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An Analysis of the People's Republic of China's Foreign Investment Law and Foreign Direct Investment in Shanghai's Free Trade Zone

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AN ANALYSIS OF THE PEOPLE'S REPUBLIC OF CHINA'S FOREIGN INVESTMENT LAW AND FOREIGN DIRECT INVESTMENT IN SHANGHAI'S FREE TRADE ZONE

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I. INTRODUCTION

"A good traveler has no fixed plans, and is not intent on arriving."
– Lao Tzu

I hopped off the metro at the People's Square line two exit in Shanghai, People's Republic of China (PRC). I was eager to explore Shanghai since I would spend the next five weeks there studying Chinese Law. I strolled East on Nanjing Road and experimented with my taste buds by sampling the local cuisine, which included bullfrog and chrysanthemum tea. After my adventurous meal, I walked further down East Nanjing Road toward Shanghai's iconic Bund.[1] When I arrived at the Bund, I almost overlooked the historical concession era English and

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1. The Bund literally translates to "outer beach" and it is a mile-long series of European architecture buildings including neoclassical, Gothic, and baroque styles. The best way to experience the "museum of buildings" is to walk along the Zhongshan East 1st Road. Directly across from the Bund is the Hangpu River. http://www.chinahighlights.com/shanghai/attraction n/the-bund.htm.

French architecture that I was walking next to. Instead, my eyes fixated on colorful neon pops and sparkles of gigantic towers of light across the boat-bustling Huangpu River. I was looking at Shanghai's futuristic Lujiaziui Financial Center buildings located within a larger district called Pudong. Shanghai's Financial District skyscrapers looked like a cluster of quartz crystals jagging into the night sky with lustrous beauty. Among the skyscrapers that stood before me was the 128-story Shanghai Tower, which is the second tallest building in the world.[2] The Shanghai Tower stands more than 2,000 feet on ground that two decades ago was swamp and farmland.[3] The Shanghai Tower is a symbol of the Financial District's recent exponential economic development that has quickly made Shanghai a financial city rivaling London and New York City.[4]

Is it possible that the Chinese city of Shanghai will be the New York City of the 21st Century as the new financial capital of the world? I remember taking a selfie on the Bund overlooking Shanghai's Financial District next to a statue of a bronze charging bull that looks exactly like the Wall Street bull in New York City. I also remember how East Nanjing Road was a part of the city that seemed to have a life of its own, with inspiring vibrant lights from the flashing signs and advertisements above that looked similar to those in Times Square. At a certain point in the evening, the roads are blocked off leading into East Nanjing Road and the pedestrians walking around are as endless as the lights. Although Shanghai is an impressive city, there are many areas of the city that still need improvement. The subway system is overcrowded, but it is pleasingly efficient in how extensive the system covers the city and the brief wait time between subway trains. Shanghai's pollution is noticeable some days in the air quality. However, the pollution levels are not a health concern and during the rainy summer months after a fresh rainfall, the city and the air are noticeably cleaner.

Indeed, Shanghai's Lujiazui Financial Center, located within the Pudong District, resembles a razzle-dazzle futuristic city on the rise to become the new financial capital of the world. However, many restrictions and slow reforms by the PRC's governmental decisions initially prevented the growth of Shanghai's Financial Center. Subsequently, the Chinese government began establishing further liberal economic reforms that ignited the spark Shanghai needed to build its

2. Dave Tacon, *Shanghai: The City That Changes the Way You See the Future*, CNN (NOV. 11, 2015 8:33PM), http://www.cnn.com/2015/11/11/travel/shanghai-future-trip-that-changed-my-life/.

3. *Id.*

4. Angus Grigg, *Shanghai Seeks to Rival London, New York, as One of the World's Best Cities*, FIN. REV. (Dec. 19, 2015, 12:15 AM), http://www.afr.com/lifestyle/shanghai-seeks-to-rival-london-new-york-as-one-of-the-worlds-best-cities-20151216-gloqmu.

Financial Center.[5] However, despite improvements in economic reform, Shanghai's Financial Center is still restricted by PRC laws and policies that inhibit the growth that it needs to become the world's leading financial center. Furthermore, improved reforms of current Chinese laws governing the Financial Center and new policies should be considered and implemented in order for Shanghai's Financial Center to compete on a global economic scale and reach its maximum potential.

This Article will explain how the megacity of Shanghai, China is currently developed and ever progressing, which is key to attracting foreign investors and continuing to build a world leading financial center. Additionally, this article will revisit the setbacks China experienced under rule by Mao Zedong and Deng Xiaoping. This article will then fast forward in time to present day China and Shanghai to describe the initial open door reforms that created specialized "zones," which was a petri dish for China to experiment with foreign investment. The largest section of this article will cover China foreign investment law and its progression over time. The first sub-section will cover the initial three vehicles of Chinese foreign investment law. The second and third sub-sections will cover the specialized foreign investment laws governing Shanghai's special economic zone. Finally, the last sections of this Article will suggest further reforms to foreign investment law and policy changes that if implemented by the PRC could immediately impact and create advantages for further foreign investment in Shanghai's special economic zone.

II. SHANGHAI'S ANATOMY

> "All states in the world, large or small, are cities of Heaven, and all the people, young or old, honourable or humble, are its subjects . . ." – Mo Tzu

The city of Shanghai is divided into two districts by a river. The Financial District in Shanghai is located in Pudong.[6] Pudong is separated by the Huangpu River from Puxi.[7] Pudong is on the East bank and Puxi is on the West bank of the river.[8] Puxi is most famous for the Bund, which

5. Major Chinese economic reforms paved the way for Shanghai's Free Trade Zone include: Reform of Chinese state owned enterprises, creation of the Shanghai stock market, the reform of Commercial Bank Law and Foreign Trade, free economic zone experimentation, and Chinas membership in the World Trade Organization. Gregory C. Chow, *Economic Reform and Growth in China*, ANNALS ECON. & FIN. 5, 127-52 (2004).

