

Foreign Direct Investment in the China-US Economic Security Dilemma

by Nils Bayer



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Abstract

The bilateral relationship between China and the United States was already in decline when longstanding concerns over Chinese foreign direct investment resulted in an overhaul of the American screening regime. This paper takes an International Political Economy perspective to investigate whether two subsequent changes in China's regulatory framework, the new Foreign Investment Law and National Security Review, can be linked to the bilateral conflict and the American enactments. After the theory of a security dilemma is conceptualized for economic security, this investigation combines policy and discourse analysis. The analysis finds that both Chinese policies were at least partially decreed as a response to turmoil in the bilateral relationship. Firstly, China's new law was retrieved amid a critical moment of the trade conflict and strongly curtailed, suggesting it was intended as a soothing measure to advance gridlocked negotiations. Articles allowing for expropriation and retaliation within this law - despite not being tied to the trade conflict directly - underscore China's willingness to take unilateral action. Secondly, China's National Security Review represents an attempt to balance out the broadened power of its American counterpart. Beyond the establishment of this connection, the analysis exposes grave discrepancies between Chinese policymaking and the propagated narrative.

Keywords: International Political Economy, U.S.-China Relations, Foreign Direct Investment Regulation, Security Dilemma, Economic Security

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Table of Contents

Table of Abbreviations.....	8
Table of Figures	9
1 Introduction	10
2 Background: Historical China-US Investment Relations.....	14
2.1 The Developments after China's WTO Accession (2001-2007).....	14
2.2 Implications of the Global Financial Crisis (2008-2016).....	15
2.3 The Role of FDI in the China-US Trade Conflict (2017-2021).....	19
3 Theoretical Discussion	24
3.1 Political Realism and the Security Dilemma.....	24
3.1.1 Realism in International Relations Theory	24
3.1.2 Offensive and Defensive Realism	24
3.1.3 The Security Dilemma.....	25
3.2 The Economic Security Dilemma.....	25
3.2.1 Economic Security Considerations in China's National Security Strategy	25
3.2.2 Defining Economic Security	26
3.2.3 Economic Security Dilemmas in the Academic Literature	27
3.2.4 Conceptualising an FDI-related Economic Security Dilemma	27
4 Research Design.....	30
4.1 Research Question and Hypotheses	30
4.2 Methodology and Data	30
5 Analysis.....	33
5.1 The Foreign Investment Law.....	33
5.1.1 Fast-Tracking through the Legislative Process	33
5.1.2 Liberalizing Provisions and their Relation to the Trade Conflict.....	34
5.1.3 Defensive Measures: The Expropriation and Retaliation Articles	35
5.1.4 Drawing Praise in the Policy Discourse	37
5.1.5 The Implementation of the Foreign Investment Law	38
5.1.6 The Law's Shortcomings in the Eyes of American Stakeholders	38
5.1.7 Conclusion.....	39
5.2 China's New Foreign Investment Security Review	41
5.2.1 Legislative Process	41
5.2.2 Restrictive Provisions in The New Security Review.....	42
5.2.3 Contradictions and Link to the Trade Conflict in the Policy Discourse.....	44
5.2.4 The Implementation Black Box.....	45
5.2.5 The Review Drawing Criticism from American Stakeholders.....	46
5.2.6 Conclusion.....	46
6 Conclusions and Strategic Implications	48
7 Discussion	52
8 Appendix	54
9 References	58

Table of Abbreviations

Abbreviation	Meaning
AI:	Artificial Intelligence
AmCham:	American Chamber of Commerce in China
CFIUS:	Committee on Foreign Investment in the United States
CRS:	Congressional Research Service
DSB:	Dispute Settlement Body
FDI:	Foreign Direct Investment
FIL:	Foreign Investment Law
FIRRMA:	Foreign Investment Risk Review Modernization Act
IFDI:	Inward Foreign Direct Investment
IP:	Intellectual Property
JV:	Joint Venture
M&A:	Mergers & Acquisitions
MOFCOM:	Ministry of Commerce of the People's Republic of China
NDRC:	National Development and Reform Commission
OECD:	Organisation for Economic Co-operation and Development
OFDI:	Outward Foreign Direct Investment
SOE:	State Owned Enterprise
UNCTAD:	United Nations Conference on Trade and Development
US:	United States of America
USCC:	United States-China Economic and Security Review Commission
USTR:	United States Trade Representative
WTO:	World Trade Organization

Table of Figures

Figure 1:	Visualization of China-US Bilateral FDI Flows and Regulation	12
Figure 2:	CFIUS Reviews and Chinese OFDI into the US (2009-2020).....	21
Figure 3:	Illustration of a Bilateral Economic Security Dilemma	29
Figure 4:	Timeline of the FIL Drafting Process.....	33
Figure 5:	Timeline of China's National Security Reviews for IFDI	41
Figure 6:	FISR Process	43
Figure 8:	Bilateral FDI Flows between China and the US (2000-2020)	55
Figure 9:	CFIUS Reviews of Chinese OFDI by Target Sector (2008-2020).....	56
Figure 10:	List of Interviews Conducted	57

1 Introduction

The economic relationship between China and the United States of America (US) has changed dramatically over the last decades. This is especially evident regarding the massive growth in bilateral investment flows. While valuations vary¹, a significant estimate demonstrates a staggering surge for the timeframe between 2001 and 2016: annual American direct investment flows into China increased from \$4 billion to \$14 billion dollars, while Chinese flows into the US grew from less than \$50 million dollars to \$48 billion dollars² (Rhodium Group, n.d.).

To begin with, some terminology is helpful. These investment flows are referred to as Foreign Direct Investment (FDI), which is defined as investment “establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy” (OECD, 2022). The economy of the investor is called the home country, while the enterprise to be invested in is referred to as the host country. Additionally, investor and enterprise to be invested in are also referred to as bidder and target, respectively. The objective of a long-term interest differentiates FDI from foreign *indirect* investment, which only seeks short-term profits and is conducted through the purchase of securities, such as stocks or bonds (International Monetary Fund, 2009, p. 110). Moreover, FDI flows between two states are bi-directional: using the example of China, outward FDI (OFDI) is made by Chinese investors into foreign countries, whereas inward FDI (IFDI) is investment made by foreign investors into China.

FDI flows are not monolithic but primarily conducted via three unique market entry modes³ which all offer specific advantages and disadvantages. The first and fastest way to invest internationally is through mergers and acquisitions (M&A). A merger describes the combination of two or more firms into a single entity on a contractual basis, while in case of an acquisition, one firm overtakes another outright by gaining full ownership (Hassan et al., 2018, p. 709). M&A allow for rapid access to the target’s assets, including knowledge stock and technology. A second mode is greenfield investment. Here the investor is not seeking to take over or merge with an already existing entity, but instead wants to build a new business from the ground up (Bebenroth, 2015, p. 16). A third mode are joint ventures (JV), for which multiple companies combine assets to work conjointly towards achieving business objectives in a newly created separate business entity (Gaughan, 2018, p.536). As all forms of FDI require the investor to take ownership of an entity or asset, market entry via FDI typically involves longer and larger capital commitments than direct and indirect exporting (Peng, 2009, p. 170).

Studies in the domain of economics have largely proven the benefits of IFDI to host countries. FDI inflows predominantly boost economic growth (Almfraji & Almsafir, 2014, p. 212), can have positive spill over effects on the domestic economy and boost innovative capacity (Cheung & Lin, 2004, p. 42f.). Yet, in recent times increasing measures to restrict FDI inflows can be observed (OECD & UNCTAD, 2018, p. 2). Despite the potential loss of economic benefits, such protectionism can be rooted in political

¹ Different official figures are available which vary, at times greatly. China’s Ministry of Commerce for example only tracks investments approved by the central government (Schwarzenberg, 2020, p. 7), thus greatly understating flows. The U.S. Bureau of Economic Analysis differs in their estimates due to different methodologies. Appendix A is a graph for the comparison of data between 2013 and 2020. Rhodium Group, a professional research institute, provides a tracker specifically for the bilateral flows between China and the US. The tracker is commissioned by the National Committee on US-China Relations and provides the most accurate representation among all public sources, as it applies the same approach to both sides of the bilateral flows, different to comparing data from China’s Ministry of Commerce and the US Bureau of Economic Analysis for example.

² Appendix B offers a detailed chart for the entire timeframe between 2000 and 2020.

³ A second classification is based on the direction of FDI in terms of industries, e.g. horizontal and vertical FDI (Bebenroth, 2015, p. 76). This is however not of concern for this analysis, as regulations are based on the outlined market entry modes.

considerations. Whether it is the fear of becoming overly dependent on the investors or the threat of espionage, policymakers have increasingly focused on the adverse effects of IFDI (Bian, 2021, p. 22; UNCTAD, 2019, p. 16).

Such changes are especially evident in the China-US bilateral investment relationship in recent history. Long-standing concerns over Chinese investment into the US have crystallized into a fundamental policy shift during the Trump administration (Foot & King, 2019, p. 47). Claims have centred around the alleged non-commercial nature of investments by Chinese state-owned enterprises (SOEs), the lack of reciprocal market access for American investors and the overall increasing consideration of economic issues as threats to US national security (Medeiros, 2019, p. 98). Not only have these misgivings led to several blockings of high-profile individual investments, with Chinese Broadcom's bid for American semi-conductor manufacturer Qualcomm being a prominent example (Trump, 2018a). But they have also resulted in an overhaul of the American screening regime for IFDI, called the Committee on Foreign Investment in the United States (CFIUS), to target inflows of Chinese investments in the US and assess whether they pose a threat to national security.

This increased regulatory scrutiny has posed a significant challenge for Chinese investors and policymakers alike. China is dependent on further bilateral FDI flows to achieve its ambitious industrial policy objectives. Not only are investments into a developed economy like the US indispensable in moving up global value chains (X. Li et al., 2021), they are also not substitutable by investments into developing economies (Guo & Clougherty, 2015, p. 152). On a rhetorical level, the answer to the American enactment was swift and unambiguous: the US was claimed to be abusing its system and discriminating against Chinese firms (W. Chen, 2018a). Yet, in light of China requiring further bilateral FDI flows, the question that drove this thesis was if these words translated into policy action.

The inquiry initially began with the line of reasoning that China may have enacted specific OFDI policies to support Chinese investments into US sectors under tighter scrutiny. No evidence of this could be identified⁴. Hereafter the analysis proceeded to investigate China's IFDI regulatory framework – put another way the set of regulations American businesses face in their endeavours to invest into China and thus the mirror image of the American enactments. Figure 1 offers a visualization for clarity. On the left-hand side are US regulations for FDI: both for outward and inward flows, the latter in which significant changes have been enacted since 2018. On the right-hand side are the Chinese complements: Chinese OFDI regulation as the initial subject of inquiry and Chinese IFDI regulation, whose recent adjustments are covered in the analysis of this thesis. Bilateral investment flows intertwine both economies through economic interdependence (Jansen & Stokman, 2004, p. 5).

⁴ Published policies pertaining OFDI by the National Development and Reform Commission, State-owned Assets Supervision and Administration Commission, Ministry of Finance and Ministry of Commerce were searched for the timeframe between 2017 and August 2021. Given the existence of internal (“内部” *neibu*) policies, whose existence was confirmed during an interview (Interview with Wang X., policy analyst at the German Chamber of Commerce in Beijing on September 15, 2021), it can't be ruled out that such policies do exist but are simply inaccessible.

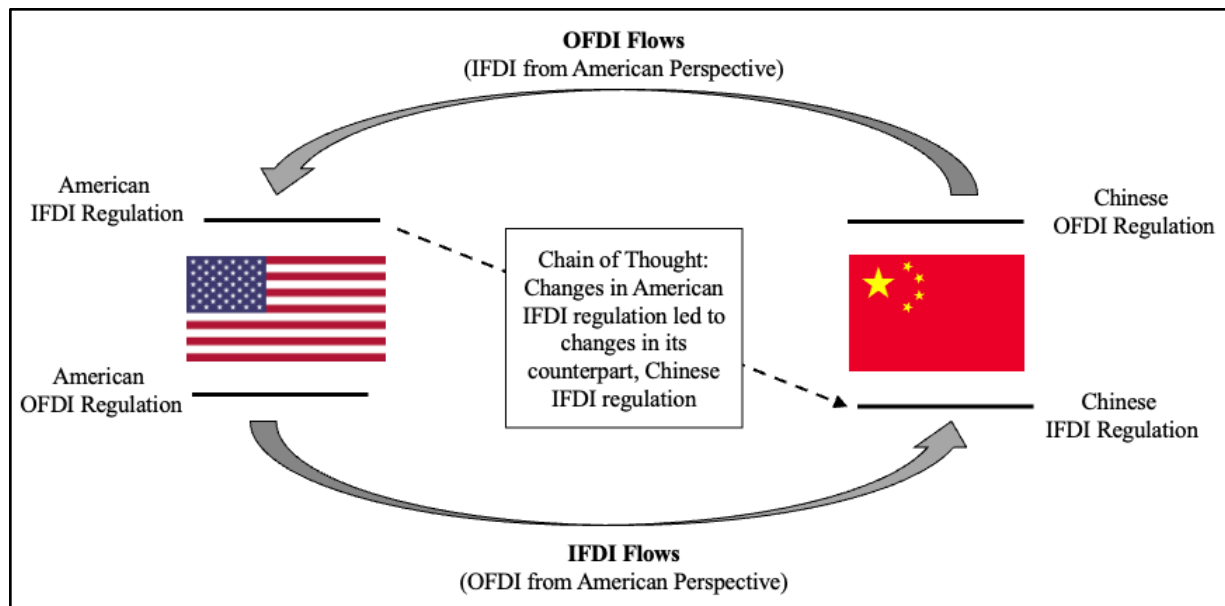


Figure 1: Visualization of China-US Bilateral FDI Flows and Regulation

Note: Naming of flows from Chinese perspective in bold font. Created by the author.

Since the enactments by the Trump administration, China has overhauled large parts of its regulatory regime for IFDI at the central government level by enacting a new law to regulate inflows and actioning a new nationwide national security review of its own. The available academic analyses of these changes however are largely of descriptive nature, outlining the policies in great detail but not taking an international perspective into account. This analysis will instead investigate the question of how far both Chinese enactments can be linked to the trade conflict. It will take on an International Political Economy perspective and combine policy with discourse analysis on four dimensions, to extend the scope beyond the final enactments alone. First, the legal dimension, which includes the legislative process and drafts to trace the enactments' evolution. Next, the policy discourse on the second level, before the third level covers the enactments' implementation. Lastly, statements by American stakeholders after the enactments are investigated to reveal the reception by some of those affected the most.

This paper is guided by two objectives. Firstly, it aims at contributing to the scarce literature on the nexus of economics and security in the China-US bilateral relationship, specifically by taking FDI as the unit of analysis instead of treating the economic relationship as a whole. Secondly, it advances the application of the security dilemma, a principal theory of International Relations to the economic realm. Adjustments to the theory are initially proposed based on the economic considerations of FDI alone, before being revisited after the analysis to consolidate the findings with the theorized dilemma.

The analysis finds that the enactments of China's new FDI law and the connected security review were at least partially decreed as a response to turmoil in the bilateral relationship. The new law was retrieved amid a critical moment of the trade conflict and strongly curtailed, largely consisting of indefinite articles promising further market liberalization to meet American demands during bilateral negotiations and at times even matching them verbatim. Articles allowing for expropriation and retaliation within the law, despite not being tied to the trade conflict directly, underscore China's willingness to take unilateral action in international economic conflicts. The revision of China's security review is argued to represent an attempt to balance out the broadened power of its American counterpart. This link is established in the policy discourse, where official statements not only directly connect China's new security review with the American enactment, but also expose grave discrepancies between Chinese policymaking and the propagated narrative.

This paper will proceed as follows. Chapter 2 first reviews the historical background of the bilateral relationship since the critical juncture of China's accession to the World Trade Organization (WTO) in 2001, focusing on the interplay of the two-way investment flows and the ensuing national and economic security concerns for both states. The recapitulation concludes with actions and reactions by both sides during the Trump presidency. While the American enactments can be identified as a direct response to earlier Chinese FDI policymaking, China's counter-response is identified as the research gap. Chapter 3 begins by presenting the security dilemma in the original context of military confrontation before adapting the theory for the domain of FDI. Subsequently, chapter 4 outlines the research design for the analysis of the enacted policies on the four outlined dimensions. Following, chapter 5 investigates both enactments by investigating links to the trade conflict and relating them to the theoretical framework. Chapter 6 concludes the analysis and sketches out possible future trajectories, whose likelihood is weighed based on the findings. Finally, chapter 7 critically reflects on the selected methodology and juxtaposes the results with the theorized economic security dilemma model, before proposing further adaptations as well as avenues for future research.

2 Background: Historical China-US Investment Relations

2.1 The Developments after China's WTO Accession (2001-2007)

The bilateral relationship between China and the US was initially on the track of good beginnings after the turn of the century. Both sides were looking forward to benefit from an intensified economic relationship (Bulman, 2021, p. 54), with high hopes in China accession to the WTO in 2001 - albeit for different reasons.

Over this period on the US side, the ensuing greater economic engagement from China's accession was hoped to provide a multitude of economic and political advantages. A report by the Secretary of Defense, the National Security Strategy, which intends to identify national security concerns and their remedy, reveals the initially positive sentiments during this timeframe. The 2002 iteration foresaw the bilateral relationship to profit from the accession due to "more export opportunities and ultimately more jobs for American farmers, workers, and companies" (White House, 2002, p. 28). Beyond purely economic benefits laid ambitious expectations for a liberalization of China's political system. The obligations of the accession could "advance openness and the rule of law in China to help establish basic protections for commerce and for citizens" (White House, 2002, p. 28). A later version of the strategy document, released in 2006, is again characterized by hopeful sentiments at large but appears slightly concerned over China's path. On the one hand, the US "encourages China to continue down the road of reform and openness" (White House, 2006, p. 41). On the other hand, Washington simultaneously demanded that China "must act as a responsible stakeholder that fulfils its obligations" not least through establishing a "market-based, flexible exchange rate regime" (White House, 2006, p. 26,41). China's lack of intellectual property (IP) protection, left out entirely in the 2002 document, is first mentioned (White House, 2006, p. 28).

