

# ENTREPÔT 2.0

## Hainan's "Island-Wide Independent Customs Operation"

### And, Its Implications for Trade, Compliance, and Market Access

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#### EXECUTIVE SUMMARY

1. Hainan is the southernmost province of the People's Republic of China, projecting into the highly contested littoral of the South China Sea. As of exactly a month ago, on 18 December 2025, it became subject to an "island-wide independent customs operation" (IWICO).
2. As the IWICO disaggregates the island's border functions, they are relocated inward, raising a question that is jural, commercial, and strategic: "What does it mean to enter China?"
3. Specifically, whether "entering China" and "entering the mainland" remain legally and commercially equivalent will matter to stakeholders in ASEAN and the PRC, and to counterparties pricing tariff treatment, origin qualification, audit exposure, and market-access risk.

#### I. BACKGROUND AND POLICY CONTEXT

In the annals of Chinese policy experimentation, the use of jurisdiction as method holds rich precedent: Deng Xiaoping's reform era treated special economic zones as bounded instruments through which the Party-state could introduce foreign capital, technology, and managerial practice without surrendering political supremacy.<sup>1</sup> Hainan entered that lineage early; yet, its first life as an experiment was uneven. After an initial boom, overleveraged speculation and property-market collapse rendered the island a cautionary tale, the so-called "Hainan Lesson," and prevented it from standing as an uncontested model of reform.<sup>2</sup> Among CPC officials, the episode was later derided as producing only "weak shoots in a greenhouse" and failing to generate self-sustaining growth.<sup>3</sup>

Under Xi Jinping, however, Hainan re-emerged as a province-scale juridical project. Namely, his 2018 decision to elevate the whole island into a pilot free trade zone, the 2020 *Overall Plan*, the 2021 *Hainan Free Trade Port Law*, and the subsequent customs-closure preparations all configured Hainan as a single, discrete, governable landmass whose interfaces could be redesigned in one piece.<sup>4</sup> By 2025, zero-tariff coverage reportedly rose from 21% to 74%, and the duty-free catalogue expanded from roughly 1,900 to more than 6,600 items.<sup>5</sup> The launch of 18 December 2025 marked the phase-change: The "free trade port" ceased to be mere aspirational branding and instead became an administrative fact to be run as a border-topology.<sup>6</sup> Regionally, ASEAN and China moved in parallel: ACFTA 3.0 was substantially concluded in 2025 and signed on 28 October 2025, and the summit statement linked cooperation among ASEAN, ASEAN Plus Three, the Greater Bay Area, and Hainan Free Trade Port.<sup>7</sup>

<sup>1</sup>Deng would eventually give Hainan his personal imprimatur, reportedly telling Yugoslav leaders in 1987 that all of Hainan should be made a special economic zone much larger than the others. See "On the 40th Anniversary of Reform and Opening: Notes on Hainan's Development," March 12, 2021; "Debates and Decisions on the Success or Failure of China's Special Economic Zones in the Mid-1980s," Shenzhen Archives, July 8, 2013.

<sup>2</sup>Rui Pan, "The 'Hainan' Lesson in China's Real Estate Industry" (PhD diss., University of Reading, 2020); Douglas Zhihua Zeng, "China's Special Economic Zones," in *Building Engines for Growth and Competitiveness in China* (Washington, DC: World Bank, 2010), 37–38.

<sup>3</sup>Sebastian Heilmann, *Experimentation under Hierarchy: Policy Experiments in the Reorganization of China's State Sector, 1978–2008*, CID Working Paper No. 172 (Cambridge, MA: Center for International Development, Harvard University, 2008), 14.

<sup>4</sup>Xinhua, *Xi Announces Support for Hainan to Deepen Reform and Opening Up*, April 14, 2018; State Council of the People's Republic of China, *Overall Plan for the Construction of Hainan Free Trade Port*, June 1, 2020; National People's Congress, *Hainan Free Trade Port Law*, June 10, 2021.

