
China Releases New Foreign Investment Catalogue (2011 Edition)

2012-01-12

China's National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") on December 24, 2011 jointly released the 2011 edition of the Guiding Catalogue on *Foreign Investment in Industry* (外商投资产业指导目录 (2011年修订)) (the "Catalogue"), replacing the 2007 edition as of January 30, 2012.

Overview

Since its initial promulgation in 1995, the Catalogue has been amended in 1997, 2002, 2004, 2007 and now 2011, a total of five times. The Catalogue constitutes one of the most important cornerstones of China's foreign investment regulatory regime and plays a critical role in shaping foreign investment in China. From one perspective, it exemplifies the continuing inclination of the state planning bureaucracy (now constituted in the NDRC) to regulate the economy, which is easier to do with respect to foreign investment because approval requirements apply to any foreign investment instead of mere registration requirements. In that sense, it constitutes an instrument of industrial policy. It also reflects the continuing priority placed on regulating foreign investment even though the Anti-Monopoly Law, national security review regulations and other legislation are arguably sufficient to prevent threatening concentrations and investments by foreign parties in industries that genuinely impinge upon national security or are objectionable regardless of the investor's nationality.

The Catalogue divides Chinese domestic industrial sectors into four categories with respect to foreign investment: "encouraged," "restricted," "prohibited" and "permitted". The "encouraged" category covers industrial sectors in which foreign investment is eligible for such benefits as greater flexibility of foreign ownership, lower levels of governmental review, and tax and other investment incentives. The "restricted" category covers industries in which foreign investment is subject to a higher level of government scrutiny and imposes such restrictions as ceilings on foreign ownership and limitations on the choice of corporate forms (e.g., foreign investment is more likely to be limited to joint ventures instead of wholly foreign-owned enterprises). Industrial sectors listed under the "prohibited" category are barred from foreign investment. Industries not expressly listed in the

Catalogue are deemed to fall in the "permitted" category, which is neither restricted nor particularly favored.

The 2011 Edition

2011 marks the tenth year after China's WTO admission, and the promulgation of the 2011 edition (one year after release of a draft revision) reflects China's latest efforts to regulate foreign investment in China.

In particular, promulgation of the new Catalogue reflects the Chinese central government's views on economic priorities and the role of foreign investment with respect to industrial structure optimization, the development of high technology and high-value added industries under the 12th Five Year Plan (2011-2015), and in particular reflects the priorities established under the State Council's *Several Opinions on Further Utilizing Foreign Capital* (关于进一步做好利用外资工作的若干意见) (March 2010). The State Council document called for further market opening and encouraged foreign investment in high-end manufacturing, high and new technology, alternative energy, and other environmentally-friendly industries, while discouraging investment in industries involving high pollution and high energy consumption and export of natural resources products. The Catalogue retains, however, the fundamental distinctions between domestically-invested and foreign-invested industry with respect to market entry and approval requirements.

Relatively few changes have been made in the new edition. Compared to the 2007 edition, the 2011 edition increased the total number of items in the "encouraged" category by 3, reduced the number of items in the "restricted" and "prohibited" categories by 7 and 1, respectively, and reduced the number of items subject to a foreign ownership ceiling in the "encouraged" and "permitted" categories by 11.

Key Developments

The new Catalogue places additional emphasis on three key areas: (1) transformation of traditional manufacturing to high-end manufacturing by encouraging foreign investment in new technology, new manufacturing processes, new materials and new equipment to transform and elevate traditional manufacturing industry; (2) cultivation of new strategic industries by encouraging foreign investment in energy efficiency, new generation information technology, biotechnology, high-end equipment manufacturing, new and alternative energy, new materials, and alternative energy automobile production; and (3) promotion of the development of modern service industries by encouraging foreign investment in venture capital investment enterprises, intellectual property services, pollution control/reduction technologies, and vocational and technical training services. With respect to service sectors of particular note, medical institutions and financial leasing have been moved from the "restricted" category into the "permitted" category.

The following summarizes key changes in the "encouraged", "permitted", "restricted" and "prohibited" categories, respectively, under the Catalogue.

