 Issuing Further Guidance on National Security Review and Countermeasures

With the adoption of a more liberal approach towards foreign investment, a national security review is becoming an increasingly significant measure for the government to review foreign investment transactions. China established the national security review regime in 2011, when the Circular of the General Office of the State Council Concerning Security Review of Mergers and Acquisition of Domestic Enterprises by Foreign Investors was issued. Following the 2011 Circular, MOFCOM issued its Provisions on Implementing a Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors in September 2011. The State Council also issued the Circular of the General Office of the State Council on Issuing Tentative Measures for the National Security Review of Foreign Investment in

⁹⁸ Bloomberg (2021).

⁹⁹ Zhai (2021). On 29 October 2021, Cyberspace Administration of China issued a draft of data export security assessments to solicit public opinions, see Notice of Cyberspace Administration of China to Solicit Comments on Measures for Data Export Security Assessments (Draft for Comments) [*Guojia Hulanwang Xinxu Bangongshi Guanyu 'Shuju Chujing Anquan Pinggu Banfa (Zhengqiu Yijiangao'* 国家互联网信息办公室关于《数据出境安全评估办法(征求意见稿)》公开征求意见的通知], http://www.cac.gov.cn/2021-10/29/c_1637102874600858.htm (Accessed 10 Nov 2021).

¹⁰⁰ Gensler (2021). Following the statement, the US Securities and Exchange Commission Office of Investor Education and Advocacy, together with the Office of the Chief Accountant and the Division of Corporation Finance, issued the Investor Bulletin to educate individual investors about the risks associated with investing in certain companies that provide exposure to China-based businesses. See US Security and Exchange Commission, Investor Bulletin: U.S.-Listed Companies Operating Chinese Businesses Through a VIE Structure. <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-95> (Accessed 10 Nov 2021).

¹⁰¹ Kinder et al. (2021).

¹⁰² The Economist Intelligent Unit (2019).

¹⁰³ US Department of State, 2021 Investment Climate Statement: China. <https://www.state.gov/reports/2021-investment-climate-statements/china/> (Accessed 10 Nov 2021).

Pilot Free Trade Zones¹⁰⁴ in 2015. It is noteworthy that the 2015 Circular applies to both acquisition activities and individual or joint investment for project construction or enterprise establishment conducted by foreign investors. The National Security Law adopted in 2015 confirms that the state establishes national security review structures and mechanisms to review foreign investments that influence or may influence national security.¹⁰⁵ The Cybersecurity Law also requires a national security review in cases in which critical information infrastructure operators purchase network products and services and national security will be affected by such purchases.

Under these laws and regulations, China established an inter-ministerial joint committee to undertake national security reviews. MOFCOM had previously acted as the point of contact for national security review notification and communication. However, this responsibility was taken over by the NDRC in April 2019 due to the adjustment of ministerial functions. In December 2019, Yonghui, a Chinese superstore whose shares are 19.99% foreign-owned, renounced its potential acquisition of a controlling interest in the Chinese state-owned retailer Zhongbai Holdings due to the national security review conducted by the NDRC. It is believed that the primary concerns of the NDRC was related to Zhongbai's role as the major provider of catering services for the 2019 Military World Games in 2019.¹⁰⁶

The draft of the FIL prepared by MOFCOM in 2015 dedicated an entire chapter of 26 articles to details on the national security review, while the FIL and the Implementing Regulation only restate the existence of the national security review regime. The Measures for the Security Review of Foreign Investments, effective from 18 January 2021, lay out the new framework for a national security review; however, it remains to be seen how the review will work in practice. Specifically, the regulation is silent on issues such as whether the security review applies to foreign-to-foreign offshore transactions and how it interacts with China's export control legal regime, as well as to what extent security review decisions are subject to judicial review.¹⁰⁷

