

1-1-2015

U.S. Foreign Trade Zones and Chinese Free Trade Zones: A Comparative Analysis

Susan Teifenbrun

Follow this and additional works at: <http://scholarlycommons.law.hofstra.edu/jibl>

 Part of the [International Trade Law Commons](#)

Recommended Citation

Teifenbrun, Susan (2015) "U.S. Foreign Trade Zones and Chinese Free Trade Zones: A Comparative Analysis," *Journal of International Business and Law*: Vol. 14: Iss. 2, Article 2.

Available at: <http://scholarlycommons.law.hofstra.edu/jibl/vol14/iss2/2>

This Legal & Business Article is brought to you for free and open access by Scholarly Commons at Hofstra Law. It has been accepted for inclusion in *Journal of International Business and Law* by an authorized administrator of Scholarly Commons at Hofstra Law. For more information, please contact lawcls@hofstra.edu.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES: A COMPARATIVE ANALYSIS

Susan Tiefenbrun *

I. INTRODUCTION.....191

 A. Trade Law.....192

 B. Theoretical Framework of FTZs.....192

II. U.S. TAX-FREE TRADE ZONES.....194

 A. Legal Framework of U.S. Foreign Trade Zones.....194

 1. The U.S. Foreign Trade Zones Act 1934.....195

 2. The 1950 Boggs Amendment to the U.S. Foreign Trade Zones Act of 1934.....196

 3. The 1952 U.S. Foreign Trade Zones Board Order No. 9.....197

 4. The 1984 Amendment to the U.S. Foreign Trade Zones Act of 1934.....197

 5. The 1991 Revised U.S. Foreign Trade Zones Board Regulations.....197

 6. The 2012 Revised U.S. Foreign Trade Zones Board Regulations.....198

 B. Definitions of FTZs.....199

 C. Types of FTZs.....200

 D. Goals of U.S. Ftzs.....200

 E. How the U.S. FTZs Work.....201

 F. Free Trade Zones vs. Free Trade Areas.....205

* Dr. Susan Tiefenbrun, Professor of Law and Director of the Center for Global Legal Studies at Thomas Jefferson School of Law. I would like to give special thanks to my colleague, Professor Jun Zhao, for his insights and to my law students, Brittany Nobles, Cristina Kinsella, and Crystal Vasalech for their able assistance in the research of this current article.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

G. Performance of U.S. Foreign Trade Zones.....	206
H. Economic Benefits of FTZ Development in the U.S.....	208
I. U.S. Government Guarantees to Users of U.S. Foreign Trade Zones.....	209
J. Bonded Warehouses vs. Free Trade Zones.....	210
III. FREE TRADE ZONES IN CHINA.....	211
A. History of Chinese FTZs.....	213
B. Chinese Laws of the Special Economic Zones and Export Processing Zones.....	214
C. Shenzhen, Zhuhai, Shantou, Xiamen Free Trade Zones.....	215
D. New Pilot Shanghai Zone.....	216
E. New Shanghai Zone Legislation.....	217
1. The Overall Plan Law for the Shanghai Zone.....	218
2. The Negative List and the Shanghai Zone.....	218
3. Shanghai FTZ Compared to Shenzhen SEZ.....	220
4. Tax Incentives for Foreign Companies Proposed in the New Shanghai Zone.....	222
5. Objectives of the New Shanghai Zone.....	222
F. Performance of the Shanghai Free Trade Zone in its First Year.....	223
G. Overall Benefit of Free Trade Zones and Development Zones in China.....	224
H. Critique of the Free Trade Zones in China.....	224
I. FTZs and China's Economic Challenges.....	225
IV. SUGGESTIONS AND CONCLUSION.....	228

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

I. INTRODUCTION

The United States and China, as well as more than one hundred thirty-five countries in the world, operate tax-free trade zones.¹ There are more than three thousand five hundred of these zones and subzones all over the world; this includes about 277 foreign trade zones² and more than 500 special purpose subzones in the United States.³

These tax free trade zones are called “foreign trade zones” in the United States.⁴ A foreign trade zone (“FTZ”) is a designated location in the United States (usually near a port or airport) where companies can make use of special procedures that encourage U.S. trade, manufacturing activity and value added by allowing delayed or reduced duty payments on foreign merchandise, as well as other savings.⁵ Unlike the U.S. “FTZs”, China’s free trade zones have many names: Export Processing Zones (“EPZs”); Development Zones (to cause regional development); Special Economic Zones (“SEZs”); Economic Development Zones (“EDZs”); Economic and Technological Development Zones (“ETDZs”); and Hi-tech Development Zones (“HIDZs”).⁶

This paper will compare and contrast U.S. foreign trade zones and Chinese free trade zones and the laws regulating these zones. Part I will discuss the institutionalization of domestic and international rules of trade law and the theoretical framework of the free trade zones. Part II will discuss the various aspects of U.S. tax-free trade zones including their legal framework; the definition of a free trade zone and a foreign trade zone; the types and goals of free trade zones; how they work; the difference between a free trade zone and a free trade area; the performance of U.S. foreign trade zones to date; the economic benefits of the development of foreign trade zones in the U.S.; the U.S. government guarantees given to users of U.S. foreign trade zones; and the difference between bonded warehouses (which are what most Chinese free trade zones resemble) and free trade zones. Part III will discuss free trade zones in China by exploring the history of Chinese free trade zones; the laws governing

¹ See generally SUSAN TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD AND IN THE UNITED STATES (Susan Tiefenbrun et al. eds., 2012) [hereinafter TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD]. See also Susan Tiefenbrun, *Foreign Trade Zones of the United States, Free-Trade Zones of the World, and Their Impact on the Economy*, 12 J. INT’L BUS. & L. 149 (2013) [hereinafter Tiefenbrun, *FTZ Impact on the U.S. Economy*].

² The United States refers to free trade zones as “foreign trade zones”, and the law governing U.S. foreign trade zones is the Foreign Trade Zones Act. See United States Free Trade Zones Act, 19 U.S.C. §§ 81a - 81u (1934) [hereinafter FTZ Act].

³ Tiefenbrun TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 1.

⁴ Dep’t of Homeland Sec. & U.S. Customs & Border Prot., *About Foreign-Trade Zones and Contact Info*, U.S. CUSTOMS & BORDER PROT., <http://www.cbp.gov/border-security/ports-entry/cargo-security/cargo-control/foreign-trade-zones/about> (last visited August 30, 2015) [hereinafter *About Foreign-Trade Zones and Contact Info*].

⁵ Dept. of Commerce & Int’l Trade Admin., *Fact Sheet: New Foreign-Trade Zones Regulations*, INT’L TRADE ADMIN., <http://trade.gov/press/press-releases/2012/fact-sheet-new-foreign-trade-zones-regulations-021712.asp> (last visited July 29, 2015) [hereinafter *FACT SHEET: New Foreign-Trade Zones Regulations*].

⁶ Siu-Wai Wong & Bo-sin Tang, *Challenges to the Sustainability of ‘Development Zones’: A Case Study of Guangzhou Development District, China*, 22 CITIES 303, 305-07 (2005), available at <http://www.ucdenver.edu/academics/colleges/Engineering/research/CenterSustainableUrbanInfrastructure/LowCarbonCities/Documents/Bo-sin%20Tang/Challenges%20to%20sustainability%20of%20development%20zones.pdf>. [hereinafter Wong and Tang].

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

these export processing zones; an in-depth look at a few well-established Chinese free trade zones such as Shenzhen, Zhuhai, Shantou, and Xiamen; and an analysis of the new Shanghai Zone, its legislation, and the performance of the Shanghai free trade zone in its first year.

This paper will analyze the overall benefit of free trade zones in China and provide a constructive critique of the Chinese free trade zones in view of the many economic challenges facing China today. In conclusion, this paper will provide some suggestions for the beneficial development of free trade zones in China and foreign trade zones in the United States.

A. Trade Law

In accordance with the International Convention on the Simplification and Harmonization of Customs Procedures, an FTZ refers to an area where goods may be landed, handled, manufactured or reconfigured, and then re-exported without the intervention of Customs authorities.⁷ Although an FTZ⁸ bears various names and is governed by diverse systems, the essence of an FTZ remains the same; namely, an FTZ provides free movement of goods and people, facilitation of administrative procedures, and the accomplishment of free trade.⁹ The creation, evolution, and expansion of FTZs worldwide are the result of the institutionalization of domestic and international rules of trade law.¹⁰

B. Theoretical Framework of the FTZ

The father of the U.S. FTZ program was Congressman Emmanuel Celler of New York.¹¹ Early in 1934, he defined a FTZ as “a neutral, stockaded area where a shipper can put down his load, catch his breath, and decide what to do next.”¹² FTZs located in the United States are considered to be outside the United States for United States Custom and Border Protection purposes; therefore, taxes and duties are not applied or are applied differently on merchandise located within the United States FTZ.¹³

Historically, the free trade zone dates back to the time of the ancient Phoenicians, when safe passage was the chief guarantee offered foreign traders visiting Tyre and Carthage.¹⁴ In the beginning, the free trade zone was a tool for the aggressive commercial powers.¹⁵ The Phoenicians were the first to create the concept of the international free trade

⁷ Li Zhipeng, “On Meanings and Developing Patterns of China’s Free Trade Zone,” *International Trade* 7 (2013):4.

⁸ On names of the FTZ and its difference with FTA, see TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 8-9, 18-19.

⁹ Wu Wenjie, *Definition, History and Functions of Free Trade Area and Strategies for Developing it in Chinese Taiwan*, *LOGISTIC TECHNOLOGY*, 29-30 (2011).

¹⁰ MARY JANE BOLLE & BROCK R. WILLIAMS, CONG. RESEARCH SERV., R42686, U.S. FOREIGN-TRADE ZONES: BACKGROUND AND ISSUES FOR CONGRESS (2013) available at <https://www.fas.org/sfp/crs/misc/R42686.pdf> [hereinafter Bolle & Williams].

¹¹ *Id.* at 152. See TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 1.

¹² Bolle & Williams, *supra* note 10, at 152.

¹³ Michael Andrusak, *The Public Interest of the U.S. Foreign Trade Zone*, 18 INT’L TRADE LAW & REGULATION JOURNAL 86 (2012).

¹⁴ KATHIANN M. KOWALSKI, OPEN FOR DEBATE: FREE TRADE 23 (2008).

¹⁵ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 166.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

zone.¹⁶ Later the Greek city-states and then the Romans developed FTZs into launching pads for economic and political domination. Citywide free zones and *entrepôts*¹⁷ that guarantee free storage and exchange along secure trade routes such as Gibraltar, Hamburg, and Singapore¹⁸ have been operating for centuries.¹⁹ For example, the free trade zones in Gibraltar and Singapore were in place as early as 1704 and 1819, respectively.²⁰ The free trade zone also helped to enrich members of the Hanseatic League.²¹ However, it was not until the later part of the 1960s that free trade zones began to play a significant role in international trade.²²

Developing countries neglected to focus on free trade zones until the late 1960s. This change of focus occurred after the United Nations' Economic and Social Council²³ adopted a resolution at the 1506th plenary meeting on August 4, 1967 suggesting that one of the fundamental means of export expansion was the improvement of ports, Customs, and trade zone facilities in developing countries.²⁴

The first modern industrial free zone was established in Shannon, Ireland, in 1959.²⁵ Tax-free trade zone programs began to develop in the 1970s and continued to proliferate.²⁶ Developing countries increased the number of their FTZs because they wanted to attract foreign direct investment, create more jobs, facilitate economic benefits, acquire technology and skills, and increase exports.²⁷ It is for these same reasons that China established its first free trade zone in 1979 when Deng Xiaoping decided to open up China's economy and attract foreign investment to China.²⁸

As a general rule, FTZs are basically governed by the laws of the host country where the FTZ is located, as well as the laws of the country that owns the FTZ.²⁹ Most FTZs are located in places that have natural and physical advantages, like near an airport or body of

¹⁶ Walter H. Diamond, *Tax-Free Trade Zones Aid Both Exporters and Importers*, THE AMERICAN BANKER 15, Oct. 20, 1980 [hereinafter Diamond]. See also WALTER H. DIAMOND & DOROTHY B. DIAMOND, *TAX-FREE TRADE ZONES OF THE WORLD I*, (Matthew Bender & Co., Inc., 1995) [hereinafter DIAMOND & DIAMOND].

¹⁷ *Entrepôt*, Definition of *entrepôt* by Merriam-Webster, MERRIAM-WEBSTER, <http://www.merriam-webster.com/dictionary/entrepot> (last visited July 29, 2015). See also WORLD BANK, SPECIAL ECONOMIC ZONES: PROGRESS, EMERGING CHALLENGES, AND FUTURE DIRECTIONS 3 (Thomas Farole & Gokhan Akinci, eds., 2011), available at http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2011/08/16/000386194_20110816014424/Rendered/PDF/638440PUB0Ext00Box0361527B0PUBLIC0.pdf [hereinafter WB 2011 Report].

¹⁸ WB 2011 Report, *supra* note 17.

¹⁹ *Id.*

²⁰ FIAS, SPECIAL ECONOMIC ZONES, PERFORMANCE, LESSONS LEARNED, AND IMPLICATIONS FOR ZONE DEVELOPMENT 2 (April 2008), available at <https://www.wbginvestmentclimate.org/uploads/SEZs%20-%20Performance,%20Lessons%20Learned%20and%20Implications%20for%20Zone%20Development.pdf> [hereinafter WB 2008 Report].

²¹ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 5.

²² See *A Brief History of the U.S. Foreign-Trade Zones Program*, FOREIGN-TRADE ZONE RESOURCE CENTER, <http://www.foreign-trade-zone.com/history.htm> (last visited Feb. 15, 2013) [hereinafter FTZ Resource Center].

²³ UN ECOSOC, 43rd Sess., 1506th plen. mtg. at 206-07 (Aug. 4, 1967).

²⁴ Diamond, *supra* note 16, at 15.

²⁵ WB 2011 Report, *supra* note 17, at 3.

²⁶ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 152.

²⁷ WB 2011 Report, *supra* note 17, at 5.

²⁸ *Id.*

²⁹ Bolle & Williams, *supra* note 10, at 3.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

water.³⁰ Even though FTZs are governed by the domestic law of the country where the FTZ is located, that law must be in accordance with international trade law rules.³¹ Therefore, the establishment of FTZs in China can help it develop its own domestic legal reforms.

II. U.S. TAX-FREE TRADE ZONES

Like China, the United States has had a steady increase in its foreign trade zone activity.³² The U.S. tax-free trade zones are intended to increase exports of American products, increase domestic manufacturing, and increase employment for Americans. More than 3,300 firms utilize these foreign trade zones.³³ Generally speaking, the foreign trade zones in the U.S. have been successful, and they serve the public interest because they allow domestic manufacturers to maintain manufacturing operations³⁴ in the United States.

In a recent study by the author, I have shown that there are conflicting reports on the advantages and disadvantages of free trade zones in the world and, specifically in U.S. foreign trade zones.³⁵ Moreover, the impact of foreign trade zones on the U.S. economy is definitely positive, but just not as positive as was anticipated.³⁶

In order for the tax-free trade zones to do what they were intended to do, that is to increase exports, facilitate constructive international trade, and enhance international business, the U.S. must make sure, through rational and reasonable regulatory schemes, that the zones are being used for the primary purpose of increasing exports and safeguarding social and environmental standards both here and abroad.³⁷

A. Legal Framework of the U.S. Foreign Trade Zones

The legal framework in which a tax-free trade zone operates, especially the proper and consistent implementation of their governing rules, is critical to the success of a zone.³⁸ An effective legal framework in a country that respects and implements the rule of law is absolutely essential to the development of free trade zones.³⁹ The legal and regulatory framework of the zone must be clear, transparent, and properly implemented in order to foster reliance and instill confidence in the foreign direct investors who often face business

³⁰ Some scholars explored and analyzed the advantages and disadvantages of main ports in Kaohsiung of Taiwan, China. They reached the conclusion that natural conditions play an important role. See Zhang Qishen, *Opportunities and Challenges Facing the Kaohsiung Port*, SPECIAL ZONE ECONOMY 9 (2012), 203-204.

³¹ Bolle & Williams, *supra* note 10, at 3.

³² Nat'l Admin. Of Foreign-Trade Zones, *U.S. Foreign-Trade Zones*, NAT'L ADMIN. OF FOREIGN-TRADE ZONES, <http://www.naftz.org/wp-content/uploads/2013/10/One-Pager.pdf> (last visited July 29, 2015).

³³ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 29. See also Andrusak, *supra* note 13, at 86.

³⁴ See Andrusak, *supra* note 13, at 86.

³⁵ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1.

³⁶ See generally *Id.*

³⁷ *Id.* at 222.

³⁸ *Id.* at 5, 11.

