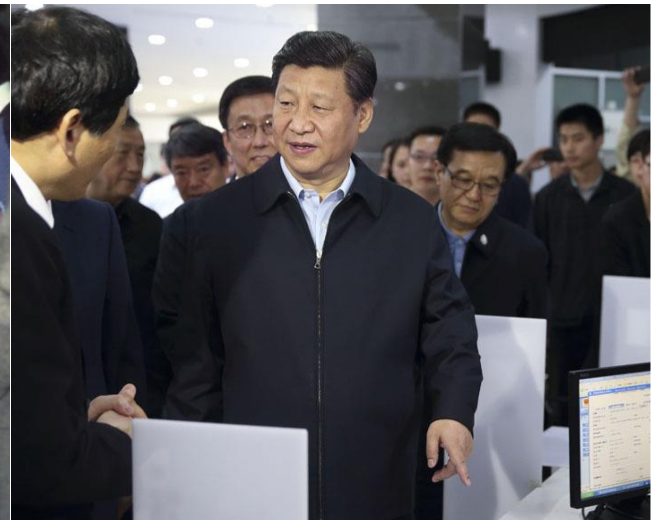



‘Reform and Opening Up’ Reloaded:

The Pathway to and Content of China’s New Foreign Investment Law

Sourabh Gupta

Institute for China-America Studies

July 2019

‘Reform and Opening Up’ Reloaded:

The Pathway to and Content of China’s New Foreign Investment Law

Sourabh Gupta

Resident Senior Fellow, Institute for China-America Studies

The Institute for China-America Studies is an independent think tank funded by the Hainan Nanhai Research Foundation in China. Based in the heart of Washington D.C. ICAS is uniquely situated to facilitate the exchange of ideas and people between China and the United States. We achieve this through research and partnerships with institutions and scholars in both countries, in order to provide a window into their respective worldviews.

ICAS focuses on key issue areas in the U.S.-China relationship in need of greater mutual understanding. We identify promising areas for strengthening bilateral cooperation in the spheres of maritime security, Asia-Pacific economics, trade, strategic stability, international relations as well as global governance issues, and explore avenues for improving this critical bilateral relationship.

ICAS is a 501(c)3 nonprofit organization.

ICAS takes no institutional positions on policy issues. The views expressed in this document are those of the author alone.

Institute for China-America Studies
1919 M St. NW Suite 310
Washington, DC 20036
www.chinaus-icas.org

Contents

Executive Summary

On Friday, March 15, 2019, China's National People's Congress (NPC) adopted the *Foreign Investment Law of the People's Republic of China* by a margin of 2929-8 vote, with eight abstentions and three delegates not voting. The Foreign Investment Law (FIL) is the most significant external economic liberalization-related measure since the recent inauguration of a new round of 'reform and opening up', and one of the most consequential economic liberalization measures since the entry of China into the World Trade Organization (WTO) almost two decades ago. Upon taking effect on January 1, 2020, the FIL will replace the current patchwork of laws (*Equity Joint Venture Law; Wholly Foreign-Owned Enterprises Law; Contractual Joint Ventures Law*) that govern China's foreign inward investment regime and date back to its initial 'reform and opening up' period.

The Foreign Investment Law (FIL) bears useful similarities with the landmark *Sino-Foreign Equity Joint Venture Law* (EJV) that was promulgated at the second session of the 5th National People's Congress in July 1979. Now, as then, the FIL is the first major piece of reform legislation to express the country's commitment to 'reform and opening-up'. Now, as then, a key purpose of the law is to expand international economic cooperation and technology flows while standardizing and promoting China's foreign investment regime. Now, as then, this expression of 'reforming and opening up' has been condensed into a compactly-worded 42-article law. The EJV law was in fact a sparse 15-articles long. Now, as then, the FIL's ambitious scope but brevity in detail has touched-off criticism from the foreign investment community. Like the EJV law, it will require more detailed implementing regulations to provide clarity and comfort to investors. Unlike the EJV implementing regulations though (which took four years to be ironed out), the FIL's implementing regulations are expected to be in place by the end of this year.

A key driver for the passage of China's new Foreign Investment Law (FIL) is foreign businesses complaints of the *de facto* technology transfer obligations that have crept into the practice of China's foreign investment-related joint venture rules. To be clear, these rules do not condition market access on technology transfer; such a conditioning would violate China's WTO accession protocol. That said, there have been instances when foreign businesses have felt the need to involuntarily share their trade secrets as a condition to enter and operate in the Chinese market. These involuntary technology leakage practices take a variety of forms. They range from foreign ownership limitations that require the foreign investor to bring in and share know-how with a local partner, the use of administrative approvals and licensing processes to pressure the transfer of technology, arbitrary and duplicative processes that unduly burden and subject the foreign investor to potentially abusive regulatory practices, to the use of regulations that necessitate the disclosure of sensitive technical proprietary information at the time of product certification and review.

The Foreign Investment Law goes a significant distance, in principle, towards assuaging these long-standing concerns. Article 22 categorically orders government officials to desist from *de facto* coercion of transfer of technology via administrative means. Article 23 insists that proprietary trade secrets be handled confidentially and without conflict of interest on the part of regulators. Malpractice on any of these counts is liable for criminal prosecution (Article 39). Article 35 envisages the setting-up of a foreign investment information reporting system and requires that government departments not unnecessarily duplicate their investment information-related requests from foreign investors. Further, Article 24 instructs lower levels of government to comply with central laws and regulations and desist from imposing discretionary entry or exit barriers. Arbitrary and duplicative processes that unduly burden foreign investors and open them to potentially abusive administrative practices are to cease. Overarchingly, Article 4 categorically spells out that a system of pre-establishment national treatment and an across-the-board negative list is being implemented. With that list having been whittled down aggressively over the past two years – meaning fewer and fewer foreign investors are forced to enter the Chinese market via the Joint Venture route, foreign investors now stand to enjoy a level playing field with their domestic counterparts across broad swathes of industry and services during the investment access stage.

The Foreign Investment Law is not without its sharp edges though. Article 35 leaves the definition of 'national security' open-ended and vague. Decisions made in this regard by the (to-be-established) foreign investment safety review system are to be treated as final like a presidential finding within the U.S.' CFIUS system, there is no recourse to appeal. Furthermore, Article 40 empowers the Chinese government to take "corresponding [retaliatory] measures" against a country or region if it imposes discriminatory, prohibitive or restrictive measures against Chinese entities in the field of investment. On the whole though, the Foreign Investment Law is a well-written one. In time, it will likely come to be seen as that milestone law which launched a dynamic new era of 'reform and opening-up.

As welcome as the Foreign Investment Law is in China's long march to advanced market economy standing, there is more work to be done. Policy attention must now shift to the negative externalities that have begun to radiate internationally from the practice of the state's industrial policies. A number of principles should be firmly inscribed in China's trade, investment and intellectual property rights (IPR) policies and practices, in this regard, going forward.

First, China's polices must abide by the 'most favored nation' and 'national treatment' principles. Aside from the area of government procurement, there should be no nationality-based conditionalities or restrictions on purchase, sale or use. Domestic regulatory oversight, not local product use, must become the norm across-the-board. Second, China's industrial policy interventions must metamorphose from a subsidies-based model to a fiscal incentives-based and indicative planning model. This will require the reformulation of the role of the state as a producer as well as subsidizer at every level of government. Criteria and classification measures that clarify the state's commercially neutral stance in the course of SOE operations should be spelt out. To the extent that subsidies are tapered down but continue to be disbursed, they should be narrowly tailored. Third, China's innovation policies must be technology-neutral and concentrate on usage rights, not proprietorial ownership *per se*. To incubate a local, high-technology manufacturing eco-system, China should experiment with an enabling tax credit regime. And insofar as knowledge-creation is concerned, the government's matrix of support measures should evolve towards government sponsorship of basic research and licensing of government-sponsored IPR. Finally, China should construe measures governing ‘national security’ reviews, including for retaliatory purposes, narrowly and as best as possible limit it to ‘essential’ security interests. Economic security preferences should not be fused with ‘national security’ considerations.

These reform principles will help alleviate tensions with its American and European trading partners. Over the longer term, it will also fuel China’s escape out of the ‘middle income trap’ and facilitate its transition from an excess investment-led and debt-fueled growth model to one that is more consumption-oriented, productivity-led and high-quality growth-based. Foreign-invested and export-oriented enterprises in its coastal regions were at the foundation of China’s remarkable late-20th century economic renaissance. Should a new round of ‘reform and opening up’ under Xi Jinping lead to a similarly far-sighted liberalization of China’s investment and industrial policy regime - much like Deng Xiaoping had engineered of its trade regime three decades ago, China could well become the advanced manufacturing center, and leader, of the world by mid-century. The Foreign Investment Law is both a milestone and harbinger of things to come in this regard.

Introduction

Forty years ago, from December 18-22, 1978, the Communist Party of China (CPC) held its Third Plenum of the Eleventh Central Committee in Beijing. At the plenum, the Party broke with prevailing orthodoxy and launched the country on an unprecedented journey of reform, opening-up and "socialist modernization." The prevailing *"two whatevers"* orthodoxy - whatever Mao had decided would remain valid; none of Mao's directives should be overturned – had been Hua Guofeng, Mao's dour successor's instrument to legitimize his rule. Deng Xiaoping skillfully circumvented this orthodoxy by building a political coalition around the argument that while one should always "seek truth from facts", as per Mao Zedong thought, "practice [should be] the sole criterion of the truth". Pragmatism, not ideological blinkers, would become the order of the day and reality, not received dogma, the ideological basis to test the correctness of policy. Having deftly turned Mao's 'truth from facts' dictum on its head, Deng reformulated the Party's 'general task' away from "waging class struggle" and set about unleashing the Four Modernizations - that of agriculture, industry, science and technology, and national defense.[i] The age of 'Reform and Opening-Up' had well and truly arrived.

Opening up the hitherto-closed Chinese economy to the world, including liberalization of the foreign investment regime, was key to Deng's modernization program. In April 1979, Guangdong Province Party Secretary, Xi Zhongxun, presented a proposal to the leaders in Beijing to delegate wider flexibility to the coastal provinces of Guangdong and Fujian in order to attract foreign investment. An additional set of exemptions was sought for four coastal cities – Shenzhen in the Pearl River Delta, Zhuhai and Shantou in Guangdong, and Xiamen in Fujian. Foreign firms willing to set-up shop in these fours "special zones," as Deng Xiaoping later coined them, were to benefit from exceptional tax treatment and other concessions. The special economic zone (SEZ) concept was itself based on a mix of prior models developed in Taiwan and South Korea. The proposal was approved on July 15 and the zones were officially established on August 26, 1979.[ii]

Earlier on July 1st, 1979, a short 15-article ***Sino-Foreign Equity Joint Venture Law*** (EJV) had been promulgated at the second session of the 5th National People's Congress. At a time when China lacked the basic legal infrastructure of a functioning market system, the *Equity Joint Venture Law* was revolutionary in its scope, laying down a basic framework of commercial intercourse with the outside world. The EJV law and its implementing rules, together with the ***Wholly Foreign-Owned Enterprise Law*** (WFOE Law) of April 12, 1986 and the ***Contractual Joint Ventures Law*** (CJV Law) of April 13, 1988, were to form the foundation and basis of China's foreign investment regulatory regime. With the passage of time, numerous joint ventures, cooperative enterprises and businesses wholly-owned by foreign firms were set up in China.[iii] And as these foreign-invested and export-oriented enterprises particularly in the light-manufacturing sector took root on the mainland, initially in the SEZs and thereafter along the entire eastern sea-board, China was gradually transformed into the 'factory of the world'. Today, as an ever-increasing share of industrial goods-related parts and components are sourced domestically in China, the country retains a lock over the development of global supply chains in these light and medium technology-intensive sectors.

The Third Plenum, and the subsequent 'reform and opening-up' modernizations, were defining events of the second half of the 20th century, inspiring reforms that spurred decades of economic growth in China. On the brink of another historic period of economic transition, the pragmatic approach to development that was the hallmark of Chinese policymaking over the past four decades remains as valuable as ever. President Xi Jinping alluded to this approach in his celebratory speech commemorating the 40th anniversary of 'reform and opening up' when he noted that theoretical innovation based on practice was the life-blood of reform and there could be no end to the development of practice.[iv] Reality as the test of policy correctness would continue to govern the day.

Deng Xiaoping visiting Shenzhen Special Economic Zone in 1984
Source: China Internet Information Center

It is a compelling serendipity that it has fallen upon the shoulders of Guangdong's reform-minded Provincial Party Secretary, Xi Zhongxun's son, Xi Jinping, to write this newest chapter of China's reform and opening-up destiny. Should Xi be able to engineer a far-sighted liberalization of China's investment regime with the same political skill and pragmatism that Deng had pioneered of China's trading regime many decades ago, China could well become the foremost advanced manufacturing center, and leader, of the world by 2049. As a first step in this direction, on March 15, 2019, the National People's Congress (NPC) passed the ***Foreign Investment Law of the People's Republic of China*** at the final plenary of this year's 'Two Sessions' meetings. The well-scripted, six-chapter law is to serve as a streamlined Basic Law, repealing the three current foreign investment laws in existence (*Equity Joint Venture Law; Wholly Foreign-Owned Enterprises Law; Contractual Joint Ventures Law*). The extent to which the Foreign Investment Law (FIL) lives up to its next-generation liberalizing promise, and intent, will depend in large part on the implementing regulations that are to breathe life into the law. The law is set to go into effect on January 1, 2020 - both, foreshadowing an intense period of rule-writing as numerous existing regulations are amended in the run-up to the New Year's Day deadline as well as heralding a 'new historical starting point' that could deliver China to its 2049 aspiration of a "fully developed and advanced nation."

This report on China's new Foreign Investment Law (FIL) is divided into two sections. Starting with a discussion of the mid-1990s ***Catalogue of Industries for Guiding Foreign Investment***, Section One will trace the path to the passage of the FIL at the 2nd session of the 13th NPC this past March. One of the key drivers of the reform will be discussed: the accumulated grievance among China's key trading partners - and concomitant threat of reprisals and exclusions - with regard to a host of unreasonable and discriminatory technology transfer requirements that had crept within the practice of China's foreign investment regime.

In Section Two, the report will discuss the content of China's new Foreign Investment Law. From first draft through final reading and passage of the FIL, this section will discuss the key aspects of the law as well as the improvements made in the text of the legislation as it wound its way through readings within the Standing Committee of the 13th National People's Congress. Given the similarity of some of the criticisms laid out against the FIL, the section will start with a discussion of the equally briskly-written ***Sino-Foreign Equity Joint Venture Law*** (EJV) of July 1979 which came to symbolize China's momentous economic 'reform and opening-up' to the outside world. The report will conclude by touching upon the challenges that China and the West are likely to face as they go-about constructing a fair, reciprocal and non-discriminatory foreign trade, investment and intellectual property rights-related relationship over the next decade-and-a-half. Given the discrepancy in their respective models of market capitalism, a set of first principles will be enunciated that will hold the Chinese side in good stead as it moves forward.

