

China's Pilot Free Trade Zone: Shanghai Free Trade Zone and the Potential Future of Free Trade Zones in Mainland China

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Abstract

China is the world's largest exporter and second largest importer. It is the only developing country other than Russia on the list of the world's top ten exporters. The value of its imports is only about 300 billion USD less than the US's imports, and over 700 billion USD from the next largest importing country. Despite its tremendous amount of trade, the slowing domestic economy encourages the national government to test new methods of promoting international trade and foreign investment. In 2013, China created the China (Shanghai) Pilot Free Trade Zone to test relaxed trading practices. This article provides an overview of special economic zones and the Shanghai Free Trade Zone. It then analyzes this new free trade zone and its political and economic effects, and offers several suggestions for the future of the Shanghai Free Trade Zone and other potential free trade zones in Mainland China.

INTRODUCTION

The People's Republic of China ("PRC," "China" or "Mainland China") is the world's largest exporter and second largest importer.¹ China is the only developing country other than Russia on the list of the world's top ten exporters.² Despite its tremendous amount of trade, the slowing domestic economy encourages the national government to test new methods of promoting international trade and foreign

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¹See Said, Sammy, *The 10 Biggest Exporting Countries in the World*, THE RICHEST (Apr. 29, 2013), available at <http://www.therichest.com/business/the-10-biggest-exporting-countries-in-the-world/>; see also Said, Sammy, *The 10 Biggest Importing Countries in the World*, THE RICHEST (Apr. 29, 2013), available at <http://www.therichest.com/rich-list/rich-countries/the-10-biggest-importing-countries-in-the-world/>.

²See Said, Sammy, *The 10 Biggest Exporting Countries in the World*, fn. 1.

investment. In 2013, China created the China (Shanghai) Pilot Free Trade Zone (“SHFTZ”) to test relaxed trading practices.³ The purpose of this article is to provide an in-depth discussion of this free trade zone (“FTZ”), analyze the effects of the SHFTZ and potential of future FTZs, and make specific suggestions for the expansion of FTZs in Mainland China.

I. Background

This article begins by presenting an overview of special economic zones (“SEZs”) and the types of SEZs in the PRC. It then provides a comprehensive review of the SHFTZ.

A. Introduction to Special Economic Zones

The predecessors of modern SEZs have existed for centuries.⁴ These took the form of entrepôts (trading posts) and municipal free storage areas.⁵ In 1959, the first modern SEZ was established in Ireland.⁶ For the next eleven years, most of the world’s SEZs were located in industrialized countries.⁷ This shifted in the 1970s. Since then, SEZs were typically created in developing countries seeking to promote foreign investment and trade.⁸ The PRC established its first four SEZs in 1980.⁹

³See generally Zhongguo (Shanghai) ZiyouMaoyiShiyanquZongtiFangan (中国（上海）自由贸易试验区总体方案) [China (Shanghai) Pilot Free Trade Zone Overall Plan] (promulgated by the State Council on Sept. 18, 2013), available at http://www.gov.cn/zwgc/2013-09/27/content_2496147.htm.

⁴See Farole, Thomas & Akinci, Gokhan, *Special Economic Zones: Progress, Emerging Challenges, and Future Directions*, WORLD BANK (Farole, Thomas & Akinci, Gokhan, eds., 2011), pg. 3, available at <http://issuu.com/world.bank.publications/docs/9780821387634>; see also e.g., Archer, E.G., *Gibraltar, Identity and Empire*, ROUTLEDGE (2006), pg. 54.

⁵See Farole, Thomas & Akinci, Gokhan, fn. 4 at 3.

⁶*Id.*

⁷See *id.*

⁸See *id.*

⁹*China’s Special Economic Zones*, HOFSTRA UNIVERSITY (last visited Sept. 21, 2014), available at https://people.hofstra.edu/geotrans/eng/ch5en/conc5en/China_SEZ.html.

SEZs have the potential to substantially benefit a nation's economy by promoting international trade.¹⁰ They utilize diverse methods of increasing trade and investment including reducing taxes and duties, relaxing customs regulations, instituting land-use privileges, and permitting access to otherwise restricted industries.¹¹ These methods provide many incentives for foreign trade and investment. However, they also bring with them several disadvantages for the government that is establishing SEZs. The most obvious disadvantage is revenue loss from financial incentives. SEZs also encounter issues with traders that take advantage of the inexpensive land rates by purchasing more land than they would use and subsequently selling it at higher prices.¹²

B. Types of Special Economic Zones

Governments will create distinct types of SEZs to promote specific aspects of trade and foreign investment. Although there is no single global definitions for the types of SEZ, the general working definitions are more than adequate for the purpose of introducing SEZs. This subsection discusses each primary type of SEZ, beginning with the FTZ.

1. Free Trade Zone

¹⁰*See id.*

¹¹*See Advantages and Disadvantages of SEZ*, EXIM GURU (last visited Sept. 18, 2014), available at http://www.eximguru.com/exim/special_economic_zone_sez/ch_4_advantages_disadvantages_sez.aspx.

