



## New Catalogue for the Guidance of Foreign Investment Industries

The long awaited revisions to the *Catalogue for the Guidance of Foreign Investment Industries* (the “Catalogue”), was approved by the State Council, the National Development and Reform Commission and the Ministry of Commerce, taking effect December 1, 2007.

The Catalogue is a comprehensive booklet covering 478 industries, classifying them according to their importance in developing the national economy of China into three formal categories, 1) encouraged; 2) restricted; and 3) prohibited, and industries which do not fall into any of the three formal categories are considered to be “permitted”. The Catalogue attempts to direct foreign investment into targeted sectors by offering increased or decreased incentives and tax benefits, depending on the industry. The Catalogue was first published in 1995 and this is the 4th revision, the last one was in 2004. Compared to its 2004 counterpart, there is an increase of 94 encouraged, 9 restricted and 5 prohibited industries.

The new Catalogue answers the call from a series of government policies announced lately, for the main purpose of re-adjusting the macro-economy, restructuring the industries and efficiently utilizing foreign investment in China.

### I. Brief Overview of Major Changes

1. To further strengthen China’s efforts to open to the outside world, the Catalogue attempts to increase investment in upgrading China’s industries. For example, hi-tech, equipment and advanced materials manufacturing will all be encouraged but investment in traditional or mature manufacturing fields where China already possesses strong capabilities, will no longer be encouraged. Additionally, the Catalogue will carry out China’s promises made upon its entry into WTO by upgrading outsourcing and logistics to encouraged industries as well as reducing the number of restricted and prohibited industries.



2. The new Catalogue seeks to reduce consumption of natural resources and protect the environment. Foreign investment into pollution saving, recyclable or renewable energy industries will be encouraged. Conversely, investment in scarce and non-renewable mining resources which are deemed vital to the national economy, will at the discretion of the government, be restricted or prohibited to foreign investment.
3. In response to China's substantial international trade surplus and growing foreign currency reserves, the Catalogue along with relevant government policies, will no longer encourage exports and therefore foreign investment which produces goods solely for export will no longer be encouraged.
4. The west and central parts of China and the traditional industrial bases in the northeast continue to lag behind the eastern coastal areas. Therefore specific investment policy regarding these areas will no longer be covered by the Catalogue but rather contained in its sister document, *the Catalogue for the Guidance of Priority Industries for Foreign Investment in the Mid-West China*.
5. Economic security of the nation's economy is of highest concern for the Chinese government. Therefore, development of several sensitive industries involving national security and the nation's long-term strategy, such as the distribution of electrical power and telecommunications will be monitored very closely.

## II. Impact on Key Industries

### 1. Natural Resources

China is acutely aware of its rapidly diminishing natural resources and the increased burden to purchase these resources on the international markets. Therefore the Catalogue will no longer encourage foreigners to invest in mining or natural resource extraction. For instance, in the previous 2004 Catalogue, exploration and mining of scarce natural resources such as copper, lead, zinc, gold, sulfur and phosphates etc. were all included in the category of Encouraged Foreign Investment Industries. However the new Catalogue moves investment in these areas to restricted or prohibited.



Furthermore, the new Catalogue has moved exploration and mining of abundant minerals such as tin, antimony, molybdenum, barite and fluorite into the category of Prohibited Foreign Investment Industries, from the Restricted Foreign Investment Industries, where they were listed under the 2004 Catalogue. Although China is rich in resources such as tin, antimony, molybdenum and barite and for many years has been a net exporter, China is now more concerned about securing its resources. In general, the new Catalogue reflects China's increasing emphasis on safeguarding its natural resources.

## 2. Real Estate

The Real Estate market in China has been booming for many years and thus has become a target of the new Catalogue. Now, "the development and construction of ordinary residential houses" has been downgraded from "encouraged" as it was classified in the 2004 Catalogue, to "permitted" in the new one. Foreign invested second-market property dealer and broker have been moved to restricted category.

This shows a continuing commitment by the government to slow down the property market. In the summer of 2006, six Ministries and Commissions of the Central Government including the Ministry of Construction, the National Development and Reform Commission and the State Administration of Foreign Exchange jointly promulgated "Opinions Concerning Regulating the Access to and Administration of Foreign Investment in the Real Estate Market", which introduced many laws and taxes to control the market. Additional regulations regarding the restriction of foreign investment in China's real estate market have been consecutively promulgated by the Ministry of Commerce and major cities such as Shanghai and Beijing.

## 3. Manufacturing of Rail Transport Equipment

The new Catalogue further opens to foreigners the manufacturing industry of equipment used in rail transportation by classifying it as an encouraged industry. However, the forms of investment are restricted to equity or cooperative joint ventures. The encouraged investment includes R&D, design and manufacturing of the assembly and key components (traction-drive system, control system and braking system) for the trains used respectively in high-speed, passenger, intercity, mainline and metropolitan railway systems and affiliated equipment and services.



The Catalogue also adds “comprehensive repair services for the infrastructures of high-speed, passenger and intercity railway” into the encouraged category, provided that the majority shareholder of such investment project is a Chinese party.

#### 4. State Grid Opened to Foreign Investment

Along with the “2005 Guiding Catalogue of Industrial Structure Regulations”, promulgated by the National Development and Reform Committee, the new Catalogue will also restrict the conventional coal-fired power plants with capacities less than 300,000 kW and expressly encourage large-scale plants with capacity over 600,000 kW.

### III. Summary

The revised Catalogue is an attempt to increase or decrease the flow of foreign investment into certain industries according to the Chinese government’s macroeconomic plans. The re-classification of industries into different categories will directly affect the taxation and other incentives that an investment is eligible. For example, encouraged industries will enjoy tax free importation of equipment brought from abroad and VAT refunds on domestically manufactured equipment. Therefore, investors should examine how the new Catalogue may affect their investment (or proposed investment), to understand how it may be treated differently in the future.

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