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Opinion

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China's new foreign investment law is a missed opportunity

The revised policy regime will not spur needed domestic competition and growth

A visitor to a robot conference in Beijing, May 2019. China's new investment law promises to give foreign companies equal rights to domestic ones but its provisions appear hollow © AP

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Attracting comparatively little notice in the midst of its trade war with the US, China's new foreign investment law, which the National People's Congress approved in March 2019, will come into effect on January 1, 2020.

For such an important statute, first drafted back in 2015, expectations were high among reformers in China and among international investors that the fruits of Beijing's efforts over so long a gestation would yield a quantum change to China's foreign investment policy regime.

The new law and its implementing regulations — which were published only in November 2019, leaving just one month for the business community to file comments and for Beijing to incorporate any modifications before the law becomes effective — do signal an improvement. But the reality is that China's posture towards foreign investment will still be significantly out of sync with global best practice.

China's reformers know full well that the country can ill afford to pass up such an opportunity for improvement. Why? Because foreign direct investment to the country has been trending downward.

Between 2013 and 2017 — before the eruption of trade frictions between Beijing and Washington — global net FDI to China was in continuous decline. Its magnitude in 2017, at $168bn, was lower than the 2008 level of $172bn. While FDI rose in 2018 to $203bn, that amount is still far less than the magnitude for each of the six years between 2010 and 2015, when the average was $261bn.

Measured in relation to GDP, an even more challenging picture emerges: China's global net FDI inflows have been on an unmistakable downward trend, from 6.2 per cent of GDP in 1993 to 1.5 per cent in 2018 — the lowest level since 1991.

Against this backdrop, one might have thought that President Xi Jinping and the Communist party leadership would have jumped at the chance to fashion a new policy that, compared with the labyrinth of existing law, would be systematic and perceived by foreign investors as truly hospitable, as a means to revive China's dimming growth prospects.

However, China's new approach is largely to establish protocols that vaguely define the limits of the rights foreign investors are entitled to enjoy and the ways in which various government agencies are to conduct themselves to ensure such rights are honoured. It is almost as if Beijing is looking through the wrong end of a telescope.

To be sure, there are some important advances. The foundational principle underpinning world-class foreign investment laws of "national treatment" — affording foreign investors rights equivalent to those enjoyed by domestic firms — is well articulated. Intellectual property rights of foreign businesses are deemed to be protected in the same way as those of Chinese firms. Agencies are prohibited from divulging foreign enterprises' trade secrets. Foreign investors are given the freedom for overseas remittance of profits, capital gains and liquidation proceeds (among other sources of income) in renminbi or in foreign currency. Participation in Chinese government procurement tenders by foreign firms is explicitly allowed. Moreover, when expropriation occurs, "fair and reasonable" compensation "shall be given in a timely manner".

However, the ways in which many of these provisions are to be exercised in practice are neither rigorously nor fully spelled out (especially in the November 2019 implementing regulations, where one would expect to see them). Some appear to be actually hollow.

For example, the text indicates that the adherence to "national treatment" may vary both across different levels of government (local, municipal, provincial and central) and across various regions of the country. Indeed, the lack of an integrated national treatment regime is reflected in the law's text: it admonishes agencies to "co-operate closely" and "in accordance with their division of responsibilities".

Although foreign investors are given the right to appeal to various governmental authorities, an independent adjudicative process is not established. Nor are there rules defining time-bound decision-making to foster timely resolution of such issues. Foreign firms may request the opportunity to review regulatory documents only when a lawsuit is instituted against administrative actions.

The stipulation of providing fair, reasonable and timely compensation for expropriation is, in fact, not terribly comforting. The standard pertains only to "expropriation authorised by law" and carried out in the "public interest". As many international businesses know, such acts often occur outside the law. Moreover, it is often the case that expropriations are done to serve a party's private interest. In effect, the expropriation provision contains a large loophole.

Aligning the extent of foreign firms' protection of intellectual property to that which applies to domestic businesses is not a very high standard. Ask any Chinese entrepreneur how effective he or she feels their intellectual property is accorded legal protection.

Perhaps the most striking aspect of the new law is its silence on the means by and the extent to which foreign investors have the freedom to enter new product or geographic markets, through greenfield projects or the acquisition of Chinese businesses.

After all, one of the key objectives of countries putting in place policies to encourage foreign investment is to lower barriers to business entry in order to stimulate domestic competition, provide local consumers with new products or services, expand employment opportunities and foster innovation — all of which are engines of growth.

On this score, unfortunately, the new foreign investment law represents a lost opportunity for China's leadership.

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