

Shanghai Pilot Free Trade Zone - China Free Trade Zones

by Jacques Bertrand

A close look at the policy and regulatory changes for Value Added Telecommunications Services in the Shanghai Pilot Free Trade Zone clearly demonstrates that genuine reforms are being trialed, offering a new economic model for China.

On September 18 2013, the State Council outlined 18 different service industries that would be opened up to foreign investment in Shanghai's Pilot Free Trade Zone. While this would not happen immediately, it was announced that the policies governing these industries would be relaxed gradually over the coming years. Value-Added Telecommunications were among the services mentioned, along with medical services, ocean freight and international shipping management, and perhaps most crucially financial services – for example, easing restrictions for foreign and private investment and loosening controls over the renminbi.

The China (Shanghai) Pilot Free Trade Zone was then officially opened on 29 September 2013, and is the first free-trade zone in mainland China where goods can be imported, processed and re-exported without the intervention of customs authorities. Furthermore, as a pilot zone, it offers a place where policies can be experimented with, and adjustments can be made for the next three years.

One key development in the Shanghai Pilot Free Trade zone is the development of a "negative list" approach, which specifies bans or restrictions on certain types of foreign investment within the Zone. However, businesses that are not explicitly forbidden by the list are allowed to register comparatively easily. Furthermore, for companies operating in areas falling outside the negative list, pre-approval by the State Council is no longer required for foreign investment projects.

Value Added Telecom Services

It is important to note that the Ministry of Information and Telecoms in Beijing and Shanghai (MIIT) remains responsible for the laws and regulations governing Value Added Telecom Services (VATS) within the Shanghai Pilot Free Trade Zone. The FTZ authorities manage the zone and deal with practical issues arising from government policy, but the policies for the sector themselves are produced by the MIIT. The MIIT's responsibilities also extend to the regulation and development of the postal service, Internet, wireless, broadcasting, communications, production of electronic and information goods as well as the software industry. In short, they write the rules pertaining to the services that are under their responsibility, and in most cases enforce them across China.

From a close investigation of the negative list, and following a number of clarifying conversations with Chinese officials, it is clear that the regulatory changes relating to foreign ownership of companies operating within the value added telecom services are meaningful, and there are now significant differences between what is permitted for international companies outside the zone and those inside.

Owning future developments

According to the Opinions issued by MIIT and SFTZ in February, foreign ownership for many VATS companies operating in the SFTZ can exceed 50 per cent. While the exact proportions permissible for a foreign company to own varies between different types of business, at the time of writing, most types of foreign VATS companies are permitted to own 100 per cent of their businesses when operating within the Shanghai Free Trade Zone.

Foreign companies operating in the FTZ whose businesses relate to online application stores, and online storage are now permitted to own more than 50 per cent of the business. Outside the Zone, a foreign company operating in this area is restricted to owning no more than 50 per cent.

In addition, the announcement that 100 per cent foreign ownership will be permitted for companies offering call centre services and Internet access services in the zone is expected soon. The extra opportunities for companies in these sectors, freed from the constraints of a JV model, are likely to be significant. No changes are expected in the regulations governing such companies outside of the Shanghai Free Trade Zone.

Further clarifying details of some aspects of the reforms should also be expected in the near future. Up to 50 per cent of foreign ownership of companies providing multi-side voice and video communication services will be permitted, however, this position can be expected to be further clarified and restricted to video communication services such as Cisco Web Meeting Platform. Likewise, for domestic Internet virtual private network businesses, foreign ownership will be allowed, though capped at 50 per cent. We should also expect a clarification that this is being limited to B2B VPN services.

Banned industries allowed

Increased opportunities for foreign ownership are not the only changes for VATS companies operating in the Shanghai Pilot Free Trade Zone. Last autumn, Microsoft announced that it had formed a JV with Shanghai-based Internet TV firm BestTV, with a view to working together to develop and deploy what could be the next generation of Xbox game console, named the BestPad, inside the FTZ. This is a striking development as games consoles have been banned for the past 13 years. However, under the new

regulations, foreign companies will be permitted to make games consoles within the FTZ, and subject to appropriate inspections, sell them on the Chinese mainland.

The Microsoft BesTV JV will operate under the name of E-Home and according to Xinhua its total combined investment will total USD237 million. E-Home could provide Microsoft with a fantastic opportunity to introduce its consoles to Chinese consumers and thus eclipse Nintendo, which at present does not have an official gaming presence in China. However, it is the fact that such activities are allowed at all, marks a notable relaxation of the regulations for foreign IT companies.

Broader significance

As can be seen by the changes in foreign ownership regulations, and the relaxing of the ban on games consoles, genuine reforms are taking place within the Pilot Free Trade Zone for VATS companies. However, these are not happening in isolation. Similar small but significant reforms are happening across a range of industries. Last month, in a very encouraging sign, proposals for opening up for the legal services sector in the SPFTZ received the go-ahead from China's Ministry of Justice. While this is a cautious step, it is significant for China, as it is the first time the country has officially loosened its grip on close cooperation between local and foreign firms.

In addition, genuine reforms have also taken place for companies operating in the SPFTZ in all industries. The minimum formation time of a company has dropped from two months to two weeks, and requirements to have a bank reference letter, feasibility study report and annual auditing report of the investor, have all been scrapped for companies within the Pilot Free Trade Zone. The streamlining of procedures offers much for foreign owned companies.

The relaxations of the administrative steps and foreign ownership required to set-up a company in SPFTZ has a direct and noticeable impact on the number of applications of foreign owned companies for registration in the SPFTZ which has now reached more than 600. This, in turn, should drive further clarification from central government (the next one due no later than June) as foreign owned VATS companies request further details. Furthermore, following the relaxation of the ban, Microsoft/BesTV's move into the Chinese market will provide a leading model that should inspire other foreign-owned IT and VATS companies to enter China.