

Investigation and Reflection on Foreign Investment Security Review Focus on Current Legal Documents in China

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ABSTRACT

Over the past decade, the total amount of Foreign Direct Investment (FDI) has fluctuated constantly with China as the leading recipient of FDI. The World Investment Report of 2020 shows that, looking back at 2019, FDI flows to developing Asian economies fell 5 percent to \$474 billion. However, Asia remains the world's largest recipient of FDI, with more than 30 percent of global FDI inflows in 2019. Moreover, China's absorption of FDI reached 141 billion in 2020 at record highs [1]. With the influx of FDI, China has implemented a negative list system for market access and strengthened the Foreign Investment Security Review (FISR) to improve investment facilitation while ensuring national security. Conclusively, whether from the perspective of China's investment situation, system construction, or the international situation, it is of great significance to analyze the FISR based on the currently effective regulations in China. This paper will point out the problems hidden in the current FISR from aspects of review subjects and division of authority, the criteria of review, and specific procedure, then provide practical and valuable improvements in response to the above problems. This not only makes up for the deficiencies of the relevant legal system in China but also provides a reasonable reference for the optimization of the relevant legal system in the world.

Keywords: foreign investment security review (FISR), Measures, FDI, International Investment Law.

1. INTRODUCTION

There is a very close correlation between the foreign investment security review (FISR) of various countries and their national security. Nowadays, the investment fields of multinational enterprises are gradually expanding and the international economic changes are becoming more and more frequent, which presents a challenge to national security and the FISR. Around the world, the foreign investment review system of the United States is in the forefront of the time. The United States issued the Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018, which expanded the review authority and extended the review time. France has increased the scope of review while lowering the threshold of review in its new regulations in 2020. As for China, the FISR system has gradually been

formed over the past 20 years. However, there are still unsolved problems in theory and practice after promulgating some legal documents, typically the Measures for the Security Review of Foreign Investment (hereinafter referred to as "Measures"). Through comparing, the pros and cons of such legal system in China will be shown. The points that China can learn from other countries also will become clear.

2. EXISTING PROBLEMS OF CURRENT LEGAL DOCUMENTS IN CHINA

On account of the realistic situation of FISR, six legal documents have been enacted to regulate related issues. However, the function of the interview has not operated well as a result of the low legal rank of the

documents and the flawed stipulation of the subjects and procedure of the FISR.

2.1. The Subjects of FISR is Unclear and the Division of Authority is Undefined

The subjects of FISR are stipulated by Article 3 of Measures, according to this provision, a FISR Working Mechanism (hereinafter referred to as the “Working Mechanism”) is founded by our state, and organization of the FISR related affairs is relying on this mechanism. Moreover, China has set up a department to undertake related work, which is the Working Mechanism Office of FISR (hereinafter referred to as the “Office”). National Development and Reform Commission (NDRC) is the headquarters location of the Office, and the Ministry of Commerce lead this Office collectively.

Although the Measures stipulates the location and the leader agencies of the Office, the functions of different departments are not clear. Firstly, what departments can participate in the Office is not defined by any laws or regulations. However, there are no clear regulations that state whether these departments are a permanent part of the Office or that they only join the Office when they are involved in the relevant areas. The regulations are also unclear as to the scope of cooperation required between the various departments within the State Council and the Office. Secondly, the relationship between other departments of the State Council and the two lead agencies is undefined. When these departments take responsibility for the security review work, the relationship between these departments is a parallel or a vertical one. In other words, other departments are cooperating with two leader departments or being managed by them to do review work in their respective fields. Further, the internal relationship between the two lead agencies is undefined [2]. The fact that the Office is located in the NDRC does not mean that the other lead agency, the Ministry of Commerce, will be guided by the NDRC. Nevertheless, the respective responsibilities of leader agencies are undefined [3]. In a word, the vague regulations on the subjects of the security review could result in a series of problems which can create confusion between power and responsibilities, such as buck-passing, low efficiency, etc [4].

2.2. The Criteria of FISR are Unscientific

In general, Article 4 of the Measures specifies the standards of the FISR. When meeting two conditions involving the essential areas, that is, the national security field, and having total control over the enterprise that it invests, the foreign investors or relevant domestic party should take the initiative to report. Furthermore, “essential areas” refer to areas that are closely related to national security such as military

industry, important agricultural products, energy and resources, high-tech and cutting-edge Internet products and services, financial services, key technologies, and other critical fields. Further, the following situations are considered as the foreign investors having actual control: holding more than 50% of the equity of the domestic enterprises, holding less than 50% of the shareholdings in the invested company but having significant voting rights that can impact on the resolutions of the board of directors or the shareholders meeting, other situations that cause investors to have a significant impact on the business decision-making, personnel, finance, technology, etc.