The scope of the national security review under the 'Measures for the Security Review of Foreign Investment' has been extended to cover economic sectors such as critical information technology and Internet products and services, critical financial services and critical cultural products and services. However, it does not provide a clear description of these sectors, leaving wide discretion to officials in interpreting its scope. Article 12 introduces conditional approval; however, there is no public precedent for conditional approval in China.¹⁰⁸ More importantly, China must maintain a balance between the liberalisation and protection of foreign investment and

¹⁰⁴ Circular of the General Office of the State Council on Issuing Tentative Measures for the National Security Review of Foreign Investment in Pilot Free Trade Zones [*Guowuyuan Bangongting Guanyu Yinfa Ziyou Maoyi Shiyangu Waishang Touzi Guojia Anquan Shencha Shixing Banfa De Tongzhi* 国务院办公厅关于印发自由贸易试验区外商投资国家安全审查试行办法的通知], Art. 1.

¹⁰⁵ National Security Law of the People's Republic of China [*Zhonghua Renmin Gongheguo Guojia Anquan Fa* 中华人民共和国国家安全法], Art. 59.

¹⁰⁶ Lau (2020).

¹⁰⁷ Yu et al. (2021).

¹⁰⁸ Xu et al. (2020b).

the protection of national security, ensuring that market access commitments are not undermined by national security–related legislation.

Before the Measures for the Security Review of Foreign Investments were issued, MOFCOM announced the Regulations on the Unreliable Entity List (UEL Regulations) in September 2020 to protect the legitimate rights and interests of Chinese enterprises and to ensure national security. Although MOFCOM confirmed that the UEL Regulations do not target any specific country or particular entities, it is worth noting that the first announcement of the UEL legislation came soon after the US began to list Huawei-related entities on the US Entity List, and the UEL Regulations came after the US Department of Commerce identified prohibited transactions related to WeChat.¹⁰⁹ It was also reported that US companies such as Apple, Cisco and Qualcomm may be subject to relevant investigations.¹¹⁰ While the UEL system was established to respond to actions taken by a foreign entity, the UEL Regulations affect these entities' key clients or distributors that are located in China. The UEL Regulations, together with the Measures for the Security Review of Foreign Investment, have led to concerns by foreign investors that protectionism will attain dominance in China. Therefore, a clearer and more refined regime is necessary to eliminate this uncertainty and to curtail the current wide discretion available to officials.

Recent years have also witnessed various countries' and regions' undertakings extending their national security review standards.¹¹¹ For instance, the US enacted the Foreign Investment Risk Review Modernisation Act¹¹² in August 2018. The Act was introduced partly in response to concerns over China's growing investment in the US.¹¹³ In February 2020, the US Department of Treasury issued a regulation to implement key parts of that act. The regulation expands the jurisdiction of the Committee on Foreign Investment in the United States to provide a more comprehensive assessment of the impact of a combination of transactions.¹¹⁴ In April 2019, the European Union adopted a new regulation to establish a framework for the screening of foreign direct investments into the EU.¹¹⁵ It also reveals the EU's concerns over

¹⁰⁹ US Department of Commerce, Identification of Prohibited Transactions to Implement Executive Order 13943 and Address the Threat Posed by WeChat and the National Emergency with Respect to the Information and Communications Technology and Services Supply Chain, <https://www.commerce.gov/files/identification-prohibited-transactions-implement-executive-order-13943-and-address-threat> (Accessed 10 Nov 2021). See Cai et al. (2020).

¹¹⁰ Cai et al. (2020).

¹¹¹ It is argued that measures that the US, Australia and the United Kingdom had taken to ban Chinese investment via national security review provided the Chinese government with the incentive to establish a similar system as a countermeasure to protect China's national security. See Li and Cheng (2016), p 154.

¹¹² Foreign Investment Risk Review Modernization Act of 2018, Pub. L. No. 115-232, § 1703(a)(4)(B) (iii), 132 Stat. 1636, 2177–83.

¹¹³ Jackson (2020).

