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China: New Measures for Deregulating and Promoting Foreign Direct Investment

Significant measures will further reduce market access restrictions and create a more level playing field for foreign investors to attract FDI.

Key Points

- China's State Council has outlined significant measures to attract foreign direct investment by relaxing market access restrictions and treating domestic and foreign investment enterprises more equally.
- The government previously relaxed pre-approval requirements for foreign investment enterprises and established intra government and public platforms to track regulatory compliance of foreign investors and foreign investment enterprises.
- The Chinese Government is expected to issue in the coming weeks a revised Foreign Investment Guidance Catalogue, which will set out a negative list of all market access restrictions applicable only to foreign investors.

Summary

On January 12, 2017, the State Council issued the *Circular concerning Measures on Expanding the Opening Up and the Active Utilization of Foreign Investment* (the Circular). The Circular sets out the government's policies and outlines specific measures for reducing existing market access restrictions for foreign investment in a wide range of industry sectors, creating a more level playing field for foreign investors and foreign investment enterprises (FIEs), and attracting foreign direct investment (FDI) into China.

The Circular follows the amendments passed last September by the National People's Congress to the *Wholly Foreign-owned Enterprise Law*, the *Chinese-foreign Equity Joint Venture Law*, the *Chinese-foreign Cooperative Venture Law* and the *Law on the Protection of Investment by Taiwanese Compatriots.* Those amendments removed the government approval requirement to establish FIEs in industry sectors that are not subject to foreign investment access restrictions, and are accompanied by the contemporaneous formation of an intra-government credit information platform for foreign investors and a public credit information platform for FIEs. These earlier measures shifted the focus of foreign investment administration from a formal review and approval procedure at the FIE establishment stage to close monitoring of FIE regulatory compliance post-establishment.

Although the Circular provides only an outline of the new measures, it specifies the government organs that are charged with the responsibility for implementing each such measure and the nature of the organs' responsibility. As the current term of the State Council will come to an end in March 2018, the current administration is under enormous pressure to ensure that detailed procedures for implementing such measures will be implemented well before then. The enactment of such detailed procedures will complete the current round of foreign investment deregulation, which is intended to further simplify the FDI regulatory regime, improve the investment environment for foreign investors, enlist the help of foreign investors in upgrading China's economy, and provide new impetus for economic growth. A number of these detailed procedures could be issued in the coming weeks.

Reducing market access restrictions

Based on the policy statements in the Circular, market access restrictions will be reduced largely in the following industry sectors:

Service sectors

- Banking, securities, fund management, futures, insurance and insurance intermediary services
- Accounting and auditing, architecture and rating services
- Telecommunications, internet, cultural, educational and transportation services

Manufacturing sectors

- Rail equipment, motorcycle, ethanol fuels and processing of oils and fats

Mining sectors

- Oil shale, oil sand and shale oil
- Oil and gas

On December 7, 2016, prior to issuing the Circular, the National Development and Reform Commission and Ministry of Commerce jointly published a draft *Foreign Investment Guidance Catalogue (Revised)* (New Catalogue) for public comment. The New Catalogue will retain and update the existing list of encouraged sectors for foreign investment in the current *Foreign Investment Guidance Catalogue (Revised 2015)* but will replace the existing lists of restricted sectors and prohibited sectors with a new and simplified list entitled "*Special Administrative Measures for Foreign Investment Access (Negative List for Foreign Investment)"* (Negative List). Once finalized and issued, the Negative List will set out all the industry sectors in which foreign investors are subject to some form(s) of market access restrictions that do not apply to domestic investors. Latham & Watkins will discuss the actual changes in a forthcoming *Client Alert* once the New Catalogue is finalized and issued.

Creating a more level playing field

The Circular places significant emphasis on leveling the playing field for domestic enterprises and FIEs, through the following measures:

- Central and local governments will conduct fair competition review in accordance with the *Opinion of the State Council Concerning the Establishment of Fair Competition Review Mechanism in the Course of Constructing a Market System* issued last June.

