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Introduction

Asia and Pacific's growing importance to the rest of the world is widely acknowledged today. The dynamics of Asian economic development have tremendously impacted global trade relationships and regional cooperation. Thus, it is with great pleasure that we deliver another volume of Research Papers on Asia-Pacific economic issues.

This year we present 19 papers by various authors who examine the Asia-Pacific region from different perspectives. We decided to group them into 3 Chapters:

- Cooperation and trade
- Economy and policy
- Risks & challenges

Papers grouped in the First Chapter describe newly emerging regional trade architecture. You will find there a few analyses of general nature and regional scope (J. Dudziński, A. H. Jankowiak, E. Majchrowska) and some studies on specific trade agreements (A. Klimek writes about Shanghai Free Trade Zone, A. McCaleb and G. Heiduk try to find out what motivates China's cities to establish partner agreements with cities in Asia, B. Michalski analysing U.S.-Republic of Korea Free Trade Agreement, while M. Maciejewski and W. Zysk look for opportunities for Polish exports in the trade agreement between EU and Vietnam).

The Second Chapter is the most diverse one. It is devoted mostly to economic policy issues (including financial sector). S. Bobowski, L. Zyblikiewicz and K. Żukrowska look at the main threads in Asian regionalism. P. Pasierbiak and K. Łopacińska analyse the movements of Chinese capital. M. Dziembała and S. Mazurek deal with the subject of innovation supporting growth and development.

Articles in the Third Chapter are focused on extraordinary events influencing economies and development of the Asia-Pacific region. J. Pera prepared an assessment of risk of APEC countries, based on the country risk classification method and selected indexes of internal stability. A. Kukułka and B. Totleben analyse the impact of natural disasters on gross capital formation in Southeastern Asia. Finally, T. Serwach and M. Grabowski and S. Wyciślak deal with synchronization of business cycles and contagion of crises.

We sincerely hope that all the articles will be of great value to those who want to understand the role of Asia-Pacific economies in the global economy. Through various interests of authors, our volume provides a valuable insight into the problems of this region.

All the papers were submitted for the 8th international scientific conference "Dimensions of Regional Processes in the Asia-Pacific Region" which took place in

November 2015 at Wrocław University of Economics, under the patronage of Polish Ministry of Foreign Affairs, Ministry of Science and Higher Education and the Ministry of Economy.

We appreciate your time and consideration, and we look forward to the submission of your own good work. We also appreciate the time and effort of our peer reviewers. Thank you!

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SHANGHAI FREE TRADE ZONE: EXPECTATIONS AND REALITY

SZANGHAJSKA STREFA WOLNEGO HANDLU: OCZEKIWANIA I RZECZYWISTOŚĆ

DOI: 10.15611/pn.2015.413.03
JEL Classification: F13, F14

Summary: The paper presents the results of in-depth analysis of operations of Shanghai Free Trade Zone. The main goal is to provide insights into regulations introduced in the free trade zone and their impact on businesses investing there. Additionally, the author analyses changes to nationwide policies as a result of experimental solutions tested in the free trade zone. Qualitative analysis of legal acts and corporate events is applied. The main conclusion coming from the analysis is that the zone may be described as a moderate success mostly due to limited freedoms provided by the Chinese authorities. Positive element of introducing the free trade zones is confirmation of the right direction of reforms in China. However, very cautious execution of policies towards the zones may reduce the overall results to the economy. If the zones were established to test experimental policies, the decisions should be bolder.

Keywords: Shanghai Free Trade Zone, liberalization, trade, investment, China.

