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Foreign Direct Investments in China

The new reform and the post-COVID-19 reality

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ABSTRACT

In Cina la transizione da un'economia puramente socialista a una orientata al mercato, così come l'inizio del processo di internazionalizzazione del paese, sono stati accompagnati da un sorprendente sviluppo del sistema fiscale, essenziale per la creazione di condizioni di concorrenza fiscale competitive. In questi anni di riforme, la Cina ha dimostrato la sua capacità di imporsi come leader nei mercati internazionali, riuscendo a competere con le economie più influenti. Prima di tutto, è stato necessario un adeguamento strutturale e istituzionale, una progressiva riformulazione della legge, in particolare del diritto societario, in termini di omogeneità tra società nazionali ed estere e in termini di complessità e chiarezza delle normative. Un ambiente istituzionale chiaro e ben organizzato è effettivamente essenziale per garantire un ambiente di sviluppo economico e cooperazione internazionale. Pensando a una strategia, la Cina si è sempre distinta per la "gradualità" nell'applicazione di nuove misure, perfettamente riassunte dall'espressione coniata da Deng Xiaoping: "Sentire le pietre prima di attraversare il fiume". Questa tesi affronta il tema degli investimenti esteri in Cina e si concentra sulla nuova legge che è entrata in vigore nel gennaio 2020. Il primo capitolo è un capitolo introduttivo alla Cina, in cui viene descritta l'economia cinese, i sistemi legislativi e fiscali, indicando il percorso delle riforme che hanno avuto luogo nel corso degli anni. Il secondo capitolo è il punto centrale della tesi, infatti, viene data una definizione di investimenti stranieri e le loro caratteristiche al fine di comprendere meglio l'argomento. Segue un'analisi della nuova legge sugli investimenti diretti esteri e i suoi effetti sulla facilità di fare affari in Cina. L'ultimo capitolo riguarda la situazione reale risultante dal Covid-19 e fornisce un suggerimento per gli investitori a prendere posizione sul mercato cinese a breve, medio e lungo termine.

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INTRODUCTION

The transition from a purely socialist economy to a market-oriented one, as well as the start of the country's internationalization process, were accompanied by a surprising development of the tax system, essential for the creation of a competitive tax playing field. In thirty years of reforms, China has demonstrated its ability to impose itself at the head of international markets, managing to compete with the most influential economies. First of all, this required a structural and institutional adjustment, a progressive reformulation of the law, especially corporate law, in terms of both homogeneities between domestic and foreign companies and in terms of complexity and clarity of the regulations. A clear and well-organized institutional environment is indeed essential to ensure an environment of economic development and international cooperation.

Thinking of a strategy, China has always distinguished itself for the "gradualness" in the application of new measures, perfectly summed up by the expression coined by Deng Xiaoping: "To feel the stones before crossing the river" (摸着 石头 过河)[1] .

[1]G. MERCURI, “Perché Deng Xiaoping superò Mao e divenne un gigante della storia”, 18/12/1018 https://www.corriere.it/extra-per-voi/2017/02/17/perche-deng-xiaoping-supero-mao-divenne-gigante-storia-4c41cc42-f50d-11e6-acae-b28574795707.shtml

This thesis addresses the topic of foreign investment in China and focuses on the new law which came into force in January 2020. The first chapter is an introductory chapter to China, in which it is described the Chinese economy, the legislative and tax systems, also indicating the path of the reforms that have taken place over the years. The second chapter is the central point of the thesis, in fact, it is given a definition of foreign investments and their characteristics in order to understand better the argument. Then, after a theoretical part, it follows an analysis of the new Foreign Direct Investment Law and its effect on the ease of doing business in China. The last chapter concerns the actual situation resulted from the Covid-19 and it provides suggestions for investors and how to take a position on the Chinese market in the short, medium and long term.

CHAPTER I. CHINESE LEGISLATION ROADMAP

1.1 CHINA OVERVIEW

Currently, China can be considered a hybrid country: it has capitalism without democracy; economic development without political freedom; it combines modernization with nationalism; it retains socialist elements, but still has strong inequalities within it[2]. It may seem that it is a dyscrasia that China, today a strong economic power, is still governed by an authoritarian political system. However, the answer to its success lies precisely in the turning point imposed by Deng Xiaoping at the end of 1978: the dual policy based on openness to the outside and the transition to a market economy. The new Chinese economic revolution has also given in a short time surprising results, unprecedented in the history of humanity, improving the living conditions of most of the population. This growth has been possible in the context of globalization and the results have led to a model that is not just the mere imitation of others system that combines capitalism and dictatorship. The paradox consists of a market economy managed by an illiberal government, which perpetrates serious abuses against human rights. The attitude of China arouses understandable interest, for example, in some parts of the world it is considered a guiding model, a possible inspiration for other

[2] F. RAMPINI, "Sistema politico e rivoluzione economica cinese", 2009 http://www.treccani.it/enciclopedia/sistema-politico-e-rivoluzione-economica-cinese_%28XXI-Secolo%29/

emerging countries. However, it is risky to describe it as a stable model, the challenges it faces are extraordinary. It is reasonable to speculate that the continuation of China's economic, technological, cultural and social development will also require changes in the political-institutional system. The evolution of the Chinese economy, on the other hand, offers positive visibility due to its integration with the rest of the world. In 2001, China joined the WTO by integrating the international trading system and its entry into the WTO has changed the global economy forever. Moreover, China has beneficiated enormously, as the WTO has allowed the country to significantly increase foreign trade: the nominal value of exports in the 15 years following the entry into the WTO has grown at a rate of over 14% annual average, while imports recorded an average compound annual growth of 13% in the same period. These data highlight the close relationship that China has established with its commercial partners and how the country has used commercial leverage for political and strategic purposes: in the last decade, this strategy has allowed China to become the main commercial partner of the largest part of African countries and to be able to establish its influence in the area. With the aim of further developing trade, China has signed a multitude of bilateral and multilateral trade agreements over the years, which have opened up new markets in terms of products. Moreover, in 2003, China signed the Closer Economic Partnership Arrangement with Hong Kong and Macao, while several Free Trade Agreements (FTAs) were signed with

ASEAN countries, Australia, Chile, Costa Rica, Korea, Peru, New Zealand and Singapore. China has become the second most favored nation by capitals around the world, behind the United States[3]. An important aspect of the impact of Chinese economic growth on the rest of the world is the increase in foreign investment in the People's Republic, in particular investments made by state-owned companies and sovereign wealth funds that have acquired equity interests in foreign companies. The Chinese state has always proven itself as an interventionist state in the economic sector, despite the promulgation of numerous normative documents in support of the development of the economic system. In fact, the nation's commercial and corporate laws have been mainly aimed at creating an economic bureaucracy rather than a market economy. The state authority deals with a system of authorization-attribution of commercial licenses, greatly reducing the decision-making and action capacity of economic operators. Today it is the Chinese government that determines economic development programs through five-year plans. The state becomes the necessary engine for the proper functioning and development of the economic system, as governmental action can determine the favorable conditions for commercial exchanges and predict frequent market fluctuations. In recent times there has been a sort of compromise between political choices and the regulatory system.

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[3] J. DESJARDINS, “Mapped: Foreign Direct Investment by Country”, 23/01/2019 https://www.visualcapitalist.com/mapped-foreign-direct-investment-by-country/

1.2 CHINESE ECONOMY OVERVIEW

The last congress of the Chinese Communist Party held during October 2017, represented for the current President Xi Jinping not only an opportunity to strengthen his leadership within the Party but also an exceptional vehicle for communicating with other world powers the aim to bring China to the center of global political and economic plots. Huge projects, such as the "One Belt One Road", have stated the objective of making China the reference point for land and sea trade routes and to control the main commercial hubs. In the past thirty years, the Chinese economy has experienced a real economic boom, which has allowed the country to become the world's second largest economy, to increase economic well-being and to bring millions of citizens out of poverty[4]. The outward opening and the economic and social reforms undertaken since the end of the 70s triggered a path of constant growth and with double-digit rates: in 2019 the Chinese gross domestic product stood at 14,216 billion USD[5], second only to that of the United States and higher than that of Japan and Germany. The economic reforms promoted by Deng Xiaoping have therefore transformed a country with a strong agricultural component in the manufacturing center of the world. Industrial development subsequently triggered the growth of the services sector, so much so that since 2011 the tertiary sector has become the main contributor to the Chinese

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[4] R. SEVERINO, “Cina obiettivo 2020: sradicare la povertà estrema”, 3/02/2020 https://www.visualcapitalist.com/mapped-foreign-direct-investment-by-country/

[5] STATISTA, https://www.statista.com/statistics/263770/gross-domestic-product-gdp-of-china/

GDP. In 2019, the tertiary sector represented around 53,9% of GDP, while the secondary and primary sector contributed 39% and 7,1% respectively[6] (see Table 1.1).

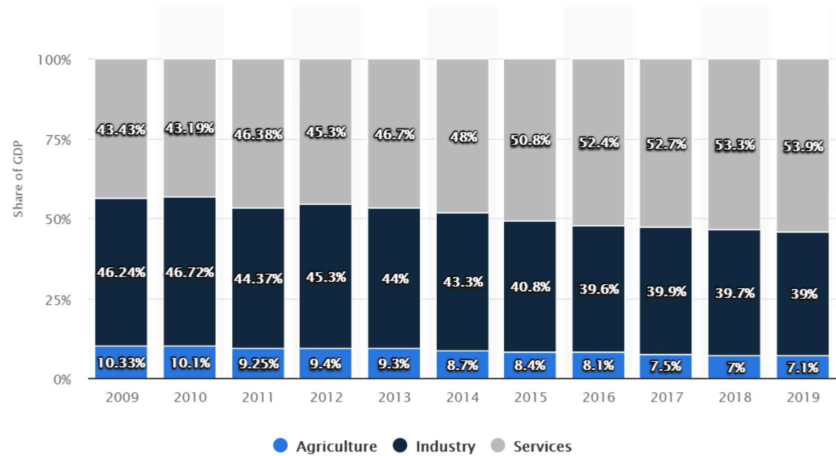

Table 1.1 - source: Statista 2020

China has addressed the global economic crisis of 2008-2009 through a package of incentives and economic stimuli aimed at promoting important investment projects in infrastructure and capital-intensive industries, and this has allowed reducing the negative effects that have affected other countries. In 2009, the year in which the global crisis hit hardest, China achieved 9.2% of GDP growth, while the other main economic powers underwent an important contraction.

The growth stimulated at the central level, however, aroused some concern in several analysts, which highlighted potential risks of the financial bubble and overcapacity of the production plants in the industrial sectors where the state-

[6] STATISTA, https://www.statista.com/statistics/270325/distribution-of-gross-domestic-product-gdp-across-economic-sectors-in-china/

controlled companies are concentrated. From the point of view of foreign trade, China has a significant surplus of the trade balance: as the main manufacturing hub, China is in fact the main exporting country in the world[7], with an export value exceeding USD 2.49 trillion in 2019, while imports settled at USD 2.13 trillion[8]. In terms of GDP per capita and level of human development, China ranks 72nd[9] and 90th[10] respectively.

1.3 THE LEGISLATION SYSTEM

“Legislative system” is the general term for the activities and principles to be followed during the process of legislation and regulation making. It is an important part of state laws and regulations. A contemporary legislative system usually consists of: a legislation structure; a main organ of legislation; a legislative right; a legislative operation; the supervision of legislation; and the relationship between legislation and relevant areas[11].

China is a unified multiethnic country with a unitary political system. To ensure that the legal system remains unified yet at the same time adapts to the uneven economic, political and cultural development of different areas, China practices a

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[7] STATISTA, https://www.statista.com/statistics/264623/leading-export-countries-worldwide/

[8] STATISTA, https://www.statista.com/statistics/268184/leading-import-countries-worldwide/

[9] INTERNATIONAL MONETARY FUND, https://www.imf.org/en/Publications/WEO, 2019

[10] UNITED NATIONS DEVELOPMENT PROGRAMME, http://hdr.undp.org/en/countries

[11] China.org.cn, http://www.china.org.cn/english/kuaixun/76212.htm

unified, multilevel legislative system. The National People's Congress and its Standing Committee exercise the state power to make laws. The NPC enacts and amends basic laws pertaining to criminal offenses, civil affairs, state organs and other matters. The Standing Committee enacts and amends all laws except for basic laws that should be enacted by the NPC. When the NPC is not in session, its Standing Committee may partially supplement and revise laws enacted by the NPC, provided that the changes do not contravene the laws' basic principles. The NPC has the power to alter or annul any inappropriate laws enacted by its Standing Committee. The NPC Standing Committee has the power to annul administrative regulations that go against the Constitution or laws concerned and revoke local statutes that contravene the Constitution, other laws or administrative regulations. The State Council formulates administrative regulations in accordance with the Constitution and other laws and reports them to the NPC for records.

In line with the specific conditions and actual needs of their administrative regions and on condition that they do not violate the Constitution or other state laws and administrative regulations, the people's congresses of provinces, autonomous regions and municipalities directly under the Central Government, as well as their standing committees, may work out local statutes and report them to the NPC Standing Committee and the State Council for record. In light of their specific conditions and actual needs and on condition that they do not conflict with the

Constitution, other laws and administrative regulations or local statutes passed by their provinces or autonomous regions, the people's congresses and their standing committees of larger cities may enact local statutes and submit them to the standing committees of the people's congresses of their provinces or autonomous regions for approval before they take effect. In addition, these standing committees shall record the local statutes with the NPC Standing Committee and the State Council. The people's congresses of national autonomous areas have the power to formulate regulations concerning autonomy and local needs in light of their own local political, economic and cultural conditions. These regulations of autonomous regions take effect after they are approved by the NPC Standing Committee. Such regulations made by autonomous prefectures or counties take effect after they are approved by the standing committees of the people's congresses of the provinces, autonomous regions, and municipalities directly under the Central Government; in addition, these standing committees shall record the regulations with the NPC Standing Committee and the State Council.

In China's multilevel legislative system, laws promulgated at different levels do not have the same effect. The Constitution has the highest legal validity, and no other laws, administrative regulations, local statutes, regulations concerning autonomy and local needs, or other regulations may violate the Constitution. State laws have greater force than administrative regulations, local statutes and

regulations. State administrative regulations have greater force than local statutes and regulations.

1.4 THE TAX SYSTEM: THE PATH OF REFORMS

A relevant point is that China has shown a commitment to clarify tax mechanisms which are not always clear, especially for foreign investors. An example in this direction is the degree of development achieved in the tax area, so that, in twenty years, tax revenues have recorded significant increases, with greater attention being paid to public spending and the maintenance of public finances in good condition. Despite this, we cannot say that the tax reform process is complete. In a report published by the OECD[12], a series of points were analyzed on which China must work, starting with the progressiveness of income taxes, which, compared to that of other countries, is significantly lower. Secondly, since China is one of the most polluting countries in the world, an increase in the tax burden on the emission of polluting gases would bring benefits both in terms of environmental protection and in monetary terms, as it would increase the level of tax revenues. The road to reform is still very long and China cannot afford to take steps back at this point.

