

Research on Environmental Legal Risks in Foreign Investment of Chinese Transnational Corporations

Xiang Ji^{1,a,*}, Jingsong Pan^{2,b}

¹*College of International Education, Henan University of Technology, Zhengzhou, China*

²*College of Foreign Languages, Changchun Normal University, Changchun, China*

a. 211170300405@stu.haut.edu.cn, b. 15525007028@163.com

**corresponding author*

Abstract: Since the development of the trend of economic globalization, the number of China's overseas investment projects has risen sharply, but at the same time, the potential environmental problems and risks in the investment process have become evident. This essay discusses the environmental legal risks faced by Chinese transnational enterprises in the process of outbound investment and analyzes the specific impact of host country environmental regulation risk and multilateral treaty environmental regulation risk. As global environmental problems become increasingly serious, the investment activities of transnational corporations (TNCs) may be harmful to the local environment while promoting local economic development. This essay summarizes the current status of research on environmental legal in Chinese and international academia, emphasizes that home countries should take responsibility for environmental protection in their investment places when promoting overseas investment. This essay proposes a strategy covering three dimensions--international level, home country and TNCs, in order to promote the sustainable development of TNCs's overseas investment.

Keywords: External investment, transnational corporations, environmental protection, environmental legal regulation risk.

1. Introduction

Driven by economic globalization, outward investment by transnational corporations (TNCs) has grown rapidly, forming a golden period of investment development. However, this surge has also brought to light prominent legal risks related to national security reviews, anti-monopoly laws, labor laws, and environmental laws. In recent years, global environmental problems have been deteriorating, and while attracting foreign investment, governments have been paying more attention to protecting their own environments and introducing stricter environmental regulations. As a result, the contradiction between TNCs and their own environmental strategies has become increasingly intensified.

While TNCs' outward investment activities contribute to the economic development of host countries, they may also bring them environmental benefits. These investments can finance environmental protection projects in host countries and support the restoration and protection of local ecosystems. Nevertheless, TNCs usually rely on the natural resources and ecosystems of host countries to support their business operations, with the potential for negative impacts on the local

environment. Additionally, TNCs must comply with local laws and regulations in host countries. However, in some cases, host countries may raise their environmental regulation standards for political or economic reasons to restrict foreign investment. Such actions can lead to conflicts between foreign investors and governments, affecting the economic interests and social stability of both parties.

In view of the above challenges, this paper will explore the environmental legal risks faced by Chinese TNCs in the process of external investment and propose corresponding solutions. This essay is designed to provide a scientific support for host countries in formulating environmental protection policies, and to help TNCs better understand and cope with environmental risks, in order to realize sustainable development. After analyzing and summarizing the current research status, this essay will explore the host country environmental regulation risks and multilateral treaty environmental regulation risks faced by those enterprises in the process of outward investment. It will analyze the specific impact of these risks on enterprise operations, and put forward corresponding countermeasure strategies, covering the international level, the national level and the enterprise level.

2. Current Research Status in Related Fields

2.1. Current Status of Research in China

When some Chinese scholars discuss environmental protection in investment areas in recent years, their perspectives tend to focus on the investment places themselves, while relatively ignoring the fact that the home country, as the main body of overseas investment, carries the necessary responsibility, obligation and importance of protecting the environment of investment areas in multiple dimensions, such as political, economic and legal aspects. However, as environmental issues have gradually become a global focal point, an increasing number of scholars are shifting their research perspectives. They now recognize and actively advocate that the home country, while promoting its overseas investment activities, should also undertake the obligation to protect the environment of the investment areas.

Han Xiuli, through studying environmental disputes arising from TNC investments, analyzes the hazards of environmental risks and discusses the international community's stance and measures on environmental protection in host countries. From a multi-dimensional perspective, she puts forward a series of strategies and recommendations to protect the environment in the investment destination, such as solving the problem of the Chinese government's regulatory malfunction, actively negotiating and concluding new BITs or revising the existing ones with other countries and strengthening the right to limit the host country's regulations [1].

