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# THE 2020 FOREIGN INVESTMENT LAW OF CHINA: CONFUCIANISM AND NEW CHALLENGES FOR SOCIAL DEVELOPMENT

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## ABSTRACT

On January 1, 2020 the new Foreign Investment Law of the People's Republic of China (中华人民共和国外商投资法) entered into force to promote investments in China. The aim of the law is to foster cross border investments. This law was passed on March 15, 2019 by the National People's Congress. The Chinese FDI legal framework is composed of a set of laws and regulations that are dynamically shaping the economic reality. What are the possible tensions between the new law and the complex system of values in China? Is the new law an agent of implementing *de facto* social development? In summary, the results show that there is a complex relationship between FDI and social development in China. The new Chinese law might be an inspirational source of non-European legal tradition for Central Europeans.

## KEYWORDS

China, FDI, business, social development

## 1. INTRODUCTION

On January 1, 2020 the new Foreign Investment Law (FDI) of the People's Republic of China (中华人民共和国外商投资法)<sup>1</sup> entered into force to promote investments in China. The objective was to foster cross border investments and foreign direct investments. The Foreign Investment Law was passed on March 15, 2019 by the National People's Congress. The political context for the new law was a US-China trade war. The Chinese FDI legal framework is thus composed of a set of laws and regulations that are intended

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1 *Zhong hua renming gong he guo wai shang touzi fa.*

to dynamically shape the economic reality. From 1.01.2020 there will be no differences in treatment between Chinese nationals and foreigners with respect to foreign investments.

In the 18th Century Adam Smith wrote about China: *China has been long one of the richest, that is, one of the most fertile, best cultivated, most industrious, and most populous countries in the world. [...] The poverty of the lower ranks of people in China far surpasses that of the most beggarly nations in Europe.*<sup>2</sup> Since that time China has changed profoundly. After the 1980s, new market economy rules meant less control for enterprise and more freedom, but China is based on Confucianism, which protect the interests of the State and its responsibility. The conception of government, the relationship between ruler and ruled, the methods of ruling, and of the obligations of individuals toward the political community go hand in hand with the Confucianism idea of social engagement.<sup>3</sup> In China there are two concepts of law: *li* (礼) and *fa* (法).<sup>4</sup> The first refers to ‘moral rule’ and the idea of individual and social obligations, and the latter is translated as ‘law’ in the sense of written law such as *lex, loi, Gesetz, prawo*. Two questions appear problematic regarding the new legal framework. Firstly, market economy rules mean less control for enterprise and more freedom, but China is based on Confucianism, which protect the interests of the State and its responsibility toward society. Moreover, social development was established as an objective to reach within the new law. Is the new law an agent of implementing *de facto* social development?

In order to deliver an answer, the paper will analyze the broad context of FDI’s development in China (2) with the provisions of new law (3). Secondly, Confucianism will be studied (4) in terms of social development (5), ending with main findings (6).

## 2. FOREIGN DIRECT INVESTMENTS IN CHINA

The Organization for Economic Co-operation and Development (OECD) provided a definition of FDI, which *is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.*<sup>5</sup> More precisely, FDI is considered *as a means of acquiring technologies, skills and access to international markets, and of entering dynamic trade and production systems internal to multinational enterprises (MNEs).*<sup>6</sup>

Figure 1 shows a comparison between the People’s Republic of China and Hong Kong. One can observe a constant drop of inwards FDI as a percentage of GDP from