<sup>5</sup>National Development and Reform Commission, *After Island-Wide Customs Operation, Hainan FTP Rewrites Firms' Business Arithmetic*, December 24, 2025; State Council Information Office, *SCIO Press Conference on Hainan Free Trade Port Construction*, July 23, 2025.

<sup>6</sup>General Administration of Customs, *Formal Customs Closure Opens a New Chapter in Hainan Free Trade Port Construction*, December 19, 2025.

<sup>7</sup>ASEAN, *Chairman's Statement of the 46th ASEAN Summit*, Kuala Lumpur, May 26, 2025, para. 53; Id., *Chairman's Statement of the 28th ASEAN–China Summit*, Kuala Lumpur, October 28, 2025, paras. 12, 16.

## II. HOW THE MODEL WORKS

The IWICO’s governing maxim is terse and dispositive: The first line opens, the second line is controlled, and free circulation prevails within the island. Hainan retains border functions and disaggregates them. Goods may enter Hainan from abroad on preferential terms, circulate within the island under a distinct regulatory environment, and only then seek admission to the mainland under a separate adjudicative screen. That first-line treatment extends beyond firms alone to qualifying entities in the FTP with actual import needs.<sup>8</sup> The island, therefore, serves as a proving ground in which the status of a flow is altered before that flow reaches the mainland market.<sup>9</sup>

For that reason, Hainan is best read as an *entrepôt 2.0*, whereby the first generation of *entrepôts* (*i.e.*, *entrepôts 1.0*), both (i) within the PRC (such as in Shenzhen) and (ii) without it (like. in Hong Kong and Singapore), monetized movement between jurisdictions. Hainan, however, aims to extract value at the moment that a flow seeks admissibility to the mainland by altering what can be substantiated about that flow in transit. The decisive question has become mainland admissibility: A good may already sit on Chinese territory and still require demonstration, under the IWICO, as admissible to the mainland on preferential terms. The relevant proofs, then, are origin, value added, and traceable custody, and their portfolio is the regime’s *raison d’être*.<sup>10</sup> This proof architecture also intersects with RCEP cumulation (Article 3.4), which broadens sourcing options while increasing documentary burden for Hainan-processed goods bound for the mainland.<sup>11</sup>

The central quantitative screen is the  $\geq 30\%$  value-added rule:

$$V\% = \frac{P_s - (M_i + M_d)}{M_i + M_d} \times 100\%; \quad V\% \geq 30\% \quad (1)$$

where  $P_s$  is the mainland sales price,  $M_i$  is the imported material cost, and  $M_d$  is the domestic material cost.

The elegance of the threshold is also its selectivity. High-margin sectors such as luxury processing, pharmaceuticals, specialized medical goods, and branded manufacturing are structurally better positioned to clear it than low-margin assembly. Hainan’s official industrial portfolio reflects precisely that margin logic: the policy privileges classes of flows that can plausibly be priced, traced, and selectively admitted under contestable scrutiny. The island’s much-touted “4+3+3” industrial system was, on this reading, an attempt to industrialize the proof-system itself.<sup>12</sup>

The older comparative shadow is Hong Kong. Hainan seeks *entrepôt* functions without the legal, financial, and arbitral depth that made Hong Kong more than a tariff interface. The scale differential remains large: Hainan’s 2024 GDP was RMB 797.271 billion, while Hong Kong’s 2024 GDP stood at US\$407.1 billion.<sup>13</sup> Goods infrastructure may be widened by decree; trust infrastructure ordinarily cannot.

The first documented beneficiary is illustrative: Jingrun Pearl, a Hainan-based jewelry retailer, became that adjudication’s first documented beneficiary when its CEO imported 40,000 pearls valued at RMB 12 million (and added domestic processing inputs) in the days following the launch, processed them on-island, and saved about RMB 1.75 million on mainland tariffs.<sup>14</sup> The case matters because it shows the regime’s margin logic with unusual clarity: jewelry clears the threshold because design, branding, finishing, and distribution command premiums over commodity inputs. Low-margin assembly ordinarily cannot. In practice, the value-added screen operates as an industrial selector. The same logic has appeared in Boao Lecheng’s medical-goods channel.<sup>15</sup>

<sup>8</sup>State Council Information Office, *Press Conference on Hainan Free Trade Port Construction*, July 23, 2025.