³⁹ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

challenges related to complicated land issues, undeveloped infrastructure, and compliance with labor and environmental standards.⁴⁰ There must be a reliable authority that has the capacity and the interest to enforce the rules in order to avoid inordinate delays and disputes that typically arise in zone projects.⁴¹

Historically, the Great Depression in the United States in 1929 caused the passage of a protectionist tariff act known as the Smoot-Hawley Tariff Act of 1930.⁴² This Act imposed very high tariffs on imports in order to encourage domestic production and consumption.⁴³ After this Act was passed, a decline occurred in exports and re-exports from the United States to other countries.⁴⁴

To counter the harmful effects of the Smoot Hawley Act, Congressman Emmanuel Celler introduced a bill in 1934 proposing the U.S. Foreign Trade Zones Act.⁴⁵ This Act was originally called the “Free Trade Zones Act,” but it eventually became known as the Foreign Trade Zones Act “to overcome any antagonism some key congressmen felt towards imports coming into the United States ‘for free’.”⁴⁶ Despite some opposition, the Foreign Trade Zone Act was passed with Congressional approval on June 18, 1934.⁴⁷

1. The U.S. Foreign Trade Zones Act of 1934

The purpose of the Foreign Trade Zones Act is to “expedite and encourage foreign commerce” and increase U.S. exports.⁴⁸ This Act established the Foreign Trade Zones Board (the “Board”), which is composed of the Secretary of Commerce, the Secretary of the Treasury, and the Secretary of the Army.⁴⁹ The Foreign Trade Zones Act provides clear and unambiguous directives to the Board concerning who can apply for operating a zone, the permissible locations for a zone, the conditions necessary to establish and operate a zone, and who can guard the zone.⁵⁰ Thus, the Board has broad authority to write necessary regulations and rules for the tax-free trade zones.⁵¹

The U.S. Foreign Trade Zones Act is a federal statute, and state statutes authorizing the establishment of a zone in that state must also be passed before the Board can approve an application to set up a zone.⁵² The Board must cooperate with the local government on issues relating to the zone.⁵³ A grantee submits information to the Board during the application process, and this information includes the location and qualification for the area, the estimate

⁴⁰ Tiefenbrun *FTZ Impact on the U.S. Economy*, *supra* note 1, at 12.

⁴¹ *Id.*

⁴² Smoot-Hawley Tariff Act of 1930, ch. 497, 46 Stat. 590 (1930) (codified as amended at 19 U.S.C. §§1206-1677 (1988)).

⁴³ *Id.*

⁴⁴ FTZ Act, *supra* note 2.

⁴⁵ *Id.*

⁴⁶ Andrusak, *supra* note 13, at 86.

⁴⁷ *Id.* at 87.

⁴⁸ See FTZ Act, *supra* note 2.

⁴⁹ FTZ Act, *supra* note 2.

⁵⁰ *Id.*

⁵¹ See RICHARD S. THOMAN, *FREE PORTS AND FOREIGN TRADE ZONES* 136 (1956).

⁵² See FTZ Act, *supra* note 2, at § 81(b).

⁵³ *Id.* at § 81(i).

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

of the cost, the timeframe for construction of the zone, and other information the Board might request.⁵⁴

According to the U.S. Foreign Trade Zones Act, merchandise can be “stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise or otherwise manipulated, or manufactured.”⁵⁵ Unlike the Shanghai new pilot FTZ, which is highly restricted by a published Negative List,⁵⁶ most merchandise is allowed in a U.S. foreign tax-free trade zone. However, the Board has the authority to order any particular merchandise, process, or treatment to be excluded from the zone if it is deemed to be “detrimental to the public interest, health, or safety.”⁵⁷ In addition, the rental rate for occupying the zone and for the use of services provided by the zone must be reasonable, and the zone must be operated like a public utility.⁵⁸ The Board also has the power to revoke the grant with four months’ notice to the grantee⁵⁹.

2. The 1950 Boggs Amendment to the U.S. Foreign Trade Zones Act of 1934

Congress passed the 1950 Boggs Amendment to the Foreign Trade Zones Act to allow for manufacturing and exhibition in the zones.⁶⁰ This was not permitted in the original 1934 U.S. Foreign Trade Zones Act.⁶¹ Manufacturing in U.S. foreign trade zones increases imports and re-exports. Manufacturing also increases the revenue that foreign countries can receive from the United States due to the increase of imports into the U.S. free trade zones. Exports from the U.S. FTZs result in increases in revenue to the U.S. due to countries buying more exports from the United States.⁶² Exhibiting products in a U.S. FTZ enables the zone to increase its commercial opportunities, increase market imports, re-exports, and transshipments.⁶³

The Boggs Amendment also introduced “foreign privileged status” which allows importers and manufacturers to have duties fixed on merchandise when they enter the foreign trade zone.⁶⁴ The importer can export the product without paying duties and taxes on the finished product.⁶⁵

⁵⁴ *Id.* at § 81(f).

⁵⁵ *Id.* at § 81(c).

⁵⁶ See *infra* notes 322-333. (discussing China’s Shanghai zone’s Negative List). See also *Reform with Chinese Characteristics*, NY Times (Sept. 28, 2013), <http://www.nytimes.com/2013/09/29/opinion/sunday/reform-with-chinese-characteristics.html> (discussing the Shanghai zone).

⁵⁷ See FTZ Act, *supra* note 2, at § 81(o).

⁵⁸ See FTZ Act, *supra* note 2, at § 81(n).

⁵⁹ *Id.* at § 81(r).

⁶⁰ William G. Kanellis, *Reining in the Foreign Trade Zones Board: Making Foreign Trade Zone Decisions Reflect the Legislative Intent of the Foreign Trade Zones Act of 1934*, 15 NW. J. INT’L L. & BUS. 606, 613 (1994-1995).

⁶¹ *Id.*

⁶² Andrusak, *supra* note 13, at 87-88.

⁶³ *Id.* at 88.

⁶⁴ Kanellis, *supra* note 60, at 611.

⁶⁵ *About Foreign-Trade Zones and Contact Info*, *supra* note 4.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

3. The 1952 U.S. Foreign Trade Zones Board Order No. 29

In 1952, the Foreign Trade Zones Board issued Order No. 29.⁶⁶ This Order allows for the creation of “special purpose zones” now referred to as “subzones”.⁶⁷ A subzone allows an FTZ to be created precisely where the company does business, rather than near a port or airport.⁶⁸ There are many such subzones in the United States, where most of the manufacturing in FTZs actually occurs.⁶⁹ The subzones are beneficial to domestic manufacturers who use component parts or raw materials of foreign origin in their operations.⁷⁰

4. The 1984 Amendment to the U.S. Foreign Trade Zones Act of 1934

In 1984, Congress passed another amendment to the U.S. Foreign Trade Zones Act, stipulating that merchandise imported from outside the United States and held in an FTZ or property produced in the United States and held in an FTZ for exportation, is exempt from state and local ad valorem taxes.⁷¹ Thus, while the merchandise is in the FTZ or if it is exported outside the U.S., the merchandise is exempt from taxes.

5. The 1991 Revised U.S. Foreign Trade Zones Board Regulations

The U.S. Foreign Trade Zones Act, as amended, the Foreign Trade Zones Board Orders, and the Foreign Trade Zones Rules and Regulations all govern U.S. tax-free trade zones.⁷² The Board regulations specify the duties and responsibilities of the Board, the procedures for filing a zone application, the procedures for denials of zone users, the types of manufacturing permitted in the zones, the operation of the zones, and other administrative requirements.⁷³ There have only been two revisions to the Board Regulations in over 20 years, once in 1991 and again in 2012.⁷⁴

The 1991 Revised Regulations adopted more specific criteria and procedures for reviewing changes in Customs tariff classifications.⁷⁵ These 1991 Revised Regulations target

⁶⁶ Foreign Trade Zones Board Order No. 29, 17 Fed. Reg. 5316 (1952).

⁶⁷ U.S. INT’L TRADE COMM’N, THE IMPLICATIONS OF FOREIGN TRADE ZONES FOR U.S. INDUSTRIES AND FOR COMPETITIVE CONDITIONS BETWEEN U.S. AND FOREIGN FIRMS, UNITED STATES INTERNATIONAL TRADE COMMISSIONS XIII (1988).

⁶⁸ Bolle & Williams, *supra* note 10, at 3.

⁶⁹ *Id.*

⁷⁰ EARNST & YOUNG, FOREIGN TRADE ZONES HANDBOOK 4 (2013), available at <http://www.austinchamber.com/site-selection/files/E&YFTZHandbook.pdf>.

⁷¹ *Id.*

⁷² DEP’T OF HOMELAND SEC., FOREIGN-TRADE ZONES MANUAL 16 (2011), available at <http://www.cbp.gov/sites/default/files/documents/FTZmanual2011.pdf>.

⁷³ See generally 15 C.F.R. § 400 (2012).

⁷⁴ Dep’t of Commerce & Int’l Trade Admin., *Foreign-Trade Zones Board Update*, INT’L TRADE ADMIN. (Feb. 04, 2015), <http://enforcement.trade.gov/ftzpage/letters/Update-4February2015.html>.

⁷⁵ Dep’t of Commerce & Int’l Trade Admin., *Preamble To The Foreign-Trade Zones Board Regulations*, INT’L TRADE ADMIN. (1991), <http://enforcement.trade.gov/ftzpage/grantee/1991preamble.html> (citing to Summary section) [hereinafter *Preamble To The Foreign-Trade Zones Board Regulations*]

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

subzones, which some people thought had become a threat to domestic industries and violated the “public interest” requirement of the U.S. Foreign Trade Zones Act.⁷⁶ The Board is required to deny zone applications or restrict activity of a zone if the activity is inconsistent with U.S. trade law or policy; if it seriously prejudices U.S. tariff and trade negotiations; or if it involves items subject to quantitative import controls or inverted tariffs, and if the use of zone procedures would be the direct cause of imports that would not have otherwise occurred.⁷⁷

The 1991 Revised Regulations also extend the radius from a port of entry where a general purpose zone could be established from 35 miles to either 60 miles or 90 minutes’ driving time.⁷⁸ These 1991 Revised Regulations insist on a greater burden for the approval of subzones than for general purpose zones.⁷⁹

6. The 2012 Revised U.S. Foreign Trade Zones Regulations

President Barack Obama has encouraged the establishment of foreign trade zones in the United States because he believes they increase domestic manufacturing and increase U.S. exports, two of his major economic goals for the United States.⁸⁰ As a result of his support of U.S. foreign trade zones, new regulations were passed on February 17, 2012, the first time in twenty years.⁸¹ The U.S. Foreign-Trade Zones Board, chaired by the Department of Commerce, issued new regulations designed to improve the FTZ program’s flexibility, responsiveness, and export activity, in order to enhance ease of use and transparency.⁸² The two most important changes in the 2012 Revised Regulations are (1) streamlining the application process for subzones and (2) establishing a combined definition of “production” that incorporates substantial transformation and processing.⁸³

President Obama stressed the importance of reducing unnecessary red tape associated with the regulatory process to promote economic growth, innovation, competitiveness, and job growth for U.S. companies and workers.⁸⁴ The 2012 Revised Regulations improve businesses’ access to FTZs by updating provisions governing the local administration of the zones, and by simplifying and clarifying zone procedures.⁸⁵

In the United States, FTZs may be used to warehouse imported and domestic products.⁸⁶ With specific authority from the Foreign Trade Zones Board, U.S. companies may use FTZs for manufacturing (by incorporating components into different, finished products).⁸⁷ Products warehoused or manufactured in FTZs may be exported or shipped back to the U.S.

⁷⁶ *Id.* (citing to Background section)

⁷⁷ See Andrusak, *supra* note 13, at 89.

⁷⁸ *Id.*

⁷⁹ *Preamble To The Foreign-Trade Zones Board Regulations*, *supra* note 75, at § 400.23(b).

⁸⁰ WHITE HOUSE OFFICE OF THE PRESS SEC’Y, PRESIDENT OBAMA TAKES ACTIONS TO PROMOTE AMERICAN MANUFACTURING AND INCREASE U.S. EXPORTS AT BOEING (Feb. 17, 2012) [hereinafter WHITE HOUSE PRESS].

⁸¹ Foreign Trade Zones Board Revised Rules and Regulations, 77 FED.REG. 12112 (Feb. 28, 2012).

⁸² See Fact Sheet: *New Foreign-Trade Zones Regulations*, *supra* note 5.

⁸³ See *id.*

⁸⁴ See WHITE HOUSE PRESS, *supra* note 80.

⁸⁵ *Preamble To The Foreign-Trade Zones Board Regulations*, *supra* note 75.

⁸⁶ *FACT SHEET: New Foreign-Trade Zones Regulations*, *supra* note 5.

⁸⁷ *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

market.⁸⁸ If products manufactured in FTZs are exported, they enjoy tariff-free status upon exportation.⁸⁹ Companies located in and using the facilities of U.S. FTZs currently employ nearly 330,000 U.S. workers and export approximately \$30 billion a year in merchandise.⁹⁰

The new regulations significantly streamline the procedures and timeframe for issuing the required advance approval for manufacturing in U.S. FTZs.⁹¹ The new regulations will reduce the ordinary processing time for notifications by two-thirds to 120 days, compared to the 12 months it used to take.⁹² The 2012 Revised Regulations include a “public comment period,” so that in the event trade issues arise regarding the proposed manufacturing activity, the Foreign Trade Zone Board will be able to conduct a more extensive “application” process.⁹³ The new regulations also streamline procedures for designating locations as “subzones” for individual companies’ use.⁹⁴ A subzone is an extension of a FTZ to a location for a specific company’s use.⁹⁵ The ordinary application processing time for subzones is now cut in half from 10 months to 5 months or less.⁹⁶

B. Definitions of FTZs

The definition of a free trade zone, as well as proposed guidelines and standards for them, are contained in the Revised Kyoto Convention of the World Customs Organization (“WCO”).⁹⁷ Tax-free trade zones, (“FTZs”)⁹⁸ also known as special economic zones (“SEZs”), are public or private duty-free areas where goods may be warehoused, processed, sold, serviced, distributed, showcased, packaged, labeled, sorted, assembled and/or manufactured as finished goods prior to re-exporting them as duty-exempt finished products.⁹⁹

FTZs exist in the United States, but are referred to there as “foreign trade zones” rather than “free trade zones”.¹⁰⁰ Some economists refer to tax-free trade zones generically as “special economic zones,” in order “to describe the broad range of modern economic

⁸⁸ *Id.*

⁸⁹ CONG. RESEARCH SERV. R42686, *supra* note 31 (citing to Summary portion).

⁹⁰ Dep’t of Commerce & Int’l Trade Admin. *Foreign-Trade Zones Enhance U.S. Competitiveness, Grow Economy*, INT’L TRADE ADMIN. (Dec. 30, 2010), <http://www.trade.gov/press/press-releases/2010/foreign-trade-zones-enhance-us-competitiveness-grow-economy-123010.asp>.

⁹¹ *FACT SHEET: New Foreign-Trade Zones Regulations*, *supra* note 5.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ Annex D of the International Convention on the Harmonization and Simplification of Customs (revised in 1999) defines a free zone as “part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs Territory...and not subject to the usual Customs control.” See WB 2008 Report, *supra* note 20, at 2, 9 n. 4.

⁹⁸ See generally TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1 (defining free trade zones, and including an encyclopedic listing and description of each of the 277 zones in the United States, with contact information and useful websites in the Appendix).

⁹⁹ DIAMOND & DIAMOND, *supra* note 16, at 1.

¹⁰⁰ WB 2008 Report, *supra* note 20, at 2.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

zones.”¹⁰¹ SEZs are defined as “geographically delimited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined Customs procedures...) to businesses which are physically located within the zone.”¹⁰² SEZs offer different and more advantageous rules of doing business with respect to “investment conditions, international trade and Customs, taxation, and the regulatory environment.”¹⁰³ Generally, a free trade zone provides a more liberal business environment.¹⁰⁴

Foreign importers and U.S. exporters engaging in international business often use tax-free trade zones in order to benefit from fiscal incentives and lower local labor standards and wages.¹⁰⁵

Both importers and exporters benefit from FTZs because both save on taxes, reduce transportation costs, avoid financing charges, and thereby increase their business cash flow. Exporters see FTZs as an entry into foreign markets, a vehicle to defer or avoid Customs duties, and a way to obtain income tax exemptions or reductions. FTZs offer special Customs treatment that is designed to stimulate international trade.¹⁰⁶

C. Types of FTZs

While there are at least five different types of tax-free trade zones, they all fall into one of the three following stereotypes: (1) a small or large “fenced-in industrial estate in a developing country, populated by ... multinational corporations enjoying tax breaks, with laborers,” mostly women, toiling in sweatshops and “in garment factories... in substandard conditions”; (2) an entire modern cosmopolitan city designated as a SEZ (like Shenzhen or Hong Kong in China); or (3) a port that serves as a base for many types of trade-related activities.¹⁰⁷

There are five types of free trade zones, which will be defined more fully later: free trade zones (commercial-free zones); traditional export processing zones (“EPZs”) for export manufacturing only; free enterprises (single unit EPZs); hybrid EPZs (where only part of a large area is an EPZ), and free port special economic zones whose objective is to achieve integrated development.¹⁰⁸

D. Goals of U.S. FTZs

Tax-free trade zones in the United States have four basic policy objectives: (1) to attract foreign direct investment; (2) to alleviate unemployment; (3) to foster economic reform strategies by developing and diversifying exports; and (4) to test new approaches to

¹⁰¹ See, e.g., WB Report 2011, *supra* note 17, at 3.