SECTION ONE – The Road to the Foreign Investment Law

> *We will expand foreign trade, develop new models and new forms of trade, and turn China into a trader of quality. We will adopt policies to promote high-standard liberalization and facilitation of trade and investment; we will 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. All businesses registered in China will be treated equally.*
>
> - *President Xi Jinping, address delivered at 19th National Congress of the Communist Party of China, October 18, 2017*

At the second session of the 13th National People's Congress on March 15, 2019, China adopted a new Foreign Investment Law (FIL). The law is due to go into effect on January 1, 2020. The law, which repeals the existing foreign investment laws and is to serve as a new Basic Law in this area, is part of a larger program of liberalization of China's foreign investment regime. That larger program, which includes a steady paring down of the existing 'negative list', was announced and kicked into high gear by President Xi Jinping during his address at the Boao Forum for Asia in April 2018. This larger program of liberalization of China's foreign investment regime is itself part of a renewed push at 'reform and opening-up', exactly forty years after Deng Xiaoping had momentously broken with prevailing ideology and pioneered an unprecedented journey of 'reform and opening-up' and socialist modernization. The origins of this latest edition of 'reform and opening-up' date back to November 2013 and the economic reform revival agenda outlined at the Third Plenum of the 18th Congress of the Communist Party of China (CPC). In these Third Plenum reforms, the Party had resolved to allow the market to play a decisive role in the economic allocation of resources and proposed the "exploration" of a scheme in which foreign businesses would enjoy 'pre-establishment national treatment plus negative list' management.[v] A pledge to unveil this 'pre-establishment national treatment plus negative list' scheme was formally announced by CPC General Secretary, Xi Jinping, in his address to the 19th Party Congress on October 18, 2017, and the recent passage of the new Foreign Investment Law is the redemption of this pledge.[vi]

In no small measure, the Trump Administration's punitive trade policy measures under Section 301 of its Trade Policy Act as well as the passage of a new foreign inward investment screening law and export control law by the U.S. Congress in August 2018 added urgency to China's push to liberalize its foreign investment regime.[vii] China aspires to perpetuate a symbiotic high-technology trade and investment relationship with the U.S. It seeks to ensure that its dynamic home-grown army of innovators is not excluded from acquiring core technologies abroad or working them at home. Leveling China's titled foreign investment regime to facilitate fair and reciprocal access for foreign businesses in China's domestic marketplace was one among a number of key conditions, in the West's view, for the (mostly) unimpeded continuation of such two-way technology flows. To ensure that China's innovators are not elbowed or embargoed out of this cross-border technology eco-system, Beijing has now made an important down-payment towards doing the needful by way of legal reform of its foreign investment framework.

The Catalogue for Guiding Foreign Investment

On June 20, 1995, China's State Planning Commission, the Ministry of Foreign Trade and Economic Cooperation and the State Economic and Trade Commission adopted the ***Interim Provisions on Guiding Foreign Direct Investment***. The regulation was an important step forward in enhancing the transparency and predictability of the foreign investment regime (composed at the time of the EJV Law, WFOE Law and CJV Law and their implementing rules). The key purpose of the regulation was to design a new investment guideline system, as implemented soon thereafter in the form of the ***Catalogue for the Guidance of Industries for Foreign Investment***. As per the ***Foreign Investment Catalogue***, foreign investment projects were to be categorized into three groups: (1) "encouraged," (2) "restricted," and (3) "prohibited." Industries not listed in any one of the three categories were considered as "permitted."[viii] Different categories of investment generally led to different degrees of application requirements and approval scrutiny.

The *Foreign Investment Catalogue* provided a simple and relatively transparent basis for foreign businesses to understand the conditions and benefits of investing in particular sectors in the Chinese economy. The relevant policy could be handily scrutinized prior to planning an investment project in China. Over time however, the *Catalogue's* strength – its categorization of industries - also became one of its weaknesses, particularly as liberalization of the overall foreign investment system failed to keep pace with the imperative for progressive additional reform. Despite amendments to the *Foreign Investment Catalogue* in 1997, 2004, 2007, 2011 and 2015 (and most recently in 2017 and 2018), it came to be associated less with transparency and opening-up and more as an entry point to understand the restrictions, and restrictiveness, of China's overall foreign investment regime.

Table 1. China's Foreign Investment Catalogue: Overview of Key Changes in 2018 Version

Sector	Summary of Requirements in 2017 FIC	Changes in 2018 FIC
Selection and cultivation of new varieties of crops and production of seeds	Chinese entity must be the controlling shareholder.	Removed controlling shareholder requirement for selection and cultivation of new varieties of crops other than corn and wheat.
Exploration and development of oil and natural gas	Limited to CJV or EJV	No Change
Manufacturing of fully-assembled automobiles	Chinese entity's investment cannot be lower than 50 percent, and the same foreign investor may establish no more than two JVs in China for the same kind of automobiles, subject to certain exceptions.	Removed foreign equity cap for manufacturing of special use vehicles and new energy vehicles. In addition, (i) in 2020, the foreign equity cap for manufacturing of commercial vehicles will be removed, and (ii) in 2022 the two JV cap and the foreign equity cap for manufacturing of passenger vehicles will be removed.
Manufacturing commercial aircraft	Chinese entity must be the controlling shareholder.	Controlling shareholder requirement removed
Construction and operation of nuclear power plants	Chinese entity must be the controlling shareholder.	No Change

Value-added Telecommunications Services	Foreign investment cannot exceed 50 percent, excluding e-commerce, and is limited to WTO commitments. Note that China classifies a broad range of internet and technology-related services under this sector.	No Change
Basic telecommunications services	Chinese entity must be the controlling shareholder and foreign investment is limited to WTO commitments.	No Change
Banking	Foreign financial institution investment cannot exceed 20 percent or 25 percent depending on how the investment is structured.	Foreign equity restriction removed
Medical institutions	Limited to CJV or EJV.	No Change
Surveying and mapping companies	Chinese entity must be the controlling shareholder.	Controlling shareholder requirement removed

Source: USTR (2018).

Since its inception, the *Foreign Investment Catalogue* has required that investments in certain sectors take **the form of a joint venture (JV),** that the proportion of foreign equity investment in the joint venture be capped at a particular level and that the Chinese party maintain a controlling interest in the joint venture. In 2017, 35 sectors were listed as "restricted" and required that foreign entry be subject to specific equity limits and/or local partner requirements. Foreign investors, on the other hand, typically prefer to invest in China through the wholly foreign-owned enterprise (WFOE) route so as to be able to maintain full control over their investments and proprietorial technologies.

The aim of the *Foreign Investment Catalogue's* JV restrictions was to channel foreign investment into sectors of the government's choosing, so as to assist in the building-up of indigenous capabilities in these sectors. For the first decade or so, the *Catalogue* largely accomplished its intended purpose. There was substantial technology sharing between the foreign investor and its Chinese joint venture partner, and that these technology spillover effects generated net positive externalities to other Chinese firms in the same industry too.[ix] Over time however, this privileging of the local Chinese partner as the JV's controlling point led in practice to a number of ills on the ground. Many of these ills were technology transfer-related – i.e. the involuntary leakage of proprietary knowhow or technologies from the foreign investor to its local partner.

To be clear, China did not violate its international legal commitments in this regard. Conditioning foreign inward investment-related approvals on technology transfer requirements is illegal as per international trade law. As per Section 7(3) of its ***Protocol of Accession*** to the WTO, China is required to:

> *… **eliminate and cease to enforce** trade and foreign exchange balancing requirements, local content and export or **performance requirements made effective through laws, regulations or other measures**. Moreover, China will not enforce provisions of contracts imposing such requirements. Without prejudice to the relevant provisions of this Protocol, China **shall ensure that the** distribution of import licenses, quotas, tariff-rate quotas, or any other means of approval for importation, the **right of** importation or **investment by national and sub-national authorities, is not conditioned on**: whether competing domestic suppliers of such products exist; or **performance requirements of any kind, such as** local content, offsets, **the transfer of technology**, export performance or the conduct of research and development in China.*[x]

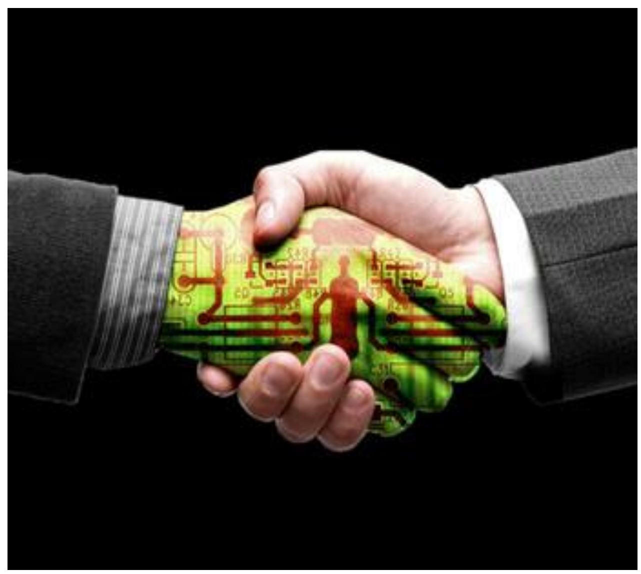
Essentially, China is at liberty to determine how open (or closed) its foreign inward investment regime should be, but investment market access liberalization cannot be conditioned on foreigners having to explicitly transfer their proprietary technologies to gain market entry. Clearly, if China engaged in such policies and practices, it would be a material violation of its accession commitments. That China did not in fact officially mandate such practices can be gauged from an unlikely source – the Office of the United States Trade Representative. (Aside from a narrow set of technology licensing measures which appear to discriminate against foreign IP holders) USTR makes no claim in its Section 301 report on China's technology transfer policies and practices that they are illegal or in violation of its accession protocol obligations. Rather, the Section 301 finding is that China's practices are **"unreasonable"** – unreasonable being defined as an act, policy, or practice that **"*while not necessarily in violation of, or inconsistent with, the international legal rights of the United States is otherwise unfair and inequitable*.'"**[xi] There is huge gap between "unreasonable" and "illegal".

Yet as foreign businesses have complained with fair legitimacy for a number of years now, the effect of the *Catalogue* was to place them in numerous instances of unenviable situations where they felt that they *de facto* needed to relinquish their technologies as a condition to enter and operate in the Chinese market. **And it was the JV requirement which, often-times, went to the heart of this malpractice.**

The Offending Technology Transfer-related Practices

De facto technology transfer practices can take a variety of forms. Typically, these range from

- foreign ownership limitations that oblige the foreign investor to bring in, share and transfer know-how to a local partner,
- use of administrative approvals and licensing processes as an avenue to pressure the transfer of technology,
- arbitrary and duplicative processes that unduly burden and subject the foreign investor to potentially abusive regulatory practices, including technology transfer-related practices,
- to the use of regulations that necessitate the disclosure of sensitive technical proprietary information at the time of product certification and review.



The most common technology transfer practice, as already discussed, is the requirement that a foreign company mandatorily enter into an equity joint venture (EJV) or contractual joint venture (CJV) with a Chinese partner to enter the market, and that the Chinese partner be the controlling shareholder or hold the majority of shares in the venture. This practice is known as the **mandatory joint venture requirement**. For example, in the aviation sector, foreign suppliers participating in tenders put out by COMAC (Commercial Aircraft Corporation of China, a central state-owned enterprise) for key components, such as advanced materials, avionics and flight control systems, must enter into a JV with a Chinese supplier/s. The foreign supplier is also expected to build-out its R&D, production and assembly, and testing capabilities for system-level products. In the area of New Energy Vehicles (battery electric vehicles, plug-in hybrid electric vehicles, fuel cell electric vehicles), the foreign-Chinese JV is required to hold intellectual property rights to one of three technologies, batteries, drive systems, or control systems – meaning, in effect, that the foreign company's IP must necessarily have already been shared with its Chinese partner.[xii] The risk of unauthorized technology spillovers is accentuated when the Chinese JV partner independently maintains parallel operations within the same business line that compete with the JV and the employees of the JV are recruited from or have ties to this parallel operation.

