

Special Economic Zones: A Catalyst for International Trade and Investment in Unsettling Times?

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Abstract

In the present unsettling times, the world is in need of an effective catalyst to drive the growth of international trade and investment. Special economic zones (SEZs) may have the strong potential to serve as such catalyst. Drawing on the experience of SEZs around the globe, this article seeks to illustrate how to make an SEZ work and how to do it right. In particular, the experience of the Hong Kong Special Administrative Region of the People's Republic of China can provide useful insights in this regard. This article will also look at how changing global trade and economic environment has given rise to new challenges and opportunities for SEZ development, including innovation in dispute resolution mechanisms, synergy with free trade agreement initiatives, greater use of modern technology, a 'green' development model and collaboration and partnership among governments as well as international organizations.

Keywords: special economic zone – legal infrastructure – catalyst for international trade and investment

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Introduction

In recent years, the development of global trade and investment has been hindered by a number of challenges, and the road ahead for international economic law has been clouded by uncertainties. The world has yet to fully recover from the global financial crisis in 2008 and many economies are still experiencing stagnant or sluggish growth.

On the international trade law front, the progress of the Doha Round negotiations in the World Trade Organization (WTO) has been slow.¹ While some of the WTO members have pursued plurilateral initiatives such as the negotiations of the Trade in Services Agreement (TiSA),² such plurilateral initiatives have yet to yield significant progress. Not to mention the impasse over the appointment of members of the WTO Appellate Body,³ what is more unsettling is the crisis that is currently faced by the multilateral trading system in light of the threat of protectionism and unilateralism or even trade wars.⁴

On the international investment law front, the current dispute settlement mechanism for investor-State disputes has been severely criticized⁵ and a

¹ ‘The Threat to World Trade: The Rules-Based System Is in Grave Danger’ (*The Economist*, 8 March 2018) <<https://www.economist.com/leaders/2018/03/08/the-rules-based-system-is-in-grave-danger>> accessed 22 July 2018.

² ‘Congressional Services Caucus Urges USTR to Restart TiSA Negotiations’ (*Inside US Trade*, 21 July 2017) <<https://insidetrade.com/daily-news/congressional-services-caucus-urges-ustr-restart-tisa-negotiations>> accessed 25 October 2018.

³ At a public event related to the latest annual report of the Appellate Body of the WTO on 22 June 2018, the Chair of the Appellate Body, Mr Ujal Singh Bhatia, remarked that the Appellate Body is facing ‘unprecedented challenges’ arising from the increasing number and complexity of appeals filed coupled with the ongoing stalemate over the appointment of new members of the Appellate Body, see WTO, ‘Unprecedented Challenges Confront Appellate Body, Chair Warns’ (22 June 2018) <https://www.wto.org/english/news_e/news18_e/ab_22jun18_e.htm> accessed 22 July 2018.

⁴ ‘The Threat to World Trade’ (n 1). See also, ‘IMF Warns Trump Trade War Could Cost Global Economy US\$430 Billion’ (*South China Morning Post*, 17 July 2018) <<https://www.scmp.com/business/global-economy/article/2155537/imf-warns-trump-trade-war-could-cost-global-economy-us430>> accessed 22 July 2018.

⁵ As a result, since 2017, Working Group III of the United Nations Commission on International Trade Law (UNCITRAL) has been tasked to study the issue of Investor-State Dispute Settlement Reform. For further information, see

number of countries have also withdrawn from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).⁶ There seems to be a sentiment against globalization and there are also skepticisms expressed over the benefits of international investment treaties.

No single solution can address all the challenges faced by the global trade and investment in the present unsettling times. To address such challenges, the world is searching for an effective catalyst to drive the growth of international trade and investment. It is the proposition in this article that Special Economic Zones (SEZs), which are essentially economic policy tools with a long history, may have the strong potential to serve as such a catalyst.

Part 1 of this article provides an overview of SEZs, tracing their history and modern developments. In Part 2, the best practices for the design of the legal infrastructure of SEZs are examined, with reference to insights drawn from the Hong Kong Special Administrative Region of the People's Republic of China. In Part 3, the contemporary challenges and opportunities faced by SEZs are identified and discussed. Further research and study on these contemporary challenges and opportunities are needed, and innovative and practical solutions are called for to address them.

1. Overview on SEZs

The origin of SEZs can probably be traced back to the ancient Greece and many consider the Island of Delos in Cyclades of Greece to be the first approximation of an SEZ.⁷ There is, however, not a universally agreed definition of SEZs and different economies have used a variety of terms to describe it.⁸

UNCITRAL, 'Working Group III' (2018)
<https://uncitral.un.org/en/working_groups/3/investor-state> accessed 22 July 2018.

⁶ Several Latin American countries have denounced the ICSID Convention in the last decade or so, namely, Bolivia (2007), Ecuador (2009), and Venezuela (2012).

⁷ Thomas Farole, *Special Economic Zones in Africa – Comparing Performance and Learning from Global Experience* (World Bank 2011) 31.

⁸ *ibid* 24. See also World Bank, 'Special Economic Zones – An Operational Review of Their Impacts' (2017) 9
<<https://openknowledge.worldbank.org/handle/10986/29054>> accessed 22 July 2018.

In a leading study conducted by the World Bank on SEZs, an attempt has been made to broadly define SEZs as ‘demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory.’⁹ The World Bank also observed that those differential rules ‘principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment’¹⁰ and the determinant structural feature of an SEZ is that it ‘benefits from a different regulatory regime from that in the rest of the economy.’¹¹

Because of the evolving development of SEZs in practice, the definition set out by the World Bank may not be able to capture all the SEZ models, especially those that have emerged only recently. For example, the Qatar International Financial Centre (QFC) is not tied with a geographical delimited area inside Qatar.¹² In Dubai, while the Jebel Ali Free Zone and the Dubai Airport Free Zone are fenced-in, other SEZs such as Dubai Multi Commodities Centre (DMCC) and Dubai International Financial Centre (DIFC) are unfenced.¹³

In this article, based on the definition proposed by the World Bank, a broad scope will be given to the term SEZ and such term will cover traditional models such as commercial free zones, export processing zones as well as more recent models such as the Shanghai Pilot Free Trade Zone in China, DMCC and QFC, and free trade ports.

While SEZs are present in most countries nowadays, it is of interest to note that, in 1975, only 25 countries had SEZs and the number of SEZs stood at around 79.¹⁴ Since then, a significant growth was observed in the number of SEZs worldwide and, as of 2006, there were 3,500 SEZs established in 130 countries.¹⁵ In 2017, it was estimated that the number

⁹ See Farole (n 7) 23.

¹⁰ *ibid.*

¹¹ *ibid* 25.

¹² See the website of QFC at <<http://www.qfc.qa/en/Setup/Pages/default.aspx>> accessed 22 July 2018.

¹³ PwC, ‘UAE Customs Alert – Free Zones’ Customs Audits’ (June 2015) 1 – 2 <https://www.pwc.com/m1/en/tax/documents/2015/uae_customs_alert_uae_free_zones_customs_audits.pdf> accessed 22 July 2018.

¹⁴ See Farole (n 7) 43.

¹⁵ *ibid.*

of SEZs in the world has reached approximately 4,300.¹⁶

This significant growth has allowed the idea of SEZs to come in a number of different shapes and forms. Four types of commonly-found SEZs are highlighted and discussed in the following paragraphs.

Commercial free zones is one of the oldest form of SEZs and they are basically fenced-in, duty free areas located in or near seaports and airports offering warehousing, storage and distribution facilities for trade, transshipment and re-export operations.¹⁷ A classic example of a commercial free zone is the Colon Free Zone in Panama.¹⁸

Export processing zones emerged in late 1950s and early 1960s for accelerating industrialization and industry-related international trade.¹⁹ Such zones are fenced-in area, which is situated outside a country's customs territory supported by simplified administrative procedures, offering developed industrial land for rent or lease and enterprises within such zones benefit from investment and operational incentives.²⁰ The Shannon Free Zone in Ireland is widely considered to be the first export processing zone in the world.²¹

There is also a variation on the model of commercial free zones and export processing zones, which is called 'single unit free zones'. Under single unit free zone schemes, individual enterprises are provided with free zone incentives and are allowed to be located anywhere in the national territory or in a designated part of the territory.²² The Mauritius Export Processing Zone is an example of this type of SEZs and individual enterprises are granted free zone status on an individual basis and are free

¹⁶ World Bank (n 8) 9.

¹⁷ FIAS, 'Special Economic Zones – Performance, Lessons Learned, and Implications for Zone Development' (April 2008) 3, 10 <<http://documents.worldbank.org/curated/%20en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development>> accessed 22 July 2018. See also Farole (n 7) 27.

¹⁸ See FIAS (n 17) 10.

¹⁹ See Farole (n 7) 27 – 28.

²⁰ *ibid.*

²¹ *ibid* 28.

²² *ibid* 28 – 29.

to locate anywhere on the island, including in industrial parks that are not limited to free zone enterprises.²³

Apart from the various SEZ models mentioned above, wide-area SEZs which focus on integrated development²⁴ instead of simply focusing on manufacturing activities have also emerged in recent years. Such SEZs, which are in a way similar to cosmopolitan cities, can encompass very large portions of the territory and may include both urban and rural areas.²⁵ China has been very active in the development of this type of wide-area SEZs and it has established 11 such zones²⁶ since 2013, with the first one being the Shanghai Pilot Free Trade Zone.²⁷

It should be noted that the establishment of SEZs has been a global phenomenon and both developed countries and developing countries have in place various initiatives for SEZ development.²⁸

In the United States, ‘foreign trade zones’ are established pursuant to the Foreign Trade Act 1934.²⁹ Such foreign trade zones serve the policy objectives of attracting foreign direct investment, alleviating unemployment, fostering economic reform strategies by developing and diversifying exports as well as testing new approaches to foreign direct investment and other policies.³⁰

²³ *ibid* 30.

²⁴ Arpita Mukherjee and others, ‘SEZs in Selected Countries: A Comparison with India’ in Arpita Mukherjee and others (eds), *Special Economic Zones in India: Status, Issues and Potential* (Springer 2016) 45. See also Farole (n 7) 29 – 30.

²⁵ See Farole (n 7) 29 – 30.

²⁶ The 11 Free Trade Zones are in Shanghai, Hubei, Sichuan, Shaanxi, Henan, Guangdong, Tianjin, Fujian, Liaoning, Zhejiang and Chongqing, see Hong Kong Trade Development Council, ‘China Pilot Free Trade Zones’ (10 May 2017) <<http://china-trade-research.hktdc.com/business-news/article/Facts-and-Figures/China-Pilot-Free-Trade-Zones/ff/en/1/1X000000/1X0A2V2D.htm>> accessed 22 July 2018.

