

Hainan: China's decisive portal for consumer imports



Highlights

The inaugural China International Consumer Products Expo (CICPE) is scheduled in Haikou, Hainan, from 7 May to 10 May 2021. With high-profile endorsement from the Central Government, the Expo will firmly establish the province as a tourism and consumption center and a trading platform for international consumer products.

The Expo will transform Hainan's supply chain, consumer market product portfolio and price competitiveness. With its free-trade port status and provincial-level facilitation policy, Hainan will help bring strong consumer demand from middle-class consumers back to the onshore market.

The Expo is only a first taste of the transformations to come for Hainan. The Free Trade Port is expected to become China's market-opening leader by 2035, and we have worked closely in the province's structural reforms and industrial development initiatives. Ultimately, transparency, simplicity, and predictability in the legal and tax systems will be the Port's operating principles, where free movement of trade, investment, capital, talent and information will be facilitated.

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“Hainan, a Pioneer of Opening-up in China”

The largest consumer products expo in Asia-Pacific

The inaugural China International Consumer Products Expo (CICPE) is scheduled in Haikou, Hainan, from 7 May to 10 May 2021. With "Hainan, a Pioneer of Opening-up in China" as its official theme, the Expo is designed to be the largest consumer products exposition in the Asia-Pacific region, with a total area of 80,000 square meters and over 1,000 exhibitors in six zones: fashion, jewelry, food and supplements, lifestyle and outdoors, hospitality and professional services, and the provinces and municipalities of China¹.

Endorsement from top-level central government officials

The Expo's objective is to build Hainan into an international tourism and consumption center and create a trading platform for global consumer products. It is part of the Master Plan for the Construction of Hainan Free Trade Port (Hainan Plan) released in June 2020, alongside a favorable tax regime, deregulation for trade and investment, further opening of the service sector and more². The plan has since received high-profile support from top level central government officials and endorsement from President Xi Jinping³. With the plan soon to be formalized into dedicated legislation, the Hainan Free Trade Port is expected to become the highest-level example of China's market opening by 2035⁴.

Fig 1 Hainan Expo is a leading platform to showcase the latest consumer products to the world



Source: CICPE

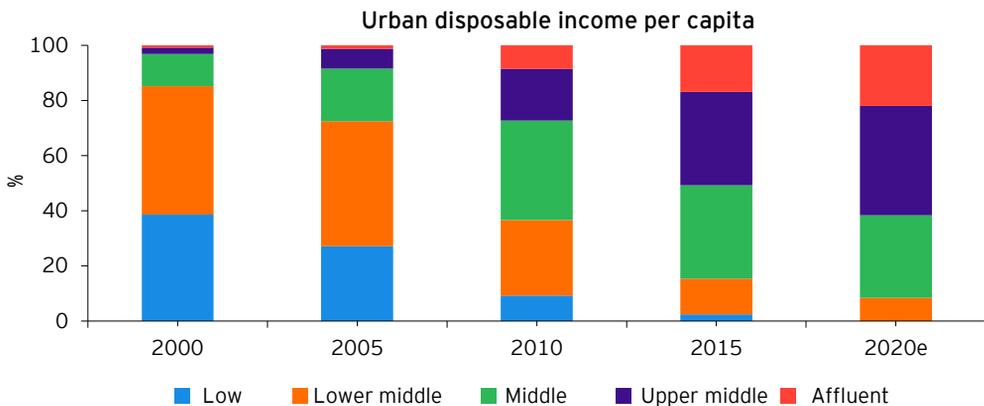
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- [3. www.gov.cn/guowuyuan/2020-06/01/content_5516623.htm](http://www.gov.cn/guowuyuan/2020-06/01/content_5516623.htm)
- [4. news.cgtn.com/news/2021-03-03/Hainan-Free-Trade-Port-legislation-China-s-highest-level-opening-up-YkCR5dMblY/index.html](http://news.cgtn.com/news/2021-03-03/Hainan-Free-Trade-Port-legislation-China-s-highest-level-opening-up-YkCR5dMblY/index.html)

Burgeoning demand for China's consumer imports

A rising middle class with a strong appetite for imports

The pledge to transform Hainan into a platform for international consumer products came at a time when consumers' desire for diversified, personalized and quality goods is increasingly being unlocked. China's imports of consumer goods have more than tripled to US\$84.9b in 2019⁵ from a decade ago, thanks largely to the emergence of the middle and upper classes that value high-quality products, new experience, and a diverse range of products. Meanwhile, the share of consumer goods in China's total imports remains remarkably low by international standard, reflecting strong potential in the market.

