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INTRODUCTION

Trade disputes between the United States and China have caught momentary worldwide attention. However, because the world's two largest economies are interlocked in various aspects, it is hard to cut these connections, despite Washington and Beijing's constant effort to dwindle each other's impact. As one of the major sources of foreign investment for the U.S.,[1] China has been adjusting its capital control policies for years in response to development needs and in order to address the changing investment environment in foreign countries.[2] This Note spotlights China's latest outbound capital control regulation, NDRC Regulation No. 11 ("Reg. No. 11"), and how it suits China's strategic plan of "made in China 2025." Briefly, this Note will also analyze this regulation's potential impact on U.S. policy on China's investment funds.

Capital control is an essential way for a country to fix its currency's exchange rate while maintaining its sovereignty over monetary policy. In his 1997 paper, the incumbent Chief Economist of the International Monetary Fund, Maurice Obstfeld, developed a "trilemma" model, which is now known as the "Mundell-Fleming trilemma."[3] This model describes the relationship between the free flow of capital, a fixed exchange rate, and an independent monetary policy. As the name "trilemma" indicates, these three policy goals cannot all be realized at the same time. According to the trilemma, if a country wants to have an independent the monetary policy, it must exercise capital control in order to achieve fixed exchange rates of its currency because only stable capital inflows and outflows can

* Yumeng Xu, J.D. Candidate at the University of California Hastings, Class of 2020.

1. China, SELECTUSA, 2018, https://www.selectusa.gov./servlet/servlet.FileDownl oad?file=015t0000000LKM1.

2. Tian Chen & Yinan Zhao, *China's Capital Controls Keep a Bad Year from Getting Worse*, BLOOMBERG (Nov. 21, 2018, 8:05 AM), https://www.bloomberg.com/news/articles/2018-11-21/china-s-capital-controls-keep-a-very-bad-year-from-getting-worse.

3. Maurice Obstfeld et al., *The Trilemma in History: Tradeoffs among Exchange Rates, Monetary Policies, and Capital Mobility* (Nat'l Bur. of Econ. Research, Working Paper No.10396, Mar. 2004).

yield a fixed exchange rate.[4]

Currently, capital control practices are no longer the mainstream monetary policy. For example, the Bretton Woods Agreement was a global exercise of capital control.[5] The rules of Bretton Woods provided for a system of fixed exchange rates—every member country would "peg" their currencies to the U.S. dollar.[6] Stringent capital control practices among the member countries allowed them to maintain an independent monetary policy (i.e., discretionary domestic interest rates).[7] The trend of globalization, particularly growing international economic activities, led to great conflicts between capital controls and pegged exchange rates, which finally brought an end to Bretton Woods.[8] Today, most countries allow their currencies' exchange rates to float.[9]

Yet, there are still several countries that stick to capital control practices. Harvard economist, Dani Rodrik, argued that the Bretton Woods system, essentially the capital control policy, was the best practice for economic growth.[10] He credited the world's stable GDP boom during the Bretton Woods era to capital control practices, while attributing frequent economic crises in recent decades to free capital flows (i.e., the financial globalization). Among the world's most important economies, China and India still exercise capital control.[11]

China has been a steady follower of the capital control policy ever since its economic reform in 1979.[12] The same year it started to globalize, China set up the State General Administration of Foreign Exchange ("SGAFE," now the State Administration of Foreign Exchange, or "SAFE") to supervise capital flows.[13] Almost 40 years have passed since the initial set-up. Since then, China has developed a more complex system of capital control. However, to date, there is not a single regulator in charge of all capital control policies in China nor a unified, formal regulatory document that

4. *See id*. at 1.

5. BENN STEIL, THE BATTLE OF BRETTON WOODS 9 (2013).

6. *Id*. at 4.

7. Steil, *supra* note 5, at 3.

8. Atish R. Ghosh & Mahvash S. Qureshi, *What's In a Name? That Which We Call Capital Controls* 22 (IMF WORKING PAPER WP/16/25, Feb. 2016).

9. *See id*. at 6.

10. *See* DANI RODRIK, THE GLOBALIZATION PARADOX: DEMOCRACY AND THE FUTURE OF THE WORLD ECONOMY 10 (2012).

11. Michael W. Klein, Conference Daft, *Capital Controls: Gates and Walls*, BROOKINGS INST., Sept. 4, 2012, at 4.

12. SAFE, *The History of State Administration of Foreign Exchange* (in Chinese language) (last visited Oct. 25, 2019), http://www.safe.gov.cn/safe/lsyg/index.html.

13. Guijun Lin, *China's Foreign Exchange Policies Since 1979: A Review of Developments and Assessment*, CITESEERX 6 (Jan. 2003), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.194.8075&rep=rep1&type=pdf.

guards against cross-border capital flow risks.[14]

Among all areas of capital control, the control over China's outbound investments has become a particular concern of destabilization to the capital control scheme. According to the Mundell-Fleming trilemma, if China wants to maintain a fixed exchange rate and an independent monetary policy, it must control both capital inflows and outflows. Buying and selling foreign exchange reserves to combat foreign investment inflows and outflows is an essential practice for China's government. Particularly, this practice is an attempt to fix currency exchange rates in order to maintain an unchanged domestic money supply.[15] A substantial drop in China's foreign exchange reserve would greatly reduce the government's capability to adjust its economy. Since 2014, China's foreign reserves have been declining.[16] Some blame Chinese enterprises' active overseas merger and acquisition activities ("M&As") for China's rapid, short-term, foreign exchange reserve drop during 2016.[17] Chinese Foreign Direct Investment ("FDI") has been steadily growing since 2010.[18] In 2016, China invested over $46.49 billion into U.S., while the U.S. only invested $13.81 billion into China.[19]

Since November 2016, in response to the skyrocketing overseas investments, regulators in China have been tightening their regulatory measures to restrict outward remittances of foreign currency. Specifically, in December 2017, the National Development & Reform Commission ("NDRC") issued Reg. No. 11, which came into effect on March 1st, 2018, and implemented new measures for enterprise investments.[20] Supposedly, Reg. No. 11 is meant to be a stringent capital control policy. However, when compared to its predecessor, NDRC Reg. No. 9 ("Reg. No. 9"), Reg. No. 11 relaxes capital controls over certain types of outbound investment, while performing its designated duty to constrain.[21] For example, under the current regime, Foreign Portfolio Investments are under scrutiny while investments in offshore research and development centers only need to go

14. Baker McKenzie, *New Restrictions on China Outbound Investments* (Jan. 2017), https://www.bakermckenzie.com/en/insight/publications/2017/01/new-restrictions-china-outbound-investments.

15. Christopher J. Neely, *Chinese Foreign Exchange Reserves, Policy Choices and the U.S. Economy*, FED. RSV. BANK OF ST. LOUIS WORKING PAPER 2017-001A (Jan. 2017).

16. SAFE, *The Scale of China's Foreign Exchange Reserves (1950-2017)* (last visited Oct. 25, 2019), https://www.safe.gov.cn/en/2018/0408/1426.html.