Streszczenie: W pracy przedstawiono wyniki dogłębnej analizy działalności Szanghajskiej Strefy Wolnego Handlu. Głównym celem jest przedstawienie uwarunkowań prawnych wprowadzonych w strefie wolnego handlu oraz ich wpływ na przedsiębiorstwa podejmujące tam inwestycje. Dodatkowo, autor analizuje zmiany w polityce gospodarczej w skali narodowej w wyniku eksperymentalnych rozwiązań sprawdzonych w strefach wolnego handlu. Metodą badawczą zastosowaną w niniejszej pracy jest analiza jakościowa aktów prawnych i zdarzeń korporacyjnych. Główny wniosek brzmi następująco: szanghajaska strefa jest umiarkowanym sukcesem głównie z powodu ograniczonych swobód ustanowionych przez władze chińskie. Pozytywnym elementem utworzenia strefy jest potwierdzenie właściwego kierunku reform w Chinach. Jednak bardzo ostrożna realizacja polityki wobec stref może zmniejszyć wyniki dla całej gospodarki. Jeśli strefy zostały utworzone w celu testowania polityki eksperymentalne, decyzje powinny być odważniejsze.

Słowa kluczowe: Szanghajaska Strefa Wolnego Handlu, liberalizacja, handel, inwestycje, Chiny.

1. Introduction

Chinese idea of combining capitalistic economy with communistic political ideology has proved to work remarkably well since 1980s when announced by Deng Xiaoping. Over two recent decades, the success of China was measured by the steep rise of economic growth, which took millions of people out of poverty and built a modern face of China.

The development was a result of the abundance of cheap labour, export promotion and vast investment. However, the model of growth is not balanced, what may jeopardize future development. Moreover, the rise of China in recent decades was strictly commanded by the government. Nowadays, the authorities try to find ways of keeping political power in hands of the Communist Party of China, while introducing further freedoms to the economy.

One of the options to maintain control is to introduce freedom in certain areas and to conduct an experiment in one part of the country before deciding to spread it nationwide. China has a long history of introducing special treatment in some locations, while keeping restrictions in the rest of the country.

Between the 17th and 19th century, Canton (today: Guangzhou) was the only port in China where foreign merchants could arrive and special administration over them was imposed. In the 1980s Deng Xiaoping decided to introduce capitalistic rules in several special areas. One of them was Shenzhen – once a fishing village – now a large city with modern manufacturing sector and important financial centre. This was the beginning of the areas named free trade zones. The idea behind them during Deng's times was to attract foreign investors with their capital and expertise. These factors were considered to be catalysts for creating the modern Chinese economy.

Nowadays, the new idea of special zones materialized in year 2013 when Shanghai Free Trade Zone was established. Soon three more similar special treatment areas were created. Such move became essential, when new turbulences hit the Chinese economy in 2015. The government proved to be inefficient in coping with substantial problems of the financial markets. The task will become even tougher with the rise of economy and its independence understood as the increasing role of the private sector.

The Shanghai zone recently celebrated its second anniversary of operations. However, analysing the effectiveness of the zone is difficult due to limited information revealed by Chinese authorities. We are able to assess scope and quality of regulations and guidelines, but their influence on the economy is not revealed. The zones were predominantly created to attract foreign investors. Therefore, the analysis from their perspective is crucial in assessing the overall results.

The rest of the paper is organised as follows: Section 2 provides basic information regarding the Shanghai Free Trade Zone; Section 3 contains details on positive and negative developments of the Shanghai zone.

2. Theoretical background and key facts regarding Shanghai Free Trade Zone

Free trade zones constitute a distinctive group within a broader category of special economic zones (SEZ), which are defined as “demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment; whereby the zone is given a business environment that is intended to be more liberal from a policy perspective and more effective from an administrative perspective than that of the national territory” [Farole 2011, p. 23]. The nomenclature of SEZ includes, among others, free ports, free frontier trade zones, or export processing zones. Particular forms vary with respect to the level of economic freedom or list of encouraged activities. SEZ are widespread worldwide, however they play different roles in particular countries.