2 A Smith, *An Inquiry into the Nature and Causes of The Wealth of Nations* (The Modern Library 1994) 82.

3 L El Amine, *Classical Confucian Political Thought A New Interpretation* (Princeton University Press 2015).

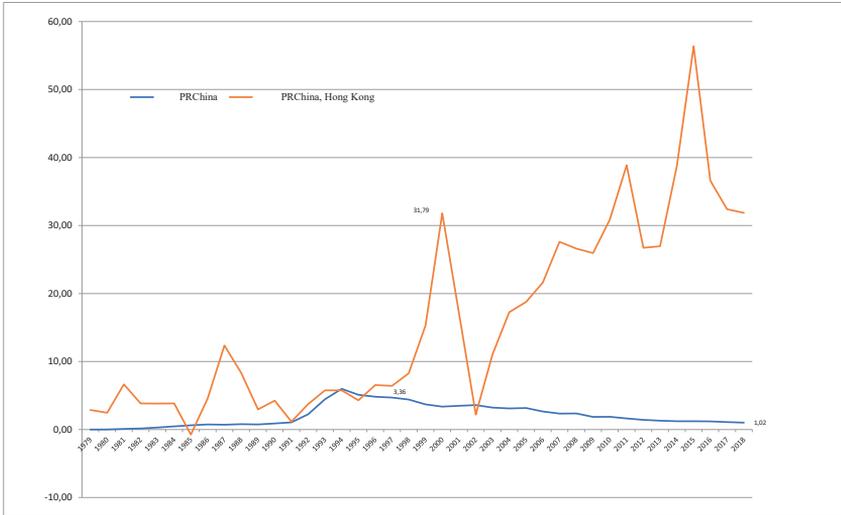
4 L Moccia, ‘The Idea of «Law» in China: An Overview’ in L Golota, J Hu, K Van der Borgh, S Wang (eds), *Perspectives on Chinese Business and Law* (Intersentia 2018) 59-94.

5 ‘Foreign direct investments (FDI)’ <<https://doi.org/10.1787/9a523b18-en>>.

6 S Lall, R Narula, ‘Foreign Direct Investment and Its Role in Economic Development: Do We Need a New Agenda?’ (2004) *EJDR* 16(3), 448.

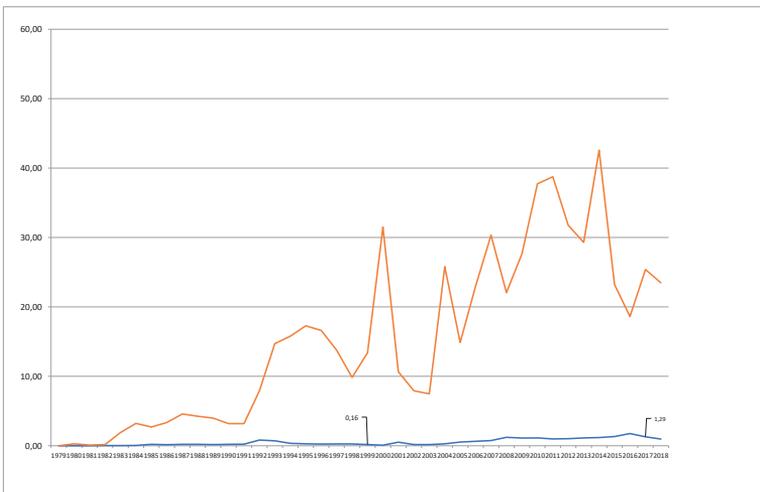
3.36% in 1999 to 1.02% in 2018 China, in the meantime it shows a growing percentage of outwards FDI, from 0.16% to 1.29%, respectively (Figure 2). Wang and Gao divided 40 years of outwards FDI into three stages: ‘restricted’ (1979-1999), ‘relaxed’ (2000-2016), and ‘regulated’ (from 2017)<sup>7</sup>. Moreover, FDI is differentiated between administrative units of the country. Does the new law make a difference for boosting FDI inflows? This question will be analyzed in the next section.

**Figure 1. FDI inwards as a percentage of Gross Domestic Product (GDP), 1979-2018**



Source: Author’s extrapolation from UNCTAD Statistics (2019) <<http://unctadstat.unctad.org/EN>>.

**Figure 2. FDI outwards as a percentage of Gross Domestic Product (GDP), 1979-2018**



Source: Author’s extrapolation from UNCTAD Statistics (2019) <<http://unctadstat.unctad.org/EN>>.

<sup>7</sup> B Wang, K Gao, ‘Forty Years Development of China’s Outward Foreign Direct Investments: Retrospect and the Challenges Ahead’ (2019) *China & World Economy* 27(3), 1-24.

