CHINA NEWS

China Releases Restrictions on Investment in Shanghai Free-Trade Zone

Regulations Could Make Venture Less Attractive to Global Companies

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BEIJING—A day after Chinese officials opened a free-trade zone in Shanghai that they said was a milestone for economic change, the government announced nearly 200 restrictions on foreign investment, which could make the venture far less attractive to global companies.

The list, which was posted online Monday by the Shanghai government on its website, runs to 10 pages and circumscribes foreign involvement across a range of industries from finance to property to entertainment to media. Banking officials and academics said the wide-ranging restrictions reflect jockeying among Chinese agencies over how broadly and quickly to open cloistered sectors to foreign competition.

The government's reluctance to fully liberalize a free-trade zone that covers just 29 square kilometers also suggests the difficulties top Chinese leaders face in putting together a national strategy of economic overhaul, which is supposed to be unveiled November in a much-anticipated Communist Party meeting in Beijing.

"The list makes it clear that progress toward financial-sector and other reforms will be slow and grinding, even in this controlled environment," said Eswar Prasad, a Cornell University China scholar. He said the party meeting is likely to produce "a strong commitment to the reform agenda but a slow, controlled and calibrated move toward actual reforms."

The free-trade zone, formally called the China (Shanghai) Pilot Free Trade Zone, was originally approved in July. On Friday afternoon, the government released a general plan for liberalization in a number of sectors, and then on Sunday it formally unveiled the zone. On Monday, the government released its so-called negative list—areas that are off-limits for foreign investment.

The use of a negative list had been touted by many analysts as an important change in Chinese economic policy-making. The idea: Anything not specifically prohibited would be allowed, rather than require companies to get specific authorization. The change, in theory, would limit the power of China's regulators who sometimes try to protect the oligopoly power of state-owned enterprises in industries such as energy, telecommunications and finance.

Bo Chen, an economist at Shanghai University of Finance and Economics, who is a consultant to the local government on the free-trade zone, said the list was crafted in such a way to give bureaucrats wide latitude in applying the restrictions.

The list applies only to the rest of this year, and officials say it will be revised in 2014, giving Beijing the opportunity to prune it. But officials involved with the zone said the scope of the restrictions reflects a continuing power struggle by the regulators to limit the reach of the zone, and it wasn't clear how such fights would be resolved.

Although China's No. 2 leader, Premier Li Keqiang, has heavily promoted the free-trade zone, the highest-ranking official at the Sunday opening ceremony was the commerce minister, which suggests the zone is "still quite controversial among policy makers," said a Bank of America analysis.

The negative-list concept is also at the heart of negotiations between the U.S. and China over an investment treaty between the two nations. That give-and-take could also prod Beijing to reduce the number of exceptions. Both sides agreed at a July meeting to make another attempt at an investment deal after years of largely fruitless discussions.

A Chinese central-government website said Monday said that of 1,069 sectors of the economy, less than one-fifth were subject to restrictions, and that the list would be adjusted in the future. "From a detailed breakdown of industries on the negative list for the pilot Free Trade Zone, it is clear than China is sincere about opening up to foreign investment," the statement said.

The zone offers wholly foreign-owned banks an opportunity to set up shop in China, with Citigroup and Development Bank of Singapore the first to receive approval to set up in the zone. They are expected to have more freedom to set interest rates and deal in foreign currency than banks elsewhere in China, though details have yet to be announced.

But investment in banks, financial companies and trust companies will be limited, the list said, without giving any further details—indicating the free-trade zone may not offer foreign companies a meaningful way into China's closed financial system.

DBS Group Holdings Ltd. , the parent of Development Bank of Singapore, signaled that it targets incremental opportunities in the areas of cash management, debt capital markets and hedging against interest-rate movements.

"We expect to get ourselves ready within six months," Neil Ge, DBS Bank China chief executive told reporters Monday. "Before we officially start we have to get an inspection by the regulators."

Foreign stakes in insurers are to be limited to no more than 50%, and in securities firms to no more than 49%. Qualified investors will be allowed to own small-loan companies and finance-guarantee companies, though these are typically small in China. Foreigners are allowed to invest in financial leasing firms, subject to a minimum value of $5 million and other conditions.

Foreign investment in high-end properties—including offices, hotels and convention centers—will be limited. So will foreign involvement in telecommunications and broadcasting, with investment in media and publications, online gaming services and news portals prohibited entirely. Investment in cinema, film and TV production falls into the "limited" category. Foreign auto companies still aren't allowed to have more than a 50% stake in any joint venture.

Analysts said that authorities are trying to play down the zone as a real-estate play, noting that the list includes a complete ban on foreign companies building villas in the zone. They said few domestic developers would be interested in such business either.

"The bottom line is: The government wants to avoid speculation in the property and the land market," said Frank Chen, China-based executive director at CBRE Research, a real-estate consultancy. "After the announcement of the free-trade zone, property prices in the surrounding area started to jump. They have to clamp down on speculation."

The rules allow investment in health-care institutions, subject to a lower limit of 20 million yuan ($3.3 million). Investment in utilities will be circumscribed, with "limited" investment in electric grid construction and operation and only minority stakes allowed in nuclear power.

Only joint ventures will be allowed in a range of industries, including oil and gas, auto parts and aircraft maintenance. Railway construction and management will likewise be restricted to joint ventures, with foreign companies allowed a minority stake in most rail services.

Investment in golf courses, Internet cafes, gambling and pornography is prohibited. Limited investment in theme parks will be allowed.

"The list is quite extensive, but it doesn't necessarily reflect the resolve to reform," said Tom Liu, chief executive at Chinascope Financial, Ltd. a market-research firm in Shanghai. "It reflects the prudence with which the authorities want to begin this program."

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