¹²*See id.*

FTZs, also known as commercial free zones, are dedicated to developing international trade.¹³ They are usually located at ports and are generally smaller than other SEZs.¹⁴ FTZs are duty-free and offer services that facilitate trade such as storage, distribution, and re-exportation.¹⁵

2. Free Economic Zone

Unlike FTZs, which are geared towards developing trade, free economic zones focus on attracting foreign companies into a country. The development of free economic zones is based on improving living and working conditions for foreign companies, providing land and tax incentives, and facilitating how companies conduct business in a foreign country.¹⁶ They are typically very large and have their own infrastructure such as airports, schools, hospitals, etc.¹⁷

3. Export Processing Zone

Export processing zones (“EPZs”) promote export-related manufacturing by offering incentives and providing facilities.¹⁸ They fall within the medium size of SEZs because they involve manufacturing processes but are not open to the general public.¹⁹ There are two types of EPZs – (1) traditional zones, which are exclusively

¹³See *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, FIAS (Apr. 2008), pg. 9, available at <https://www.wbginvestmentclimate.org/uploads/SEZs%20-%20Performance,%20Lessons%20Learned%20and%20Implications%20for%20Zone%20Development.pdf>.

¹⁴See *id.*

¹⁵*Id.*

¹⁶See, e.g., *What is FEZ*, FEZ PLANNING OFFICE, REPUBLIC OF KOREA (last visited Sept. 21, 2014), available at <http://www.fez.go.kr/en/what-is-free-economic-zone.jsp>.

¹⁷See *id.*

¹⁸See *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, fn. 13 at 9.

¹⁹See *id.*

dedicated to export-related manufacturing, and (2) hybrid zones that are divided into export-focused zones and general manufacturing zones.²⁰

4. Bonded Logistics Park

Bonded logistics parks are small enclosed zones that are located close to ports.²¹ Many bonded logistics parks are located between SEZs (usually FTZs) and ports.²² They provide comprehensive logistics functions including storage, testing, maintenance, exhibition, processing, and value-added tax (“VAT”) services.²³ These parks often allow simple assembly and processing.²⁴

5. Free Port

Free ports are large multi-use SEZs that provide a broad array of incentives to foreign trade, tourism, and development.²⁵ Unlike other types of SEZs, many free ports allow retailers to sell goods on-site, and also provide housing options for the public.²⁶

6. Industrial Park

Industrial parks are dedicated to promoting manufacturing and foreign investment through a combination of collective infrastructure services (e.g. roads, telecommunications, quality control testing, etc.), transportation services, proximity to

²⁰See *id.*

²¹See Pfaar, Michael & Wang, Xiaodan, *Chinese Bonded Areas: Choosing the Right Location*, TAX NOTES INTERNATIONAL (Jan. 3, 2011), pg. 62, available at [http://apps.osgoode.yorku.ca/Quickplace/jinyanli/PageLibrary852574DA004EB5B7.nsf/0/C7AF85B2783581838525778D000AA286/\\$file/Chinese%20Bonded%20Areas-%20Choosing%20the%20Right%20Location.pdf](http://apps.osgoode.yorku.ca/Quickplace/jinyanli/PageLibrary852574DA004EB5B7.nsf/0/C7AF85B2783581838525778D000AA286/$file/Chinese%20Bonded%20Areas-%20Choosing%20the%20Right%20Location.pdf).

²²See *id.*

²³*Id.*

²⁴See *id.*

²⁵See *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development*, fn. 13 at 9.

²⁶See *id.*

ports, and other incentives such as discounted land and tax breaks.²⁷ They are often located near large urban areas, but far enough away to reduce associated health effects.²⁸

C. China's Special Economic Zones

The PRC has several of the types of SEZs discussed above. As many of its SEZs are further categorized pertaining to industry or governmental association, this subsection divides China's SEZs into four broad categories: (1) China-specific SEZs, (2) industrial zones, (3) EPZs, and (4) bonded logistics parks.

1. China-Specific Special Economic Zones

The term "special economic zone" is used in China to identify two distinct concepts. It is sometimes used broadly - encompassing FTZs, EPZs, and industrial zones.²⁹ However, the general understanding of SEZ is that it refers to seven SEZs.³⁰ This subsection focuses on the definition of SEZ as pertaining to specific economic zones in Mainland China.

i. Overview

The Cultural Revolution, which lasted from 1966 to 1976, devastated the PRC's economy.³¹ Beginning in 1978, the PRC, led by Deng Xiaoping, began to focus on

²⁷See Falcke, Caj, *Industrial Parks: Principles and Practice*, 20 JOURNAL OF ECONOMIC COOPERATION AMONG ISLAMIC COUNTRIES 1, 5 (1999) available at http://www.sesrtic.org/jecd/jecd_articles/ART98100101-2.pdf.

²⁸See *id.* at 7.

²⁹See *Building Engines for Growth and Competitiveness in China: Experience with Special Economic Zones and Industrial Clusters*, WORLD BANK (Zeng, Zhihua, 2010), pg. 4.

³⁰*Id.* at 5 (providing that "[i]n China, SEZ normally refers to seven specific zones: Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, Shanghai Pudong New Area, and Tianjin Binhai New Area").

