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THE SPECIAL ECONOMIC ZONES OF CHINA: A NEW TYPE OF EXPORT PROCESSING ZONE?

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I. INTRODUCTION: SEZs AND EPZs

THE term "Special Economic Zone" (SEZ) first attracted attention when China announced the setting up of four such zones in the southern provinces of Guangdong and Fujian.[1] These zones are "special" in the sense that different sets of rules and regulations are allowed to operate such that an economy will develop and thrive which is different from that in the rest of the country. The primary differences are (1) the economy of the zones is based mainly on the free-market system; (2) foreign investment is encouraged and may possibly become the dominant source of investment within the zones; and (3) their open system of higher technology and management skills allows the zones to serve as nodal points for technology transfer.[2]

That the above differences are allowed and are indeed being fostered is actually quite a "special" development from the viewpoint of the current centrally-directed economic system in China and its emphasis on state ownership. What prompted China to decide on the creation of these special economic zones is certainly an interesting issue. But we first turn to examine the relation between China's SEZs and the export processing zone (EPZ) of developing countries, both because the two look similar and because in their formulating of detailed policy for the SEZs the Chinese authorities made use of the experiences of the EPZs [22].

It is difficult to trace the origin of the special economic zone as very broadly defined since many countries have a long history of bestowing special economic incentives to promote the development of a part or parts of their territory.[3] If, for the sake of simplicity, we take the free trade zones of the United States as being among the earliest special economic zones, then such zones have a history of about fifty years and can trace their origin to a developed country. In 1934 the United States legislated that certain cities might set up free trade zones where imported goods would be tax free [13]. Quite a number of such zones turned into areas of manufacturing activity, processing tax-free imported materials or parts. At one time 300 cities had the right to set up these zones, but at present there are 65 such zones in the United States. Their basic function is to

1 Announced at the end of 1979. See [2, p. 11].

2 These points may be gleamed from the Regulation of Special Economic Zones in Guangdong Province, announced in August 1980. See [24].

3 Detailed discussion of the classification and connotations of different types of free trade zones can be found in [5] [9] [16].

TABLE I

EXPORT PROCESSING ZONES IN SELECTED ASIAN COUNTRIES, 1980

Country/Region	Name/Type	No.[a]	Date Established[b]
Taiwan	Export processing zone	3	1965–69
Philippines	Export processing zone	3(4)	1969–79
Pakistan	Export processing zone	1	—
Thailand	Export processing zone	1(4)	1976
Malaysia	Free trade zone	2(–)	—
Korea, Rep. of	Free export zone	2	1970–74
India	Free trade zone	2	1965–78
Singapore	Jurong industrial estate	1	1961
Hong Kong	Industrial estate	2	1976–81
Sri Lanka	Industrial estate	1(1)	1978
Indonesia	Bonded warehouse	1	1974

Source: [18, p. 155].

[a] The figure in parentheses indicates numbers of EPZ under planning or construction.

[b] Date construction started.

allow foreign firms to penetrate the U.S. market or U.S. firms to make use of imported materials and components for processing into goods for sale locally. In 1980, the volume of trade passing through the zones was about 1 per cent of all U.S. external trade and the zones employed some 11,000 persons. It is quite obvious that these zones play an insignificant role in overall U.S. trade and contribute very little to employment.

Despite their very different nature, some special economic zones of developing countries such as Malaysia and India have borrowed the name "free trade zones." In these countries, the free trade zones provide incentives for foreign investors in the hope of promoting exports. In fact, they are more aptly called export processing zones, as is the case with Taiwan, the Philippines, and Thailand.[4]

The first zone to bear the name of EPZ was set up at Ireland's Shannon International Airport [20, p. 1]. The major purpose of the Shannon EPZ is to promote export industries, taking advantage of local labor and special trade and tax incentives provided within the zone. It is the Shannon-type zone that many developing countries seem to have been interested in emulating, especially since 1970. Table I shows the situation in Asia (other than the Middle East) where, by 1980, eleven countries had set up one form or another of special economic zones for a total of nineteen all told. Nine more were already under construction or being planned. If the four in China are included, then there were twelve countries involved and twenty-two zones in Asia by 1980 [18].

The growing popularity of EPZs among the developing countries of Asia may be partly attributed to disappointment with the "import substitute" industrialization strategy commonly adopted in these countries in the 1950s and 1960s,

[4] [18]. See also footnote 3.

and to the growing interest in international subcontracting [15]. It is fairly evident that the import-substitute type of industrialization produced a very slow pace of growth whereas there is no lack of successful cases of rapid growth among the Asian export-led economies such as Hong Kong and Singapore. Of course, the change in technology and development tactics of multinational cooperations as well as growing differentials in labor costs among the developed and developing nations have contributed to comparative factor advantages in the production of certain components and parts as well as in the processing of finished products in developing countries [8].