6. ALEXANDRA KHOO, LIVING IN SHANGHAI 1-2 (2013).

7. *Id.*

8. *Id.*

is home to multi-influenced European style buildings.[9] Together, Pudong and Puxi make up the megalopolis that is Shanghai. Shanghai's 2014 population reached more than 24 million inhabitants.[10] Shanghainese registered residents accounted for 14.29 million of the population and 9.96 million more lived in the city for at least six months.[11] By the end of 2020, the Shanghai population is expected to be 26.5 million.[12]

As the population rose in Shanghai, so did the city's infrastructure and attractions. One-third of the worlds cranes helped pave the way to build the largest subway system in the world today in Shanghai.[13] By early 2016, Shanghai will have a Disneyland park located in the Pudong area.[14] In 2010, Shanghai hosted and constructed the World Expo Park in the Pudong area, which covers more than 3.93 square kilometers.[15] Several financial institutions located in Pudong's Lujiazui District include HSBC, Citibank, Bank of East Asia, and Standard Chartered Bank.[16] Similarly, Puxi has its own buffet of attractions. The People's Square, which is at the same metro exit mentioned earlier and is known as "Green Lung of Shanghai," is a massive garden square in downtown.[17] Across the People's Square are the Shanghai Museum, which has free entry, and the Shanghai Urban Planning Exhibition Hall.[18] Close by is the Yu Garden, a beautiful 400-year-old garden dating back to the Ming dynasty.[19] The Yu garden is a popular shopping site and abundant in famous Chinese snacks.[20] The Bund, located along the Huangpu River is Shanghai's most famous attraction.[21] The Bund is a symbol of Shanghai's past and the city's willingness to absorb foreign cultures.[22] The Nanjing Road Pedestrian Street is a 1,200-meter strip that is a bustling metropolitan-style shopping scene.[23]

Pudong's Lujiazui District has undergone an amazing transformation that has taken place over a couple of decades to transform it from flat rice fields into stratospheric skyscrapers. The local saying by the

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9. *Id.*

10. Du Qiongfang, *Shanghai May Not be Able to Suppress its Growing Population*, GLOBAL TIMES (Dec. 28, 2015), http://www.globaltimes.cn/content/960911.shtml.

11. *Id.*

12. *Id.*

13. Grigg, *supra* note 4.

14. *Id.*

15. *Popular Attractions*, OFFICIAL SHANGHAI CHINA TRAVEL WEBSITE, http://www.meet-in-shanghai.net/highlights/tourist-attraction/hot-attractions.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

Shanghainese used to be that "a bed in Puxi was better than a house in Pudong."[24] The saying was an attestment to how disparaged the Shanghainese viewed an entire half of their city located in Pudong. However, the old local saying is obsolete today since Pudong has transformed itself into the financial pride of the PRC. As much as Shanghai, and in particular Pudong has developed, there are many suggestions and observations to improve the success and development of Pudong that will be described in this Article.

III. BACKFIRE IN CHINA

"To read too many books is harmful." – Mao Zedong

The PRC was formally organized in October 1949.[25] Mao Zedong of the Chinese Communist Party (CCP) ruled the PRC unitarily.[26] Under Zedong, the PRC operated under a socialist market economy.[27] The PRC's socialist market economy created many trade barriers that inhibited economic growth.[28] From 1949 to 1978, the PRC was self-sufficient in its trade and commerce sectors.[29] Also, Foreign Direct Investment (FDI) was virtually non-existent throughout Zedong's supremacy.[30]

In addition to unstable economic policies, Zedong implemented a series of ideology campaigns that backfired the PRC's progress.[31] Mao [Zedong] executed the Anti-Rightist Campaign which began in 1957-58 and ended when Mao [Zedong] died in 1976.[32] The Anti-Rightist Campaign was a period of social and political bedlam against the nation [critics of the Communist Party] that often lead to death.[33] Mao [Zedong] also launched the Great Leap Forward from 1958-60, which led directly to famine that killed 20 to 30 million Chinese people.[34] The Great Leap

24. ZISHENG SHAO, THE NEW URBAN AREA DEVELOPMENT: A CASE STUDY IN CHINA 182 (2015).

25. DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA IN A NUTSHELL 14 (2d ed. 2003).

26. Kaitlyn Johnson, *Variable Interest Entities: Alibaba's Regulatory Work-Around to China's Foreign Investment Restrictions*, 12 LOY. U. CHI. INT'L L. REV. 249, 251 (2015).

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. Chow, *supra* note 25, at 16.

32. *Id.* at 15.

33. *Id.* at 17.

34. *Id.* at 16.

Forward required families to melt their farming items in backyard furnaces to make steel.[35] The steel production aimed at building roads and factories proved to be impractical, led to insufficient crop production, and caused mass starvation.[36] Additionally, Mao [Zedong] ordered the Cultural Revolution political terror campaign, which lasted from 1966-76.[37] The Cultural Revolution affected over 100 million people, victimized 1 million people, and cost more than 400,000 lives.[38] Mao [Zedong] mobilized millions of Chinese teenagers, the Red Guards, who would break into homes, destroy, beat, and sometimes kill their victims.[39] Mao [Zedong] believed the violence was necessary to promote the revolution in support of his rule under the communist party.[40]

The Chinese legal system was nonexistent during the Cultural Revolution.[41] However, the Chinese legal system revived as a result of economic reforms by Zedong's successor Deng Xiaoping.[42] In 1978, Xiaoping initiated the Open-Door Policy of economic reform.[43] During Zedong's rule, all property was owned by the state and the state profited from industrial and agricultural enterprises.[44] Zedong controlled the industrial economy through state-owned enterprises (SOE).[45] However, in 1978, Xiaoping shifted the economy to implement development of free markets and limited private enterprises.[46] Currently, the PRC's economic reforms have loosened state control over the economy; however, the PRC still uses state-sponsored economic plans and control.[47] By 1994, SOEs accounted for only 38% of PRC's industrial output.[48] SOEs continue to control the banking, telecommunications, oil, electricity, water, and steel production segments of the economy.[49] Today, the PRC is operating under a socialist market economy.[50] The PRC economy is based upon liberal capitalism; however, socialism is the dominating political element affecting the economy regarding private ownership and certain sectors controlled by the state.[51]

35. *Id.*
36. *Id.* at 16-17.
37. *Id.* at 17.
38. *Id.*
39. *Id.* at 17-18.
40. *Id.* at 18.
41. *Id.* at 21.
42. *Id.*
43. Johnson, *supra* note 26, at 252 (footnote omitted).
44. Chow, *supra* note 25, at 21.
45. *Id.* at 23.
46. *Id.* at 27.
47. *Id.* at 22.
48. *Id.* at 24.
49. *Id.* at 25.
50. *Id.* at 28.
51. *Id.*

After 1978, the PRC experienced substantial economic growth. In 2007, the PRC had the fourth largest economy in the world in GDP, only trailing the United States, Japan, and Germany.[52] Foreign investment into the PRC has played a significant role in developing China's economy. Since 1992, the PRC is second only to the United States in receiving foreign capital.[53] In 2005, China received $69 billion in foreign investment capital.[54] In a dramatic fashion, despite China's history of self-inflicted development, modern day China is driven towards economic development.