Wang Yanbing, from an international perspective, examines how TNCs can align with global environmental protection trends and fulfill their environmental responsibilities in overseas investments [2]. Sun Shiyan focuses on the home country perspective and explains the important role of the home country in promoting the awareness of environmental protection in the investment process of TNCs [3]. These perspectives complement each other, forming a comprehensive framework for analyzing and solving environmental legal problems in TNC investments.

2.2. Current Status of International Research

Internationally, some scholars recognize the relationship between environmental protection and overseas investment, suggesting that environmental measures should be integrated into investment activities. However, research on environmental protection measures in investment places is not yet sufficient, especially from a Chinese perspective.

Doak Bishop recognizes the close connection between overseas investment and environmental protection, and illustrates that neglecting environmental protection of the investment place in the process of investment may lead to serious consequences as well as derivative legal risks. However,

his research often remains surface-level and lacks effective suggestions for robust strategies [4]. Kevin R. Gray continues to carry out in-depth analysis of the research direction, analyzing the reasons for the formation of environmental risks from a multi-dimensional perspective through multiple real-life cases of environmental disputes. Nevertheless, his proposed solutions are often simple and idealized, lacking practical applicability [5].

To sum up, existing literature offers a foundation on the legal risks related to environmental protection in overseas investments but lacks specific, practical solutions. Therefore, this paper aims to explore this field further. By examining the types of legal risks in the investment environment of TNCs, and combing the actual situation and cases of the international, host and home countries, the paper provides suggestions and theoretical references for the improvement of the environment of overseas investment of TNCs.

3. The Types of Environmental Legal Risks in Chinese Foreign-Related Enterprise Investment

3.1. Risks of Host Country Environmental Regulation

Under the background of global economic integration, ecological environmental protection has become an essential part of the development strategies of every country, especially in many developing countries along the Belt and Road Initiative. While aiming for high economic growth, these countries have gradually elevated environmental protection to the core of their national development agendas. As a consequence, when concluding international investment treaties or agreements, they paid more attention to strengthening environmental regulation of foreign enterprises engaged in investment activities in their countries. Originally, the host country's elevation of environmental protection standards was a legitimate action within its sovereign rights. However, the uncertainty and frequent fluctuations in environmental protection laws and policies in some countries, coupled with the arbitrary implementation of environmental regulations and the failure to deliver on government promises of preferential treatment, pose significant potential risks to investment projects reliant on policy support.

3.1.1. Inconsistency of Environmental Standards

Environmental protection standards are a comprehensive collection of norms and technologies established at the national or international level to protect and enhance the quality of the environment. The system covers a number of key components, which include, but are not limited to, environmental quality standards, pollutant emission standards, national environmental sample standards and environmental foundation standards. Currently, the scale of outward investment by Chinese enterprises continues to expand at the forefront of the world. According to the data, 26,870 newly established foreign-invested enterprises were set up nationwide, a rise of 14.2% year-on-year; the actual amount of foreign investment utilized was 498.91 billion yuan, a decline of 29.1% year-on-year, and the investment was widely distributed geographically [6]. Generally, countries along the Belt and Road have become important investment destinations for Chinese enterprises, with nearly 70% prioritizing these regions for investment.

However, differences in economic development status, recognition of environmental protection challenges, and varying environmental protection capabilities have led to diverse environmental protection standards among countries. As a developing country, China has made remarkable progress in improving its own environmental protection standards in recent years, but there is still a gap compared with developed countries. When engaging in foreign investment activities, Chinese TNCs often struggle to fully meet the increasingly strict environmental protection requirements of their host

countries due to their existing operating habits or lack of technological adaptation, leading to potential environmental legal compliance risks and, ultimately, economic losses.

Although some countries currently have lower environmental protection standards and more relaxed investment entry thresholds, this may change as host governments raise standards later. For example, in Peru, the country rich in mineral resources, strict environmental legislation and enforcement are standard. On March 30, 2014, Aluminum Corporation of China's (Alcoa) Tromoc copper mine project in Peru was ordered to stop because Peruvian officials claimed the investment caused environmental damage. Alcoa had to withdraw from the investment, resulting in significant losses.