<sup>9</sup>National Development and Reform Commission, *What Does Island-Wide Customs Closure Bring to Hainan Free Trade Port?*; General Administration of Customs, *Sails Fill the Sea as Hainan Free Trade Port Nears Customs Closure*, December 17, 2025.

<sup>10</sup>See *Overall Plan for the Construction of Hainan Free Trade Port*, arts. 7–11, and *Hainan Free Trade Port Law*, arts. 18–31.

<sup>11</sup>Regional Comprehensive Economic Partnership Agreement, ch. 3 (Rules of Origin), art. 3.4 (Cumulative Rules of Origin).

<sup>12</sup>CGTN, *Hainan’s Economic Secret: The 4+3+3 Strategy*, March 12, 2024; Hainan Provincial Government, *Hainan’s Value-Added Domestic-Sales Duty Exemption Accelerates Manufacturing and Industrial Clustering*, August 25, 2025.

<sup>13</sup>Hainan Provincial Bureau of Statistics, *Hainan Statistical Monthly Report*, February 2026; Hong Kong Monetary Authority, *Annual Report 2024: Annex and Tables* (Hong Kong: HKMA, 2025), 316.

<sup>14</sup>Hainan Daily, *Central Media on Hainan: Half a Month after Customs Closure, Hainan FTP Shows Tangible Gains*, December 31, 2025; National Development and Reform Commission, *After Island-Wide Customs Operation, Hainan FTP Rewrites Firms’ Business Arithmetic*, December 24, 2025.

<sup>15</sup>Hainan Provincial People’s Government, “Hainan Free Trade Port’s ‘Zero-Tariff’ Imports of Medicines and Medical Devices Exceed RMB 220 Million,” October 15, 2025.

### III. INDICATORS TO WATCH

The IWICO’s viability depends on whether the membrane converts at scale. Conversion is the master variable:

$$C = \left( \frac{E_3}{I_1} \right) \times 100 \quad (2)$$

where  $I_1$  is first-line import value and  $E_3$  is third-line qualifying egress value.

The early numbers are striking, given that, in the week after launch, more than US\$57.5 million in first-line zero-tariff goods reportedly entered Hainan, while only about US\$0.9 million cleared as processed and value-added goods sold domestically through the third line. That implies an immediate conversion rate of roughly  $C \approx 1.6\%$ , or an import-to-egress ratio exceeding 60:1. By the end of the first month, the membrane had already thinned, though it remained thick: approximately US\$107.8 million in imports corresponded to about US\$12.4 million in qualifying third-line egress, for  $C \approx 11.5\%$  and a ratio of roughly 8.7:1.<sup>16</sup>

Those data admit two competing readings: (a) **manufacturing lag**—firms build inventory before sixty- to ninety-day processing cycles complete; or, (b) **proof-system capacity** as the binding constraint, whereupon the discriminator should arrive in Q2 2026. If conversion rises into the 5–8% range while latency and rejection remain bounded, early dispersion will likely have reflected temporal lag. If conversion stagnates below 3% as volumes rise, or if latency and documentary burdens increase sharply, the system will have revealed that proof capacity is the scarce factor.<sup>17</sup>

Moreover, Hainan’s early commercial profile reveals the sheer pull of consumption. In the first month of the new regime, duty-free sales reportedly reached roughly US\$699.4 million, while qualifying value-added egress totaled about US\$12.4 million, a disparity of approximately 56:1. The same month recorded roughly 214 value-added transactions against 53 zero-tariff imports totaling just over US\$108 million.<sup>18</sup> Under effective enforcement, 2027 qualifying egress should skew toward pharmaceuticals, luxury processing, and specialized manufacturing; a low-margin share above 40% would indicate screening relaxation or pricing arbitrage.