The very general model of free economic zones was proposed by Grubel [1982]. The theory focused on the welfare effects of introducing deregulation to taxes and tariffs. Theoretical foundations of FTZ are also associated with the theory of multinational corporations (MNC) and foreign direct investment (FDI). FTZ are frequently designed to attract foreign investors and foster industrialization of the economy. The main advantage of such zone is good investment climate and the access to attractive markets. This is in line with the model of export-platform FDI by Ekholm, Forslid and Markusen [2003]. Thanks to the operations in the export platform location the MNC has preferential access to attractive markets. In the case of Shanghai FTZ companies have access to the market of one province, but also the entire Chinese economy. There are also particular factors of the business environment considered, e.g. FDI are also attracted to FTZ by tax incentives [Devereux, Maffini 2006]. The operations of Shanghai FTZ in this paper are analysed mainly with respect to attractiveness to foreign investors.

Further part of the section is devoted to the presentation of basic information regarding establishment and operations of the China (Shanghai) Pilot Free Trade Zone, henceforth Shanghai FTZ. The name of the zone clearly indicates that it is not a local concept, but should serve as a national establishment. Moreover, adding the word “pilot” underlines the fact that the zone is a kind of experiment. This creates incentives to introduce new policies, which may be altered any time with respect to the current needs.

The role of the Shanghai FTZ was also confirmed by the fact that it was established according to the decision of the State Council. The legal proceedings regarding the creation of the zone were very prompt. In July 2013, the decision of the State Council was passed, in August 2013 the formal approval was made, and in September the same year, the zone was launched.

The Shanghai FTZ consists of four main locations of the total area of over 120 sq. km (Table 1). Particular elements of the zone represent different functions.

Table 1. Areas of Shanghai FTZ

No.	Name	Ares [sq. km]
1	FTZ Bonded Area	28.78
2	Lujiazui Financial Area	34.26
3	Jinqiao Export Processing Zone	20.48
4	Zhangjiang High Tech Park	37.20

Source: Own study, based on [SFTZ 2015a].

The FTZ Bonded Area is the core element of the Shanghai zone and it was the starting point for the initiative. The FTZ Bonded Area was created as a result of the merger of the Waigaoqiao Free Trade Zone, the Waigaoqiao Free Trade Logistics Park, the Yangshan Free Trade Port Area and the Pudong Airport Free Trade Zone. The four elements of the FTZ Bonded Area were already bonded areas created in the 1990's and the 2000's. The FTZ Bonded Area took advantage of the ready infrastructure and many years of experience. It covers a logistics park, a sea port and an airport. This area can be described as the doors to the world.

However, FTZ Bonded Area was too distant and too isolated from the city centre. Due to this fact many companies, especially these which are foreign owned, were reluctant to relocate their main operations to the zone. Therefore, a decision to include the financial district of Shanghai – Lujiazui – was very welcome. It meant that many companies already existing and operating in China were included in the zone. We can say that the zone did not attract investors, but investors attracted the zone to the city centre.

According to the article 12 of the *Regulations of China (Shanghai) Pilot Free Trade Zone*, the following activities are particularly promoted [SFTZ 2015b]:

- financial services,
- shipping services,
- commercial and trade services,
- professional services,
- cultural services,
- social services,
- general manufacturing.

Such composition confirms that Chinese authorities recognise the key role of services in the future development of the country. Even if manufacturing is mentioned generally on the list, the knowledge intensive industries are these which are particularly welcome in the zone.

Numbers describing first full year of operations of the Shanghai zone confirm its scale and importance to the rest of the economy. “Shanghai FTZ had registered

23,243 companies by the end of 2014, 14,860 of them newly registered and 2,342 foreign-funded. They generated 16 trillion yuan (US\$2.6 trillion) in business revenues in 2014, up by 11 percent from the year before. Product sales rose 11.5 percent to 13.8 trillion yuan; earnings of shipping and logistics companies grew 15 percent to 118 billion yuan. Foreign trade totalled 762.3 billion yuan, an increase of 8.3 percent” [SFTZ 2015c]. The zone was created to attract foreign investors; however domestic companies significantly outnumber them. Anyhow, the list of important foreign investors confirms that large multinational firms are interested in participation in the zone (Table 2).

