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# **The China Soybean Industry Policy**

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## **Overview of Chinese Government Policies Related to the Soybean Industry**

Prior to the mid 1990's China was a net soybean exporter. A rapid increase in the demand for imported soybeans not only turned China into the world's largest soybean importing country, but also reshaped the geographical distribution of China's oilseed crushing industry. Earlier, China's soybean crushing plants were mainly located in the soybean producing regions (Northeast and Northern Plains). Beyond the late 1990s, many new soybean-crushing plants were built along the coastal region of China to more readily receive imports. As part of china's crushing expansion, many pre-existing crushing plants added more production lines to expand their capacity. Most of the newly built crushing facilities were located near the major port areas to take advantage of the good transportation systems and eventually, solely rely on imported soybeans from the U.S. and South America for their crushing needs. Though the strong demand for meal and oil has been the driving force behind the phenomenal growth in processing capacity and soybean imports, the government's policies created a flourishing business environment and facilitated the soybean industry development as well. In this study, we reviewed and identified a series of policies introduced by the central and local governments in the past and assessed their impact on the development of the soybean processing industry.

### **1. China's Preferential Business Income Tax Treatment for Soybean Industry**

Foreign investment in China's soybean crushing industry has grown rapidly during the past 10 years. Even though China's ever-growing demand for soybean oil and soybean meal was the driving force behind the entry of foreign investments into China's soybean crushing industry, the Chinese government's preferential policies have played an important role in encouraging investment in the soybean crushing industry. One of the most important preferential policies the Chinese government put in place was that foreign ventures pay business income taxes at a much lower rate compared to their domestic

Chinese counterparts. Though the policy was applied to a wide spectrum of the industries, and not just specific to the soybean crushing industry, it did apply to the soybean industry and this policy played a major role in the development of a large scale soybean crushing industry that relied on imported soybeans.

In 1991, the Chinese government promulgated its business income tax law (National People's Congress, 1991), which contained favorable tax treatment for businesses with foreign investments. Under the law, soybean-crushing mills with foreign investments were only subject to a 15 percent tax on their business income. In contrast, domestic Chinese crushers were required to pay a 33 percent tax on their business income. In addition, for foreign investments that intend to operate in China for more than 10 years, there is no business income tax for the first two years after they start to generate profits and the businesses only need to pay half of the required 15 percent rate for the following third through fifth years.

The preferential business income tax policy had been successful in attracting more foreign investments into China. The case also was true for the soybean crushing industry. Since the introduction of the preferential business income tax treatment for foreign investments, the growth of soybean crushing capacity with foreign investments quickly exceeded the growth of domestic investments and eventually became the dominant players in China's soybean crushing industry.

While foreign investors have been enjoying several preferential policies set by the Chinese government, there also is tax relief available for major domestic agricultural product processors including domestic soybean crushers. In 2002, the Chinese government introduced a measure to exempt business income taxes for selected agricultural processing firms for three years (The State Administration of Taxation, 2001). To qualify for the business tax exemption, a firm must be designated by the National Agricultural Industrialization Commission as one of the leading players in the industry. Many large domestic soybean crushers acquired this status and took advantage of the tax breaks to expand their crushing capacity.

On January 1, 2008, the Chinese government promulgated a new business income tax law (National People’s Congress, 2007) that unified domestic and foreign investment business income taxes. Under the new tax law, all businesses, whether domestic or foreign, will be subject to a 25 percent tax rate. But, the new tax law also introduced a transition period of five years. Businesses with foreign investments will continue to enjoy the preferential tax treatment under the old business income tax law for five years from the date the new law was enacted.

## **2. China’s Preferential Industry Investment Policy for Soybean Industry**

The Chinese government issued the “Industry Investment Guideline for Foreign Investors” in 1995 to attract more foreign investments (The State Planning Commission, 1995). The guideline divides China’s industries into two broad categories: one category that welcomes foreign investors and the other that restricts or even bans the entry of foreign investments. For foreign investments that fall under the first category, foreign investors are exempted from paying import tariffs and VAT (Value-Added Tax) for the machinery and equipment they bring into China. In addition, if foreign investors purchase machines and equipment made in China, these foreign investors are eligible for VAT rebates, as well. In the 1995 guidance and subsequent revisions before 2007, there was no explicit term regarding the soybean crushing industry. However, compound feed, feed additive and the protein meal industry is listed as a welcome industry. So, all the foreign invested crushing plants are claimed as a protein meal producer in order to qualify for the preferential treatment. The policy reduced the business startup cost for foreign investors to enter the Chinese soybean crushing industry and led to the rapid buildup of the Chinese soybean crushing capacity, which relies heavily on imported soybeans for its crushing needs.

