WILMERHALE

China's State Council Announces Promotion of Foreign Investment Growth

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On August 8, China's State Council published the Notice on Promotion of Foreign Investment Growth (Guo Fa [2017] No. 39). The Notice is intended to further liberalize foreign investment, and calls on China to actively utilize foreign capital in an optimal way. While this signifies recognition by the State Council that restrictions on foreign investment are holding the economy back, the timing and extent of the relaxation on market access restrictions remain unclear.

The Notice tasks specific ministries with implementing the following five items and publishing specific implementation timelines:

Item 1: Further reducing market entry barriers for foreign investment. This item calls for nationwide implementation of preadmission national treatment plus a negative list management system, as are already instituted in special trade zones, and further opening of markets to foreign investment in such industries as special vehicle and new energy vehicle manufacturing, ship design, aircraft maintenance, international maritime transportation, railway transportation, gas stations, internet service business premises, call centers, performance agencies, banking, securities, and insurance, all of which currently have joint venture or Chinese majority equity control requirements.

The extension of the special trade zones negative lists nationwide is long overdue, as the increase in the number of such zones to 11 provincial-level jurisdictions handicapped investors wanting to do business on a nationwide basis. However, the benefit of this reform will be limited unless the range of industries is further expanded and restrictions on foreign equity are lifted. The relaxation of foreign equity caps may materialize more quickly in such industries as call centers, for which the Shanghai Pilot Free Trade Zone already allows 100% foreign ownership, but there is as yet no sign that the caps will be lifted in such sectors as vehicle manufacture and life insurance.

Item 2: Formation of fiscal and taxation supporting policies. By way of tax exemption and other preferential treatment, the state will direct foreign investment into encouraged sectors, high-technology and high-value-added service industries, western and northeastern industrial areas, and infrastructure and major projects. Establishment of regional headquarters in China by multinationals is also encouraged.

Expanding financial and tax preferences is welcome, but the apparent intention is to tie the preferences to the establishment of regional headquarters, the restructuring of struggling domestic companies, and investments in lagging economic regions rather than making them generally applicable, which will limit their attractiveness.

Item 3: Perfection of investment environment of national-level development zones. This will give national-level development zones more management authority to streamline administrative approvals and optimize services, introduce more manufacturing-oriented foreign enterprises, and elevate the conduct of pilot high-technology and high-value-added maintenance business to boost the processing trade to the top of the global industrial chain.

Improvements to policy on national-level development zones may help, but most development zones are provincial or local, so this item appears to be as much about expanding central government influence vis-à-vis local political power. Moreover, it primarily addresses manufacturing rather than the faster-growing service sector.

Item 4: Facilitation of the entry and exit of foreign talent. This item basically offers a wider welcome to high-level talent and foreign experts, which is already happening, is likely to be of greater relevance to individuals working for domestic entities rather than foreign-invested enterprises (FIEs), and is undermined by tightened restrictions on internet access.

Item 5: Optimization of the business environment. This item calls for urgent improvement of the foreign investment legal system, enhancement of the service level for foreign investment, assurance of the free remittance of foreign dividends and interest, sharing of management information and coordination of business for FIEs, encouragement of FIEs to participate in the optimization and reorganization of domestic enterprises, protection of FIEs' intellectual property (IP), improvement of research and development competitiveness, and maintenance of the stability of foreign investment policies.

The promise of improvements to service and simplification of bureaucratic procedures is welcome, but some of these measures with respect to non-controversial investments have already taken place. Skepticism is warranted, however, with respect to assurance of repatriation of dividends and interest by FIEs, given the foreign exchange controls that are now known to be tightened and relaxed without warning and may cause delays even in normal times, particularly for large transactions. In addition, the commitment to IP protection still does not address the timing of strengthened trade secrets legislation, which is a major concern for foreign investors.

While taking the Notice as a sign of an intent to further relax restrictions on foreign investment, especially in non-strategic financial services sectors, foreign investors should exercise caution before planning to act upon the Notice. Concrete policy plans and timelines to address the deep concerns of foreign investors in terms of repatriation of investment returns, IP protection and other matters have yet to be issued. The Notice appears to focus more on directing foreign capital into areas to promote China's industrial policies and agendas, such as in the manufacturing and infrastructure sectors, less economically developed regions, and domestic enterprise reorganization rather than a broader welcome to foreign investment.

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