

Beijing Issues Catalogue Banning or Restricting 'New Addition' Projects in Various Industries

- After-the-Event Urban Planning Comes to China

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Overview

On July 21, 2014, the General Office of the People's Government of Beijing Municipality published the *Beijing Municipality Catalogue of Prohibited and Restricted New Addition Industries (2014 Edition)* ("**Beijing Catalogue**"). The Beijing Catalogue was jointly formulated by 10 government departments at the Beijing Municipality level, including the Commission of Development and Reform, the Commission of Education, the Commission of Economy and Information Technology, the Bureau of Land and Resources, the Environmental Protection Bureau, the Commission of Housing and Urban-Rural Development, the Commission of Transport, the Commission of Rural Affairs, the Commission of Commerce and the Commission of Health and Family Planning.

The Beijing Catalogue marks a significant shift towards a more restrictive investment environment, being the first example of an 'investment' catalogue issued by China that does not encourage or specify areas open to investment but whose sole purpose appears to be to specify areas off-limits and restricted for further investment – the closest example prior to this being the *Catalogue of Technologies Prohibited or Restricted from Export by China* which is outward facing and quite different in nature. This note will explore the reasons behind the publication of the Beijing Catalogue and the implications for investors, particularly those who might have been planning to invest in a sector caught by the Beijing Catalogue. It would be easy to dismiss the Beijing Catalogue as being driven by air pollution concerns, but in reality it goes a lot further than just cracking down on polluting industries, with the sectors covered ranging from manufacturing to real estate development through to educational institutions. The theme seems to be more about trimming over-capacity and over-concentration of certain types of facilities and resources. The obvious question it raises and does not answer is whether this is just a local initiative or more like 'the thin edge of the wedge', and we will see this

pattern replicated in other major cities such as Shanghai or elsewhere in China.

Background

The Beijing Catalogue was released against the backdrop of continuing urban migration and population expansion leading to huge pressure on urban infrastructure and resources, an overloaded road system facing permanent gridlock, shortages of natural resources and disturbing levels of air pollution in Beijing. The main purpose of promulgating the Beijing Catalogue appears to be to address these issues by 'relocating' new entrants in industries consuming high levels of scarce natural resources (such as energy and water), which give rise to serious pollution or overstocked educational or medical institutions to locations outside of the Beijing Municipality proper, including to neighbouring provinces/cities such as Tianjin Municipality and Hebei Province. Whether it will work in spreading investment to less prosperous surrounding areas remains to be seen: some investors who feel the need to be in or near to a large metropolis may, as a result of the Beijing Catalogue, simply shift their focus to Shanghai or elsewhere.

Implications of the Beijing Catalogue

Under the Beijing Catalogue, being classified as a "prohibited industry for new additions" means no more fixed asset investments or new entrants will be allowed in that industry; being classified as a "restricted industry for new additions" means restrictions will be placed on new investments in that industry in terms of location, scale, operating processes, or types of products. What needs to be understood here in assessing the impact of the Beijing Catalogue is that the Beijing Catalogue does not apply to either on-going projects nor to the reconstruction or upgrading of existing projects except to the limited extent that it may impose restrictions or prohibitions on new bed capacity for existing generalist hospitals, for example. Query where the cut-off line for on-going projects will be drawn for real estate projects,

where the land use rights have been secured but the developer entity not yet set up: logically this should be seen as a project in process as the party(ies) cannot back out at this stage. On the other hand, selling undeveloped land is already highly restricted under current law.

The Beijing Catalogue provides a general exception that if there are special policies provided in laws, administrative regulations or State Council documents or approved by the Beijing Municipal government to apply in certain areas, such policies shall be followed. Certain areas mean the so-called High-End Industrial Functional Zones (高端产业功能区), specifically including Zhongguancun National Innovation Model Zone (中关村国家自主创新示范区), Beijing Economic-Technological Development Area (北京经济技术开发区), the Central Business District (商务中心区), Finance Street (金融街), Olympic Core Area (奥林匹克中心区), the Beijing Airport Economic Zone (临空经济区), the Tongzhou High-end Business Service Area (通州高端商务服务区), the Shougang (Capital Steel) High-end Comprehensive Industrial Service Area (新首钢高端产业综合服务区), the Lize Financial Business District (丽泽金融商务区) and the Huairou Cultural and Technological High-end New Industrial Area (怀柔文化科技高端产业新区). So it would be fair to say that specially designated zones may provide for exceptions and carve-outs, but a silence in the law in these designated zones would mean the Beijing Catalogue would apply by default.