3.1.2. Media Publicity on Environmental Impact of Chinese Enterprises

Despite further development in economic globalization, Cold War-era ideologies persist, and ideological conflicts often manifest in national policies, including political, economic, and cultural aspects. Recently, the rapid growth of China's external investment and its increasing national power have raised concerns among the United States, Western countries, and neighboring nations. They fear that China's rise could alter the global geo-economic and political landscape, leading to speculation about China's emergence as a potential “new ruler” of the world.

Meanwhile, in the current national public opinion field, some western media are trying to create a gap between China's friendly relations with countries along the Belt and Road and African countries. They frequently hype the “Chinese environmental threat theory”, incorrectly portraying China as a primary culprit in global warming and over-interpreting Chinese enterprises' outward investment behaviors. This has been elevated to accusations of human rights violations and deprivation of development rights, with claims that China is practicing a “new type of colonial strategy”.

For example, articles in the Financial Times such as “China and Africa: Building a New World Order?” and “U.S. accuses China of ‘exporting’ air pollutants” failed to correctly reflect China's philosophy and principle of friendly cooperation and mutual benefit. Instead, they enhanced the misunderstanding of the external world about China's outbound investment, which brought great risks to China's investment. Specific cases, such as the violence against Chinese businessmen in Papua New Guinea in May 2009, were fueled by misguided public opinion. The US\$1.4 billion investment by the Metallurgical Group of China in the Rimu nickel mine project in the country, which is supposed to be a positive initiative to promote local economic development, was distorted by some forces as a symbol of “neo-colonialism”, which triggered unnecessary conflicts and social unrest [7].

3.2. Multilateral Treaty Regulation of Risk

Under the framework of international environmental law, multilateral environmental regulation has brought many potential non-commercial risks to the investment activities of Chinese foreign-related enterprises. Although international environmental law does not impose hard and fast rules on the size and total amount of overseas energy investment by countries, the restrictions on the total carbon emissions of developed countries and some large developing countries have undoubtedly adversely affected China's overseas energy investment. Chinese companies may have acquired the right to explore and exploit oil, natural gas and coal, but were ultimately unable to ship these resources back to China for consumption due to the limits of total carbon emissions. With the impact of international environmental conventions on national domestic laws, countries will increase their legal and social responsibilities in their own environmental laws, further increasing the economic and social costs of Chinese foreign-related enterprises [8].

3.2.1. International Environmental Law

International environmental law consists of a number of specialized and highly targeted environmental protection treaties. Each treaty addresses a particular environmental issue independently and has its own working and monitoring mechanisms, which has led to the fragmented and fragmented nature of international environmental law. For example, the World Environmental Convention (WECC) attempts to integrate and codify key principles of international environmental law in order to improve legal uniformity. However, the principles in different treaties, such as the precautionary principle, are unique and need to be regulated by different standards to achieve their binding and counterbalancing effects. In fact, the fragmentation of international environmental law is caused by the characteristics of international law itself and is an inevitable phenomenon in the development of the international legal system. Moreover, environmental issues are inherently cross-cutting and have intricate relationships with other issues, making it difficult to isolate them simply from other issues [9].

This fragmentation also means that multilateral treaties can become tools serving the interests of a few. The inconsistency of the negotiation demands of the negotiators is essentially due to the inconsistency of interests. In 2018, in the voting on the resolution sponsored by the United Nations General Assembly with the theme “Towards a World Environmental Convention”, the United States did not hesitate to vote against it based on its national interests. Among the EU member states, France and Germany, which are more influential, are more concerned about environmental protection, making it easy for the EU's final environmental policy to vary according to the preferences of these two countries. These international treaties have had a direct impact on China's foreign-related investment [10]. For example, the International Convention on the Prevention of Marine Oil Pollution and the International Convention on Oil Pollution Preparedness, Response and Cooperation provide for the prevention, preparedness and response of marine pollution from ships, and clarify the importance of the protection of the marine ecological environment. The United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement require countries to take responsibility for controlling and preventing the ecological impacts that may be caused by global warming. These treaties impose significant restrictions on the development of China's foreign-related investment [8].