³¹See, e.g., *id.* at 9.

economic development through promoting international investment and trade.³² In 1980, China opened four SEZs: Shenzhen, Zhuhai, Shantou, and Xiamen.³³ Three other SEZs were later established: Hainan (1988), Shanghai Pudong New Area (1989), and Tianjin Binhai New Area (2006).³⁴

It is interesting to note that only one SEZ, Tianjin Binhai New Area, is located outside of southern China. There are several reasons why the PRC established SEZs in southern China, including (1) geographic distance from Beijing, so as to reduce political influence and risks, (2) access to ports, and (3) proximity to Hong Kong and Taiwan.³⁵

China's SEZs demonstrated remarkable economic growth within the first few years of their establishment. For example, Shenzhen grew 58 percent from 1980 to 1984, while the national average was 10 percent.³⁶ In 1981, the four initial SEZs attracted an astounding 59.8 percent of China's FDI.³⁷

ii. Structure

China's SEZs consist of or are located in different levels of local government. Shenzhen, Zhuhai, and Shantou are cities located in Guangdong Province, and Xiamen is a city in Fujian Province. Hainan is an entire province (the PRC's largest island, following Taiwan). Shanghai Pudong New Area is a small urban area located

³²*See id.*

³³*See id.*

³⁴*See id.* at 10.

³⁵*See id.* at 9.

³⁶*Id.* at 10.

³⁷*Id.* at 9.

in the eastern part of Shanghai's city center, and Tianjin Binhai New Area is the coastal district of one of China's four centrally administered municipalities.³⁸

SEZs attract foreign investment through economic policies, relaxed regulations, and tax incentives that ordinarily are not available in other areas of Mainland China.³⁹ The national government also allows SEZs more independence related to international trade as well as reduces commonplace political consequences on the market.⁴⁰ These SEZs are the largest type of economic zones in China – for example, the Hainan SEZ is an entire province, and the Shenzhen SEZ encompasses almost 400 square kilometers.⁴¹

According to national law, SEZs shall be regulated by their municipal and/or provincial people's congresses.⁴² Legally, this means that municipal SEZs such as Shenzhen can be specifically regulated by both municipal and provincial governments, while provincial SEZs (Hainan) and SEZs in centrally administered municipalities (Shanghai New Pudong and Tianjin Binhai) will only be regulated by their respective provincial or quasi-provincial governments. In reality, this legal distinction is not very significant because the regulation of SEZs typically occurs at the local level.

2. Industrial Zones

³⁸See Kossof, Paul, *Business Franchise Compliance in Mainland China*, 2 JOURNAL OF TRANSNATIONAL LEGAL ISSUES 131, 140 fn. 66 (2013) (providing that the term “centrally administered municipality” (直辖市) refers to cities that have both municipal and provincial powers, and the PRC has four centrally administered municipalities which are Beijing, Chongqing, Tianjin, and Shanghai).

³⁹See *China's Special Economic Zones (New Areas & SEZs)*, UNDERSTAND CHINA (last visited Sept. 22, 2014), available at <http://understand-china.com/special-economic-zone-sez/>.

⁴⁰See *id.*

⁴¹See *Utilizing Development Zones in China*, CHINA BRIEFING (May 28, 2013), available at <http://www.china-briefing.com/news/2013/05/28/utilizing-development-zones-in-china.html>.

⁴²See Legislation Law of the People's Republic of China (promulgated by the Ninth National People's Congress, last revision effective on July 1, 2002), art. 65 (“经济特区所在地的省、市的人民代表大会及其常务委员会根据全国人民代表大会的授权决定，制定法规，在经济特区范围内实施”) (emphasis added).

The PRC has two distinct types of industrial zones: (1) national economic and technological development zones (国家级经济技术开发区) (“ETDZs”) and (2) high-tech parks (高新技术园区). These industrial zones focus on developing specific industries, and combine foreign and domestic capital.⁴³

i. National Economic and Technological Development Zones

a. Overview

In 1984, after witnessing the successes of its four initial SEZs, China’s national government decided to establish a second type of economic zone referred to as “national economic and technological development zones.”⁴⁴ From 1984 to 1988, the PRC created 14 ETDZs along its coast, as far north as Dalian and as southwest as Zhanjiang.⁴⁵ China continued to establish ETDZs, and there are currently 215 ETDZs in Mainland China.⁴⁶ Unlike its SEZs, China also promoted the establishment of ETDZs in western provinces. In fact, 21 of its ETDZs are located in middle or western Mainland China.⁴⁷

b. Structure

As discussed above, SEZ designation may be given to an entire city or even province. In comparison, ETDZs are small areas within municipalities. For

⁴³See *Type of Industrial Areas and Zones in China*, BUSINESS-IN-ASIA.COM (last visited Sept. 22, 2014), available at http://www.business-in-asia.com/china/china_industrial_park_type.html.

⁴⁴See *A Brief Introduction of National Economic and Technological Development Zones in China*, MINISTRY OF COMMERCE OF THE PEOPLE’S REPUBLIC OF CHINA (last visited Sept. 22, 2014), available at <http://www.china.org.cn/english/SPORT-c/76751.htm>.

⁴⁵See *id.*

⁴⁶See *GuojiajiJingjiJishuKaifaqu 215Ge* (国家级经济技术开发区 215 个) [215 National Economic and Technological Development Zones], MINISTRY OF COMMERCE OF THE PEOPLE’S REPUBLIC OF CHINA (last visited Sept. 24, 2014), available at <http://www.mofcom.gov.cn/xglj/kaifaqu.shtml> (note that most Chinese government English sources do not reflect the current number of ETDZs).

