

Dual Circulation Series

Issue 6

– *Driving China's opening-up and international circulation*

Hainan Free Trade Port and its Implications for the Greater Bay Area



In the past few years, China has intensified its drive for reform and opening-up through policy experimentation in selected regions or cities, most notably the various pilot Free Trade Zones (FTZs), the Guangdong–Hong Kong–Macao Greater Bay Area (GBA)¹, the plan to build Shenzhen into a pilot demonstration area of socialism with Chinese characteristics, and the latest plan to develop Hainan Free Trade Port (Hainan FTP).

These initiatives are also important platforms for China to participate in the international economic system, i.e., the 'international circulation' in the 'dual circulation' strategy². In this report, we will take a look at the areas of focus and latest developments of Hainan FTP, and the implications for the GBA.

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¹ For an analysis of the 'Outline Development Plan for the Guangdong–Hong Kong–Macao Greater Bay', see <https://www.fbicgroup.com/sites/default/files/GBA.pdf>

² For a general overview of the 'dual circulation' strategy, see https://www.fbicgroup.com/sites/default/files/Dual_Circulation_Issue01.pdf

I. Construction of Hainan Free Trade Port

1. Background

On 1 June 2020, the Communist Party of China (CPC) Central Committee and the State Council released the *Master Plan for the Construction of Hainan Free Trade Port* ('the Master Plan' hereafter) to transform the entire Hainan Island into a high-level free trade port.³ The Master Plan is now being written into law – the *Hainan Free Trade Port Law* – the second draft of which was released in late April this year.⁴

The Master Plan and the draft law represent a continuation of recent reform and opening-up efforts in Hainan which date back to April 2018, when Chinese President Xi Jinping first announced the decision to develop Hainan into a free trade port to spearhead the next phase of China's reform and opening up.⁵ Immediately after President Xi's announcement, a guideline was released by the CPC Central Committee and the State Council to stipulate that Hainan will be further opened up.⁶ As the first step of building Hainan FTP, a plan was unveiled by the State Council in October 2018 to make Hainan a pilot Free Trade Zone (FTZ).⁷

The establishment of Hainan FTP was a response to the growing internal and external pressure for further reform and opening-up in China. Domestically, as China has entered a 'new normal' of slower growth, economic restructuring and institutional reforms are needed to achieve sustained and quality growth. Internationally, China is facing an increasingly complicated external environment, with growing geopolitical tensions with Western countries and rising trade protectionism around the world. The development of Hainan FTP will help China better position itself in these ongoing dynamics.

³ http://www.gov.cn/zhengce/2020-06/01/content_5516608.htm

⁴ <http://www.npc.gov.cn/flcaw/flca/ff80818178f90e4d01791b2f30b72704/attachment.pdf>

⁵ http://www.xinhuanet.com/2018-04/13/c_1122680495.htm

⁶ 'Guiding Opinions of the Central Committee of the CPC and the State Council on Supporting Hainan for Comprehensively Deepening Reform and Opening-Up', 11 April 2018, see http://www.gov.cn/zhengce/2018-04/14/content_5282456.htm

⁷ 'Notice of the State Council on Issuing the Overall Plan for China (Hainan) Pilot Free Trade Zone', 16 October 2018, see http://www.gov.cn/zhengce/content/2018-10/16/content_5331180.htm

Exhibit 1: Hainan's profile (2020)

