Pursuing the private sector

The new opinions from the State Council encouraging private sector investment allow foreigners to participate, especially if they can offer new technologies, but detailed implementation rules are lacking

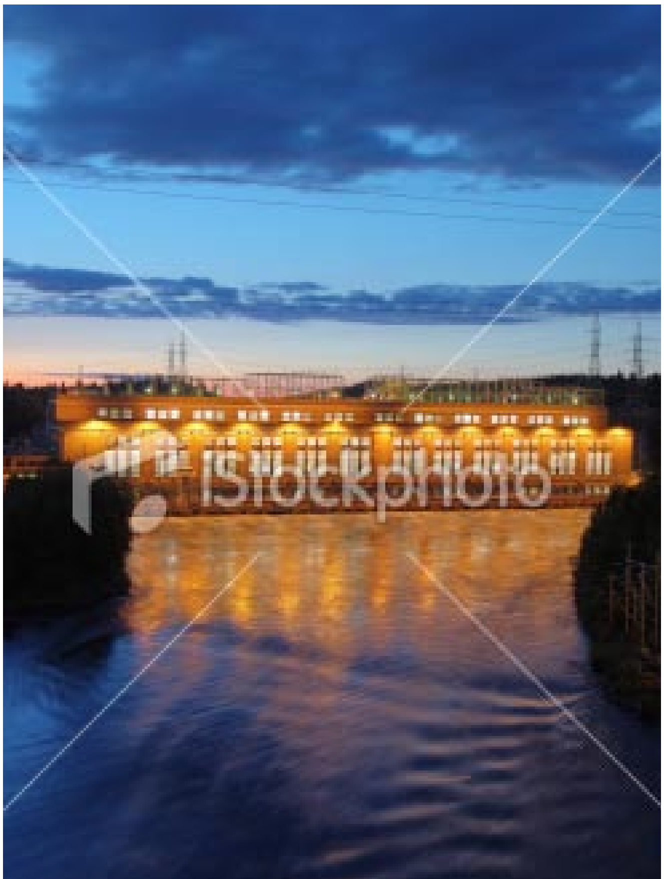
The State Council's issue of its *Opinions on Encouraging and Guiding the Healthy Development of the Investment from the Private Sector* (国务院关于鼓励和引导民间投资健康发展的若干意见) on May 13 2010 (the New 36 Opinions) widens the door for the private sector to participate in the economy's development.

The Chinese government has never given up efforts to stimulate the development of its private sectors since China's accession to the World Trade Organisation (WTO) in 2001. On July 16 2004, the State Council issued its *Decision on Reforming the Investment System* (国务院关于投资体制改革的决定)(the Decision). One of the purposes of the Decision was to encourage investments from the private sector (private investments) and to provide greater financing options for the private sector. Following the Decision, the *Several Opinions of the State Council on Encouraging, Supporting and Guiding the Development of Individual and Private Economy and Other Non-Public Sectors of the Economy* (国务院关于鼓励支持和引导个体私营等非公有制经济发展的若干意见)(the Old 36 Opinions) were promulgated on February 19 2005, which were applicable to investments by all the non-state-owned sectors including the private sector and foreign investors. The principle of equal treatment to foreign-invested enterprises (FIEs) and domestic enterprises was first set out in the Old 36 Opinions. The implementation of the Old 36 Opinions was incomplete in practice due to the lack of detailed rules from the relevant authorities.

The New 36 Opinions:

- Expressly encourages (not limited to "allow" as in the Old 36 Opinions) private investments. The Old 36 Opinions merely "allowed" them;
- Encourages and guides private investments to access those industries and areas where the private investments have not been excluded expressly by the law and regulations;
- Lists more specific industries and areas open to the private sector, such as the construction of roads, airports, railways, ports and intercity rail transit systems, and accession models therein, including, but not limited to sole proprietorship, majority holding and share participation;
- Opens new industries to the private sector, such as the health-care services; and
- Is limited to private investments.

