

Utilizing and Prospects for the Guangdong Pilot Free Trade Zone

Kazutaka Sakauchi
China ASEAN Research & Advisory Department
Hong Kong Corporate Banking Division No. 1, Mizuho Bank, Ltd.

It has been over one year since the first pilot free trade zone (hereinafter referred to as an “FTZ”) in China was established in Shanghai. This April, a second group of FTZs was officially launched in Guangdong, Tianjin, and Fujian. Among all, the Guangdong FTZ has been chosen as a model district to promote economic cooperation and further collaboration with Hong Kong and Macau, and for foreign enterprises, even less barriers to entry than ever achieved through previous deregulations, mainly in terms of financial restrictions, as well as new potential cross-border financial schemes can be expected. This article introduces the characteristics of each area that constitutes the Guangdong FTZ as well as the latest movements of the companies, based on the recently issued Overall Plan of the Guangdong FTZ and interview results with the authorities.

Guangdong: Seeking to deepen cooperation with Hong Kong and Macau

According to the Overall Plan released by the State Council of the People's Republic of China, the three recently launched FTZs and the Shanghai FTZ respectively takes approximately 120 square kilometers in size. Each consists of multiple areas as bonded port areas (Fig. 1), and a common negative list is applied for foreign investment to the FTZs.

The Shanghai FTZ has been positioned as a “test field” that experiments institutional reforms and liberation ahead of the rest of the country to promote domestic structural reforms. Meanwhile, for the second group of FTZs, the government has set each a special role featuring their regional characteristics, to promote further openness to the international community. For example, the Guangdong FTZ has been positioned as: (1) a model district for deepening economic cooperation with Hong Kong and Macau; (2) a hub for the “21st-Century Maritime Silk Road” as part of the “One Belt and One Road” vision; and (3) an area that takes the lead in new economic reforms for the country; the Fujian FTZ has been positioned as a platform for

economic cooperation with Taiwan and other nations and regions along the “21st-Century Maritime Silk Road”; whilst the Tianjin FTZ has been positioned as the leading platform of the “Jing-Jin-Ji” area (Beijing, Tianjin, and Hebei) for cooperation, development, and openness to the international community. Based on the different positioning above, key industries and major policies/principles for respective areas that comprise each FTZ have also been clarified.

Fig. 1: Four FTZs and their distribution



Source: Compiled by Mizuho Bank, Ltd., based on the websites of the FTZs and on various news releases

The Guangdong FTZ consists of three areas: the entire area of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (hereinafter referred to as “Qianhai”), which is an existing special district, and the neighboring Shekou district, part of Hengqin New District of Zhuhai and part of Nansha of Guangzhou. The three separate areas form a triangle of three small FTZs in the central area of the Pearl River Delta.

The key policies of the Guangdong FTZ are, in principle, based on the existing policies of each area. The policies aim to develop high-added-value industries, such as: finance, advanced logistics, and service industries for Qianhai; tourism, leisure, and health care industries for Hengqin; and shipping, finance, and high-end manufacturing industries for Nansha. The deregulation toward foreign enterprises in each area is also centered on the above (Fig. 2). In other words, this is a form of development born from the Closer Economic Partnership Arrangement (CEPA) developed between Mainland China and Hong Kong & Macau, and further deregulation is expected mainly in the industries and fields listed in the Overall Plan.

Fig. 2: Key points in the Overall Plan for the Guangdong FTZ

Name	China (Guangdong) Pilot Free Trade Zone
Characteristics of each area	<ul style="list-style-type: none"> ▪ Qianhai and Shekou: Development of strategic emerging services such as finance and the information industry; becoming a model area for the financial open-up and a major hub for the services trade. ▪ Nansha: Development of shipping, logistics, and high-end manufacturing industries, construction of an integrated service terminal. ▪ Hengqin: Development of finance and high-tech industries; becoming a leading area for cultural and educational reforms; becoming a hub for business services, tourism, and leisure; promotion of the pluralistic development of Macau's economy.
Major policies	<ul style="list-style-type: none"> ▪ Lifting the ban for the service industry to enterprises in Hong Kong and Macau: International shipping, self-funded overseas education, overseas (excluding Taiwan) group tour for Mainland China residents, certification and inspection, advanced medical care, etc. ▪ Increasing the use of RMB between the FTZs and Hong Kong & Macau: Offshore RMB denominated borrowing for enterprises in the FTZs; cross-border RMB business by non-banking financial institutions ▪ Lifting the ban for the finance industry to enterprises in Hong Kong and Macau: Application of the same laws and regulations to branches of Hong Kong and Macau insurance companies as those applied to domestic insurance companies; permitting third-party payment services for capital from Hong Kong and Macau ▪ Promoting restructuring and advancement in processing trade: Development of bonded custom inspection and maintenance ; permitting of maintenance and remanufacture of mechanical and electrical products by foreign-invested enterprises

