

An overview of the latest changes to China's Industry Catalogue for Foreign Investment

On 24 December 2011, the National Development and Reform Commission (**NDRC**) and the Ministry of Commerce (**MOFCOM**) jointly issued the revised Industry Catalogue for the Guidance of Foreign Investment (**Catalogue**). The revised catalogue (**2011 Catalogue**) will become effective as from 30 January 2012 to replace its previously revised version issued in 2007.

Background

Those familiar with China's foreign investment regime will understand the importance of the Catalogue. The Catalogue was first published in 1995 and had since been updated from time to time to reflect China's changing macro-economic policy towards social and economic development and in particular, the introduction and utilization of foreign investment.

The Catalogue lists a number of industries and classifies them according to whether foreign investment is encouraged, restricted or prohibited. An industry which is not expressly listed is deemed to be one in which foreign investment is permitted. The classification under the Catalogue has a direct bearing in determining the required level of government approval for foreign investment which in turn, usually impacts on the length and complexity of the approval process. For some industries, the Catalogue restricts the corporate form of the foreign-invested vehicle allowed or limits the maximum amount of foreign ownership in line with China's specific WTO commitments. For industries that fall within either the encouraged or permitted category, local governments may offer certain incentives to the foreign investment concerned.

Change of China's policy focus

In recent years, China has gradually shifted its focus on enhancing the "quantity" to "quality" of foreign investment. Hence, the Chinese government is now more receptive to foreign investment in emerging industries such as hi-tech and innovative technology, environmental protection, renewable resources, new energy, modern agriculture, manufacturing and services. This shift has been reflected in China's latest 12th Five-year Plan promulgated in March 2011.

Key Issues

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If you would like to know more about the subjects covered in this publication, please contact:

Beijing

Terence Foo +86 10 6535 2299

TieCheng Yang +86 10 6535 2265

Jin Hao +86 106535 2287

Shanghai

Emma Davies +86 21 2320 7215

Kelly Gregory +86 21 2320 7234

Glen Ma + +86 21 2320 7217

If you would like to know more about our China publications, please contact:

Chlorophyll Yip +852 2826 3426

Clifford Chance, 28th Floor, Jardine House,
One Connaught Place, Hong Kong SAR
www.cliffordchance.com

Key changes introduced in the 2011 Catalogue

The key changes in some major industries are set out below:

Manufacturing industry

Foreign investors are encouraged under the 2011 Catalogue to invest in projects that call for energy-saving and environmental protection, or engage in new-generation IT, biotechnology, high-end equipment manufacturing, new-energy, new materials and new-energy automobiles. For instance, key components for new-energy automobiles and new generation internet system equipment based on IPv6 have been added to the encouraged category.

In contrast, the manufacturing of complete automobiles, industries related to polysilicon, coal chemical and other industries with current problems of over-capacity are no longer listed in the encouraged category. Although foreign investment is technically still permitted in such industries, the change is a clear signal that approval for such projects may be more difficult to obtain.

Service industry

Notably, quite a few activities relating to the service industry have been added to the encouraged category, including automobile recharging stations, intellectual property services and offshore oil pollution cleaning.

For the first time, foreign investment in venture capital enterprises is recognized as "encouraged" under the Catalogue. This change should facilitate the establishment of VC investment enterprises or funds in China.

In the education sector, foreign investment in vocational skills training has now been classified as encouraged. There is no change to educational institutes for higher education, which remain in the encouraged category and are still limited to equity or cooperative joint venture. Foreign investment in common senior high school education institutions, which remain in the restricted category, may now only adopt the form of a cooperative joint venture rather than an equity joint venture. The prohibition on foreign investment in compulsory education and special education is retained.

Financial industry

The only notable change for the financial industry under the 2011 Catalogue is that foreign investment in financial leasing companies is no longer restricted but now permitted. Under Chinese laws and regulations, financial leasing companies are regulated by CBRC (the banking regulator in China). It remains to be seen whether CBRC will relax its regulation of financial leasing companies following this change in the 2011 Catalogue.

There is no change to China's foreign investment policy with regard to other financial institutions, such as banks, finance companies, trust companies, money brokerage companies, insurers and insurance brokers, securities companies, fund management companies, and future companies, all of which remain in the restricted category, some still being subject to foreign ownership restrictions.

Transportation, warehousing and postal industries

An important change in the 2011 Catalogue is that foreign investment in domestic express delivery of mails, while once permitted, has now become prohibited. This is consistent with the rule set out in the *Administrative Measures on Operating Permits of Courier Services* issued by the Ministry of Transportation in 2009.