These IP issues were to become a major point of friction later in the realm of FDI. While potential threats to national and economic security were overshadowed by the benefits of increased interdependence (Bulman, 2021, p. 55; Foot & King, 2019, p. 41f.), IP was one of the first issue areas to show cracks under the surface. Two years after the United States Trade Representative (USTR) placed China on their Priority Watch List in 2005 for failing to effectively protect the rights of IP holders (Office of the USTR, 2005), the US brought its first case against China at the WTO's institution to settle trade contentions, the Dispute Settlement Body (DSB) (WTO, 2007). The complaint alleged that, in violation of the accession agreements, China's criminal laws were unable to prevent "trademark counterfeiting and copyright piracy", claimed to be occurring "on a commercial scale" (WTO, 2007). The dispute case was eventually ruled in favour of the US, and China vowed improvement (WTO, 2007).

China had itself pushed to join the WTO, yet to fulfil a different set of objectives. Politically, the accession was hoped to provide China with greater leverage in influencing the international rulemaking on trade and investment, by joining one of the world's most powerful institutions (Prime, 2002). Economically, growth in Chinese exports could be fuelled by making use of the WTO's framework of lower trade barriers (Prime, 2002). Furthermore, the accession could bring new FDI inflows, which had decreased in the wake of the Asian financial crisis after 1997, by moving further towards a rules-based economy. Foreign investors had difficulties in manoeuvring through a market lacking the formal institutions they had grown accustomed to in their home country (Walmsley et al., 2006, p. 316). In China instead, they found business to be reliant on informal networks (Walmsley et al., 2006, p. 316). Beyond these microeconomic FDI issues, the envisaged rise in inflows would also help achieve

macroeconomic objectives. New entrances by foreign firms could assist China in continuing its track of economic reforms and revitalizing the so far insufficient restructuring of its SOEs (Prime, 2002). The eagerness for the WTO accession was partly rooted in the hopes of producing relief to these core issues (Walmsley et al., 2006, p. 316).

The accession to the WTO not only brought China potential benefits, but it was also accompanied by several obligations. Most importantly, China had to agree to the WTO's two guiding principles: the most-favoured-nation treatment, which prohibits any discrimination among the trading partners of one country, as well as the national treatment, which stipulates an equal treatment of imported and locally-produced goods (WTO, n.d.). Further requirements were specified in the accession protocol, for which the agreement on Trade-Related Aspects of Intellectual Property Rights and the Agreement on Trade-Related Investment Measures are the most important in the realm of FDI. The protocol specifically mentions that investment shall not be "conditioned on [...] the transfer of technology" (WTO, 2001, sec. 7.3), which will become a further pain point in later developments. To ensure compliance with the WTO framework, China revised parts of its regulatory framework for IFDI (Yu, 2017, p. 171f.).

Besides these contractual provisions China was now obliged to after the accession, the state enacted several policies independently to change the regulatory framework for OFDI and switched the overall approach from restricting to promoting Chinese firms in internationalizing (Sauvant & Chen, 2014, p. 141f.). Among the array of new policies, the 'Go Out' policy ('走出去' zou chuqu) was most significant. Incorporated into the 10th Five-Year Plan in 2001, the policy aimed to encourage enterprises with comparative advantages to internationalize and vowed to intensify international cooperation (NDRC, 2001). China here followed bipartite objectives: on the one hand, Chinese firms were now actively emboldened to venture overseas to become internationally competitive, while on the other hand OFDI was selectively fostered in industries most important for further economic growth (Sauvant & Chen, 2014, p. 141f.). As a direct result of these state policies, China's OFDI began to expand dramatically (Y. Li, 2018, p. 6), including to the US.

Retrospectively, the overall relationship during this period was still one characterized by aspirations. The US side foresaw itself benefiting greatly from China's accession, with additional, in hindsight arguably illusory, hopes to steer China's course towards political liberalisation through greater economic engagement. For China, not only did the accession offer a range of benefits, the additional OFDI policies were the beginning of a new era in the internationalisation of Chinese firms.

2.2 Implications of the Global Financial Crisis (2008-2016)

The outbreak of the global financial crisis, which originated in the US real estate market before impacting international markets in the course of 2008, marked the beginning of a new phase in the bilateral relationship. The impact of the crisis not only led to changed perceptions and policies in both countries, but it also altered the overall dynamic of bilateral FDI flows and the related security implications.

To begin with, the US suffered from great economic turmoil due to the crisis. Besides the immense uncertainty over the future development of the US economy, the sharp economic downturn drastically reduced the available capital American business could utilize for OFDI. Consequently, the annual value of OFDI transactions from the US to China declined sharply in 2009 and did not recover to pre-crisis levels until 2017 (Rhodium Group, n.d.). In terms of perceptions, growing mistrust can be observed by the American side on a multitude of aspects, which stem directly from Chinese industrial policymaking. While the publications of the US National Security Strategy for this timeframe did not outline these issues, other American government agencies painted a clear picture.

Two concerns pertain to Chinese OFDI policies. Firstly, suspicions grew that China may be acquiring critical technology under the guise of its industrial policies through subjectively unfair means on a systematic scale (Hannas et al., 2013). Especially acquisitions of so called ‘dual-use technologies’ sparked fear. Such technology can be used in both commercial and military applications (Crawford, 1994, p. 34), and includes machine learning, virtual reality applications, big data processing and artificial intelligence (AI) (Foot & King, 2019, p. 44). A second and interrelated concern stemmed from the dominance of SOEs in Chinese OFDI, which had benefited the most from the ‘Go Out’ policy (Sauvant & Chen, 2014, p. 155). A 2011 congress hearing spelled out these fears plainly, when Congresswoman Rosa DeLauro remarked, “the practices of China's state-owned enterprises are of paramount concern to us” (DeLauro, as cited in USCC, 2011, p. 4). The entrance of China’s SOEs into the American market was enabled through the subsidies by China’s state-dominated financial system, which could easily fund these ambitions. Such behaviour was claimed to be “decimating critical manufacturing sectors” in the US (DeLauro, as cited in USCC, 2011, p. 4). In another hearing a year later, one observer noted that Chinese OFDI into the US was “based on strategic rather than market-based considerations”, with the subsidies granting Chinese firms “a nearly unlimited capacity to compete” (Daly, as cited in USCC, 2012, p. 128).

Two further concerns were rooted in China’s IFDI policies. First, asymmetries in market access were seen as an issue. While Chinese firms had relatively unhindered access to the American market, especially to energy and infrastructure sectors, vice versa reciprocity was lacking (Y. Li, 2018, p. 35). Here, a report by the Congressional Research Service (CRS), which consists of nonpartisan experts and “operates solely at the behest of and under the direction of Congress” (Sutter, 2021, p. 60), is informative. The report mentions the challenge of “how to persuade China to address economic policies the United States sees as denying a level playing field to U.S. firms trading with and operating in China” (Lawrence, 2013, Chapter Summary). Beyond limitations on FDI directly, American firms were subject to restrictions regarding China’s large government procurement market, which has been estimated to constitute between 12 and 20 percent of China’s gross domestic product in 2011 (European Union Chamber of Commerce in China, 2011, p. 16). As part of China’s “indigenous innovation policies”, domestic firms were favoured over foreign-invested enterprises in the bidding process for public procurement (Davies, 2013, p. 8). Second, the existent concerns over the lacking protection of IP rights intensified, with China falling far short of its WTO commitments. While there was acknowledgment that it had taken some initial steps, a report by the USTR from 2015 states that “inadequacies in China’s IPR [IP rights] protection and enforcement regime continue to present serious barriers to U.S. exports and investment” (USTR, 2015, p. 9). In many industries, American investors could only enter the Chinese market through JV agreements. In this market

entry mode, American and Chinese firms were partners who closely worked together. However, Chinese JV regulation at the time, the ‘Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment’, limited technology transfer agreements to a ten-year timeframe after which the Chinese domestic firms gained the right to use the technology shared by their foreign partners (MOFCOM, 2007, art. 43). While the Chinese side argued such an exchange of market access for technology constitutes a quid pro quo, the American side saw it as the systematic attempt to obtain foreign technology and IP. To recall, conditioning market access on the transfer of technology is explicitly forbidden in the accession protocol (WTO, 2001, sec. 7.3).

Despite the issue areas being spelled out rather clearly during this timeframe, American policy action failed to remedy them. The Obama administration’s ‘Rebalance to Asia’ policy aimed to deepen political and economic ties with the Asia-Pacific region to avert the upcoming of a new hegemon or struggle for regional supremacy between states (Shambaugh, 2013, p. 16). Different to the previous strategy of engagement, the objective was now to “engage but hedge”: engaging with China wherever possible, while US military and intelligence would “hedge” against a rising China through tighter alliances with the American allies in the region (Hu, 2017, p. 65). In the end, this policy was largely a failure and unsuccessful in addressing the fundamental issues (Kolmaš & Kolmašová, 2019). Notable policy action only came in the form of blockings on individual deals, like Huawei’s proposed acquisition of American firm 3Leaf. Huawei had proposed the acquisition, but after the White House ordered CFIUS, the American national security review body for IFDI, to conduct a review, Huawei eventually dropped its plans (Reuters, 2011).

China, very different to most economies, weathered the storm of the crisis relatively unscathed (Davies, 2010, p. 105). In terms of OFDI, the global financial crisis was a blessing in disguise and the mentioned mistrust on the American side not without cause. Advancing the acquisition spree that had begun earlier with the ‘Go Out’ policy, China intensified its efforts to acquire key technologies abroad to propel the value chain upgrading of its firms. This moving up the global value chains was to be accomplished through the acquisition of foreign firms’ assets via OFDI, to then transfer the acquired assets back to the parent firm through reverse knowledge spill overs. As this process can severely shorten the learning curve, firms can ‘leapfrog’ up the technological ladder towards higher stages in the production processes (Y. Li, 2018, p. 18). Chinese policy-making eagerly supported this approach, with the 12th Five-Year Plan initiating a more targeted OFDI approach, both in terms of host countries and target industries (State Council, 2011b, Chapter 4). Other major industrial policies further emphasised Chinese ambitions, including the ‘Made in China 2025’ policy (‘中国制造 2025’ *zhongguozhizao erlingerwu*) which outlined multiple dual-use technologies as key industries (State Council, 2015b). Chinese OFDI flows to many countries hardly decreased after the crisis, and flows into the US even increased from \$760 million dollars in 2008 to \$6.9 billion dollars in 2010 (Rhodium Group, n.d.).

In terms of IFDI regulation, China introduced a first screening regime in 2011, the ‘Security Review for M&A of Domestic Enterprises’ (‘并购境内企业安全审查制度的通知’ *bingguo jingnei qiye anquan shencha zhidu*) (State Council, 2011a). In essence, a review of a proposed transaction would take place

in two cases. Either, if a foreign investor was to take control over a Chinese military enterprise or any enterprise in the vicinity of military infrastructure, or if an enterprise to be taken over was producing important agricultural products, key technologies or important manufacturing equipment, or was operating in important energy or resource sectors, or transportation (State Council, 2011a, art. 1.1). If any of these were found to be the case, a review would be conducted by an inter-ministerial joint conference comprising of the State Council, National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM). The scope of the review was limited to four considerations, which were relatively narrow and confined to elements more traditionally associated with a bearing on national security. A review should investigate whether the proposed transaction has an influence on China's national defence security, on "the stable operation of the national economy" ("国家经济稳定运行的影响" *guojia jingji wending yunxing de yingxiang*), on "the basic social order" ("社会基本生活秩序的影响" *shehui jiben shenghuo zhixu de yingxiang*), or on the research and development of key technologies required to maintain national security (State Council, 2011a, sect. 2, art. 1 and 2).

Regarding this first national security review for IFDI in China, the discussion in the academic literature was bipartite. Some linked it to the mentioned CFIUS rejection of Huawei's proposed acquisition of 3Leaf, suggesting the establishment was China's "protectionist backlash" and "reactionary in motive" (Saha, 2012, p. 199,215). Others however argued that China was "motivated by a genuine intention to protect its strategic industries in sensitive sectors (Bian, 2021, p. 72) and "by economic security concerns rather than retaliation" (Hartge, 2013, p. 249).

In 2015, China expanded the review by introducing a slightly modified version to the Pilot Free Trade Zones in Shanghai, Guangdong, Tianjin and Fujian (State Council, 2015a). Instead of only being confined to mergers and acquisitions as in the 2011 national review, the trial for the local areas was expanded to include greenfield investment and various forms of indirect investment (State Council, 2015a, para. 1 art. 2). Furthermore, the scope was extended by three additional considerations, beyond the four already laid out in the 2011 national review: the potential influence on "national cultural security" ("国家文化安全" *guojia wenhua anquan*) and "public morality" ("公共道德" *gonggongdaode*), and which effect investments could have on China's cybersecurity (para 2 art. 4 und 5).

The institution of an FDI screening regime during that time tied into China's overall national security strategy, which moved from primarily militaristic means to a more integrated approach including the domain of economic security. The 'National Security Law' ('中华人民共和国国家安全法' *zhonghuarenmingongheguo guojia anquanfa*) enacted in 2015 for example names economic security as the "foundation" ("基础" *jichu*) of national security (State Council, 2015c, para. 3). It sets forth that the state shall more actively work towards preventing and resolving economic security risks, and safeguard critical industries related to "the lifeline of the national economy" ("国民经济命脉的重要" *guominjingji mingmai de zhongyao*) (State Council, 2015c, para. 19).

Comparing the developments during this period reveals a disparity. For the American side, awareness of China's economic rise and unfair practices grew. Coupled with the intensified perception of the US in relative decline after the global financial crisis, this led to the impression that China had become less a partner and more of a competitor (Liu & Woo, 2018, p. 17) - yet policy action failed to materialize. China on the other hand took advantage of the opportunities

the crisis afforded and expanded its efforts to acquire US technology, mostly untroubled apart from few specific interventions.

2.3 The Role of FDI in the China-US Trade Conflict (2017-2021)

The 20th of January 2017 was not only the date Donald J. Trump was inaugurated as the new American president (White House, 2017), it also marks the beginning of a new period in the bilateral relationship. While the fundamental concerns outlined in the previous segment did not change, the US approach to remedy them finally did (Foot & King, 2019, p. 47). In terms of the bilateral relationship overall, this period represents a new low point, with FDI flows being drawn into the vortex of economic and security issues.

Already during his election campaign, Trump spelled out his mercantilist and protectionist positions on China rather bluntly, demanding straightforwardly: “We can't continue to allow China to rape our country” (Trump, as cited in Diamond, 2016). His ‘7 Point Plan To Rebuild the American Economy by Fighting for Free Trade’, published during his campaign trail in 2016, included three hard-line measures directed at China specifically (Trump, 2016). He planned to label China as a currency manipulator, launch cases against China’s “unfair subsidy behaviour” both in the US as well as with the WTO, and further utilize his presidential authority “to remedy trade disputes if China does not stop its illegal activities, including its theft of American trade secrets” (Trump, 2016). As part of the ‘America First’ doctrine and stemming from his conception of trade as a zero-sum game, the trade deficit to China was to be reduced by any means necessary. In addition, Trump announced that with him as president, “the theft of American prosperity will end” (Trump, 2018c).

The reports published by agencies during the early days of his tenure paint a picture of a perception of China that is deteriorating even further. Beyond the US trade deficit to China, which was a focal point of Trump’s campaigning, further awareness grew over the issue of IPR and critical technology (Liu & Woo, 2018, p. 17). The 2017 issue of the National Security Strategy, the first under the new administration, spelled out the concerns and pain points evermore drastically. China was claimed to “challenge American power, influence, and interests, attempting to erode American security and prosperity” (Trump, 2017, p. 2). The report voiced the realization that past strategies “based on the assumption that engagement with rivals and their inclusion in international institutions and global commerce would turn them into benign actors and trustworthy partners” had failed, as “[f]or the most part, this premise turned out to be false” (Trump, 2017, p. 3). China was alleged to have fuelled its economic growth through “access to the U.S. innovation economy” (Trump, 2017, p. 25). The Department of Defense in its 2017 Report to Congress expounded these allegations, describing China as actively acquiring foreign dual-use technologies through “targeted foreign direct investment” and “illicit” means (Secretary of Defense, 2017, p. ii). While previous strategy rested on the assumption that the US could always stay “two generations” ahead of China technologically and protect its critical assets from being absorbed (Meijer, 2016, pp. 151–157), this premise turned out to be false as a rapidly catching-up China was narrowing the technological lead. Even regret about China’s WTO accession can be identified in a report by the USTR: the US had “erred in supporting China’s entry into the WTO on terms that have proven to be ineffective

in securing China's embrace of an open, market-oriented trade regime" (USTR, 2018a). Lastly, China was described as untrustworthy: it "will sometimes make broader commitments when pressed at very high levels, but it is not prepared to follow through on significant commitments or to make fundamental changes to its trade and investment regime" (USTR, 2018a, p. 4).

Beyond these reports, Trump ordered the USTR to investigate whether "China's laws, policies, practices, or actions" have been to the detriment of American technological developments and IP by invoking an investigation under Section 301 of the Trade Act of 1974 in August 2017 (Trump, 2018b). This investigation concluded in March 2018 when the USTR presented his Section 301 Report, which unearthed four principal findings (USTR, 2018b, p. 5). First, China was using ownership and investment restrictions to force the transfer of technology (USTR, 2018b, p. 5). Second, Chinese intervention denied US firms to negotiate on "market-based terms" (USTR, 2018b, p. 5). Third, "systematic", state-directed Chinese OFDI had been accessing critical technologies and IP in the US (USTR, 2018b, p. 5). Fourth, the Chinese government had further gained access to technologies and IP through intrusions into the networks of American firms (USTR, 2018b, p. 5). This Section 301 Report laid the foundation for the Trump administration to take hard-line measures against China - and action was soon to follow.