17. SAFE, *supra* note 12.

18. Rhodium Group, *The U.S.-China Project* (last visited Oct. 25, 2019), https://rhodiumgroup.gistapp.com/us_china_foreign_direct_investments.

19. SAFE, *supra* note 12.

20. Nat'l Dev. And Reform Comm'n, *Measures for the Administration of Overseas Investment of Enterprises* (Dec. 2017), http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=307304 (effective since March 2018).

21. *See id*.

through minimal procedures.

"Made in China 2025" is the key to understanding the inconsistent design of Reg. No. 11. "Made in China 2025" is a blueprint for transforming the country from a labor-intensive economy that makes toys and clothes, into one that engineers advanced products, like robots and electric cars.[22] It calls for 70% of related materials and parts to be made domestically within a decade.[23] The plan funnels billions of dollars into ten industries, ranging from biopharmaceuticals to aerospace to telecom devices.[24] It is not a coincidence that these industries are also facilitated by Reg. No. 11.

Having features that both tighten and loosen, Reg. No. 11 is not only a capital control policy. By streamlining the process for outbound investments in cutting-edge technologies, Reg. No. 11 also sets a clear goal for supporting the strategic "Made in China 2025" plan. Whether China's outbound investment regulation reform will be effective remains to be seen, as the new policy has only been implemented for less than a year. Furthermore, considering externalities is essential in evaluating the effectiveness of Reg. No. 11. "Made in China 2025" is now a focus of the U.S.-China trade dispute. Directly addressing Reg. No. 11, the U.S. issued the Foreign Investment Risk Review Modernization Act ("FIRRMA") to disincentivize the types of investments encouraged by Reg. No. 11.[25]

The newly amended Reg. No. 11 of the National Development & Reform Commission creates a tightened control over China's capital outflows regarding outbound investments. This new policy also loosens control over certain types of investments, such as investments in advanced technology and manufacturing, to facilitate China's strategic plan of "Made in China 2025." However, this investment favoritism is unlikely to reform the pattern of China's outbound investment due to its ineffective enforcement power of ex-post supervision and international externalities, such as FIRRMA of the Committee on Foreign Investment in the United States ("CFIUS").[26]

The focus of this Note is the study of Reg. No. 11. This Note first argues that this newly tightened capital control policy loosens control over certain types of investments. Second, this Note discusses the rationale behind the design of Reg. No. 11—to serve the strategic "Made in China 2025" plan.

22. Jessica Meyers, *How 'Made in China 2025' Became the Real Threat in a Trade War*, L.A. TIMES (Apr. 24, 2018), https://www.latimes.com/world/asia/la-fg-china-2025-20180424-story.html.

23. *Id*.

24. Meyers, *supra* note 22.

25. Thilo Hanemann, Cassie Gao & Adam Lysenko, *Net Negative: Chinese Investment in the US in 2018*, RHODIUM GROUP (Jan. 13, 2019), https://rhg.com/research/chinese-investment-in-the-us-2018-recap/.

26. *See id*.

Third, this Note examines the effectiveness of the new measurement in dealing with existing loopholes and obstacles set by countries of destination, such as the FIRRMA of CFIUS.

BREAKING DOWN REG. NO. 11

In 2004, the NDRC issued interim outbound investment measures in an attempt to regulate Chinese enterprises' FDI projects, primarily to facilitate outbound investments in resource development.[27] In 2008, the NDRC made a few adjustments to the 2004 measure, primarily by raising the threshold of the amount of required investment to file for approval and extended discretion of local NDRCs.[28] In 2014, the NDRC issued Reg. No. 9 to replace the 2004 regime.[29] Reg. No. 9 abandoned the taxonomy of "resource development" versus "other projects," and adopted the classifications "sensitive investment" and "non-sensitive investment[s]." Reg. No. 9 further raised the threshold and ceiling amounts for different filing procedures. Reg. No. 11, which is the current regulation for China's outbound investments, further reformed both the procedures and the scope of the regulation.

THE NDRC AND THE OUTBOUND INVESTMENT FILING SYSTEM

The NDRC is a macroeconomic management agency under the Chinese State Council.[30] It has broad administrative and planning control over the Chinese economy.[31] The NDRC's main functions include to: study and formulate policies for economic and social development, maintain the balance of the economic development, and guide the restructuring of China's financial system.[32] Each year, the NDRC submits a plan for national economic and social development to the National People's Congress on behalf of the State Council.[33]

Besides the NDRC's guidelines, an investor has to work with other

27. NDRC, *Interim Measures for the Administration of Examination and Approval of Overseas Investment Projects* (Oct. 2004), http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=55603.

28. NDRC, *Notice of the National Development and Reform Commission regarding Decentralizing the Approval Authority of Foreign Investment Projects* (July 2008), http://en.pkulaw.cn/display.aspx?id=48189f87d68a74aabdfb&lib=law.

29. NDRC, *Measures for the Administration of Confirmation and Recordation of Overseas Investment Projects* (Apr. 2014), http://en.pkulaw.cn/display.aspx?cgid=223005&lib=law.

30. *See* NDRC, *Main Functions of the NDRC* (last visited Oct. 25, 2019), http://en.ndrc.gov.cn/mfndrc/.

31. *See id*.

32. *See* NDRC, *supra* note 30.

33. *See* NDRC, *Measures for the Administration of Confirmation and Recordation of Overseas Investment Projects* (Apr. 2014), http://en.pkulaw.cn/display.aspx?cgid=223005&lib=law.

government agencies before it can finalize an outbound investment.[34] The Ministry of Commerce ("MOFCOM") is another crucial agency in regulating Chinese outbound investments.[35] In its business nature, the MOFCOM pays more attention to China's economic and trade relations with other economies (chiefly the U.S., the E.U., and the BRICS).[36] The State-owned Assets Supervision and Administration Commission ("SASAC") is responsible for managing the State-Owned Enterprises ("SOEs"), including appointing top executives, approving M&As, and agreeing to sales of stocks or assets.[37] The China Securities Regulatory Commission ("CSRC") reserves discretion in examining outbound investment proposals of Chinese listed companies.[38] If an investment involves leverage, the People's Bank of China ("PBOC") is a competent regulator.[39] The last step requires filing the project with SAFE for the transmission of foreign currency funds out of China.[40]

In general, the prerequisite for all the subsequent regulatory compliance procedures for Chinese outbound investors is the NRDC's consent.[41] After the consent of MOFCOM, depending on the investor's characteristics, it may have to file with the SASAC or the CSRC.[42] The final step requires applying to SAFE for foreign exchange registration.[43] Because the NDRC is both the

34. For the purposes of this paper, the term "investor" only refers to legal persons (i.e., enterprises) that make outbound investments. Individual investors, being natural person per se, are not regulated by the NDRC outbound investment regimes, thus, are not the topic of this paper.

35. MOFCOM, *Main Mandate of the Ministry of Commerce* (Feb. 2009), https://web.archive.org/web/20090207180223/http://english.mofcom.gov.cn:80/mission.shtml.

