

# SOEs in China and AI Development: Legal Constraints for Foreign Investments towards China's Digital Transformation

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## Abstract

While developments and applications of artificial intelligence (AI) are observed in various countries, few have demonstrated the determination and rapid growth like China has shown over recent years. Foreign investors seeking to benefit from the developments in China's AI sector are required to comply with various laws and regulations. It follows the methodology of a comparative legal analysis and policy evaluation to identify the major factors impeding or facilitating foreign investments in China's AI market. The purpose of this article is to identify the major factors impeding or facilitating foreign investments in China's AI market, the role of the state-owned enterprises (SOEs) in either inducing or acting as an obstacle to foreign investments and the regulatory environment within which investment in the developing AI and other digital technology markets in China is conducted.

## Keywords

Artificial Intelligence (AI), Digital Economy, Fintech, Foreign Investment, State Owned Enterprises, China

## 1. Introduction

Regarding technological developments, China is either one of the leaders or is on the same level as the leaders in the global markets of commercial nuclear power, electric vehicles, and battery technologies. Being the forerunner in these fields, voraciously China has joined the rest of the world in combating climate change through clean energy and sustainable technology, hence leading the energy transformation trend around the world.

While it lags behind in most of the advanced industries like robotics, biopharma,

chemicals, and artificial intelligence, it is catching up very fast (Khanal et al., 2024). Especially in terms of AI, China is advancing unbelievably, largely because of SOEs and their technology. Such SOEs make a big contribution to the research, development, and commercialization of AI technologies, which is very helpful for the Chinese government in its attempts to catch up with the global technology leaders (Yu & Nijkamp, 2008). Another of China's aspirations is parallelism between the economy and digitization of the enterprise, whereby state-owned enterprises take the leading role.

Regarding the issue of a digital economy, it is accepted that China belongs to a category of outstanding countries in the world as far as the use of advanced technologies is concerned (Zhang & Chen, 2019).

Functions covered in AI include those ranging from face detection to empathetic, self-adjusting, and self-learning technologies, with these initiatives being driven by state-directed programs (Markus et al., 2024). The government plays a significant role in ensuring the full benefits of digitalization while mitigating associated risks such as labor market disruptions, privacy invasion, oligopolies, and financial turmoil (Verhoef et al., 2021). Consequently, China is strategically positioned on the global roadmap for artificial intelligence (AI) synthesis and application in the future world bloc.

Another essential factor in this AI surge is the role of Chinese state-owned enterprises (SOEs), which dominate critical industries such as telecommunications, manufacturing, and digital networks (Huang, 2022). SOEs in China, operating under state ownership, not only contribute to innovation but also exercise control over its flow. They often collaborate with private and foreign enterprises to accelerate technological advancements, ensuring the nation's competitive edge in AI development (Markus et al., 2024; Verhoef et al., 2021).

The major impetus toward technological advancement in China has been foreign investment (Zhao et al., 2024). As the forecast for the AI industry in China is likely to grow, foreign investors will not want to let this opportunity slip away. However, there are various legal impediments that they have to cross through, which include a cap on the ownership of foreign investors, strict supervision, and the protection of intellectual property. This relationship between cooperation and restraint renders confrontation and opportunities in China's AI industry for global players.

## 2. The Influence of Chinese SOEs on the Market Ecosystem of AI

SOEs in China function as specific instruments of the government, integrate perfectly with the "Made in China 2025" and "New Generation Artificial Intelligence Development Plan", amongst other national goals. Such policies highlight AI as a priority sector and have placed SOEs on the front line of the application of AI in industries.

According to the "Made in China 2025" initiative, the strategy aims to transform

China from being perceived as a global factory to a producer of high technologies. The plan focuses on improving the manufacturing industry, reducing reliance on foreign technologies, and strengthening China's competitive position in rapidly growing sectors such as robotics, aerospace, and biotechnology, with SOEs playing a crucial role in achieving these goals.

China has also adopted the "14th Five-Year Plan for the Digital Economy" endorsed in 2021, which aims to enhance artificial intelligence and develop AI infrastructure to further economic growth (State Council, 2022). The 2022 "Guiding Opinions" issued by the Ministry of Science and Technology also emphasized the importance of innovative AI applications to drive social and economic development (Ministry of Science and Technology, 2022).