IV. SHANGHAI'S ROAD TO ECONOMIC REFORM

"Share your knowledge. It is a way to achieve immortality."
– Dali Lama XIV

The economic reform began in the PRC during the late 1970s.[55] At the head of the reforms was the creation of five special economic zones (SEZs).[56] The SEZs and coastal cities are located along the East coast of the PRC.[57] The SEZs have special laws, different from the rest of China, designed to appeal foreign investment.[58] For example, under the SEZs, enterprise ownership may be non-state owned through foreign equity joint ventures, foreign contractual joint ventures, and exclusively foreign owned enterprises.[59] Another example, under SEZ laws, the central government in Beijing gives foreign enterprises more autonomy in operation and management.[60] Foreign enterprises shaped under SEZs are formed quicker and simpler as a result of SEZ laws when compared to laws governing mainland China.[61]

Evolving from the SEZs are the Free Trade Zones (FTZs), which focus on financial reforms.[62] Shanghai's Pudong Financial District is a Pilot Free Trade Zone.[63] The Chinese State Counsel on April 18, 1990

52. *Id.* at 33.

53. *Id.* at 34.

54. *Id.*

55. Bin Xue Sang, *Pudong: Another Special Economic Zone in China? – An Analysis of the Special Regulations and Policy for Shanghai's Pudong New Area*, 14 NW. J. INT'L L. & BUS. 130, 130 (FALL 1993).

56. *Id.* (footnote omitted).

57. *Id.*

58. *Id.* at 132.

59. *Id.*

60. *Id.* at 133 (footnote omitted).

61. *Id.*

62. Shen Wei, *"A Tale of Three Zones" – Promises and Pitfalls of Three Financial Experimental Zones in China*, 131 BANKING L.J. 397, 410 (2014).

63. *Id.*

opened Pudong to foreign investment.[64] Banks and financial organizations led the way. In the first year, the local Shanghai government approved twenty branches of foreign and domestic banks in Pudong.[65] By 1992, $770 million worth of investments and 157 capital enterprises were approved.[66] By 1994, Shanghai had contractual foreign investments of $10 billion, which surpassed other popular rival Chinese FTZ cities such as Guangzhou and Shenzhen.[67] The Shanghai Foreign Investment Commission initially compiled statistics according to surveys completed by firms in the Pudong area that started their operations during 1992-1994.[68] The first statistic involves motivating factors for investing in Pudong. The top five motivating factors for overseas investors in terms of answer frequency included: (1) huge market potential in China, (2) lower wage levels of Shanghai workers, (3) high technical skills, (4) high technological capabilities, and (5) low recoupment period of investment.[69] Accordingly, an initial key of foreign investment was Pudong's location and low wage prospects. Shanghai is centrally located at the mouth of the Yangzi River, which runs from Shanghai across Eastern China (and intersects with Shanghai's Huangpu River).[70] Furthermore, wages are lower for Shanghainese workers than workers in the rival FTZ cities of Guangzhou and Shenzhen in Southern China.[71] In fact, Shanghai workers were cheaper to pay than other cities competing for FDI; for example, as Hong Kong, Japan, and Taiwan.[72] Additionally, in 1995, an average worker in Hong Kong could earn ten times more per month in wages compared to wages workers earned from foreign investors in Pudong.[73]

Furthermore, foreign investment in Shanghai banks surged. During 2001-03, seven major foreign corporations bought equity in Chinese banks.[74] In 2003, the largest acquisition was Citigroup's investment in the Shanghai Pudong Development Bank.[75] Citigroup invested $72 million and acquired a 5% ownership interest with options to increase

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64. Sang, *supra* note 55, at 136.
65. *Id.* at 137.
66. *Id.*
67. Y.M. YEUNG & SUNG YUN-WING, THE CHINESE UNIVERSITY PRESS, SHANGHAI: TRANSFORMATION AND MODERNIZATION UNDER CHINA'S OPEN DOOR POLICY 251 (1996).
68. *Id.* at 253-54.
69. *Id.* at 256.
70. *Id.*
71. *Id.*
72. *Id.*
73. *Id.*
74. Jack E. Jirak, *Equity Investment in Chinese Banks: A Doorway into China's Banking Sector*, N.C. BANKING INST. 330, 345 (2006).
75. *Id.*

investments in the future.[76] Citigroup's investment in Pudong led to Chinese banks learning from the foreign banks. In 2004, Shanghai Pudong Development Bank and Citibank jointly issued Visa cards, which were the first credit cards at the time that settled in both local and U.S. currency.[77] By 2005, Citigroup exercised its option to increase its stake in the Shanghai Pudong Development Bank to 19.9%.[78]

Furthermore, another initial player of FDI in Pudong's finance sector was Bank of America. In 2005, Bank of America invested $2.5 billion in the China Construction Bank and received a 9% stake in the bank.[79] Also, Bank of America created a plan to send 50 managers to teach basic banking tools and methodologies to China Construction Bank managers.[80] The managers of Bank of America would train Chinese bankers in skill sets such as drafting loans compared to their risk levels and accepted American practices of due diligence.[81] In effect, new American banking concepts were learned in the Chinese banking sector.[82] As a result, Chinese banking services improved and modernized with the help of FDI in Pudong's financial sectors.

However, Pudong was not formally announced a FTZ until September 29, 2013, by the 18th Central Committee of the Chinese Communist Party.[83] In 2013, Pudong was regulated by preferential policies and laws substantially more liberal than those of the SEZs.[84] On its outset, China regulated FDI inside Shanghai's FTZ with a negative list approach (negative list). The 2013, negative list identified sectors of China's economy in Shanghai's Pudong area that would be restricted to foreign investment.[85] Many foreign companies were disappointed with the restrictions imposed on opportunities for FDI in Pudong.[86] Chinese officials recognized the disappointment, but firmly believed that the restrictions were necessary as China gradually opened its doors to FDI, and revisions to the negative list were implemented.[87] It followed that the foreign business community had bittersweet feelings in 2013, as

76. *Id.*
77. *Id.* at 348-49.
78. *Id.* at 346.
79. *Id.* at 345-46.
80. *Id.* at 351.
81. *Id.*
82. *Id.*
83. Lutz-Christian Wolff, *Chinese Outbound Investments in the Food Sector: Hungry for Much More!*, 69 FOOD & DRUG L.J. 399, 413 (2014).
84. Sang, *supra* note 55, at 136.
85. Matthew Margulies, *Changes to Shanghai FTZ Negative List Fall Short of Expectations*, U.S.-CHINA BUSINESS COUNCIL, https://www.uschina.org/changes-shanghai-ftz-negative-list-fall-short-expectations.
86. *Id.*
87. *Id.*