The Beijing Catalogue on its face is even-handed: it applies across the board to foreign and domestic investors alike, but it also includes a specific reference to foreign investment: which remains subject to the *Guidance Catalogue for Foreign Investment Industries* ("**Foreign Investment Catalogue**"). We assume this reference simply means that in addition to the Beijing Catalogue, foreign investors will also need to follow the Foreign Investment Catalogue. This was confirmed by our telephone inquiries with relevant Beijing government authorities. This means that foreign investors seeking to invest in Beijing will be subject to two preliminary layers of feasibility analysis, starting with the Beijing Catalogue and if this does not impose a ban or restrictions on the sector in question, the Foreign Investment Catalogue. Government authorities responsible for project approval or entity establishment at Beijing municipal and district government level will be required henceforth to review relevant applications

against the Beijing Catalogue. Presumably for domestic capital projects not requiring specific establishment approvals, it will be the responsibility of the Administration of Industry and Commerce to catch the project at the registration stage. With foreign-invested projects, it will typically be the local branch of Ministry of Commerce ("**MOFCOM**") in charge of approving, so presumably the onus will be on MOFCOM to vet against the Beijing Catalogue.

Structure of the Beijing Catalogue

The Beijing Catalogue is divided into five sub-catalogues, with one generally applicable to the entire area of Beijing, and each of the other four applicable respectively to the Core Areas for Capital Urban Functions ("**Core Areas**"), the Extended Areas for Urban Function ("**Extended Areas**"), the New Areas for Urban Development ("**New Areas**"), and the Developing Areas for Ecological Preservation ("**Developing Areas**").

Under the Beijing Municipality Major Areas Functional Plan published in July 2012, the city is divided into four major areas generally based on the distance of an area from the center of Beijing, as well as functional plans for different districts: these are the Core Areas, consisting of two administrative districts Dongcheng District and Xicheng District; the Expanded Areas, consisting of four districts, Chaoyang District, Haidian District, Fengtai District and Shijingshan District; the New Areas, consisting of Tongzhou District, Shunyi District, Daxing District (where Beijing's high tech zone is located) and the other areas of Changping District and Fangshan District and the Developing Areas, consisting of Mentougou District, Pinggu District, Huairou District, Miyun County, Yanqing County, as well as the mountain areas of Changping District and Fangshan District. The Core Areas and the Extended Areas are generally regarded as the urban or downtown areas, with the New Areas as near suburbs and the Developing Areas as the extended suburbs of Beijing.

Main Prohibitions and Restrictions

Notable prohibitions/restrictions in the Beijing Catalogues include (1) in general, no new retail or warehousing facilities with a gross (construction) area of over 10,000 square meters, high end residential buildings, golf courses, hotels, office buildings, exhibition centers, hospitals, universities, call centers, and data centers will be approved (the prohibition of

construction of new data centers confirms a long running market rumour) in downtown Beijing; and (2) generally no new manufacturing facility will be permitted to be established in the Core Areas and the Developing Areas. Even in the Extended Areas and the New Areas, there is a long list of products which are no longer permitted to be manufactured. It should be noted, however, that there are no prohibitions imposed on R&D, design, purchase, marketing, technical services, or financial services in relation to manufacturing industries.

Conclusion

The Beijing Catalogue raises perhaps more issues than it answers. Whilst the concern over over-capacity in some industries is understandable, the Beijing Catalogue seems to be going in the opposite direction of years of reform that have given greater play to the role of the market in deciding which investments are made and where. You could say it, in some measure, marks a return to central (urban) planning. It basically imposes politically-driven prohibitions and restrictions on key industry sectors in the economy, such as real estate development – where retail demand may outgrow current capacity going forward.