²⁷ See Shanghai Free Trade Zone, ‘Introduction’ (2018) <<http://en.shftz.gov.cn/about-ftz/introduction/>> accessed 22 July 2018.

²⁸ See FIAS (n 17) 61 – 70.

²⁹ Susan Tiefenbrun, ‘US Foreign Trade Zones and Chinese Free Trade Zones: A Comparative Analysis’ (2015) 14 *J Intl Bus & Law* 189, 191.

³⁰ *ibid* 200 – 201.

The establishment of foreign trade zones in the United States has an intriguing historical context, which may be of relevance to the situation that the global economic and trade environment is facing these days. Back in 1930, following the Great Depression in 1929, a protectionist tariff act known as the Smoot-Hawley Act of 1930 was passed to impose very high tariffs on imports and such act has resulted a decline in exports and re-exports from the United States.³¹ Congressman Emmanuel Celler then came up with the idea of foreign trade zones and introduced the Foreign Trade Act in 1934 to counteract the negative economic effects of the Smoot-Hawley Act.³² Till today, foreign trade zones are still being established in the United States under the Foreign Trade Act 1934 and, according to the information in the website of the Department of Commerce of the United States, the number of foreign trade zones has almost reached 300.³³

In Asia, China has not only used SEZs as a platform for attracting foreign direct investments, but also as laboratories to experiment regulatory and economic reforms.³⁴ A classic SEZ example in China is Shenzhen which was transformed by the SEZ initiative from a traditional fishing village to one of the most important high-tech research and development and manufacturing bases in China.³⁵

In 2013, Japan embarked on the initiative of National Strategic Special Zones, which adopts a top-down governance approach, and focuses on attracting foreign direct investment through bold regulatory and structural reform to create the ‘most business-friendly environment in the world.’³⁶

³¹ *ibid* 195.

³² *ibid*.

³³ See US Department of Commerce, ‘US Foreign Trade Zones’ (12 October 2018) <<https://enforcement.trade.gov/ftzpage/letters/ftzlist-map.html>> accessed 22 July 2018.

³⁴ Jiaxiang Hu, ‘A Retrospective View on the First Three Years of China (Shanghai) Pilot Free Trade Zone’ (2017) 50(4) *The Chinese Economy* 225, 225 – 28.

³⁵ Douglas Zhihua Zeng (ed), *Building Engines for Growth and Competitiveness in China – Experience with Special Economic Zones and Industrial Clusters* (World Bank 2010) 55 – 56.

³⁶ See Invest Tokyo, ‘National Strategic Special Zone’ (2018) <http://www.seisakukikaku.metro.tokyo.jp/invest_tokyo/english/invest-tokyo/nssz.html> accessed 22 July 2018.

Thailand also launched its SEZ programme in 2015 to establish zones in its border areas to connect with the neighboring countries in terms of trade, economy and investment.³⁷

Despite the wide-spread use of SEZs in the world, the establishment of SEZs does not necessarily guarantee success in boosting trade and investment. The performance of SEZs has so far been mixed³⁸ and many have not performed well for reasons such as poor site locations, uncompetitive policies and lack of differentiation, poor zone development practices, cumbersome procedure and controls as well as ill-designed administrative structure.³⁹

At the same time, there is no shortage of examples of SEZs which prove to be highly successful in attracting foreign direct investment and supporting a wider economic reform strategy of the relevant countries.⁴⁰ These SEZs often demonstrate that a good overall design coupled with appropriate policies are the keys to their success, which will be further elaborated below.

2. Best Practices for the Design of the Legal Infrastructure of SEZs – Insights from the Hong Kong Special Administrative Region

The global experience in SEZs has shown that, if done right, SEZs do have strong potential to serve as a catalyst for international trade and investment, especially in the current unsettling times. However, if not

³⁷ See Vasundhara Rastogi, ‘Thailand’s Special Economic Zones – Opportunities for Investment’ (*ASEAN Briefing*, 13 April 2018) <<https://www.aseanbriefing.com/news/2018/04/13/thailands-special-economic-zones-opportunities-investment.html>> accessed 22 July 2018.

³⁸ Douglas Zhihua Zeng, ‘Global Experiences with Special Economic Zones – With a Focus on China and Africa’ (April 2015) 2 <<http://documents.worldbank.org/curated/en/810281468186872492/Global-experiences-with-special-economic-zones-focus-on-China-and-Africa>> accessed 22 July 2018.

³⁹ See FIAS (n 17) 50 – 51.

⁴⁰ For example, the Jebel Ali Free Zone contributes more than 20% of Dubai’s GDP and accounts for more than 30% of inward FDI into Dubai. See Cathy Mullan, ‘Global Free Zones of the Year 2017’ (*fDi Intelligence*, 9 October 2017) <<https://www.fdiintelligence.com/Rankings/fDi-Global-Free-Zones-of-the-Year-2017-the-winners>> accessed 22 July 2018. See also Zeng (n 38) 2. See also FIAS (n 17) 6, 12 – 13.

done right, it will result in a waste of valuable public money and may tarnish the reputation of the relevant economy as a destination for foreign direct investments. Worse still, SEZ initiatives that are poorly designed and executed may be prone to dispute settlement actions under the WTO and investor's claim under investor-State dispute settlement mechanisms in international investment agreements. The key question would then be how to make an SEZ work and how to do it right. Clearly, a prime geographical location and a high level of supporting physical infrastructure that enhances connectivity are crucial to the success and sustainability of an SEZ.⁴¹ Most of the successful SEZs in the world are located in strategic locations which are close to population and urban centres with sophisticated infrastructure such as roads, seaports, airports and railroads.⁴² For examples, the Shannon Free Zone in Ireland is located near Shannon Airport,⁴³ and Free Trade Zone No. 74 in Baltimore, Maryland of the United States has direct access to Baltimore port, which is one of the top 25 ports worldwide, as well as access to major rail and road lines of transportation.⁴⁴ The early SEZs of China are located in coastal areas of Guangdong and Fujian.⁴⁵ The Tanger Med Zone of Africa is located near the Strait of Gibraltar, offering investors good access to maritime shipping routes only 14 kilometres from European markets.⁴⁶ The DMCC free zone is also located in the most populous city of the United Arab Emirates (UAE).⁴⁷

⁴¹ See FIAS (n 17) 50 – 51. See also United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), 'Handbook on Policies, Promotion and Facilitation of Foreign Direct Investment for Sustainable Development in Asia and the Pacific' (2017) 158 – 160 <<https://www.unescap.org/resources/handbook-policies-promotion-and-facilitation-foreign-direct-investment-sustainable-0>> accessed 22 July 2018.

⁴² See ESCAP, *ibid* 158.

⁴³ Cathy Mullan, 'fDi Global Free Zones of the Year 2015: Winners' (*fDi Intelligence*, 12 October 2015) <<https://www.fdiintelligence.com/Rankings/fDi-Global-Free-Zones-of-the-Year-2015-Winners>> accessed 22 July 2018.

⁴⁴ *ibid*.

⁴⁵ See Zeng (n 35) 9.

⁴⁶ Cathy Mullan, 'Global Free Zones of the Year 2016' (*fDi Intelligence*, 10 October 2016) <<https://www.fdiintelligence.com/Rankings/Global-Free-Zones-of-the-Year-2016>> accessed 22 July 2018.

⁴⁷ See Mullan (n 43).

Apart from the geographical location and supporting physical infrastructure, a well-designed legal infrastructure is vital to the success of an SEZ. As with all government initiatives, a policy has to be formulated. In the context of SEZs, it is important that policies and incentives are properly set out in legislation or regulations so that they can be introduced as the laws of SEZs. Generally speaking, a well-designed legal infrastructure of an SEZ would be composed of SEZ laws that are sufficiently stable to ensure consistent, transparent and predictable implementation of the SEZ policy, and SEZs regulations and SEZ operating procedures that are practical, flexible and responsive to the needs of investors.⁴⁸

Designing the legal infrastructure of an SEZ is no easy task and there are various elements in the design of the legal infrastructure including investment principles and policies of the SEZ, institutional arrangements, fiscal incentives and tax administration, licensing and regulation of business activities, trade facilitation and customs control, and dispute settlement mechanisms.⁴⁹ Furthermore, it is essential to ensure that the legal infrastructure of the SEZs and their operations are compatible with international trade rules of the WTO as well as the relevant free trade agreements (FTAs) and international investment agreements.

In relation to the design of legal infrastructure, Hong Kong provides an interesting case of reference. Hong Kong is a special administrative region of China which exercises a high degree of autonomy and enjoys executive, legislative and independent judicial power, including that of final adjudication, in accordance with the Basic Law.⁵⁰ The Basic Law, which came into effect on 1 July 1997, was adopted by the National People's Congress of China and promulgated by the then President of China on 4 April 1990⁵¹ in accordance with the Constitution of China.⁵²

⁴⁸ See the presentation of Jean-Paul Gauthier, Secretary-General of the World Economic Processing Zones Association (WEPZA), 'Legal and Institutional Framework for SEZs' (2015) 10 <<http://www.wepza.org/conferences-and-presentations>> accessed 22 July 2018.

⁴⁹ *ibid* 12 – 16.

⁵⁰ See art 2 of the Basic Law.

⁵¹ See the Decree of the President of China No 26 (4 April 1990) <<https://www.basiclaw.gov.hk/en/basiclawtext/decreed.html>> accessed 22 July 2018.

⁵² The English translation of Article 31 of the Constitution of China provides that

The Basic Law sets out the high autonomy enjoyed by Hong Kong as well as the systems and policies practised in the special administrative region. Such systems include the social and economic systems, the system for safeguarding the fundamental rights, freedoms and duties of its residents, the executive, legislative and judicial systems, and the relevant policies.⁵³ It is also worthwhile to note that Hong Kong itself is a separate customs territory and a founding member of the WTO.⁵⁴

Hong Kong exhibits a number of the characteristics of an SEZ, such as having in place a regulatory regime different from that in the rest of China. Under the principle of ‘one country, two systems,’ which is enshrined in the Basic Law, Hong Kong practises the capitalist system instead of the socialist system practised in the rest of China.⁵⁵ While the legal system of Mainland China is one based on civil law, the legal system of Hong Kong is common law-based.⁵⁶ Article 18 of the Basic Law provides that the national laws of China shall not be applied in Hong Kong except for those listed in Annex III of the Basic Law, which are confined to those relating to defence and foreign affairs as well as other matters outside the limits of the autonomy of Hong Kong as specified by the Basic Law. Moreover, Hong Kong is required by Article 114 of the Basic Law to maintain the status of a free port and is widely acclaimed for such status. With these features, Hong Kong can provide useful insights with respect to designing the legal infrastructure of modern SEZs.

