CURRENT FOREIGN INVESTMENT POLICY OF CHINA

Abstract. Foreign direct investments play a significant role in development strategies in developing countries. They are fundamentally important for the country's economic development. Foreign direct investments certainly support the national economy facing domestic investment resources shortage, and may cover the gap between investment resources and national investments. So, foreign direct investments can affect economic development and accelerate economic development.

China is an example of a country that has demonstrated incredible growth in a relatively short period of time, becoming an important player in the global economic system. Over the years, foreign direct investments in the country has steadily increased, and a significant role in this investment incentive was played by China's investment policy of the early 2000s, which was aimed at attracting investments into the country, thereby stimulating various production industries. In this context, it is worth mentioning special economic zones that were established to increasingly “open China” to investors and contribute to accelerating economic growth.
So, China is well known as an importer of investments, but in recent years its role as an exporter of investments has been increasing. China's international presence abroad is growing, and it may happen that China even overtake the United States in the near future. Foreign investments give China an opportunity not only to strengthen its own economy, but also to apply its economic power to increase its influence abroad. Partly guided by Beijing's strategy to enter foreign markets and the “One Belt, One Road” Initiative, which encourage investments in foreign markets, Chinese firms have been actively expanding their foreign presence in a number of sectors in recent years, along with active investments attracted to their country, including through the numerous special economic zones.

**Keywords.** Foreign investments attraction, foreign direct investments (FDI), liberalisation of the foreign direct investments regime, foreign investments regulation, China’s Foreign Investment Law, “Made in China 2025” strategy.

**Problem statement.** The issue of Chinese capital market liberalisation becomes relevant not only in the context of China itself, but also for many investors around the world. This statement can be explained by the fact that due to economy liberalisation, China is gradually transforming into a superpower that may leave behind the United States. China is in the process of gradual liberalisation of its economy, and foreign investments attraction is one of the ways of achieving this. However, recently, China has become more cautious about foreign investments attraction due to increased foreign capital controls. China plans to change its model of an export-dependent economy to the model based on domestic consumption. This may result in increased demand for foreign investments in Chinese domestic market. Although China is increasing its foreign capital control, it continues attracting foreign investments by establishing special economic zones and changing the rules for foreign investments.

**Recent research and publications analysis.** In the scientific literature, a large number of researchers paid their attention to the China's policy for foreign investments. For example, investment policy of China has been studied by such scholars as Michael Porter, Zhao Jingping, In-Won Chang, Wong Zhongwei, Fang Shihua. Although, China's investment policy and its impact on the world economy are not sufficiently covered by domestic economic literature, nevertheless, the works of such researchers as Leonid Melamed, Viktor Taranenko, Irina Tyurina, Alexander Moskalenko and others are devoted to this topic. It should be also mentioned the scholars who have contributed to the study of the issue of foreign investments attraction to Chinese economy, including Stephen Roach, John Pomfret, Li Xiaochun, Yu Jinhua, Michael N. Madison, Stefan Leuter, Cecilia Eng, James MacDonald and others.

**Purpose of the article.** The main purpose of this work is to study the strategy and policy of China for foreign investments attraction, which are used in modern
conditions. The article intends to reveal the aspects such as China's investment policy, legal framework for foreign investors, existing obstacles and other important aspects; and to give a general understanding of the ways China develops its economy through foreign investments.

**Basic material presentation.** Recently, China has gradually become one of the main destinations for global cross-border investors, recognized as the most promising national economy and the second most promising host economy after the United States in terms of foreign direct investments. But, China is also a powerful importer of investments (Fig.1).

![Dynamics of FDI attraction to China (in bln. $)](image)

Source: [1]

**Fig. 1 Dynamics of FDI attraction to China in 1979-2021**

Since the 90s of the last century, China has increasingly opened up its economy to investments, and accordingly, over the years, the volume of attracted investments has grown despite certain years reduction. If in 2000 the volume of attracted investments amounted to $42.1 billion, then in 2010 they amounted to $243.7 billion [1]. Analysing the trend of the last 5 years, it can be noted that, with exception of 2019, when FDI amounted to $187.17 billion, there was an upward trend. In 2017, the volume of investments amounted to $166.08 billion, in 2020 – $253.1 billion, and in 2021 – $333.98 billion [1].