⁴⁷See *A Brief Introduction of National Economic and Technological Development Zones in China*, fn. 44.

example, Beijing's only ETDZ is located in a southeast suburb of Beijing,⁴⁸ and Shanghai's six ETDZs are found in separate areas throughout Shanghai.⁴⁹

ETDZs attract domestic and foreign investment by providing financial incentives as well as establishing an infrastructure dedicated to manufacturing and transportation.⁵⁰ In addition to lowered property prices and taxes, ETDZs facilitate manufacturing by placing highways and railways close to the ETDZ, offering high voltage electricity, security, medical services, etc.⁵¹ They also promote collective investment opportunities, and will often adapt their infrastructure depending on the type of industries operating within the area.⁵²

ETDZs are subject to several levels of government regulation: (1) laws from the National People's Congress ("NPC")⁵³, (2) national regulations from the State Council⁵⁴ and associated administrations, (3) provincial laws, (4) municipal and local laws, and (5) regulations created by ETDZs themselves.⁵⁵ Examples of

⁴⁸ *Beijing Economic and Technological Development Area*, MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA (last visited Sept. 24, 2014), available at <http://www.china.org.cn/english/SPORT-c/75819.htm>.

⁴⁹ *See, e.g., Shanghai Hongqiao Economic and Technological Development Zone*, MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA (last visited Sept. 24, 2014), available at <http://www.china.org.cn/english/SPORT-c/75862.htm> (note that this website only provides four of Shanghai's six ETDZs, and that a complete and updated list of China's ETDZs may be found at *Guojiaji Jingji Jishu Kai fa qu 215Ge*, fn. 46).

⁵⁰ *See, e.g., Guojiaji Changsha Jingji Jishu Kai fa qu Jianjie* (国家级长沙经济技术开发区简介) [Introduction to the Changsha Economic and Technological Development Zone], HUAXIAJINGWEI WANG (Aug. 19, 2004), available at <http://www.huaxia.com/20040819/00234251.html>.

⁵¹ *See, e.g., id.*

⁵² *See, e.g., id.*

⁵³ The NPC is the world's largest parliament and, as China's primary legislative body, it elects the heads of executive and judicial institutions and also ratifies bills. As the NPC meets only twice a year, the Standing Committee, which consists of a select few NPC members, functions as the PRC's permanent legislative institution, and determines most of China's national laws. Paul Kossow, *Chinese Legal Research*, CAROLINA ACADEMIC PRESS (2014), pgs. 22–23.

⁵⁴ The State Council, also known as the "Central People's Government," is the PRC's head administrative authority. The State Council creates China's national administrative regulations. *Id.* at pg. 23.

⁵⁵ *See Ji Shuangcheng, Guojiaji Jingji Jishu Kai fa qu de Fa lv Di wei Tan xi* (国家级经济技术开发区的法律地位探析) [An Analysis of the Legal Status of National Economic and Technological Development Zones], 509 *GUANLI GUANCHA* 3, 3 (2013).

administrations that issue regulations affecting ETDZs are the Ministry of Commerce (“MOFCOM”), Ministry of Land and Resources, and Ministry of Housing and Urban-Rural Development.⁵⁶

ii. High-Tech Parks

a. Overview

Four years after the establishment of the first ETDZ in the PRC, the State Council established the Beijing New Technology Industrial Trial Zone.⁵⁷ This trial zone was the first high-tech park in Mainland China.⁵⁸ Since then, the PRC has created over 100 high-tech zones, and these zones can be found in every province.⁵⁹

b. Structure

China’s high-tech zones are found in developed cities, provincial capitals, and all four of its centrally administered municipalities.⁶⁰ Only companies qualified as high-tech firms are allowed to operate in high-tech zones, and the qualification requirements are the company must (1) develop or use technology listed in the *Catalog for High and New Technology Products*, published by the Ministry of Science and Technology, (2) spend at least three percent of its gross revenue on R&D, (3) employ

⁵⁶See *id.*

⁵⁷See *Zhongguancun Science Park*, ZHONGGUANCUN SCIENCE PARK (last visited Sept. 24, 2014), available at http://en.zgc.gov.cn/2011-11/14/content_14025989.htm.

⁵⁸See *id.*

⁵⁹See *Guojiaji Gaoxin Jishu Chanye Yuanqu Mingdan (Jie zhi 2014 Nian 1 Yue)* (国家级高新技术产业园区名单(截止 2014 年 1 月)) [List of National High-Tech Parks (Up to Jan. 2014)], SINA CORPORATION (Mar. 27, 2014), available at http://blog.sina.com.cn/s/blog_60ba14aa0101dc52.html.

⁶⁰See Zhang, Haiyang & Sonobe, Tetsushi, *Development of Science and Technology Parks in China, 1988–2008*, 5 *ECONOMICS: THE OPEN-ACCESS, OPEN-ASSESSMENT E-JOURNAL* 2011–6 (Apr. 12, 2011), pg. 3, available at <http://www.economics-ejournal.org/economics/journalarticles/2011-6>.

a work force composed of at least 30 percent of employees with a college degree or higher, and (4) dedicate 10 percent or more of its personnel to R&D.⁶¹

High-tech parks attract investment through substantial financial incentives. For example, companies in high-tech parks are exempt from corporate income tax for the first two years, and are then taxed ten percent less than if they were not in high-tech parks.⁶² There are also other regulatory incentives such as that customs does not require import licenses for companies in high-tech parks if the imported materials will be incorporated into a product designated for exportation.⁶³ High-tech parks have the same regulatory schemes as ETDZs, although their associated administrations are different depending on the industries in a specific park.