The increasing integration of artificial intelligence technology into all aspects of business operations—spanning policy-making, research, organization, manufacturing, and sales—is fueled by market competition and significant government support. State-owned enterprises (SOEs) are at the forefront of industrial automation and intelligent manufacturing, particularly within the aviation and electronic manufacturing sectors. As some of the largest contributors to research and development (R&D) in China, these enterprises are strategically positioned to drive innovation in AI systems tailored to meet specific industry demands, backed by robust governmental support (Li, Wang, & Wang, 2024).

This strategy places artificial intelligence at the core of national development projects, aiming to position China as one of the world's leaders in AI by 2030, as outlined in the New Generation Artificial Intelligence Development Plan (State Council, 2017). State-owned enterprises (SOEs) are strategic in the time frames associated with the extensive resources, power from the state, and market control over different sectors in implementing and innovating advanced technological development.

In industries such as steel, energy, and transportation, which are traditionally considered older sectors, state-owned enterprises (SOEs) are leveraging artificial intelligence (AI) to improve systems and boost performance. For example, major state-owned power companies are utilizing predictive maintenance, driven by AI, to optimize system operations and reduce downtime (Ucar, Karakose, & Kırımça, 2024). State-owned enterprises (SOEs) are also instrumental in developing cutting-edge cities that utilize artificial intelligence (AI) to manage urban infrastructure, traffic, and power systems. These cities incorporate AI technologies to improve governance and anticipate future urban needs (Cugurullo & Xu, 2024). Furthermore, state-owned enterprises (SOEs) collaborate with governments, which have established AI innovation centers, and other institutions engaged in AI advancements. These collaborations often involve research on new technologies, frequently in partnership with the private sector and Chinese universities (Marcello, et al., 2023).

In addition to the aforementioned initiatives, state-owned enterprises (SOEs) also focus on other national strategic priorities, such as green development, the

Belt and Road Initiative (BRI), cybersecurity, and advanced technologies. SOEs are particularly involved in international mega-construction projects related to BRI, where AI plays a crucial role in logistics and construction management (Eg-wim et al., 2024). It would mean, in essence, that such SOEs are vital in supporting telecommunications and defense functions, including the national protection of IT infrastructure through mobile AI cybersecurity technologies, which play a key role in supporting national defense (Mishra et al., 2022).

On the other hand, it is very often criticized as ineffective and bureaucratic with regard to decision-making, which could further delay the process of integrating AI technology. Also concerning over their dependency on government aid, it creates a tendency to rely on government policy for grants and subsidies instead of fully exploring ways to be innovative and competitive globally without such assistance. Where SOEs are the most prominent players, competition remains low, curtailing innovation (Caiza et al., 2024). Also, the government of China has taken initiatives and policies to inject more competition in the market and promote innovations by guidance on investments and resources.

Whereas, on the other hand, there exist highly successful partnerships in the form of Joint Ventures and technology transfer between Chinese SOEs and foreign firms (Raslan, 2024). For instance, it is worth mentioning how the cooperation of worldwide leaders like IBM and the Chinese telecom SOEs has yielded some unique AI and Cloud works (Feijóo et al., 2020). In order to make successful cooperative arrangements, foreign investors need to fully understand the legal burdens such as the requirement for sub-licensing and protection of the host country, which may face during the relationships with local officer.

### 3. Law and Policies Steering Foreign Investments in the AI Sector in China

A juncture exists in China regarding the regulation of artificial intelligence, which has attracted the attention of foreign investors. The Foreign Investment Law, presented in 2020, marked a milestone in bringing an end to the fragmentation in the legal framework of foreign investments in China (National People's Congress, 2019).

This law embodies fair competition between domestic and international investors. As a new line of business, AI technologies posed some security concerns, especially since they were believed to have military applications (People's Republic of China, 2021). Hence the stringent requirement of foreign companies entering the AI market to enter into joint ventures with Chinese state-owned enterprises.

Owing to the constraints in the target market, foreign investors are compelled to partner up with local firms, Chinese SOEs being one of them (Lin, Lu, Zhang, & Zheng, 2020). The government monitors and manages them stringently in all compliance and working aspects.

