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by

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Abstract

In recent years much light has been shed on Chinese outbound investment, *inter alia* its geopolitical, economic and security-related implications in Europe, North America and the Asia-Pacific regions. Perhaps less attention has been paid to China's FDI screening system of its own on the ground of national security. This Note discusses the policy background, legislative development, and key features of China's national security review of foreign investment. Debuted in 2011 and updated in 2020, China's national security review mechanism for foreign investment has been up and running for more than a decade. However, very little information has been known to the public as to how the system is enforced in practice. In addition to the lack of transparency, China's national security review of foreign investment also repels any form of administrative or judicial redress, which is a development not in conformity with prevalent international practices. One may argue that the distinct features of China's investment screening on the ground of national security, compared with other jurisdictions monitored by the CELIS project, are ultimately attributed to China's unique economic and governance models.

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1. Political background

1.1. Foreign investment policy

China is the world's second biggest FDI recipient.¹ The predominant political perception and approach of the Chinese government towards inward FDI is in principle welcoming and conducive. Since 1979 when China adopted its 'reform and opening-up' policy, a national strategy that transformed China into a socialist market economy and warranted rapid economic growth, attracting FDI has always been a salient feature and component of China's continuous economic reform. FDI has significantly propelled employment growth in China, notably in primary and secondary, labour-intensive sectors like textile and electronics. Foreign firms in China have brought technology, managerial experience and tax revenue. The Chinese government offers tax incentives, discounted land-use right fees, and expedited customs to attract foreign investors. These incentives have drawn FDI to the nation, particularly during its economic transition. At the moment, China's FDI law and policy are characterised by a mixture of incentives that attract FDI and control over FDI.

In terms of regulating FDI, the central government (the State Council) and legislature (National People's Congress) are responsible for formulating and adopting related laws and policies that are applicable nationwide. Local governments at the provincial and municipal levels are allowed to adopt local FDI regulations and policies on certain issues that apply within their jurisdiction, insofar that local governments do not surpass their legislative power bestowed by the central government, and local rules cannot contradict with laws and regulations at the central level.

China adopted its Foreign Investment Law in March 2019, which provides foreign investment promotion, protection, management, among others.² In principle the Law aims to render FDI

¹ UNCTAD, World Investment Report 2022 (Geneva: UN Publication, 2022), p. 9.

² 中华人民共和国外商投资法 (Foreign Investment Law of China) (Promulgated by the National People's Congress on 15 March 2019, effective on 1 January 2020) (Translated Version available, see <https://investmentpolicy.unctad.org/investment-laws/laws/317/china-foreign-investment-law-of-the-people-s-republic-of-china>).

regulation more transparent and predictable, while preserving the state's prerogatives in controlling the sensitive or essential sectors. In particular, China grants pre-establishment national treatment, meaning that foreign investors and their investments are treated no less favourably than domestic investors and their investments in the market access phase, with the exception of FDI made in the Negative List of Foreign Investment.³ National treatment is essentially an investment protection standard originated from international investment agreements (IIAs), and is innovatively incorporated in Chinese domestic law, which is a commitment most other countries do not afford to their foreign investors. National treatment is also guaranteed in the post-establishment phase, meaning equal treatment to foreign investors and their investment vis-à-vis domestic ones in the operation of business, such as in the application of national preferential policies in support of the development of enterprises; participation in the formulation of standards; application of compulsory state standards; government procurement; and sectoral approval and licencing.⁴ Furthermore, a foreign-invested-enterprise service system is established to provide service and consultation to foreign investors regarding foreign investment law and policy, and investment projects and opportunities. Lastly, China has established 21 Free Trade Zones (FTZs) across the country that promotes further trade facilitation and investment liberalization, their sizes vary from just more than 100 km² (such as Shanghai FTZ) to the whole province (such as the Hainan Free Trade Port). Since the outbreak of the Covid-19 pandemic, China also promulgated a number of regulations and policies that facilitate, promote and protect foreign investors and their investment projects.⁵

In terms of control of market access, China adopts a Negative List for Foreign Investment, which includes a restricted catalogue and a prohibited one.⁶ In the 13 restricted sectors, such as publication, nuclear powerplant, transportation, certain telecommunication and Internet business, education, and medical institutions, foreign investors are subject to certain

³ For a detailed discussion on the Negative List see *infra* note 6.