3. Export Processing Zones and Bonded Logistics Parks

Although Taiwan created its first EPZs in the 1960s, Mainland China did not establish its own EPZs until the political reforms under Deng Xiaoping in the 1980s.⁶⁴ There are currently 58 EPZs in Mainland China.⁶⁵ China's EPZs are similar to the definition of EPZ provided above, and are regulated by both the municipal government and their own regulatory commission.⁶⁶

⁶¹ See *id.*

⁶² See *id.* at 4.

⁶³ See *id.*

⁶⁴ *Qiantan Zhongguo ZiyouMaoyi Qu (FTZ) de Leixingjiqi Fa* (浅谈中国自由贸易区 (FTZ) 的类型及其发) [Briefly Discussing Chinese Free Trade Zone (FTZ) Classifications and Development], CHINA EXPORT & CREDIT INSURANCE CORPORATION (Nov. 30, 2010), available at <http://www.sinosure.com.cn/sinosure/xwzx/rdzt/tzyhz/dqjmhzyhj/130398.html>.

⁶⁵ See *id.*

⁶⁶ See, e.g., *JigouShezhi* (机构设置) [Organizational Structure], ADMINISTRATIVE COMMITTEE STATE-LEVEL GUANGXI BEIHAI EXPORT PROCESSING ZONE (last visited Sept. 28, 2014), available at <http://www.bhepz.gov.cn/Agency.asp?Class2=13>.

Much like EPZs, China's bonded logistics parks are also small enclosed areas located near ports, and are similar to the definition provided above. China's first bonded logistics park, the Waigaoqiao Bonded Logistics Park, was later subsumed under the SHFTZ.⁶⁷

D. Shanghai Pilot Free Trade Zone

Having discussed the types of Chinese SEZs, this subsection begins by providing the history of the SHFTZ as well as its purpose and structure. It then explores the overall regulatory differences between the SHFTZ and Mainland China in general. Finally, it outlines the primary laws and regulations that form the legal backbone for the SHFTZ.

1. History

i. Component Special Economic Zones

The SHFTZ is composed of four pre-existing SEZs: (1) Waigaoqiao Free Trade Zone, (2) Waigaoqiao Bonded Logistics Park, (3) Yangshan Free Trade Port Area, and (4) Pudong Airport Free Trade Zone.⁶⁸

a. Waigaoqiao Free Trade Zone

In June 1990, the State Council approved of the Waigaoqiao Free Trade Zone, an 8.5 square kilometer duty-free area dedicated to promoting free trade through

⁶⁷ *Shanghai Waigaoqiao Free Trade Zone*, SHANGHAI WAIGAOQIAO FREE TRADE ZONE XIN DEVELOPMENT CO., LTD. (last visited Sept. 28, 2014), available at <http://www.pudong-xin.com/en/brief.htm>.

⁶⁸ *Location*, CHINA (SHANGHAI) PILOT FREE TRADE ZONE (last visited Sept. 29, 2014), available at <http://en.shftz.gov.cn/About-FTZ/Location/>.

services including export processing and storage.⁶⁹ By 2003, this FTZ had attracted over 8.6 billion USD in investment from 75 countries as well as 99 Fortune 500 companies.⁷⁰

b. Waigaoqiao Bonded Logistics Park

The Waigaoqiao Bonded Logistics Park was established by the General Administration of Customs (“GAC”) in April 2004.⁷¹ This bonded logistics park offers private storage and offices for rent, registration services, public storage, inspections, and security.⁷² It currently rents storage to some of the world’s largest transportation providers such as DHL and Nippon Express.⁷³

c. Yangshan Free Trade Port Area

In December 2005, the PRC established its first FTZ located in a port – the Yangshan Free Trade Port Area.⁷⁴ This FTZ has all of the offices associated with a port including customs, taxes, maritime affairs, and border inspection.

d. Pudong Airport Free Trade Zone

The fourth component SEZ, the Pudong Airport Free Trade Zone, was approved by the State Council in July 2009.⁷⁵ Most of the investment associated with this FTZ

⁶⁹See *Shanghai Waigaoqiao Baoshuiqu* (上海外高桥保税区) [Waigaoqiao Free Trade Zone], SHANGHAI ZHAOSHANG WANG (last visited Sept. 29, 2014), available at <http://www.zhaoshang-sh.com/kfqzs/waigaoqiao/>.

⁷⁰*Id.*

⁷¹*Shanghai Waigaoqiao BaoshuiWuliYuanqu* (上海外高桥保税物流园区) [Waigaoqiao Bonded Logistics Park], SHIPPING CHINA COMPANY LTD. (last visited Sept. 29, 2014), available at <http://info.shippingchina.com/bluenews/index/detail/id/39447.html>.

⁷²*See id.*

⁷³*See id.*

⁷⁴*Yangshan BaoshuiGangquJianjie* (洋山保税港区简介) [Introduction to Yangshan Free Trade Port Area], CHINA (SHANGHAI) PILOT FREE TRADE ZONE ADMINISTRATION COMMISSION – OFFICE OF YANGSHAN FREE TRADE PORT AREA (last visited Sept. 29, 2014), available at http://www.ysftpa.net/show_news.asp?id=3934.

