China reemphasizes a broader opening-up and high-quality focus

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Ever since the launch of China's initial "opening-up" policy at the end of 1970s, China has experienced explosive growth over the decades, making it one of the world's most attractive investment destinations. China's economic growth has created continuous and promising business opportunities with sizeable market for foreign investors; and in return, China has been benefited from capital's driving force for the industrial upgrading, economic transformation and solid employment rates.

This newsletter highlights the key aspects of foreign investment outlook in China and provides our observations.

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Upon the tone set in the "Two Sessions" held in March 2023, economic recovery is placed as one of the key tasks of the new leadership for the state government. New Premier Li Qiang made the remarks at his first press conference[2], reiterating China's steadfast commitment to deepening reform and opening-up.

Note:

1. 2023 Report on the Work of the Government, http://www.gov.cn/zhuanti/2023lhzfgzbg/index.htm
2. Premier Li Qiang Meets the Press: Full Transcript of Questions and Answers https://www.mfa.gov.cn/eng/zxxx_662805/202303/t20230314_11040394.html

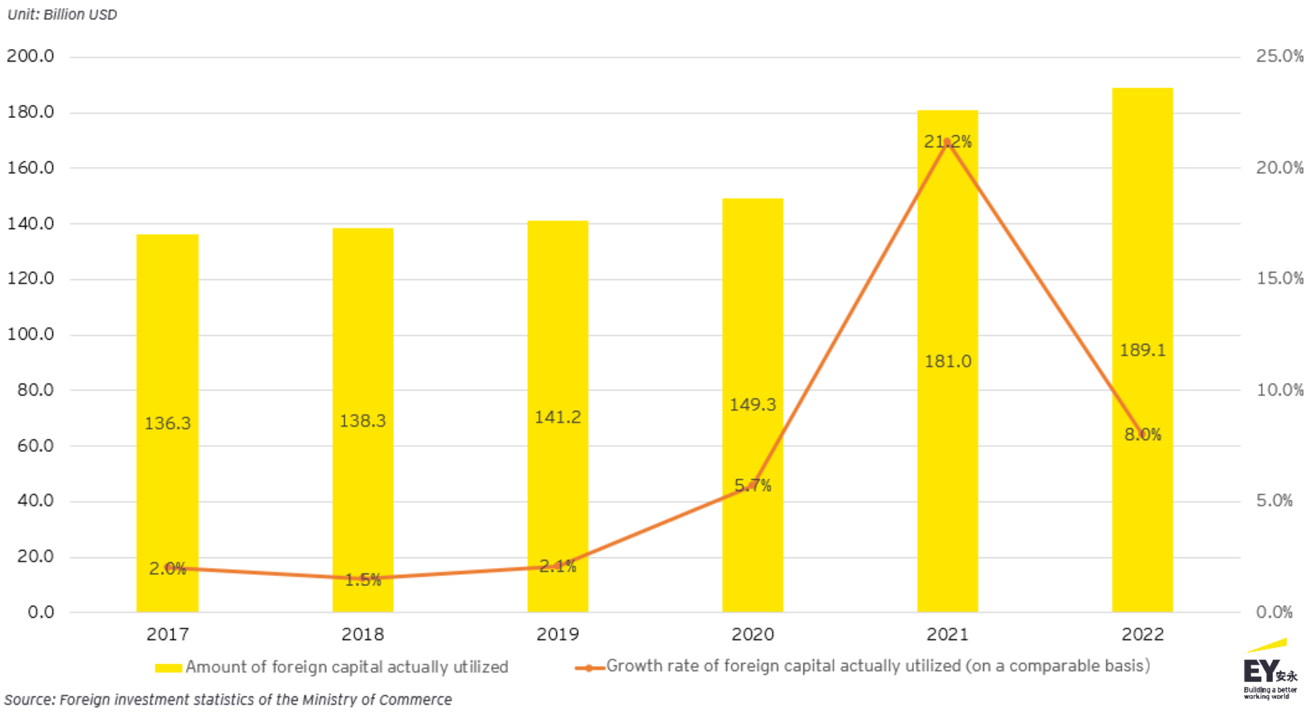
Two Sessions is a key event on China's political calendar held annually (normally in March). It serves as an important window to look into and analyze China's development. The economic growth target has always been a focus of attention, both domestically and abroad. This year's National People's Congress (NPC) session has also elected the new leadership of China government led by President Xi and the new Premier Minister Li Qiang.

