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The Second Opening: 20 Measures

China’s New Policy on Utilizing Foreign Investment and Its Impact on Foreign-Invested Enterprises

by Lucy Sun

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Economic globalization faces the risk of retrogression. China, the world's second-largest economy, has become an indispensable part of the global trade and production system in the last three decades. How China responds to rising trade protectionism will not only affect the direction of the global economy, but also its own interests. On January 17, 2017, Chinese President XI Jinping delivered an important keynote speech at the World Economic Forum annual meeting in Davos, stressing that China is the defender of globalization and the country will continue to open up to the world. On the same day, the State Council promulgated a matching document, the *Notice on Measures for the Active Use of Foreign Investment in Opening Up to the Outside World*, also known as *20 Measures*, which outlines the steps to enhance market access and promote fair competition for foreign-invested enterprises (FIEs) in China.

New Level of Market Access for FIEs

The new *20 Measures* initiative is expected to have significant impact on FIEs in China's market.

First, with the concept of open development, the new policies focus on relaxing restrictions on FIEs' market access in the sectors of services, manufacturing, mining, and infrastructure.

The new promises regarding the service industry is most noteworthy because, in comparison to the manufacturing sector, China's service industry is relatively slow to open up. As *20 Measures* suggests, the service industry shall focus on the "relaxation of restrictions" on foreign capital access by banking financial institutions, securities companies, securities investment fund management companies, futures companies, insurance institutions and insurance intermediaries. At the same time, it will "lift restrictions" of market access on foreign investment in such fields as accounting and auditing, architectural design, and rating services. In addition, the document calls for an "orderly opening" in the sectors of telecommunications, internet, culture, education, transportation and other fields (Article 2).

In the manufacturing industry, the document recommends "abolishing" foreign capital access restrictions in the following sectors: rail transportation equipment manufacturing, motorcycle manufacturing, fuel ethanol production, oil processing and others. For the mining industry, it will relax access restrictions on unconventional oil and gas including oil shale, oil sands and shale gas and mineral resources development. For oil and natural gas projects with foreign cooperation, the existing approval review system is to be replaced by the reporting or recording system (Article 3).

Second, as part of the response to the demand of foreign-invested enterprises, *20 Measures* puts forward a number of measures to support FIEs to participate in the national strategy and plan of "Made in China 2025," as well as to promote FIEs' in-depth integration into the plan of upgrading China's manufacturing industry. It states that FIEs are qualified to apply for funding from the National Science and Technology Program to support their R & D investment as equals to Chinese enterprises. With the support of "Made in China 2025," FIEs are encouraged to invest in high-end manufacturing, intelligent manufacturing, and green manufacturing, as well as industrial services such as industrial design and innovation, engineering consulting, modern logistics and inspection and certification. (Article 4 and 6). The new measures support FIEs to participate in the construction of infrastructure, including energy, transportation, water conservancy, environmental protection, and municipal public works and so on, in the form of franchising operations (Article 5).

Level a Playing Field

A highlight of *20 Measures* is the determination to broaden a fair competition business environment. As it states, FIEs, state-owned enterprises, and private enterprises are all important parts of Chinese economy, and as long as they are registered as China's enterprises, they should enjoy the same treatment.

Any new foreign investment policy, according to the document, should be reviewed to ensure fair competition among different types of enterprises, including FIEs, noting that all localities and departments shall not arbitrarily increase restrictions on foreign-invested enterprises (Article 8). The fair competition review is aimed to ensure the transparency, stability, predictability, and consistency of implementation of related policies. Particularly, uniform standards apply for domestic and foreign enterprises on matters including registration, business license examination, standard-setting, government procurement, access to financing channels and protection of intellectual property (Article 9, 11-14).

It is interesting to note that the new policy opens the financial market to foreign-invested enterprises. It emphasizes that FIEs can be listed equally on all public stock markets, issue corporate bonds, convertible bonds, and non-financial corporate debt financing instruments as domestic enterprises (Article 13).