¹⁰² WB 2008 Report, *supra* note 20, at 2.

¹⁰³ WB 2011 Report, *supra* note 17, at 3.

¹⁰⁴ See *id.*

¹⁰⁵ *Id.* at 4.

¹⁰⁶ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 159.

¹⁰⁷ WB 2011 Report, *supra* note 17, at 1.

¹⁰⁸ WB 2008 report, *supra* note 20, at 10-11.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

foreign direct investment and to policies related to law, land, labor, and the pricing of goods.¹⁰⁹ Tax-free trade zones generate foreign exchange through exports and create economic value added.¹¹⁰

E. How the U.S. FTZ Works

Authority for establishing an FTZ in the United States is granted by the *Foreign Trade Zone Board* ("the Board") under the U.S. Foreign Trade Zones Act of 1934, as amended (19 U.S.C. 81a–81u).¹¹¹ The Executive Secretariat of the Board is located in the Import Administration of the U.S. Department of Commerce in Washington, D.C.¹¹² Foreign trade zones are subject to the laws and regulations of the United States as well as the laws of the states and communities in which these zones are located.¹¹³

In a free trade zone, the standard formal *customs entry procedures* and payments of duties are not required for foreign merchandise unless, and until, it enters Customs Territory for domestic consumption.¹¹⁴ At that point, the importer has the choice of paying duties at the rate of either the original foreign materials or the finished product.¹¹⁵ "Domestic goods moved into the zone for export may be considered exported upon admission to the zone for purposes of excise tax rebates and drawbacks."¹¹⁶ "FTZs are sponsored by qualified public or private corporations."¹¹⁷ "Operations of the FTZ are conducted on a public utility basis with published rates."¹¹⁸ Free trade zones are divided into *general purpose zones* and *subzones*.

"General purpose zones" involve public facilities that can be used by more than one firm.¹¹⁹ They are usually located in industrial parks or ports, and they are used by small and medium-sized businesses that lease space for storage, warehousing, distribution, processing or assembly of merchandise.¹²⁰ Generally, the warehousing buildings provide access to various modes of transportation.¹²¹

¹⁰⁹ WB 2011 Report, *supra* note 17, at 4.

¹¹⁰ *Id.* at 8.

¹¹¹ See FTZ Act, *supra* note 2. See also Foreign-Trade Zones Bd., 57th Annual Report of the Foreign-Trade Zones Board to the Congress of the United States 1 (Sept. 30, 1995), <http://ia.ita.doc.gov/ftzpage/ftzar-95.html> [hereinafter 57th Annual Report].

¹¹² Foreign-Trade Zones Bd., 58th Annual Report of the Foreign-Trade Zones Board to the Congress of the United States 1 (Sept. 30, 1996), <http://enforcement.trade.gov/ftzpage/ftzar-96.html>.

¹¹³ *Id.*

¹¹⁴ Greg Jones, U.S. Foreign-Trade Zone Program Use Grows Among U.S. Based Manufacturing Operations, FOREIGN TRADE ZONE CORP. (Sept. 15, 2010), <http://www.ftzcorp.com/ArticleDetails/tabid/210/ArticleID/12/Default.aspx> [hereinafter U.S. FTZ Program Grows].

¹¹⁵ *Id.*

¹¹⁶ 57th Annual Report, *supra* note 111, at 1.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ Glossary of FTZ Terms, U.S. FOREIGN-TRADE ZONES BD., <http://enforcement.trade.gov/ftzpage/grantec/glossary.html> (defining "subzones") [hereinafter Glossary of FTZ Terms].

¹²¹ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 2.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

Subzones are sponsored by general purpose zones. Subzones are private plant sites authorized by the Board and sponsored by a grantee for operations that typically cannot be accommodated within an existing general purpose zone.¹²² The subzone is usually only one firm's site that is used for more extensive manufacturing, processing or warehousing and distribution of goods.¹²³ Most export activity emanates from subzones.¹²⁴ Subzones enable an existing business to declare tax-free status without having to move away its plant to the location of the general purpose zone usually near a seaport or airport.¹²⁵

Special purpose zones are established as part of a zone project for a limited purpose that cannot be accommodated within an existing general purpose zone.¹²⁶

An *empowerment zone* is similar to an *enterprise zone*. An empowerment zone is a highly distressed urban or rural community which may be eligible for a combination of grants, tax credits for businesses, bonding authority, and other benefits under the U.S. Empowerment Zone Program.¹²⁷ This program is primarily managed through partnerships between the local entity and either the Department of Housing and Urban Development ("HUD") for urban empowerment zones or the U.S. Department of Agriculture ("USDA") for rural empowerment zones. Qualifying businesses located in empowerment zones are eligible for employment tax credits, low cost loans, increased Section 179 tax deductions, partial-exclusion of tax on capital gains upon the sale of certain assets, and other economic benefits.¹²⁸ The empowerment zone employment credit provides businesses with an incentive to hire individuals who both live and work in an empowerment zone.¹²⁹

A free trade zone in the U.S. may apply for the authority to reorganize itself into an *alternative site framework* referred to as an "ASF". The ASF is an option for grantees to establish an FTZ or reorganize an existing general-purpose zone.¹³⁰ This reorganization can permit significantly greater flexibility in the designation of new "usage-driven" FTZ sites for operators or users located within a grantee's service area.¹³¹ Without the ASF program, and before the 2012 Revised FTZ Regulations were passed, an application to establish an FTZ or to increase the size of an existing FTZ could take approximately three months.¹³²

¹²² *Id.*

¹²³ *Id.* at 2-3.

¹²⁴ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 161.

¹²⁵ *About Foreign-Trade Zones and Contact Info*, *supra* note 4.

¹²⁶ *General Definitions*, FOREIGN-TRADE ZONE RES. CTR., http://www.foreign-trade-zone.com/g_definitions.htm (last visited Feb. 15, 2014) (defining "special purpose zones") [hereinafter *General Definitions*].

¹²⁷ U.S. GOV'T ACCOUNTABILITY OFFICE, EMPOWERMENT ZONE AND ENTERPRISE COMMUNITY PROGRAM: IMPROVEMENTS OCCURRED IN COMMUNITIES, BUT THE EFFECT OF THE PROGRAM IS UNCLEAR 6 (Sept. 22, 2006).

¹²⁸ *Id.* at 8.

¹²⁹ *Id.* at 27.

¹³⁰ *Ensuring Your Foreign-Trade Zone Alternative Site Management Framework is a Success*, FOREIGN-TRADE ZONE CORP., <http://www.ftzcorp.com/ftz-services/alternative-site-management-framework-asf.aspx> (last visited July 29, 2015).

¹³¹ Foreign-Trade Zone 8-Toledo, Ohio Application for Reorganization (Expansion of Service Area) Under Alternative Framework, 80 Fed. Reg. 33479, 33479-33480 (June 12, 2015).

¹³² TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 3.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

A *grantee* of a zone is a corporation that is granted permission by the Foreign Trade Zones Board to establish, operate, and maintain a foreign trade zone.¹³³ Grantee corporations must be either public corporations including a state, a political subdivision, public agency, corporate municipal instrumentality of one or more states or private corporations organized for the purpose of establishing a zone project.¹³⁴ Qualified private corporations must be chartered for this purpose under a law of the state in which the zone is located.¹³⁵ The responsibilities of a grantee of a FTZ project are set forth in the U.S. Foreign Trade Zones Act, the Foreign Trade Zones Board Regulations, and the U.S. Customs Regulations.¹³⁶

The grantee files all applications with the Foreign Trade Zones Board. In addition to the original application to establish a FTZ and a zone project, the grantee files all applications to expand the zone and establish subzones. The grantee also files requests such as minor boundary modifications that can be handled by the Foreign Trade Zones Board as an administrative action.¹³⁷

The grantee is responsible for site selection and maintenance of zone facilities. The grantee must make sure the entire zone project is operated under public utilities principles. The grantee is responsible for filing all annual reports to the FTZ Board. Moreover, the grantee must maintain the following documents concerning the zone project: grant of authority, Board Orders, applications/requests submitted to the FTZ Board including applications, boundary modification requests, manufacturing/processing requests, and grantee/operator agreements. The grantee may choose an operator of the zone or decide to act as the zone operator him or herself.¹³⁸

The zone *operator* is chosen by the grantee, and the operator is required by Customs to be bonded.¹³⁹ "The grantee decides who will run the zone and what services the zone project will offer."¹⁴⁰ A zone operator may be a warehouse person, a real estate developer, or an administrator of the zone.¹⁴¹ "Some FTZ grantees elect to operate the general purpose zone themselves in order to maintain the greatest direct control over the zone operations."¹⁴² However, this choice makes the grantee/operator liable. "Some grantees subcontract the responsibility to operate the general purpose zone to a separate company in an attempt to distance themselves from substantial liability."¹⁴³

¹³³ *Glossary of FTZ Terms*, *supra* note 120 (defining "grantee").

¹³⁴ *Grantee Information*, U.S. FOREIGN-TRADE ZONES BD., <http://cnforccment.trade.gov/ftzpage/grantee.html> (last visited July 29, 2015).

¹³⁵ *FTZ Glossary of Terms*, PORT AUTH. OF NY & NJ, <https://www.panynj.gov/port/ftz-glossary-terms.html> (last visited July 29, 2015) (defining "grantee").

¹³⁶ *Responsibilities of the Zone Grantee*, FOREIGN TRADE ZONE RES. CTR., http://www.foreign-trade-zone.com/grantee_respon.htm (last visited July 29, 2015).

¹³⁷ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 3-4.

¹³⁸ *Id.*

¹³⁹ *Id.* at 4.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

Manufacturing in a FTZ refers to activity involving the “substantial transformation” of a foreign article resulting in a new and different article having a different name, character, and use.¹⁴⁴ This substantial transformation can affect the “origin” of the merchandise for purposes of Customs and tariffs. *Merchandise that is received* into a FTZ space in the United States includes both *foreign status merchandise* and *domestic status merchandise*.¹⁴⁵

Domestic status merchandise (also referred to as “domestic status inputs”) is the Customs status¹⁴⁶ for domestic-origin and duty-paid foreign-origin zone merchandise.¹⁴⁷ “Foreign status merchandise” (also referred to as “foreign status inputs”) is merchandise admitted to a zone site under United States Customs and Border Protection supervision that is normally of foreign origin.¹⁴⁸ Foreign status merchandise is admitted to zone sites without being subject to formal Customs entry procedures and payment of duties, unless and until the foreign merchandise enters Customs Territory for domestic consumption.¹⁴⁹

Foreign status merchandise is either *non-privileged foreign* or *privileged foreign* merchandise. “Privileged foreign status” is one of two Customs categories of foreign status merchandise.¹⁵⁰ “Privileged foreign status” applies to merchandise of foreign origin when classified and appraised with duties liquidated and taxes determined as of the date the application for this status is approved.¹⁵¹ Privileged foreign status allows the importer to alter or manufacture merchandise into new products without changing (for duty-assessment purposes) the original product classification.¹⁵² Foreign status merchandise maintains its status based on its condition when admitted to the zone.¹⁵³ When the merchandise is shipped from the zone to the U.S. market and is entered for consumption by the Customs and Border Protection, it is evaluated based on its condition at the time of admission, even though it might have undergone a transformation in the zone.¹⁵⁴ Prior to any manufacture or manipulation of the merchandise (which could change its tariff classification) an importer may apply to the port director to have imported merchandise in the zone given privileged foreign status.¹⁵⁵ After classification, appraisal, and transfer from the zone of the merchandise for U.S. consumption, either in its original state or after it is manufactured, the applicable duties and taxes would be paid based on the rate established when foreign privileged status

¹⁴⁴ See generally Dep’t. of Homeland Sec. & U.S. Customs & Border Prot., *Foreign Trade Zones (FTZ): Manufacturing Technical Information for Pre-Assessment Survey (TIPS)*, U.S. CUSTOMS & BORDER PROT. (Oct. 2003),

http://www.cbp.gov/linkhandler/cgov/trade/trade_programs/audits/focused_assessment/fap_documents/cxh5k1.ctt/cxh5k1.pdf. See RALPH H. FOLSOM ET. AL., INTERNATIONAL TRADE AND INVESTMENT IN A NUTSHELL 114 (1996). See also “Rule of Origin” in 19 U.S.C.A § 2518(4)(B) (discussing “substantial transformation”).

¹⁴⁵ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 4.

¹⁴⁶ FTZ Act, *supra* note 2.

¹⁴⁷ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 4.

¹⁴⁸ *Glossary of FTZ terms*, *supra* note 120 (defining “foreign status”).

¹⁴⁹ *Id.*

¹⁵⁰ See *id.* See also FTZ Act, *supra* note 2.

¹⁵¹ *General Definitions*, *supra* note 126 (defining “privileged foreign status”).

¹⁵² TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 4.

¹⁵³ *Glossary of FTZ Terms*, *supra* note 120 (defining “Privileged Foreign (PF) Status”); TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 4.

¹⁵⁴ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 4.

¹⁵⁵ *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

was granted.¹⁵⁶ Privileged foreign status cannot be abandoned even though the form of the merchandise has been changed.¹⁵⁷ However, this status cannot be granted to non-privileged foreign merchandise, which has previously been manufactured in a zone.¹⁵⁸

Non-privileged foreign status is the second of the two Customs categories of foreign status merchandise. Non-privileged foreign status applies to merchandise of foreign origin, but it can also apply to certain domestic merchandise which, because of its non-compliance with foreign trade zone regulations, has lost its domestic status.¹⁵⁹ "Non-privileged foreign status allows zone users to pay duty based on the character, condition, and quantity of the merchandise at the time it enters Customs Territory for consumption or for Customs bonded warehousing."¹⁶⁰ Articles composed entirely of, or derived entirely of, non-privileged merchandise are classified and appraised in their condition at the time of transfer into the Customs Territory.¹⁶¹ Non-privileged foreign status is a residual category for merchandise which does not have privileged or zone restricted status.¹⁶²

FTZs provide relief from *inverted tariff rates*.

Inverted tariff [rates] penalize companies for making their products in the [U.S.] The [] FTZ Program enables companies to apply to the FTZ Board for the authority to obtain relief from inverted tariffs when a component item or raw material is subject to a higher duty rate than the finished product. [Thus], the importer of the finished product pays a lower duty rate than [the] manufacturer of the same product in the United States. This gives the importer an unfair advantage...over the domestic manufacturer. The Foreign-Trade Zones Program [evens] the playing field[.]¹⁶³

F. Free Trade Zone vs. Free Trade Area

There is a difference between a free trade zone and a free trade area. For example, the areas in the North American Free Trade Agreement (NAFTA)¹⁶⁴ and the European Union (EU)¹⁶⁵ are free trade areas.

¹⁵⁶ *Introduction to the Foreign Trade Zone- FTZ Procedures, Privileged Foreign Status*, INT'L BUS. AND TRADE HELP CTR., <http://www.importexporthelp.com/foreign-trade-zone.htm> (last visited July 29, 2015) (describing the process of obtaining privileged foreign status).

¹⁵⁷ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 4.

¹⁵⁸ *Id.*

¹⁵⁹ 19 C.F.R. § 146.42 (2013).

¹⁶⁰ *What Happens in Foreign Trade Zones*, HAWAII FOREIGN TRADE ZONE NO. 9, <http://www.ftz9.org/index.php?action=21> (select "What Happens in Foreign-Trade Zones?" under FAQ Section, located on the bottom of the site) (last visited July 29, 2015).

¹⁶¹ Dep't of Homeland Sec. & U.S. Customs & Border Prot., *Non-Privileged Foreign Status*, About Foreign-Trade Zones & Contact Info, U.S. CUSTOMS & BORDER PROT., http://www.cbp.gov/xp/cgov/trade/cargo_security/cargo_control/ftz/about_ftz.xml (last visited July 29, 2015).

¹⁶² U.S. BUS. LAW HANDBOOK: STRATEGIC INFO. AND LAWS, 88 (Int'l Bus. Pub. 2013).

¹⁶³ *Relief from Inverted Tariff When Manufacturing in a Foreign-Trade Zone or Subzone*, FOREIGN-TRADE ZONE CORP., <http://www.ftzcorp.com/foreign-trade-zone-benefits/relief-from-inverted-tariffs.aspx> (last visited July 29, 2015).