Regional uptake supplies a second test: Hainan’s ASEAN-facing role should be visible in trade intensity, origin-issuance practice, and port-network substitution.<sup>19</sup> The 28th ASEAN–China Summit made the institutional signal explicit by linking cooperation across ASEAN, ASEAN Plus Three, the Greater Bay Area, and Hainan Free Trade Port.<sup>20</sup> Trust infrastructure is a third test: Despite stronger Hong Kong inflows, Hainan handled only 34 foreign-related arbitration and mediation cases in 2024, far below Hong Kong’s scale.<sup>21</sup> A fourth test is the maritime calendar: ASEAN and China reported third-reading completion of the COC text, redesignated the SDNT as a Draft COC, and targeted conclusion by the ASEAN Post-Ministerial Conference with China in 2026.<sup>22</sup>

### IV. RISKS AND CONSTRAINTS

In practice, the membrane is priced before it is proven, and pricing is adversarial. The tariff differential creates structural arbitrage: zero-tariff treatment at the first line, preferential admission at the third line for qualifying goods, and obvious room in between for leakage, resale, and quota abuse. Enforcement then intensifies at the island-mainland interface because anti-smuggling becomes existential to the regime’s credibility. The resulting feedback “doom-loop” is structural: Openness generates leakage, leakage generates scrutiny, scrutiny raises compliance uncertainty, and that uncertainty suppresses the very

<sup>16</sup>State Council, *Statistical Bulletin: First Month of Hainan Free Trade Port Customs Operation*, January 19, 2026; *China Daily*, “Hainan FT Port Sees Smooth Start after Customs Closure,” January 20, 2026.

<sup>17</sup>For the simplified 33-item declaration set, see *Public Security Organs Fully Support Hainan FTP Customs Closure*, December 19, 2025; for the control-bias problem, see Chaisse, “The Pervasive Problem of Special Economic Zones,” 301–4.

<sup>18</sup>State Council, *Statistical Bulletin: First Month of Hainan Free Trade Port Customs Operation*; *China Daily*, “Hainan FT Port Sees Smooth Start after Customs Closure.”

<sup>19</sup>State Council Information Office, *SCIO Press Conference on Hainan Free Trade Port Construction*, July 23, 2025; General Administration of Customs, *GACC Press Conference on 2025 Annual Import and Export Performance*, January 13, 2026.

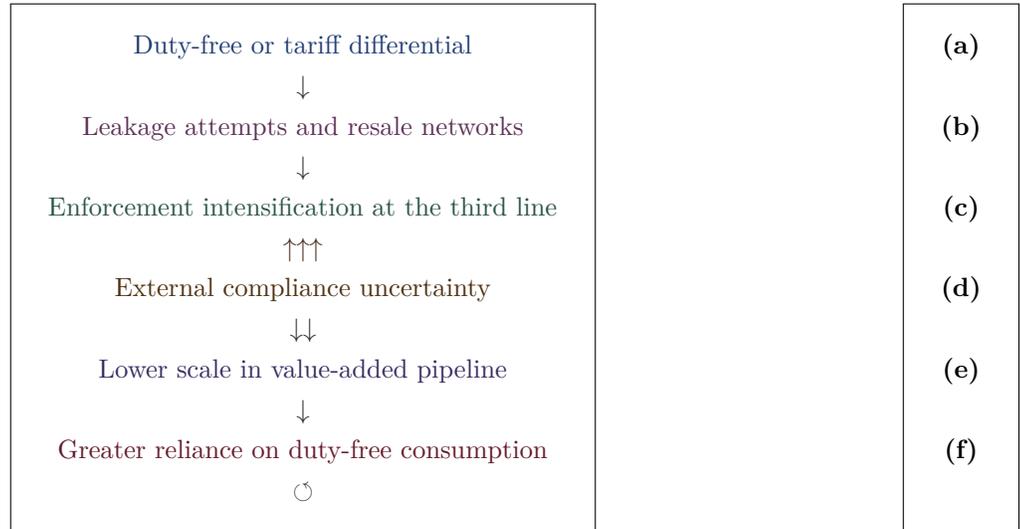
<sup>20</sup>ASEAN, *Chairman’s Statement of the 28th ASEAN–China Summit*, October 28, 2025, para. 16.

