



Viewpoint

Policy and politics behind Shanghai's Free Trade Zone Program

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ARTICLE INFO

Keywords:

Shanghai
Container ports
Free Trade Zone
Reforms
Governance

ABSTRACT

China launched the Shanghai Free Trade Zone (FTZ) Program on September 29, 2013 in a bid to reduce administrative interventions, ease restrictions on investments, further open up its financial system, and internationalize its currency to booster shipping, logistics, and commerce. This article aims to present a background of the Shanghai FTZ and some reflections on it. China's economic reconstruction has made a major impact on its port cities. Competitions between ports are gradually evolving into competitions between supply chains, with ports no longer considered as isolated links in the transport chain but rather as integral links in the supply chain. Ports are transitioning into fourth-generation ports with the establishment of logistics and value-added activities, which are developed in conjunction with local industrial and service businesses. In this trend, China's port cities can provide a wide range of value-added services and become centers of commodity flow, capital flow, and information flow. Specifically, the combined effects of driving the development of peripheral industries and actively coordinating the activities of relevant parties help regulate the operations of the entire supply chain to obtain potential value-added benefits. The implementation of the Shanghai FTZ will not only stimulate trade but will also bring increased shipping and finance opportunities to the city. With free trade as the new direction and focus of the country's economic initiatives, the Shanghai FTZ will hopefully lay the groundwork for a new round of reforms and restructuring of the Chinese economy.

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1. Introduction

Seaports are an important component of the transportation system because they play a pivotal role in international trade. China's seaports have undergone rapid development in the 21st century with increased investments in port infrastructure, accelerated pace of construction, optimized functional structures, and increased port throughput (Cullinane et al., 2004). As of 2012, China is home to seven of the ten largest container ports in the world.¹ Port development and China's foreign trade are closely related (Keller et al., 2011). However, the weak global economy and China's continuing economic reconstruction prompt the country to tap other means to stimulate port development. Global trade remains generally weak because of slow global economic recovery. WTO statistical data show that in 2012, the global trade in goods increased by 2% (WTO, 2013), which was well below the 5.2% growth rate in 2011. The internal and external environments of China's foreign trade market are both complex and severe with its share of external demands, rising costs, and

increasing trade frictions.² Table 1 shows that export–import growth in China slipped to single digits starting from 2012.

The economic transition of China began with reforms in its international trade and industrial structures (Cai and Wang, 2010). China's economy is now transitioning from one that is anchored on labor-intensive industries (particularly in the textile, clothing, and toy industries, to name a few) to one that is based on high value-added, high-technology manufacturing. Statistical data from Chinese customs (China Trade Data, 2013) show that the growth rate of China's mechanical, electrical, and high-technology products has become significantly faster than that of its labor-intensive products. This economic transition has far-reaching implications on China's shipping industry, with more and more Chinese export goods becoming high value, lightweight, and small sized. However, the continuous increase in shipping capacity and

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¹ A list of the top 50 world container ports can be found at: <http://www.worldshipping.org/about-the-industry/global-trade/top-50-world-container-ports>.

² China's competitive edge in the processing and manufacturing industry has gradually deteriorated in recent years because of soaring manufacturing costs that result from exchange rate appreciation and increased labor costs (Yang et al., 2010). Foreign companies have gradually moved their bases from the eastern coastal area to regions and countries that have low manufacturing costs. Shanghai understands that port cities cannot solely rely on traditional hinterland supply from their own manufacturing bases or from inland cities (Beresford et al., 2012) to propel their economic development. Port cities should increase their value-added services.

Table 1
China's export and import (2004–2012). Source: China Trade Data (2013).

Year	Export and import		Export		Import	
	Total (USD Billion)	Growth (%)	Total (USD Billion)	Growth (%)	Total (USD Billion)	Growth (%)
2004	1154.554	35.7	593.326	35.4	561.229	36.0
2005	1421.906	23.2	761.953	28.4	659.953	17.6
2006	1760.439	23.8	968.978	27.2	791.461	19.9
2007	2176.572	23.6	1220.456	26.0	956.116	20.8
2008	2563.260	17.8	1430.693	17.3	1132.567	18.5
2009	2207.535	−13.9	1201.612	−16.0	1005.923	−11.2
2010	2974.001	34.7	1577.754	31.3	1396.247	38.8
2011	3641.864	22.5	1898.381	20.3	1743.484	24.9
2012	3867.075	6.2	2048.764	7.9	1818.311	4.3

port construction can inevitably lead to overcapacity (Xiao et al., 2012).