3.2.2. The Outcome of The Game Between Countries

Environmental issues are not a separate economic or technical issue, but also a strategic game issue, involving the rights and obligations of various countries in the international community. Although the characteristics of international environmental law and the current international situation have hindered the conclusion of multilateral treaties, in essence, in the process of global environmental negotiations, the struggle between countries for political discourse and economic dominance is the fundamental reason. Political power is a means used to achieve economic interests. In international affairs, countries with significant influence can shape the formulation of international rules to their advantage, ensuring that global environmental governance develops in their favor. For example, in the negotiation of the World Environmental Convention, major countries such as the United States have always explicitly opposed it, primarily because their environmental policies and national interests were dominant. They did not believe that adopting the World Environmental Convention would bring substantial benefits to them [9].

Since the outbreak of the financial crisis, there have also been some changes in the attitudes of countries around the world on environmental governance issues. In the face of the environmental crisis, countries around the world will put their own economic development needs first. The need for finance to deal with the financial crisis has largely taken away the share that environmental protection

should have. Due to the development stage, national strength, and emission differences of various countries, there are great differences in the demands of the environmental field, and the game between major countries is particularly obvious. When countries approach environmental issues, they weigh their interests, and economic interests are usually at the center. If the issue is beneficial to their country, they support it; otherwise, they resolutely oppose it.

4. Optimal Pathways for Chinese Outbound Investment Enterprises to Deal with Environmental Legal Risks

4.1. International Level

4.1.1. Promote the Establishment of A Multilateral Dispute Settlement Mechanism

In order to make up for the shortcomings of "behavioral disorientation" caused by the differences in the environmental legal systems of the host country and the domestic country, the best way is to establish a sound and complete multilateral rule on investment and environmental protection between the host country and the domestic country. The system of interaction between environmental policies established by the Energy Charter Treaty (ECT) is a typical reference. The ECT aims to establish an open and inclusive market for energy trade and investment among the countries of the Agreement, and it establishes basic rules covering energy trade, investment rules, dispute settlement and ancillary issues. The ECT's Protocol on Energy Efficiency and Environmental Protection establishes the guidelines and systems that must be followed by the agreement countries for circular development and eco-friendliness, and the awareness of environmental protection runs throughout, reflecting the sustainability of energy trade in both the preamble and the text [11]. The system not only provides a clear code of conduct for investment enterprises, but also reduces environmental legal risks to a certain extent. Chinese foreign-related companies can ensure that their investments in host countries are more transparent and legal by promoting similar multilateral dispute settlement mechanisms.

4.1.2. Active Use of International Treaties And Customary Law Rules

Given the inadequacy of the domestic and overseas investment insurance legal systems and the ineffective implementation of international dispute settlement mechanisms, using existing international investment mechanisms to avoid environmental risks is the best solution. At present, Chinese investors rarely use the Multilateral Investment Guarantee Agency (MIGA) to avoid environmental risks, which requires investment enterprises to actively declare projects with greater environmental risks to the MIGA Convention, and solve the communication barriers with the host country through information symmetry and environmental data transparency. This approach can avoid the host country's judicial process and reduce the hostile attitude of the host country to foreign investors, thereby maximizing the company's profits while the host country's environment is not damaged [12]. Specific measures include participating in and promoting the formulation and implementation of international environmental protection standards, learning from the successful experience of other countries, and improving the company's own environmental protection capabilities and compliance levels.

4.2. National Level

4.2.1. Improve Judicial Interpretations of Laws Related to Outbound Investment

With the increase in the increment of outbound investment and the increasing diversification of risks, it is necessary to optimize the overall layout of the domestic environment and rule of law at the national level. Environmental rule of law refers to environmental protection actions guided by laws

and regulations, including improving the environmental legal system at the legislative level and the dynamic process of implementing environmental systems. In terms of environmental laws and regulations for investment and exports, China should establish an environmental legal system with the Environmental Protection Law and the Foreign Investment Law as the core, and improve the legal system for the prevention and control of environmental risks in an all-round, multi-level, and wide-ranging manner [13]. China should further promote special legislation on the regulation of environmental risks in overseas investment and strengthen the importance of legislation on corporate behavior and the precision of regulation. This will enhance the competitiveness of domestic enterprises in the international market, and ensure that their investment behavior in the host country complies with local legal requirements and reduce potential legal risks.