International financial centers play an important role in directing foreign financial flows to China. According to official data, more than 50% of Chinese FDI in 2020-2022 were received by China via Hong Kong, and a significant share also flowed from the Virgin Islands. These financial centers offer favorable conditions or services to international investors, who in most cases are located in the third countries.
According to Fig. 2, China's main investor is Hong Kong – $131.76 billion, which is significantly ahead of other countries in terms of investments. Singapore is also among the active investors ($10.33 billion), the Virgin Islands ($5.28 billion), Korea ($4.04 billion), Japan ($3.91 billion) and the United States ($2.57 billion) [2]. Although China's economic development has spread from the Eastern China to the domestic provinces, foreign FDI inflows are still mainly directed to the coastal regions, which have attracted more than 80% of the total investments in recent years. Foreign companies were most active in the Yangtze River Delta, namely, in Shanghai, Jiangsu and Zhejiang, in the Great Bay Area in Guangdong and in the North in Beijing, Tianjin and Shandong. Many investments have been made in special economic zones, which create favourable conditions for foreign investors.

The facts confirm that hundreds of billions of dollars of investments are attracted to China every year, but now there is an issue of their distribution. Statistics show that the distribution of annually attracted FDI to economy is very irregular.

**Table 1**

<table>
<thead>
<tr>
<th>Geographical region</th>
<th>Share of the total investments attracted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern China</td>
<td>84.4%</td>
</tr>
<tr>
<td>Central China</td>
<td>6.2%</td>
</tr>
<tr>
<td>Western China</td>
<td>5.3%</td>
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<tr>
<td>Relevant divisions</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

Source: prepared by the author according to [2]

**Fig. 2. Main countries-sources of investments to China**
In 2021, approximately 84.4% of the actual foreign direct investments used in China were invested to Eastern China. Central and Western China attracted only a small share of the total FDI revenue (Table 1).

![Volume of direct foreign investments to China in 2021 by sectors (US$, bln.)](image)

**Fig. 3 Volume of foreign direct investments to China in 2021 by sectors (US$, billion).**

Speaking of the distribution by sectors (Fig. 3), it was found that foreign investments to China are traditionally strong in production sector. In 2021, it was the production sector that attracted the largest part of investments – $33.73 billion [4]. However, due to the center of China's economic development to shift from production to technology, services and consumption, the landscape is rapidly changing. Production sector's contribution to the total FDI inflows has gradually declined from almost 60% in 2005 to less than 20% in 2021, while the service sector accounted for more than 75% that year. Leasing and business services, real estate, retail and wholesale trade, financial mediation, and construction attracted $33.09 billion, $23.61 billion, $16.72 billion, $12.02 billion, and $2.27 billion, respectively [4]. In particular, research and technology, IT, leasing and business services are rapidly gaining in importance, which contributes to investments diversification to China.

The most popular investment forms for foreign companies in China include a fully foreign-owned enterprise, joint venture, and representative office. An enterprise fully owned by foreign countries is the most common and desirable investment instrument for foreign investors to enter the market. This is the equivalent of a limited liability company founded solely using the capital of a foreign investor for business. This gives foreign investors the highest level of independence and control over business transaction, strategies and employment. This type of enterprise can be engaged in any commercial activities that were not specifically indicated in the “Negative List” [5]. With full control over the employment process, the company may employ both foreigners and Chinese citizens. Another popular
form is a joint venture. A joint venture is also deemed to be an LLC. Its main difference from an enterprise fully owned by foreign investors is that to establish a business you need a partnership with Chinese investor or the company. It is more difficult to manage JV due to diverging interests of their shareholders. This type of investment mechanism is often used by the companies that want to start business in the sector indicated in the Negative List, and the companies that want to reduce the risks when entering the market. Another typical legal form is a representative office. The representative office is deemed to be a branch or Head Office extension, and it is allowed to carry out limited activities in Chinese market. It can be only engaged in marketing and research activities, as well as act as a link coordinating business contacts for its parent company. It may not be engaged in commercial activities, sign contracts, generate revenue, or issue invoices to the customers.