[12] OECD, https://www.oecd.org/china/

Tax legislation in China follows a centralized path, local governments, therefore, have no legislative power in the tax administration. The tax administration is managed by the Chinese Ministry of Finance (MOF) and, subordinately, by the State Administration for Taxation (SAT), both through the emanation of circulars, interpret tax laws. In particular, the MOF provides essential support for the development of tax policies (implemented by the SAT), while as regards the formulation and coordination of tax policies, the SAT has a fundamental role, as it controls and supervises the work of local tax bureau (地方 税务局), for each jurisdiction level. The SAT is entrusted by the State Council with the collection and administration of taxes that generate revenue for both the central government and local administrations, while the tax offices are responsible for resolving ordinary administrative tax issues at a territorial level, as well as for collecting and management of local taxes[13]. The Chinese tax system is, despite the important reforms of recent years, still an apparatus in continuous evolution. In fact, there is no single national tax law or tax code that regulates taxation for both individuals and companies. The only references are precisely the MOF and the SAT which, through the issue of regulations, sentences and interpretations and circulars, implement and supervise the tax system in general. The Chinese tax system is

[13] L. Riccardi, "*Guida alla fiscalità in Cina, India e Vietnam*" Ed. Gruppo 24 Ore, Milano, 2011

characterized by the presence of 18 different kinds of taxes[14], which can be divided into three categories according to their nature.

- Goods and services taxes, including VAT, Excise Tax, Business Tax, Vehicle Purchase Tax and Customs Duty.
- Income taxes, including Corporate Income Tax and Individual Income Tax.
- Property and behavior taxes, including Real Estate Tax, Urban and Township Land Use Tax, Land Appreciation Tax, Arable Land Use Tax, Deed Tax, Resources Tax, Vehicle and Vessel Tax, Stamp Duty, Urban Maintenance and Construction Tax, Tobacco Tax, and Vessel Tonnage Tax.

In general, China has made great strides in the tax area, managing to increase tax revenues in twenty years, carrying out economic development and the level of GDP, to support public spending while keeping public finances healthy. Despite this, we cannot say that the tax reform process is complete. To foster effective economic growth and reduce social inequalities, the fiscal lever must be supported by various measures: first of all, the revision of the political balance between central and local government and the overcoming of the gap between urban and rural areas. There are many problems relating to the decision-making power of the provinces, often limited even in the field of application of the taxes for which they

[14] STATE TAXATION ADMINITRATION OF RPC, http://www.chinatax.gov.cn/eng/c101270/c101272/c5094513/content.html?wscckey=d7194dd8ef045cd7_1590401391

are responsible. Tax budgets are distorted indicators of state funds, as there are dozens and dozens of informal and unauthorized items (at a local level) which, however, represent the main resources of local administrations.

One of the main stages of the "Chinese miracle" was undoubtedly the series of institutional and structural reforms strongly supported by Deng Xiaoping and known together as the Open-door policy (开放 改革). The reforms were intended to introduce a market liberalization mechanism, despite the country's socialist matrix imposing a planned economy. During the first phase of the reforms, until 1984, greater emphasis was placed on the agricultural sector and on its limited production, with the gradual dismantling of the enclosures in the agricultural sector, in favor of a semi-private system, the so-called "Household responsibility system" (家庭 联产承包 责任制), according to which there was the possibility to keep for itself (and/or sell on the market) all the production in excess of the level established by the government, while previously the entire production was transferred to the government which established the prices[15].

Public enterprises (SOE, State Owned Enterprises, 国有 企业) were allowed to keep profits for themselves, as an incentive to improve performance. After the initial successes in the agricultural sector, interventions were undertaken in favor of the industrial sector between 1984 and 1988, with the gradual liberalization of

[15] H. Huang, "*Signal Left, Turn Right: Central Rhetoric and Local Reform in China*" Political Research Quarterly, 2012

prices and wages[16], the adoption of a system of corporate taxation, the gradual easing of the monopoly in the banking sector but above all the opening to international trade and foreign investments with the establishment of the so-called SEZ (Special Economic Zones) in a number of large cities and coastal areas[17]. Altogether, these geographical areas began to produce intensive legislation intended to regulate foreign trade, largely inspired by foreign and international models[18]. Since the beginning of the 21st century, the Chinese government has made a series of adjustments and improvements to the tax system, which have guaranteed the government's revenue stream and contributed to the country's rapid economic growth[19]. The tax system of the PRC has a rather recent history and it has experienced the main changes especially in the last twenty years. Its elaboration dates back to 1994[20], a reform which represented a very important step for the country (especially in view of its entry into the WTO) and whose

[16] B. Naughton, "*The Chinese economy: transitions and growth*" The MIT Press, Cambridge, 2007
[17] In 1979 the first three SEZs were created in the municipalities of Shenzhen, Zhuhai and Shantou, (Guangdong); in 1980 the SEZ of Xiamen, (Fujian) was established, and finally in 1988 the SEZ of the entire island of Hainan was established, which at the same time became a province. In 1984, the Open Coastal Cities (Dailan, Qinhuangdao, Tianjin, Yantai, Qingdao Lianyungang, Nantong, Shanghai, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai) and several Open Coastal Regions were established. Since 1985 the policy of opening to foreign investment was extended by the coastal cities near the Pearl river delta and Yangtse river, in the southern part of Fujian Province, the provinces of Shandong, Hebei and Guangxi to form an entire open coastal strip. Thus, a chain of "open" cities was formed that extended to the plain of the Yellow River.
[18] R. Cavalieri, "Tendenze del diritto commerciale cinese dopo Tienanmen", Mondo Cinese n. 83/84, 1994
[19] STATE TAXATION ADMINITRATION OF RPC, http://www.chinatax.gov.cn/eng/c101270/c101271/c5094511/content.html
[20] Although the reform was officially implemented in 1994, several bilateral treaties were concluded in the early 1980s to avoid double taxation for companies operating in China, as well as tax evasion.

spokesman was Zhu Rongji[21]. The system on which it was based, it was a sort of fiscal federalism (分税制), with the aim of rationalizing the control over financial outgoings at all levels in line with the division of administrative powers between central and local authorities[22]. According to the new system, taxes were divided into three categories: central, local and shared; their collection and administration were entrusted to a "double-track" system of central and local agencies, which replaced the previous system based on the annual negotiation of tax resources. The implementation of fiscal federalism obviously changed the relationship between the center and the periphery, at the same time increasing the dependence of the provinces on the central government (the system provided for the collection and later the redistribution of taxes from the center to the suburbs). The main changes were, as regards income tax, the introduction of a homogeneous discipline concerning the taxation of Chinese individuals and foreigners and the corporate income tax, the rate of which was 33%, valid throughout all the national territory and for all types of businesses. The corporate taxation regime, although considered uniform, left many advantages for foreign companies, to which numerous concessions and exemptions were in fact reserved. The introduction of a single value added tax which, together with turnover tax and consumption tax,

[21] From 1987 to 1991 he held the position of Vice Premier. From 1998 to 2003 he was the fifth Chinese premier.
[22] ASIAN DEVELOPMENT BANK, "*Fiscal management and economic reform in the People's Republic of China*" Oxford University Press, 1995

made up the framework of indirect taxation, is probably the main innovation of the 1994 tax reform. The basic principle of the calculation of taxes was the "residence": that is, *residents* (居民) were taxed (regardless of the physical or legal nature of the person) on income produced anywhere in the world and *non-residents* on income produced within the territory of the People's Republic of China. As for the methods of calculating the income tax of individuals (个 人 所 得 税), a single law contained the rules valid for both Chinese citizens and for those who reside in China. Instead, the tax discipline for organizations and companies distinguished the law that regulates the income tax of companies with foreign investments and foreign companies (外 散 投资 企业 外国 企业 税)[23] from the law on the tax applied to the income of "national" companies (中国 企业 税). The new tax regime also exerts pressure on local government budgets, because, although they depended on central authorities, they were at the same time directly responsible for basic necessities such as education and health and it was not uncommon for local governments that their budgets were often in red[24].

In addition to strengthening central finances, with the reform of the tax revenue-sharing system, Zhu Rongji had also developed a unified exchange rate system that would replace the previous dual-track system (an official exchange rate and a

[23] The full text of the law can be consulted online: http://www.china.org.cn/english/14960.htm

[24] D. D'Amico, "*Tax systems and Tax Reforms in South and East Asia: China*", Working paper No.394, Università di Roma "La Sapienza", 2005

market exchange rate), which on the one hand protected state-owned companies and their profits, on the other made the black market of foreign currencies very fertile. The 1978 and 1994 reforms reopened China's path for the entry in the WTO[25] (World Trade Organization) in December 2001, after 15 years of negotiations. This date is a key point for the PRC. For the reforms, it represents a sort of binding force between those of '97 and those of 2008; precisely at this stage, the government's activity was concentrated to reach adequate standards of regulation and control of economic activities, an adjustment necessary as a member of the WTO. First of all, this involved the gradual removal of customs barriers, as well as a revision of the regulatory framework for international trade, both as regards the quota system and foreign investments. The government has adopted fiscal and monetary policy measures to promote the development of manufacturing activity and exports. In particular, infrastructure costs have increased, and the salaries of public employees have increased, interest has been reduced and the reserve charges for banks have been less onerous. The economic policies implemented and the favorable conditions at the international level, together with the increase in domestic demand (encouraged by an expansionary fiscal policy) and the increase in exports have favored the country's vigorous

[25] The path to the entry in the organization was tortuous: although the milestone was only reached in 2001, it should be noted that China was one of the 23 signatory countries of the protocol of accession to GATT (the ancestor of today's WTO), but the historical political events that have affected the country have led to continuous suspension of negotiations. For further details see: R. Cavalieri, "*L'adesione della Cina alla WTO: implicazioni giuridiche*" Argos, 2003

growth. The main areas of this economic policy concerned technological innovation, promoting the development of the non-public sector, intensifying environmental protection measures and improving the quality of life in terms of poverty reduction and strengthening of the social security system. During 2002, the government pushed economic reforms aimed at stimulating in turn the competitiveness of the Chinese economy on international markets. Numerous legislative and regulatory interventions have therefore been carried out, with the aim of facilitating the flow of foreign capital into the country, promoting the private sector and promoting the efficiency of public enterprises. Foreign investments have proliferated massively especially in some sectors (telecommunications, insurance, etc.), access to the domestic securities market has been opened abroad, allowing participation also by qualified institutional investors; finally, some restrictions on the operations of foreign banks have been removed. In 2003, the government set ambitious economic policy objectives: promoting rapid GDP growth, reducing unemployment, ensuring price stability, consolidating the balance of payments surplus. Consequently, structural reforms were given greater vigor. In the early months of 2004, the government implemented an economic policy that was careful to check that the unstoppable growth of the country was aimed at resolving the strong imbalances that still characterized the internal market. Therefore, it has adopted a restrictive monetary policy: financing in some industrial sectors has been rationed, stringent reserve

requirements have been put in place for banks, maintaining the high discount rate. At the same time, protectionist measures of an administrative nature were adopted to protect certain sectors (financial, steel, aluminum and cement) while encouraging investments in the energy and communications sectors[26]. Decades of reforms and the entry into the World Trade Organization have developed a regulatory system in China with the aim of creating a stable administration and a solid tax structure. The main Chinese tax reform can be considered the Enterprise Income Tax Law[27], enacted on January 1, 2008. One of the objectives was to end the distinction (in terms of tax treatment) between foreign capital enterprises and domestic enterprises, with the removal of privileges for the former and the formulation of new legislation in harmony with western tax systems. In practice, the new rules did not affect only foreign companies: by harmonizing the tax base, the aim was to end the widespread practice of round tripping[28], which generated distortions and losses of taxable income[29]. The new system adopted a single rate of 25%, valid indifferently for both Foreign Invested Enterprises and Domestic Enterprises. Before the changes were applied, foreign companies paid a variable tax between 10 and 24%, depending on their location. The change in the tax

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[26] P. Coppola, et al. "Cina", in Enciclopedia Italiana, VII appendix

[27] CHINA SECURITES REGULATORY COMMISSION, http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/statelaws/201212/t20121205_217645.html

[28] Using this practice, Chinese companies exported capital to entities located outside the country, then returning them to the PRC in the form of foreign investments, thus benefiting from the deductions and exemptions reserved for FIEs.

[29] G. Cervino, C. Borsatto, "*Riforma fiscale cinese del 2008*" il Fisco, nr 29/2007 fasc. nr 1

regime also affected national companies, with a decrease in the flat-rate tax of 8 points. With the entry into force of the new Enterprise Income Tax Law, the preferential treatments reserved for foreign investments in China have been eliminated. The tax exemptions (Tax Holiday) for production companies (whose formula provided for 2 years of total exemption + 3 years of 50% reduction) and for export-oriented companies, established after March 16, 2007, they have been eliminated. However, there are categories that have continued to maintain tax benefits. The Regulations on the Implementation of Enterprise Income Tax Law (2008 EIT Regulations) establish the types of facilities provided according to the time of establishment and the type of activity carried out. For companies incorporated in China before March 16, 2007, which enjoyed a preferential tax regime, a "grandfathering treatment" was expected: companies that at the time of the entry into force of the new law in China enjoyed particular tax benefits for a fixed period (including Tax Holiday 3+2) continued to take advantage of the benefits acquired (taking 2008 as the first year of preferential treatment). The previous law also did not establish any withholding tax on dividends distributed by FIEs to foreign investors. Since 2008, the deduction on dividends, interest, royalties, etc. it was set at 20% both in relation to the profits of the FIES and to the income of foreign companies not established in China. The EIT Regulations have reduced the rate to 10%.

In line with the recommendations of the OECD[30], more stringent measures relating to tax avoidance and transfer pricing[31] have been introduced: previously, corporate income was not subject to strict controls by the competent authorities, so companies enjoyed certain freedom in entering into agreements even without specific commercial purposes in order to reduce the tax base or profit; specific rules of "thin capitalization"[32] have been introduced according to which there is a precise "physiological" limit of the debt/equity ratio referable to shareholders (equal to 2 to 1, with the exception of companies operating in the financial sector, for which the ratio can go up to 5 to 1); the introduction of the "interest revenue" clause, which imposes an interest for each adjustment made, this was new for China as previously there were no penalties or surcharges for price adjustments.

