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China's New FDI Law: Reform or Retaliation*

Abstract

The Foreign Investment Law (FIL) was the most significant legislation approved by China's National People's Congress in its March 2019 session. It repeals three existing laws that have served as pillars of the FDI regime for almost four decades. It introduces several path-breaking reforms aimed at creating a level-playing field for foreign companies such as pre-establishment national treatment for foreign enterprises (except for Negative list items), unified corporate governance norms for foreign invested and domestic companies, and specific safeguards for intellectual property of foreign investors. While these elements appear to be largely positive for foreign investors the law also appears to lay the ground for a slew of retaliatory measures that could be selectively deployed against foreign investors such as the national security review process for foreign investments and principle of reciprocity based on place of origin. This assumes significance in the context of the Sino-US trade war and controversies relating to Chinese ODI investments (including BRI projects) in several countries. In addition to this, the final version of FIL is much broader in scope than its initial draft version in 2015. The provisions of FIL are also much vaguer compared to those of the three laws it is replacing leaving much of its impact to be decided by subordinate legislation. Does the FIL represent a step forward for foreign investors in China? Or is it just a veneer for retaliatory measures against investors from countries that jeopardise China's global ambitions?

Keywords: *China, Foreign Investment Law, FDI, Reforms.*

In March 2019 the 13th National People's Congress adopted the Foreign Investment Law 外商投资法 (FIL). This new legislation will replace three existing laws that have governed foreign investors over the last four decades – Sino-Foreign Equity Joint Venture Law 中外合资经营企业法 for equity joint ventures (EJVs); Sino-Foreign Cooperative Joint Venture Law 中外合作经营企业法 for contractual joint ventures (CJVs); and Wholly Foreign-Owned Enterprises Law 外资企业法 for wholly owned subsidiaries (WFOEs). Each of these laws governed one distinct category of Foreign Invested Enterprises (FIEs) depending on their investment structure. So not only did the law discriminate between enterprises based on the source of their investment but there was further demarcation among foreign invested enterprises based on their investment structure. It was an arrangement that placed utmost emphasis on simplicity by sparing foreign investors the legal complexities applicable to domestic companies.

As a result, corporate governance practices of FIEs in China have evolved along a parallel track with those of domestic companies regulated by the Company Law which was enacted in 1993. When the FIL comes into effect on 1 January 2020, these three laws will be repealed and existent FIEs will be allowed a transitional period of five years within which they will need to modify their internal organisational structures and comply with provisions of the Company Law.

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Is the FIL a progressive step in constructive reforms or does it also have measures that may adversely affect foreign investors? This paper argues that while the FIL has many features that will benefit foreign investors, the existent ambiguity and the arbitrariness will undermine the very equal playing field that it seeks to promise. The expanded reach of the National Security Review, the open warning of retaliation against countries or regions that treat Chinese companies unfairly, and the omission to classify the status of Variable Interest Entities (VIEs) which have raised foreign capital by side-stepping the prohibition on FDI in a few sectors, are all features of the new law that will likely enhance rather than reduce risks for many foreign investors. Such provisions dilute the FIL's stated purpose of creating an equal playing field for foreign investors and private domestic investors by eroding the benefits that the inequality provided in the first place.

This paper will unfold as follows: first it will lay out features of China's FDI regime that were advantageous to foreign investors alongside those which posed challenges over the last three decades. Secondly it will contrast them against some key provisions of the new FIL and evaluate their potential impact on foreign investors in China.

I. Numbers, Effects & Challenges

Foreign Direct Investment has played a very important role in the economic transformation of China since its reform and opening-up in 1979. In the four decades since, China has attracted FDI at an average annual growth rate of 13.1%. From 1979-2000 China attracted a cumulative total of USD 346.2 billion in FDI and during the period 1992-1998 (Huang 2003: 6) it accounted for about 13% of the gross capital formation in China, making it one of the highest in Asia (Huang 2003: 10). In 2017, 35652 new FIEs were established with an utilised investment above US$130 billion (China Statistical Yearbook 2018). And in 2018, even as global FDI declined by 13% and the US-China trade war further intensified, China attracted US$139 billion, with over 60000 new FIEs established (Xinhua 2019). By 2014 China had attracted cumulative FDI of nearly US$1.6 trillion (Enright 2017: 20). While there were numerous determinants that contributed to China's phenomenal track record in attracting FDI, the legal system did play an enabling role especially when contrasted with FDI laws that were designed differently in other developing countries such as India (Sweeny 2010).