2.1 Key Principles and Policies

The high level design of the legal infrastructure of an SEZ needs to set out its key principles and policies⁵⁷ to, on the one hand, guide the design of the

‘[t]he State may establish special administrative regions when necessary. The systems to be instituted in special administrative regions shall be prescribed by law enacted by the National People’s Congress in the light of specific conditions.’
Text available at <http://www.npc.gov.cn/npc/xinwen/2018-03/22/content_2052489.htm> accessed 22 July 2018.

⁵³ See the website of the Department of Justice of Hong Kong <<https://www.doj.gov.hk/eng/legal/index.html>> accessed 22 July 2018.

⁵⁴ See the website of the Trade and Industry Department of Hong Kong at <https://www.tid.gov.hk/english/ito/wto/wto_overview.html> accessed 22 July 2018.

⁵⁵ See arts 1 and 5 of the Basic Law.

⁵⁶ See Department of Justice of Hong Kong (n 53).

⁵⁷ See Gauthier (n 48) 12.

other elements of the legal infrastructure and, on the other hand, signal to the outside world as to the underlying policies and objectives of the SEZ in order to attract the targeted foreign investments.

Under the Basic Law of Hong Kong, there are a number of provisions on its trade policy. For example, apart from Article 114 mandating the maintenance of a free port status as mentioned above, Article 115 provides that Hong Kong shall pursue the policy of free trade and safeguard the free movement of goods, intangible assets and capital.

Given that a main function of an SEZ is to attract foreign direct investments, principles in relation to protection of property rights are extremely important and such principles should be enshrined in the legal infrastructure in order to instill confidence in foreign investors for investing in the SEZ.

In the case of Hong Kong, Article 6 of the Basic Law provides that the right of private ownership of property should be protected and Article 105 of the Basic Law further provides that Hong Kong shall protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property. Such compensation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay.⁵⁸ It is also made expressly clear under Article 105 of the Basic Law that the ownership of enterprises and the investments from outside Hong Kong shall be protected by law.

Hong Kong also recognizes the importance of intellectual property protection and attaches great weight to the contribution that the creation of intellectual property makes to our economy.⁵⁹ According to Article 139 of the Basic Law, the Government of Hong Kong formulates its policies on science and technology and protects by law achievements in scientific and technological research, patents, discoveries and inventions. Furthermore, pursuant to Article 140 of the Basic Law, the Government of Hong Kong formulates its policies on culture and protects by law the achievements and the lawful rights and interests of authors in their literary and artistic creation.

⁵⁸ See art 105 of the Basic Law.

⁵⁹ See the website of Intellectual Property Department of Hong Kong at <https://www.ipd.gov.hk/eng/intellectual_property/ip_hk.htm> accessed 22 July 2018.

The intellectual property laws of Hong Kong are developed with the aim to reach the highest international standards and to put Hong Kong at the leading edge of intellectual property development and protection.⁶⁰ Foreign investors in Hong Kong are assured that intellectual property protection provided would be on par with and may even be better than in any other economies in the world.⁶¹ In this regard, the Customs and Excise Department of Hong Kong is tasked with helping rights-owners to enforce their rights in relation to copyright and trademark goods through border enforcement measures in accordance with the Agreement on Trade Related Aspects of Intellectual Property Rights of the WTO.⁶²

It is a good practice for SEZs to adopt a general policy that embodies the principles of most-favored-nation treatment and national treatment⁶³ in its high level design because such principles are also enshrined in the disciplines under the covered agreements of the WTO, such as the General Agreement on Tariffs and Trade (GATT) 1994⁶⁴ and the General Agreement on Trade in Services (GATS), as well as under most international investment agreements. Such general policy can set the direction for the development of the SEZs to ensure that they would be designed in a way compatible with international legal norms in relation to trade and investments.

2.2 Institutional Framework

The institutional framework of an SEZ is critical as it serves as the backbone of the legal infrastructure. The institutional framework of an SEZ typically involves a number of key actors, namely government, regulator, owner, developer, operator and tenants of the SEZ.⁶⁵ The government is responsible for the strategic planning, administration and

⁶⁰ *ibid.*

⁶¹ *ibid.*

⁶² *ibid.*

⁶³ See Gauthier (n 48) 12.

⁶⁴ It should be noted that the principle of national treatment is also reflected in the disciplines of the Agreement on Trade-Related Investment Measures of the WTO, which govern the so-called ‘performance requirements.’

⁶⁵ See Farole (n 7) 171. See also ‘ASEAN Guidelines for Special Economic Zones (SEZs) Development and Collaboration’ (2016) 15 <<https://asean.org/storage/2016/08/ASEAN-Guidelines-on-SEZ-Development.pdf>> accessed 22 July 2018.

regulation of the SEZ programme, selecting sites and developers for SEZs and providing offsite and connecting infrastructures.⁶⁶

The regulator is often considered to be one of the most important actors in an SEZ and its authority, quality and capacity will make or break an SEZ programme⁶⁷ because the regulator plays a crucial role in monitoring the compliance and enforcement of the legal framework of the SEZ and facilitating licensing and regulatory services within the SEZ in relation to matters such as land use, business registration, environment and building permits and labor regulations.⁶⁸ It has been suggested that it is a good practice to establish the regulator as an independent agency under a board of directors that includes both public and private sector members.⁶⁹ In light of the functions of the SEZ, considerations should be given to whether the board should include cross-ministerial involvement and whether the regulator should be given authority over the normally mandated agency or ministry for matters within the SEZ.⁷⁰

The owner, developer and operator can be a sole entity or a multitude of entities, depending on the various aspects of the design of an SEZ. While developers are responsible for land-use planning and provision of on-site infrastructure, operators provide facility leasing, utilities provisions, marketing and other value-added services.⁷¹

Yet, what have been discussed above are merely ideas based on the experiences of existing SEZs and there should be no limits to innovations with respect to the design of the institutional structure of SEZs in order for them to serve as catalysts for international trade and investment.

In the context of Hong Kong, the Basic Law has set out a number of provisions that may shed lights on the institutional role of the Government of Hong Kong as a planner, administrator and regulator on economic, trade and investment matters in Hong Kong. Article 109 and Article 118 of the Basic Law provide that the Government of Hong Kong

⁶⁶ See Farole (n 7) 171.

⁶⁷ *ibid* 182.

⁶⁸ *ibid* 171.

⁶⁹ *ibid* 182 – 184.

⁷⁰ *ibid* 184 – 185.

⁷¹ *ibid* 171.

shall provide an economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre and for encouraging investments, technological progress and the development of new industries.

Article 119 of the Basic Law further provides that the Government of Hong Kong shall formulate appropriate policies to promote and coordinate the development of various trades such as manufacturing, commerce, tourism, real estate, transport, public utilities, services, agriculture and fisheries, and pay regard to the protection of the environment. Moreover, Article 128 of the Basic Law provides that the Government of Hong Kong shall provide conditions and take measures for the maintenance of the status of Hong Kong as a centre of international and regional aviation. In other words, the autonomy given to the Government of Hong Kong has allowed Hong Kong to function very well in providing an excellent environment, as one would have hoped for in the situations of SEZs.

The Government of Hong Kong upholds the free market principle and at the same time seeks to play the role of a facilitator and a promoter to boost the economic vibrancy of Hong Kong through efforts in various areas, including land supply, talent, government-to-government business, policy directions, investment, business friendly environment and taxation.⁷² It should also be noted that a number of the regulatory bodies in Hong Kong such as the Securities and Futures Commission,⁷³ the Competition Commission⁷⁴ and the Insurance Authority⁷⁵ are independent statutory bodies.

The institutional structure of an SEZ can range from fully public, with the SEZ being operated, developed and regulated by the government, to fully

⁷² The Chief Executive's 2017 Policy Address, 'We Connect for Hope and Happiness' (2017) para 3 <<https://www.policyaddress.gov.hk/2017/eng/pdf/PA2017.pdf>> accessed 22 July 2018.

⁷³ See the website of the Securities and Futures Commission at <<https://www.sfc.hk/web/EN/index.html>> accessed 22 July 2018.

⁷⁴ See the website of the Competition Commission at <<https://www.compcomm.hk/>> accessed 22 July 2018.

⁷⁵ See the website of the Insurance Authority at <<https://www.ia.org.hk/en/index.html>> accessed 22 July 2018.

private, with the SEZ being privately operated and developed.⁷⁶ Back in the 1980s, less than 25% of zones worldwide were in private hands.⁷⁷ However in 2005, 62% of the 2301 zones in developing and transition countries were private sector developed and operated.⁷⁸

In between the two extremes, there is also the public-private partnership (PPP) model. PPP model is becoming a very important model, especially for infrastructure works.⁷⁹ PPP model can take many forms such as public provision of off-site infrastructure and facilities as an incentive for private funding of on-site infrastructure and facilities, assembling land parcels with secure title and development rights by the government for lease to private zone development groups as well as build-operate-transfer and build-own-operate approaches to on-site and off-site zone infrastructure and facilities.⁸⁰ During the early stage of the establishment of Shenzhen SEZ in China, joint ventures and private developers from Hong Kong have provided significant contribution to the development of basic infrastructure of the SEZ through PPPs.⁸¹

With the increasing participation of private parties in the development and operation of SEZs, one must not overlook the risk that the act of such private parties can potentially result in violations of the applicable international agreements and such acts may be attributed to the relevant States under the rules on State responsibility.⁸²

In the case of *Ampal-American Israel Corporation and others v Arab Republic of Egypt*, the investor's company was granted free zone privileges by Egypt and it entered into a contract with two state-owned

⁷⁶ See ESCAP (n 41) 152 – 153.

⁷⁷ See FIAS (n 17) 2.

⁷⁸ *ibid.*

⁷⁹ See the website of the Public-Private-Partnership Legal Resource Center of the World Bank Group at <<https://ppp.worldbank.org/public-private-partnership/overview/ppp-objectives>> accessed 22 July 2018.

⁸⁰ See FIAS (n 17) 18 – 19.

⁸¹ Yue-Man Yeung, Joanna Lee and Gordon Kee, 'China's Special Economic Zones at 30' (2009) 50(2) *Eurasian Geography and Economics* 222, 228 – 229.

⁸² Jacopo Dettoni, 'SEZ Plays Catch-up on Investment Treaties' (*fDi Intelligence*, 15 February 2018) <<https://www.fdiintelligence.com/index.php//Locations/SEZs-play-catch-up-on-investment-treaties>> accessed 22 July 2018.

corporations of Egypt. The company subsequently got its free zone privileges withdrawn by Egypt and its contract terminated by the two state-owned corporations. The ICSID tribunal ruled in favor of the investor and held that conduct of the two state-owned corporations, which amounted to expropriation, was attributed to Egypt.⁸³

In the proceeding which sought to set aside the arbitral award of *Lee John Beck and Central Asian Development Corporation v Kyrgyz Republic* made under the CIS Convention for the Protection of Investors Rights, while Kyrgyz Republic argued that the SEZ in question was not a state organ, the Moscow Arbitration Court held that attribution was found because the management of the SEZ was an executive body established by the Prime Minister of Kyrgyzstan and the SEZ enjoyed the same executive status under the Kyrgyz legislation as a Ministry within the Kyrgyz government.⁸⁴

As a result, one should be careful in the selection and vetting process for private parties' participation in the development, management and operation of SEZs. It would also be prudent to set up monitoring and coordination mechanisms to ensure that the conduct of such private parties would not be in breach of the obligations under the relevant international investment agreements.