¹¹⁴ Jackson (2020), p 39.

¹¹⁵ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ L 79I, 21.3.2019, pp 1–14. See also European Commission, EU Foreign Investment Screening Regulation enters into force, Brussels, 10 April 2019. <http://trade.ec.europa.eu/doclib/press/index.cfm?id=2008>.

China's investment in the Union.¹¹⁶ Investment in China continues to face mounting political pressure. The US has banned Huawei for years, alleging that the tech company is closely linked to the Chinese government. Recently, the US asked its Western allies to shut out Huawei, singling it out among a wave of wireless communications. Australia, New Zealand and Japan have now joined the US in banning and phasing out Huawei's products.¹¹⁷

Against this backdrop, Article 40 of the FIL provides that where any country or region takes any discriminatory prohibitive or restrictive measures against Chinese investment, China may take corresponding measures against that country or region in light of actual conditions. The 'tit-for-tat' nature of such countermeasures imports the retaliatory measures used by China and other countries in the context of trade.¹¹⁸ Referring to countermeasures in this way is regarded as a measure to induce compliance with investment protection law, and this is not generally precluded in international investment law.¹¹⁹ Investment arbitration has confirmed that trade countermeasures affecting foreign investors should be lawful.¹²⁰ However, it is suggested by the European Chamber of Commerce in China that Article 40 should be removed, arguing that conflicts should be dealt with through the WTO or under the terms of previous international economic agreements reached by China and any given partner.¹²¹ To foster the confidence of foreign companies and eliminate ambiguities, China must also consider specifying the conditions and scope of the countermeasures it may take.

4.4 Shortening the Negative List and Further Opening Up

As regulated in Article 4 of the Implementing Regulation, the negative list should be proposed jointly by the investment authority and the competent commerce department of the State Council as well as by other relevant departments. It is to be promulgated or approved by the State Council. The State Council is to adjust the negative list in a timely manner to meet the needs of further opening up and economic and social development. The current regime of the negative list consists of the Special Administrative Measures (Negative List) for the Access of Foreign Investment, the Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot FTZs, the Market Access Negative List, which is applied equally between foreign investors and domestic investors, and the Encouraged Foreign Investment Industry Catalogue. These regulations are subject to periodic changes in the interest of opening up.

¹¹⁶ Blenkinsop (2019).

¹¹⁷ Buchholz (2020).

¹¹⁸ Kim and Lo (2019).

¹¹⁹ Paparinskis (2008), p 266.

¹²⁰ Losari and Ewing-Chow (2015).

¹²¹ European Chamber of Commerce in China, European Chamber's Stance on the (Draft) Foreign Investment Law, 25 February 2019. https://www.eurochamber.com.cn/en/press-releases/2902/eurochamber_s_stance_on_the_draft_foreign_investment_law (Accessed 10 Nov 2021).

China announced the Foreign Investment Negative List 2020 and the Market Access Negative List separately in June 2020 and December 2020, respectively. Whilst the list of items continues to be reduced, minor modifications were made and most of the openings were announced in 2019. The two new lists lift the equity caps for foreign investors in the financial sectors. However, foreign investors, specifically European investors, criticised that the removal of the market barrier was so late that domestic investors had already saturated the market.¹²²

Although China has committed itself to accelerating the easing of restrictions on market access by foreign investors, foreign investors still have concerns over market access. For instance, according to the most recent survey conducted by the American Chamber of Commerce in China, a majority of investors from the US are dissatisfied with the pace of market opening.¹²³ Foreign investors are still subject to regulations restricting the foreign ownership of most value-added ICT industries.¹²⁴ For industries that are not on the negative list, some criticise that foreign investors must comply with additional steps and seek approval and other necessary permits. Thus, effective implementation is necessary to ensure that national treatment is truly granted to foreign investors.¹²⁵