The impact of this massive inflow of foreign capital reverberated across several industries and provinces. A system of Catalogue of Industries for Guiding Foreign Investors (外商投资产业指导目录) was adopted in 1995 to strategically direct this flow of foreign capital into industries that promoted China's national interest most relative to time and the level of economic maturity. While initially most investments were directed towards industries ranked low in the value-chain, as China's economy underwent fundamental changes, the Catalogue was revised multiple times in 2011, 2015, 2017 and in 2019 to encourage foreign investment in emerging industries that were earlier prohibited or restricted to foreign investors. The fact that FDI has consistently flowed into China and progressively into sectors that were liberalised amply demonstrates that the classification of industries into categories titled "encouraged", "prohibited" and "restricted" was effective in signalling the host government's attitude towards FDI and provided requisite investor confidence.

Legal tools have also influenced the distribution of FDI across the primary, secondary and tertiary sectors. The proportion of foreign investment in the primary sector has always been pretty low at around 3-5%. Main reason for this is the fact that the agricultural industry has for long been limited only to domestic investments. The secondary sector, on the other hand, had for the longest time attracted the largest chunk of the cumulative inward foreign investment, accounting for close to 80% of the total share in 2004. It was only in 2010-2011 that the tertiary sector overtook the secondary sector. Ever since, its proportional share has continuously increased, reaching close to 70% in 2016 (KPMG 2018: 61). This change is largely because of two reasons. Firstly, China's rise in the economic value chain and secondly, in the past few years China has especially encouraged foreign investments in the high-tech services sector, seeking to take a lead in such emerging industries.

Another aspect of FDI in China influenced by law is its regional distribution. The first special economic zones were established along the eastern seaboard by employing a legal fiction that suspended application of domestic laws within such notified areas. This sowed seeds for such powerful forces that incoming foreign capital has largely been limited to the eastern region. In 1992, some 92% of the total FDI went to coastal regions. By 2012, while not as substantial, it still remained dominant at 70% (Granneman and Van 2015: 926). Of the 27 provinces and autonomous regions and four municipalities with provincial-level status, two provinces – Guangdong and Jiangsu – received more than 30% of the incoming foreign capital in the period from 1979 to 2013 (Enright 2017: 25). Being among the first to open up to international trade and investment, southern provinces like Guangdong and Fujian received the largest share of the foreign capital in the early years of the reform. The later opening up of coastal provinces like Jiangsu, Liaoning, Zhejiang, and Shandong diversified the destination of foreign capital (Enright 2017: 27).

The spill over effects of foreign capital on the Chinese economy has also been wide ranging. When foreign capital began to enter China, the country was devoid of even the basic components of a modern economy. The entry of FIEs laid down the foundations of a modern industrial value-chain. FIEs contributed widely by raising overall output, adding value and generating employment in the Chinese economy through a range of activities including constructing factories and offices, setting up associated services businesses including legal, accounting, business management etc. Estimates for the period 1995-2013 show that FIEs accounted for 16-34% of China's GDP and generated about 11-19% of employment each year (Enright 2017: 39-52).

FDI was also central to making China the world's largest trading country. While other factors like labour cost, domestic investments, GDP, exchange rate etc. also are determinant components, studies have also shown a strong positive correlation between FDI and exports in China (Zhang 2005). The manufacturing sector has especially seen a substantial rise in exports as a result of FDI, with labour-intensive goods more so than capitalist-intensive goods exports in the early years (Gu et. al 2008; Buckley 2010: 270-283). This, of course is a result of FDI policies that for long encouraged greater investment in the manufacturing sector. But, as mentioned earlier, given that investments in the tertiary sector is on the rise, it is likely that more foreign capital would go into the export of services in the future.