- Under the “Made in China 2025” initiative, China’s manufacturing sector will be upgraded through the promotion of high-end manufacturing, intelligence manufacturing, green manufacturing, industrial design and branding, project consultation, modern logistics, and testing and certification. Such promotional measures will be accessible to both domestic enterprises and FIEs alike.

- Central and local governments will support cooperation between domestic and FIE R&D institutions and support FIEs establishing R&D centers, technical centers and post-doctoral research stations. FIEs will be allowed to participate in state-sponsored science and technology projects, and incentive policies for high and new technology enterprises and R&D centers and tax deduction policies for R&D expenses will apply equally to domestic enterprises and FIEs.

- Senior level talent of foreign nationality who hold PRC permanent residency certificates will receive the same preferential treatment accorded to individuals of PRC nationality in establishing science and technology enterprises in China

- The government will promote the participation of foreign investors in infrastructure projects in China’s energy, transportation, water conservation, environmental protection and municipal development sectors through concessionary arrangements.

- In assessing applications for business permits and qualification certificates domestic enterprises and FIEs will be subject to the same assessment criteria and time lines.

- In tender processes for government procurement, the government will accord the same treatment to products of domestic enterprises and FIEs.

- Public disclosure of information will be strengthened in future reforms of national and industry standards so as to facilitate the participation of FIEs in such reforms.

- Intellectual property (IP) enforcement will be strengthened, FIEs’ IP rights will be protected in accordance with the law, and international IP organizations will be encouraged to establish IP arbitration and conciliation centers in China.

- FIEs will be allowed to seek public listing on the Main Board, Small and Medium Enterprises (SME) Board and Growth and Emerging Market (GEM) Board of Chinese securities exchanges and listing on the New Third Board (*i.e.* the Beijing-based National Equities Exchange and Quotations).

- FIEs will be allowed to issue corporate bonds, convertible bonds and other debt instruments.

- Local land use policies will apply to domestic enterprises and FIEs alike.

- Domestic enterprises and FIEs will be subject to the same registered capital requirements.

If properly implemented, these measures will go a long way to address many of the key complaints that foreign business councils in China have been drawing to the government’s attention over the years.

Promoting foreign investment

The Circular also adopts the following policies to provide new incentives for foreign investors and promote FDI:

- Local governments are permitted, within limits, to offer incentive policies for foreign investment that are based on the concept of an innovative, coordinated, green, open and sharing economy, and to support projects that create employment, promote economic development or technical innovation, or reduce investment or operating costs.

- FIEs are encouraged to relocate their operations to the Central West and North East regions of China and will qualify for preferential funding and land treatment offered by the state.

- Foreign invested industrial projects that fall under the “encouraged” category in the Foreign Investment Guidance Catalogue and that have a significant need for land will be supplied with land at a 30% discount to the national minimum price for the same class of land.

- Foreign multinationals are encouraged to set up regional headquarters, procurement centers and settlement centers in China and will be allowed to centrally manage their Renminbi and foreign exchange receipts and payments from China so as to improve funding and investment efficiency.

- The foreign exchange administration of foreign debts will be streamlined to enhance FIEs’ ability to obtain financing outside of China

- Customs procedures will be simplified. Government online application platforms will be upgraded to improve efficiency in application submissions and enable applicants to monitor the status of their applications.

- Seven new free trade zones are being established in Sichuan, Chongqing, Zhenjiang, Hunan, Henan, Shaanxi and Liaoning so certain forward-looking foreign investment measures can be tested in more economically diverse pilot zones before being rolled out nationally.

Outlook

Given the series of foreign investment reforms the Chinese government has outlined or implemented, foreign investors should be encouraged by the greater transparency, improved administrative efficiency, expanded national treatment and new investment incentives. The gradual implementation of these reforms could lead to a surge in FDI and mergers and acquisitions.

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