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Article — Digitized Version

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Intereconomics

Suggested Citation: Pissula, Petra; Lösch, Dieter (1990) : Special economic zones in the People's Republic of China, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 25, Iss. 5, pp. 257-262,
<https://doi.org/10.1007/BF02933659>

This Version is available at:

<https://hdl.handle.net/10419/140264>

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Petra Pissula and Dieter Lösch*

Special Economic Zones in the People's Republic of China

By setting up a number of special economic zones, i.e. clearly demarcated regions regulated by special commercial legislation, the Chinese leadership intended, after a period of economic isolation, to integrate China more closely into the international division of labour and to stimulate production by using foreign capital and technology. Have the special economic zones so far been able to live up to expectations? What are the prospects for the future?

The death of Mao Zedong in 1976 marked the end of a period of economic isolation for China, an era of encapsulation particularly from the Western industrialized nations. Policymakers came increasingly to realize that China's economic problems could not be mastered without the aid of Western capital, know-how and technology. In 1978 the new economic open-door policy was introduced, which in 1980 brought about the establishment of the first four special economic zones (SEZs) in the south of the country, the special economic zones Shenzhen, Zhuhai and Shantou in the Province Guangdong and the special economic zone Xiamen in the Province Fujian immediately adjacent to major regional world trading centres, Hong Kong, Macao and Taiwan.

The idea of setting up these first special economic zones as clearly demarcated regions regulated by special commercial legislation was to integrate China more closely into the international division of labour by means of improved cooperation with other countries and to stimulate industrial production by using foreign capital and technology. At the same time the Chinese wanted to limit the scope of access for foreign capital by first establishing small, geographically narrowly defined and hence controllable economic zones.

Essentially, the Chinese leadership pursued five major goals in its open-door policy:

- ☐ import of foreign capital;
- ☐ import of advanced Western technology;

- ☐ import of Western management know-how;
- ☐ export promotion and import substitution;
- ☐ upgrading the qualification of, and creating jobs for, Chinese manpower.

In addition to this, the special economic zones were allotted two further major tasks. First, they were to serve as a kind of economic laboratory, an experiment to test economic reform policy before introducing it in the rest of China. The impacts of a largely free economy based on free-enterprise principles were first to be monitored in a regionally confined setting. Second, from the standpoint of the Chinese, the special economic zones are windows to the West through which technology, management expertise and better information on the world economy and markets can and should flow as well as enabling a more favourable presentation of their own economy and economic system.¹ A major component of the window function was the understanding that the larger the national economy and the more a country pursues an inward-looking policy the greater the need for special economic zones. For small countries that have outward-looking policies anyway, such as Singapore, SEZs tend to be superfluous.

Since the beginning of the 80s, the Chinese open-door policy has developed rapidly. Except for Shenzhen, the territories of the first four special economic zones have been tangibly enlarged. A large number of additional provinces, areas and urban centres have

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¹ Cf. A. Gutowski, R. Merklein: Bericht über einen Aufenthalt in der VR China zur Beratung der chinesischen Regierung über die Bedeutung der Sonderwirtschaftszonen für die wirtschaftliche Entwicklung des Landes, Hamburg 1984, p. 8.

been opened up to foreign direct investments while the dividing lines between the so-called open areas and the rest of China have become less sharply demarcated. A key development is the opening up of the coastal region.

Whereas the special economic zones in the South were more or less stamped out of the ground, the 14 coastal towns opened up in 1984, in particular, already had traditional industries, a better developed infrastructure and organic employment patterns. On 4 May 1988, the island of Hainan, which had to all intents and purposes already been placed on an equal footing with the special economic zones in 1983, received provincial status and was officially declared the fifth special economic zone. At the same time it was decided to open up the entire coastal region from the Province Liaoning in the north up to the Province Guangxi adjoining the Guangdong Province.

Special Laws for Zones

Until the advent of its reform and open-door policy, the PR China had no special commercial code. Firms were links in the chain of the hierarchical centralized economic administration. It was not until the reform initiatives aimed at both greater autonomy of local businesses and making China accessible for foreign enterprise that the need for economic legislation, and for special regulations for the special economic zones, arose. Especially in foreign trade much legislation has been passed over the last ten years,² which has meant

that Chinese commercial law is now very involved, though there are still large areas which are not regulated.