On the other hand, a number of developing countries in Asia, such as Thailand and Sri Lanka, have found a new means of industrialization which favors international subcontracting. This is one of concentrated development in selected areas to save on costs of investment in infrastructure and to create separate, special economic, administrative, financial, and even political environments within these areas in order to attract investments, both local and foreign. These concentrated manufacturing areas are EPZs, a new means to provide employment and earn foreign exchange for the country concerned without interfering too much with the existing tax, labor, import-export, and other laws and regulations that apply to the rest of the country [15].

In 1975 the Asian Productivity Organization launched a survey of EPZs in Asia. The objectives of Asian countries in setting up EPZs were found to be, in descending order of importance: (1) to increase government revenue, (2) to expand exports and diversify local industries, (3) to increase local employment, and (4) to transfer technology from the industrialized countries [20, p. 1]. Subjectively, EPZs seem to be aimed at enhancing economic development, though their short-term benefits are mainly a gain in foreign exchange and local employment.

As most of Asia's EPZs possess the same objectives, target the same clients (multinational enterprises of the industrialized countries) and use the same approach, there is intense competition among them. This takes the form of incentive packages offered to foreign investors which include waivers of land costs, tax holidays and tax-reduction, unrestricted remittance of profits, labor cost subsidies, provision of infrastructural facilities, and a promise of the minimum of red-tape. However, in the end, what the foreign investors seem to value and weigh most seriously are (1) the quality of labor, (2) the efficiency of the managing authority, and (3) the possibility of industrial linkages with the surrounding areas (which are often constrained by location and local business laws). Among the Asian countries, Taiwan's EPZs are said to be more competitive in these matters and are the more successful cases [20, p. 1].

However, the foregoing may not be taken as a complete picture of EPZs in Asia, especially with regard to their role in the national spatial economies. In Thailand, for example, EPZs also serve the purpose of decentralizing industries from Bangkok in order to relieve congestion and lessen the capital's pollution problems. In the Philippines, as an integral part of the national regional development policy, at least one EPZ has been built or is in planning for each state in the country.

The addition of the Special Economic Zones of China to the ranks of Asian EPZs brings yet another new breed to the growing family of EPZs. Why is a country like China, which is relatively industrialized, self-contained in terms of market and range of products and has long been emphasizing self-reliance "prodded into putting [its] labour force for hire in the international market?" [8, p. 76].

Before 1978, China in general shied away from normal international business exchanges. Her import-export trade was insignificant, amounting to less than 10 per cent of her national income in most years. Only recently has there been a significant increase in her trade volume to about 18 per cent in 1982. With her strong anti-capitalist inclination, China neither allowed nor received foreign investments on her territory. In brief, she adopted a closed-door attitude regarding foreign investments and business participation. She was opened to foreign investment again only after the fall of the Gang of Four in 1976. The "defreezing," so to speak, of her economic relations with the outside world was clearly evidenced in the adoption of the regulations on joint ventures in 1979 and confirmed by the announcement of the creation of the Special Economic Zones in Guangdong and Fujian.[5] These zones were initially taken to reflect a Chinese desire to limit foreign investments to a few carefully selected, cordoned-off and controlled coastal locations—to reflect China's uneasiness about and underlying aversion to hosting foreign capitalists on her own soil. The development of the SEZs since, however, has dispelled a good deal of such suspicions. With the burst of infrastructural construction and the start of production by a fair number of joint ventures and wholly foreign-owned enterprises, the SEZs are now taken more seriously as a new type of cheap labor haven for multinational firms.

In many way, the SEZs are fairly similar to the EPZs. To list a few examples from the regulations on SEZs in Guangdong Province:

(1) In order to develop economic cooperation and technical exchanges with foreign countries and to promote the socialist modernization programme, certain areas are to be delineated...for the establishment of special economic zones (Article 1).

(2) Products of the enterprises in the special zones are to be sold on the international market (Article 9).

(3) Investors may independently operate their own enterprises in the special zones and employ foreign personnel for technical managerial work (Article 10).

(4) Machinery and equipment, spare parts, raw and semi-processed materials, means of transportation and other capital goods required for production imported by enterprises in the special zones shall be exempted from import duties (Article 13).

5 The full titles of these laws are: "The Law of the People's Republic of China on Chinese-Foreign Joint Ventures" and "Regulations on Special Economic Zones in Guangdong Province." Details can be found in [24].

(5) The enterprise income tax rate in the special zones is 15 per cent. Special preferential treatment shall be given to enterprises established within two years of the promulgation of these Regulations, to enterprises with an investment of U.S.$5 million or more, and to enterprises involving higher technology or a longer capital turnover period (Article 14).
(6) The lawful profit that an investor receives after payment of the enterprise income tax, and the wages and salaries and other legitimate income that foreign, overseas Chinese and Hong Kong and Macau staff, and workers of an enterprise in the special zones receive after payment of the personal income tax may be remitted abroad. . .(Article 15).
(7) An investor that reinvests in the special zones, for a period of five years or longer, its share of the profit may apply for a reduction of or an exemption from income tax on the reinvested portion (Article 16).
(8) Entry and exit procedures will be simplified and conveniences given to the foreign personnel (Article 18).

The above list of provisions is very close to those found in legislation regarding EPZs or FTZs in many developing countries.