Here below the most relevant improvements and adjustments that can be considered the milestones for the Chinese legislation in the last years: in 2008, Corporate Income Tax System for domestic enterprises and foreign enterprises were integrated; in 2009, Real estate tax systems for domestic enterprises, foreign enterprises and individuals were integrated and Fee-to-excise tax

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[30] OECD, "*Transfer Pricing guidelines for multinational Enterprises and Tax administration*" Parigi, 2010

[31] Transfer pricing is an elusive technique through which "manipulating" the transfer prices applied in intra-group transactions, taxable income is moved from one company to another. For further information on the regulations: C. Cheng, L. Zhang, G. Gibson, K. Zhu, "*China*", KPMG Advisory China Ltd. Shanghai, 2012

[32] The rules on "thin capitalization" had already been the subject of a special circular of 2008 (n. 121), which also established a series of documents that the taxpayer had to prepare in accordance with the principle of "free competition", such as the analysis of the firm's creditworthiness, the nature and purpose of the loan, market conditions, currency, interest rate applied, duration, etc.

conversion on refined oil products was adopted; in addition the VAT transformation from manufacture-oriented to consumption-oriented was completed. Enterprises were allowed to deduct the input VAT on purchasing machinery and equipment from their output VAT; in 2010, Urban Maintenance and Construction Tax for domestic enterprises, foreign enterprises and individuals were integrated; in 2012, Business Tax to VAT Pilot Reform was carried out in the transportation sector and certain modern services sectors in several regions; in 2013, Business Tax to VAT Pilot Reform was extended to other parts of China; in 2014, Business Tax to VAT Pilot Reform was further extended to the sectors of railway transportation, mail and telecommunications; in 2015, progress was steadily made with the Business Tax to VAT Reform and Excise Tax Reform. Resource Tax was reformed to be levied on an ad valorem basis; in 2016, Business Tax to VAT Pilot Reform was extended comprehensively to cover all goods and services. Resource Tax Reform on an ad valorem basis was enlarged in its coverage. Environmental Protection Tax Law of the People's Republic of China, as adopted at the 25th Session of the Standing Committee of the Twelfth National People's Congress of the People's Republic of China, came into force on January 1st, 2018; in 2017, VAT rates were simplified with the rate of 13% abolished, which led to a structure of VAT with 17%, 11% and 6%. The Provisional Regulations of Business Tax of the People's Republic of China was abolished. The Provisional Regulations of VAT of the People's Republic of China

was revised. The Corporate Income Tax Law of the People's Republic of China was revised to give further support to donations for public welfare. The scope of pilot reform on Water Resource Tax was enlarged to nine provinces (autonomous regions, municipalities directly under the Central Government) including Beijing. The Enforcement Regulations of the Law of the People's Republic of China on Environmental Protection Tax was issued. The Law of the People's Republic of China on Tobacco Tax and the Vessel Tonnage Tax Law of the People's Republic of China were approved by voting during the 31st Session of the Standing Committee of the Twelfth National People's Congress and will take effect from July 1st, 2018; in 2018, with the VAT reform further pressed ahead, the original 17% and 11% tax rates were adjusted to 16% and 10% respectively to form the current three-tier VAT rate schedule of 16%, 10% and 6%. By raising the threshold of small-scale VAT taxpayers to the annual turnover of no more than five million RMB, qualified general VAT taxpayers were given the right to re-register as small-scale taxpayers by the end of 2018. Companies in the advanced manufacturing industry like equipment manufacturing and modern service industries like R&D and power grid companies with outstanding input VAT not credited in a specified tax period are eligible for a refund on a lump-sum basis. The Fifth Session of the Standing Committee of the Thirteenth National People's Congress of PRC voted to pass the amendments to the Individual Income Tax Law on August 31st, 2018. On the same day, President Xi Jinping signed the

presidential decree No. 9 to issue the Law. On December 22nd, Premier Li Keqiang signed the decree of State Council to issue the Provisional Regulations on Specific Deductions of Individual Income Tax and the Revised Regulations on Implementation of Individual Income Tax Law. A combination of a comprehensive IIT system and a scheduler IIT system came into force on January 1st, 2019.

The legislative process was quite complex, as the government, in addition to managing the difficulties that the formulation and application of new rules require, had to face the issue of incentives and tax deductions granted to foreign companies (which guaranteed a huge flow of capital to China and driving force behind the country's economic development) and rules imposed by the WTO relating to the abolition of preferential tax regimes for the creation of a competitive economic system. In general, the reform has been welcomed internationally. Despite the distortions and complexities that it still preserves, on the whole, the effort of wanting to promote a more transparent and difficult to understand system for foreign investors is observable, thus reducing uncertainty and misunderstandings.

In the next chapter, it will be analyzed more in depth the argument of foreign investments, keeping the focus on China and the new law that provides an equal environment for foreign investors.

CHAPTER II. THE NEW CHINESE FDI REFORM

2.1. FOREIGN DIRECT INVESTMENTS: SOME DEFINITIONS

The internationalization of companies can be achieved through three methods: exports, collaboration agreements and foreign direct investment (FDI). In particular, according to the definitions provided by the International Monetary Fund (IMF)[33] and the Organization for Economic Cooperation and Development (OECD)[34] an FDI is an investment in a foreign company (direct investment company) in which the foreign investor (direct investor) owns at least 10% of the ordinary shares or 10% of the voting power, which aims to establish a lasting interest in the country, a long-term relationship and a significant influence in the management of the company. FDI implies a transfer of a package of assets or intermediate products, including financial capital, organizational and management skills, technology, entrepreneurship, incentive structures, cultural values and norms, and access to foreign markets. Moreover, FDI does not imply changes in ownership: decision-making power over transferred resource use remains to the investor. In this sense, foreign direct investments differ from portfolio investments

[33] INTERNATIONAL MONETARY FUND, "*Balance of Payments and International Investment Position Manual*" Sixth Edition, Washington DC, 2009
[34] OECD, "*Benchmark Definition of Foreign Direct Investment*" Fourth Edition, Paris, 2008

which, on the other hand, only involve the transfer of financial capital and do not imply a significant influence in the management of the company[35].

The foreign investor, the one who makes an IDE, is identified in individuals or groups of individuals, companies or groups of public and private companies, and governments that have acquired at least 10% of the voting power of a capital company, or the equivalent for a non-capital company incorporated in a company, residing in another economy. This enterprise is a direct investment company, also referred to as a foreign affiliate, in the form of joint stock companies such as the subsidiary (where the investor controls more than 50% of the power of vote) and the affiliate (where the investor controls at least 10% but not more than 50% of the voting power), or in the form of a non-incorporated company . The creation of subsidiaries in a foreign country can mainly be done in two ways: greenfield FDI, that is when investment projects imply the creation of completely new plants or the merger and acquisition process (M&A: Mergers and Acquisitions) of pre-existing companies. Both forms of investment have characteristic advantages and disadvantages that push a company to adopt either one or the other type of FDI according to the type of company and according to its objectives. M&A operations are generally motivated by the desire to obtain greater efficiency and better profits and directed towards more competitive markets where it is difficult

[35] J. Dunning, S. Lundan, "*Multinational Enterprises and the Global Economy*", Edward Elgar Pub, 2008

to penetrate in different ways. In fact, the advantages of M&A consist of gaining access to the host market avoiding any barriers to entry, acquiring thanks to the merger or acquisition also trained workers, licenses, technologies as well as stable and long-lasting relationships with customers and suppliers. The disadvantages instead lie in the fact that a merger or acquisition involves an effort to integrate the different corporate cultures of the companies involved, as well as to train the local management and also the technology of the company to be acquired or merged may already be obsolete. Greenfield investments, on the other hand, are directed towards less competitive markets and often in developing countries. Greenfield investments ensure greater control over all aspects of the business, also avoiding the clash of different corporate cultures, allow you to focus on the long term instead of the short, allow you to achieve economies of scale and purpose in production, in the research and development, in marketing, in transport and in purchases. However, these also present critical aspects as they usually cost more than a merger or acquisition, in the host market there may be expensive entry barriers to overcome as well as strong competition, and also host country government interventions to regulate investments entering the country may disadvantage multinationals in the short term. These two different methods of entering the foreign country have different effects on its economy, as, generally, a M&A does not involve significant changes in the performance of economic activities such as production, employment and the volume of business, unless

significant restructuring is to be carried out in the acquired company. Greenfield investments, on the other hand, add new dimensions to the economic performance of the host country, such as job creation, and earnings of those who invest.

When talking about the foreign direct investment it is important to distinguish between FDI flow and FDI stock. The difference lies in the fact that the flow of FDI refers to a variation while the stock to an accumulation. Measures related to foreign direct investment are represented by FDI flows which include share capital, reinvested earnings and other direct capital investments and the FDI stock which, on the other hand, represents the total direct capital owned by non-residents in a certain country in each year[36]. To offer a general view of the theme we must distinguish between the two different types of foreign direct investment, the horizontal and vertical FDI. Following the vision of Shatz and Venables[37], two main reasons are identified why an enterprise decides to become international: to better serve a local market and to obtain low cost resources for production. The first motivation is the basis of horizontal FDI, while the second is the basis of vertical FDI. To serve a foreign market, the company may decide to create a horizontal FDI, specifically, a phase of the production process is duplicated with the creation of a plant, in addition to the plant already present in the country of origin. The transition to local production will bring benefits such as reducing costs

[36] B. Navaretti, J. Venables, "*Le multinazionali nell'economia mondiale*", Il Mulino, 2006

[37] H. Shatz, J. Venables, "*The Geography of International Investment*", World Bank, 2000

related to the replenishment of markets (transportation costs and tariffs) and the consolidation of the competitive position of the company, due to its proximity to the market and its ability to respond to changes in local circumstances and preferences. Horizontal FDI tend to replace exports in case the costs of access to the market are high or the costs of setting up a local plant are low. In addition, the same substitution occurs in the case that the markets are large, for two reasons: the fixed costs of the plant can be spread over several product units and the presence of numerous local businesses and therefore greater competition, leads to a lowering of product prices, in this way, if the marginal cost of supply market through exports is high, an enterprise will consider cheaper to move local production. Vertical FDI, on the other hand, refer to the movement of entire phases of the vertical chain production in countries where production factors such as labor, raw materials, intermediate goods and access to externalities are low cost. For this type of FDI it is necessary to consider the fact that the different stages of the production process may require different production factors, the price of which is different in the various countries, so for the enterprise it can be convenient to divide the production process into various areas. Vertical FDI in general tend to stimulate exports, as products are exchanged at different stages between the various locations.

Last but not least, based on the objective of the FDI, these can also be divided into four categories: resource seeking, which includes all foreign investments whose

main objective is to acquire resources not available in the domestic country or available at a lower cost; market seeking, investments that aim to exploit the opportunities offered by a foreign market by reducing the costs necessary to serve it remotely; the efficiency seeking, investments through which multinationals exploit differentials and availability of resources in different countries costs, economies of scale and scope and the differences in consumer preferences; and finally the strategic asset seeking that have the aim of acquiring a new technological base instead of exploiting the existing one.

2.2 FACTORS OF ATTRACTION FOR FDI

A firm's decision regarding the location of the investment is determined by a series of factors that are based on the country 's characteristics and needs and to the intentions of the company itself.

These attraction factors are the geographical distance, the size of the market, the effects of agglomeration[38] , the cost of production factors, tax incentives, the economic and political environment, its stability and openness to trade, some of these factors affect all types of FDI, while others have different effects on the

[38] The agglomeration phenomenon refers to the fact that both horizontal and FDI verticals have a tendency to cluster in certain places, probably because of links between projects, which create incentives to locate businesses in the same place.

various types of FDI[39]. Regarding the geographical distance, this represents an important determinant in the decision to locate an FDI, given that it is considered in terms of costs, for example transport costs, in this case, by their very nature, horizontal FDI and market seeking will be stimulated in the presence of high costs, while vertical ones and natural resource seeking will be discouraged. Generally, FDI are affected positively also from the geographical proximity, since, reducing the uncertainty related to the information, transportation and monitoring costs, the multinational enterprise is not exposed to risk. Also, the size of the host market, its growth prospects and real GDP and GDP per capita are one of the most relevant factors that the company takes into consideration. A large market and high GDP growth encourages horizontal FDI and market seeking, while vertical and natural resource seeking are substantially indifferent to this type of factor. The agglomeration effects, since they generate positive externalities in the area concerned and increase the productivity and profit of the company, they are considered as an important determinant in relation to each type of FDI. The factors contributing to agglomeration effects are essentially the state, the infrastructure development, the degree of industrialization and the size of FDI stocks already present in the host country. Agglomeration economies act as a clear signal for other foreign enterprises of the existence of a favorable economic environment. The cost of inputs, such as low labor costs, has a

[39] H. Lim, "*Trade and Human Rights*", J.W.T., 2001

particular influence on vertical FDI, natural resource seeking and efficiency seeking, and to a lesser extent on those horizontal and market seeking. The tax incentives offered by the host country have positive effects on all types of investment, especially on vertical FDI, natural resource seeking and efficiency seeking as they are more cost sensitive. To attract FDI, a country can offer special measures and investment tax incentives, for example by establishing Special Economic Zones (SEZ), where different rules are in force compared to the rest of the country in which they are established. Multinational companies are driven to invest in countries characterized by a favorable economic and political environment, which presents a certain degree of liberalization, convenient interest and exchange rates and also strong protection of intellectual property rights. Furthermore, a depreciation of the host country's currency tends to increase FDI inflows, while an appreciation and the consequent increase in the rate exchange have negative effects. Such an environment, of good governance, characterized by policies to promote competition at domestic and international level, by transparent legal systems and regulatory frameworks and effective delivery of public services, reduces additional costs that are presented to a company when it decides to invest abroad, related to regulatory, bureaucratic and legal barriers. In this way you have positive effects on all types of FDI. In contrast, a situation of political instability, especially in reference to developing countries, have negative effects on FDI. Liberalization and openness to trade have

a positive influence on all FDI particularly on vertical and *natural resource seeking*, which require numerous exchanges. Horizontal FDI and *market seeking* can be indirectly influenced by this factor, as they can be encouraged by the economic environment and by the market growth prospects deriving from such an opening. A company prefers to invest in countries with which it has cultural similarities, as it provides an easier adaptation. The social environment is just as important as well as a high level of entrepreneurial culture[40]. Even a country's level of corruption has an impact on FDI, which for the most part, it is negative because a corrupt system is strongly related to a bad government[41].

2.3 THE EFFECTS OF FOREIGN DIRECT INVESTMENTS

The issue of foreign direct investment is highly controversial, as shown by the numerous concerns of governments resulting from the effects they have in the country of origin and in that of destination.