4.2.2. Raise Project Export Standards

When an enterprise submits an investment project for review, it is required to submit an application for environmental protection. However, due to relatively relaxed export conditions, lack of clarity in relevant domestic regulations, and lack of strict supervision of investment, many enterprises rarely actively fulfill their social obligations in pursuit of profits [14]. Strengthening export controls on energy investment projects and improving enterprises' environmental protection practices are necessary. First of all, when reviewing the export conditions of the project, it is necessary to provide a detailed and clear Environmental Impact Assessment (EIA) report, EIA implementation plan and other options. Foreign investment management organs shall review the authenticity and feasibility of foreign investment projects, and have experts and scholars from relevant departments conduct research and verification of the environmental impact factors, measures, and potential risks of foreign investment projects. Second, after the initial review is passed, environmental information such as environmental protection measures and alternatives should be published on the China OFDI website, but no specific time limit for disclosure should be set. It is necessary to listen to the local people of the host country, as they have a higher level of local awareness. This can be a way to participate in the project and timely reflect potential environmental risks. Finally, approval should be denied for projects that involve serious environmental impacts in order to protect the host country's ecological environment.

4.2.3. Strengthen Government Supervision of Export Enterprises

In view of the unclear environmental protection responsibilities and regulatory failures in China's overseas investment management, the key is to reconstruct the environmental legal management system and establish the responsibility boundary to ensure that the Ministry of Commerce and other core departments can define management functions and roles in accordance with the law, compliance and due diligence. In order to achieve this goal, the country's top priority is to establish a framework for ongoing regulation. For example, in the “going out” stage of a project, a comprehensive assessment of its environmental friendliness is carried out in the approval of overseas investment. Implementing a dynamic supervision mechanism throughout the process will enable quick responses to potential or emerging environmental problems and immediate corrective measures. In addition, the government should strengthen regular inspections of export companies to ensure the implementation of their environmental protection measures, establish a whistleblowing mechanism, and encourage the public and non-governmental organizations to monitor their environmental behavior, so as to enhance their environmental responsibility and self-discipline.

4.3. Enterprise Level

4.3.1. Strengthen Legal Compliance in Investments

The overseas investment behavior of domestic foreign-related enterprises is not only subject to the national legal framework of the host country, but also involves its diverse regional local regulations and policy systems. Investors need to understand and follow the local laws and policies that are closely related to environmental protection. Given the global differences in environmental protection standards, Chinese enterprises should adopt a forward-looking strategy when making outbound investments. This means following stricter environmental protection standards initially. In particular, when the host country's environmental protection standards are lower than China's domestic standards, investment activities should be based on China's high standards to prevent potential environmental legal risks that may arise in the future due to the host country's improvement of environmental standards and ensure the compliance of investment activities. Specific measures include establishing a professional legal team or hiring external legal counsel, and regularly training employees to improve their legal awareness and environmental awareness, so as to create a good legal compliance atmosphere within the enterprise.

4.3.2. Proactively Assume Social Responsibility

Corporate social responsibility is often fulfilled under external pressure. However, the core competitiveness of modern enterprises is closely tied to their proactive assumption of social responsibilities. Enterprises that actively practice social responsibility are more likely to win the recognition and respect of the host country, industry peers and consumers with their corporate culture and values. For Chinese outbound companies, the host country's environmental social responsibility includes improving the company's ethical standards, effectively implementing environmental governance measures, and strengthening the protection of local workers. Therefore, Chinese enterprises with foreign investment should take the initiative to internalize environmental social responsibility as a guide for corporate actions. Establishing a social responsibility department within the enterprise, formulating a detailed social responsibility plan, publishing social responsibility reports on a regular basis, actively participating in local community construction and environmental protection activities, and establishing a good corporate image are essential steps.

