

New Automotive Industry Policy Promises Rosy Prospects

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China has seen rapid and sustained growth in the automotive sales market in recent years. Prior to June 1 2004, the previous automobile industry policy was issued in 1994 (the 1994 Policy). In the intervening ten years, this policy came to be out of step with the changing times, and could no longer accommodate the rapid development of the PRC auto industry. The new Automotive Industry Development Policy (the New Policy) has been formulated to explain China's WTO commitments, the development of China's economy and aims to turn the auto industry into one of China's pillar industries. The New Policy's scope has been expanded when compared with the 1994 Policy, e.g., it includes affiliated or fringe industries. The New Policy includes both more restrictive and more liberal clauses, such as stipulating an automaker's aggravated liability in disclosing exhaust discharge standards to the public and, on the other hand, removing the special approval procedures for car sellers.

DEVELOPMENT ORIENTATION

Running to 13 chapters, the New Policy aims at keeping the auto industry in step with the pace of economic and social change, and aims at a policy based on sustainable development. The third chapter covers the use of technology and self-development of new technologies. Cars with small displacement are encouraged, as are new energy-saving technologies and energy sources. Automobiles may employ recycling materials and information technology as well.

Structural Adjustment

The New Policy stresses structural adjustments within the auto industry. Retirement mechanisms shall govern automakers that fail to maintain normal operations. "Shell transaction" modes (i.e., conducting mergers and acquisitions with the present "white elephant" automakers and feeding the purchaser's own assets into the shell to earn itself a position in the auto market) have been made use of by eager investors, and have contributed to a chaotic market situation. The authorities have found it necessary to put a curb on these practices, and in the New Policy have prohibited dormant companies from transferring their manufacturing licences to non-automakers. Meanwhile, the New Policy encourages automakers to develop into large auto manufacturing groups via asset restructurings.

Market Access Administration

An open and fair market should have a uniform access standard established with reference to the New Policy. The National Development and Reform Commission (NDRC) and the General Administration of Quality Supervision, Inspection and Quarantine may collectively issue notices on road auto manufacturers and products that are in compliance with the compulsory authentication standards and pass the compulsory authentication procedures. The products that fall in the abovementioned notices shall bear the PRC compulsory certification (3C) mark.

Sales Networks

The ninth chapter, a newly added chapter in the New Policy, sets out the operation of dealers' networks. The current measures for the administration of the approval of the right to sell automobiles will be abolished. Now, an auto sales company may conduct business within a business

scope approved by the relevant administration of industry and commerce. Further, automakers are encouraged to set up their own distribution networks and develop their own brand presences in the international market.

Regarding simultaneous distribution of domestic and imported cars, the New Policy is unclear. However, officials from the NDRC explain that a sales company may combine the distribution of domestic and imported cars together, as long as the automakers agree to this arrangement.

TRADEMARK ON PRODUCTS

In the 1994 Policy, there was no provision for trademark protection. The New Policy, however, devotes a chapter to trademarks and includes discussion of them in other sections. The government is keen on fostering the development of first class domestic enterprises across a range of industries, including automotives, and this entails brand protection and heightened public awareness of brand names.

Chapters Six and Seven mainly concern product research and development, and especially products bearing an enterprise's brand name. Certain branding strategies may be engaged to boost recognition. Automakers and other related manufacturers are required to register their own trademarks and service marks. From 2005, all domestically produced cars and assembly parts must bear their producers' registered trademark and names or geographical marks, unless the geographical marks have been contained in the trademarks. Trademarks and/or service marks of auto manufacturers must be displayed prominently by distributors at their sales premises.

INVESTMENT MANAGEMENT

The most significant change in investment management is an approval mode that can be considered more favourable to investors, in accordance with the newly promulgated PRC Administrative Licensing Law. According to the law, administrative licensing is not necessary if market mechanisms ensure a proper adjustment of competition (Article 13). Recordal with the NDRC or investment regulatory departments at the provincial level applies to automakers that are expanding their production, to auto parts businesses and to other qualified enterprises. Meanwhile, approval must be obtained when the newly established object company engages in the manufacture of automobiles, farm-use vehicles and vehicle engines or if an existing automaker manufactures whole vehicles in a different category. For those companies, all procedures must follow from the approval. Namely, the land management authority is not allowed to sanction land requisition; state-owned banks have no rights to grant loans; customs will not approve duty-free treatment; an IPO and listing is prohibited; the administration for industry and commerce will not accept applications for registration and the relevant state departments will not accept applications for access to the market. Division of approval decision making among different branches of the government depends on the type of product rather than on the investment contribution amount. All approvals for farm-use vehicles will be suspended until January 1 2006.