China government has sent a clear signal that it focuses on boosting confidence and open further to foreign players. New Premier Li has also voiced support for economic reforms. During his tenure in Shanghai, he has chaired many foreign investment conferences and demonstrated a pro-business and pragmatic work style.

FDI in China continues to grow

In 2021, the actual use of FDI (Foreign direct investment) in China hit a record high of USD180.96 billion, with a growth rate of 21.2%. 48,000 foreign invested enterprises (FIEs) were newly established, a year-on-year increase of 23.5%[3]. In 2022, under the heavy hit of the pandemic, the China FDI number still maintained strong which climbed to USD189.13 billion.

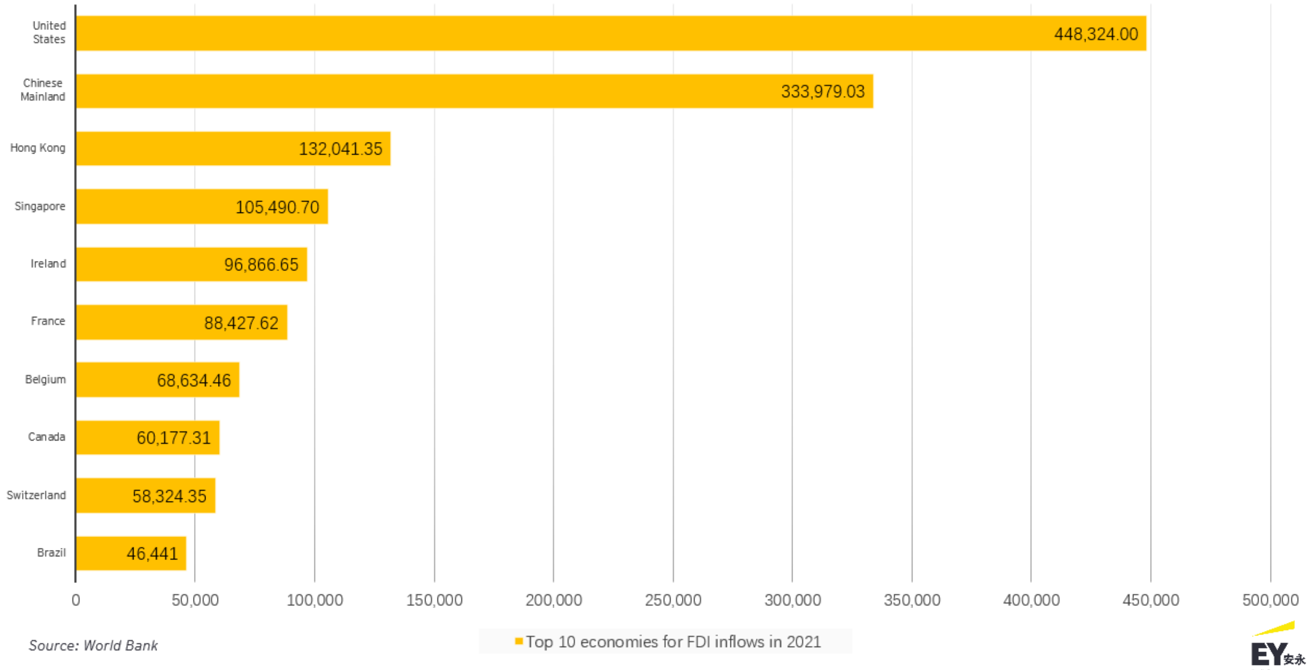
FDI in China during 2017-2022



Note:
3. http://wzs.mofcom.gov.cn/article/ztxx/202301/20230103377273.shtml

According to the data released by the World Bank[4], Chinese Mainland's FDI inflows ranked 2nd in the world in 2021, only second to the United States.

