Chinese Government Issues 2015 Foreign Investment Catalogue — Effective April 10, 2015

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The Chinese government makes no secret of the fact that in its view, foreign investment should be consistent with China's economic development plans and industrial policies. Its ability to administer foreign investment in accordance with industrial policy is aided by the fact that all foreign investment must go through an often rigorous approval process. By contrast, only particularly large or sensitive foreign investments require approval in the US. (For a more thorough treatment of the Chinese approval process for foreign investment, see the report prepared by Covington for the U.S. Chamber of Commerce available here.)

Since 1995, foreign investment in China has been guided by the Catalogue of Industries for Guiding Foreign Investment ("Catalogue"). The Catalogue is divided into three lists which, respectively, list (1) "encouraged" industry sectors for which the government is actively seeking foreign investment and will therefore provide special advantages to foreign investors (e.g., preferential tax treatment, easier government approval), (2) "restricted" industry sectors for which special restrictions such as a relatively more onerous and time-consuming approval process apply, and (3) "prohibited" industry sectors in which foreign investment is banned altogether. Sectors not specifically listed are considered "permitted."

The categorization of industry sectors is updated approximately every three years in order to reflect the government's then prevailing economic and political goals and policies. On March 10th, the National Development and Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM"), the two principal authorities in charge of foreign investment in China, issued a new version of the Catalogue (full Chinese version available here; English translation available here). The new Catalogue will take effect on April 10th, replacing the previous 2011 version, which became effective in 2012.

The latest revision represents a more marked change than was seen the last time the Catalogue was revised, indicating that the government is more keen to attract foreign investment in the face of declining interest (see a post we wrote on this blog about declining foreign investor sentiment here). The government's keenness is particularly evident when it comes to foreign investment in advanced and green technologies (e.g., manufacturing of high-throughput gene sequencing equipment and production of pollution-free feeds and additives) as well as in traditionally inefficient state-dominated sectors into which the government is seeking to inject new life (e.g., the construction and operation of urban and interurban railways and the operation of eldercare facilities).

The new Catalogue lifts restrictions on foreign investment in many sectors. Most of the liberalization is seen in the manufacturing sector, with some relaxation also found in other sectors including services, agriculture, and infrastructure. According to an NDRC official's count, the number of restricted industries has been reduced from 79 to 38, with direct sales and insurance brokerage companies among the beneficiaries. The 2011 Catalogue listed 44 industries for which Chinese-controlled joint ventures were required, and that number has been reduced to 35 in the new Catalogue. In addition, the number of industries requiring joint ventures (with Chinese partners), but without the Chinese control requirement, has been reduced from 43 to 15, including in such sectors as real estate development. These numbers to some extent reflect improved market access in some areas and reduced market access in others, as well as the consolidation of some items — which resulted in lower numbers of restricted sectors but no actual lifting of market access restrictions. Nonetheless, the overall trend is one of liberalization.

In general, we find that foreign investment restrictions remain largely unaltered in industries that traditionally face heavy restrictions — e.g., banking, telecommunications, and cultural industries — though a significant and welcome exception is e-commerce, an industry in which companies' foreign equity may now exceed 50%. Some types of investments face new restrictions. For example, higher education and pre-school education have been moved into the restricted category, and TV and radio ratings survey companies must now be controlled by Chinese parties.

Other industries that appear to be newly prohibited (e.g., internet publishing services, wholesale tobacco retail, and the sale of culture relics have been added to the prohibited category), or that appear to face new restrictions such as equity caps (e.g., a single foreign investor may hold no more than a 20% share of a Chinese bank, with total foreign-held shares capped at 25%) or nationality requirements (e.g., the chief partner of a foreign-invested accounting firm and the principal of a Sino-foreign cooperative school must be Chinese nationals), do not reflect actual changes to the status quo. Instead, they represent an effort by the authorities to incorporate restrictions contained in other laws, regulations, and policies that were not reflected in previous versions of the Catalogue in order to make the Catalogue more comprehensive and useful. Interestingly, a disclaimer at the end of the 2011 Catalogue that any administrative regulations or industrial policies touching upon matters related to market access shall prevail over the provisions of the Catalogue has been removed. Whether this reflects an intention to make the Catalogue a single, one-stop list for foreign investment restrictions (bringing it closer to the concept of an economy-wide negative list, as described below) is unclear, as the text does not explicitly state that the Catalogue is now to be considered as comprehensive.

Although the new Catalogue indicates some attempt to build a friendlier, less discriminatory investment environment for foreign investors in China, it does not remove as many restrictions as foreign investors had hoped. The European Chamber of Commerce described the draft version of the Catalogue issued in November 2014 (if anything, slightly less restrictive than the final version) as merely an "incremental development," arguing that a simplified negative list (a presumption that all investment is permitted except for a small number of narrowly crafted exceptions all listed in an easily accessible negative list) would have showed more ambition. The government has already accepted a negative list approach in the Shanghai Pilot Free Trade Zone (though it drew significant criticism for an overly extensive list of exceptions), in an important new draft foreign investment law, and in US-China bilateral investment treaty negotiations. With the release of the final version of the new 2015

Catalogue, it appears that those waiting for a negative list approach to foreign investment nationwide must wait a bit longer.

For foreign investors interested in the Chinese market who would like to carefully examine the new Catalogue and its changes, we have prepared a color-coded “redline” version identifying changes between the new 2015 Catalogue and the previous 2011 version.

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