Regime liberalization for foreign investments started de facto in the late 1980s, when certain special economic zones were already established involving foreign investors, but de jure the relevant laws were introduced only later. From the very beginning of the reforms, the entire system of foreign investors regulation was designed for liberalization, for foreign investors admission to China, but now the state legislation clearly defends its state interests. In fact, the essence of China's national programme can be summed up as a combination of the state's interests and the interests of private foreign investors, in other words, a combination of national economic development goals and the goals of foreign investors, who want to increase their profit despite certain restrictions imposed by the state [6]. By wisely attracting foreign investments and properly directing these investments into the state's priority sectors, huge industrial regions were created, and a number of industrial sectors were boosted. It can be concluded that China used foreign investments as a catalyst for industrial growth.

In China, there are two separate regimes governing foreign investments: the foreign investment regime and the national security verification regime [7]. The main difference between these regimes is that the foreign investment regime is applied to all foreign activities without exception, while the second regime is applied only to those exclusive foreign activities that may pose a threat to China's national security.

In general, all foreign investments to China are covered by four categories: encouraged, allowed, restricted, and prohibited. The Chinese government uses a system of so-called “negative lists” to control foreign investments in restricted sectors, which are prohibited, while foreign investments in restricted sectors are allowed under certain restrictions (for example, foreign ownership limit). Foreign investors are encouraged to invest to encouraged industries listed in the “Catalogue of Encouraged Industries for Foreign Investment” [8]. This Catalogue and lists are updated annually by the Ministry of Commerce and the National Development and Reform Commission.
The main government bodies that review foreign investments include the Ministry of Finance, the National Development and Reform Commission (NDRC), and the State Administration for Market Regulation (SAMR). Previously, any foreign investments that were included in restricted sector category required approval from the Ministry of Finance before registering with SAMR or its local branches, which are China's Corporate Registry. Since the Law “On Foreign Investments” came into force on 1 January 2020, a preliminary permit from the Ministry of Finance and Investments is no longer required in any case [9]. It is important to note that perhaps the most notable event regarding foreign investment regime over the past year was that the US Treasury Department and the NDRC published the 2021 National Negative List, which came into force on 1 January 2022. It is aimed at further opening up the Chinese market and increasing its attractiveness to foreign investors. For example, according to 2020 version of the National Negative List, except for the special vehicles, new energy vehicles and commercial vehicles, foreign investors were not allowed to hold collectively more than 50% of shares in any automobile company, and a foreign investor was not allowed to invest in more than two automobile companies that produced similar types of vehicles. When analysing these facts, it becomes clear that China continues reducing its negative lists and opens up its domestic market to foreign investments, and the national security regime has started playing a more prominent role.

The Law “On Foreign Investments” contains a number of principles of market liberalization, which reflect the Chinese government wish to facilitate further market access and create equal conditions for foreign investors [9]. According to this law, foreign investments are given higher protection, such as increased protection of intellectual property rights and trade secrets of a foreign investor, as well as a more simplified and transparent regulatory regime. The latest “Negative Lists” have further removed access restrictions, and the last “Catalogue of Encouraged Industries for Foreign Investment” identifies more industries in which China welcomes foreign investments through the preferential treatment (for example, exemption from tariffs on machinery import for self-use). Foreign Investments Law and its regulations are the basic laws and regulations of the foreign investment regime in China. They establish the principles under which foreign investments in certain strategic or sensitive sectors are prohibited or restricted according to the Negative Lists, but national treatment is granted to other foreign investments. In addition, foreign investments may also comply with applicable industry regulations issued by the industry regulators. For example, the Banking and Insurance Regulatory Commission of China – the main regulator for banking and insurance sectors – has issued the rules for foreign investments in these sectors. Depending on transaction structure and other factors, there are additional rules and regulations that foreign investments may have to follow. For example, if the target company is listed...
on a Chinese stock exchange, the relevant Chinese securities laws and stock exchange regulations shall be applied. If the target company is a state-owned company, the rules governing the acquisition of state-owned assets shall come into force.

