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Chinese auto industry fully open up to foreign OEMs?

Background

Significant news on China's further open-up of foreign investment in automotive industry has recently been released by National Development and Reform Commission ("**NDRC**"). According to a newsletter on NDRC's Answer to Reporter's Request regarding Formulation of New Foreign Investment Negative Catalogue and Market Opening for Manufacturing Industry ("国家发展改革委就制定新的外商投资负面清单及制造业开放问题答记者问") available on 17 April 2018 at the official website of NDRC ("**NDRC Newsletter**")[1], the Chinese automotive industry is promised to be fully opened up to foreign investors in the next five years with concrete time schedule.

Since the very first *Policy on Development of Automotive Industry* issued in 1994, foreign investment in manufacturing of complete built-up vehicles ("**CBU**") has been imposed with strict restrictions: Sino-foreign Joint Venture ("**JV**") is the only legitimate way for foreign direct investment in OEMs manufacturing CBU, special purpose vehicles ("**SPV**") and motorcycles in China, and the foreign shareholding ratio in such JV shall not be higher than 50% ("**Shareholding Cap**"). Meanwhile, as a further general restriction, one foreign investor shall be allowed to invest in no more than two JVs manufacturing passenger cars and no more than two JVs manufacturing commercial vehicles ("**2+2 Restriction**"). In practice, one foreign OEM normally may be permitted to engage at maximum two Chinese OEMs as JV partners.

The abovementioned restrictions, esp. the Shareholding Cap, used to be one of the red lines of the Chinese foreign investment policies. Since 2017, however, there are signals indicating the change of the central government's attitude. In May 2017, VW successfully engaged a third Chinese JV partner JAC to manufacture new energy passenger vehicles; one week before the NDRC Newsletter, President XI Jinping addressed in a speech at the opening ceremony of Bo'Ao Asia Annual Seminar held in Hainan province[2] regarding further market open in automotive industry and the lift of Shareholding Cap.

Time Schedule

As clearly provided in the NDRC Newsletter, the Shareholding Cap and the 2+2 Restriction will be entirely removed in the next 5 years according to following time schedule:

- By 2018: Removal of Shareholding Cap with regard to OEMs manufacturing new energy vehicles ("**NEV**") and SPV;
- By 2020: Removal of Shareholding Cap with regard to OEMS manufacturing commercial vehicles;
- By 2022: Removal of Shareholding Cap with regard to OEMs manufacturing of passenger vehicles and the 2+2 Restriction.

Accordingly, a new foreign investment negative list will be promulgated and implemented in the first half of 2018.

Outstanding Issues

Despite of the exhilarating signals sent by the NDRC Newsletter, as the usual process, several house-keeping measures need to be put in place with other outstanding issues to be clarified in the further accompanying regulations in order to bring the relaxation into the real show, for examples:

- The current Policy on Development of Automotive Industry promulgated in 2004 need to be amended to match the NDRC Newsletter;

- Implementing details need to be clarified in further measures, e.g. whether the removal of Shareholding Cap in 2018 will apply to all types of SPV and NEV or only certain types.

Outlook

The removal of Shareholding Cap and 2+2 Restriction would be a significantly positive signal for foreign OEMs with ambition in the Chinese market. One the other hand, the automotive industry in China faces over-capacity challenges and investment in building up additional capacities in the traditional fuel vehicle is strictly controlled; and the investment in new NEV project would require powertrain technology and R&D capacities.

For those foreign OEMs which have been already operated together with their Chinese partners (some of which are state-owned giants) in China, the relaxation may provide more strategic re-structuring opportunities and options.

Footnotes

[1] Please refer to http://www.ndrc.gov.cn/gzdt/201804/t20180417_882714.html
[2] Please refer to http://www.fmprc.gov.cn/web/zyxw/t1549414.shtml

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