However, the following problems remain unsolved. Some other important areas besides the military industry related to national security are also listed in the Measures such as key technologies, essential cultural products and services, and crucial agricultural products. Complicating matters is that these important areas are undefined and ambiguous. For example, the proper understanding of the scope of key technologies, the meaning of “essential” for cultural products, or “crucial” for agricultural products are all left undefined in the Measures or any other legal document. This lack of definition and the predictability it provides for investors will likely result in a decrease in the inflow of foreign investment for the state. At the same time, the unclear regulations will result in the excessive discretion of the Office [5], which brings uncertainty and unpredictability to foreign investors. In addition, the scope of the current FISR is still too limited to include some important areas such as environmental area, which will lead to failure to fully protect national security.

2.3. The Procedure of FISR is Imperfect

After the promulgation of the Measures, the review procedures for the FISR in China are mainly stipulated under Articles 5 to 11, which provides supporting measures at both Foreign Investment Law and National Security Law levels. Under the Measures, the review procedure mainly consists of four basic phases: submission of reporting, preliminary review, general review, and special review.

2.3.1. The Issues of Consultation Procedure is Restricted and Ambiguous

Article 5 of the Measures and Article 4 of Provisions respectively stipulate the consultation procedure that parties or applicants can choose to communicate and negotiate with relevant departments (Ministry of Commerce or Office) before formally reporting for FISR. It is worth noting that Article 4 of the Provisions clearly states that “the content of the consultation only includes procedural issues, and the consultation results do not have any binding force or legal effect”. Article 5

of the Measures uses the expression of “related problem” without clarifying the specific problem types, which leads the foreign investors to confusion. Today, the FISR in China has been extended from the level of M&A to all forms of foreign investment. Therefore, the number of FISR cases is likely to surge in the coming period. For foreign investors, the costs of a FISR will rise as well. For the review subjects, the workload and the difficulty of the work will also increase. In conclusion, the pre-consultation process in China should be given a greater role in the security review process and also further refined.

2.3.2. The Supervision Procedure is Lacking and Impractical

Currently, China’s supervision procedure is in a blank state. From the perspective of legislation, the supervision measures in the process of FISR are not mentioned in the Measures. The Notice and the Provision on special fields only stipulate that reports should be submitted to the State Council only when opinions on the result are deeply divided or when decisions cannot be made within the prescribed working days. Although the draft of the Foreign Investment Law (2015) suggested the establishment of a work reporting system, this proposal has not been adopted in the official law. Conclusively, in the procedure of FISR, who should supervise it and how to supervise it need to be further explored.

2.3.3. The Appeal Procedure is Absent

In recent years, the FISR in some developed countries shows a trend of politicization [6], which is closely related to the flexibility and ambiguity of the concept of national security, and political judgment contained in the review. According to the legislation of various countries around the world, the legal remedy for foreign investors has not been established under the FISR, and only some procedural provisions are provided. At present, Article 35 of the Foreign Investment Law stipulates that "A decision legally made upon a security review shall be final." At the same time, China has not stipulated any actual remedy for foreign investors in any administrative legislation or normative documents. Thus, like most developed countries such as the United States, China has not set up remedy approaches for investors. However, as one of the most important recipients of Foreign Direct Investment (FDI), if China hopes to establish a more comprehensive FISR while addressing concerns and maintaining the enthusiasm of foreign investors, it is necessary to increase the design of rights remedy in the system.

3. IMPROVEMENTS OF THE FISR OF CURRENT LEGAL DOCUMENTS IN CHINA

In consideration of the existing problems of the FISR leads to inadequate protection of the national security in China, from the perspective of promoting legalization process and adapting to the trend of globalization, the valid FISR currently can be completed from the following elements.

3.1. Specify the Review Subjects and Division of Authority

First of all, every department of the State Council related to the FISR should be included in the Office, moreover, how and when every department performs its duties should be stipulated in detail. Furthermore, the relationships between the NDRC and the Ministry of Commerce and the relationships between these two lead departments and other departments need to be specified. It seems to us that the NDRC, the Ministry of Commerce, and other departments should cooperate with each other to complete the review work since they are of the same rank. Other departments should not be led or directed by these two organizers. Besides, this equal relationship between these review subjects contributes to mutual restraint and supervision, which in favor of the FISR system operating effectively. Additionally, to some extent, the changing power of decision-making is a guarantee to FISR’s professionalization and efficiency. The changing pattern is when it comes to a department’s expertise, this department’s decision should have more proportion of the final FISR’s conclusion. Last but not the least, the mechanism of supervision and accountability of the Office should be established, which can form a complete system with procedural remedy. The rights of foreign investors will be ensured, and as a result, the attractiveness of foreign investment will increase.