Shanghai's Pudong FTZ initially opened to foreign investment. The benefits were that Shanghai became an outlet to invest in the PRC and access mainland China's economy; however, the disadvantages were that several investment barriers and market options were still severely limited.[88]

In 2013, the negative list included 190 restrictions.[89] In 2014, the negative list governing FDI in Pudong was revised.[90] The 2014 negative list included 139 restrictions.[91] However, the reduction of foreign investment restrictions in 2014 was skewed because one-third of the reductions were re-classified rather than there being actual restriction reductions.[92] For example, in 2013 the "legal services" category included two restrictions, but the 2014 negative list combines these two restrictions into one.[93] The 2014 negative list of legal services kept many of the same restrictions, but made the list shorter on its face.[94] However, 28 negative list sectors, previously restricted from FDI in the 2013 negative list, were removed outright.[95] The new sectors of Shanghai's economy open for FDI in 2014 included: (1) investment in companies engaged in certification services for imported and exported goods, (2) production of over twenty pharmaceutical drugs and vitamins, (3) investment in land development, (4) production of all types of ordinary level bearings and parts, (5) production of wheeled or crawler cranes, and (6) development and application of new technologies to improve oil recovery.[96] Additionally, the 2013 negative list was revised in 2014 and it altered the restrictions on FDI in Pudong.[97] For example, the 2013 negative list required the applicants of foreign direct investment in China to have a minimum of 50% Chinese ownership in motorcycle manufacturing, while the 2014 negative list reduced the restriction by requiring a minimum of 50% Chinese ownership in manufacturing motorcycles with engine displacement greater than 250 milliliters.[98] In 2013 foreign companies involved in direct investment could not sell wholesale or distribute tobacco, sugar, or vegetable oil. Conversely, in 2014 foreign companies could not invest in wholesale or distribution of sugar and vegetable oil as prohibited items.[99]

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88. *Id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*

After 2013, FDI in Shanghai's Pudong area grew exponentially. According to the Shanghai Commerce Commission, in 2015 Shanghai's FDI grew to $18.459 billion, which was a 1.6% increase from 2014.[100] The financial service industry in Shanghai alone, saw an increase of FDI of more than 70%.[101] In 2015, 15 new investment companies opened in Shanghai.[102] Also in 2015, 45 multinational corporations (MNCs) established regional headquarters in Shanghai.[103] By the end of 2015, the new MNC regional headquarters in Shanghai totaled 535, which put Shanghai at the top among mainland China city with the most regional headquarters of multi-national companies.[104] Most notably, in 2015, contracted foreign investment in Shanghai rose to $58.9 billion, an 86% increase from 2014.[105]

Attributing to Shanghai's economic reform is the deregulation of the PRC's firm grasp on foreign investment. In 2015, the negative list only included 122 sectors of the economy, down from the 190 prohibited sectors included in the 2013 negative list.[106] As of 2015, there were 37 service industries and 17 manufacturing industries that were permitted in Pudong's FTZ, but not permitted for FDI in other parts of mainland China.[107] Chairman of Shanghai's FTZ administrative committee, Shen Xiaoming, believes that the best attractions come from Pudong's administrative reform and from cutting red tape for industries such as customs, logistics, shipping, and professional services.[108]

Therefore, Shanghai's increase in FDI after 2013 is credited to the gradual elimination and relaxation of investment restrictions on foreign companies. The elimination and relaxation of investment restrictions on foreign companies will be discussed more in depth in a later Part.

V. CHINESE FOREIGN INVESTMENT LAW

"I hear and I forget. I see and I remember. I do and I understand."

100. Shanghai Municipal People's Government, *FDI Continue to Rise in Shanghai Last Year* (Jan. 6, 2016), http://www.shanghai.gov.cn/shanghai/node27118/node27818/u22ai81769.html.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. Gabriel Wildau, *Shanghai Free-Trade Zone Struggles for Relevance*, ASIA-PACIFIC ECONOMY (Sept. 27, 2015, 4:39AM), http://www.ft.com/cms/s/0/8cec0faa-6364-11e5-9846-de406ccb37f2.html.

107. *Id.*

108. *Id.*

– Confucius

Investment in modern times has been defined as "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."[109] Chinese FDI law has played a vital role in China's transformation to the economic powerhouse it is today.[110] Additionally, Chinese FDI law is considered a national priority to support China's economic progress.[111] There are two parts to China's FDI history, both of which are discussed in this article. The first part includes a long standing Foreign Investment Law framework that includes three different types of FDI business vehicles available for foreign investment.[112] The three different FDI business types usually include: (1) the Equity Joint Venture, (2) the Contractual Joint Venture, and (3) the Wholly Foreign Owned Enterprise.[113] Notably, the Catalogue for the Guidance of Foreign Investment (Catalogue) has a symbiotic relationship to the three FDI models, and acts as a guide for foreign investors.[114] The Catalogue, which was created by the Ministry of Commerce (MOFCOM), became effective Chinese law on April 10, 2015.[115]

On a different and important note, the second part of this section discusses China's substantially new Draft Foreign Investment Law (Draft Law). On January 19, 2015, the PRC's MOFCOM released a draft version (Draft Law) of the new Foreign Investment Law that will apply to the entire PRC.[116] Once the draft is passed into law, it will replace the long standing Sino-Foreign Equity Joint Venture Law, the Wholly Foreign-Owned Enterprise Law, and the Sino-Foreign Contractual Joint Venture Law described in the paragraph above.[117] In contrast from the

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109. Jordan Brandt, *Comparing Foreign Investment in China, Post-WTO Accession, with Foreign Investment in the United States, Post 9/11*, 16 PAC. RIM L. & POL'Y J. 285, 286 (2007).

110. Chow, *supra* note 25, at 373.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Foreign Investment Law Update Mar. to Jun. 2015 China Bulletin*, ISHIMARU & ASSOCIATES LLP (JUNE 16, 2015), http://www.ishimarulaw.com/i/. *Foreign Investment Law Update Mar. to Jun. 2015 China Bulletin*, MARSON LAW (JUNE 16, 2015), http://marsonlaw.com/?p=369.

115. Jan Bogaert, *China's new Foreign Investment Guidance Catalogue Enters into Force Today*, LEXOLOGY (APR. 10 2015), http://www.lexology.com/library/detail.aspx?g=41a5237f-9ec7-4706-bb6b-f8c0f1fe30a0.