Going through the National Security Review process (Bian, 2020) instituted by

Chinese authorities is an invaluable step and practically required before any foreign investment targeting any sensitive subsector such as AI goes through. The aim of the NSR mechanism is to impede any foreign investment that threatens China's national security interests. Some of its high-end developments, like AI, must avoid unique scrutiny caused by the national security review process. This implies that foreign firms have to prepare for maximum control and limitations over how the operations, management, and acquisition of data and their privacy will be within the larger governance control in China (Creemers, 2022).

According to the *Cybersecurity Law of the People's Republic of China (2017)* in China remains one of the biggest hindrances to foreign investors due to its regulations on handling data. It includes new specific types of data, such as where data on people within a state must be stored and processed in that state. This can pose serious business issues for foreign artificial intelligence companies, especially those focusing on building and training AI models and carrying out research that entails using such techniques as transfer learning, which requires cross-border data transfers. For such industries as AI, where large amounts of data are necessary for machine learning to take place, for example, AI models and systems producers will have to implement changes in how they operate within China if they are to do so legally (Creemers, 2023). Moreover, foreign firms cannot exchange data with external organizations, protecting the country's internal security. Such companies are subjected to tough content regulation as well as data security due to the provision of generative AI services.

In a similar vein, the Administrative Provisions on Deep Synthesis of Internet-based Information Services, which was adopted 2022 in China, target the use of AI in deepfake and synthetic media technologies. These laws aim to prevent the dissemination of false information and the misuse of AI, which complicates the concerns and compliance of potential foreign investors in the AI market.

Especially relevant is the Trial Measures for Ethical Review of Science and Technology Activities (Ethical Review Measures, 2023), which presents the ethical review processes encompassing AI and other advanced technologies. This aligns with the increasing focus in China on AI ethics, particularly when putting out autonomous systems on ethics to ensure that these systems are fair, private, and accountable, among other values. Implementation of irresponsible AI solutions is not permissible by foreign AI firms unless they pass this ethical review attesting to how their solutions are ethical.

The Administrative Provisions on Algorithm Recommendation for Internet Information Services pursue the same goals, which set revisions to the algorithms for controlling the recommendation of Internet information content.

Foreign AI companies should focus on compliance and leverage restricted internal processes and ought to remember that being in China implicates more than simply wooing the market with goods. It is aimed at galloping development of this region in the near future, which is expected to be one of the largest AI markets in the world. Despite the regulatory challenges, there are ripe opportunities for

foreign investors in specific AI sectors in China. Among the very important laws related to the establishment of companies within the AI industry in China are the Foreign Investment Law, National Security Review, Generative AI Measures, and Deep Synthesis Provisions. The day foreign players integrate with China's legal policies and show support for responsible AI, then there is the ability to profit from one of the fast-growing AI scenes in the world.

#### 4. Challenges and Risks for Foreign Investors

The governance systems of Chinese SOEs could be more exacting and therefore problematic for foreign investors who require some degree of accountability. Typically, SOEs have to report to several ministries of the government, which causes delays in bureaucratic processes and decision-making. Getting this environment is essential for other foreign companies joining SOEs because managing negative internal and outside stakeholders requires lots of local understanding and knowledge.

##### a) *Unstable Legal Environment and Policy Change*

There is a risk of a quick shift of policies for foreign investors in China's AI sector. Changes in ownership requirements-related policies, data control policies, and even in factors of national security policies can directly affect investments (Tseng, 2003). This increases risk in that it makes doing any planning suitable for the capitalist sometimes more challenging than what is required, and that increases the level of risk in AI development and deployment in China, particularly with SOEs facing cuts that could affect government agencies.

##### b) *Concerns Over Intellectual Property and the Transfer of Technology*

Foreign investors consider protecting intellectual property to be a critical concern in the AI industry. In order to access many markets, regulations in China normally impose technology transfer, which raises the aspect of losing cross-border investment (Lee, 2020). Due to these technology transfer issues, foreign firms are forced to make their contracts with Chinese state-owned enterprises in a manner that their legal obligations concerning technology sharing will be fulfilled, while at the same time their intellectual property rights will be protected.