The 2011 Catalogue also confirms that basic telecommunication services are uniformly subject to a 49% foreign ownership restriction, which is in line with China's specific WTO commitments.

Wholesale, retail and logistics industries

The 2011 Catalogue further elaborates on "modern logistics business" which was added to the encouraged category of the Catalogue in 2007. It is now listed in the encouraged category to include common delivery of ordinary commodities, low-temperature delivery of live and fresh agricultural products and other modern logistics and relevant technological services as well as rural chain delivery.

Notably, commercial entities relating to franchising, entrusted operation and business management have been removed from the restricted category, while those relating to direct sales, mail orders and online sales remain.

The wholesale, retail and distribution of automobiles has been reclassified from the restricted to the permitted category, which means that the prior requirement for Chinese majority control in chain stores with more than 30 branches that sell different types and brands of automobiles from various suppliers will be lifted. The restriction that a distributor of audiovisual products must be controlled by a Chinese majority has also been removed.

Healthcare industry

The wholesale, retail and distribution of pharmaceuticals has been reclassified from the restricted to the permitted category. Similarly, this echoes the above in removing the prior requirement for Chinese majority control in chain stores with more than 30 branches that sell different types and brands of pharmaceuticals from various suppliers.

Notably, foreign investment in medical care institutions is now classified as permitted as opposed to restricted. This appears to suggest that China is now more willing to reform its state-controlled healthcare system by utilizing private capital.

However, whether foreign investors may actually access China's huge healthcare market in a meaningful way by virtue of these changes is hard to predict. This would largely depend on the endorsement by the relevant industry regulators, i.e., the Ministry of Health and the State Food and Drug Administration.

Media and publications industry

Under the 2011 Catalogue, foreign investors are no longer prohibited from investing in the main distribution and import of books, newspapers and magazines, the import of audio and visual products and electronic publications as well as music-related Internet culture business. This relaxation follows from China's efforts to liberalize its media and publications sectors since 2007 when it first reclassified the main distribution (but not import) of audio and visual products and electronic publications from the prohibited to the restricted category.

However, foreign investment in the publication of books, newspapers and magazines, the publication and production audio and visual products and electronic publications, and operation of news websites, provision of audio and video programs on network, operation of business premises for Internet-access services and Internet culture business (excluding music) remain to be prohibited.

Real estate industry

The only substantive change for the real estate industry under the 2011 Catalogue is that the development and operation of villas is now reclassified from the restricted to the prohibited category. This reflects China's continued tightening of policy in the already overheated real estate sector.

Mining industry

For the mining sector, prospecting and mining of high alumina refractory clay, tabular spar, graphite and other non-metallic minerals, mining and dressing of lithium ores and pyrite ores, and refinery of salt lake brines resources have been added to the restricted category.

On the other hand, foreign-invested enterprises that engage in the following activities (all of which are classified within the encouraged category) may now adopt the corporate form of an equity joint venture in addition to a cooperative joint venture: (i) the development and application of new technologies for oil exploration and exploitation in areas of geophysical prospecting, drilling, well logging, mud logging and down-hole operation; and (ii) exploration and exploitation of unconventional oil resources including oil shale, oil sand, heavy crude oil and extra-heavy crude oil. In addition, the exploration and exploitation of unconventional natural gas resources such as shale gas and marine gas hydrate have also been added to the encouraged category, and the relevant foreign-invested vehicle may adopt the form of either an equity or cooperative joint venture.

CEPAs, ECFA and FTAs take precedence

The 2011 Catalogue clarifies that China's Closer Economic Partnership Arrangement (CEPA) with Hong Kong and Macau, the arrangements under the Economic Cooperation Framework Agreement (ECFA) with Taiwan and the free trade zone agreements (FTA) with relevant countries will take precedence over the Catalogue in case of discrepancy. The 2011 Catalogue also provides that specific provisions and industry policies of the State will prevail in case of inconsistency, which leaves room for the State Council to offer more flexible incentives for the development of less developed regions, in particular the Northeast, Western and Central China regions.

Conclusion

Most of the changes under the 2011 Catalogue are understandably driven by China's new shift of focus to the "quality" of foreign investment, some of which may already have been reflected in recently revised laws and regulations. While it may take time to assess the real impact of the 2011 Catalogue on the current foreign investment regime, it no doubt delivers a clear message about the change in China's foreign investment policy.

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