⁴ Foreign Investment Law of China, *supra* note 2, Arts. 9, 15, 16, 30.

⁵ See, e.g., 商务部关于应对疫情进一步改革开放做好稳外资工作的通知 (Notice of the Ministry of Commerce of Further Expanding Reform and Opening up and Stabilizing Foreign Investment in Response to the Covid-19 Outbreak) (issued on 1 April 2020, effective on promulgation) (Translated Version available, see <http://www.lawinfochina.com/display.aspx?id=32704&lib=law&EncodingName=big5>).

⁶ 外商投资准入特别管理措施（负面清单）（2021年版）(Special Administrative Measures (Negative List) for Foreign Investment) (2021) (issued by National Development & Reform Commission and Ministry of Commerce on 27 December 2021, effective on 1 January 2022) (Translated Version available, see [https://www.tjftz.gov.cn/tisip/upload/files/2022/4/TheSpecialAdministrativeMeasures\(NegativeList\)forForeignInvestmentAccess\(2021Edition\).pdf](https://www.tjftz.gov.cn/tisip/upload/files/2022/4/TheSpecialAdministrativeMeasures(NegativeList)forForeignInvestmentAccess(2021Edition).pdf)).

requirements such as mandatory joint venture structures and a case-by-case approval. In the 18 prohibited sectors, no foreign participation of any form is allowed under Article 28 of the Foreign Investment Law, which include (but are not limited to) fishing, mining of rare earth, tobacco, postal service, legal service, human stem cells and genetic diagnosis and therapy, news agency, publication, radio and television programming and broadcasting, and movie production and theatres. This is in addition to the availability of a national security review system of foreign investment.

1.2. Other relevant policies

China's FDI screening mechanism is operated on the ground of national security, which is a term loosely defined as to encompassing not only military security but also other considerations. The national security review regime of foreign investment was originally established in 2011 and updated in 2020. According to the currently effective Measures for Security Review of Foreign Investment, which stipulate the substantive and procedural aspects of the review, China conducts review of foreign investment that 'affects or may affect national security'.⁷ The Measures do not define the terms "affect" or "national security". One can make a reference to China's National Security Law, which defines national security as "the status of absence from danger and internal and external threats over state sovereignty, territorial integrity, welfare of the people, sustainable economic and social development, and other material interests of the state".⁸ This means that national security in China can be interpreted to encompass sovereign security, military security, economic security, social security, and other national interests, at the least. Other sectoral regulations introduce more aspects of security when it comes to foreign investment in that specific sector, for instance, cybersecurity as stipulated in the Measures for Cybersecurity Review.⁹

⁷ 外商投资安全审查办法 (Measures for Security Review of Foreign Investment) (Promulgated by National Development & Reform Commission and Ministry of Commerce on 19 December 2020, effective on 18 January 2021), Article 2 (Translated Version available, see <http://www.lawinfochina.com/display.aspx?lib=law&id=34385&EncodingName=big5>).

⁸ 中华人民共和国国家安全法 (National Security Law of China) (Promulgated by the NPC on 1 July 2015, effective on promulgation), Article 2 (Translated Version available, see http://www.npc.gov.cn/zgrdw/npc/lfzt/rllys/2014-08/31/content_1876769.htm).

⁹ 网络安全审查办法 (Measures for Cybersecurity Review) (Promulgated by Cyberspace Administration of China et al. on 28 December 2021, effective on 15 February 2022) (Translated Version available, see <http://www.lawinfochina.com/display.aspx?id=37344&lib=law>).

1.3. Key features

There are two key features of China's screening mechanism that are disparate from prevalent international practice such as that of France and Germany. The first is the lack of transparency and information disclosure over past track records of review. China's national security review was first established in 2011. Over the past 11 years, only one case that was subject to review was made publicly known.¹⁰ The authorities do not have a legal obligation to disclose the number of cases reviewed, approved or rejected. To explain the scarcity of cases reviewed and known in the public domain, it is debated whether China's national security review is hardly put into use which suggests its exceptional nature, or it is in practice widely used but the results are kept away from the public which indicates the lack of transparency of the process.