Foreign investors find it difficult to invest in China's AI sector due to complex governance structures of SOEs, policy instability, and bureaucratic delays, which only raise risks and complicate decision-making. Further, mandatory technology transfer and intellectual property concerns have compelled investors to balance strict legal requirements with protection for proprietary assets.

#### 5. Strategic Opportunities for Foreign Investors

Since 2023, China's National Quality and Performance Frameworks (NQPFs) have been explicitly aimed at high-tech sectors such as artificial intelligence, robotics, biotechnology, and new energy industries (Connotative Characteristics and Development Priorities, 2024). NQPFs have a special place in China's development strategy since they contribute to China's sustaining advancement in competitive

global markets and economies.

“New-type” industrialization, a stride pursued by China, is also in sync with NQPFs in that it focuses on improving the manufacturing capacity, safeguarding the supply chain, and becoming self-reliant on technology to boost China’s standing in the global high-tech industry ([New Industrialization Is the Main Front, 2024](#)). Simultaneously, China is also looking for a “future industry”, which is projected to be associated with the emergence of advanced quantum computer technology and networks, which is now in its infant stages ([Chen, Wu, & Dai, 2023](#)). These strategies emphasized further enhancing and extending the development of China’s economy by applying advanced technologies and entering into new industries.

Foreign investors also believe that the potential returns of the future can be uncovered given the commitment of China to being more proactive and competent in science and technology. Certain features are relatively promising, including promotion from the Chinese government in foreign direct investment. Some particular industries, an example being the industrial internet, industrial software, and industrial automation, are developing at a very fast pace and making a landscape of co-operation and entry to the market for outsiders. In particular, the AI industry has been receiving a lot of foreign investment in China due to strong governmental support, a fast-growing market, and favorable conditions ([Leading Scale, Diversified Fields, Win-Win Cooperation, 2024](#)).

For example, the opportunities for foreign investors to reach one of the largest consumer markets in the world are included, together with friendly government policies and tax incentives. SEZs and FTZs have become recognized to offer corporate income tax rates as low as 15%, compared to the nation’s standard rate of 25%. For example, all corporations headquartered in the Guangdong-Hong Kong-Macau Greater Bay Area currently enjoy a 15% reduced tax rate. This will provide greater incentive for enterprises to achieve innovations in the fields of biotechnology, AI, renewable energy, and more—so long as R&D tax deductions can be as high as 75% of expenses ([Southeast Asia Tax Guide, 2024](#)).

The AI market is not just growing in China. Instead, the Chinese market has very high opportunities for styling the best AI techniques. The AI market rose sharply in its value marketing from 213.7 billion RMB to 50 billion USD in 2023. Massive building blocks and substantial language models are set to increase the size of the data economy by approximately 32.9% by 2028. Enormous in the population, per the understanding of this massive potential, is also a clarion call for investors searching for markets. This is mainly to the AI sub-industries such as the AI chip, the generative AI, the AI robotics, the neural AI networks, and most AI applications in verticals ([Arendse, 2024](#)).

In addition to the market viability, the Chinese government has also outlined goals for developing AI. It’s important policy papers, for example, the Guiding Opinions on Accelerating Scenario Innovation and High-Level Application of Artificial Intelligence to Promote High-Quality Economic Growth ([Notice of Six](#)

Departments, 2022). These opinions aim at implementing AI across intelligent manufacturing, agriculture, logistics, finance, and smart home systems. A shift towards tools like industrial brains, machine-aided manufacturing, and machine vision is being sought in the manufacturing sector. Most AI farming applications also apply to satellite farming and intelligent farm management. In logistics, smart warehouses and sorting robotic arms are also one of the futures. All these different application scenarios create different windows for foreign companies to step in and offer their knowledge, technologies, and capital.

The Chinese political space transcends itself in fostering the establishment of a venture and innovation-led AI ecosystem whereby the state emphasizes private firms in AI scenario design, resources, and demonstrative works (Zhu & Mattlin, 2024). This creates a favorable and profitable environment for international firms to collaborate with their Chinese counterparts due to the expanding market for AI-based designs.

The 2022 Foreign Investment Encouraged Catalogue embraces the emerging smart devices, neural network chips, neuron sensors, and more AI technologies anticipated in China (National Development and Reform Commission & Ministry of Commerce, 2022). In this case, such benefits are available due to particular provisions of government policy, such as the provision of a special rate of 15% Corporate Income Taxes, for foreign companies operating in designated development areas.