The positive consequences of the incoming flow of investments in the destination country could be that investments can provide capital (given that, due to their size, multinational companies have access to both internal and external financial

[40] Cheung, Secretary for Labour and Welfare, GIS 15 March 2012

[41] J. Dunning, S. Lundan, "*Institutions and the OLI paradigm of the multinational enterprise*", Springer Science, 2008

resources not available in local companies), technology (especially important in less developed countries where R&D centers and adequate skills are lacking to develop advanced local technologies and products), and managerial skills that increase the country's economic growth. Moreover, FDI increase the employment rate as they create jobs in the destination country that otherwise would not be created, thanks to a direct effect (number of hires by the multinational in the host country) and an indirect effect (job creation for local suppliers and due to the higher expenditure of employees of the multinational's foreign subsidiary); As regards the effect of FDI on the balance of payments, if these are substitutes for imports of goods and services, or if multinationals use a foreign subsidiary to export to other countries, the effect is to improve the current account (which tracks the import and export of a country) of the host country's balance of payments. If FDI take the form of greenfield investments, these have the effect of increasing competition in the local market, which leads to a reduction in prices and consequently greater economic well-being for consumers. In addition, a greater degree of competition stimulates companies to invest in R&D with the aim of obtaining an advantage over competitors thus increasing the country's economic growth.

However, there are also negative consequences of the incoming investment flow in the destination country. It may happen that the foreign subsidiaries of multinationals have more economic power than local businesses (since they are

part of a large international organization) and therefore are able to attract better sources of financing. This could lead to a monopolization of the market by the multinational company with undoubted repercussions for local businesses, for the economic well-being of consumers and for the growth of the country. Furthermore, if greenfield investments are expected to increase competition, mergers and acquisitions have an ambiguous effect on competition. In any case, in many countries the antitrust authorities have the right to block any merger or acquisition that can decrease the level of competition in the local market. Some host country governments fear that FDI will follow a loss of economic independence due to the fact that many important decisions that can affect the economy of the local country are made by the parent company which has no commitment to the country where it is precisely its subsidiary leased. There may also be a negative effect on the balance of payments due to the return to the parent company of profits previously made in the subsidiary or due to the fact that the subsidiary imports a substantial number of inputs from abroad.

While for the country of origin the positive consequences according to Hill (2013) are: a positive effect on the domestic country's balance of payments due to the incoming flow of earnings from foreign subsidiaries, and the creation of demand for exports from home country to host country.

There may be a positive effect on the employment rate if foreign investment creates export demand for the domestic country. Another positive effect may

derive from the fact that the multinational, thanks to its exposure to a foreign market, can develop new skills and knowledge to be transferred to the domestic country. The negative consequences of the country of origin according to Hill (2013) could be a negative effect on the balance of payments due to the initial outflow of capital to finance foreign investment. Another negative effect on the current account of the balance of payments can arise if the reason for the FDI is to serve the domestic market from a low-cost country, or if the FDI is a substitute for exports. In addition, there may also be a negative effect on the employment rate when foreign long-term investment replaces local production.

2.4 FOREIGN DIRECT INVESTMENTS IN CHINA

One of the strengths of the "Chinese model", supported with great enthusiasm by the Chinese leaders, was certainly that of investments, which led China itself to consolidate its position as a global investor. Certainly, the role of the government has been fundamental both for incoming FDI (with the open-door policy implemented since 1978) and for outgoing FDI (with the "go out policy" implemented in 1999). China remains one of the most vigorous and growing economies, positioning itself in terms of GDP generated in second place behind the United States. The economic improvement has allowed a structural change in the consumption and needs of the population: an increase in incomes and well-

being, combined with increasing urbanization, has led to the rise of new trends and consumption patterns, in particular of luxury goods and food.

China has two specific advantages that can incentivize foreign companies and entrepreneurs to invest locally: it is the manufacturing center par excellence and it is the first market in terms of potential number of consumers. According to the 2019 World Investment Report published by UNCTAD, China was ranked the world's second largest FDI recipient after United States and before Hong Kong. The country is the largest recipient of investments in Asia and China's economy was ranked the second most attractive to multinational companies for 2017-2019, only behind the U.S. With steady growth for several years (see Table 2.1), FDI inflows continued to increase between 2017 and 2018, from USD 136 billion to 139 billion (+3.7%, all-time high).

Foreign Direct Investment	2016	2017	2018
FDI Inward Flow *(million USD)*	133,71	134,063	139,043
FDI Stock *(million USD)*	1,354,613	1,488,676	1,627,719
Number of Greenfield Investments***	798	751	871
FDI Inwards *(in % of GFCF****)*	2.8	n/a	n/a
FDI Stock *(in % of GDP)*	12.1	n/a	n/a

Table 2.1 - source: UNCTAD 2019

*Note: * The UNCTAD Inward FDI Performance Index is Based on a Ratio of the Country's Share in Global FDI Inflows and its Share in Global GDP. ** The UNCTAD Inward FDI Potential Index is Based on 12 Economic and Structural Variables Such as GDP, Foreign Trade, FDI, Infrastructures, Energy Use, R&D, Education, Country Risk. *** Green Field Investments Are a Form of Foreign Direct Investment Where a Parent Company Starts a New Venture in a Foreign Country By Constructing New Operational Facilities From the Ground Up. **** Gross Fixed Capital Formation (GFCF) Measures the Value of Additions to Fixed Assets Purchased By Business, Government and Households Less Disposals of Fixed Assets Sold Off or Scrapped.*

This growth is favored by the Chinese government that promotes and encourages foreign investments in sectors characterized by high innovation. Among the most stimulated sectors could be found high technology products, highly innovative industrial equipment and machinery and renewable energies. In November 2017, a novelty was also introduced relating to foreign investments in the financial and insurance sector, which removes the previous limits on foreign investments in financial intermediation companies, banks, securities management companies and insurance companies. In addition, tax incentives and reduced tax rates are provided for business initiatives in the internal and western regions of China, in order to promote and stimulate the economy of these areas which have benefited from the Chinese economic boom to a lesser extent than coastal areas. The reduced rates are also provided for innovative companies with a strong technological component, which are recognized with a special license that certifies their high-tech enterprise status. Despite trade tensions with the United States, more than 60 000 companies were established by foreign investors in 2018, a 70% increase compare to 2017. The country continued absorbing flows from developing Asian countries and developed countries (UK and Germany), thanks to M&A deals. Main deals were the acquisition of a majority stake in Sichuan Swellfun by Diageo ($9 billion), an investment of $4 billion by BMW in the country. However, inflows from the US decreased from $10 to $ 6 billion in 2018. Stocks increased by 9%, reaching 1 627 billion (12.1% of the GDP). In

2017, Hong Kong was the largest investor in China. Singapore, the Virgin Islands, South Korea, Japan, the United States, the Cayman Islands, the Netherlands, Taiwan, and Germany were other major investors. Investments were mainly oriented towards manufacturing, computer services, real estate, leasing business and services, wholesale and retail trade, financial intermediation, scientific research, transport, electricity, and construction[42].

Moreover, in the World Bank's 2020 Doing Business report, China was ranked 31st out of 190 countries, that consist on a relevant improvement from 2019, when it was ranked 46th out of 190.

This progress reflects improvement in a wide array of subcomponents ranging from procedures for starting a business to measures to improve electricity access and get construction permits. The country demonstrated reform agendas that aim to improve the business regulatory environment in the country over the course of several years. The reforms mainly focus on increasing the efficiency of business processes, such as tax cuts, trade with tariff cuts, and reduced barriers to foreign investors. In order to attract further foreign investment, the country has introduced mechanisms to improve the delivery of major foreign investment projects, reduce import tariffs, streamline customs clearance, and establish an online filing system to regulate FDI. With a wealth of employees and potential partners eager to learn and evolve, the country is a base for low cost production, which makes it an

[42] SANTANDER TRADE, https://santandertrade.com/en/portal/establish-overseas/china/

attractive market for investors. Nevertheless, certain factors can hinder investments, such as China's lack of transparency, legal uncertainty, low level of protection of intellectual property rights, corruption or protectionist measures which favor local businesses. FDI inflows to the high-tech sector have been rising significantly and currently account for almost a third of total inflows[43]. The following tables (2.2, 2.3) regard FDI inflows by country and by industry in China.

Main Investing Countries	2017, in %
Hong Kong	72.1
Singapore	3.6
Virgin Islands	3.0
South Korea	2.8
Japan	2.4
USA	2.0
Cayman Islands	1.6
Netherlands	1.6
Taïwan	1.3
Germany	1.1

Table 2.2 - source: China Statistical Yearbook, 2018 - Latest available data

[43] SANTANDER TRADE, https://santandertrade.com/en/portal/establish-overseas/china/foreign-investment

Main Invested Sectors	2017, in %
Manufacturing	25.5
Information transmission, computer services and software	15.9
Real estate	12.8
Leasing and business services	12.7
Wholesale and retail trade	8.7
Financial intermediation	6.0
Scientific research, technical service and geologic prospecting	5.2
Transport, storage and post	4.2
Production and supply of electricity, gas and water	2.6
Construction	1.9

Table 2.3 - source: China Statistical Yearbook, 2018 - Latest available data

However, even if these data are indicating the relevance of China in attracting investments, Foreign direct investment into China dropped 6.1 percent year-on-year to CNY 286.55 billion, in the first four months of 2020 due to the Covid-19 outbreak (see Table 2.4). Still, investment in the high-tech service industry rose by 2.7 percent. Among them, information services, e-commerce services, and professional technical services increased by 46.9 percent, 73.8 percent, and 99.6 percent respectively. Meanwhile, the investment from countries along the Belt and Road went up by 7.9 percent, and that from ASEAN countries rose by 13 percent. But the investment from the EU dropped by 29.1 percent. In April only, the FDI surged 11.8 percent from a year earlier[44].

[44] TRADING ECONOMICS, https://tradingeconomics.com/china/foreign-direct-investment

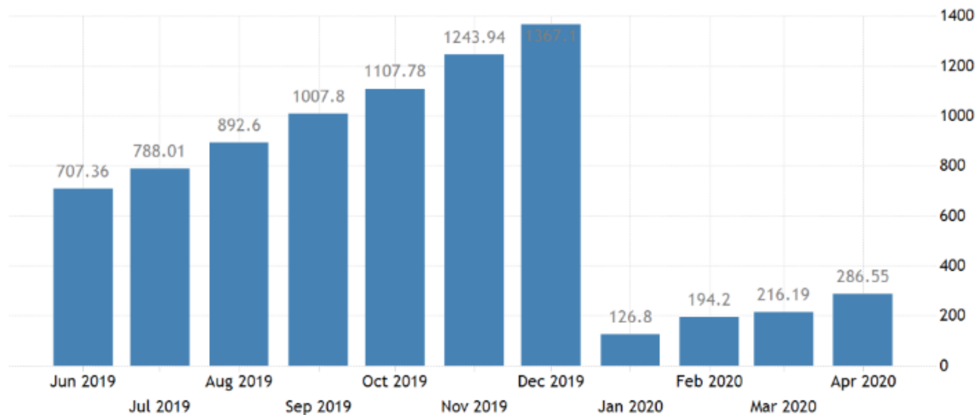

Table 2.4 - source: tradingeconomics – Ministry of Commerce of the PRC

2.4.1 What to consider when investing in China

When investing in China it is important to have in mind what are its strong points, its weakness and the Government measures to motivate or restrict FDI[45].

Strong points for FDI in China include:

- The largest internal market in the world, with 1.3 billion potential customers
- Importance of foreign currency reserves and public debt owned by Chinese government and individuals
- A well-developed production sector (manufacturing sector and heavy industry)

[45] SANTAND TRADE https://santandertrade.com/en/portal/establish-overseas/china/foreign-investment

- A favourable geographic location (close to emerging Asian markets, to Japan, maritime frontage)
- Top economy in terms of purchasing power parity (PPP) thanks to rapid growth of the economy
- Labour costs remain comparatively low, although the situation is changing in certain areas
- New opportunities with the development of the western provinces (particularly Sichuan province)
- Development of a new export network (Silk Road network)

Weak Points for FDI in China include:

- An ever-changing legal environment
- Bureaucratic and administrative complexities
- A lack of transparency, corruption and weak intellectual property rights protection
- Ageing population
- High level of corporate indebtedness
- Production overcapacity in several sectors
- A strongly degraded environmental situation in several big cities
- Cultural differences in business practices that may be difficult for foreigners to learn and apply in new business situations

- Underdeveloped middle management and low rate of qualified workers

Government Measures to Motivate or Restrict FDI:

- Generally speaking, the Chinese government is more restrictive than other big economies in regard to foreign investment, with numerous sectors closed to FDI. State companies and "national flagships" are protected (discriminatory practices, non-independent judicial power, selective application of regulations). The Chinese state demands forced technology transfer and its intellectual property protection system is weaker than most industrialized countries.
- The Chinese government encourages investment in the following industries or sectors: high technology, production of equipment or new materials, service sector, recycling, use of renewable energies and protection of the environment. In addition, the country appears to discourage foreign investment in key sectors, for which China seeks to transform domestic firms into globally competitive multinational corporations and sectors that have historically benefited from state monopolies or traditionally of State. The government also discourages investments intended to profit from speculation (money, real estate, or assets). In addition, the government plans to limit foreign investment in resource-intensive and highly polluting industries.

2.5 THE NEW FOREIGN DIRECT INVESTMENT LAW

The Thirteenth National People's Congress meeting held in March 15th, 2019, was concluded with the approval of the draft of the new Foreign Investment Law (in Chinese: 中华人民共和国外商投资法), which came into effect the 1st of January 2020 (an earlier version of the draft law was initially introduced in 2015 but was put on the back-burner due to disagreements on its content). This long-awaited reform, which is undoubtedly one of the milestones of the Chinese legislation of this decade, aims to completely reshape the discipline of access, promotion, protection and management of foreign investments in the mainland China[46]. The discipline mentioned above was governed by three laws inspired by the Open Door policy, namely: the "Chinese-Foreign Equity Joint Ventures Law", the "Wholly Foreign-Owned Enterprises Law" and the "Chinese-Foreign Contractual Joint Ventures Law ", adopted between the early eighties and late nineties of the last century and destined for repeal with the entry into force of the new law (in accordance with the Art.42 of the Foreign Investment Law).

The new Foreign Investment Law follows China's moves to further open its market and level the playing field for foreign businesses competing with domestic private firms and state-owned enterprises. China hopes that the updated legislation will improve the country's ease of doing business, which has begun to lag and

[46] G. PISACANE, "CINA, Legge sugli investimenti stranieri" 02/04/19 http://www.diritto24.ilsole24ore.com/art/avvocatoAffari/mercatiImpresa/2019-04-02/cina-legge-investimenti-stranieri-2019--125540.php

coincides with rising competition from ASEAN for foreign investment in the region[47], this is going to be explained better in the next subchapter.