⁷⁵*See Tengfei de Pudong JichangZongheBaoshui Qu* (腾飞的浦东机场综合保税区) [The Rapidly Developing Pudong Airport Free Trade Zone], CHINA (SHANGHAI) PILOT FREE TRADE ZONE ADMINISTRATION COMMISSION -

comes from Pudong International Airport.⁷⁶ It offers the same services as the SHFTZ's other SEZs, and its success is directly attributable to its superior air and ground transportation.⁷⁷ Four months after the Pudong Free Trade Zone was established, it entered into a strategic development alliance with the other three SEZs called the 三港三区 (“Three Ports, Three Areas”).⁷⁸

ii. Creation of Shanghai Pilot Free Trade Zone

On August 30, 2013, the NPC promulgated the “Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Temporarily Adjust the Relevant Administrative Approval Items Prescribed in Laws in China (Shanghai) Pilot Free Trade Zone.”⁷⁹ This legislative document determined that the four aforementioned SEZs would merge to become a single FTZ, and gave the State Council authority to create administrative regulations to set up and regulate the SHFTZ for three years.⁸⁰ Pursuant to this document, the SHFTZ was established on October 1, 2013.⁸¹

Less than three weeks after the NPC promulgated the document that granted the State Council authority over the SHFTZ, the State Council issued the “China

OFFICE OF PUDONG AIRPORT FREE TRADE ZONE (last visited Sept. 29, 2014), available at http://www.pdaftz.net/show_news.asp?cataid=195&id=3790&.

⁷⁶See *id.*

⁷⁷See *id.*

⁷⁸*Id.*

⁷⁹See Quanguo Renda Changweihui Guanyu Shouquan Guowuyuan zai Zhongguo (Shanghai) Ziyou Maoyi Shiyanguan Zanshi Tiaozheng Youguan Falv Guiding de Xingzheng Shenpi de Jueding (全国人大常委会关于授权国务院在中国（上海）自由贸易试验区暂时调整有关法律规定的行政审批的决定) [Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Temporarily Adjust the Relevant Administrative Approval Items Prescribed in Laws in China (Shanghai) Pilot Free Trade Zone], (promulgated by the Standing Committee of the 12th National People's Congress on Aug. 30, 2013, effective on Oct. 1, 2013), available at http://www.npc.gov.cn/npc/xinwen/2013-08/31/content_1805118.htm.

⁸⁰See *id.*

⁸¹See *id.*

(Shanghai) Pilot Free Trade Zone Overall Plan” (“SHFTZ Plan”).⁸² This plan begins by discussing the overarching purpose of the SHFTZ.⁸³

2. Purpose

The main purposes of the SHFTZ are to (1) accelerate governmental change in accordance with a changing economic environment, (2) explore new methods of administrative regulation, (3) promote trade and investment, and (4) serve as an experiment for national regulatory reform.⁸⁴

The SHFTZ Plan provides that during the initial three years of the SHFTZ, it will focus on reforms concerning foreign investment, trade, financial services, merchandise classification, and currency exchange.⁸⁵

3. Organizational Structure

The SHFTZ is composed of a complex structure of governmental organizations that can be categorized into two administrations for industry and commerce (“AICs”)⁸⁶ and a variety of local offices.

i. Administrations for Industry and Commerce

The SHFTZ is regulated by two local AICs: (1) the Shanghai Administration for Industry and Commerce (“Shanghai AIC”) and (2) the Shanghai Pilot Free Trade

⁸²See Zhongguo (Shanghai) Ziyou Maoyi Shiyuanqu Zongti Fangan, fn.3.

⁸³See generally *id.*

⁸⁴See *id.* at 1 (“试验区肩负着我国在新时期加快政府职能转变、积极探索管理模式创新、促进贸易和投资便利化，为全面深化改革和扩大开放探索新途径、积累新经验的重要使命，是国家战略需要。”).

⁸⁵See *id.* at 1.2 (“经过两至三年的改革试验，加快转变政府职能，积极推进服务业扩大开放和外商投资管理体制改革，大力发展总部经济和新型贸易业态，加快探索资本项目可兑换和金融服务业全面开放，探索建立货物状态分类监管模式，努力形成促进投资和创新的政策支持体系，着力培育国际化和法治化的营商环境，力争建设成为具有国际水准的投资贸易便利、货币兑换自由、监管高效便捷、法制环境规范的自由贸易试验区，为我国扩大开放和深化改革探索新思路和新途径，更好地为全国服务。”).

⁸⁶ Administrations for industry and commerce are local level authorities in charge of market supervision and regulation. See Paul Kossof, *Chinese Legal Research*, fn. 53 at 191.