In addition to the calls to shorten the negative list, foreign investors' attention has increasingly focused on issues relating to equal treatment and the reform of SOEs.¹²⁶ These concerns indicate that China must reform SOEs to promote mixed-ownership reform and cut government subsidies. In June 2020, a three-year action plan for SOE reform was released to restructure the state-owned economy to make it more competitive and effective.¹²⁷ Reforms of SOEs are also stated as a priority in the 14th Five-Year Plan.¹²⁸ In spite of these efforts, it is reported that SOEs still hold the advantage in almost all areas of doing business and that this has worsened over the last few years. Some recently adopted policies by the Chinese government, in particular China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces, are thought to further empower SOEs and increase their presence in the economy.¹²⁹ The immunity of SOEs from any form of competition, in the eyes of European investors, illustrates that China is moving towards a 'one country, two systems' policy.¹³⁰ These concerns call for China to apply the principle of competitive

¹²² European Chamber of Commerce in China, *European Business in China Position Paper 2020/2021*, 2020. <https://www.eurochamber.com.cn/documents/signup/en/pdf/864> (Accessed 10 Nov 2021).

¹²³ Koty (2021).

¹²⁴ *Ibid.*

¹²⁵ US Department of State, *2021 Investment Climate Statement: China*. <https://www.state.gov/reports/2021-investment-climate-statements/china/> (Accessed 10 Nov 2021).

¹²⁶ European Chamber of Commerce in China (2019).

¹²⁷ Wang (2020).

¹²⁸ Zhong (2020).

¹²⁹ European Chamber of Commerce in China, *European Business in China: Position Paper 2020/2021*, 2020. pp 22–23. <https://www.eurochamber.com.cn/documents/signup/en/pdf/864> (Accessed 10 Nov 2021).

¹³⁰ *Ibid.*, p 22.

neutrality to SOEs, to provide equal treatment to all enterprises and to ensure a more level playing field.

4.5 Enhancing Regulatory Transparency

Since its accession to the WTO, China has committed itself to enhancing the transparency of its regulatory system. This goal is clearly referenced in China's Legislation Law, which requires that legislation persists with transparency and ensures that people can participate in legislative activities through various channels. In July 2011, the State Council Office of Legislative Affairs revised the 'Interim Measures on Openly Soliciting Opinions on Draft Laws and Regulations', which provides that the commenting period for draft administrative regulations posted online shall normally be no less than 30 days except in cases of emergency.¹³¹

In spite of its progress on transparency issues, China received a score of only 1.75 out of 5 points according to the World Bank Global Indicators of Regulatory Governance.¹³² Inconsistent regulatory transparency has remained a major challenge for foreign investors in China and a focus of discussion between the US and China.¹³³ Surveys reveal that the opaque regulatory system is among the top challenges of doing business in China.¹³⁴ The principle of transparency is written into the FIL. Nonetheless, it seems that it is not strictly followed. For instance, the Implementing Regulation was adopted with a public comment period of less than 30 days.¹³⁵ Furthermore, the Measures for the Security Review of Foreign Investment was adopted without any period for public comment or prior consultation with the business community.

It is also necessary to ensure that the liberalisation commitments of the FIL are not undermined by regulatory authorities, in particular by local authorities when their interests are at stake. As mentioned in Part II, the investment information reporting system is not a precondition for the registration of FIEs. Yet it has been observed that in some provinces and cities, only after completing the foreign investment information reporting procedures may foreign investors submit online registration and go to the relevant authorities for on-the-spot enterprise registration.¹³⁶

¹³¹ Interim Measures on Openly Soliciting Opinions on Draft Laws and Regulations, Art. 6.

¹³² World Bank, Global Indicators of Regulatory Governance: China. <https://rulemaking.worldbank.org/en/data/explorecountries/china>.

¹³³ Nelson (2021).