The text, approved in record time at the last session of the plenary meeting of the National People's Congress (NPC), has a total of 42 articles and is divided into 6 chapters: General Provisions, Investment Promotion, Investment Protection, Investment Management, Legal Liability and Supplementary Provisions.

The brevity of the text and the programmatic nature of the provisions, many of which basically limit themselves to setting out principles and guidelines, have been the subject of perplexity and criticism considering the fundamental importance of the matter that the law proposes to regulate and the possible consequences for commercial traffic, in case of uncertainty on the interpretation of the discipline. However, it should be noted that, the Chinese legislator is no stranger to this type of regulatory drafting. It is not uncommon for the National People's Congress to issue short and general texts, containing only the guiding principles, which are then destined to be applied, implemented and specified, only subsequently by means of special laws and regulations. This integration process is carried out, in particular, through administrative regulations, the importance of which in defining the application of the rules, becomes equal, if not superior, to the text of the law.

[47] Q. ZHOU, "China's New Foreign Investment Law: A Backgrounder" 17/10/19 https://www.china-briefing.com/news/china-new-foreign-investment-law-backgrounder/

2.5.1 Background of the new law

The emanation of this law was characterized by an unusual and expedited legislation (see Table 2.5), in fact the FIL was passed only three months after being brought back onto the agenda by Chinese policymakers, where the same level of legislation often takes years.

Dec 26, 2018	Jan 29, 2019	Mar 8, 2019	Mar 15, 2019
The 1st draft of the FDI was released for comment	The 2nd draft was released for review	The 3rd draft was deliberated at the National People's Congress	The final Foreign Investment Law was passed and released

Table 2.5

The FIL is an attempt by the Chinese government to respond to international criticism from the US and other countries about China's openness, or lack thereof, to foreign businesses. According to World Bank's index, China's ease of doing business score is ranked 31 in the world[48], still behind many countries such as the US, Malaysia, Germany, and Russia.

In this context, it is clear to see why China needs a law like the FIL to demonstrate a commitment to a more open and transparent business environment for foreign investment.

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[48] WORLD BANK GROUP, http://documents.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf

Moreover, it is important to take into consideration that the legislation was inspired by another concern: the three existing laws on wholly foreign owned enterprises (WFOEs), Sino-foreign contractual joint ventures (CJVs), and Sino-foreign equity joint ventures (EJVs) were no longer serving the needs of the economy. As already said, these corporate establishment structures were announced between 1979 and 1990, the early years of China's economic opening. With China's economic growth slowing down, and ASEAN's (Association of Southeast Asian Nations) rise as an alternative FDI destination, China needed a more welcoming investment climate to remain competitive. In fact, ASEAN has become a strong competitor of China in attracting FDI (see Figure 2.1). More and more labor intensive and export-oriented industries are relocating to ASEAN countries for lower costs. For example, in 2017, FDI inflows into ASEAN countries increased by 11 percent, far more than the two percent FDI increase in China in the same period.

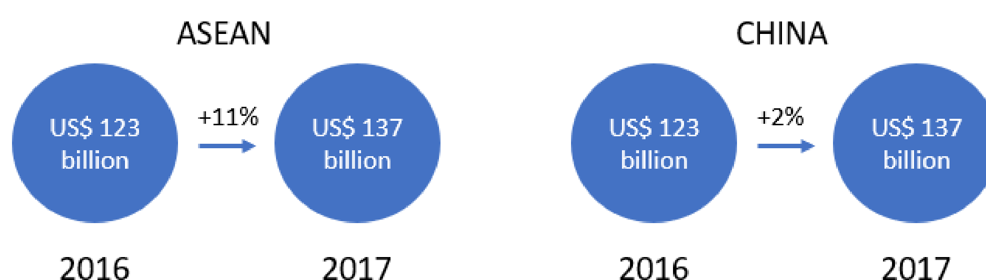

Figure 2.1 – source: UNCTAD, MOFCOM

Key FDI sectors are also changing, in fact the proportion of FDI into general manufacturing and real estate sectors are declining, while the proportion of FDI into high-tech industries, such as computer, internet, and finance sectors, continues to rise (see Figure 2.2).

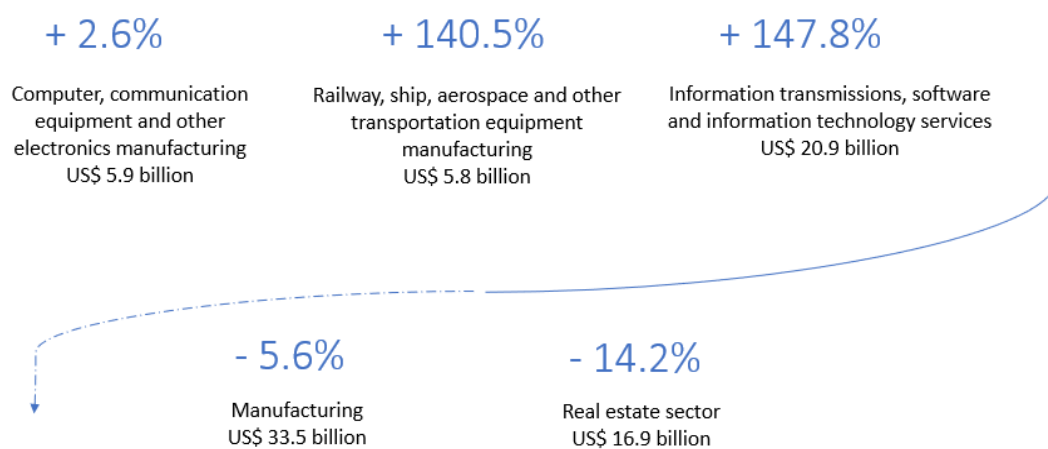

Figure 3.2 – source: MOFCOM

In this context, China needed a modern and unified law to reflect its new economic structure and assure the foreign investment community about the incentives associated with investing in the country.

2.6 ANALYSIS OF THE SECTIONS OF THE LAW

Here follows the analysis of the Foreign Investment Law divided into the 6 thematical areas: General Provisions, Investment Promotion, Investment Protection, Investment Management, Legal Liability and Supplementary Provisions.

2.6.1 General and Supplementary provisions

The first chapter defines, first of all, the field of application of the law and its aim that is to actively promote foreign investments, protect the legitimate rights and interests of foreign investment, regulate foreign investment management, promote the formation of a comprehensive new opening pattern, and promote the healthy development of the socialist market economy. The rule recognizes any individual, business or other organization belonging to a foreign country as a "foreign investor". Any "foreign company" established under Chinese law which is affected by an investment, even if only partially, made by a foreign investor is considered a "foreign company". It also includes investors originating from Hong Kong, Macau, and Taiwan. Finally, the law recognizes as "foreign investments", investments (both direct and indirect) made by foreign investors, in the territory of the R.P.C., expressly including (Art.2): the establishment of foreign-invested enterprises (FIE) and the simple investment in new projects, individually or collectively with other investors; the acquisition of stocks, shares, property shares,

other form of equity, or other similar rights and interests of enterprise within the territory of China; investments in laws, administrative regulations or other methods prescribed by the State Council.

As regards the FIE, the internal distinctions will fall, as a consequence of the repeal of the three laws that regulated the possible forms of investment and their corporate organization (ie the types of Joint Ventures (EJV and CJV) and Wholly Foreign Owned Enterprises). In replacement, the new text establishes that, in terms of "corporate organization, institutional framework and standards of conduct", the FIEs will be governed by the regulations applied to Chinese companies (as explained in the Art.31, that expressly refers to the P.R.C. Company Law[49] and the P.R.C. Partnership Law[50]. Finally, in the last chapter of the law that regards the Supplementary Provisions, in order to avoid frictions during the implementation of the new law, the normative text ends (Art.42) with a provision that introduces a transitional period of 5 years from the entry into force of the text, during which the FIE will be able to maintain the their current form entity and chosen corporate organization (CJV, EJV and WFOE), in derogation of the new provisions.

Among the newly introduced general principles, the "Pre-entry National Treatment plus negative list" system (Art.4) stands out. In the previous

[49] To read the full law: http://www.fdi.gov.cn/1800000121_39_4814_0_7.html

[50] To read the full law: http://www.fdi.gov.cn/1800000121_39_4109_0_7.html

regulations, investments were divided into prohibited, restricted and favored categories. The belonging of the various sectors affected by the investments to these category-lists was identified by administrative regulations. The new text instead establishes a single "negative list" of prohibited and limited investments, for which the Council of State, the supreme administrative body, will be competent in identifying its content. With the consequence that, for all the investments not included in this list, by virtue of the principle just mentioned, the foreign investor must be granted a treatment no less favorable than that granted to domestic investors/investments in the same sector.

The sectors of the negative list are specifically divided into:

"Prohibited Sectors", the investment in these areas is totally inhibited to foreign investors, in any way, directly or indirectly (both through the acquisition, also of minority interests, and through the start of new business);

"Limited Sectors", here operate special rules defined by the list and regulations, which may insist on the maximum percentage of shares held by the foreign investor (such as in the automotive sector, where, even in the most recent version of the list, the limitation of 50% of the quotas remains as the maximum limit for foreign investment), or on the subjective qualifications and composition of the top corporate bodies, in particular the Board of Directors. In order to invest in these sectors, therefore, in addition to maintaining the requirements, an administrative

permit (Entry permit, previously introduced under the FTZ regime, for example in Shanghai in 2013) is also required.

It must be explained, that in 2017, the Chinese government implemented a nationwide system of special administrative measures for foreign investors' access to the Chinese market (Negative List)[51]. In the same year, the Chinese government also released a catalog of the encouraged industries for foreign investment (Catalog of Encouraged Industries, see Figure 2.3). The government amended the Negative List in each of 2018 and 2019 by reducing the number of restricted and prohibited industries for foreign investment from 63 (in 2017) to 40 (in 2019). The Catalog of Encouraged Industries was also amended in 2019 (see Figure 2.4)

[51] M. SETO, S. WANG, "China speeds up the making of 2020 Negative List and Catalogue of Encouraged Industries for Foreign Investment" 07/04/20, https://www.deacons.com/

Key Industries Added to China's New Draft Encouraged List	
Industry category	Encouraged areas of investment
Agriculture, forestry, animal husbandry and fishery	Aquatic seedling breeding, construction and management of ecological environment protection projects
Manufacturing industry	Recycling used textiles
Pharmaceutical industry	New key raw material for production of vaccines, cell therapy drugs, and large-scale cell culture products
Rubber and plastic product industry	Development, production and application of biodegradable plastics and their products
General equipment manufacturing	Fifth generation mobile terminals (such as mobile phones, car, drones, virtual reality and enhanced displayed) and its core components (optical lenses and lenses, lasers, sensors, motors etc.)
Information transmission (new industry category)	E-commerce system development and application services
Technical service	AI technology, smart devices, medical robots for health advancement, green buildings, energy
Water conservancy, environment and public facilities management industry	River and lake water environment management
Health and social work	Medical institutions and aged institutions now distinguished
Culture, sports and entertainment	Tourism infrastructure construction and tourism information services

Figure 2.3 – source: asiabreafing ltd.

Changes to China's 2019 National Negative Lists		
Sector	**2018 National Negative List**	**2019 National Negative List**
Mining	The exploration and development of oil and natural gas (excluding coalbed methane, oil shale, oil sands, shale gas, etc.) shall be limited to joint ventures and cooperation.	Removed
	• Foreign investment in exploration and mining of tungsten, molybdenum, tin, antimony, and fluorite shall be prohibited. • Foreign investment in exploration, mining, and mineral processing of rare earth shall be prohibited. • Foreign investment in exploration, mining, and mineral processing of radioactive minerals shall be prohibited.	Foreign investment in exploration, mining, and mineral processing of rare earth, radioactive minerals, and tungsten shall be prohibited. Remark: Restriction on foreign investment in exploration and mining of molybdenum, tin, antimony, and fluorite has been removed.
Manufacturing	Foreign investment in the production of Xuan paper and ink ingot shall be prohibited.	Removed
Production and supply of electricity, heat, gas and water	In cities with the population of more than 500,000, the construction and operation of gas, heat, and water supply and drainage networks shall be controlled by the Chinese side.	In cities with the population of more than 500,000, the water supply and drainage networks shall be controlled by the Chinese side. Remark: The restriction on foreign participation in the construction and operation of gas and heat in cities with the population of over 500,000 has been removed.
Transportation	Domestic shipping agents shall be controlled by the Chinese side.	Removed
Value-added telecommunications	For telecommunication companies: Under the telecommunication services open as per China's WTO commitments, the foreign share of value-added telecommunication services shall not exceed 50% (except for e-commerce business), and the basic telecommunication services shall be controlled by the Chinese side.	For telecommunication companies: The foreign share of value-added telecommunication services shall not exceed 50% (except for e-commerce, multi-party communication, store-and-forward, and call center businesses), and the basic telecommunication services shall be controlled by the Chinese side. Remark: The 50% limit on foreign shares in multi-party communication, store-and-forward and call center businesses has been removed.
Water conservancy, environment, and public facilities management industry	Foreign investment in the exploitation of wildlife resources originally produced in China and protected by the country shall be prohibited.	Removed
Culture, sports, and entertainment	The construction and operation of cinemas shall be controlled by the Chinese side.	Removed
	Performance brokerage institutions shall be controlled by the Chinese side.	Removed

Figure 2.4 – source: asiabreafing ltd.

On 19 January 2020, China's National Development and Reform Commission announced that it would amend the Negative List in 2020 to further open up market access for foreign investment. In addition, China will also step up its efforts in opening-up pilot free trade zones which have been used as a testing ground as part of its economic reform strategy. On 10 March 2020, China's State Council announced that in the face of the impact of the coronavirus pandemic, it would launch six measures to stabilize foreign trade and foreign investment in China. Such measures include, among others, stepping up efforts to shorten the Negative List, and expanding the Catalog of Encouraged Industries to enable foreign investors in more sectors to benefit from preferential policies for tax and others. With respect to the release of the new Negative List, the Chinese government stated that it would speed up the relevant process so that the 2020 Negative List can be released earlier than usual[52]. As for the new Catalog of Encouraged Industries, the Chinese government said that it would move forward to expand the scope of the encouraged industries and focus on the promotion of high-quality development of the manufacturing sector. Moreover, the new Catalog of Encouraged Industries is expected to further develop the potential of China's central, western and northeast regions in supporting the inter-regional industrial transfer in China.

[52] The Negative Lists of years 2017, 2018, and 2019 were all released in June and became effective in July of the same year

*2.6.2 **Investment promotion***

The second chapter introduces some possible future developments of the progressive opening to the market, including the possibility of expanding the Special Economic Zones and implementing other experimental policies (Art.13) as well as establishing more favorable regimes, through laws and regulations, to guide and intensify foreign investments in certain industries, sectors, and geographical areas (Art.14). This chapter establishes the possibility for the FIEs: to participate in public contracts on equal terms (Art.16); as well as having recourse to public capital financing through stocks, corporate bonds and other securities (Art.17).