The increasing presence of FIEs in China has also changed the R&D landscape in the country. R&D investment has increased rapidly in the 25 years from 1992-2017, at an annual average of 20.3% (China Daily 2018). Foreign R&D centres in China have risen from less than 250 in 2001 to over 1500 in 2017 (Dehn 2015). Moreover, according to one survey, increasing number of foreign companies engaged in R&D in China are not doing so to merely to cut-costs (18%), rather to innovate and create new products for the global market (54%) and were involved in fundamental research (28%) (Yip 2017). Given that scientific and engineering labour in China continues to be less costlier than in Western countries, and China provides a market for efficient collection of big data for technological innovation, the trend of foreign investments in R&D is likely to continue in the future (Yip 2017).

Incoming foreign capital, therefore, has positively impacted China multidimensionally. Foreign investors have also made positive gains from this engagement with China. However, despite the gains investors continue to face several challenges in doing business in China. The three most common challenges are: market access, inadequate IP protection and ambiguity of regulations. The 2019 annual survey of business sentiment by the American Chamber (AmCham) in China, 73% of surveyed companies in the services and the R&D sector replied that their business operations were inhibited by market limitations (AmCham 2019: 8). About 62% of the surveyed companies responded that among other reasons it was market access on which they were most unfairly treated in comparison to local counterparts. The 2019 Business Confidence Survey by the European Chamber in China found that 45% of the surveyed companies faced direct or indirect restrictions in their industries (European Chamber 2019: 14).

The challenge of protecting intellectual property is particularly prominent in the high-tech industry. 42% of the respondents to the European survey considered the implementation of IPR laws and regulations as inadequate, even though more that 50% saw the written IP laws and regulations as adequate (European Chamber 2019: 47). The AmCham survey found that lack of adequate IP protection was preventing 35% of companies from investing in innovation (AmCham 2019: 57), and 50% of those in technology and other R&D-intensive industries limit their investments because of inadequate intellectual property protection (AmCham 2019: 62). IP protection related concerns has also played a central role in the current ongoing trade war between the US and China. The US has accused China of practising forced transfer of technology through the means of joint ownership, busniess licensing, and also of indulging in counterfeiting brands, and stealing trade secrets (Yeung and Sidney 2019; Clark 2019). The United States Trade Representative (USTR) estimated that the total damage done as a result of American IP theft was between USD225 billion to USD600 billion (Pham 2018).

A third challenge is the ambiguity of regulation and inconsistent interpretation of laws. The AmCham survey found that this problem overlaps several industries including Technology and other R&D industries (55%), Resources and Industrial (56%), consumer (50%) and services (56%) (AmCham 2019: 40). The European survey indicates that the top two challenges faced by companies are – ambiguous rules and regulations and unpredictable legislative environment. Much of the ambiguity and inconsistency arises from the wording of legal clauses, many of which finish open-endedly - "[…] as provided by other/relevant laws and regulations" (European Chamber 2019: 27). Such wordings allow for multiple interpretations of the same law, thus making it difficult for businesses to be certain that they are in compliance with the requirements of law.

II. Regulations

Since China's opening up in 1979, the laws governing FDI have continuously undergone reforms. When China began this journey it was devoid of the most basic structures required to regulate foreign capital. At the outset China chose to categorise regulations based on the investment structures of FIEs. These include: Sino-Foreign Equity Joint Venture Law 中外合资经营企业法 (EJVs); Sino-Foreign Cooperative Joint Venture Law 中外合作经营企业法 (CJVs); and Wholly Foreign-Owned Enterprises Law 外资企业法 (WFOEs). These laws govern the establishment, operations and management of FIEs in China. These three regulations were supplemented by laws on, among others, national security, anti-monopoly, and the Catalogue system filtering incoming foreign capital based on sectors encouraged, permitted, restricted, or prohibited. However, these three laws will be replaced by the landmark Foreign Investment Law which was adopted in March 2019 by the 13th National People's Congress. The FIL would come into force on January 1, 2020, thus signalling a new turning point in China's FDI regulatory history.

