The Negative List in China—Causation, Content and Implication

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Abstract. This paper introduces current prevalent situation of the negative list in the field of international investment. It discusses that the Trans-Pacific Partnership Agreement and the China-U.S. bilateral investment treaty negotiation directly promote the reform of China's foreign investment regulation. The paper then explains the contents and development of three versions of the negative list in China (Shanghai) Pilot Free Trade Zone, and discusses its implications for foreign investors.

Introduction

The negative list management model has been a widely accepted regulation model for foreign investment. The multilateral negotiation within WTO framework has been impeded since the Doha Round due to the huge differences among member countries in aspects of the economic development, political system and ideology. Since states cannot reach agreement on investment liberalization within the existing WTO framework in a short time, they instead start FTA negotiations to achieve the investment liberalization agreement within the region. As of December 2015, 619 notifications of regional trade agreements (counting goods, services and accessions separately) had been received by the GATT/WTO. Of these, 413 were in force. [1]

The Promoting investment liberalization plays an important part of free trade agreements (FTA) and bilateral investment treaties (BIT). One of the major tasks in the process of investment liberalization is to simplify cumbersome approval process and to reduce abstract approval criteria in host countries, so as to decrease government involvement as much as possible and to eliminate unfairness caused by administrative measures. [2] The "negative list + pre-establishment national treatment" management model is the main trends in the field of investment. Since the NAFTA firstly adopted the negative list in foreign investment domain, the negative list model has been gradually accepted by more and more countries, especially developed ones. It could be expected that the general trend is that this model will be a dominant one in the field of foreign investment regulation.

Why Does China Need the Negative List?

Current Situation in China

A negative list, or black list, in international investment domain regulates areas that are off-limits or come with restrictions to investors. Any sectors not appearing on the list are open to foreign investors, and will receive pre-establishment national treatment. This means that, instead of applying for approval from government before setting up business, foreign investors will only need to inform authorities in the free trade zone

(FTZ). [3] Therefore, the negative list is an effective approach to increase foreign investors' freedom in cross-border investment.

Currently, the negative list model has not been adopted by China nationwide. The "positive list" mode is the dominant measure on foreign investment. Under this mode, examination and approval to foreign direct investment are required beforehand. The Catalogue of Industries for Guiding Foreign Investment is the guideline to divide foreign investment projects into encouraged, permitted, restricted and prohibited categories. At the same time, China is actively working on the transformation of its investment supervision mode, from prior examination to post supervision. Such transformation is consistent with the international trend, and directly driven by the Trans-Pacific Partnership (TPP) Agreement and the China-U.S. BIT negotiation.

The TPP Agreement

The TPP agreement negotiation, which started in the year of 2010, is widely considered as a substitute of WTO to restructure global economic order. Though contents of the negotiation are not open to the public, available public documents show that the negotiation involves the protection of foreign capital, intellectual property right protection, competition policies and strict environmental standards. [4] The date of October 5, 2015 witnessed successful completion of the negotiation. The next step is for each negotiating party to pass the agreement in their legislative branch respectively. Once this process is completed, there will be a highest-standard trade group taking about 40% of the world's economy.

China is not within and also not ready for the TPP Agreement at this moment. The high standard requirement on trade and investment regulations is one of the main obstacles. The Agreement requires its member countries to adopt "negative list + pre-establishment national treatment" management model for inbound foreign direct investment. Before joining the Agreement, China needs to modify current examination and approval system for foreign investment.

The China-U.S. BIT Negotiation

Another direct causation for introduction of the negative list is due to the BIT negotiation between the U.S. and China which was mandated by the China – U.S. Strategic Economic Dialogue in 2008. The China-U.S. BIT broke with China's traditional BIT model in respect of pre-establishment national treatment, and China has agreed to negotiate on the basis of "negative list."

China made the concession for two reasons. One is the insistence of the U.S. The other one is the established fact that the negative list model has been widely accepted by international community. Chinese overseas investment has been climbing rapidly since China's accession to the WTO. In 2014, foreign direct investment (FDI) inflows to China reached $129 billion, made it the largest FDI recipient in the world. FDI outflows from China grew by 15 per cent to reach a record-high USD 116 billion in the same year. [5] With the increase of activities in international investment field, China needs to establish negative list management model.

What Are the Contents of the Negative List in China?

The Establishment of the China (Shanghai) Pilot FTZ

The Negative list at present is a big challenge for China. As a developing country, China has not yet established a complete service sectors, and the legal system also need an in-depth development. China therefore needs to build a good protective system to support the service sectors of the economy. If not to do so, based on the basic meaning of the negative list, newly emerging service industries would face fierce competition from developed countries in the future due to the lack of reservations. The difficulty now lies in the fact that it is much more difficult to expect the would-be situation than to regulate existing phenomenon.

Consequently, Chinese central government enacted a notice to establish China (Shanghai) Pilot FTZ. [6] The FTZ would be used as a bridge connecting Chinese market and the outside markets. [7] It is for institutional reform, and innovation on the aspects of trade, investment and finance. The FTZ is also a test area for the negative list management model and a more convenient supervision of the foreign investment.