36. The acronym "BRICS" stands for: Brazil, Russia, India, China, and South Africa. Jida Zhang & Feng Yang, *Comparison of Outbound Investment Regulators*, VANTAGE ASIA (in Chinese language) (June 2015), https://www.vantageasia.com/zh-hans/%E4%B8%AD%E5%9B%B D%E4%BC%81% E4%B8%9A%E5%A2%83%E5%A4%96%E6%8A%95%E8%B5%84%E7%9B%91%E7%AE%A1% E9%83%A8%E9%97%A8%E6%96%B0%E8%A7%84%E6%AF%94%E8%BE%83/.

37. State-Owned Assets Supervision and Administrative Council, *What We do* (last visited Oct. 25, 2019), http://en.sasac.gov.cn/2018/07/17/c_7.htm.

38. China Securities Regulatory Commission, *Decision of the China Securities Regulatory Commission on Amending the Provisions on the Material Asset Reorganization and Ancillary Financing of Listed Companies* (Aug. 2011), http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=156089.

39. People's Bank of China, *Notice of the People's Bank of China on Further Clarifying Matters concerning the RMB Loans Granted Overseas by Domestic Enterprises* (Nov. 2016), http://en.pkulaw.cn/display.aspx?cgid=287011&lib=law.

40. State Administration of Foreign Exchange, *The Provisions on the Foreign Exchange Administration of the Overseas Direct Investment of Domestic Institutions* (July 2009), http://en.pkulaw.cn/display.aspx?cgid=119255&lib=law&EncodingName=big5.

41. Ernst & Young China, *Joint Notice of Seven National Regulators on Outbound Investment Regulation* (In Chinese Language) (Feb. 9, 2018), https://www.ey.com/Publication/vwLUAssets/ey-belt-and-road-other-insights-9-feb-2018/$FILE/ey-belt-and-road-other-insights-9-feb-2018.pdf.

42. Deloitte China, *Scrutinizing the regulations of China's outbound investments* (in Chinese language) (last visited Oct. 25, 2019), https://www2.deloitte.com/content/dam/Deloitte/dl/Documents/legal/ChineseOutbound_Mandarin.pdf, at 2-3.

43. *See id*.

planner and administrator of China's macroeconomy, a study on the NDRC's policies can directly interpret the authorities' positioning of China's outbound investments.

THE EVOLUTION OF NDRC'S OUTBOUND INVESTMENT POLICIES

2004 Interim Measures and the 2008 amendment

The earliest NDRC regulation distinguished outbound investments in resource development, such as drilling oil wells, from all other investments.[44] For example, an investor had to obtain approval from the NDRC if the investment was over $10 million.[45] However, if the investment was in outbound resource development, the investor did not need Beijing's approval, unless the investment amount was greater than $30 million.[46] Therefore, as compared to the same amount for investments in other areas, transaction costs for investments in foreign resources development would be far lower.

The 2004 measures also facilitated outbound investments made by SOEs. For example, if an SOE's resource development investment was more than $30 million, the enterprise only had to file a recordation with the NDRC.[47] If the investors were not SOEs, then approval from either the NDRC or the State Council was required for resources investments greater than $30 million.[48] With the recordation requirement instead of the approval requirement, the cost of compliance for SOEs to make outbound investments were much lower than for non-SOEs.

The primary purpose of facilitating resource development investments and SOE investments remained unchanged in the 2008 amendment. The notice primarily amended the threshold and ceiling amounts for different categories of investments, and the mechanism would raise the amounts for each ten-fold.[49] Another feature of the 2008 note was to centralize power of the NDRC. For example, the 2008 note delegates the State Council's authority to the NDRC.[50]

44. *See* NDRC, *supra* note 20, § 4.
45. All the investment amounts for the NDRC's outbound investment regulations are in U.S. Dollar amounts.
46. NDRC, *supra* note 20, § 6.
47. *Id*. at § 8.
48. *Id*. at § 9.
49. *Id*. at § 3.
50. *Id*.

Reg. No. 9 of 2014

The 2014 reform completely replaced the 2004 regime. There was no longer a fast pass for resource development projects. Instead, Reg. No. 9 focused primarily on limiting "sensitive" investments. Reg. No. 9 defined both sensitive countries/regions and sensitive industries.[51] The sensitive countries/regions included countries without established diplomatic relations, sanctioned countries, and investment projects in countries/regions where war or upheaval occured.[52] Sensitive industries included baseline telecommunication operations, utilization of trans-border water resources, large-scale land development, electric mains, power grids, and news media[53] For either investments in sensitive countries/regions or industries, investors had to obtain approval from the State Council or the NDRC.[54]

By simplifying the approval procedure for the recordation process, Reg. No. 9 better facilitated all insensitive outbound investments. The recordation system was no longer only a fast-track for SOE investments. Most of the investments, so long as they were not too sensitive and large-scale, were not required for approval, but only recordation.[55] An investment only needed approval from the NDRC if it exceeded $1 billion.[56] By contrast, the great compliance burden on all sensitive investments, imposed by the Reg. No. 9, discouraged investments to the defined countries/regions and industries. The preferential treatment to different types of investments remained an effective tool of the NDRC to shape China's outbound investments, as this Note will later discuss.

Another notable innovation for Reg. No. 9 was that it added more transparency by providing a detailed submission procedure and specifying the requirements for completing the Project Application Report.[57] Moreover, Reg. No. 9 provided timelines measures for certain approval steps.[58] In contrast, the 2004 regime did not specify mandatory times for responses. Such a policy vacuum left the NDRC with great discretion and added uncertainty for investors. The defined timelines in Reg. No. 9 substantially reduced the transaction costs for all types of investments. Yet, the comparative advantage for SOE still existed in the Reg. No. 9. Unlike the substantial investments made by non-SOEs, which required approval from

51. NDRC, *supra* note 33, § 7.
52. *See id*.
53. *See id*.
54. *See id*. at § 14.
55. *See id*. at 11.
56. *See id*. at § 7.
57. *See id*. at § 10.
58. *See id*. at § 13-16.

the NDRC or the State Council, SOEs' outbound investments only required recordation with the NDRC, even if the investment exceeded $1 billion.[59]

Summary

In general, from the 2004 regime to the 2008 amendments to the 2014 comprehensive reform, the NDRC's regulations added high dimension and granularity regarding outbound investments. By exempting resource development projects and SOE investments, the 2004 regime reflected the NDRC's intent to incentivize domestic capital, especially state capital, and to engage in overseas raw material explorations. The 2014 Reg. No. 9 completely reformed the 2004 regime's philosophy by implementing an entirely new taxology of "sensitive investment[s]." While easing the compliance burden with more transparency to the procedure, the NDRC's focus shifted from a rough goal—of encouraging overseas resource development—to a more elaborate strategy of promoting national interests through preferential treatment embedded in Reg. No. 9.