Special arrangements for specific regions in the PR China have been adopted at national as well as at regional level. The legal framework for the three special economic zones in the Province Guangdong was basically devised by the provincial government and had a formative influence on the special economic zone legislation for Xiamen in the Fujian Province. A point to note is that there is no uniform legislation governing special economic zones; rather, each of the five special economic zones has its own commercial law. These do not differ so much as regards the possible activities and the preferential treatment of businesses in the zones as the individual conditions and details (e.g. fees for land usage, approval procedure for investments, etc.).

In all special economic zones the regulations on business activity noticeably reflect the desire to curb government influence and render the economic administration less intricate and more efficient. Apart from the legislative separation of the special economic zones from the mainland, where business, including joint ventures, is more heavily subject to the Chinese bureaucracy and the system of centralized economic planning, the major points of attraction of the zones for

² Cf. K. Bolz, D. Lösch, P. Pissulla: *Freihandels- und Sonderwirtschaftszonen in Osteuropa und in der VR China*, Hamburg 1990, p. 100 ff.

PUBLICATIONS OF THE HWWA- INSTITUT FÜR WIRTSCHAFTSFORSCHUNG-HAMBURG

Christine Borrmann
Jochen Michaelis

LEBENSMITTEL IM EUROPÄISCHEN BINNENMARKT

Zwischen Verbraucherschutz und Wettbewerb

The admission of foreign foodstuffs which do not comply to the strict German legislation does not lead to the feared reduction of the quality standard to the lowest common denominator in the European internal foodstuffs market. On the contrary, there is a growing diversity of products and high quality is increasingly demanded. The main beneficiary of this trend will thus be the consumer. This is one of the surprising conclusions of this study, which was conducted by the HWWA-Institute for the Federal Ministry of Economics. (Only available in German).

Large octavo,
310 pages, 1990,
price paperbound DM 65.—
ISBN 3-87895-386-0

VERLAG WELTARCHIV GMBH – HAMBURG

foreign investors are the tax benefits (although these are to a large extent available to joint ventures elsewhere), the now comparatively well developed infrastructure, and the more flexible conditions on the labour and capital markets. The open-door policy, which accorded special status to ever more regions and special legal privileges to all technologically advanced or export-intensive foreign firms and firms with foreign capital participation, irrespective of location, also meant, though, that the difference in attractiveness for foreign capital between the original special economic zones and the rest of China diminished radically. Apart from the factors already mentioned, the decisive advantage of the special economic zones, especially in Shenzhen and Zhuhai, over the other areas consists in their proximity to Hong Kong, Macao and Taiwan.

Increasing Number of Foreign-funded Enterprises

The figures on the businesses with foreign participation now located in China vary a great deal. Virtually no two sources provide identical data; recent publications record a total of 21,221 registered businesses with foreign participation as of the end of November 1989 in the PR China, i.e. so-called equity joint ventures, contractual joint ventures and wholly foreign-owned enterprises.³ Premised on 1988 figures, some 50% of these are estimated to be already in operation. The aggregate contractually agreed volume of foreign investment at the end of 1989 amounted to some US\$ 33 billion, around US\$ 14 to US\$ 15 billion of which had been actually disbursed.

As to the regional distribution of capital, reliable figures are only available up to mid-1988. Of the then approved total of roughly 11,500 companies with foreign capital participation over 95% were located in the coastal region and most of these in the Provinces Guangdong and Fujian, where the four special economic zones are situated. The total contractually pledged capital of these 11,500 firms with foreign participation amounted to some US\$ 24 billion, only US\$ 9 billion of which, however, had already been actually invested. Approximately 30% of the then approved projects (3,300 businesses) were set up in the special economic zones alone. Total pledged capital involvement there amounted to US\$ 7.9 billion, of which US\$ 3.1 billion had already been invested, i.e. an average US\$ 940,000 per joint venture. By the end of

1989, the value of contractually bound capital had risen in Shenzhen alone from US\$ 4.6 billion (end of 1987) to US\$ 5.46 billion and nearly US\$ 3.2 billion had been actually invested.

Considering these figures and measured against the purpose for which the special economic zones were established, how successful have they been? An assessment of the developmental impact of the special economic zones is attempted although it is impossible to conduct a quantitative analysis of their direct and indirect linkage and spillover effects on the regions in which they are situated and on the Chinese hinterland as a whole for lack of data.