3.2. Revise the Criteria of FISR

3.2.1. To Adjustment the Scope of FISR

In the first place, making scientific explanations for the sensitive sectors that are listed is the core. As for the definition, such as the key technologies, important cultural products and services and important agricultural products, enumerating and miscellaneous provisions is a rational model to adopting. These means can not only give foreign investors a guarantee of predictability, but also play a positive role in protecting some ever-changing and emerging technologies. Furthermore, to specify the scope of the FISR, some essential fields, such as the environmental area that is closely related to humankind, should be added in to fully protecting national security [7]. What requires attention is that

there should be priority in the refinement of the scope of the review and not too intensive [8]. Otherwise, for foreign investment, they would have concerns about paying more time and money, and for the subjects of FISR, they would waste their resources and efforts.

3.2.2. Set the Criteria of the FISR More Flexible

At first, the conception of “control” should be explained flexibly in the sensitive sectors such as in the area of key technologies. The threshold should be more strict in the fields of some sensitive sectors for the purpose of discovering threats in time [9]. Besides, it is necessary to making adjustment to the standard of holding 50% shares, which means a total control of the enterprises. However, given the considerations that the fields of the review are important, the 50% shares of total control cannot be a standard. The practice of other countries can be used as references, which is holding 10%-20% shares [10].

3.3. Develop the Procedure of FISR

3.3.1. Improve the Consultation Procedure

There is a huge difference between the informal consultation procedure in the United States and the pre-consultation procedure in China. In the informal consultation procedure in the United States, the parties can communicate with The Committee on Foreign Investment in the United States (CFIUS) about substantive details and issues related to the investment. On this basis, CFIUS can directly give specific opinions on contracts or agreements, so as to avoid the parties’ entering into the complex formal review process [11]. On this issue, China can make full use of the practice of the United States by adding substantive questions about the investment into the pre-consultation process and affirming the bonding force and validity of the consultation situation. In addition, matters of consultation, including substantive issues, should be clearly stated in the relevant documents. It should be noted that during the consultation process, the Office should adhere to the principle of safeguarding national security, and respond to concerns of foreign investors under the requirement of strictly guarding state secrets. These methods will not only effectively improve the efficiency of the review and save resources, but also help to save costs for foreign investors and protect the enthusiasm of investors [12].

3.3.2. Strengthen and Detail the Supervision Procedure

The lack of practical supervision system is possibly lead to the rights abuse of the review subjects and inadequate supervision. As a result, the enthusiasm of investors may damp. In the absence of a detailed system

design, the most feasible approach to strengthen the supervision is the publication of the review work report [7]. The publication of the work report can promote public supervision and prompt the review department to carry out the review work carefully and prudently. In addition, a work report system should be established so that Joint Conference and Office should be subject to the supervision of their superior administrative organs or the Standing Committee. The Joint Conference and the Office will make regular work reports every year to summarize and reflect on the FISR in this year. Then the higher administrative organs and the Standing Committee of the National People’s Congress will review the content of the report, and form opinions for feedback.

3.3.3. Establish the Appeal Procedure

According to Article 35 of the Foreign Investment Law, the review results are not open to appeal, and the relevant administrative legislation and normative documents do not provide any access. However, some scholars point out that the “A decision legally made” stipulated in Article 35 actually provides the possibility for foreign investors to seek legal remedy [13]. According to the interpretation of this article, only decisions made in strict accordance with the law are final. Thus, decisions made in violation of legal provisions or procedural requirements can be changed. Since the act of review in administrative law is a kind of administrative act, China can establish a procedural re-review system on the basis of Article 35. Conclusively, foreign investors, as the counterpart of the administrative act, can bring an administrative suit to the court to safeguard their rights and interests.

4. CONCLUSION

Under the background of economic globalization, transnational investment has become one of the important models of global business development. Putting its development under legal supervision is a key measure to protect the rights and interests of participating countries and maintain the world economic order. Based on the deficiencies of the current system in China, this paper makes a theoretical analysis from three aspects: review subjects and division of authority, the criteria of review and specific procedure, and points out that the reconstruction and improvement of the legal system of transnational investment in China will have a positive impact on the practice of transnational investment in China and even the world. In the future, the relevant legislative system will continue to improve on this basis.

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