Table 2. Equity Restrictions by Sector

	Australia	Brazil	Canada	Chile	China	France	Germany	India	Indonesia	Japan	Korea	Malaysia	Mexico	Netherlands	Norway	Poland	Russia	Saudi Arabia	South Africa	United Kingdom	United States	Average
Primary	0	0	0.138	0.125	0.322	0.113	0.056	0.269	0.334	0.000	0.250	0.208	0.094	0.056	0.125	0	0	0.521	0	0.125	0.125	0.1362
Agriculture & Forestry	0	0	0	0	0.075	0.225	0	0.263	0.148	0	0.250	0.415	0	0	0	0	0	0.042	0	0	0	0.0675
Agriculture	0	0	0	0	0.150	0.450	0	0.525	0.247	0	0.500	0	0	0	0	0	0	0.042	0	0	0	0.0911
Forestry	0	0	0	0	0	0	0	0	0.05	0	0	0.830	0	0	0	0	0	0.042	0	0	0	0.0439
Fisheries	0	0	0.500	0.500	1	0	0.225	0.500	0.500	0	0.500	0	0.375	0.225	0.500	0	0	1	0	0.500	0.500	0.3250
Mining & Quarrying (incl. Oil extr.)	0	0	0.050	0	0.138	0	0	0.050	0.538	0	0	0	0	0	0	0	0	1	0	0	0	0.085
Secondary	0	0	0	0	0.098	0	0	0.032	0.032	0	0.060	0.107	0	0	0	0	0.024	0.042	0	0	0.027	0.020
Manufacturing	0	0	0	0	0.047	0	0	0.032	0.007	0	0	0	0	0	0	0	0.033	0.042	0	0	0	0.008
Food and other	0	0	0	0	0.013	0	0	0.1	0	0	0	0	0	0	0	0	0	0.042	0	0	0	0.007
Oil ref. & Chemicals	0	0	0	0	0.010	0	0	0.058	0.033	0	0	0	0	0	0	0	0	0.042	0	0	0	0.007
Metals, machinery and other minerals	0	0	0	0	0.035	0	0	0	0	0	0	0	0	0	0	0	0	0.042	0	0	0	0.004
Electric, Electronics and other instruments	0	0	0	0	0.013	0	0	0	0	0	0	0	0	0	0	0	0	0.042	0	0	0	0.003
Transport equipment	0	0	0	0	0.163	0	0	0	0	0	0	0	0	0	0	0	0.167	0.042	0	0	0	0.018
Electricity	0	0	0	0	0.325	0	0	0.063	0.04	0	0.417	0.500	0	0	0	0	0	0.042	0	0	0.192	0.075
Electricity generation	0	0	0	0	0.15	0	0	0.125	0.04	0	0.333	0.500	0	0	0	0	0	0.042	0	0	0.383	0.075
Electricity distribution	0	0	0	0	0.500	0	0	0	0.04	0	0.500	0.500	0	0	0	0	0	0.042	0	0	0	0.075
Construction	0	0	0	0	0.125	0	0	0	0.15	0	0	0.250	0	0	0	0	0	0.042	0	0	0	0.027
Tertiary	0.042	0.057	0.097	0.044	0.257	0.014	0.014	0.244	0.398	0.050	0.130	0.196	0.102	0.007	0.102	0.111	0.177	0.223	0.072	0.027	0.068	0.116
Distribution	0	0	0	0	0.038	0	0	0.090	0.500	0	0	0.167	0.075	0	0	0	0	0.083	0	0	0	0.045
Wholesale	0	0	0	0	0.025	0	0	0	0.375	0	0	0	0	0	0	0	0	0.042	0	0	0	0.021
Retail	0	0	0	0	0.05	0	0	0.180	0.625	0	0	0.333	0.15	0	0	0	0	0.125	0	0	0	0.070
Transport	0.060	0.250	0.167	0.354	0.354	0.150	0.150	0.125	0.352	0.167	0.492	0.083	0.428	0.075	0.333	0.075	0.267	0.278	0.167	0.075	0.500	0.233
Surface	0	0.250	0	0.063	0.125	0	0	0	0.150	0	0	0	0.333	0	0	0	0.300	0.750	0	0	0	0.094
Maritime	0	0	0	0.500	0.438	0.225	0.225	0	0.405	0	0.975	0.250	0.450	0	0.500	0	0	0.042	0	0	1	0.239
Air	0.180	0.500	0.500	0.500	0.5	0.225	0.225	0.375	0.500	0.500	0.500	0	0.500	0.225	0.500	0.225	0.500	0.042	0.500	0.225	0.500	0.368
Hotels & restaurants	0	0	0	0	0	0	0	0	0.063	0	0	0.05	0	0	0	0	0.05	0.042	0.1	0	0	0.015
Media	0	0.375	0.500	0.125	0.925	0	0	0.200	0.825	0.188	0.563	0.625	0.375	0	0.125	0.25	0.25	0.521	0.25	0.225	0.25	0.313
Radio & TV broadcasting	0	0.250	0.500	0.250	0.950	0	0	0.150	0.750	0.375	0.750	0.750	0.500	0	0.250	0.500	0.500	0.042	0.500	0.450	0.500	0.379
Other media	0	0.500	0.500	0	0.900	0	0	0.250	0.900	0	0.375	0.500	0.25	0	0	0	0	1	0	0	0	0.246
Communications	0.200	0	0.400	0	0.500	0	0	0	0.230	0.2	0.275	0.250	0	0	0	0	0	0.125	0	0	0	0.104
Fixed telecoms	0.200	0	0.400	0	0.500	0	0	0	0.200	0.4	0.275	0.250	0	0	0	0	0	0.125	0	0	0	0.112
Mobile telecoms	0.200	0	0.400	0	0.500	0	0	0	0.260	0	0.275	0.250	0	0	0	0	0	0.125	0	0	0	0.096
Financial services	0	0	0	0	0.283	0	0	0.204	0.146	0	0.033	0.150	0	0	0.033	0	0.308	0.097	0.008	0	0	0.060
Banking	0	0	0	0	0.250	0	0	0.188	0.050	0	0	0.188	0	0	0	0	0.25	0.125	0	0	0	0.050
Insurance	0	0	0	0	0.375	0	0	0.4	0.100	0	0	0.250	0	0	0	0	0.625	0.125	0	0	0	0.089
Other finance	0	0	0	0	0.225	0	0	0.025	0.288	0	0.100	0.013	0	0	0.100	0	0.05	0.042	0.025	0	0	0.041
Business services	0	0	0	0	0.125	0.003	0	0.563	0.469	0	0	0.063	0	0	0.313	0	0.125	0.125	0.250	0	0	0.097
Legal	0	0	0	0	0.500	0.01	0	1	0.500	0	0	0.250	0	0	1	0	0.5	0.125	0.500	0	0	0.209
Accounting & audit	0	0	0	0	0	0	0	1	0.500	0	0	0	0	0	0.250	0	0	0.125	0.500	0	0	0.113
Architectural	0	0	0	0	0	0	0	0	0.438	0	0	0	0	0	0	0	0	0.125	0	0	0	0.027
Engineering	0	0	0	0	0	0	0	0.25	0.438	0	0	0	0	0	0	0	0	0.125	0	0	0	0.039
Real estate investment	0.200	0	0	0	0	0	0	1	1	0	0	0.300	0.167	0	0.250	0.900	0.333	0.900	0	0	0	0.240
Total FDI Index	0.021	0.028	0.073	0.045	0.218	0.027	0.017	0.181	0.270	0.025	0.129	0.170	0.068	0.014	0.074	0.056	0.096	0.219	0.036	0.036	0.066	0.089

Note: Indicative scale: domestic minority holding 0.25; domestic majority holding 0.5; fully excluded 1.
Source: OECD (2017).

A second route that leads to the *de facto* transfer of technology concerns implicit pressures that arise in the course of the **administrative approvals and licensing process**. Numerous such review and licensing processes must be complied with at the central, provincial and municipal level before a foreign company can establish or expand operations in China. Ambiguously worded provisions and uncertainty about applicable rules create avenues for opaque, deal-specific requirements that result in the leakage of foreign IP, particularly at lower levels of government. These pressures are exacerbated when the Chinese JV partner is designated as the nodal contact point for the JV - meaning it must be trusted with the JV's sensitive transaction-related documents at the time of obtaining the numerous investment approvals.

<u>Technology Transfer Measures – Common Features</u>

There are four features that are in general common to technology transfer practices.

First, they entail an **implicit *quid pro quo* arrangement** in terms of access to a given market in exchange for the transfer of proprietary technology. The more proximate the appeals to transfer are read as a hard pre-condition, the more non-compliant they are with international rules.

Second, they constitute a **violation of the transparency principle.** The measures are typically masked in administrative clauses or provisions that are written in discretionary language and lack firm clarity in terms of obligations to be exchanged between the foreign and domestic JV partners. In economies where trade secrets protection is not up-to-the-mark, the risk of unauthorized leakage of proprietorial technologies is greater.

Third, they typically constitute a **violation of the non-discrimination principle**. The more proximate these measures are in terms of their application on less favorable terms to foreign owners of IP in comparison with domestic IP holders, the more non-compliant they are with international rules.

Finally, such measures tend to predominate in countries **where the state plays an active or interventionist role on the production side of the economy**. Typically, this tends to be the case in developing and emerging economies – although there are wide divergences within this grouping on the state's role. Where state-owned enterprises (SOEs) or public sector undertakings (PSUs) are the ones at the forefront of these implicit *quid pro quo* arrangements, the risk of involuntary transfer is greater.

Source: *see Andrea Andrenelli, Julien Gourdon and Evdokia Moise (24 January 2019), "International Technology Transfer Policies," Organization for Economic Cooperation and Development*.

Next, and on a related note, are the **duplicative processes that subject the foreign investor to excessive run-arounds, resulting potentially in unauthorized technology transfer pressures during the investment approval process.** China's FDI approval process can be long-winded and complex. As noted in a recent Organization for Economic Cooperation and Development (OECD) report:

> *Investors in non-prohibited sectors need to apply for antitrust review to the MOFCOM. The review process lasts 30 days but, in some cases, a second 90 day phase and a third "exceptional" 60 day phase may apply. Upon successful completion of the antitrust review, investors who obtain actual control on a Chinese company need to pass a national security screening. As part of the security screening, the MOFCOM sends the application to a Ministerial Panel, which requests written opinions from relevant government agencies. The relevant governmental agencies have twenty days to respond to the Ministerial Panel, which takes a final decision on the basis of the opinions received. Investors which pass the security review then have to ask for further approvals from the local Development and Reform Commission (DRC) for the use of the land and the general implementation of the project. Once the relevant DRC has approved a project, the investor needs to seek further approval from the local Commerce Department, which uses very broad criteria in making a decision, including the development of China's national economy and potential transfer of technology to local firms. This phase usually takes 20 days. Required documents for submission may also include confidential information.*[xiii]

The numerous hoops that a foreign investor is asked to jump through creates opportunity for arm-twisting. Vaguely worded provisions provide government officials, particularly at lower levels of government, with significant discretion to reach beyond written legal clauses and impose *de facto* technology transfer requirements at each stage of the approvals process.

The requirement to **disclose sensitive technical information, including proprietorial designs, during the product certification and review process** creates a final avenue for implicit but coercive transfers of foreign IP. Chinese authorities retain, in particular, the right to examine the machinery and proprietary technologies provided by the foreign JV partner and require submission of documentation in this regard. This requirement holds even in cases where the foreign investor takes a major or controlling interest in the JV (as promulgated in the *2006 Provisions for Mergers and Acquisition of Domestic Enterprises by Foreign Investors*). An example of such disproportionately intrusive screening processes is the *Examination, Approval and Registration of Foreign-invested Seeds Companies of the PRC*. The measure makes establishment of a Foreign Invested Enterprise (FIE) in the area of crop seeds conditional upon the investor possessing and introducing "superior varieties … and advanced seeds techniques and equipment" in China. The Ministry of Commerce retains the right to requisition exhaustive IPR-related documents at the time of approving the transaction.[xiv] This risk of unauthorized IP transfer is exacerbated when the screening rules for product certification do not explicitly require - *but implicitly encourage* - the disclosure of sensitive information against a backdrop of deficient trade secrets protections.

Beyond these listed pathways of involuntary technology transfer, there are also anecdotal instances of the court system being allegedly utilized to threaten the invalidation of firms' patents and licensing arrangements, cases of companies being harassed by zealous anti-trust and other investigators, and anecdotes of regulatory panels stacked with conflict of interest-ridden technical specialists who may be suitably well-placed to cherry-pick trade secrets and pass them along to Chinese competitor companies.[xv]

It would be helpful though if these complaints were formally articulated and deposited with Chinese administrators. As China's Ambassador to the U.S., Mr. Cui Tiankai noted in a recent interview, the U.S. companies' public complaints might be many but the specific cases brought by these companies to the notice of Chinese administrators is practically non-existent. **Without specific cases to investigate and prosecute, Chinese authorities are not in a position to get to the nub of these complaints.**[xvi] It has also been pointed out that if individual firms did not want to furnish the specifics of their technology transfer-related complaints with the Chinese side – for fear of reprisals, USTR could have organized a group of companies in a given industry, in order to spread the burden of retaliation, and brought a case at the WTO.[xvii] That this move has not been contemplated suggests that the grounds to claim coercion in the first place might be somewhat-suspect. Chinese entities, after all, are huge remitters of fees and royalties for the use of foreign technology. Such payments recorded a four-fold increase over the last decade and reached $28.6 billion in 2017 – the fourth-highest in the world. Almost $8 billion in licensing fees were paid to U.S. businesses itself in 2016.[xviii] **Technology flows, the data would seem to suggest, are far more consensual than coerced.**

The Trump Administration's Response to China's *"Unreasonable"* Technology Transfer Practices

To compel China to eliminate its *"unreasonable"* technology transfer practices as well as level the playing field in terms of obtaining markedly greater investment market access, President Donald Trump issued a **Presidential Memorandum** on March 22, 2018 laying out a three-course path of action.[xix] First, in order to counter China's allegedly discriminatory intellectual property rights and forced technology transfer policies and practices, Trump directed his United States Trade Representative (USTR), Robert Lighthizer, to publish a proposed list of Chinese products that were to be subject to tariff increases. Next, Trump directed USTR Lighthizer to pursue dispute settlement at the World Trade Organization (WTO) against China's questionable licensing practices related to technology-related contracts. Finally, Trump directed his Treasury Secretary, Steven Mnuchin, to provide a strategy to erect investment restrictions against Chinese inward and China-destined outward investment, thereby addressing concerns in the U.S. about leakage of industrially significant technologies to China.

Table 3. Timeline of key events for US and China Section 301-related special tariffs in 2018-19

Date	Event
March 22, 2018	Trump indicates forthcoming Section 301 tariffs on up to $60 billion of imports from China, USTR releases Section 301 report
April 3, 2018	US announces list of Chinese products worth $50 billion over which it will impose Section 301 tariffs of 25 percent
April 4, 2018	China announces list of US products worth $50 billion over which it will impose tariffs of 25 percent in retaliation to US Section 301 tariffs
June 18, 2018	Trump instructs USTR to identify an additional $200 billion of imports from China that would be subject to a 10 percent tariff under Section 301
July 6, 2018	US imposes Section 301 tariffs of 25 percent on revised list of $34 billion of imports from China
July 6, 2018	China imposes tariffs of 25 percent on revised list of $34 billion of imports from US in retaliation to US Section 301 tariffs of July 6
July 10, 2018	US announces list of Chinese products worth $200 billion over which it will impose Section 301 tariffs of 10 percent
August 3, 2018	China announces list of US products worth $60 billion over which it will impose tariffs of 5 to 25 percent if US imposes Section 301 tariffs on $200 billion of imports from China
August 23, 2018	US imposes Section 301 tariffs of 25 percent on revised list of $16 billion of imports from China. Combined with July 6 action, this completes imposition of tariffs on the first $50 billion of Chinese imports
August 23, 2018	China imposes tariffs of 25 percent on revised list of $16 billion of imports from US retaliation to Section 301 tariffs of August 23
September 24, 2018	US imposes Section 301 tariffs of 10 percent on $200 billion of imports from China. Tariffs will increase to 25 percent on January 1, 2019
September 24, 2018	China imposes tariffs of 5 to 10 percent on $60 billion of imports from US in retaliation to US Section 301 tariffs of September 24
December 1, 2018	Trump and Xi announce commencement of negotiations. Scheduled US tariff increase from 10 to 25 percent on $200 billion of imports from China put on hold for 90 days
February 24, 2019	Trump tweets he will delay the tariff increase from 10 to 25 percent scheduled to go into effect on March 1, 2019, and is planning a summit with Xi
March 5, 2019	USTR issues formal order postponing until further notice the increase in the rate of additional duty to 25 percent

May 5, 2019	Trump says that China is attempting to "renegotiate" its previously offered commitments and announces that scheduled US tariff increases that had been put on hold will now proceed as planned
May 9, 2019	Stating that China had "chosen to retreat from specific commitments," USTR issues formal notification raising rate of additional Section 301 duties, starting July 1st, from 10 to 25 percent on $200 billion of imports from China
May 14, 2019	USTR initiates processes towards imposing a fourth tranche of tariffs on $300 billion of imports from China – essentially covering all products not currently covered under the previous tranches
June 1, 2019	China imposes tariffs as high as 25 percent on $60 billion of imports from US in retaliation to US Section 301 action
June 29, 2019	Trump and Xi announce re-commencement of negotiations. Proposed US tariff increases on remaining $300 billion of imports from China put on hold

Source: Peterson Institute for International Economics (2019).

