Understanding China's Latest Reforms to the (FTZ) Negative List

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40 Years of Economic Reforms

In 2018, China will celebrate the 40-year anniversary of its economic reform and opening-up policy which was formally launched by the late Deng Xiaoping in December 1978. The intention was to kick-start growth by experimenting with more market-oriented policies.

Over the years, many different economic zones have been spreading all over China with the aim to test new enterprise legislation and provide preferential (tax) policies to attract Foreign Direct Investment (FDI) and expand foreign trade before adopting these in the rest of China.

Since 1995, FDI in China has been regulated by the 'Catalogue of Industries for Guiding Foreign Investment' (Catalogue) that has categorized FDI into Permitted, Encouraged, Restricted and Prohibited industries. The Catalogue has generally been updated every 2-5 years to direct FDI according to the Chinese government's latest industrial policy. The latest version of the Catalogue was published in 2017.

FTZs Spearheading Change

To further economic reform, the 'China (Shanghai) Pilot Free Trade Zone' (Shanghai FTZ) was launched in 2013 to test new policies and attract more FDI. This was later followed by new FTZs in Guangdong, Tianjin and Fujian in 2015 and Chongqing, Liaoning, Henan, Hubei, Shaanxi, Sichuan and Zhejiang in 2017. Hainan Island has been designated as the next FTZ. Each FTZ has their own strategic focus and incentives.

One of the most novel reform policies in Shanghai FTZ was the introduction of the 'FTZ Negative List' in which foreign investors in principal enjoy equal treatment with Chinese companies in industries not on the list. The aim is to test new pro-business policies and open-up specific sectors to FDI that are otherwise off-limits in the rest of China. The 'FTZ Negative List' policy has since been adopted in all the Chinese FTZs.

The overall concept of the 'Negative List' has also been introduced nationwide to direct FDI to the rest of China outside the FTZs whereby business activities not on the Negative List are open to foreign investors.

New Negative List

On 28 June 2018, the National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) jointly announced the latest 'Special Administrative Measures on Access to Foreign Investment, 2018 Version' (Negative List), which reduces the number of Restricted and Prohibited industry activities from 63 to 48 items. The new Negative List will take effect on 28 July 2018. An updated version of the 2017 Catalogue that lists 350 encouraged industry activities has not yet been published.

<u>Highlighted Changes</u>

Automotive Industry

- Restrictions on foreign shareholdings in the manufacturing of special purpose motor vehicles and new energy vehicles eliminated.
- Restrictions on foreign shareholdings in the manufacturing of commercial vehicles cancelled in 2020.
- Restrictions on foreign shareholdings and the limitation of up to two joint venture companies per foreign investor for the production of passenger cars eliminated in 2022.

Shipping Industry

- Restrictions on foreign investment in the repair, design and manufacturing of ships, shipping agencies and international marine transportation companies eliminated.

Aircraft Industry

- Restrictions on foreign investment in the design and manufacturing of cargo aircrafts, regional aircrafts, utility aircrafts, helicopters, unmanned aircrafts, and aerostats eliminated.

Mining Industry

- Restrictions on foreign investment in the exploration and exploitation of special and rare coal and graphite eliminated.
- Restrictions on foreign investment in the smelting and separation of rare earth and tungsten eliminated.

Financial Industry

- Restrictions on foreign shareholdings in Chinese commercial banks eliminated.
- Restrictions of foreign shareholdings in Chinese life insurance companies, securities companies, fund management companies and futures companies raised to 51%, and will be fully eliminated in 2021.

Infrastructure

- Restrictions on foreign investment in the construction and operation of cargo railway networks and power grids eliminated.
- Restrictions on foreign investment in railway passenger transport companies eliminated.

Commercial Trade

- Restrictions on foreign investment in the construction and operation of petrol stations eliminated.
- Restrictions on the purchase and wholesale of rice, wheat and corn eliminated.

Internet Services

- Prohibition on foreign investment in business premises/venues for Internet access eliminated.

Weapons and Ammunition

- Prohibition on foreign investment in the manufacturing of weapons and ammunition eliminated.

Agriculture

- Restrictions on foreign investment in the cultivation of new varieties of seeds (except wheat and corn) eliminated.

Please refer to the latest MOFCOM - Negative List with current Restricted and Prohibited industry activities.

New FTZ Negative List

On 30 June 2018, NDRC and MOFCOM jointly announced the latest 'Special Administrative Measures on Access to Foreign Investment in the Pilot Free Trade Zones, 2018 Version' (FTZ Negative List) which reduces the number of Restricted and Prohibited industry activities from 95 to 45 items. The new FTZ Negative List will take effect on 30 July 2018.

Highlighted Changes

Energy

- Restrictions on foreign investment in the exploration and exploitation of petroleum and natural gas by Sino-foreign joint ventures eliminated.

- Prohibition on foreign investment in the smelting and processing of radioactive minerals and the production of nuclear fuel eliminated.

Telecom Services

- Opening-up measures applicable in the Shanghai FTZ such as limitations on foreign investment in call centres, Internet access services and domestic VPN networks will be introduced in all other Chinese FTZs.

Culture

- Requirements on majority shareholding by Chinese investors in stage performance agencies eliminated.
- Prohibition of foreign investment in art performance groups eliminated and changed to minority share.

Agriculture

- Restrictions of foreign shareholdings in the cultivation of new wheat and corn varieties from 49% to 66%.

Real Reforms to FDI?

The latest economic reforms do highlight China's willingness to further open up its economy to attract more FDI by improving market access and increasing competition.

Although the number of Restricted and Prohibited industry activities on the latest Negative List and FTZ Negative List have been reduced or eliminated, many of these are in industries already dominated by large Chinese State-Owned Enterprises (SOEs) in e.g. mining, finance and shipbuilding or Sino-foreign joint ventures in e.g. automotive and aircraft manufacturing.

This makes it very costly and difficult for both new and existing overseas investors in China to enter and compete as many of these industries are de facto state sponsored oligopolies or joint ventures.

Only time will tell if the latest updated Negative Lists reflect real reforms to FDI as many of these industries are still highly regulated and controlled by the Chinese State.

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