China Further Removes Foreign Investment Restrictions

July 2019

Authors: Z. Alex Zhang, Vivian Tsoi, Farhad Jalinous, Richard Burke, Lucy Xu, Lin Li

On June 30, 2019, China's National Development & Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly issued the updated negative lists for year 2019 (the 2019 Negative Lists) that set out the sectors where foreign investment is either limited or prohibited, along with a consolidated encouraged list of sectors for foreign investment (the Encourage List), both of which will further remove restrictions and facilitate foreign investment in China. The above measures will come into effect on July 30, 2019.

Shorter Version of "Negative Lists"

China pledges to provide equal treatment of foreign investment putting foreign investors on equal footing with domestic ones in the Chinese market and giving them equal protections and market access. However, in certain sectors and industries, such treatment and market access can be limited for foreign investors, which has been administered by the Chinese government by its publication of the Negative Lists from time to time. Under this system, foreign investment is either prohibited or limited in sectors only if they are covered under the Negative Lists; and for any sectors that are not specifically identified in the Negative Lists, foreign investors are treated equally as domestic investors, and no additional restrictions on market access will apply.

Like the previous 2018 versions, the 2019 Negative Lists are comprised of two separate lists that are applicable in the designated pilot free trade zones (FTZs) (see *NDRC & MOFCOM Joint Order No. 26* at here)and the rest of China (see *Joint Order No. 25* at here), respectively. The 2019 Negative Lists specifically ease restrictions on market access in agriculture, mining, infrastructure and manufacturing industries, as well as multiple service sectors.

The 2019 Negative Lists now contain 40 items, down from 48 in the 2018 version; and the 2019 Negative List for pilot FTZs now contains 37 items, down from 45. Specifically, the following restrictions now have been fully eliminated nationwide, including in the pilot FTZs, from the 2019 Negative Lists:

- Mining — prohibition on foreign investment in exploration or mining of molybdenum, tin, antimony, or fluorite (however, the same prohibition in exploration or mining of tungsten is not removed in the 2019 Negative Lists);
- Manufacturing Sectors — prohibition on foreign investment in manufacturing of Xuan paper or ink;
- Transportation — requirement for a Chinese party to take a controlling stake in a domestic marine shipping agency company;
- Infrastructure — requirement for a Chinese party to take a controlling stake for building or operating an urban gas and heat network for a city with a population of 500,000 or above;

- Telecommunication Services — limitation of not exceeding 50% on foreign stake in value-added services of domestic multi-party communication, storage and transfer, and call centers;
- Agriculture — prohibition on foreign investment in development of wild fauna and flora resources originating in China under national protection; and
- Movies and Entertainment — requirement of the Chinese party taking a controlling stake in building or operation of a motion picture theater.

For trial purposes, China tends to open up certain sectors in pilot FTZs first before removing restrictions on such sectors from the national negative list. For instance, the 2019 Negative List for pilot FTZs grants more access to foreign investment within pilot FTZs than the national one by further eliminating restrictions on the following sectors:

- Fishing — prohibition on investment in harvesting of aquatic products in the territorial waters or inland waters of China; and
- Printing — requirement of Chinese party taking a controlling stake for printing of publications.

When such a trial in the pilot FTZs proves successful, China may revise the national negative list in the next annual update. We observe this trend in the 2019 update for the following areas:

- Oil & Gas — exploration and development of oil or gas (including coal-bed methane but excluding oil shale, oil sands, and shale gas) in areas other than pilot FTZs were once restricted to equity joint ventures and contractual joint ventures in the 2018 national list, and now this requirement has been eliminated; and
- Cultural Sector — requirement for a Chinese party to take a controlling stake in a performance brokerage agency has been fully eliminated nationwide.

As of June 30, 2019, China has twelve pilot FTZs in operation, namely (i) Shanghai FTZ, (ii) Guangdong FTZ, (iii) Tianjin FTZ, (iv) Fujian FTZ, (v) Zhejiang FTZ, (vi) Henan FTZ, (vii) Sichuan FTZ, (viii) Shaanxi FTZ, (ix) Hubei FTZ, (x) Chongqing FTZ, (xi) Liaoning FTZ, and (xii) Hainan FTZ.