Table 2. Selected foreign investors in the Shanghai FTZ

Name	Country of origin	Industry
Apple	United States	IT
Amazon	United States	E-commerce
BNP Paribas	France	Finance
Citigroup	United States	Finance
Ermenegildo Zegna	Italy	Apparel
Henry Bath	United Kingdom	Logistics
Nomura Holdings	Japan	Finance
Microsoft	United States	IT
Porsche	Germany	Automotive
Victoria’s Secret	United States	Apparel

Source: Own study.

Besides the Shanghai zone, three more zones were created with the following main activities:

- Guangdong FTZ – shipping logistics, finance, trade, manufacturing, modern services;
- Tianjin FTZ – shipping logistics, aviation logistics, finance, trade, manufacturing, modern services;
- Fujian FTZ – modern services, finance, trade, tourism.

Establishment of the zones in other locations of China confirms that concept of experimenting with economic freedom is accepted by Chinese political leaders. However, the number of zones is not as important as the depth of liberalisation. Looking from this perspective, each zone is based on similar regulations, what may threaten their ability to attract new investors interested in unique solutions and may also increase the competition between the zones. This may not bring the best outcome for the entire Chinese economy.

3. Evaluation of the Shanghai Free Trade Zone

The operations of the Shanghai FTZ started in September 2013, therefore after two years it is necessary to evaluate its results. On the one hand, the two-year period is quite short to define the spillover effects in the rest of the economy. On the other hand, this is a pilot project, therefore it should be assessed frequently to introduce any necessary changes in the strategy. Moreover, the testing period was set at three years, so not much time is left for implementing amendments. Importantly, the topic of the Shanghai zone has not been analysed in the mainstream economic literature. This analysis is aimed at shedding some light on the issue.

The idea of the Shanghai zone is quite different to what might be observed in special economic zones worldwide or in free trade zones during Deng's times. The most important difference is that the new zone does not bring explicit incentives for companies, especially these which are from abroad. It was created rather as an area of many economic freedoms, not of governmental support. Investors that expect generous tax breaks may be disappointed [O'Meara 2015, p. 30]. However, according to Ho [2013], tax policy may be described as containing certain favourable measures, such as tax deferral payment via instalments on some incomes, export tax cuts for leasing companies, or tax policy on foreign investment. The tax policy also addresses the issue of highly skilled professionals, who are paid in stock rights, and may pay their taxes by instalments within a five-year period. However, these measures are limited and applicable only to certain types of business activities.

The core idea of the Shanghai zone is to simplify the procedures regarding setting up new companies. Bureaucratic barriers to enter Mainland China discourage many foreign businesses, especially medium-sized (small foreign enterprises are very unlikely to become foreign direct investors in China). Foreign invested enterprises in the Shanghai zone only record their activities rather than look for approval of the authorities. There are four steps to establish an enterprise in the zone [China Law & Practice 2015]:

- “Step 1: Name pre-approval with the Administration for Industry and Commerce of the Shanghai FTZ;
- Step 2: Online application. Log on to the online application platform, check the proposed business scope against the Negative List and fill in the online forms;
- Step 3: Onsite submission of the printed online application forms and other documents to the General Service Centre of the Shanghai FTZ;
- Step 4: Collection of the record (for FIEs engaged in industries outside the Negative List) or approval (for FIEs engaged in industries within the Negative List) certificate, business license, organisation code certificate and tax registration certificate of the FIE from the General Service Centre.”

To support trade within the zone and with external partners, a spot commodities trading platform was created. It allows to trade ferrous and nonferrous metals. In the beginning of operations, 76 firms opened their accounts at the platform, including 24

offshore companies [Wang 2015]. Another trading platform opened in the zone is Shanghai Gold Exchange, allowing for international transactions in the precious metal. The authorities also plan to create trading platforms for other commodities.

An important element of the policy in the zone is granting foreign investors national treatment. This is an innovative step in introducing equal rights of two categories of companies. In other words, Chinese authorities will have limited discretionary power over foreign firms and should be deterred from interfering in the business. Such policy should also level the playing field, as local firms should not be treated in a privileged way or receive unfair support. Such attitude towards business is vital, especially for foreign investors.