Old: The Regulatory Trio

EJVs were the first kind of FIEs to be established in China in 1979. EJVs were essentially separate legal entities with each party having liability in proportion to their capital contribution. Foreign shareholders needed to hold at least 25% of the registered capital. The parties were permitted to make their contributions in cash or in kind. The Articles of Association (AoA) would determine the composition and size of the board of directors. The representation of each party on the board was dependent on the proportional capital contribution. The board was the ultimate decision-maker on matters of management, overall operations, budgeting, expansion, among others. It would appoint managers to carry out day-to-day operations and implement resolutions of the board. One important purpose of the EJV was to attract advanced foreign technology and therefore Article 5 specifically warned against employing backward technology and that doing so would result in being penalised (Public Information Services I).

WFOEs (legislated first in 1986), were exclusively owned and operated by one or more foreign investors. They differ from EJVs and CJVs in the crucial point of independence. WFOEs could solely manage and operate the enterprise without the hassles of managing relations with Chinese partners that foreign investors in EJVS and CJVs had to. The implementation rules especially encouraged WFOEs to be export-oriented and employ advanced technology and engage in development of new, advanced products. Encouragement to export was also met with incentives in the form of tax reduction, exemption or refund. Organisationally, WFOEs were limited liability companies wherein investors were liable only as far as their capital contributions. Such enterprises were not permitted to reduce their registered capital unless under urgent conditions with prior approval (Public Information Services II).

Parties to CJVs, legislated in 1988, involved foreign and Chinese partners who engaged in a venture with an operation term as decided upon through contracts and which could be extended after the expiry of the term through an agreement between partners and submissions made to relevant departments. The main differentiating point of CJVs was their flexibility. Parties involved could decide the basis on which profits and losses would be shared, and this could be disproportionate to their respective capital contributions. CJVs could also be established either as a separate legal entity or as a non-legal person entity. In the former case, CJVs functioned as limited liability companies and were organised and managed similar to EJVs. In the latter case there were special provisions that governed such entities: each parties had to shoulder civil responsibilities according to China's civil law; the partners could own their respective investments separately or jointly, as contractually agreed upon; they were also to setup joint management teams to manage the venture; and partners were expected to possess accounting books separately as well as a unified one at the site of the venture (Public Information Services III).

New: The Foreign Investment Law

The new Foreign Investment Law 外商投资法 (FIL) which was adopted by the 13th National People's Congress on March 2019 will come into force on 1 January 2020. The FIL which consists of 6 chapters and 42 articles is largely based on the 2018 draft bill. It resembles a set of broad principles which the State Council is expected to follow up with more detailed implementing rules. This is in sharp contrast with the original draft versions which were more focussed and voluminous.

The FIL defines foreign investments as activities in mainland China conducted directly or indirectly by natural persons, enterprises, or other organisations of foreign countries including the following circumstances:

- Where foreign investors individually or jointly with other investors establish foreign-invested enterprises in mainland China.
- Where foreign investors acquire stock shares, stock equity, property shares, or other similar rights and interests in mainland Chinese enterprises.
- Where foreign investors individually or jointly with other investors invest in new projects in mainland China.
- Other methods of investment as stated in laws, administrative regulations, or the State Council.

After the new law becomes active the extant EJVs, WFOEs, and CJVs can retain their current structure for a period of 5 years to restructure in accordance with provisions of the FIL.