ANATOMY OF REG. NO. 11

The "tight" feature of Reg. No. 11

Unlike Reg. No. 9 completely overturning previous regulations, Reg. No. 11 is a refined successor of Reg. No. 9. The 2018 regime adopted Reg. No. 9's sensitive/non-sensitive terminology. However, Reg. No. 11 further tightens capital control by expanding the scope of regulated investments and broadening the spectrum of exemptions. Reg. No. 11 includes Chinese holding companies' overseas operation companies in its supervision scope. In contrast, Reg. No. 9 only covered investors deemed Chinese domestic legal persons who directly provided financing or security interests to overseas investment projects.[60] Domestic investors who conducted outbound investments through their offshore entities were not governed by Reg. No. 9, unless the investors directly provided financing or guarantees to their investment projects.[61] Therefore, the abuse of "offshore entities" became a way for investors under Reg. No. 9 to arbitrage the regulation.[62] In practice,

59. *See id.* at § 11.
60. *See id.* at § 2.
61. *See id.* at § 12.
62. Kaiding Wang, *Interpreting NDRC Reg. No. 11*, KING & WOOD MALLESONS (in Chinese language) (last visited Oct. 25, 2019), https://www.chinalawinsight.com/2017/12/articles/corporate-ma/%E7%83%AD%E7%82%B9%E8%A7%A3%E8%AF%BB%EF%BC%9A%E5%9B%BD%E5%AE%B6%E5%8F%91%E6%94%B9%E5%A7%94%E6%AD%A3%E5%BC%8F%E5%8F%91%E5%B

many investors set up offshore entities and avoided approval and recordation procedures by sending the remittance to their overseas subsidiaries in the name of internal financial operations instead of outbound investments.[63] Once the subsidiaries received the remittance, domestic investors could engage in any investment activities and be free from the NDRC, MOFCOM, and SAFE's regulation.[64] In contrast, under Reg. No. 11, offshore entities are subject to regulation if Chinese enterprises, directly or indirectly, hold at least 50% voting rights, or if Chinese enterprises obtain authority to manage the entities' operational, financial, personnel, technological, or other important affairs.[65] This part of the law is designed adequately because it carries out the NDRC's purpose of restricting substantial foreign currency withdrawals without unnecessarily burdening ordinary business operations. Under this precise definition, overseas subsidiaries' business decisions will not be affected by Reg. No. 9 if the Chinese holding companies do not *de facto* exercise their dominion over subsidiaries.

"Sensitivity" becomes the quintessential term of art under Reg. No. 11, as it reserves approval power only for sensitive investments. Previously under Reg. No. 9, sensitive countries/regions included countries without established diplomatic relations, sanctioned countries, and investment projects in countries/regions where war or upheaval occurs.[66] Sensitive industries included baseline telecommunication operations, utilization of trans-border water resources, large-scale land development, electric mains, power grids, and news media.[67] Leaving the definition of "sensitive countries/regions" untouched, Reg. No. 11 deletes certain types of investments off the "sensitive industries" list. The definition of "sensitive industries" is an independent document incorporated into Reg. No. 11 by reference.[68] Under the 2018 version of the list, "basic telecommunication operation," "large-scale land development," "electric mains," and "power grids" are removed from the list of sensitive industries.[69] Instead, Reg. No. 11 adds a new category, "research on, manufacture and repair of weaponry," and a catchall provision, "industries to be restricted from outbound investments according to laws, regulations[,] and relevant macro-control

8%83%E7%AC%AC11%E5%8F%B7%E4%BB%A4%E3%80%8A%E4%BC%81%E4%B8%9A%E5%A2%83%E5%A4%96/.

63. *See id*.

64. *See* Wang, *supra* note 62.

65. NDRC, *supra* note 20, § 2.

66. NDRC, *supra* note 33, § 2.

67. *See id*.

68. NDRC, *List of Sensitive Industries for Overseas Investments* (in Chinese language) (2018), http://www.ndrc.gov.cn/gzdt/201802/W020180211608651590809.pdf.

69. *Id*.

policies."[70] The catchall provision is another independent document incorporated by reference—i.e., guidelines on overseas investment—that is issued by the General Office of the State Council.[71] The current effective guideline, introduced in August 2017, includes real estate, hotels, entertainment, sports, and equity investment funds or platforms. Reg. No. 11 leaves great discretion and flexibility for the NDRC to incorporate different independent documents and publish an updated list. Such a design allows the NDRC and the State Council to conveniently implement macroeconomic planning and government policy goals. This innovative definition of "sensitivity" is a hybrid of tightening and loosening features. In all, this improvement is a net tightening policy.

The inclusion of Foreign Portfolio Investments ("FPIs") is another significant step forward. FDI and FPI are two of the most common routes for investors investing in overseas economies.[72] FDI implies direct investment by foreign investors into the productive assets of another nation; FPI means investing in financial assets.[73] While the previous regimes comprehensively addressed regulations on FDI, regulations on FPI activities were never acknowledged. While the financial market debated over the applicability of the 2004 Interim Measures and the 2014 Reg. No. 9, Chinese financial enterprises' overseas FPI activities remained a grey area. Nonetheless, China's foreign currency withdrawals primarily comprise of FPIs.[74] Under Reg. No. 11, the NDRC explicitly includes Chinese financial institutions' outbound portfolio investments.[75] Furthermore, one FPI activity, equity investment funds or platforms, is now listed among the enumerated sensitive industries.[76] Consequently, this particular category of FPI will be under the highest scrutiny from filing with the NDRC to SAFE.

Another centralization aspect of Reg. No. 11 is its enhanced sanction and enforcement capabilities. Previously, Reg. No. 9 set up administrative penalties.[77] However, such deterrence punishment only applied in cases of failing to obtain a Project Information Report elaboration (i.e., "road-pass"),

70. NDRC, *supra* note 20, §13.

71. *See* General Office of the State Council, *Notice of the General Office of the State Council on Forwarding the Guiding Opinions of the NDRC, the MOFCOM, the PBOC and the Ministry of Foreign Affairs on Further Directing and Regulating the Direction of Overseas Investments* (Aug. 2017), http://lawinfochina.com/display.aspx?id=26336&lib=law.

72. *See* Elvis Picardo, *FDI and FPI: Making sense of it all*, INVESTOPEDIA (last visited Oct. 25, 2019), https://www.investopedia.com/articles/investing/012914/foreign-investment-routes-fdi-and-fpi.asp.

73. *See id*.

74. According to SAFE's quarterly report, China's FPI for the 3d quarter of 2017 was peaked at $61.55 billion. *See* CIEC Data, *China Foreign Portfolio Investment* (last visited Oct. 25, 2019), https://www.ceicdata.com/en/indicator/china/foreign-portfolio-investment.

75. *See* NDRC, *supra* note 20, § 2.

76. *See id*.

77. *See id*. at §§ 50-57.

where the administrative penalty was to reject the later filing for recordation/approval. Under Reg. No. 11, investor misconduct, such as trying to conceal or misrepresent transactions, is subject to administrative penalties (i.e., refusal of approval/recordation) or criminal proceedings.[78] Specifically, Reg. No. 11 provides mechanisms for reporting adverse material conditions, project completion and inquiry, and reports about material matters.[79] Moreover, sanctions are shared with other authorities through online published documents.[80]

Reg. No. 11 expanded the scope of the NDRC's regulatory power by adding a new type of investor entity (i.e., overseas subsidiaries of Chinese holding companies), a new category of investment (i.e., FPIs), and a new way of defining an essential term of art to the objects of regulation. Besides, Reg. No. 11 also extends the NDRC's power to exercise penalties and enforcement. As discussed above, Reg. No. 11 was anticipated as an updated measurement to tighten capital control in response to skyrocketing outbound investments. However, apart from the newly introduced constraining provisions, Reg. No. 11 effectively loosened its control due to exemptions from approval requirement, implicit preferences, and a new system for notice filing.