Following President Trump's memo, on April 3, 2018, USTR Lighthizer recommended that an additional 25 percent duty covering 1,333 tariff lines be applied to about $50 billion worth of Chinese exports to the U.S. The duty was put into effect in two installments – on a list of $34 billion worth of imports from China on July 6, 2018, and on a $16 billion list of imports on August 23, 2018.[xx] A second tranche of 10 percent tariffs on $200 billion of imports from China was imposed on September 24, 2018. The scheduled increase of the tariff level from 10 percent to 25 percent on these $200 billion of imports, due to kick-in on January 1, 2019, was withheld following the Xi-Trump meeting in Buenos Aires on the sidelines of the G20 summit and the initiation of the 90-day bilateral trade talks. Following the (interim) breakdown of these talks in early-May 2019, the rate of duty was increased to 25 per cent on these $200 billion of imports from China. All together at this time, a list of $250 billion of imports from China is subject to an additional 25 percent rate of duty under the Section 301 action. An additional 10 percent duty on a final list of $300 billion worth of Chinese imports is also under contemplation and formal processes in this regard have been initiated.

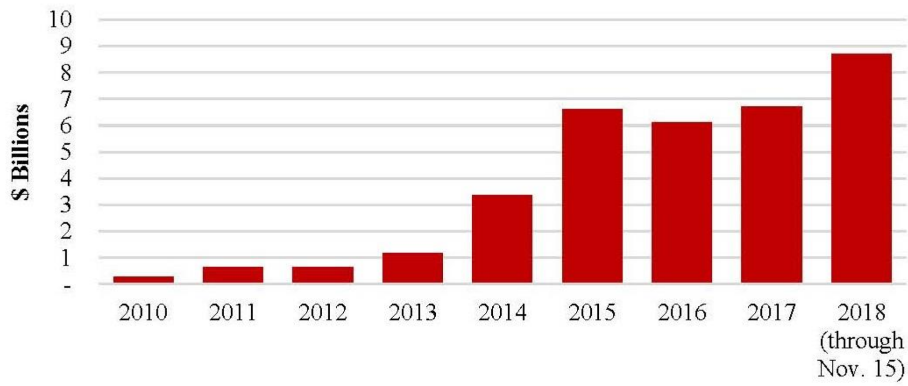
With regard to the **WTO dispute settlement track** to rein-in China's alleged technology licensing practices, the Trump Administration filed a **Request for Consultation** on March 23, 2018 which complained that China was in violation of certain technical aspects of the TRIPs (Trade-Related Aspects of Intellectual Property Rights) Agreement.[xxi] A Request for Consultation is the first step towards launching a formal case against another member over an alleged WTO violation. The Request for Consultation outlined two specific violations:

- First, that China denies foreign patent holders the ability to enforce their patent rights against a Chinese joint-venture party after a technology transfer contract ends. Because domestic patent holders continue to enjoy this right after a technology transfer contract ends, China's policies and practices amount to a violation of the WTO's "national treatment" rules;
- Second, that China imposes mandatory adverse contract terms that discriminate against and are less favorable towards imported foreign technology. These pertain to clauses that require foreign licensors to indemnify Chinese licensees for potential liability for infringement resulting from use of the transferred technology, as well as clauses that provide that any improvements in imported technology belong to the joint venture party making the improvement, irrespective of agreements among the parties. Because China's policies and practices do not place a similar indemnification and improvements-related

burden on domestic licensors, these policies and practices amount to a violation of the WTO's "national treatment" rules.

A number of technical provisions in Chinese laws and regulations which allegedly violate TRIPs Article 3 (related to national treatment) and Article 28 (related to patent rights) are listed in the Request for Consultations. At this time of writing, the case has been suspended within the WTO's dispute settlement system until December 31, 2019. Although a panel was constituted by the Dispute Settlement Body (DSB) on November 21, 2018 to hear the complaint, the panel's work in the proceedings was suspended at the U.S.' own request in June 2019.

Figure 1 – Value of VC Investment Deals in the United States Involving at Least One Chinese Investor ($ Billions)



Source: Bloomberg.

Finally, on the **investment restrictions track**, President Trump signed into law the ***Foreign Investment Risk Review Modernization Act (FIRRMA)*** on August 13, 2018.[xxii] *FIRRMA* constitutes the most sweeping change to the foreign acquisitions-related law governing the Committee on Foreign Investment in the United States (CFIUS) since the passage of the *Foreign Investment and National Security Act (FINSA) of 2007.* In the chapter detailing China's outbound investment practices in its Section 301 report, USTR had accused Beijing of directly and unfairly facilitating:

> *the systemic investment in, and acquisition of, U.S. companies and assets by Chinese companies, to obtain cutting-edge technologies and intellectual property (IP) and generate large-scale technology transfer in industries deemed important by state industrial plans. The role of the state in directing and supporting this outbound investment strategy is pervasive …the government has devoted massive amounts of financing to encourage and facilitate outbound investment in areas it deems strategic … [and] enlisted a broad range of actors to support this effort, including SOEs, state-backed funds, government policy banks, and private companies.*

To allay the national security risks posed by Chinese foreign investment in the U.S., *FIRRMA* obliges CFIUS to henceforth scrutinize any merger, acquisition or takeover of a U.S. company or "other investment" in a U.S. company by a Chinese entity that could lead to the disclosure of "material non-public technical information" related to sensitive personal data, critical infrastructure or critical technologies with a fine-tooth comb. Gaps and loopholes within the CFIUS processes that could otherwise enable a Chinese entity, particularly a state-owned or statelinked entity, to exploit minority position investments in early stage U.S. technology companies and gain access to cutting-edge intellectual property, trade secrets and key personnel are to be closed down too. A U.S. Treasury Department-led pilot program to test the real-world implementation of this new law is currently underway.

Table 4: Overseas Acquisition Transactions with Chinese Investment Vetoed by the US from 1990 to 2018

Year	Buyer	Target	Sector
1990	China National Aero-Technology Import and Export Corporation (CATIC)	MAMCO (Manufacturer of Aircraft Parts)	Manufacturing
2012	Ralls, Affiliate of Sany Group	Wind Farm in Oregon	Energy
2016	Fujian Grand Chip	Aixtron (American Subsidiary of a German Chip Maker)	Semiconductor
2017	Canyon Bridge	Lattice Semiconductor Corporation from Oregon	Semiconductor

Table 5: Chinese Companies' Overseas Acquisitions Revoked as a Result of CFIUS Reviews from 2005 to 2018

Year	Buyer	Target	Sector
2005	CNOOC	Unocal	Energy
2008	Huawei/Bain	3Com	Communications
2009	Northwest Non-Ferrous International Investment Company Ltd	Firstgold Corp.	Energy
2010	Tangshan Caofeidian Investment Corporation	Emcore	Communications
2010	Anshan Iron and Steel Group	Steel Development Company	Manufacturing
2010	Huawei	3Leaf	Communications
2016	GSR Ventures	Royal Philips' Lumileds (US operations included)	Manufacturing
2017	TCL	MIFI of Novatel Wireless	Communications
2017	NavInfo, Tencent and GIC	Dutch mapping data provider (US operations included)	Mapping
2017	HNA Group	Global Eagle Entertainment	Entertainment
2017	Zhongwang International Group	Aleris	Manufacturing
2018	Ant Financial	MoneyGram	Finance
2018	Da BeiNong Group	Waldo Genetics	Agriculture
2018	BlueFocus Group	Cogint	Internet
2018	China Heavy Duty Truck Group	UQM	Manufacturing
2018	HNA Group	Skybridge Capital	Finance

Source: Information Office of the State Council of the People's Republic of China, September 2018

In parallel with the passage of *FIRRMA*, President Trump also signed into the law a new export control law, the ***Export Control Reform Act of 2018***.[xxiii] *ECRA* is meant to complement *FIRRMA* by subjecting China-bound U.S. foreign direct investments and technology transfers to markedly deeper checks. In particular, the law is meant to identity and control the export of "emerging and foundational technologies" that may be China-bound. At this time, preliminary rulemaking under aegis of the U.S. Commerce Department is underway to flesh out a fit and proper definition of the term "emerging technologies." A fit and proper definition of the term "foundational technologies" is to follow thereafter. Once defined, technologies identified and export-controlled as "emerging and foundational technologies" are to be deemed as "critical technologies" too, insofar as the CFIUS regime is concerned, and acquisition-related transactions in regard to these technologies subjected to markedly greater scrutiny.

Simultaneously, on a parallel **United States-European Union-Japan trilateral track, a work program is currently underway to craft new global rules to counter the economic effects of China's state-run policies and practices, including the alleged forced technology transfer practices**.[xxiv] The goal of this work-program is to build on existing WTO rules and develop stronger disciplines and enforcement mechanisms to address the domestic regulatory shortcomings and abuses that, in effect, lead to the unauthorized transfer of foreign IP on Chinese soil.

SECTION TWO – The Content of China's Foreign Investment Law

The "Foreign Investment Law of the People's Republic of China" has been adopted by the 2nd Session of the 13th National People's Congress on March 15, 2019 and is hereby promulgated to take effect on January 1, 2020.

With these few, short words, Order No. 26 of the President of the People's Republic of China, the *Foreign Investment Law of the People's Republic of China*, became the law of the land on March 15, 2019. The Foreign Investment Law (FIL) is the most significant external economic liberalization-related measure since the inauguration of a new round of 'reform and opening up' in December 2018. It is also one of the most consequential economic liberalizations since the entry of China into the WTO almost two decades ago.

The law has been long in the making. A 170-article draft of an earlier proposed draft foreign investment law was first released in early-2015.[xxv] Particularly over the past 18 months, there have been unmistakable signs that something significant was brewing within the policy framework of China's foreign inward investment regime. At the 19th National Congress of the Communist Party of China in October 2017, General Secretary Xi Jinping had declared that China would "*adopt policies to promote high-standard liberalization and facilitation of trade and investment … [and] implement the system of pre-establishment national treatment plus a negative list across the board … and protect the legitimate rights and interests of foreign investors."* Six months later, in his keynote address to the Boao Forum for Asia, President Xi – reiterating China's commitment to openness and globalization - promised to broaden market access, create a more attractive investment environment, strengthen protection of intellectual property rights, and expand imports. A number of specific, near-term liberalizations in the financial and auto sector were unveiled too.

President Xi Jinping at the 19th CPC National Congress
Source: Xinhuanet

In late-June 2018, China unveiled a trimmed negative list for foreign investment *(Special Administrative Measures on Access to Foreign Investment – Negative List, 2018 Version)*, paring the number of restricted items down to 48 from 63 and introducing new opening-up measures in 22 sectors.[xxvi] Some of these openings, such as in seeds, railway networks, power grids, and aircraft manufacturing, were ones that the government had hitherto been reluctant to open. On December 31, 2018, the auto sector 50:50 joint venture requirement for companies building electric vehicles was eliminated (and those for all vehicles are to be eliminated by 2022). Finally, also in late-December, the first draft of China's new Foreign Investment Law (FIL) was introduced and discussed at the 7th Session of the Standing Committee of the 13th National People's Congress. On

March 15, 2019, the third draft became law at the final plenary of the 'Two Sessions' meetings. Once the implementing regulations that will breathe life into the law are written by year's-end, China's foreign inward investment regime will have witnessed a great leap forward. It will also fully redeem General Secretary Xi's pledge at the 19th National Party Congress to adopt "a system of pre-establishment national treatment plus a negative list across the board … and protect the legitimate rights and interests of foreign investors." Similarly, as part of the U.S.-China trade talks, the foreign investment law will substantially redeem China's pledge to the U.S. to treat all businesses registered in China, including foreign-owned businesses, equally.

The promulgation of the Foreign Investment Law (FIL) comes almost four decades to the month that China adopted the *Sino-Foreign Equity Joint Venture Law*. That law threw open China's window to the world and would set in train China's storied 'reform and opening up' of the late-20th century. It was a landmark moment in the history of the second half of the 20th century and spurred decades of economic growth thereafter. At this new landmark moment in China's deeper economic engagement with the outside world, it is worth looking back and briefly reviewing this momentous first chapter of foreign investment liberalization that well-and-truly launched 'reform and opening'.

The Sino-Foreign Equity Joint Venture Law – Opening-up China to the World

On July 1, 1979, at the second session of the 5th National People's Congress, the *Sino-Foreign Equity Joint Venture Law* was legislated into effect. It was the first major reformist law to see light of day following Deng's Xiaoping's skillful orchestration of reform at the third plenary session of the Party's 11th Central Committee meeting in December 1978.[xxvii] The law was composed of 15 short articles and understandably therefore was "more political statement than meaningful legal guidance."[xxviii]

The first two articles introducing the law confirmed its purpose as "expanding international economic cooperation and technological exchange" and permitted "foreign joint ventures" to establish equity joint ventures with their Chinese counterparts. Article 3 required that all proposed JV's needed to be vetted by China's Foreign Investment Commission prior to acquiring a business license. Article 4 laid down the requirement that the foreign partner's equity contribution in the EJV must not "in general (be) less than 25 percent of its registered capital." Article 5 listed that the foreign equity contribution could be in cash, in kind or in industrial property right. It required though that "the technology and equipment contributed by a foreign joint venture as its investment in kind must be advanced technology and equipment *that really suit China's needs*." Article 6, the longest – and most contentious – article, required that a Chinese national appointed by the Chinese partner in the EJV had to necessarily chair the board of directors. Functions and power of the board were also enumerated. Because final decisions were to be made by the board through consultations on the basis of the vague principle of "equality and mutual benefit," this provision in effect ensured that the Chinese chairman, not necessarily equity control, would be the final determining factor with regard to decision-making.

