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China's Foreign Investment Law and TRIMs Agreement: Conflicts, Amendments, and Applications

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ABSTRACT

This article explores the developmental trajectory of China's Foreign Investment Law and its consistency issues with the WTO TRIMs Agreement. Covering four developmental stages from 1979 to 2020, it provides a detailed account of the evolution and amendments of China's legal framework on foreign investment. The article identifies inconsistencies in national treatment, elimination of quantitative restrictions, and transparency principles, analyzing adjustments and revisions made across these stages to align with international trade environments and WTO requirements. Despite significant progress, the article highlights areas for further improvement, such as the implementation of national treatment principles and resolution of transparency issues.

KEYWORDS

China's Foreign Investment Law; TRIMs Agreement; National treatment

1. INTRODUCTION

China's journey in developing its foreign investment laws reflects a dynamic evolution driven by the imperative of integrating into the global economic landscape while accommodating domestic developmental priorities. From its early stages of opening-up in the late 1970s to its accession to the World Trade Organization (WTO) in 2001, China's legislative framework on foreign investment has undergone profound transformations. These changes have been shaped not only by the need to align with international trade agreements but also by the strategic goal of fostering a conducive environment for foreign capital while ensuring equitable treatment alongside domestic enterprises.

This paper traces the developmental history of China's foreign investment laws, focusing on key legislative milestones from the initial establishment of the "three laws on foreign investment" to the enactment of the comprehensive "Law on Foreign Investment of the People's Republic of China" in 2019. It examines the adaptations made to address inconsistencies with international trade principles, particularly those stipulated in the WTO's Trade-Related Investment Measures (TRIMs) Agreement. Emphasis is placed on how amendments to China's foreign investment laws have aimed to enhance transparency, ensure national treatment, and eliminate quantitative restrictions, thereby promoting a more level playing field for foreign-invested enterprises.

Through an analysis of these legislative changes, this paper aims to provide insights into the ongoing efforts of the Chinese government to refine its legal framework on foreign investment. It also discusses the impacts of these amendments on the operational autonomy and competitive environment for foreign investors in China. While acknowledging the progress made, the paper also

highlights remaining challenges and areas for further improvement in achieving full alignment with international standards and ensuring consistency and transparency in China's foreign investment regime.

2. DEVELOPMENT HISTORY OF CHINA'S FOREIGN INVESTMENT LAW

From 1979 to 1991, China's foreign investment law was in its preliminary development stage. In 1978, China initiated its policy of opening-up to the outside world, allowing the existence of non-publicly owned economic forms, thus laying the institutional legitimacy for attracting foreign investment. The "Law on Chinese-Foreign Equity Joint Ventures" enacted in 1979, the "Law on Foreign-Capital Enterprises" established in 1986, the "Law on Chinese-Foreign Cooperative Joint Ventures" passed in 1988, along with subsequent implementing rules and regulations, formed the foundational framework known as the "three laws on foreign investment." The establishment of the socialist market economy system at the Fourteenth National Congress in 1992 demanded further expansion of the market and openness to the outside world, significantly promoting the further refinement and development of China's legal framework on foreign investment. However, certain provisions in the laws governing foreign investment were found to contradict principles stipulated in the TRIMs Agreement, posing legal barriers as China moved towards WTO accession. In order to align China's legal framework on foreign investment more closely with WTO rules, necessary amendments were made to the three laws based on TRIMs principles. Subsequently, adjustments to the "three laws on foreign investment" were made in accordance with evolving circumstances.

From 1992 to 1999, China's foreign investment law entered a phase of gradual improvement. Regulations such as the "Labor Management Regulations for Foreign-Invested Enterprises" introduced in 1994, the "Implementation Rules of the Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures" in 1995, and the "Guidelines for Foreign Investment Industries Catalogue" were enacted.

From 1999 to 2011, China's foreign investment law was in an adjustment phase. Amendments were made to relevant clauses of the "Law on Chinese-Foreign Cooperative Joint Ventures" and the "Law on Foreign-Capital Enterprises" in 2000 and 2001 respectively. Despite revisions to the "three laws on foreign investment," many provisions did not meet practical needs, necessitating unified legislation on foreign investment.

From 2012 to the present, China's foreign investment law has been in a phase of transformation. The "Draft Foreign Investment Law of the People's Republic of China" was released in 2015, the "three laws on foreign investment" were removed in 2016, amendments were made to the draft in 2018, and in 2019 the "Law on Foreign Investment of the People's Republic of China" was enacted, which officially came into effect on January 1, 2020.

3. INCONSISTENCIES BETWEEN CHINA'S FOREIGN INVESTMENT LAW AND TRIMS

3.1. Inconsistencies with the National Treatment Principle

3.1.1. Super-National Treatment

In terms of tax incentives, domestic and foreign-funded enterprises in China are subject to their respective corporate income tax laws. Foreign-invested enterprises typically face a corporate income tax rate of 33%, which can be reduced to 24%, 15%, or even lower depending on the location, nature of the enterprise, and industry. Moreover, they may benefit from tariff reductions or exemptions. However, many countries had phased out tax holidays for foreign investments by then, aiming to

balance tax differences between domestic and foreign enterprises and gradually implement national treatment for both.