Constructive Reforms

The FIL's stated objective is to create a marketplace in which foreign players, not listed in the negative list, can compete on an equal footing with their domestic counterparts (Article 4). It reiterates China's intention to further open up its economy to foreign investment, and create improved mechanisms for promoting foreign investment, build stability, transparency, predictability and an environment for fair competition 建立和完善外商投资促进机制，营造稳定、透明、可预期和公平竞争的市场环境 (article 3) (National People's Congress of the People's Republic of China 2019; Wei 2019; The US-China Business Council 2019).[1]

The first significant step taken in that direction is the "pre-establishment national treatment" which mandates equal treatment of foreign and domestic investors at the pre-investment stage. This condition is applicable to all sectors that are not

[1] References include the original Chinese version as well as unofficial translated versions.

part of the Negative List (article 4; article 28). National treatment is further expanded by extending state business support policies to FIEs (article 9), participation is also extended in the formulation of standards, in which they are also expected to strengthen information disclosure and public oversight (article 15), and opening up state procurement of products and services sources to FIEs, wherein such goods and services are produced within China (article 16). Article 10 elaborates that opinions and suggestions of foreign investors would be solicited in the formulation of laws, regulations and rules relating to foreign investment. Access to capital markets is also relaxed for FIEs by allowing them to raise capital through issuing shares, debentures, and other securities (article 17). All these provisions are aimed at re-assuring FIEs of China's commitment to treat them on par with domestic peers and heed concerns on regulatory challenges.

Next, the law also seeks to address a sticking point in the ongoing US-China trade war – Intellectual Property (IP) protection. The importance of IP protection in the ongoing trade war cannot be overemphasised given that IP protection essentially has become the centre of gravity around which other forces revolve (Cai 2018). The US has consistently accused China of forcing American companies operating in China to part with Intellectual Property (IP). Though there are already extant measures to address IP related issues, the background of the trade war gives Article 22 special importance as it reemphasises China's commitment to protect foreign investors against the embezzlement of their IP rights. It has three main highlights:

1. China will protect the intellectual property of foreign investors and foreign invested enterprises, and intellectual property rights and interests of foreign companies and relevant rights holders (Article 22).
2. In the case of infringement of intellectual property rights, will strictly apply laws to investigate legal liability. China encourages foreign investors to enter into technology cooperation on the basis of principles of voluntariness and business rules. The various participants in technology cooperation should through fair and just consultations come to a deal (Article 22).
3. Administration and their employees should not use government means to coerce technology transfers (Article 22).

The law also re-iterates the obligations of administrative bodies to safeguard the interests of foreign investors. Articles 23 and 39 reiterate the responsibility to keep information submitted by FIEs confidential by prescribing penalties for breaches. This is to address the oft-repeated complaints of FIEs that China's administrative bodies were complicit in leaking proprietary information to domestic peers (Wei and Chao 2019). Article 24 deters Chinese officials from formulating subordinate legislations that diminishes the legal rights and interests of foreign investors and " interfere[s] with the normal business activities of the foreign-invested activities." This is in response to concerns of FIEs that Chinese regulations were often ambiguous and introduced uncertainty into their business plans. The law also limits the right to promote and facilitate foreign investment, within the limits of law, to government organisations above the county level. This aims to eliminate corruption and informal pacts between government officials and FIEs. Finally Article 25 mandates the honouring of policy and contractual commitments made to foreign investors. Taken together these provisions of the FIL can be characterised as being constructive in nature and addressing several of the cumulative concerns of FIEs since 1979.

Retaliations?

National Security Review (NSR)

The National Security Review regulations (NSR) were the first dedicated regulations to scrutinise investments based on their potential impact on China's national security. In 2011 the State Council promulgated the "Circular on the Establishment of National Security Review System Pertaining to the Mergers and Acquisitions of Domestic Chinese Companies by Foreign Investors" (Circular of the General Office 2011). Subsequently in 2015 the National Security Law was adopted. As a result the scope of the NSR was expanded and conditions under which it would be triggered were specified (Hogan Lovells 2015). The current scope of the NSR encapsulates brownfield investments that involve mergers with or acquisition of Chinese domestic companies, investment in certain specified sectors and where acquiring control is involved (Circular of the General Office 2011).