The EJV Law, then, and the FIL now

The timing and content of the *Sino-Foreign Equity Joint Venture Law* bears useful similarities with the newly passed *Foreign Investment Law.*

- Then, as now, the EJV law was the first major piece of reform legislation to express the country's commitment to 'reform and opening-up';
- then, as now, the key purpose of the EJV law was to expand international economic cooperation, technological exchange and standardize and promote foreign investment;
- then, as now, this expression of 'reforming and opening up' was condensed into a concisely worded law. The EJV law was in fact a sparse 15-article law. With 42 articles, the FIL is somewhat longer and more detailed … although far shorter than the originally envisaged 170-article draft of 2015;
- then, as now, the EJV law was ambitious in scope but its provisions touched-off criticism from the foreign investment community given that they were written in somewhat ambiguous language;
- then, as now, it would require more detailed implementing regulations to provide clarity and (relative) comfort to foreign investors. The *Regulations for the Implementation of the Law of the People's Republic of China on Sino-Foreign Equity Joint Venture* was 16 chapters and 118 articles long. These EJV's implementing regulations took four years to frame. By contrast, the FIL's implementing regulations are expected to be written by (this) year's-end.

Article 7 concerned the distribution of net profits and taxes. Equity joint ventures "equipped with advanced technology by world standards" could apply for a reduction or, even, exemption from income tax for the "first two to three" profit-making years. Reinvestment of shared profits in the EJV could also merit a partial income tax refund. Article 8 permitted the direct raising of funds from foreign banks but required that the EJV open an account with, or approved by, the Bank of China. Articles 9 to 14 pertained to business-related issues - production and business operating plans; raw materials sourcing; profits distribution; contract period and termination, including due to heavy losses or failure on the part of a party to perform said obligations; dispute resolution, etc. - concerning the EJV. Importantly, profits earned by a foreign investor were permitted to be remitted abroad but "in accordance with foreign exchange regulations" (i.e. at the prevailing official exchange rate). Finally, Article 15 noted that the law would come into effect on the date of its promulgation.

The *Sino-Foreign Equity Joint Venture Law* was truly groundbreaking in timing and scope. At a time when China's legal commercial infrastructure was rudimentary and at a moment when there was no western business presence in China, the EJV breathed life into China's international economic opening.[xxix] It would take four years – and numerous complaints from Western businesses – though to write the law's implementing regulations, which were promulgated by the State Council on September 20, 1983. The Implementing Regulations consisted of 16 chapters and 118 articles and were considerably more detailed than the slim 15 article EJV law. Elements within the Regulations would later provide the basis for the *Catalogue for the Guidance of Industries for Foreign Investment* of the mid-1990s. As these Implementing Regulations were themselves amended in the 1980s, important commercial law concepts (of "legal person") and principles (of "alienability of ownership") were developed.[xxx] The EJV law, its implementing regulations and the Encouragement (of foreign investment) Provision of October 1986 were to also provide the basis for the *Wholly Foreign-Owned Enterprise Law* (WFOE Law) of April 12, 1986 and *the Contractual Joint Ventures Law* (CJV Law) of April 13, 1988. Together, these laws were to form the foundation and framework of China's foreign investment regulatory regime.

The New Foreign Investment Law (FIL) – Chapter-by-Chapter breakdown

On Friday, March 15, 2019, China's National People's Congress (NPC) adopted the *Foreign Investment Law of the People's Republic of China* by a margin of 2929-8 vote, with eight abstentions and three delegates not voting. Upon taking effect on January 1, 2020, the FIL will replace the current patchwork of laws (*Equity Joint Venture Law; Wholly Foreign-Owned Enterprises Law; Contractual Joint Ventures Law*) in existence.

Three key elements within the FIL stand out in particular. First, the law categorically establishes and spells out the **meaning of "pre-establishment national treatment"** as affording foreign investors treatment that is no less favorable than that afforded to Chinese investors during the investment access stage. National treatment is to be afforded to all foreign investment outside of the negative list. Second, the law's **investment protection clauses specifically prohibit forced technology transfer by administrative means** and require the conditions for technology cooperation to be determined solely through consultation among businesses concerned on the basis of fairness and equality. Various levels of local people's governments are obliged to strictly abide by the central government's rules and must not introduce arbitrary market access or exit conditions and must not interfere with the normal business activities of foreign-invested enterprises. Finally, **a working mechanism is envisaged to expeditiously and fairly address foreign investors' complaints**, while preserving at the same time the rights of investors to seek recourse to judicial means too.

Here is the chapter-by-chapter summary of the evolution of six-chapter, 42 article text of FIL as it wound its way through three readings in the National People's Congress.[xxxi]

Chapter I lays down the **general provisions, key principles and basic definitions** applicable to foreign investment in China. The law covers "foreign investment", defined as any investment – direct or indirect, wholly or partially invested – by a foreign investor by way of:

- Establishing a foreign-funded enterprise, independently or jointly with other investors;
- Acquiring shares, equities, property shares or any other similar rights and interests in a domestic enterprise
- Investing in a new project, independently or jointly with other investors; and

- Making an investment in any other way, as stipulated in laws, administrative regulations or provisions put out by the State Council.

Articles 3 and 4 are the key provisions of Chapter I. They confirm the state's policy of opening up and encouraging foreign investment, particularly with the intent to promote a high-level of investment liberalization and level the playing field. The lack of a level playing field has hitherto been a key grievance of the foreign investor community. In this regard, China is to implement a "system of pre-establishment national treatment and negative list." The description of "pre-establishment national treatment" itself went through an iteration. In the **first draft** of late-December 2018, the first part of **Article 4** simply reads as:

> *The State shall implement the management scheme of pre-establishment national treatment plus negative list with respect to foreign investment;*

By the time of the **second draft** in late-January 2019, the provision had been expanded to provide a clearer description of the term "pre-establishment national treatment."

> *The State shall implement the management systems of pre-establishment national treatment and negative list for foreign investment.*
>
> *For the purpose of the preceding paragraph, pre-establishment national treatment refers to the treatment given to foreign investors and their investments during the investment access stage, which is not lower than that given to their domestic counterparts.*

The **final text** of "pre-establishment national treatment" hews to the description laid out in the penultimate draft. The law does not apply to investments from Hong Kong, Macau and Taiwan.

On a separate note, **Variable Interest Entities (VIEs)**, i.e. corporate structures whereby a foreign-owned entity effectively controls a Chinese-owned entity through an elaborate series of contracts despite lacking majority voting interest, are expected to come under the ambit of the law.[xxxii] How this plays out on the ground will be interesting to watch, given that a number of prominent Chinese brand companies, Baidu and Alibaba among others, are structured as VIEs in sectors that fall within the negative list's purview (internet, telecommunications). Presumably, for an interim period going forward, those entities that are effectively controlled by Chinese investors will be treated as Chinese entities in terms of application of the negative list's 'restricted' or 'prohibited' rules. But this remains to be seen.

Chapter I General Provisions

Article 1 The Foreign Investment Law of the People's Republic of China (hereinafter referred to as "the Law") is hereby formulated in accordance with the Constitution of the People's Republic of China in a bid to further expand opening-up, vigorously promote foreign investment, protect the legitimate rights and interests of foreign investors, standardize the management of foreign investment, impel the formation of a new pattern of all-round opening-up and boost the sound development of the socialist market economy.

Article 2 *The Law shall be applicable to the foreign investment within the territory of the People's Republic of China ("the territory of China").*

For the purpose of the Law, foreign investment refers to the investment activity directly or indirectly conducted by a foreign natural person, enterprise or other organization (the "foreign investors"), including the following circumstances:

1. A foreign investor establishes a foreign-funded enterprise within the territory of China, independently or jointly with any other investor;

2. A foreign investor acquires shares, equities, property shares or any other similar rights and interests of an enterprise within the territory of China;

3. A foreign investor makes investment to initiate a new project within the territory of China, independently or jointly with any other investor; and

4. A foreign investor makes investment in any other way stipulated by laws, administrative regulations or provisions of the State Council.

For the purpose of the Law, a foreign-funded enterprise refers to an enterprise that is incorporated under the Chinese laws within the territory of China and is wholly or partly invested by a foreign investor.

Article 3 *The State shall adhere to the basic state policy of opening-up and encourage foreign investors to make investments within the territory of China.*

The State shall implement policies on high-level investment liberalization and convenience, establish and improve the mechanism to promote foreign investment, and create a stable, transparent, foreseeable and level-playing market environment.

Article 4 *The State shall implement the management systems of pre-establishment national treatment and negative list for foreign investment.*

For the purpose of the preceding paragraph, pre-establishment national treatment refers to the treatment given to foreign investors and their investments during the investment access stage, which is not lower than that given to their domestic counterparts; negative list refers to special administrative measures for the access of foreign investment in specific fields as stipulated by the State. The State shall give national treatment to foreign investment beyond the negative list.

The negative list will be issued by or upon approval by the State Council.

If more preferential treatment concerning access is offered to a foreign investor under any international treaty or agreement that the People's Republic of China concludes or joins in, relevant provisions in such treaty or agreement may prevail.

Article 5 *The State shall protect foreign investors' investment, earnings and other legitimate rights and interests within the territory of China in accordance with the law.*

Article 6 *Foreign investors and foreign-funded enterprises carrying out investment activities within the territory of China shall observe the Chinese laws and regulations, and shall not impair China's security or damage any public interest.*

Article 7 *The competent departments for commerce and investment under the State Council shall, pursuant to the division of duties, promote, protect and manage foreign investment; other relevant departments under the State Council shall take charge of the relevant work in the promotion, protection and management of foreign investment within the scope of their respective duties.*

The relevant department under the local people's government at or above the county level shall carry out the work relating to promotion, protection and management of foreign investment in accordance with laws and regulations and in line with the division of duties determined by the people's government at the same level.

Article 8 Employees of a foreign-funded enterprise shall, pursuant to the law, establish trade union, carry out trade union activities, and safeguard their legitimate rights and interests. A foreign-funded enterprise shall provide necessary conditions for its trade union to carry out relevant activities.

Source: *Foreign Investment Law of P.R. China* http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

Chapter II of the law spells out a list of **investment promotion measures**, including providing transparency, equality and due process to foreign investors. Investors are to be afforded a level playing field with their domestic counterparts with respect to the formulation of rules and regulations, including at the time of soliciting opinions (Article 10); with respect to formulating standards (Article 15); and in the course of government procurement of goods and services (Article 16). In keeping with the past, the state will continue to utilize the special economic zone/pilot policy approach as well as the Encouraged Industries Catalogue to steer foreign investment towards preferred sectors, such as advanced manufacturing and artificial intelligence. Articles 13 and 14 specifically note:

> *Article 13 - The State may, as needed, establish special economic area or carry out pilot polices and measures on foreign investment in specific areas, so as to promote foreign investment and expanding opening-up.*
>
> *Article 14 - The State may, according to the requirements of national economy and social development, encourage and guide foreign investors to invest in specific industries, fields and areas. Foreign investors and foreign-funded enterprises may enjoy preferential treatments in accordance with laws, administrative regulations or provisions of the State Council.*

Local levels of government, too, are at liberty to devise their investment promotion and facilitation measures, although these measures must not derogate from national law (Article 18).

Chapter II Investment Promotion

Article 9 All national policies on supporting the development of enterprises shall equally apply to foreign-funded enterprises in accordance with the law.

Article 10 Comments and suggestions from foreign-funded enterprises shall be sought in a proper manner when formulating laws, regulations and rules relating to foreign investment.

Normative documents and judgment documents relating to foreign investment shall be published in accordance with the law in due time.

Article 11 The State shall establish and perfect the service system for foreign investment, and provide foreign investors and foreign-funded enterprises with consultation and services in respect of laws and regulations, policies and measures, investment project information and other aspects.

Article 12 The State shall establish multilateral and bilateral cooperation mechanisms for the promotion of investment with other countries, regions and international organizations, so as to enhance international exchanges and cooperation in terms of investment.

Article 13 The State may, as needed, establish special economic area or carry out pilot polices and measures on foreign investment in specific areas, so as to promote foreign investment and expanding opening-up.

Article 14 The State may, according to the requirements of national economy and social development, encourage and guide foreign investors to invest in specific industries, fields and areas. Foreign investors and foreign-funded enterprises may enjoy preferential treatments in accordance with laws, administrative regulations or provisions of the State Council.

Article 15 The State shall guarantee that foreign-funded enterprises can equally participate in setting standards in accordance with the law, and enhance information disclosure and social supervision on standard setting.

The compulsory standards formulated by the State shall equally apply to foreign-funded enterprises.

Article 16 The State shall guarantee that foreign-funded enterprises can participate in government procurement activities through fair competition. Products produced and services provided by foreign-funded enterprises within the territory of China shall be treated equally in a government procurement.

Article 17 Foreign-funded enterprises may conduct financing through public offering of shares, corporate bonds and other securities or by other means.

Article 18 Local people's governments at county level or above may, in accordance with the provisions in laws, administrative regulations or local regulations, formulate policies on promotion and facilitation of foreign investment within their respective statutory authorities.

Article 19 People's governments at all levels and relevant departments there under shall, under the principle of convenience, efficiency and transparency, streamline procedures for handling affairs, raise their efficiency and optimize government services, so as to further improve the services offered for foreign investment.

Relevant competent departments shall prepare and publish guidelines for foreign investment and provide foreign investors and foreign-funded enterprises with services and convenience.

Source: *Foreign Investment Law of P.R. China http://www.fdi.gov.cn/1800000121_39_4872_0_7.html*

Chapter III is by far the **most important chapter of the FIL**. It concerns **investor protection and goes to the nub of the various coerced technology transfer grievances and complaints that have been leveled** against China's existing foreign investment regime. The chapter's investment protection clauses **specifically prohibit forced technology transfer by administrative means** and enjoin the state to protect intellectual property rights to the fullest limit of the law. **Article 22** is explicit in this regard:

> *The State shall protect the intellectual property rights of foreign investors and foreign-funded enterprises, and protect the legitimate rights and interests of holders of intellectual property rights and relevant right holders; in case of any infringement of intellectual property right, legal liability shall be investigated strictly the legal liability in accordance with the law.*
>
> *During the process of foreign investment, the State shall encourage technology cooperation on the basis of free will and business rules. Conditions for technology cooperation shall be determined by all investment parties upon negotiation under the principle of equity.* ***No administrative department or its staff member shall force any transfer of technology by administrative means.***

During the **third and final reading** of the draft law, a new article **(Article 23)** was added which unequivocally bars officials from divulging corporate secrets unlawfully under pain of criminal prosecution (**Article 39** of Chapter V). Officials are obliged to protect commercially confidential information that they encounter in the course of their duties and eliminate conflicts of interest.

> ***Administrative departments and their staff members shall keep confidential any trade secret of foreign investor or foreign-funded enterprise they are aware of during the performance of their duties, and shall not divulge or illegally provide to others the secret****.*

Various levels of local people's governments too are obliged to strictly abide by the central government's rules and must not set market access or exit conditions, and must not interfere with the normal business activities of foreign-invested enterprises. A working mechanism to address complaints by foreign businesses, too, is envisaged. The working mechanism does not negate foreign businesses recourse to the domestic court system though. While Article 25 of the **second draft** of the FIL was silent in this regard, an added paragraph (highlighted below) was inscribed in what became **Article 26** in the **final version**.