We now turn to examining the Chinese argument for making use of what seems to be a "capitalist" method for promoting its "socialist modernization program" and to investigating in more detail the present development of the SEZs, especially the Shenzhen SEZ. It will be learned that the SEZs are not just areas of concentrated foreign investment but are busy laboratories for far-reaching reforms for the Chinese bureaucracy and economic machinery with an eye to final application in the rest of the country. It is this latter role which makes the SEZs significantly different from EPZs. They serve the historical function of bringing into contact two systems—the market system and the centrally directed system—with the interaction between the two intended to modify China's centrally directed system. At least that is what appears to be in the minds of the present Chinese leaders.

II. PURPOSE OF THE SEZs

China's theoretical justification for allowing an expanded cooperation with foreign capital and freer exercise of market forces has been the focal theme in recent Chinese literature dealing with economic development and national planning. A few salient points have emerged from the debates.[6] First, the primary objective of the socialist revolution is to improve the material life of the Chinese people. Hence the priority of the country and party should be shifted from the previous mistaken overemphasis on politics to an emphasis on economic construction in order to raise standards of living [23, p. 101]. Second, there are basic economic laws and principles that transcend ideological boundaries. These principles must be adhered to or employed for increasing productivity and for enhancing develop-

[6] Many of these debates are contained in articles appeared in *jingji yanjin* (Beijing) and *Gang-Au jingji* (Guangdong).

ment even by socialist states. As such, "active effort must be made to promote economic and technical cooperation with foreign countries" [23, p. 93]. Third, among the developing countries there are experiences which China can borrow from or make use of in a modified form for promoting her economic development; the EPZ is one of these [6, p. 1]. These arguments aside, the Chinese have found justification from a more familiar source, that is, the writings of Lenin and the Soviet experience. They have quoted Lenin at length on the "leasing system" of the 1920s whereby foreign capital was allowed to participate in industrial projects in certain parts of the Soviet Union. The following passage serves to indicate the basic tenet of these arguments:

> At the time the most debated and hence central issue within the Soviet was whether the leasing system should be allowed. Lenin believed that the transition to socialism in a country dominated by a petty peasant economy was a very difficult path, much more so than in any other possible situation. In order to effect the transition to the final goal, such countries must adopt *special* methods. Among the latter, the better ones were: absorption of foreign investment, adoption of state capitalism and implementation of the leasing system. A proletarian country could make better use of the capitalist West through the leasing system. [10, p. 35]

According to Lenin, successful implementation of the leasing system could help the Soviet Union acquire a few large enterprises of advanced modern capitalist models. In a few decades these enterprises would be operated solely by the Soviet Union. "Without the system there will not be the electrification of the nation," and "revival of our economy within a decade will be impossible." In the leasing of factories to foreigners, Lenin also claimed to have found the best method of learning. No school or other forum could have the practical teaching value of actual work within a factory. The profits gained by the capitalists were justified by Lenin on the ground that "we must use all possible methods, employing economic concessions as the price to pay for the development of our economic strength in order to promote our economic recovery." "If the capitalists will help us to complete our national electrification program, why should we regret letting them take away a few billion kilogram of our crude oil?" [10, p. 36].

All in all, the numerous theoretical research conclusions and discussions of the justification of the Special Economic Zones boil down to a few basic considerations: (1) China needs to promote economic and technical exchanges with foreign countries; (2) the achievement of such exchanges involves payment of a price which may take the form of capitalist exploitation and the "adverse" social influence of capitalism; and (3) to maximize the benefits while minimizing the negative costs, a few convenient areas have to be singled out for concentrated development, effective promotion and easy control.

On the basis of their perceived needs and the problems involved, the Chinese feel that they can minimize the ill-effects (ideological and material) of the SEZs if they adhere to the following basic principles within the SEZs: (1) Chinese sovereignty with the sole right to legislate relevant laws to control and regulate business and daily life within the SEZs; and (2) Mutual benefit and joint consultation.

In the actual development of the SEZs, however, the notion of promoting economic and technological cooperation has gained substantial breadth in application. This may be witnessed by the three stages in the course of development of the most advanced SEZ—Shenzhen.