Top 10 economies for FDI inflows in 2021

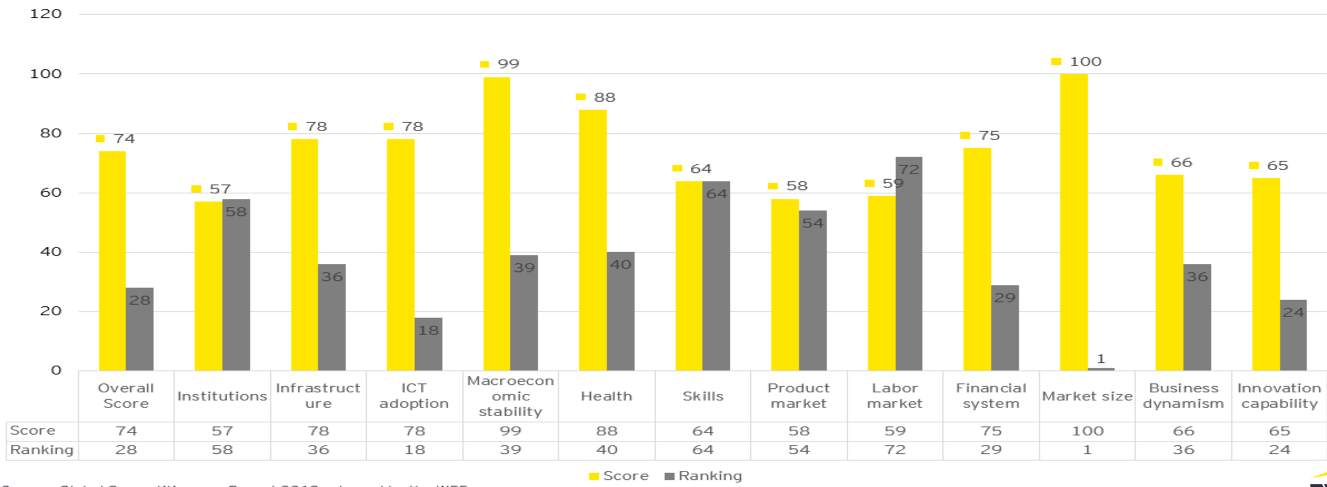


Source: World Bank

China's competitiveness remains strong

The World Economic Forum (WEF) released the "Global Competitiveness Report 2019"[5] (as the most updated version available issued by WEF), offering insights into the economic prospects of 141 economies by 12 pillars, i.e., institutions, infrastructure, ICT adoption, macroeconomic stability, health, skills, product market, labor market, financial system, market size, business dynamism, and innovation capability. The report shows Chinese Mainland ranks 28th overall (the newest ranking available in WB as the issuing date of this newsletter).

Performance overview of Chinese Mainland in 2019 (12 Pillars of the Global Competitiveness Report 2019)



	Overall Score	Institutions	Infrastructure	ICT adoption	Macroeconomic stability	Health	Skills	Product market	Labor market	Financial system	Market size	Business dynamism	Innovation capability
Score	74	57	78	78	99	88	64	58	59	75	100	66	65
Ranking	28	58	36	18	39	40	64	54	72	29	1	36	24