### 3. THE NEW INVESTMENT LAW

The new law on Foreign Direct Investments<sup>8</sup> is the result of the long process of establishing rules and practices during last forty years (1979-2019) in terms of doing business and investments by foreigners. This period experienced different paths of development of FDI transfers.<sup>9</sup>

The Chinese laws had adopted until 2019 a separate registration system for Chinese FDI enterprises and domestic companies.<sup>10</sup> In other words, the establishment of domestic companies applied the Company Law of the PRC, in the meantime China had three different laws for the establishment of wholly foreign owned enterprises, Joint Venture law and Contractual Joint Ventures respectively. Since 2020, a new era of FDI has emerged.

As far as general provisions are concerned, according to Art. 2 foreign investments are all those including investment activities within China directly or indirectly conducted by foreign natural persons, enterprises, and other organizations:

- (1) A foreign investor forms a foreign-funded enterprise within China alone or jointly with any other investor,
- (2) A foreign investor acquires any shares, equities, portion of property, or other similar interest in an enterprise within China,
- (3) A foreign investor invests in any new construction project within China alone or jointly with any other investor,
- (4) Investment in any other manner as specified by a law or administrative regulation or the State Council.

The main objective includes a *high-level investment liberalization and facilitation policy, establishes and improves foreign investment promotion mechanisms, and creates a stable, transparent, predictable and fair market environment* (Art. 3). According to Art. 4:

8 Order No. 26 of the President of the People's Republic of China, Xi Jinping, Foreign Investment Law of the People's Republic of China, adopted at the Second Session of the 13th National People's Congress on March 15, 2019.

9 From 1978 – 2000, China set up its complex legal framework for FDI, starting 2001 China in amended legal provision in broad scope of issues (S Wang, 'Chinese Foreign Direct Investment Law' in L Golota, J Hu, K Van der Borgh, S Wang (eds), *Perspectives on Chinese Business and Law* (Intersentia 2018), 215-244, <<http://doi.org/10.1017/9781780687643>>)].

10 These laws are:

- 1) Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, 1979 (2016 Amendment);
- 2) Law of the People's Republic of China on Wholly Foreign-Owned Enterprises, 1986 (2016 Amendment);
- 3) Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, 1988 (2017 Amendment). Detailed Rules for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures ('2017 Second Revision PKULAW Version' <<http://www.lawinfochina.com/display.aspx?id=b216ad17914f6f4dbdfb&lib=law>> accessed 1 Dec 2019).

*The State shall implement a foreign investment management system addressing pre-entry national treatment to include a foreign investment negative list.*

Pre-entry national treatment is defined as treatment given to foreign investors at the stage of entry in which the investment standards are not lower than that of domestic investors and their investments; the negative list refers to state regulations for foreign investment in specific areas to include special management measures for investment implementation approval. The negative list will be issued by the State Council. Moreover, in any international treaty or agreement concluded which will be more favorable in respect of access for foreign investors, the relevant provisions of the treaty or agreement may apply.

According to Art. 6, national security and the public interest should be preserved and foreign investors and foreign-funded enterprises conducting investing activities within China shall abide by the laws and regulations of China, and neither compromise China's national security nor cause damage to the public interest.

Chapter II starts with Art. 9, which introduced the principle of equality between national and foreign enterprises: the state's various policies shall equally apply to foreign-funded enterprises. Comments and suggestions from foreigners should be considered 'in a proper manner' (Art. 10). More cooperation is needed which might be multilateral or bilateral between China and countries, regions or international organizations (Art. 12). In order to boost investments, the State can establish special economic areas to promote foreign investment (Art. 13) or guide foreign investors to invest in specific industries, fields and areas, taking into account national economic and social development (Art. 14). According to Art. 17, foreign enterprises may conduct financing through public offering of shares, corporate bonds and other securities or 'by other means'.

