The Shanghai Free Trade Zone

www.lehmanbrown.com

LEHMANBROWN
雷 博 國 際 會 計
International Accountants

Background

The Shanghai Pilot Free Trade Zone (FTZ) is the first Free-Trade Zone in Mainland China. It was officially launched on September 29, 2013, created as an environmental space to test major policy reforms. The zone covers an area of 29 square kilometres (11 sq mi) and integrates four existing bonded zones (the Waigaoqiao Free Trade Zone, the Waigaoqiao Free Trade Logistics Park, the Yangshan Free Trade Port Area and the Pudong Airport Comprehensive Free Trade Zone) in the district of Pudong.

Chinese Commerce Minister Gao Hucheng has said that the zone is set to become a pilot project for economic reform and a role model in efforts to upgrade the Chinese economy. The guiding principle is to develop Shanghai into an International Fnancial Centre and trading hub by 2020, by loosening the government's tight grip on **foreign investment, the currency market and the banking system**.

The intention is for the SFTZ to expand gradually to cover the entire 1,210 square kilometres (470 sq mi) of Pudong. Chinese Prime Minister Xi Jinping has announced that the FTZ will be expedited to other parts of Shanghai in the future. Other cities are currently going through an application process to set up their own FTZ regions.

Stated Goals

The main goal of the Shanghai FTZ initiative is for a **functional transformation** of the government – to shift the overriding role of the government from administrative to supervisory and to promote trade by encouraging multinational companies to set up their Asia-Pacific regional headquarters and/or operations centers in Shanghai, making the city an **international trade settlement center**. The easing of restrictions on **RMB convertibility** for capital account items will allow for cross-border financing and fund transfers (currently highly regulated outside the FTZ), allowing enterprises to bypass SAFE (State Administration of Foreign Exchange) for matters involving currency conversion. There has also been talk of implementing **tax policies** to promote trade and boost investment.

The Chinese cabinet has highlighted **six areas of focus** for the free trade zone: financial services; shipping and logistics; commercial trade; professional services such as law and engineering; culture and entertainment; and social services including education and healthcare. As expected of a free trade zone, customs formalities are greatly simplified for goods imported into the FTZ. Goods imported by companies in the FTZ may be **exempted from import tax**. Moreover, declaration on goods can be done **14 days after entry**. There is a policy to give an instant pass-through and collective deflation on goods meaning that an importer can bring goods into the country in batches and then declare together collectively once a complete shipment has arrived. An internet-based **registration system** has been introduced for enterprises, which has shortened the registration period from the **29 days to 5 days**.

Timeline

27th-29th March 2013	"Reforms should be promoted to open up the city" Li Keqiang encouraged setting up an FTZ in Shanghai during his three-day visit
16th April 2013	Shanghai started the mobilization and deployment process to set up the Free Trade Zone
2nd May 2013	The Shanghai municipal government held a special meeting on the introduction of the FTZ and ordered relevant departments to form an overall plan as soon as possible
11th May 2013	Consensus was reached on the content frame and an overall plan of the FTZ at a meeting held by Shanghai Mayor Yang Xiong and Commerce Minister Gao Haocheng
28th June 2013	Shanghai finalised the overall plan and sent relevant government ministries and commissions to be countersigned.
22nd August 2013	State Council approved the establishment of a Free Trade Zone in Shanghai
29th September 2013	The long-awaited Free Trade Zone was launched, 36 domestic companies in the first batch of firms to were enter the zone
30th September 2013	FTZ issued the first "negative list" See "Key Policy 2014" Section
15th October 2013	HSBC and BEA won approval for FTZ operation, following in the footsteps of Citigroup and DBS, which were the first two foreign banks to get a green light to operate in the FTZ.
16th October 2013	1st foreign-funded firm, Alier, to get FTZ approval
23rd October 2013	SFTZ has drawn 157 firms - 135 Chinese and 22 foreign-funded, with a combined registered capital of $829 million
21st November 2013	About 700 domestic and foreign companies have been approved for the Free Trade Zone, 60% in trading and 30% are service companies, Financial Institutions only account for 1%
29th November 2013	The SFTZ has drawn 38 overseas firms bringing in $560 million of capital to the zone, and 1,400 homegrown companies
1st July 2014	Negative List reduced substantially See "Key Policy 2014" Section

Successes

Entries into the FTZ so far include **Microsoft** (using its FTZ presence for XBox assembling and software content downloading, creating a market opening for games console production in China) and **HSBC** (focusing on International Banking Services, targeting corporate customers in the zone, with a view to then expanding its service scope as the regulatory framework for the pilot zone evolves). Other major entry successes for FTZ so far includes Citibank, Bank of America, Morgan Stanley, Deloitte, MetLife, Amazon and ArthurMed (the first Foreign-Owned Hospital to establish in the FTZ). Nationwide bans on potentially sensitive websites such as Facebook, Twitter and the New York Times have also been relaxed in the zone, in order to make foreigners feel more comfortable.

The Current Situation

However, at present, the general consensus among the foreign business community is that there is **no real advantage or incentive** to setting up in the FTZ. Companies are waiting and watching the situation closely to see if the incentives improve.

In recent surveys:

- Only **14%** of members of the European Chamber of Commerce for China (EUCCC) planned to establish a presence there.
- Only **16%** of members of the American Chamber of Commerce for China (AmCham) planned to establish a presence there.

Currently, there are **10,500** companies registered in the FTZ with only **120** of these being American. The vast majority of registered companies are domestic, with the majority of foreign companies originating from Hong Kong, Japan and Singapore. Currently, only **800** companies are registering per month; this rate is **slow and less than expected**.