The second feature is the non-justifiable nature of China's national security review decisions. Compared with other jurisdictions, it is a quite unique feature that all decisions made from China's national security review are final and not subject to any administrative reconsideration or judicial redress at domestic courts.¹¹ Therefore it is criticized for a lack of accountability of the review agency (the Working Mechanism) and process.

2. Domestic Framework

2.1. Overview of Domestic Screening Mechanisms

China's national security review of foreign investment aligns with those of a mixed screening mechanism.

In principle, the government has the power to conduct a cross-sectoral review over foreign investment whenever it deems necessary under Article 35 of the Foreign Investment Law of China, as long as the investment threatens or may threaten national security. Specifically, a number of sectors are identified which impose an *ex-ante* notification obligation on foreign investors (as well as the domestic target) prior to the investment is made. Sectors subject to this heightened scrutiny include:

1. Arms industry, an ancillary to the arms industry, and other fields related to national defence.
2. Investment in an area in proximity to a military premise or an arms industry facility.
3. Important agricultural products.

¹⁰ This case is the Yonghui-Zhongbai supermarkets merger that was reviewed in 2019, which was eventually abandoned by the acquirer amid an ongoing review.

¹¹ Foreign Investment Law of China, *supra* note 2, Article 35.

4. Important energy and resources.
5. Critical equipment manufacturing.
6. Important infrastructure.
7. Important transportation services.
8. Important cultural products and services.
9. Important information technology and Internet products and services.
10. Important financial services.
11. Key technology.
12. Any other important field related to national security.

Terms such as ‘important’, ‘critical’, ‘technology’ and ‘infrastructure’ are not defined by law, giving the authority a broad scope of discretion in practice to determine the exact meaning and call upon investors to notify the reviewing authority pre-establishment of the investment.

China’s national security review of foreign investment does not include an asset-based screening mechanism, nor does it incorporate a designated-entity screening mechanism.

Aside from a national security review applicable nationwide, a set of separate rules apply to the Pilot Free Trade Zones *lex specialis*, which are special economic zones in China served as a testing ground for deepened economic and social reforms. These rules are found in Notice of the General Office of the State Council on Measures for a Pilot Program of National Security Review of Foreign Investment in Pilot Free Trade Zones, applicable to 21 PFTZs.¹²

2.2. Overview of relevant framework

The main legislative framework in force governing foreign investment in China is:

1. Foreign Investment Law (Promulgated by the National People’s Congress on 15 March 2019, effective on 1 January 2020).
2. Implementing Regulation of the Foreign Investment Law (Promulgated by the State Council on 26 December 2019, effective on 1 January 2020).¹³

¹² 国务院办公厅关于印发自由贸易试验区外商投资国家安全审查试行办法的通知 (Notice of the General Office of the State Council on Measures for a Pilot Program of National Security Review of Foreign Investment in Pilot Free Trade Zones) (Issued on 8 April 2015, effective on 8 May 2015) (Translated Version available, see <http://www.lawinfochina.com/display.aspx?id=19036&lib=law&EncodingName=big5>).

¹³ 中华人民共和国外商投资法实施条例 (Regulation for Implementing the Foreign Investment Law of the People's Republic of China) (Issued on 26 December 2019, effective on 1 January 2020) (Translated Version available, see <http://www.lawinfochina.com/display.aspx?id=31891&lib=law>).

3. Interpretation of the Supreme People's Court on Several Issues concerning the Application of the Foreign Investment Law (Issued on 26 December 2019, effective on 1 January 2020).¹⁴
4. Measures for Security Review of Foreign Investment (Promulgated by National Development & Reform Commission and Ministry of Commerce on 19 December 2020, effective on 18 January 2021).
5. Special Administrative Measures (Negative List) for Foreign Investment (2021) (Issued by National Development & Reform Commission and Ministry of Commerce on 27 December 2021, effective on 1 January 2022).
6. Measures for Information Reporting of Foreign Investment (Promulgated by MOFCOM and SAMR on 30 December 2019, effective on 1 January 2020).¹⁵
7. Working Measures for Complaints of Foreign-Invested Enterprises (Promulgated by MOFCOM on 25 August 2020, effective on 1 October 2020).¹⁶

Foreign investment that are outside of the prohibited sectors stipulated in the Negative List for Foreign Investment may be screened on the ground of national security. In addition, certain sensitive sectors may involve extra review by sectoral regulators, such as the review of operators of critical information infrastructure or data processors of online platforms on the ground of cybersecurity, according to Measures for Cybersecurity Review.