> *The State shall establish a complaint mechanism for foreign-funded enterprises, timely solve the problems reported by foreign-funded enterprises or their investors, and coordinate and improve relevant policy measures.*
>
> *Where a foreign-funded enterprise or its investor deems that any administrative act of an administrative department or its staff member infringes its legitimate rights and interests, it may seek coordination and resolution thereof through the complaint mechanism for foreign-funded enterprises.*
>
> ***Where a foreign-funded enterprise or its investor deems that any administrative act of an administrative department or its staff member infringes its legitimate rights and interests,*** *in addition to seeking coordination and resolution through the complaint mechanism for foreign-funded enterprises,* ***it may apply for administrative review, or lodge an administrative litigation***

Chapter III Investment Protection

Article 20 The State is not to expropriate any investment made by foreign investors.

Under special circumstances, the State may expropriate or requisition an investment made by foreign investors for public interests in accordance with the law. Such expropriation or requisition shall be made pursuant to statutory procedures and fair and reasonable compensation will be given in a timely manner.

Article 21 A foreign investor may, in accordance with the law, freely transfer inward and outward its contributions, profits, capital gains, income from asset disposal, royalties of intellectual property rights, lawfully obtained compensation or indemnity, income from liquidation and so on within the territory of China in CNY or a foreign currency.

Article 22 The State shall protect the intellectual property rights of foreign investors and foreign-funded enterprises, and protect the legitimate rights and interests of holders of intellectual property rights and relevant right holders; in case of any infringement of intellectual property right, legal liability shall be investigated strictly the legal liability in accordance with the law.

During the process of foreign investment, the State shall encourage technology cooperation on the basis of free will and business rules. Conditions for technology cooperation shall be determined by all investment parties upon negotiation under the principle of equity. No administrative department or its staff member shall force any transfer of technology by administrative means.

Article 23 Administrative departments and their staff members shall keep confidential any trade secret of foreign investor or foreign-funded enterprise they are aware of during the performance of their duties, and shall not divulge or illegally provide to others the secret.

Article 24 In formulating normative documents concerning foreign investment, the people's governments at all levels and their relevant departments shall comply with laws and regulations. Where relevant laws and regulations are not available, the people's governments at all levels and their relevant departments shall not impair the legitimate rights and interests of or impose any additional obligation to a foreign-funded enterprise, set any condition for market access and withdrawal, or intervene any normal production and operation activity of a foreign-funded enterprise.

Article 25 Local people's governments at all levels and their relevant departments shall strictly keep their policy commitments made to foreign investors and foreign-funded enterprises and perform all contracts entered into in accordance with the law.

If any policy commitment or contract needs to be changed due to national interests or public interests, the statutory authority and procedures shall be strictly followed, and the foreign investor or foreign-funded enterprise concerned shall be compensated for losses incurred thereby in accordance with the law.

Article 26 The State shall establish a complaint mechanism for foreign-funded enterprises, timely solve the problems reported by foreign-funded enterprises or their investors, and coordinate and improve relevant policy measures.

Where a foreign-funded enterprise or its investor deems that any administrative act of an administrative department or its staff member infringes its legitimate rights and interests, it may seek coordination and resolution thereof through the complaint mechanism for foreign-funded enterprises.

Where a foreign-funded enterprise or its investor deems that any administrative act of an administrative department or its staff member infringes its legitimate rights and interests, in addition to seeking coordination and resolution through the complaint mechanism for foreign-funded enterprises, it may apply for administrative review, or lodge an administrative litigation.

Article 27 Foreign-funded enterprises may legally establish and voluntarily join in a chamber of commerce or association, which shall carry out relevant activities in accordance with laws, regulations and the articles of association thereof and safeguard the legitimate rights and interests of its member.

Source: *Foreign Investment Law of P.R. China http://www.fdi.gov.cn/1800000121_39_4872_0_7.html*

Chapter IV spells out various **investment management measures** related to the regulation of foreign investment. Foreign investors are barred from investing in prohibited industries on the negative list and must comply with specified requirements when investing in restricted industries on that list (Article 28). Regulators must be even-handed, too, when administering foreign investors' application for licenses in industries where obtaining such license is a requirement (Article 30). The most important provision in this chapter is the one that pertains to 'national security'. **Importantly, national security-related review decisions are final and non-contestable** – just as they are in the case of Committee on Foreign Investment in the United States (CFIUS)-linked presidential decisions. The text of **Article 35** read as follows:

The State shall establish a safety review system for foreign investment, under which the safety review shall be conducted for any foreign investment affecting or having the possibility to affect national security.

The decision made upon the safety review in accordance with the law shall be final.

The other notable provision in this chapter is one that was introduced during the **second reading** of the law. In that reading, a new article was added that subjects foreign mergers and acquisitions to an anti-monopoly review. **Article 32** of the **second draft** read as:

Foreign investors who acquire a company within the territory of China through mergers and acquisitions or participate in the concentration of undertakings by other means shall be subject to the examination for concentration of undertakings as stipulated by the Anti-Monopoly Law of the People's Republic of China.

The language remains unchanged in the **final version**. A prior paragraph in Article 32 of the final version, which was added at a late hour, subjects foreign-invested enterprises to laws and regulations "related to labor protection and social insurance" too. Also explicitly introduced in the **second draft** (as Article 30), and remaining unchanged in the **final text** (as Article 31), is a clause stating that the provisions of the "Company Law" and the "Partnership Enterprises Law" are the key instruments that will henceforth govern foreign-invested enterprises (FIEs) standing within Chinese law.

Chapter IV Investment Management

Article 28 Foreign investors shall not invest in any field forbidden by the negative list for access of foreign investment (hereinafter referred to as the "negative list").

For any field restricted by the negative list, foreign investors shall conform to the investment conditions provided in the negative list.

Fields not included in the negative list shall be managed under the principle that domestic investment and foreign investment shall be treated uniformly.

Article 29 During the process of foreign investment, where verification and record-filing of a foreign investment project are required, relevant provisions of the State shall be followed.

Article 30 If a foreign investor invests in an industry or field where license is required in accordance with the law, relevant licensing formalities shall be handled as stipulated by law.

Unless otherwise provided by laws or administrative regulations, relevant competent department shall review the application for license filed by the foreign investor based on the same conditions and procedures as those for domestic investment.

Article 31 The organization form, institutional framework and standard of conduct of a foreign-funded enterprise shall be subject to the provisions of the Company Law of the People's Republic of China, the Partnership Law of the People's Republic of China, and other laws.

Article 32 In carrying out production and operation activities, foreign-funded enterprises shall conform to relevant provisions on labor protection and social insurance stipulated in laws and administrative regulations, handle tax, accounting, foreign exchange and other matters in accordance with laws, administrative regulations and relevant *provisions of the State, and shall be subject to the supervision and inspection conducted by relevant competent departments in accordance with the law.*

Article 33 Foreign investors who acquire a company within the territory of China through mergers and acquisitions or participate in the concentration of undertakings by other means shall be subject to the examination for concentration of undertakings as stipulated by the Anti-Monopoly Law of the People's Republic of China.

Article 34 The State shall establish a foreign investment information reporting system. Foreign investors or foreign-funded enterprises shall submit the investment information to competent departments for commerce through the enterprise registration system and the enterprise credit information publicity system.

The contents and scope of foreign investment information to be reported shall be determined under the principle of necessity; investment information that is available through interdepartmental information sharing will not be required to be submitted again.

Article 35 The State shall establish a safety review system for foreign investment, under which the safety review shall be conducted for any foreign investment affecting or having the possibility to affect national security.

The decision made upon the safety review in accordance with the law shall be final.

Source: *Foreign Investment Law of P.R. China http://www.fdi.gov.cn/1800000121_39_4872_0_7.html*

Chapter V governs the **legal responsibilities** of the government and the foreign investor. Building on **Article 23** (of Chapter III) which instructed that:

> *Administrative departments and their staff members shall keep confidential any trade secret of foreign investor or foreign-funded enterprise they are aware of during the performance of their duties, and shall not divulge or illegally provide to others the secret.*

Article 39 of Chapter V lays out the logical judicial consequence of violations committed during the official performance of duties.

> *Where a staff member of an administrative department **abuses his/her functions and powers**, neglects his/her duties or **engages in malpractice for personal gain** during the work relating to promotion, protection and management of foreign investment, or **divulge or illegally provide to others any trade secret** he/she is aware of during the performance of duties, **a penalty will be imposed upon him/her in accordance with the law;***

Violations of the provisions of the FIL by foreign investors, equally, are liable for punishment by monetary means (Article 37). Such violations are also to be recorded in the enterprise credit information system (Article 38).

Chapter V Legal Liability

Article 36 Where a foreign investor invests in a field forbidden by the negative list, relevant competent department shall order the said investor to stop its investment activity, dispose of the shares and assets thereof or take any other necessary measures within a prescribed time limit, and restore the state to what it was prior to the investment; if there is any illegal gain, such gain shall be confiscated.

Where an investment activity of a foreign investor breaches any special administrative measures for restrictive access provided in the negative list, relevant competent department shall order the investor to make corrections within a prescribed time limit, and take necessary measures to meet the requirements of the aforesaid measures; if the foreign investor fails to make corrections within the time limit, measures specified in the preceding paragraph shall be taken.

Where an investment activity of a foreign investor violates any provision in the negative list, the said investor shall bear corresponding legal liability in accordance the law, in addition to being subject to measures specified in the preceding two paragraphs.

Article 37 Where any foreign investor or foreign-funded enterprise violates the provisions herein and fails to report their investment information as required by the foreign investment information reporting system, competent department for commerce shall order it to make corrections within a prescribed time limit; if such corrections are not made in time, a penalty of not less than CNY100,000 yet not more than CNY500,000 shall be imposed.

Article 38 Foreign investors and foreign-funded enterprises violating any law or regulation shall be subject to investigation and measures by relevant departments in accordance with the law and shall be included in the credit information system pursuant to relevant provisions of the State.

Article 39 Where a staff member of an administrative department abuses his/her functions and powers, neglects his/her duties or engages in malpractice for personal gain during the work relating to promotion, protection and management of foreign investment, or divulge or illegally provide to others any trade secret he/she is aware of during the performance of duties, a penalty will be imposed upon him/her in accordance with the law;

Source: *Foreign Investment Law of P.R. China* http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

Chapter VI, the final chapter, is also the shortest one and contains three **supplementary provisions**. It also mostly remained unchanged through the legal drafting process. It lists the date - January 1, 2020 - when the FIL takes effect (Article 42). It provides a carve-out for financial services-related foreign investment transactions – banking, securities, insurance, and currency – from the purview of the FIL (Article 41). **And, crucially, it provides discretionary power to the authorities to retaliate in kind ("corresponding measures") for discriminatory measures imposed against China (Article 40)**.

> *Where any country or region takes any discriminatory prohibitive or restrictive measures, or other similar measures against the People's Republic of China in terms of investment, **the People's Republic of China may take corresponding measures against the said country or region in light of the actual conditions.***

In the context of the on-going US-China trade war and the unilateral tariff impositions and technology denials, this provision assumes particular importance.

Chapter VI Supplementary Provisions

Article 40 Where any country or region takes any discriminatory prohibitive or restrictive measures, or other similar measures against the People's Republic of China in terms of investment, the People's Republic of China may take corresponding measures against the said country or region in light of the actual conditions.

Article 41 For foreign investors who invest in such financial industries as banking, securities and insurance or manage any investment in such financial markets as securities market and foreign exchange market within the territory of China within the territory of China, where the State has any other provisions, such provisions shall prevail.

Article 42 The Law shall come into effect as of January 1, 2020. The Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures shall be repealed simultaneously.

Foreign-funded enterprises, which were established in accordance with the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures before the implementation of the Law, may retain their original organization forms and other aspects for five years upon the implementation hereof. Specific implementation measures shall be formulated by the State Council.

Source: *Foreign Investment Law of P.R. China* http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

Summary

It is a measure of the prioritization and urgency of passage of the Foreign Investment Law (FIL) that it went from a 39 article-long first reading in the National People's Congress Standing Committee (NPCSC) to its 42 article-long final passage by the National People's Congress *within a span of time shorter than 3 months*. With the 2nd session of the 13th National People's Congress due to convene on March 5, 2019 and because China's Constitution mandates that the NPCSC circulate any bill requiring the full NPC's assent at least one full month in advance, the NPCSC even went so far as to convene in special session on January 29 and 30, 2019 to conduct a second reading of the draft FIL.[xxxiii]

The Foreign Investment Law goes a significant distance in principle towards assuaging the long-standing concerns of the foreign investor community:

Article 4 categorically spells out the implementation of a system of pre-establishment national treatment and negative list. With the negative list being whittled down aggressively in the past two years – meaning that fewer and fewer foreign investors are forced to enter the Chinese market via the Joint Venture route, foreign investors now stand to enjoy a level playing field with their domestic counterparts across broad swathes of industry and services during the investment access stage.

Article 22 categorically orders government officials to desist from *de facto* coercion of transfer of technology via administrative means. **Article 23** insists that proprietary trade secrets be handled confidentially and without conflict of interest on the part of regulators. Malpractice on either count is liable for criminal prosecution **(Article 39).**

Article 35 envisages the setting-up of a foreign investment information reporting system and requires that government departments not unnecessarily duplicate their investment information-related requests from foreign investors. Further, **Article 24** instructs lower levels of government to comply with central laws and regulations and desist from imposing discretionary entry or exit barriers. Arbitrary and duplicative processes that unduly burden foreign investors and open them to potentially abusive administrative practices are to cease.

Article 10 requires that foreign investors are fully brought into the loop during the course of formulating laws, regulations and rules, including during the public comment process. They must also be compulsorily engaged on an equal parity with their domestic counterparts in the standards development process **(Article 15).** These articles should go towards assuring foreign investors that the legislative and rule-writing process is not gamed to their detriment. And foreign investors' recourse to the judicial system remains fully intact **(Article 26).**

The Foreign Investment Law is not without its harsh edges though.

The definition of 'national security' has been left open-ended and vague in **Article 35**[xxxiv] – in part, due to the paucity of time in framing this definition.[xxxv] Crucially, a decision made by the (to-be-established) foreign investment safety review system is to be treated as final. Like a presidential decision within the U.S.' CFIUS system, there is no recourse to appeal. Furthermore, **Article 40** empowers the Chinese government to take "corresponding [retaliatory] measures" against a country or region if it imposes discriminatory, prohibitive or restrictive measures against Chinese entities in the field of investment.

On the whole, the Foreign Investment Law (FIL) is a well-written one. In time, it will likely come to be seen as that milestone law which launched a dynamic new era of 'reform and opening-up.