Furthermore, the action of private entities such as private SEZs operators may also give rise to concerns under WTO disciplines if such entities are carrying out a governmental directive, or the benefits of the WTO-inconsistent incentives provided through such entities are funded by the government.⁸⁵

2.3 Good Governance and Rule of Law

Apart from having an effective institutional arrangement, good

⁸³ *Ampal-American Israel Corporation., EGI-Fund (08–10) Investors LLC, EGI-Series Investments LLC, and BSS-EMG Investors LLC v Arab Republic of Egypt*, ICSID Case No ARB/12/11, Award (21 February 2017) para 354.

⁸⁴ Presentation of Olga Boltenko on '*Lee John Beck and Central Asian Development Corporation v Kyrgyz Republic*' in the Asia FDI Forum IV – Special Economic Zones: Issues and Implications for International Law & Policy held on 22 – 23 March 2018 in the Chinese University of Hong Kong.

⁸⁵ Stephen Creskoff and Peter Walkenhorst, 'Implications of WTO Disciplines for Special Economic Zones in Developing Countries' (April 2009) 30 <<https://openknowledge.worldbank.org/handle/10986/4089>> accessed 22 July 2018.

governance and a high degree of rule of law under the legal regime of an SEZ are crucial to its success. To achieve good governance, it is necessary to have in place effective and efficient coordination mechanism for various government agencies involved in the regulation of an SEZ. Such government agencies may include those involved in policymaking, investment, trade, land development, labour, finance and customs.⁸⁶

Moreover, the importance of rule of law for SEZs cannot be over emphasized. In this connection, Hong Kong may also provide a good illustration. Strong rule of law has always been the core value of Hong Kong and such rule of law is supported by a robust legal and judicial system. Pursuant to Article 19 of the Basic Law, Hong Kong is vested with independent judicial power and the courts shall have jurisdiction over most cases in the special administrative region but not over acts of state such as defence and foreign affairs.

Furthermore, under Article 82 of the Basic Law, the power of final adjudication is vested in the Court of Final Appeal of Hong Kong, which may as required invite judges from other common law jurisdictions to sit on it as non-permanent judges. It is also expressly provided under Article 85 of the Basic Law that the courts of Hong Kong shall exercise judicial power independently, free from any interference. Insofar as judicial independence is concerned, Hong Kong ranked first in Asia according to the Global Competitiveness Report 2017–2018 prepared by the World Economic Forum.⁸⁷ The high degree of rule of law of Hong Kong is globally recognized. According to the Rule of Law Index 2017–2018 of the World Justice Project, Hong Kong is ranked 16th among 113 countries and jurisdictions for its overall rule of law performance.⁸⁸

The absence of corruption, which is a facet of good governance, is important for attracting foreign direct investment because foreign investors would clearly be reluctant in investing in a region where corruption and uneven enforcement of regulations are rampant.⁸⁹ According to the Rule of Law Index 2017–2018 of the World Justice Project, Hong Kong ranked 10th with respect to the ‘absence of

⁸⁶ See ESCAP (n 41) 160.

⁸⁷ World Economic Forum, *The Global Competitiveness Report 2017–2018* (World Economic Forum 2018) 140 – 141.

⁸⁸ World Justice Project, *Rule of Law Index 2017–2018* (World Justice Project 2018) 20 – 21.

⁸⁹ *ibid* 11.

corruption.⁹⁰ The absence of corruption in Hong Kong can be attributed to the effective functioning of the independent powers of the Independent Commission Against Corruption in investigation, the Department of Justice in prosecution and the Judiciary in adjudication to keep corruption under effective control.⁹¹

2.4 Fiscal Incentives and Tax Administration

Fiscal incentives are commonly featured in SEZs.⁹² It is observed that the variety of fiscal incentives has almost become standardized internationally among SEZs and such incentives may include corporate tax reductions or exemption, duty-free importation of raw material, capital goods, and intermediate inputs, no restrictions or taxes on capital and profits repatriation, exemption from foreign exchange controls and exemption from most local and indirect taxes.⁹³

Researches have suggested that some of the fiscal incentives offered in SEZs are ineffective and constitute a drain on public resources.⁹⁴ Moreover, it has been observed that the use of income tax holidays and other corporate income tax regimes has been widely abused.⁹⁵

Hong Kong's policy tends to focus on longer term arrangements and relies on its track records, credibility and competitiveness in order to attract businesses and investments, instead of *ad hoc* short term fiscal benefits. Such policy has contributed to attracting long-term, sustainable and profitable investments, as opposed to simply short term entries that do not stay long in the markets.

It should also be noted that some of the fiscal incentives may not necessarily sit well with the disciplines on subsidies under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) of the WTO. The SCM Agreement regulates two types of subsidies, namely

⁹⁰ *ibid* 37.

⁹¹ See the website of the Independent Commission Against Corruption of Hong Kong at <<https://www.icac.org.hk/en/intl-persp/control/rule-of-law-in-hk/index.html>> accessed 22 July 2018.

⁹² See FIAS (n 17) 54 – 55.

⁹³ *ibid* 54.

⁹⁴ *ibid*.

⁹⁵ *ibid*.

prohibited subsidies⁹⁶ and actionable subsidies.⁹⁷

Prohibited subsidies are non-agricultural subsidies that are contingent on export performance, and subsidies that are contingent on the use of domestic goods in place of imported goods.⁹⁸ As such, subsidies in the form of cash payments provided by the government based on the export performance of SEZ tenants as well as subsidies that are contingent on the SEZ tenants' use of domestic over import goods could be considered as prohibited subsidies.⁹⁹ Actionable Subsidies, on the other hand, are those that are granted by a WTO member that have 'adverse effects' on international trade, because they either cause injury to the domestic industry of another WTO member; nullify or impair WTO benefits; or cause 'serious prejudice' to the interests of another WTO member.¹⁰⁰

In light of the disciplines under the SCM Agreement, one should bear in mind that provision of WTO-inconsistent fiscal incentives in SEZs may give rise to risks of dispute settlement actions under the WTO as well as countervailing duties being imposed on the relevant products by the other WTO members.

Fiscal incentives in SEZs, once imposed, are often difficult to be removed and they are described as being 'sticky.' From the perspective of international investment law, it may be argued by investors that withdrawal of fiscal incentives has frustrated their legitimate expectation and given rise to claims of violation of the fair and equitable treatment obligation and the like. Whether such argument would succeed depends on, *inter alia*, whether the cancellation and withdrawal of incentives are made in accordance with the laws related to SEZs in the host jurisdictions. Withdrawal of free trade zone privileges has in the past given rise to a number of investor-State dispute actions, such as *Albacora S.A. v Republic of Ecuador*¹⁰¹ and *Link-Trading Joint Stock Company v*

⁹⁶ See Agreement on Subsidies and Countervailing Measures (adopted 15 April 1994, entered into force 1 January 1995) 1869 UNTS 14 (SCM Agreement) pt II.

⁹⁷ See *ibid* pt III.

⁹⁸ See FIAS (n 17) 55.

⁹⁹ See Creskoff and Walkenhorst (n 85) 31 – 33.

¹⁰⁰ See FIAS (n 17) 55.

¹⁰¹ *Albacora SA v Republic of Ecuador*, PCA Case No 2016 – 11 (pending, commenced 4 April 2016).

*Department for Customs Control of the Republic of Moldova.*¹⁰²

Researches have revealed that successful zone programmes nowadays are moving increasingly toward the removal of fiscal incentives and toward integration of zone tax regimes with those of the rest of the economy.¹⁰³ Such integration should be orderly and gradual as well as predictable to minimize risks of claims that may be brought by the investors.

One may also explore alternatives to fiscal incentives such as enhancement of regulatory efficiency and placing greater emphasis on the business development service provided in the SEZs.¹⁰⁴ For example, the Birmingham Enterprise Zone in the United Kingdom offers an aftercare relocation service to investors and supported the recent relocation of the headquarters of the HSBC from London to the zone.¹⁰⁵ The Pomeranian SEZ in Poland also offers post-investment support for SEZ tenants, such as consulting services, assisting in local media promotion and organizing conferences and business meetings.¹⁰⁶

A simple tax regime and an efficient administration of the tax collection system in an SEZ would facilitate business activities and enhance the attractiveness of the SEZ as an investment location. While tax rates offered in SEZs should be competitive in order to attract investments, SEZs should not be mistaken as tax heavens.

Take the example of Hong Kong, it is well-known for its simple and efficient tax regime.¹⁰⁷ Under Article 108 of the Basic Law, Hong Kong practises an independent taxation system separated from that of Mainland China and enacts its own laws on taxation. According to the Inland Revenue Ordinance (Cap. 112 of the Laws of Hong Kong), there are only three types of direct taxes, namely profits tax, salaries tax and property tax. In the Paying Taxes 2018 Report prepared by the World Bank and PwC, Hong Kong ranked 3rd among 190 economies in the overall ranking

¹⁰² *Link-Trading Joint Stock Company v Department for Customs Control of the Republic of Moldova*, UNCITRAL, Award (18 April 2002) paras 1 – 7.

¹⁰³ See Farole (n 7) 178 – 179.

¹⁰⁴ *ibid.*

¹⁰⁵ Mullan (n 40).

¹⁰⁶ *ibid.*

¹⁰⁷ Terry Miller, Anthony B Kim and James M Roberts, *2018 Report of Index of Economic Freedom* (The Heritage Foundation 2018) 215.

for ease of paying taxes.¹⁰⁸ In 2018, it is also estimated that the overall tax burden equals approximately 13.9 percent of total domestic income only.¹⁰⁹

2.5 Efficient and Liberal Regulatory Regime for Business Activities in SEZs

Given that SEZs play the role of attracting investments and experimenting with regulatory reforms, it should have an efficient and liberal regulatory regime and allow the broadest possible of business activities.¹¹⁰ For instance, Hong Kong follows the economic policies of free enterprise and free trade.¹¹¹ There are no import tariffs save for that excise duties are levied on a limited number of commodities such as liquors and tobacco.¹¹² Under the Basic Law, there are a number of provisions that strengthen Hong Kong's position as a world renowned international financial centre. According to Article 110 of the Basic Law, the Government of Hong Kong formulates its monetary and financial policies, safeguards the free operation of financial business and financial markets, and regulates and supervises them in accordance with law.

