SWITZERLAND GLOBAL ENTERPRISE

China
Update on Shanghai Free Trade Zone, the Incubator for the Country's Economic Reform

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Officially launched on 29 September 2013, the **China (Shanghai) Pilot Free Trade Zone** (Shanghai FTZ) is the first Hong Kong-like free trade area in mainland China and an incubator for economic reform. The Shanghai FTZ pioneers an unprecedented degree of openness in relation to foreign investment and international trade in both goods and services, with the objective of promoting and leading the development of an open Chinese economy. It is a plan of two to three years of piloting reform and covers a geographical area of 28.78 square kilometers, comprising the following four customs supervisory zones: Waigaoqiao Bonded Zone, Waigaoqiao Bonded Logistics Park, Yangshan Bonded Port and Pudong Airport Comprehensive Bonded Zone. As of Oct. 2014, 12,226 companies have been registered in the zone and among which, 1,677 are foreign companies.

BACKGROUND INFORMATION

Domestically, as China moves from an export-driven economy toward increased domestic consumption, many foreign-invested manufacturers have transferred their operations to elsewhere in Asia, which pressures Chinese government to offer new incentives for Foreign Direct Investment (FDI) and thereby transform its economic structure and sustain growth. Against the backdrop of the USA actively promoting TPP (Trans-pacific Partnership Agreement) and the United States and European Union starting negotiations on TTIP (Transatlantic Trade and Investment Partnership), Chinese authorities hope the Shanghai FTZ, among other measures, will boost China's competitiveness with respect to TPP and TTIP.

KEY POINTS IN THE PLAN

The Shanghai FTZ has created fresh opportunities for mature businesses in China, and at the same time opened new avenues into industries that have heretofore been restricted to foreign investment.

(1) Trade facilitation. More than 60 facilitation measures for trade supervision, covering customs, tax filing, inspection and quarantine, have been introduced, which has significantly improved the efficiency of customs clearance at the FTZ and reduced the logistics costs of companies concerned.

(2) Investment liberalization. The Shanghai FTZ has adopted the negative list approach (accessible unless limited or prohibited), which is a positive signal that China is further opening up to overseas investors and integrating with international rules. The revised version of negative list in June 2014 has cut the number of restricted sectors from 190 to 139 and gives companies greater assurances and flexibility when making investment decisions based on market development needs. Other practice adopted includes the pre-establishment of national treatment of foreign investment.

(3) Financial innovation. As compared to other free trade zones currently under construction outside China (e.g. Hong Kong), China may have the biggest gap in the financial sector and the government is under pressure to relax existing controls over investment and foreign exchange, as well as RMB internationalization. The financial reform within the Shanghai FTZ is supporting pilot programs in terms of RMB convertibility under capital account, facilitating foreign investment and financing, cross-border two-way RMB cash pooling business, facilitating transactions of commodities derivatives and interest rate liberalization.

(4) Redefining relationship between government and market. Its objectives are to shift the administrative focus from prior approval to in-event and after-event supervision (e.g. company set-up; replacement of annual inspections with the publication of annual reports and then listing of non-compliant companies) and to enhance transparency; reform custom's regulatory system that facilitate efficient and smooth flow of people and goods in the zone; and allow an ad hoc three-year suspension of implementation of three foreign investment laws.

WHO WILL BENEFIT (SELECTED INDUSTRIES)

1. Various firms operating/planning to operate in the zone. Benefit from the above mentioned trade facilitation and simplification measures.

2. Education and vocational training institutions. Establishment of Sino-foreign cooperative joint venture is allowed.

3. Medical service. Establishment of wholly foreign-owned medical institutions is allowed.

4. Banking service. Qualified foreign financial institutions are allowed to set up wholly foreign-owned banks and Sino-foreign equity joint venture banks with eligible private capital within the zone.

5. Specialized health and medical insurance. Setup of foreign invested specialized health and medical insurance institutions is allowed.

6. Other professional services including lawyer service, credit inquiry, tourism companies, human resources services and investment management are either now allowed or entry restrictions relaxed.

As Shanghai FTZ is located quite far from the city center, companies who choose to incorporate in the zone could register a virtual address there and maintain a physical address in downtown Shanghai.

Shanghai FTZ being still an ongoing project, some of the regulatory framework surrounding it remains vague and various innovative policies still await improvement. However, as China's President Xi Jinping underlined recently, the replicable and scalable experience gained from the FTZ should be copied to more locations as soon as practicable and extended to the whole country if possible. It can be foreseen that China will establish more investment and trade systems in line with international practice over the next two years, as more reform experiments reach maturity and are promoted nationwide.

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