Source: Global Competitiveness Report 2019 released by the WEF

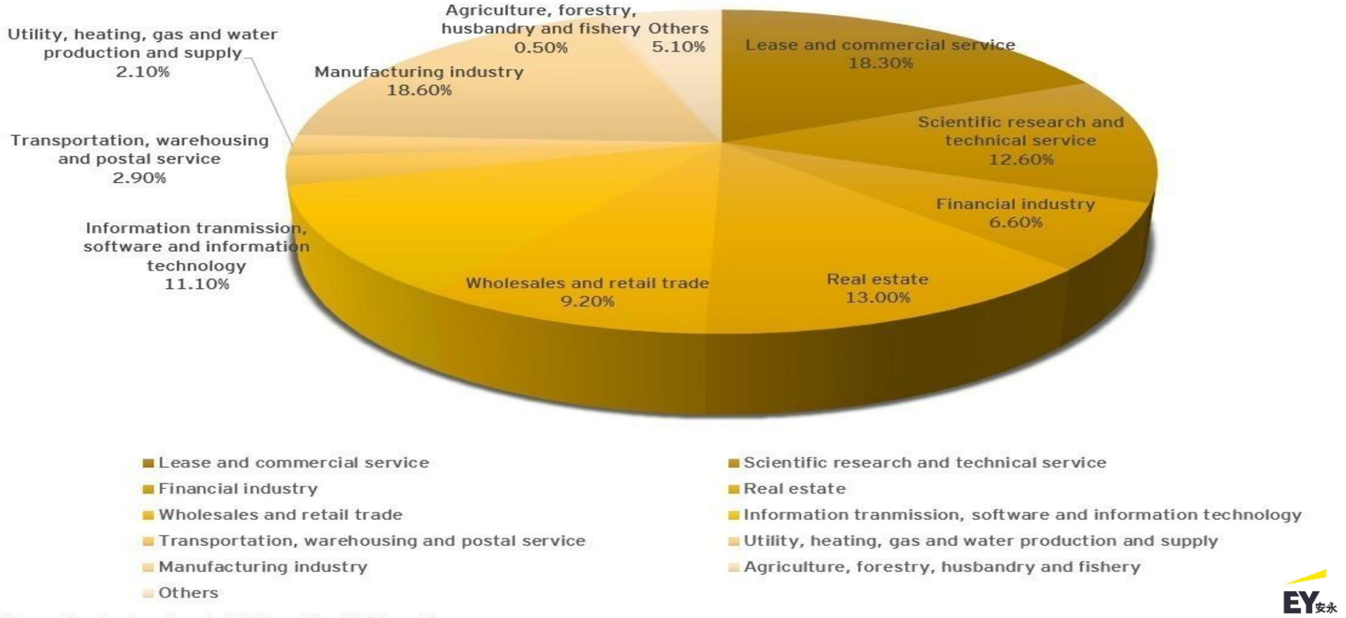
Note:
4. https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?most_recent_value_desc=true.
5. https://www.weforum.org/reports/global-competitiveness-report-2019

More specifically, Chinese Mainland's sizeable market stood out among all, ranked 1st; it also had great advantages in macroeconomic stability, innovation capability and ICT adoption. In addition to WEF's report, the "2022 World Competitiveness Rankings"[6], released by an independent academic institution, evaluated 63 economics based on 20 sub-factors of four main factors, i.e., the economic performance, government efficiency, business efficiency and infrastructure. Chinese Mainland ranked 17th overall and 4th in economic performance.

High-quality and Service have become the capital attractions

Over recent years, as directed by China's industrial structure upgrading guidelines which responds to the maturity of manufacturing industry and high demand on services, foreign investment in China has heavily flown to high quality areas including high-tech businesses and modern services. In 2021, the actual use of FDI in China in service industry increased to 79.6% of the total FDI in China, while the proportion of actual use of FDI in the manufacturing industry decreased to 18.6%.