Trump, who had repeatedly criticized Obama's 'Pivot to Asia' policy, decided to opt for a different approach. Despite the first three out of the four issue areas in the Section 301 Report being directly related to Chinese FDI policy, Trump began confronting China in the domain of trade by initiating tariffs on a variety of Chinese imports, including steel and aluminium (Lawrence et al., 2019, p. 20). Afterwards, action came regarding the FDI issues. First, the US opened a new case at the WTO's DSB, this time specifically on the issue of forced technology transfer (USTR, 2018c). Then, shortly after labelling Chinese social networks TikTok and WeChat as potential threats to US national security (Executive Office of the President, 2020a, 2020b), Trump signed the National Defense Authorization Act into law in August 2018, which included the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) (U.S. Department of Treasury, 2018). FIRRMA was intended to strengthen CFIUS, the US national security review for IFDI, which had come to be seen as inadequately equipped to deal with the ongoing issues over the acquisitions of critical technology and infrastructure through Chinese investment into the US. Within FIRRMA, for the first time ever in the 43 year long history of CFIUS, a country was mentioned by name when new reporting requirements were set for Chinese OFDI into the US and specifically investments made for China's Made in China 2025 policy (CFIUS, 2018a, sec. 1724). Besides this naming in the report itself, statements made by FIRRMA's drafters clearly demonstrate that Chinese investment was the prime target of the enactment. Chief architect, Republican senator John Cornyn, stated that because "China's figured out that it can really weaponize investment", "CFIUS has simply fallen out of date and needs to be modernized (Cornyn, as cited in Council on Foreign Relations, 2017). Furthermore, drafter David Hanke testified to Congress that China was using OFDI "to meet strategic government objectives" (Hanke, as cited in USCC, 2021).

The increased scrutiny resulting from the tightening of the review process through FIRRMA becomes evident in the annual reports published by CFIUS. Figure 2 shows "covered notices", viz. transactions the agency deemed were within its jurisdiction (CFIUS, 2021, p. ix), as well

as which of those were classified as acquisitions of US critical technology⁵ in the timeframe between 2009 and 2020. The grey line shows Chinese OFDI flows into the US for the timeframe for perspective on the right axis.

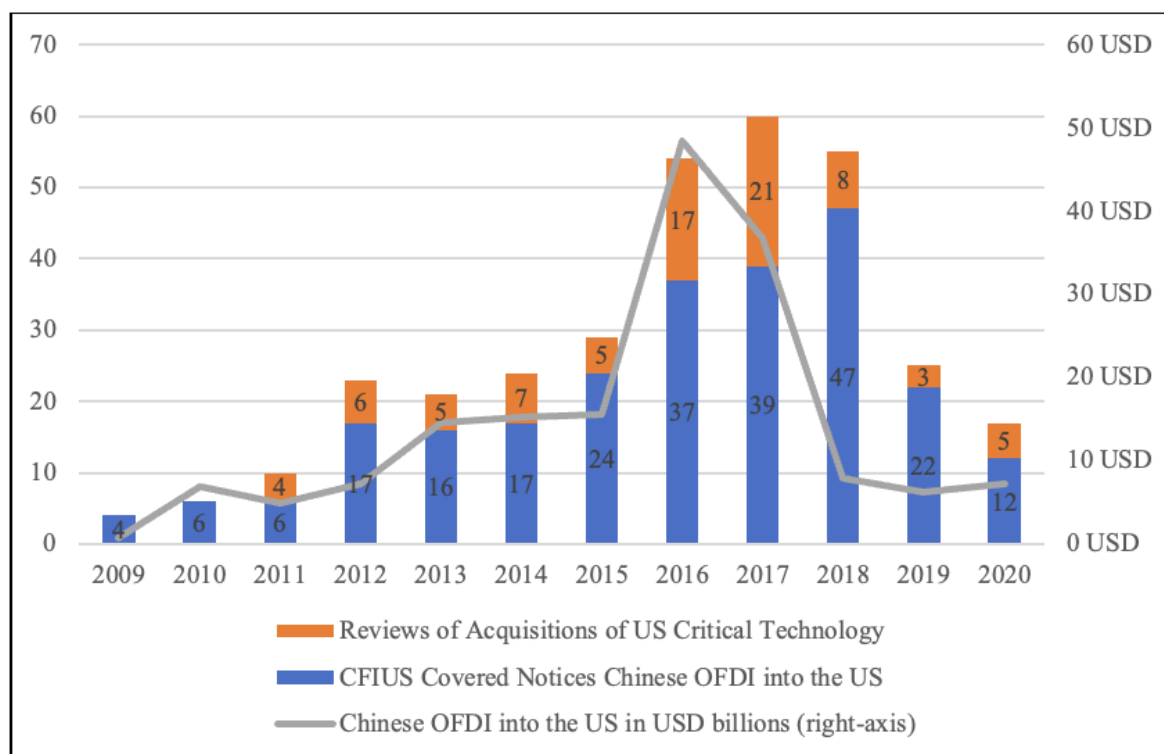


Figure 2: CFIUS Reviews and Chinese OFDI into the US (2009-2020)

Note: Created by the author. With data from CFIUS Annual Reports 2009-2020 and Rhodium (CFIUS, 2015, 2018b, 2019, 2020, 2021; Rhodium Group, n.d.).

Both overall reviews and those of critical technologies had already increased in absolute terms in 2016, the year before Trump's inauguration, but rather due to an overall increase in investments and therefore not increasing relatively. In the following two years however, reviews increased even further despite inflows dropping significantly from their peak in 2016. Especially in 2018, the year of FIRRMA's enactment, the total review count of 55 is still immense, despite Chinese investments being heavily reduced⁶. These decreased flows have been identified as a direct consequence of the enactment FIRRMA (S. Chen et al., 2020, p. 55).

In addition, the completion rates of M&A transactions (greenfield investments is not within the scope of the American review) declined since Trump's inauguration, indicating that transactions were abandoned before a CFIUS decision was even made (S. Chen et al., 2020, p. 39). Besides this premature abandonment of proposed transactions, behavioural conditionality deterred investors from even attempting to conduct a transaction (S. Chen et al., 2020, p. 41).

⁵ Any technology on which export controls have been imposed by the US.

⁶ Appendix C includes a further chart with a breakdown of covered notices for the timeframe, categorized by industry.

The Chinese response, especially with regard to punitive tariffs, was not long in coming. Gao Feng, spokesman of MOFCOM, deplored the American actions as “trade bullying” (Gao, as cited in MOFCOM, 2018) and China enacted counter tariffs. The strategy here followed three principles: the volume of the counter tariffs did not escalate but was restrained, the products on which tariffs were imposed were substitutable, and the reaction given aimed at causing economic and political costs (M. Li et al., 2018, p. 4). The invoked counter tariffs were justified on the basis of article 47 of the ‘Foreign Trade Law’ (‘中华人民共和国对外贸易法’ *zhonghua-renmingongheguo duiwaimaoyifa*) (Adekola, 2019, p. 128), which allows the state to take “counter-measures” in case a foreign state or region is discriminating against Chinese trade (MOFCOM, 2004).

In the realm of FDI, the enactment of FIRMA aroused criticism at the highest levels. The Information Office of the State Council released a white paper titled “The Facts and China’s Position on China-US Trade Friction” (Information Office of the State Council, 2018). It underlined China’s previous liberalization efforts, before calling the accusations of state-sponsored investments to acquire critical technologies “groundless” (Information Office of the State Council, 2018, p. 31,39). The US actions were claimed to be “clearly self-serving and protectionist” and the security reviews an “[a]buse [...] to obstruct the normal investment activities of Chinese companies in the US” (Information Office of the State Council, 2018, p. 42f.). Similar sentiments were voiced by MOFCOM spokesman Gao Feng, who claimed the US was discretionarily blocking Chinese investments in the US without a “factual or legal basis” (Gao, as cited in MOFCOM, 2020). He went on to predict that the “clampdown will undoubtedly shake investors’ confidence in investing in the States” (Gao, as cited in MOFCOM, 2020). The accusations of IP theft and forced technology transfers were rejected as “a gross distortion of history and reality” (Gao, as cited in MOFCOM, 2020).

This heavy criticism was not unfounded. The measures soon proved to be a serious challenge for Chinese firms wishing to invest in the US, as they themselves confirmed in surveys by the China General Chamber of Commerce – USA. In 2018, 28% of respondents named “[s]trict CFIUS reviews of projects of state-owned companies” as a major concern, while 31% said the unstable American FDI policy is one of the “most difficult challenges in conducting business in the US” (CGCC, 2018, p. 16). Overall, the perception of the US “investment and business environment” has decreased continuously since 2016 (CGCC, 2019, p. 15, 2021, p. 15), falling short of the high expectations at the beginning of the Trump administration’s term when 60% of respondents expected the environment to improve (CGCC, 2019, p. 15).

While the rhetorical response and the challenge for Chinese investors are evident, what remains open at this stage is if the Chinese institutions have reacted to these changes in terms of policy. To recall, FIRMA was a direct response to Chinese FDI policymaking: the lack of IP protection and forced technology transfers, the subsidized buying spree of China’s SOEs, as well as the nonreciprocal market access and public procurement conditions all stemmed from the regulations on IFDI and OFDI by China’s central government. Given the significance of the bilateral investment relationship, it seems plausible that the Chinese side may have responded to these enactments beyond rhetoric.

Reports in international media outlets were quick to draw a connection between friction in the bilateral relationship and changes in China's IFDI regulatory framework. For one thing, China's new law regulating IFDI enacted in 2019 was seen as a soothing measure amidst trade negotiations. The enactment was described as "widely seen within the U.S. business community as an effort, in part, by Beijing to address on paper some complaints underlying the bitter U.S.-China trade dispute" in a report by Reuters (Woo & Yao, 2019). Stephen McDonnell, China correspondent of the BBC, alleged that "the Chinese government appears to have rushed through the investment law as an olive branch to the US amid trade war negotiations" (McDonnell, as cited in BBC, 2019). For another thing, China's revision of its national security test for IFDI in late 2020 was viewed "as retaliation for the Trump administration's ongoing blacklisting of hundreds of Chinese firms on national security grounds" (Wang, 2021). Yet the published articles lack a substantiation of the connecting elements: why these elements were "widely seen" as they were, went unanswered.

The academic analyses for China's new IFDI law are existent, but primarily situated in the legal domain and rather of a descriptive character. As they often apply a doctrinal research methodology, their focus is by and large on the details of the enactment itself (see Ramaswamy, 2019; Zhao, 2019; Zheng, 2021), rather than in how far international developments may have played a role. If they delve into this aspect at all, it is only as a minor matter which doesn't go beyond the claims made in the media accounts. Lewis and colleagues for example state that "[m]any viewed it [the law] as China's attempt to address international criticism (particularly from the United States) about its lack of openness and improve its image as a frustrating place to do business" (Lewis et al., 2021, p. 54). Academic analyses of China's newest national security review are not only rare because it is a rather recent enactment from late 2020, but the few available analyses also have a similar focus on the technicalities of the enactment. Yet, in light of FIRRMA being a direct response to China's FDI policies, I judge it reasonable to investigate in how far China's newest enactments might themselves have been a response to American policymaking. This research gap calls for an investigation beyond the unfounded media articles and descriptive policy analyses in the academic literature.

3 Theoretical Discussion

3.1 Political Realism and the Security Dilemma

3.1.1 Realism in International Relations Theory

In the study of International Relations, liberalism and realism represent two principal theories about how states interact in the international system, under which conditions they can cooperate, and the effect of economic interdependence. A direct comparison best reveals the differences between these two theories.

Liberalism posits that institutions, rules about interstate cooperation and competition, can reduce the likelihood of war and crisis between states (Mearsheimer, 1994, p. 6ff.). Similarly, stronger economic ties here are believed to reduce the threat of war by “increasing the weight of trading over the alternative of aggression” (Tanious, 2018, p. 42).

The realist school of thought on the other hand rejects such views as utopian, contending that the effect of institutions is minimal and state interaction is based primarily on power (Mearsheimer, 1994, p. 7ff.). States here are regarded as self-interested actors which strive to accumulate power in order to protect themselves from others and ensure their own survival (Joseph, 2011, p. 307). Contrary to liberal thinking, realists deem greater economic interdependence to raise the threat of war (Tanious, 2018, p. 39). Such war among states is not perpetual, but always within the realms of possibility due to the endless competition for security (Mearsheimer, 1994, p. 9).

Realism in International Relations theory is based on four core assumptions which define state interaction. First, the principal actors within the international system are sovereign states (Sørensen, 2001, p. 165). Non-state actors like the United Nations are not ignored but only play a subordinate role. Second, the international system is assumed to be anarchic, thus without an overarching authority to resolve disputes and enforce penalisation for rule-breaking (Sørensen, 2001, p. 165). This anarchy leads to uncertainty among states about others’ intentions. Third, given the anarchic system, states are “self-help” agents, which are compelled to protect themselves from others to ensure survival (Waltz, 1979, p. 11). Fourth, states are assumed to be rational actors, thinking strategically about desired goals (Sørensen, 2001, p. 165).

Realism provides a valuable application to the logics of policies to restrict IFDI. Because increased IFDI flows can lead to uncertainties about future security, policymakers aim to mitigate these risks by selectively intervening in proposed transactions. Here, political considerations transcend the potential economic gains (Waltz, 1979, p. 107).

3.1.2 Offensive and Defensive Realism

While all realist states strive to acquire power for their own protection and to ensure their survival, not all of them follow the same behavioural patterns. Rather, realist states can be classified as falling within the two extremes of a spectrum between offensive and defensive orientations. This orientation not only determines how much security they strive for, but it also impacts their ability to cooperate with other states. Offensive realism regards power as a scarce resource. The objective of an offensive state is thus to “maximize offensive capabilities to pursue relative gains” (Louie, 2011, p. 165). Given this logic, states naturally assume other states also follow offensive thinking and therefore seek maximum power for themselves. Such orientation forecloses any possibility to cooperate with others, except for short-lived alliances to counter common opponents (Tang, 2009, p. 588). Defensive states on the other hand strive to maintain the status quo (Louie, 2011, p. 165). Contrary to offensive realist states, they aim for

minimal increases in security, acknowledging that any large accumulation of power to seek hegemony would threaten others and compel them to form coalitions to jointly balance out such accumulation (Louie, 2011, p. 165).

In the analysis of state behaviour within the realist school of thought, offensive and defensive tendencies of a single state are neither absolute for all the state's international relationships, nor constant over time. Lim's analysis of Chinese military foreign policy sets out such a required differentiation clearly. He finds that China's militaristic strategy towards greater powers like the US and Japan is offensive, while its policy towards smaller Southeast Asian countries "might appear closer to defensive realists' expectations" (Lim, 2011, p. 311). Attending to the thought of orientations being time-dependent, others argue that China's security strategy has by and large evolved from offensive realism under Mao Zedong towards defensive realism since Deng Xiaoping (Tang, 2017, p. 141). It follows that the determination of a state's orientation is contingent both on a concrete circumstance and within specified time limits (Raditio, 2019, p. 29).

3.1.3 *The Security Dilemma*

Within defensive realist thought, one notion has emerged as a centrepiece: the security dilemma. First theorized by German American scholar John Herz in 1950, it describes the complicity of defensive realist states attempting to increase their own security without concurrently decreasing the security of others (Herz, 1950, p. 157). Following the previously outlined fundamental realist assumptions of states operating in an anarchic system without a central authority and being constantly uncertain about others' intentions, states permanently face the threat of "being attacked, subjected, dominated, or annihilated" by others (Herz, 1950, p. 158). Naturally, and in contrast to offensive realism, they aim to acquire power to defend themselves in light of such attacks. This very accumulation of power however concurrently reduces the security of others, which in turn triggers other states to increase their power as a countermeasure. Such countervailing reinforces the already existent fear and uncertainty (Tang, 2009, p. 594), resulting in a "vicious circle of security and power accumulation" (Herz, 1950, p. 157). Breaking this circle and avoiding the self-defeating outcomes of the dilemma requires states to either send signals of their benign intentions (Montgomery, 2006, p. 152) or reciprocate offers of cooperation (Goldstein, 1995, p. 454).

3.2 The Economic Security Dilemma

3.2.1 *Economic Security Considerations in China's National Security Strategy*

The security dilemma has been applied to different realms which depart from its militaristic origin, for example in the forms of a "societal security dilemma" (Waeber et al., 1993) or an "ideological security dilemma" (Jie, 2020). Another field is economics and the related subject matter of economic security. Although Herz had already mentioned economic aspects in his original conception of the security dilemma, he only conceived them as a minor matter in the larger context of military confrontation. Economic aspects to him were mere means to be "self-sufficient in war" and disputes over foreign investments could lead to military conflict (Herz, 1950, p. 173ff.).

In recent times however, national security strategies have increasingly taken economic considerations into account. This can be attributed to two developments in the international system, which have already been briefly touched upon in the background.

First, globalization and the resulting intensified economic interdependencies have transformed the relations between states. Factors of production, especially capital as with FDI, transcend borders when flowing through the international financial system. Some argue economic relations have turned into the deciding factor of International Relations among states (Andruseac, 2015, p. 232). In consequence, globalizing forces transform “the integration of the economic dimension in national securities into a need” (Andruseac, 2015, p. 233).

China for its part regards the economic dimension explicitly in its “comprehensive security concept” (“总体国家安全观” *zongti guojia anquan guan*) (Xi, 2014). Just like in the mentioned National Security Law, Xi Jinping, in outlining the concept mentions economic security as the “foundation” (“基础” *jichu*), next to political security as the “root” (“根本” *genben*), and military, cultural and social security as the “guarantee” (“保障” *baozhang*) to protect China’s interests (Xi, 2014).

Second, the spill over between commercial and military innovations has undermined previous distinctiveness (Crawford, 1994, p. 26). The outlined frictions over dual-use technologies underscore this plainly. Supremacy in the innovation of these technologies blurs the lines between what would traditionally be conceived of as national security in terms of military capability, and economic considerations. Whether it is AI or big data, products developed initially in commercial markets now find their way into military applications later in the product life cycle, as opposed to the reverse direction before.

That the development of these dual-use technologies is crucial to China is exemplified by the fact that it has policies specifically for these technologies, for example the ‘Military-Civil Fusion’ policy (“军民融合” *junmin ronghe*) (Bitzinger, 2021). Furthermore, the fact that multiple dual-use technologies were included in the ‘Made in China 2025’ policy as key industries (Laskai, 2018) further underscores their importance for the achievement of “national security with Chinese characteristics” (“中国特色国家安全” *zhongguo tese guojia anquan*) (Xi, 2014).

