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Brief Analysis of the Revision of the Catalogue of Priority Industries for Foreign Investment in Central and Western China (2013)

By David Yu and Sam Feng

In May 2013, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly promulgated the revised *Catalogue for Foreign Investment in the Dominant Industries of the Central and Western Regions* (国家发展和改革委员会、商务部中西部地区外商投资优势产业目录). Effective as of 1 June 2013, the Catalogue replaces the 2008 version.

Identifying Priority Industries

On 16 June 2000, the first Catalogue was released and listed priority industries of 20 provinces (including autonomous regions and cities) located in central and western China (central-western region). To encourage foreign investment in these areas, the Catalogue provides foreign-invested projects that meet certain thresholds with preferential policies.

The Catalogue played a positive role in expanding foreign investment, enhancing investment quality and optimising industrial structure. The Catalogue has been revised in 2004 and 2008 in order to further open the central-western region, to adapt to domestic and international economic changes and to balance development of the central-western region with coastal areas in eastern China.

Since 2011, the impact of the global financial crisis has meant China's economic growth has slowed down, resulting in a decrease in foreign investment, especially in the central-western region. Statistics from MOFCOM show that from January to April 2013, a total of 6,687 new foreign-invested enterprises were established in China, representing a 4.69% fall compared with the same period in 2012. Given the current economic environment, it was necessary to revise the Catalogue so as to further open the central-western region to foreign investment, optimise and upgrade industrial structures, conserve natural resources, protect the environment and discourage blind investments to reduce excess

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production in certain industries. Before the new Catalogue, the national-level *Foreign Investment Industrial Guidance Catalogue* (外商投资产业指导目录) was revised in 2011, primarily with the purpose of accelerating the transformation of economic development by focusing on China's domestic development and the accumulation of foreign investments. This included optimising the structure of foreign capital in China, promoting technology innovation and upgrading industrial structure.

This is why the NDRC and MOFCOM jointly issued the third revision of the Catalogue in May 2013, to better accommodate the 2011 revision of the Foreign Investment Industrial Guidance Catalogue. The new Catalogue is designed to implement China's 12th Five-year Plan, which requires adopting China's differentiated and industry-oriented development policy in order to enhance economic development in the central and western region.

Key Changes

The Catalogue has a total of 500 categories, adding 173 more to the previous Catalogue. The amended Catalogue emphasises that to encourage industries, it is necessary to adopt specific measures to meet the local situation and to improve industry quality and structure. The revised Catalogue further provides that it is advantageous to develop an overall plan for improving efficiency of investment, promoting industrial upgrading and minimising excess production capacity.

Preferential Policies

In addition to traditional manufacturing industries, new encouraged industries primarily include emerging industries and service businesses. For example, solar power generation equipment and parts manufacturing projects are encouraged in Ningxia province. Wholesale general merchandise projects are encouraged in Shanxi province. In Heilongjiang province, animation projects, manufacture and derivative development are encouraged. Shanxi province is asking for more foreign investment for projects developing next generation information systems and applications, including cloud computing, the Internet of Things and mobile internet. A new preferential policy also covers investment in elderly care services, broadband internet services and telecom value-added services. In addition, industries like manufacturing of whole-automobiles and special purpose vehicles have been re-listed as encouraged in the Catalogue, despite their previous removal from the national-level Investment Catalogue.

Agriculture

The majority of added provinces in the Catalogue encourages foreign investments in farming and processing of plantation and farmed animals. Compared with the previous Catalogue, the revised Catalogue includes more encouraged projects in agriculture industries and the agriculture-related field in the central-western region. This signifies the government's support of the agriculture industry as well as the entry of foreign investment. Newly encouraged projects include planting of grain crops, potatoes and the development of relevant products in Shanxi province like the planting and processing of navel orange, ramie, bamboo, Chinese yam, lotus and pueraria. In Jiangxi province, farming of pigs, cows, sheep and smaller meat animals, in Henan province the comprehensive utilisation of by-products and the processing of sweet potatoes and non-grain plants in Sichuan province are encouraged.

Provincial Needs

The Catalogue takes into account the development planning and industrial structure of provinces in the central-western region and differentiated policies were given to encourage individual projects. Provinces with abundant natural resources regard exploitation of these resources as their key encouraged projects. For example, Inner Mongolia autonomous region encourages foreign investment in processing copper, lead, zinc and magnesium, while Guangxi Zhuangzu autonomous region regards processing of zinc, tin, antimony and manganese as encouraged projects. Other provinces based their choices of encouraged industries on their own features and requirements of industrial structure. For example, Jiangxi province encourages the development and production of art ceramics and domestic ceramic, while Liaoning province encourages foreign investments in pilot training and aeronautic clubs.