¹⁶⁴ North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

With the signing of NAFTA, all duties on goods traded among Canada, Mexico, and the United States were eliminated.¹⁶⁶ Although some concern was expressed about the future of free trade zone operations and their role in facilitating world trade in the light of the development of free trade areas such as NAFTA and the EU, NAFTA and other free trading areas created around the globe have not impeded the flow of trade into or out of the traditional free trade zones located in designated areas within a host country.¹⁶⁷

For instance, in the case of Mexico, the long-established *maquiladora* along the border with the United States has not diminished in importance since the signing of NAFTA.¹⁶⁸ Foreign investments did not move out; instead, they have supplemented their *maquiladora* facilities (which are all FTZs) with new plants in urban sectors of Mexico where low-cost labor is also available.¹⁶⁹ Nevertheless, objections to NAFTA have been raised by powerful United States labor unions pressuring Washington to terminate USAID and other government agency payments designed to fund export-processing zones overseas.¹⁷⁰

G. Performance of U.S. Foreign Trade Zones

In July 2012, the National Association of Foreign-Trade Zones reported substantial growth in merchandise received in the United States zones and goods exported from United States tax-free zones.¹⁷¹ The International Automotive Manufacturing industry, which has shown a miraculous resurgence in recent years, leads in zone export growth, and Texas, one of the most business-friendly states in the United States, actually leads all states in zone activity.¹⁷²

As is true of the marked increase in FTZs in China, there has been a steady increase in zone activity in the United States.¹⁷³ For example, in 2008, the Foreign Trade Zones Board approved one new general purpose zone and 20 new subzones; in 2009 the Board approved two new general purpose zones and 26 new subzones.¹⁷⁴ According to the 70th Annual Report of the FTZ Board, “[t]he combined value of shipments into general purpose zones and subzones totaled over \$692 billion [in 2009], compared with \$502 billion in the previous year [2008] . . . General purpose sites received nearly \$75 billion in merchandise. Total shipments

¹⁶⁵ *North American Free Trade Agreement (NAFTA)-duties, benefits*, REFERENCE FOR BUS., <http://www.referenceforbusiness.com/encyclopedia/Mor-Off/North-American-Free-Trade-Agreement-NAFTA.html> (last visited July 29, 2015).

¹⁶⁶ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 5.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ M. ANGELES VILLARREAL, CONG. RESEARCH SERV., RL32934, *U.S.-MEXICO ECONOMIC RELATIONS: TRENDS, ISSUES, AND IMPLICATIONS* 9 (Jan. 25, 2012); TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 6.

¹⁷⁰ WB 2008 Report, *supra* note 20, at 23.

¹⁷¹ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 167.

¹⁷² Brian Hannigan & Brian Picone, *Foreign-Trade Zones a Bright Spot in U.S. Economic Recovery*, Study Shows GLOBENEWSWIRE (July 18, 2013, 3:10PM), <http://globenewswire.com/news-release/2012/07/18/273850/262649/en/Foreign-Trade-Zones-a-Bright-Spot-in-U-S-Economic-Recovery-Study-Shows.html>.

¹⁷³ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 167.

¹⁷⁴ Foreign-Trade Zones Bd., *70th Annual Report of the Foreign-Trade Zones Board to the Congress of the United States* 1 (2009), <http://ia.ita.doc.gov/ftzpage/annualreport/ar-2008.pdf>.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

received at subzone sites amounted to over \$617 billion.”¹⁷⁵ Exports from foreign trade zones were \$40 billion.¹⁷⁶ Moreover, foreign trade zones in the United States employed over 330,000 persons in 2009.¹⁷⁷ The oil refining, automotive, pharmaceutical, and electronic products industries are heavy users of U.S. foreign trade zones.¹⁷⁸ These statistics indicate a successful performance of U.S. foreign trade zones.

The 71st Annual Report of the FTZ Board also showed that exports from the U.S. to foreign countries from facilities operating under FTZ procedures amounted to more than \$28 billion in 2009.¹⁷⁹ It should be noted that this figure does not include certain indirect exports involving FTZ merchandise that undergoes further processing in the U.S. at non-FTZ sites prior to export.¹⁸⁰ U.S. FTZ activity tends to involve domestic operations that combine foreign and domestic inputs.¹⁸¹

Despite the plethora of bilateral trade agreements and the fall in U.S. tariff rates, which have increased the importation of foreign products into the U.S., the use of U.S. foreign trade zones has grown significantly since the 1970s when there were only eight U.S. foreign trade zone projects in the U.S.¹⁸² Today, there are 277 zones and more than 250 active special-purpose subzones.¹⁸³ The total zone-related manufacturing activity exceeds \$400 million a year.¹⁸⁴

U.S. FTZs enable companies to reduce or eliminate duties on products produced for domestic consumption.¹⁸⁵ This is called the “tariff rate rationalization” benefit in the U.S. where the inverted tariff is eliminated.¹⁸⁶ “An inverted tariff relationship exists when the duty rate for an imported component or raw material is higher than that which would apply to an import of the finished product into which the component or raw material is incorporated.”¹⁸⁷ If the inverted tariff rate applies, the U.S.-based manufacturer would be better off moving manufacturing operations offshore.¹⁸⁸ Another solution to this problem is to move the U.S.-based manufacturer’s operation into an FTZ, which would also do away with the negative effects of the inverted tariff rate.¹⁸⁹

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 2; Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 168.

¹⁷⁸ Foreign-Trade Zones Bd., *71st Annual Report of the Foreign-Trade Zones Board to the Congress of the United States* 2 (2010), <http://ia.ita.doc.gov/ftzpage/annualreport/ar-2009.pdf>. [hereinafter *71st Annual Report of the FTZ Board*].

¹⁷⁹ *Id.* at 2.

¹⁸⁰ Town of Islip, *Islip Foreign Trade Zone #52*, <http://www.ftz52.com/blog/66-the-value-of-increased-exports-through-ftzs> (last visited July 29, 2015); Foreign-Trade Zones Bd., *62nd Annual Report of the Foreign-Trade Zones Board to the Congress of the United States* 1 (Sept. 30, 1999), <http://enforcement.trade.gov/ftzpage/ftzar-99.html>.

¹⁸¹ *71st Annual Report of the FTZ Board*, *supra* note 178.

¹⁸² *See id.*

¹⁸³ *See id.*

¹⁸⁴ *See id.*

¹⁸⁵ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 8.

¹⁸⁶ *See generally* *U.S. Foreign-Trade Zone Program Use Grows*, *supra* note 114.

¹⁸⁷ *See id.*

¹⁸⁸ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 8.

¹⁸⁹ *Id.*

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

Since FTZs in the U.S. can reduce costs for U.S.-based businesses and incentivize exportation of U.S. products, the FTZs may even help to keep factories open and maintain value-added economic activity in the U.S.¹⁹⁰

H. Economic Benefits from FTZ Development in the U.S.

The economic benefits from zone development include the following: direct and indirect employment creation and income generation; export growth and export diversification; increased foreign exchange earnings; increased foreign direct investment, increased earning of government revenues, upgrading of employees' skills, increased employment of females, increased technology transfers, increased regional development, and "demonstration effect" arising from the application of "best practices" in the zones.¹⁹¹ "Today's version of the Customs duty-free zone offers many more advantages to business people than were ever dreamed of in ancient and medieval times."¹⁹²

More specific business benefits derived from using a free trade zone are as follows: absence of Customs formalities; improved cash flow;¹⁹³ owner access to merchandise; showroom space availability;¹⁹⁴ accounting advantages ("Because invoices are not completed until the goods are sold, the zone user who holds title to the merchandise while on display does not have to show the sale in his books until it is actually made."¹⁹⁵ This may mean postponement of taxes to a more convenient taxable year for reporting the earnings.¹⁹⁶); reduced insurance and duty costs¹⁹⁷ (savings on insurance premiums for goods in storage in the zone can be considerable); easier assembly of domestic goods with foreign goods¹⁹⁸ (which may enable the exporter to put a "Made in U.S.A." label on the finished product); access to an ideal location for the manufacture of goods¹⁹⁹ at a lower cost to the business; easier processing or manipulation of goods²⁰⁰; convenient services for packing, repacking, and labeling of goods²⁰¹; ease of discarding substandard goods²⁰²; and ease of handling a wide variety of products.²⁰³ Import quotas do not apply in most free trade zones.²⁰⁴

¹⁹⁰ See generally *id.*

¹⁹¹ WB 2008 Report, *supra* note 20, at 34.

¹⁹² Diamond, *supra* note 16, at 17.

¹⁹³ See *U.S. Free-Trade Zone Program Grows*, *supra* note 114, at 1.

¹⁹⁴ *Id.*

¹⁹⁵ Diamond, *supra* note 16, at 17.

¹⁹⁶ *Id.*

¹⁹⁷ See generally *Foreign Trade Zone (FTZ) #220, SOUTH DAKOTA PORT U.S.A.* 21, <http://www.internationalportinfo.com/services/foreigntradezone#ftz2>. See also TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 695-696.

¹⁹⁸ See generally George Hanks & Lucinda Van Alst, *Foreign Trade Zones* (includes related article on history of foreign trade zones), 80 MGMT. ACCT. U.S.A 20, 20-23 (1999) [hereinafter Hanks & Van Alst].

¹⁹⁹ *Id.* at 22.

²⁰⁰ *Id.* at 21-23.

²⁰¹ *Operations in the Colon Free Trade Zone*, BUS. PANAMA, <http://www.businesspanama.com/investing/opportunities/cfz.php> (last visited July 29, 2015).

²⁰² Hanks and Van Alst, *supra* note 199, at 21-23.

²⁰³ See Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 186.

²⁰⁴ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 21.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

Merchandise subject to quotas may be imported into a free trade zone and manufactured into a product for which there are no quota limitations.²⁰⁵

The United States Treasury Department amended the Customs Regulations so that overhead and labor costs are excluded from the dutiable value of goods assembled, manufactured, or manipulated in the United States foreign trade zones.²⁰⁶ Profits are also excluded.²⁰⁷ Tenants who manufacture or assemble in a zone such products as automobiles and motorcycles are subject to a lower tariff on the end product.²⁰⁸

The transfer of bonded merchandise may be expeditiously handled at free trade zones because Customs Officers are located on the spot.²⁰⁹ Thus, goods may be exported with a minimum of delay. In this way, the foreign trader is able to benefit from immediate recovery of taxes previously paid when the bond was cancelled or when the time limit applicable to a bonded warehouse has expired.²¹⁰

Because of the easy availability of Customs officers located at U.S. foreign trade zones, prompt recovery of duties or state taxes paid may be obtained when merchandise is entered into the zone for exportation at a later date.²¹¹ Moreover, goods stored or warehoused in a U.S. foreign trade zone have added protection against theft of the merchandise.²¹²

Besides all these advantages, the greatest benefit for business is the favorable tax treatment of zone users and the avoidance of double taxation.²¹³

I. U.S. Government Guarantees to Users of Foreign Trade Zones

Under the United States Foreign Trade Zones Act, as amended, the United States guarantees that there will be no Customs or excise taxes in the foreign trade zones.²¹⁴ The U.S. government guarantees the free convertibility of currency and does not restrict transfers of capital and profits.²¹⁵ Export credit guarantees are available from the Export-Import Bank of Washington, and export credits insurance guarantees may be granted by the Foreign Credit Insurance Association in amounts up to 95% of political risk and 90% of commercial risk covered.²¹⁶

²⁰⁵ *Id.*

²⁰⁶ See generally Treasury Department New Foreign Trade Zone Rule on Appraisalment, 45 Fed. Reg. 17976 (March 20, 1980).

²⁰⁷ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 21.

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ Dep't of Homeland Sec., U.S. Customs & Border Prot., *Foreign Trade Zones: U.S. Customs Procedures and Requirements*, U.S. CUSTOMS & BORDER PROT. (2010), http://www.cbp.gov/linkhandler/cgov/newsroom/publications/trade/foreign_trade.ctt/foreigntradezones.pdf.

²¹² TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 22.

²¹³ See Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1 (discussing the tax advantages of using foreign trade zones).

²¹⁴ See FTZ Act, *supra* note 2.

²¹⁵ *Id.*

²¹⁶ See *id.*

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

J. Bonded Warehouses vs. Free Trade Zones

Some legal scholars claim that some of the Chinese free trade zones are nothing more than “bonded warehouses”.²¹⁷ For the past two decades since the use of free trade zones has become more and more popular, many people ask this question: “What is the difference between a free trade zone and a Customs-bonded warehouse?” Most Customs laws around the world have built-in provisions for bonded storage exemptions and the rebate of duties on materials used in re-exports.²¹⁸ The Customs-free benefits ordinarily operate in conjunction with a country’s specific free trade zone aspirations.²¹⁹ However, rebates based on re-exportation from a Customs Territory may be accelerated when goods are placed in a zone destined for export.²²⁰

Because of lack of space or technology, bonded warehouse facilities ordinarily do not offer such important services as assembly, processing, manufacturing or even such less complex facilities as mixing, labeling, and other forms of minor manipulation.²²¹ In addition, there are no restrictions or penalties for goods left at free trade zones for periods exceeding 90 days, whereas restrictions do exist in some bonded warehouses.²²² Customs officials must make special visits to bonded warehouses in contrast to permanent assignments at free trade zones.²²³ Most free trade zones are created to attract commercial operations that otherwise would be carried out in other countries for Customs reasons.²²⁴ This is clearly seen in the savings from trans-shipment costs and time.²²⁵ In other cases, zones are established purely for their shelter plans when licensing operations may be carried out or when processing or manufacturing is not feasible.²²⁶

In conclusion, U.S. foreign trade zones have one well-administered federal statute that has been amended to permit manufacturing and exhibiting in the tax-free zones.²²⁷ A Foreign Trade Zones Board has been created and issues orders and regulations to enable the zones to increase exports, encourage foreign direct investment, facilitate international trade, and employ American workers.²²⁸ There is little if any evidence of local corruption or poor enforcement of the federal statute or Board regulations.²²⁹ The U.S. foreign trade zones work quite differently from bonded warehouses because they provide very sophisticated services, favorable tax treatment, and exemption from duties if the merchandise is exported from the

²¹⁷ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 43.

²¹⁸ See generally *Foreign Trade Zones v. Customs Bonded Warehouses*, V.T. GLOBAL TRADE P’SHP (2012), <http://accd.vermont.gov/sites/accd/files/Documents/business/vgtip/ComparisonofFTZvsCBW.pdf> [hereinafter ACCD].

²¹⁹ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 46.

²²⁰ ACCD, *supra* note 218, at 2.

²²¹ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 46.

²²² ACCD, *supra* note 218, at 2.

²²³ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 46.

²²⁴ *Id.*; See generally Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 154.

²²⁵ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 46.

²²⁶ ACCD, *supra* note 218, at 2.

²²⁷ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 48.

²²⁸ *Id.*

²²⁹ See generally Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 167.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

zone.²³⁰ In order to serve their public purpose, the U.S. foreign tax-free trade zones should be administered as an integral part of the economic development program of the community where they are located. Only in this way can free trade zone services be intertwined with the other resources and incentives of the U.S. effort to reduce unemployment, stimulate international trade, earn foreign exchange, and make a positive contribution toward the nation's trade and payments balances. More importantly, when a tax-free trade zone is used properly, the operational and tax savings to importers, exporters, and bankers all over the world can mean the difference between success and failure for international businesses.

III. FTZS IN CHINA²³¹

In keeping with its more receptive attitude toward the outside world since 1979, the People's Republic of China continues to try to emulate advanced nations by establishing export processing zones.²³² One such zone is at Shenzhen just north of Hong Kong's New Territories.²³³

"Special economic zones were established by China to serve as 'demonstration areas' for policy reforms and to encourage foreign investment. The economic impact of these free trade zones in China has been enormous, transforming entire regions and economies."²³⁴ Shenzhen, for example, has been transformed from a "small, sleepy fishing village into a thriving urban metropolis."²³⁵ Shenzhen has an export-oriented economy. In 2003, Shenzhen had an export value of \$48 billion (14 percent of the Chinese National Economy), \$30 billion in foreign direct investment, and 3 million people directly employed there.²³⁶ While the whole city of Shenzhen is now a free trade zone, Shenzhen also includes a separately administered area named Shekou.²³⁷

A third free trade zone in China is at Xiamen (Amoy Island), while a fourth is in the Zhuhai municipality near Macau, whose entire territory is a free zone.²³⁸ A fifth zone is at Shantou.²³⁹ These zones, which have attracted chiefly Chinese investors, engage in small processing and assembly operations, actually offer foreigners considerably more freedom than they have enjoyed up until now.²⁴⁰ Non-investors can own 100% of their own subsidiaries; sign long-term leases on land; set wages; and discharge incompetent workers who formerly

²³⁰ *Id.* at 208.

²³¹ See Deborah Brautigam & Tang Xiaoyang, *China's Investment in Special Economic Zones in Africa*, in WB 2011 Report, *supra* note 17, Chapter 4, at 69-100. See also Min Zhao & Thomas Farole, *Partnership Arrangements in the China-Singapore (Suzhou) Industrial Park: Lessons for Joint Economic Zone Development*, in WB 2011 Report, *supra* note 17, Chapter 5, at 101-125.

²³² Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 174.

²³³ See WB 2008 Report, *supra* note 20, at 29.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 174.