*2.6.3 **Investment Protection***

The law reiterates a general prohibition on the state expropriation of investments, except for "special circumstances" and "in the presence of a public interest", unless adequate compensation is provided (Art.20). From the same chapter, the FIE is granted the right of free transfer in and outside of mainland China of capital contribution, profits, capital gains, assets disposal income, intellectual property license fees, legally obtained compensation or compensation, and liquidation income that may be freely remitted in RMB or foreign currency in accordance with the law (Art.21). Still on the subject of investment protection, the FIL (Art.22) reaffirms the importance of protecting the intellectual property rights of

foreign investors by emphasizing the need to reconsider the legal liability of subjects who act in violation of these rights (a specification which was added following the third and final discussion of the draft). The same article also provides a general prohibition for the administrative bodies and for the individual employees of the same administrative bodies, to exert any type of pressure aimed at obtaining a "forced" technological transfer of the technology belonging to the FIE, by means of administrative acts and measures. The rule seems to wink at the diplomatic demands of the States representing foreign investors, in particular of the United States, who have made this issue one of the main topics of the trade war.

Indeed, the prescription is not the only burden on the administrative bodies and their employees, they are in fact burdened to keep the information relating to the FIE confidential and in particular that relating to confidential business information the so called "trade secrets" (Art.23). Also prescribing, to local governments and their employees, not to interfere in the performance of the normal activities of the FIE, except on the basis of laws and regulations, as well as not to make access and exit to the domestic market through administrative measures or local regulations for the FIE, more expensive and/or with different conditions, compared to what is established by the FIL at national level.

In order to make the aforementioned obligations more stringent, the text provides that administrative sanctions have to be determined by law, for employees of the

administrative bodies that carry out certain conduct, including those just described (the article expressly also cites abuse of office , negligence and the distorted use of one's own powers to obtain personal advantages) also mentioning the possible implications of criminal liability where ascertained (Art.39).

To further guarantee foreign investments and to facilitate the uniform application of the principles described above, a new alternative mechanism for resolving any disputes between FIE and administrative bodies is provided by law: FIE complaint working mechanism (外商投资企业投诉工作机制). The law specifies that the complaint made to this body, that has still to be established, against government bodies and their employees, does not preclude the possible recourse to ordinary jurisdiction (Art.26).

2.6.4 Investment Management

The chapter opens with the rules relating to the new system of the "negative list" anticipated above (examination of article 4). In this regard, Article 28 specifies that the principle of equal treatment with domestic investments must be applied to non-prohibited and non-restricted investments. To complete the discipline, the law establishes that if a "prohibited" investment (i.e. "restricted" without adhering to the limitations) is made, the administrative bodies may order the restoration of the status quo ante (or, in the case of a restricted investment, they can grant a time frame to comply with limited investment arrangements). In both cases, if the

condition of illegality persists, the law recognizes the right of government bodies to proceed with confiscation (Art.36). Equal treatment is also postulated with regard to obtain special licenses for the exercise of certain activities, identified by law (Art.30). Regarding the governmental control over investments, in addition to the general-preventive one carried out by drawing up the negative list, the law places further limitations, albeit in some respects mitigated, with respect to current regulations. In particular, the FIL, provides for the establishment of the "Foreign Investment Information System" by means of which, the FIE will be required to submit certain information relating to the investment, collected in special documents, the "Foreign investment information reports". The content and scope of these documents, specifies the law, are to be determined according to the principle of "real necessity", with the same ratio, the law postulates the interdepartmental sharing of information concerning the FIE and the investment; so that the latter are not required to provide the same information several times, where it can be found in other government databases (Art.34).

Finally, the law provides sanction regulations in case of non-compliance by the FIE. Thus, the government bodies competent to receive these Foreign investment info reports, can solicit the defaulting FIEs to provide the requested information and if the default persists, they have the right to impose a sanction on the foreign company, between 100,000 and 500,000 RMB (Art. 37).

However, in terms of government interference the main objections have been raised in relation of two forecasts which at the moment, in the absence of implementing regulations, are particularly vague and dangerously open to multiple interpretations. First of all, the possibility for the State to scrutinize and possibly inhibit the investment, for reasons of national security (Art.35) as well as, the reserve for the PRC, to establish prohibitive, restrictive and similar countermeasures, if a state or specific geographical area impose such measures against the investments of entities belonging to the PRC (Art.40) introducing by law a sort of reciprocity principle, which can be activated unilaterally.

2.6.5 Legal Liability

As explained above, the FIL introduces various profiles of responsibility for certain behaviors, generally identified: a) the civil liability of the subjects who act in violation of intellectual property rights; b) the responsibility of government bodies and their auxiliaries, for "forced" technology transfer, for disturbing the exercise of the economic activity of the FIE, as well as, where these officials illegally exercise their duties and functions; and again, c) fines for FIEs, provided for in case of specific non-compliance; to these provisions, already mentioned, must be added d) the general duty of observance of the law and regulations for foreign investors and FIEs, in this regard the law explicitly establishes that any

violations will be recorded in the database of the enterprise credit information system (Art.38).

2.7 THE EFFECTS OF THE NEW REFORM

The FIL represents a 'turning point', even if the previous discipline in the past has played a determining role in the qualitative growth of the internal economy and in the development of opportunities for foreign investors in China, however, it should also be noted that, to fully tap into the potential of the present, a reform was in any case desirable and necessary. The backbone of the current legislation, in fact, for more than twenty years has remained almost unchanged. Therefore, the modernization of the discipline arrives on time, in full coordination with the governmental agenda, to push China to a stage of further opening to the market, even if dampened by the usual "Chinese characteristics". Not even the particular speed with which the text was approved seems casual, but, on the contrary, responding to today's international situation. Probably, in favor of a faster release, the text initially composed of more than 150 articles has subsequently undergone a significant reduction. As a consequence of this decrease, the high administrative bodies, in particular the Council of State, will be called upon to play an absolutely decisive role in the implementation of the discipline in the months following the entry into force of the Law. Precisely because of the generality and vagueness of

some forecasts, the effectiveness and the goodness of the reform will depend on this supplementary activity, which will surely be followed carefully. This final outcome, therefore, will ultimately significantly influence the fate of future foreign investment in China.

To conclude, from the companies and investors perspective, they should expect that this new law set a positive tone for the future of foreign investments in China and allows better protection on the rights for foreign investors. However, as already stated, there are still many practical questions yet to be answered, and they will ultimately decide how and to what extent the new rules will lead to tangible improvement in investment conditions for foreign companies in China. Foreign investors with existing joint ventures in China, in particular, should pay close attention to the relevant provisions of the FIL and the upcoming implementation regulations and measures, prepare themselves for the impending changes to the corporate governance structure in a timely manner and grasp new opportunities for cooperation with Chinese partners[53].

2.8 EASE OF DOING BUSINESS IN CHINA AND IN ITALY

China keeps advancing in Ease of Doing Business rankings, in the latest report of "Doing Business 2020" released on October 24, 2019, the World Bank named

[53] ERNST & YOUNG, "*China*", 2019, https://www.ey.com/en_cn/china-opportunities

China among the top 10 performers in implementation of reforms across eight areas during the past year. And China is ranked 31 out of 190 economies, up 15 places from the previous year. These results clearly reflect the profound efforts China has made to improve the environment for doing business.

Chinese government agencies at many levels have gone to great lengths to achieve this result, and China has launched a series of policies and measures in various fields and capacities. According to Martin Raiser, World Bank Country Director for China, "China has undertaken substantial efforts to improve the domestic business climate for small and medium-size enterprises, maintaining an active pace of reforms" and he said laudable progress has been achieved on a number of Doing Business indicators, particularly in the area of construction permitting.

In the context of the current synchronous slowdown of the world economy and increasing uncertainty, the ranking serves as a vote of confidence in China's opening up, reforms and economic prospects, which should boost the Chinese market confidence[54]. Companies looking to expand into China can be comforted by the report. Chinese business reforms in key areas such as taxing, permits, utilities and trade have not only helped the country move up the rankings, but have also helped the companies have an easier time doing business there[55]. As already stated, the new foreign investment law aligns with international rules and

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[54] H. SHUQUAN, "China keeps advancing in Ease of Doing Business rankings" 28/10/19 http://www.china.org.cn/opinion/2019-10/28/content_75346490.htm
[55] DAXUE CONSULTING, https://daxueconsulting.com/ease-of-doing-business-in-china/

specifies the principles and directions for fostering a stable, fair, transparent and predictable business environment in China. It guarantees equal market access and fair competition by protecting market entities' management autonomy, property rights and other legitimate rights and interests, as well as by promoting the establishment of a unified national platform for safeguarding those rights and interests. And this is not the only measure taken to establish a friendlier business climate. In 2019, China announced the reduction of taxes and social insurance contributions of enterprises, not to mention the lowering of government-levied charges and operating service fees. These actions together have contributed to the expansion of the corporate sector this year, especially private and small enterprises. The "Doing Business" report analyzed only Beijing and Shanghai among Chinese cities, and it has to be considered that it is a challenge to transfer the policies and practices originated in the two cities to other provinces and cities. Yet this has been in progress over the past number of years. Starting from Shanghai, China's Free Trade Zone (FTZ) has expanded inland and to northeastern provinces, forming the so-called "1 + 3 + 7 + 1 + 6" pilot FTZ network. The policies developed within these FTZs are replicable and transferable. Among others, the "negative list" on foreign investments, first adopted within Shanghai's FTZ, has become a country-wide practice, with a significantly shortened list compared to the first version in 2013. Despite the improvements laid out in this year’s ease of doing business report, there are still

areas that foreign companies will encounter issues. China still has work to do in regard to tax compliance, getting credit and cross-border trade, as it still ranks 105th, 80th and 56th in these categories, respectively. According to the report, companies in China must spend an average of 138 days annually when complying with fiscal requirements, which is more than double the amount of time it takes in Singapore. From the report, one of the most important achievement of China regards business reforms aimed at contract enforcement. Policies were able to do this by "regulating the maximum number of adjournments that can be granted and limiting adjournments to unforeseen and exceptional circumstances," according to the report. These reforms now help China rank as one of the most efficient countries in regard to contract enforcement and judicial administration. According to the report, no other country scores as high as China when it comes to judicial administration. Other improvements are that Chinese business reforms implemented in 2019 related to tax included a preferential tax treatment for small enterprises and another aimed at decreasing the value-added tax in certain industries. Another Chinese business reform is a policy that aims to strengthen the protection of minority investors. China also moved up the rankings in the category of trading, in fact, policies aimed at simplifying the process of exporting and importing was able to help in this regard. All these elements made China a great attraction for investments, in this sense the normative system has made great steps ahead in order to provide an environment favourable for foreign investors.

It is possible to make a comparison with Italy, in order to point out the importance of the norms in a certain country, from the point of view of attraction. China as already mentioned is 31th in the index, while Italy is 58th (See below the graphics for the comparison).

Figure 2.5 – source: Doing Business 2020 (World Bank)

Figure 2.6 – source: Doing Business 2020 (World Bank)

Unfortunately, Italy is not an attractive country for foreign investors. The Cgia Research Office says so, according to which the many problems faced by our

entrepreneurs on a daily basis have raised a hypothetical entrance barrier that "diverts" foreign capital elsewhere. Behind this disaffection, explains the Mestre Association, with many taxes, suffocating bureaucracy, little legal certainty, slow and inefficient civil justice, payment times of our Public Administration among the highest in Europe and a frightening infrastructure deficit, "It is no wonder that Italy is in the penultimate position in the European Union for Foreign Direct Investment (FDI)". In 2018, in fact, FDI amounted to 20.5% of GDP, equal to 361.1 billion euros. A figure that places Italy - among the European Union countries monitored by the OECD, only before Greece, which records a worse result than ours[56].

The presence of foreign holding companies is important. In fact, the weight of foreign holding companies active in the country is not indifferent. Indeed, according to the latest Istat data available (year 2017), multinationals (i.e. foreign resident-controlled companies) are approximately 15 thousand units, employ more than 1.35 million employees and produce 572.3 billion euros in turnover per year. The secretary of the CGIA, Renato Mason, contributes to highlighting this concept, according to which "although they are increasingly widespread in the services sector and less in the industrial sector, foreign multinationals are still an important component of our economy, especially in sectors with high added

[56] F. MANCINI "Italia: penultima nell'Ue per investimenti stranieri" 05/12/19 https://www.fondionline.it/news-fondi/italia-penultima-nell-ue-per-investimenti-stranieri-00028787.html

value". In addition, the analyst would like to remind "that in terms of work these realities directly employ about 6% of all employees present in Italy and contribute to producing just over 17% of the national turnover".

As a practical example of what is happening in the business world and, in particular, of why the flow of foreign investments in our country is significantly "cooling", the Cgia report cites the Ikea case, "emblematic in highlighting the cultural aversion that exists in the country towards those who do business". The Swedish multinational has in fact decided to renounce the opening of two new stores in Arese and Verona. It seems, according to some indiscretions, that the reasons for this abandonment are attributable to the uncertainty triggered by politics, which is more than one circumstance has raised the hypothesis of not allowing Sunday opening and, in particular for the delays and postponements accumulated in recent months for the identification of the area, following the high number of bureaucratic and administrative obligations that have arisen in the meantime.

It appears clear that from an investor point of view, the propensity to invest in a country is dictated by the presence or absence of certain contextual factors and by the incidence of institutional phenomena and conditions. Among the factors that a foreign investor takes into consideration when choosing a country are political stability, the tax burden or other aspects such as the regulatory and bureaucratic burden, the presence of corruption, the certainty of the regulatory framework, the

quality of resources human resources and labor market flexibility. Data in hand, with the Aibe Index, the index (created by AIBE, the association of foreign banks, with the collaboration of Censis) which measures the attractiveness of the Italy-system from a foreign investment point of view. The first three factors in which Italy appears attractive to a foreign investor, they are in the order: the quality of human resources (74%), the solidity of the banking system (38%), the infrastructure and logistics (30%). On the contrary, the three factors for which Italy is not considered attractive at all are the regulatory and bureaucratic burden (58.3%), the timing of civil justice (58%), the effectiveness of government action (46%). In the Italian case the normative system should be updated in order to create an environment that is interesting for investors otherwise there would not be any newer foreign investments and worse other companies may decide to redirect their capitals elsewhere, in a market that is more favorable.

2.9 THE POLITICIZATION OF BUSINESS

The political environment can impact business organizations in many ways. It could add a risk factor and lead to a major loss. It is important to understand that the political factors have the power to change results. It can also affect government policies at local to federal level. Companies should be ready to deal with the local and international outcomes of politics.