Foreign investors and enterprises with foreign investments that conduct investment activities in China should comply with Chinese laws and regulations. Offshore mergers and acquisitions made outside China (for example, an offshore acquisition of the enterprise with foreign investments by foreign shareholder) are not subject to China's foreign investment verification regime; however, if an offshore transaction results in changes in the reports submitted to the Ministry of Commerce or its local branches, these changes should be reported to the Ministry of Commerce [10].

Currently, there are three “Negative Lists”: (1) special administrative measures for foreign investments access; (2) special administrative measures for foreign investments access to the pilot free trade zones (negative FTZ list); and (3) special administrative measures for foreign investments access to Hainan free trade port [10]. These negative lists are the main sources that identify prohibited and restricted sectors for foreign investments and restrictions applied across the country, in all free trade zones and in Hainan free trade port, respectively.

In general, the number of sectors prohibited or restricted has been reduced, and restrictions have been liberalised over the years. In addition, the FTZ Negative List and Hainan Negative List, as local pilot measures, are less restrictive than the National Negative List, indicating China's intention to further reform the pilot free trade zones and open up its market. According to 2021 National Negative List (latest edition), foreign investors are prohibited from investing in 21 industries in 10 areas, ranging from agriculture to Information Technology and research. The most discussed prohibited industries include:

- online news information services, online publishing services;
- internal express mail services;
- editing, publishing and books, newspapers, periodicals, audiovisual recordings and electronic publications;
- compulsory education;
- social survey service;
- artistic and performing groups.

FTZ Negative List and Hainan Negative List contain fewer prohibited zones. For example, foreign investors are not prohibited from investing in artistic groups at FTZ and Hainan HTP (High-Tech Park).

So, now in the National Negative List for 2021 there are 10 restricted industries [10]. When investing in a limited sector, foreign investors usually have to
team up with Chinese partners and comply with certain requirements put forward by the Negative Lists (for example, requirements for the shareholding and nationality of the legal representatives). For example, in a Chinese state-owned air transport company, no foreign investor is allowed to own more than 25% of shares, and the controlling shareholder and legal representative should be Chinese. The same requirements shall be applied to prohibited sectors; the FTZ Negative List and Hainan Negative List have fewer restrictions on the sectors prohibited than the National Negative List.

Despite the recent currency control regime liberalisation, the inflow of investments, dividends repatriation and outflow of sales proceeds generated by foreign investors are still subject to various currency control requirements and should comply with established procedures.

However, despite some restrictions imposed by the state, China offers its potential foreign investors a wide range of favorable preferential policies to encourage them to invest to China, including tax benefits. Small and low-income foreign companies, high-tech and new technology companies are eligible for lower income tax rates. It is 20% for small and low-income companies, high-tech and new technology companies, while usual corporate income tax rate amounts to 25%. Companies or projects focused on technical development, environmental conservation or protection, energy saving, or water protection may be eligible for various income tax benefits. Income generated by foreign businesses through the stock gains, interest, retirement benefits, online work, and capital gains (net rental income and income from businesses in which the taxpayer is not significantly involved) from the sources in China previously had to pay a 20% withholding tax, which has been reduced to a preferential rate of 10% since then. In addition, if any foreign investor has established a company in one of China's five special economic zones, the company may be eligible for the following benefits [11]:

- lower corporate tax – 15%;
- “2+3 years” benefit shall mean exemption from tax for the first two years and tax at 12.5% rate for the next three years;
- for some projects in the field of basic infrastructure, environmental protection and energy, there are "3+3 years" tax holidays;
- under certain conditions, enterprises that invest in the integrated circuits and manufacture may be provided with “5+5 years” tax holidays.