China has become a place of conquest in the world due to its broad tech ambitions, developing AI market, and a good policy to support foreign investment. Even though regulation and data governance issues remain hurdles, they also represent non-research challenges that manufacturers need to address to exploit the potential of AI and other novel technologies in China. Foreign investors can quickly adjust to the technologically changing atmosphere in China via strategic alliances, entering new-wave spin-offs, and participating in China's technological innovation ecosystem.

## 6. Case Studies: Foreign Investment in Chinese AI SOEs

It can be viewed that IBM's relationships with Chinese State-Owned Enterprises could reduce regulatory risks in Chinese AI industry. Branded for tough regulations, the company has widened its market access by collaborating with local telecommunications service providers and system integrators. A case in point is that IBM consolidated its presence on the Chinese market by collaborating with China UnionPay in upgrading the company's financial technologies, allowing the company not to overlook the rapid development of the fintech market in China, which was valued at RMB 309.98 billion (USD 47 billion) (Improve Business Efficiency with a Unified Data and AI Platform, 2023).

Through such collaborations, IBM enters into terms that enable it to abide by the controls typical with Foreign Investment Law and National Security Review that permeate through sectors like AI specializing in sensitive matters. IBM has

also incorporated AI tools in Chinese industries, such as finance and telecommunications, to support China's strategic policies for digital transformation. Doing so would also help China realize its economic potential with new technologies, especially in the cloud business and cognitive computing, wherein government policies emphasize highly additional valued economic activities projected to contribute to 3.97 trillion Yuan by 2025 (Dougherty, 2024).

IBM has also used China's data sovereignty policies to portray itself as a data lodging partner for SOEs. As an illustration, for its part, following the Cybersecurity law of 2017, IBM was able to come up with the required data governance while considering local legislation, thus shielding the organization from legal risk. Over time, this has been instrumental to IBM's expansion in the Chinese market, with AI revenue generated in China making considerable contributions to its global AI market share. For IBM, the presence in the AI market of China is not only business but a contribution to the cause of the country's technological advancement.

Meanwhile, establishing research collaborations with local universities and state-funded AI research institutes is rapidly giving IBM access to more advanced technologies, while further consolidating its prestige as a key player in AI development in China. The market size is expected to show an annual growth rate (CAGR 2024-2030) of 28.61%, resulting in a market volume of US\$154.80bn by 2030 (Market Insights, 2024).

## 7. Conclusion

The interrelationship that occurs between state-owned enterprises and foreign investments in China's AI industry is complex and shows positive notes. The "Made in China 2025" and "New Generation Artificial Intelligence Development Plan" strategic programs of China underpin the fact that the country is hugely investing in technological advancement thru SOEs. In addition, these enterprises not only accelerate the development of AI technologies by focusing on critical sectors but also serve the interest of the state, including national self-sufficiency and global power status.

Political risks are unsurprisingly turning out to be stumbling blocks in the way of efficient foreign direct investment. The aim of capturing a market for one of the foremost growing AI industries can be very appealing. The anticipated growing average rate of 28.61% between 2024 and 2030 suggests that the Chinese AI market should be able to touch the predicted astronomical dollar value of 154.80 billion. Unfortunately, the legal aspect of these business operations proves to be a mountain to climb. Foreign investors should collaborate with SOEs as stipulated in the Foreign Investment Law and relevant supporting documents and comply with checks and balances. So, this is, instead, necessary to maintain and safeguard globalization.

Despite the challenges, the changing dynamics of the Chinese AI market also present opportunities for collaboration. Activity by IBM suggests that cooperating with Chinese SOEs could also reduce the compliance risk and improve market

access. Foreign investors may, therefore, also contribute significantly to and benefit from this evolving AI market, given both local investors and industries and broader digitalization ambitions in China.

China is improving as a dominant hub in AI, and foreign investors need to adjust to the knowledge waves, know the policies, and shape them while leveraging the influence of artificial intelligence technologies. It can be a long way with lots of ups and downs. However, the opportunities for development and cooperation within this key sector are very high.

## Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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