Understanding China’s Free Trade Zones and Foreign Ownership in E-Commerce

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China’s economic reform and opening-up policy was formally launched by Deng Xiaoping in December 1978. On 26 August 1980, the first ‘Special Economic Zone’ (SEZ) was established in Shenzhen neighbouring Hong Kong to kick-start growth by experimenting with more market-oriented policies.

Over the last 37 years, new economic zones have been spreading along the coastal areas and especially within the three major river delta areas of the Pearl River (south), Yangtze River (east) and Yellow River (north). The purpose has been to test new enterprise legislation and tax preferential policies to attract Foreign Direct Investment (FDI) and expand foreign trade before adopting these in the rest of China.

To further economic reform, the ‘China (Shanghai) Pilot Free Trade Zone’ (Shanghai FTZ) was launched on 29 September 2013 to test new policies and attract more FDI. Shanghai FTZ was promoted as a symbol of China’s commitment to continued economic reform with special focus on trade facilitation, financial sector liberalisation and the opening-up of professional services.

Following in the footsteps of Shanghai FTZ, several new FTZs have since been established starting with Guangdong, Tianjin and Fujian on 27 April 2015 and Chongqing, Liaoning, Henan, Hubei, Shaanxi, Sichuan and Zhejiang on 1 April 2017. Each of the current eleven FTZs have their own strategic focus and incentives.

With the rapid development and growth of the Chinese e-commerce sector, Shanghai FTZ became the first place in China that on 6 January 2014 allowed majority foreign ownership of an e-commerce company. This policy was later changed to full ownership on 13 January 2015 and extended to all of China on 19 June 2015.

"Crossing the River by Feeling the Stones"

Although named Free Trade Zones, China's FTZs are less about promoting free trade with no tariffs and low taxes and more about testing out new economic reform policies before they are introduced to the rest of China. From the beginning, China has followed the famous saying by Deng Xiaoping of "crossing the river by feeling the stones" which remains the pragmatic guiding principle of China's continued reform policies.

The launch of FTZs in China has so far gone through three stages gradually expanding the scale and scope of the reform policies by moving from the coastal areas to the inland regions. The location of the latest FTZs are clearly in line with China's national development strategy of stimulating growth through the 'Yangtze River Economic Belt' (YREB) initiative and the 'One Belt, One Road' (OBOR) initiative.
The below table gives a general overview of the current 11 China Pilot Free Trade Zones. Further details from the 'Hong Kong Trade Development Council': www.hktdc.com/research under 'China Trade'.

Date	Location & Areas	Total Area	Industry Focus	Regional Focus
Stage 1: 29 September 2013	**Shanghai:** Waigaoqiao, Yangshan Port and Shanghai Pudong Airport	28.7 km2	Bonded Zones - Export Processing, Logistics, Storage, Cargo Shipping	Global Market, OBOR
Stage 2: 27 April 2015	**Fujian:** Pingtan, Xiamen and Fuzhou	118.0 km2	Cross-Strait Trade & Investment, Logistics, Maritime, R&D, Medical, High-Tech, Tourism	Taiwan
	Guangdong: Guangzhou, Shenzhen and Zhuhai	116.2 km2	Maritime, R&D, Logistics, **E-commerce**, Financial Services, R&D, Culture, IT, Tourism, Education	Hong Kong - Macau, OBOR
	Tianjin: Tianjin Port, Tianjin Airport and Binhai	119.9 km2	Logistics, Tourism, R&D, Telecom, Aviation, Media, Aerospace, **E-commerce**, Advanced Manufacturing, Financial Leasing	Beijing - Tianjin - Hebei
Expansion	**Shanghai:** Lujiazui, Jinqiao and Zhangjiang	92.0 km2 (total of 120.6 km2)	Financial Services, Legal, Telecom, R&D, Advanced Manufacturing, Maritime, **E-commerce**, HR Talent	Global Market, Regional HQs
Stage 3: 1 April 2017	**Chongqing:** Liangjiang, Xiyong and Guoyuangang	120.0 km2	Logistics, Transportation, **E-commerce**, R&D, Cloud Computing, Bio-medicine	Western China – OBOR, YREB
	Henan: Zhengzhou, Kaifeng and Luoyang	119.8 km2	Logistics, Transportation, Advanced Manufacturing, **E-commerce**, Medical Tourism, Design, R&D	Central China - OBOR

	Hubei: Wuhan, Xiangyang and Yichang	120.0 km2	Logistics, Transportation, IT, Biotechnology, R&D, Advanced Manufacturing, Biomedicine, **E-commerce**	Central China - YREB
	Liaoning: Dalian, Shenyang and Yinkou	119.9 km2	Finance, IT, Shipping, Logistics, High-Tech, Advanced Manufacturing, **E-commerce**	Northeast China
	Shaanxi: Central area, Xian and Yangling	119.9 km2	High-Tech, Aviation Logistics, Trade Finance, Tourism, Financial Services, **E-commerce**, Agricultural Science	Western China - OBOR
	Sichuan: Chengdu – Tianfu and Qingbaijiang, and Chuannan Lingang	120.0 km2	Advanced Manufacturing, F&B, Shipping, Logistics & Storage, IT Services, Modern Medicine	Western China - OBOR
	Zhejiang: Zhoushan Island	120.0 km2	Commodities Trade: Petrochemicals, Logistics Storage, Aviation, Aquatic Products, Ocean Tourism	Global Market