Zone Administration for Industry and Commerce (“SHFTZ AIC”).⁸⁷ These AICs are responsible for managing enterprise registration within the SHFTZ.⁸⁸ All companies in the SHFTZ except for financial institutions such as banks and securities companies, insurance companies, and joint-stock limited companies created through stock flotation must use these two AICs’ registered capital subscription registration system.⁸⁹ The SHFTZ is not subject to China’s ordinary minimum registered capital rules.⁹⁰

ii. Offices

In addition to being subject to regulations from the national government, Shanghai municipal government, Shanghai AIC, and SHFTZ AIC, the SHFTZ also has various offices which manage the daily operations in the zone. These offices can roughly be categorized as (1) the General Office, (2) departmental offices, and (3) geographic offices.

a. General Office

The General Office functions as the overall administrative center for the SHFTZ.⁹¹ It coordinates foreign affairs issues including interacting with foreign businesses, issuing news releases, and coordinating foreign interaction with domestic

⁸⁷ See *Guanyu Zhongguo (Shanghai) ZiyouMaoyiShiyanquNeiqiyeDengjiGuanli de Guiding (关于中国(上海)自由贸易试验区内企业登记管理的规定)* [Concerning the China (Shanghai) Pilot Free Trade Zone Internal Company Registration Administration Regulations], (promulgated by the Shanghai Administration for Industry and Commerce on Sept. 30, 2013, effective on Oct. 1, 2013), art. 3, available at <http://www.sgs.gov.cn/shaic/html/govpub/2013-10-21-0000009a201310150001.html>.

⁸⁸ See *id.*

⁸⁹ See *id.* art. 4.

⁹⁰ See *id.* art. 6.

⁹¹ *Organization structure*, CHINA (SHANGHAI) PILOT FREE TRADE ZONE (last visited Oct. 13, 2014), available at <http://en.shftz.gov.cn/GOVERNMENT-AFFAIRS/Organization/>.

political groups.⁹² The General Office also manages the SHFTZ's documents, digital information, and emergency services.⁹³

b. Departmental Offices

The SHFTZ has the following departmental offices: Human Resources Bureau, Policy and Regulation Research Office, Economic Development Bureau, Fiscal and Financial Services Bureau, Construction Planning and Environmental Management Bureau, and the Comprehensive Supervision and Execution Bureau.⁹⁴

The Policy and Regulation Research Office has two important tasks that are unique to the SHFTZ. First, it advises how to draft and revise the laws and regulations that affect the SHFTZ.⁹⁵ Second, it researches how ideas implemented in the SHFTZ could be used in other areas of Mainland China.⁹⁶

c. Geographic Offices

The SHFTZ also has three geographic offices – the Yangshan Free Trade Port Office, Pudong Airport Free Trade Zone Office, and Waigaoqiao Free Trade Zone Office (the two Waigaoqiao FTZs have one consolidated office).⁹⁷ These offices are responsible for attracting foreign investment to their respective areas.⁹⁸ They also coordinate trade within their areas.⁹⁹

4. Regulatory Differences

⁹²See *id.*

⁹³See *id.*

⁹⁴See *id.*

⁹⁵See *id.*

⁹⁶See *id.*

⁹⁷See *id.*

⁹⁸See *id.*

⁹⁹See *id.*

The SHFTZ offers an array of incentives to foreign investors that are not available in other parts of Mainland China.

i. Finance

Unlike in the rest of the PRC, which has stringent business scope restrictions, the SHFTZ allows financial leasing companies to operate businesses that are associated with their primary business.¹⁰⁰ It also allows foreign finance institutions to establish foreign banks in the zone.¹⁰¹ Additionally, foreign medical insurance companies may established wholly foreign-owned enterprises (“WFOEs”).¹⁰²

ii. Professional Services

The SHFTZ is exploring methods of increasing the ability of foreign legal counsel to provide advice in China.¹⁰³ It allows foreign companies to establish credit investigation companies, joint-ventures (“JVs”) to create human resource agencies, and has removed the engineering-design performance requirement for foreign engineering design companies.¹⁰⁴

iii. Commerce

The Chinese government has exercised continuous and pervasive control over its domestic telecommunications industry. As such, it is very surprising that the national government allows foreign companies to operate specific telecommunication

¹⁰⁰See *Shanghai's New Free Trade Zone – General Plan and Regulations*, CHINA BRIEFING (Sept. 28, 2013), available at <http://www.china-briefing.com/news/2013/09/28/china-releases-general-plan-and-regulations-for-the-shanghai-free-trade-zone.html>.

¹⁰¹See *id.*

¹⁰²*Id.*

¹⁰³See *id.*

¹⁰⁴*Id.*

businesses within the SHFTZ.¹⁰⁵ Also, foreign companies are allowed to manufacture and sell gaming consoles in the zone.¹⁰⁶ This is another interesting aspect of the SHFTZ because China banned foreign gaming consoles in 2000.¹⁰⁷

iv. Social and Cultural

The SHFTZ allows the establishment of joint educational training organizations, and it also permits foreign healthcare organizations to be established within the zone.¹⁰⁸ Finally, it cancels the equity restrictions for foreign performance agencies.¹⁰⁹

II. Analysis

This article has provided an in-depth discussion of SEZs, both generally and in China, and the SHFTZ. Moving forward, it furthers the discussion of the SHFTZ by analyzing the SHFTZ's underlying goals, effects on China's economy, and potential influence on the national government.

A. Policy Considerations

As discussed above, the SHFTZ was established as a pilot program for increasing foreign investment. The benefits of foreign investment are relatively obvious – more capital, increased access to foreign markets, economic development, and availability

¹⁰⁵ *See id.*

¹⁰⁶ *Id.*

¹⁰⁷ *See, e.g., Xbox One to be the first game console sold in China in 14 years, but the PS4 still rules the West, EXTREME TECH (Apr. 30, 2014), available at*<http://www.extremetech.com/extreme/181580-xbox-one-to-be-the-first-game-console-sold-in-china-in-14-years-but-the-ps4-still-rules-the-west>.