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ See generally Joseph Kahn, *Chinese Markets Soar on Interest by Foreigners - Class A Share Reform Could Widen Holdings but Obstacles Remain*, ASIAN WALL ST. J., Sept. 6, 1994, at 1.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

held their jobs for life.²⁴¹ Provisional regulations have been established for labor and wages, entry and exit, and so-called "enterprise registrations."²⁴² More than 300 Hong Kong companies are engaged in manufacturing at Shenzhen, which is supplied with telephone service and power from Hong Kong.²⁴³ Generous tax and other incentives are available to attract foreign investment in the special economic zones ("SEZ"s) of Southern China, although some care must be taken to ensure that a SEZ has received the approval of the central government.²⁴⁴ In the 1990s, China conducted a campaign to close down hundreds of such zones which were not authorized by the Chinese government.²⁴⁵

China attempted to attract foreign direct investment by setting up SEZs; this effort met with success. In fact, the Chinese economic boom may be due to its establishment and development of SEZs.²⁴⁶ In 1979, China established four SEZs in the southeastern coastal region of the country, and later added a fifth zone on Hainan Island.²⁴⁷ China patterned these zones after similar zones that were established in Taiwan, the Republic of Korea, Singapore, and Hong Kong.²⁴⁸

Hundreds of zones have now been established around the country, offering low taxes and infrastructure at international standards.²⁴⁹ These zones are largely government run, and they have become one of the principal means by which the Chinese government provides preferential policies at the local, provincial and national levels, in order to foster the development of technology and industry.²⁵⁰

China has also established overseas economic zones. In 2006, the Chinese government announced a new policy to establish up to 50 overseas economic and trade cooperation zones.²⁵¹ Chinese companies had already ventured into the establishment of overseas industrial and trade zones in Egypt in 1999 in order to set up an industrial zone in the Suez economic area.²⁵² In 1999, the Chinese appliance company Haier built its first industrial complex (a 46-hectare industrial park) in South Carolina.²⁵³ The Chinese government selected 19 overseas zone proposals across 15 countries for official support under its global policy of establishing overseas zones consisting of science and technology parks, manufacturing and processing bases, or multiuse facilities.²⁵⁴ The objectives of these overseas economic zones are to increase the demand for Chinese-made machinery and equipment and

²⁴¹ See generally Ching-Chang Hwang, *Chinese (Taiwan) Yearbook of International Law and Affairs*, 9 CHINESE Y.B. INT'L L. & AFF. 392 (1991).

²⁴² See generally Lothar Determann & Allan Marson, *Internet Business Law in China for US Companies*, 26 COMPUTER & INTERNET LAWYER 1 (2009).

²⁴³ See generally *Chinese Regional Economics: Shenzhen, Shanghai, and Wenzhou*, FACTS AND DETAILS: CHINA (2008), <http://factsanddetails.com/china/cat9/sub58/item374.html>.

²⁴⁴ TIEFENBRUN, TAX-FREE TRADE ZONES OF THE WORLD, *supra* note 1, at 10.

²⁴⁵ See generally GEORGE T. CRANE, THE POLITICAL ECONOMY OF CHINA'S SPECIAL ECONOMIC ZONES 3 (1990).

²⁴⁶ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 174.

²⁴⁷ WB 2011 Report, *supra* note 17, at 70.

²⁴⁸ *Id.*

²⁴⁹ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 174.

²⁵⁰ WB 2011 Report, *supra* note 17, at 70.

²⁵¹ *Id.* at 69.

²⁵² *Id.* at 71.

²⁵³ *Id.* at 72.

²⁵⁴ *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

to facilitate the provision of post sales product support.²⁵⁵ By producing products overseas and then exporting them to Europe or North America, Chinese companies hope to avoid trade frictions and trade barriers imposed on exports from China.²⁵⁶ The zones have helped China “boost its own domestic restructuring and move up the value chain at home.”²⁵⁷ These overseas economic zones are intended to create economies of scale for overseas investment and to assist less experienced, small enterprises to go overseas “in groups.”²⁵⁸ The last objective of Chinese overseas FTZs is to transfer an element of China’s own success to other developing countries in order to benefit China ultimately by creating allies that trade with China.²⁵⁹

A. History of Chinese FTZs

From 1949 to just before 1979, under the leadership of Mao Zedong and the rise of Communism, China showed little interest in international business transactions.²⁶⁰ During this period, China’s import-export trade was less than 10 per cent of its national income,²⁶¹ because China neither allowed nor received foreign investments on its territory.²⁶² China became more open to foreign investments only after the fall of the Gang of Four in 1976.²⁶³ By 1979, China had adopted regulations on joint ventures and created Special Economic Zones (“SEZ”s) in Guangdong Province and Fujian.²⁶⁴ Initially, these zones were designed to limit foreign investments to only a few carefully selected and controlled coastal locations, but later China invested in the development of SEZs as well as the expansion of joint ventures and wholly-owned foreign enterprises.²⁶⁵

Under the leadership of Deng Xiaoping, by 1982 there was a significant increase in China’s trade volume to about 18 percent.²⁶⁶ The concept of free trade zones was actually adopted by the Chinese government in the early 1980s when Deng Xiaoping promoted an

²⁵⁵ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 175.

²⁵⁶ *Id.*

²⁵⁷ WB 2011 Report, *supra* note 17, at 71.

²⁵⁸ *Id.*

²⁵⁹ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 175.

²⁶⁰ Victor F. S. Sit, *The Special Economic Zones of China: A New Type of Export Processing Zone?*, 23 *DEVELOPING ECONOMIES* 69, 72 (1985).

²⁶¹ *Id.*

²⁶² WB 2011 Report, *supra* note 17, at 71.

²⁶³ Thayer Watkins, *Economic Development in China After Mao*, SAN JOSE STATE UNIVERSITY, <http://www.sjsu.edu/faculty/watkins/china2.htm> (last visited July 29, 2015).

²⁶⁴ The Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment (promulgated and effective July 8, 1979), *reprinted in* 1 *CHINA L. FOREIGN BUS. (CCH AUSTL. LTD.)* ¶ 6-500 (governing Equity JVs in China). On the subject of joint ventures in China, see Susan Tiefenbrun, *Joint Ventures in the USSR, Eastern Europe, and the People’s Republic of China as of December 1989*, 21 *N.Y.U. J. INT’L L. & POL.* 667, 745 (1989). See also Regulations of the People’s Republic of China on Special Economic Zones in Guangdong Province, (promulgated by the Standing Committee of the National People’s Congress and effective, Aug. 26, 1980), *reprinted & translated in* 1 *CHINA L. FOREIGN BUS. (CCH AUSTL. LTD.)* ¶ 70-800 (governing special zones and cities).

²⁶⁵ U.S. Dep’t of State, *2006 Investment Climate Statement-China*, U.S. DEP’T OF STATE (2006), <http://2001-2009.state.gov/e/eeb/ifd/2006/61971.htm>.

²⁶⁶ Sit, *supra* note 260, at 72.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

economic open-door policy.²⁶⁷ “With the introduction of the open-door policy at the end of the 1970s, the Chinese government approved the creation of four Special Economic Zones (Shenzhen, Zhuhai, Shantou and Xiamen) in which special policies were granted to test the applicability of the market-oriented mechanism to China’s economic and social development.”²⁶⁸ Favorable tax concessions, access to credit and raw materials, and other beneficial treatment was given to companies doing business within these four zones in order to attract foreign investment in export-processing production.²⁶⁹ Chinese laws and regulations with respect to foreign investment were formulated specifically to attract and protect foreign investors’ assets, profits, rights, and other interests.²⁷⁰

B. Chinese Laws of the Special Economic Zones and Export Processing Zones

The laws and provisions of SEZs and EPZs in China are rather similar. SEZs were originally designed to encourage foreign investment in China.²⁷¹ For example, according to the Regulations of the People’s Republic of China on Special Economic Zones in Guangdong Province, SEZs were created “in order to develop economic cooperation and technical exchange with foreign countries and to promote the socialist modernization programme...”²⁷² Products made in the SEZs are “to be sold on the international market.”²⁷³ Investors in SEZs are permitted to “independently operate their own enterprises ...and employ foreign personnel for technical managerial work”.²⁷⁴ Foreign goods brought into the Chinese SEZs are exempted from duties, and this feature is very attractive to foreign investors in China.²⁷⁵ “Machinery and equipment, spare parts, raw and semi-processed materials, means of transportation and other capital goods required for production imported by enterprises in the special (economic) zones shall be *exempted from import duties*.”²⁷⁶ Moreover, the enterprise income tax rate in the SEZs is only 15 per cent.²⁷⁷ Profits earned in SEZs may be repatriated abroad.²⁷⁸ If the investor reinvests in the SEZs for a period of five or more years, the investor may apply for a reduction of, or even an exemption from, income tax on the reinvested portion.²⁷⁹ SEZs also simplify entry and exit procedures for foreign personnel.²⁸⁰ These

²⁶⁷ Gregory C. Chow, *Economic Reform and Growth In China*, 5 ANNALS OF ECON. AND FIN. 127, 141-142 (2004).

²⁶⁸ Wong & Tang, *supra* note 6, at 306.

²⁶⁹ *Id.*

²⁷⁰ *Id.*

²⁷¹ *Export Processing Zones: Past and Future Role in Trade and Development*, OECD (May 23, 2007), [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TD/TC/WP\(2006\)39/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TD/TC/WP(2006)39/FINAL&docLanguage=En).

²⁷² *Sit, supra* note 260, at art. 1.

²⁷³ *Id.* at art. 9.

²⁷⁴ *Id.* at art. 10.

²⁷⁵ MICHAEL W. BELL ET. AL., CHINA AT THE THRESHOLD OF A MARKET ECONOMY 40 (1993) (citing to the fact that they are exempt, not the attractiveness); Wanda Tseng & Harm Zebregs, *Foreign Direct Investment in China: Some Lessons for Other Countries*, INT’L MONETARY FUND (Feb. 2002), <http://www.imf.org/external/pubs/ft/pdp/2002/pdp03.pdf>.

²⁷⁶ *Sit, supra* note 260, at art. 13.

²⁷⁷ *Id.* at art. 14.

²⁷⁸ *Id.* at art. 15.

²⁷⁹ *Id.* at art. 16.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

provisions found in the Guangdong Province SEZ legislation are very similar to provisions found in Chinese legislation for EPZs and in the laws governing FTZs in many developing countries.²⁸¹

Chinese SEZs first began as Export Processing Zones and were in fact initially called “Special Export Zones,” but they were renamed “Special Economic Zones” in 1980 “to overcome the limitations of the EPZs and to avoid direct competition with EPZs in Taiwan and Korea.”²⁸² The first four SEZs established in Guangdong Province (Zhuhai, Shenzhen, Shantou, and Xiamen) developed rapidly and “achieved remarkable economic outputs at the beginning of the 1980s.”²⁸³ SEZs are not just areas of concentrated foreign investment. SEZs are also “laboratories for far-reaching reforms of the Chinese bureaucracy and economic machinery,”²⁸⁴ and the aim of the SEZs is to apply these reforms to the rest of China.²⁸⁵ SEZs have had a greater economic impact on reforms than EPZs in China.²⁸⁶ While EPZs may look like they function similarly to SEZs, EPZs do not have the same far-reaching goals as SEZs to reform the rest of China.²⁸⁷

C. Shenzhen, Zhuhai, Shantou, and Xiamen Free Trade Zones

Shenzhen, which was started as a free trade zone in January 1980, is the largest export base in Guangdong Province, and it is the largest of the first four SEZs established in China.²⁸⁸ Shenzhen is composed of five industrial processing zones (Shekou, Liantang, Bagualing, Shangbu, and Shuipu).²⁸⁹ The Shenzhen model relied on government streamlining services for foreign enterprises.²⁹⁰ The corporate tax rate in Shenzhen was set at an internationally competitive rate, allowing foreign firms to pay at half the rate of domestic enterprises.²⁹¹ The government of Shenzhen encouraged the mass migration of young workers into the city such that young migrants comprised 83 percent of the city’s population, and people over sixty years of age were only 6 percent of the population.²⁹² Shenzhen soon moved from providing only cheap labor-intensive work to more high-tech production, which increased the investment in research and development to 4 % of the city’s GDP by 2010.²⁹³

²⁸⁰ *Id.* at art. 18.

²⁸¹ *Sit, supra* note 260, at 73.

²⁸² Wong and Tang, *supra* note 6, at 306.

²⁸³ *Id.*

²⁸⁴ *Sit, supra* note 260, at 73.

²⁸⁵ Ann Fenwick, *Evaluating China’s Special Economic Zones*, 2 INT’L TAX & BUS. LAW 376, 377 (1984).

²⁸⁶ *Sit, supra* note 260, at art. 9.

²⁸⁷ *See id.* at 73.

²⁸⁸ GEORGE T. YU, CHINA IN TRANSITION: ECONOMIC, POLITICAL, AND SOCIAL DEVELOPMENTS 251 (July 9, 1993).

²⁸⁹ JAMIE K. MCCALLUM, EXPORT PROCESSING ZONES: COMPARATIVE DATA FROM CHINA, HONDURAS, NICARAGUA AND SOUTH AFRICA 6 (2011), available at http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---dialogue/documents/publication/wcms_158364.pdf [hereinafter EXPORT PROCESSING ZONES].

²⁹⁰ Dean Dastvar, Note, *Follow the Global Silk Road to Security and Prosperity*, 6 BUS. L. BRIEF (AM. U.) 44, 46 (2010).

²⁹¹ *Id.*

²⁹² *Id.*

²⁹³ *Id.*

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

Shenzhen developed new laws to encourage multinational corporations to move their headquarters into Shenzhen by offering government streamlining and by providing over 100 industrial parks to house these companies.²⁹⁴ Shenzhen continuously adapts to fit the needs of global business.

The Zhuhai SEZ is much smaller than Shenzhen and is split into three separate zones along the border with Macau.²⁹⁵ The Shantou SEZ was originally an EPZ called Longhu.²⁹⁶ The Huli EPZ covers the whole region of Xiamen Island.²⁹⁷

Shenzhen is the most advanced free trade zone in terms of development and is being copied by other SEZs in China.²⁹⁸ Based on the success of Shenzhen, the mayor of this city claimed that the Shenzhen SEZ provides a better environment than EPZs to attract foreign capital and industries of a technology-intensive nature.²⁹⁹

China's economic strategy of opening its borders to trade and foreign investment through the creation of SEZs and development zones has enabled 300 million people to enter China's new middle class.³⁰⁰

D. New Pilot Shanghai Zone

The zone in Shenzhen helped to transform Shenzhen within thirty years from "a sleepy fishing village off the southern coast of China"³⁰¹ with just 30,000 inhabitants into a well-known international metropolis with more than 12 million residents.³⁰² Similarly, it is believed that the new pilot Shanghai zone "will help support [China's] sluggish economy, which expanded by just 7.7 percent in 2012, according to revised figures released ...by the National Bureau of Statistics."³⁰³ China's economy continued to slowdown in 2013 and 2014,³⁰⁴ and the economy in 2015 has continued to slow down.³⁰⁵

The economic and social success of the Shenzhen FTZ inspired Prime Minister Li Keqiang to pursue the opening of a new pilot Shanghai Free Trade Zone on September 29,

²⁹⁴ *Id.*

²⁹⁵ EXPORT PROCESSING ZONES, *supra* note 289.

²⁹⁶ *Id.*

²⁹⁷ *Id.*

²⁹⁸ *See* Sit, *supra* note 260, at 79.

²⁹⁹ *Id.* at 85.

³⁰⁰ Dastvar, *supra* note 290, at 47.

³⁰¹ *Id.* at 44.

³⁰² Li Qiaoyi, *In the Zone*, GLOBAL TIMES (Sept. 4, 2013), <http://www.globaltimes.cn/content/808378.shtml>.

³⁰³ *Id.*

³⁰⁴ Keith Bradsher, *As China's Economy Slows, the Pain Hits Home*, N.Y. TIMES (Jan. 30, 2014), at B1 ("Economists and investors around the world have been fretting in recent days about the effects on smaller emerging markets if China's economic slowdown worsens...China's role as the largest buyer of a long list of commodities, from iron ore to palm oil, means that emerging markets are heavily exposed to any economic slowdown.").

