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Foreign Investment Catalogues and Investment Environment in China

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On 23 December 2008, the National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") of People's Republic of China jointly issued Catalogue of Foreign Investment Advantageous Industries in Central and Western China ("Central and Western Catalogue"), which became effective on 1 January 2009. This marks the second revision to the Central and Western Catalogue since its first promulgation in 2000 (the previous revision occurred in 2004). The Central and Western Catalogue was issued to supplement the Foreign Investment Industrial Guidance Catalogue ("Guidance Catalogue") which was jointly revised by NDRC and MOFCOM on 31 October 2007 and became effective on 1 December 2007. Guidance Catalogue was first promulgated in 1995 with updating in 1997, 2002, 2004 and most recently in 2007.

Guidance Catalogue and Central and Western Catalogue are the basic blueprints for foreign investment in China. Sectors falling within different categories have different investment policies for foreign-invested enterprises. There are three basic categories in the Guidance Catalogue: "encouraged", "restricted", and "prohibited". Industries not listed in Guidance Catalogue are deemed to be "permitted", all industries listed in Central, and Western Catalogue shall be deemed as encouraged categories. In addition, the aforementioned two catalogues have different application scope. Guidance Catalogue is applicable to full China, Central and Western Catalogue is only applicable to 21 provinces, autonomous regions and municipalities located in central and western China.

1. Catalogues Consequences

The two catalogues affect the tax incentives, approval requirements and market entries for foreign investors dramatically by classifying the sectors in which foreign investors intend to invest.

A. Tax Incentives

Foreign-invested enterprises in the sectors falling into encouraged categories can enjoy certain tax preferences. Foreign-invested enterprises engaged in the industries falling into the encouraged categories of Guidance Catalogue or listed in Central and Western Catalogue can enjoy exemption from customs duty for imported equipment for self-use, including the corresponding technology, accessories and spare parts. Moreover, foreign-invested enterprises in central and western China belonging to the industries listed in the Central and Western Catalogue can enjoy the reduced income tax rate of 15% from 2001 to 2010, provided that their major business income at least accounts for 70% of their total income.

B. Approval Requirements

Current foreign investment approval procedure in China mainly based on two indispensable approval procedures of NDRC or its local counterparts and MOFCOM or its local counterparts. If foreign investment involves any other industrial competent authority, it is necessary for foreign-invested enterprises to obtain the approval from the competent authority. For example, foreign investors intending to invest in education sector in China need to apply for the approval from Ministry of Education or its local counterparts besides NDRC.
and MOFCOM, foreign investors intending to invest in listed company also need to obtain the additional approval from China Security Regulatory Commission.

It is subject to a simpler approval procedure to set up foreign-invested enterprises in the sectors falling into encouraged or permitted categories than restricted categories. To set up foreign-invested enterprises in the sectors falling into restricted categories, the applicants have to obtain approvals from higher level government compared with establishing enterprises within the encouraged or permitted sectors. The approval procedure is simpler and more time saving to obtain the approval from lower level government than higher.

C. Market Entries
According to the two catalogues, in some of the sectors falling within encouraged or restricted categories, foreign-invested enterprises are subject to certain restrictions regarding market entries. For example, in the foreign-invested enterprises engaged in the sector of special and scarce coal exploration and mining, Chinese investor must take a majority stake. Foreign-invested enterprises engaged in accounting and audit shall only be made in form of cooperative joint venture or partnership with Chinese party. Moreover, it is worthy to note that foreign investors cannot invest in any sectors falling within the prohibited categories.

II. Catalogues Changes Compared with 2004 Version

A. Guidance Catalogue
There are 478 sectors in sum listed in Guidance Catalogue including 351 encouraged sectors, 87 restricted sectors and 40 prohibited sectors. Compared with its 2004 counterparts, 94 encouraged sectors, 9 restricted sectors and 5 prohibited sectors have been added in

The Guidance Catalogue.

In order to update China’s industry structure, Guidance Catalogue paid more attention to high-end technology and value added industries. For example, “manufacturing of the colored metal materials with new and high technology” has been added into the encouraged categories. In contrast, certain manufacturing industries in which Chinese enterprise have obtained strong capacity would no longer be encouraged or permitted for foreign investors, e.g., the sector of “repairing, designing and manufacturing of the common ship” has been downgraded into restricted categories from encouraged categories.

China had taken certain measures to impel its service industry, the revised Guidance Catalogue was one of them. “Information technology outsourcing and business process outsourcing” and “modern logistics” have been listed in the encouraged categories to improve China’s service industry, create more high quality job positions and conform to China’s WTO commitments.

In addition, “future company” and “construction and management of grid” were firstly opened to foreign investors through upgrading from prohibited categories to restricted categories.

Energy saving and environmental protection was one of the most important objectives embodied in the Guidance Catalogue. “Use of sea water, treatment and recycling of industrial wastewater” and “development technology of bio-energy” were listed into encouraged categories. On the other hand, some scarce non-renewable minerals were no longer encouraged, e.g., “development of the coal and its accompanying resource” were downgraded from encouraged to permitted.