"Encouraged" Category

- Several sectors have been newly added to the "encouraged" category to promote the development of energy efficient technologies (e.g., the Catalogue expands the list of encouraged new and alternative energy sectors to include electric and hybrid car fueling and power charge stations) and environmentally-friendly and pollution control industries (e.g., marine oil spill cleanup/control technologies) as well as high-end manufacturing using advanced technologies (including new products/technologies in the production of textiles, chemicals and machinery and equipment);
- Venture capital enterprises have been moved from the "permitted" to the "encouraged" category, which is consistent with government policy to encourage foreign investment in onshore private equity and venture capital investment funds;
- Intellectual property service entities (e.g., patent and trademark agents and consulting firms) have been moved from the "permitted" to the "encouraged" category;
- Vocational education and training has been added to the "encouraged" category;
- The manufacture of key components of new-energy vehicles has been added to the "encouraged" category, which is consistent with the government's policy to develop energy-efficient and alternative energy vehicles;
- Production of special textile products with high and new technology has been added to the "encouraged" category, which reflects the government's efforts to upgrade and transform traditional manufacturing to high-end manufacturing; and
- Several service sectors such as household/family care services have been added to the "encouraged" category.

To curb perceived overcapacity, certain sectors such as automobile manufacture (foreign investment still capped at 50%) and the establishment of automotive research and development institutions have been shifted back from the "encouraged" to the "permitted" category. Certain high energy-consumption and high pollution sectors such as polycrystalline silicon (PSC) production and coal chemical processing have also been downgraded from the "encouraged" to the "permitted" category. Moreover, the qualification thresholds for certain "encouraged" sectors have been raised to encourage a shift to more advanced higher end products, e.g., production of only sixth or higher generation LCD panels will be treated as "encouraged".

"Permitted" Category

- Medical service institutions have been removed from the "restricted" category, which means that foreign investors no longer need to do business in the form of equity or cooperative joint ventures. Wholly foreign-owned enterprises are now permitted in this sector;
- While foreign investment in banking and other financial institutions (including insurance companies) remains "restricted", financial leasing companies have been removed from the "restricted" category and have therefore become "permitted";
- Carbonated soft drink production has been removed from the "restricted" category and has therefore become "permitted" while the production of wine and liquor remains "restricted";

- The production of certain medical devices, such as disposable injectors, blood transfusion instruments and blood bags, has been removed from the "restricted" category and has therefore become "permitted";
- The foreign investment ceiling in certain basic telecommunications services sectors (including domestic and international services) has been raised from 35% to 49%, which is consistent with China's WTO commitment;
- Commercial companies engaging in franchising, commission business and business management and consulting are now in the "permitted" category, reflecting the government's efforts to develop a modern services sector;
- Companies engaged in the distribution of audio/video products are no longer required to be controlled by the Chinese parties, although they still must take the form of joint ventures;
- Commodity auctions have been moved from the "restricted" to the "permitted" category; and
- Import and general distribution of books, newspapers and magazines and the import and production of audio/video products and electronic publications have been removed from the "restricted" category and have therefore become "permitted" while publishing itself remains "prohibited". This is in compliance with a recent WTO ruling against China.

"Restricted" and "Prohibited" Categories

The Catalogue also reveals a few decisions to limit foreign investment:

- Letter courier services within China have been moved from "permitted" status to the "prohibited" category.
- The construction of golf courses and villas has been moved from the "restricted" to the "prohibited" category. This is consistent with government efforts to crack down on illegal conversions of farmland to commercial and residential uses and cool the real estate market.

In sum, medical institutions, the production of key components of alternative energy vehicles, venture capital enterprises and a number of energy/high-end manufacturing sectors appear to benefit the most from the 2011 edition, with more limited relaxation in connection with certain highly regulated areas such as media, financial institutions, publishing, public transportation, advanced/compiling education, real estate, direct and online sales, utility services and telecommunications without further industry-specific regulatory reforms. It remains to be seen, however, whether even the more limited relaxation will be implemented in such protected sectors as telecommunications. In addition, the interface between the Catalogue and the Catalog on Foreign Investment in the Western and Central Regions (2008 edition) (中西部地区外商投资优势产业目录), which is more liberal with respect to foreign investment in less developed regions of the country and is expected to be amended this year, remains unclear.

Authors



Lester Ross

PARTNER

Partner-in-Charge, Beijing
Office

✉ lester.ross@wilmerhale.com

☎ +86 10 5901 6588



Kenneth Zhou

PARTNER

✉ kenneth.zhou@wilmerhale.com

☎ +86 10 5901 6588