The Old 36 Opinions was applicable to all non-state-owned economies, but the New 36 Opinions seems to exclude foreign investment due to the April 2010 issue of *Several Opinions of the State Council on Further Utilising Foreign Capital* (国务院关于进一步做好利用外资工作的若干意). Despite this seemingly overt exclusion, foreign investment opportunities can still be found by comparing the New 36 Opinions with the policies and laws of foreign investments.



Public Private Partnerships in public utilities are favoured

Less industrial restrictions on private investment than foreign investment

FIEs have been enjoying super-national treatment in most aspects of their operations since the opening of China in 1978. This brought about many complaints from domestic enterprises, especially those in the private sector. This preferential treatment has been in decline since the issue of the Old 36 Opinions and the implementation of the new *PRC Enterprise Income Tax Law* (中华人民共和国企业所得税法) that was uniformly applied to all enterprises in China, no matter whether it was a state-owned enterprise (SOE), or a private or foreign-invested enterprise. However, the dual administration system in China for domestic enterprises and FIEs continually gives preferential treatment to the latter.

The New 36 Opinions aims for greater fairness and better treatment in the industrial accession to the private sector. The following chart lists and compares the selected industries where private investments are restricted less than foreign investments:

Industries	Investment Resources	Private Investment Restrictions	Foreign Investments
Communication & transportation	Construction of grid of national trunk railways	No restrictions	Chinese partner shall hold the majority of shares (China Majority)
	Construction of grid of feeder railways and ferry facilities	No restrictions	limited to equity joint ventures (EJV) or contractual joint ventures (CJV)
	Construction of civil airports	No restrictions	China Majority
	General aviation companies for agriculture, forest and fishery	No Restrictions	EJV or CJV
	Intercity rail transmit	Construction (Share participation)	Comprehensive maintenance of intercity rail transmit(China Majority)
Energy	Production of biology liquid fuel (fuel ethanol, bio-diesel)	No restrictions	China Majority
Mining	Exploration and development of resources	No restrictions	Some minerals such as tungsten, molyb-denum, tin, antimony, fluorite, rare earth and radioactive minerals are pro-hibited. Most of the others are limited to EJV or CJV or China partners holding majority
Public Utilities	Construction and management of fuel gas in big city, heating power and water supply and sewage networks	No restrictions	China Majority
	Construction and management of metro and city light rail	No restrictions	China Majority
Heath care service	Hospital	No restrictions	EJV or CJV
Education	Common high school education	No restrictions	EJV or CJV
	Institution of com-pulsory education	No restrictions	prohibited

Note: this comparison is based on the New 36 Opinions and the National Development and Reform Commission and Ministry of Commerce, Foreign Investment Industrial Guidance Catalogue (Amended in 2007)) (国家发展和改革委员会、商务部外商投资产业指导目录 (2007年修订)) (the Catalogue).

By comparison, the private sector is treated more favourably than the foreign investors in the above industries. However, fewer restrictions to private investments does not mean that the foreign investments can not benefit from the New 36 Opinions.

Opportunities for foreign investors

Foreign investors must grasp the opportunities available to enable them to expand their operations in China and benefit from the encouraging policies for the private sector in the New 36 Opinions.

Currently, foreign investors can operate in China through wholly-owned foreign enterprises, EJV,s CJVs, qualified foreign institutional investors (QFIIs), branches, partnerships and representative offices. Which model should be taken in a specific project depends on the guidance contained in the Catalogue. If the foreign investors desire to cross the barriers in the Catalogue and participate in the industries outlined in the chart above, they may need to consider other available options.

Firstly, the cooperation with private enterprise in China needs to be built up in a suitable form which enables foreign investors to be indirectly (at present) and directly (in the future) involved in that industry. This requires that foreign investors collect more information about private enterprises, especially those major local enterprises, as target companies for cooperation.