Location Hainan Province is situated at the southernmost part of China



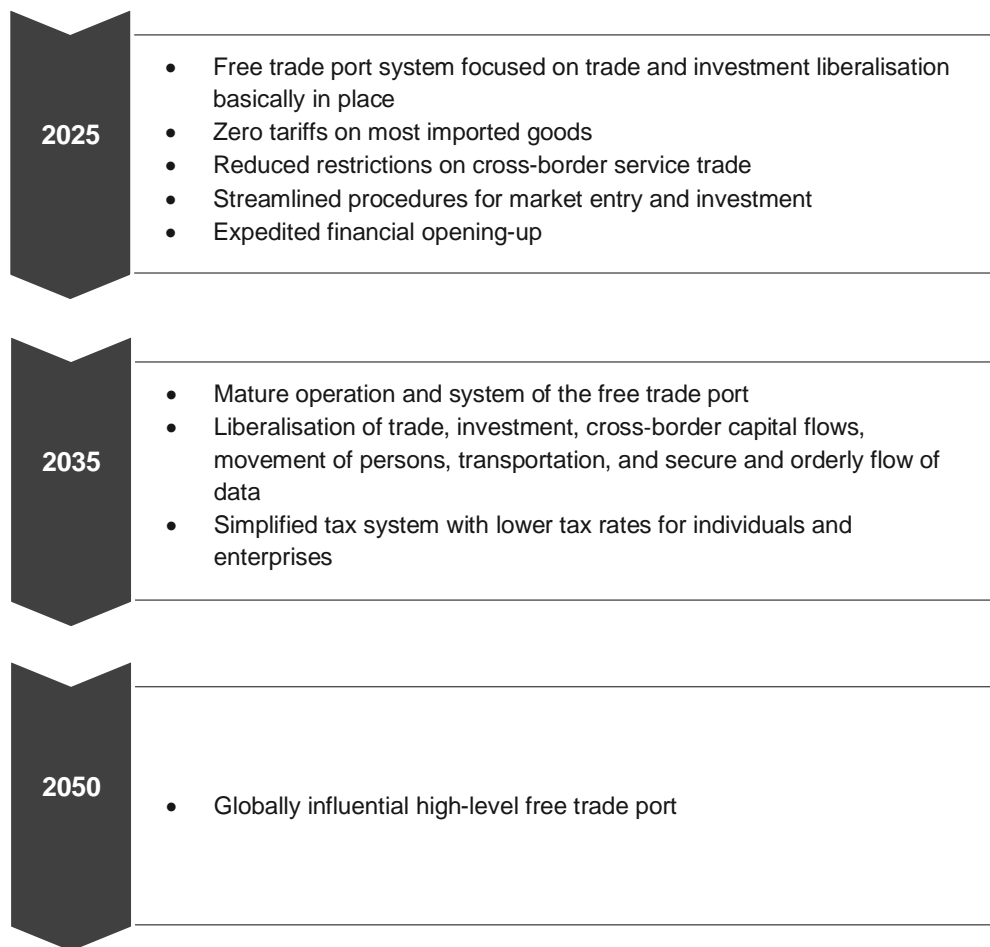
Area	35,191 square kilometres
Population	10.08 million (end-2020)
Major cities	<ul style="list-style-type: none"> • Haikou (the provincial capital) • Sanya (a well-known tourist destination)
GDP	553.2 billion yuan (+3.5% yoy)
GDP per capita	54,878 yuan (ranked 19 th out of 31 provincial administrative divisions)
GDP composition	<ul style="list-style-type: none"> • Primary – 20.5% • Secondary – 19.1% • Tertiary – 60.4%
Export of goods	27.6 billion yuan (-19.6% yoy)
Import of goods	65.7 billion yuan (+16.8% yoy)
Number of tourists	64.6 million (-22.3% yoy)

Source: *Monthly Bulletin of Statistics Hainan – December 2020, National Bureau of Statistics; compiled by Fung Business Intelligence*

2. Roadmap for building Hainan FTP

The ultimate goal is to develop the entire Hainan Island into a globally-influential high-level free trade port by the middle of the century. The Master Plan lays out three stages for the development of Hainan FTP:

Exhibit 2: Road map for Hainan FTP development



3. Key areas of focus

The Chinese authorities have charted a development programme for Hainan FTP.

Highlights of key areas of focus are shown below:

3.1 Liberalization and facilitation on six fronts

<p style="text-align: center;">Trade</p> <ul style="list-style-type: none"> • The entire Hainan Island will develop into a special area for independent customs operations. • Trade liberalization will be implemented with 'free flow through the first line' and 'effective control at the second line'.⁸ • 'Negative lists' for prohibited goods and restricted goods will be formulated. Zero tariffs will be applied on goods not on those lists. • Hainan will issue a 'negative list' for cross-border service trade and grant national treatment to overseas service providers. 	<p style="text-align: center;">Investment</p> <ul style="list-style-type: none"> • Market access into Hainan will be greatly expanded. • Hainan will implement a minimal approval process on investment by removing barriers to market access and formulating 'negative lists' for foreign investment. • Pre-establishment national treatment will be granted to foreign investors.
<p style="text-align: center;">Cross-border capital flows</p> <ul style="list-style-type: none"> • Hainan will open up its capital account in stages and implement a free trade account system to promote free and convenient capital flows between Hainan FTP and overseas. • Hainan FTP will take the lead in expanding the opening-up of the financial service sector, and it will support the setting up of trading venues for financial products related to energy, shipping and equities. 	<p style="text-align: center;">Movement of people</p> <ul style="list-style-type: none"> • Hainan will implement a more accommodative travelling policy to encourage talents in high-end industries to reside and work in Hainan. • Hainan will offer relaxed visa requirements to foreign tourists, scholars, business travellers and professionals.
<p style="text-align: center;">Transport</p> <ul style="list-style-type: none"> • Hainan will strive to develop into an international shipping and aviation hub for the new land-sea corridor in western China. • Progress should be made to develop Yangpu Port into a port of registry. • Hainan will establish a more open sea and air transport system. Restrictions on air traffic control and sea routes will be loosened. 	<p style="text-align: center;">Secure and orderly flow of data</p> <ul style="list-style-type: none"> • Hainan will expand opening-up in the data sector and develop the digital economy while ensuring that the data flow is secure and under control. • Communication resources and business will be opened up in an orderly manner.