Recent Developments and Conclusion

With the passage of the *Foreign Investment Law of the People's Republic of China*, attention now shifts to the framing of the implementing regulations. With the FIL mandated to take effect on January 1, 2020, the rule-writing process which includes the amendment of a number of existing laws has shifted into high gear. In late-April, the National People's Congress approved amendments to eight laws, including the *Anti-Unfair Competition Law* to qualitatively strengthen protection for trade secrets. In parallel, moves continue afoot to pare down the foreign investment negative lists, both for the piloted free trade zones and for the rest of the country.[xxxvi] On June 30, the National Development and Reform Commission (NDRC) published a revised *Special Management Measures for Foreign Investment Access (Negative List 2019) Update*, which pared the general list down to 40 from 48 items and the piloted free trade zones down from 45 to 37. Sectors ranging from transport, infrastructure, gas and heating pipelines, petroleum and natural gas exploration to value-added telecommunications are to henceforth be thrown open to foreign investors. In parallel with the winnowed-down negative list, NDRC also released a new version of the *Encouraged Industries for Foreign Investment Catalogue*, updating the 2017 version. Green, intelligent and high-end manufacturing, including 5G core components, integrated circuits, new energy vehicle components, artificial intelligence and carbon capture are some of the sectors that will benefit from expedited regulatory approvals.

Table 6. Special Administrative Measures (Negative List) for the Access of Foreign Investment (2019)

SERIAL NUMBER	SPECIAL ADMINISTRATIVE MEASURES
1.Agriculture, forestry, animal husbandry and fisheries industries	
(1)	The Chinese party's shareholding in selective breeding of new varieties of wheat and corn, and the production of seeds may not be less than 34%
(2)	Investment in the research, development, husbandry and plantation of rare, distinguished, and extraordinary types of species, and production of related reproduction materials (including good gene of products in agriculture, animal husbandry and fisheries industries) is prohibited.
(3)	Investment in selection and breeding of transgenic agricultural products, livestock, fishery seeds, and the production of such transgenic seeds is prohibited.
(4)	Investment in fishing in China's arbitrated water and inland water is prohibited.
2. Mining industry	
(5)	Investment in the prospecting, exploiting, and dressing of rare earth materials, radioactive minerals and tungsten is prohibited.
3. Manufacturing industry	
(6)	Chinese capital must own a controlling number of shares in publication printing companies.
(7)	Investment in smelting and processing radioactive minerals, as well as production of nuclear fuel is prohibited.
(8)	Investment in the concoction techniques and the application of Chinese herbal medicines such as steaming, stir-frying, roasting, calcining, and in the production of herbal preparation based on secret recipe is prohibited.
(9)	Except for special purpose vehicles and alternative energy vehicles, the equity percentage of the Chinese party in the manufacture of whole vehicles may not be less than 50%, and one foreign investor may establish two or fewer equity joint ventures in China to produce the same whole vehicle product. (In 2020, the equity percentage restriction on foreign investors in the manufacture of commercial vehicles will be abolished. In 2022, the equity percentage restriction on foreign investors in the manufacture of passenger vehicles and the restriction that one foreign investor may establish two or fewer equity joint ventures in China to produce the same whole vehicle product will be abolished.)
(10)	Production of ground receiving facilities and key components for satellite television broadcasting is prohibited.

4. Electricity, Heat, Gas and Water Generation and Supply	
(11)	The construction and operation of nuclear power stations require the Chinese party to have a controlling interest.
(12)	The construction and operation of urban water supply and discharge pipe networks in cities with populations of at least 500,000 people require the Chinese side to have a controlling interest.
5. Wholesale and Retail Industries	
(13)	Investment in the wholesaling and retailing of tobacco leaves, cigarettes, flue-cured tobacco leaves and other tobacco products is prohibited.
6. Transport, warehousing and postal industries	
(14)	Investment in companies engaged in domestic transportation by water requires the Chinese side to have a controlling interest.
(15)	Public air transport companies require the Chinese side to hold a controlling interest, the investment percentage of a single foreign investor and its affiliated enterprises may not exceed 25% and the legal representative shall be a Chinese national.
(16)	General airline companies require the legal representative to be a Chinese national, limited to equity joint ventures for general airline companies for agriculture, forestry and fisheries, and limited to Chinese control for other general airline companies.
(17)	The construction and operation of civilian airports require the Chinese party to have a relative controlling interest.
(18)	Investment in and operation of air traffic control are prohibited.
(19)	Investment in postal service companies, or investment in domestic express mail delivery is prohibited.
7. Information transmission, software and information technology service industries	
(20)	Telecommunications companies: limited to services the liberalization of which were committed to by China in accession to the WTO, the percentage of foreign shareholding in value-added telecommunications services not exceeding 50% (except for e-commerce, domestic multi-party communications, store-and-forward services and call centers) and basic telecommunications services requiring the Chinese side to hold a controlling interest.
(21)	Investment in internet news information services, online publishing services, online audio and video program services, internet cultural business (except for music), and public information services provided through the internet is prohibited. (In the foregoing services, commitments with respect to liberalization made by China in accession to the WTO are excepted.)
8. Financial industry	
(22)	The equity percentage of foreign investors in a securities company shall not exceed 51% and the equity percentage of foreign investors in a securities investment fund management company shall not exceed 51%. (In 2021, the restriction on the equity percentage of foreign investors will be abolished.)
(23)	The equity percentage of foreign investors in a futures company shall not exceed 51%. (In 2021, the restriction on the equity percentage of foreign investors will be abolished.)
(24)	The equity percentage of foreign investors in a life insurance company shall not exceed 51%. (In 2021, the restriction on the equity percentage of foreign investors will be abolished.)
9. Leasing and commercial service industries	
(25)	Investment in China legal affairs (excluding the provision of information on the effect of the China legal environment) is prohibited and it is not allowed to become a partner in a domestic law firm.
(26)	Market surveying is limited to equity and cooperative joint ventures. For radio and television listener and viewer surveying, the Chinese side must have a controlling interest.
(27)	Investment in social surveying is prohibited.
10. Scientific research and technical service industries	
(28)	Investment in the development and application of human stem cell, gene diagnostic and treatment technologies is prohibited.
(29)	Investment in humanities and social science research institutions is prohibited.
(30)	Investment in geodetic surveying, marine surveying and cartography, aerial photography for cartographic purposes, mobile land surveying, administrative division boundary surveying and cartography, compiling of topographic maps, world administrative maps, national administrative maps, provincial level and below administrative maps, national instructional maps, local instructional maps, three-dimensional maps and electronic navigational charts, and surveying concerning regional geological mapping, mineral geology, geophysical, geochemical, hydrogeological, environmental geology, geological hazards, remote sensing geology, etc. is prohibited.
11. Education	
(31)	Pre-school, ordinary high school and higher educational institutions are limited to Sino-foreign cooperative joint ventures, and the Chinese party must have a leading role (the president or chief administrative officer shall have Chinese nationality, and constituent members appointed by the Chinese party to the executive board, board of directors or joint management committee may not be less than one-half).
(32)	Investment in compulsory education institutions and religious education institutions is prohibited.

12. Health and social work	
(33)	Medical institutions are limited to equity and cooperative joint ventures.
13. Culture, sports and leisure industries	
(34)	Investment in press agencies (including but not limited to news agencies) is prohibited.
(35)	Investment in the editing, publication and production of books, newspapers, periodicals, audio and video products, and electronic publications is prohibited.
(36)	Investment in radio stations, television stations, radio and television channels (frequencies), radio and television transmission coverage networks (transmission stations, relay stations, radio and television satellites, satellite uplink stations, satellite reception and relay stations, microwave stations, monitoring stations, cable radio and television transmission coverage networks, etc.) at all levels is prohibited. Providing services in radio and television video-on-demand, and satellites television radio ground reception device installation are prohibited.
(37)	Investment in companies engaged in the production or operation of radio or television programs (including import business) is prohibited.
(38)	Investment in film production companies, distribution companies, cinema chain companies and film import business is prohibited.
(39)	Investment in auction companies auctioning cultural relics, antique stores and state-owned cultural relics museums is prohibited.
(40)	Investment in cultural and artistic performance troupes is prohibited.

Source: State Development & Reform Commission

As welcome as the Foreign Investment Law as well as the slimmed-down negative list is in China's long march to advanced market economy standing, it is not enough. Policy-makers' attention must now shift to the cross-sectoral distortions that flow from the practice of the state's industrial policy and, in particular, to the negative externalities of China's state-owned enterprises' (SOE) practices that have begun to radiate internationally. **A number of principles should be firmly inscribed in China's trade, investment and intellectual property rights (IPR) policies and practices** in this regard, going forward:

- First, China's polices must abide by the 'most favored nation' and 'national treatment' principles. **Non-discrimination, i.e. disallowing discrimination between foreign and local producers, must reside at the heart of every policy action** – be it procurement, innovation incentives, license issuances, competition law or judicial enforcement. There should be no nationality-based conditionalities or restrictions on purchase, sale or use. Domestic regulatory oversight, not local product use, must be fully become the norm across-the-board.

- Second, China's **industrial policy interventions must metamorphose from a subsidies-based model to a fiscal incentives-based and indicative planning model**. This will require the reformulation of the role of the state as a producer as well as subsidizer at every level of government. Criteria and classification measures that clarify the state's commercially neutral stance in the course of SOE operations should be spelt out. To the extent that subsidies are tapered down but continue to be disbursed, they should be narrowly tailored and transparently recorded.

- Third, China's **innovation policies must be technology-neutral and concentrate on usage rights, not proprietorial ownership *per se***. To incubate a local, high-technology manufacturing eco-system, China should experiment with an enabling tax credit regime (tax credits for private R&D; reduced rates on IP income; patent box schemes, etc.). Performance requirements as a condition for market access must be eliminated in law (as it is) and fact. And insofar as knowledge-creation is concerned, the government's matrix of support measures, too, should evolve towards government sponsorship of basic research and the licensing of government-sponsored IPR.

- Finally, **China should construe measures governing 'national security' reviews, including for retaliatory purposes, narrowly and as best as possible limit it to 'essential' security interests.** Economic security-related objectives should not be fused with 'national security' considerations during such reviews.

These reform principles will help alleviate tensions with its American and European trading partners. **Over the longer term, it will also fuel China's escape out of the 'middle income trap' and facilitate its transition from an excess investment-led and debt-fueled growth model to one that is more consumption, productivity and high-quality growth-based.** During the last two decades of the 20th century, Deng Xiaoping's historic 'reform and opening up' measures irrevocably altered the course of global manufacturing. Foreign-invested and export-oriented enterprises in China's coastal regions were at the foundation of this transformation. As their supply chains took root, an ever-increasing share of parts and components began to be sourced domestically, such that China today retains a lock over the development of these supply chains in key medium-technology intensive sectors such as computers and electronics. Should Xi Jinping's new round of 'reform and opening up' engineer a similarly far-sighted liberalization of China's investment and industrial policy regime - much like Deng Xiaoping had engineered its trade regime three decades ago, China could well become the advanced manufacturing center, and leader, of the world by mid-century. The Foreign Investment Law is both a milestone and harbinger of things to come in this regard.

China has transformed itself into a prodigious exporter of capital too, notably as part of its Belt and Road Initiative (BRI), during this second decade of the 21st century. It must now also take the lead in mainstreaming the 'national treatment' and the 'most favored nation' principles within the WTO's embryonic multilateral investment order. "That international trade should be abundant, that it should be multilateral, that it should be non-discriminatory" was the widely expressed sentiment at the Preparatory Committee gathered in October 1946 to frame the charter for the post-war global trading order. China must endeavor to inscribe this sentiment as the guiding principles of the 21st century global investment order too.

Endnotes

---

[i] See Kenneth Lieberthal (1995), "*Governing China: From Revolution through Reform*," W.W. Norton & Company, Inc., p. 129-30

[ii] See Ezra Vogel (2011), "*Deng Xiaoping and the Transformation of China*," Belknap Press, p.398

[iii] See Shen Jiaming (1988), "*Investment in the People's Republic of China: The Basic Legal Framework*," U.Pa.J.Int' lBus.L. 10, p. 409. At: https://www.law.upenn.edu/journals/jil/articles/volume10/issue3/Shen10U.Pa.J.Int'lBus.L.409(1988).pdf

[iv] Xi Jinping (18 December 2018), Speech on 40th Anniversary of Reform and Opening Up

[v] On the Third Plenum reforms, see Barry Naughton (2014), *"After the Third Plenum: Economic Reform Revival Moves Towards Implementation,"* China Leadership Monitor, No. 43, Hoover Institution. At: https://www.hoover.org/sites/default/files/uploads/documents/CLM43BN.pdf

[vi] Xi Jinping (18 October 2017), Address delivered at 19th National Congress of the Communist Party of China

[vii] On the Trump Administration's Section 301 measures, see White House (22 March 2018), "*Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation*."At: https://www.whitehouse.gov/presidential-actions/presidentialmemorandum-actions-united-states-related-section-301-investigation/

[viii] In 2017, a "negative list" approach was adopted under which the Catalogue was divided between a list of "encouraged" sectors and a "Foreign Investment Access Negative List" (Negative List), which consisted of three types of industries: (a) "restricted" (b) "prohibited" and (c) certain "encouraged" industries subject to limitations on shareholder structure or other limitations. Essentially, the "restricted" and "prohibited" industries were re-categorized and placed under the Negative List. On this point, see US Trade Representative (22 March 2018), "*Findings of the Investigation into China's Acts, Policies, and Practices related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974*," p.25. At: https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF

[ix] See Kun Jian, Wolfgang Keller, Larry Qiu and William Ridley (May 2018), "*International Joint Ventures and Internal vs External Technology Transfer: Evidence form China*," National Bureau of Economic Research, Cambridge, MA. At: https://www.nber.org/papers/w24455.pdf

[x] See World Trade Organization (10 December 2001), "*Accession of the People's Republic of China*." At: https://www.wto.org/english/thewto_e/acc_e/a1_chine_e.htm

[xi] See USTR's March 2018 Section 301 Report on China's Technology Transfer Policies and Practices, p.44.

[xii] Starting 1 January 2020, this restriction on New Energy Vehicles (NEVs) is to be removed.

[xiii] See Organization for Economic Cooperation and Development (7 November 2017), "*International Technology Transfer Measures in an Interconnected World: Lessons and Policy Implications*." At: http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP(2017)1/FINAL&docLanguage=En

[xiv] On disproportionately intrusive screening processes, see Andrea Andrenelli, Julien Gourdon and Evdokia Moise (24 January 2019), *"International Technology Transfer Policies*," Organization for Economic Cooperation and Development. At: https://www.oecd-ilibrary.org/docserver/7103eabf-en.pdf?expires=1562618350&id=id&accname=guest&checksum=08D1416DF74178296815D7822AED4FCE

[xv] For anecdotal instances in this regard, see Lingling Wei and Bob Davis (26 September 2018), "*How China Systematically Pries Technology from U.S. Companies*," The Wall Street Journal.