Article 35 of the FIL has diluted these trigger conditions for NSR and made the criteria more generic, thus encapsulating a large number of sectors. It states that a foreign investment review system shall be established to investigate foreign investments that will or may affect the *national security* of the country. The use of the open-ended term 'national security' without specifying type or sectors will broaden the coverage of the NSR and introduce considerable uncertainty into FIE's investment plans. The law also makes it clear that the decisions made under the NSR would be final and cannot be challenged. As a result of these provisions it can be argued that the Chinese is preparing the ground for retaliatory measures against foreign companies especially from countries such as the US which has initiated CFIUS actions against Chinese investors.

Variable Interest Entities (VIEs)

The previous two drafts of the foreign investment law in 2015 and three years later in 2018 had given rise to much speculation about the future of one particular model of business likely to be greatly impacted – the Variable Interest Entities (VIEs). VIEs are special structural mechanisms used by China domiciled companies operating in sectors where FDI is restricted. The domestic entity along with its shareholders form contractual agreements with WFOEs which are owned by shell companies in tax havens and listed on foreign stock exchanges. Therefore such contractual agreements with WFOEs indirectly translate to contractual relationship with offshore investors. Such contractual arrangements include investment obligations to remit funds and returns generated from profits. In essence, the ultimate control and beneficiaries are foreign investors who own the WFOE. Even though such a model clearly circumvents existent regulations, it has been used by several Chinese technology industry champions like Alibaba, Tencent, Baidu, among others.

This arrangement has never been unequivocally accepted by the Chinese government as a mode of tapping foreign capital in restricted and prohibited sectors, but neither has it been deemed illegal. Rather, the government has turned a blind eye to it so far. The 2015 draft sought to regulate VIEs by including "control through contract" feature in the definition of foreign investment. This was reversed in the 2018 draft where all articles that addressed or made explicit reference to VIEs in the previous draft were removed (NPC Observer 2018;

USChina.org 2015). The expanded definition of foreign investment in the FIL brings back the discussion on VIEs into the spotlight. The FIL's sub-clause (2) of Article 2 when read in conjunction with the entirety of the 'foreign investment' definition, VIEs could be interpreted as falling within the regulation of the FIL. This attempt to bring VIEs under regulations increases the uncertainty and risks faced by foreign investors (Zhang and Vivian 2019).

Reciprocity Article

Among the many distinctive features of the FIL, one that carries the maximum potential to legitimise retaliatory actions against FIEs is Article 40. The article states that companies from those countries or regions that adopt discriminatory practices against Chinese investments will be faced with reciprocal measures by China. In late 2018, the US senate through bipartisan support passed a law to broaden the powers of CFIUS – America's version of NSR – to allow it to investigate a wider range of deals (including minority stake investments and deals that threaten the competitive edge of American industries) especially in critical technology sectors that are deemed essential for national security, an issue that has further aggravated the current US-China trade standoff (Hendricks 2019). The expansion of powers of CFIUS has clearly had an adverse impact on the ability of Chinese companies to purchase high-tech American companies which were in the up in previous years (Dickinson 2019a). The reciprocity article along with the broadened coverage of the NSR therefore can also be read as China's response. China has already warned India of 'reverse sanctions' against Indian companies operating in China if Huawei is not permitted to participate in India's 5G deployment (Miglani & Neha 2019). Similarly Article 40 can also be used to power the spread of Chinese investments under BRI.

The Long View

In order to arrive at an objective stand on the FIL it is important to remind ourselves of the extensive hospitality that China has accorded to FIEs in the earlier phases of the post-opening up era. Local officials went out of their way to incentivise foreign investors with benefits that were not extended to domestic investors. So stark was this discrimination that a phenomenon of 'fake FDI' came about, where domestic enterprises round-tripped their investments from a foreign destination to avail of the benefits that only FIEs were entitled to (Tsai 2007: 184). Such preferential policies were especially pronounced in the Economic and Technology Development Zones (ETDZs) during the period 1990-2005. Foreign firms in the ETDZs were levied only 15% income tax. Firms staying for more than 10 years could avail a complete exemption from corporate income tax for two years, and be taxed a nominal 7.5% for the following three years. About 40% to 100% of taxes paid were returned if profits were reinvested in the zone. For most foreign firms outside of the ETDZs the corporate tax rate was 24%, and for those in the encouraged list of the Catalogue it was only 15%. In addition exports of products produced in the ETDZs and the machinery and raw materials imported to produce such products were exempt from tariffs (Chen 2018: 55). Domestic firms, on the other hand, were taxed a steep 33% (Chen 2018: 63).