Challenges

The relative youth of the Shanghai FTZ concept is holding it back. The government is still assessing its options; they are reforming cautiously so as to balance risk factors. However this raises a number of challenges for the SFTZ at present. There are currently **no implemented tax incentives** for businesses, and many benefits of the Shanghai Free Trade Zone are **shrouded in mystery**. "Banks are quite reluctant to invest a large sum of money in the zone ... details are still unclear and foreign banks as a whole are not making very good profits on the mainland" says a Shanghai-based executive at HSBC. Many companies are wary as most of the decision-making and political influence in the zone is controlled by Beijing, with Shanghai's autonomy limited, and it is unclear how revenue from outside of the zone or branches throughout the rest of China can flow **in and out of the zone**. The FTZ has created a region with potential investment borders and businesses are still yet to receive sufficient clarification as to how this will affect their financial operations. Moreover, other cities also going through an application process to set up their own FTZ regions are counterproductive to the Shanghai FTZ. It further encourages the '**wait and see**' stance that the majority of businesses have taken.

The American Chamber of Commerce (AmCham) are lobbying the Shanghai Government to move faster and make more meaningful reforms as opposed to taking "baby-steps". AmCham representatives are meeting with FTZ officials, and have produced 2 white papers for the Shanghai Government.

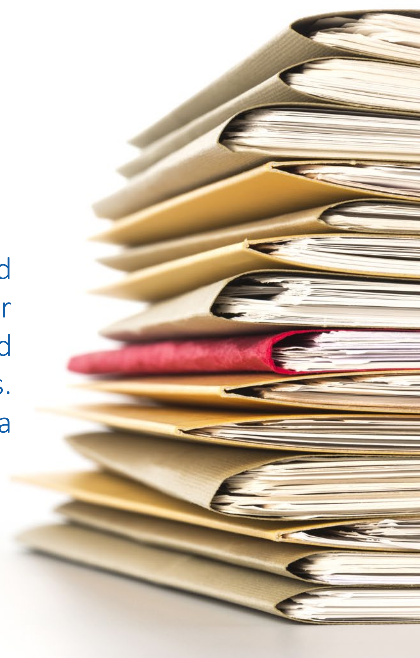
Key Policy 2014: The Negative List

The most significant development in 2014 has been the publication of **the latest negative list**, which specifies bans or restrictions on certain types of foreign investment. The initial list, released by the Shanghai municipal government around the time of the launch, covered 1,069 businesses in 89 divisions within 18 main categories. Compared with the 2013 version, the number of restricted businesses has been significantly **reduced**. However, the 2014 list has been largely met with **scepticism** from the foreign business community. There are **23 instances** where prohibited business sectors were merged and **14 other sectors** were erased completely, including; Pornography websites, Real Estate (investment in the agency sector) and Internet cafés. This has therefore distorted the numbers. We conclude therefore that due to the number of merged sectors, this reform was n**ot such a drastic reduction**, and is not as significant as is being promoted.

In Sum

It is disappointing that there has been **no headline-grabbing reform in** 2014, but we are beginning to see steps forward in certain areas. While the overall volume of setup in the FTZ has been low to date (August 2014), there is still great growth potential and Lehman Brown are watching the situation closely.

This article was prepared by LehmanBrown International Accountants.



Contact Us 联系我们

For further information about how we can add value and support your individual or business needs, please contact us.
如您希望获得更多信息或者得到我们的支持，请联系我们：

Beijing 北京

6/F, Dongwai Diplomatic Building, 23 Dongzhimenwai Dajie, Beijing 100600, China
中国北京市朝阳区东直门外大街 23 号，东外外交办公大楼 602
Tel: +86 10 8532 1720
Fax: + 86 10 6532 3270
E-mail: beijing@lehmanbrown.com

Shenzhen 深圳

Room 3206, News Building 2, Shennan Middle Road, Shenzhen 518027, China
中国深圳市深南中路 2 号新闻大厦 3206
Tel: +86 755 8209 1244
Fax: + 86 755 8209 0672
E-mail: shenzhen@lehmanbrown.com

Hong Kong 香港

Unit 1902, 19/F, Asia Orient Tower, 33 Lockhart Road, Wanchai,HongKong
中国香港湾仔骆克道 33 号中央广场汇汉大厦 19 楼 1902 室
Tel: + 852 2426 6426
Fax: + 852 2426 6427
E-mail: hongkong@lehmanbrown.com

Shanghai 上海

Room 1501 & 1504, WanTai International Building, No. 480 North Urumqi Road, Shanghai 200040, China
中国上海市静安区乌鲁木齐北路（华山路）480 号 1501 & 1504
Tel: +86 21 6249 0055
Fax: +86 21 6288 1636
E-mail: shanghai@lehmanbrown.com

Tianjin 天津

Unit 2901-04, The Exchange Tower 2 189 Nanjing Road, Heping District Tianjin 300051, China
中国天津市和平区南京路 189 号 津汇广场 2 座 29 层 2901-104 室
Tel: + 86 22 2318 5056
Fax: + 86 22 2318 5001
E-mail: tianjin@lehmanbrown.com

Macau 澳门

No. 367, Avenida da Praia Grande, “Keng Ou” Commercial Building #16, A & B, Macau
中国澳门南湾大马路 367 号京澳商业大厦 16 楼 AB 座
Tel: + 853 2835 5015
Fax: +853 2837 1884
E-mail: macau@lehmanbrown.com

Guangzhou 广州

Room 3317, China Shine Plaza, 9 Lin He Xi Road, Guangzhou 510610, China
中国广州市林和西路 9 号耀中广场 3317 室
Tel: + 86 20 2205 7883
Fax: +86 20 2205 7880
E-mail: guangzhou@lehmanbrown.com