VI−13 Contemporary Movement on Construction Industry in China

Kochi University of Technology, Student Member, PhD Candidate, ○Xiangrong DU
Kochi University of Technology, Fellow Member, Professor, Shunji KUSAYANAGI

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The Ministry of Construction ("MOC") and the Ministry of Foreign Trade and Economic Co-operation ("MOFTEC"), now the Ministry of Commerce ("MOFCOM"), PRC, jointly issued Regulations on Administration of Foreign Investment Construction Enterprises ("Construction Regulations") and Regulations on Administration of Foreign Investment Construction and Engineering Design Enterprises ("Design Regulations") On 27 September 2002 based on commitments made by China to open Chinese construction market to foreign participation as part of China' s entry into the World Trade Organization. These regulations came into force on 1 December 2002. The implementation measures ("Implementation Measures") for the Construction Regulations were issued by MOC on 8 April 2003. However, implementation measures for the Design Regulations have not been issued.

The regulations for the first time allow wholly foreign owned construction enterprises ("WFOCE") and wholly foreign owned construction and engineering design enterprises to be set up in China (although there still are restrictions on the types of work that a WFOCE may undertake). And foreign contractors and designers may also set up Sino-foreign equity or co-operative joint ventures, and those already set up may continue to operate subject to certain conditions.

After 1 April 2004, foreign contractors may not undertake projects in China by applying for approval on a project-to-project basis pursuant to Tentative Measures on Administration of Foreign Enterprise Skill Qualification for Contracting Construction Works Within the Territory of China ("Decree No. 32") issued by MOC in 1994. Rather, a foreign contractor may carry on business in China only through a Chinese corporate entity after that date. However, any project awarded to a foreign contractor before 1 April 2004 and for which approval has been given may be completed, even if after April 1.

WFOCEs and Sino-foreign construction joint ventures (collectively, "foreign investment construction enterprises" or "FICEs") in their applications for skill qualification certificates ("SQC") must comply with the same requirements as domestic counterparts. Foreign investment construction and engineering design enterprises ("FIDEs") are subject to more onerous requirements than their domestic counterparts under the Design Regulations

CONSTRUCTION REGULATIONS

The Construction Regulations stipulate repeal on 1 October 2003 of the system under which foreign contractors are allowed to undertake projects in China without setting up a Chinese corporate entity. The Construction Regulations also specify the requirements for setting up FICEs. On September 28, 2003, the deadline of October 1, 2003 was extended to April 1, 2004. The Implementation Measures give more detail about the requirements for setting up these FICEs, including the types of enterprise entitled to obtain a SQC, the classes of SQC available, track record requirements, and management and technical staff qualification requirements.

1. Wholly Foreign Owned Construction Enterprises

The Construction Regulations require WFOCEs to satisfy all the requirements that Chinese contractors of the same class must satisfy, including minimum amounts of registered capital, management and technical personnel requirements, number of projects to be carried out each year and the like, but their market is limited to the four categories of projects described on the Report of the Working Party on the Accession of China into WTO. These restrictions are likely to make WFOCEs unattractive to foreign contractors as vehicles for long-term investment although most foreign contractors now are interested only in tendering for the four permitted types of projects.

2. Sino-Foreign Joint Ventures

Foreign contractors have been allowed to participate in the Chinese construction market by way of Sino-foreign equity or co-operative joint ventures since 1995. The Chinese party may be an enterprise of any class, and the required registered capital for the joint venture is similar to that for Chinese contractors of the same class. The Chinese venture' s equity must be at least 25 percent. There is no requirement that the Chinese venture be a Chinese construction company. They can undertake the same projects like domestic Chinese contractors so long as the projects are within the scope of their SQCs. Joint ventures; therefore, appear to be better long-term investments for foreign contractors than WFOCEs.

3. Other Options

Besides WFOCEs and Sino-foreign joint ventures, there are other options available to foreign contractors wishing to enter the Chinese market. One is to acquire an equity interest in an existing Chinese construction company. Another option is to use an existing joint venture to invest in a new joint venture.

DESIGN REGULATIONS

Unlike FICEs, FIDEs are not conferred "national treatment" regarding the requirements for skill qualification. When a FIDE applies for skill qualification, it must satisfy the requirements stated in the Construction and Engineering Design Enterprise Skill Qualification Classification issued by MOC. These requirements apply to all design enterprises in China. In addition, a FIDE must comply with the following requirements:

For wholly foreign-owned design enterprise (Sino-foreign joint venture design enterprise), A quarter (an eighth) of the minimum number of registered professional staff that it must employ under its skill qualification classification must be foreign service providers who are registered architects or engineers in China. And, a quarter (an eighth) of the key technical personnel required of the enterprise must be foreign service providers with relevant design experience.

Residence requirement: An FIDE' s foreign service providers must reside in China at least six months cumulatively of each year.

These requirements are difficult for any foreign designer to satisfy, particularly the minimum number of registered professional foreign service providers that it must employ. (However, steps have been taken toward reciprocal recognition of certain professional qualifications between Hong Kong and Mainland China.) Even if these requirements can be met, it will be worthy of consideration whether foreign designers can remain competitive on fees if they have to maintain a large number of expatriate staff in China. The authorities have not yet set a date for receiving applications to set up FIDEs, and it is uncertain when they will do so.

PROJECT CONSULTANCY

Though the Construction and Design Regulations do not apply to project and engineering consultancy companies. However, when authorities approve setting up a project management or engineering consultancy company, the authorities tend to scrutinize in some detail the applicant' s expertise and track record against the nature of the business that the company wishes to conduct. Some of these foreign-owned engineering and project consultancy companies are seen to enter into EPC contracts in joint venture with Chinese contractors. The consultants provide project management services or transfer technology, and their Chinese partners carry out the "physical" work, such as detailed design and actual construction. Such arrangements that benefit to promote co-operation between foreign and Chinese contractors are permissible and consistent with recent efforts by MOC to promote different models of EPC contracting in China.

CLOSER ECONONOMIC PARTNERSHIP ARRANGEMENT

MOFCOM and the government of the Hong Kong SAR signed the Mainland/Hong Kong Closer Economic Partnership Arrangement On June 29, 2003. the Arrangement provides beneficial treatment for Hong Kong-invested construction and engineering services companies.

Hong Kong-invested construction companies can undertake projects with any level of foreign investment; there is no minimum foreign investment. And Hong Kong companies can count projects that they performed in Hong Kong as part of their track record when applying for SQCs for their PRC companies.

Hong Kong companies may set up wholly owned "engineering consultancy" companies (which refer to design companies) in the PRC effective 1 January 2004.

In view of these benefits, foreign contractors and consultants that have companies in Hong Kong may consider using their Hong Kong companies to invest in the PRC.