3.2.2 Defining Economic Security

Yet, what exactly is defined as economic security is rather vague and nebulous, with varying conceptions ranging from narrow to broad. Compared to military security, the concept of economic security is much fuzzier (Buzan et al., 1998, p. 99). As China’s “comprehensive security concept” doesn’t specify the term further, I will draw from examples in the academic literature to develop a definition that can be applied in an economic security dilemma.

In a sense of directly bolstering military capability, economic security can refer to the ability to procure weaponry and ensure militaristic supremacy (Cable, 1995, p. 306). Such a definition however neglects the changing aspects of national strategies outlined above and revert the concept of an economic security dilemma solely back to its militaristic origins.

Incorporating the key realist assumption of anarchy and thus providing a more useful definition for the desired application in a dilemma, Huang and Geeraerts define economic security as “the strategic ability of states to maintain and develop their socio-economic system of choice and their relative economic power position under conditions of anarchy” (Geeraerts & Huang, 2016, p. 187). The definition however leaves open what exactly states try to safeguard in the economic domain. Here, Hacker offers a valuable concretization, by defining economic security as the “vulnerability to economic loss” (Hacker, 2018, p. 203). Importantly, *economic* here describes the “consequences (such as income loss) rather than the

causes of insecurity” (Hacker, 2018, p. 203). The reduction of this vulnerability in turn is achieved through the use of policy instruments. Connected herewith, the approach by states to tackle this issue, has shifted “from reactive to preventive” (Kuznetsov et al., 2010, p. 26).

In the work presented here, I apply a Huang and Geeraerts’ definition, narrowed through Hacker’s ascertainment. Accordingly, I define economic security as the state use of policy instruments to maintain relative economic power positions by preventing threats to economic loss.

3.2.3 Economic Security Dilemmas in the Academic Literature

Almost as diverse as the definitions of economic security are the conceptualisations of economic security dilemmas in the literature. They can be divided into two categories according to their point of view. I will briefly present one example for each to draw conclusions for the adaptation of the traditional model to the economic domain of FDI.

First is a conceptualisation which more closely resembles the original security dilemma outlined in chapter 3.1.3: still analysing the relation among two states, in the following example China and the US, but with a sharper focus on the economic dimension. Here, Bulman offers an analysis of the bilateral relationship between 1994 and 2020 by applying the security dilemma as a game theoretic framework (Bulman, 2021). He trisects the timeframe under investigation and assigns each segment a game theoretic model. Most importantly, he argues that after 2017 an economic security dilemma emerged from the misinterpretation of “defensive behaviors as offensive threats and defections” (Bulman, 2021, p. 53). Because both states have “unsuccessfully attempted to coerce opponent behavior”, they ultimately suffered undesired economic loss (Bulman, 2021, p. 49). While his analysis provides a valuable explanation for the developments, it has two shortcomings. First, it treats the economic relation as a whole, neglecting the different concerns for trade and FDI. Second, Bulman ignores relative gains in his analysis altogether (Bulman, 2021, p. 51f.), despite a catching-up China being a key concern for the US (Foot & King, 2019, p. 42ff.) and relative gains being “tilted in America’s favor” (Gupta, 2018, p. 27). Afterall, it is relative economic growth that determines the power and security of states in the international system (Buzan et al., 1998, p. 99).

A very different economic security dilemma was conceptualised by Beverly Crawford (Crawford, 1994). What she conceived as such was not an extension of the traditional dilemma to the economic realm, as in the situation of states in the anarchic international system. Instead, Crawford attends to the paradoxical decision-making of state actors when weighing between the market allocation of resources to increase military capability and the potential risk of losing the “ability to secure those resources” (Crawford, 1994, p.26). States must allocate sufficient resources to the market to develop new innovations, including commercial products for dual-use technology (Crawford, 1994, p.34). Yet at the same time need to safeguard the access to these resources from other states (Crawford, 1994, p.26).

While the two security dilemma conceptualisations are different theories despite sharing the same name, I argue that for the realm of FDI policies they can be merged into a unified framework. This conceptualisation will now be outlined.

3.2.4 Conceptualising an FDI-related Economic Security Dilemma

The traditional security dilemma’s principal considerations, both as outlined in chapter 3.1.3 and in Bulman’s application, lie in the interplay between states. When applied to the realm of FDI at the

example of a bilateral relationship, a reciprocal balancing out of measures takes place between both states. On the one hand, liberalizing concessions can be made by one state which are then retorted. Such an exchange is often highly visible, codified in the form of contractual bilateral investment treaties which directly outline the reciprocation between the involved parties. On the other hand, what is perceived as threatening FDI policymaking by another state is countered by the enactment of defensive or restrictive measures to protect national security. Defensive measures for example could allow states to retaliate against the other state unilaterally, while restrictive measures aim to selectively throttle inflows. Here, FIRRMA is a case in point: the enactment of American IFDI policy is the response to Chinese OFDI and IFDI policies. Nevertheless, compared to the direct reciprocation of liberalizing concession in investment treaties, the mechanism and connection between states' defensive or restrictive measures is more opaque. This is what I term the 'external dimension' of the economic security dilemma.

Crawford's dilemma on the other hand is an internal one, which arises from the paradoxical decision-making of state actors - in her concept over resource allocation (Crawford, 1994, p. 26). In terms of IFDI policymaking however, the two conflicting objectives are market liberalization, and investment restrictions to safeguard national and economic security (Bian, 2021, p. 19). Overall, states have an interest in attracting IFDI due to the economic benefits: boosting economic growth through the transfer of capital or increasing the innovative capacity of domestic firms, for example. At the same time however, states need to mitigate three threats that arise from IFDI. First, excessive FDI inflows risk becoming overly dependent on the investors (Bian, 2021, p. 23). Especially in industry sectors deemed 'critical', home country governments may restrict the supply of goods or services, with adverse effects on the host country's economy. Second, there are concerns that foreign investment could access and skim off intangible assets (Bian, 2021, p. 23). Third, states need to mitigate the risks of "espionage, surveillance, sabotage, or other actions of a disruptive nature by means of infiltration of the acquired entity's operation" (Bian, 2021, p. 23). While the first threat is equally existent for trade, the other two are strictly FDI related. The importance of these threats in the bilateral relationship is evidenced by the historical background in chapter 2. I term this the 'internal dimension' of the economic security dilemma.

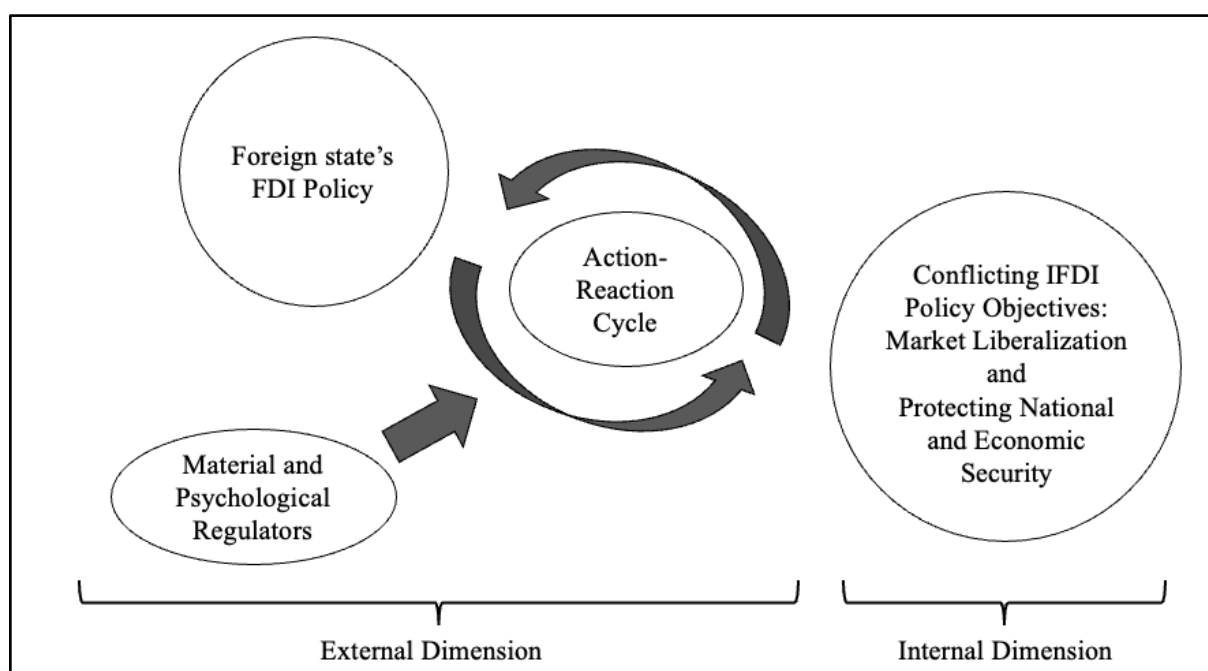


Figure 3: Illustration of a Bilateral Economic Security Dilemma

Note: Created by the author. External dimension adapted from Tang, 2009, p. 596.

Figure 3 visualises the conceptualized model for the interplay of two states, based on the outlined theoretical considerations for the realm of FDI. The link between the internal and external dimension stems from economic interdependence, which is reinforced in the case of FDI by the objective of a long-term interest vis-à-vis the more dynamic form of trade. Hereby, actions by the foreign state in the external dimension influence the scope of decision-making in the internal dimension. Two potential causes may incline a state to restrict IFDI: either if a foreign state's OFDI policy poses a threat to its economic security, or if the foreign state itself enacts restrictive measures, for example by blocking investment deals or tightening its review process. In either case, the internal decision-making possibilities are gravitated towards reacting with counter-restrictions as it seeks to balance. If on the other hand a foreign state enacts market liberalization reforms to further open the market to foreign investors, the host country can reciprocate these measures as the internal dimension then enables such decision-making. Both mechanisms lead to a constant adjustment process, intensified or alleviated by regulators. Tang offers two categories here: material regulators, for example asymmetric distributions of power or technological advances, and psychological regulators like misperceptions (Tang, 2009, p. 529,621).

The severity of the traditional security dilemma is affected by the difficulty in distinguishing between offensive and defensive security aspirations (Jervis, 1978, p. 186). Whether a build-up of rocket systems is intended for defensive or offensive actions is nearly impossible to judge by the other state, amplified by the constant uncertainty about others' intentions. This indistinguishability operates with even greater harshness in the economic realm, for example due to the mentioned fluent transition between commercial and military applications of dual-use technologies.

4 Research Design

4.1 Research Question and Hypotheses

It may be helpful to briefly recall the research gap identified in chapter 2.3. Long standing concerns by Washington over Chinese FDI policy finally translated into policy action under the Trump administration with the enactment of FIRRMA. The causal connection here has been established. How China has in turn responded to this in terms of policy is unclear. Although two subsequent changes in China's IFDI regulatory framework after the beginning of the trade conflict have been claimed to be connected to the trade conflict, no systematic analysis has probed these assertions yet. This leads to the following research question:

Q1: Can the enactments of China's Foreign Investment Law and the New Security Review Measures be linked to the trade conflict?

The two-dimensional model of the economic security dilemma conceptualized in chapter 3.2.4 allows the deduction of two testable hypotheses. As FIRRMA was a measure to restrict the inflows of Chinese FDI into the US, the model holds that China would attempt to balance this out, both externally and internally. Therefore, the first hypothesis read as follows:

H1: The restrictions under FIRRMA have influenced China to enact restrictive IFDI policies itself.

This first hypothesis is based on the external dimension, which assumes that an action by a foreign state, whether liberalizing, defensive or restrictive, is followed by a categorically equivalent response. In case of FIRRMA being restrictive and the China answer to this hypothesized to also being restrictive, the model holds that such a measure would need to be balanced out. Thus, the second hypothesis read as follows:

H2: China implemented market access liberalization to attract foreign direct investments and balance its enacted restrictive FDI policies.

This hypothesis assumes that China still has an overarching desire to attract FDI inflows. Thus, with respect to the internal dimension, China would have balanced out its restrictive response by enacting other measures of market liberalization.

Given these two hypotheses, the aim of this study is to identify which policy elements within both enactments were liberalising, defensive or restrictive, and in which temporal and contextual relation they stand to the American enactment of FIRRMA and the trade conflict.

4.2 Methodology and Data

This research is situated in the interdisciplinary field of International Political Economy. The approach applies a classical theory of International Relations to the economic realm of transnational capital flows in the forms of FDI. Two enactments of Chinese IFDI regulatory framework are treated as cases: the new FDI law and national security review. Contrary to the available analyses by legal specialists, this paper puts forward a more encompassing evaluation based on mixed qualitative methods by combining policy and discourse analysis. The author shares Ham and Hill's understanding that "the purpose of policy analysis is to draw on ideas from a range of disciplines in order to interpret the causes and consequences of government action, in particular by focusing on the processes of policy formulation"

(Ham & Hill, 1984, p. 11). To be clear, doctrinal research is far from futile, but the sole analysis of the policies in their enacted form has proven to be unable to uncover the inner aspect of the law, which “is not predicated solely on the concrete body of legal rules” (Banakar 2000, p.282f.). Instead, this analysis is conducted on four dimensions, which will now be outlined together with their primary data sources.

First is the legislative dimension. This covers both the legislative process to investigate when drafts of the policies were published for public comments, and the legal texts of the enactments. The focus here isn’t primarily on technicalities, which have already been investigated thoroughly by legal specialists, but based on the research question on how far traces of the trade conflict can be identified. If provisions themselves can already be linked, they are directly juxtaposed to developments of the conflict. Data for this dimension was drawn from the online presences of the Chinese policy-making agencies themselves. The State Council, NDRC and MOFCOM are jointly responsible for IFDI regulation at the central government level and have published regulations on their respective websites. A comparison of their English and Chinese website versions reveals the former to be incomplete. The latter however lists policies numbered consecutively and is therefore assumed to be complete. All policies for the timeframe were first archived before those pertaining to IFDI were individually assessed.

As a second dimension, the policy discourse is analysed. This entails public statements by the enacting agencies to investigate how these enactments were framed. As FIRRMA has shown, the political rhetoric surrounding an enactment can offer insights into the rationale. Further, the reports by Chinese state-affiliated media are incorporated. Although such reporting is characterized by a “following the leader” approach and thus close to party-line (Fröhlich & Alpermann, 2021, p. 117), certain reports nevertheless offer additional insights into policies. The data for this dimension came from two sources. First, the regular press conferences by MOFCOM for the timeframe were searched for keywords. Second, the reports in China’s largest state-affiliated media (China News Service, Global Times, People’s Daily, Xinhua) before and after the enactments were searched with keywords and a search catalogue maintained to ensure completeness.

The third dimension covers the official interpretations and implementation of the regulations. The Chinese policies under investigation are formulated relatively broad and in a sweeping manner. It is thus the interpretation and implementation level in which the impact of the policy emerges more clearly. Interpretations and implementing guidelines were searched on the websites of the State Council and China’s Supreme People’s Court. At times, these were linked on the website of the published policy itself.

Lastly, the fourth dimension covers the reception of the enactments by US stakeholders. Within the theorized economic security dilemma, perceptions and misperceptions can play a crucial role as psychological regulators. It is therefore deemed necessary to take into account how these changes were perceived by American state actors and stakeholders through the analysis of comments about these policies. Data for this dimension was sourced from three outputs which released documents timely on the rather new developments. First are publications by the CRS. Second is the commentary by the American Chamber of Commerce in the People’s Republic of China (AmCham). AmCham is “officially registered as a foreign chamber of commerce in China and is licensed by China’s government” and represents nearly 1,000 American companies in China⁷ (AmCham, n.d.). Its publications are the clearest outline of the concerns of the US business community in China, which are among those affected the

⁷ AmCham, like other foreign chambers of commerce in China, is registered as a “non-profit, non-governmental organization” (AmCham, n.d.). This is however rather a legal technicality due to Chinese regulation for foreign organisations operating in China.

most by changes in China's IFDI regulation. Third, is the latest annual report by the United States-China Economic and Security Review Commission (USCC).

Besides these four dimensions, a total of eight semi-structured interviews were conducted with a variety of interviewees. They were selected based on their expertise and at times referred through snowball sampling. A more general interview was conducted with a German business journalist who has been reporting from China for over 25 years (Sieren, n.d.). Four policy analysts were interviewed, two working at foreign chambers of commerce in China, and one each from an American and German China-focused think tank, respectively. The purpose of these interviews was to properly understand and contextualize the two analysed policies. Two interviews were conducted with lawyers based in China, one of them specializing on FDI regulation, to discuss the intricacies of the enactments. Lastly, one interview was conducted with Professor Bulman to discuss his publication mentioned in chapter 3.2.3 and the theory of an economic security dilemma in greater detail. The rationale to include such a variety of interviews was to avoid confirmation bias by getting different opinions, as well as following Fröhlich and Alpermann's advice on combining discourse analysis with expert interviews to extract the principal elements of the often-orotund Chinese discourse (Fröhlich & Alpermann, 2021, p. 124). Not all interviews are cited in this study, as some were conducted to get a better understanding of the topic. A complete list of held interviews, all conducted virtually through online chat software due to the pandemic and geographic distances, can be found in appendix D.

Additional interview requests were sent to Chinese think tanks, including the Foreign Investment Research Center at the Shanghai Academy of Social Sciences. Further, a question catalogue was submitted through a proxy⁸ to the Finance Minister's mailbox. Furthermore, Chinese lawyers were contacted and asked to provide written or verbal statements with an offer to provide any information anonymously. All of these attempts were to no avail.

⁸ Submitting questions requires a Chinese identification number (see http://wsxf.mof.gov.cn/myDoip/jsp/login/login_ws.jsp).

5 Analysis

5.1 The Foreign Investment Law

5.1.1 Fast-Tracking through the Legislative Process

The main pillar of China's IFDI regulation is the 'Foreign Investment Law of the People's Republic of China' (FIL, '中华人民共和国外商投资法' *zhonghuaren mingongheguo waishang touzifa*). Implemented on the 1st of January 2020, it superseded three individual laws which previously governed IFDI in China and replaced their provisions in one unified body (MOFCOM, 2019, art. 42). The preceding laws, namely the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises and the Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures had all been regulating different types of FDI since the early days of China's economic reforms in the 1970s and 1980s (Zhao, 2019, p. 354f.).

