



**China (Shanghai) Pilot  
Free Trade Zone –  
China's Springboard to a  
Free Market?**

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# China (Shanghai) Pilot Free Trade Zone – China's Springboard to a Free Market?

## OFFICIAL LAUNCH

On 29 September 2013, China officially launched the pilot free trade zone in Shanghai ("**Shanghai FTZ**"). At the inauguration ceremony, 25 Chinese and overseas companies together with 11 financial institutions were the first batch of entities granted permission to register in the trial zone.

The Shanghai FTZ will first cover a non-contiguous geographic area of 28.78 square kilometres in the city's Pudong New Area, consisting of the following four existing bonded zones: Waigaoqiao Free Trade Zone, Waigaoqiao Free Trade Logistics Park, Pudong Airport Comprehensive Free Trade Zone, and Yangshan Free Trade Port Area. It is believed that it may eventually expand to cover the entire Pudong district which covers 1,210.4 sq. km.

## WHAT IS THE "HYPE" ABOUT?

There has already been much anticipation over the Shanghai FTZ. The Shanghai FTZ's significance could be comparable to that of the Shenzhen Special Economic Zone established more than 30 years ago in that it could serve as China's testing ground for ground-breaking economic reforms. These reforms include:

- the liberalization of many investment sectors currently restricting foreign investment
- structural changes in the financial sector and foreign exchange administration
- the further development of trade in goods within the Shanghai FTZ

The expectations are more than just free trade, but a free market whereby the State will loosen the controls over China's economic engine and create a level-playing field for all market participants.

## FLURRY OF LEGISLATION AND MEASURES

So far, China has issued a flurry of legislation and measures demonstrating top-to-bottom coordination in the zone's rollout. On 27 September 2013, the State Council issued the *Overall Plan for the China (Shanghai) Pilot Free Trade Zone* ("**Overall Plan**"), which is the overarching framework for liberalization within the zone. Two days later, on 29 September 2013, the Shanghai

municipal government issued the Negative List (discussed further below) and five administrative measures governing the administration of the Shanghai FTZ, the establishment procedures for foreign-invested enterprises and foreign-invested projects in the zone, and the record-filing procedures for offshore investments by zone entities. The Standing Committee of the National People's Congress issued a decision effective 1 October 2013, suspending 11 administrative approval items regulated under the relevant foreign investment rules so as to streamline the process of setting up foreign-invested enterprises in the zone. About 40 other measures couched in very general terms were announced by various industry regulators and other agencies, including the China Banking Regulatory Commission, the Ministry of Finance, China Insurance Regulatory Commission, China Securities Regulatory Commission, the Ministry of Culture, General Administration of Customs, the People's Bank of China, the State Administration of Foreign Exchange, General Administration of Quality Supervision, Inspection and Quarantine, and the Administration of Industry and Commerce.

## DEVIL IS IN THE DETAILS

The most concrete and significant rules on reform can be seen in the Overall Plan and the Negative List. In some areas (such as sector liberalization), it is relatively clear how the Shanghai FTZ will seek to achieve market reform. In other areas (such as financial reforms), there is much less articulation and so the scope of market reforms and whether they will indeed be ground-breaking remain open questions. We touch on just a few of the significant areas below.

### 1. Financial reforms

The Overall Plan states that "[U]nder the precondition that risks can be controlled, China will create conditions to test yuan convertibility under the capital account, market-based interest rates and cross-border use of the Chinese currency in the zone."

The Overall Plan pledges to establish a foreign exchange management mechanism appropriate for trade and investment reforms in the zone. Enterprises are "encouraged" to participate in cross-border

financing and multinationals are encouraged to establish regional headquarters or global capital management centers in the zone. Further, foreign companies will be permitted to gradually participate in commodities futures trading in the zone.

The commitments above are rather broad and qualified by statements on risk control, appropriateness and gradual implementation. It is expected that financial reforms within the zone will be limited in the early stages and rolled out incrementally.

## **2. Simplified Record-filing Process for FIEs – the “Negative List” Approach**

The Overall Plan provides that the Shanghai FTZ will adopt a “negative list” approach towards foreign investment administration, which means that foreign investment in all sectors should be allowed unless listed as prohibited or restricted under the “negative list” (“**Negative List**”). The Negative List covers 18 main sectors divided further into 1,069 subcategories, and includes 190 special regulatory measures.