As compared with the situation of Mainland China in which certain measures of foreign exchange control are in place,¹¹³ Article 112 of the Basic Law provides that no foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region and the Hong Kong dollar shall be freely convertible. Moreover, the Government of Hong Kong shall safeguard the free flow of capital within, into and out of

¹⁰⁸ World Bank and Pricewaterhouse Coopers, 'Paying Taxes 2018 Report' (2018) 88 <https://www.pwc.com/gx/en/paying-taxes/pdf/pwc_paying_taxes_2018_full_report.pdf?WT.mc_id=CT13-PL1300-DM2-TR2-LS1-ND30-TTA4-CN_payingtaxes-2018-intro-pdf-button> accessed 22 July 2018.

¹⁰⁹ See Miller, Kim and Roberts (n 107) 215.

¹¹⁰ See Gauthier (n 48) 13.

¹¹¹ 'Hong Kong: The Facts – Trade and Industry' (August 2017) <https://www.gov.hk/en/about/abouthk/factsheets/docs/trade_industry.pdf> accessed 22 July 2018.

¹¹² *ibid.*

¹¹³ Hong Kong Trade Development Council, 'Guide to Doing Business in China – Foreign Exchange Control' (2018) <<http://www.hktdc.com/info/mi/bgcn/en/>> accessed 22 July 2018.

the region.¹¹⁴

In Hong Kong, there is neither a general foreign investment legislation governing the admission of foreign investments nor a general screening mechanism for admission of foreign investments.¹¹⁵ Licensing requirement exists in some sectors¹¹⁶ such as banking,¹¹⁷ insurance,¹¹⁸ broadcasting¹¹⁹ and telecommunications.¹²⁰ Further, in most cases, foreign investors can maintain 100 percent ownership of their investments in Hong Kong.¹²¹

According to the report of the Heritage Foundation on the Index of Economic Freedom in 2018, Hong Kong ranked first among 180 economies.¹²² In fact, since the Index of Economic Freedom was first published in 1995, Hong Kong has been ranked the world's freest economy for 24th consecutive years.¹²³ The report of the Heritage Foundation noted that Hong Kong is an exceptionally competitive financial and business hub with regulatory efficiency, openness to global commerce and a vibrant entrepreneurial climate.¹²⁴

According to the Doing Business 2018 Report prepared by the World Bank, Hong Kong ranked 5th among 190 economies in the ease of doing

¹¹⁴ See art 112 of the Basic Law.

¹¹⁵ See Miller, Kim and Roberts (n 107) 215.

¹¹⁶ See 商務部國際貿易經濟合作研究院課題組 (Chinese Academy of International Trade and Economic Cooperation), ‘中國(上海)自由貿易試驗區與中國香港、新加坡自由港政策比較及借鑑研究 (‘A Comparative Study on the Policies of the China (Shanghai) Free Trade Pilot Area and the Free Trade Ports of Hong Kong and Singapore’) (September 2014).

¹¹⁷ See the Banking Ordinance (Cap 155 of the Laws of Hong Kong).

¹¹⁸ See the Insurance Ordinance (Cap 41 of the Laws of Hong Kong).

¹¹⁹ See the Broadcasting Ordinance (Cap 562 of the Laws of Hong Kong).

¹²⁰ See the Telecommunications Ordinance (Cap 106 of the Laws of Hong Kong).

¹²¹ See Miller, Kim and Roberts (n 107) 215.

¹²² *ibid* 214.

¹²³ See the website of the Heritage Foundation at <<https://www.heritage.org/index/about>> accessed 22 July 2018.

¹²⁴ See Miller, Kim and Roberts (n 107) 214 – 215.

business ranking.¹²⁵ In this regard, it is worth mentioning that Hong Kong has a very efficient regime in place for the registration of companies. The Companies Registry of Hong Kong is responsible for administering and enforcing the provisions of the Companies Ordinance (Cap. 622 of the Laws of Hong Kong) and related legislation as well as the registration of Hong Kong and non-Hong Kong companies.¹²⁶

As of 31 March 2018, there were 1,398,897 Hong Kong companies and 10,525 non-Hong Kong companies from 81 countries on the register.¹²⁷ The time required for online registration of a new Hong Kong company is less than one hour and it takes only 4 working days for applications delivered in hard copy form.¹²⁸ As for non-Hong Kong companies, the time required for the registration of such company is 11 working days.¹²⁹ The experience of Hong Kong discussed above has illustrated the importance of having in place efficient and liberal regulatory regimes for business activities in SEZs.

With respect to market access for foreign investments, the Shanghai Free Trade Zone has experimented with the negative list system while the rest of Mainland China was still following the positive listing system under the Guideline of Industries for Foreign investment.¹³⁰ Given that the negative list system is a recent innovation in Mainland China, it will take time to assess the effectiveness of such system and to see if refinements can be made to it for further liberalization.¹³¹

¹²⁵ World Bank, 'Doing Business 2018 – Reforming to Create Jobs' (2018) 4 <<http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf>> accessed 22 July 2018.

¹²⁶ 'Hong Kong: The Facts – Companies Registration and Insolvency Administration' (May 2018) <https://www.gov.hk/en/about/abouthk/factsheets/docs/companies_rs.pdf> accessed 22 July 2018.

¹²⁷ *ibid.*

¹²⁸ *ibid.*

¹²⁹ *ibid.*

¹³⁰ Jiaxiang Hu, 'FTZs, Can They Initiate a New Round of Reforms in China?' (2016) 59 *Boletim Ciencias Economicas* 9, 16 – 17.

¹³¹ The National Development and Reform Commission and the Ministry of Commerce of China have recently unveiled new negative lists in relation to foreign investment on 30 June 2018, see 'China Unveils New Negative List for Foreign Investments in FTZs' (*Xinhua News*, 30 June 2018)

Furthermore, SEZs in some countries,¹³² such as China, Malaysia,¹³³ Korea,¹³⁴ Dubai and Singapore also provide for the so-called ‘one-stop shop’ regulatory approval mechanisms to consolidate and expedite government approvals.¹³⁵ Under the ‘one-stop shop’ approach, the relevant legislation provides a body with a single-point authority over other government agencies in core regulatory areas related to SEZs.¹³⁶ Generally speaking, the ‘one-stop shop’ service would assist investors in obtaining business licenses, export and import licenses, work permits, health and safety certificates, environmental clearances, and a wide range of permits as well as dealing with the day-to-day bureaucratic processes for regulatory matters.¹³⁷

Effective customs facilitation measures are also an important facet of the

<http://www.xinhuanet.com/english/2018-06/30/c_137292210.htm>. At the national level, the Special Administrative Measures (Negative List) for Foreign Investment Access (2018 Edition) <<http://english.mofcom.gov.cn/article/policyrelease/announcement/201807/20180702765903.shtml>> will replace the previous Catalogue for the Guidance of Foreign Investment Industries (Revised in 2017). At the level of Pilot Free Trade Zones, the Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2018 Edition) <<http://english.mofcom.gov.cn/article/policyrelease/aaa/201807/20180702765905.shtml>> is applicable (all accessed 22 July 2018).

¹³² Douglas Zhihua Zeng, ‘Special Economic Zones: Lessons from the Global Experience’ (2016) 12 <https://assets.publishing.service.gov.uk/media/586f9727e5274a130700012d/PED_L_Synthesis_Paper_Piece_No_1.pdf> accessed 22 July 2018.

¹³³ The Penang Development Corporation (PDC) as established in 1969 was the principal development agency of Malaysia and was subsequently appointed Free Trade Zone authority. PDC acted as a one-stop agency for investors to not only help them obtain all relevant information but also arrange for them to meet with the relevant regulatory authorities to obtain clearances and approvals. See Farole (n 7) 190.

¹³⁴ Masan Free Trade Zone of Korea is an example of SEZs with ‘one-stop shop’ system. See Hyung-Gon Jeong and Jong-Hun Pek, *2016 Modularization of Korea’s Development Experience – Special Economic Zones: What Can Developing Countries Learn from the Korean Experience?* (Ministry of Strategy and Finance, Republic of Korea 2016) 35.

¹³⁵ See FIAS (n 17) 55.

¹³⁶ *ibid* 57.

¹³⁷ See Farole (n 7) 214 – 215.

legal infrastructure of successful SEZs. Under the framework of the WTO, there is the Trade Facilitation Agreement (TFA),¹³⁸ which entered into force on 22 February 2017. TFA is concerned with the simplification of import and export processes and contains provisions related to expeditious release and clearance of goods as well as simplification of customs formalities and documentation requirements.¹³⁹ Hong Kong has been the global forerunner in the expeditious movement and release of goods and was the first WTO member to formally accept the TFA in December 2014.¹⁴⁰

With respect to the legal system under which businesses operate, a flexible yet predictable system of law is often considered to be more business friendly.¹⁴¹ As mentioned above, Hong Kong practises a common law-based legal system,¹⁴² which is different from the civil-law based system applicable to the rest of China. This model of an SEZ adopting a common law-based system that is different from the one practised in other parts of the country concerned is also found in a number of SEZs such as the QFC in Qatar,¹⁴³ DIFC¹⁴⁴ and Abu Dhabi Global

¹³⁸ See WTO, 'Trade Facilitation' (2018) <https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm> accessed 22 July 2018.

¹³⁹ See Government of the Hong Kong Special Administrative Region, Trade and Industry Department, 'Trade Relations: Agreement on Trade Facilitation' (2018) <https://www.tid.gov.hk/english/trade_relations/tradefora/trade_facilitation.html> accessed 22 July 2018.

¹⁴⁰ *ibid.* See also WTO, 'Members Accepting the Protocol of Amendment to Insert the WTO Trade Facilitation Agreement into Annex 1A of the WTO Agreement' (2018) <https://www.wto.org/english/tratop_e/tradfa_e/tradfa_agreeacc_e.htm> accessed 22 July 2018.

¹⁴¹ A common law system is often less prescriptive than a civil law system (providing for flexibility) and largely based on precedent, established by case law and follows the doctrine of judicial precedents (providing for predictability). However, it is by no means to say that a common law system is superior to that of civil law or other legal systems. For a useful comparison of common law and civil law systems and their respective advantages and limits, see Caslav Pejovic, 'Civil Law and Common Law: Two Different Paths Leading to the Same Goal' (2001) 32 *Vict U of Wellington L Rev* 49.

¹⁴² See arts 8 and 18 of the Basic Law.

¹⁴³ See QFC, 'Legal' <www.qfc.qa/en/Operate/Legal/Pages/default.aspx> accessed 22 July 2018.