It is important to say that companies that invest in China may face problems in case they act in a way that does not "respect" the RPC, in fact, companies need to bend to Beijing's political will in order to retain market access. A clear example it is when Daimler (a German car manufacturer) had to apologize in 2018 after its Mercedes-Benz brand posted on Instagram an ad that featured a quote from the Dalai Lama, whom it is considered a separatist. The incident is illustrative of a broader problem that foreign companies face when doing business in China[57].

In an increasingly tense geopolitical environment, the problem is getting worse, considering also the massive economic slowdown result of the spread of a virus that appears to have originated in China, the trade war engaged by Beijing and Washington, and the recent protests in Hong Kong. According to a recent survey by the European Union Chamber of Commerce in China, 43% of European companies in China believe that the business environment has become more political over the last year.

In fact, two in five companies say that the Chinese Communist Party (CCP) is present in their operations. This is not entirely surprising, since most businesses in China have party units in their ranks, and often in their leadership. The reason lies in the reason that private entrepreneurs need to prove their loyalty and gain support from the party by showing that they can serve the party's political

[57] A. TIMSIT, "European companies are walking a political tightrope to do business in China" https://qz.com/1867033/european-companies-in-china-say-doing-business-is-more-political/

course[58]. European businesses surveyed by the Chamber report, from the perspective of the private entrepreneur, that the presence of the CCP in their ranks is a good deal when the move reduces interference or secures protection from the local government, giving them “access to government contacts,” “guaranteed approval in administrative matters,” and “early access to regulatory/administrative information”. However, this can lead to unfair competition in exchange for political favors and recognition as a government confidante, which in turn can trap the entrepreneur in a political power struggle, resulting in personal danger.

Moreover, the survey’s findings are in line with a report published this month by the US-based Human Rights Foundation[59], which found that “since the 2019 Hong Kong protests, the CCP has clearly signaled that foreign companies operating in China must help advance its agenda, or face expulsion from the Chinese market.” However, Chinese authorities have promised to accelerate the reforms, in specific I am referring to the new law on foreign investments, according to the European Chamber, these reforms have largely failed to materialize. This is a consequence of the Chinese economy that struggles to recover from Covid-19, and many believes that the business environment will likely get worse for foreign companies. In fact, “The cake is getting smaller, so

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[58] Z. Lin, “Chinese Communist Party needs to curtail its presence in private businesses” 2018, https://www.scmp.com/economy/china-economy/article/2174811/chinese-communist-party-needs-curtail-its-presence-private

[59] To read the full article: https://hrf.org/wp-content/uploads/2020/06/Corporate-Intimidation-Censorship-In-China-6.9.20.pdf

we have to make them leave, and we'll replace them with Chinese companies," this is how David Baverez describes Beijing's thinking. Baverez, is a French investor based in Hong Kong, and believes that these obstacles, far from being a glitch in the system, are one of its features. He argues that an increasingly nationalistic Chinese government wants foreign companies to shoulder the burden of the economic downturn. Although European companies in China appear to be wary of the increasingly political dynamics of doing business there, half of the respondents of the European Chamber's survey plan to expand their China operations, and only 11% said they were considering shifting current or planned investments in China to other markets.

From this analysis emerge that in China politics has a central role, and as a consequence the normative system is strongly related to what the Chinese Communist Party wants. It is a substantial difference from the European Union, where all the states have to submit to certain laws valid for each member of the EU, laws that try to be fair enough for each member respecting all the differences in their respective markets.

Probably, in China the root of this situation can be found in the political-institutional order around which contemporary China was built, a system of government formed by the interplay of state and party different from that of a modern democratic nation. This particular system has taken its current shape as the result of the revolutions that have followed in China for almost a century:

triggered with the aim of creating a democratic state, they have finally led to the creation of a “state-party” (党 国). According to official historiography, the Chinese Communist Party, the vanguard of the people, has created a new state, emerging as an irreplaceable ruling party with an unlimited right to monopolize the administration of the state. This unique position has allowed the Party to be both above the State, “the Party guides the State and society through the organs of state power”, in the words of the Resolution, and internally,” supervising the general situation and controlling the different players”.

With the adoption and implementation of the "Reform and openness" policy, the Party had to rethink its role according to the goal of building a socialist market economy with Chinese characteristics. On the one hand, from the point of view of institutional architecture, the leading role of the Chinese Communist Party has not been abandoned and has indeed been strengthened in various ways. On the other hand, however, the expansion of the market economy has led to a contraction of Party control over certain sectors of the economy and society. The aim of this setback is not to abjure the leading role of the Party, but to allow the market to play a more significant role in some areas. Indeed, the Party continues and will continue in the future, to dictate the direction of Chinese development. Many Western political scientists believed that diversification of interests would necessarily lead to democratization with the introduction of the market economy. However, 36 years have passed since the launch of the "Reform and opening"

program and the signs of a transition to democracy have not yet appeared. Not only did the success of the market economy not weaken the Party's leading role, but on the contrary it contributed to its strengthening, guaranteeing a new source of legitimacy against the backdrop of the decline of revolutionary enthusiasm: the rapid economic development of the country. In a market economy, the Party will increasingly give up direct intervention in the economy, reserving instead a role of supervision of the market economy, in particular through the control of regulatory and regulatory instruments. As the authority of last resort in the formulation of laws and regulations, the Party will in fact direct government activities and guarantee the development of the market. However, it should be recognized that achieving this ideal goal is actually very complicated.

In the last chapter, the focus will shift to the current situation emerged by the post pandemic emergency and what the investors should have to understand in order to make favourable investments.

CHAPTER III. CHINA POST COVID19

3.1 CHINESE ECONOMY POST COVID-19

On April 17, 2020, the National Institute of Statistics (INS)[60] of China published the official data on the country's economic trend for the first quarter of 2020. The most salient points concern the collapse of the Gross Domestic Product (GDP), which registered a -6.8% on an annual basis and a -9.8% compared to the previous quarter. These figures were partially expected, as a consequence of the prolonged health crisis due to the new Coronavirus (Covid-19), which had forced the government to close some areas with a high concentration of productive activity and, in general, triggered a significant spillover in terms of damage to the Chinese economic fabric. However, the collapse confirms a worsening of the preliminary average estimates, which had stopped at around 6%, and represents the worst setback in the economic growth of the Asian giant since 1992, the year in which the Chinese INS began to publish statistics quarterly of this type.

The GDP figure (see the Figure 3.1) is the litmus test of the general Chinese situation, which has inevitably been affected by the outbreak of the pandemic, and the effects generated by the containment measures on the country's economy, which is still struggling to benefit from the reopening.

[60] NATIONAL INSTITUE OF STATISTICS, http://www.stats.gov.cn/english/

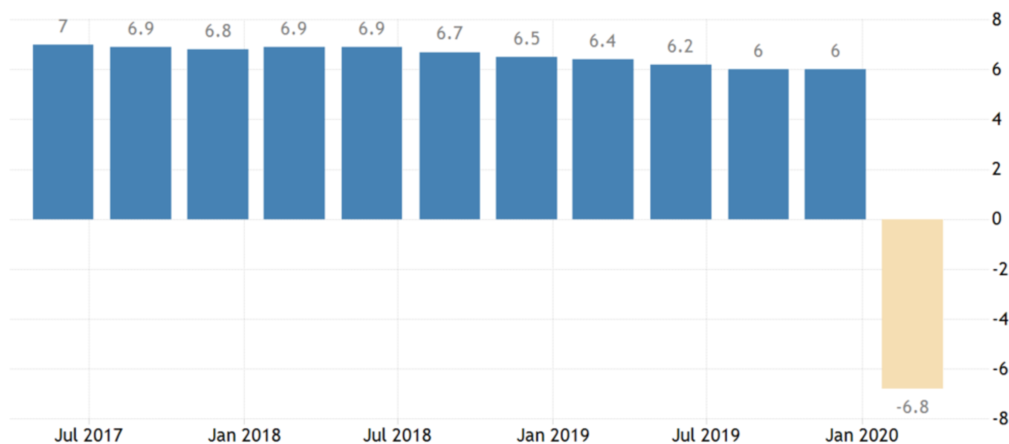

Figure 3.1 – source: Tradingeconomics.com/National Bureau of statistics of China

For example, retail sales recorded a significant drop of 15.8%, a symptom of the fact that the re-start of consumption, beyond the goods of necessity, is still extremely limited. Likewise, investments reported -16.1% compared to a year earlier, marking another alarm bell for the prospects for recovery, while the signal from industrial production data was more optimistic (-1.1%), already significantly improved compared to the previous months, but not fully restored. More generally, in fact, the Chinese economy seems in is way of reactivation: according to the Trivium National Business Activity Index[61] (which relates China's current use of its economic capacity compared to the usual pre-COVID levels), (see Figure 3.2) the vast majority of businesses in China have at least turned the lights back on, with 98.7% of large companies having resumed operations. Moreover, a

[61] TRIVIUM CHINA, https://triviumchina.com/2020/03/07/coronavirus-getting-china-back-to-work/

positive aspect is that 30 provinces are reporting full resumption rates (of between 99-100%) for large businesses. These provinces account for 95.4% of GDP. That said, capacity utilization at many of these companies is still closer to 90% of normal levels, with many far below that. Overall, then, industrial enterprises appear to be operating at 87.9% of normal activity levels, up from 85.3% exactly one month ago. SMEs are coming back to life. It is estimated that small businesses are now operating at 87.8% of their normal activity. This is up from 86.5% two weeks ago.

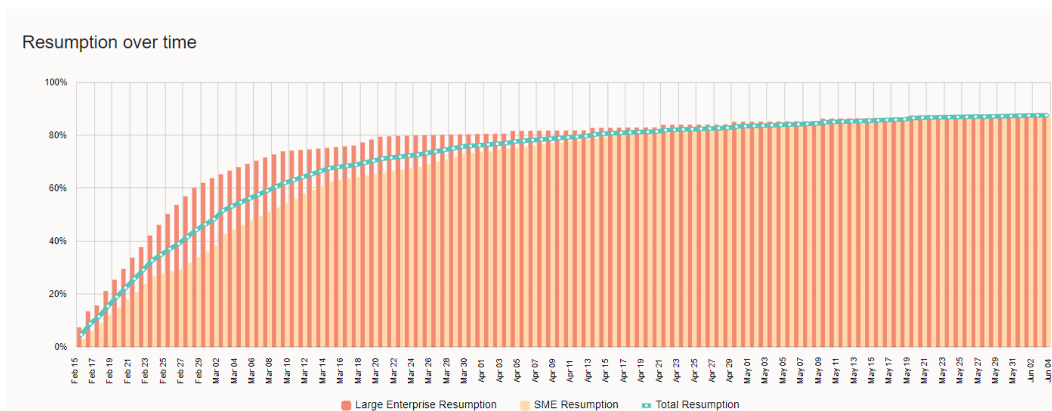

Figure 3.2 – source: triviumchina.com

The Asian country is, therefore, in a very delicate moment of transition, which does not depend exclusively on the evolution of internal conditions but is inevitably also linked to the unknown factors on the conditions of the international economy. Although in China the most critical phase has been overcome from the health point of view and a large part of the economy has started up again, it must

be taken into account that, in the meantime, the pandemic has reached a global expansion and that this will have further consequences in terms of international trade. The official data released by the INS already marks a -13.3% on exports in the first quarter of 2020, but it must be borne in mind that the course of the crisis abroad is "late" compared to what has already been faced by Beijing and that therefore, the demand from outside of Chinese products will continue to be significantly reduced compared to the previous year. Since Made in China products have Europe and North America as their main markets, and in both of these scenarios, the lockdown measures still in force do not allow a release of the economies, exports could become an Achilles heel for the same recovery of Beijing.

Now we expect Chinese economic activity to resume a full regime only in June due to pressure on both internal and external demand. Frequently collected data suggest that production is still 15-20% below the usual levels and is at an even lower level in relation to consumption (for example, expenditure for durable goods it is probably about 65% of the usual levels). The recovery appears to have stopped in April, probably due to lower external demand due to the confinement measures taken by China's trading partners. Social withdrawal and the impact on disposable income in the first quarter should also put a brake on private

consumption on the domestic market. While Chinese data generally surprised positively in March, there may be disappointments in the coming months[62].

A key variable to try to unlock the economic recovery process is represented by the choices that the government will make in the coming weeks to support the aid plan activated so far by the authorities, which would be worth about 1.7% of GDP. A first step in this direction was marked by the approval by Beijing of a new series of fiscal measures, such as the issue of infrastructure bonds, subsidized loans for companies in difficulty, intensified support for banking sector entities. These were expansionary measures, some conventionally used by the government, others of a more exceptional nature. Among the extraordinary measures, the decision to resort to special central government bonds stands out. China uses this tool only in isolated cases of crucial importance (only two, in fact, the precedents in this sense: the Asian financial crisis of the 90s and the creation of the China Investment Corporation sovereign wealth fund in 2007). Despite the arrival of these particular bonds, which are not part of the orthodoxy of Beijing's economic policy, the Chinese government seems not to be inclined to "bail out", that is, a rescue based on massive doses of liquidity at a very low interest rate , as a key to saving the national economy. In fact, the authorities are reluctant to undertake powerful injections of money, due to the fact that both public and private debt are

[62] https://www.eulerhermes.com/it_IT/eh-magazine/news-in-evidenza/covid19/cina-alla-ricerca-della-domanda-perduta.html

now very significant. Emissions from local governments have been very intense over the years and the ratio to GDP would now seem to be around 40%. In addition, in a moment many of the assets held by banks and individuals are rendered underperforming due to the shocks triggered by the pandemic, adding more debt on the shoulders of the banking sector and individuals could further aggravate their financial performance, with a dangerous cascading effect on the normalization of internal economic conditions.

Given the performance of the economy, the leaders of the Chinese Communist Party (CCP) are now forced to re-examine the official growth targets. The CCP's long-term strategy envisaged the symbolic goal of doubling the Gross Domestic Product over the course of a decade, to be completed by the end of 2020, or in conjunction with the centenary of the Party. This year, a + 5.6% would have been enough to reach the long-term target with relative agility, but the possible contraction will make this plan almost impossible. In fact, according to estimates by the International Monetary Fund, the current year will record, at most, a growth of 1.2%.

The problem extends far beyond the simple nominal distinction, as President Xi Jinping also intended to pursue the aforementioned ten-year milestone, after having given his leadership of the constant achievement of the officially set economic objectives. In addition, the steep drop in the growth rate towards which this year's economic performance is heading follows the already chronic decreases

in expansionary performance in recent years. Data in hand, the growth had been 6.1% of GDP in 2019, clearly falling after 6.7% of the previous year, and however far from the double-digit values that the country had become accustomed to in the five-year period 2003- 2007.