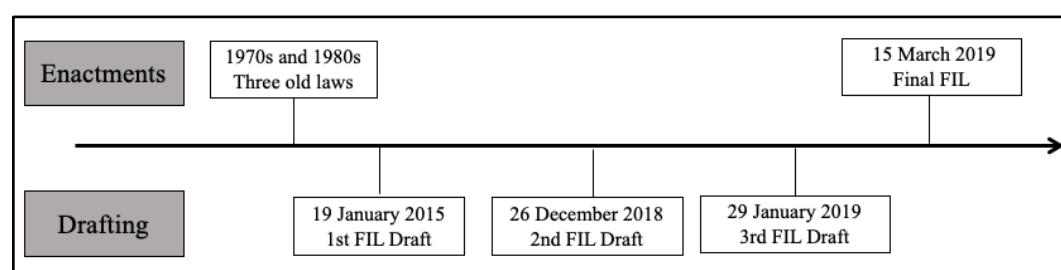


Figure 4: Timeline of the FIL Drafting Process

Note: Created by the author.

Figure 4 is a visualization of the drafting process. As early as 2015, a first draft was circulated for public opinion and the comments of stakeholders by MOFCOM (MOFCOM, 2015). But afterwards, it disappeared from the scene entirely, until a revised and strongly abbreviated version was published in December 2018 (Yamei, 2018). This second draft was drastically reduced, trimming the earlier 170 articles to a remaining total of only 42. The unexpected release after a three year standstill emerged in the midst of the trade conflict and less than four weeks after Trump and Xi had negotiated a 90-day truce at the G20 summit in Argentina (Rampton & Martina, 2018). Afterwards a third, slightly modified draft was quietly released in January (The National People's Congress of the People's Republic of China, 2019). Then, only three months after the publication of the unexpected second draft in late 2018, the law was fast-tracked through the legislative process and enacted on the 15th of March 2019 at the 13th National People's Congress (MOFCOM, 2019). The imminent passage through the legislative process within 80 days after a three-year standstill was attributed to the bilateral negotiations of the trade conflict. He Weifang for example, law professor at Peking University, said that "[t]he acceleration of the review of the FIL is obviously due to pressure from the trade war" (He, as cited in Bermingham et al., 2019). While AmCham did not comment on this matter, Mats Harborn, president of the European Chamber of Commerce voiced similar reservations, stating that the process for the second draft "is being squeezed between the normal legislative process and the negotiation table with the US, in part to address the trade conflict" (Harborn, as cited in European Union Chamber of Commerce in China, 2019). As one interviewee confirmed, "the draft should definitely be seen in the light of the trade war"⁹.

⁹ Interview with a German, FDI-specialized lawyer based in Shanghai on November 16, 2021.

5.1.2 Liberalizing Provisions and their Relation to the Trade Conflict

The final law, as enacted in 2019, contains several provisions which simplify the regulatory regime and pledge further market liberalization. The vast majority of these enacted provisions corresponds directly to the long-standing demands of American stakeholders. Many were newly added for the final law, missing entirely from the 2015 draft. Followingly, the key administrative provisions will be outlined, before the liberalizing provisions are directly juxtaposed with the American demands to infer a connection between the FIL and the trade conflict, which goes beyond the basic assumptions of the media accounts.

To begin with, the law formally defines foreign investment as “investment activity directly or indirectly conducted by a foreign natural person, enterprise or other organization” (MOFCOM, 2019, art.2). It further classifies the following forms as direct or indirect investment: the individual or joint establishment of foreign-funded enterprises, the acquisitions of shares, equities, or property shares of a Chinese domestic enterprise, the individual or joint investment into new projects, and investment through other ways (MOFCOM, 2019, art.2). This marks an extension of jurisdiction, as the three previous laws only covered greenfield investment, with other forms of investment covered by separate regulations. Now instead, all types of foreign direct and indirect investment are covered by the unified FIL.

The law re-affirms the state’s commitment to the “basic state policy of opening-up” and the encouragement of foreign investors, for whom the state shall “create a stable, transparent, foreseeable and level-playing market environment” (MOFCOM, 2019, art.3). While the adherence to the overall trajectory of further opening-up had already been included in the 2015 draft (MOFCOM, 2015, art.1), the pledge of a level-playing field was newly added in the second draft in December 2018. Not only has a more level-playing field been demanded by American stakeholders repeatedly (see AmCham, 2017, p. 2), it was even mentioned verbatim by both Trump in his reform plans for the bilateral relationship (Trump, 2015), as well as the USTR in the Section 301 Report (USTR, 2018b, p. 45,151).

As its guiding principle, the law decrees “pre-establishment national treatment”, which pledges the same treatment to domestic and foreign investors alike (MOFCOM, 2019, art.4). Foreign investors are therefore no longer subject to restrictions at the initial investment stage unless they invest in industries included in the negative lists (MOFCOM, 2019, art.4) or reviews are deemed necessary on the grounds of national security (MOFCOM, 2019, art.35). Not only does this result in a reduction of the approval procedures, indeed “all national policies on supporting the development of enterprises” shall equally apply to foreign investors going forward (MOFCOM, 2019, art.9). The entire precept of the national treatment for foreign investors was absent from the 2015 draft and matches the calls by US stakeholders for “eliminating all direct and indirect forms of discrimination against foreign investors in industrial policies and the tools used to implement them” (AmCham, 2019, p. 24).

A further element of reform concerns the protection of IP. The law stipulates that “[t]he state shall protect the intellectual property rights of foreign investors and foreign-funded enterprises, and protect the legitimate rights and interests of holders of intellectual property rights and relevant right holders” (MOFCOM, 2019, art.22). The previous three laws did not contain any relevant provisions in respect thereof. Instead, stronger IPR protection first appeared in the 2015 draft, in which an article simply stated that the “[s]tate shall protect the intellectual property rights” (MOFCOM, 2015, art.116). This article was extended in the final law by the protection of the “legitimate rights and interests” of IP owners (MOFCOM, 2019, art.22). As outlined extensively in the background, the lack of IPR protection had

been a key concern for American firms and the state alike and was the fundamental reason to instigate the Section 301 Report (USTR, 2018b, p. 4).

Related to the protection of intellectual property are forced technology transfers. While the 2015 draft did not contain any provision on the matter at all, the final law did cover this element by stipulating that the state “shall encourage technology cooperation on the basis of free will and business rules” and “[n]o administrative department or its staff member shall force any transfer of technology by administrative means.” (MOFCOM, 2019, art.22). This ban is ever more striking because for years, the sheer existence of these transfers was outrightly denied (Zhou, 2019). As late as May 2018, Zhang Xiangchen, Chinese Ambassador to the WTO, claimed that “[t]here is no forced technology transfer in China” (Zhang, as cited in Miles, 2018). With the US stakeholders arguing the exact opposite, this issue area was the one with the biggest gap between negotiation positions, making this provision even more remarkable.

The last liberalizing article pertains public procurement. While still absent from the 2015 draft, the final law mandates a “guarantee that foreign-funded enterprises can participate in government procurement activities through fair competition” (MOFCOM, 2019, art.16). Furthermore, products and services of foreign enterprises “shall be treated equally in government procurement” (MOFCOM, 2019, art.16). Again, the inaccessibility to the public procurement market and discrimination of foreign enterprises in the bidding process has been another longstanding concern. Not only was the issue mentioned in the Section 301 Report (USTR, 2018b, p. 5), it was also voiced as a pressing concern by American businesses in China (AmCham, 2019, p. 84).

At some points the analysis so far might give the impression of being too shallow. This is because the provisions remain largely unspecified in the law itself. Key elements such as the ban on forced technology transfers and enforcement mechanisms for violations are not elaborated on in further detail. Notably however, what stands out is the similarity between the long-standing American concerns, on which only slow progress had been made for years, and the final provisions – many of which were added into the critical second draft in December 2018. As one interviewee concluded it pointedly, “what the USA had demanded was written into it [the second draft]”¹⁰.

5.1.3 Defensive Measures: The Expropriation and Retaliation Articles

Beyond the outlined liberalizing provisions, the FIL also carried two defensive measures. These two articles are categorically different, as they do not aim at opening the market further for foreign investors. Instead, they allow for economic coercion through retaliation.

A first option to retaliate in the FIL arises from an article about expropriation (‘the expropriation article’), which was carried over from the 2015 draft (MOFCOM, 2015, art.112). The FIL excludes any expropriation in principle (MOFCOM, 2019, art.20). However, “[u]nder special circumstances, the State may expropriate or requisition an investment made by foreign investors for public interests in accordance with the law” (MOFCOM, 2019, art.20). In case such an act takes place, it must “be made pursuant to statutory procedures and fair and reasonable compensation will be given in a timely manner” (MOFCOM, 2019, art.20).

A similar provision was already included in two of the preceding legislations, namely the Law on Wholly Foreign-Owned Enterprises and Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures and is therefore unsurprising. Nevertheless, as these two laws only governed

¹⁰ Interview with a German, FDI-specialized lawyer based in Shanghai on 16 November 2021.

greenfield investments, the provision is now expanded to all forms of direct and indirect investment based on the scope of the FIL. The wordings of “special circumstances” and “the public interests” are broad in nature and based on the decision-making of upper power circles. As a lawyer based in China encapsulated it: “public interest *is* the line of the party” (italics added)¹¹. No evidence could be found of the provision, whether in the proceeding laws or the FIL, having been utilized already. Nevertheless, the article grants the state the ability to reciprocate against foreign companies in China during international conflicts by disowning investors.

The FIL includes a second and more direct provision of retaliation (‘the retaliation article’). Here, the law states that (MOFCOM, 2019, art.40):

“Where any country or region takes any discriminatory prohibitive or restrictive measures, or other similar measures against the People's Republic of China in terms of investment, the People's Republic of China may take corresponding measures against the said country or region in light of the actual conditions.”

This article is an extension of a related provision in the first draft from 2015. Back then, only “discriminatory measures” (“歧视性措施” *qishixing cuoshi*) of other countries or regions were included (MOFCOM, 2015, art.165), not “prohibitive or restrictive measures” as well. Furthermore, the matching of countervailing measures to be “in light of actual conditions” was also absent in the draft and added for the FIL.

Apart from the inclusion in the earlier draft, such a retaliatory mechanism did not exist in any of the three laws which were mandated in the realm of IFDI before the FIL came into effect. Instead, the provision is a carryover of an article from the Foreign Trade Law which reads (MOFCOM, 2004, art.7):

“In the event that any country or region applies prohibitive, restrictive or other like measures on a discriminatory basis against the People's Republic of China in respect of trade, the People's Republic of China may, as the case may be, take counter-measures against the country or region in question.”

Already at first sight, the similarity of both articles is striking. Besides the change in wording in the official English translation, the Chinese version is different in only one aspect: the context is changed from the trade law’s “in terms of trade” (“在贸易方面” *zai maoyi fangmian*) to the FIL’s “in terms of investment” (“在投资方面” *zai touzi fangmian*). The trade law’s provision cannot be applied to the context of FDI, as its scope is limited to foreign trade, defined as “the import and export of goods and technologies, and international service trade” (MOFCOM, 2004, art.2). The wording of the retaliation articles in the Chinese version, both in the FIL and Foreign Trade Law, is noteworthy. The Chinese word for discrimination (歧视 *qishi*) carries a certain degree of emotiveness, as it not only refers to “making distinction between”, but also “insult” and “bullying” (Luan, 2004, p. 957).

Remarkably, the FIL’s retaliation article is entirely absent from some academic analyses (e.g. Zheng, 2021), while receiving only little attention in others (e.g. Ramaswamy, 2019; Zhao, 2019). Zhao welcomed this very provision, stating that it “conforms to the principle of reciprocity in international economic and trade relations” and “to China’s existing international obligations in investment” (Zhao, 2019, p. 363). While the retaliation article is indeed based on the principle of reciprocity through the incorporation of “corresponding measures”, it is at odds with China’s obligations, particularly at the WTO. As explained in the historical background, international investment regulation may be scarce, but does exist under the roof of the WTO and within the agreements made as part of China’s accession.

¹¹ Interview with a Beijing-based lawyer specializing in mergers and acquisitions, on November 16, 2021.

China is therefore bound to first open a case at the WTO DSB and await a ruling before taking any unilateral action, whether for trade or investment. Any unilateral action, taken before a DSB ruling would not be compliant with the WTO's most-favoured nation principle, which forbids the discrimination among members. The unilateral action by the Trump administration that stemmed from the Section 301 Report is a case in point: the WTO ruled this to be inconsistent with its principles (WTO, 2020). I therefore disagree with Zhao's conclusion that the provision is "conducive to promoting the principle of non-discrimination as a basic principle of international investment" (Zhao, 2019, p. 363). The very contrary seems to be the case. China appears to be creating the legal basis for retaliatory action in the realm of FDI on a unilateral basis, which is not based on the decisions of the WTO DSB and therefore not compliant with its obligations. The fact that China has already used the analogue article in the Foreign Trade Law as its justification for tit-for-tat counter-tariffs during the trade conflict (Adekola, 2019, p. 128) underscores that it is indeed willing to make use of such a mechanism. As one interviewee described the rationale, the FIL's article "is not only a theoretical warning but should also be enforced or implemented"¹².

5.1.4 Drawing Praise in the Policy Discourse

The FIL was heralded as a milestone for China's IFDI regulation by the involved institutions, their key actors, and state-affiliated media alike. It was framed as a measure to further the goal of opening-up and to revive the confidence of foreign investors amid stagnating FDI inflows.

Li Keqiang, premier of the State Council, praised the FIL on the day of the enactment as „designed to better protect and attract foreign investment through legislative means”, foreseeing that “[i]n hindsight, when we review the course of China's opening-up, we would realize how tremendous a change that has taken place in this country” (Li, as cited in State Council, 2019a). In a similar vein, MOFCOM's spokesman Gao Feng, said China will “continue to build a business environment that is market-oriented, based on rule of law and internationalized” and “continuously enhance the transparency and facilitation of the investment environment” (Gao, as cited in MOFCOM, 2021). Foreign investors stand to benefit from an improved protection of their “rights and interests”, he proclaimed (Gao, as cited in MOFCOM, 2021).

Unsurprisingly, the bias towards the liberalizing elements was also prevalent in the accounts presented by Chinese state-affiliated media. On the day before the enactment, the People's Daily reported extensively as part of its coverage about the 13th National People's Congress. The lengthy list of provisions in its reporting spared both the expropriation and retaliation articles. Instead, the FIL was described as a reassurance, which will give foreign investors “peace of mind” (“定心丸” *dingxinwan*) (People's Daily, 2019). A day later, on the day of the enactment, Xinhua hailed it as “a landmark legislation that will provide stronger protection and a better business environment for overseas investors” (Xinhua, 2019a). Both defensive articles were again missing in the published piece. In a later report, Xinhua claimed that the law will “bring more certainty to an uncertain world” (“为不确定的世界注入更多确定性” *wei buqueding de shijie zhuru gengduo queding-xing*) (Xinhua, 2019b).

The question as to how far the new FIL was a response to American demands or the trade conflict was not addressed in either the official statements or the media commentary. Even when Li Keqiang was asked directly whether the FIL was “only in large measure a response to pressure from the United States”

¹² Interview with a German, FDI-specialized lawyer based in Shanghai on 16 November 2021.

at a press conference on the day of the enactment, he neither denied or confirmed, confining his answer to the FIL promoting further inflows (Li, as cited in State Council, 2019) .

5.1.5 The Implementation of the Foreign Investment Law

The broad formulations and concise articles of the FIL necessitated further regulations to be released. Already at the time of enactment, Guo Xinming, a deputy to the National People's Congress and president of the Nanjing Branch of the People's Bank of China, stressed that the FIL is a “principle law” (“一部原则性的法律” *yi bu yuanzexing de falü*), for which implementation details need to be developed (Guo, as cited in China Financial News, 2019). Two documents about the law’s implementation were released simultaneously on December 26, 2019, one week before the FIL came into effect.

Firstly, China’s Supreme People's Court published its interpretation of the law (Supreme People’s Court, 2019). The short document of seven articles only provided clearance on minor details of the FIL, mainly on the validity of contracts in case of negative list adjustments (Supreme People’s Court, 2019, art. 2-5). The expropriation and retaliation clauses were not addressed.

Secondly, the State Council released a decree about the implementing regulations for the FIL (State Council, 2019c). These regulations again offer clarifications on technicalities of the law, including the application of the negative lists and their exceptions (State Council, 2019b, art.4), as well as reporting requirements (State Council, 2019b, art. 38,39). In terms of the expropriation article, they state that shall reimburse the investor according to “market value” (“市场价值” *shichang jiazhi*) (State Council, 2019b, art.21). The retaliation article is not expanded upon.

On a lower administrative level, the municipal government of Shanghai was first to issue their implementation regulations on the 18th of September 2020, titled the “Opinions on the Further Promotion of Foreign Investment in Shanghai” (Shanghai Municipal People’s Government, 2019). The decree is structured only by liberalizing objectives: further opening-up, attracting more foreign investors and protecting their “legitimate interests” (“合法权益” *hefa quanyi*) (Shanghai Municipal People’s Government, 2019). Both defensive measures again go unmentioned, which indicates that they may only be used at the national level and under the direct administration of the State Council and NDRC. The measures issued by the Shanghai municipal government were later forwarded by MOFCOM to other local governments to serve as a blueprint, suggesting that their respective local implementation will be alike (Lewis et al., 2021, p. 57).

5.1.6 The Law’s Shortcomings in the Eyes of American Stakeholders

Beyond these first three dimensions, an analysis of how the law was perceived by American stakeholders helps to place it in context and reveals the crux of the matter for some of those affected the most. After all, how these enactments are perceived will determine the further course of action in the theorized security dilemma.