Proportion of China FDI by sectors in 2021



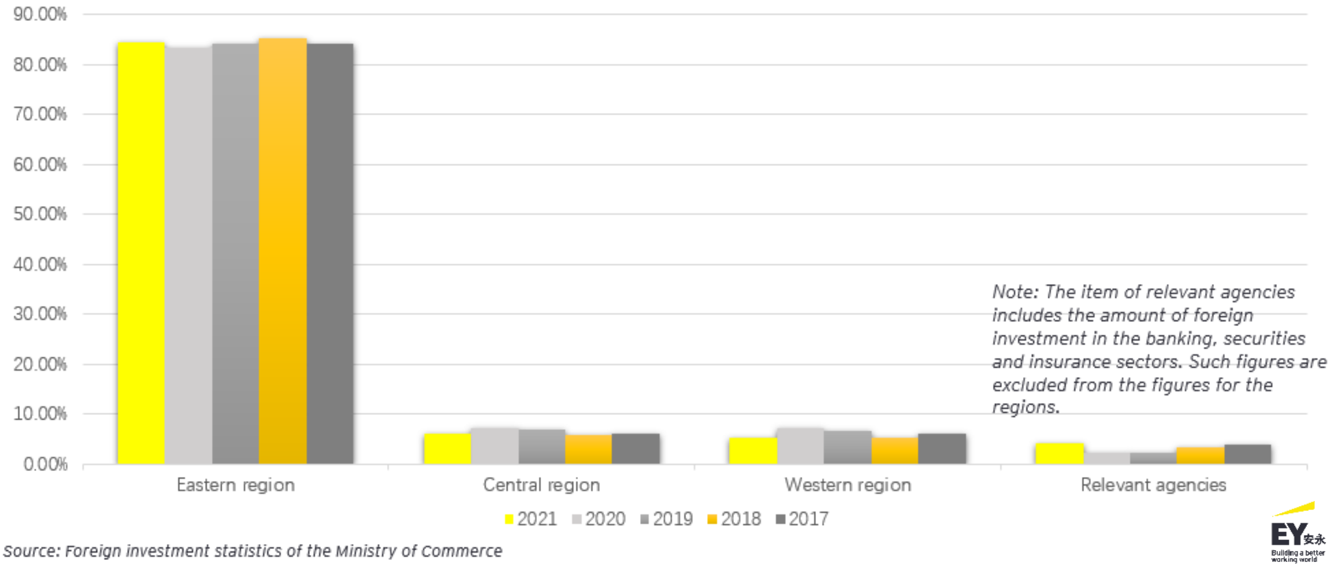
Source: Foreign investment statistics of the Ministry of Commerce

Note:
6. https://imd.cld.bz/IMD-World-Competitiveness-Booklet-2022/64/

Eastern region continues as the favorite while more areas emerge

In 2021, the FDI inflows in the eastern region (Beijing, Tianjin, Hebei, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong and Hainan) accounted for 84.4% of the total FDI inflows of China. During the same period, the proportion of FDI inflows in the central and western regions grew by 0.2%.