5. Conclusion

This paper systematically analyzes and discusses the environmental legal risks faced by Chinese foreign-related enterprises in the process of outbound investment, mainly including the environmental regulatory risks of the host country and the regulatory risks of multilateral treaties. Through an in-depth study of the sources, manifestations and impacts of these risks on enterprises, this paper proposes a series of theoretical frameworks and policy recommendations to help Chinese foreign-related enterprises better cope with environmental legal risks and achieve sustainable development.

In general, the environmental legal risks faced by Chinese foreign-related enterprises in the process of outbound investment are multifaceted, including regulatory risks from the host country and regulatory risks from international environmental treaties. In order to better respond to these risks, enterprises need to take a variety of measures, including strengthening their understanding and adaptation to host countries and international environmental regulations, improving their own environmental protection capabilities, and paying close attention to the dynamics of international environmental governance. Through these measures, companies can effectively reduce environmental legal risks and achieve sustainable development.

The research presented in this paper aims to provide more theoretical support and practical guidance for managing the environmental legal risks of Chinese foreign-related enterprises in outbound investment. It is hoped that these insights will help enterprises achieve better development and growth in the context of globalization, ensuring their operations are both legally compliant and environmentally sustainable.

Authors Contribution

All the authors contributed equally and their names were listed in alphabetical order.

References

- [1] Wang Na. (2018). *M.S. in Environmental Protection in China's Overseas Investment* (Dissertation, Northwest University).
- [2] Wang Yan Bing. (2009). *Ph.D. in Environmental Law Issues in International Investment Rules* (Dissertation, East China University of Political Science and Law).
- [3] Sun Shiyan, *New Development of International Law*, Beijing: China Social Sciences Press, 2010.
- [4] Bishop, R.D., Crawford, J.R., & Reisman, W.M. (2014). *Foreign Investment Disputes: Cases, Materials and Commentary*.
- [5] Gray, K.R. (2002). *Foreign Direct Investment and Environmental Impacts – Is the Debate Over? Review of European Community and International Environmental Law*, 11, 306-313.
- [6] MINISTRY OF COMMERCE PEOPLE'S REPUBLIC OF CHINA. *From January to June 2024, China absorbed 498.91 billion yuan of foreign investment*. July 12, 2024. Retrieved on July 15, 2024. Retrieved from: https://www.mofcom.gov.cn/xwfb/roxwfb/art/2024/art_40c540bd5d994587a7e3e364c43e594a.html
- [7] Wang Wenjun. (2012). *Environmental Legal Risks of China's Outward FDI and Its Preventive Measures*. (Doctoral dissertation, University of International Business and Economics).
- [8] Yan Scion, "Research on the Prevention and Control of Legal Risks of China's Energy Investment in Arctic Countries", Northwest University of Political Science and Law, March 15, 2022
- [9] Faye Wong, *The Dilemma Faced by the Negotiation of the World Environmental Convention, Its Causes and Solutions*, Environmental Protection.
- [10] ISD Reporting Services. *Summary of the Third Substantive Session of the Ad Hoc Open-ended Working Group towards a Global Pact for the Environment [EB/OL]*. (2020-08 23). <https://enb.iisd.org/vol35/enb3503e.html>.
- [11] Chen Demin, Zheng Zeya. *Xinjiang Social Sciences*, 2020, (02):83-90+147-148.
- [12] Zheng Zeya, "On the Institutional Value of Multilateral Investment Guarantee Mechanism to Prevent Environmental Risks Based on the Analysis of Environmental and Social Sustainability Criteria", *Journal of Central South University of Forestry and Technology*, No. 4, 2018.
- [13] Hou Lu and Zheng Xue ying, "The Construction of Environmental Rule of Law from the Perspective of Ecological Civilization", *Guangxi Social Sciences*, No. 8, 2017
- [14] Hu De Sheng and Ou Jun, "The Environmental Responsibility of Chinese Enterprises' Direct Investment in Other Countries along the Belt and Road", *Journal of Xi'an Jiao Tong University (Social Sciences)*, No. 4, 2016, p. 48.