Chapter III established the core issue of a completely new provision on protection of Intellectual Property (IP) rights, which was one of the main issues at stake for foreign investors - protection of their company's know how (Art. 22). The State shall 'encourage technology cooperation on the basis of free will and business rules'. In addition, according to Art. 20 there will be no expropriation (*State is not to expropriate any investment made by foreign investors*).

Chapter IV established clear rules on how the business must be operated. It is not allowed to invest in specific fields named in the 'negative list' (Art. 28). In any other activities, the treatment between domestic investment and foreign investment should be equal. In some industries obtaining an investment license is required (Art. 30). According to Art. 31, the business forms, structures, and rules of activities of foreign funded enterprises shall be governed by the Company Law of the People's Republic of China, the Partnership Enterprise Law of the People's Republic of China, and other laws. A foreigner must comply with anti-monopoly assessments of the business operations in accordance with the provisions of the Anti-Monopoly Law of China (Art. 33). In addition, foreign investors must submit investment information to the commercial authorities

through the enterprise registration system and the enterprise credit information publicity system (Art. 34).

According to Art. 14 of the new law:

*the State encourages and guides foreign investors to invest in specific industries, fields, and regions in accordance with the needs of national economic and social development. Foreign investors and foreign-invested enterprises may enjoy preferential treatment in accordance with laws, administrative regulations, or provisions of the State Council.*

In conclusion, the freedom of FDI was established within the new legal regulation framework. In addition, the unification of legal frameworks and equalization before State's law came into effects. The new law changed the Intellectual Property rights. However, the new regulation included open clauses that should be still defined from the legal practice, for example 'a proper manner' (Art. 10), 'free will', 'business rules', 'principle of equity' (Art. 22), 'efficiency and transparency' (Art. 19).

There are three barriers in FDI for foreign investors: national security, public order and finally monopoly activities. On one hand, antimonopoly legislation must be the rule, but on the other hand, no harm to any State's activities may occur, which stems from the Chinese system of value what will be analyzed in the following part.

#### 4. CONFUCIANISM AND LAW

The combination of Confucianism and Taoism lies at the root of legal understanding in China. The system of social hierarchy based on Confucius (Kǒngfūzǐ, 孔夫子) refers to the legal system: *li* 礼 (禮) that means rites and moral obligations, and the strictly legal approach referring to a written law *fa* (法). *Li* has different meaning.<sup>11</sup> Is Confucianism still present in modern China?

During the New Cultural Movement (新文化运动), 1915-1919, Confucianism was suppressed in the name of democracy and science. According to Zhu Cheng,<sup>12</sup> in modern China, Confucianism is revived, but only for the *elite*: government, socialists, and scholars. Confucianism is needed for the following reasons: 1) to resolve problems, 2) nationalistic attitudes, 3) to implement moral order. However, modern Chinese people, especially the younger population, do not follow Confucian ideas, as long as economic prosperity is considered.

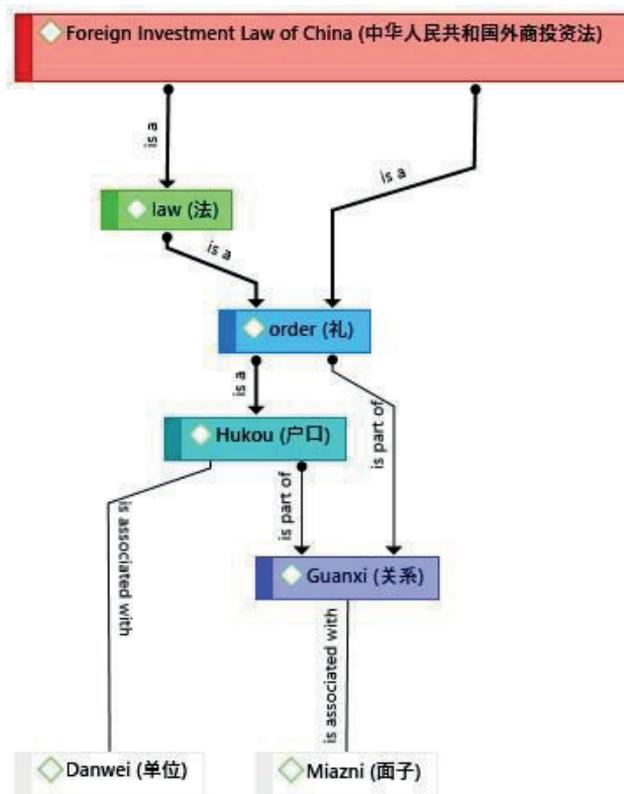
What is the relation between Confucianism and the new law on FDI? Do *li* and *fa* have an impact on Foreign Direct Investments? Figure 3 shows that written law in China is immersed in the moral order of *li*, which has its origins directly in *bukou* and *guanxi*.

