Business, Trade and Competition

# China Bulletin

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## In This Issue...



Welcome to this month's bulletin covering updates on the regulation of business, trade and competition in China.

## International Trade

### All Eyes on the Shanghai Free Trade Zone

The formal launch of the Shanghai Free Trade Zone (**SFTZ**) on September 29, 2013 could be a watershed moment for ushering in key financial and economic reform in China and propelling Shanghai into the ranks of the world's leading financial centers such as Hong Kong, London and New York. The SFTZ, which will commence on a trial basis, is expected to cover 28 square kilometers and combine four existing bonded trade zones, namely the Yangshan Bonded Port, the Waigaoqiao Bonded Zone, the Waigaoqiao Bonded Logistics Park, and the Pudong Airport Comprehensive Bonded Zone. Most observers agree that the planned SFTZ will act initially as a test site for the liberalization of the services and financial services sectors, including initiatives covering 18 different industries and reforms concerning interest-rate deregulation, foreign direct investment (**FDI**), and convertibility of the Chinese currency among others.

Events surrounding the establishment of the SFTZ have moved quickly. The Ministry of Commerce (**MOFCOM**) declared the State Council's formal approval to establish the SFTZ on August 22, 2013. Then in an unprecedented move on August 30, 2013, the National People's Congress (**NPC**) authorized the State Council to suspend temporarily for three years certain laws and regulations[1] governing foreign investment, foreign capital enterprises, and Chinese/foreign equity joint ventures to facilitate the establishment of the SFTZ and boost foreign capital inflow. Nearly one month later on September 25, 2013, numerous press sources noted that the Chinese government reportedly agreed to allow access to "sensitive and blocked" websites (*e.g.*, Twitter, Facebook, etc.) and may solicit bids for licenses from foreign telecommunications companies to provide Internet services in the SFTZ.

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1 These include the Foreign-Invested Enterprise Law, the Sino-Foreign Equity Joint Ventures Law, and the Sino-Foreign Cooperative Joint Ventures Law.

### Some Expected New Policies

- As a customs supervised area, the SFTZ will not only enjoy preferential policies granted by the central government, but also formulate its own preferential policies by seeking approval from relevant authorities, *e.g.*, seeking approval from the Ministry of Finance (**MOF**) with respect to financial policies or from the General Administration of Customs (**GAC**) on customs policies. If the relevant authorities need to coordinate on such approval or seek review from a higher level, they will submit a request to the State Council.
- The Chinese government is expected to relax foreign investment thresholds in the SFTZ. As a first step, it may revoke the necessity for recognition of qualifications, equity ratios for foreigners, and business scope restrictions for foreign investment in the areas of finance, shipping, commerce and trade, culture, and social services.
- Investment in the SFTZ will be subject to a "negative list" approach whereby only a list of prohibited or restricted investment areas will be published. This approach marks a first for China and signals a departure from traditional foreign investment catalogues that classify investments into encouraged, allowed, restricted, or prohibited categories.
- According to the draft SFTZ blueprint, the Chinese government will accelerate financial institution innovation in the SFTZ, including through the convertibility and internationalization of the Chinese currency as well as promote cross-border financial liberalization. Reportedly, the government has authorized the Shanghai Equity Trust Trade Center to set up a financial trade platform through a Corporate Stock Transfer System (**CSTS**). Initially, domestic enterprises located in the SFTZ may be able to obtain overseas investment directly through the CSTS. While foreign enterprises located therein will not be eligible at first, the government may relax the CSTS requirements down the road.

### Implications and Outlook

The SFTZ is an ambitious idea coming from the highest levels of the Chinese bureaucracy. Premier Li Keqiang is reportedly leading the strategy behind the establishment of the SFTZ, aiming to usher in a second round of openness and reform in China. Supported by the Political Bureau of the Central Committee of the Chinese Communist Party, Premier Li overcame numerous challenges and hurdles in promoting the planned SFTZ during the past several months. Currently, the Chinese government is accelerating the procedures of formulating new policy and regulations for the SFTZ, with seven[2] key competent ministries tasked with formulating detailed regulations.