Import of Foreign Capital

Goal No. 1 of the special economic zones was to promote capital imports. As already mentioned, in the whole of China so far a total of some US\$ 14 to US\$ 15 billion have actually been invested (including participation in offshore oil), of which – assuming unchanged relations – about a third have flowed into the special economic zones. This achievement needs qualifying, however: according to a study published by the World Bank at the beginning of the 80s, China needs approximately US\$ 630 billion worth of foreign capital to attain its ambitious development goals by the year 2000.⁴ Given this figure, the contribution of the special economic zones thus far to promoting capital imports – by 1988, some US\$ 3 billion, by the end of 1989 an estimated US\$ 5 billion – is rather modest. Add to this that some 80% of the investors as well as of the value of foreign capital in the special economic zones stem from Hong Kong and Macao, it becomes clear that the zones have not been inordinately successful in making China attractive to capital from the Western industrialized nations.

The major point of attraction of the special economic zones is obviously their proximity to Hong Kong, Macao and Taiwan; in particular the shortage of labour and the scarcity of land in Hong Kong on the one hand and the comparatively favourable real estate prices and low wages in the special economic zones on the other made them interesting for the relocation of wage-intensive production stages. The firms in the special economic zones are often viewed simply as an extended workbench. So far investors from Western industrialized nations have shown less interest in locating in a strictly demarcated special economic zone essentially geared to export promotion than in an area with a good overall infrastructure, a close link with the hinterland and with developed industrial and employment structures.

³ Cf. China Economic News, No. 2, 1990, and No. 6, 1990.

⁴ Cf. U. Hiemenz, B. Li: Die VR China – Absatzmarkt und Investitionsstandort der Zukunft?, Kieler Diskussionsbeiträge, Kiel, December 1986, p. 6.

Technology Transfer

The second goal of special economic zones was and is the promotion of technology transfer. The practical idea of creating the special economic zones was to attract modern manufacturing technologies in the hope of achieving spillover effects for the modernization of the whole of China's economy. A look at the investments in the special economic zones, though, shows that in the first six years, hotels and other service industries were in the forefront. Only gradually did more industrial factories locate, but these were largely labour-intensive and used conventional technologies. In 1988 in Shenzhen for example the structure of industry was as follows: electronics 43%, light industry 10%, textiles 7% and mechanical engineering 4%. For the most part, the production firms with foreign capital located in the special economic zones process imported intermediate products or assemble imported components. As a rule foreign technology is used (machinery, equipment and plant), but the plant and machinery is rarely up to the latest standards in the Western industrialized countries. Moreover, a major incentive for foreign investors is the still comparatively low wages in the special economic zones, which induces direct foreign investors to opt as a rule for labour-intensive technologies, and to use modern, automated, highly capital-intensive production methods to a limited degree only.

In particular the volume of technology transfer from the zones to the Chinese hinterland is unlikely to be very high. Precisely the most modern showcase factories in the zones are least closely interlinked with the Chinese economy so that the spillover effect of their technologies is negligible or non-existent. Another aspect is that China's capacity to absorb modern technology is low. If we are to believe the figures, according to which in the whole of China outside agriculture there are only 7-8 million qualified skilled workers, technicians, engineers, etc., i.e. 14 out of 15 of those employed in industry are unskilled or very badly trained,⁵ the hoped-for spillover of technological know-how will be severely impeded in the short and medium term. As long as inadequate qualification of the labour force hampers the absorption of Western technology, the provision of technical descriptions, assembly and operation instructions, blueprints and other technical documentation, demanded from the joint venture partners for use in other Chinese firms as well is unlikely to be of much more than limited utility.

In technology transfer China's experience is similar to that of other export processing zones in South East Asia. As a rule, most of the technologies applied in the zones had and have only limited relevance to the production requirements of the local markets in question. The international links of the primarily export-oriented special economic zones in China are far closer than their ties and interlocking at national level.

Management

The third objective is the import of foreign management know-how. Assuming that under the guidance of the foreign partners the Chinese managers of the joint ventures and cooperation firms learn to plan staffing efficiently, especially in administration, to cut storage costs, to better streamline operational sequences, introduce quality controls, improve accountancy methods, build up a system of distribution, etc., the special economic zones certainly bring about benefits. It is however questionable to what extent the knowledge acquired can be put to account later in the rest of the country with its completely different overall conditions, i.e. with its still marked system of central planning. Neither the qualitative not the quantitative effect of this know-how transfer should be overestimated.