Consolidated "Encourage List"

On the same day, NDRC and MOFCOM also issued in their *Joint Order No. 27* (available at here) a new catalogue of industries where foreign investment is encouraged (new Encourage List). As a replacement of the encouraged industries section under the *Catalogue of Industries for Guiding Foreign Investment* (2017 Revision) and the *Catalogue of Priority Industries for Foreign Investment in Central and Western China* (2017 Revision), the new Encourage List not only combines the above two catalogues but also expands the preferential policies for foreign investment to certain news sectors.

Specifically, the new Encourage List that is divided into the National Section and the Central and Western China Section, now contains 1,108 sectors in total. The National Section contains 415 sectors of encouraged industries, in which foreign investment anywhere in the nation is eligible for preferential policies. Compared to the original catalogue in 2017, it adds 67 new sectors and 45 amended ones, most of which are related to manufacturing industries. Highlights of the National Section include:

- electronic information industries, such as the manufacture of 5G core meta components, integrated circuits (IC) etching machine, IC chip packaging machine, cloud computing equipment;
- equipment manufacturing industries, such as the manufacture of industrial robots, key parts and components for new-energy vehicles and smart vehicles;
- modern pharmaceutical industries, such as the manufacture of key materials for cell therapy medicine, large-scale cell culture products, etc.;
- new materials manufacturing industries, such as manufacture of new aerospace materials, monocrystalline silicon, large diameter wafers;
- certain commercial services sectors, such as engineering consultation, accounting and tax consultation, inspection and test service;

- certain commercial logistic sectors, such as cold-chain logistics, e-commerce, industrial railway; and
- certain technical service sectors, such as AI, clean production, carbon capture and circular economy.

The Central and Western China Section of the new Encourage List contains 693 region-specific sectors, tailored to the respective features of the 22 designated provinces and municipality within this area, including Shaanxi, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, Hunan, Guangxi, Hainan, Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang. Certain sectors where foreign investment is no longer encouraged in the developed areas are now being gradually transferred to the Central and Western China areas, where incentives for foreign investment are still available according to the new Encourage List. Such sectors are mostly labor intensive or related to advanced technology and supporting facilities. For instance, foreign investors are encouraged to invest in sectors involving:

- agricultural products, textile, clothes and furniture manufacture, within the areas of Yunnan, Inner Mongolia and Hunan;
- regular IC, tablet PC and communication terminals, within the areas of Anhui, Sichuan and Shaanxi; and
- logistic and storage facilities and vehicle fueling stations, within the areas of Henan and Hunan.

According to NDRC, preferential policies available to sectors under the original catalogues are still valid for those in the new Encourage List, including, among others:

- tariff duty exemption for imports of self-use equipment (the value of which shall not exceed the total amount of foreign investment);
- enterprise income tax at a preferential rate of 15% for qualified foreign invested enterprises located in certain western areas (including Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang, Inner Mongolia, Guangxi, and certain autonomous prefectures in Hunan, Hubei and Jilin, as well as Ganzhou City of Jiangxi.); and
- priority in supply of land and up to 30 percent discount of the benchmark land price for foreign investment in intensive land use projects.

China Continues Opening-Up amid Trade Tensions

China adopted the negative list management system in 2016 and has updated it on an annual basis to gradually ease the control on foreign access and streamline the administrative process with regard to foreign investment. China has also incorporated such a system in the new Foreign Investment Law adopted on March 15, 2019 (which will go into effect on January 2, 2020; please refer to *White & Case Client Alert: China Adopts New Foreign Investment Law*, released in March 2019, available at here).

The on-going trade frictions between China and the United States have created certain challenges to inbound investments into China, and the 2019 updates to the Negative Lists signal the extent to which China is seeking to loosen its control on foreign access to its markets. The fact that China decided to release the annual update of the negative lists right after the G10 Osaka Summit where China and the US agreed to restart trade talks, reinforces China's promise of opening-up to foreign investment, and also reflects its positive gesture to cool the tensions between the two nations. If the coming trade talks go well between China and the US, a greater market access to foreign investment may be expected in the near future.

White & Case LLP, Beijing Office
19th Floor, Tower 1 of China Central Place
81 Jianguo Lu, Chaoyang District
Beijing 100025
China

T +86 10 5912 9600

White & Case LLP, Shanghai Office
39th Floor, CITIC Square
1168 West Nanjing Road
Shanghai 200041
China

T +86 21 6132 5900