The Contents and Development of Negative List in China

Negative List 2013 Version. Up to now, the Shanghai pilot FTZ has published three versions of negative list. The first one is usually referred to as Negative List 2013 Version. It bases on the Catalogue for the Guidance of Foreign Investment Industries (Amended in 2011) (Catalogue 2011) to group the national economy into 18 main sectors. These sectors are subdivided into 1,069 subcategories. The list involves 190 special regulatory measures covering a wide range of activities out of the 1,069 subcategories. [8]

The Negative List 2013 version uses the "reserved industries + special management measures" framework. If the foreign investment belongs to reserved industries or needs special management measures, government approval is required. Otherwise, recording of the project will satisfy the requirement. The Negative List 2013 version is significant to indicate that China has taken its first step of reform to the deepwater area in investment field. However, the 2013 version Negative List almost completely refers to the Catalogue 2011 on restricted industries and prohibited industries. It is therefore to be considered as essentially a condensed version of the Catalogue 2011. [9]

Negative List 2014 Version. The 2014 version of Negative List further reduced from the old version of the 190 measures to 139. 14 measures are substantively cancelled as the result of further openness. [10] These canceled measures relate to a variety of industries such as manufacturing, real estate, infrastructure, commerce, shipping, social services, etc. Overall, the 2014 version more accords with the transparency and the characteristics of international standards.

An example of the transparency of Negative List 2014 Version is the provision description of R87 culture and art industry. The previous version only prescribes that "Investment in culture and art industry must comply with the relevant laws and regulations." There is no further explanation on "the relevant laws and regulation," which confuses investors. The 2014 Version deletes special regulatory measures in this aspect to eliminate the ambiguity. As to regulations with international standards, Version 2014 repealed the prohibition of investment in pornography industry and gambling industry from the negative list. The reason is that prohibition of investment in these two industries is also applied to domestic enterprises, so that it is not necessary to repeat the requirement in the negative list. [11]

Negative List 2015 Version. The general office of the State Council announced the "Special Administrative Measures (Negative List) on Foreign Investment Access to Pilot Free Trade Zones" (Negative List 2015) on April 20, 2015. This version is an important signal in at least two respects. First, the negative list management model in Shanghai FTZ has received initial success, and it is the right time to spread the experience to other regions. The China (Guangdong) Pilot FTZ, China (Fujian) Pilot FTZ, and China (Tianjin) Pilot FTZ are the ensuing areas where the negative list management model would be tested. Second, the Negative List 2015 version is introduced to further explore the negative list management model, to accelerate the pace of opening to outside, and to deepen the reform of foreign investment management system. By achieving these purposes, the central government intends to create a transparent and effective foreign investment access system, and an internationalized and institutionalized business environment in FTZs. These successful policies and mechanisms will be used in multilateral and bilateral investment treaty negotiations. [12]

Though the negative list experiment has achieved essential success in Shanghai FTZ, it still has a long way to go to be in line with international practice. The 2015 version of Negative list, comparing with the previous two editions, further reduces number of the protection measures and reserved industries. However, it is still a refurbished version of the Catalogue 2015, without substantial modification on provisional structure. More efforts are required to make China an ideal country for foreign investment, while at the same time to ensure the country's security and best interest.

What Does the Negative List in China Imply?

More Open Market, More Investor-Friendly Environment

The development of the Negative List indicates that there would be a more open Chinese market. Within the Negative List framework, foreign investment would be allowed in all industries and sectors, except as specifically carved out. This means that China has to "opt out" of protections, rather than "opt in." In addition, the Negative List and the pre-establishment national treatment are supporting measures. The latter would allow non-discriminatory access to domestic market at all stages and to protect pre-investment activities. Once the Negative List is spread nationwide, current examination and approval system for foreign investment would be replaced by record-filing system if the investment does not fall into the negative list. This will afford greater certainty for investments in various sectors.

Decentralization and Transformation of Government Role and Function

Current foreign investment examination and approval system is deficient in many ways. A good example is about the examination and approval agencies. Currently, foreign investment projects are subject to supervision of the National Development and Reform Commission, the Ministry of Commerce and the State Administration for Industry & Commerce. The multi-agency supervision inevitably brings overlap of power, waste of administrative resources, corruption and rent-seeking. The negative list management model would to some extend solve this problem, since the new model will decentralize the administrative examination and approval authority and change the role of government from the examiner to the administrator.

The Construction of Foreign Investment Law

Under the existing legal system, foreign investment is mainly subject to the Law of the PRC on Chinese-Foreign Equity Joint Ventures, the Law of the PRC on Chinese-Foreign Contractual Joint Ventures, and the Law of the PRC on Foreign Capital Enterprises. Besides these three laws, there are various legal documents related to foreign investment, e.g. the Antimonopoly Law, the Catalogue for the Guidance of Foreign Investment Industries, and the Provision on Merger and Acquisition of Domestic Enterprises by Foreign Investors. Foreign investors usually feel frustrated facing these innumerable laws and regulations. The experiment of negative list management model in FTZ and the publication of the draft of Foreign Investment Law for comments indicate that there will be a uniform Foreign Investment Law in China to give foreign investors a full and clear picture for dos and don’ts when investing in China.

Summary

The adoption of negative list and the reform of the foreign investment management model are required by the international common practices and the practical needs of China's economic development. So far, the application and development of the negative list in FTZs has made initial achievements. The government currently needs to think of following three questions to further proceed the reform: How to promote the experience to other places outside FTZs? How to entitle the government necessary policy-making powers in the field of foreign investment regulation? And how to consummate the foreign investment national security review mechanism to ensure the state’s safety and best interests after further opening up to foreign investment? At the present stage, it is for sure that foreign investors are enjoying institutional dividends brought by the negative list management model in FTZs, and this kind of bonus will spread all over the country in the future.

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