11 Order, moral obligation, morality, etc.

12 Personal interview with Zhu Cheng (朱承), Shanghai Academy, 15 October 2019, Shanghai.

Introduced by Mao Zedong in the time of planification economy and society, *hukou* (户口) refers to a household registration system that divided the population into two categories: agricultural registrants in rural areas and non-agricultural (urban) in metropolitan areas, set up under the Regulations on Hukou Registration in 1958 by the National People’s Congress (NPC). The objective was to regulate internal movement of the Chinese. It created a legal domicile for every person and bound each person to that dwelling. The information included details on births, deaths, marriages, divorces, and the movement of all members in the family. *Hukou* was *de iure* abolished in 2003 as a consequence of the Sun Zhigang Case.<sup>13</sup> This case showed the impacts of a changing society on the old institutions of stratification such as *hukou*.

Figure 3. Model of the normative paradigm of law



Source: Author’s analysis.

13 Sun Zhigang Case (孙志刚事件) in 2003. On March 20, 2003, 27-year-old Sun Zhigang died in the medical clinic of a detention center (拘留所) in Guangzhou. He had been detained after being unable to show his three identification documents: a temporary living permit (暂住证), his identity card, and his residence permit (*hukou*) which was with his family in Hubei. Three jurist scholars: Dr. Xu Zhiyong, Dr. Yu Jiang and Dr. Teng Biao prepared an official reply on the basis of violation of Constitutional principle, as the only legislative body is the NPC.

However, *hukou* is important nowadays in the developed main cities such as Beijing, Shanghai, and Guangdong, where education, social security and health services are still provided through formal registration. However, in the rural areas it is less important, as most of the younger generation choose to migrate to the cities. Table 1 shows the relationship between urban and rural *hukou*.

**Table 1. Theoretical model to explain *hukou* and *guanxi* in modern China**

Company members	<i>Hukou</i>		<i>Guanxi</i>	
	rural	urban	rural	urban
Chinese	weak	strong	strong	weak
Foreigner	weak	weak	weak	strong

Source: own elaboration.

The question of whether *hukou* has an impact on FDI should be addressed. On the urban level there is a weak influence of *hukou*. Nevertheless, at the rural level, a person who is registered in the locality would have social relations that will allow a foreigner to make investments easily and with a possible positive impact in the region.

On the contrary, nowadays most Chinese from rural areas migrate to the urban cities and they keep their status from their homelands, but the emotional connection with their households and hometown is extremely weak. For them, living in urban cities might be difficult as an urban *hukou* has more privileges than a migrant from other provinces, but this is the only option to improve their life conditions. Wang observes that ‘people are treated differently in accordance with where their legal residency is, and the change and relocation of any citizen’s legal residency must be approved by the government’.<sup>14</sup>

*Hukou* focuses on where people come from, and *danwei* (单位), also introduced by Mao, refers to the place of employment and political affiliation. Previously all urban workers were organized as part of a *danwei*: a factory, a store, a school, or a government office. Xie et al. observed that ‘in pre-reform China, *danwei* were largely responsible for generating inequality in benefits, but not in earnings. During the economic reform, the central role of *danwei* in determining benefits has been displaced either by the private market (in the case of housing) or by social welfare (in the case of medical benefit and pension)’<sup>15</sup>. It was still important independent from region or sector. *Danwei* was the first step and principal channel for implementing party policy in the Chinese socialist infrastructure.<sup>16</sup>

Moreover, in Chinese society *guanxi* (关系) plays an important role for political, economic and business activities, but has different impacts on the rural and urban levels,

14 F-L Wang, *Organizing Through Division and Exclusion: China’s Hukou System* (Stanford University Press 2005) XII-XIII.