The "loose" feature of Reg. No. 11

Reg. No. 11 abandoned the amount-sensitive management under Reg. No. 9, exempting a large amount of outbound investments from approval requirements. Reg. No. 9 had great granularity for the size of foreign investments involved: any investment larger than $2 billion was subject to the State Council's scrutiny; any investment less than $2 billion, but exceeding $300 million, was contingent on NDRC approval.[81] Under Reg. No. 11, however, only sensitive investments need approval.[82] For large amounts of investments, so long as they are not deemed sensitive by the NDRC's definition, the maximum compliance cost will be filing for recordation with the NDRC, even if the investment exceeds $2 billion.[83] For FDIs less than $300 billion, only recordation is required at the local Development and Reform Committee level.[84]

Moreover, the General Office's guidelines on overseas investments

78. *See id*. at §§ 52-53.
79. *See id*. at §§ 50-57.
80. *See id*. at § 58.
81. *See id*. at § 14.
82. *See id*. at § 13.
83. *See id*.
84. *See* NDRC, *supra* note 20, § 13.

provides a "VIP" list of procedural reviews that must be conducted in the light most favorable to listed industries.[85] The current version of the guidelines for the 'encouraged category' includes investments in:

- Construction and facility connection along the route of "the Belt and Road;"
- Overseas projects that facilitate the exportation of industrial capacities, equipment, and technical standards;
- Increasing investment in, and cooperation with, overseas high-tech enterprises, advancing manufacturing enterprises, an establishing offshore research and development centers;
- Participating in the exploration and extraction of offshore oil, gas, mining, and other energy resources based on a prudent assessment of cost benefits;
- Expanding investment and cooperation in agricultural projects;
- Promoting investment in commerce, trading, cultural sector logistics, and other service sectors in an orderly manner, as well as supporting qualified financial institutions to set up offshore branches and service networks.[86]

Even though the NDRC has been improving approval/recordation process transparency by capping the deadline of each of its transactional operations (e.g., 30 days for approval, seven days for recordation), in practice, there remains great elasticity. According to a few experienced practitioners, the NDRC's approval procedure can take approximately 106 days.[87] Because the previous 2004 and 2014 regimes never referred to any indicators regarding when the NDRC will exercise its discretion to approve an investment project, the opacity created great compliance burdens and uncertainty.[88] For the first time, authorities are enumerating industries that will be promoted by favorable discretion. By incorporating the General Counsel's guideline into Reg. No. 11, the NDRC endorses preferential treatment. Though implicitly, the NDRC carves out a fast-pass for overseas projects that qualify under the description above. Consequently, these industries will enjoy loosened regulatory supervision.

Reg. No. 11 juxtaposes a system with fewer procedural requirements, the notice system, with an existing approval and recordation practice. Under

85. General Office of the State Council, *supra* note 71, § 3.

86. *Id*.

87. *See* Doug Ferguson & Sunny Song, *Understanding the New Chinese Outbound Investment Regulations*, KPMG AUSTRALIA (last visited Oct. 25, 2019), https://home.kpmg.com/xx/en/home/insights/2018/02/chinese-outbound-investment-regulations-16-february-2018.html.

88. *See id*.

Reg. No. 9, the recordation system served as an exemption measure to facilitate smaller investments and SOE investments. Compared to the 20-106 day procedure to obtain an approval,[89] a filing procedure that only takes seven business days significantly reduced the compliance cost.[90] Reg. No. 11 further eases this compliance burden by including a notice practice, which only takes five business days.[91] Starting on March 1st, 2018—Reg. No. 11's effective date—FPI amounts of $300 billion or more began enjoying this unique measurement.[92]

Apart from its decentralization practice on non-sensitive outbound investments, the NDRC also eases compliance burdens by further streamlining filing processes and by adding more transparency to the procedure. Road-pass in Reg. No. 9 was a significant step forward for the NDRC to further extend its power to regulating outbound investments. It required Chinese enterprises, that were contemplating overseas acquisitions or bidding a substantial amount for investments, to submit their intended project before the initiation of any substantive work.[93] The NDRC's design of the road-pass was meant to prevent cutthroat competition between Chinese enterprises in overseas acquisitions or bidding. As a prerequisite for subsequent confirmation, the road-pass procedure enabled the government great discretion to veto an intended overseas acquisition at a very early stage. However, the compliance burden and uncertainties imposed by the road-pass requirements also made Chinese investors less competitive as compared with investors from other countries.[94]

Reg. No. 11 reduces compliance burdens by eliminating the road-pass requirement. As discussed above, since the 2004 regime, the exercise of road-pass requirements was quite controversial. The NDRC set this road-pass requirement early in the procedure, i.e., before Chinese enterprises start any substantive work, such as submitting an offer or accepting an offer by signing a binding contract.[95] This policy design was redundant because it was meant to regulate Chinese enterprises' overseas acquisition patterns. Uncertainty about a successful petition for the NDRC's pre-confirmation letter added significant burdens and uncertainty at the early stages of an intended overseas acquisition. This disadvantage was exacerbated when multiple Chinese bidders intended a common project. Meanwhile, the policy goal anticipated by this road-pass regime can be achieved without

89. *See* NDRC, *supra* note 68.
90. *See id*.
91. *See* NDRC, *supra* note 20, § 21.
92. *See* NDRC, *supra* note 20, § 14.
93. *See* Wang, *supra* note 62.
94. *See id*.
95. *See* NDRC, *supra* note 33, § 13.

implementing this regulation. Without the additional measure, overseas acquisitions still must through approval/recordation scrutiny before closing a deal. To streamline the process and ease this unnecessary burden, Reg. No. 11 eliminates the entire road-pass regime.[96]

Reg. No. 11 also adds more procedural transparency by clarifying the definition of “investment value.” Even though the new regime abolishes most of the investment size granularity, the amount of $300 billion remains as a watershed. For example, for FDIs, if the amount exceeds $300 billion, the investor has to file recordation with the NDRC in Beijing.[97] FDIs below $300 billion, in contrast, only need to record with local NDRC.[98] For FPIs, investments lower than $300 billion are not subject to regulation; only if the FPI is more than $300 billion will it be required to file a notice with the NDRC.[99] Thus, different calculation methods might lead to varying results in the appraisal of investment sizes, thus, affecting the cost of compliance. Reg. No. 11 defines investment value as the sum of currency, securities, assets, technology, intellectual property, equity, debt, financing, and security guarantees a Chinese enterprise provides, either directly or indirectly, through the operation of off-shore subsidiaries.[100] This precise definition of investment value substantially unifies the different appraisal measurements and makes compliance costs more predictable.

