MARKETS

One Year On, Shanghai Free-Trade Zone Disappoints

Progress Has Been Modest for Project Promoted as an Effort to Remake China's Economy, Executives Say

BySHEN HONG

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People shop for seafood in the Shanghai Free Trade Zone. *Shen Hong/The Wall Street Journal*

SHANGHAI—One year after the launch of the Shanghai free-trade zone, promoted as a landmark effort to remake China's economy, the project has generated few significant reforms.

While there have been changes, including cutting some red tape for businesses and opening up certain industries to investment, executives say the overhauls don't amount to much. The removal of the project's leader, Dai Haibo, on Sept. 15 marked the latest setback for the free-trade zone.

Overhauls in Shanghai

What the Free-Trade Zone did

- Simplify customs procedures
- Cut red tape for company registration
- Let Chinese companies borrow yuan offshore
- Liberalize rules on company fund transfers

"Progress on the Shanghai FTZ has been quite modest, even by the low standards of China's gradual and incremental approach to market-oriented and financial-sector reforms," said Eswar Prasad, a China expert at Cornell University.

Allow yuan-denominated gold trading

What the FTZ didn't do

Loosen exchange rates

Liberalize yuan interest rates

Allow foreign banks into capital market

Let yuan-denominated bonds in the zone

Allow trading of derivatives

Promoted by Premier Li Keqiang as a symbol of China's commitment to reform, the Shanghai free-trade zone, launched on Sept. 29, 2013, initially fueled hopes for a repeat of the Shenzhen special economic zone in the 1980s, which transformed the fishing village into the heart of China's export machine.

The Shanghai zone encompasses nearly 11 square miles of docks, hangars and warehouses in Shanghai's Pudong district. It was promoted as an incubator for financial revamps such as interest-rate liberalization and easier cross-border capital flows that would eventually spill over the entire country.

Instead, the most visible change inside the zone is cheap, directly imported seafood. Waiting in lines that are often 100 meters long, customers snap up frozen Mozambique lobsters, Chilean king crabs and Vietnamese tiger prawns, which are usually sold out within an hour after opening.

There have been some overhauls in the free-trade zone, including a reduction in red tape for business registration, minimizing bureaucracy at customs, and opening up investments for foreign capital in areas such as health care and engineering.

But business executives aren't impressed. "I still don't find the FTZ as a physical entity very exciting because one year on, I would expect more to have happened," said Fredrik Hähnel, general manager of merchant banking at the Shanghai branch of Nordic lender Skandinaviska Enskilda Banken AB.

Mr. Hähnel said he had hoped for breakthroughs such as the permission for companies to issue yuan-denominated bonds in the free-trade zone and full access for wholly owned foreign investment banks or brokerage firms to China's domestic capital markets.

Mr. Hähnel said SEB isn't considering setting up a branch in the free-zone now. "We don't see anything we can do in the FTZ that we can't do outside now…. But if we see fundamental changes, such as total access to offshore funding or the capital markets, we'll look into it," he said.

Other modest overhauls include a measure to allow companies registered in the zone to borrow the Chinese currency from offshore and another allowing companies to transfer yuan-denominated funds between their entities registered in the free-trade zone and those offshore or in the mainland. In March, the central bank also removed the upper limit on foreign-currency deposit rates offered by lenders in the zone.

Those moves are in contrast to the ambitious vision that regulators initially painted for the reform testing ground. In addition to proposals for giving banks broad freedom to set interest rates and trade in foreign exchange, there were plans to build marketplaces in the zone for trading of financial derivatives and foreign-company shares. The changes have fallen far short of those expectations.

Two weeks ago, as the one-year anniversary of the free-trade zone approached, the government announced that the leader of the zone, Mr. Dai, had been removed, without giving a reason. State-run media have reported that he is under investigation for alleged corruption. On Friday, Shanghai's vice mayor, Ai Baojun, said at a news conference that Mr. Dai's removal was a "normal personnel shift."

The latest effort to put some shine on the free-trade zone is an international trading platform at the Shanghai Gold Exchange, which will allow investors to price and trade the precious metal using the

Chinese currency. Hours after Mr. Dai was stripped of his post, the government announced that the launch date would be moved up to Sept. 18 instead of on Monday's anniversary.

The debut of the new gold-trading platform coincided with a surprise visit to the zone by Premier Li, whose failure to appear at the zone's launch spurred speculation that Beijing was scaling back its reform ambitions.

There have been other encouraging signs lately. Microsoft Corp. said on Thursday that its new game console, the Xbox One, will go on sale through the Shanghai free-trade zone on Sept. 29. It will become the first game console to be legally sold in mainland China after the country lifted a ban that lasted more than a decade.

The good news is overshadowed by what still isn't allowed in the free-trade zone. Beijing has kept a long "negative list" that details industries that are off limits to foreign investors. The government did cut the number to 139 from 190 in July, lifting barriers to foreign investment in banks and other financial companies, land, Internet cafes and rail-freight transport. But business executives say the list is still too long.

"I think they must be concerned that the free-trade zone is some kind of Trojan horse that could breach the capital controls and become a source of instability. Caution prevails again," said Tim Condon, an economist at ING.

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