Shanghai zone shows the way

The FTZ's experimental reforms can be replicated by the 10 others springing up across China

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As a big country, China often uses special zones to do social experiments before a reform is extended to the whole country, especially at a time when society needs to break through some bottlenecks.

In August 2013, the State Council, China's cabinet, approved the establishment of the China (Shanghai) Pilot Free Trade Zone (FTZ). The government stressed that the establishment of the Shanghai FTZ was a national strategy to test a number of economic and social reforms. The reasons for establishing it can mainly be classified in two categories.

On the one hand, China was experiencing a turning point in economic growth in 2013. The average growth rate of GDP was 11.7 percent from 2003-07 and 9 percent from 2008-13, but it was only 7.7 percent in 2013. Experts noted that it might be lower in the future.

It is increasingly clear that China's economy has stepped into a new stage and the role of government should transform from investment-oriented to service-oriented. Also, the efficiency of the government needs to be improved by streamlining its management process.

On the other hand, China is strong enough to promote the yuan's globalization, but it has two bottlenecks: There is no onshore market to accommodate the reinvestment of the currency's inflows, and there is no place to experiment with the opening of a capital account.

There were also other reasons for establishing the Shanghai FTZ. In bilateral trade negotiations between China and the United States, the US requires a national treatment of overseas investment and asks to provide a negative list for investments.

As the US request is in fact an international practice, and it is conducive to improving the management level of the Chinese government, China needs to embrace such a practice. However, the negative list and supporting administrative procedures must be tested first before they can be widely applied.

Against this background, the Shanghai FTZ has an important historical mission. However, the mission is also urgent — the central government requires the Shanghai zone to form a group of replicable experiences within five years.

In fact, the management of the Shanghai government is indeed commendable. In less than three years, it has formed many experiences in four aspects.

First, it has established an investment management mechanism with the negative list as the core. Second, it has created a system of FTA financial accounts as an infrastructure to experiment with the opening of a capital account, to aid the inflow of overseas yuan.

Third, it has practiced many policies to simplify investment and trading procedures. And fourth, it has made a lot of efforts to change government functions from a prior approval system to a post-filing system.

Although the devaluation of the yuan has slowed the pace of a capital account opening, which makes the FTZ financial account somewhat redundant, the Shanghai FTZ's achievements are impressive.

Now that there are 10 other FTZs, they can learn a lot from Shanghai's experiences. As China needs only one onshore market for overseas yuan inflows, and the Shanghai FTZ is the best choice, the financial account system is hard to copy to other zones. But the new FTZs can copy almost all of the other practices from Shanghai.

As the five years are almost over, the pressure for the Shanghai FTZ to experiment with reforms that can be replicated by the whole country has been much released. Now all of these FTZs scattered around the country can have more experiments according to their local situations, and each can try to have its own features.

Besides a cooperation relationship of learning from each other, they also have a competitive relationship, since the government officials who can give more replicable experiences will benefit from such political achievements.

The FTZ is a creative way of deepening China's reform and opening-up. The way of reform that uses special zones to do experiments shows the Chinese government's prudence and wisdom. But it may not be applicable to other countries.

China has a strong central government, a large geographic field and an almost identical management institutional setting. To establish a special zone to do social experiments is efficient for a big country with a uniform system, but may not be so for small countries with multiple systems.

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Questions remain over FTZs

New zones will help lift poor regions but a key focus must be on geographic location and co-branding business deals

By **MIKE BASTIN**

With the recent government announcement of a further seven free trade zones (FTZs) across the Chinese mainland, subsequent discussion and analysis has focused very much on the eclectic nature of the industrial sectors they will cover.

But little debate appears to have taken place on the geographical dispersal of these additional zones and the overall regional coverage of what will soon be a total of 11 FTZs across the Chinese mainland.

Of course, the government is to be applauded for selecting geographic locations in different parts of the hinterland of the Chinese mainland, with five of the new seven situated far inland.

But has it gone far enough? And are the FTZs well placed to stimulate the poorest regions?

Most would agree that western China — in particular the vast northwestern provinces starting from Shaanxi, Gansu and Qinghai and stretching to the furthest outposts of the Ningxia Hui and Xinjiang Uygur autonomous regions — present the greatest challenge to the sustainability and social cohesion of the Chinese economy.

So, the announcement of a new FTZ in Shaanxi makes a lot of sense and will, without doubt, provide some sort of boost to the economic development of the overall western region.

But the vastness of the northwestern region, together with the sizeable poverty gap between this area and comparatively more affluent parts of China, prompts the central government to do more.

According to the recent announcement, the new Shaanxi FTZ will cover an area of 120 square kilometers — a respectable size. This FTZ will also be characterized by different sections with their own industrial focus, such as high-tech production, international trade and sci-tech production.

All very good but, situated at the very eastern tip of this enormous region, the Shaanxi FTZ could struggle to act as any sort of regional hub of economic activity and its influence could, therefore, be quite severely limited.

The key reasoning behind this spread of new FTZs, especially the new Shaanxi FTZ, is the creation of an economic and business environment that is far more conducive to foreign direct investment (FDI).

An influx of FDI is sought in order to engage local and international business. Let's not forget that it was the establishment of China's coastal special economic zones, the consequent injection of foreign capital and arrival of international business that ignited the Chinese economic miracle almost 40 years ago.

But geographic location is crucial. FDI and any international business relocation will only take place if the incentives are sufficient and, crucially, the regional base can facilitate wider regional growth.

In the case of the Shaanxi FTZ, the location at the eastern edge of the wider northwestern region will create equivocation among foreign investors, and subsequent investment will likely spread westward back toward the coastal provinces and first-tier cities of Beijing and Shanghai.

And where the new Chongqing FTZ is concerned, the chosen location is also far from central in the wider southwestern area of the Chinese mainland.

An over-reliance on foreign businesses and their brands perhaps limits further elevation of the Chinese economy more than any other factor.

It is, therefore, imperative that foreign businesses that take advantage of the economic and investment incentives inside China's FTZs also have to ensure they contribute to the development of local industry.

Alliances and partnerships may help, if only a little, in the short term but for lasting, long-term advancement of domestic Chinese companies, co-branding agreements are the only way forward.

Co-branding ensures the Chinese partner also develops, in part, a competitive brand identity in conjunction with any established foreign enterprise and this is just what is needed if Chinese industry is going to make an effective transition from reliance on low cost advantage.

Foreign companies that decide on entry to any of what will soon be a total of 11 Chinese FTZs should do so with a long-term vision and detailed plan that is much more about Chinese mainland market penetration than simply low-cost production.

And in order to achieve significant and sustainable competitive advantage across China, foreign enterprises should be well aware of the need for local knowledge and learning that can only happen with a suitable local company as a co-branding partner.

Expanding China's FTZs to 11 in such a short time span is very much a step in the right direction, but there is still time to review the detail.

Subtle but significant modifications are needed in geographic location, especially moving the Shaanxi FTZ closer to the geographical center of Northwest China, and in replacing "cooperation" between global and local business with "co-branding".

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