

Legal Update

China Issues New Negative Lists and Encouraged Industry Catalogue

China has for some time been streamlining the administration of foreign investment and has recently taken further steps to remove restrictions, which continues a process that has been underway since 2013.

Three new relaxations were introduced on 30 June 2019 by China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM)

- *Special Administrative Measures (Negative List) for Foreign Investment Access (2019 Edition)*

(the "**Negative List 2019**")

- the *Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2019 Edition)* (the "**FTZ Negative List 2019**"); and
- the *Catalogue of Encouraged Industries for Foreign Investment (2019 Edition)* (the "**Encouraged Industry Catalogue 2019**").

These new lists and catalogue take effect on 30 July 2019.

FDI Relaxations

BEFORE
SEP 2013

CASE-BY-CASE
APPROVAL SYSTEM

TO
SEP 2013
OCT 2016

NEGATIVE LIST SYSTEM
LAUNCHED IN FTZS AS
PILOT PROGRAMMES

- *Catalogue of Industries for Guiding Foreign Investment* (the "**Catalogue**") classified industry sectors as *prohibited*, *restricted* and *encouraged* for foreign investors. If not covered by the Catalogue, investment was treated as *permitted*.
- Despite such classification, all foreign investments in China were subject to a case-by-case review and approval system.
- The establishment of and subsequent corporate changes to, foreign-invested companies required approval from MOFCOM or its competent local counterparts (the "**MOFCOM Approval**").
- Along with the establishment of the Shanghai FTZ on 29 September 2013, the first Negative List was enacted and implemented in Shanghai FTZ as a pilot programme.
- The Negative List sets out industries that are either prohibited for foreign investment or subject to MOFCOM approval. Unlisted industries were subject only to a record-filing formality instead of the old approval procedure.
- 190 items were listed in the first Negative List for Shanghai FTZ. Such Negative List has been further shortened.

AFTER
OCT 2016

NEGATIVE LIST SYSTEM
IMPLEMENTED
NATIONALLY

- The nationwide implementation of Negative List system commenced on 8 October 2016. The then effective Catalogue (which was further amended in 2017) served as the nationwide Negative List in the initial stage. MOFCOM approval was no longer required if the invested industry was not classified as restricted or prohibited in the Catalogue.
- The first nationwide Negative List was issued in July 2018 and included 48 items.
- China introduced the *Foreign Investment Law* on 15 March 2019, which reaffirmed the Negative List system. The *Foreign Investment Law* will come into force on 1 January 2020.

2019 Negative List

The Negative List has now been further shortened and only 40 items remain with 37 items included in the FTZ Negative List 2019.

The key changes are as follows:

- **Value-added telecommunications:** Foreign ownership restrictions (being a 50% cap on foreign investment) have been removed with respect to the domestic multi-party communication, store-and-forward business as well as call centres, which means that foreign investors may establish wholly foreign-owned enterprises (WFOE) to carry out such businesses.
- **Shipping:** Following the opening-up of international shipping agency sector last year, the requirement for Chinese control of shipping agencies engaged in domestic water transportation has been removed.
- **Culture:** Foreign-invested entities engaged in the construction and operation of cinemas and performance brokerage are no longer required to be Chinese controlled.
- **Power and heating:** Previously, any foreign-invested entity engaged in construction and operation of power and heating networks for cities with a population of more than 500,000 people needed to be Chinese-controlled party. This restriction has been removed.
- **Manufacturing:** Manufacturing of *xuan* paper and inksticks are no longer prohibited for foreign investments. Notably printing houses within FTZs no longer need to be Chinese controlled.
- **Mining:** WFOEs may now engage in prospecting and the exploitation of oil and natural gas (including coalbed methane but excluding oil shale, oil sands and shale gas). Prohibitions on prospecting and exploitation of molybdenum, stannum, stibium and fluorite have been lifted.
- **Fishing and Environment:** The exploitation of state-protected wild animals and plants resources is no longer prohibited. Within FTZs, foreign investment is allowed in aquatic products fishery in Chinese territorial and inland waters.

New Encouraged Industry Catalogue

The Encouraged Industry Catalogue sets out the industries in which foreign investment is encouraged and in connection with which certain tax and land-related preferential arrangements are available.

The new 2019 Encouraged Industry Catalogue (replacing the 2017 edition) is comprised of two parts:

- nationwide encouraged industries (the “**National Catalogue 2019**”); and
- a list applying to specific regions, most of which are located in central and western China (the “**Central and Western Catalogue 2019**”).

In total, 1,108 items are listed in the Encouraged Catalogue 2019 as encouraged industries, more than 121 were contained in the 2017 version.

National Catalogue

Major changes lie in manufacturing and service industries. High-tech industries such as 5G, circuits and chips, artificial intelligence (AI) and cloud

computing, new energy vehicles and so-called 'smart' cars now featured in the catalogue.

Examples of the key changes to the National Catalogue 2019 include the following:

SECTOR	INDUSTRY	NEWLY ADDED OR REVISED/EXPANDED ITEMS
Manufacturing	Electronic information	<ul style="list-style-type: none"> • 5G core components • etching machines for integrated circuits • chip encapsulation equipment • cloud computing equipment
	Equipment manufacturing	<ul style="list-style-type: none"> • key parts of industrial robots • new energy motor cars • intelligent motor cars
	Modern pharmacy	<ul style="list-style-type: none"> • key raw materials for cell therapy medicine • large-scale cell culture products have been added
	New materials	<ul style="list-style-type: none"> • new materials for aerospace • monocrystalline silicon • large wafers
Services	Business services	<ul style="list-style-type: none"> • engineering consultancy • business, accounting and tax consulting • inspection, testing and certification services
	Commercial circulation	<ul style="list-style-type: none"> • cold chain logistics for fresh agricultural products • development and application of e-commerce system • construction and operation of public transportation systems
	Technology service	<ul style="list-style-type: none"> • artificial intelligence • clean production technologies • carbon capture • circular economy
	Others	<ul style="list-style-type: none"> • medical institutions • tourism infrastructure construction and tourism information services

Central and Western Catalogue

The Central and Western Catalogue is designed to attract foreign investment to China's inner regions (notwithstanding the title covers 22 provinces in central, western China, as well as some northeastern and southern parts of China).

With rising costs in previously favoured coastal provinces, the Central and Western Catalogue encourages a shift in the focus of foreign investment to favour certain locations.

Practical Issues

The revised Negative List and new Encouraged List are a clear sign of China's determination to open up its markets further. Additional reforms should be expected, especially in FTZs as well as in the financial and motor vehicle sectors.

It should be remembered that change will not be immediate and the amendment of relevant regulations will be necessary to allow the law to catch up with the new rules. For example, although the foreign shareholding restriction for cinemas has been removed in the Negative Lists, the *Provisional Regulation on Investment in Cinemas by Foreign Investors* has not yet been amended to reflect such change. A careful legal review of the evolving PRC investment environment is clearly important before making any investment.

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