⁸ To have free flow through the 'first line' (i.e. between Hainan FTP and overseas), tariffs and non-tariff barriers to trade between the FTP and overseas will be lifted. To have effective control at the 'second line' (i.e. between Hainan FTP and the Mainland), tariffs will apply when the goods leave the FTP and enter the Mainland market.

3.2 Priority industries

Hainan FTP strives to build a modern industrial system, focusing on developing tourism, modern service sector and high-tech industries.



Tourism

Hainan strives to build itself into an international tourism and consumption centre.

Hainan plans to integrate tourism with culture and sports, and medical and health care.

To internationalize its tourism, Hainan plans to develop Sanya into a home port for international cruise ships and to construct a pilot zone for cruise tourism.



Modern service sector

Hainan will further open up itself to attract multinational corporations to set up their headquarters in the FTP.

It looks to expand its maritime service cluster, comprising bonded warehouses, international logistics and distribution, re-export trade, etc., and develop itself into an international shipping hub.

Hainan strives to develop into an international centre for design and education, and a regional international exhibition centre.

It will develop the marine economy and build a competitive marine service system.



High-tech industries

Hainan will develop information technology industries, focusing on IoTs, AI, blockchains, and digital trade.

Hainan will nurture deep sea industries and outer space industries.

Advanced manufacturing industry will be strengthened with emphasis on environment protection, bio-medicine, new energy vehicles and smart cars.

4. Key measures announced

The Chinese authorities have announced more than 110 policy documents for the development of Hainan FTP. The following are some key measures:

4.1 New and eased duty-free shopping policy

A new duty-free shopping policy for visitors to Hainan has been implemented since 1 July 2020. Visitors to Hainan are allowed to buy more duty-free products with fewer restrictions. The government also encourages more licensed duty-free retailers to operate in Hainan.⁹

Exhibit 3: Comparison of duty-free shopping policy in Hainan before and after 1 July 2020

	Before 1 July 2020	After 1 July 2020
Annual duty-free shopping quota	30,000 yuan per person	100,000 yuan per person
Products categories of duty-free items	38	45 (Additions include consumer electronics and red wine)
Duty-free limit for a single product	8,000 yuan	No limit
Products subject to limit on purchase quantity	All products	Cosmetics, mobile phones and liquor

Source: Compiled by Fung Business Intelligence

4.2 Preferential taxation policies

China's Ministry of Finance and State Taxation Administration on 30 June 2020 set out detailed preferential taxation policies for Hainan FTP.¹⁰

Individual income tax

The highest individual income tax rate for eligible domestic and overseas talents in Hainan FTP is 15% till 2025, compared with 45% in the rest of China. According to the Master Plan, Hainan FTP will continue to reduce the individual income tax rates to 3%, 10%, and 15% (i.e., three tax brackets) from 2025 to 2035.

⁹ https://www.hnftp.gov.cn/zcfg/zcwj/bwzc/202006/t20200630_3282708.html

¹⁰ https://www.hnftp.gov.cn/zcfg/zcwj/bwzc/202006/t20200630_3282729.html;
https://www.hnftp.gov.cn/zcfg/zcwj/bwzc/202006/t20200630_3282730.html

Corporate income tax

The new taxation policies provide for a reduced corporate income tax or tax exemption for eligible enterprises. A 15% corporate income tax rate would apply to enterprises in encouraged industries. Corporate income tax on the income of Hainan enterprises generated from new overseas direct investment in tourism, modern services and high-tech industries would be exempted. Besides, 100% immediate expensing or accelerated depreciation and amortization would be allowed for capital expenditure on newly purchased fixed assets and intangible assets.