Foreign enterprises will generally enjoy national treatment, that is, like Chinese investments, foreign investments in the Shanghai FTZ will generally not be required to undergo an approval process with the relevant government department (the Ministry of Commerce and its local counterparts, collectively, “**MOFCOM**”). The establishment of foreign-invested enterprises and projects need only complete a record-filing process, unless the investment is on the Negative List. This is a giant leap for foreign investments which have always generally been subject to MOFCOM's “discretionary” approval.

The Negative List effectively replaces (in the Shanghai FTZ) the 2011 *Foreign Investment Industrial Guidance Catalogue* (“**General Catalogue**”), a catalogue setting out all sectors in which foreign investment is encouraged, restricted or prohibited in China. Like the General Catalogue, the Negative List will be updated from time to time to cater to the on-going development needs of the zone.

## **3. Sector Liberalization**

The Overall Plan also provides equal market access to foreign investors by scrapping market entry restrictions and eliminating certain qualification thresholds in six investment areas (18 service sectors) ranging from finance and shipping to cultural services. A list of the liberalization initiatives in all 18 service sectors as set out in the Overall Plan is attached to the Appendix. Below are highlights of some of those initiatives.

## ***INVESTMENT AREA I – FINANCIAL SERVICES***

### ***Banking Services***

Allowing qualified foreign financial institutions to set up foreign-invested banks in the Shanghai FTZ and permitting qualified domestic private capital enterprises to set up joint venture banks with foreign financial institutions.

- Under current regulations (*PRC Administrative Regulations on Foreign-invested Banks*), foreign banks or the sole/controlling investors of foreign banks must set up a representative office and operate it in China for at least two years before they may set up an operating branch or a wholly foreign-owned bank. The Overall Plan therefore appears to eliminate the pre-condition of a rep office establishment.

## ***INVESTMENT AREA III – TRADE AND COMMERCIAL SERVICES***

### ***Value-added Telecommunications***

Allowing foreign enterprises to run certain types of telecommunication businesses in the Shanghai FTZ; if doing so involves a departure from existing administrative regulations, such departure shall be subject to approval by the State Council.

- Under the *Administrative Provisions on Foreign Invested Telecommunications Enterprises*, the proportion of foreign investment in value-added telecommunications services (“**VATS**”) must not exceed 50%. However in practice, VATS licenses are seldom granted where direct foreign investments are involved, even where such investment is restricted to less than 50% equity ownership. This has led to the use of “variable interest entity” structures in the telecommunications space. It remains to be seen if, in practice, direct foreign investment in this sector will indeed be allowed in the Shanghai FTZ.

### ***Selling and Servicing of Gaming Consoles and Amusement Machines***

Allowing foreign enterprises to produce and sell gaming and amusement equipment, which, with approval from the cultural authorities after content censorship, may be offered for sale to the domestic market.

- This can be seen as a lifting of the 13-year ban on video game consoles, which was put in place by the Ministry of Culture and six other government agencies to protect the “mental health” of Chinese youth. On 29 September 2013, the E-Home Entertainment Development, a joint venture of Microsoft and BesTV (a subsidiary of a major

broadcaster, Shanghai Media Group) became one of the first batch of 25 Chinese and foreign companies registered in the Shanghai FTZ and the first to benefit from this initiative.

#### **INVESTMENT AREA IV - PROFESSIONAL SERVICES**

##### ***Credit Investigation***

Allowing foreign invested credit investigation companies to be established in the Shanghai FTZ.

- Under the General Catalogue, a foreign-invested credit investigation company must be in the form of a joint venture; presumably under the Overall Plan, a wholly foreign owned credit investigation company is possible in the zone.

##### ***Engineering Design***

Cancelling the criteria on past engineering design experience for foreign engineering design companies (excluding engineering survey enterprises) in the Shanghai FTZ when applying for the qualification to provide services to Shanghai for the first time.

- Under the *Implementing Rules to the Administrative Regulations on Foreign-Invested Construction Engineering Design Enterprises*, a foreign engineering design company must demonstrate completion of two or more projects undertaken outside of China, of which at least one must have been undertaken in its home country or region.

##### ***Construction Services***

Cancelling the equity percentage restrictions applied to Sino-foreign construction projects in Shanghai for which wholly foreign-owned construction companies are permitted to contract.

- Under the *Administrative Regulations on Foreign-Invested Construction Enterprises*, wholly foreign-owned construction companies are restricted from building Sino-foreign construction projects in which the foreign equity investment is less than 50%.