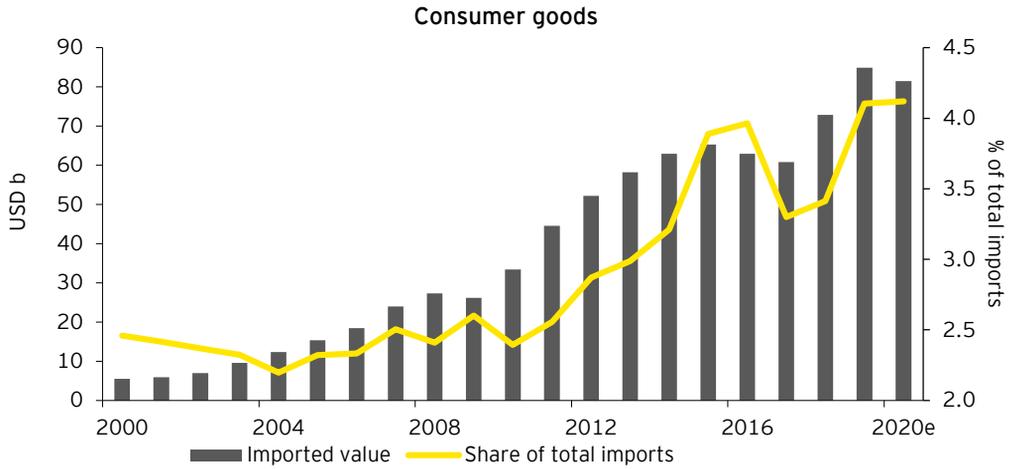
Fig 2 China's rapid transformation to a middle-class society



Source: Wind, EY

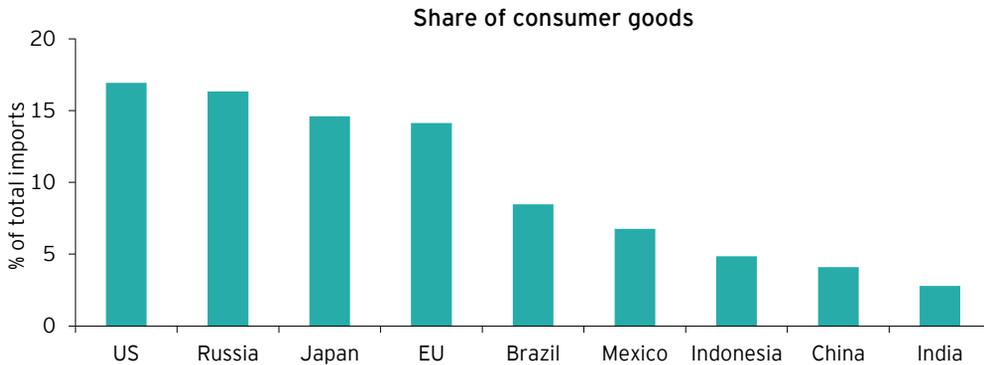
5. www.gov.cn/xinwen/2020-01/14/content_5468996.htm

Fig 3 Consumer goods imports more than tripled in the past decade



Source: UNComTrade

Fig 4 The share of consumer imports remains low in China



Note: As of 2019
Source: UNComTrade

Consumer spending leakage through outbound tourism

Historically, consumer imports in mainland China's domestic market were sold at a significant premium above overseas price due to limited demand and import duties. In the past decade, the price gap has narrowed amid increased volume and tariff cuts⁶. Favorable domestic policies, travel restrictions amid the COVID-19 pandemic, mainland-only limited edition products by international luxury brands and the emergence of attractive domestic brands all boosted spending at home. Nevertheless, overseas shopping continues to be strong and constitutes a leakage in China's consumer spending.

6. www.gov.cn/zhengce/2019-12/24/content_5463432.htm

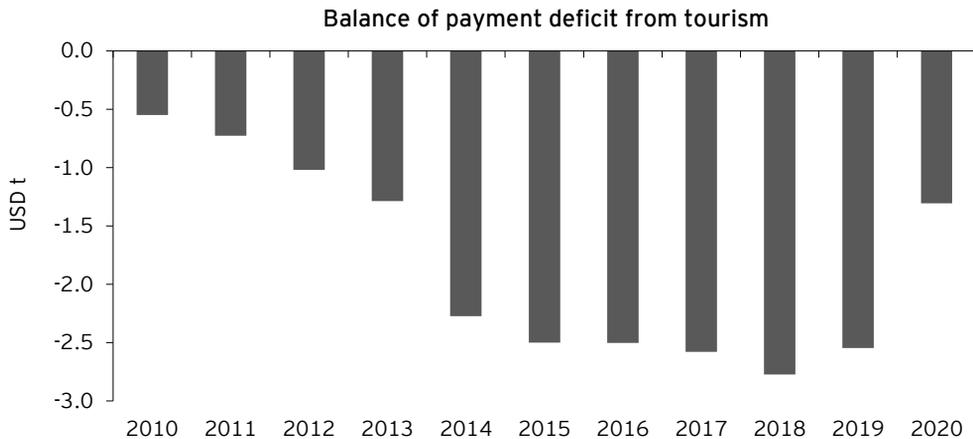
Fig 5 Around 70% of luxury goods are purchased on overseas trips