The failure to achieve the growth objectives, among other things, could be compounded by the risk of failing the "poverty eradication" project: another cornerstone of the state's agenda and, similarly to the growth plan, another plan whose feasibility was of the all in line with the trends of the Chinese pre-Coronavirus economy. It is believed that, again according to the National Statistics Institute of China, citizens below the poverty line had dropped to just over 5 million in 2019 (compared to about 100 million recorded just 7 years earlier). Overcoming poverty is perhaps even more prominent among Xi's priorities, who last March reiterated the "solemn promise" made by the CCP Central Committee to the poor.

It is difficult to understand how (and if) the CCP plans to reallocate its priorities. In operational terms, the government could use that moment to put some inefficient spending chapters in order, budgeted by the provincial level administrations. The problem remains, however, from a strictly financial point of view, as the room for maneuver is certainly limited and, when it comes to revising the economic objectives downwards, the government actually reduces the performance of which it was now become a reliable and esteemed guarantor.

This could cause, as a further consequence, problems with the stability of the country. The worsening economic conditions and a possible increase in unemployment could foment discontent on the part of a population. A setback in growth, which affected the interests of that new middle class that dictated the internal transformation of the Chinese system in the last decade, could undermine the confidence of some sections of the population with respect to government and capacity authorities to protect the interests of the population. As already emerged during the first months of the spread of the infection, the management of the health emergency has caused outbreaks of protest in different areas of the country, primarily in the epicenter of Wuhan (Hubei province). President Xi's own choice to entrust key people to his trusted men, such as the management of the party leadership of the Hubei Province (entrusted to Ying Yong in February), seems to respond to the desire to secure the management of the most critical phase , to avoid any possible backlash pending recovery.

In this regard, the measures taken are also to be read with a view in the direction towards the "rebound" phase. The same outlooks presented by the International Monetary Fund instill optimism in China. It seems, in fact, that as early as 2021 the country could start a recovery, with projections for growth of over 9%. Therefore, the aid maneuvers launched by the authorities at this critical moment aim to transform these estimates into a sort of self-fulfilling prophecy or to build

the launching pad that gradually brings the country back to normalcy, which guarantees not only economic prosperity but above all internal stability.

3.2 “RE-NATIONALIZATION” OF THE ECONOMY

A first effect resulted from this situation was the sharp increase in digitization. Another effect, which will also be increasingly found in western economies, will be that of the decrease in external exposure, hence the increase in percentage and political importance of internal markets, internal finance and indigenous technology. Moreover, China has never completely abandoned internal markets to their destiny, unlike what many western economies have done, more and more subtly export led. But the process of "re-nationalization" of the economy will be clearly visible both in China and in those western countries, such as Italy, which have blocked their internal markets to fully run the adventure of exports. Competitive intensity will also increase in China, which is the pressure of competition between industries in the same sector. Consumption will also change which, in China as elsewhere, will be more attentive to health and quality and less tied to the "image" and glamour, the industry that will win, in the near future, will be much more no frills, more essential and more attentive to its effects on health. However, the space of the private sector and also of the Third Sector will also increase in China. The pandemic, as we said before, in China as elsewhere, has

greatly accelerated digitization in B2C (business to consumer) but also in physical transactions (less and less frequent, given the pandemic) and in B2B (business to business). The 55% of consumers in China will continue to buy food and goods for daily use online even after the pandemic ceases, but China had started to decrease its exposure to world economies long before the viral pandemic exploded.

Reallocation of elements of the supply chain in other economic and political areas, therefore, and still re-entry in the Chinese territory or in the closest countries of many of the sectors that, in the first phase of Chinese globalization, had been projected externally, and here we are at cassation of a project that, until the Covid-19 pandemic, was typical of Chinese politics.

So, for Beijing and also for the EU, according to the latest projects developed by their think tanks, this is a real decoupling: the start of a great phase of industrial diversification and new global specialization between the production areas and between nations.

With an "industrial sequence", however, much narrower than the very long "value chains" that have characterized, up to now, the American-led globalization and the structure of world trade.

As for industrial diversification, it is good to note that, in China, the highest decile of companies and businesses today captures over 90% of profits, while elsewhere the average is 70%.

Maximum verticalization, in China, which corresponds to a particular, but less obvious than imagined, relationship between economy and political direction.
This system will certainly change, and many new companies will enter the top ten of profits, with an internal transformation of production systems, many of which are mature, and then the entry, in the top management, of new activities: digital systems, replacement technology for work, mass distribution, entertainment.

3.3 INVESTMENTS SUGGESTIONS

Now, for investors it is relevant to know how to take a position on the Chinese market in the short, medium and long term, taking advantage of the possible economic rebound. China is clearly ahead of Europe and the United States on its way to contain the new coronavirus and to return to normal at the same time, at least in terms of production activities. This favorable gap towards the rest of the world should be a winning determinant for all investors in the Chinese markets, despite the higher valuations and the risks associated with a second epidemic, in addition to the structural interruption of the distribution chain and the renewed hostility of President Trump, recalled a note edited by Anthony Chan, Chief Asia Investment Strategist of Union Bancaire Privée (UBP)[63].

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[63] https://www.borsainside.com/mercati_asiatici/73243-investire-in-cina-nel-2020-scenari-di-breve-medio-e-lungo-termine/

Therefore, three interesting guidelines on investments in Chinese markets can be provided, in order to seize all the opportunities that will emerge from Beijing in the near future in the short, medium and long term:

Chinese short-term investments: *taking advantage of the post-lockdown rebound*

First, given that in China, unlike the rest of the world, the recovery is already underway, this scenario should have an immediate favorable effect on consumption, retail trade and services. Tourism, or at least domestic tourism, has also started to recover well. Therefore, companies operating in the transport and logistics sector should especially benefit.

Medium-term Chinese investment: *government plans*

In addition to taking advantage of the short-term impulse of Chinese investments, it will also be necessary to try to take a position to take advantage of the medium-term benefits, largely induced by the political moves. In fact, the government wants to reinvigorate its infrastructure investments, including those projects that have suffered a sudden stop at home of the coronavirus. To support them, the National Development and Reform Commission will double the issuance of special bonds to $ 567 billion. It is also possible that the Ministry of Finance may issue special Treasury Bonds to supplement the financing pool of these investments. Specific subsidies should be directed towards the automotive sector: in fact, an immediate increase in the number of cars is estimated, in order to travel safely and avoid crowds in public transport.

Long-term Chinese investment: *following permanent changes*

Then there are some investments that could allow investors to take the best position in the long term. It is clear that the advent of the new coronavirus has induced the country to press the pedal of "digital acceleration" even more decisively in various sectors, such as online learning, entertainment, gaming and shopping, in addition, of course, e-commerce, 5G and not only (think of innovation applied to healthcare) should, therefore, benefit from it on an ongoing basis.

CONCLUSIONS

In this thesis, an attempt was made to understand what the determinants for a foreign company may be to make a direct investment in the PRC. As a result, were analyzed the advantages that the different FDI can provide to the investors and in specific was analyzed the Chinese effort to create a favorable environment for foreign companies with the introduction of the Foreign Direct Investment Law. The determinants that can, therefore, affect the location choices of the multinationals can be the GDP, growth, the degree of openness of the economy, exchange rate stability and the tax system. Multinational companies prefer to invest in countries with higher GDP and higher GDP growth rates. These two variables explain a country's potential market and therefore the potential demand for the multinational's products. The use of the GDP growth rate as an additional variable for the choice is explained by the fact that a high GDP could be a symptom of a market now saturated and no longer attractive for further investments. Multinational companies are, therefore, also interested in growth potential and consequently in the potential increase in domestic demand. Moreover, countries characterized by a restrictive trade regime are not able to attract FDI as much as countries characterized by a greater degree of openness of the economy, the openness that intends to reach China. In addition, exchange rate instability adversely affects the cash flow of a foreign company and the expected

profit and is therefore a deterrent to the inflow of FDI. Many studies have been conducted to verify whether profit taxes affect companies' behavior on investment location decisions, on the amount of dividends distributed by foreign branches and repatriated from the parent company and on decisions relating to profit shifting, through the contraction of debts and the manipulation of intra-group prices (transfer pricing). A company that decides to make a foreign direct investment in order to sell its products directly on the market, instead of producing the products in its own country and then exporting them, will decide to make its investment in the country that can guarantee greater profits. Analyzing the profit of an FDI in the various countries, the company, after taking into consideration the variables listed above, will certainly also consider the tax aspects of the various countries. The economic literature identifies some main variables to which companies refer their analysis on the tax system of a country, on the one hand, the marginal tax rate that influences the cost of capital, which in turn establishes the optimal level of output in every single state and indirectly can affect the localization of multinational choices. The average tax rate, on the other hand, influences the net profit, the profit already subjected to a tax levy and can therefore have a more direct impact on the location decisions of the multinationals. International tax agreements are aimed at eliminating double taxation and therefore should favor FDI, but in reality, these agreements are also introduced to avoid tax evasion, and thus can also have negative effects on FDI. If the taxation turns out to influence

the localization choices of the multinationals, the latter will analyze the net return on their investment in the long run. This implies that tax concessions that allow companies to save tax only for a short period and introduced with transitional rules, which therefore companies can only use for a fixed and short-term period, do not guarantee an increase in the influx of FDI. If two states have the same characteristics as regards the economic and political environment, corporate tax can have a decisive impact on the location choices of a multinational company. However, it is difficult to trace an evident correlation between the tax system and the inflow of FDI, as the impact of the tax system on multinationals also depends very much on the characteristics of the multinationals themselves. The company's activity, their mobility, their presence in different markets and their motivations to invest abroad are all characteristics that influence the impact of the tax system on the companies themselves. From this analysis, however, it emerges that the tax system does not have an exclusive relevance in the location choices of the multinationals and therefore the interventions of the Chinese government should also focus on improving the market and the administration, given also the problem of corruption already explained in the previous chapter. Trying to resolve the profound social differences and inefficiency problems of the administration can improve the environment economic and thus guaranteeing not only greater income for foreign and national companies, but also guaranteeing higher tax revenues to the state. So, China can continue the path taken in 1978 and meet the new needs

of the country, increasingly oriented towards a market free of constraints and restrictions. The current structure of the Chinese tax system derives from the turning point of 1979, when was introduced a tax system closer to that of developed countries. The application of corporate profit taxes, the introduction of a value added tax, the decision to implement tax decentralization are just some of the fiscal policies implemented by the Chinese government in those years. Furthermore, with the 1994 reform, the government intended to continue the journey towards the socialist market economy by applying a value added tax as a major source of tax revenue, introducing a consumption tax and applying a single individual income tax, both for residents and non-residents. However, a differentiation in taxation applied to Chinese enterprises and foreign-funded enterprises was persisting. The facilitated tax treatment for foreign companies can be explained as the PRC, after 1979, wanted to attract foreign capital to allow the development of its economy. With the entry of the PRC into the WTO, many tax concessions granted to foreign companies have been eliminated as they conflict with the rules established by the WTO. Nowadays, the Chinese government has recently implemented a reform of the tax system which provides for the introduction of a new Foreign Direct Investment Law, with the aim to treat companies fairly and meet the new needs of the Chinese company increasingly oriented towards a market economy. The main advantages of the FIL are identifiable in the attempt to reduce the gap between domestic and foreign

companies, in the simplification of the list system, nevertheless, in the introduction of a principle of equal treatment of the FIE with respect to the corresponding domestic entities (even if not total); furthermore, in the general reduction of the burdens for the FIE and the simplification of the discipline reserved to them; in strengthening (at least programmatically) the protection of IP rights owned by the FIE, a theme on which, moreover, the High Offices of the R.P.C., have recently announced, the strong will to carry out an ad hoc reform. FDI law can be interpreted as a legislative effort in order to improve the overall foreign climate and it shows the commitment of China in being more serious about protecting the investor's rights. This is an important step in order to attract more foreign investors. In addition to the protection of investor's rights, great emphasis is given on equal national treatment of foreign investments, giving foreign investors equal protection and putting them on a more level playground with domestic investors. Another aim of this law is to solve common complaints from governments and foreign companies, for example by ensuring equal treatment for foreign firms in government procurement (Art.16), by promising better intellectual property rights protection (Art.22), and by banning, explicitly, forced technology transfers (Art.22). Moreover, this new law might help to get closer to international practices in order to create a law-based environment to protect foreign investor's legitimate rights and interests. To achieve this objective, the local governments have to go through standardization of their administrative

actions on foreign investment and have to make sure that officials act according to law. As already stated in the second chapter, illegal behaviors by officials, such as the disclosure of trade secrets, self-seeking misconduct, neglect of duty, and misuse of authority. May result in criminal charges. Furthermore, a unified governing law for foreign investment could help reduce confusion for new foreign investors in the future, easing the process of investing and doing business in China. However, there are some concerns over the new provision in the Foreign Direct Investment Law. In fact, despite the assurances from government officials, many analysts are not sure if this legislation will create benefits for foreign investors that are looking to do business in China. The reason lies in the too general nature of the FDI Law, that leaves many details to be addressed in other regulations, as the BBC has reported, the law is seen "as a kind of sweeping set of intentions rather than a specific, enforceable set of rules"[64]. This lack of details may bring new difficulties for foreign companies operating in China. For example, the law forbids forced technology transfer by administrative means, but it is not defined what administrative means are. In practice, this means that the government may apply non-administrative measures to acquire technology from foreign-invested enterprises. In addition to concerns over the FIL's vague wording, some observers believe that new provisions may in fact empower the government to intervene in investments in the event of a dispute with a foreign

[64] BBC, "China foreign investment law", https://www.bbc.com/news/business-47578883

country. For example, according to the FDI law in the Article 20, foreign investments could be expropriated under “special circumstances” and “for the public interest” and are subject to broad national security reviews. In case of an international dispute, this gives the government the right to retaliate against foreign companies in the event of an international dispute. There are also other aspects that have investors concerned about how the FIL will be interpreted and implemented in practice. Even if China promised that measures will be implemented based on the central government’s interpretation, investors are concerned they will remain subject to inconsistent implementation by local governments, which have been common in China over the past several decades.

To conclude, despite the concerns over the vagueness and the potential implementations, the new law is in many ways a step in the right direction, it is a solution to address long-existing issues in foreign investment and foreign investors that want to hold a cautiously optimistic view stand on good ground. As the new Foreign Direct Investment Law replaces the previous three laws on WFOE, CJV, and EJV, which have been governing the FIE’s establishment and management over the past few decades, investors need to pay more attention to the new law’s practical implications to their daily operations or future investments. Moreover, investors should, in a proactive way, assess the FIL’s impact as it develops further, keeping a close eye on the regulations, local administrative approvals and the supporting legislation.

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