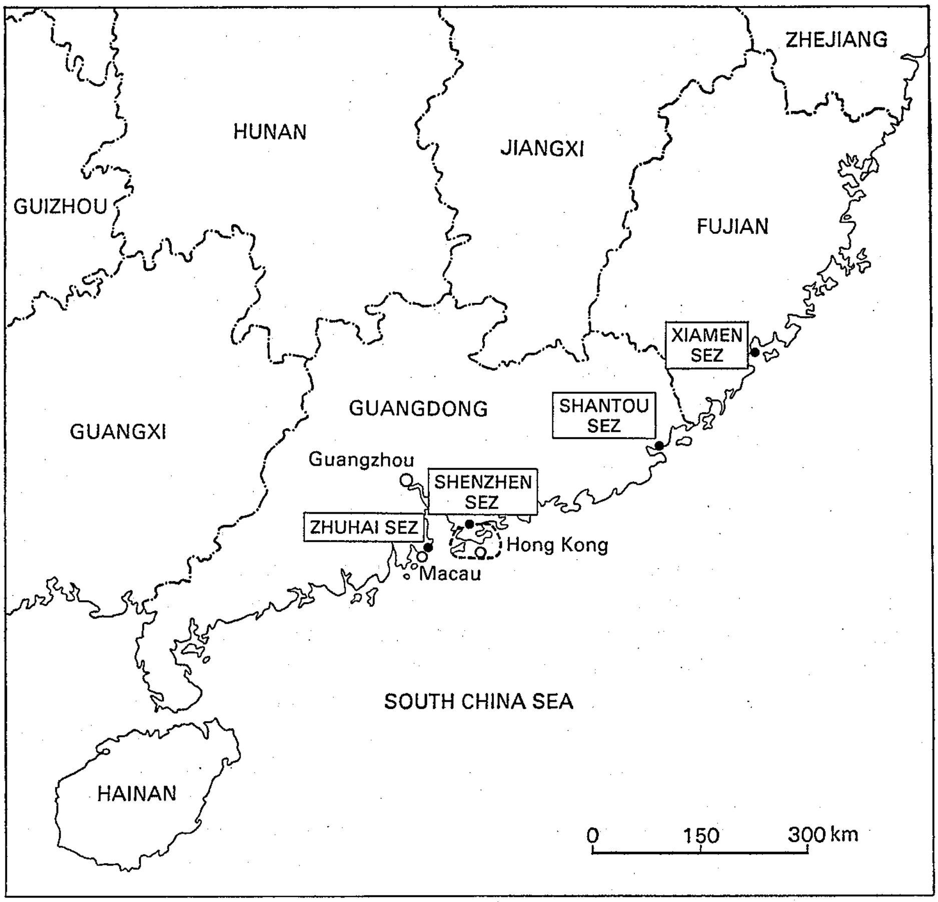
Initially, a small piece of land of about one square kilometer (Shekou) was marked out in Shenzhen as an export processing zone to facilitate joint ventures and cooperative projects between the China Merchant Steam Navigation Co. (CMSN), a Hong Kong based Chinese enterprise, and foreign firms. The CMSN was responsible for developing and managing the infrastructure of the zone and other general matters such as approval of project proposals, the hiring of labor, and internal and external transportation [3]. Less than a year later, the formation of the three SEZs in Guangdong was announced, with Shenzhen designated for comprehensive development for the promotion of the transfer of technology and management skills from foreign countries in various sectors including agriculture, commerce, and cultural activities. Since 1982, Shenzhen's role has been further broadened. It is to be developed into a new type of border city with the following attributes: financing and construction are to be mainly by foreign capital; there is to be a new approach to development and management; there is to be a special set of laws and material incentives; and the economy is to be based on market forces. Shenzhen is physically separated from the rest of the country by a new fence and will remain administratively and economically distinct. However, it will be closely linked with the rest of the country in a different sense, as it will serve as a laboratory where the Chinese can observe and learn from the outside world at first hand. It will also serve as a place for testing new reforms in enterprise management, finance and labor matters which, if found successful, could be applied to the rest of China. The Chinese have condensed Shenzhen's new role into six Chinese characters:

Guancha (to observe), Xuexi (to learn), and Shiyan (to experiment).

The purpose of the SEZ may be summed up by a terse statement by Wu Nansheng, the head of the Guangdong Provincial SEZ Administration:

> It is hoped that through the SEZs China will be able to gain an understanding of the development of modern capitalist economies, accumulate experience in the formulation of regulations for economic development programmes cooperating with overseas businesses, and obtain access to advanced technology and management techniques. This would suggest that the SEZs, in addition to their role as foreign currency earners, are intended to be more or less self-contained pilot projects for highly integrated economic activity. This high concentration of activity in a small area offers a greater administrative control and makes economic planning more tractable. The SEZs are a testing ground for integrated development in infrastructure, regulation and law, industrial projects, construction, tourism and foreign investments. [2, p. 14]

Fig. 1. Locations of China's Four Special Economic Zones



III. THE FOUR SEZs

A. *Location*

China's four SEZs are all located along the coast of South China and are close to one or another of its long-established trading ports (Figure 1). Thus they have easy access to existing port facilities and are conveniently located for international trade. Two of them, Shenzhen and Zhuhai, share borders with Hong Kong and Macau and are benefited by the urban markets of these two established Far Eastern trading ports. Hong Kong, in particular, offers the nearby zones excellent transport and communication services as well as a major source of outside investment, being itself a sizable economy. Shantou and Xiamen, though more remote from Hong Kong, are connected to Hong Kong and Southeast Asia ethnically. Many overseas Chinese in the region originated

TABLE II

THE FOUR SEZs IN CHINA, 1984

Name	Total Area (sq. km)	Names of Industrial Processing Zones	Area (sq. km)	Port Zone (sq. km)	Agri-cultural Zone (sq. km)	Date Started
Shenzhen[a]	327.5	Shekou	1.3			Jan. 1980
		Liantang	1.7			
		Bagualing	0.6			
		Shangbu	10.0			
		Shuipu	0.4			
Zhuhai[b]	15.2	Middle zone	3.0	2.63		Jan. 1980
Shantou[b]	13.3	Longhu	1.6	1.70	10.0	Jan. 1980
Ximen[b]	123.0	Huli	2.5			Oct. 1980

Source: [17].