³⁰⁵ *See generally* S.R., *A Slower Slowdown*, THE ECONOMIST (May 13, 2015), [http://www.economist.com/blogs/freeexchange/2015/05/chinas-economy.%20S.R.](http://www.economist.com/blogs/freeexchange/2015/05/chinas-economy.%20S.R;); S.R., *From A Very Big Base*, THE ECONOMIST (January 20, 2015), <http://www.economist.com/blogs/freeexchange/2015/01/chinas-slowdown>.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

2013.³⁰⁶ The State Council of China approved the Shanghai FTZ in a decision on July 3, 2013. The Shanghai zone covers almost 29 square kilometers,³⁰⁷ encompassing four existing bonded zones in the city's³⁰⁸ Pudong New Area. The four existing bonded zones are Waigaoqiao Free Trade Zone, Waigaoqiao Free Trade Logistics Park, Pudong Airport Comprehensive Free Trade Zone, and Yangshan Free Trade Port Area.³⁰⁹

E. New Shanghai Zone Legislation

Recently in 2013, some Chinese legislation relating to the new Shanghai FTZ was passed. On September 27, 2013, the State Council issued the *Overall Plan for the China (Shanghai) Pilot Free Trade Zone* ("Overall Plan"), which contains the framework for liberalization within the Shanghai zone.³¹⁰ On September 29, 2013, the Shanghai municipal government issued the Negative List and "five administrative measures governing the administration of the Shanghai FTZ, the establishment procedures for foreign-invested enterprises and foreign-invested projects in the zone, and the record-filing procedures for offshore investments by zone entities."³¹¹ On October 1, 2013, the Standing Committee of the National People's Congress issued a decision suspending 11 administrative approval items regulated under the relevant foreign investment rules in order to streamline the process of setting up foreign-invested enterprises in the Shanghai zone.³¹² About 40 other measures "couched in very general terms" were announced by industry regulators and other agencies, including

the China Banking Regulatory Commission, the Ministry of Finance, China Insurance Regulatory Commission, China Securities Regulatory Commission, the Ministry of Culture, the General Administration of Customs, the People's Bank of China, the State Administration of Foreign Exchange, the General Administration of Quality Supervision, Inspection and Quarantine, and the Administration of Industry and Commerce.³¹³

This long list of regulatory agencies governing FTZs in China provides some insight into one of the main differences between U.S. and Chinese FTZs.³¹⁴ U.S. FTZs are regulated by one federal agency, The Foreign Trade Zone Board, its orders and regulations, and the one

³⁰⁶ *Shanghai Free Trade Zone: The Next Shenzhen?*, THE ECONOMIST, Oct. 5, 2013, at 49 [hereinafter *Shanghai Free Trade Zone*].

³⁰⁷ *No Special Internet Rules for Shanghai FTZ*, XINHUA NEWS AGENCY (Sept. 27, 2013), http://news.xinhuanet.com/english/china/2013-09/28/c_125462501.htm [hereinafter *No Special Internet Rules*].

³⁰⁸ Qiaoyi, *supra* note 302.

³⁰⁹ Hogan Lovells, *China (Shanghai) Pilot Free Trade Zone-China's Springboard to a Free Market?* (Oct. 10, 2013), <http://www.hoganlovells.com/china-shanghai-pilot-free-trade-zone---chinas-springboard-to-a-free-market-10-10-2013> [hereinafter *Hogan Lovells Report*].

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.*

³¹³ Hogan Lovells Report, *supra* note 309, at 1.

³¹⁴ China has many regulatory agencies that increase bureaucratic delays for the FTZs, but the U.S. has only one agency, the FTZ Board, which makes the process faster and more efficient.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

and only Foreign Trade Zones Act of 1934, as amended, is the sole federal statute and source of legislation related to U.S. tax-free trade zones.³¹⁵

1. The Overall Plan Law for the Shanghai Zone

The reforms desired by the Chinese government related to the new Shanghai FTZ are outlined in the Overall Plan as well as in the Negative List.³¹⁶ Although people hope that the Shanghai Zone will produce Yuan convertibility, the Overall Plan indicates an interest in merely testing yuan convertibility: "Under the precondition that risks can be controlled, China will create conditions to test yuan convertibility[.]"³¹⁷ As of 2015, the Yuan is still a non-convertible currency.³¹⁸ The Overall Plan pledges to create a foreign exchange management mechanism appropriate for trade and investment reforms in the zone and foreign companies will be permitted gradually to participate in commodities futures trading in the zone.³¹⁹ These lofty goals are conditioned upon risk control, appropriateness, and slow and gradual implementation, all of which are typical of creating economic reform with Chinese "characteristics".³²⁰ The Overall Plan provides equal market access to foreign investors by eliminating market entry restrictions and certain qualification thresholds in six investment areas ranging from finance and shipping to cultural services.³²¹

2. The Negative List and the Shanghai Zone

The Negative List is published on China's FTZ's website: <http://zbw.sh.gov.cn>.³²² The list is composed of hundreds of line-item restrictions in 16 different industrial categories, ranging from culture to hydropower to telecommunications.³²³ The Negative List covers 18 main sectors with 1,069 subcategories that are prohibited or restricted from being developed in the zone and includes 190 special regulatory measures.³²⁴ The 190 special regulatory measures on the 10-page Negative List outline the sectors that are off limits to foreign

³¹⁵ Dep't of Homeland Sec. & U.S. Customs & Border Prot., *About Foreign-Trade Zones and Contact Info*, U.S. CUSTOMS & BORDER PROT., <http://www.cbp.gov/border-security/ports-entry/cargo-security/cargo-control/foreign-trade-zones/about> (last visited July 29, 2015).

³¹⁶ *China (Tianjin) Pilot Free Trade Zone is officially launched*, KPMG, <http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/ChinaAlerts/Documents/China-tax-alert-1504-08-Tianjin-Pilot-Free-Trade-Zone.pdf> (last visited Oct. 3, 2015) (discussing changes being implemented by the Overall Plan and the Negative List).

³¹⁷ Hogan Lovells Report, *supra* note 309, at 1.

³¹⁸ *How Can You Invest In Non-Convertible*, MERK FUNDS, <http://www.merkfunds.com/currency-asset-class/currencies-unplugged/can-invest-in-non-convertible-currencies.html> (last visited Oct. 03, 2015) (generally stating the Yuan's non-convertible status).

³¹⁹ Hogan Lovells Report, *supra* note 309, at 2.

³²⁰ *Id.*

³²¹ *Id.*

³²² Lu Jianxin & Pete Sweeney, *Shanghai Trade Zone Publishes Restrictions For Foreign Investment*, REUTERS (Sept. 30, 2012), <http://www.reuters.com/article/2013/09/30/us-china-shanghai-idUSBRE98T05U20130930>.

³²³ *FTZ Unveils Restrictions*, SHENZHEN DAILY (Oct. 1, 2013), http://www.szdaily.com/content/2013-10/01/content_8583920.htm [hereinafter *FTZ Unveils Restrictions*].

³²⁴ Hogan Lovells Report, *supra* note 310, at 2.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

investors, as well as, those from Hong Kong, Macao, and Taiwan, within the Shanghai free trade zone.³²⁵

Under the entertainment sector, gambling, sex, and pornography businesses are barred from entering the Shanghai zone. Other banned areas include exploration of noble metals and rare earths, Internet data centers, compulsory education, transgenic crops, cultural heritage auctions, golf courses, and arms. Telecommunication, TV broadcasting, and cinema are restricted, and news agencies and websites, publishing and online games remain closed to foreign investors. Foreign investors may set up hospitals in the free trade zone if they invest a minimum of 20 million yuan (\$3.27 million USD) and stay a maximum of 20 years in operation. Foreign investment in banking, insurance and securities in the zone remains subject to limitations. For example, foreign stakeholders may have no more than a 50 percent stake in an insurance company, and no more than 49 percent of a securities company. Foreign investment in land development may be done only through a joint venture. Investing in luxury hotels and office buildings is also limited. Investment in manufacturing automobiles, railway cars, ships, aircraft and motorbikes must include a local Chinese partner as does a business in road, rail, water or air transport. Investments in public projects like underground railways and high-speed railway projects or nuclear reactor construction is permitted but only by means of a joint venture in which the Chinese company is the dominant shareholder.³²⁶

Foreign firms are also proscribed from the production and development of genetically modified (GM) seeds.³²⁷

There are some trade benefits to the Negative List. Investments in areas that are not on the Negative List do not require approval, but merely the filing of a report with authorities.³²⁸ The good news about the Negative List is that for the first time foreigners will be permitted to invest in projects exploring nontraditional natural gas resources such as shale gas and sea-bottom natural gas, but only via joint ventures with Chinese partners.³²⁹ The other bit of good news about the Negative List is that the registration period for foreign investors is shortened from the current 29 days to a minimum of four days.³³⁰ Foreign businesses in the Shanghai zone will enjoy national treatment and will not be required to undergo an onerous

³²⁵ Wei Tian, *FTZ 'Negative List' Defines Maximum Opening Possibilities*, CHINA DAILY (Oct. 1, 2013), http://usa.chinadaily.com.cn/epaper/2013-10/01/content_17006687.htm [hereinafter Tian, *FTZ 'Negative List'*].

³²⁶ *Id.*

³²⁷ *FTZ Unveils Restrictions*, *supra* note 323, at 1.

³²⁸ Xu Ping et. al, *A New Era For The PRC Foreign Investment Regime—An Introduction To The Discussion Draft Foreign Investment Law of PRC*, CHINA LAW INSIGHT (Jan. 22, 2015), <http://www.chinalawinsight.com/2015/01/articles/corporate/mergers-acquisitions/a-new-era-for-the-prc-foreign-investment-regime-an-introduction-to-the-discussion-draft-foreign-investment-law-of-prc/>.

³²⁹ *FTZ Unveils Restrictions*, *supra* note 323, at 1.

³³⁰ Tian, *FTZ 'Negative List'*, *supra* note 325, at 2. See also, Zhang Yu & Li Qian, *Shanghai FTZ Opens Doors Wide*, GLOBAL TIMES (Oct. 7, 2013), <http://www.globaltimes.cn/content/814967.shtml#UwKD-UJdXw0>.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

approval process with the relevant government department or the Ministry of Commerce and its local counterparts called “MOFCOM”.³³¹ Foreign-invested enterprises and projects in the Shanghai zone will simply have to complete a record-filing process, on condition that the subject areas of these foreign enterprises are not on the Negative List.³³²

Despite the disincentive of the Negative List to attract investment by foreign investors, on Sunday, October 6, 2013 at the inauguration ceremony to unveil the administrative committee of the FTZ and the commencement of the new Shanghai FTZ, 25 enterprises and 11 financial Institutions, including eight Chinese banks and two foreign banks, were licensed to establish branch offices in the Shanghai FTZ.³³³

3. Shanghai FTZ Compared to Shenzhen SEZ

It is interesting to compare the Shenzhen and Shanghai FTZs. The Shenzhen SEZ focuses on the manufacturing industry, and the Shanghai FTZ concentrates mainly on service sector-liberalization.³³⁴ The Shanghai FTZ is “mainly focused on developing the financial, shipping and logistics industries.”³³⁵ The Shanghai zone is modeled on the existing free trade businesses in the country’s economic hubs.³³⁶

Leaders have called the establishment of the Shanghai FTZ a landmark, innovative moment, similar to the creation of the Shenzhen SEZ near Hong Kong more than three decades earlier. Shenzhen ushered in “reforms and spectacular growth” in China.³³⁷ Many hope the new Shanghai SEZ will provide much needed reforms like access to the uncensored Internet,³³⁸ cuts in corporate tax, permission for foreign auctioneers to sell antiquities, yuan convertibility, interest-rate liberalization, and a more detailed and specific set of centralized regulations and rules on how to run the SEZs.³³⁹

The political Bureau of the Communist Party of China (“CPC”) Central Committee issued a statement claiming that “the establishment of the flagship FTZ in Shanghai will spearhead the CPC Central Committee’s endeavor to explore new ways of improving management, advancing the transformation of government functions, facilitating trade and investment, deepening reform and opening up of the economy.”³⁴⁰ Unfortunately, none of these reforms has actually been provided as yet.

³³¹ Hogan Lovells Report, *supra* note 309, at 2.

³³² *Id.*

³³³ Yui & Qian, *supra* note 213, at 1.

³³⁴ Yiping Huang, *Questions Linger Over Free Trade Reforms*, AUSTRALIAN FIN. REV. (Oct. 21, 2013), <http://www.globaltimes.cn/content/814967.shtml#.UwKD-UJdXw0>.

³³⁵ Qiaoyi, *supra* note 302.

³³⁶ *China To Inaugurate Shanghai FTZ on Sept. 29*, ENGLISH NEWS (Sept. 24, 2013), http://news.xinhuanet.com/english/china/2013-09/24/c_132747045.htm

³³⁷ *Shanghai Free Trade Zone*, *supra* note 3606 at 49.

³³⁸ *No Special Internet Rules*, *supra* note 307 (“The Internet regulation in China’s pilot free trade zone (FTZ) in Shanghai will be conducted in accordance with laws, with no special treatment, the FTZ authorities said Friday evening.”).

³³⁹ *The Next Shenzhen?*, THE ECONOMIST, October 5, 2013,

<http://www.economist.com/news/china/21587237-new-enterprise-zone-could-spark-wider-market-reforms-but-only-if-bureaucrats-ease-their-grip>.

³⁴⁰ Qiaoyi, *supra* note 302.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

Despite hopes that the Shanghai zone would eliminate Internet censorship, “[i]t now looks like China will not lift its Great Firewall restrictions on Facebook and Twitter in the new Shanghai free-trade zone, despite reports to the contrary.”³⁴¹ Some complain that the Shanghai SEZ is nothing more than a bonded warehouse.”³⁴²

Bonded warehouse facilities, [in contrast to free trade zones] do not offer such sophisticated services as assembly, processing, manufacturing, or even such less complex facilities as mixing, labeling, and other forms of minor manipulation.... There are no restrictions or penalties for goods left at free trade zones for periods exceeding 90 days, as do exist in some bonded warehouses. Customs officials must make special visits to bonded warehouses in contrast to permanent assignments at free trade zones.”³⁴³

The Chinese authority’s release of the “Negative List” of sectors in which foreigners cannot invest may deter economic growth and development in the Shanghai zone. The Negative List does not simply ban guns, drugs, and pornography in the new Shanghai zone.³⁴⁴ The Negative List is a blacklist for foreign investors in the FTZ,³⁴⁵ and it contains over 1,000 banned areas closed off to foreign investors.³⁴⁶ However, it has been reported in the National Business Daily that these restrictions will be loosened eventually for businesses allowed in the Shanghai FTZ.³⁴⁷ Nevertheless, if China is to compete with other nations offering cheaper labor and efficient manufacturing, China will have to expand its service sector, namely finance, and become more open to foreign investment.³⁴⁸ “A total of 577 people applied for enterprise registration at the newly-launched Shanghai pilot FTZ on the first day of registration.”³⁴⁹ At this point three dozen firms have been given permission to enter the Shanghai zone, the American banking giant Citibank among them.³⁵⁰

³⁴¹ Clifford Coonan, *Great Firewall of China will not be Lifted for Shanghai Free-Trade Zone*, IRISH TIMES (Oct. 1, 2013), <http://www.irishtimes.com/business/sectors/technology/asia-briefing-great-firewall-of-china-will-not-be-lifted-for-shanghai-free-trade-zone-1.1545124>.

³⁴² *Free Trade Zone*, BEIJING REV. (Feb. 7, 2013), http://www.bjreview.com.cn/THIS_WEEK/2013-02/01/content_515990.htm (“Shanghai has applied for a permit to build the FTZ on the basis of its existing comprehensive bonded zones.”).

³⁴³ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 208.

³⁴⁴ *The Next Shenzhen?*, *supra* note 339.

³⁴⁵ Tian, *FTZ ‘Negative List’*, *supra* note 325.

³⁴⁶ *The Next Shenzhen?*, *supra* note 339.

³⁴⁷ *Shanghai to Trim FTZs Off-Limits List, Paper Says*, ECON. J. INSIGHT (Oct. 28, 2013), <http://www.ejinsight.com/chinaDigest/article/id/333310> (“As the zone opens up, policies will become more specific and the list of activities that are off limits will shorten.”).

³⁴⁸ *Shanghai Free Trade Zone*, *supra* note 306, at 49.

³⁴⁹ *China’s Shanghai Free Trade Zone Begins Offering Registration Services*, NEW CHINA NEWS AGENCY (Oct. 9, 2013), http://news.xinhuanet.com/english/china/2013-10/09/c_132782546.htm.

³⁵⁰ *The Next Shenzhen?*, *supra* note 339.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

4. Tax Incentives for Foreign Companies Proposed in the New Shanghai Zone

The initiatives proposed in the Shanghai FTZ will offer tax incentives to foreign companies and benefits to startups.³⁵¹ Companies registered in the Shanghai zone can opt to pay income tax in installments over five years and thereby increase their cash flow.³⁵² Those working in the Shanghai zone can also pay tax on their stock options in installments.³⁵³ Startup companies need to invest most of their income in the company in order to grow, and if they are allowed to defer their tax payments and pay only a small amount of tax every year, the startup company will have more available cash during the first few years.³⁵⁴ Foreign investors may own up to 70 percent of joint venture human resources companies, and those investors from Hong Kong and Macao can establish solely funded human resources companies according to the new policies in the Shanghai FTZ (SFTZ).³⁵⁵

5. Objectives of the New Shanghai Zone

China's overall objectives in the establishment of the FTZ in Shanghai include the internationalization of trade, the application of the rule of law,³⁵⁶ as well as the adoption of a policy that actively adheres to international trade law rules.³⁵⁷

The adherence of the Shanghai free trade zone ("SFTZ") to international trade laws and standards may have the beneficial effect of upgrading China's economy and providing China with more opportunities for economic globalization and increased foreign investment. China needs to adopt a policy of trade transparency and openness in order to attract more foreign investment. To achieve this goal and increase investor confidence, the FTZ in Shanghai must focus on adherence to the rules of international trade. This may require the SFTZ to adopt a management style and a taxation system similar to those found in international business. The Overall Plan Law of the SFTZ actually requires a "high standard" of legal support and the establishment of open and transparent regulation as well as a taxation system that is created according to international standards and international trade practice.³⁵⁸ In order to achieve its goals, the SFTZ must systematically and consistently commit to the elimination of corruption and graft, adopt a policy of internationalization by adherence to

³⁵¹ Shi Jing, *Tax Policy Set to Benefit Startups*, CHINA DAILY (Sept. 28, 2013), http://usa.chinadaily.com.cn/business/2013-09/27/content_17000906.htm.

