A Commentary on China's New Foreign Investment Law

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*[**Abstract**: China's slowing economic growth and the course of the US-China trade talks propelled China to overhaul its outdated legal regime for foreign investment. The enactment of the Foreign Investment Law in March 2019 is an attempt by China to establish itself as an adherent of fair trade practices and a responsible participant in the international trade system as well as to address the issues that impact foreign investors. However, implementation rules and ancillary regulations when formulated and published will truly reflect if the intended improvements for foreign investors will fructify. The core concept of the new law is that of national treatment to foreign invested enterprises, which can expose them to the laws as applicable to national enterprise circumventing their special status. But even so, there is potential for ease of doing business in China.]*

On March 15, 2019, China's National People's Congress (NPC) passed the Foreign Investment Law (FIL). Effective January 1, 2020, this law will replace the three primary laws regulating foreign invested enterprises (FIEs) in China: the Law on Sino-Foreign Equity Joint Ventures, the Law on Wholly Foreign-owned Enterprises, and the Law on Sino-Foreign Cooperative Joint Ventures (collectively the Three FIE Laws).

The New Foreign Investment Law contains 42 articles under the following six chapters: general provisions, investment promotion, investment protection, investment management, legal liability, and supplementary provisions. "Foreign investment under the law refers to investment activities directly or indirectly conducted by a foreign natural person, enterprise, or other organisation (Foreign Investor). An FIE is an enterprise that is incorporated under the Chinese laws within the territory of China and is wholly or partly invested by a foreign investor."[1]

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[1] Zhang, L. (2019), "China: Foreign Investment Law Passed," Library of Congress, May 30. Available at: https://www.loc.gov/law/foreign-news/article/china-foreign-investment-law-passed/

The key highlights of the new law are:

1. Replacement of the Three FIE Laws which were passed in the late 1970s and 1980s when China adopted the "open door policy" to allow foreign businesses to enter the country. When the Foreign Investment Law takes effect in 2020, the Three FIE laws will be abolished simultaneously. The organisational forms, institutional framework, and the standards of conduct of FIEs will be subject to the provisions of the Chinese Company Law, the Partnership Law, and other relevant laws. Existing FIEs incorporated under the three FIE laws will have a grace period of five years, during which they may retain their original organisational form.
2. The Foreign Investment Law provides that the state will give national treatment to foreign investment that falls outside the negative list drawn up by the state council.
3. The Foreign Investment Law affirms promotion and protection of foreign investment, and emphasises the protection of intellectual property. The law specifically prohibits the government and its officials from forcing transfer of technology, but at the same time encourages technology cooperation on the basis of free will and business rules.
4. The law ordains that the government and its officials must keep confidential any trade secret of FIEs they become aware of during the performance of their duties.[2]

The move to adopt the new law is an "olive branch" within the context of the ongoing US-China trade war, to establish China as an adherent of fair trade practices, to position it as a responsible participant in the international trade system, and to demonstrate that Beijing has a strong grip on the country's economy.

China's new Foreign Investment Law indicates China's willingness to address issues that impact foreign investors, and more broadly the international community. Will the intention translate into real and positive change? The provisions of the law, however,

[2] *Ibid*.

are relatively general and vague. Implementation rules and ancillary regulations are expected to be formulated subsequently, which will provide decisive details and show whether the law will indeed bring about improvements vis-à-vis foreign investors in China. For example, the use of the negative list as a tool that enables the Chinese officials to technically champion the rule of law while allowing the larger state to keep its grip on the economy.[3]

The view has been expressed that the intent and reality of the FIL is to pull down foreign investors to the status of privately owned Chinese companies. At that level, FIEs will operate at a permanent disadvantage to the state owned enterprises (SOE). It is pointed out that at the core of the new FIL is the concept of '"national treatment." Under this principle, foreign invested companies will be treated the same way as the privately owned Chinese companies. Foreign invested companies will receive no incentives or benefits over private Chinese companies. No "special status" will shield the FIEs, which will expose them to the invasion and control by the government and the Chinese Communist Party. Further, the new FIL does not really put the FIEs on an even footing with the Chinese invested companies. The new FIL makes it clear that the government will continue with its negative list policy. Foreign investors will only be permitted to invest in sectors not on the negative list. If the negative list remains near to the current negative list, a number of attractive sectors will remain closed to foreign investment. In fact under the new FIL, the opportunities for foreign investors will be less than those available to the Chinese investors.[4]

A more optimistic view about FIL is that it shows China is getting more serious about protecting foreign investors' rights. It lays emphasis on the equal national treatment of foreign investment, putting foreign investors on a more level playing field with domestic investors, and giving them equal protection, explicitly banning forced technology transfers, promising better intellectual property rights protection, and

[3] Kim, D. and I. Lo (2019), "What is China's New Foreign Investment Law, and What Does It Mean for Canada and the Global Economy?" Asia Pacific Foundation of Canada, April 9. Available at: https://www.asiapacific.ca/blog/what-chinas-new-foreign-investment-law-and-what-does-it-mean

[4] Dickinson, S. (2019), "New China Foreign Investment Law: Not Good," China Law Blog, April 23. Available at: https://www.chinalawblog.com/2019/04/new-china-foreign-investment-law-not-good-news.html

ensuring equal treatment to foreign firms in government procurement. The driving factors for the new FIL are:

1. Realisation that though China has been the second largest recipient of FDI at US$142 billion (2018), accounting for 11.9 per cent of all global FDI inflows, yet only it ranks 46th in the World Bank's Ease of Doing Business ranking.
2. Existing laws concerning JV were placed in position over 25 years ago and need to be redesigned to cater to the fast-changing world of technology.
3. China's growth has been slowing.
4. Proportion of FDI into high-tech industries is overtaking traditional manufacturing.[5]

As mentioned previously, the core concept of the new FIL is that of national treatment to FIEs. For FIEs, the following measures can better the ease of doing business score in China:

1. The procedure for forming a foreign-owned company in China would stand simplified with considerable savings in the costs of norms and procedures as applicable for forming a domestic company.
2. Under the new FIL, foreign investors should be eligible to acquire stocks in private Chinese companies on the same basis as a Chinese investor. This would enable Chinese companies to pay for technology or high-tech services from their own stock rather than in cash.
3. The new FIL would enable the Chinese companies to hire foreign experts by offering them stock options as they offer when they employ Chinese nationals.
4. Under the new FIL's national treatment system, the vast Chinese investment fund market should open to foreign investors, either operating on their own or in partnership with the Chinese investors.

[5] Silk Road Briefing (2019), "China's New Foreign Investment Law and the Impact on the Belt & Road Initiative," June 29. Available at: https://www.silkroadbriefing.com/news/2019/06/25/chinas-new-foreign-investment-law-impact-belt-road-initiative/

The above consequences are indicative only at this stage. As of now one would not know how the new system would work until formal rules are issued and adopted and the role of local government becomes clear.

The opening up measures outlined above will remain constrained if the economy remains closed. If foreign investors are consigned to a small field within the Chinese economy because of the negative list, the rights under the new FIL would correspondingly be limited.[6]

[6] Dickinson, S. (2019), "China's New Foreign Investment Law Benefits: Like Putting Lipstick on a Pig," China Law Blog, April 25. Available at: https://www.chinalawblog.com/2019/04/chinas-new-foreign-investment-law-benefits-like-putting-lipstick-on-a-pig.html