15 Y Xie, L Quing, W Xiaogang, ‘«Danwei» and Social Inequality in Contemporary Urban China’ (2010) *Res Sociol Work* 1(19), 295, <[http://www.doi.org/10.1108/S0277-2833\(2009\)0000019013](http://www.doi.org/10.1108/S0277-2833(2009)0000019013)>.

16 E Y-H Tsang, *Understanding Chinese Society: changes and transformations* (World Scientific 2016) 8.

as shown in Table 1. It means relationships and informal networking, which are critical parts of doing business in China, it is of especially great importance on the urban level in first tier cities such as Beijing, Shanghai, Guandong, and Shenzhen.

*Guanxi* is source of stratification, and more and more its impact is reduced in modern society.<sup>17</sup> Tsang refers it to ‘dyadic, particular, and sentimental tie that has the potential to facilitate exchange of favors between parties connected by the tie’.<sup>18</sup> It originates from a Confucian thought meaning ‘mutual responsibility’, and non-family based interpersonal networks. It is still important on the rural level.

Social face, *mianzhi* (面子) means to ‘give face’, to take your own responsibility. The social contract of the state is built on the idea of harmonious society *héxié shèhuì* (和谐社会), which stems from the Confucius’s the Great Harmony (an ideal or perfect society), *dàtóng* (大同) and prosperous society, *xiǎokāng shèhuì* (小康社会). These are the bedrocks of the official state policy *guó cè* (国策) in the post-transformative era.

In conclusion, for rural Chinese, *hukou* is less important and *guanxi* is more important. The market economy drives the forces of migration and consumption. That’s why for urban Chinese, *hukou* is very important, but *guanxi* less important. People in an urban megalopolis would like to be ruled by law, not by informal relations such as moral order, *li* or *guanxi*. For a foreigner, on the rural level *hukou* and *guanxi* are both weak. But on the urban level, *guanxi* for foreigners is of the utmost importance.

## 5. CONCLUSION

From January 1, 2020 there is no difference between Chinese and foreigners in treatment with respect to foreign investments. According to Art. 42, Foreign Owned Enterprises Law, Joint Ventures Law, and Chinese-Foreign Cooperative Enterprises Law will expire, however, foreigners can continue with any activities established before January 1, 2020, until five years after the implementation of the new Law. The concept of the law must take into account the social context in order to challenge the gaps between the developments of the West and the East in China. Social stratification in contemporary urban China, which stems from *hukou* and *danwei*, should be challenged by the new law, however these institutions of social stratification still play a significant role in modern China.

Up to now, FDI has brought inequalities, and moreover, has not solved the problems of social exclusion and inequality.<sup>19</sup> Finally, analysis of the new Chinese FDI law is particularly

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17 The example of the diminishing role of *guanxi* is ‘ant tribes’ (蚁族 *yǐ zú*) who live in the outskirts of first-tier and second-tier cities, in poor conditions. *Guanxi*, non-family based interpersonal networks are not sufficient in the rural areas and small urban cities, so university graduates from poor regions migrate to big cities and become ‘ant tribes’. The crisis of masculinity frequently occurs with *wen* (being intellectual) and *wu* (being physically masculine) as suggests Tsang (Ibid). To feel like an outsider, 外地人 (*wàidìrén*), outlander non-local person, from out of town. Face (脸 *liǎn*) refers to loss their status. According to Confucius, the main virtue guiding the behavior of the leader is *ren* 仁 (benevolence).

18 E.Y-H Tsang, *Understanding Chinese Society: changes and transformations* (World Scientific 2016) 8.

19 Global City 2017 Report’ on FDI.

important for Poland and other Central and East European countries, that have to diversify not only their own business relationships, but also consider a global perspective.

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