Regarding import and export rights, foreign-invested enterprises in China enjoy the privilege of conducting import and export activities directly, importing necessary machinery, equipment, and raw materials, as well as exporting their products directly. In contrast, many domestic enterprises in China do not have direct import and export rights; some even require import licenses for imported goods.

In terms of foreign exchange management benefits, foreign-funded enterprises in China are permitted to retain a certain amount of their current account income and are allowed to maintain foreign exchange accounts, in addition to conducting foreign exchange settlements through banks. Conversely, most domestic enterprises are required to sell most of their current account foreign exchange income to designated banks and are restricted from maintaining foreign exchange accounts. Furthermore, foreign-funded enterprises have additional channels for foreign exchange allocation compared to domestic enterprises.

3.1.2. Sub-National Treatment

In the field of foreign investment, various prohibitions or restrictions on foreign investment were stipulated in the "Interim Provisions on Guiding Foreign Investment Directions" and the "Guidelines for Foreign Investment Industries Catalogue" issued in 1995. Despite allowing foreign investment in sectors such as finance, insurance, transportation, trade, and aviation, there were still numerous restrictions concerning geographical regions, quantity, equity shares, and business scope.

Regarding local content requirements, provisions such as Article 9 of the original "Law on Chinese-Foreign Cooperative Joint Ventures," Article 57 of its "Implementing Regulations," and Article 15 of the "Law on Foreign-Capital Enterprises" mandated that foreign-invested enterprises should first purchase necessary equipment, raw materials, and other materials in China.

In terms of trade balance requirements, Article 18 of the original "Law on Foreign-Capital Enterprises" stipulated that exporting all or part of the products produced was a condition for establishing a foreign-invested enterprise, while the "Implementing Regulations of the Law on Chinese-Foreign Cooperative Joint Ventures" required joint venture contracts to include provisions on the proportion of domestic and international sales of products.

3.2. Inconsistencies with the Principle of General Elimination of Quantitative Restrictions

Inconsistencies with the principle of general elimination of quantitative restrictions are mainly reflected in restrictions on foreign exchange used for imports and requirements for domestic sales. Essentially, this is achieved by limiting enterprises' access to foreign exchange to force them to implement import substitution. Prior to amendment, Article 20 of the "Law on Chinese-Foreign Cooperative Joint Ventures" stipulated that joint ventures must balance their foreign exchange receipts and payments independently. If unable to do so, they could seek assistance from relevant authorities as per national regulations. Additionally, Article 14 of the "Implementing Regulations of the Law on Chinese-Foreign Cooperative Joint Ventures" required joint venture contracts to specify the proportion of product sales in China and abroad.

3.3. Inconsistencies with the Transparency Principle

Firstly, many of the laws and regulations that have been promulgated are overly simplistic, lacking practical operational provisions. They often rely on judicial interpretations to compensate for their shortcomings, which are not always transparent to foreign investors. Secondly, there is an abundance of internal documents, notices, approvals, and other forms of administrative measures in China, particularly concerning foreign investment management. Finally, the Chinese government follows

specific principles and standards when examining the feasibility study reports, contracts, and articles of association of foreign-invested enterprises, but these criteria are often non-public and subject to the discretion of the approving authorities, which does not align with the transparency requirements.

4. ADAPTATION AND AMENDMENTS OF THE THREE LAWS

To meet the objective requirements for accession to the WTO, China made modifications to its foreign investment laws based on the principles of "national treatment" and "general elimination of quantitative restrictions". The core legislation governing foreign investment, particularly representative in the amendments, is the "Law on Foreign-Capital Enterprises". The Standing Committee of the National People's Congress made significant revisions to the "Law on Chinese-Foreign Cooperative Joint Ventures" and its "Implementing Regulations" in 2001.

4.1. Law on Foreign-Capital Enterprises

4.1.1. Adaptation and Amendments in Accordance with the National Treatment Principle

The principle of national treatment throughout the investment stages, from admission to operational phases, was emphasized. Before admission, foreign investors and their investments were to be treated no less favorably than domestic investors and their investments during the investment admission phase. The country implemented a system of national treatment prior to admission combined with a negative list. Articles 4 and 28 of the law established the management model of national treatment prior to admission combined with a negative list. Articles 9, 15, 16, and 30 focus on the post-admission phase, ensuring equal application of relevant policies for foreign-funded enterprises, participation in standard setting, government procurement, and obtaining industry licenses.

4.1.2. Adaptation and Amendments in Accordance with the Transparency Principle

The "Law on Foreign Investment" fully embodies the principles of consistency between domestic and foreign investment and transparency. Article 7(2) stipulates that normative documents related to foreign investment must be promptly published in accordance with the law, and those not published cannot serve as the basis for administrative management. Normative documents closely related to the production and operation activities of foreign-funded enterprises should be published within a reasonable timeframe prior to implementation, considering practical needs.