Tax exemption apart foreign investors were also lured with low-to-zero land prices and discounts on office rental price. In certain counties local officials were giving away land free of cost if the investments exceeded USD100 million. Moreover, land rights of foreign firms were constitutionally guaranteed, while this was made available to domestic firms only through a constitutional amendment in 1999 (Huang 2003: 123). So zealous were the local bureaucracies to attract foreign investments that they had literally created a 'service' oriented culture where they represented the interests of foreign business and negotiated favourable deals with upper-levels of the government (Chen 2018: 39). Other advantages in the 1990s also included: exemption from social welfare payments for employees; exemption from personal income taxes for foreign employees; freedom from control by CCP and freedom from workers unions (Dickinson 2019b). Such generous incentives allowed China to direct FDI into locations and industries with high precision to generate jobs, transfer technology to government companies and expand the manufacturing sector.

However, winds began to shi4ft during the mid-2000s as central and local policies began to readjust to encourage indigenous innovation. As Chinese companies emerged as significant players in many sectors, their growth was endangered by incentives to FIEs. In 2007, preferential tax policies were phased out and since both foreign and domestic have been subject to an equal 25% income tax. The FIL is the final in this direction. Steve Dickinson, a veteran lawyer who has dealt with Chinese law for more than 20 years, believes that the principle of 'national treatment' stressed in the FIL will totally erode whatever benefits FIEs enjoyed as a result of their unequal treatment, and pull them down to a status of domestic private companies or even worse (Dickinson 2019b). Take for instance the requirement under article 31 of the FIL that the "organizational forms, institutional frameworks, and standards of conduct" of the FIEs, would in the future be governed by the Company Law (公司法). This would mean that FIEs would now have to organisationally make space for a unit of the Communist Party of China, according to article 19 of the Company Law (Public Information Services IV). On the other hand, as far as the challenge of market access is concerned, the FIL continues to limit access to FIEs in many sectors through the use of the Negative List system. Therefore, even as FIEs are expected to compromise on many benefits by virtue of them being subject to the same status as private companies, in reality they would be for the first time since 1978 operating in a more restricting space than domestic private companies.

Conclusion

In the final analysis FIL is a reflection of the current state of play in Chinese industry and China's global aspirations. Hence, there are sufficient reasons to be wary of FIL's true direction and impact. The stated objective of promoting FDI by improving IP protection might be sincere to the extent that China wants to ramp up its share of high-tech manufacturing to increase value addition in line with the 'Made in China 2025' plan. A more realistic logic behind enhancement of IP protection might be the fact that China is fast catching up with the US in the number of patents being filed (Croft 2019). So IP protection is now as important for Chinese companies as FIEs.

The principle of reciprocity blurs the line between political and economic consideration. In practice the BRI has always been viewed as a political vehicle with an economic veneer. The FIL confirms this view. The ambiguity around VIEs is not a new one but FIL represents a wasted opportunity to regularise this curious anomaly. Again foreign investors stand to lose more. Lastly, the haste with which the FIL was propelled through the legislation also suggests that more serious thinking was reserved for implementation regulations. This move by itself is regressive for FDI since it increases uncertainty, reduces the ease of doing business and might even encourage flight of existing FDI in China. Perhaps the only certainty relating to the FIL is that it will serve to further China's policy objectives as effectively as its predecessor laws. If FIEs seek to enforce even the favourable provisions of FIL they will have a whole plethora of 'rule of law' challenges in China and a judiciary which is reluctant to pass scriptures against the government.

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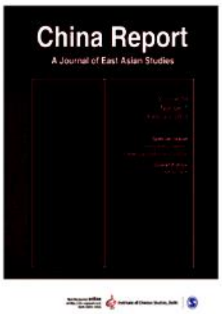

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