Source: YaoK institute

Travelers from the Mainland spent US\$255b overseas in 2019, out of which around a third was spent on merchandise shopping⁷. Industry studies have found that as much as 40% of global luxury goods were purchased by China consumers, although around 70% of transactions were done overseas⁸. Strong demand for overseas products has given rise to the parallel import industry and a significant offsetting factor in China's balance of payment surplus.

Fig 6 Oversea shopping contributed to a sizeable deficit in China's balance of payment



Source: Wind

7. www.gov.cn/xinwen/2019-01/30/content_5362139.htm

8. www.apexmanual.com/news/women/201812255975157708876009.html

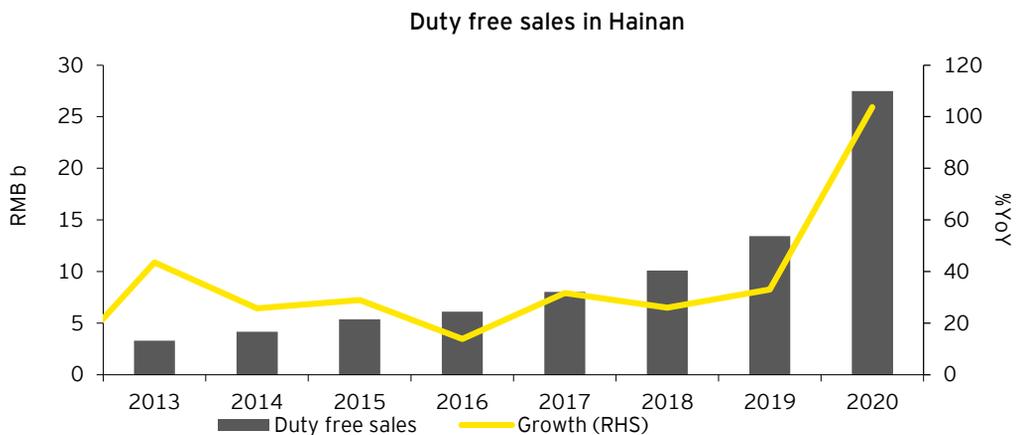
A pivot in consumer sector transformation

For the consumer sector, the Hainan Plan calls for the province to leverage its unique features as a Free Trade Port, a tropical tourist paradise and a duty-free shopping destination to play a pivotal role in China's consumer sector transformation.

Competitive product portfolio and pricing

Hainan's offshore duty-free policy took off in 2018 when domestic travelers departing the island by airplane, train, or ship were allowed to enjoy zero import duty shopping on specific items for a quota of RMB30,000 per person per year, with no limit on times of purchase⁹. The policy has since expanded in 2020 to 1) expand the eligible list from 38 to 45 items to include mobile phones and computers; 2) remove the single purchase limit; and 3) raise the annual quota to RMB100,000 per person per year¹⁰. The policy change, rapid recovery of China's economy from COVID-19 and ongoing restrictions for overseas travels contributed to a boom in Hainan's duty-free sales in 2020.

Fig 7 Hainan duty-free sales reached three-digit growth in 2020



Source: Wind, EY

9. www.chinatax.gov.cn/n810341/n810755/c3920173/content.html

10. www.chinatax.gov.cn/chinatax/n810341/n810755/c5153841/content.html

So far, the limited choice of products, lack of shopping locations and the persistent price gap with overseas outlets continued to draw criticism for Hainan¹¹. Because of this, the Hainan government has stated that it is actively exploring new pro-business policies to expand the number of duty-free shops, innovate delivery options¹² and reduce restrictions on duty-free purchases¹³. In our view, the Expo is an important step toward committing Hainan as a premier shopping location for consumer imports in China. For leading international brands, it is an opportunity to boost their recognition in China by offering a more comprehensive range of their products at a more competitive price level.

