China's free trade zones – overview of 2017 developments

July 14, 2017

For more than thirty years, China has facilitated economic growth by attracting foreign investment through Special Economic Zones ("SEZ"). As part of these efforts, in 2013 China's first Free Trade Zone ("FTZ") was established in Shanghai, which was followed in 2015 by three additional FTZs in Guangdong, Fujian and Tianjin. Companies registered in FTZs are subject to a less stringent regulatory framework than in other parts of China. Benefits include fewer restrictions on customs procedures and business registration, expedited approval of foreign investment, more lenient trade regulation and a significant discount on import/export taxes. Each FTZ also has a specific industry and development focus, supported by additional corresponding regulatory policies.

On 1 April 2017, the Chinese government opened seven additional FTZs, bringing the total number of FTZs to eleven. On 16 June 2017, the Chinese government also published a new version of its FTZ "negative list", reducing the number of restricted and prohibited areas of industry for which foreign investment is not allowed. Although both developments indicate a new round of economic liberalisation and reform – and corresponding opportunities – the Chinese environment for foreign investments remains unvaryingly regulated and challenging. We discuss these developments in this article.

Introduction

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The FTZs have generally been successful in attracting substantial foreign investment and have made significant contributions to China's economic development. In the first half of 2016, a total of 4,923 foreign-funded companies were established in the four FTZs, with total investments amounting to RMB 359 billion. In 2016, the four FTZs attracted foreign investment of RMB 87.96 billion, which was an increase of 81.3% compared to the previous year.

2017 expansion, seven new FTZs

On 31 March 2017, the Chinese State Council released an official statement, announcing that it had approved the launch of seven new FTZs. The new FTZs opened on 1 April 2017, bringing the total number of FTZs to eleven. In contrast to the existing FTZs, which are all located in rich coastal areas, the new FTZs are mainly located in underdeveloped areas in China's interior.

This shift in location is indicative of two policy considerations. First, the Chinese government seems to be primarily using the new FTZs to stimulate regional economic development and further develop its interior. Second, the location of the new FTZs is specifically designed to contribute to China's national development strategies, most importantly One Belt, One Road ("**OBOR**").

The seven new FTZs and their key areas of focus can be summarised as follows:

The western FTZs, located in Chongqing, Shaanxi and Sichuan, serve the main purpose of opening up western China for foreign investments through the promotion of comprehensive economic reform. In addition, these FTZs will be developed as an OBOR transport, logistics and commerce centre (including the port of Guoyan). In Chongqing, the government wants to create a cluster for high-end industries, such as cloud computing and biological medicine.

The FTZs in Hubei and Henan will mainly serve as epicentres of logistics and transportation within the OBOR strategy. Furthermore, the Hubei FTZ will accommodate industrial transfers from the coastal regions to central China, while the Henan FTZ will provide a hub for international cultural trade and medical tourism.

The Liaoning FTZ aims to enhance productivity and competitiveness of northeast China's industrial base through economic reforms. For this purpose, the Chinese government aims to develop a modern finance and IT services industry alongside advanced equipment manufacturing, including automobile and aerospace.

Unlike the other six new FTZs, the Zhejiang FTZ is located in an already economically well-developed area. As such, this FTZ's focus is on further developing currently existing economic activity, including a new focus on exploring the liberalisation of international commodity trading, most importantly with regard to oil and associated products. Additional developments include establishing an international maritime service centre and promoting regional storage, transport, trading and supply industries.

2017 revised FTZ negative list

An important element of the FTZ framework is the "negative list", a list of sectors for which foreign investment in FTZs is subject to specific restrictions, or still completely prohibited. For those industries not mentioned on the list, foreign investors will receive treatment equal to domestic Chinese companies.

On 16 June 2017, the State Council released a new negative list, which replaces the previous negative list of 2015. The new list became effective on 10 July 2017. The new list is narrower than that of 2015: 27 measures in 20 different industries have been removed, including shipbuilding, aeronautical, automotive and railway manufacturing, road and water transportation, and mining. In these industries, notable specific measures that have been removed include the design and manufacturing of specific helicopters and aircrafts, exploration and mining of certain precious metals, and the construction and operation of large scale theme parks.

Although the introduction of the new negative list and the corresponding removals seems to signal another round of economic liberalisations, the list remains carefully orchestrated. Many of the apparently liberalised industries feature dominant Chinese companies. Additionally, depending on the industry, foreign investments can still be subject to a MOFCOM filing and national security review, providing the Chinese authorities with a powerful tool for control.

As such, we recommend that our clients carefully consider all potential challenges in connection with any new investment opportunities. We are, of course, available to assist.