New investment is subject to restrictions, and different conditions apply to different types of automotive manufacturers. Total investment of no less than Rmb200 million is required for motorcycle manufacturers, and Rmb20 million is required for enterprises producing special purpose automobiles. A minimum of Rmb2 billion must be invested for new automotive manufacturing projects, of which Rmb800 million must be self-owned capital. Such a project must include a product research and development organization with an investment of no less than Rmb500 million. The project must also include a product research and development organization with an investment of no less than Rmb500 million.

The New Policy follows the 1994 Policy, with limitations continuing on the equity interests that can be held by the foreign party in a vehicle assembly joint venture. Foreign equity is capped at a maximum of 50%. Foreign components manufacturers in joint ventures are not subject to this 50% limitation. As for a listed vehicle assembly joint venture, the total share proportion of all foreign investors shall be less than the stake of the controlling Chinese shareholders. A single foreign investor can invest in two vehicle assembly joint ventures; the 1994 Policy limited foreign investors to a single investment. Different entities with a controlling relationship shall be deemed as the same foreign investor for the purpose of these provisions. There is an exception to this limitation in that a foreign investor may, together with its Chinese partner, merge with domestic auto manufacturers. Projects geared to export and located in export processing zones are free from these restrictions upon special endorsement from the State Council. The 1994 Policy gives four additional requirements for foreign investors; the New Policy shows no sign of these requirements, thus indicating that the domestic market is more open to foreign enterprises.

AUTOMOTIVE LOANS

With a relatively low initial investment, a consumer can buy a car via auto loans. This consumption mode has found its way into the New Policy. In the wake of auto finance liberalization measures, some supporting facilities have been built to foster their implementation. The latest action by the China Banking Regulatory Commission (CBRC) is the Administration of Auto Loans Procedures, providing that the maximum ratio of the automobile loan to its price is 80%.

The New Policy allows applying for automobile loans with the purchased car mortgaged to banks or other qualified non-bank finance institutions. According to the current common practice, the deal should be guaranteed by the distributor, and simultaneously mortgage registration be made against the object car. The simplified formalities result in greater liability for the lender, especially that the mortgagee will run more risks without the agencies' involvement. Another development in the auto market recently is the appearance of auto finance companies; the New Policy offers scope for their further development. Rules and implementing measures regulating this type of company have been promulgated. SAIC GM Auto Finance Co., the first auto financing company approved by the CBRC for operation, was granted the capability of engaging in auto credit loans and other relevant business. An increasing number of automakers are expected to share the market, and more auto transactions by means of credit loans will arise.

The potential development of the secondhand auto market has also gained attention. The New Policy requires stipulating detailed regulations concerning secondhand car transactions. The parties on a voluntary basis may employ a qualified agency to appraise the value of a vehicle. As to auto distributors, liability is enhanced, in that they should provide true and accurate information that the purchased car carries a registration certificate, a driving licence and effective annual review certification. Ownership transfer is requisite in the course of auto transactions, and is recorded in the registration certificate, with evidence of all the prior ownership titles. Those who will benefit most from the policies are auto consumers. More transparency paves the way for their purchase and less risk secures the transaction.

WTO COMMITMENTS

Since China's entry into the WTO, revisions to regulations governing trade in automobiles and related products have been underway. To be more precise, the decrease on average tariffs has accelerated. Further measures remain to be taken that will abolish import quotas by 2005, reduce the average tariff on whole autos to import quotas by 2005, reduce the average tariff on whole

autos to 25%, on parts and components to 10%, and a general trade policy that makes no biases for or against local and imported cars at any stage. WTO commitments have spurred China to adjust its internal guidelines on the auto market and the adjustments reflect the eleventh chapter on 'Import Management' of the New Policy.

In line with the New Policy, no ports that handle imports can take up bonded storage and display businesses for imported cars. Previously, foreign companies imported cars in bulk and stored them in a holding area, thus only paying tax as the cars were sold. Obviously, the new stipulation deprives the bonded areas of some bonding functions and ends in the import duty being imposed as soon as imported cars arrive in China.

Moreover, market practice has been that most auto joint venture assembly operations use spare parts because this shortcut cuts down on production time and expense. This practice harms domestic enterprises in their technical research and development efforts and in establishing their own brands. The New Policy, however, regards any assembly as whole car manufacture from a tax viewpoint. The requirement meets China's WTO commitments and fills tax loopholes that allowed importing spare parts only and then using them for complete automobile assembly. Currently, the tariffs on imported cars are 30-38%, while the tariffs on parts range from 10-23%.

CONCLUSION

As an industry guideline, the New Policy provides a general view for the rational development of the industry. At the same time, many detailed rules and regulations have yet to be issued. Relevant government departments are liable for drawing-up the necessary additional regulations. Automakers shall take these stipulations into account when making future plans. It is predicated that more big companies in the auto industry will arise as cooperation and further development lead to more Sino-foreign joint ventures. All parties concerned will definitely benefit from the New Policy.

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