4.2. Amendments to the Law on Chinese-Foreign Cooperative Joint Ventures and its Implementing Regulations

4.2.1. Compliance with National Treatment

Firstly, the requirement for "local content" was abolished. For instance, Article 9(2) of the original Law on Chinese-Foreign Cooperative Joint Ventures stipulated that materials, fuels, and components needed by joint ventures should primarily be purchased in China or funded through foreign exchange directly procured in the international market by joint ventures. This was later modified to Article 10: "Materials, fuels, and other substances required within the approved business scope of a joint venture can be purchased in the domestic or international market based on fair and reasonable principles." Similar provisions were also removed from Article 57 of the Implementing Regulations of the Law on Chinese-Foreign Cooperative Joint Ventures.

Secondly, the requirement for production and operation plan approval by competent authorities was deleted. Article 9(1) of the Law on Chinese-Foreign Cooperative Joint Ventures and Article 56 of its Implementing Regulations previously contained relevant provisions, which were subsequently deleted. Thirdly, methods for obtaining site usage rights for joint ventures were aligned with those

for domestic enterprises, and insurance requirements for joint ventures were enhanced, better meeting the requirements of national treatment.

4.2.2. Consistency with the General Elimination of Quantitative Restrictions

Firstly, the requirement for "domestic sales" was completely abolished. Article 10(2) of the amended Law on Chinese-Foreign Cooperative Joint Ventures encourages joint ventures to export products overseas. Products can be sold directly to foreign markets by joint ventures or their relevant delegated agencies, or through Chinese foreign trade agencies. Joint venture products can also be sold in the Chinese market. Secondly, joint ventures are no longer required to balance foreign exchange receipts and payments. Article 75 of the original Implementing Regulations of the Law on Chinese-Foreign Cooperative Joint Ventures, which mandated balancing foreign exchange receipts and payments for joint ventures, was removed in the amended regulations.

4.2.3. Increased Transparency

The Law on Chinese-Foreign Cooperative Joint Ventures removed the requirement for foreign-invested enterprises to comply with laws and relevant regulations. It stipulates that all activities of joint ventures must comply with the laws and regulations of the People's Republic of China. The Implementing Regulations of the Law on Chinese-Foreign Cooperative Joint Ventures deleted six listed industries eligible for investment. The Enterprise Income Tax Law adopted in 2007 unified the corporate income tax rate for domestic and foreign-funded enterprises to 25%, resolving the issue of "super-national treatment" for foreign-funded enterprises regarding taxation.

5. IMPACT OF LEGAL AMENDMENTS

Following the amendments to the "Three Laws", foreign-invested enterprises gained greater autonomy in production and operations, further standardizing their management activities. Many provisions became more aligned with those for domestic enterprises and international rules, essentially meeting the requirements of the TRIMs Agreement and fulfilling China's commitments upon joining the World Trade Organization.

However, it should be noted that despite the revisions, there are still inconsistencies between China's Foreign Investment Law and the TRIMs Agreement. For instance, concerning the national treatment principle, foreign-invested enterprises still face "super-national treatment" in taxation, import and export rights, and establishment of enterprise organizations, while their investment fields remain subject to certain internal regulations. Moreover, there are transparency deficiencies: at the time, government departments lacked a sense of open management and service; internal documents, administrative instructions, approvals, and internal notices did not meet the transparency requirements.

6. CONCLUSION

In the developmental trajectory of China's foreign investment laws described in this article, we have witnessed a series of adjustments and revisions to the "Three Laws" to adapt to changes in the international trade environment and China's accession requirements to the World Trade Organization (WTO). Particularly in the process of rectifying inconsistencies with the TRIMs Agreement, the Chinese government has endeavored to balance the status of domestic and foreign-funded enterprises, continuously improving the legal framework to ensure relative equality in their operational activities.

Throughout the amendment process, one can observe the Chinese government's earnest adherence to the principles of national treatment and the general elimination of quantitative restrictions. This commitment is evident not only in adjustments concerning tax incentives, import-export rights, and foreign exchange management but also in the removal of previous restrictions on geographical,

numerical, and business scope limitations. These measures have enhanced the competitiveness and flexibility of foreign-invested enterprises. Moreover, the emphasis on the transparency principle is reflected in the amendments, with timely publication of normative documents and gradual clarification of regulations, thereby improving the predictability of legal application and management provisions for foreign-funded enterprises.

However, despite significant progress achieved through the amended Foreign Investment Law, areas for improvement remain. In terms of the national treatment principle, instances of "super-national treatment" persist in certain sectors, necessitating further adjustments to ensure fair competition between domestic and foreign-funded enterprises. Additionally, transparency issues need to be addressed to ensure openness and clarity of laws and policies, thereby reducing uncertainties arising from information asymmetry. Furthermore, there are challenges related to the coherence within the legal system, coordination among laws of equal rank, and local irregularities interfering with the rule of law in investment policies.

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