#### **INVESTMENT AREA VI - SOCIAL SERVICES**

##### ***Education and Vocational Skills Training***

Allowing the establishment of for-profit Sino-foreign cooperative joint venture educational training institutions and vocational skills training institutions.

- Under the General Catalogue, this area of foreign investment should be permitted. However, in practice, the authorities do not grant licenses to foreign investors wishing to set up training institutions as distinct from joint education programs, such as university programs, which have been permitted. Foreign invested training activities have been sometimes done by way of "variable interest entity" structures or consulting companies. Again, it remains to be seen how the Shanghai FTZ will open up opportunities to foreign players aiming for entry into this sector.

#### **THE LONGER HAUL**

Despite the hype over the Shanghai FTZ, very few people expect seismic shifts to happen overnight-- even in this rather small pilot zone. For those who have operated in China long enough, the conventional wisdom has been that China takes a measured approach and sets its own timetable in pushing forward every major reform. But that does not diminish the significance of these reforms, nor does it mean that China will fail to accomplish what it sets out to achieve. One of the country's end goals is to transform Shanghai into an international financial center—similar to Hong Kong—by the year 2020. With such high aspirations, China is poised to move forward reforms in the Shanghai FTZ with determined speed and agility. Indeed, there will be bureaucratic resistance and setbacks as China creates its new landscape. But for those who have followed China's short road to modernity and prosperity in the last few decades, these bureaucracies are simply par for the course and often overshadowed by the ultimate success of the reforms.



## Appendix

## MEASURES FOR FURTHER OPENING UP SERVICES SECTORS WITHIN THE CHINA (SHANGHAI) PILOT FREE TRADE ZONE ["FTZ"]

### I. Financial Services Sector

<b>1. Banking Services (National Economic Industrial Classification: J Financial Sector – 6620 Currency and Banking Services)</b>	
Measures	<p>(1) Qualified foreign financial institutions shall be permitted to set up foreign banks, and qualified [domestic] businesses funded by private capital shall be permitted to set up Sino-foreign joint venture banks with foreign financial institutions. When conditions allow, restricted license banks may be set up within the FTZ as pilots.</p> <p>(2) Provided that related administrative measures are in place and effective regulation is reinforced, qualified Chinese banks shall be permitted to engage in offshore business activities within the FTZ.</p>
<b>2. Professional Health and Medical Insurance (National Economic Industrial Classification: J Financial Sector – 6812 Accident and Health Insurance)</b>	
Measures	Foreign professional health and medical insurance companies may be set up as pilots.
<b>3. Financial Leasing (National Economic Industrial Classification: J Financial Sector – 6631 Financial Leasing Services)</b>	
Measures	<p>(1) Restrictions on minimum registered capital shall be lifted for single-aircraft or single-vessel subsidiaries set up by financial leasing companies within the FTZ.</p> <p>(2) Financial leasing companies shall be permitted to engage in commercial factoring activities relating to their principal business activities.</p>

### II. Shipping Services Sector

<b>4. Ocean Freight (National Economic Industrial Classification: G Transportation, Warehousing and Postal Industries – 5521 Ocean Freight)</b>	
Measures	<p>(1) Restrictions on the proportion of equity held by foreign parties in Sino-foreign equity and cooperative joint ventures in the international shipping sector shall be relaxed, and the transportation authorities under the State Council shall formulate relevant provisional administrative measures.</p> <p>(2) As part of the pilot programme, vessels not carrying China's national flag which are owned, or whose controlling interests are held, by Chinese companies shall be the first to be permitted to engage in coastal piggybacking activities in which international import/export containers are transported between domestic ports and Shanghai terminals.</p>
<b>5. Management of International Vessels (National Economic Industrial Classification: G Transportation, Warehousing and Postal Industries – 5539 Other Services Auxiliary to Water Transportation)</b>	
Measures	Establishment of wholly foreign-owned international vessel management enterprises shall be permitted.

**III. Trade and Commercial Services Sector**

<b>6. Value-added Telecommunications (National Economic Industrial Classification: I Information Transmission, Software and Information Technology Services Sectors – 6319 Other Telecommunications Services, 6420 Internet Information Services, 6540 Data Processing and Storage Services, 6592 Call Centres)</b>	
Measures	Provided that network information security is guaranteed, foreign enterprises shall be permitted to engage in certain types of value-added telecommunications activities; if [such activities] involve a departure from existing administrative regulations, such departure shall be subject to approval by the State Council.
<b>7. Sale of Game Consoles and Amusement Machines and Related Services (National Economic Industrial Classification: F Wholesale and Retail Sector – 5179 Wholesale of Other Machinery and Electronic Goods)</b>	
Measures	Foreign enterprises shall be permitted to produce and sell gaming and amusement equipment, which may be sold in the domestic market after having passed the content review conducted by the competent cultural authority.

