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China's new Foreign Investment Law: deeper reform and more trust are needed*

by
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On March 15, 2019, China's new Foreign Investment Law was passed, creating a general framework for FDI in China.[1] It marks a milestone in a 40-year policy process, through which China has opened up to the outside world, while incrementally adopting international standards to drive domestic reform. It also signals a new stage of increasingly difficult and substantive reforms.

Notwithstanding the current criticism of globalization, the integration of global value chains has significant implications for the international economic order. China's investment law endeavors to establish an open market to attract and promote the free flow of resources, with Pilot Free Trade Zones serving as experimental precursors. Three features are noteworthy:

- Investment facilitation is the first step toward improving the domestic investment environment. The Law provides for a transparent law- and standard-setting process, entitling the participation of foreign investors; mandates a system enabling consultations regarding all investment law and policy matters; simplifies administrative procedures for FDI (e.g., permissions, licensing); and provides for the establishment of bilateral or multilateral cooperative institutions to enhance the international exchange of best practices for FDI, all of which reflect the principles of the WTO's Joint Ministerial Statement on Investment Facilitation for Development. This is supported by China's general policy to streamline administrative procedures, delegate powers and improve regulations and services. As investment facilitation does not address market access, standards of treatment and dispute settlement, it does not impinge on the country's sovereignty and is therefore a rather low-hanging fruit for enhancing the doing-business environment.

- The Law grants foreign investors pre-establishment national treatment, with Special Management Measures for Foreign Investment Access (negative list) as the only exception. This mechanism changes China's FDI regulatory regime substantially. The negative list is the result of the Pilot Free Trade Zones experimentation underway since

2013 and the exercise of evaluating the potential risks of an open investment market, while responding to foreign investors' concerns regarding particular issues such as forced local partners. In its latest version, the list (which replaces China's long-standing Catalogue of Industry Guidance for Foreign Investment) lays out the market-opening timelines for automobile manufacture and finance industries, and eliminates the shareholding ratio requirements for sectors such as the power grid and railway network infrastructure, as well as aircraft design, manufacture and maintenance. Although the list will continue to become shorter (thus opening more industries), its current implementation is insufficient, as the list adopts China's Industrial Classification, which differs from international practices and might cause confusion for foreign investors; the listed special management measures fail clearly to refer to specific regulatory rules and thus lack transparency; and once an investment is established, doing business in certain industries remains subject to licenses or permissions. A more transparent, precise and integrated regulatory system is needed so that foreign investors can truly enjoy national treatment.

- Regarding investment protection, however, law and policy makers are too eager to please foreign investors, partly because they stretch to address issues not properly included in an FDI law. Concerning the protection of intellectual property rights, the Law explicitly prohibits government officials to force intellectual property transfers or to reveal foreign investors' business secrets acquired in exercising their authority to any third party. However, this issue might be better addressed through amending the intellectual property law and related mechanisms. The Law also provides foreign affiliates with a complaint mechanism, to facilitate communication with foreign investors in terms of policy coordination or public bodies' tortious acts. However, enforceable procedures are absent, as well as explanations about the relationship between the complaint mechanism and existing administrative procedures. The Law touches upon issues outside its scope and lacks enforceable mechanisms. This may arouse suspicion rather than boost the trust of foreign investors.

The Foreign Investment Law will take effect in January 2020. Detailed regulations are currently being drafted and reviewed at the national level, led by the State Council, the Ministry of Commerce and the National Development and Reform Commission. As provided for in the Law, comments from foreign investors submitted through the drafting process shall be taken into account. While this reform process reflects China's long-term interests, it faces the immediate difficulty of winning the trust of international investors.

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[1] The Law is based on a longer and more detailed draft released by China's Ministry of Commerce (MOFCOM) in 2015 for public comment. The Law was swiftly passed in reaction to external pressure to put China's domestic system in line with international standards, leaving details for further legislation.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Alexa Busser, alexa.busser@columbia.edu.

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