Export Promotion

The fourth purpose is export promotion, which has turned out to be the prime goal of the special economic zones. The first point to note is that even after ten years the special economic zones are only slowly leaving that stage of development where rapid export growth is usually attended by equally expansive imports. Not until two years ago did Shenzhen for example start recording modest export surpluses, largely due to drops in imports with virtually stagnant exports (in 1989 the export surplus amounted to some US\$ 200 million with exports worth US\$ 2.1 billion). Nevertheless, the special economic zones are now making a respectable contribution to overall Chinese exports; the share in exports from the PR China of Shenzhen special economic zone alone, which accounts for over 50% of the aggregate exports of all four special economic zones, amounted to some 4.5% in 1989.

Also, the efforts of zone firms with foreign participation to sell their products on the domestic market have contributed to import substitution and reduced the pressure on the country's foreign exchange account to the extent that these local sales contain local inputs. In all the quantitative net foreign exchange effect

⁵ Cf. R. Machetzki: Chinas Jahrzehnt der Reformen: „Neue historische Etappe – Abkehr vom Primat der Ideologie?“, in: China aktuell, December 1988, p. 916.

of the export promotion and import substitution via the special economic zones is, however, still meagre.

Employment

Goal number five of the special economic zones is raising employment and upgrading qualification. Without question, the establishment of special economic zones has had a marked effect on regional employment. In the Shenzhen special economic zone, for instance, the population grew from some 70,000 in 1980 to nearly 800,000 in 1989, of whom 417,000 were employed in industry.⁶ The share that joint ventures have had in creating additional jobs in the special economic zones, where at the end of the 70s there were hardly any industrial firms, is substantial: as early as the mid-80s the share of the joint ventures' workforce in total employment in the special economic zones averaged over 10%, in Shenzhen as much as 17% and above.

Without question, the quantitative employment effect emanates well beyond the special economic zones. Above all the Province Guangdong benefited from the creation of induced jobs in its three special economic zones: especially in the early years most of those employed in the special economic zones came from the surrounding province itself.

The net employment effect induced by the special economic zones, i.e. the creation of additional jobs in the entire national economy of China, is, however, difficult to quantify because jobs have shifted from the provinces to the special economic zones and because new jobs have also been generated in the hinterland as a result of the development of the special economic zones. There are estimates on neither of these contrary effects, but even assuming a million newly created jobs – a rather liberal estimate – in view of the 700 million strong labour force, over 500 million of whom are engaged in agriculture, this is merely the proverbial drop in the ocean.

Even more difficult to estimate are the qualitative employment effects. Most of the manpower that has immigrated from the mainland to the special economic zones is unqualified and is usually trained by the firms themselves. As most of the jobs to be filled very often involve very straightforward tasks, such as sewing, simple measuring and checking, assembling parts, etc., the in-firm training periods often last hardly longer than one to two weeks. Only very few joint ventures run their own apprenticeship training. The skills imparted to the Chinese workers in these short periods are thus very

limited in scope. When the labour in the special economic zone returns to former or different employers outside the special economic zone, usually after three to five years, the qualification spillover is likely to be meagre. Rather, due to the attractive pay in the special economic zones and in the joint ventures of the coastal regions made accessible to foreign capital, there is more of a pull effect in the other direction. Qualified manpower emigrates from the hinterland to the special economic zones, which makes for an even greater shortage of skilled labour outside the special economic zones, as is already the case in Guangdong.

All in all, a comparison of the actual results with the goals of China's special economic zone policy presents an only modestly successful picture. Possibly, the zones might have been able to contribute more to national economic development if the goals had been defined differently: on closer scrutiny they are by no means unambiguously complementary. The goal of locating the latest production technology in the zones and that of creating additional jobs in industry, for example, are incompatible, since modern Western technology is obviously highly capital-intensive.

An even more profound contradiction exists between export promotion and technology transfer. The quality standards for export goods destined for the industrialized nations usually require that nearly 100% of intermediate products and parts have to be imported, while in China itself only simple assembly work is carried out. The local content in the final product, therefore, remains as minimal as the technology transfer via supply relationships.

Over the last ten years a number of cooperation contracts between firms in the special economic zones and Chinese suppliers from the surrounding regions have been concluded – estimates for Shenzhen vary between 440 and nearly 1,000 cooperation agreements at the beginning of 1987 – but particularly in the joint ventures the share of local supplies in production is still very low. The special economic zones in China thus face the same problem as most other East Asian export processing zones, where according to a World Bank investigation the share of locally produced intermediate products is 10%-30% at the most.⁷

One cause of the low percentage of local supplies, the same report concludes, is the structure of industry in the zones of East Asia. The growing role of electronics and its demand for sophisticated components, circuits etc. usually causes a decline rather than a rise in local

⁶ Cf. Shenzhen Municipal Foreign Propaganda Office: Shenzhen 1989.