A national hub for inbound retail cross-border e-commerce

The Hainan government is also positioning the province as a national hub in China's inbound retail cross-border e-commerce (CBEC). Inbound CBEC is intended to make importing certain foreign goods easier for personal use than duty-free shopping. No license is required to import more than 1400 items on the inbound CBEC positive list¹⁴, while consumers are still liable to tax payment, albeit at preferential rates for small purchases.

Specifically, the Hainan government has pledged to fully utilize its status as China's largest free trade area and designated pilot area for inbound retail CBEC¹⁵. In August 2020, it announced a plan to facilitate inbound CBEC business development requiring both the use of its bonded area as a stopping point for high volume imports and direct customs clearance (Customs supervision code 1210 and 9610)¹⁶. Under this plan, e-commerce platforms could offer their imported products to China's consumers with expedited delivery using Hainan's bonded warehouses. Additionally, inbound retail CBEC platforms are encouraged to open experience centers at duty-free shopping complexes to showcase their products, possibly as an attraction offered as part of travel packages¹⁷.

11. www.scio.gov.cn/xwfbh/gssxwfbh/xwfbh/hainan/Document/1685717/1685717.htm

12. www.customs.gov.cn/customs/302249/302266/302267/3543998/index.html

13. dxs.moe.gov.cn/zx/a/xyh_xyh_hndx/200722/1569883.shtml

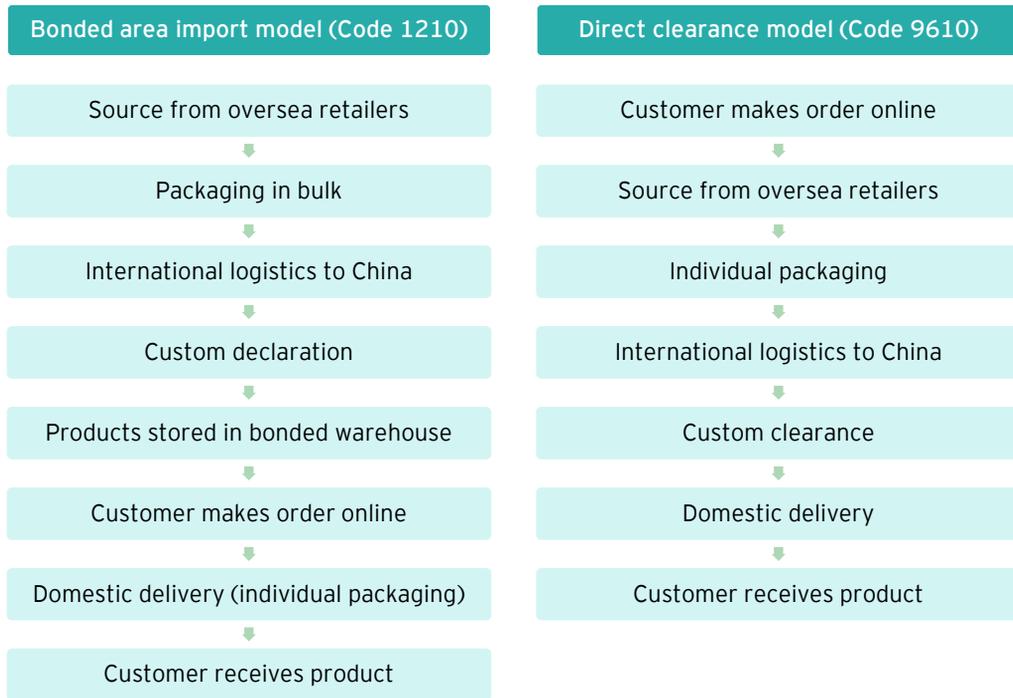
14. images.mofcom.gov.cn/cws/202001/20200110143527533.pdf

15. www.gov.cn/xinwen/2020-01/19/content_5470591.htm

16. www.hainan.gov.cn/hainan/szfbgtwj/202008/3493eba45aff48a8b7c5f892b760eafe.shtml

17. hi.people.com.cn/n2/2020/1004/c231190-34333571.html

Fig 8 Two models for inbound retail cross-border e-commerce



Source: EY

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How EY can help

The first of many steps to become China's market-opening leader

These measures are expected to incentivize China's consumer spending to repatriate to the domestic market and strengthen Hainan's position as an international tourism and consumption center in the next five years. Yet these are only the first few of a series of steps that will turn Hainan into China's market-opening leader by 2035.