Source: "Circular on Printing and Issuing the Overall Plan for the China (Guangdong) Pilot Free Trade Zone" (Guo Fa [2015] No.18), State Council of the People's Republic of China

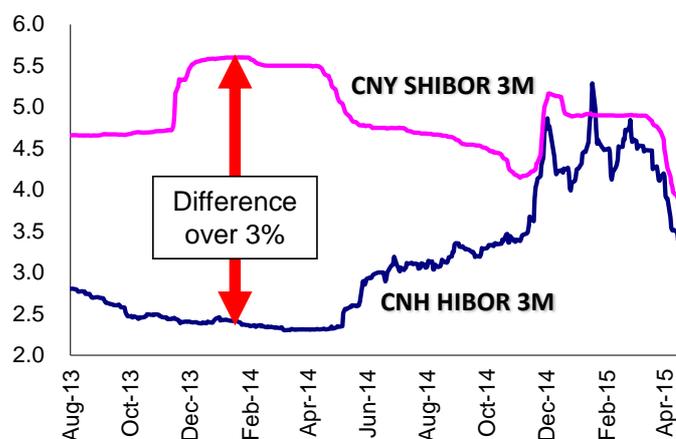
Active responses from domestic enterprises while foreign enterprises sit on the fence

Based on these government principles, enterprises from Mainland China have been actively investing in the FTZs since even before the establishment of the Guangdong FTZ. In particular, there have already been over 28,000 enterprises registered in Qianhai, which shares a border with Hong Kong, out of which more than 90% are estimated to be enterprises from Mainland China.

For enterprises in Mainland China, the greatest merit in expanding their business to Qianhai would be the deregulation of offshore RMB financing. Even though it has become somewhat easier to procure funds in China

compared to the past, the situation is still rough especially for small and medium-sized enterprises. Furthermore, although the Chinese monetary authorities have been cutting interest rates to stimulate the economy, the maximum spread between bank interest rates in Mainland China and in Hong Kong still reached around 3% last year, (Fig. 3). Under such circumstances, it can be inferred that many domestic enterprises have decided to expand their business to Qianhai seeking to procure lower-cost funds from financial institutions in Hong Kong. According to a statistics by Shenzhen City, the amount of newly registered cross-border RMB loans between Hong Kong and Qianhai grew more than four times in just one year, from RMB 15 billion in 2013 to RMB 69.8 billion in 2014.

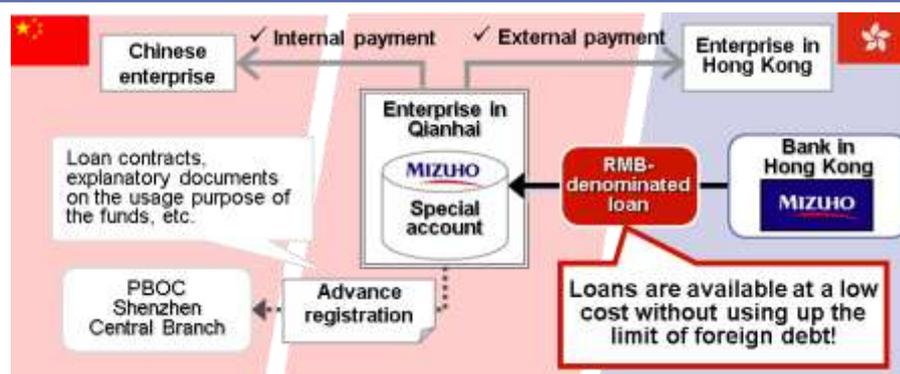
Fig. 3: Short-term interest rates in onshore and offshore RMB markets



Source: Compiled by the Hong Kong Treasury Division, Mizuho Bank, Ltd.