Secondly, they may establish a financing guarantee company (FGC) by themselves or jointly with local private enterprises. An FGC can provide guarantees for the financing of enterprises in the private sector whose business scope covers one or more industries in the New 36 Opinions. The foreign investors may realise indirect participation in the relevant industries through this arrangement.

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Thirdly, private equity (PE) may be another choice for foreign investors to consider. Although China has not issued any regulations on PE in Rmb by foreign investors (FPE), the issue of the *China Partnership Law* (中华人民共和国合伙企业法) in 2006 and the *Measures for the Administration of the Establishment of Partnerships in China by Foreign Enterprises or Individuals* (外国企业或者个人在中国境内设立合伙企业管理办法) in 2009 provide the theoretical possibility for the establishment of FPE. Moreover, local governments, such as Beijing, Shanghai and Tianjin have proceeded further in promoting the FPE in their respective jurisdictions since the beginning of 2009. The rules issued by the local governments above are silent about whether FPE is subject to the Catalogue. Before the promulgation of the unified rules by the State Council or its components, it should be noted that there are some uncertainty and risks requiring the balance of the foreign investors in their operation.

Besides the above, foreign investors also face the following opportunities as the private sectors develop and flourish:

Construction and operation of public utilities through Public Private Partnerships (PPPs)

The New 36 Opinions states that the PPPs system for the public utilities will be established completely. This expression is used by the State Council for the first time to indicate its positive attitude on PPPs in the public utilities areas. The law or regulation on the PPPs is expected to be formulated in the near future, when the foreign investors can find the legal basis at a higher level for its involvement in the infrastructures by PPPs. The practical option for the foreign investors in the PPPs is to cooperate with the local partners or through their shell companies in Hong Kong.

The most innovative points in the New 36 Opinions are those encouraging the development of the new emerging industries

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Low carbon economy and technology upgrade

To enjoy encouragement from the government, the private sector needs new technologies from foreign investors. The most innovative points in the New 36 Opinions are those encouraging the development of the new emerging industries, such as recycling, green tech, energy saving and emission reduction, water saving and consumption reduction, bio-pharmaceutical, information networks, new energy, new material, and environmental protection. There is no doubt that China lacks the technologies and talents in these emerging industries. The United States has grasped the preemptive opportunities to export their technologies in the energy fields through President Obama's visit in 2009 and the Secretary Hilary Clinton's most recent efforts in the Sino-US strategic and economic dialogue. Although other economic entities, such as the EU, are following the US closely, it is believed that the enterprises from the US will benefit a lot from the active involvement of the private sector in the emerging industries in the near future.

Recently, the requirements for the elimination of outdated capacity and technology upgrades have been enhanced by the State Council. Local governmental leaders and enterprise managers have more pressure to eliminate outdated capacity by technology upgrades. In this regard, the SOEs and private enterprises will also seek assistance from foreign investors.

Opportunities in the overseas investment of Chinese private sectors

Considering its huge foreign exchange reserve, the Chinese government expects private enterprises to actively seek investment opportunities overseas. China has noted the issues caused by the SOEs in their global acquisitions and investments, especially in the resources and energy industries. In order to mitigate the hostilities of foreign countries to the China's investments, China is now encouraging the private sector to invest overseas independently or jointly with SOEs. The government will make efforts to create favourable environments for those outbound investments, such as the execution of bilateral agreements on investment protection and inter-governmental consultation, and support in financing, foreign exchange and insurance. This encouragement additionally creates opportunity for foreign enterprises to utilise Chinese funds after the credit crisis. In the energy, mining and resource industries, it also can open a door for their products to enter and occupy the vast market in China.

Conclusion

In the New 36 Opinions, the determination of the State Council to support the development of the private sector is evident. Under China's current economic situation, the government urgently needs the private sector to invest their funds with the purpose of creating a sustainable and healthy economic increase. The New 36 Opinions needs greater detailed rules from the relevant authorities regarding their implementation. In this process, foreign investors may be closely involved in the development of the private sector through their new technologies. The foreign investors who hold the technologies and resources China needs certainly have a bright future.

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