¹⁴⁴ See the website of the DIFC of Dubai at <<https://www.difc.ae/>> accessed 22 July

Market (ADGM) in Dubai¹⁴⁵ as well as the recently established Astana International Financial Centre in Kazakhstan.¹⁴⁶

2.6 Linkages and Integration with National and Global Initiatives

Lastly, one must also avoid common pitfalls found in some SEZ projects. One of such common pitfalls is related to the so-called ‘enclave syndrome.’ SEZs suffering from this problem are usually established as isolated economic enclaves that do not have sufficient linkage with the rest of the country.¹⁴⁷ SEZ programmes are often put in place and then left to operate on their own, with little effort to support domestic investment into the zone, to provide training and upgrading, or to promote links with the rest of the economy.¹⁴⁸ Such SEZs would be unlikely to have a catalytic impact in most economies due to their isolation from the wider economic strategies of the relevant countries.¹⁴⁹

Researches have shown that one of the critical differences between SEZ programmes that have been successful and sustainable and those that have either failed to take off or have become stagnant ‘enclaves’ is the extent to which the SEZ in question has been integrated in the broader economic policy framework of the country.¹⁵⁰ In the case of Hong Kong, while an economic system that is different from Mainland China is practised under the principle of ‘one country, two systems’,¹⁵¹ it enjoys close linkages with Mainland China in various aspects, in particular in relation to economic development. For example, there is the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) which contains

2018.

¹⁴⁵ See the website of the ADGM of Dubai at <<https://www.adgm.com/>> accessed 22 July 2018.

¹⁴⁶ See the website of the Astana International Financial Centre of Kazakhstan at <<https://aifc.kz/>> accessed 22 July 2018.

¹⁴⁷ Martin Norman, ‘Have “Special Economic Zones” Entered the 21st Century Yet? A Tale of Two Cities’ (28 March 2018) <<https://blogs.worldbank.org/psd/have-special-economic-zones-entered-21st-century-yet-tale-two-cities>> accessed 22 July 2018. See also ESCAP (n 41) 155.

¹⁴⁸ See Farole (n 7) 9.

¹⁴⁹ *ibid* 9 and 25.

¹⁵⁰ *ibid* 9.

¹⁵¹ See art 5 of the Basic Law.

provisions that are similar to those found in FTAs generally.

CEPA adopts a building block approach in that Mainland China and Hong Kong have been working closely to introduce further liberalization measures continually by way of supplemental arrangements after it was first signed in 2003.¹⁵² Under such approach, CEPA, which initially focuses on trade in goods, now has a very comprehensive coverage covering also trade in services, investment, and economic and technical cooperation.¹⁵³ The CEPA arrangement has been highly beneficial in strengthening the trade relationship in goods and services and fostering trade and investment between Mainland China and Hong Kong, as well as accelerating the economic integration and enhancing the long term economic and trade development of both places,¹⁵⁴ thereby allowing Hong Kong to serve as a bridge or a springboard for both inbound and outbound investments into or from Mainland China.

Hong Kong is also closely involved in various national initiatives such as the Belt and Road Initiative as well as the Guangdong-Hong Kong-Macao Greater Bay Area.¹⁵⁵ In particular, for the Belt and Road Initiative, a new model of trilateral cooperation featuring ‘mainland China plus Hong Kong plus a country along the Belt and Road’ is being explored.¹⁵⁶

In today’s inter-connected world, new development in technology and an enabling policy environment have allowed businesses to internationalize their operations across the globe in order to increase efficiency, lower costs and speed up production.¹⁵⁷ Such development has resulted in the phenomenon of global value chains where the production process of

¹⁵² See Government of the Hong Kong Special Administrative Region, ‘CEPA’ (2018) <https://www.tid.gov.hk/english/cepa/cepa_overview.html> accessed 22 July 2018.

¹⁵³ *ibid.*

¹⁵⁴ *ibid.*

¹⁵⁵ See Chief Executive’s 2017 Policy Address (n 72) para 56.

¹⁵⁶ Office of the Commissioner of the Ministry of Foreign Affairs of the People’s Republic of China in the Hong Kong Special Administrative Region, ‘A New Model of “Mainland plus Hong Kong plus X” and a New Platform for Belt and Road Cooperation’ <<http://www.fmcofprc.gov.hk/eng/gdxw/t1488870.htm>> accessed 22 July 2018.

¹⁵⁷ Deborah K Elms and Patrick Low (eds), *Global Value Chains in a Changing World* (WTO 2013) xix.

goods is divided into different steps to be carried out in different economies.¹⁵⁸

In light of the increasing connectivity and inter-dependence among different economies, it is important that SEZs are integrated not only with the rest of domestic economy but also with the global economy. In this regard, Hong Kong, acting under the general authorisation of the Basic Law or the specific authorisation of the Central People's Government of China, has been actively maintaining and developing relations with foreign states and regions, and has entered into a broad range of international agreements. Hong Kong has, as of December 2018, concluded five FTAs and 20 Investment Promotion and Protection Agreements with foreign economies and is seeking further expansion of its network of trade and investment agreements to strengthen its economic connection with the rest of the world.¹⁵⁹ To craft a successful SEZ programme nowadays, one should adopt an international mindset and pay close attention to the positioning of the SEZ in light of the ongoing global initiatives.

3. Contemporary Challenges and Opportunities for Development of SEZs

Having reviewed the designs of the legal infrastructure of SEZs, in particular, on the six areas of (i) key principles and policies, (ii) institutional framework, (iii) good governance and rule of law, (iv) fiscal incentives and tax administration, (v) efficient and liberal regulatory regime for business activities in SEZs and (vi) linkages and integration with national and global initiatives, it has also been observed that innovative ideas on SEZ models are being further explored. In China, President Xi Jinping mentioned that more powers will be granted to pilot free trade zones to conduct reform, and the establishment of free trade ports is to be explored.¹⁶⁰ Vice-Premier Wang Yang¹⁶¹ said that free trade

¹⁵⁸ See Centre for Economic Policy Research, 'Research Network on Global Value Chains, Trade and Development' <<https://cepr.org/content/research-network-global-value-chains-trade-and-development>> accessed 22 July 2018.

¹⁵⁹ See Chief Executive's 2017 Policy Address (n 72) para 48.

¹⁶⁰ English translation of President Xi Jinping's report at the 19th National Congress of the Communist Party, 'Secure a Decisive Victory in Building a Moderately Prosperous Society in All Respects and Strive for the Great Success of Socialism with Chinese Characteristics for a New Era' <http://www.xinhuanet.com/english/download/Xi_Jinping's_report_at_19th_CPC_National_Congress.pdf> accessed 22 July 2018.

port is a specified area that is ‘within the territory but outside the customs’ of a country, where there are free entry and exit of goods, capital, and personnel, and most goods are exempted from tariffs and such free trade port is a form of SEZ with the highest level of openness in the world.¹⁶² He also mentioned that Hong Kong, Singapore, Rotterdam, and Dubai are examples of free trade ports.¹⁶³ At the 40th year following the launch of China’s economic reform in 1978, a plan has been announced to explore the establishment of a free trade port with Chinese characteristics in Hainan, with reference to the experience of other well-established free trade ports in the world. Such free trade port will move away from *entrepôt* trade, manufacturing and processing and focus on tourism, modern services sectors and high-tech sectors.¹⁶⁴

While the design and establishment of an SEZ is already a daunting task, the operation and development of an SEZ to respond to the changing global trade and economic environment has given rise to even greater challenges. The following aims to provide a preliminary sketch of five major contemporary challenges or opportunities to the development of SEZs, identifying some areas worthy of further research and study or calling for innovative and practical solution to address them.

¹⁶¹ Mr Wang Yang is a member of the Standing Committee of the 19th CPC Central Committee Political Bureau, chairman of the 13th National Committee of the Chinese People’s Political Consultative Conference, Vice-Premier of the State Council and a member of its Leading Party Members Group. See People’s Republic of China, State Council, ‘Wang Yang – Chairman of 13th National Committee of Chinese People’s Political Consultative Conference’ (14 March 2018) <http://english.gov.cn/state_council/vice_premiers/2018/03/14/content_281476077822738.htm> accessed 22 July 2018.

¹⁶² See Vice-Premier Wang Yang’s article in People’s Daily (人民日報), ‘推動形成全面開放新格局 (Promoting a New Level of Opening-up with Comprehensive Coverage)’ (10 November 2017) <<http://politics.people.com.cn/n1/2017/1110/c1001-29637499.html>> accessed 22 July 2018.

¹⁶³ *ibid.*

¹⁶⁴ See ‘中共中央國務院關於支持海南全面深化改革開放的指導意見 (Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Supporting Hainan’s Comprehensive Deepening of Reform and Opening-up)’ (*Xinhua News*, 11 April 2018) <http://www.xinhuanet.com/2018-04/14/c_1122682589.htm> accessed 22 July 2018.

3.1 Innovations in Dispute Resolution Mechanisms of SEZs

No matter how well an SEZ has been designed and operated, it is inevitable that for one reason or another, some of the investments in the SEZ may give rise to disputes between investors as well those between investors and the host government as well as any other entities that are involved in the operation and management of the SEZ. A well-designed specialized dispute resolution mechanism for SEZs can ensure fair resolution of disputes and in turn give greater comfort for investors to make investments in the zones.

Furthermore, depending on the relevant foreign investment laws, investment contracts and international investment agreements of the host jurisdiction of the foreign investments, disputes arising from conducts related to SEZs may be escalated to investor-State arbitration, which can result in substantial cost to the host jurisdictions. In this regard, it has been observed that effective mechanisms within an SEZ to tackle effectively and efficiently possible disputes can prevent a foreign investor to escalate the disputes to investor-State arbitration.¹⁶⁵

Legal innovations with respect to dispute resolution have been recently observed in various SEZs. As mentioned in the previous sections, a specialist common law-based court system has been set up in some SEZs and such system is different from the court system in other parts of the country concerned. Qatar and UAE are both civil law jurisdictions. Given QFC's and DIFC's positioning as international financial centers, the adoption of a common law-based system, together with specialists courts for resolving civil and commercial disputes is in line with the common law system adopted in most of the major international financial centers and chosen by the most active international investors.¹⁶⁶

Other special dispute resolution mechanisms have also been set up in the SEZs of some economies. For example, with respect to the Shanghai Free Trade Zone, the free trade zone tribunal of the Shanghai Pudong New Area People's Court, including the free trade zone intellectual property tribunal, functions as its court and the Shanghai International Arbitration Center functions as its arbitration centre.¹⁶⁷

¹⁶⁵ See Dettoni (n 82).

¹⁶⁶ Zain Al Abdin Sharar and Mohammed Al Khulaifi, 'The Courts in Qatar Financial Centre and Dubai International Financial Centre: A Comparative Analysis' (2016) 46 HKLJ 529, 529 – 530.

