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The Chinese foreign investment regulatory environment and what it means for your Pacific business

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Key Points

- China's Overseas Foreign Direct Investment (**OFDI**) will continue to play a part in its overall strategy for economic development.
- China's recent regulatory reforms will improve efficiency for OFDI transactions and could drive smaller investments from a more diverse range of investors
- There is growing momentum for Chinese-Pacific business engagement in the private Chinese SME investor space.

Introduction

China's outbound investment has been gradually increasing and in 2014 China's Overseas Foreign Direct Investment skyrocketed to US $120 billion, rising 10% from 2013.[1] China's foreign investment policies and regulatory regime influences China's inbound and outbound foreign investment levels. There are several impending and recent policy changes including the implementation of China's 13th Five Year Plan (due in 2016) and the relaxation of the foreign investment approval regime (over the last two years) which will have the cumulative effect of further promoting China's investment levels.

Although its OFDI is currently focussed toward the US, UK and Australia,[2] in 2010 over $106 million of Chinese foreign investment was directed to Pacific Island countries.[3] This coupled with the recent interest by Shenzhen companies during the 2015 *Pacific Islands (Shenzen) Investment and Trade Promotion Forum* (**Trade Forum**), [4] demonstrates a growing (and continued) interest by Chinese investors in the Pacific region.

To understand what drives China's foreign investment policies and the opportunities for Pacific businesses it is necessary to understand China's key policy documents and its regulatory framework.

China's "go-global strategy" and the Five Year Plans

Every five years China releases a new *National Economic and Social Development Five Year Plan*, a roadmap for China's economic development which guides regulators and policy decisions.[5] The Five Year Plan sets government's priorities and uses targets to ensure that China meets its social and economic goals.[6] For example the 12th Five Year Plan (from 2011-2015) emphasised “higher economic growth”, setting an annual GDP target of 7 percent for the five years from 2011.[7]

Since the early 2000 period China has actively encouraged OFDI. Beginning with the inclusion of the “go-global” strategy in its 10th Five Year Plan, China has pursued a programme of gradually reforming its OFDI and foreign exchange approvals system.[8] Since the 10th Five Year Plan, the “go-global” strategy has been a prominent feature of China’s external economic policy and in each subsequent Five Year Plan.

Priority areas of investment are outlined in each Five Year Plan. With the 12th Five Year Plan expiring in 2015, China is well into the process of developing its 13th Five Year Plan, with a view to the period of 2016-2020. Preliminary meetings indicate that it will largely reflect the priority areas identified in the 12th Five year Plan, with the aim to deepen the level of reform. China also intends to double its gross domestic product and average income by 2020 from 2010 levels.[9] The “go-global” strategy is likely to continue to play an integral part in achieving these development goals in the wake of a “structural slowdown” in China”.[10]

A draft version of the 13th Five Year Plan is due to be handed down in October this year with the final report expected to be released in March 2016.[11] As a critical policy document the direction of China’s future OFDI trends will be heavily reliant on the next iteration of its Five Year Plan.

China’s foreign investment approvals process

Previously, a myriad of provincial and central government filings and approvals were required for OFDI transactions through several Chinese government authorities, most notably, the National Development Reform Commission (NDRC) (and its provincial level regulators the Development Reform Commissions (DRCs), the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE).

However in the last two years China has made some unprecedented changes in an attempt to simplify and streamline the foreign investment approvals process. Broadly speaking, the reforms have progressed from a pre-approval requirement to simply a filing obligation in many instances. For OFDI, the State Council and the NDRC have liberalised the approvals process.[12] The effect reforms have increased the thresholds for NDRC approval so that now only investments above $2 billion or those which involve ‘sensitive countries’ require NDRC approval and those investments which involve an amount less than $300 million usually only require filing with local authorities.[13]

This gradual relaxation of China’s OFDI approvals process will enable China to better execute its “go-global” strategy and will have the desired consequence of stimulating OFDI. Similarly the simplification of the regulatory approvals process will mean greater efficiency for Chinese companies wishing to invest abroad and it is arguable that the increased thresholds for foreign investment requiring approval will drive smaller investments from a more diversified body of Chinese investors.

In the context of any transaction involving a Chinese counterparty it is important to understand the outbound regulatory approval regime and how this may affect the timing and execution of transactions. Similarly, in future as more Chinese companies look to go abroad, purchaser due diligence will become a greater imperative for counterparties.

Inbound Investment and China’s foreign investment Catalogue

The *Catalogue for the Guidance of Foreign Investment Industries* (Catalogue) outlines the ‘encouraged’, ‘restricted’ and ‘prohibited’ industries for foreign direct investment into China. Earlier this year the Chinese government released the sixth revision of the Catalogue, which has been one of the most significant revisions of the Catalogue in the last two decades, having reduced the amount of ‘restricted’ investments from 70 down to 38.[14]

From a Pacific perspective, the latest Catalogue which came into effect on the 10th April 2015, has an emphasis on agricultural products as well as energy and resources (amongst other things) coffee, palm oil and the exploitation of petroleum and natural gas.[15] Although the Catalogue concerns inbound foreign investment, through examining the Catalogue in a broader policy context it is possible to see the areas of focus for China's domestic growth. Organisations with complementary businesses and supply chains may increasingly be an area of focus for China-Pacific business-to-business exchange.

What does this mean for your Pacific Business?

Over the next decade it is predicted that China will spend US $1.25 trillion in ODFI.[16] OFDI has the potential to stimulate domestic growth through the injection of foreign capital. In regions like the Pacific this is important as countries look to move away from a reliance on foreign aid and concessional loans to growth motivated through private investor participation in local economies.[17]

China has had a long trading history with the Pacific region. More recently, there have been several high profile acquisitions by Chinese state owned enterprises (**SOEs**) in the Pacific region, perhaps most notably the Ramu mine in Papua New Guinea by the China Metallurgical Group, China's largest greenfield mining investment abroad, the project estimated to be worth approximately $2.1 billion.[18] Other investments include the $40 million acquisition by the ZhongRun International Mining Company of a stake in Vatukoula Gold Mines in Fiji as well as several other large-scale infrastructure projects across the Pacific.[19]

However there is growing momentum for Chinese investment in the Pacific not just by China's SOEs but also private Chinese SME investors interested in doing business in the region. This is demonstrated by the 150 Shenzhen companies who participated at the Trade Forum earlier in April this year.[20] During the Trade Forum the Ambassadors of several Pacific countries including Samoa, Federated States of Micronesia, Papua New Guinea (PNG) and Vanuatu, expressed interest in partnering with Chinese businesses. Areas of interest ranged from agriculture, fishing and renewable energy in Samoa, to oil, gas and mining in PNG.[21]

Similarly, tourism and hospitality are industries with potential to expand with direct flights between China and Pacific Islands under consideration which would have the potential of greatly extending the reaches of the Pacific's beaches to Chinese tourists.[22]

Chinese investment in the Pacific will present new opportunities for business engagement between China and the Pacific. Understanding the Chinese policy framework to appreciate the key industries and sectors which are being targeted by China to improve its overall development as well as the regulatory approvals process in China and how this can impact on commercial transactions are crucial considerations when positioning your business for Chinese investment.

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