China Promises Additional Opening to Foreign Investment

2010-04-22

China's State Council on April 4 promulgated the Certain Opinions on Further Improvement of the Utilization of Foreign Investment (Circular 2010 No. 9) (the "Opinions"). The principal provisions in the Opinions raise the ceiling for local government approval of foreign investment projects (in the "encouraged" and "permitted" categories) in China from USD100 million to USD300 million, which should speed and add certainty to the approval process; promise to open the door to the listing of foreign invested enterprises ("FIEs") on China's stock exchanges; and otherwise provide guidance and clarification on investment preferences, capital contributions and other regulatory issues affecting foreign investment in China.

Highlights

Key provisions of the Opinions are as follows:

- provincial and local government approval authority for "encouraged" and "permitted" foreign investment projects under the Catalogue Guiding Foreign Investment by Industry (the "Catalogue") is raised from $100 million to $300 million;
- the Catalogue will be revised to encourage foreign investment in the Chinese government's priority areas of high-end manufacturing, high and new technology, modern services, alternative energy, energy efficiency and environmental protection;
- the Catalogue Guiding Foreign Investment in Central and Western China (the "CW Catalogue") will be revised to include labor-intensive environmentally friendly projects;
- a reduced minimum land grant fee (70% of the minimum fee for the grant of land for industrial use) will be provided for foreign investment projects in the "encouraged" category;
- FIE qualification for the high and new technology enterprise status tax preferences will be facilitated by improving the certification process;

- the establishment of foreign-invested regional headquarters, R&D centers, procurement centers, financial and settlement centers will be encouraged by simplifying approval procedures and granting import duty and import VAT exemptions on R&D related items;

- the relocation of FIEs from eastern China to the generally less developed central and western areas of China will be facilitated by further streamlining registration/approval procedures, foreign exchange and tax administration in the destination areas;

- foreign participation in the restructuring of Chinese domestic enterprises will be encouraged through mergers and acquisitions, and domestic A-share companies will be encouraged to attract foreign strategic investors;

- the establishment of foreign-invested private equity (PE) and venture capital (VC) firms will be encouraged, active utilization of their funds will be facilitated, and regulatory mechanisms for exits will be improved;

- qualified FIEs will be allowed to list on domestic stock exchanges and to issue corporate bonds and other financial instruments, and Chinese domestic banks will be encouraged to support FIEs; and

- foreign exchange settlement procedures for FIEs will be simplified.

Comments

While the details remain to be seen, the Opinions represent positive policy developments in multiple respects for foreign investors in China.

Increasing the central government approval threshold from USD100 million to USD300 million provides local governments with greater authority with respect to encouraged and permitted foreign investment projects, which will speed and increase certainty in the approval process.

Setting a national policy to encourage relocation of FIEs from eastern China to lower cost areas in central and western China is particularly important to combat local protectionism which often impedes such rationalization.

Reforming certification procedures to determine eligibility for "high and new technology enterprise" tax preferences will help to encourage high-tech investment.

The Opinions for the first time provide that the State encourages the development of foreign-invested PE/VC investment. Compared to the domestic PE/VC industry which has been developing rapidly in recent years, foreign PE and VC investment has encountered less welcome in China. While such provincial-level jurisdictions as Shanghai, Beijing and Tianjin have adopted policies to encourage foreign PE/VC, the central government has generally favored domestic capital over foreign capital. The Opinions now recognize the contribution of foreign PE/VC to domestic economic development.

Allowing qualified FIEs to conduct domestic IPOs is a significant policy development. While FIEs in theory are subject to the same standards as Chinese domestic companies, only a few have so far been approved to conduct domestic IPOs. The chief impediment lies with the central government, in particular the China Securities and Regulatory Commission ("CSRC"), because the domestic capital markets have been largely viewed as a funding and liquidity platform for locally-owned, particularly, State-owned enterprises ("SOEs"), rather than foreign investors. Allowing FIEs to conduct domestic IPOs opens up additional sources for capital, which is particularly important given that the traditional "red chip" model has been rendered unviable since the promulgation of a series of regulations by the Ministry of Commerce and State Administration of Foreign Exchange beginning in 2006.

In sum, the Chinese government has reaffirmed its welcome to foreign investment, particularly to the extent such investment coincides with the government's broader development objectives. The timing and even the substance may be a response to recent expressions of discontent by foreign business organizations. However, the impact of the Opinions remains to be seen because detailed implementing regulations have yet to be promulgated. For example, the Opinions remain silent on the approval threshold and process for foreign investment projects in the "restricted" category. Will such projects be subject to the same level of government scrutiny in the future? The Opinions mention that in addition to anti-monopoly review, the government will also expedite the establishment of a national security examination system on foreign mergers and acquisitions. What is the substance of such system and will such system become a potential impediment to foreign mergers and acquisitions in China? Will FIEs be required to register their IP first in China to qualify for high and new technology enterprise status? Which services will be regarded as "modern" and therefore encouraged, and in what ways will they be encouraged? Will the lack of reference to government procurement mean that preferences for Chinese-owned businesses will remain intact with respect to sales to government and SOEs?

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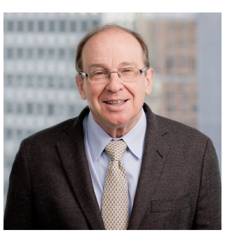

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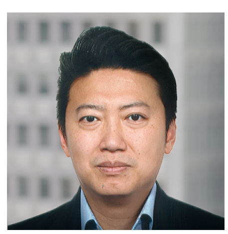

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