Raising the Bar

To prevent over-concentration of foreign investment in the central-western region, which might bring homogenisation and too much competition, the thresholds for popular encouraged projects were raised in the Catalogue. Taking the automobile parts manufacturing industry as an example, the previous Catalogue encouraged manufacturing of parts which involves relatively simple techniques, while the amended Catalogue encourages the manufacture of parts which involve more advanced technology. Raising the bar in popular industries plays a positive role in reducing excessive production in certain industries.

Labour-intensive Industries

Considering the advantage of the central-western region in labour resources, the Catalogue particularly encourages foreign investment in labour-intensive traditional manufacturing industries which have adequate foundation and have been playing a leading role in local economic development. For instance, Sichuan province encourages projects relating to high-end home electrical appliances such as LCD TVs, digital TVs, energy-efficient refrigerators and smart washing machines. Anhui province encourages foreign investment in distributed control system projects for major technological equipments such as large metallurgical equipment sets.

High-energy Industries

To achieve sustainable development in the central-western region, projects which create severe environmental pollution or involve high consumption of energy, material and natural resources have been removed from the Catalogue.

Obstacles to Foreign Investors

Although it is undisputed that the Catalogue represents a step forward in attracting foreign investment in the central-western region, there are still some practical difficulties that foreign investors may encounter. Compared with the more developed eastern coastal cities, the central-western region lacks infrastructure, the socialist market economy system lacks maturity and economic foundation. Apart from these practical constraints, foreign investors are advised to pay more attention to non-market activities, structural limitations and more stringent government control in the central-western region, which include:

- Local governmental authorities tend to exercise rigid administrative intervention and adopt complicated approval procedures for projects. Local authorities have also relatively low efficiency and neglect to exercise law-based administration. Foreign investors may sustain considerable operation costs from interventions by the local government.

- Local governmental authorities have a complicated bureaucratic structure but vague hierarchical division in the administration of economic activities. Also, the allocation of duties and responsibilities is blurred and mixed between different authorities. This often results in finger-pointing and wrangling among local authorities, resulting in great operation difficulties.

- State-owned enterprises have rigid control and liability mechanism, hindering their ability to carry out great varieties of economic or technological cooperation with foreign enterprises. This heavily limits state-owned enterprises' function of working with foreign investors in the central-western region.

- Many enterprise officers have inadequate experience in corporate management as required by the international customary standard. As most enterprises in the central-western region follow the traditional management style of state-owned enterprises, decisions are heavily influenced by objective factors, creating substantial operation difficulties to foreign-invested enterprises.

New Opportunities

The Catalogue creates new business opportunities for foreign investors. Taking the automobile industry as an example, manufacture of whole-automobiles is restored, despite being removed from the national-level Catalogue from June 2011, which sought to reduce China's excess capacity of automobile manufacture, ending the seven-year preferential treatment of overseas automobile enterprises. In the past few years, due to the increased restrictions in the purchasing and use of automobiles in bigger cities, automobile enterprises have started to target smaller and developing cities. Tier two and three cities in the central-western region have gradually become the new growth points for the automobile industry. To adapt to this change, the Catalogue reintroduced whole-automobile manufacturing as an encouraged industry, bringing new opportunities to car markers planning to increase production.

In fact, just before the release of the Catalogue, many foreign manufacturers such as Volkswagen, GM and Ford, announced the plan to expand production in China and many targeted the central-western region. As a rough estimation, from late 2012 to mid 2015, automobile production capability in the central-western region has reached the production scale of more than a million automobiles and several hundred thousand engines. As such, these popular automobile manufacturers adjusted their investment according to the changing policies. Leveraging their advantages in resources, labour cost, preferential taxation policies and government subsidies in the central-western region, they have accelerated their expansion plans in China. Their strategy of making key investments and building factories in the central-western region has proved to be a successful model worthwhile for foreign investors to follow.

The Catalogue was issued in response to the new economic situation and is aligned with the national-level Catalogue, aiming at attracting foreign capital in the central-western region. Also, the Catalogue puts great emphasis on sustainable development, encourages investment in new industries and service businesses, and adopts varied policies in accordance with the different characteristics and advantages of provinces to avoid over-competition and over-concentration. Moreover, some industries traditionally considered to be part of the state-owned monopoly have also been included in the Catalogue, like medical treatment, elderly care, broadband internet and value-added telecommunication services. Further, reintroducing whole-automobile manufacturing has into the catalogue as an encouraged industry is a big move.

The Catalogue positively encourages foreign investment in the central-western region. As a result, foreign investors should broaden their perspective, adjust to the new policies, abandon stereotypes and pay more attention to new industries in the central-western region, as well as energy-efficient and environmental protection industries. However, investors need to take note of various practical constraints in making investment decisions in the central-western region.

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