With "liberalization" and "facilitation" as the keywords found in both the draft of Hainan Free Trade Port's overarching legislation¹⁸ and the province's dedicated section in the 14th Five-Year Plan¹⁹, we expect further breakthroughs to come in stages. It will call for a comprehensive upgrade in the Free Trade Port's regulatory and physical infrastructure:

- ▶ Transparency, simplicity and predictability in the legal and tax systems to provide an ideal environment for business and entrepreneurs
- ▶ Deregulation of cross-border service trade (including financial, technology, communications, logistics, health care and professional services) that will be closely integrated with the release of the national negative list for service trade
- ▶ High-level liberalization of the remaining restrictions in foreign investment, including further deregulation in capital flow, protection of intellectual property, and simplification of administrative hurdles
- ▶ Creation of an attractive environment for foreign talent with relaxed restriction for travel and residence, a negative list for work permit to expand the opportunity for employment of foreign professionals, and competitive health care and education support
- ▶ Aggressive reforms in the environmental and ecological preservation, government and fiscal budgetary structure, residence registration system and data security

18. www.npc.gov.cn/flcaw/userIndex.html?lid=ff808081752b7d430176b7d4efe04982

19. www.gov.cn/xinwen/2021-03/13/content_5592681.htm

Fig 9 Hainan Free Trade Port Law



Source: EY

EY role in Hainan's transformation

EY is among the first professional services organizations to offer comprehensive services in Hainan. Since 2018, we have been one of the most active participants in developing the Free Trade Port, working closely with the government both as a third-party advisor in the province's regulatory reform and as a professional services provider in its industrial development.

Government structural and regulatory reform: EY has collaborated with the provincial Committee for Hainan's Comprehensive Deepening of Reform since 2019. In the process, EY witnessed Hainan's development from a pilot area to a Free Trade Port, as the province deepened its institutional innovations and reforms.

So far, more than 111 innovations have been proposed to break departmental silos and upgrade the regulatory competitiveness in Hainan, and many have received high-level recognition from the Central Government. They include the automated approval system in Hainan's e-government portal and simplified import lab screening requirements for cosmetics. These innovations are then expected to be evaluated and studied for national implementation.

Business environment competitiveness: EY also assisted the provincial government to evaluate its foreign direct investment policy as a third-party consultant. With our professional experience in investment promotion programs worldwide, EY member firms are engaged by local governments at different levels to assess their business environment and offer customized solutions and training to strengthen their international competitiveness. Between February 2019 and March 2021, 85 improvements have been proposed in Hainan, and half of them are focused on facilitating the province's business attractiveness.

Hi-tech industry development: In addition, EY is involved in advising on project planning, policy research, and investment promotion of both the Moon Island and the Sanya Nanfan Science and Technology City projects. Moon Island is an artificial island earmarked to become a global transit base for animal and plant germplasm resources, which will work alongside high-level research capability at Nanfan. So far, EY teams have made 129 proposals on industrial development policy, out of which 32 have been announced, and the proposal to deregulate seed production permit has been adopted.

Much more than a customs inspection and quarantine center for agricultural products, Moon Island and Nanfan are promised to become research and development bases and personnel training centers with extensive collaboration with foreign countries in germplasm-related technologies. These projects are going to be the crown jewel of the Free Trade Port to contribute to the province's technological upgrade, China's ambition in agricultural science and technology, and the country's ultimate goal for food self-sufficiency.

Fig 10 Moon Island, China's agricultural science hub and transit base for germplasm resources



Source: Hainan Free Trade Port

Customized business solutions: With our extensive networks in China and knowledge in Hainan, we can help EY clients navigate through policy to capitalize on new opportunities and implement the right balance of bold strategic choices. From devising an agile business strategy for high-end consumer product business in the Free Trade Port, optimizing tax structure for eligible inbound retail CBEC and adopting a suitable model for cross-border capital management for Qualified Foreign Limited Partner, to understanding new service sector reforms in tourism and finance, and recruiting high-caliber international talent, we have developed targeted solutions to help businesses fulfill regulatory requirements, keep investors informed and meet stakeholder needs.

Capitalizing on new opportunities in the transformation

In Hainan, we are witnessing the dynamism of China in a transformative age. It is a world where traditional business models are upended, sectors are converging and workforces are transitioning while the economy is becoming ever more complex. With the consumer sector as the first step, this is also a world in which China's technology-focused and domestically driven growth engines are created.

It is up to business sector's leaders to anticipate emerging expectations, reinvent themselves and build the capabilities that future relevance will require. This is where we come in through our four integrated service lines – Assurance, Consulting, Strategy and Transactions, and Tax – and our local insights for EY clients to capitalize on new opportunities as China delivers the high-quality growth outlined in the 14th Five-Year Plan.

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