³⁵² *Tax Payment by Instalments-China's New Tax Policy on Investment by Individuals with Non-monetary Assets*, CHINA TAX AND BUSINESS ADVISORY 1, 1-2, http://www.pwchk.com/webmedia/doc/635671068260220774_chinatax_news_may2015_19.pdf.

³⁵³ Jing, *supra* note 351.

³⁵⁴ *Id.*

³⁵⁵ *Id.*

³⁵⁶ See *supra* notes 316-321, for a discussion of the SFTZ Overall Plan Law which specifically requires the construction of systems of cross-border investment and trade rules that are in accordance with the principles of internationalization and the rule of law.

³⁵⁷ *USCBC Recommendations for Revisions to the China (Shanghai) Pilot Free Trade Zone Negative List and Other Reforms*, U.S.-CHINA BUSINESS COUNCIL, 6 (Mar. 2014), <https://www.uschina.org/sites/default/files/2014.03%20USCBC%20Comments%20to%20Shanghai%20FTZ.pdf>.

³⁵⁸ *Overall Plan For The China (Shanghai) Pilot Free Trade Zone*, CHINA.ORG (Oct. 16, 2013), http://www.china.org.cn/business/2013-10/16/content_30310013.htm

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

international trade law standards, and recognize and follow the customary and standard business practices of international trade.

F. Performance of the Shanghai Free Trade Zone in its First Year

According to the *China Daily*, which is an official Chinese government newspaper, after its first year of operation the Shanghai Free Trade Zone had reached a “record-breaking milestone.”³⁵⁹ Reportedly, more than 12,000 firms “had registered in the 20-square-kilometre (11 square-mile) area, and foreign firms were flooding in.”³⁶⁰ Government officials stress the Shanghai zone’s innovations such as the launching of an international gold exchange in order to open China’s gold market,³⁶¹ more trade in other commodities such as crude oil; and ease of registration of new firms in the zone because firms are not required to obtain explicit permission to operate in the zone as long as their product is not on the “negative list.”³⁶²

According to one of the consultants of the zone, Vivian Jiang of Deloitte, the Shanghai zone has made small, but helpful improvements in Customs clearance, logistics, and in the bureaucracy of setting up new businesses in China.³⁶³ Moreover, some useful reforms have been made in the settlement of disputes between companies.³⁶⁴ Despite these positive assessments of the Shanghai free trade zone in its first year of operation, Chen Bo of the Shanghai University of Finance and Economics, an advisor to the Chinese government on the zone, admits that reforms in the zone have been slow.³⁶⁵ But he is optimistic that financial reforms that have been too difficult or risky to be undertaken on a national level may be pushed through more quickly in the Shanghai zone.³⁶⁶ However, other experts, including influential figures at the Chinese central bank, believe that the Shanghai zone project cannot work, even in principle, because it is unworkable to experiment with bold financial reforms in one area without implementing them in the rest of the country.³⁶⁷ In fact, the zone is widely viewed by businesses as a disappointment.³⁶⁸

Foreign firms that have moved into the Shanghai zone did so to obtain a first-mover advantage, but this advantage has not materialized for them; local Chinese firms have set up in the zone reportedly because of pressure to do so by Chinese government officials.³⁶⁹ Only 5 percent of the firms registered in the Shanghai zone have headquarters outside greater China.³⁷⁰ Complaints have been made about the painfully slow movement of reforms in the Shanghai zone such as financial liberalization, freeing up of the Chinese currency and

³⁵⁹ “*Li who will not be obeyed: The Shanghai Free Trade Zone’s frustrating first year*,” THE ECONOMIST, October 11, 2014, <http://www.economist.com/news/china/21623776-shanghai-free-trade-zones-frustrating-first-year-li-who-will-not-be-obeyed> [hereinafter *Li who will not be obeyed*].

³⁶⁰ *Id.*

³⁶¹ *Id.*

³⁶² *Id.*

³⁶³ *Id.*

³⁶⁴ *Id.*

³⁶⁵ *Li who will not be obeyed*, *supra* note 359.

³⁶⁶ *Id.*

³⁶⁷ *Id.*

³⁶⁸ *Id.*

³⁶⁹ *Id.*

³⁷⁰ *Li who will not be obeyed*, *supra* note 359.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

lowering interest rates.³⁷¹ Moreover, the infamous Negative List, blocking certain industries from entering the zone, is too long and restricts activities in 139 industries.³⁷² What is causing this slow movement towards reform in the Shanghai zone?

Bureaucracy, turf battles among powerful regulators such as the central bank and the banking supervisor, and the crackdown on official corruption are some of the most obvious causes of the slow progress in the Shanghai zone.³⁷³ This crackdown on corruption has made zone administrators reluctant to initiate bold policy reforms that they may be criticized later if the reforms fail. Mr. Li, the most senior economic figure in China's central administration, recently visited the Shanghai zone and complained of its slow progress due to excessive government regulations.³⁷⁴

G. Overall Benefit of Free Trade Zones and Development in China

There has been an explosion of free trade zones otherwise referred to generally as "development zones" in China since the early 1990s.³⁷⁵ The State Council approved the designation of Economic Development Zones ("EDZ"s) in the early 1980s, and over 1400 were established in various provinces and cities since then.³⁷⁶ Because of their superior geographical locations and excellent infrastructure, these development zones have enjoyed competitive advantages over other areas in attracting foreign investment.³⁷⁷ They have become the areas in China with the largest foreign investment and the highest economic growth.³⁷⁸

These free trade zones have played a successful role in opening up China to foreign trade, attracting foreign capital, increasing Chinese exports, and importing science and technology into China.³⁷⁹ There is no doubt that free trade zones located in China have contributed to China's economic achievement, and they have served as 'windows and bases' for opportunities to spur on more interaction between the western and the Chinese culture. In these zones foreign investors can learn more about the social and economic traditions of China, and China can learn more about western technology, management and expertise.³⁸⁰

H. Critique of the Free Trade Zones in China

Despite the economic achievement of the free trade zones in China, there has been much criticism lodged against them. As a result of the accession of China to the World Trade Organization ("WTO") in 2001 and the WTO's fundamental principles of non-discrimination and national treatment, some fear that these development zones (that grant preferential

³⁷¹ *Id.*

³⁷² *Id.*

³⁷³ *Id.*

³⁷⁴ *Id.*

³⁷⁵ Wong & Tang, *supra* note 6, at 304.

³⁷⁶ *Id.*

³⁷⁷ *Id.* at 306.

³⁷⁸ *Id.*

³⁷⁹ *Id.* at 306-307.

³⁸⁰ *Id.* at 307.

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

treatment to foreign investors) may violate the rules of the WTO and may lose their competitive advantage over other areas in China.³⁸¹ Several of these zones, such as Guangzhou, Pudong (Shanghai), and Tianjin, have already undergone a transformation over the past 10 years.³⁸² There is a tendency now to integrate these development zones with old urban areas by better planning and administrative interventions.³⁸³ The Chinese development zones were supposed to develop land in China.³⁸⁴ However, only one-fifth of the land area was actually ever developed.³⁸⁵

There has been a 'virtual zone' fever in China, with conflicting results. Some scholars attribute the only marginal success of these developmental zones to weak governance, institutional capacity, abuse of the policy and administrative systems, and real estate speculation in a transitional socialist economy.³⁸⁶ It is also possible that graft and corruption may be diminishing the potential success of the zones in China, although very little has been written about corruption in the zones.³⁸⁷

Other scholars believe the zones have been very successful. Some have estimated that 2700 Economic and Technological Development Zones ("ETDZ"s) in China have been established since 1992 as well as Hi-tech Development Zones ("HIDZS"), and the overall performance of these state-level development zones was considered by the Chinese central government to be a relatively successful venture.³⁸⁸ Since China is now planning another free trade zone in Guangdong Province, and since the new Shanghai pilot free trade zone has already been approved by the Chinese government and in operation for more than one year, one must conclude that these zones have been an economic success for China.

1. FTZs and China's Economic Challenges

China is currently facing a severe job market challenge.³⁸⁹ In 2013, China had to provide work for about seven million new college graduates.³⁹⁰ This employment problem in China continued into 2014.³⁹¹ It is for this reason that Premier Li Keqiang recently said that China will have "to forge ahead with economic reform, including further opening up to

³⁸¹ Wong & Tang, *supra* note 6, at 307.

³⁸² *Id.*

³⁸³ *Id.*

³⁸⁴ *Id.* at 305 (discussing urban centers being developed via development zones).

³⁸⁵ *Id.* at 304.

³⁸⁶ *Id.*

³⁸⁷ President Xi Jinping of China is conducting an anti-corruption campaign, but there has been no indication in the Chinese press of corruption in the free trade zones.

³⁸⁸ Wong & Tang, *supra* note 6, at 304-305.

³⁸⁹ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 151; see also WB 2011 Report, *supra* note 17, at 5.

³⁹⁰ Li Jiabao & Ding Qingfen, *Li promises to speed up service growth*, CHINA DAILY (May 30, 2013), http://usa.chinadaily.com.cn/china/2013-05/30/content_16545334.htm.

³⁹¹ See generally Günter Schucher, *A Ticking "Time Bomb"?-Youth Employment Problems in China*, GIGA RESEARCH UNIT INSTITUTE OF ASIAN STUDIES, http://www.giga-hamburg.de/en/system/files/publications/wp258_schucher.pdf (discussing the overall youth employment market, and issues associated with it in 2014).

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

overseas investment and building free trade zones in pilot cities.”³⁹² Li Keqiang stressed the importance of establishing more free trade zones in China. He said:

The development of service industry in China is a little backward. The major obstacle comes from the system and mechanism. The way out is reform and opening up. We will uphold the reform direction of the socialist market economy, release the reform bonus to a maximum, ‘loosen the control’ lawfully over service industry to a maximum, and allow enterprises to move ahead without burdens so as to increase their vitality and creativity. We will further expand the opening up and scope of service industry and explore pilot projects for establishing free trade zones.³⁹³

China’s rate of economic growth since 1979 has been extraordinary, and many attribute China’s economic success to globalization.³⁹⁴ This globalization began when Deng Xiaoping liberalized trade and foreign investments in China by setting up special economic zones in the coastal provinces.³⁹⁵ China’s export-oriented manufacturing, largely foreign-funded, has employed millions of rural migrants, boosted their income earned, and reduced poverty in China far and wide.³⁹⁶

The passage of the Law on Chinese-Foreign Equity Joint Ventures in 1979 committed the Chinese government to the protection of foreign property rights,³⁹⁷ and helped make China a major economic trading power.³⁹⁸ China’s accession to the World Trade Organization in 2001 also helped to advance China’s role in international trade.³⁹⁹ However, some scholars believe that despite the vast number of free trade zones established in China, more effort must be made to integrate these zones into the regional and urban contexts in order to increase the economic and social development of China.⁴⁰⁰

The creation of SEZs in China after 1979 transformed the Chinese economy rapidly because global demand for inexpensive labor increased and was satisfied by Chinese suppliers.⁴⁰¹ “China’s rapid economic and social growth was experienced most vividly by the inhabitants of Shenzhen,” once a “sleepy fishing village...that blossomed into a global business hub of nearly nine million people within thirty years,” quickly competing with Hong Kong, its neighboring “international business powerhouse.”⁴⁰²

³⁹² Jiabao & Quingfen, *supra* note 390.

³⁹³ PRC Premier Li Keqiang Addresses Global Services Forum Beijing Summit, WORLD NEWS CONNECTION, May 31, 2013, http://web2.westlaw.com/result/default.wl?mt=7&origin=Search*sskey-CLIDSSSA5810313251487&query.

³⁹⁴ Heiner Flassbeck et. al., *China’s Spectacular Growth Since the Mid-1990s-Macroeconomic Conditions and Economic Policy Challenges*, in CHINA IN A GLOBALIZING WORLD I, 1 (2005).

³⁹⁵ Yasheng Huang, *How Did China Take Off?*, 26 J. ECON. PERSPECTIVES 147, 147 (2012).

³⁹⁶ *Id.*

³⁹⁷ *Id.*

³⁹⁸ WAYNE M. MORRISON, CONG. RESEARCH SERV., RL33534, CHINA’S ECONOMIC RISE: HISTORY, TRENDS, CHALLENGES, AND IMPLICATIONS FOR THE UNITED STATES I (2015).

³⁹⁹ *China’s Role in the WTO*, CHINA BUSINESS REVIEW (Oct. 1, 2011), <http://www.chinabusinessreview.com/chinas-role-in-the-wto/>

⁴⁰⁰ Wong and Tang, *supra* note 6, at 4.

⁴⁰¹ Dastvar, *supra* note 290, at 46.

⁴⁰² *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

China's economic strategy of opening its borders to trade and foreign investment by establishing special economic zones has enabled 300 million people to enter China's new middle class.⁴⁰³ China's ability to provide skilled labor and land at low cost while also opening itself to trade in the special economic zones has helped China attract 80% of its current cumulative foreign direct investment which helps fuel its rise in the global economy.⁴⁰⁴ In 2014, even though wages and labor expenses such as government-mandated benefits have increased in China, Chinese exports continue to grow, as the Chinese currency slowly rises against the United States dollar.⁴⁰⁵

Export gains...suggest that despite years of predictions of trouble for China's export juggernaut, it has not yet been derailed by fast-rising costs for blue-collar labor, by an appreciating Chinese currency or by foreign investment shifts toward other, lower-wage Asian countries. China is poised to announce ...its largest annual trade surplus in dollar terms since 2008.⁴⁰⁶

Wages to blue-collar workers in China have increased between five and nine times in dollar terms in the last ten years.⁴⁰⁷ There is an acute shortage of manufacturing laborers because the younger generation in China is going to college, and there are fewer young adults in rural China to send to the factories.⁴⁰⁸ Chinese exporters claim they have been able to keep prices for goods low and retain overseas customers like the United States because factories in China have become more productive and the supply chains leading to and from the factories remain among the best in the world.⁴⁰⁹

However, some foreign companies in China are leaving or have already left China, and "those companies who are staying in China are struggling. IBM reported that revenues in China fell by 23%, during the last quarter of 2013."⁴¹⁰

Revlon said in December that it was pulling out [of China] altogether. L'Oreal, the world's largest cosmetics firm, said...that it would stop selling one of its main brands, Garnier. Best Buy, an American electronics retailer, and Media Market, a German rival, have already left, as has Yahoo, an internet giant. Tesco, a British food retailer, last year gave up

⁴⁰³ *Id.*

⁴⁰⁴ *Id.*

⁴⁰⁵ Keith Bradsher, *Even As Wages Rise, China Exports Grow*, N.Y. TIMES, Jan. 09, 2014, http://www.nytimes.com/2014/01/10/business/international/chinese-exports-withstand-rising-labor-costs.html?_r=0.

⁴⁰⁶ *Id.* at B5.

⁴⁰⁷ *Id.*

⁴⁰⁸ Edna Curran, *China's Manufacturing Hub Faces Labor Shortage and Higher Wages*, BLOOMBERG (May 06, 2015, 10:20PM), <http://www.bloomberg.com/news/articles/2015-05-07/china-s-manufacturing-hub-faces-labor-shortage-and-higher-wages>; Kathy Chu, *China: A Billion Strong But Short on Workers*, WALL ST. J., May 01, 2013, 3:16PM, <http://www.wsj.com/articles/SB10001424127887323798104578455153999658318>.