<sup>21</sup>Hainan Provincial Government, *Seizing the Opportunity of Hainan’s Customs Closure to Deepen Hainan–Hong Kong Cooperation*, September 17, 2025; Hainan International Arbitration Court, *2024 Annual Work Report* (Haikou: HIAC, 2025), 1.

<sup>22</sup>ASEAN, *Chairman’s Statement of the 28th ASEAN–China Summit*, October 28, 2025, paras. 44–45.

value-added activity that the system was meant to induce.<sup>23</sup>

That “doom-loop” is simple:



Already, reported enforcement data suggest a persistent abuse of duty-free channels. Authorities tied 495 criminal cases to resale and quota abuse since 2024; airport interdictions reportedly involved 13 passengers, 52 cellphones, and about US\$65,000 in cash. Under those conditions, Hainan risks islandization: formally open, yet operationally thickened vis-à-vis the mainland. The danger is that the FTP may yield outcomes other than promised, becoming a domestic periphery whose principal output is credentialing. Even the present simplification is cabined: The reduction from 105 declaration items to 33 applies only to imported “zero-tariff” and bonded goods that do not involve inspection, quarantine, or license-document administration.<sup>24</sup> If declaration requirements drift back toward 105 items from the streamlined 33, the regime will have revealed a control bias under uncertainty.<sup>25</sup>

There exists also an external compliance problem: In particular, foreign trade, sanctions, export-control, and rules-of-origin systems presume territorial singularity; Hainan complicates that premise because goods can be on Chinese territory yet remain contingently admissible to the mainland market. Maritime conditions raise the stakes: ASEAN and ASEAN–China statements in 2025 reiterated UNCLOS, freedom of navigation and overflight, and self-restraint in the South China Sea, while throughput remained high—about 10 billion barrels of petroleum and petroleum products and 6.7 trillion cubic feet of LNG in 2023.<sup>26</sup> In rigid compliance systems, contingent legal status raises risk premia and pushes legitimate operators out. The problem deepens if comparable 30%-type incentives spread to the Greater Bay Area, weakening Hainan’s uniqueness while preserving its compliance complexity.<sup>27</sup>

## V. CONCLUSION

The deepest significance of Hainan’s independent customs operation is that it disaggregates the category of entry itself. Once the border that matters for value creation is relocated inward, jurisdiction ceases to function as a simple line and becomes a staged process of admissibility. Whether Hainan proves commercially transformative or administratively self-defeating, it already marks a consequential development in the PRC’s attempt to reorder trade, compliance, and market access under its own sovereignty. That disaggregation stands as the regime’s most fruitful output—irrespective of any pecuniary savings that may result and follow.

<sup>23</sup>National People’s Congress, *Hainan Free Trade Port Law*, arts. 57–58; Chaisse, “The Pervasive Problem of Special Economic Zones,” 304–9.

<sup>24</sup>Hainan Provincial People’s Government, *Special Press Conference on Customs Supervision Supporting Systems for Hainan Free Trade Port Customs Closure*, October 31, 2025; General Administration of Customs, *Hainan Free Trade Port Customs Closure Marks Its First Month*, January 18, 2026.

<sup>25</sup>For the 33-item figure, see *Public Security Organs Fully Support Hainan FTP Customs Closure*, December 19, 2025.

<sup>26</sup>ASEAN, *Chairman’s Statement of the 16th ASEAN Summit*, May 26, 2025, para. 168; Id., *Chairman’s Statement of the 28th ASEAN–China Summit*, October 28, 2025, paras. 44–45; U.S. Energy Information Administration, *The South China Sea Is an Important World Energy Trade Route*, updated March 21, 2024.

<sup>27</sup>Chaisse, “The Pervasive Problem of Special Economic Zones,” 309–14; ASEAN, *Chairman’s Statement of the 28th ASEAN–China Summit*, October 28, 2025, para. 16.