China has two policies that seem to be contradictory: on the one hand, it constantly opens up its national industry to foreign investors, and on the other hand, it increases its foreign investments verification for the national security reasons. Limitations and restrictions set out in the Negative Lists are being reduced for the fifth consecutive year. There are also various local pilot programs to promote foreign investments. In general, the Chinese government can be expected to continue its policy of openness, and optimize its foreign investment environment.
In this context, it is also worth mentioning the “Made in China 2025” strategy, which came into force in January 2016. This is a strategic plan primarily aimed at reducing China's dependence on foreign technologies and promoting Chinese technology manufacturers in the global market. According to this strategy, it is planned to develop 10 key sectors, including [11]:

− new information technologies;
− automated machine tools and robotics;
− aerospace and aerotechnics;
− marine equipment and high-tech transportation;
− modern railway vehicles;
− energy saving and new energy equipment;
− electrical engineering equipment;
− agricultural machinery;
− new materials;
− biopharmacology and promising medicines.

By focusing on these developing industries, China is concentrating its development on these areas for growth, so that the country would have greater resilience and less interdependence on other countries.

To achieve the goals of initiative, the government encourages these technology and innovation sectors development, including clean energy, IT, and robotics. The government provides more support for the specialized goods production and invests in research and development. In addition, China provides subsidies and funds to state-owned enterprises to achieve these ambitious goals. Historically, part of the “Made in China 2025” plan included direct and indirect government support in high-tech production segments.

As for the national security regime, it has been in place for some time, but the government has only recently started launching additional investigations. However, it is not expected to be applied as actively as China's merger control rules at the moment. The 14th Five-Year Plan (2021-2025) indicates that Chinese government is focusing on a high-quality development rather than rapid growth and “high-quality, intelligent and environmentally friendly production” [11]. Foreign investments to these areas will continue to be welcomed, and China's national security rules are likely to be applied as a defensive measure, rather than overly intrusive to deter foreign capital. In light of this, the general expectation is that the national security verifications will become a more prominent part of China's foreign investment regulatory framework, given the pre-verification procedure cancellation for investments to the most sectors on the Negative Lists, and the shift in China's merger control regime to focus on actual competition issues in verifying transactions rather than national security or industrial policy issues. In addition, the rising wave of regulatory control by Western governments on incoming investments (especially
from China) is likely to encourage the Chinese government to adopt a similar approach in this regard [12].

**Conclusions.** Over the years, China's role and place in the global economic system has been growing and becoming stronger. In just a few decades, China has moved from “periphery to the center of the world economy”. China maintained stable growth in recent years, and is a popular investment destination. In 2021 alone, more than $300 billion was invested in the country. The main investor was Hong Kong, followed by Singapore, the Virgin Islands, Korea, Japan, the United States and other countries. It is known that China has traditionally developed production, so it is not surprising that the largest share of investments falls on this sector ($33.73 billion); other sectors that attract the largest amount of investments include real estate, leasing services, construction, financial mediation, etc.

Foreign direct investments to China are regulated by China's governing bodies applying two separate regimes — foreign investment regime and national security verification regime. In addition, China takes active steps to regulate investments. For this purpose, all foreign investments are divided into several categories, including encouraged, allowed, restricted and prohibited. So, China pays significant attention to the national security measures and, on the one hand, encourages investments to its economy, but on the other hand, restricts them by approving “Negative Lists” and introducing additional control restrictions. Tax cuts, better local policies, and openness to foreign investments are the key elements that the Chinese government uses to attract foreign expertise to the country. However, the “Chinese model” of growth offers very useful experience and lessons that other countries may implement in their policies.

Although it is still impossible to talk about complete openness of this country, it is worth noting that China became an active participant in the global economic market and relations, and has even become the largest investor in the global economy.

**References:**


