

Hainan a promising trade gateway

South China's island province can emerge as a major commercial bridgehead to Indian and Pacific oceans

By SUN DAN

China aims to establish a free trade zone (FTZ) in South China's Hainan province by 2020, and a free trade port there by 2025 as part of the most proactive opening-up strategy of the past 40 years. The island is expected to become one of the most important gateways to the Pacific and Indian oceans, according to the government.

The strategy is backed by geoeconomics. Located in the southernmost part of China, Hainan is the country's bridgehead to the South Pacific and a key point on the 21st Century Maritime Silk Road, which connects Southeast Asia and South Asia from China to the Indian Ocean via the South China Sea and Malacca Strait.

The Hainan FTZ can comprehensively strengthen economic ties between five countries (the Philippines, Malaysia, Indonesia, Brunei and Vietnam) of the 10-member Association of Southeast Asian Nations (ASEAN), and improve cooperation in trade, finance, talent, technology and culture.

Under these strategic requirements, 35,400 square kilometers of Hainan Island will be a FTZ, 25 times the area of the existing 11 FTZs in China.

There are three reasons to choose Hainan as the FTZ. First, the Qiongzhou Strait naturally separates Hainan from the inland region. There is zero cost in physical isolation for offshore trade and offshore financial business, just as most international offshore financial centers are located on islands.

Second, Hainan has 78 natural harbors, most of which can be built into port cities, providing extremely favorable conditions for economic opening-up.

Third, the whole island can be developed uniformly without worries about unfair competition, the siphon effect or the spillover effect brought by institutional innovation.

A Hainan FTZ will draw on the experience of Singapore and Hong Kong. In the early stages of development, it will become an international trade gateway connecting countries in Southeast Asia by building an international shipping hub with strong radiating capacity, so as to promote the completion of infrastructure, transportation, finance, communications, tourism and other supporting systems of the island.

According to an industrial economic model estimate, its leveraged economic benefit can reach 1.6 times, which will greatly increase GDP growth, per capita GDP and the urbanization rate of the province.



Afterward, we need to focus on three aspects to realize strategic requirements as follows:

The 200-year history of more than 600 free trade ports in the world shows that most development paths start from transit trade. However, it is impossible for that to be the key to offshore trade in the Hainan FTZ. Why is that?

From the international point of view, countries choose a third country to conduct transit trade because they can avoid the restrictions of various trade barriers with its help, such as anti-dumping and countervailing. But with the trade war between China and United States, the trade barriers against China may only increase rather than decrease.

From a domestic perspective, as China's demographic dividend disappears gradually, processing trade can no longer meet the requirements of industrial upgrading and transformation. Only international services trade such as medical treatment, tourism, culture and sports can fully release the potential of the island's economy to build an economic system of green and low-carbon circular development.

After 30 years of development, Hainan has a relatively high level of international trade in services. The first entry visa policy was implemented in 2000. The third, fourth and fifth international air routes were opened in 2003.

The construction of international tourism infrastructure on the island began in 2009. An offshore shopping tax exemption policy was implemented in 2011. The International Medical Tourism Pilot Zone was established in 2013.

In 2017, Hainan's services sector accounted for 55.7 percent of GDP, 4.1 percentage points higher than the national average, and contributed more than 70 percent to its economic growth.

With the development of offshore trade, the offshore financial business is bound to be highly developed as well.

This is an important move for China to promote the opening-up of the financial industry from a new historical starting point. Building the largest offshore renminbi market and promoting internationalization of the RMB is China's ultimate goal.

How should the Hainan FTZ proceed? On one hand, the People's Bank of China will further expand the cross-border use of RMB and explore capital account convertibility. Cross-border trade settlement has been the main channel for exporting RMB from the onshore market to offshore market.

When the global amount of offshore RMB deposits reached an all-time high of 1.6 trillion yuan (\$230 billion) at the end of 2014, 90 percent of them were obtained through cross-border trade settle-

ment. However, the global offshore RMB capital pool has shrunk dramatically in the past three years, and offshore RMB deposits in Asia totaled only 1 trillion yuan in 2017.

Through the financial innovations of the Hainan FTZ, China exports RMB to ASEAN countries facing the Pacific and Indian Oceans, and opens the backflow channel, which is conducive to promoting the extensive use of RMB in Asia.

In 2017, China's imports and exports accounted for about 12 percent of the world's total international trade, while the amount of payments in RMB was less than 2 percent globally, and the settlement in RMB accounted for just 15 percent of China's total exports and imports.

On the other hand, the China Securities and Futures Commission would supervise the international commodity exchange on the basis of regional offshore trading centers for commodities such as rubber in the Hainan FTZ.

Nowadays, most of the world's commodities trade is denominated in US dollars. Shifting even a fraction of China's commodity trade to RMB would greatly increase the flow of RMB-denominated trade.

The trading of derivatives, including commodities futures and options denominated in RMB, could not only help Chinese import and export enterprises hedge the risks of commodity price fluctuations and

exchange rate fluctuations effectively but also help to increase the demand for RMB in global financial markets and provide new channels for RMB back into China.

Establishment of an intellectual property trading center in the Hainan FTZ would be conducive to promoting Chinese enterprises' innovation and industrial upgrading. Scientific and technological advancement is the decisive factor of the competition among countries in the future.

Therefore, the current tariff sanctions on China's exports to the US involve a large number of high-tech products, and the door for China to invest in US high-tech industries is closed by strict foreign investment reviews.

It is not just an isolated incident between China and the US, but also between China and other economies. It reflects the ongoing battle over intellectual property rights between developed countries and China.

In the long run, China has to integrate domestic industrial policies, intellectual property systems and international trade rules to encourage innovation and ensure sustainable and fair access for companies.

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