## **3. Preferential Policies by Local Governments in China**

In addition to the preferential policies set by the central government aimed at attracting more foreign investments, local governments at the provincial, city and especially at the county level, also have mounted great efforts to attract both domestic and foreign investments. For many local government officials, regional economic development has been the dominant measurement of their job performance and it is often associated with awards and job promotions. Since investment is the driving force that supports local economy development and employment, recruiting investments from outside regions or foreign countries has been on top of local government officials' agenda for many years. In some extreme cases, many officials would be assigned an investment recruiting quota by their leaders and the results would be reviewed annually as a benchmark for promotion or demotion. In the government's mind, importing soybeans to process for meal and oil contributes to the domestic economy growth and employment. Therefore, it is not difficult to understand why the Chinese government favors soybeans imports over soybean meal and oil imports.

In order to attract more investments into the region, a local government has to compete with governments in other regions in offering preferential investment treatments. Common preferential policy treatments include a reduction or a refund in land leasing rent, assurance of bank loans and utility supplies as well as the extension of the business income tax exemption period, which included the soybean crushing mills as well.

Other local incentives include:

(a) Partial to full rebate of rent for land leasing from the government. Since the government is the legal owner of the land, business operations must lease the land from the government directly or indirectly through their business partners. Local governments often use land rent rebates as an incentive to lure investments. The rebate amount varies according to the size of the investment and whether the business is listed as a "welcomed category" by the central government. For example, many county governments in Shandong province, where many new crushing mills were built, offered one year full rebate of the land leasing fee for investments of between 1 to 5 million US dollars and two year' full rebate of land rent with investments greater than 5 million US dollars.

During the period of rapid expansion in soybean crushing capacity, many crushing mills enjoyed this preferential treatment.

(b) In addition to the tax relief from the central government, the local governments offered additional tax breaks for new investments. Normally, investors would receive an additional 1 to 4 years of business income tax exemptions depending on the investment size and negotiations after the central government's exemptions expire. This is a gray area for the local government and businesses located under its administration. The general rule for the qualification is whether a firm is considered as an advanced technology firm. Whether a firm is considered technology advanced is a subjective assessment open to interpretation. Usually, local government officials are the judges of the qualification. As a result, personal relationship and connections as well as government's eagerness to attract businesses determine whether a firm can get an extension and the duration of the extension.

(c) China's economy has been largely investment and export driven. Investors fight with each other for limited bank loans. In order to attract more investments, local governments especially at municipal and county level typically will guarantee to match investors' investment amount with bank loans. In some cases, local governments are even willing to go extra miles by partially subsidizing bank loan interest to lure in the investments. However, investors in the development of the soybean industry rarely enjoyed this preferential treatment.

#### **4. Conclusions**

Over the past decade, a series of government policies at different jurisdictional levels facilitated the development of China's soybean industry and even shaped the industry as it exists today. Other than soybean production and trade policies that are not within the scope of this study, our research found that few policies were specifically directed at the soybean crushing industry. There were rather broader multi-industrial policies that covered the soybean-crushing industry as well. However, these multi-industrial policies

had created a favorable business environment for the Chinese soybean industry to grow at a rapid pace and became the largest soybean importer in the world over the past decade. In addition, though there were no explicit policies targeted at the soybean crushing industry, the development of this industry was viewed as contributing more to the local economy growth and employment and as such was viewed with favor by local governments. Therefore, encouraging the development of soybean crushing industry to process domestic and imported soybeans for protein meal and oil to keep the value added within China became an obvious policy choice. Looking into the future, since domestic economic growth and increasing employment opportunities will remain the top priority of the Chinese government agenda, we believe that Chinese government will continue to favor soybean imports over protein meal and oil imports for the foreseeable future.

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