The Guidance Catalogue heavily affected real estate industry. To calm down the overheated real estate market in 2007, the Guidance Catalogue generally downgraded the real estate related industries for foreign investors. The sector of “development and construction of the ordinary residential” were downgraded from encouraged categories to permitted categories. Foreign-invested enterprises in secondary real estate market and firms engaged in real estate intermediates and brokering would be restricted instead of permitted. To tighten the real estate foreign investment policy, “construction and operation of the golf course” was downgraded to prohibited categories from restricted categories.

B. Central and Western Catalogue
In the Central and Western Catalogue, 411 encouraged sectors were listed with an increase of 126 sectors comparing with its 2004 counterparts. Besides the 2004 version of the Central and Western Catalogue, Catalogue of Foreign Investment Advantageous Industries in Liaoning Province was also integrated into the new revised Central and Western Catalogue. It is worthy to note that the particular catalogue for each province, autonomous region and municipality was set forth in the Central and Western Catalogue. There was no unified catalogue applicable to all of the 21 provinces, autonomous regions and municipalities located in central and western China.

To promote industries updating, certain industries in which Chinese enterprises had matured were removed from the Central and Western Catalogue, e.g., “manufacturing of electric instruments”, “manufacturing of films for electrical purposes” and “producing of numerical control cutting tools”. Meanwhile, many industries were added into the Central and Western Catalogue, such as, “manufacturing of the high performance tire”, “automobile financial service”, “vocational education institutions” and “medical institutions”.

“Deep processing of tungsten and molybdenum”, “producing of barium salt” and “deep processing of manganese” was removed from the Central and Western Catalogue to protect the environment in central and western China. On the other hand, “restoring of the ecosystem in the mined-out and subsidence area of mining” was listed in
the Central and Western Catalogue. It is clear that environmental protection is a key concern when China's government guides the direction of foreign investments.

III. Introduction of Upcoming Catalogues in 2010

On April 6, 2010, the Several Opinions on Further Improving the Work on the Use of Foreign Investment ("Opinions") was promulgated by the State Council and entered into effect at the same time. The Opinions include 20 measures with the main purpose to enhance the quality of use of foreign investment. It represents the latest point of views of the Chinese government at the highest level in connection with the foreign investment in China after the international financial crisis. In the Article 1 of the Opinions, it is stipulated that the Guidance Catalogue shall be revised to open up more sectors, to encourage foreign investment in high-end manufacturing, high and new technology, modern services, alternative energy, and energy conservation and environmental protection sectors. In the Article 8 of the Opinions, it is required by the State Council to revise the Central and Western Catalogue based on the revision to the Guidance Catalogue.

It is reported that the MOFCOM and NDRC are handling the revision of the two foregoing catalogues. According to an unnamed person close to the MOFCOM, the draft version of the revised Guidance Catalogue will be promulgated to solicit suggestions from the public by the end of 2010 and the Central and Western Catalogue will be revised subsequently. In April 2010, Zhang Xiaoming, Vice Chairman of the NDRC which is in charge of investment policy of China, delivered remarks at the Boao Forum that China would no longer express welcome to foreign investments in energy-demanding, heavy-polluting industries and sectors with overcapacity; nonetheless China would keep the door open for technology-intensive and service-oriented investments and foreign invested enterprises with the ability to make full use of China's labor market competitiveness. In a word, China is trying to avoid the growth which is achieved by high-energy consuming, heavy-polluting and resource-driven industries because such kind of development is not sustainable.

The upcoming revised catalogues may also reflect the recent development of foreign investment in China. The first half of 2010 has witnessed growth of the number of newly established foreign invested enterprises and the increasing foreign investment in all of the eastern, central and western regions of China. However, it is worth noting that although the number of foreign invested enterprises in the western region increased dramatically, the amount of the foreign investment only climbed by 4.9%. Actually, the gap between the western region and the eastern region of China is widening instead of narrowing.

Therefore, the drafters of the upcoming revised version of Central and Western Catalogue will pay more attention to the development in western region of China. According to Liu Yajun, Director General of the Department of Foreign Investment Administration of the MOFCOM, the revised version of the Central and Western Catalogue will include more incentive measures in order to inject more capital of foreign investors into the western regions of China so as to promote the pace of development of the impoverished area in these regions. These measures include tax incentive policies, preference arrangement on land use, market entries and so on.

To sum up, based on the above discussion, it is easy and clear for us to make the conclusion that the scientific development mode and development of the western region have become the main concerns of Chinese central government in the process of revision to the catalogues. Firstly, the industries in which the Chinese central government encourages the foreign investors to pour their capital have quietly shifted from the traditional energy-demanding, heavy-polluting industries to the technology-intensive and service-oriented industries under the guidance of the sustainable development strategy. Secondly, in respect of the regions where the foreign capitals are promoted to be put in, Chinese central government has released various signals regarding foreign investment policies in order to facilitate the development of the western region of China. It appears that the foreign investors could enjoy more tax preferences and other incentives upon such revision to the above-mentioned catalogues.

IV. Conclusion

It is no doubt that China's market will continue to boom in a long-term look. Foreign investors who want to share the benefit of China's growth should better select their investment area carefully. The foregoing two catalogues and their revised version will continue to be the fundamental legal documents controlling foreign investment in China in future. Foreign investors intending to enter China market shall conduct a comprehensive check on the current catalogues and relevant revised provisions regarding foreign investment incentives and restrictions. The existing foreign investors also need to check the catalogues and provisions to ensure regulatory compliance while they are seeking for additional investment opportunities.

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