The Shanghai zone is also a testing ground for further internationalization of Chinese currency – renminbi (RMB). The People's Bank of China implemented new measures to promote RMB by introducing convertibility of the capital account, expanding cross-border usage of the currency, setting interest rates in a freer way and attracting investment in the banking sector within the zone [Lui 2014].

Additionally, Chinese authorities mull over giving individuals in the Shanghai zone the possibility to invest directly in the financial markets abroad. Such move would mean liberalisation of many financial rules regarding the operations with the rest of the world.

Another innovative solution applied in the zone is a negative list. This changes the way of operations of Chinese authorities. Normally they operate with a positive list. This means that only fields of business activity mentioned on the list are permitted in the country or region. In the case of a negative list all activities are legal, besides these which are listed. Another issue is the length of the list, that is how many and how important business activities are subject to restrictions. In the beginning of operations of the Shanghai FTZ there were 190 forbidden activities, in 2014 – 139. The original number of restricted industries could pose the question about the real intentions of the authorities when it comes to the liberalization process in the zone. Such a long list meant that not much changed in the attitude of the government and restrictions in many industries would still prevail. Moreover, there were no clear criteria of selecting prohibited activities. If the selection key was not revealed, we can assume that it was predominantly political.

The latest issue of the negative list dated April 20th, 2015 includes 119 types of investment projects by foreign companies. The list includes seeding, fishing, oil and gas, aviation manufacturing, and nuclear power [State Council 2015].

The Shanghai zone should be also perceived as a pilot project for assessing the quality of central and regional governments. Operations of the zone should provide answers to the questions regarding openness, efficiency and attitude towards the reforms of the government. Positive answers may provide further incentives for the government to introduce once pilot reforms as nationwide rules.

The Shanghai zone was heavily promoted by the Chinese central authorities. It may be perceived as successful by the Chinese government because further zones

have been recently established. However, they reduced relative appeal of the Shanghai zone that came from exclusivity and novelty of regulations of business environment [Sweeney 2014].

One can say that it was the idea of the pilot zone to transfer good practices to the rest of the economy. The government in Beijing decided to introduce nationwide regulations regarding RMB settlements under the current account for individuals, possibility to retain foreign exchange by foreign owned companies, opening services sector and reforming customs supervision [Reuters 2015]. The number of experimental policies applied to other locations in China is 27 and further 28 are due to be implemented soon [SFTZ 2015b].

It is important to note that the zone was designed to support the services sector. This is a crucial change in the economic policy of the government. For many years, development of China was based on the expansion of the manufacturing sector.

Even if there are simplified procedures for a group of nominated business entities, it is difficult to enter the group. For example, easier access to capital was introduced to banks that are approved by the authorities. However, to get the approval, it takes around one year and till now only limited number of banks was granted this privilege, and they were mostly Chinese institutions [Weinland, Ren 2015].

4. Conclusions

This paper presented recent developments regarding the free trade zones in China. Particular focus was placed on Shanghai Free Trade Zone; however, conclusions may be also generalised to the other areas of this type in China.

Recent negative events in Chinese economy confirm the urgent need to introduce measures allowing for smooth introduction of economic reforms. They cannot be implemented overnight, because such a shock therapy could cause even more harm to the economy. China needs a gradual increase of economic freedom and its implementation should be transparent and business oriented. Unfortunately, this is not the case when we analyse operations of the free trade zones. The decisions are undertaken by high level authorities and their motivation is not always clear. The very good example is the negative list of business activities, which was very long when the Shanghai FTZ was incepted. This was not justified by any economic reasons. Soon the list of restrictions was significantly reduced. However, it had limited the relative appeal of the zone at the start.

Positive element of introducing the free trade zones is the confirmation of the right direction of reforms in China. However, very cautious execution of policies towards the zones may reduce the overall results to the economy. If the zones were established to test experimental policies, the decisions should be bolder. Moreover, there is no automatic transfer of good practises to the rest of the country.

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