SHAPING UP

Creating a Better Legal Environment for Investment

Increasing concerns over national security alongside the domestic ambitions of the China Manufacturing 2025 (CM2025) initiative have triggered increasing pessimism among foreign investors regarding China's attitude towards future foreign investment. In general, though, there are more positive developments than setbacks, say **Dr Michael Tan** and **Lynn Zhao** of **Taylor Wessing**. In this article they share their insights, bringing an on-the-ground perspective on this topic.

Foreign direct investment (FDI) has long been viewed as crucial to boosting China's fast-growing economy, and has quite often been associated with preferential policies introduced by governments at different levels. Now, after more than thirty years' rapid development, China has become the world's second largest economy and its growth has reached a turning point: some growth deceleration is now being observed. This has led to a perception that the days of rolling out the red carpet for FDI are coming to an end, particularly with sensitive topics like national security and CM2025 now frequently hitting the headlines. This may be true to an extent, but it very much depends on the specific business case and there is always a positive side to the story, for example the constant liberalisation of China's investment environment.

Negative List

The 'negative-list concept' was first introduced in China with the launch of the China (Shanghai) Free Trade Zone (CSPFTZ) when the *Special Administrative Measures for Foreign Investment Access in the China (Shanghai) Pilot Free Trade Zone (Negative List)* was released in late 2013. As indicated by its name, it generally means that foreign investment in areas included on the list will be subject to access control (i.e. approval requirements), while those that do not appear only need follow a simple procedure such as filing. Given that foreign-investment projects in China have historically required approvals, this concept is almost a complete turnaround. Its introduction reflects China's plan to take a more market-orientated approach, like in the West, which becomes increasingly important as it continues to participate in various global trade and investment treaty negotiations. The 'negative-list concept' was recently adopted by the other pilot free trade zones (FTZs) operating in Tianjin, Guangdong and Fujian.

In a move aimed at consolidating all market-access restrictions (both domestic and foreign) into one piece of legislation, the National Development and Reform Commission and the Ministry of Commerce (MOFCOM) jointly rolled out the national-level *Market Access Negative List (Trial Version)* on 2nd March, 2016. Initially it will apply only to the four abovementioned FTZs until the end of 2017, but eventually it is supposed to be extended nationwide. While there are currently many questions regarding the interaction between the local and the national negative lists, the direction that is being taken is generally positive. This is further reflected by the CSPFTZ's *Negative List*, which has undergone a number of reductions since its launch.

Encouraged FDI

For many years, China has been using the so-called *Foreign Investment Guidance Catalogue* (*Catalogue*) to regulate foreign investment. The *Catalogue* specifies business sectors in which foreign investment is either 'prohibited', 'restricted' or 'encouraged'. For those that are not explicitly addressed by the *Catalogue*, it generally means that foreign investment is permitted. This mixture of a positive/negative list approach currently remains the prevailing practice for regulating foreign investment in China.

The *Catalogue* is regularly adjusted by the Chinese Government, with the most recent revision being released on 10th March, 2015. Compared with the previous (2011) revision, the updated *Catalogue* shows a trend towards a more liberalised investment environment: restricted items have been reduced almost by half (from 79 to 38); items subject to equity joint ventures (JVs) or cooperative JV restrictions have been reduced by almost two thirds (from 43 to 15); and items subject to Chinese majority control have also been reduced from 44 to 35.

Taking a closer look at the *Catalogue* there is another finding that may actually address some concerns associated with CM2025. An instinctive reaction towards the plan seems to be that China is going to focus more on indigenous products in the future by reducing its demand for foreign solutions, so as to improve and strengthen its global position. However, there are also good reasons to say that this pessimism is unnecessary – to do everything by oneself, without external support or collaboration, would be neither economical nor even possible in today's globalised world. A typical example is China's jetliner C919 project, which has become a new source of profit boosting many foreign suppliers' sales. The *Catalogue* reflects other such demands in China. The ten priority industries highlighted under the CM2025 roadmap can easily find relevant hits for foreign investment under the 'encouraged' category, such as new advanced information technology, automated machine tools and robotics, aerospace and aeronautical equipment, and new-energy vehicles and equipment.

Streamlined Procedures

The whole FDI regime in China is quite complicated. The simple establishment of a limited liability company may involve different FDI laws and regulations depending on its business scope and share structure. Most significantly, almost all investment requires governmental approval, which can sometimes develop into a time consuming, bureaucratic journey. This picture is expected to change in the foreseeable future, when the MOFCOM finally releases the new Foreign Investment Law, a draft of which was released for public comments on 19th January, 2015.

This draft law introduces several new mechanisms which may overhaul the existing FDI regime. It will first abolish the present complex arrangement under which different laws and regulations apply to the incorporation of different types of foreign investment projects, like equity JVs, contractual JVs, wholly

foreign-owned enterprises, foreign investment holding vehicles, companies limited by shares and so on. The law will focus on regulating foreign investment access and post-supervision, without further interfering with those areas that are already addressed by the more general Company Law, such as incorporation form, corporate governance structure and operational issues.

Another major breakthrough presented by this draft law is the general abolishment of approval requirements now applicable to all foreign investment projects, except for those addressed by a negative list, which will still require governmental approvals. The general idea behind this approach is the same as the negative lists now being utilised in the various FTZs, but it will have more significant procedural implications by granting easier investment access. Future FDI approvals will also be granted with more flexibility: besides a straight forward 'yes' or 'no', as currently practiced, there will also be the possibility for a conditional approval in the future.

In general the draft law will bring some quite positive developments related to the facilitation of FDI in the future. There are still some technical concerns that remain to be clarified and discussed, but its final enactment is expected in the near future.

Prospect

Foreign direct investment has been, and will still be, an important pillar of China's growth. The ambition of China to become a global manufacturing power, as reflected by CM2025, indicates not so much a threat to foreign companies, but rather more opportunities. Slower economic growth has pushed China to shift to a more sustainable model. Many measures taken so far have been aimed at further improving the government's efficiency and capability to better serve business, such as the piloting of the FTZs, the ongoing anti-corruption campaign and developing more transparent legislative processes.

Liberalisation can also be observed at the operational level, like flexible incorporation funding requirements; the replacement of annual inspections by annual reporting; permission of direct inter-company lending; relaxed foreign exchange control over the use of equity funds; and cross-border security arrangements. Indeed there *are* still problems and even new problems to come, but there is no reason to deny the fact that the country is working hard to offer a more business-friendly environment to investors, including those from abroad. Eb

__Taylor Wessing__ is a full service law firm with over 1,200 lawyers in 33 offices in Europe, the Middle East and Asia, including two representative offices (Shanghai and Beijing) in China. For more information please visit www.taylorwessing.com.