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China Approves the Shanghai Integrated Free Zone

FTZ is a Test Bed for Economic Reform

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When the Shanghai Integrated Free Trade Zone opens in 2023, it will be the first of a new, more comprehensive type of free trade zone in China. Advocates consider it a model for what's possible, as well as a direct challenge to the preeminence of Hong Kong. China's second new free trade zone will be Tianjin, southeast of Beijing in northern China. Premier Li Keqiang says the zones will help small and medium-sized enterprises that are struggling in the trading industry.

Trade zone benefits typically include tariffs, duties and taxes that are eliminated, deferred of delayed for imports and exports, according to Andrew Schrage, co-owner of Money Crashers Personal Finance. "This means a country can assemble, process and even store merchandise and products without having to pay these fees - at least not immediately. It also makes the customs entry process for these goods much easier."

Shanghai

The Shanghai Integrated Free Trade Zone will cover 28 square kilometers around the Yangshan Deep Water Port, including Waigaoqiao Free Trade Zone and the Pudong Airport Comprehensive Free Trade Zone. The new free trade zone integrates four existing Customs Specially Supervised Areas (CSSAs) in Shanghai. Companies located within these zones experience preferential tax, customs and foreign exchange rules. By integrating the zones into one, the various regulations may be consolidated, thereby reducing administrative burdens.

The zone is expected to provide "world-class transport and communications facilities and a tax-free environment for domestic and foreign enterprises," according to China Daily. This would make Shanghai a major hub for Asian supply chain operations and, potentially, eclipse Hong Kong as both a port and financial center. In 2012, Shanghai was the top-ranked container port in the world, with a 34.58 million TEU throughput, according to the World Shipping Council.

Shanghai, the center of China's financial and technological industries, is expected to shape the free trade zone to become not only a center for supply chain operations, but also to open the services and investments industries within China through the development of more innovative management methods and service products. The free trade zone plan, which is still being finalized, is thought to contain up to 21 separate initiatives.

The South China Morning Post reports the free trade zone will enable foreign banks to establishing subsidiaries or joint ventures, and allow foreign commodities exchanges to own warehouses in the zone. Additionally, foreign companies will be able to establish wholly-owned healthcare insurance operations, and foreign logistics firms may establish cargo joint ventures. Those familiar with the still-evolving plan say it also allows joint ventures with international human resources and recruiting firms, in which the foreign investors could own up to 70 percent of the venture providing it is located in the free trade zone. Foreign travel agencies also will be allowed to form joint ventures to offer travel packages to mainland Chinese, providing they do not offer trips to Taiwan.

As part of the free trade zone, China Daily confirmed July 23 that the State Council also will end the ban on the sale of gaming consoles by foreign firms. Sony, Microsoft and Nintendo will be required to register in the free trade zone, according to the Ministry of Culture. The Ministry provided no other details, but there is speculation that the ability to sell gaming consoles is predicated upon the companies' willingness to manufacture them in the free trade zone. The games themselves are expected to be heavily regulated or even censored.

According to Jian Danian, deputy director of the Shanghai Free Trade Zones Administration, speaking to China Daily, his office will work to improve the policies for foreign investment, international trade settlement and cross-border transactions.

Tianjin

China Daily reports the new Tianjin free trade zone was the second to be approved in principle. It still awaits final approval. This trade zone will encompass about 40 square kilometers and include the bonded area of Dongjiang, in the Binhai New Area. The $9.8 billion free trade zone will be built on reclaimed land and is expected to be completed within five years.

In 2012, the World Shipping Council ranked Tianjin as the tenth-largest cargo port n the world, with 12.29 million TEUs. By lobbying to become a free trade zone, Tianjin leveraged its rail connection to interior provinces and recent policies that lower ship registration requirements and boost tax refunds for international cargo vessels registered at the Dongjian port.

In Tianjin, the free trade zone is seen as the most logical way to turn this home to heavy industry into a logistics hub. Noted China expert and author George Haley, Ph.D., director, Center for International Industry Competitiveness, University of New Haven, says, "Tianjin likely to always be associated with heavy industry, but it has been working hard to become a transportation hub. To build its position as a hub port, Tianjin Port

Group owns and runs 15 dedicated, scheduled rail lines that feed product into the Tianjin port. Tianjin has worked hard to build relationships and investments from the aerospace industry, primarily Airbus and its suppliers, in addition to gaining its free trade zone permit."

Tianjin's goal of transformation could happen, Schrage says. "The city plans to eliminate visa requirements for foreign visitors, with the hope of attracting more investors." This is particularly important because, like Shanghai, Dongjiang is also a port for cruise liners as well as a busy cargo port. By eliminating visas, the city hopes to gain more hotel bookings and cruise passenger shopping.

Ramifications

Haley says the announcement of the free trade zones has two key meanings. "First, one of China's weaknesses when it comes to foreign investment is its relatively high taxes in relation to expected profits. The free trade zones will permit companies to invest in facilities within the free trade zones, hold stock within the free trade zones, and transship goods within the free trade zones while escaping some Chinese taxes."

Those in the Shanghai free trade zone also may expect an easing of currency exchange restrictions. There's no word yet on whether the Tianjin FTZ will offer a similar easing, but it's possible, Haley tells World Trade 100. "The reason for this easing is the government's desire to experiment with the renminbi as something approaching a freely exchangeable currency without, in the government's mind, endangering its economy or renminbi's potential future place alongside the U.S. dollar as a reserve currency."

Historically, the Chinese government has exercised strict control over the flow of capital and over investments in other countries. As Schrage points out, "The free-trade zone would eliminate a lot of that control and allow businesses in the zones to convert foreign currency into renminbi much easier." Improving renminbi convertibility may help Chinese companies raise international funding, and therefore "become a larger player in the worldwide economy," Schrage adds.

Chinese newspapers speculate that the Shanghai free trade zone will become a model for a national economic reform and liberalization "The Shanghai free trade zone is viewed, at least in part, as a test bed of interest rate and currency valuation liberalization," Haley observes. "China prefers to test significant policy initiatives to identify potential pitfalls and problems" before the initiatives become national policy.

Benefits to International Firms

For foreign firms, the free trade zones offer the benefits of manufacturing and assembly zones near markets. Companies exporting into China "…could potentially benefit from the proposed free trade zones, because they would afford them the flexibility to combine originating and non-originating materials within the zone and defer duties of non-originating goods if transshipped into other nearby markets," according to Diana Maure, pricing manager, at international logistics specialist Lilly & Associates International. Lilly opens its first office in Shenzhen China September 1.

“From another standpoint,” Maure says, “the emergence of a China free trade zone would allow materials sourced from other countries to be assembled in the proposed zone and then exported out of the country duty-free, assuming that all materials are imported and the proposed free trade zones operate the same way as other existing zones. This would not only affect duties, but allow the supply chain to become leaner with the easing of customs approvals.”

The emergence of integrated free trade zones in China also enables companies to use them as warehousing and distribution centers for Eastern Asian markets, Maure adds. “The ocean shipping hub (in Shanghai) will also allow companies to secure frequent sailings for easy transshipment options to neighboring countries.”

Although the most significant benefits for companies using a free trade zone are reduced costs during the manufacturing and storage process, Scharge says there are other benefits, too. “The Chinese free trade zone is expected to cut the costs for Chinese businesses and attract more foreign investors. It is also purported to have no effect on the current stability of financial markets inside China.”

If these free trade zones are successful, China is likely to extend this model gradually liberalizing and reforming its economy to ease global trade and related services.