116. Rocky T. Lee, *China's New Foreign Investment Law: Implications for Restricted Industry Investments in China*, MARTINDALE.COM (Mar. 26, 2015), http://www.martindale.com/corporate-law/article_Cadwalader-Wickersham-Taft-LLP_2198046.htm.

117. Dezan Shira & Associates, *China Releases Draft Foreign Investment Law, Signaling Major Overhaul for Foreign Investment*, CHINA BRIEFING (JAN. 21, 2015), http://www.china-briefing.com/news/2015/01/21/breaking-news-china-releases-draft-foreign-investment-law-signaling-major-overhaul-foreign-investment.html.

three-part vehicle model Foreign Investment Law, the Draft Law "intends to consolidate the existing laws regulating foreign investments into one uniform statutory regime and unify the corporate legal requirements for both foreign and domestic investments in China."[118]

Several Chinese FDI laws have promoted, while not exploiting, the maximum economic potential to further Pudong's economic development. It is important to keep in mind that sub-parts A and B describe the longstanding Foreign Investment Law and 2015 Catalogue. Once the Draft Law is passed, the Foreign Investment Law and the 2015 Catalogue are supposed to be eliminated and replaced, respectively. Thereafter, sub-part C goes into detail of the Draft Law and how it is expected to be implemented. Although, the new Foreign Investment Law is still in draft form, there are many predictable changes from the draft that will significantly transform foreign investment law in China.

A. *Vehicles of Foreign Investment Law*

A joint venture is formed "by a combination of two or more business entities into a third party."[119] In China, a foreign investor company and a PRC company form a joint venture company, which then becomes a PRC company.[120] In the PRC, there are two types of joint ventures: the equity joint venture and the contractual joint venture.[121] Equity joint ventures are governed by the Equity Joint Venture Law and the Equity Joint Venture Law Implementing Regulations.[122] Similarly, contractual joint ventures are governed by the Contractual Joint Venture Law and the Contractual Joint Venture Law Implementing Rules.[123] The difference between the two is that the "equity joint venture is more structured by law and the contractual joint venture is more flexible."[124] The flexibility of the contractual joint venture is demonstrated by the fact that, unlike the equity joint venture, the contractual joint venture is not required to distribute its profits in proportion to the capital contributions of each joint venture partner.[125] However, foreign investors generally favor the equity joint venture because its model yields a more predictable form of

118. Christopher W. Betts, Will H. Cai, Z. Julie Gao, & Gregory G.H. Miao, *"China's MOFCOM Aims to Fundamentally Change the Legal Landscape on Foreign Investments,"* SKADDEN, ARPS, SLATE, MEAGHER, & FLOM LLP (FEB. 2015), https://www.skadden.com/insights/chinas-mofcom-aims-to-fundamentally-change-the-legal-landscape-on-foreign-investments.

119. Chow, *supra* note 25, at 375.

120. *Id.*

121. *Id.* at 376.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* at 377.

business.[126] All joint ventures must go through a multi-step approval process done by the PRC governmental authorities.[127] The Chinese governmental authorities have sole discretion in the application process and may reject applications to set up a joint venture.[128] The Foreign Investment Industrial Guidance Catalog lists the industries where foreign investment is restricted.[129] Industries prohibited to foreign investment (which will be discussed in more detail later) include (but are not limited to) agriculture, forestry, fishery, mining, coal, gas, firearms, ammunition, production and supply of electric power, water, education, motion pictures, and broadcasting.[130]

The wholly foreign-owned enterprise (WFOE) is a business vehicle where a foreign investor has whole ownership of the business enterprise and may operate the business without restraints from other Chinese partners.[131] The Wholly Foreign-Owned Enterprise Law, which was last amended in 2000, and the Wholly Foreign-Owned Enterprise Implementing Rules, last revised in 2001, govern WFOEs.[132] The WFOE has become the business model of choice for FDI in recent years.[133] In 1997, WFOEs increased by 26.5% from the previous year.[134] Also, in 1997, WFOEs surpassed the number of equity joint ventures approved by the Chinese government in the same year.[135] By 2007, WFOEs exceeded the number of joint ventures.[136] An advantage of the 2001 revision of the WFOE Rules included abolishing technology and export requirements that previously mandated that WFOEs use advanced technology or export a minimum of 50% of their products each year.[137] The revised 2001 WFOE Rules only require that the WFOEs benefit the Chinese national economy.[138] Unlike in joint ventures where Chinese partners may assist in the application process, a foreign investor gets no help from local Chinese partners when applying to establish a WFOE.[139] Lastly, as a safety net in the application process, foreign investors typically hire PRC law firms or use their own legal departments in applying to become a

126. *Id.*
127. *Id.* at 378.
128. *Id.*
129. *Id.* at 380.
130. *Id.*
131. *Id.* at 394.
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.* at 395.
138. *Id.*
139. *Id.* at 396.

WFOE.[140]

B. *China's Guide to Foreign Investment Law*

On March 13, 2015, the PRC's MOFCOM released the sixth version of the Foreign Direct Investment Industries Guidance Catalogue.[141] The Catalogue went into effect April 10, 2015.[142] The Catalogue is the method by which the PRC regulates the influx of FDI across a wide range of Chinese industries.[143] Also, it is used as a guide for foreign investors to determine what their business projects will be categorized as.[144] The 2015 Catalogue lists three categories that Chinese industries fall under based on their openness to FDI. [145] The three categories are: (1) encouraged, (2) restricted, and (3) prohibited.[146] Under the encouraged industries category, "foreign companies that invest in encouraged industries may receive preferential terms," which include discounted land prices and tax rates.[147] When dealing with restricted industries, foreign companies can expect to be "subject to extra steps in the approval process or restrictions on their operations."[148] Foreign investors need to be wary of the prohibited category of industries since "foreign companies are not permitted to invest in industries listed in the prohibited category."[149] The 2015 Catalogue improved the 2011 version by reducing the number of restricted industries from 79 to 38 and the number of prohibited industries from 38 to 36.[150] Also, the 2015 Catalogue boasts a total of 349 encouraged industries for FDI.[151]

The 2015 Investment Catalogue illustrates the demanding market expectations to liberalize and facilitate foreign investments into China

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140. *Id.* at 397.

141. Xu Ping & Wang Rongkang, *China Plans Sweeping Foreign Investment Reforms*, KING & WOOD MALLESONS (Apr. 24, 2015), http://www.kwm.com/en/us/knowledge/insights/china-plans-sweeping-foreign-investment-reforms-20150414.