[a] According to the plan, out of 327.5 sq.km. 98 sq.km. is used for industrial and other purposes.

[b] Recently revised to present size.

in these port cities and some still have relatives there. Such a connection offers the SEZs an edge in terms of foreign relations. Not surprisingly, therefore, the first efforts in investment promotion by the SEZs were aimed at the overseas Chinese.

The natural conditions of the harbors and existing port facilities of the four SEZs are not the same, and the differences could affect the pace and final scale of development.[7] Of the four, Shenzhen, being right next to Hong Kong, possesses obvious advantages over the others. Xiamen's potential is also large, as it has a good port and a fairly developed economy.

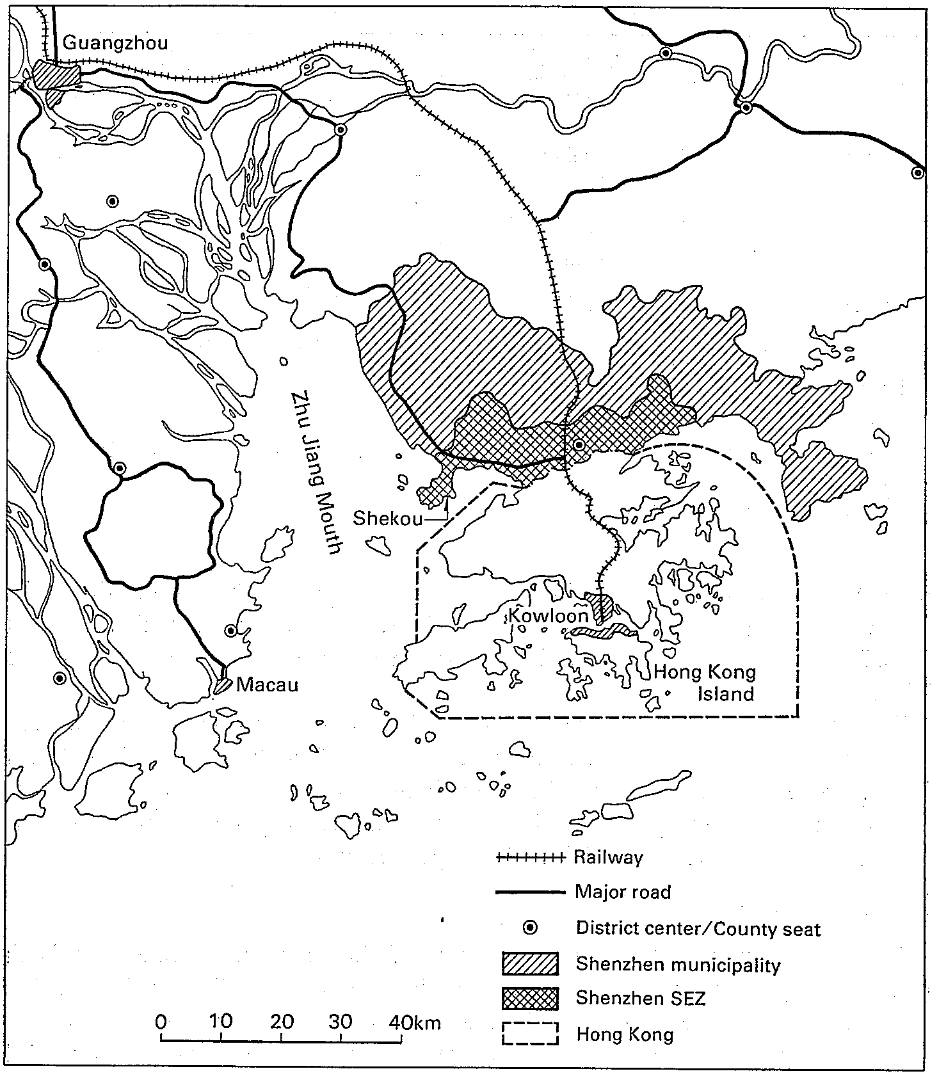
B. *Size and Character*

Table II summarizes the general features of the four zones. Shenzhen is the largest, with a territory of 327.5 square kilometers. The Shekou Export Processing Zone is a special zone within a special zone (Figure 2). As we have seen, it was initiated a few months before the announcement of the large SEZ and is directly developed and managed by CMSN, though in theory it is under the Shenzhen SEZ Management Authority. Within the SEZ are four other areas for concentrated industrial development (Table II). In addition, intensive property and commercial developments are underway at Lowu, the border crossing to Hong Kong, which is also designated as the SEZ's financial and commercial core. The major portion of the land of the SEZ is to be devoted to agricultural, tourist, and residential projects.

According to its Twenty-Year Development Outline, the Shenzhen SEZ will have a population of 800,000 by the year 2000 and by then its per capita

[7] Details of the natural setting of the zones are contained in [4].