On the other hand, not many positive reactions have been seen from foreign enterprises. In the case of foreign-invested enterprises, as long as they are registered and established and actually operates or invests in the FTZ, it is possible to borrow RMB from financial institutions in Hong Kong without using up the overseas borrowing quota which is usually restricted to a certain amount in general areas in China (Fig. 4). Moreover, for an enterprise invested from Hong Kong, preferential interest rates may be applicable if approved by the People's Bank of China (PBOC). There are also other preferential measures for enterprises in the FTZ, whether domestic or foreign-invested, such as corporate tax reduction (from 25% to 15%) for certain industry groups.

Fig. 4: RMB-denominated foreign debt scheme in Qianhai



Source: "Interim Measures for the Administration of Cross-Border RMB Loans in Qianhai" (Shen Yin Fa [2012] No. 173), etc.

However, the corporate tax reduction, for example, is a temporary measure that will only be adopted until the end of 2020, and, in principle, this measure is not applicable to the address transfer or the branch establishment of an existing company. In other words, only newly established corporations can enjoy the preferential tax rate, and thus it is practically difficult to benefit from a tax advantage. Remotely because of such inconvenience, many foreign enterprises, including Japanese enterprises, have chosen to wait for further details to be announced or for other enterprises to take action.

Further deregulation is expected

According to the Shanghai FTZ, only approximately 100 Japanese enterprises newly expanded their business to the FTZ within one year after its launch. Even though certain results, mainly in terms of fund management systems like cross-border cash pooling, centralized account settlement and netting, has been seen in terms of institutional reforms and liberation, only a few enterprises have been able to actually make use of such systems in business operation. It appears that quite some enterprises in the FTZ are still uncertain of how to apply the preferential policies to the business practice.

The Overall Plan of the Guangdong FTZ presents the intention of expanding to the entire Guangdong FTZ the various RMB-denominated cross-border financial schemes that are currently being tested in Qianhai in the times ahead. However, as with the case of the Shanghai FTZ, enterprises will not use the scheme or invest in the FTZ if the deregulation and preferential policies do not practically benefit their business operations. In order to actually "create a business environment that is internationalized, commercialized, and governed by law; establish a new structure for an open economy; achieve advanced cooperation among Guangdong, Hong Kong, and Macau; and formulate a renewed superiority in international economic cooperation and competition, all through the pilot reforms in the next three to five years", as has been mentioned in the Overall Plan, it is expected that the FTZ shall provide more practical measures that encourage foreign enterprises to invest in the region.

Disclaimer & Confidentiality

1. Legal and accounting advice: The information contained herein does not incorporate advice on legal, accounting or tax issues. You should obtain your own independent professional advice on the legal, accounting and tax aspects of this information.
2. Confidentiality: The information contained herein is given for general informational purposes only and shall be kept strictly confidential. This information is intended for your company's internal use only, and the disclosure to any third party is strictly prohibited.
3. Copyright: The information contained herein is, as a general rule, the intellectual property of MHBK, and may not be copied, duplicated, quoted, reproduced, translated, or lent, in whole or in part, in any form or by any means for any purpose whatsoever without prior consent.
4. Limitation of liability:
 - (a) The information contained herein was obtained from information sources deemed reliable by MHBK but in no way is the accuracy, reliability or integrity of such information guaranteed. MHBK disclaims any liability whatsoever for any damage arising out of or relating to this information. Moreover, the analysis herein is hypothetical and is not intended as an indication of the certainty or completeness of the results thereof.
 - (b) Please note that information to be disclosed hereafter, appraisals, the opinions of credit rating agencies, and/or changes in the system and/or financial environment may necessitate substantial modification to the relevant processes and/or schemes, which may have the effect of rendering the analysis herein ineffectual. Further, this information is not intended to be an exhaustive statement of the risks to which your company is exposed.
5. The information contained herein does not constitute a solicitation or offer by MHBK to buy or sell any financial instruments or to provide investment advice or service.