¹⁶⁷ Gonzalo Villalta Puig and Sabrina Leung Tsam Tai, 'China (Shanghai) Pilot Free

To build an effective specialized dispute resolution mechanism for SEZs, clear and adequate scope of jurisdictions¹⁶⁸ and easy enforceability of judgments and arbitration awards delivered under such mechanism outside the SEZs in the rest of the economy or in the other jurisdictions¹⁶⁹ are essential features.

In the case of Hong Kong, arbitral awards made within its jurisdiction can be enforced in all State parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), and this is complemented by an arrangement between Hong Kong and Mainland China for reciprocal enforcement of arbitral awards,¹⁷⁰ which contains provisions similar to those of the New York Convention. Furthermore, there are arrangements between Hong Kong and Mainland China for reciprocal recognition and enforcement of judgments in civil and commercial matters¹⁷¹ and judgments in civil matrimonial and family cases.¹⁷² In this regard, it is worth mentioning that the Hague Conference on Private International Law (HCCH) is working on and closing in on the ‘Judgments Project,’¹⁷³ which involves the development of a new international convention on the recognition and enforcement of judgments related to civil and commercial matters.¹⁷⁴

Trade Zone Investor-State Dispute Settlement: An Uncertain Experiment’ (2017) 18 JWIT 673, 689.

¹⁶⁸ *ibid* 689 – 690 and 700 – 703.

¹⁶⁹ See Al Abdin Sharar and Al Khulaifi (n 167) 529 – 531 and 541.

¹⁷⁰ See Government of the Hong Kong Special Administrative Region, Department of Justice, ‘Arbitration’ (2018) <<https://www.doj.gov.hk/eng/public/arbitration.html>> accessed 22 July 2018.

¹⁷¹ See Government of the Hong Kong Special Administrative Region, Department of Justice, ‘Enforcement of Civil and Commercial Judgments Between Hong Kong and the Mainland’ (2017) <<https://www.doj.gov.hk/eng/public/enforcement.html>> accessed 22 July 2018.

¹⁷² See Government of the Hong Kong Special Administrative Region, Department of Justice, ‘Enforcement of Civil Judgments in Matrimonial and Family Cases Between Hong Kong and the Mainland’ (2018) <<https://www.doj.gov.hk/eng/public/family.html>> accessed 22 July 2018.

¹⁷³ See HCCH, ‘The Judgments Project’ (2018) <<https://www.hcch.net/en/projects/legislative-projects/judgments>> accessed 22 July 2018.

¹⁷⁴ See the latest draft of the new convention on the recognition and enforcement of

As for DIFC Courts and ADGM Courts, they have also entered into bilateral memoranda of guidance and memoranda of understandings with courts of common law and civil law jurisdictions on reciprocal recognition and enforcement of judgment as well as other forms of cooperation.¹⁷⁵

In light of the recent development with respect to the legal innovation of the dispute settlement of SEZs, further study can shed light on other critical success factors for establishing an effective dispute resolution mechanism in SEZs as well as future improvements to the mechanism such as inclusion of other forms of alternative dispute resolutions like mediation.

3.2 Creation of Synergy Between SEZs and Free Trade Agreement Initiatives

Another major contemporary challenge may come with the rise of mega FTAs in recent years, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).¹⁷⁶ There are intensive rounds of negotiations for the Regional Comprehensive Economic Partnership (RCEP). In the context of APEC, there is also the suggestion for the establishment of the Free Trade Area of the Asia-Pacific (FTAAP).¹⁷⁷

judgments related to civil and commercial matters at <<https://www.hcch.net/en/projects/legislative-projects/judgments/special-commission1>> accessed 22 July 2018.

¹⁷⁵ See eg the Memorandum of Guidance as to Enforcement Between the DIFC Courts and the Commercial Court, Queen’s Bench Division, England and Wales (23 January 2013) <<https://www.difccourts.ae/2013/01/23/memorandum-of-guidance-as-to-enforcement-between-the-difc-courts-and-the-commercial-court-queens-bench-division-england-and-wales/>> and the Memorandum of Guidance as to Enforcement Between the High Court of the Hong Kong Special Administrative Region of the People’s Republic of China and Abu Dhabi Global Market Courts (5 May 2017) <<https://www.adgm.com/doing-business/adgm-courts/memoranda-of-understanding/>> both accessed 22 July 2018.

¹⁷⁶ See Comprehensive and Progressive Agreement for Trans-Pacific Partnership (signed 8 March 2018, entered into force 30 December 2018) available at <<https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/cptpp/>> accessed 30 October 2018.

¹⁷⁷ See ‘2016 APEC Leaders’ Declaration’ <https://apec.org/Meeting-Papers/Leaders-Declarations/2016/2016_aelm> accessed 22 July 2018.

While SEZs and FTAs are different types of arrangements,¹⁷⁸ both SEZs and FTAs are economic policy tools that can potentially promote trade and investment of countries and regions.¹⁷⁹ FTAs stimulate investment by both domestic and foreign firms by lowering barriers to regional trade and facilitating the potential for realizing economies of scale in regional production.¹⁸⁰ SEZs lower the cost and risk to firms in undertaking investments by providing infrastructure, an improved regulatory environment and various business facilitating services.¹⁸¹ As such, it may be worthwhile to vigorously explore the synergy between SEZs and FTAs, which may provide additional opportunities to further drive economic growth and investments.

It appears that the currently available research indicated that existing FTAs only deal with SEZ-related issues passively¹⁸² and they focus narrowly on tariff issues such as imposition of restrictions on entry of goods processed under SEZ schemes and rules of origin for addressing the issue of trade triangulation.¹⁸³ It is also noted that some FTAs may disallow exports from an SEZ to the area of other FTA party which may adversely affect the operation of existing SEZ investors in a substantial manner and may even cause the failures and termination of SEZ programmes.¹⁸⁴ Moreover, the exclusion of SEZ investors from benefits of FTAs seems to run counter to the goal of driving economic growth and investment and would fail in realizing the full potential of these two

¹⁷⁸ For instance, the former is based on the laws of the economies concerned while the latter are governed by international law. Furthermore, FTAs are entitled to the exceptions from the most-favored-nation treatment principle under Article XXIV of GATT 1994 and Article V of GATS.

¹⁷⁹ Thomas Farole and Gokhan Akinci (eds), *Special Economic Zones: Progress, Emerging Challenges, and Future Directions* (World Bank 2011) 127.

¹⁸⁰ *ibid.*

¹⁸¹ *ibid* 127 – 128.

¹⁸² *ibid* 143 – 144.

¹⁸³ Trade triangulation refers to the situation under which if a product processed under a preferential duty scheme of an SEZ of an FTA member is allowed to enter into the customs territory of another FTA member as an originating product, it opens up the possibility that any product not originating in the FTA concerned may enter that FTA free of duties through the SEZ. See Farole and Akinci (n 179) 136.

¹⁸⁴ See Farole and Akinci (n 179) 128 and 137 – 143.

economic policy tools in achieving effective regional integration.¹⁸⁵

While it is essential that SEZs should be compatible with the disciplines set out under the FTAs such as those related to national treatment, most-favored-nation treatment, performance requirements and subsidies in order to minimize the litigation risks arising from SEZs under FTAs, further research is needed on how to find the synergy between FTAs and SEZs on new issues such as harmonization of SEZs regulations, collective actions to lower or remove financial incentives and establishment of strategic framework among SEZs in FTAs, in order to fully unlock their potential.¹⁸⁶

3.3 Making Greater Use of Modern Technology in SEZs

Contemporary challenges or opportunities are also associated with advancement in modern technology in the current digital age. For instance, various initiatives have been made to incorporate the use of modern technology in SEZs. Port of Rotterdam of the Netherlands has in place a communication system called Portbase to facilitate communications among parties along the logistics chain in the port area.¹⁸⁷ The China (Hangzhou) Cross-border E-commerce Pilot Zone established in 2015 has a cyber court.¹⁸⁸ DMCC free zone of the UAE implements electronic signature initiative to allow companies to electronically validate contract and allows DMCC companies to attend hearings of DIFC Small Claims Tribunal via video link at a specified location.¹⁸⁹ In the Zona Franca Santander of Colombia, an online digital platform is provided to investors

¹⁸⁵ *ibid* 128.

¹⁸⁶ *ibid* 143 – 149.

¹⁸⁷ See the official website of Portbase at <<https://www.portbase.com/en/>>. See also ‘世界銀行高級經濟學家曾智華專訪 – 自由貿易港建設將有力推進中國經濟轉型升級’ (Interview of World Bank Senior Economist, Mr Douglas Zhihua Zeng – The establishment of free trade ports will promote the economic transformation and upgrade of China) (21 May 2018) <http://www.xinhuanet.com/fortune/2018-05/21/c_1122864883.htm> both accessed 22 July 2018.

¹⁸⁸ See the website of the litigation platform of Hangzhou Internet Court (杭州互聯網法院訴訟平台) at <<https://www.netcourt.gov.cn/portal/main/domain/index.htm>> accessed 22 July 2018.

¹⁸⁹ See Mullan (n 40). See also DMCC free zone of the UAE, ‘DMCC Disputes Centre’ (2018) <<https://www.dmcc.ae/free-zone/already-a-member/value-added-services/disputes-centre>> accessed 22 July 2018.

for free to assist in human resources management and recruitment.¹⁹⁰ To shed light on the way forward for make greater use of modern technology in SEZs, it will be necessary to conduct studies to survey the use of such technology in SEZs and the best practices for incorporating such technologies into the designs of SEZs. New developments related to artificial intelligence, blockchain, big data, smart contracts and online dispute resolution will also certainly provide valuable opportunities for SEZs to leverage on. That said, one should not overlook the risks arising from such new modern technologies such as cyber-crime and critical malfunctioning of such technologies and have in place appropriate measures to monitor and guard against such risks, which would require further research and consideration.

3.4 Building a ‘Green’ Model for SEZs for Sustainable Development

Nowadays, people are also more concerned with balancing economic growth and environmental conservation,¹⁹¹ and such concerns equally apply to SEZs. Past experiences with SEZs have shown that SEZs, especially those engaged in export processing and manufacturing, have resulted in environmental degradation and there are also concerns that SEZs may have lax environmental controls and standards to attract investments.¹⁹² For example, in the Republic of Korea, about 650 industrial parks account for 63 percent of industrial emissions of greenhouse gas in the country.¹⁹³

It has also been observed that growth of the *maquiladora* programme in Mexico, which comprised of a country-wide single factory export processing zone model,¹⁹⁴ has far outpaced the ability of border cities of the country in providing the necessary waste treatment infrastructure and

¹⁹⁰ See Mullan (n 40).

¹⁹¹ For example, please see the 2030 Agenda for Sustainable Development which seeks to achieve ‘sustainable development in its three dimensions – economic, social and environmental – in a balanced and integrated manner’. See ‘Transforming Our World: The 2030 Agenda for Sustainable Development’ UNGA Res 70/1 (25 September 2015) UN Doc A/RES/70/1 (21 October 2015) para 2.