⁴⁰⁹ *Id.*

⁴¹⁰ *China Loses Its Allure*, THE ECONOMIST, Jan. 25, 2014, at 9.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

trying to go it alone, and entered a joint venture with a state-owned firm.⁴¹¹

Chinese businessmen have responded to increased wages to laborers in China by investments in automation where a machine takes the place of five workers.⁴¹² It is widely known that the Chinese economy in 2015 has not increased as markedly as it has in the past few years, and China is experiencing a frightening economic slowdown in growth.⁴¹³

It is difficult to assess the future of China's economy and whether Chinese growth in supply, demand, and credit will continue. The Chinese GDP, which was worth over \$9 trillion U.S. dollars in 2013, decreased in 2014 and is likely to decrease in 2015.⁴¹⁴

Optimists [about the Chinese economy] contend with pessimists, apologists with alarmists, bulls with bears. Figures released this month encouraged both camps. China's economy grew by 7.7% in 2013, a little faster than once feared. But a widely watched index of manufacturing, published by HSBC, a bank, fell for the fourth month in a row.⁴¹⁵

"Chinese leaders and some economists have contended for years that a decline in China's export competitiveness is imminent, but their country has continued to post trade surpluses."⁴¹⁶ "Foreign investment in China has stagnated while it is surging in Southeast Asian rivals like Cambodia, Indonesia, and Vietnam..."⁴¹⁷ where labor costs are low. Despite all this uncertainty, China still continues to invest heavily in China by creating more tax-free trade zones, the newest being the free trade zone in Shanghai.⁴¹⁸

IV. SUGGESTIONS AND CONCLUSION

Whether or not free trade zones in the United States and in China have been successful is a controversial question. Some economists in China and some economists in the United States claim that free trade zones are only marginally successful.⁴¹⁹ Some economists claim they are wildly successful and are the cause of China's miraculous economic boom and U.S. prosperity.⁴²⁰ Despite the controversy, both U.S. President Barack Obama and Chinese Prime Minister Li Keqiang have publicly encouraged the establishment of more free trade

⁴¹¹ *Id.*

⁴¹² See Bradsher, *supra* note 405, at B5.

⁴¹³ Andrew Walker, *Why China's Slowdown Matters*, BBC NEWS (May 08, 2015), <http://www.bbc.com/news/business-32380523>.

⁴¹⁴ Bradsher, *supra* note 405.

⁴¹⁵ *China's Economy in Three Parts*, THE ECONOMIST, Jan. 25, 2014, at 59.

⁴¹⁶ Bradsher, *supra* note 405.

⁴¹⁷ *Id.*

⁴¹⁸ William Kazer, *China To Set More Free-Trade Zones*, WALL ST. J., Mar. 24, 2015, 8:13AM, <http://www.wsj.com/articles/china-to-set-more-free-trade-zones-1427199186>

⁴¹⁹ *Political Priority, Economic Gamble*, THE ECONOMIST, Apr. 04, 2015, <http://www.economist.com/news/finance-and-economics/21647630-free-trade-zones-arc-more-popular-ever-with-politicians-if-not>.

⁴²⁰ *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

zones in both countries.⁴²¹ Some trade zone officials have predicted that manufacturing activity in foreign trade zones in the United States will quadruple in the next ten years.⁴²² Thus, if foreign trade zones in the United States are due to increase, we must dramatically increase the amount of exports from these zones in order to positively impact the U.S. economy. The increase of exports from China due to their export processing zone activity has greatly enhanced its economy since 1979.

The recent trend in the United States is toward development of export processing zones to absorb unemployment in depressed areas as well as to expand export shipments to help reduce the trade deficit.⁴²³ Unlike most of the export processing free trade zones of the developing countries and of China in particular, the foreign trade zones in the United States generally are involved with warehousing, labeling, assembling or distributing operations instead of exporting merchandise.⁴²⁴ U.S. foreign trade zones could play a vital part in reducing the United States trade deficit through export expansion. In order to accomplish this much needed goal the U.S. should revise its present legislation and require a minimum of 60% to 70% of zone activity to be devoted to export processing.⁴²⁵

In response to the negative impact on the American economy of outsourcing and transfer of manufacturing overseas into export processing zones, the Omnibus Budget Reconciliation Act of 1993 prohibited the use of U.S.AID funds to help export processing zones overseas.⁴²⁶

It is unlikely that the pace of new zone approvals in the United States will slow down in the future, despite the harsh criticism of these zones by certain factions of the American people.⁴²⁷ For example, in 1989 pressure from the United Auto Workers, the Automotive Parts and Accessories Association, Midwest parts companies, and steel industry lobbyists, as well as several members of Congress, led to a decision by the House Ways and Means Committee to hold hearings on the proliferation of United States foreign trade subzones.⁴²⁸ Nevertheless, the U.S. auto industry has seen a rebirth and a resurgence of manufacturing of automobiles in the United States.⁴²⁹

In 2012, Paul Piquado, Assistant Secretary for the Import Administration at the International Trade Administration announced the "first regulatory overhaul to the U.S. Foreign Trade Zone (FTZ) program in 20 years."⁴³⁰ The FTZ Board issued new regulations designed to improve the FTZ program's flexibility and responsiveness, enhance ease-of-use

⁴²¹ *Shanghai Free-Trade Zone Launched*, BBC NEWS (Sept. 29, 2013), <http://www.bbc.com/news/business-24322313>.

⁴²² TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 29.

⁴²³ *Id.* at 28.

⁴²⁴ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 215.

⁴²⁵ *Id.* at 216.

⁴²⁶ Omnibus Budget Reconciliation Act of 1993, H.R. 2264, 103rd Cong. § 1391(b) (1993-1994)

⁴²⁷ Tiefenbrun, *FTZ Impact on the U.S. Economy*, *supra* note 1, at 216.

⁴²⁸ See U.S. GOV'T ACCOUNTABILITY OFFICE, *FOREIGN TRADE ZONES PROGRAM NEEDS CLARIFIED CRITERIA* (1989).

⁴²⁹ See President Barack Obama, State of the Union Address (Jan. 20, 2015). See also Louis Jacobson, *Barack Obama Says U.S. Auto Industry Has 'Created About 500,000 New Jobs' in Past 5 Years*, POLITIFACT (Jan. 20, 2015, 5:18 PM), <http://www.politifact.com/truth-o-meter/statements/2015/jan/20/barack-obama/barack-obama-says-us-auto-industry-has-created-abo/>.

⁴³⁰ *FTZ Regulation Revision Promotes Flexibility, Transparency*, GLOBAL CAROLINA BUS. J., (Feb. 23, 2012) http://gcbusinessjournal.com/index.php?option=com_content&view=article&id=1706:ftz-r.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

for applicants, and promote even greater transparency for both stakeholders and the public.⁴³¹ China should look to these new regulations to improve the functioning of their own zones. The new U.S. FTZ regulations replace the prior manufacturing-approval procedures with a simpler and faster standard notification process, reducing the ordinary processing time for notifications to 120 days.⁴³² This report claims that FTZs in the U.S. export approximately \$30 billion a year in merchandise.⁴³³ The regulations support President Obama's National Export Initiative by enabling U.S. manufacturers to compete more effectively for global export business.⁴³⁴ Rather than continuing to require advance approval by the FTZ Board,⁴³⁵ the regulations allow a company manufacturing for export to simply report its FTZ activity at the end of the year. This change could dramatically improve the flexibility and responsiveness of the FTZ program for U.S. exporters.

The National Association of Foreign-Trade Zones ("NAFTZ") released a report on July 18, 2012, claiming that there has been impressive growth in merchandise received in, and exports from, foreign-trade zones which outpaced comparable growth in the overall U.S. economy as the nation struggled to recover from the depths of the recession in 2009-2010.⁴³⁶ The FTZ exports that totaled \$34.8 billion are actually a "23-percent increase that outpaced the 16 percent growth in exports generated by the overall U.S. economy."⁴³⁷ Daniel Griswold, the President of NAFTAZ, said, "Export growth is a critical component for our national economic recovery," and "[t]his report documents how market-leading firms are using the foreign-trade zone tool to boost exports and profits despite continued sluggish economic conditions."⁴³⁸ The state of Texas led all states in the value of merchandise received into FTZs (\$161.1 billion), the number of firms operating in zones (393), the amount of zone exports (\$7.2 billion), and employment (51,085).⁴³⁹ In Texas, the foreign-trade zones help create jobs and increase exports. The international automotive sector led the way with \$11 billion worth of FTZ exports in 2010.⁴⁴⁰ FTZs actually help auto companies access parts and raw materials around the world at more competitive prices, thereby reducing costs and making the United States a more competitive location for manufacturing motor vehicles for domestic sale and for export.⁴⁴¹ Thus, when U.S. foreign trade zones are used strategically, they can increase U.S. manufacturing and U.S. exports.

⁴³¹ Dep't of Commerce & Int'l Trade Admin, *Foreign Trade Zone Regulation Revision Promotes Flexibility and Transparency*, INT'L TRADE ADMIN. (FEB. 17, 2012), <http://trade.gov/press/press-releases/2012/foreign-trade-zone-regulation-revision-promotes-flexibility-and-transparency-021712.asp>.

⁴³² *Id.*

⁴³³ *Id.*

⁴³⁴ *Foreign Trade Zones Enhance U.S. Competitiveness*, GLOBAL CAROLINA BUS. JOURNAL (Jan. 3, 2011), http://gcbusinessjournal.com/index.php?option=com_content&view=article&id=859.foreign.

⁴³⁵ *Id.*

⁴³⁶ *Foreign-Trade Zones A Bright Spot in U.S. Economic Recovery, Study Shows*, NAT'L ASSN. OF FOREIGN-TRADE ZONES (July 18, 2012), <http://www.marketwatch.com/story/foreign-trade-zones-a-bright-spot-in-us-economic-recovery>.

⁴³⁷ *Id.*

⁴³⁸ *Id.*

⁴³⁹ Ascension Business Journal, INSPIRED MEDIA 1, 7-8 (Aug. 2012), <http://www.inspiredmedia-la.com/abj/archives/pdf/2012.pdf>.

⁴⁴⁰ *Id.*

⁴⁴¹ *Id.*

U.S. FOREIGN TRADE ZONES AND CHINESE FREE TRADE ZONES

Labor conditions and practices in the U.S. foreign trade zones as well as the labor practices by U.S. companies manufacturing abroad in free trade zones have been highly criticized.⁴⁴² For example, Apple Inc. is a U.S. company that has been accused of egregious labor abuses in China.⁴⁴³ Apple contracts with original equipment manufacturers in China such as Foxconn, whose largest factory is located in Longhua, Shenzhen, where 230,000 Chinese workers are employed in what is referred to as “Foxconn city.”⁴⁴⁴ Apple’s Foxconn factories have been highly criticized in a report “Students and Scholars Against Corporate Misbehavior” written by Debby Chan, Project Officer of a Hong Kong based firm.⁴⁴⁵ This report found serious labor abuses in Apple’s Foxconn factory, and the report was issued on March 29, 2012.⁴⁴⁶ Since then Apple has tried to correct these alleged abuses.⁴⁴⁷ Apple has easy access to the Chinese supply chain because of its location in the factory in the free port city of Shenzhen.⁴⁴⁸ Apple has agreed to make serious labor reforms in order to benefit the many Chinese Foxconn employees on the production line in Shenzhen.⁴⁴⁹

Therefore, the foreign trade zones in the United States have been criticized for many reasons including bad labor practices, environmental abuses, and the failure to increase exports sufficiently.⁴⁵⁰ Despite the avalanche of attacks on U.S. foreign trade zones, there are some United States auto manufacturers, as well as the Motor Vehicle Manufacturers Association, who maintain that the automotive subzones in the United States help American companies keep up with imports.⁴⁵¹ They say that “it is the single most effective means to reduce the cost of manufacturing automobiles in America.”⁴⁵² Since tariffs on assembled cars coming into the United States from a U.S. subzone are reduced to 2.5% on the final product, compared with an average of from 6% to 8% on the imported parts, the saving on each assembled U.S. subzone car comes to about \$5 on a small car and as much as \$8 on a larger

⁴⁴² *Apple Supplier Accused of Labor Abuses by China Watchdog*, THE HUFFINGTON POST (July 29, 2013, 1:18:PM), http://www.huffingtonpost.com/2013/07/29/apple-supplier-accused-of-labor-abuses_n_3669526.html.

⁴⁴³ *Id.*

⁴⁴⁴ Tiefenbrun, *FTZs Impact on the U.S. Economy*, *supra* note 1, at 219.

⁴⁴⁵ Letter From Debby Chan, Project Officer of Students & Scholars Against Corporate Misbehavior, to Wintek Corp., available at <http://sacom.hk/wp-content/uploads/2009/10/20091013-letter-to-wintek.pdf>.

⁴⁴⁶ Debby Chan, *A Closer Look at Apple and Foxconn: Labor Practices in China and Brazil*, ECONOMIC POLICY INSTITUTE (April 11, 2012), <http://www.epi.org/event/apple-foxconn-labor-practices-china/#materials>.

⁴⁴⁷ Henry Blodget, *Your Iphone was Built, In Part, By 13 Year-Olds Working 16 Hours a Day*, BUS. INSIDER (Jan. 15, 2012), www.articles.businessinsider.com/2012-0. See also *Work Conditions Said to Improve at Apple Supplier*, N.Y. TIMES (August 23, 2012) at B8 [hereinafter *Work Conditions Said to Improve at Apple Supplier*]. Protests against Hong Kong and Chinese bosses in Bangladesh who pay workers low wages (\$50 a month) and want further cuts in wages broke out in violence in an Indian Export Processing Zone in Bangladesh. India, now an export powerhouse for apparel exports to the United States and Europe, second only to China. See Jim Yardly, *Export Powerhouse Feels Pangs of Labor Strife*, N.Y. TIMES (August 24, 2012) at A1.

⁴⁴⁸ See Debby Chan, *supra* note 446.

⁴⁴⁹ See *supra* note 447 and accompanying text.

⁴⁵⁰ Tiefenbrun, *FTZs Impact on the U.S. Economy*, *supra* note 1, at 221.

⁴⁵¹ *Id.*

⁴⁵² See generally David Ostheimer, *FTZs Are Valued as Vehicle Processing Centers*, G.A. FOREIGN-TRADE ZONE (2007), <http://www.georgiaftz.com/case-studies>.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

vehicle.⁴⁵³ For companies producing approximately 200,000 cars annually, the economic benefit of manufacturing in U.S. foreign trade zones could amount to a substantial additional profit of \$1.6 million annually.⁴⁵⁴ Japanese producers of American-made cars, who are more dependent on imported parts than the “Big 3” of the U.S., report a savings of \$35 per car by using a U.S. zone.⁴⁵⁵

Moreover, some United States companies claim that general purpose zones and subzones encourage the establishment of more factories in the United States.⁴⁵⁶ This helps reduce the trade deficit and also helps create new jobs for American workers.⁴⁵⁷

Since 1984, U.S. Customs has regarded merchandise temporarily imported into the U.S., subsequently processed, and then moved into a zone for manufacturing into a different product as having been “exported.”⁴⁵⁸ Because of complaints from the influential steel and automotive associations and institutes, Customs is under pressure to change the interpretation in order to discourage imports of these highly competitive products.⁴⁵⁹

In the United States, Customs rulings are issued monthly on product classification since the new “essential character” criterion that replaced the “chief value” criterion has created some question on the classification of goods for the purposes of Customs.⁴⁶⁰ The frequency of Customs rulings is an example of the attempt by the United States to make the laws relating to U.S. foreign trade zones as specific as possible.⁴⁶¹ This is exactly the direction in which the laws governing free trade zones in China need to move.

It is essential to establish Chinese legal reform in order to bring China under a rule of law and not a rule by laws. The free trade zone legislation must be clearer, more specific, and more transparent. Under the leadership of Xi Jinping, China is now engaging in an all-out campaign to rid the nation of corruption, especially in the judicial system.⁴⁶² Once this occurs on all levels, local, city, state, and country, the free trade zones in China will continue to develop and increase in their effectiveness. More effective free trade zones in China will positively impact the Chinese economy, increase customer confidence in international trade and international business, and cause the very same beneficial reforms instituted in the free trade zones to trickle down to the local levels in order to expedite the development of infrastructure in the whole country.

⁴⁵³ See generally Deborah Swenson, *Explaining Domestic Content: Evidence from Japanese and U.S. Automobile Production in the United States*, in THE EFFECTS OF U.S. TRADE PROT. AND PROMOTION POLICIES 33-54 (Robert C. Feenstra Ed., 1995), available at <http://www.nber.org/chapters/c0308.pdf>.

⁴⁵⁴ Tiefenbrun, *FTZs Impact on the U.S. Economy*, *supra* note 1, at 221.

⁴⁵⁵ Swenson, *supra* note 453, at 33.

⁴⁵⁶ Tiefenbrun, *FTZs Impact on the U.S. Economy*, *supra* note 1, at 221.

⁴⁵⁷ *Id.*

⁴⁵⁸ TIEFENBRUN, *TAX-FREE TRADE ZONES OF THE WORLD*, *supra* note 1, at 33.

⁴⁵⁹ *Id.*

⁴⁶⁰ Tiefenbrun, *FTZs Impact on the U.S. Economy*, *supra* note 1, at 222.

⁴⁶¹ *Id.*

⁴⁶² See *Rule of Law in China: China with Legal Characteristics*, THE ECONOMIST (Nov. 1, 2014), www.economist.com/newsleaders/21629383-xi-jinping-invoking-rule-of-law-thats-risky-him-and-good-china-china-legal.