4.3 Zero-tariff policy for raw and auxiliary materials

On 12 November 2020, the Ministry of Finance, the General Administration of Customs, and the State Taxation Administration jointly released the *Notice on Hainan Free Trade Port's Zero-Tariff Policy for Raw and Auxiliary Materials*.¹¹

Starting from 1 December 2020, for enterprises registered in Hainan FTP, the imported raw and auxiliary materials on the 'positive list' used for own production needs, export processing activities or trade in services with an 'import-service-export' model, have been exempted from import tariff, import value-added tax and consumption tax.¹² The 'positive list' has a total of 169 items, covering natural resources, agricultural products, chemical raw materials, etc.

4.4 Relaxation of market access

On 7 April 2021, the National Development and Reform Commission and the Ministry of Commerce jointly issued guidelines on relaxation of market access in Hainan FTP across selected sectors:¹³

- Medicine and health sector: Support will be given to the innovative development of indigenous, high-end healthcare equipment, and the development of high-end medical cosmetology.
- Financial sector: Support will be given to the development of securities, insurance, and fund management industries in Hainan.
- Cultural sector: Support will be given to the establishment of an international relics and artworks trading hub. Development of cultural and art and online gaming industries will be encouraged.
- Education sector: Support will be given to leading Chinese universities to establish colleges of international education in Hainan. Development of vocational education will be encouraged.

¹¹ http://www.gov.cn/zhengce/zhengceku/2020-11/13/content_5561242.htm

¹² <http://www.gov.cn/zhengce/zhengceku/2020-11/13/5561242/files/652efab20322460aaba2df7a088e1ad2.pdf>

¹³ https://www.ndrc.gov.cn/xxgk/zcfb/tz/202104/t20210408_1271896.html

II. Implications for the Greater Bay Area development

1. Hainan and the GBA at different development stages with different missions

The development gap between the GBA and Hainan is quite large. The GBA is one of the most economically advanced regions in China with a population of more than 70 million. Meanwhile, Hainan, home to 10 million people, is relatively backward with a small economic scale and an underdeveloped industrial base.

The development gap of the two regions is also reflected in the different strategic positioning of the two regions, as shown in Exhibit 4. Although both the GBA and Hainan FTP are testing grounds for China to build a new system of open economy, the GBA would be leading China's innovation-driven development and supporting the continued growth in innovation capability and competitiveness of the Chinese economy, while Hainan FTP would focus more on Hainan's domestic development.

Exhibit 4: Strategic positioning of Hainan FTP and the GBA

Hainan FTP	GBA
<ul style="list-style-type: none"> • A pilot zone for comprehensively deepening reform and opening up • A pilot zone for ecological civilization • An international tourism and consumption centre • A zone offering services and support to China's major development strategies 	<ul style="list-style-type: none"> • A vibrant world-class city cluster • A globally influential international innovation and technology hub • An important support pillar for the Belt and Road Initiative • A showcase for in-depth cooperation between the Chinese Mainland and Hong Kong and Macao • A quality living circle for living, working and travelling

Source: *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area, Master Plan for the Construction of Hainan Free Trade Port*; compiled by Fung Business Intelligence

2. Evolving collaboration between Hainan FTP and the GBA

Although Hainan was part of the Guangdong province before it became a separate province and was designated a Special Economic Zone in 1988, the economic interaction between the two provinces has not been commensurate with their close proximity so far. Hong Kong and Macao have had even less economic linkage with Hainan.¹⁴ However, as the development of Hainan FTP started, GBA cities have begun to explore cooperation opportunities with Hainan:

¹⁴ In 2019, Hong Kong–Hainan trade totalled only 3.8 billion yuan, compared with 1,099.8 billion yuan for Hong Kong–Guangdong trade. Macao–Hainan trade was a tiny 32 million yuan in the same year.

Hong Kong

Hainan's leaders have noted the youth employment and entrepreneurship schemes implemented to lure Hong Kong young people to other parts of the GBA, and Hainan is taking the initiative to provide similar opportunities for Hong Kong young people as well.

Guangdong provincial government

On 10 September 2020, the provincial governments of Guangdong and Hainan signed a *Strategic Cooperation Framework Agreement*, which lays out the overall direction for further cooperation, including cooperation in rule-setting and institutional reforms for better business environment, cooperation in coordinated regional economic development, industrial and market cooperation, strengthening infrastructure connectivity, and improving cooperation and exchanges of the two provinces at various levels.

Guangdong FTZ

In mid-July 2020, Shenzhen Qianhai–Shekou Area of the Guangdong Pilot Free Trade Zone (Guangdong FTZ) signed a *Memorandum of Cooperation* with Danzhou city of Hainan to deepen their cooperation in finance, logistics and tourism. Qianhai will encourage financial institutions and private capital to provide financing and financial services for Hainan, and will support key logistics and supply chain management service companies to invest in Danzhou. Qianhai will also leverage its advantages in cultural and creative industries to help Danzhou develop its tourism.¹⁵

In late August 2020, Shenzhen Qianhai–Shekou Area of the Guangdong FTZ signed a *Memorandum of Cooperation* with Haikou Jiangdong New District of Hainan. The two places will work closely to develop into an international aircraft maintenance centre, a cross-border trade settlement centre, and a headquarter hub connecting the ASEAN, Hainan and the GBA. These two regions will also collaborate in institutional innovations and jointly explore a new and streamlined administrative approval and supervision system.¹⁶

Nansha Area of the Guangdong FTZ has also been exploring potential cooperation with the Yangpu Port in Hainan. Nansha officials hope that Nansha can collaborate and integrate with the Yangpu Port in such fields as merchandise trade, shipping and logistics, transit consolidation, and supply chain optimization. Cooperation is also expected in the areas of cruise tourism, health tourism, art trading, etc.¹⁷

¹⁵ http://qh.sz.gov.cn/ljqh/xcjs/qhjsd/content/post_7897883.html

¹⁶ <https://www.hainan.gov.cn/hainan/sxian/202008/09841ffc714e4d5fb552512a44fcdabca.shtml>

¹⁷ http://www.cnbayarea.org.cn/news/focus/content/post_263201.html

3. Business opportunities for GBA enterprises

With the construction of Hainan FTP and the implementation of liberalization policies, market access into Hainan will be greatly broadened. Enterprises would also enjoy preferential policies granted by both the central government and local government. These will provide ample opportunities in various sectors in Hainan for GBA enterprises and Hong Kong enterprises in particular.

3.1 Tourism and retail

Already a popular tourist destination¹⁸, Hainan is set to further develop into an international tourism and consumption centre. With a relaxed duty-free shopping policy now in-place, Hainan could become a shoppers' paradise that tempts Chinese tourists to spend at home, rather than abroad.¹⁹ In fact, Hainan has already witnessed a surge in the number of tourists and duty-free spending since the new duty-free shopping policy was implemented: During 1 July 2020 to 6 April 2021, 4.96 million tourists visited the island, up 101% yoy; and duty-free shopping by tourists amounted to 34.7 billion yuan in the period, up 244% yoy.²⁰ Meanwhile, five enterprises have obtained licenses to run duty-free business and six new duty-free shops have opened in Hainan since July 2020.

That being said, Hainan's tourism sector is still under-developed compared with Hong Kong. While Hong Kong (55.9 million) had fewer visitor arrivals than Hainan did (83.1 million) in 2019, its total tourism expenditure amounted to 223 billion yuan in the year²¹, more than twice of Hainan's tourism earnings (105.8 billion yuan)²². Hainan has a long way to go before it can match Hong Kong's attractiveness as a shoppers' paradise. On the positive side, this implies vast potential for growth. The anticipated increase in tourists to Hainan, together with the further opening-up of its retail sector, especially duty-free shop operations, will bring ample investment opportunities to Hong Kong businesses, who are experienced in retail, catering, and personal services.

On the other hand, the rich experience of Hong Kong tourism and retail practitioners, in areas such as business operation, investment, and provision of supporting services, will contribute to the development and upgrade of Hainan's tourism sector and help Hainan offer world-class services and customer experience to tourists.

Hainan also plans to promote sport tourism and cultural tourism. Macau, as a world-class tourism and leisure centre, has the experience in building and operating integrated resorts. Amusement park operators from Guangdong and Hong Kong will also find a new avenue for business growth in Hainan. For instance, Hong Kong-based Keystone

¹⁸ Tourists to Hainan increased from 25.9 billion person-times in 2010 to 83.1 million person-times in 2019 (with 98% being domestic visitors) and tourism revenue jumped from 25.8 billion yuan to 105.8 billion yuan during the period.

¹⁹ The top purpose of overseas travel for China's 150 million outbound travellers in 2019 was 'shopping', according to a report jointly released by Trip.com and China UnionPay in November 2019. Chinese outbound travellers spent US\$254 billion overseas in 2019, more than the US and Germany combined, according to the World Tourism Organization.

²⁰ 'Hainan cracks down on duty-free arbitrage', Xinhua, 13 April 2021

²¹ 'Tourism Performance in 2019', Hong Kong Tourism Commission

²² 'Hainan Statistical Yearbook 2020', Hainan Provincial Bureau of Statistics

Group started the construction of a Hello Kitty theme park in Sanya last December, which is set to open in the second half of 2024.

Building a global centre for premium goods and boutique shops in Hainan

Hainan plans to build a 'Global Consumer Boutique Centre' in Haikou Jiangdong New District, a key industrial park of Hainan FTP. The project, which will be developed in two phases and will cover an area of 2 million square metres, aims to attract international tourists to spend in Hainan and to provide a world-class exhibition and trading platform for global brands and premium goods.



In early May 2021, LF Logistics, the logistics arm of Li & Fung, signed a cooperation agreement with Hainan Development Holdings Co., Ltd. and other enterprises to jointly build the Global Consumer Boutique Centre in Hainan.

3.2. Maritime services

The GBA has established itself as a premier international shipping hub that is home to three of the world's largest container shipping ports in Hong Kong, Guangzhou and Shenzhen (see Exhibit 5). It has a flourishing maritime cluster providing a full range of maritime and trade-related services, from ship management, maritime legal and arbitration services, marine insurance, to warehousing, logistics and distribution, and many others.

Hainan strives to become an international shipping centre and develop its maritime service cluster. The development of Hainan's shipping sectors will provide plenty of investment opportunities for enterprises in the GBA. For example, Hainan's liberalisation measures in maritime transport and freight forwarding, such as the lifting of limits on foreign equity share in international maritime transport companies and international

shipping agency companies²³, will create new opportunities for maritime service providers from the GBA.

Exhibit 5: Cargo throughputs of major ports in Hainan and the GBA

Cargo throughputs (million metric ton)						
Year	Hainan		GBA			
	Haikou	Yangpu	Guangzhou	Shenzhen	Hong Kong	Macao
2000	8.1	0.5	124.6	57.0	174.6	0.4
2010	57.0	28.3	272.8	153.5	267.8	0.2
2014	89.2	35.3	500.1	223.2	297.7	0.3
2015	92.0	39.0	521.0	217.1	256.6	0.3
2016	99.5	40.6	544.4	214.1	256.7	0.2
2017	113.0	42.9	590.1	241.4	281.5	n/a
2018	118.8	42.1	613.1	251.3	258.5	n/a
2019	124.5	50.2	626.9	257.9	263.3	n/a

Source: Hainan Statistical Yearbook 2020; Guangdong Statistical Yearbook 2020; Hong Kong Marine Department; Macao Statistics and Census Service

3.3. Medical and education services

Medical and education industries are another focus of Hainan FTP, which attempts to build itself into a regional medical centre and an international innovative island in education. Hainan's target of attracting talents from the Mainland and overseas also calls for the provision of quality medical and education services for those talents and their families.

The experience of the GBA, especially Hong Kong and Macau, in setting up and operating medical and educational facilities of international standards can be transferred to Hainan. There are also successful precedents in the GBA:

- The University of Hong Kong (HKU) operates the HKU-Shenzhen Hospital in accordance with Hong Kong's practices.
- The Chinese University of Hong Kong and Shenzhen University jointly established the Chinese University of Hong Kong, Shenzhen.
- The Macao authorities established the University of Macau in Hengqin Island, Zhuhai, on a piece of land rented by the Macao government.

²³ The measures were first announced in the 'Overall Plan for China (Hainan) Pilot Free Trade Zone'.

3.4 Processing trade

We notice that the guiding document for Hainan's development, *Guiding Opinions of the Central Committee of the CPC and the State Council on Supporting Hainan for Comprehensively Deepening Reform and Opening-Up*, states that re-export trade and processing trade are not the key for Hainan FTP.²⁴ However, given Hainan's development level, the benefits of a free trade port, and the special import processing policy implemented in Hainan FTP, processing trade will still be a good start to attract foreign investment and to build a sound industrial base in Hainan. The point here is to ensure that the processing trade activities will support the development of high-tech industries such as advanced manufacturing and will not bring pollution to Hainan.

In Hainan FTP, raw materials imported for domestic production or for processing trade of which the final products would be exported to overseas are exempted from import duties and import value-added taxes. For encouraged industries, products with over 30% of processing value-added in Hainan FTP are also exempted from tariffs when being sold to other parts of China. That is to say, enterprises engaging in processing trade within Hainan FTP may still enjoy zero import duties for their imported raw materials even if the final products are sold to the China market.

GBA enterprises have extensive experience in processing trade. In recent years, some of them have moved their production to Belt and Road countries due to cost considerations and the China–US trade war. The processing trade policy in Hainan FTP will provide opportunities for manufacturers in the GBA to relocate their production and optimize their supply chains.

4. Joint efforts of Hainan FTP and the GBA in institutional innovation

Hainan FTP, once fully developed, and the GBA together could form the most open region in China and spearhead the next phase of China's reform and opening-up. But for this to happen, collaboration between the two regions and breakthroughs in institutional innovation are needed.

The central government aims to establish a sound free trade port system in Hainan. On this front, Hong Kong will be able to provide valuable experience. Besides, the central government hopes that Hainan could implement 'opening-up policies of the highest level', which implies that Hainan FTP will be a testing ground for future reform and opening-up measures that may be adopted by the GBA, other FTZs or the whole country. In this regard, the GBA should keep a close eye on the new policies in Hainan FTP and explore whether those policies can be replicated in the GBA.

²⁴ http://www.gov.cn/zhengce/2018-04/14/content_5282456.htm

4.1. Hong Kong as a benchmark for a high-standard free trade port

Hong Kong, along with Singapore and Dubai, is one of the most successful free ports in the world. Hainan FTP can draw on the experience from Hong Kong to innovate its institutional framework and develop its free-trade-port economy.

Hong Kong has sophisticated institutions, laws and practices that collectively enable the operation of its free-trade-port economy which could be replicated to Hainan FTP, such as:

- A legal system based on the rule of law
- Laws to protect private property rights
- A clean and efficient government
- A free trade policy with no barriers to trade
- A simple taxation system with low tax rates

Take the legal system as an example, Hainan will make efforts to establish a ‘free trade port law system with the *Hainan Free Trade Port Law* as the basis and local regulations and commercial dispute resolution mechanisms as important components’. Hong Kong can provide practical experience on how to establish a legal system and relevant institutions aligned with a free trade port. Some senior posts in those institutions (such as the arbitral tribunal for dispute resolution) could even be staffed by experienced Hong Kong personnel.

4.2. Piloting policies in Hainan to chart a way forward for the GBA and China

As a Special Economic Zone as well as a free trade port, Hainan has the unique advantage of piloting opening-up policies of the highest level. A series of institutional arrangements and policies that are to be rolled out in Hainan FTP will represent the direction for future reform and opening-up policies for China as a whole.

Given the small economic scale of Hainan, which accounts for just 0.5% of China’s GDP, even successful implementation of new policies in Hainan would not mean much to the whole country. In this regard, the GBA provides a big enough and open enough platform to test out new policies on a larger scale, before those policies can be replicated to other parts of China.

In this section, we focus our discussion on Hainan and the nine PRD cities on the Guangdong side of the GBA, as Hong Kong has already been consistently rated the freest economy in the world.

Example 1: Financial opening-up

Promoting opening-up in the financial sector and freer cross-border capital flows is an essential part of China's plan to develop Hainan FTP. Some of China's policies for nationwide financial opening-up would first be implemented in Hainan, including:

- Qualified Foreign Limited Partner (QFLP) scheme: The GFLP scheme, which allows qualified overseas investment institutions to convert foreign capital into Renminbi and invest it in domestic private enterprises and venture capital markets, was launched in Hainan FTP on a pilot basis. The first QFLP fund in Hainan was established in September 2020 by Hong Kong subsidiaries of the Bank of Communications.
- Real estate investment trusts (REITs): Hainan will be one of the first regions/cities to carry out the pilot scheme for REITs in the infrastructure sector.
- New foreign debt management system: Hainan FTP will pilot the foreign debt management framework regarding merger transactions, and improve the record-filing and registration system for foreign debt issuance by enterprises. This reform measure is not yet available in other FTZs.

Hainan FTP is an ideal testing ground for financial opening-up. Its small economic scale will help ensure that the consequence will not be devastating if the experiment fails. If the experiment is successful, the experience could then be adopted in other GBA cities, other free trade zones, and ultimately across the country.

Potential financial risks as an obstacle to Hainan's financial reform

The Chinese government has been very cautious in financial reform. Financial stability has always been emphasized as the prerequisite for any financial reforms in FTZs or other regions. There were cases that reform measures were shelved or cancelled because of financial risks.

One example is the Qualified Domestic Investment Enterprise (QDIE) scheme which was introduced in Qianhai, Shenzhen in 2015. Under such scheme, qualified asset management institutions could make foreign investment with no restrictions on investment destinations and investment products. The State Administration of Foreign Exchange granted Shenzhen a total of US\$2.5 billion in QDIE quota in 2015. In the first two batches of licensing exercise, 41 asset management institutions acquired QDIE qualifications. However, possibly due to capital outflows and the depreciation pressure on the Renminbi, the scheme was then put on hold. No QDIE license had been granted for two years after late 2015. It was not until January 2018 that Shenzhen authorities accepted new applications for QDIE quota again.

Financial liberalization measures proposed in Hainan, in particular those on freer cross-border capital flows, could face a similar fate in the worst case. Without a real border between Hainan FTP and the rest of China to effectively block capital flows, it is difficult to confine the financial reform measures within Hainan, and any mistakes might pose a threat to national financial stability. Thus, it remains to be seen whether Hainan could make tangible breakthroughs in its financial opening-up.

Example 2: Taxation policies

Hainan's policies on tariffs and tax rates for both individuals and companies are more favourable than those of the nine PRD cities in the GBA, as shown in Exhibit 6.

Exhibit 6: Comparison of preferential tariff and taxation policies in Hainan FTP and in the nine PRD cities in the GBA

	Hainan FTP	Nine PRD cities in GBA
Tariff		
- Zero tariff and consumption tax on imported goods	For processing trade firms, manufacturers in encouraged industries, residents and tourists	For processing trade firms only*
- Annual duty-free shopping quota	100,000 yuan per person	--
Taxation		
- A maximum of 15% individual income tax rate	For domestic and overseas personnel with 'high-end and urgently-needed skills' (implemented till end-2024); Will be expanded to cover all qualified residents (i.e., residents who stay in Hainan for no less than 183 days a year) from 2025 to 2035	For qualified talents from overseas till 2024
- 15% corporate income tax	For firms in encouraged industries (implemented till end-2024, to be expanded to all firms not in the 'negative list' from 2025 to 2035); Corporate income tax exemption for income generated by new outward direct investment by Hainan FTP firms in the tourism, modern services and high-tech industries (implemented till end-2024)	High-tech firms only*
- Simplification of taxation	The current value-added tax, consumption tax, among other taxes, will be streamlined into a single 'sales tax'.	--

* Policies applicable to elsewhere in the Chinese Mainland

Source: Compiled by Fung Business Intelligence

While lower taxation is always good for individuals and firms, it should not be a single-minded pursuit for the GBA, except for solving the tax rate difference within the region. This is because China as a whole ought to establish a unified tax system for a unified domestic market with a level playing field. However, China could, based on the experience from Hainan FTP, pursue a nationwide tax reform aimed at a simplified tax system with lower import duties and tax rates, which would benefit the GBA as well.

5. Concluding Remarks

In many ways, Hainan is an ideal place for China to conduct its policy experimentation to push forward a comprehensive, deeper-level reform and higher-level opening-up. With Hainan's small-sized economy and distant location from Beijing, the risks posed to the whole country from failed reforms could be minimized. In addition, Hainan's proximity to the GBA allows the two regions to join forces to form the most open region in China and lead China's next stage of reform and opening-up.

That being said, given Hainan's current undeveloped industrial base and infrastructure, Hainan has a long way to go to catch up with the highly modernized cities in the GBA like Shenzhen or Guangzhou, let alone Hong Kong. However, Hainan is full of potential for businesses. The expanded market access and preferential policies offered by Hainan FTP will provide ample investment and market opportunities for foreign firms as well as GBA firms. As Hainan is expected to roll out more detailed implementation measures to support the policies unveiled in the Master Plan, businesses should pay continued attention to the latest announcements regarding Hainan FTP.

Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

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Fung Business Intelligence was established in the year 2000.

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