Ever since China adopted a market economy and decentralized port management, the country has aggressively exploited its port resources for city-as-a-unit competition more than any other developed region or country. Ports are vital gateways to attract investments for the development of the export processing industry, which is pivotal to the local economy. The main regulatory bodies in China's port development are often not port authorities but local governments. Local governments focus on gaining competitive advantage rather than adopting the usual business strategies. However, this “competitive advantage” is in fact a homogeneous, low-benefit advantage that often brings serious negative effects to society. For instance, to gain competitive advantage and expand their market share, local ports conduct blind and excessive investments,³ which waste social resources (Xiao et al., 2012). Furthermore, a large number of port and related transportation projects harm the ecological environment in the area because these projects often require land reclamation (Wang et al., 2010).

The future direction of how ports evolve is a major concern in China. As competitions between ports gradually evolve into competitions between supply chains, ports are no longer considered as isolated links in the transport chain but are rather integral links of the supply chain (Slack and Frémont, 2005). In other words, the problems that confront the manufacturing industry spread to virtually every link of the supply chain, including ports. The market requirement of efficient and agile production of goods, which also becomes the requirement of the entire supply chain, affects the traditional mode through which ports operate, and causes a series of changes in supply chains (Paixão and Marlow, 2003). UNCTAD (1992) classifies the evolution of ports into three successive generations. With the development of supply chain management theory and the expansion of port functions, UNCTAD (1999) has added fourth-generation ports (Table 2), which are defined as networks of physically separated ports (terminals) linked through common operators or common administration. The main functions of ports together comprise a node of international operations and economic activities.

Logistics study by Chinese researchers have once mainly focused on the physical movement of goods rather than the integrated supply chain system (Mahpula et al., 2013), but increasingly more Chinese scholars (He et al., 2011; Du, 2006; Zhao et al., 2007) have started to pay close attention to the concept of fourth-generation ports and expanded the concept. They believe that as important nodes of global transportation, ports are devel-

oping in the direction of providing full value-added services and are fast becoming centers of commodity flow, capital flow, and information flow. Fourth-generation ports are no longer considered as passive service providers; they are active production organizers, planners, and leaders in the supply chain. Ports are not merely transportation centers, but are they are increasingly strengthening their links with the general manufacturing supply chain and traditional logistics services⁴ (Fig. 1).

Seamless supply chains constitute a key characteristic of fourth-generation ports. This seamless connection includes extensions of port logistics services. In other words, the connection is based on port cargo handling and container transshipment and is facilitated by building a port's logistics service system in hinterlands to integrate ports' maritime capabilities, trade functions, and warehouse functionalities. It also means deep supply chain integration among ports, shipping companies, and logistics companies. Ports provide tailored services instead of “one-size-fits-all” services (Paixão and Marlow, 2003). The integration of the logistics chains is a major challenge for Chinese ports. It entails not only the integration of data and services among parties but also a breakdown of the walls between administrative divisions to allow the free flow of commodities between supply chains. The severe lack of economic freedom⁵ in China has seriously undermined productivity growth.

2. The Shanghai FTZ

As a large eastern coastal city, Shanghai possesses a unique geographical advantage. It is located in the golden waterway, at the mouth of the Yangtze River and in the middle of the eastern coast. Shanghai's economy can extend to the Yangtze River Delta and the entire Yangtze River watershed through river transport. The adjacency of the city to eastern waters and the Pacific is therefore a notable geographic advantage of Shanghai in relation to the construction of an international shipping hub within its territory (Wang and Ducruet, 2012). However, despite being the world's largest cargo port, the Shanghai Port has yet to be developed as a full-scale fourth-generation port.

⁴ One such example is the cooperation between Shanghai Baosteel Company and the Shanghai Port. Baosteel Company closely works with the Shanghai Port to optimize inventory management and thus lower logistics costs and the procurement costs of raw materials. The Shanghai Port also works with other ports along the Yangtze River to efficiently distribute Baosteel's products to end users. This close collaboration proves to be a win-win situation for both Baosteel and the Shanghai Port. Similarly, the Shanghai and Ningbo ports have also jointly set up an investment company (Shanghai Port and Shipping Equity Investment Co., Ltd.) to engage in the manufacturing and service sectors, with the hope that ports can strengthening their links with the general manufacturing supply chain.

⁵ The 2013 Index of Economic Freedom compiled by The Heritage Foundation and The Wall Street Journal shows that China's economic freedom score ranks 136th among 177 countries. Generally, China remains not conducive to business activities. More information can be found at Heritage Organization (2013).

³ A concrete example is the case of the Caofeidian Port, which aims to compete with the nearby Tianjin port. The entire port city of Caofeidian is now mired in debt of USD91B and is on the verge of bankruptcy. The full story can be retrieved at: <http://online.wsj.com/article/SB10001424127887323971204578625412243604252.html>.

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