First are iterations of AmCham’s ‘American Business in China White Paper’. The annual reports are written based on a survey of American businesses operating in China. Within, AmCham assesses the latest Chinese economic policies and puts forward recommendations for both governments. In the first iteration after the promulgation of the law, released in April 2019, the chamber was cautiously optimistic about the policy. It remarked that the enactment “has the potential to usher in meaningful reform and a more level playing field - depending on the content of its implementing regulations and their enforcement” (AmCham, 2019, p. 122). A year later, in April 2020, with the law already having been

in effect for three months, the chamber called it a “promising development” which “hinges on how it is implemented” (AmCham, 2020, p. ii). It critiqued the FIL Implementing Regulations as too “high-level in nature and lack[ing] sufficient detail” (AmCham, 2020, p. 2). Further, it remarked that “true reform requires more than high-level commitments and general policy principles” (AmCham, 2020, p. 4). In regards to the retaliation article, the chamber warned that it “may trigger tit-for-tat” reactions against actions by the American government (AmCham, 2020, p. 68). In the latest white paper, released in April 2021, the chamber not only reiterated its criticism of the unclear implementation fifteen months after the law had already come into effect, but it also criticized the FIL at the fundamental level, remarking that “the mere existence of a separate law governing foreign investment underscores the fact that foreign investors will be continue to be subject to differential treatment in certain respects” (AmCham, 2021b, p. 168).

A second publication by AmCham gives further insight into the effect of the FIL on American businesses in China. In its annual ‘Business Climate Survey’, the chamber evaluates the sentiment of its member businesses. The 2021 edition presented findings of a survey conducted between October and November of 2020 (AmCham, 2021a, p. 16) – a timeframe in which the FIL had already been in effect for almost a year. Asked in which areas members perceive discrimination, market access, public procurement and government financial support remained atop the ranking (AmCham, 2021b, p. 61). While slight improvements were perceived in a few other areas, the percentage of respondents which answered market access, regulatory enforcement and IPR protection even increased slightly between 2019 and 2020 (AmCham, 2021b, p. 61). All of these three issue areas which saw a year-on-year increase in perceived discrimination were included in the FIL and should have led to further improvements for foreign investors by this time. This would have been even more expected given the praise the FIL received in the policy discourse.

In regard to the continued occurrence of forced technology transfers, the CRS notes different understandings of the concept and a lack of enforcement for implicit conditioning. It states that from the perspective of Chinese officials, “foreign firms willingly give their technology” (Sutter, 2020, p. 2). Despite the FIL outlawing forced technology transfers, it remains “silent on China’s policies and practices that encourage theft and the ways in which the government directs, encourages, and facilitates technology transfer” (Sutter, 2020, p. 2). This criticism marks an important point. Ultimately, the ban on forced-tech transfer in the FIL is redundant, as China had already outlawed the conditioning of market access on tech transfer *de jure* when it entered the WTO (Gupta, 2018, p. 1). Thus, while on paper the FIL’s commitments seemed promising, the *de facto* challenges for American investors remain.

In summary, it can be stated that while the FIL was welcomed with mixed feelings at the time of the enactment, the opinions a year after the implementation are not in line with the major concessions and improvements that were promised as part of the law. Significant issue areas including market access and the protection of IP were assured to improve greatly through the FIL by Chinese authorities and repeatedly praised in the policy discourse. Yet, the reality of American investors on the ground has fallen short of initial expectations.

5.1.7 Conclusion

The holistic analysis has allowed for a more nuanced answer as to how far a connection between the FIL and the trade conflict can be established empirically and proves the meaningfulness of a categorical distinction between the constituting elements of a single policy.

Both the fast-tracked legislative process and the liberalizing provisions strongly point to the enactment of the FIL being linked to the trade conflict. Especially the cohesiveness between American demands and the short-dated adjustments to the law's investor-friendly provisions at a critical moment suggest that the enactment was indeed an 'olive branch' to advance the gridlocked negotiations. This assertion is further amplified by the fact that the implementation of these very provisions has, after the bilateral negotiations broke down again, failed to induce the significant change for American investors that came to be expected after their announcement and the praise by Chinese actors in the policy discourse. The open-endedness may have been an attempt to minimise the potential cost of the FIL as a costly signal *ex ante*, in case the further bilateral developments would not proceed as hoped by the Chinese side. In any case, the ambiguity of the provisions and unclear implementation is rather causing uncertainty, than leading to "more certainty to an uncertain world", as claimed by Xinhua (Xinhua, 2019b).

Nevertheless, it must be noted that two factors hinder the establishment of a direct connection between the two at the policy level. Firstly, the law itself does not reference the US or the trade conflict. After all, it is a law that covers all foreign investments into China. Secondly, and related to this is the fact that some of the pain points do not only concern the American, but also other foreign investors. The EU for example has called out difficulties for European firms in accessing Chinese public procurement, "compulsory" technology transfers and the weak protection of intellectual property rights (De Sarnez, 2012). In sum however, the sum of evidence speaks clearly for at least a partial connection between the enactment and the trade conflict.

The defensive articles within the FIL, the retaliation and expropriation articles, do not offer any clues on being related to the trade war directly, as they had already been existent in previous laws or were already included in the first draft in 2015, well before the beginning of the trade conflict. Nevertheless, they do deserve attention. The retaliation article, by definition, considers international conditions in IFDI policymaking under the principle of reciprocity by allowing retribution based on the perceived discrimination against Chinese OFDI. Instead of relying on the WTO agreements which allow for retaliation after a DSB decision, the provision instead enables reactions at the state's discretion. The adoption from the Foreign Trade Law to the FIL can thus be interpreted as laying the legal groundwork for retaliation in the context of FDI. The fact that China was already willing to use the analogous retaliation article in the Foreign Trade Law to justify its tit-for-tat retaliation of counter-tariffs underscore China's willingness to use such a provision in terms of investments. Thus, while Luan concludes that the Foreign Trade Law's retaliation provision is "a 'mirror' result of standing foreign *trade* protectionist actions" (*italics added*) (Luan, 2004, p. 971), the FIL's retaliation article is the equivalent in the realm of FDI.

Given the unclear implementation, the internal logic of the retaliation article remains in the dark. Whether it may be used to pressure foreign investors directly or only regard them as intermediaries, which themselves then apply pressure on their respective governments to ease a hawkish course on China is unclear. In any case however, the inclusion of the article in the law is intended "to send a clear message"¹³, not only to foreign stakeholders but also the domestic audience. This message is straightforward: the party-state won't tolerate what it perceives as discrimination against Chinese OFDI and will defend its interests unilaterally.

¹³ Interview with a Beijing-based lawyer specializing in mergers and acquisitions, on November 16, 2021.

5.2 China's New Foreign Investment Security Review

5.2.1 Legislative Process

The enactment of the FIL was followed by a second element of legislation: China's new national security screening regime for IFDI, the 'Foreign Investment Security Review Measures' (FISR, '外商投资安全审查办法' *waishangtouzi anquan shencha banfa*) (NDRC, 2020). Adopted by the NDRC on the 27th of November 2020, and later approved by the State Council, the FISR came into effect on the 18th of January 2021 (NDRC, 2020). The 23-article FISR established a new nationwide procedure to test whether foreign investments into China pose a threat to national security, replacing the older national security reviews of 2011 and the Pilot Free Trade Zone trial from 2015, which were outlined in the historical background. Figure 5 offers a timeline visualization, beginning with China's very first review in 2011 and ending with the latest enactment, the FISR in 2020.

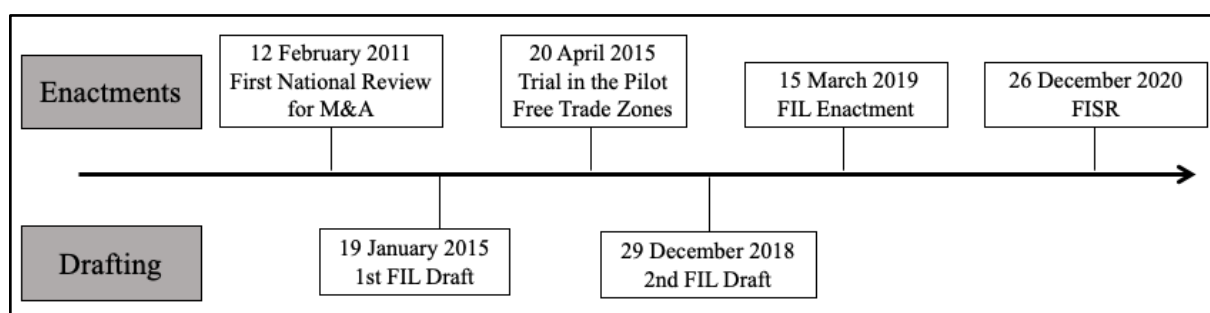


Figure 5: Timeline of China's National Security Reviews for IFDI

Note: Created by the author.

In the previously mentioned draft for a new FIL, which was publicized in 2015 and disappeared for three years afterwards, an entire chapter had been dedicated to a more comprehensive review mechanism (MOFCOM, 2015, Chapter 4). The drafters included an extensive list of factors to be considered in a review, among them the potential influence on China's national defence security, research and development capabilities for key technologies, "technological supremacy" ("技术领先地位" *jishulingxian diwei*) in key technologies, dual-use technologies, and critical infrastructure (MOFCOM, 2015, art.57). This comprehensive list in the draft far exceeded the scope of the national security review active at the time, which had been in place since 2011 and was primarily concerned about the impact on China's defence security. With the FIL's first draft in 2015 instead came an extension of the scope to include potential impacts of IFDI on elements closer aligned to economic security. Especially the mentioning of research capabilities as well dual-use technologies underscored this. This extended scope however was only left on paper and not enacted, as the draft vanished after the first publication.

After the three-year disappearance, when the critical second draft for the FIL emerged, the entire chapter about a revised review mechanism had been reduced to a single article. It only mentioned that "[t]he state shall establish a safety review system for foreign investment, under which the safety review shall be conducted for any foreign investment affecting or having the possibility to affect national security." (The National People's Congress of the People's Republic of China, 2019, art.33). Any decision would be final, without the possibility of appeal (The National People's Congress of the People's Republic of China, 2019, art.33).

This short article was adopted unchanged into the final FIL, which was enacted in March of 2019 (MOFCOM, 2019, art.35). Any further specifications about the working mechanism or the scope were thus absent. A year and a half later, the new security review was eventually outlined in a separate

regulation by the NDRC and MOFCOM on the 19th of December 2020, shortly before becoming effective only one month later (NDRC, 2020). This is the final regulation which has been active since and which will now be analysed in detail.

5.2.2 *Restrictive Provisions in The New Security Review*

The FISR begins by cross-referencing the FIL and China's National Security Law, stating it have been formulated in accordance with them and other laws (NDRC, 2020, art.1). The purpose of the law is to meet the needs of promoting the formation of a new pattern of comprehensive opening up, and to effectively prevent and mitigate national security risks while actively promoting foreign investment (NDRC, 2020, art.1). This reasoning depicts the FISR as the means through which further market-opening becomes feasible.

The second article specifies the scope of the FISR, which could hardly be defined any more broadly. Subject to review is *any* foreign investment into China that “affects or may affect” (“对影响或者可能影响” *dui yingxiang huozhe keneng yingxiang*) national security (NDRC, 2020, art.2). This is essentially a catch-all term, which grants the enforcing authorities considerable discretion to launch a review. This latitude is further amplified by the fact that the concept of national security itself is not further specified in either the FISR, or the overarching FIL.

The FISR allows for reviews to be initiated both for targets which are domestic enterprises, as well as foreign-invested enterprises (King & Wood Mallesons, 2020). It covers all forms of foreign investment, both direct and indirect: greenfield investment, M&A and investments through “other means” (“其他方式” *qita fangshi*) (NDRC, 2020, art.2). This again represents a significant extension. greenfield investment and those through “other means” were so far only within scope in the Pilot Free Trade Zones (State Council, 2015a, art.1), not in the former nationwide review (State Council, 2011a, art.1).

Beyond this extensive of scope for authorities to initiate a review, the FISR further requires a proactive declaration by the foreign investor in certain sectors (NDRC, 2020, art.4). This includes investment in defence security or into enterprises located within the vicinity to defence infrastructure, as already existent in the previous review and typically associated with national security. Next is a myriad of additional sectors. Besides the influence on “the stable operation of the national economy” and “the basic social order” which had already been included in the 2011 review, the new enactment included investments into agricultural products, transportation infrastructure, “important energy and resources” (“重要能源和资源” *zhongyao nengyuan he ziyuan*), internet products and services, as well as “key technologies and other important areas” (“关键技术以及其他重要领域” *guanjian jishu yiji zhongya lingyu*) (NDRC, 2020, art.4). These factors are not typically associated with national security but more closely resemble economic security. In addition, the call for a proactive declaration for investment in “key technologies and other important areas” is rather open-ended. A more precise description of these sectors is absent, which may lead investors to declare their transactions as a precaution, regardless of the actual effect on national security.

The proactive declaration for investments in the listed sectors are mandatory if the investors gains “actual control” (“实际控制” *shiji kongzhi*) through the transaction (NDRC, 2020, art.4). This control can be gained through three different modes: a shareholding of at least 50%, being able to control the board of directors or shareholder meetings, or having *any* “significant influence” (“重大影响” *zhongda yingxiang*) over the business decision making, human resources, finances or technology (NDRC, 2020, art.4). This third condition is again essentially a catch-all term. Any investment comes with an increase

of influence, at minimum through capital. Whether this can be equated with “significant influence” is ultimately the judgement of the involved agencies.

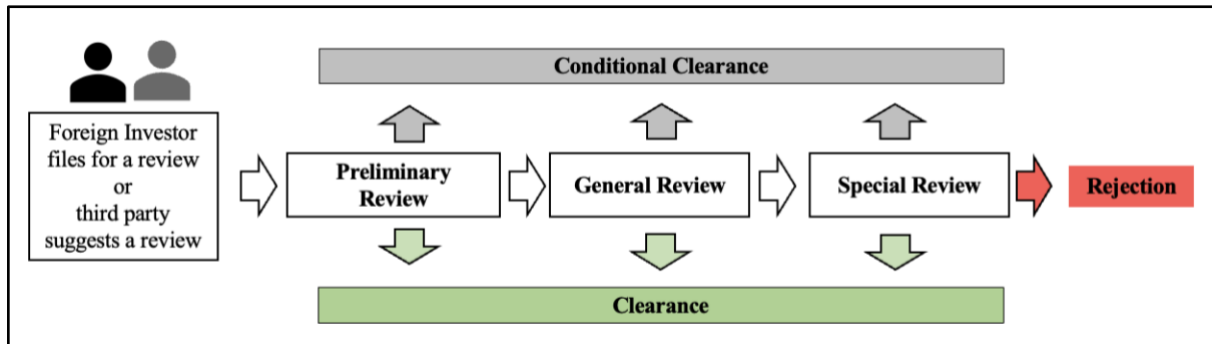


Figure 6: FISR Process

Note: Created by the author.

The FISR follows a three-stage process (NDRC, 2020, art.7-9), illustrated in figure 6. A review can be initiated by the foreign investor or requested by any third party (viz. a whistle-blower) (NDRC, 2020, art.15). Subsequently, the “Office of the Working Mechanism” (“工作机制办公室” *gongzuo jizhi bangongshi*), led by the NDRC and MOFCOM (NDRC, 2020, art.3), conducts a preliminary review (NDRC, 2020, art.7). If the investment is found to not affect national security, it is cleared to proceed. Otherwise, either conditional clearance is given, or the investment is subject to a succeeding regular review. Once again, it is either cleared entirely, cleared conditionally, or moves on to a special review for a final evaluation. The review period for this special review is limited to 60 working days but can be extended “in special circumstances” (“特殊情况下” *teshu qingkuangxia*) (NDRC, 2020, art.9). As specified in the FIL, the verdict is final with no possibility to appeal (MOFCOM, 2019, art.35).

Although I will not delve into a direct comparison between CFIUS and the FISR due to the limitations of this paper, some similarities are remarkable. As outlined in chapter 2.3, since the enactment of FIRRMA, certain transactions came with a mandatory filing requirement, particularly Chinese investments. This change was also done with China’s security review, where for the first-time proactive declarations became mandatory.

To summarize the policy level, the FISR represents a significant extension in scope and further exemplifies the increasing consideration of economic security concerns for FDI inflows into China. While the list of factors taken into consideration for a proactively declared review is already extensive and important terms like “key technologies” remain unspecified, the possibility to conduct a review for *any* investment that may affect the ill-defined national security is even more severe.

It needs to be said that such national security reviews tend to be general and without many details in many states (Lai, 2021, p. 497ff.). Nevertheless, even when taking this into account, the FISR seems exceptionally vague. Lai argues that such ambiguity is intentionally constructed “as a tool to achieve a balance of power” (Lai, 2021, p. 497), which relates directly to the

definition of economic security outlined in chapter 3.2.3. Essentially, the FISR appears to be a policy to restrict any investment at the discretion of China's central government.

5.2.3 Contradictions and Link to the Trade Conflict in the Policy Discourse

On the rhetorical level, the motivation and intention of the enacting authorities, at least as far as publicly expressed, transcend the ambiguous legal terms. Here statements by the Head of the Review Mechanism Office, Chinese state-affiliated media, as well as by two Chinese think tanks are remarkable.

The State Council published answers to the most frequently asked questions regarding the FISR on the 21st of December 2020, one month before it became active. In this catalogue of questions and answers, the Head of the Review Mechanism Office, in charge of the review process but not named, offered further details about the FISR. They declared that the main purpose of the FISR is to further open up the market, simultaneously promote and protect FDI, and to prevent national security risks (State Council Information Office, 2020). China, according to this statement, needs to “build a solid national security barrier” (“筑牢国家安全屏障” *zhu lao guojiaanquan pingzhang*) in a more “targeted” approach (“增强针对性” *zhengqiang zhenduixing*) (State Council Information Office, 2020). Just like the purpose of the law stated in its first article, the narrative portrayed in this official stance is that China needs new measures to protect its national security in order to achieve the underlying objective of further opening-up: only *through* enacting further restrictions can China continue its course of further liberalization. Explaining the background of the FISR further, the spokesperson referred to existing screening regimes in other regions, explicitly naming FIRRMA first and foremost before enumerating the screening regimes of the EU, Australia, Germany, Japan and the UK (State Council Information Office, 2020). He argues that China shall apply the learnings of foreign countries' screening regimes in order to construct its own mechanism (State Council Information Office, 2020). The argued eagerness to learn as well as the reference to FIRRMA highlight two critical elements, namely self-contradiction and the political motives.