¹⁰⁸ *See Shanghai's New Free Trade Zone – General Plan and Regulations*, fn. 100.

¹⁰⁹ *Id.*

of foreign products to domestic consumers. However, foreign investment also has its consequences.

First, foreign investment increases the ability of foreign interests to affect domestic politics. These has been an important policy consideration for China, which historically strongly resisted foreign influence. Second, the incentives utilized to promote foreign investment reduce the funds received by the government. Decreased minimum capital requirements, relaxed duties and fees, and lowered requirements for interacting with Chinese counterparts all have monetary consequences.

In consideration of the balance between the positive and negative aspects of promoting foreign investment, the national government chose Shanghai, China's financial center and testing ground for economic reform, to minimize the risks involved while maximizing the potential gains. As Shanghai, specifically Pudong, holds the offices of many foreign companies in China, and also hosts conferences and other events that promote trade, consolidating the four existing FTZs allowed the SHFTZ to utilize existing infrastructure and benefit from the proximity to foreign companies.

B. Effects on Trade

The effect that the SHFTZ will have on foreign investment will likely be much greater than its influence on trade with the PRC. The SHFTZ does not make many changes from how the pre-existing FTZs promoted trade, other than opening up

trade-related industries to foreign companies. Additionally, China's EPZs and bonded logistics parks provide sufficient incentives to promoting trade with the PRC. Finally, these incentives only have a minimal effect on foreign interests in trading with China.

C. Influence on National Government

The SHFTZ will have a strong influence on how the national government creates and revises its laws associated with foreign investment and trade. One of the most pressing issues in Chinese politics is how to maintain high yet stable growth. The results of this pilot program will help politicians determine how to move forward as the PRC transitions away from high-risk growth based almost exclusively on manufacturing to a growth-model more similar to those applied in developed countries.

As mentioned before, a consequence of foreign investment is that it allows foreign interests to participate in domestic politics. As the SHFTZ is in Shanghai, and its incentives only apply to the zone itself, the effect of the SHFTZ on national politics is minimal. However, if other areas in China were to implement a similar model for promoting trade, then foreign businesses and their governments may be able to participate more in domestic politics.

III. Proposal

This article makes several suggestions for how the PRC may interact with the SHFTZ and other FTZs in Mainland China.

A. Shanghai Pilot Free Trade Zone

There has been much discussion concerning whether the SHFTZ should expand to encompass the entirety of Pudong New Area. Parties that promote this expansion look to the positive effects of the SHFTZ on foreign investment, and assert that it would similarly increase foreign interest in Pudong New Area. The author disagrees with this view, and suggests that the SHFTZ maintain its present boundaries.

Pudong New Area, which includes Lujiazui, is generally viewed as the best area for foreign offices in Mainland China. It is one of the most developed districts in China. If the SHFTZ were to expand to include Pudong New Area, then the costs of its incentives would probably outweigh the benefits of the increased foreign investment. Simply put, the national government and Shanghai would lose opportunities to collect revenue from foreign companies that are already interested in Pudong New Area.

Similarly, it is important for Shanghai to reduce the effects of the SHFTZ on the city proper. It is potentially dangerous for a FTZ to be so close to highly populated areas due to pollution concerns. An attractive aspect of Shanghai is that its air quality is significantly better than other cities including Beijing. If the SHFTZ were to affect Shanghai's air quality, then it would also decrease foreigners' willingness to choose Shanghai over China's capital.

Ultimately, it is too soon to make substantial changes to the SHFTZ. The law that established the SHFTZ determined that it would be a pilot program for three

years. Accordingly, the author believes that it should exist under its current model, except for making and revising local laws and regulations.

B. China's Free Trade Zones

If the national government determines that the SHFTZ was a successful program, and decides to create additional FTZs in China, then it may consider replacing some of its SEZs with FTZs. Some of China's SEZs, particularly Hainan, encompass very large areas. As areas within SEZs develop and attract more residents, it will become increasingly important to protect against the harmful effects of industrialization. Thus, these areas could switch from being SEZs to having FTZs in specific areas. This would allow them to maintain and focus the benefits of free trade, while reducing the effects that it has on populated areas.

Additionally, China may consider reducing the number of industrial parks as it reduces its reliance on manufacturing. Cities may consider combining industrial parks or moving them further away from urban areas. Additionally, the PRC should consider focusing on high-tech parks instead of general industrial parks.

Finally, FTZs will decrease the need for EPZs and bonded logistics parks in adequately developed areas. For these areas, especially coastal second- and third-tier cities, EPZs and bonded logistics parks could be subsumed under FTZs.

CONCLUSION

The Shanghai Pilot Free Trade Zone is an exciting opportunity for China to reevaluate its economic policies associated with foreign investment and trade. Since

its inception, it has created substantial incentives that challenge the current regulatory infrastructure for foreign companies. On the other hand, the SHFTZ will face significant problems attempting to implement these incentives.

This pilot program for establishing free trade zones in China has two more years to consider how to effectively promote investment and trade while reducing the negative aspects of foreign investment. The SHFTZ will provide valuable data and lessons to the national government as it revises China's policies to promote sustainable growth.