Fig. 2. Extent of Shenzhen Special Economic Zone



income will have been raised from the present level of U.S.$500 to U.S.$3,132.[8] It will then be a highly industrialized economy with a per capita industrial output value of U.S.$8,824. To achieve these aims, Shenzhen must maintain an average growth rate in industrial output value of 28.8 per cent and an average per capita income growth rate of 24.6 per cent. The level of accumulated foreign investment will have to increase from the U.S.$1.3 billion of 1982 to U.S.$7.2 billion by the turn of the century [1].

The Zhuhai SEZ is much smaller than Shenzhen. Its 15.2 square kilometers

[8] These and other figures in the paragraph are taken from [1].

is split into three separate zones along the border with Macau, with the middle zone (about 3 square kilometers) to be developed into an export industrial zone. The other two zones will be used mainly for property (residential) and recreational developments.

The Shantou SEZ was originally confined to an area of about 0.8 square kilometers, the Longhu export processing zone. Since 1982 it has been extended to cover 13.3 square kilometers, including an expanded export processing zone of 1.6 square kilometers, a port zone of 1.7 square kilometers, and an agricultural zone for commercial and export production of 10 square kilometers. Current efforts are devoted mainly to the construction of the port zone.

The Huli export processing zone is now but a part of an enlarged Xiamen SEZ which covers the whole of Xiamen Island (123 square kilometers). The construction of Huli is to be in two stages taking ten years to complete. It will be an export industrial area with a projected 200 factories and a total manufacturing employment of some 30,000. There will also be a service sector with 6,000–7,000 workers. The total population resident at Huli will probably be 70,000–80,000. The first stage development of Huli took four years and is now almost completed (June 1984). This phase I site will house about 100 factories, some in standard buildings available for rent.

Of the four SEZs, Shenzhen is the most advanced in terms of development. What is more, Shenzhen is being generally copied by the other SEZs which are still in very early stages of construction. Hence, to gain insight into the situation of the SEZs and to evaluate their impact and growth prospects, we can take Shenzhen as an example.

IV. EVALUATING THE SEZs

A. *Investments and Technology Transfer*

The SEZs were first conceived as a means to promote China's contact with modern technology and a capitalist style of business management through industrial joint ventures. Thus manufacturing was given first priority within the SEZs, at least in theory. However, external capital invested in Shenzhen (up to 80 per cent of it from Hong Kong) was at first channelled mainly toward the tourist and property development sectors. In 1980 only 10 per cent of total foreign investment was in manufacturing [18]. The situation has improved somewhat since the slump of Hong Kong's real estate market in 1981–82 and the reorientation of the SEZs promotion efforts toward industrial investment in 1982 (see Table III). But the downturn of Hong Kong industries and general sluggishness of the world market have also adversely affected industrial investments in Shenzhen in the past two years (Table IV).

The lopsided pattern of investments in the earlier years of Shenzhen reflected the strong influence of Hong Kong on the development of the SEZ. In 1980, as much as 33 per cent and 30 per cent of the foreign investment went, respectively, to tourist and property development projects. The dearth of space for

TABLE III

BREAKDOWN OF FOREIGN INVESTMENT IN SHENZHEN SEZ (up to End of 1983)

	Contract		Investment	
	No.	% of Total	(Actual Amount in HK$ million)	% of Total
Industrial	1,847	73.7	1,299	43.6
Property	59	2.4	789	26.4
Tourism & recreation	16	0.6	151	5.1
Commerce, restaurant, & service	132	5.3	225	7.5
Transport & communications	28	1.1	37	1.2
Agriculture & fishery	415	16.6	45	1.5
Others	8	0.3	435	14.6
Total	2,505	100.0	2,981*	99.9

Source: [17, opening page].

* This total is slightly different from the related figure in Table IV. The origin of such difference may be rounding.

TABLE IV

RECORD OF PROGRESS OF SHENZHEN SEZ, 1979–83

	1979	1980	1981	1982	1983	Total
Investment in infrastructure (RMB¥ million)	50	125	270	633	886	1,964
Gross industrial output (RMB¥ million)	60	84	243	362	720	1,470
Foreign investment:						
No. of constracts signed	170	303	578	583	878	2,152
Contract investment (HK$ million)	235	2,136	6,800	1,420	2,634	13,224
Money actually invested (HK$ million)	120	250	590	880	1,130	2,970
Types of foreign participation (No. of enterprises):						
Joint investment	7	4	13	11	92	127
Cooperative venture	30	24	39	47	149	289
Sole ownership	–	5	18	8	13	44
Distribution of foreign investment by industrial sector (No. of contracts):						
Iudustrial	112	243	321	457	714	1,847
Commerce, restaurants, & services	5	10	5	25	87	132
Transport & communications	3	4	5	1	15	28
Properties	2	9	25	6	17	59
Tourism & recreation	2	5	3	2	4	16
Agriculture & fishery }	46	32	218	86	41	415
Others }						8
Floor space completed (1,000 sq.m):						
Total floor space	130	346	546	927	1,464	3,413
Residential	53	179	234	456	624	1,545

Source: [17, opening page].

recreation and residence in Hong Kong was indeed the major factor behind the flood of investments into Shenzhen soon after its declaration as an SEZ [19]. The same phenomenon was also witnessed in Zhuhai, under Macau's influence. In the other two SEZs, this kind of phenomenon is much weaker. However, as long as overseas Chinese form the major potential source of foreign capital, similar patterns of foreign investment are likely to develop there as well. The adverse effect of such a pull from Hong Kong has been seriously attended to by the Chinese. In their latest twenty-year plan for the SEZ, released in 1982, the emphasis on manufacturing was reiterated.