Other streamlining reforms also add transparency to the process and enhance the competitiveness of Chinese investors in permissible outbound investments. Reg. No. 11 further elaborates on NDRC procedures for sending notice for receipt of petition and notice of amendments.[101] These improvements help procedural transparency and filing predictability. Another streamlining advancement is extension of the term of validity of NDRC approval/recordation. Under Reg. No. 9, except for construction projects, an approval/recordation of an outbound investment lasted for one year. Reg. No. 11 extends this term to 2 years.[102] Consequently, Chinese enterprises now enjoy a longer time to negotiate their overseas deals.

Policy Algorithm/Deduction

For a Chinese enterprise to invest in a foreign business entity, before it goes to MOFCOM and SAFE—no matter for FDI or FPI, if the intended

96. *See supra* note 20.
97. NDRC, *supra* note 20, § 14.
98. *Id*.
99. *See id*. at § 14.
100. *Id*.
101. *See* NDRC, *supra* note 20, §§ 23-25.
102. NDRC, *supra* note 20, § 14.

investment is in the sensitive industries of weaponry, cross-border water resources development and utilization, news media, real estate, hotels, entertainment, sports and equity investment funds or platforms,[103]—it has to file the plan with the NDRC for approval. If an enterprise wants to invest in non-sensitive industries, but the destination country is among the countries without established diplomatic relations, sanctioned countries, or investment projects in countries/regions where war or upheaval occurs, the investor must also file with the NDRC for approval.[104] It usually takes 20 to 106 days for the NDRC to confirm an approval.[105] Because this investment is labelled as sensitive by the NDRC, the latter procedure will also be time consuming.[106] For any SOEs, sensitive or insensitive, the investment project only needs to record with the NDRC.

For an intended outbound non-sensitive FDI investment, it has to be recorded with the NDRC.[107] When the intended investment amount is higher than $300 billion, the investor has to get the NDRC's proof of recordation before closing the deal.[108] If the intended investment is lower than the $300 billion ceiling, such an investment must be recorded by the local NDRC.[109] The recordation process usually takes seven business days.[110]

If the investment is an FPI, the regulatory cost is slightly lighter. Still, when the investment exceeds $300 billion, there is a requirement: the investor has to file a notice with the NDRC.[111] Such a procedure will take five business days.[112] It is clear that non-sensitive investments, especially those below $300 billion, when compared to sensitive investments, receive great convenience under Reg. No. 11.

Summary

Across the board, Reg. No. 11 tightens authorities' capital control through broader discretion both in scope and in actual review. By including Chinese offshore entities and FPI into its regulatory objects, the NDRC directly addresses existing arbitrage practices and hopefully slows down the draining of SAFE's foreign exchange reserves. Through its savvy design for the definition of "sensitivity," the NDRC retains great flexibility that allows

103. *See* KPMG AUSTRALIA, *supra* note 87.
104. NDRC, *supra* note 20, § 7.
105. Picardo, *supra* note 72.
106. NDRC, *supra* note 20, § 2.
107. *Id*.
108. *Id*. at § 14.
109. *Id*.
110. NDRC, *supra* note 68.
111. NDRC, *supra* note 20, § 14.
112. NDRC, *supra* note 68.

it to instantly add or remove certain industries to or from the list, subject to the highest scrutiny. Reg. No. 11 also extends the NDRC's power of exercising penalties and enforcement beyond the scope of the road-pass.

Meanwhile, Reg. No. 11 consists of some decentralizing characters that do not serve its streamlining purposes. The elimination of the approval requirement for large-size investments substantially reduces the NDRC's scrutiny over such investments. Incorporation of the preference list produced by the General Office of the State Council indicates the NDRC's commitment to loosen control over outbound investments in the listed industries. The introduction of a notice system provides a prototype for further decentralization of the NDRC's regulatory power.

Some investor-friendly streamlining improvements, such as competitiveness, must be highlighted for their positive impacts on domestic entities or Chinese offshore entities regarding negotiating, structuring, and timing of an outbound deal. The removal of the road-pass regime will boost Chinese bidders' competitiveness in international acquisition deals. The extension of validity terms will reduce the passivity of Chinese investors when the negotiation process is prolonged. A clear definition of investment amount unifies diverged accounting methods, thus, clarifying the investment appraisal grey area.

All of the relaxed regulations are counterintuitive. As discussed earlier, Reg. No. 11 is an updated version of Reg. No. 9 in the context of China's rapid drop in its foreign exchange reserve. Because the foreign exchange reserve is the primary tool for China's government to stabilize the Renminbi exchange rate, an urgent priority is stringent capital control through outbound investment policy. Therefore, the substantial delegation of power in Reg. No. 11 counters the urgency to tighten capital control by implying that the NDRC is more involved in carrying out some policy goals.

The inconsistency in Reg. No. 11's policy goal is to serve the strategic plan of "Made in China 2025." Looking back at the evolution of the NDRC's outbound investment regulations, the consistent logic of preferential treatment is the key to decipher these counterintuitive emancipatory designs in Reg. No. 11. The beneficiaries of Reg. No. 11 are quite ascertainable: large-size, non-sensitive investments in areas encouraged by the State Council that will receive the maximum regulatory dividend. By facilitating investments in these targeted industries, the NDRC will reshape the ecology of Chinese outbound investments by boosting harvests in technologies from overseas research and development projects.

POLICY GOAL OF REG. NO. 11.

As discussed above, Reg. No. 11 is a set of stringent capital control policies with some counterintuitive exceptions. Significantly, non-sensitive investments over $2 billion no longer have to undergo prolonged scrutiny required by the approval procedure; brownfield investments in high-tech enterprises and greenfield investments in overseas research and development centers ("R&D centers") will implicitly enjoy the most favorable treatment.[113] Given the fact that capital control is an urgent need for China's economic stability, the upstream emancipation illustrates China's strong commitment to accelerating the outbound development of those listed industries. It is not a coincidence that the industries mentioned above are also the targeted industries in carrying out China's strategic plan "Made in China 2025."

MADE IN CHINA 2025

Issued in 2015, China's strategic plan "Made in China 2025" became an initiative to comprehensively upgrade Chinese industry.[114] This ten-year national guideline came out in light of China's imminent need to restructure its domestic economy.[115] China, as a world factory, is now suffering from a series of challenges, such as rising labor costs, low added value, and razor-thin margins.[116] Currently, China's domestic manufacturing heavily relies upon high-end technologies developed by foreign countries. According to 2017 data, foreign content comprised more than 50% of the high-tech products and goods.[117] In some categories, such as high-level digital control systems and high-level hydraulic components, China is almost entirely dependent on foreign production.[118]

To survive the pressure from both developed economies, with more efficient means of production, and emerging economies, with cheaper labor costs, the plan focuses on escalating the value-added chain in production and innovation networks. This plan identifies the goal of raising domestic content

113. *See* NDRC, *supra* note 20, § 3.

114. Scott Kennedy, *Made in China 2025*, CTR. FOR STRATIGIC & INT'L. STUD. (June 2015), https://www.csis.org/analysis/made-china-2025.