Should the SFTZ prove a success following the pilot period, it will ikely serve as a model for institutional innovation and replicated in other major cities across the country. Already other municipalities and cities, including Tianjin, Xiamen, Chongqing, and Guangdong-Hong Kong-Macau are applying to establish free trade zones (**FTZ**) within their own districts.

Yet, despite the hype surrounding the SFTZ, details surrounding its implementation are scant and numerous questions remain. For instance, how will the Chinese government manage financial risk following liberalization, assess responsibility and liability in the event of mismanagement, reign in competing vested interests of different government ministries, and ultimately accept less control? Time will tell. In the short term, however, the SFTZ will need to build up evidence in support of transparent markets without the meddling of the old guard.

## China and Korea Progress to Second Phase of Bilateral FTA Negotiations; Intersection of RCEP and TPP Remains Key Area of Interest

Chinese and Korean negotiators convened for three days in early September 2013 for the seventh round of China-Korea Free Trade Agreement (**CKFTA**) negotiations in the Chinese city of Weifang in central Shandong Province. The bilateral discussions have finally progressed beyond the first phase of identifying each side's priorities and sensitive sectors, defining the agreement scope and establishing negotiating modalities to a second more arduous phase of actual negotiation of the agreement text itself. The Parties are expected to meet for the eighth negotiating round before the end of the year to begin work on the draft text.

During the latest round of negotiations, both sides agreed to (i) liberalize or eliminate import tariffs on 90% of tariff lines, *i.e.*, approximately 85% of import value; (ii) treat agricultural and industrial products separately under the sensitive and highly-sensitive tracks;[3] and (iii) gradually reduce and eliminate tariffs on non-sensitive items over a period of 10 years from entry into force of the Agreement, while sensitive items would be subject to a tariff reduction and elimination modality commencing 10 years from the effective date of the CKFTA. Specifically, Korea considers agriculture and fisheries as its most sensitive sectors, while China categorizes its manufacturing industries, which include the automobile, machinery and oil sectors, as its sensitive ones. Reportedly, approximately 10% of tradable goods will be excluded from the scope of tariff reduction and elimination, a significant amount when compared to Korea's

2 The Ministry of Commerce (MOFCOM), Ministry of Finance (MOF), General Administration of Customs (GAC), State Administration of Taxation (SAT), General Administration of Quality, Supervision, Inspection and Quarantine (AQSIQ), People's Bank of China (PBOC), and State Administration of Foreign Exchange (SAFE).

3 Highly-sensitive and sensitive items will be excluded from tariff concessions or will be subject to only partial tariff reduction.

recently concluded trade agreements with the European Union and the United States. The Parties also established negotiating modalities for services and investment, economic cooperation and rules governing areas such as intellectual property, transparency, competition, and e-commerce. For trade in services, the two sides may consider adopting a comprehensive negative list approach – a first for China – for future services negotiations according to Chinese Ministry of Commerce officials.

Both China and Korea are economic powerhouses in their own right. China is Korea's largest trading partner, while Korea is China's third largest trading partner. According to Korea's Ministry of Strategy and Finance (**MOSF**), Korea's gross domestic product (**GDP**) is expected to increase by approximately one percent within five years following the entry into force of the CKFTA. Moreover, once effective, Korea would be the only country to have an FTA with the three largest global markets, namely the European Union, the United States and China. China's former Minister of Commerce, Chen Deming, anticipates that the CKFTA negotiations could be completed within two years, stressing that early conclusion of the negotiations could push forward the trilateral China-Japan-Korea FTA (**CJKFTA**) negotiation process.