Foreign investment inflows by regions from 2017 to 2021



Source: Foreign investment statistics of the Ministry of Commerce

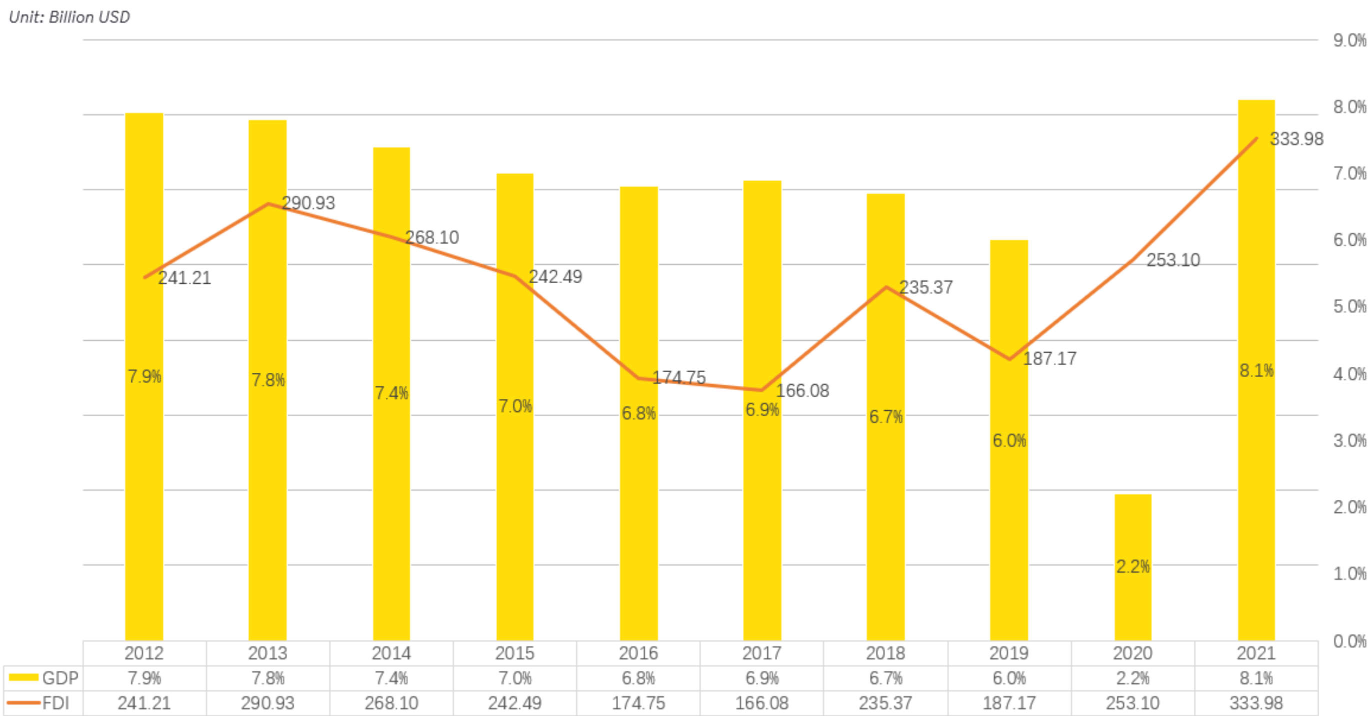
Outlook of foreign investment – investor confidence advances

The Two Sessions set the tone clear that greater efforts shall be made to attract and utilize foreign inbound investment through further widening market access, promoting further opening-up of modern service industries and granting foreign invested enterprises national treatment etc. Meanwhile, China has been actively promoting the access to high-level economic and trade agreements, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (hereinafter referred to as the "CPTPP").

China's expected GDP growth rate and FDI in 2023

China's GDP growth rate in 2022 was 3%, and it is set to grow 5% this year. In this respect, it is not unreasonable to expect that FDI would increase along with the GDP in 2023. The figure below shows the trends of FDI and GDP in the 10-year period between 2012 and 2021.

GDP growth and FDI trends during 2012-2021



Source: World Bank

FDI Confidence Index

According to the 2023 FDI Confidence Index published by Kearny[7], China makes significant progress in its foreign investment confidence index ranking for past two years, rising from 12th in 2021 to 7th in 2023.

The 2023 FDI Confidence Index

Country	Ranking in 2023	Ranking in 2022	Compared with ranking in previous year
USA	1	1	-
Canada	2	3	↑
Japan	3	4	↑
Germany	4	2	↓
UK	5	5	-
France	6	6	-
China (including Hong Kong)	7	10	↑
Spain	8	8	-
Singapore	9	18	↑
Australia	10	11	↑

Source: Report of Foreign Direct Investment Confidence Index in 2023

Note:
7. https://www.kearney.com/foreign-direct-investment-confidence-index/2023-full-report

Special zones would welcome FDI with more flexibilities

From the basic opening up of commodities and factors to a new level of opening up featuring institutional and systemic openness, China's strategy of such transformation has proved to be a success and also make it more aligned with international standards.