115. *See "Made in China 2025" plan unveiled to boost manufacturing*, GB TIMES BEIJING (May 20, 2015), https://gbtimes.com/made-china-2025-plan-unveiled-boost-manufacturing.

116. *Id*.

117. Sara Hsu, *Foreign Firms Wary of 'Made in China 2025,' But It May Be China's Best Chance at Innovation*, FORBES (March 2017), https://www.forbes.com/sites/sarahsu/2017/03/10/foreign-firms-wary-of-made-in-china-2025-but-it-may-be-chinas-best-chance-at-innovation/#3c9737ac24d2.

118. *See id*.

of core components and material to 40% by 2020, and 70% by 2025.[119] Specifically, it urges for the creation of R&D centers with the goal of building 15 R&D centers by 2020, and 40 by 2025.[120]

Compared to the previous national strategic plan in boosting high technology,[121] "Made in China 2025" no longer focuses on domestic technology innovation. Besides, "Made in China 2025" shifts from state funding to a market mechanism with supporting investment policies. In 2006, the predecessor leadership, the Hu-Wen administration, issued a 15-year plan.[122] The 2006 project aimed to promote "indigenous innovation" through funding for domestic R&D centers in Strategic Emerging Industries (SEIs).[123] However, in the text of "Made in China 2025," the term "indigenous innovation" appears only twice.[124] The drafters of the 2015 plan are conscious about the omission of such a term of art, because "indigenous innovation" was a keyword in the 2004 plan.[125] Additionally, unlike the previous plan, which committed large state funding to the development of SEIs, "Made in China 2025" delegates the duty to market mechanisms, such as financing for Small and Medium Enterprises ("SMEs"), to accelerate technology developments.[126] Consequently, "Made in China 2025" abolishes the traditional top-down, state-supported industrial development. Instead, the latest plan incentivizes the private sectors to play a leading role in technology innovation. Specifically, and relevant to this Note topic, the 2015 plan calls for the building of multinationals and achieving a bump-up of "core competitiveness" through the development of these outbound investments.[127]

NDRC REG. NO. 11'S MOTIVATION MECHANISM

Although Reg. No. 11 is designed to tighten China's capital control in order to address the skyrocketing draining of SAFE's foreign exchange reserve, this regulation has certain counterintuitive features that contradict the general goal of capital constraint. Through this Note's closer look at Reg.

119. The State Council of PRC, *Notice of the State Council on Issuing the "Made in China"* (in Chinese language) (May 8, 2015), http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm.

120. *Id*.

121. *See* The State Council of PRC, *Outline of the National Program for Long- and Medium-Term Scientific and Technological Development* (in Chinese language) (Feb. 2006), http://www.gov.cn/jrzg/2006-02/09/content_183787.htm.

122. *Id*.

123. The State Council of PRC, *supra* note 119.

124. *Id*.

125. *Id*.

126. *Id*.

127. Hsu, *supra* note 117.

No. 11, the reduction of the NDRC's scrutiny in large-size investments, and the relaxed control over the outbound investments in the listed industries, all serve the benefit of the targeted industries of "Made in China 2025." Notably, the language of "increasing investment in and cooperation with overseas high-tech enterprise and advanced manufacturing enterprises and establishing offshore research and development centers" is the guideline[128] directly addressing the "Made in China" strategy of bumping up Chinese enterprises' "core competitiveness" through the development of these outbound investments.[129]

Therefore, it is highly likely that Reg. No. 11's upstream, relaxed control over outbound investments in advanced technology and manufacturing is a substantive implementation of the policy goal of "Made in China 2025." Incorporating the General Office's guideline into Reg. No. 11, the NDRC effectively endorses the State Council's sorting system by identifying "what's hot"[130] and "what's bad."[131] The NDRC then designs substantive mechanisms to incentivize "what's hot" and disincentivizing "what's bad" by imbedding the design into Reg. No. 11. On one hand, the NDRC downgrades its approval scrutiny on "what's hot" to a more streamlined recordation system. Then, the NDRC commits a favorable treatment to these investment projects by exercising its recordation power. That procedure, as indicated by Reg. No. 11, usually only takes seven business days.[132]

For "what's bad," on the other hand, the NDRC puts all investment projects under its scrutinized approval system.[133] In case some industries are accidentally left off the list, the NDRC provides a catch-all provision to the enumerated definition of "sensitive industries."[134] Compared to the fortunate non-sensitive industries, sensitive industries must undergo a thorough examination that, in some cases, will take the NDRC more than 106 days to complete.[135] This substantial preferential treatment (together with a collaboration with the MOFCOM, PBOC, SAFE, and potentially SASAC and CSRC), is anticipated to achieve the goal of "Made in China 2025" by bumping up Chinese enterprises' "core competitiveness" through the

128. *Id*.

129. *Id*.

130. Here, this term refers to investments in overseas high-tech enterprises, advanced manufacturing enterprises and R&D centers.

131. Additionally in the context of economic development. Here the term particularly refers to sensitive industries such as real estate, hotels, entertainment, sports and equity investment funds or platforms.

132. *See* NDRC, *supra* note 20, § 22.

133. *Id*. § 25.

134. *Id*.

135. NDRC, *supra* note 121.

development of outbound investments in venture capital funding and acquisition of high-tech enterprises and R&D centers.[136]

EFFECTIVENESS OF REG. NO. 11.

Even though well-intended and ingeniously designed, Reg. No. 11 will have a limited effect on promoting the goal of boosting the number of Chinese outbound high-tech enterprises and R&D centers. Two major factors affect these challenges. First, even though Reg. No. 11 responds to some of the existing arbitrage practices, loopholes in ex-ante and ex-post supervision will still drain the foreign exchange reserve. Second, externalities, such as destination countries' counter policies, will create a high compliance burden that dwarfs Reg. No. 11's motivating mechanisms.

REG. NO. 11'S RESPONSE TO EXISTING ARBITRAGE

There were two significant practices before Reg. No. 11 that circumvented the NDRC's regulations regarding outbound investments, FPI, and structured finance through offshore Special Purpose Entities ("offshore SPEs"). Another practice that substantially frustrated the capital control purpose was an abuse of the system: *de facto* asset smuggling in the name of investment.

For a long time, the NDRC only regulated FDIs. All predecessors of Reg. No. 11 remained silent about FPI, i.e., the more speculative way of investing. As a grey area that might be free from the NDRC's supervision, FPI activities, such as offshore financial operations in China Hong Kong,[137] European banks, and the British Virgin Islands, were a quick and easy way to launder money.[138] This regulation defect mainly frustrated the NDRC's capital control purposes and substantially drained the SAFE exchange reserve. In addition to the hazards of money laundering and given the natrure of the capital market, portfolio investments are generally more risky and fragile than FDIs.[139] Reg. No. 11 directly addresses these issues by including FPI into its regulatory scope.[140] Mainly, investments in equity funds or platforms are listed as "sensitive investment[s]" and are, therefore, subject

136. Hsu, *supra* note 117.

137. Hong Kong is a Special Administrative Region of China; thus, it enjoys a semi-independent jurisdiction.

138. *See* Diane Francis, *Why $10B of China's money is laundered every month*, (July 26, 2014, 5:00 PM), https://nypost.com/2014/07/26/why-10b-of-chinas-money-is-laundered-every-month/.