Firstly, the presented narrative of a willingness to learn from the American review mechanism is contradictive to the repeated criticism of this very system by Chinese state media and officials. In particular, CFIUS and FIRRMA were criticized for being discriminatory against China (W. Chen, 2018b). Wang Wenbin, spokesman of the Foreign Ministry, claimed the US is “overstretching the concept of national security and abusing national power to oppress certain foreign businesses” (Wang, as cited in ChinaDaily, 2020). This criticism however ignores the conscious ambitions in any national security review to remain ambiguous, as outlined above. After all, the FISR was defined in a manner of arguably even less precision. Thus, criticising CFIUS and FIRRMA and concurrently enacting the FISR with its the catch-all clauses is greatly conflicting.

Secondly, the nominal reference to FIRRMA by the Head of the Review Mechanism Office directly, instead of naming CFIUS, the general and longstanding review process, is telling. To recall, FIRRMA was an increase of regulatory scrutiny of FDI in the US enacted by the Trump administration, in which the prime target was Chinese investment. The narrative of applying learnings from other countries may explain certain similarities between the FISR and CFIUS, but it doesn't explain why China needed to tighten its review procedures in the first place. Through negative lists and other mechanisms, China was already well equipped to restrict IFDI as desired. Instead of simply learning from the American side, I argue the new FISR is an act of balancing out the increased scrutiny under FIRRMA on a reciprocal basis. In other words, a primary inducement to implement such a comprehensive security review is to

protect China's economic and national security in the face of the US' increasing measures. This in essence is the external dimension of the conceptualized economic security dilemma in effect.

Despite not being a state official, I would like to draw attention to statements made by Pan Yuanyuan (潘圆圆), researcher at the Institute of World Economics and Politics at the Chinese Academy of Social Sciences. Her statements transcend the diplomatic speak and arguably expose the rationale even more forthrightly. Besides the contradictions of stating that CFIUS is too vague, while the FISR "give a clear basis for a review" ("清晰的审查依据" *qingxi de shencha yiju*), she linked the enactment of the new review to its overarching body, the FIL (Pan, 2021). The FISR, she stated, is "based on "the principle of reciprocity" ("对等原则" *duideng yuanze*) (Pan, 2021). Therefore, the FISR can also be used to take corresponding measures against perceived discrimination (Pan, 2021). Such reciprocity for reviews would again take international conditions into account for the IFDI decision-making progress.

An article published by the Institute of Science and Technology Management of the China Academy of Management Science is similarly insightful. Despite the FISR being prima-facie country neutral, "everyone already knew in their heart" ("大家都已经心知肚明" *dajia dou yijing xinzhiduming*) it was targeting the US (Wen, 2021). The article argued that he repeated criticism of American "unfriendly behaviour" ("不友好的行为" *bu youhao de xingwei*) had failed to induce any change of course, forcing China to counteract (Wen, 2021). While China remains welcoming of foreign investors, the article stressed, it won't allow foreign countries to interfere with its interests (Wen, 2021).

5.2.4 The Implementation Black Box

Regarding the implementation of the FISR, no case of a review has been made public so far. Further implementing guidelines are absent, and the FIL's guidelines only reiterate the article, which calls for the establishment of the review (State Council, 2019c).

Under the preceding frameworks from 2011, the only publicly known case however can shed some light on the implementation details. In 2019, a Chinese retailer whose largest stakeholder was an enterprise from Hong Kong, planned to increase its shareholding in another retailer from 29.9% to 40% (Ding, 2019). The target's largest stakeholder was Wuhan State-Owned Assets Supervision and Administration Commission with a 34.9% share (Ding, 2019). At the request of the NDRC, the bidder filed a security review in August of 2019 (Zhongbai, 2019). Five months later, the firm eventually dropped its acquisition plans (Yonghui, 2019).

While neither of both involved firms publicly stated that the initiated security review was the deciding factor in abandoning the planned deal, the case still signposts two critical elements. First, as the acquisition plans only involved an increased to a 40% stake, the condition of a controlling stake by a shareholding of at least 50% was not triggered. The 2011 review already had a backdoor mechanism of acquiring "significant influence" over the business decision making, human resources, finances and technology (State Council, 2011, sect.1, art. 3.4), but there was no public evidence to suggest control over the target was sought through such means (Bian, 2021, p. 80) Second, both involved firms were retailers and therefore not included in the industries which fell under the scope of the security review at the time. This case exemplifies that already back then under the preceding reviews, the interpretation of what constitutes "actual control" or relevant industries that could potentially affect national security was very broad. As the FISR expanded this scope for reviews even further in 2021 onward, only more discretionary power is to be expected. With no option for the involved firms to appeal a verdict or receive

information on the decision-making process, the black box of China's national security review got even darker.

5.2.5 The Review Drawing Criticism from American Stakeholders

Compared to the initially hopeful sentiment regarding the FIL, the criticism about the FISR by American stakeholders was hardly allusive.

The American Chamber in its 2021 white paper observed that the FISR had caused “widespread concern” among its members, which “will create greater uncertainty and constitute an impediment to foreign investment.” (AmCham, 2021b, p. 172). It argues the criteria for a review are “defined very broadly” and “uncertain”, which may lead investors to file for reviews regardless of actual impact on national security (AmCham, 2021b, p. 172). It further stressed the redundancy of the review in certain sectors, as industries like culture and tourism are already inaccessible to foreign investors due to the negative lists. Lastly, the Chamber recommended the Chinese government to apply the FISR “narrowly” and refrain from utilizing it “for economic protectionism or in support of industrial policy” (AmCham, 2021b, p. 18).

The CRS was even more outspoken. It remarked a similarity to CFIUS and the short timeframe of just over a year between the enactments of FIRRMA and the FISR (Sutter, 2021, p. 16f.). In line with the assertion made on the political rhetoric level that the FISR was influenced by American measures and particularly by the enactment of FIRRMA, the analysis states that the FISR represents “an effort to [...] seek parity with the United States” (Sutter, 2021, p. 16). It may further “facilitate China's ability to pressure CFIUS through retaliatory responses to CFIUS determinations on PRC transactions” (Sutter, 2021, p. 16).

One further statement came from the USCC in its 2021 Annual Report. In line with the assertion made by Pan Yuanyuan, who connected the FISR to the overarching FIL, the report claimed that the FISR “could be used to retaliate against companies or coerce countries with companies seeking to invest in China” (USCC, 2021, p. 139). If such actions would actually take place to retaliate against CFIUS decisions to block certain Chinese investments into the US, the act would be a clear-cut example of economic coercion. Further, it would lead to adverse results, as the action-reaction cycle of the economic security dilemma continues on the external dimension. Restrictions then wouldn't be made based on actual effect of national security, but simply to exact vengeance.

5.2.6 Conclusion

In comparison to the previous security reviews, the FISR is an extension in scope and geographic application. Not only does it extend certain elements of the Pilot Free Trade Zone trial from 2015 nationwide, it also further enlarges the factors considered as having an impact on national security, which depart further from traditional defence security towards economic security. Both the vague language and encompassing terminology reflect a desire to not confine the review in any way. Backdoors grant the enforcing authorities considerable policy discretion: whether it is the definition of “actual control” or the consideration of “key technology and other areas”, the FISR is greatly ambiguous.

While genuine national security concerns may still be existent, the rhetoric and timing of the implementation seem far from coincidental. Only a year and a half after Trump signed FIRRMA, China

implements its new review and even refers to the American policy publicly - not the long-existing CFIUS review, but instead the targeted restriction to Chinese investments. Whether the motivation is to retaliate as argued by Chinese academic Pan and in the American criticism or not, the simple narrative of wanting to “learn” from other countries holds little explanatory power as to why the enactment was necessary in the first place, given China’s already encompassing toolkit to restrict investments. Even more then does the argument of requiring a new review to enable liberalization seem contradicting. Instead, I argue China increased its own measures, in part, *because* of FIRRMA in order to balance the equilibrium of congruent national security reviews. This is in essence the theorized external dimension of the economic security dilemma at play: an increase in the US measures to protect national and economic security is followed by a Chinese reaction, which itself aims to increase national and economic security. This is not to say that the FISR enactment itself was retaliation or that it must ultimately be utilized to retaliate against CFIUS decisions, rather that the enactment was necessitated by developments on the external dimension.

6 Conclusions and Strategic Implications

The bilateral relationship between China and the US is following a course of deterioration. Not only the highly publicized action-reaction cycle of reciprocal trade tariffs points it out, it is also evident in the development of bilateral FDI flows. Mutual FDI has become less of a stabilizing factor and is increasingly being perceived as a potential threat to both countries' national and economic security. While issue areas like IP protection and equal market access have long been a concern, it was until the Trump administration that an actual shift in terms of US policy to address these problems emerged. This research has addressed the question if the subsequent enactments in China's IFDI regulatory framework, China's new law for IFDI and the related national security review can be linked to the trade conflict. The data presented in this analysis supports the theory that both elements were influenced by the trade conflict.

The FIL came at a critical moment of the conflict and was strongly curtailed. The remains in the final enactment largely consisted of broad concessions to further liberalize the market, a mirror image of the demands long voiced by American stakeholders. Its lacklustre implementation so far is in line with the repeated criticism made by American stakeholders over and over again during the last decades that China makes broad concessions but does not follow through on them. The failure to induce change for American firms even two years post-enactment supports the argument that the enactment was indeed a peace offering during the 90-day truce. What was proclaimed as a revolution in Chinese IFDI regulation, propped by the political rhetoric of Chinese state actors, has so far fallen short of expectations.

While it is the liberalizing provisions that allow the clearest connection to be drawn to the bilateral economic conflict, the two defensive articles and especially its retaliation article is nevertheless noteworthy. After all, its analogue article justified Chinese counter-tariffs, prior to a WTO DSB decision. This suggests that China is extending its retaliatory toolkit by another domain and may resort to unilateral action against whatever it perceives as discrimination.

The FIL can be tied to the conceptualised economic security dilemma, but differently than expected. On the one hand, the data clearly suggests that the enactment was influenced by the trade conflict. This in turn would substantiate the theory of an external dimension, in which IFDI policymaking by one state is influenced by another state's policies. On the other hand though, the FIL is the enactment that first followed FIRRMA. If the FIL was actually intended to bring as much liberalization as was praised in the policy discourse, it would break the conceptualized dilemma, which would most probably result in a categorically equivalent response to follow immediately, presumably a restriction on IFDI. Assuming however that the FIL was primarily intended as a soothing measure for the bilateral negotiations at least at the time of the enactment, which the data suggests, the FIL would fall outside of the scope of the conceptualized model. It would then not be accounted for, as in that case, it is neither a restrictive, defensive nor liberalizing policy in effect – but rather an empty shell of liberalizing provisions as a bargaining chip.

Different to the FIL, the FISR is a policy of restrictiveness alone. The extension of scope and factors taken into consideration clearly underscores the desire to expand the review process for economic security concerns. While no link can be established at the policy level, the policy discourse connects the enactment with the trade conflict directly. Even further, the direct reference to FIRRMA lets the rationale for the enactment shine through more clearly than the policy document. I argue that the establishment of the FISR reflects a desire to balance out the American counterpart.

The enactment of the FISR fits more smoothly into the conceptualized model. If one assumes that the enactment was at least partially motivated by FIRRMA, as the data suggests, it exemplifies both external and internal dimensions. On the external dimension, a restrictive IFDI policy is countered by the enactment of a similar policy in the other state of the bilateral setting. Interestingly, the internal dimension is mentioned in the policy discourse, albeit not verbatim of course. China must walk a fine line between balancing out the restrictions and keeping the market accessible enough to maintain sufficient IFDI flows. While the inclination to retaliate against the perceived discriminations of Chinese OFDI may at times be great, any disturbance could deter existent and potential foreign investors.

Comparing the FIL's articles for retaliation and expropriation with the FISR, the risk which foreign investors are exposed to differs. The first distinction is due to their onset. The FISR already sets in during the pre-establishment phase. In case a proposed transaction is blocked on the grounds of national or economic security concerns, the investor's capital is not yet at risk. This ties into the mentioned shift in the pursuit of national security towards preventive approaches. Differently, both defensive articles of the FIL apply to the post-establishment phase, or to put it plain when the foreign investor has already transferred his capital into the Chinese market. Given the long investment horizon of FDI, the timeframe here is much greater and thus the risk level for the investors much higher. A second difference arises from the factors considered in the application of the legislations. While the FISR, at least in writing, only considers factors specific to the transaction to determine whether a proposed investment has a bearing on China's national security, the retaliation article of the FIL reflects external considerations. If Pan's statement and the criticism by the USCC hold true however, the FISR will equally take perceived discrimination of Chinese OFDI into account.

Both policies were enacted rather recently. Given that no review by the FISR has been made public so far, and the retaliation and expropriation articles haven't been utilized yet, several scenarios are imaginable. Followingly, I will sketch three possibilities and weigh their likelihood based on the findings.

In a scenario of maximum utilization, the measures could herald the start of drastic impacts on bilateral FDI flows. Not only could the liberalizing provisions of the FIL not be implemented any further, but the expropriation article could also be applied to disown large US enterprises to absorb their capital into China's SOEs, expounding "fair and reasonable compensation" at the minimal level. Whenever China perceives what it regards as acts of discrimination, the retaliation clause could be applied widely, given the arbitrary interpretation the law provides. In terms of the FISR, targeted blockings of American investments not based on the details of the transaction, but simply as a retribution for blocked deals of Chinese investors in the US are within the realms of possibility. The broad criteria of the FISR and its catch-all clauses would allow the Chinese state to justify such a blocking, as the FISR is anchored within the FIL which carries the retaliation article. This outlined scenario however would lead to immense uncertainty for investors from both states. Consequently, bilateral FDI flows would decrease sharply, which would hinder China in achieving its ambitious industrial policy goals. The relatively small gains from expropriating select enterprises is outweighed by the detrimental effects.

A second scenario, which may be more likely, is based on deterrence instead of direct impact. The defensive articles could be applied only to smaller firms. If the strategy follows the principles used in terms of trade action, China would target equivalent enterprises and aim at inflicting economic and political cost to the US. Potentially firms of other countries could be targeted. Such an application would already be without precedent in the realm of FDI and drastic enough to cause a signalling effect. Similarly, the FISR and its extensive requirements for proactive declarations may already be discouraging investments into sensitive sectors from even being proposed. This

scenario may also lead to negative impacts, as investors will be discouraged from further transactions when the perceived risks outweigh the potential economic rewards. Capital, as shy as a deer, tends to avoid uncertainty and unpredictable policies, and may thus spare the Chinese market in favour of other economies.

A third scenario, and one I argue is the likeliest, is based on inducing positive reciprocity and bilateral negotiations. For one, the implementation of the liberalizing provisions of the FIL could move forward to better address the concerns of US stakeholders. Further, the expropriation article continues to not be applied, as it already has not been for decades with the preceding laws. The retaliation article is not used directly to pressure firms, but rather to encourage other countries to enter into bilateral investment agreements with China. Instead of using the FISR in a logic of tit-for-tat retaliation, like in the first scenario, reciprocity could be applied in a positive sense of liberalisation. The market entry for a specific Chinese firm into the US could be exchanged for the entry of a select US firm into China. In essence, a FISR approval could be exchanged for a CFIUS approval. While still tit-for-tat or quid pro quo, the reciprocity is in terms of liberalisation instead of restriction. Such an exchange however would have to not be too apparent, as it would contradict the basic principles of both reviews based on national security. After all, China is still seeking to increase IFDI and OFDI flows. Using the provisions in this sense would be utility-maximizing in terms of economic gain but would require China to set back the political considerations which have come to determine IFDI policymaking. If this approach fails to achieve the desired results however, China could retort to the second and ultimately first scenario for more drastic actions.

Regardless of which scenario will hold true, the further continuation of an increasing importance of economic security concerns seems apparent for both sides.

China for its part has expressly underlined its desire to expand economic security, as both the rhetoric of the highest level and policy documents reveal. In October 2021, Xi Jinping, warned that “the more open we are, the more importance we must attach to security” (“越是开放越要重视安全” *yueshi kaifang yue yao zhongshi anquan*), when referring to China as a host country for foreign investment in his speech at a Congress in celebration of the 100th year since the party’s founding (Xi, as cited in People’s Daily, 2021). Furthermore, the outline for the 14th Five-Year Plan, which presented China’s vision for 2035, called for a “strengthening of national economic security and safety” (“强化国家经济安全保障” *qianghua guojia jingjianshanquan baozhang*) (State Council, 2021). It foresees further prevention and control mechanisms to safeguard China’s interests in the economic domain.

On the American side of the equation, self-proclaimed deal maker Donald Trump, who once boldly stated that “[t]rade wars are good, and easy to win” (Trump, as cited in Reuters, 2018), has since left office. A new administration under Joseph Biden assumed office in January 2021, whose China approach has so far been a continuation of the trajectory with new policies set to further restrict Chinese investments into the US (USCC, 2021, p. 7). While being more delicate with his wording, Biden’s approach and rhetoric appears eerily similar: there needs to be an end to China “robbing” American firms of their IP and the subsidization of its SOEs, giving it “a leg up on dominating the technologies and industries of the future” (Biden, 2021). In its first National Security Strategy, the Biden administration stated it plans to “out-compete” China and

“will confront unfair and illegal trade practices, cyber theft, and coercive economic practices” (White House, 2021, p. 20).

In regard to the American review for IFDI, a further clampdown on Chinese investments is on the horizon. In its latest report, the USCC calls for an additional strengthening of the existing review measures for Chinese investments, describing the current framework as unable to “keep pace with the Chinese government’s military-civil fusion strategy” (USCC, 2021, p. 11). Interestingly, not only are incoming investments into the US set to be further scrutinized, in a novel step the USCC also calls for more regulation governing American OFDI to safeguard critical supply chains (USCC, 2021) and “to protect U.S. national and economic security interests” (USCC, 2021, p. 270f.). In terms of CFIUS specifically, the review board has been increasingly opening investigations retrospectively, with transactions already cleared in the past now subject to a review (Xu Klein, 2021). While new legislation is yet to be enacted by the Biden administration, one proposal is striking. In October 2021, Republican senator John Kennedy introduced a bill to require CFIUS reviews specifically for Chinese greenfield investments (Kennedy, 2021). He argued that while China “uses greenfield investments to gain leverage over the U.S. economy”, it “keeps its domestic markets largely insulated from foreign influence” (Kennedy, 2021). So far, such reviews laid outside of the jurisdiction of CFIUS, as opposed to the FISR which has been covering greenfield investment since January 2021. To put it straight, a mere eight months after China enacted greenfield reviews, a US proposal is brought forward to follow suit. The action and reaction cycle could hardly be more blatant and clearly underscores the attempted balancing-out of foreign reviews on the external dimension of the economic security dilemma.