Looking at the total sum invested between 1979 and 1983, Shenzhen seems to be doing quite well, surpassing all other Asian EPZs in terms of the amount of foreign capital it has been able to attract within a short span of four years (Tables III and IV). Of course, this fact must be interpreted in context, by remembering that the SEZ is not just an EPZ, but involves multi-sectoral developments amounting to the building of a new border city, and that it has a very special market and source of capital adjacent to it. Indeed, it appears very much to be the economic adjunct of Hong Kong if its other roles are left aside. Its major investment projects in the past four years have been mainly concentrated in the following areas: (a) activities formerly in Hong Kong which moved to Shenzhen because of comparative factor advantages (land and labor in particular); (b) manufacturing in which Hong Kong provides the market for the final or semi-manufactured products; (c) activities or products that are highly in demand but limited in supply in Hong Kong (e.g., certain types of recreational establishments). Even in manufacturing investments, there is danger that Shenzhen may become Hong Kong's dumping ground for lower rung labor-intensive or otherwise undesirable industries. With the shift of investment emphasis back to manufacturing, Shenzhen has to find new ways and means to attract the right sort of investment which will bring the modern technology that China wants without having it pass through the "Hong Kong filter." New means to attract industrial investments are the more necessary as the total foreign capital that will be attracted into the zone will substantially shrink with the de-emphasis on property and tourist development projects, a phenomenon already demonstrated in 1981–82 in the wake of the Hong Kong real estate slump (Table IV).

In order to boost Shenzhen's attractiveness to foreign capital in a time of general economic depression and to direct investments back to "the proper track," a number of new measures have been taken since 1983 (see Table V for the old package).[9] First, the land rents for industrial use have been lowered by 10–20 per cent and the tax holiday for some industries is being extended to two–five years after commencement of production. Second, there are more liberal rules governing the access of SEZ products to the Chinese domestic market. Third, efforts are being made to promote joint venture and cooperative projects

[9] [21]. A further concession of 20–50 per cent of the 15 per cent of corporate tax for foreign investments exceeding U.S.$5 million and other reduction of land rent were announced on the *Ta kung pao* newspaper, June 12, 1984.

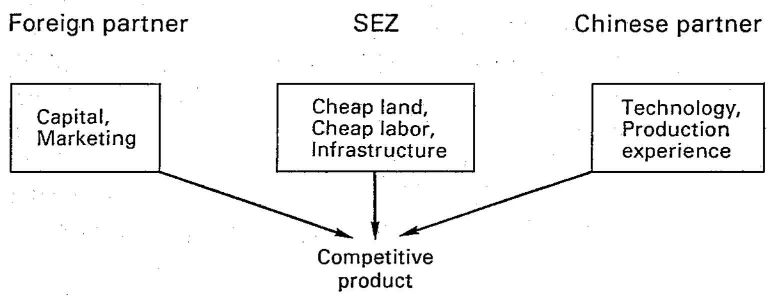
TABLE V

INCENTIVE PACKAGE FOR SHENZHEN SEZ, 1981

Item	Details
Tax on corporate profits	15 per cent.
Tax holiday	One–five years.
Labor wage	Minimum U.S.$100 monthly.
Duties	All imported goods tax-free except tobacco and liquor.
Land rent (industrial)	U.S.$3.3–10/sq. m per year (lease 20–50 years).
Land utility cost (industrial)	U.S.$0.33–0.67/sq. m per year.
Capital movement	Free movement of capital and after-tax profits.
Freedom of management	Hiring of foreign technical and management staff; right to hire and fire local staff and workers; income of foreign workers can be repatriated after payment of tax.

Source: [2].
Note: See text for more up-to-date picture.

between foreign capital and established Chinese industrial enterprises. This new kind of partnership is intended to combine the strengths of the three participants to turn out products that are competitive in international markets as illustrated in the following diagram:



Besides providing the physical location and the basic infrastructure, the SEZ also plays the role of match-maker between the other participants.

At the moment, although the industries that the SEZ wants to attract are still basically the labor-intensive type (Table VI), it is very clear that the Chinese also want those which involve higher levels of technology. China is willing to consider joint-venture projects producing more sophisticated products or even certain types of heavy industries.[10] In 1983, there were already forty-three large state enterprises producing in the zone under different forms of cooperation with foreign firms, ranging from production under license to joint ventures [21].