Taking the example of the Shanghai Free Trade Zone ("Shanghai FTZ") the extent of the social and geographical engineering and steering becomes apparent: the Shanghai FTZ has, in contrast, just opened up call centres to foreign investment in the form of wholly foreign-owned enterprises (although it also bans investment in the sensitive sector of data centres in the Shanghai FTZ), whilst the Beijing Catalogue simply bans call centres across the entire area of Beijing – in effect giving away with one hand and taking back with the other. It raises questions about the treatment of sites currently left vacant which are, for example, slated for development of retail facilities – it cannot be the intention for these to be left as idle land implying either a re-drawing of the boundaries into smaller plots falling below the size limits or a rezoning.

One inevitable consequence will be to drive up real estate prices and prices of buying existing capacity in areas where there is a ban or severe restrictions on new additions in the sector. This will largely benefit State-owned Enterprises and other incumbents. Stepping back from this, it raises even wider issues. For example, how does this new raft of restrictions fit within China's World Trade Organization commitments to

open up sectors to foreign investment and does this introduce a new set of geographical and industry-based restriction on foreign investors that were not previously there?

For foreign investors, some of the prohibitions in the Beijing Catalogue will look familiar. For example, the Foreign Investment Catalogue already prohibits any foreign investment in the construction of golf courses. In fact, the building of new golf courses has been suspended nationwide by the central government since January 2004¹, but in practice some local governments still approve the construction of golf courses under various guises. Thus it remains to be seen whether the prohibition in the Beijing Catalogue is just a gesture by the Beijing Municipality Government in support of the central government's decision or a real policy shift.

In some industries, however, the Beijing Catalogue completely shuts doors that were only half-closed to foreign investors under the Foreign Investment Catalogue. For example, the construction of high-end hotels, office buildings, or exhibition centers falls in the restricted category under the Foreign Investment Catalogue (meaning a more stringent approval process and lower local approval thresholds), but these areas are now completely prohibited in downtown Beijing under the Beijing Catalogue. Even some industries in which foreign investment is currently encouraged for the introduction of new technologies under the Foreign Investment Catalogue are also shut down for new investment. For example, both natural fabric products processing and manufacturing of environmentally-friendly apparel are encouraged under the Foreign Investment Catalogue, but the textile industry is subject to a blanket prohibition in Beijing under the Beijing Catalogue.

On a more positive note, while Beijing is imposing restrictions on certain commercially important industry sectors in the economy, according to comments made by Beijing municipal officials in many news reports but not mentioned in the Beijing Catalogue itself, the Beijing Municipal government is encouraging investment in other sectors, including finance, culture and high-technology enterprises. It has also been reported that

¹ See the *General Office of the State Council Notice on Suspending the New Construction of Golf Courses* 《国务院办公厅关于暂停新建高尔夫球场的通知》 issued on January 10, 2004 ("Notice"). The Notice provides that the new construction of golf courses shall not be approved until new policies are promulgated.

the central government is making efforts to build strategic cooperation areas around Beijing, which might become future relocation choices for investors in the sectors that have had restrictions imposed upon them.

At the end of the day, there is clearly a serious pollution issue to address in Beijing and this is a positive first but significant step towards reducing air pollution and other forms of pollution in the capital (it notably does not address pollution by private cars). The big question that the Beijing Catalogue poses and does not answer is whether it is possible to impose other restrictions that run contrary to market demand and expectations, and whether the policy could backfire by giving rise to attempts to circumvent it; for example, by buying up and expanding existing capacity at inflated prices, rather than spreading investment around more evenly as intended by the drafters and backers of the Beijing Catalogue, leading to the inevitable result of consumers paying ever higher prices for the same goods and services.

A more detailed summary of the industry-specific prohibitions/restrictions in the Beijing Catalogue is set out in the Appendix. A full translation of the Beijing Catalogue can be obtained by our clients or potential clients by writing to our marketing manager Christina Wu at the following address: christina.wu@hoganlovells.com.

Contacts

Beijing

Jun Wei

jun.wei@hoganlovells.com

+86 10 6582 9501

Shanghai

Andrew McGinty

andrew.mcginity@hoganlovells.com

+86 21 6122 3866

Appendix

Industry-specific prohibitions/restrictions in the Beijing Catalogue

Note: Restricted industries are denoted with an asterisk (for 1(c) and 3(a), all bolded items should be deemed denoted). All others are prohibited.

