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What does the recent free trade zone in China mean for Australian private businesses?

I'm an optimist... I'm running with the bulls on China.

Dr Geoff Raby

Doing business in China

Insights and opportunities for Australian private businesses

In 20 years the Chinese economy will be 4 times it's size

Dr Geoff Raby describes himself as a 'Pamplona economist'. "I'm an optimist," he says. "I'm running with the bulls on China."

Dr Raby is speaking as someone who has been watching China for the past 35 years, 12 of those from within China itself, where he lives and works.

According to Dr Raby, the current negative sentiment surrounding China's fortunes is short-sighted – "marginal changes in basis points from quarter to quarter are utterly meaningless".

Addressing an audience of private business owners in Sydney, he pointed to the recent change in leadership and the central government's reformist agenda which is working to stamp out corruption and the continued liberalisation of the financial system, including opening the capital account and the internationalisation of the Chinese currency, the RMB, as extremely positive signs.

"The Chinese economy has grown two-fold since 2007," Dr Raby says. "To see 7% plus growth year on year from that base is extraordinary – and there's no reason not to expect that to continue. It's a safe bet that in 20 years' time, the Chinese economy will be four times the size it is now."

Key drivers of this growth will be the migration of some 300 million more rural workers to large cities, which will drive productivity improvements, along with the rise of the middle class and increased discretionary spending.

As well, the tendency of government policy to follow market direction has meant a slow but steady opening up of China to foreign investors and businesses looking to take advantage of the enormous opportunities.

The latest example of the Chinese government's willingness to let the market lead economic policies - is the China (Shanghai) Pilot Free Trade Zone (PFTZ).

Although the zone is geographically small, at just 28.8km2, its aims are more ambitious than its size would indicate. Along with some fundamental financial reforms, the FTZ is trialling an upgrade of the customs supervision framework, simplifying the administrative systems to support the opening up of the services sector, and creating a more competitive regulatory and tax environment.

The Shanghai PFTZ is part of a broader liberalisation strategy (with Special Economic Zones (eg. Qianhai, Shenzuen) attracting different industries), and will be the template for the rollout of other Free Trade Zones in the future.

What does this mean for Australian private businesses?

Bill Yuan, PwC China Tax and Business Advisory Director, and James McElvogue, PwC Private Clients Asia Leader joined Dr Raby to discuss the pros and cons of doing business in China, with a particular focus on the new China (Shanghai) Pilot Free Trade Zone (PFTZ).

"The name is significant," Yuan says. "It's clearly a national program, and while it's being trialled in Shanghai, I fully expect many of the policies will be replicated nationwide and more Free Trade Zones to be established elsewhere in China."

He cautions that the exact details of what will be allowed within the Shanghai PFTZ are hazy – and are likely to remain so for the next 12 months as the government refines its goals and consults with business on key points.

"What is clear is that the relaxation of trading in RMB and interest rate liberalisation are at the core of the reforms in the PFTZ," says Yuan. "That means companies will have much more flexibility of funds coming in and out."

"There has been a lot of restriction in the past with companies unable to move money in and out of China, so the free flow of foreign currency and RMB is a big change, along with a reduction in the requirement of registered capital ," says James McElvogue, PwC's Private Clients Asia Leader.