There is no doubt that this new strategy of the SEZ has added a new dimension to the modernization of China's existing industries. It also represents a new development in the general EPZ concept. The new strategy accords very well

[10] These include high-tech electronics and a number of oil-based and oil-related industries. See [17, Part 1, Chapter 6].

TABLE VI

INDUSTRIES RECOMMENDED FOR SHENZHEN SEZ

Industrial Group	Products/Processes
1. Light industries	Paper products, pressure cookers, lamps, printing ink, cigarettes, soap, plastic sheeting and bags, glassware, carpets.
2. Textiles	Weaving, knitting, towels.
3. Electrical & electronics	Color TVs, refrigerators, washing machines, telephones, calculators, Hi-fi parts and components, transformers, electronic games, photostat machines, cameras, precision equipment, other household electrical goods, injection-moulded parts.
4. Food & beverages	Composite food manufacture, biscuits and candy, noodles, preserved vegetables, beverages and beer, frozen foods.
5. Metal & machinery	Freezing equipment, air-conditioning equipment, stainless steel cutlery, metal tools, aluminum products.
6. Furniture & household goods	Metal goods for daily use, stationery, steel and wooden furniture, rattenware.
7. Crafts & garments	Jewelry, art ceramics, leather goods, toys, embroidery.
8. Others	Electroplating, pottery and ceramics.

Source: [7].

with Chinese circumstances as China has a substantial industrial base and is fairly advanced in certain types of technology, though she is lacking in modern market knowledge and marketing techniques. The Chinese domestic market, too, is among the best in the developing countries. The potential of the new strategy for enhancing future economic and technological exchanges between China and the West within the SEZs are certainly great.

At present Shenzhen is already a burgeoning industrial economy. Its manufacturing employment has grown from about 5,000 persons in 1978 to around 25,000 in 1983 and its gross manufacturing output has jumped from 60 million yuan to 720 million yuan in the same period. The latter figures represent, respectively, 34.3 per cent and 72.8 per cent of the total gross output value of agriculture and manufacturing for the two years in question, indicating a tremendous shift from a largely rural to a largely industrial economy.[11] Among the factories with foreign capital participation, electronics factories figure prominently. By the end of 1983 the SEZ possessed 62 electronics factories employing 13,000 workers [11, opening page]. In terms of employment, this represents a tremendous jump from 1982 when, at the end of that year, only 4,700 workers were employed in the industry [21]. Electronics is now being regarded as the prime industry for active promotion of foreign participation.

11 [21]. Compared to the rest of the country, the Shenzhen SEZ is still the major location for joint ventures; in the period 1979–82, there were only forty-eight joint ventures located in the rest of China, with a total investment capital of U.S.$2.23 million, of which U.S.$1.03 million is foreign capital [12].

B. *Reform Laboratory*

The broader and more deep-reaching impact of the SEZs, even a mere five years after their birth, lies outside the areas of technology transfer or gains in foreign exchange. In fact, the SEZs serve as the vanguard in China's recent attempt to reform her economy and come up with new ways to manage her enterprises. It may be recalled that China legislated quite a number of economic laws and regulations in the 1950s. Many of these were not put into practice because of disruptions caused by the political upheavals of the 1960s and 1970s. Today most of them have become obsolete as China has shifted to a re-emphasis on the role of enterprise independence, material incentives, and general application of market forces in factor allocation. China therefore requires a new set of laws for regulating business activities. The SEZs obviously provide a testing ground for rules and regulations related to foreign capital and joint ventures, but the Chinese have much far greater tasks in mind for them. So far, in addition to the Regulations on Special Economic Zones in Guangdong Province, six provisional SEZ laws regarding enterprise registration, immigration and emigration, labor hiring and wage rates, land and land rent, economic contracts concerning foreign partners, and technology transfer have been announced and put into force.[12] And more laws concerning banking and finance, insurance, lawyers, and arbitration will be announced shortly. The implications of these attempts are clearly twofold. On the one hand, the Chinese want to enforce the rule of law such that foreign capital will find it safe to invest in China and there will be a framework to follow when doing business inside China. On the other hand, these laws touch on topics that the Chinese had been hotly debating among themselves and recently seem to have accepted in principle. Their writing into legal form, official endorsement, and trial implementation within the SEZs signify, to some extent, official approval in principle, and, possible general application in the rest of China in future.

The method of labor hiring and the wage system in the SEZ are good cases in point. Within the SEZs, labor bureaus recommend possible candidates for certain posts [14, p. 10]. These candidates are interviewed by the managements of enterprises who finally decide who will get the jobs. Besides the right to choose, the enterprise has the right to fire as well. For its part, the wage system consists of a general minimum wage and a formula for splitting the actual amount paid by the employer: 50 per cent as basic wage, 20 per cent floating (bonus, attendence prize, productivity prize, etc.) 5 per cent for medical and recreational funds handled by the management, and 25 per cent as welfare contribution. The welfare contribution is paid to the SEZ authority which is responsible for subsidized housing within the SEZ for the workers, and for their retirement pensions, etc. The principle of "hire and fire" is becoming popular within China and contract labor has already been tried out in a number of state enterprises. China wants to replace "the iron ricebowl" of completely secure life employment by

[12] