

**PILOT FREE TRADE ZONE IN
SHANGHAI: LI KEQIANG'S STRATEGY
TO REINVIGORATE REFORMS**

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Executive Summary

1. The China (Shanghai) Pilot Free Trade Zone (FTZ) was unveiled on 30 September 2013. It is expected to become “a model of China’s upgraded economy” and “a vehicle to further integrate China with the rest of world.”
2. Personally promoted by Premier Li Keqiang and positioned in the same vein as Shenzhen’s Special Economic Zone, the establishment of the FTZ demonstrates the new leadership’s determination to reinvigorate China’s unfinished market reforms through further economic opening.
3. The new FTZ is significant from both domestic and external considerations. Domestically, the country is facing the challenge of rebalancing the economy. Externally, China is encountering difficulties and uncertainties due to weak economic recoveries, as well as rising protectionism and a global zeal for regional trading blocs.
4. As an important powerhouse for China’s economy and on the path to become a leading international financial center, Shanghai is ideal for experimenting with further reforms.
5. The Shanghai FTZ has three features. First, a new “negative-list” approach will be used to regulate foreign investment, with an emphasis on supervision. This is in line with the goal to reduce state intervention in the market.
6. Second, the pilot zone will be China’s first bonded area that is fully open to the world economy while remaining segregated from the rest of the economy in mainland China.
7. Third, the government aims to open up China’s much sheltered service sector in the zone. It has relaxed controls on 18 sectors ranging from finance and

shipping to cultural services. Among them, services in trading and shipping have drawn the most expectations.

8. Many hope that the zone will eventually introduce interest rates liberalisation, allow free capital flows, and promote renminbi's internationalisation. But details of financial sector reforms have yet to be disclosed. Indeed, Chinese top leaders have emphasised that such trials must be conducted under the pre-condition of manageable risks.
9. While the significance of the pilot zone is evident, its success is far from guaranteed. The impact of the reform initiatives so far remains unclear. For example, the complex and long negative list announced may only result in marginal improvement to the overall investment environment.
10. Moreover, the Shanghai FTZ needs certain political clout to support its reforms efforts, which may likely encounter strong resistance from various vested interests, such as the monopolistic SOEs in protected sectors. Expanding the Shanghai experiment nationwide will also be challenging.