142. *Id.*

143. *Id.*

144. Brinton Scott & Matthew Durham, *China Proposes a New Foreign Investment Law: Does this Represent the Death of the VIE Structure?*, LINKEDIN SLIDESHARE (Mar. 20, 2015), http://www.slideshare.net/WinstonStrawn/china-proposes-a-new-foreign-investment-law-does-this-represent-the-death-of-the-vie-structure.

145. *Id.*

146. *Id.*

147. *Finalized Catalogue Guiding Foreign Investment in Industry Falls Short*, THE US-CHINA BUSINESS COUNCIL (Mar. 18, 2015), https://www.uschina.org/finalized-catalogue-guiding-foreign-investment-industry-falls-short.

148. *Id.*

149. *Id.*

150. Bogaert, *supra* note 115.

151. *Id.*

with Shanghai's FTZ as the PRC's leading model.[152] Although with a slow start, Shanghai's FTZ in Pudong has led the way for FDI. For example, in 2013 when Shanghai's Pudong District was formally established as a FTZ, the FTZ was regulated by a hefty "negative list" approach.[153] Industries under the negative list could not enjoy national treatment in the same way Chinese investors could.[154] Accordingly, the negative list deterred initial foreign investment from its inception.[155] However, the most recent negative list, which became effective on May 8, 2015, has improved Pudong's potential for FDI because less restrictions mean everything not restricted will receive equal treatment as Chinese companies.[156] For instance, many rules have been lifted in the mining and exploitation of China's natural resources.[157] Oil and gas deposits are allowed to be explored and developed as long as the foreign enterprise forms a contractual or equity joint venture.[158] Regarding manufacturing, processing of rice, corn, alcohol, tobacco, and chemicals is permissible.[159] Further lifted restrictions also include those on manufacturing of construction vehicles and motorcycles.[160]

However, it is important to note that many restrictions are still prohibited for foreign investors and are subject to a Foreign Investment National Security Review.[161] The most important feature the restricted category affects to the Financial District in Pudong is the finance sector regarding FDI in banks. Restricted financial requirements still mandate that a foreign investor in a fully Chinese-owned bank must be a financial institution.[162] Additionally, the main foreign capital contributor into a consumer finance company must be a financial institution as well.[163] Foreign banks operating in a FTZ shall not act as an agent to issue government bonds, issue bank cards, nor act as an agent for receipt and payment of funds.[164] Regarding professional services, they still contain

152. Ping, *supra* note 141.

153. Lynn Yang, *New 2014 Negative list reduces restrictions for foreign investment in the Shanghai Free Trade Zone*, NORTON ROSE FULBRIGHT (July 2014), http://www.nortonrosefulbright.com/knowledge/publications/118112/new-2014-negative-list-reduces-restrictions-for-foreign-investment-in-the-shanghai-free-trade-zone.

154. *Id.*

155. *Id.*

156. Dezan Shira & Associates, *The New Free Trade Zones Explained, Part II: The Negative List*, CHINA BRIEFING (Apr. 30, 2015), http://www.china-briefing.com/news/2015/04/30/new-free-trade-zones-explained-part-ii-negative-list.html.

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

restrictions. In the accounting sector, the main partner of an accounting firm must be Chinese, credit rating services remain under the restricted category, and investment in social surveys and polling remain a prohibited category.[165] Perhaps the most thought-provoking of them all are the restrictions regarding the internet. In the mainland PRC or the Pudong FTZ, it is forbidden for a foreign investor or foreign established business to operate news websites and to broadcast information on the internet.[166] A Chinese entity that works together with a foreign entity to produce online news is subject to a National Security Review.[167] An exception to the ban on FDI online commerce are sectors provided from China's membership in the World Trade Organization (WTO), such as music.[168] Other service industry restrictions mandate that foreign law firms may only be established in a FTZ through a representative office in the FTZ, and subject to approval.[169] Foreign nationals shall not become partners of a Chinese law firm.[170] Also, a foreign entity seeking to establish an educational institution must have a Chinese party as a partner and may not educate in the areas of religion, military, politics, or political parties.[171] Another last important point of the 2015 "negative list" is that it expanded to apply to all of China's four FTZ's, which now include Shanghai, Tianjin, Guangdong, and Fujian.[172]

C. *New Foreign Investment Law Framework*

Despite the great advances coupled with restrictions in the 2015 Catalogue, it is expected to be replaced. Responsible for the replacement will be the Foreign Investment Draft Law (Draft Law).[173] The Draft Law's version of the "negative list" will be called the Catalogue of Special Management Measures List.[174] The Draft Law aims "to grant national treatment to all foreign investment, except that which falls under the 'Special Administrative Measure List' ('Negative List')."'[175] Accordingly, the Draft Law's version of the "negative list" is set to create

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165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *China Publishes 2015 Negative List for FTZs*, PRACTICAL LAW (Apr. 28, 2015), http://us.practicallaw.com/2-610-4726.
173. Norman B. Page, Ron Cai, and Chao Tong, *Draft of China's new Foreign Investment Law*, LEXOLOGY (Jan. 29 2015), http://www.lexology.com/library/detail.aspx?g=ddb5907e-b45c-4f4c-b8b1-f4cedf78a711.
174. *Id.*
175. *Id.*

the most economic freedom to FDI that China's economy has seen in modern times. Furthermore, the Draft Law's "negative list" will simplify the 2015 Catalogue's encouraged, restricted, and prohibited categories, by creating two distinct industries where foreign investment is either: (1) restricted or (2) prohibited.[176] The "restricted" category restricts foreign investment enterprises that require pre-approval from the MOFCOM and meet certain conditions.[177] Under the "prohibited" category, no FDI is permitted.[178]

The Draft Law's proposed "negative list" is already currently applied in Shanghai's FTZ in Pudong.[179] This means that Chinese foreign investors will benefit by not having to obtain MOFCOM approval regarding foreign investment not explicitly mentioned on the "negative list," exactly like the FTZ in Pudong is currently enjoying.[180] Another change in the Draft Law includes a simplified filing requirement. Pudong's FTZ rules state that any FDI not on the FTZ "negative list" must register with Shanghai's Administration for Industry and Commerce (AIC), and in effect, the investment filings are allowed to bypass MOFCOM.[181] As a result, the Draft Law will allow FDI in Shanghai's FTZ to file and go through the investment process similar to Chinese domestic investments.[182] This is an important step in deregulating the Shanghai FTZ and bolstering FDI incentives because now foreign investors will not need pre-approval from the State Council in MOFCOM. Instead they can file directly with local departments handling foreign investment.