There are other regional trade developments at play as well that drive the CKFTA negotiations and their respective positions. Korea and China are both parties to the ASEAN-led Regional Economic Partnership Agreement (**RCEP**). Thus, the CKFTA and CJKFTA are opportunities to clarify positions, minimize policy differences, and develop specific strategies on how to pursue the FTAs by linking them to the RCEP. Considering the existence of multi-track sub-regional and bilateral FTAs in the region, the RCEP negotiations will likely be tedious and complex, especially given that not all ASEAN+1 partners[4] have FTAs with each other. Mitigating disagreements early on in the CJKFTA will be a boon to RCEP negotiations as RCEP Trade Negotiating Committee Chair Iman Pambagyo noted that negotiators will follow the RCEP ministers' guidance that liberalization commitments run on a single schedule.

The pace and breadth of RCEP negotiations is likely spurred onwards by the parallel Trans-Pacific Partnership (**TPP**) negotiations, of which Japan is a member and Korea has indicated interest in participating, as well as a host of political and economic developments in the Asia Pacific. First, the RCEP was late to launch due to delays at the East Asia level, particularly differences between China and Japan over membership, the former preferring the ASEAN+3 (China, Japan, Korea) East Asia Free Trade Area (**EAFTA**) and the latter preferring the ASEAN+6 (Australia, China, India, Japan, Korea, New Zealand) Comprehensive Economic Partnership in East Asia (**CEPEA**). Second, there was concern regarding the relevance of ASEAN centrality if the CJKFTA materialized. Third, the dual participation of ASEAN members Brunei, Malaysia, Singapore, and Vietnam in the TPP and RCEP made clear that the TPP emerged as a viable competitor platform for meaningful Asian economic integration.

Korea's recent signal of interest of joining the TPP negotiations should be viewed in tandem with its long-view to bridge the RCEP and TPP, an increasingly fashionable strategic concept in Asian and trans-Pacific economic integration policy. For Korea, the benefits of TPP membership are clear: sizable gains from trade, greater bargaining power in ongoing negotiations with China and Japan to tackle non-tariff barriers, and the rationalization of its FTA "noodle bowl." Further linking TPP to RCEP will guide negotiators towards early interoperability and eventual harmonization of high-standards in Asia-Pacific free trade.

4 The "ASEAN +1 partners" include Australia, China, India, Japan, Korea, and New Zealand.

## China Trade Remedy Cases (June 2013 – October 2013)

| Product | Country of Origin | Petitioner Country | Announcement |
|---|---|---|---|
| Acetone | Japan, Korea, Singapore, Taiwan | China | AD expiry review initiated on June 7, 2013 |
| Sulfamethoxazole (SMZ) | India | China | Definitive decision of AD expiry review made on June 14, 2013 |
| Toluidine | EU | China | AD final decision made on June 27, 2013 |
| Wines | EU | China | AD & CVD investigations initiated on July 1, 2013 |
| Saloon Cars and Cross-country Cars | US | China | Definitive decision of AD new shipper review made on July 17, 2013 |
| Solar-Grade Polysilicon | Korea, US | China | AD provisional decision made on July 18, 2013 |
| Chloroprene Rubber (CR) | Japan | China | Final decision of AD interim review made on July 26, 2013 |
| Grain Oriented Flat-rolled Electrical Steel | US | China | Decision of AD & CVD re-investigations made on July 31, 2013 |
| IMP, GMP, I+G | Indonesia, Thailand | China | Final decision of AD interim review made on August 6, 2013 |
| Single-mode Optical Fiber | India | China | AD investigation initiated on August 14, 2013 |
| Tertiary Butylhydroquinone (TBHQ) | India | China | AD investigation initiated on August 22, 2013 |
| Bisphenol-A (BPA) | Japan, Korea, Singapore, Taiwan | China | Definitive decision of AD expiry review made on August 29, 2013 |
| Solar-Grade Polysilicon | US | China | CVD provisional decision made on September 16, 2013 |

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