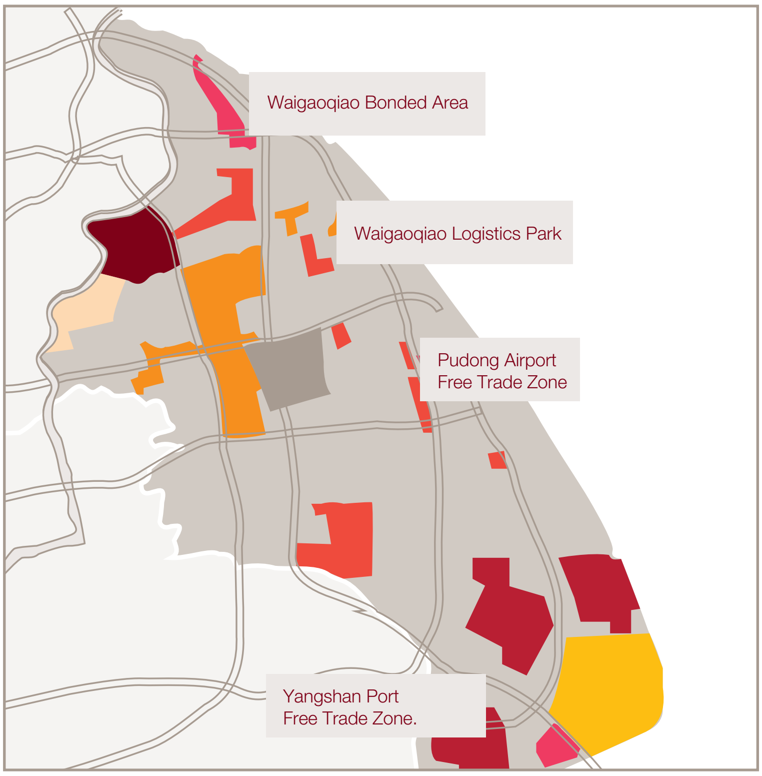
"Government intervention has also been top of the list of issues for many foreign investors, so the Shanghai PFTZ is also looking at simplifying the customs regulations, reducing approvals and improving ease of market entry."

Key sectors being targeted include services industries including financial and professional services, shipping and trade.

"If you have an existing presence in China, setting up in the PFTZ could be an opportunity to restructure how you're doing business, to reduce costs where possible, in order to make better returns," says McElvogue. "And if you're a new entrant, the PFTZ certainly makes it more cost-effective to establish a business."

The Shanghai PFTZ is not for everyone, and any move to set up there is not without risks – cultural, political and financial. China remains a complex country to do business in, and the PFTZ is still largely untested. But Dr Raby for one is willing to look on the bright side when it comes to doing business in China.

Shanghai PFTZ



	People's Republic of China	Shenzhen (PFTZ)	Shanghai (PFTZ)	Hong Kong
Interest rate	6%	5%+	5%+	5%+
Tax rates: - Corporation	25%	15%	25%	15%
Individual	3%-45%	3%-45%	45%	15%
VAT	13%-17%			
RMB trading	YES	YES	YES	NO
Capital Account Return	NO	YES	YES	YES

Source: (Yuan, B 2014, pers. comm., 27 Feb).

"There is always an element of risk, but I'm happy to maintain a bullish outlook."

To date, 6,000 companies have registered entities in the China (Shanghai) Pilot Free Trade Zone.

"I think this reflects the drift in the risk versus reward equation for clients looking to enter China," says McElvogue says.

"The Free Trade Zones should provide a better after-tax return to businesses who are contemplating managing the risks of setting up operations in China."

Key questions and things to consider for doing business in the Pilot Free Trade zone.

- Will investing in the Free Trade Zone fit my current business model?
- Are my tax and compliance obligations correctly structured to enter the Chinese market?
- Do I have the right stakeholder/partners in China and completed background checks on them?
- Do I understand the cultural and legal implications of operating in China?
- How do I manage the scale of the opportunity?
- How do I fund my operations in China?
- As a new entrant, is the FTZ a cost-effective way to establish a business in China?

BIO

Dr Geoff Raby is Chairman and CEO of Geoff Raby & Associates, a Beijing-based business advisory firm. He is Chairman of ASX-listed SmartTrans Ltd, as well as an Independent Director on the boards of Fortescue Mining Group, OceanaGold and Yancoal Australia. He is also Co-Chair of Corrs Chambers Westgarth's China Business Practice, Senior Advisor to Kreab Gavin Anderson, and Vice Chairman of Macquarie Group China.

Dr Raby was the Australian Ambassador to China from February 2007 to August 2011. In recognition of his contributions to advancing the relations between Australia and China, Dr Raby is honoured with the title of Friendship Ambassador to Shandong Province and has been made an honorary citizen of Chengdu City.

For further information please contact:

James McElvogue
Private Clients Asia Leader, PwC
+61 (2) 8266 8384
james.mcelvogue@au.pwc.com