There are no administrative guidelines regarding China's FDI screening on grounds of national security.

In terms of a supervisory framework, China imposes an information reporting system under Article 34 of the Foreign Investment Law of China to foreign-invested enterprises, according to the Measures for Information Reporting of Foreign Investment. It consists of information reporting obligations upon the occurrence of certain events, including initial reports, modification reports and deregistration reports, and an annual report regarding the basic information of a foreign-invested enterprise such as shareholding structures. The information reporting system is not an *ex-ante* approval mechanism, but an *ex-post* supervision system

¹⁴ 最高人民法院关于适用《中华人民共和国外商投资法》若干问题的解释 (Interpretation of the Supreme People's Court on Several Issues concerning the Application of the Foreign Investment Law of the People's Republic of China) (Issued on 26 December 2019, effective on 1 January 2020) (Translated Version available, see <https://www.lawinfochina.com/display.aspx?id=31888&lib=law>).

¹⁵ 外商投资信息报告办法 (Measures for the Reporting of Foreign Investment Information) (Issued 30 December 2019, effective on 1 January 2020) (Translated Version available, see <http://www.lawinfochina.com/display.aspx?id=32031&lib=law>).

¹⁶ 外商投资企业投诉工作办法 (Work Measures for Complaints of Foreign-Funded Enterprises) (Issued 25 August 2020, effective on 10 January 2020) (Translated Version available, see <https://lawinfochina.com/display.aspx?id=33867&lib=law>).

that aims at making certain corporate information transparent and accessible to the general public, such as via the Online Enterprise Registration System¹⁷ and the National Enterprise Credit Information Publicity System.¹⁸

3. Developments to follow

3.1. *Expected legal developments*

It is expected that a separate set of rules on national security review of foreign investment by means of purchasing public-traded stocks on the Chinese stock market will be promulgated in the future.

3.2. *Ongoing discussions*

Ongoing critiques and recommendations mainly focus on the improvement of the system in order to bring more legal certainty (such as the narrower scope of transactions subject to review), more predictability and less ambiguity (such as clearer sectors subject to review), more accountability (such as judicial recourse), and more transparency (such as annual reports).

¹⁷ Accessible at <http://wsdj.samr.gov.cn/saicmedjweb/>.

¹⁸ Accessible at <https://www.gsxt.gov.cn/index.html>.

Annex 1: Relevant laws, ordinances, regulatory guidelines

Measures for Security Review of Foreign Investment (Promulgated by National Development & Reform Commission and Ministry of Commerce on 19 December 2020, effective on 18 January 2021). Unofficial translation can be found at Chinalaw Info: https://www-pkulaw-com.eur.idm.oclc.org/en_law/c9e69a9f6ef98599bdfb.html?flag=english (subscription required).

Annex 2: Relevant administrative and court cases

There have not been relevant administrative or relevant court cases in this matter in China.

Annex 3: Relevant literature

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- Ziyu Liu, 'Security Review in the Evolution of Foreign Investment Law with Chinese Characteristics: Part II', *Business Law Review*, Vol. 41, Issue 6 (2020), pp. 217-224.

About the CELIS Institute

The CELIS Institute is an independent non-profit, non-partisan research enterprise dedicated to promoting better regulation of foreign investments in the context of security, public order, and competitiveness. It produces expert analysis and fosters a continuous trusting dialogue between policymakers, the investment community, and academics. The CELIS Institute is the leading forum for studying and debating investment screening policy. More about the Institute's activities under www.celis.insitute.

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CELIS Country Reports (hereafter "Report") are produced by leading experts for any European and select non-European jurisdiction following an elaborate model, allowing for comparison and evaluation across jurisdictions. The project's aim is to identify and suggest best practice and to propose a common European (model) law on investment screening.

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