Twenty Measures also encourages provincial and local governments to play a larger role in attracting foreign investment. For example, it allows local governments to introduce preferential policies to attract foreign investment with the aim to promote employment, economic development, and technological innovation (Article 15). The document grants more preferential policies to the provinces of the central and western regions and the northeastern region, for example, in terms of enterprise income tax and land transfer tax (Article 16 and 17).

Assessing Influence on FIEs in China

According to a report recently released by the United Nations Conference on Trade and Development, an extensive survey shows that China is still the world's second most popular investment destination. The survey, which was conducted by the American Chamber of Commerce in China, the European Chamber of Commerce in China, the Japan External Trade Organization and other relevant organizations, also shows that a large proportion of foreign-invested enterprises plan to expand investment in China.

However, China's prospect of attracting foreign capital faces challenges from different sources. Trade protectionism and populism are spreading widely while bringing considerable uncertainties. Clearly, China is facing double the pressure for attracting foreign capital: competition in low-income countries brings "diversion" effect to labour-intensive sectors and re-industrializing policies of advanced countries may cause the backflow of foreign investment. Further, China's position as the world's top three to attract foreign investment has been challenged internally by the rise of wage and manufacturing costs. The factors above combine to usher in the new measures of attracting foreign investment in further opening up.

Overall, if the new measures are enforced, market access to FIEs will be greatly improved, especially in sectors where foreign enterprises enjoy a competitive advantage. More opportunities of green field investment and M & A can be expected in manufacturing, infrastructure investment and equipment manufacturing, and services, especially financial services and professional services.

In response to the strong demand for foreign companies to participate in the Chinese market, China's current policy moves toward the application of national treatment, fair competition, and other internationally accepted principles. It is an encouraging and vital step to adopt the review mechanism of fair competition to ensure a level playground for FIEs in competition with state-owned enterprises on equal footing. It can be expected that market access improvement of foreign investment should not be limited to the free trade pilot zones established in Shanghai, Tianjin, Fujian, and Guangdong, but also applied to the country as a whole.

Cautious Optimism: The Key is in Implementation

Recently, China's powerful regulators, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), have made the latest efforts to improve FIEs market access by cutting down the list in the Catalog of Foreign Investment. For example, the 93 restrictive measures in the 2015 edition of the Catalog (including 19 items in encouraged category with limited share of ownership, 38 restricted items and 36 prohibited items) has been reduced to 62 items in the 2016 edition. This was encouraging progress, and undoubtedly the new *20 Measures* will continue opening the market for FIEs.

In recent years, China has been thinking about how to build a new open economy system under the new economic situation at home and abroad. It can be said that Chinese enterprises going global, engaging actively in regional free trade agreements, the Belt and Road Initiative (OBOR) and increases in attracting foreign investment are important elements of this new economic system in the making. The opening-up goals are set clearly, but implementation is key, requiring greater political commitment and institutional safeguards.

China, in recent years, has undergone great changes. The current policy emphasizes the party's leadership in state-owned enterprises. The anti-corruption movement has imposed strict restrictions and disciplines on officials at all levels and, because of fears of responsibility, many officials talk about reform and opening up, but actually do nothing. In strengthening the ideological management, leaders stress political security, which is believed to affect the atmosphere of public opinion.

The awareness of international financial risks is strong, though a cautious approach is justified to emerging economies like China when opening up their financial industries. Decision makers have proposed to conduct a pressure test in free trade pilot zones before coming to a specific timetable for opening financial sectors to foreign financial institutions. But if the risk is manageable, such a practice will be rolled out across the country.

Foreign-invested enterprises will watch how a specific implementation plan will be written and study the exact measures of new market access carefully. However, one thing is clear: China acknowledges the importance of creating a transparent and fair competition investment environment. Canadian enterprises will have more opportunities to secure a firm, equal, foothold in the Chinese market, particularly in the sectors of service, mining, manufacturing, infrastructure, and food processing.

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