National Security Review included in the Draft Law will provide the PRC with a national security procedure.[183] The Draft Law instructs for the formation of a "reviewing commission" by MOFCOM to conduct reviews of FDI.[184] Interestingly, the "reviewing commission" is comparable to U.S. foreign investment review by the Committee on Foreign Investment in the United States (CFIUS).[185] On the other hand, the Draft Law orders that any administrative decisions by the "reviewing commission" are immune from judicial review, unlike U.S. judicial review over CFIUS.[186]

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176. *Id.*

177. *A New Regime for Foreign Investors*, ECONOMIST (Apr. 22, 2015), http://www.eiu.com/industry/article/303104014/a-new-regime-for-foreign-investors/2015-04-22.

178. Page, *supra* note 173.

179. Foreign Investment Law Update, *supra* note 114.

180. Page, *supra* note 173.

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

Additionally, the Draft Law redefines and broadens the scope of "foreign investment."[187] Under the Draft Law foreign investment will now include: (1) the establishment of domestic enterprises, (2) obtaining rights and interests of domestic enterprises such as equity interests, voting rights, and shares of property, (3) financing of a year or more to domestic enterprises, (4) obtaining concession rights relating to construction, operation, or development of natural resources or infrastructure projects in the PRC, (5) obtaining rights to immovable property such as domestic land use rights and housing ownership, and (6) obtaining control or equity interests in domestic enterprises through contracts or trusts.[188] The dominating concept in determining whether there is a foreign investment deals with "control."[189] There will be a foreign investment if the nationality of the controlling person or entity is not Chinese and there is control through a business arrangement, shareholding structure, and voting power.[190] The broader scope of foreign investment may frustrate the purposes of holding structures used by current foreign investors to make and depart investments in Shanghai.[191]

With the application of the Draft Law, the old three-vehicle foreign investment enterprise system will be abolished.[192] Instead, new foreign investment enterprises will need to comply with PRC Company Law.[193] Although the Draft Law will unify all FDI under Company Law, the change will present new problems to enterprises operating under the old system of an equity joint venture, contractual joint venture, or wholly foreign owned enterprise. One key problem is that the old-three vehicle system differs significantly from PRC Company Law.[194] For example, under the Equity Joint Venture Law, the board of directors is in charge of corporate governance, but under PRC Company Law it is the shareholders meeting.[195] Another example is that PRC Company Law mandates companies have supervisors, while the three-vehicle enterprise model does not have any requirement for companies to designate supervisors.[196] In addition to the change in governing law, the PRC's Company Law is still developing.[197] On April 12, 2016, the Supreme

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187. Todd Liao, Frank Niu, Sarah Zeng, *China's Draft Foreign Investment Law*, MONDAQ (Apr. 27, 2016), http://www.mondaq.com/china/x/486510/Inward+Foreign+Investment/Chinas+Draft+Foreign+Investment+Law.

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. *See* Cuatrecasas Goncalves Pereira, *Legal Flash I Shanghai Office – May 2016:draft*

People's Court in China issued a new draft which interpreted several issues of PRC Company Law.[198] The interpretation's purpose was to clarify areas of PRC Company Law.[199] For example, now senior management, employees, and creditors with direct interest may request the court to authorize whether resolutions are valid from shareholders and board of directors' meetings.[200]

It may take years before the Draft Law is fully integrated and applicable to Pudong's FTZ. The reasoning is foreshadowed above that there are still many obstacles to overcome in order for the Draft Law's different system to apply to Pudong. Some of the changes will enhance FDI, such as the local simplified filing process. However, some of the adjustments proposed by the new Draft Law will change the practices of business of foreign investors, such as the new definition of "foreign investment" and the new governing PRC Company Law. Although there are many pros and cons to the new Draft Law, Rome was not built in a day. Pudong's FTZ has proven itself by transforming from rice fields into skyscraper city in a matter of decades with the help of Beijing's commitment to open Shanghai up to foreign investment. Still, there are many reforms the PRC should consider to improve Shanghai's foreign investment potential. The next Part will describe further reforms needed in order for the FTZ in Shanghai to compete with other financial megacities around the globe.

VI. FURTHER REFORM

"Can you imagine what I would do if I could do all I can?"
– Sun Tzu

The PRC should consider reforming its laws on the internet. One of the most important hindrances to Shanghai progressing is the Chinese internet system. Shanghai's Pudong FTZ area has been contradicted by PRC censorship of the internet.[201] Internet censorship reduces the potential for economic investments.[202] Chinese internet censorship is known as the Great Firewall of China.[203] The Great Firewall's program

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judicial interpretations on Company Law for Public Comments, LEXOLOGY (May, 20 2016), http://www.lexology.com/library/detail.aspx?g=6a6c7425-a3df-470a-a6c9-566a940c711f.

198. *Id.*

199. *Id.*

200. *Id.*

201. Rashaad Mubarak, *The Shanghai Free Trade Zone is Not Enough to End China's Internet Censorship*, MIC (Oct. 4, 2013), http://mic.com/articles/66339/the-shanghai-free-trade-zone-is-not-enough-to-end-china-s-internet-censorship#.tM0YMqg8r.

202. *Id.*

203. *Id.*

restricts access to websites and content the PRC considers inappropriate.[204] Methods of censorship include URL filtering, IP blocking, redirection, and connection reset and DNS filtering.[205] Websites blocked in mainland China and the Pudong FTZ comprise of many popular websites such as Facebook, Google, Twitter, and YouTube.[206]

In Shanghai, I observed first-hand the frustrations of the Great Firewall. When attempting to access a restricted website, there is no warning or notice that the website is restricted. Instead, the internet runs slowly and then can do a number of various things, ranging from showing a blank screen, to never loading the webpage at all. In addition, with non-mainstream websites, there is no telling if the website will be accessible or not until it is attempted to be accessed. The "Great Firewall of China" is a tool used by the PRC to control the inflow of information to the Chinese public and is an indication that the PRC is unwilling to let go of full control of exposure to foreign information. It is easy to anticipate that without access to basic mainstream websites and unpredictable internet censorship, foreign investment into Pudong might not be as plentiful as it could be. It seems interesting that some of the largest companies in the world want to invest in a city where they cannot predict what websites will be blocked and which ones will be accessible.

