

## Chapter 9

# Changing Tide of China's Foreign Investment Regulatory Reform Starting From Free Trade Zones: The Case of Negative Lists

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### **ABSTRACT**

*China Pilot Free Trade Zones have played important roles in promoting foreign investment and openness by conducting various administrative and legislative reforms. Since the establishment of the first Pilot Free Trade Zone, Shanghai Pilot Free Trade Zone, the market access negative list for foreign investment has been introduced within SHFTZ and gradually promoted in other FTZs and nationwide. This nationwide regulatory reform of market access has significantly changed China's long-time practice of 'case-by-case approvals' (positive-list) and is consistent with China's approach of reservations and non-conforming measures under the Regional Comprehensive Economic Partnership and the EU-China Comprehensive Agreement on Investment. This chapter examines the historical evolution of negative lists from FTZs to the whole country. It explores the interaction among the local, national, and transnational investment legal regimes in regard to market access. Last, it proposes suggestions for better alignment of market access negative lists in FTZs, the nationwide, and free trade agreements.*

### **INTRODUCTION**

An important aspect of providing policy flexibility under international investment agreements (IIAs) relates to the choice of modality used to negotiate and schedule liberalisation commitments. Two alternative approaches are found in IIAs: the positive-list approach, on the one hand, and the negative-list approach, on the other. The former means the positive listing of sectors, sub-sectors and individual

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modes of supply in which countries voluntarily undertake liberalisation commitments. In contrast, the latter allows countries agree on a set of general obligations and then list all individual measures to which such obligations either do not apply or which qualify their obligations (UNCTAD, 2006). The negative-list approach is first used by Australia and New Zealand in the Australia-New Zealand Closer Economic Agreement, and then by the United States, Canada and Mexico in the North American Free Trade Agreement. The negative-list approach is useful for producing a detailed inventory of all non-conforming measures IIA contracting parties maintain. In the case of negative lists, the liberalisation commitments apply in full *ab initio* to measures that do not appear in reservation lists, which is more appropriate for countries with a high degree of liberalisation. Such negative lists require host countries to reveal the precise nature of investment-restrictive measures enshrined in their laws and policy reservations. Accordingly, they can allow for more informed investment decisions to be taken by potential foreign investors. Also, the negative list usually implies 'standstill' commitments — contracting parties are not allowed to introduce new non-conforming measures beyond those included in the negative list. In other words, the negative-list approach involves a potentially higher level of bound liberalisation to the extent that it locks in the regulatory *status quo* (UNCTAD, 2006).

Before the Regional Comprehensive Economic Partnership (RCEP) and the EU-China Comprehensive Agreement on Investment (CAI), China had used the positive-list approach in its IIAs to make commitments on foreign investment. The underlying reason for China's previous positive-list approach can be traced back to the lack of negative lists in its domestic investment regulatory regime before 2013. However, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) forced China to reform its domestic investment legal and regulatory regime for its future IIAs with high degree of liberalisation to avoid marginalisation in the Asia Pacific trade landscape. The conclusion of the CPTPP of which China is not a member becomes a challenge to China for being more engaged with economic integration in the Asia Pacific trade landscape. The CPTPP is a trade agreement among Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. It evolved from the Trans-Pacific Partnership (TPP), which never entered into force due to the withdrawal of the United States. Nevertheless, the TPP was originally designed by the United States to counter China's assertive rise and two-thirds of its provisions were remained by the CPTPP. After the withdrawal of the United States, all other TPP signatories agreed to revive the agreement in 2017 and concluded CPTPP on 8 March 2018. The CPTPP accounts for a substantial share (about 13%) of world GDP (Australian Government Department of Foreign Affairs and Trade, 2021). Unlike China's positive-list approach, CPTPP adopts negative lists of non-conforming measures.

On 28 June 2018, China released its first nationwide negative list to prepare for adopting negative-list approach in its future IIAs.<sup>1</sup> As will be discussed in detail below, China's domestic regulatory reforms in regard to negative lists are gradual and from down to top. To maintain a balance between the interests and security of China and further protection of foreign investments, China is cautious about its domestic legal reform for foreign investment and needs a testing ground for more liberal admission and a smooth shift from the positive-list approach to the negative-list approach before the nationwide institutional reform. Such administrative and legislative reforms for foreign investment start from the Free Trade Zones in China.

The Shanghai Pilot Free Trade Zone (SHFTZ) was launched in September 2013, as a new attempt to maintain the allure as a premier destination for foreign business through relaxed controls in foreign investment. Since then, along with Go Global Strategy, Belt and Road Initiative (BRI) and other policies, China has set up 21 FTZs to facilitate investment and regulatory reforms.<sup>2</sup> One of functions of FTZs is

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