**IV. Professional Services Sector**

<b>8. Legal Services (National Economic Industrial Classification: L Leasing and Commercial Services Sector – 7221 Lawyers and Related Legal Services)</b>	
Measures	Methods and mechanisms to enhance collaboration between Chinese law firms and foreign law firms (including those in Hong Kong, Macau and Taiwan) shall be explored.
<b>9. Credit Investigation (National Economic Industrial Classification: L Lease and Commercial Services Sector – 7295 Credit Services)</b>	
Measures	Establishment of foreign-invested credit investigation companies shall be permitted.
<b>10. Travel Agencies (National Economic Industrial Classification: L Leasing and Commercial Services Sector – 7271 Travel Agency Services)</b>	
Measures	Qualified Sino-foreign joint venture travel agencies incorporated within the FTZ shall be permitted to engage in overseas travel (excluding travel to Taiwan) business.
<b>11. Human Resources Intermediary Services (National Economic Industrial Classification: L Leasing and Commercial Services – 7262 Recruitment Intermediary Services)</b>	
Measures	(1) Establishment of Sino-foreign joint venture human resources intermediaries shall be permitted, provided that the foreign party owns no more than 70% of the equity. Hong Kong and Macau service providers shall be permitted to set up wholly-owned human resources intermediaries.  (2) The minimum registered capital for foreign-invested human resources intermediaries shall be reduced from US\$300,000 to US\$125,000.
<b>12. Investment Management (National Economic Industrial Classification: L Leasing and Commercial Services – 7211 Corporate Headquarters Management)</b>	

Measures	Establishment of foreign-invested joint-stock investment companies shall be permitted.
<b>13. Engineering Design (National Economic Industrial Classification: M Scientific Research and Technology Services Enterprises – 7482 Engineering Surveying and Design)</b>	
Measures	Investors in foreign engineering design (excluding engineering survey) enterprises within the FTZ providing services to Shanghai shall no longer be required to provide past performance information in the engineering design sector on first application for qualifications.
<b>14. Construction Services (National Economic Industrial Classification: E Construction Sector – 47 Building Construction Sector, 48 Civil Engineering Construction, 49 Construction and Installation Sector, 50 Decoration, Fit-Out and Other Construction Sectors)</b>	
Measures	When undertaking Sino-foreign construction projects in Shanghai, wholly foreign-owned construction enterprises within the FTZ shall no longer be subject to the restrictions on the proportions of investments made by foreign and Chinese parties in the Sino-foreign construction projects.

#### V. Cultural Services Sector

<b>15. Performance Agents (National Economic Industrial Classification: R Culture, Sports and Entertainment – 8941 Culture and Entertainment Agents)</b>	
Measures	Restrictions on the proportion of equity held by foreign performance agencies shall be lifted to allow the establishment of wholly foreign-owned performance agencies that provide services to Shanghai.
<b>16. Entertainment Premises (National Economic Industrial Classification: R Culture, Sports and Entertainment – 8911 Dance Hall Entertainment Activities)</b>	
Measures	Establishment of wholly foreign-owned entertainment premises providing services within the FTZ shall be permitted.

#### VI. Social Services Sector

<b>17. Education and Vocational Skills Training (National Economic Industrial Classification: P Education – 8291 Vocational Skills Training)</b>	
Measures	(1) Establishment of for-profit Sino-foreign educational training cooperative joint venture institutions shall be permitted. (2) Establishment of for-profit Sino-foreign vocational skills training cooperative joint venture institutions shall be permitted.
<b>18. Medical Services (National Economic Industrial Classification: Q Health and Social Services – 8311 General Hospitals, 8315 Specialized Hospitals, 8330 Outpatient Clinics)</b>	
Measures	Establishment of wholly foreign-owned medical institutions shall be permitted.

Note: The Measures set forth above shall only be applicable to enterprises within the China (Shanghai) Pilot Free Trade Zone.

### **Further information**

If you would like further information please contact a person mentioned below or the person with whom you usually deal.

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