⁷ Cf. P. G. Warr: Export Processing Zones and Trade Policy, in: Finance & Development, June 1989, p. 34

content as the intermediate products are not available at all or in the required quality. This is the prospective trend too in the Shenzhen and Zhuhai special economic zones, where most supplies stem from the Western industrialized countries or from other, usually non-Chinese zone companies, but hardly ever from the Chinese hinterland. Here, too, it would seem that the PR China is having the same experience as other South East Asian export processing zones: studies have demonstrated that some ten to twelve years after their establishment, local content in electronics and optics manufacturing made up around 1% and in raw materials supply, some 10%-15%.⁸

Notwithstanding the at best limited success of the special economic zones as measured against the aims, the Chinese assessment is largely positive, at least it was until May 1989. Although less so from a national standpoint, the cost-benefit analysis of the Chinese policy of special economic zones is viewed positively in terms of regional economic development. Particularly the experimental and the window or showcase function of the special economic zones seemed to be judged as successful, since otherwise the open-door policy would not have been extended to encompass the entire coastal region. The relative success of the zone experiments was a condition for the broader outward-looking policy of the Chinese economy. Furthermore, the zones have convincingly performed their window function. After all, they were primarily set up as a signal to the Western industrialized nations that China was departing from its policy of self-encapsulation and that investments in Hong Kong and Macao would be safe after 1997.

Renewed Centralization Trends

In the light of the recent political developments in China after the June events of 1989, there is reason to doubt whether these two latter functions are still valid. Though never explicitly voiced as official policy, the zones were to serve as experiments to prepare the way for the liberalization of the Chinese economy. The political unrest in May/June 1989, though, has evidently deterred the Chinese leadership from taking further initiatives to liberalize the economy, having perceived that economic liberalization inevitably arouses great expectations and hopes for political reform in the country. The events in June have clearly signalled that greater political freedom is not on the agenda in the immediate future; it also looks as though economic policy is being placed more firmly under the central control of Beijing. Practical action by the Chinese government, such as trade and import restrictions,

discrimination – including closures – against private enterprise, curtailment of profits, credit limitations and the like adopted in the summer of 1989 point to a shift of policy, assurances that it is still proceeding to liberalize the economy apparently serving a more rhetorical function.

Overall the general conditions for joint ventures in China have also deteriorated. Western investors responded reticently to the unrest in 1989, though the official figures for newly founded firms with foreign participation showed no decline.⁹ It was not until the first half of 1990 that foreign investment in China fell after all by a total of 23%, whereby the decline would have been much more dramatic, if Taiwan had not stepped into the breach with surprisingly high investments (about one billion dollars).¹⁰ It remains to be seen to what extent the new joint venture regulations adopted at the beginning of 1990 and the assurances by the Chinese government that in future joint venture enterprises will be given priority regarding supplies of materials and energy will be able to contribute to overcoming these uncertainties and to improving the investment climate.

It is generally expected that the special economic zones with their own administrations and in part special laws will be less affected by the recentralization and protective measures towards the "Western bourgeoisie" than the other regions in China. Nevertheless, the loss of a stable overall economic environment in the PR China could also act here as a severe disincentive to Western propensity to invest. It should also be borne in mind that over the last ten years a large number of light industry firms (electronics, textiles, clothing) have been drawn in particular to the special economic zones. Their labour-intensive production processes and comparatively small capital investment afford them a high degree of independence in terms of location; in most cases they can locate elsewhere without great difficulty, if the conditions in the special economic zones of another country appear more attractive. This flexibility could well mean that capital is withdrawn from the special economic zones, especially as other zones in South East Asia can also offer the major investors from Hong Kong and Macao the advantage of geographical proximity.

⁸ Cf. M. Ariff: Export Processing Zones: The ASEAN Experience, in: Chia Siow Yue, Cheng Bifan (eds.): ASEAN-China Economic Relations, Developments in ASEAN and China, Singapore 1989, p. 286.

⁹ In the first 11 months of 1989 a total of 5,224 businesses with foreign capital are estimated to have been founded (+ 0.2% on the same period in the previous year); the aggregate foreign capital pledged amounted to US\$ 5.14 billion (+ 17.3%). The high growth rates of previous years were not attained. Cf. China Economic News, No. 2, 1990, p. 7.

¹⁰ Cf. Handelsblatt, No. 156, 15. 8. 1990.