In addition to free internet access, another reform China should consider is free access to information. In July 2016, China's internet regulator (the Cyberspace Administration of China) ordered major companies such as Sina Corp., Tencent Holding Ltd., Sohu.com, and NetEase, Inc. to stop online news reporting.[207] The PRC claims that the identified companies "seriously violated" internet regulations because their news content was obtained through original reporting which caused "huge negative effects."[208] The PRC internet regulator instructed the online news services to stop reporting on "current-affairs news."[209] The online companies were not allowed to have their own news operations and provide original content, because in China, online news reports must be provided by government-controlled print or online media.[210] In essence the ban of online news reporting by third party companies gives the PRC virtually absolute control over online news reporting and

204. *Id.*

205. *Id.*

206. *Id.*

207. Keith Zhai, *China Bans Internet News Reporting as Media Crackdown Widens*, BLOOMBERG (last updated July 25, 2016 5:54 AM), http://www.bloomberg.com/news/articles/2016-07-25/china-slaps-ban-on-internet-news-reporting-as-crackdown-tightens.

208. *Id.*

209. *Id.*

210. *Id.*

political discourse.[211] This is in line with Chinese President Xi Jinping's ideology that the media must serve the interests of the dominant Communist Party in China.[212]

The PRC government has continued to find ways to influence the media in China. In early 2016, Chinese officials met with internet providers to discuss a system where the internet providers could obtain a license from the PRC to provide daily news in exchange for government officials taking board seats and stakes of 1% in the companies.[213] It follows then that the concept of "control" seems to be a re-occurring topic in, not only foreign investment systems, but other aspects of the PRC.[214] For example, the Tencent company, which China ordered to stop online news reporting, in part provides news content through popular apps such as QQ and WeChat to more than a billion users combined.[215] Other online news providers have had their news or investigative stories on corruption cases removed by the PRC.[216] For example, in April 2016, NetEase published a story relating to the PRC and announced it would investigate Zhang Yue, a senior Hebei provincial official.[217] After publication, NetEase's story was removed from the internet.[218]

The PRC must reconsider the overbearing media censorship in its country in order for Shanghai's FTZ to flourish with greater FDI. It is not the most appealing place in particular for western foreign investors if the media is virtually totally controlled by the government. Foreign investors might be skeptical on business statistics and not have confidence or trust in the PRC.

Economic growth is important because it is the amount of the total value of goods and services produced.[219] Economists compare China's economic growth by analyzing their Gross Domestic Product (GDP) against the GDP at the exact same time the previous year.[220] China's GDP number comes from a collection of data from provinces across the country.[221]

Once again, in early January 2016, China reported that its latest economic growth data was nearly in sync with its official target.[222]

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211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*
219. Andreas Illmer, *China's Growth Data – Can You Trust It?*, BBC NEWS SERVICES (Jan. 19, 2016), http://www.bbc.com/news/business-35341869.
220. *Id.*
221. *Id.*
222. *Id.*

Economists believe China inflates the data and therefore do not trust the data when China releases its Gross Domestic Product (GDP) every three months for several reasons.[223] One reason is that China is a developing country in the area of fiscal management.[224]

In December 2015, it was discovered that regional economic data from one province reported inflated revenue by 127% of the actual number.[225] Even China's current Premier Li Keqiang has described regional GDP as unreliable and "man-made."[226] Hong Kong based investment analyst Peter Churchouse stated that "[w]e all know the growth data is overstated . . . [i]t's a political gesture: they have to keep the domestic markets believing that growth is roughly close to 7%."[227] China's obsession with meeting its unrealistic growth statistics concerning GDP growth affects foreign investment confidence in China. For instance, European and Japanese car companies need to know the actual spending power of the Chinese middle class and Australia, and Indonesia need to know whether China's demand for iron ore and coal is increasing or slowing.[228]

Another suggested reform is advancing the rule of law. China needs to show the world they are trying to construct deeper connections with the world and depart from its economy under Zedong. One notable area of progress in the advancement of law is China's membership in the World Trade Organization. Participants in the WTO or other global organization are required to make law that is consistent with international standards. Furthermore, under the Draft Law, foreign investment law and foreign Chinese investors would be treated the same when investing in the PRC.[229]

However, despite the advancements in foreign investment law, the PRC's central government in Beijing seems to shoot itself in the foot in ways that deter foreign investment. For example, in July 2016, China rejected a ruling from The Hague International Tribunal over a legal dispute between the Philippines and China over reefs and atolls in the South China Sea.[230] The Hague Tribunal sided with the Philippines and ruled that the waters were "within the exclusive economic zone of the Philippines, because those areas are not overlapped by any possible

223. *Id.*
224. *Id.*
225. *Id.*
226. *Id.*
227. *Id.*
228. *Id.*
229. Scott & Durham, *supra* note 144.
230. Owen Bowcott, Oliver Holmes & Tom Phillips, *Beijing Rejects Tribunal's Ruling in South China Sea Case*, GUARDIAN (July 12, 2016 1:21 PM), https://www.theguardian.com/world/2016/jul/12/philippines-wins-south-china-sea-case-against-china.

entitlement of China."[231] The tribunal further ruled that China violated Philippine sovereign rights in the South China Sea.[232] China interfered with the Philippine fishing and petroleum exploration when the Chinese constructed artificial islands.[233] However, President Xi Jinping said the PRC's "territorial sovereignty and marine rights" in the South China Sea would not be affected by The Hague Tribunal ruling.[234] Ironically, the flagship communist party newspaper, The People's Daily, published an editorial that The Hague Tribunal ignored "basic truths" and that it "trampled" on international laws.[235]

The Chinese government refuses to follow international law despite China's ascension into the WTO and obligations to comply with international rulings. In effect, China's noncompliance with international standards and the uncertainty of the rule of law in China is another form of unpredictability. The Chinese government should consider advancing their rule of law in order to keep attracting foreign investors to mainland China inside Shanghai's FTZ.

VII. CONCLUSION

> "When our thousands of Chinese students abroad return home, you will see how China will transform itself." – Deng Xiaoping

The Foreign Investment Law in China has been gradually opening more to foreign investment. Particularly with the proposal and prospective passage of the Draft Law China is poised to become the most open to foreign investment that it has ever been in its history. Stemming from Xiaoping's "open door" policy, foreign investment into Shanghai's FTZ is partially responsible for China's Draft Law and a desire to surpass all other countries. As China continues to increase in population, wealth, and investing in economic reforms, it is conceivable that the PRC will establish the international presence in the world that they desire. The only question that the world is waiting for is: with China's growing economy and other sectors of its nation, can it become the most powerful country of the twenty-first century?

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231. *Id.*
232. *Id.*
233. *Id.*
234. *Id.*
235. *Id.*

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