¹³⁴ See, for instance, American Chamber of Commerce in China, 2021 American Business in China White Paper. https://www.amchamchina.org/white_paper/2021-american-business-in-china-white-paper/ (Accessed 10 Nov 2021).

¹³⁵ Indeed, a longer period of public comments is requested by the foreign community. See USCBC, US–China Business Council comments on the People's Republic of China's Foreign Investment Law Implementing Regulations (Draft for Comment), 6 November 2019. <https://chinaipr2.files.wordpress.com/2019/11/english.pdf> (Accessed 10 Nov 2021).

¹³⁶ Zheng et al. (2020).

5 Conclusion: Towards a New Era of the Foreign Investment Law Regime

With the adoption and implementation of the FIL, the laws and regulations that have governed China over the last four decades fall away. The FIL establishes the basic framework for a new type of foreign investment legal regime and unifies provisions on market access, investment promotion, investment protection and investment management. As a landmark piece of legislation in China's foreign investment law regime, the FIL is underpinned by a combination of internal experience and international practice. It provides a stronger legal guarantee of further opening up and the active and effective utilisation of foreign investment. With the adoption of the FIL, China is entering a new era of foreign investment wherein a level playing field will be created and a more stable, fair and transparent regime will be established.

The COVID-19 pandemic has prompted countries all over the world to change their economic priorities, and China is no exception. Facing the pandemic and increasing trade tensions, the Chinese government brought forward the Dual Circulation Strategy in 2020. As a new economic development pattern, this strategy takes the domestic market as the mainstay while allowing internal and external components to complement each other. Referring to the emphasis on 'internal circulation' and 'international circulation', it aims to increase domestic consumption as a driver of economic growth while reaffirming the fundamental policy of opening up. In February 2021, MOFCOM issued the Circular on Centring on Building a New Development Pattern and Effectively Stabilising Foreign Investment, setting out 22 specific measures to implement the FIL and its Implementing Regulation. MOFCOM also issued the 14th Five-Year Plan for the use of foreign investment in October 2021, indicating China's efforts to open up further to foreign investment. It is clear that the Dual Circulation Strategy does not convey that China will shut its doors to foreign investors. This is evidenced by plans to make the Hainan Free Trade Port the largest special economic zone in China,¹³⁷ an idea that was first put forward as early as the 2008 global financial crisis, which prompted authorities to expand domestic demand and supply and advance supply-side structural reforms. The EU adopted a similar strategy to fortify supply chain resilience during the COVID-19 pandemic.¹³⁸

The FIL represents China's efforts to pursue high-quality development. While the new development pattern focuses on tapping into internal consumption patterns and the domestic market, an insufficient high-quality domestic supply requires opening up to foreign investment on a deeper level. The FIL, together with the ongoing reduction of the negative list, is expected to usher in a new era of foreign investment in China. There is an estimated potential of 1.5 trillion USD in inbound mergers and acquisitions over the following 10 years.¹³⁹

When the first draft of the FIL was introduced by MOFCOM in 2015, it comprised 11 chapters and 170 articles, including detailed provisions on the national

¹³⁷ Wong (2020).

¹³⁸ Grieger (2020).

¹³⁹ Liu (2019).

security review and information reporting system. In comparison, the FIL only covers 6 chapters and 42 articles. The FIL, as the fundamental legislation governing foreign investment, is clearly aimed at the level of general principles. It also reflects China's cautious and prudent attitude towards opening up.¹⁴⁰ While it represents a momentous first step, many questions remain unanswered, and more regulations and guidance must be drafted to fully implement the law.

Since 1978, China's opening up and domestic reform have gone hand in hand. Instead of simply boosting liberalisation and facilitating foreign investment, China must implement institutional opening-up measures and pursue ongoing domestic reform and systematic development. The FIL will form the cornerstone of China's accelerated regulatory reform of its foreign investment law and foreign investment management system, allowing China to create a transparent, legalised and equal business environment.

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¹⁴⁰ Zheng (2021), p 402.

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