139. *See* Wang, *supra* note 59.

140. *See id*.

to the highest scrutiny by the NDRC.[141] All of these significant moves demonstrate the NDRC's determination to regulate the FPI market, which might lead to an effective outcome.

Structured financing through offshore SPEs was also a popular method to bypass the NDRC's regulation.[142] Before Reg. No. 11, the NDRC only regulated outbound investments conducted by domestically incorporated Chinese enterprises.[143] As a result, some domestic enterprises exploited the use of offshore entities to avoid the NDRC.[144] Through this practice, domestic enterprises only needed to file with the NDRC once before setting up offshore SPEs.[145] Once the SPEs were set up, domestic enterprises were able to send remittance in the name of internal financial operation, thus, circumventing the NDRC regulation.[146] After funding arrived to offshore entities, domestic enterprises were able to make outbound investments by directly instructing their outbound subsidiaries to do so.[147] In response to this arbitrage, Reg. No. 11 expands its regulatory scope to overseas entities controlled by domestic enterprises.[148] The regulatory scope of Reg. No. 11 also includes *de facto* enterprise investments by individual investors through offshore SPEs.[149] However, the supervision mechanism for offshore SPE investments is somewhat relaxed: for investment less than $300 billion, Reg. No. 11 does not have any requirements; for investment more than the $300 billion ceiling, Reg. No. 11 only requires notice.[150] It remains to be seen whether such an easygoing regulation will serve as a deterrence to speculative arbitrage.

Even though Reg. No. 11 has made great strides to eliminate loopholes of predecessors' drafting defects, it leaves out general outbound investments: outbound investments are to be conducted by domestic individual investors. Reg. No. 11 restricts its regulation only to domestic enterprises and offshore SPEs controlled by domestic enterprises and individuals. Such an exclusion of individual investor outbound investment is likely caused by drafting errors, since the drafters of Reg. No. 11 are aware of this generical investment and addresses part of it (i.e., individual investor outbound investments through control over offshore BVI) in the code. Whether this

141. NDRC, *supra* note 19, § 13.

142. *See NDRC reshapes regime on outbound investments*, De Brauw Blackstone Westbroek (Mar. 15, 2018), https://www.debrauw.com/newsletter/ndrc-reshapes-regime-on-outbound-investments/#.

143. *See* NDRC, *supra* note 26, § 2-4.

144. *See* Wang, *supra* note 62.

145. *Id*.

146. *Id*.

147. *See id*.

148. *See* NDRC, *supra* note 20, § 2.

149. *Id*.

150. *Id*.

exclusion of individual investors' direct outbound investment will become a widespread arbitrage practice is uncertain at this point, since Reg. No. 11 has only been implemented for eight months.[151]

Being the planner of China's macroeconomy, the NDRC employs its policy goals through various sets of regulations. As explained above, the NDRC has been shaping and reshaping the landscape of the private sectors' outbound investments throughout the evolution of its outbound investment policies. This current version's policy goal is to constrain capital outflow while channeling all the possible outflows to areas targeted by "Made in China 2025." However, the current version, like all of its predecessors, is bound by its limited ability to regulate the early stages of investments. In other words, Reg. No. 11's biggest weakness is its lack of follow-up supervision and enforcement mechanisms. Notwithstanding the newly added ex-post supervision mechanism, Reg. No. 11's enforcement power is still weak when it comes to certain abusing practices. Even though the new regime now shares information with all other administrative agencies, including criminal prosecutors, it only requires an investor to notify the NDRC about *subsequent* progress after the NDRC confirms the transaction.[152] The sheer requirement of information disclosure will leave outbound investors the wiggle room to maneuver what and how much to disclose, leaving the NDRC and relevant administrative agencies high and dry.

EXTERNALITIES

Externalities, such as counter policies issued by destination countries, will also negatively impact the effectiveness of Reg. No. 11 in carrying out "Made in China 2025" goals. Even though the General Office guidelines specifically focus on investments in countries that make up "the Belt and Road" initiative, outbound investments that can yield substantial technological breakthroughs will mostly occur in the Organization for Economic Co-operation and Development countries ("OECD"),[153] especially the U.S., Europe, and East Asia. As the world's leading technology developer, however, the U.S. adopts a hostile attitude towards "Made in China 2025."[154]

On June 18, 2018, the U.S. Senate passed the FIRRMA bill, that aimed

151. This paper was written in November 2018.

152. NDRC, *supra* note 20, § 14.

153. *See* The Organization for Economic Co-operation and Development, Member List, https://www.oecdwatch.org/oecd-guidelines/oecd.

154. Lorand Laskai, *Why Does Everyone Hate Made in China 2025*, COUNCIL ON FOREIGN REL. (Mar. 28, 2018), https://www.cfr.org/blog/why-does-everyone-hate-made-china-2025.

to enhance the power of the Committee on Foreign Investment in the United States ("CFIUS"). This bill directly addresses concerns about high-levels of foreign investments in U.S. technology through an extension of its regulatory power. Now the CFIUS has policing control over any non-passive foreign investments by a foreign person in an unaffiliated U.S. critical technology or infrastructure company.[155] It is not a coincidence that this extension overlaps investments most favored by China's NDRC.

By widely extending the CFIUS' regulatory discretionary power, FIRRMA appears to be an obstacle to "Made in China 2025." One of the key features of this new bill is that it prolongs the initial review period (from 30 days to 120 days) of CFIUS for investments under its jurisdiction.[156] For those benefitted by Reg. No. 11's shortened review mechanism, the lengthy review by the CFIUS will lead a net even in the time cost of compliance. Most likely to frustrate China's purposes, FIRRMA requires Chinese investments to submit biennial reports, including how it comports with the objectives of the "Made in China 2025" plan, how it compares to U.S. investments in China, and any data collection difficulties.[157] These high-pressure supervision mechanisms are likely to impose extraordinary compliance burdens and uncertainties on Reg. No. 11's most favored investments, dwarfing Reg. No. 11's motivational mechanisms, and offsetting the NDRC's efforts of channeling China's outbound investments.

CONCLUSION

Through an extensive discussion in this Note, it is clear that Reg. No. 11 lets the NDRC exercise tightened control over China's capital outflows to slow down the draining of SAFE's foreign exchange reserve. Exempting investments in outbound high-tech enterprises and R&D centers from the heightened scrutiny, Reg. No. 11 incentivizes such developments to achieve the policy goals behind "Made in China 2025." Besides, this policy update contains many ingenious designs that reduce unnecessary compliance burdens and fix Reg. No. 9's loopholes. The effectiveness of Reg. No. 11 is unclear as it faces great challenges from some possible arbitrage activities and counterintuitive policies from destination countries.

155. *See* Foreign Investment Risk Review Modernization Act ("FIRRMA") of 2018, H.R. 5515-538 Title XVII, § 1701 (2018).
156. FIRRA § 1709.
157. FIRRA § 1719 (b)(2)(H).