1. New additions which are prohibited or restricted across the entire area of Beijing:
 - (a) animal husbandry and aquaculture (with a few exceptions, e.g. breeding);
 - (b) mining;
 - (c) manufacturing industries, including but not limited to the making or manufacturing of tobacco, textiles, wooden/leather/feather products, furniture, paper, as well as selected **food, drinks, chemical, medicine, rubber, metal/nonferrous metal, mining or ceramic products**, selected **general/specialised equipment, vehicle-related products** (manufacturing of vehicles using new energy sources is permitted), **transportation equipment, and electric machinery and equipment***, vehicle dismantling, ship repairs and so forth²;
 - (d) coal-fired or nuclear power plants;
 - (e) wholesaling of mining, construction, chemical or industrial products, machinery, equipment, metal hardware, digital products; recycling and wholesaling of recyclable materials; other vendor trading markets (except for farmers' vegetable markets); vehicle and vehicle component trading markets; petrol stations that are not included in specific plans;
 - (f) regional logistics centers or warehousing facilities* with a construction area of over 10,000 square meters (except for grain-related distribution facilities or delivery stations);
 - (g) restaurants, dry cleaning facilities, vehicle repair shops* which may give rise to smoke emissions, odd smells, or waste gas in residential buildings buildings not fitted with a special smoke flue or those mixed use buildings adjoining residential buildings;
 - (h) call centers, bank card centers and data centers, except for cloud computing data centers with power usage effectiveness values of under 1.5;
 - (i) residential developments* with a plot ratio equal to or lower than 1.0 (inclusive);
 - (j) education*, specifically:
 - (i) no more new college, university or occupational schools;
 - (ii) no more students shall be enrolled each year for college, university or occupational schools;
 - (iii) no more land shall be granted to college, universities and occupational schools;
 - (iv) no more in-school students (i.e., on-line is acceptable) for adult higher education schools and newly-established adult higher education schools can only recruit Beijing residents; and
 - (k) construction of golf courses.
2. In addition to those listed in Section 1 above, there is a prohibition or restriction on new additions in the Core Areas, i.e., Dongcheng District, Xicheng District in the following sectors:
 - (a) manufacturing;
 - (b) mining;
 - (c) agriculture, forestry, animal husbandry and fishery;
 - (d) construction;

² Please refer to the Beijing Catalogue for a full list of specific products, the manufacture of which is now prohibited.

- (e) wholesale markets;
 - (f) retail facilities* with a construction area of over 10,000 square meters;
 - (g) passenger transport stations;
 - (h) warehouses;
 - (i) postal services (except for postal delivery stations);
 - (j) on-campus expansions of higher education institutions;
 - (k) residential estates, hotels, office buildings (except for government-sponsored projects or in the High-End Industrial Functional Zones);
 - (l) exhibition facilities; and
 - (m) comprehensive medical institutions and increases in the number of patient beds in these institutions.
3. In addition to those listed in Section 1 above, new additions are prohibited or restricted in the Extended Areas, i.e., Chaoyang District, Haidian District, Fengtai District and Shijingshan District in the following sectors.
- (a) manufacturing of a longer list of selected **metal products, general/specialised equipment, transportation equipment, electrical machinery and equipment, electronic products*** and repairs to transportation equipment³;
 - (b) coal-fired or oil-fuelled heating facilities;
 - (c) production and supply of fuel gas, except for natural gas;
 - (d) retail facilities* with a construction area of over 10,000 square meters within the East, West and North Fourth Ring Roads and the South Third Ring Road;
 - (e) passenger transport stations* within the Fourth Ring Road;
 - (f) exhibition facilities, hotels, office buildings* within the East, West and North Fifth Ring Road and the South Fourth Ring Road; and
 - (g) comprehensive medical institutions* and increases in patient beds in such institutions within the Fifth Ring Road:
4. In addition to those listed in Section 1 above, new additions are prohibited or restricted in the New Areas in the following sectors:
- (a) coal-fire or oil-fuelled heating facilities;
5. In addition to those listed in Section 1 above, the following new additions are prohibited or restricted in the Developing Areas:
- (a) manufacturing (except for the area of Zhongguancun National Innovation Model Zone (中关村国家自主创新示范区) where rules applicable to the Extended Areas shall apply); and
 - (b) coal-fired or oil-fuelled heating facilities (except for those areas where no clean gas supply is available).

³ Please refer to the Beijing Catalogue for a full list of specific products, the manufacture of which is now prohibited.

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