¹⁹² See FIAS (n 17) 33 and 41.

¹⁹³ See Farole and Akinici (n 179) 284.

¹⁹⁴ See FIAS (n 17) 26.

facilities, and the air and solid waste pollution resulted from the *maquiladora* programme posed health hazard for nearby populations.¹⁹⁵

Sustainability is critical to the survival and success of SEZ programmes.¹⁹⁶ A number of countries are experimenting ways to implement 'green' SEZs and such measures include green-house gas mitigation and environmental and carbon footprint management.¹⁹⁷ For example, China has entered into a partnership with the European Union to transform Jilin City into a low carbon SEZ.¹⁹⁸ India has also issued in 2010 the Guidelines for Energy Conservations in SEZs, which covers a wide range of measures to promote energy efficiency, renewable energy usage and environmental management.¹⁹⁹ The Sohar Innovation Zone within Sohar Port and Free Zone in Oman was established as energy self-sustaining and the zone, which is completely disconnected from the national grid, is able to create its own energy, recycles all its wastes.²⁰⁰

Researches have indicated that there is not yet a clear model for establishing low-carbon, green SEZs²⁰¹ and further thoughts can be given on the policy and regulatory framework of low-carbon, green SEZs. The design of such model needs to take into account relevant international instruments such as the United Nations Framework Convention on Climate Change and the Paris Agreement.

That said, the disciplines under WTO laws and international investment law should not be overlooked as a number of governmental measures related to renewable energy have given rise to disputes. For example, in the WTO case of *India – Certain Measures Relating to Solar Cells and Solar Modules*,²⁰² the Appellate Body and the Panel held that the

¹⁹⁵ *ibid* 33 and 41.

¹⁹⁶ See ESCAP (n 41) 160.

¹⁹⁷ See Farole and Akinci (n 179) 284 and 304 – 306.

¹⁹⁸ *ibid* 305.

¹⁹⁹ *ibid*.

²⁰⁰ See Mullan (n 40).

²⁰¹ See Farole and Akinci (n 179) 304 – 306.

²⁰² See WTO, *India: Certain Measures Relating to Solar Cells and Solar Modules*, Report of the Panel (24 February 2016), WT/DS456/R, and WTO, *India: Certain Measures Relating to Solar Cells and Solar Modules*, Report of the Appellate Body (16 September 2016), WT/ DS456/AB/R.

domestic content requirement imposed by India on solar power developers was in breach of the Agreement on Trade-Related Investment Measures and GATT 1994, and the United Nations Framework Convention on Climate Change cannot justify the relevant measure in that case.²⁰³ In Spain, the reforms on its renewable energy subsidy regime in recent years have resulted in a series of investor-State dispute settlement actions against the country.²⁰⁴

One should also bear in mind that many modern international investment agreements contain a provision stating that it is inappropriate for the contracting parties to such agreements to encourage investments in their areas by relaxing their health, safety or environmental measures.²⁰⁵

3.5 Enhancing Collaboration and Partnership among Governments as well as International Organizations on the Development of SEZs

The reference to the need to take into account relevant international instruments mentioned above has also illustrated that there is room for further collaboration and partnership among governments for the development of SEZs which could provide further opportunities to harness the full strength of SEZs. Collaboration and partnership are the most important for building successful SEZs. Such collaboration and partnership come in many varieties. It can be collaboration among SEZs

²⁰³ See WTO, 'India – Solar Cells (DS456)' (2018) <https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds456sum_e.pdf> accessed 22 July 2018. For the discussion of the relevance of the United Nations Framework Convention on Climate Change in Article XX(d) GATT, please see WTO, *India: Certain Measures Relating to Solar Cells and Solar Modules*, Report of the Panel (24 February 2016), WT/DS456/R, paras 7.293 – 7.301 and WTO, *India: Certain Measures Relating to Solar Cells and Solar Modules*, Report of the Appellate Body (16 September 2016), WT/DS456/AB/R, paras 5.138 – 5.149.

²⁰⁴ See Carmen Otero García-Castrillón, 'Spain and Investment Arbitration: The Renewable Energy Explosion' (November 2016) <<https://www.cigionline.org/sites/default/files/documents/ISA%20Paper%20No.17.pdf>> accessed 22 July 2018.

²⁰⁵ See eg Agreement on the Promotion and Protection of Investments Between Hong Kong and Canada (signed 10 February 2016, entered into force 6 September 2016) art 15; Investment Agreement Between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the Republic of Chile (signed 18 November 2016) art 15; both available at <<https://www.tid.gov.hk/english/ita/ippa/index.html>> accessed 22 July 2018.

established by different governments. For example, there is a co-operation agreement between China-Belarus industrial park Great Stone and the Freeport of Ventspils, Latvia, and under such agreement, the SEZs will exchange and co-operate with each other in a number of areas, including logistics.²⁰⁶ The Pomeranian Special Economic Zone in Poland and Free Economic Zone Brest in Belarus also collaborate on attracting companies in the high-tech sectors.²⁰⁷ In the past, the collaboration between Hong Kong and the Shenzhen SEZ has resulted in so-called ‘Front Shop and Back Plant’ (前店後廠) model. Such model has facilitated the Shenzhen SEZ in building up its manufacturing capacity and contributed to the transformation of Hong Kong into a service economy.²⁰⁸

Collaboration and partnership can also take the more intensive form under which SEZs are jointly developed by different governments. Some examples include the China-Singapore (Suzhou) Industrial Park,²⁰⁹ Japan-Myanmar Thilawa Special Economic Zone²¹⁰ and Russia’s participation in the development of the free trade zone on Armenia’s border with Iran.²¹¹

Collaboration and partnership among governments for the development of SEZs, especially those in the form of joint development of SEZs, add another dimension to the design of the legal infrastructure of an SEZ because coordination mechanisms between the relevant governments need to be in place and new features will be needed for the institutional structure and governance model of the SEZ to reflect the agreed mode of collaboration and partnership. At present, much spotlight has been on the SEZ initiatives of individual governments, but further study may give

²⁰⁶ See Mullan (n 40).

²⁰⁷ *ibid.*

²⁰⁸ 李曉惠, ‘粵港澳大灣區與香港 (Guangdong-Hong Kong-Macao Greater Bay Area and Hong Kong) (商務印書館(香港)有限公司)’ (January 2018) 313 – 315.

²⁰⁹ See Farole and Akinci (n 179) 101 – 123.

²¹⁰ See the website of Myanmar Japan Thilawa Development Limited at <<http://www.mjtd.com.mm/>> accessed 22 July 2018.

²¹¹ First Iranian English Economic Daily – Financial Tribune, ‘Russia Offers to Join Development of Iran – Armenia Free Trade Zone’ (26 October 2017) <<https://financialtribune.com/articles/economy-business-and-markets/74950/russia-offers-to-join-development-of-iran-armenia-free>> accessed 22 July 2018.

inspirations on how to make such collaboration and partnerships work and explore new model(s) of collaboration and partnership in light of global initiatives such as the United Nations' 2030 Agenda for Sustainable Development²¹² and the Belt and Road Initiative.²¹³ In this regard, it is also of note that some SEZs such as the Pomeranian SEZ in Poland²¹⁴ and Aqaba SEZ of Jordan²¹⁵ are located on the new Silk Road of China's Belt and Road Initiative. The Guangdong-Hong Kong-Macao Greater Bay Area will include Hong Kong, Macao, Nansha free trade zone in Guangzhou, Qianhai free trade zone in Shenzhen and Hengqin free trade zone in Zhuhai, and there is much anticipation on the new model of cooperation in the Greater Bay Area.²¹⁶

Governments are not the only actors in the design of SEZs. International organizations such as the World Bank and the Asian Development Bank also contribute to the SEZ development by providing detailed research and policy recommendations on SEZs. The Asian Infrastructure Investment Bank (AIIB) is also involved in the financing for the establishment of the Duqm Special Economic Zone in Oman.²¹⁷

There are also other organizations such as the World Economic Processing Zones Association (WEPZA)²¹⁸ operating as a platform for knowledge sharing and collaboration on SEZs. The question on what further action can be done by the existing or new international

²¹² See United Nations, 'Transforming Our World: The 2030 Agenda for Sustainable Development' <<https://sustainabledevelopment.un.org/post2015/transformingourworld>> accessed 22 July 2018.

²¹³ See the website of the Belt and Road Portal at <<https://www.yidaiyilu.gov.cn/>>. See also the website of Hong Kong Trade Development Council at <<https://beltandroad.hktdc.com/>> both accessed 22 July 2018.

²¹⁴ See Mullan (n 40).

²¹⁵ See Mullan (n 46).

²¹⁶ See 李曉惠 (n 208) 106–107.

²¹⁷ See 'Asian Infrastructure Investment Bank Breaks New Ground Approving Two Projects in Oman' (AIIB, 9 December 2016) <https://www.aiib.org/en/news-events/news/2016/20161209_001.html> accessed 22 July 2018.

²¹⁸ WEPZA was originally formed by the United Nations Industrial Development Organization but was subsequently reorganized into an independent entity involving both governmental and non-governmental members in 1985. See the website of WEPZA at <<http://www.wepza.org/>> accessed 22 July 2018.

organizations to assist governments in preventing failures of SEZs, sharing best practices of SEZs and fostering collaboration and partnership among governments on SEZs, can be further explored.

Conclusion

In light of the growing number of SEZs in the world,²¹⁹ it is expected that SEZs would continue to play an important part in the economic policies of different jurisdictions, in particular those in the Asian regions. As explained above, SEZs have strong potential to be a catalyst in driving economic growth and investment, experimenting with bold and innovative regulatory and economic reform ideas and cultivating a culture of openness, fairness and competitiveness to facilitate trade and investment.

Especially in the present unsettling times for the global economic and trade environment, SEZs can be a powerful policy tool for economies to counter the threats posed by the rise of protectionism, unilateralism and anti-globalization. At the same time, history has shown that some SEZs have difficulties to realize their full potential which can result in substantial economic and social costs.

Building an effective legal infrastructure is essential for the success of SEZs. In this regard, Hong Kong has provided some useful insights on a number of aspects in relation to the legal infrastructure design. Furthermore, it should also be emphasized that SEZs are presented with a number of contemporary challenges and opportunities arising from new developments in the global economic and trade environment. Innovative and practical solutions are needed to tackle such challenges and to seize such opportunities in order to unlock the full potential of SEZs as a catalyst for international trade and investment. While this article has not provided a full answer for such solutions, hopefully, it has highlighted some of the areas which are worth being further explored at conferences including those of the Society of International Economic Law and addressed in other research papers in the near future.

²¹⁹ See World Bank (n 8) 1 and 9.