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Chinese Economic Reforms Foreign Cos. Should Know About

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Nearly 40 years ago, China initiated economic reforms and began opening its economy to foreign trade and investment. Today, China is the second largest economy in the world and ranks among the top destinations for foreign direct investment. While China has experienced tremendous economic growth over the past few decades, its ability to sustain growth going forward depends on further trade liberalization and free market reforms.

Tim Stratford

The new leadership of the Communist Party of China (CCP) is embarking on the next wave of economic reforms and recently revealed its reform agenda — to be implemented by 2020. The proposed reforms offer significant opportunities for foreign companies, especially those that tailor their China strategies to suit China's reform priorities and assist in shaping implementation of reform policies.

Significant Economic Reforms Proposed and What This Means for Foreign Businesses

The November 2013 Third Plenary Session of the 18th Central Committee, a key meeting of the CCP leadership to decide major policies and launch economic and political reforms, set forth a series of proposed reforms in a range of areas. A communique issued following the meeting outlined in broad strokes the reforms to be implemented by 2020. This was followed by a second document providing a 60-point reform blueprint covering plans for economic liberalization, among other reforms.

Of the proposed reforms announced in connection with the Third Plenum, those of most interest to companies operating or seeking to establish in China include the following:

- Elevating the role of the market in the economy. For the first time, the plenum stated that market forces will play a "decisive" role in allocating resources in the economy. This is significant since the previous language referred to the market as having a "basic" role in resource allocation. China plans to liberalize controls on the prices of water, oil, natural gas, power, transportation and telecommunications, and also to implement financial sector reforms that will allow markets to determine more fully the cost and allocation of capital. These reforms will help foreign companies compete on a more level playing field with Chinese companies.

- Liberalizing rules on market access and foreign investment. China has signaled its interest in improving market entry, including through conclusion of a robust bilateral investment treaty now being negotiated with the United States (discussed below). Under the treaty, domestic and foreign companies would be given equal access in sectors that are not on a negative list. In the meantime, China has indicated that it will further open the following sectors to foreign investment (in an "orderly" manner): financial services, education, culture, healthcare, child and elderly care, architectural design, accounting and auditing, logistics, and e-commerce.

- Establishing free trade zones. According to senior Chinese officials, the Shanghai Free Trade Zone, established in 2013, is a testing ground for reforms that may ultimately be implemented throughout the country, so that China will be prepared to conclude the BIT with the U.S. and also explore participation in the Trans-Pacific Partnership when the time is right. Additional free trade zones will also be developed in other parts of China.

- Implementing new financial reforms. Among the areas of financial reforms outlined are liberalization of interest rates, allowing domestic private capital to establish small to medium-sized banks, modernizing the system for launching initial public offerings, and establishing a national deposit insurance system.

- Reforming state-owned enterprises. SOE reform proposals include: increasing SOE dividends to the government from the current rate of 5-15 percent to 30 percent by 2020, allowing nonpublic entities to invest in SOEs, and encouraging private participation in certain public sector projects. The proposed reforms are noteworthy given the dominance of SOEs in China and the new opportunities being created for the private sector, including foreign investors.

- Improving anti-corruption mechanisms. The CCP is aggressively clamping down on corrupt activities and reducing interference in investigations.

Developments in Bilateral Investment Treaty Negotiations with the U.S. and EU

In addition to the reforms announced in connection with the Third Plenum, recent progress in BIT discussions with both the United States and the European Union help confirm China's interest in accelerating economic growth through greater foreign direct investment.

The first round of BIT negotiations between the EU and China took place in January 2014. On the U.S.-China BIT, while negotiations have been underway since 2008, an important milestone was reached last summer when China signaled for the first time its willingness to allow foreign investors to participate in the Chinese economy on an equal basis with domestic investors, subject only to specific exceptions

listed in an annex to the agreement. Foreign companies should be particularly interested in monitoring and influencing negotiations related to the contents of this “negative list.”

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