In the past decades, the country has been relaxing market access for foreign investments and providing more flexibilities in selective special zones. Taking free trade zones (FTZs) as an example, foreign investments in the 21 pilot FTZs are subject to much less restrictions and their operations are facilitated with more liberalized foreign currency control policies. China is a big country with diversified economic development status and cultural background. It is a common approach that some trial strategies are "tested" in selected areas and a national roll-out would be implemented following successful pilot experiences. To deliver China new government leadership's economic agenda, it is not unreasonable to expect that the Chinese government would allow the special zones to try more "systematic" openness to attract capital, talent and advanced technologies. The pilot areas may therefore be more open to accept new business models.

Advanced manufacture and modern services are encouraged

High quality investment with the focuses on innovation and modern service are named particularly as the investments China market would appreciate. Tax incentives, financial support, local facilitations would be provided accordingly. Pharmaceutical, electronic information, automobile manufacturing, and business services (financial services, information services, research and development, design and etc.) are all on the list.

Modern service industry, including telecommunication, internet, culture and entertainment (need to double check) businesses may be opened for foreign investors in the pilot FTZs or the Hainan Free Trade Port.

Sustainability will be a hot topic

According to the Outline of the 14th Five-Year Plan (2021-2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035 (hereinafter referred to as the "Outline"), it is expected that the Chinese government would further encourage foreign investment in new energy, green and low-carbon key technology innovation and application demonstrations, etc.. This has been reflected in the lates update of the Catalogues of Encouraged Industries for Foreign Investments (2022 Version)[8] that, a number of items such as low-carbon green energy and water-saving advanced system integration technology and services are newly added.

Ending remarks

The global economy, which is recovering from the three-year pandemic, is under a lot of challenges while all the countries are resuming to normalcy. The "slowbalisation", geopolitical tensions, climate changes all have added the burdens to the governments around the world. The policies among politics, economics, environment, international relations and domestic demand have to be carefully balanced yet the governments competency and focuses vary which creates more uncertainties. Many investors have chosen to stay on the sidelines as spectators rather than participants in the wobbly economic. China is no exception to this set of challenges while its sizable market, mature infrastructure, highly productive workforce and commercial vitality all continue as notable competitive advantages and present compelling opportunities for overseas investors.

More specifically, China's political and society stableness is the foundation for its policy consistency and economy resilience and could be regarded as a driver toward certainty - another strong advantage seen in savvy investor eyes in this uncertain era. The newly sworn-in China leadership provides strong confidence to the businesses while acknowledges the continuous challenges. As the premier suggested, foreign investors who have been walking along with China in its economic take-off would definitely continue to benefit from the country's full range of new growth.

Note:
8. http://www.gov.cn/zhengce/2022-11/29/content_5730383.htm

Appendix

The prevailing tax incentives for foreign investments

Tax incentives for encouraged investments

- Tax deferral policy for reinvestment of overseas investors.

  Profits derived by overseas investors from resident enterprises in Chinese Mainland are entitled to a tax deferral policy if they are directly reinvested in non-prohibited foreign investment in China.

- Reduced Corporate Income Tax (CIT) rate of 15% for qualifying foreign investment enterprises established in:
  - Western region,
  - Hainan Free Trade Port (FTP)
  - Guangdong-Macau In-depth Cooperation Zone in Hengqin ("Hengqin")
  - Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone ("Qianhai")
  - Pingtan of Fujian
  - Nansha District of Guangzhou ("Nansha"), etc.

- FIEs engaging in encouraged investments could be exempted from customs duties for their purchases of imported equipment for self-use purpose.

- Equipment imported by Foreign-funded R&D centers are exempted from import level taxes.

- Tax exemption policies for qualifying foreign-funded R&D centers for their importation of supplies for scientific research and scientific and technological development purposes.

Regional foreign investment incentives (examples)

The Lin-gang Special Area of China (Shanghai) Pilot Free Trade Zone

Market access	Further promote the opening-up of key sectors such as telecommunications, scientific research and technical services, education and healthcare.
Tax incentives and talent attraction	► Eligible legal entities that are engaged in core products and technology of key industries such as integrated circuits, artificial intelligence, biomedicine, and civil aviation in the Special Area and carry out substantive production or research and development (R&D) activities, are subject to a reduced CIT rate of 15% within 5 years from the date of establishment. ► A subsidy policy for overseas talents to cover the difference of their IIT burden between the mainland and overseas shall be studied and implemented.
Liberation on cross-border transactions	FIEs established in Lin-gang are not required to set up a special RMB capital account for FDI where their investors contribute the registered capital in RMB is removed. Commercial banks can directly handle capital settlement business for the injected capital.