FTZ Negative List

One of the most novel reform policies in Shanghai FTZ was the introduction of the 'FTZ Negative List' which specifies the industries that are restricted or prohibited for FDI. In principle, foreign investors enjoy equal treatment with Chinese companies in industries not on the list. The aim is to test new pro-business policies and open-up specific sectors to FDI that are otherwise off-limits in the rest of China. The 'FTZ Negative List' policy has been adopted in all the other FTZs.

The number of items (special administrative measures) on the 'FTZ Negative List' has fallen from 190 in 2013 (Shanghai), 139 in 2014 (Shanghai), 122 in 2015 (first 4 FTZs), and 95 in 2017 (all 11 FTZs). Please refer to the 'State Council of the PRC' at www.gov.cn for the latest version of the 'FTZ Negative List'.

Pilot Zones for Cross-border E-commerce

On 12 January 2016, to further promote cross-border e-commerce in China, the Chinese government set-up 13 comprehensive pilot zones including Chengdu, Chongqing, Dalian, Guangzhou, Hangzhou, Hefei, Ningbo, Qingdao, Shanghai, Shenzhen, Suzhou, Tianjin and Zhengzhou.

Shanghai Leading the Pack

Shanghai FTZ was established with the aim of maintaining the city's competitive edge, developing a more business-friendly environment, internationalizing the RMB and testing new reform policies later to be adopted nationally. It was first to introduce the 'FTZ Negative List', opened-up the financial service industry with trial programs for RMB convertibility and market-oriented interest rates, created the online record-filing procedures for company set-up, relaxed minimum registered capital requirements, and streamlined customs clearance procedures. Shanghai FTZ operates one of the pilot zones for cross-border e-commerce.

Today, over 48,000 companies are registered in the seven locations comprising the Shanghai FTZ of which 8,800 are foreign-owned, and with a total investment of USD 16.7 billion. According to the latest figures, companies registered in Shanghai FTZ have a total trade volume of USD 49.0 billion or 60% of the total for Shanghai. In 2016, Shanghai FTZ stood for 25% of Shanghai's GDP.

Foreign Ownership in E-Commerce

Based on the listed priorities of the current eleven FTZs in China, it is evident that E-commerce is one of the key industries included in their defined development goals. This in line with the March 2015 announcement of the 'Internet Plus' policy by the Chinese government that aims to stimulate domestic growth through the expansion of a national e-commerce industry. The 'Draft E-commerce Law of the PRC' from 27 December 2016 also shows its commitment to the development of a leading online economy.

As previously mentioned, majority and later full foreign-ownership of a registered e-commerce company in China was first allowed in Shanghai FTZ and since extended nationwide. However, it was not until 28 April 2016 that the Japanese company 'Heiwado' was the first to secure a 'Value-Added Telecom Services' (VATS) license (e-commerce). Despite the lifting of restrictions, it is still difficult for foreign investors to obtain the VATS license and operate an e-commerce business, which in Shanghai is only possible in Shanghai FTZ.

One the biggest challenges for foreign-ownership is the unclear definition of "E-commerce" given by the Ministry of Industry & Information Technology (MIIT) in its 19 June 2015 'Notice on Lifting the Restrictions on Foreign Equity Ratios in Online Data Processing and Transaction Processing Business' (Circular No. 196) and in the 'Classification Catalogue of Telecommunication Services' that took effect on 1 March 2016.

Furthermore, foreign ownership is still subject to the 'Provisions on the Administration of Foreign Invested Telecom Enterprises' from 2002 and updated in 2008. Article 5 states that the minimum registered capital for a foreign-invested company providing telecom services within one province is RMB 1 million or RMB 10 million for the whole country or across different provinces. Article 10 also states that the foreign investor shall have a good track record and experience in providing telecom services which excludes many foreign investors interested in tapping into the booming Chinese e-commerce market.

From Test Lab to Open E-conomy?

The transformation of the Chinese economy from an impoverished nation to a leading consumer market is remarkable and a very good illustration of the determination, desire and pragmatism of the country's leaders. By threading carefully and experimenting with new reform policies in confined economic zones, China has created its own unique and partly protected eco-system of economic development and growth.

Shanghai has for many years been at the forefront of economic reforms in China and served as a valuable testing ground for the rest of the country. However, it remains to be seen whether Shanghai can keep the momentum and continue to lead as the rest of the country is steadily catching up.

With the rapid expansion of e-commerce in China, more and more foreign companies and brands want their share of the market but the question is to what degree China will allow foreign ownership, control and competition in an industry dominated by its own national players.

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