China and the US may be able to overcome the dilemma by increasing engagement with the WTO as an independent body. The WTO’s DSB has often been referred to as the ‘crown jewel’ in the litigation of economic disputes. This solution to the problem would however require both states to subordinate themselves to the rulemaking of the DSB before taking any unilateral action. With the Biden administration seemingly continuing the Trump administration’s approach to its China foreign policy, and itself China enacting the retaliation clause within the FIL, it seems more likely that further unilateral action is on the horizon.

7 Discussion

Having concluded the findings of this analysis, I would like to reflect critically upon the choice of methodology and the theoretical approach. Furthermore, I will offer avenues for further research.

To begin with, this paper has provided a topical contribution to the analysis of the so-called ‘trade war’, by delineating the domains of FDI and trade. The role of FDI in the bilateral relation has so far been under-researched, with available analyses either investigating the economic relationship as a whole or focusing on trade specifically. While this paper treated FDI as the unit of analysis, there seems to be an even more microscopic differentiation in terms of investments into information technology. For these investments have a range of new policies been enacted on both sides, which future research could analyse.

The findings support the methodological approach to conduct a policy analysis that extends beyond the final enactments alone. Not only have the other dimensions revealed how the policies were framed and in turn perceived, but the discourse level has also revealed links which are absent from the policy document itself. This approach was not a brainchild of imagination, but rather stemmed from the analysis of FIRRMA itself, in which the policy discourse more clearly revealed Chinese FDI policies as the cause and in consequence the prime target of the enactment. It is unfortunate that all attempts to get further insights into the Chinese policymaking by requesting interviews were in vain. While many interviewees in the US and in Germany seemed to perceive of the topic as rather mundane, attempts to get an interview with a Chinese lawyer specializing on FDI were denied with the reasoning that the topic is too sensitive to even be discussed anonymously.

This research has aimed to adopt a model better suited for economic security in the traditionally military focused security dilemma. The model was developed in line with the theoretical implications of FDI policymaking, specifically by incorporating the everlasting internal dimension of weighing between liberalization and restriction. Not only is this internal dimension even acknowledged by policymakers themselves as they struggle to keep the internal balance, but the findings also support the existence of the external dimension. The action and reaction cycle seems to follow a rather clear pattern, if one looks at FIRRMA, the FISR, and now at the latest proposal by Senator Kennedy to further strengthen the American screening regime. Nevertheless, the model is better suited for responses in a tit-for-tat manner. The fact that on the American restrictions the overall liberalizing FIL followed can only be explained through the understanding that it was enacted as a way of negotiating. When this function failed to induce the expected response, the FISR followed soon after.

As this thesis only investigated one bilateral relationship using the model, this naturally opens avenues for further research. The basic considerations of an internal and external dimension are universal. Thus, the developed model could be applied to other international relations with China, for example between China and the European Union, or even between two entirely different states whose FDI flows have become a securitized domain. One example here would be Japan and the US in the 1980s, where widespread concern over Japanese investments into the US led to a regulatory revision in 1988 (Griffin, 2017, p. 1764). How Japan reacted in terms of its FDI policy in return could be tested against the assumptions of the conceptualized model. Beyond bilateral relations, it could be extended to multilateral economic relations, although extracting effect between enactments would then be even more challenging.

Like any model, this conceptualized two-dimensional economic security dilemma is made possible by simplification. FDI policymaking is not purely a matter of influences by other states

but impacted by an infinity of other factors. Nevertheless, the adjusted application to the realm of FDI has offered valuable insights as to how far these internal and external dimensions do play a role, by narrowing the focus exactly on them.

8 Appendix

Appendix A - Comparison of OFDI Data Sets

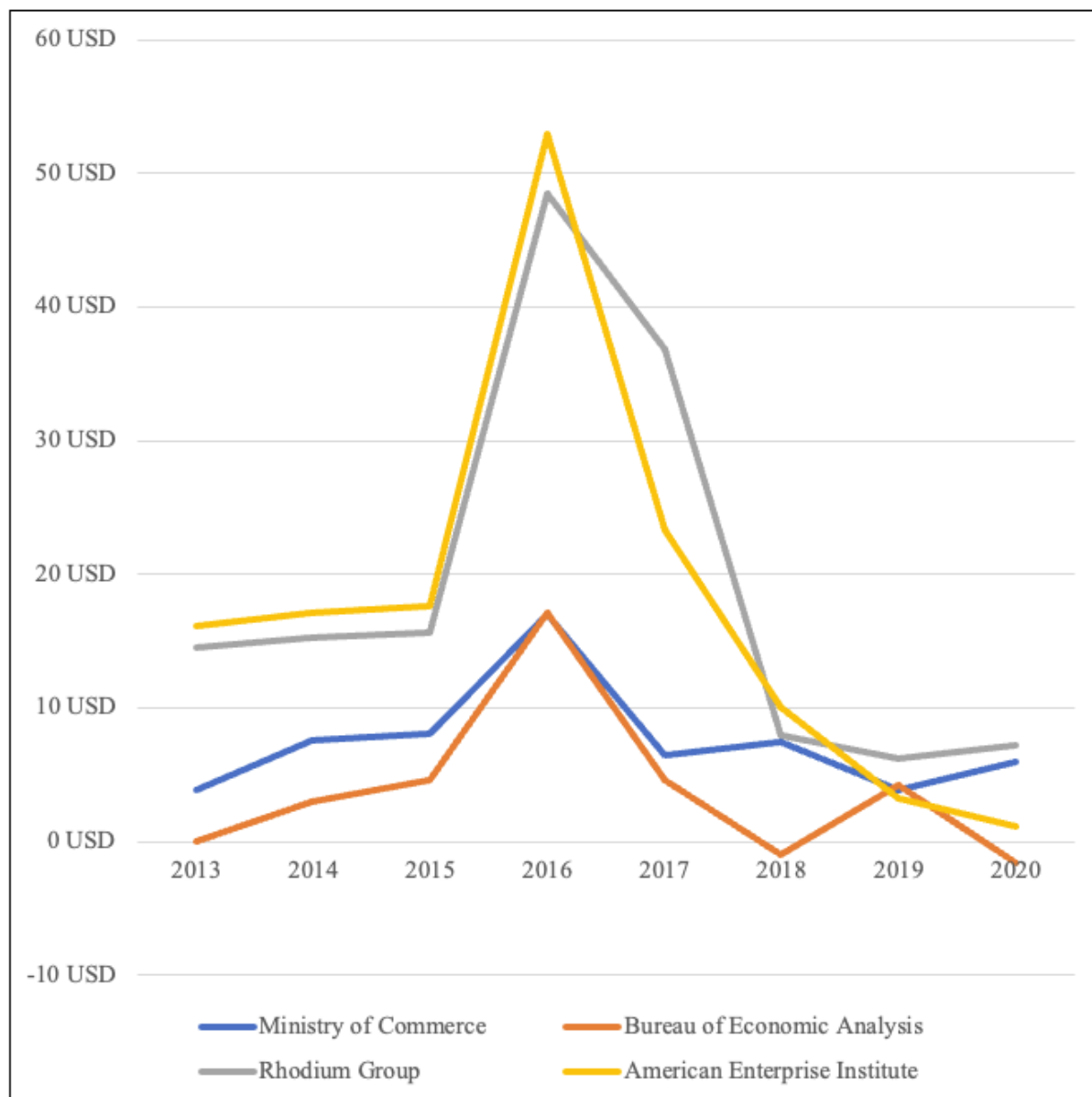


Figure 7: Estimates for Chinese OFDI into the US in USD billions (2013-2020)

Note: Created by the author. The figures from the Bureau of Economic Analysis include divestments, thus at times annual net flows are negative. Data from American Enterprise Institute, n.d.; Bureau of Economic Analysis, 2021; National Bureau of Statistics of China, n.d.; Rhodium Group, n.d.

Appendix B - China-US Bilateral FDI Flows

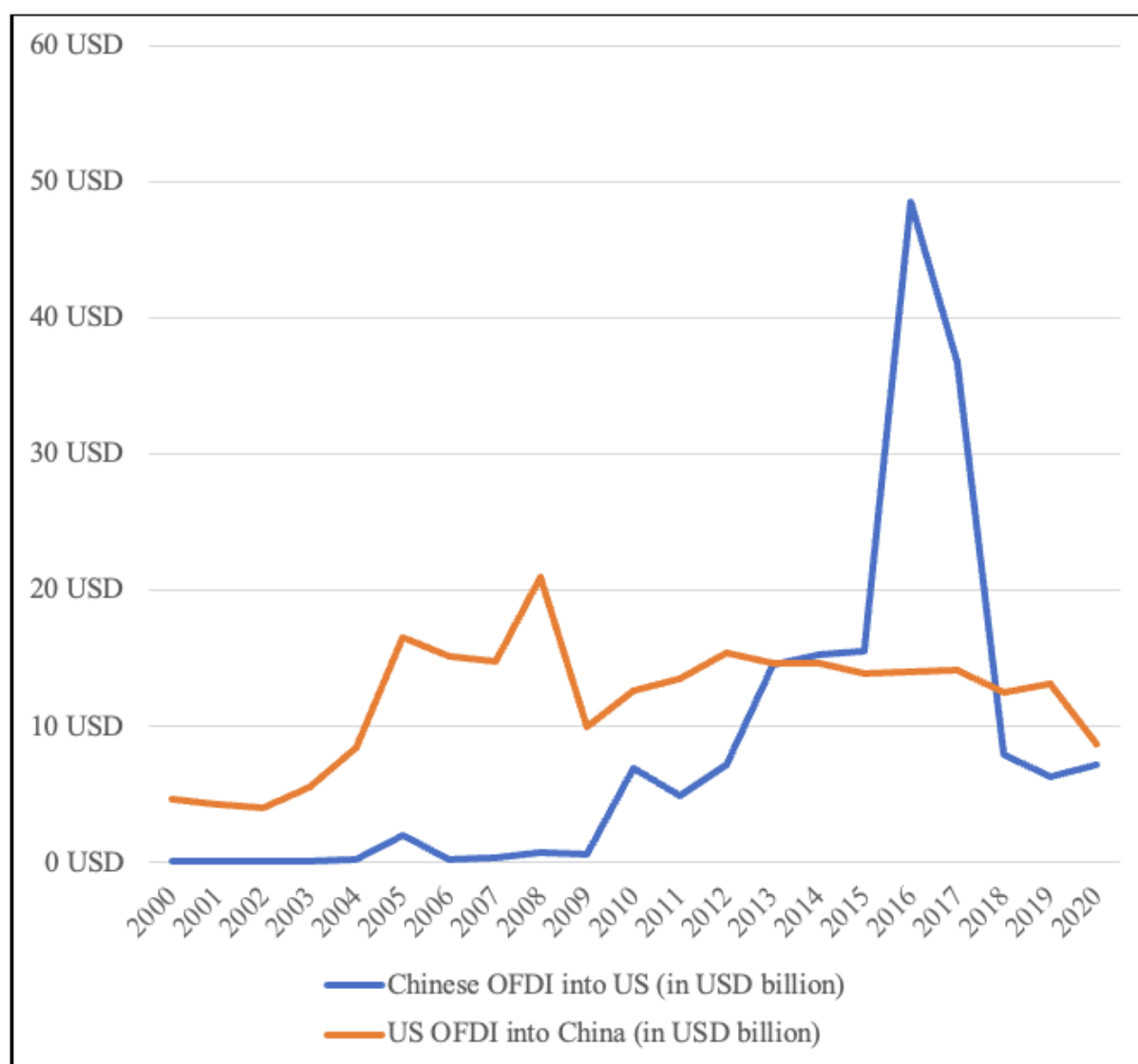


Figure 7: Bilateral FDI Flows between China and the US (2000-2020)

Note: Created by the author. Data taken from Rhodium, n.d.

Appendix C - Breakdown of CFIUS Notices for Chinese OFDI

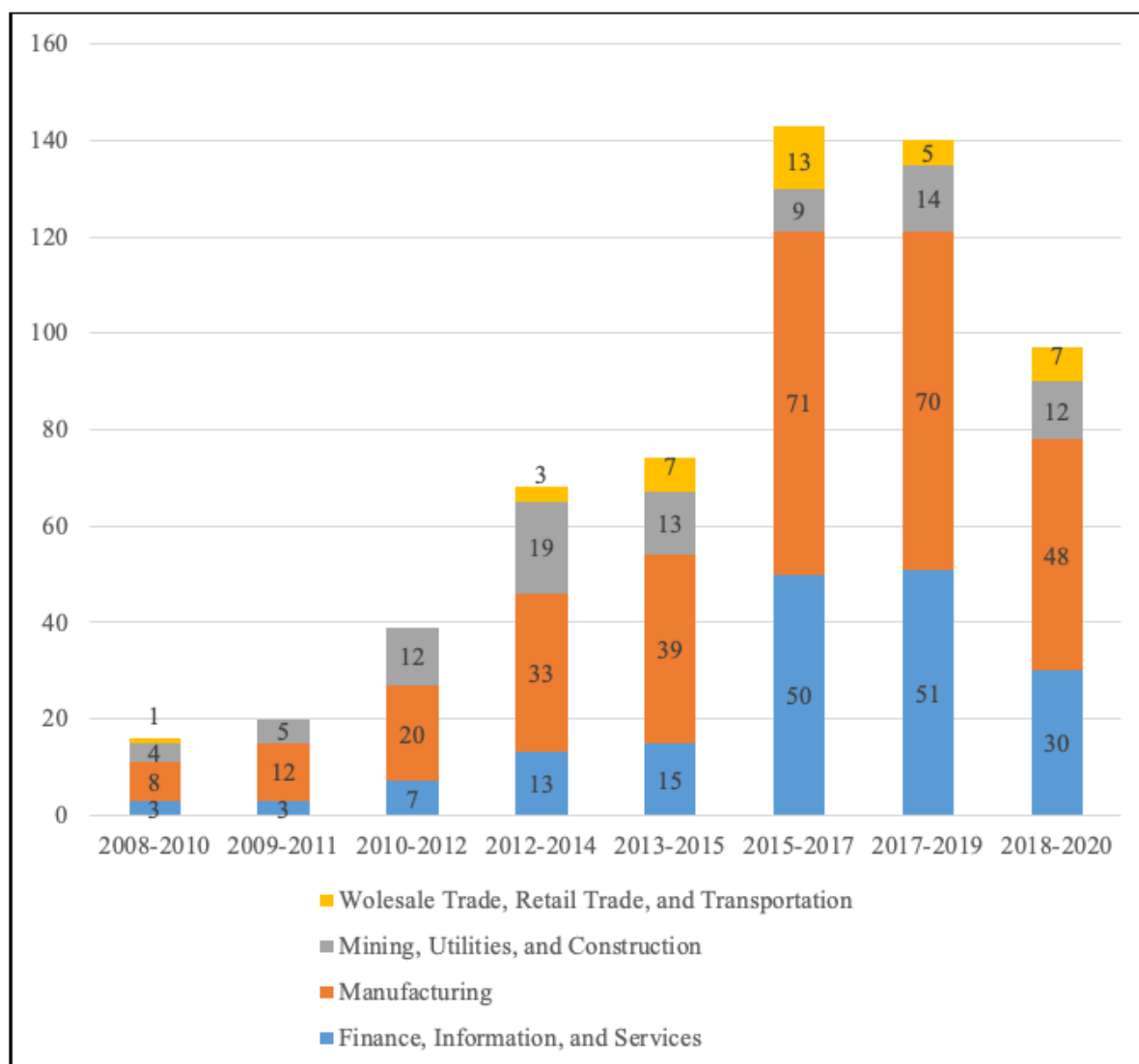


Figure 8: CFIUS Reviews of Chinese OFDI by Target Sector (2008-2020)

Note: Created by the author. Data from CFIUS Annual Reports (CFIUS, 2015, 2018b, 2019, 2020, 2021).

Appendix D - List of Interviews

Date / time of interview	Interviewee	Occupation / Affiliation	Focus of Interview
8 September 2021 18:30 – 20:30	Sourabh Gupta	Resident Senior Fellow Institute for China-America Studies (ICAS)	Section 301 Report and China-US trade conflict.
9 September 2021 15:30 – 16:30	David Bulman	Assistant Professor of China Studies and International Affairs Johns Hopkins School of Advanced International Studies (SAIS)	His publication “The Economic Security Dilemma in US-China Relations” (2021).
10 September 2021 16:00 – 17:30	Anon.*	Policy Analyst Foreign Chamber of Commerce in China	The perception of the Foreign Investment Law and China’s National Security Review by foreign businesses in China.
13 September 2021 18:00 – 18:30	Katja Drinhausen	Policy Analyst Mercator Institute for China Studies (MERICS)	Foreign Investment Law in the context of retaliation in Chinese policymaking.
15 September 2021 10:00 – 11:00	Wang Xinling	Policy Analyst German Chamber of Commerce in China	Foreign Investment Law, Negative Lists and 2020 National Security Review.
29 October 2021 09:00 – 09:30	Frank Sieren	Independent Business Journalist	China-US Relations and trade conflict.
16 November 2021 09:00 – 10:00	Anon.*	Lawyer based in Beijing Practicing in China and specialized on M&A	Administration of justice in China.
16 November 2021 12:00 – 12:45	Anon.*	Lawyer based in Shanghai Practicing in China and specialized on FDI regulation	Legal technicalities of the Foreign Investment Law and 2020 National Security Review.

Figure 9: List of Interviews Conducted

Note: Interviewees marked with an asterisk have requested anonymity.

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