Hainan FTP

Market access	Promote the opening-up of key areas such as value-added telecommunications service, education, business services and mining.
Tax incentives and talent attraction	► Qualifying enterprises registered in the Hainan FTP and engaged in substantial business in encouraged industries shall be subject to a reduced CIT rate of 15%. ► For qualifying high-end or urgently needed talents that work in the Hainan FTP, their IIT burden exceeding 15% shall be exempted[9]. ► Enterprises with independent legal entity status that are registered in Hainan FTP may be exempt from Customs Duty, import level Value-added Tax (VAT) and Consumption Tax (CT) for importing self-use equipment for manufacturing purpose, except for those commodities covered in the Negative list or the lists of prohibited importation commodities or non-tax-exempt commodities in accordance with relevant laws and regulations. ► VAT, CT, Vehicle Purchase Tax, Urban Maintenance and Construction Tax and education surcharges are proposed to be combined into Sales Tax in 2025, which will be levied in the retail of goods and services.
Liberation on cross-border transactions	► Establish a multi-functioned free trade account system. ► Facilitate the registration and exchange processes for transactions of cross-border direct investments. ► Fully implement the macro-prudential management on cross-border financing and support businesses engaging in certain industries in Hainan to list or issue bonds overseas.

Note:
9. In practice, the IIT would be paid in full during the provisional filings and any applicable exemption maybe refunded during the annual filing.

The Guangdong-Hong Kong-Macau Greater Bay Area (GBA)

Market access	▶ Relax the restriction of market access for Hong Kong and Macau investors to invest in the service industry in the GBA. ▶ Expand the opening-up of the financial industry, such as encouraging the establishment of branches and subsidiary banks of overseas banks as well as foreign invested security companies, fund management companies in the GBA. ▶ Further relax and optimize the application of market access for advanced technology application and industrial development, education and culture, transportation, communications, etc. in Shenzhen.
Tax incentives and talent attraction	▶ Measures for facilitating efficient cross-border flow of talents, e.g., mutual recognition schemes for talents from Guangdong, Hong Kong and Macau. ▶ Qualifying overseas high-end and urgently needed talents who work in the GBA shall be provided with a tax-exempt financial subsidies to cover their IIT burden exceeding 15% (qualifying talents working in Nansha of Guangzhou and Heqin of Zhuhai shall be applicable for direct IIT exemption[10]).
Liberation on cross-border transactions	▶ In the GBA, the process of handling cross-border RMB business are further simplified and the pilot of cross-border capital pool business integrating local and foreign currencies is implemented. On the other hand, the administration of foreign exchange settlement and payment are further simplified. ▶ It is proposed that a cross-border electronic capital networking between Hengqin and Macau (电子围网系统) and the cross-border financial management system shall be established by 2025 to further explore the free flow of cross-border funding, convenience of cross-border investment and funding, opening-up of finance sector. ▶ A sound policy and management system on expansion and opening-up of the financial sector as well as the internationalization of RMB shall be established in Qianhai with high level of interconnection with the Hong Kong financial market.

Other key regions for foreign investment attraction

Notably, China has established comprehensive demonstration zones for further opening-up in the service sector in 11 cities, i.e., Beijing, Tianjin, Shanghai, Hainan Province, Chongqing, Shenyang, Nanjing, Hangzhou, Wuhan, Guangzhou and Chengdu. The pilot measures implemented in these comprehensive demonstration zones include lifting restrictions on the establishment of wholly foreign-owned financial companies, studying the possibilities to remove the record-filing process for commercial franchise, etc.

Note:
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