[xvi] On Ambassador Cui's interview, see Bob Davis and Gerald F. Seib, (26 November 2018), *"U.S.-China Trade Fight Risks Fragmenting Global Market, Says Beijing Ambassador,"* The Wall Street Journal.

[xvii] On this point of bringing an industry-wide case to the WTO, see Jane Cai and Keegan Elmer (10 January 2019), *"Is the U.S. Right to Cry Foul about Forced Technology Transfer to do Business in China – and What is China's Position?"* South China Morning Post.
[xviii] On data related to Chinese payments of royalties and fees, see State Council Information Office (September 2018), "*The Facts and China's Position on China-US Trade Friction*," p.24. At: http://www.xinhuanet.com/english/2018-09/24/c_137490176.htm
[xix] See White House *Presidential Memo.* At: https://www.whitehouse.gov/presidential-actions/presidentialmemorandum-actions-united-states-related-section-301-investigation/
[xx] US Trade Representative (May 2018), "*Notice of Determination and Request for Public Comment Concerning Proposed Determination of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*." At: https://ustr.gov/sites/default/files/files/Press/Releases/301FRN.pdf
[xxi] See World Trade Organization, *"DS542: China – Certain Measures Concerning the Protection of Intellectual Property Rights."* At: https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds542_e.html
[xxii] For an analysis of the Foreign Investment Risk Review Modernization Act (FIRRMA), see Sourabh Gupta (17 September 2018), "*Trump's New Rules on Chinese Investment Screening: Examining the FIRRMA Update to CFIUS' Acquisition Rules*," ICAS Issue Primer. At: https://chinaus-icas.org/primer/trumps-new-rules-on-chinese-investment-screening/
[xxiii] For an analysis of the Export Control Reform Act, see Akin Gump Strauss Hauer & Feld LLP (12 September 2018), "*The Export Control Reform Act of 2018 and Possible Controls on Emerging and Foundational Technologies*," Akin Gump International Trade Alert. At: https://www.akingump.com/images/content/9/7/v2/97168/International-Trade-Alert-09-12-2018-The-Export-Control-Refo.pdf
[xxiv] Other work-streams constituted as part of this trilateral work program include one on **Confronting Non-Market-Oriented Policies and Practices** and another one **on Strengthening Rules on Industrial Subsidies and State-owned enterprises (SOEs).** The aim of the former is to identify elements or criteria that signal that market conditions exist for businesses and industry within an economy. The absence of these criteria would, in effect, signal that the relevant economy is not operating under market-oriented conditions and would thereby be excluded from the benefits conferred upon the other market-oriented economies. The aim of the latter is to develop effective rules to address the market-distorting behavior of state enterprises and confront particularly a variety of harmful subsidy practices.

[xxv] For an examination of the proposed – and now withdrawn - 2015 draft of the foreign investment law, see Meichen Liu (2018), *The New Chinese Foreign Investment Law and Its Implication on Foreign Investors*, 38 Nw. J. Int'l L. & Bus. https://scholarlycommons.law.northwestern.edu/njilb/vol38/iss2/3
[xxvi] On key changes in China's Foreign Investment Catalogue 2018 Version, see US Trade Representative (November 2018), "*Update Concerning China's Acts, Policies and Practices related to Technology Transfer, Intellectual Property, and Innovation*," p.50. At: https://ustr.gov/sites/default/files/enforcement/301Investigations/301%20Report%20Update.pdf
[xxvii] The Communiqué of the Third Plenary Session of the 11th Central Committee of the Communist Party of China is available at: http://www.bjreview.com/Special_Reports/2018/40th_Anniversary_of_Reform_and_Opening_up/Timeline/201806/t20180626_800133641.html
[xxviii] For a detailed study of the Sino-Foreign Equity Joint Venture Law, see Shan Gao (2017), *"The Evolution of China's Foreign Investment Policy and Law" SJD Dissertations*. 7. At: https://elibrary.law.psu.edu/sjd/7. See also David I. Salem (1981), "*The Joint Venture Law of the Peoples' Republic of China: Business and Legal Perspectives,*" 7 Md. J. Int'l L. 73. At: http://digitalcommons.law.umaryland.edu/mjil/vol7/iss1/9

[xxix] See Lieberthal, "*Governing China*," p.150.
[xxx] See Barry Naughton (1995), "*Growing Out of the Plan: Chinese Economic Reform, 1978-1993,"* Cambridge: Cambridge University Press, p.300.
[xxxi] The full text of the *Foreign Investment Law of the People's Republic of China* is available at: http://www.fdi.gov.cn/1800000121_39_4872_0_7.html
[xxxii] On this point, see NPC Observer*, "NPCSC Session Watch: Foreign Investment, patent, Resource tax, Local Government Debt & More."* At: https://npcobserver.com/2018/12/16/npcsc-session-watch-foreign-investment-patent-resource-tax-local-government-debt-more/
[xxxiii] On this point about Chinese law and legislative timetables, see NPC Observer, *"NPCSC Adds Special Session for Second Review of Foreign Investment Law (UPDATED)*." At: https://npcobserver.com/2019/01/16/npcsc-adds-special-session-for-second-review-of-foreign-investment-law/
[xxxiv] By contrast, the European Union list of factors to be taken into account at the time of screening inbound investment for 'national security or public order' risk is far more illuminating. They include screening for effects of inbound investment on the integrity of: (a) **critical infrastructure**, whether physical or virtual, including energy, transport, water, health, communications, media, data processing or storage, aerospace, defense, electoral or financial infrastructure, and sensitive facilities – as well as land and real estate crucial for the use of such infrastructure; (b) **critical technologies and dual use items**, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies; (c) the **supply of critical inputs**, including energy or raw materials, as well as food security; and (d) access to **sensitive information, including personal data**, or the ability to control such information; or the **freedom** and pluralism **of the media.** To review the EU Regulation, see "*Regulation (EU) of the European Parliament and the Council establishing a framework for the Screening of Foreign Direct Investment into the Union*," 19 March 2019, Office Journal of the European Union. At: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0452&from=EN

[xxxv] See Wang Liwei, Zhang Yu, Shan Yuxiao and Teng Jing Xuan (11 March 2019), "In Depth: New Foreign Investment Law Goes on Fast Track," Caixin. At: https://www.caixinglobal.com/2019-03-11/in-depth-new-foreign-investment-law-goes-on-fast-track-101390458.html
[xxxvi] At this time, there are 12 free trade zones (FTZs) across the country with six more on the anvil.

About the Author

Sourabh Gupta is Resident Senior Fellow at the Institute for China-America Studies (ICAS) in Washington, D.C. He is an Asia-Pacific international relations policy specialist with two decades of Washington, D.C.-based experience in a think-tank and political risk research and advisory capacity. His key area of expertise appertains to the intersection of international law, both international trade and investment law and international maritime law (the Law of the Sea), with the international relations of the Asia-Pacific region. Other key areas of specialization include: analysis of developments in World Trade Organization and Asia-Pacific trade and economic regionalism; analysis of key flashpoints as well as outstanding boundary and territorial disputes in Asia; and analysis of major power relationships in the Asia-Pacific region (China-U.S., China-Japan, China-India, U.S.-Japan, U.S.-India, Japan-India relations). He holds master's degrees in international security studies and international relations from the Walsh School of Foreign Service, Georgetown University and the Maxwell School of Citizenship and Public Affairs, Syracuse University, respectively. His bachelor's degree was awarded by the University of Mumbai. He is a member of the United States Council for Security Cooperation in the Asia-Pacific (USCSCAP).

Acknowledgements

I am deeply grateful to Mengze Li, Yilun Zhang, and Matthew Geraci for their excellent editorial support and technical assistance – SG

Bibliography

Akin Gump Strauss Hauer & Feld LLP, "The Export Control Reform Act of 2018 and Possible Controls on Emerging and Foundational Technologies," *Akin Gump International Trade Alert*, September 12, 2018, https://www.akingump.com/images/content/9/7/v2/97168/International-Trade-Alert-09-12-2018-The-Export-Control-Refo.pdf

Andrenelli, Andrea., Gourdon, Julien., and Moïsé, Evdokia. "International Technology Transfer Policies," *Organization for Economic Cooperation and Development*, January 24, 2019, https://www.oecd-ilibrary.org/docserver/7103eabf-en.pdf?expires=1562618350&id=id&accname=guest&checksum=08D1416DF74178296815D7822AED4FCE

Beijing Review, "Communique of the Third Plenary Session of the 11th Central Committee of the Communist Party of China," *Beijing Review*, December 29, 1978, http://www.bjreview.com/Special_Reports/2018/40th_Anniversary_of_Reform_and_Opening_up/Timeline/201806/t20180626_800133641.html

Cai, Jane., and Elmer, Keegan. "Is the U.S. Right to Cry Foul about Forced Technology Transfer to do Business in China – and What is China's Position?" *South China Morning Post*, January 10, 2019, https://www.scmp.com/news/china/diplomacy/article/2181528/us-right-cry-foul-about-forced-technology-transfer-do-business

China Information Office of the State Council. "The Facts and China's Position on China-US Trade Friction," *Xinhuanet*, September 2018, http://www.xinhuanet.com/english/2018-09/24/c_137490176.htm

Davis, Bob., and Seib, Gerald. "U.S.-China Trade Fight Risks Fragmenting Global Market, Says Beijing Ambassador," *The Wall Street Journal*, November 26, 2018, https://www.wsj.com/articles/u-s-china-trade-fight-risks-fragmenting-global-market-says-beijings-ambassador-to-the-u-s-1543228321

European Union, "Regulation (EU) of the European Parliament and the Council establishing a framework for the Screening of Foreign Direct Investment into the Union," *Official Journal of the European Union*, March 19, 2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0452&from=EN

Gao, Shen. "The Evolution of China's Foreign Investment Policy and Law," *SJD Dissertations*, 2017, https://elibrary.law.psu.edu/sjd/7

Gupta, Sourabh. "Trump's New Rules on Chinese Investment Screening: Examining the FIRRMA Update to CFIUS' Acquisition Rules," *ICAS Issue Primer*, September 17, 2018, https://chinaus-icas.org/primer/trumps-new-rules-on-chinese-investment-screening/

Jiang, Kun., et al. “International Joint Ventures and Internal VS. External Technology Transfer: Evidence from China,” *National Bureau of Economic Research*, March 2018, https://www.nber.org/papers/w24455.pdf

Lieberthal, Kenneth. *Governing China: From Revolution through Reform*. New York: W.W. Norton & Company, Inc., 1995.

Liu, Meichen. “The New Chinese Foreign Investment Law and Its Implication on Foreign Investors,” *Nw. J. Int'l L. & Bus* 38:2 2018, https://scholarlycommons.law.northwestern.edu/njilb/vol38/iss2/3

National People’s Congress, “Foreign Investment Law of the People’s Republic of China”, *Invest in China*, March 15, 2019, http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

Naughton, Barry. “After the Third Plenum: Economic Reform Revival Moves Towards Implementation,” *China Leadership Monitor*. March 14, 2014, Hoover Institution. July 18, 2019, https://www.hoover.org/research/after-third-plenum-economic-reform-revival-moves-toward-implementation

Naughton, Barry. *Growing Out of the Plan: Chinese Economic Reform, 1978-1993*. Cambridge: Cambridge University Press, 1995.

NPC Observer, “NPCSC Adds Special Session for Second Review of Foreign Investment Law (UPDATED),” January 16, 2019, https://npcobserver.com/2019/01/16/npcsc-adds-special-session-for-second-review-of-foreign-investment-law/

NPC Observer, “NPCSC Session Watch: Foreign Investment, patent, Resource tax, Local Government Debt & More,” December 16, 2018, https://npcobserver.com/2018/12/16/npcsc-session-watch-foreign-investment-patent-resource-tax-local-government-debt-more/

OECD, “International Technology Transfer Measures in an Interconnected World: Lessons and Policy Implications,” November 7, 2017, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP(2017)1/FINAL&docLanguage=En

Salem, David. “The Joint Venture Law of the Peoples' Republic of China: Business and Legal Perspectives,” *7 Md. J. Int'l L. 73*, 1981, http://digitalcommons.law.umaryland.edu/mjil/vol7/iss1/9

Shen, Jiaming. “Investment in the People’s Republic of China: The Basic Legal Framework,” *U. Pa.J.Int’l Bus.L.* 10:3 1988: 409.

US Trade Representative (a), “Findings of the Investigation into China’s Acts, Policies, and Practices related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974,” March 22, 2018, https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF

US Trade Representative (b), “Notice of Determination and Request for Public Comment Concerning Proposed Determination of Action Pursuant to Section 301: China’s Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation,” May 2018, https://ustr.gov/sites/default/files/files/Press/Releases/301FRN.pdf

US Trade Representative (c), “Update Concerning China’s Acts, Policies and Practices related to Technology Transfer, Intellectual Property, and Innovation,” November 2018, https://ustr.gov/sites/default/files/enforcement/301Investigations/301%20Report%20Update.pdf

Vogel, Ezra. *Deng Xiaoping and the Transformation of China*. p.398. Cambridge, Massachusetts: The Belknap Press of Harvard University Press, 2011.

World Trade Organization (a), “Accession of the People’s Republic of China,” December 10, 2001, https://www.wto.org/english/thewto_e/acc_e/a1_chine_e.htm

Wang, Liwei., et al. “In Depth: New Foreign Investment Law Goes on Fast Track,” *Caixin*, March 11, 2019, https://www.caixinglobal.com/2019-03-11/in-depth-new-foreign-investment-law-goes-on-fast-track-101390458.html

Wei, Lingling., and Davis, Bob. “How China Systematically Pries Technology from U.S. Companies,” *The Wall Street Journal*, September 26, 2018, https://www.wsj.com/articles/how-china-systematically-pries-technology-from-u-s-companies-1537972066

White House, “Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation,” *White House*, March 22, 2018, https://www.whitehouse.gov/presidential-actions/presidentialmemorandum-actions-united-states-related-section-301-investigation/

World Trade Organization (b), “DS542: China – Certain Measures Concerning the Protection of Intellectual Property Rights,” *Dispute Settlement*, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds542_e.html

Xi, Jinping, “Full text of Xi Jinping's report at 19th CPC National Congress”, *Xinhua*, November 3, 2017, http://www.xinhuanet.com/english/special/2017-11/03/c_136725942.htm

Xi, Jinping. “President Xi delivers keynote speech at 40th anniversary conference”, *CGTN*, December 18, 2018, http://www.china.org.cn/china/2018-12/18/content_74287361.htm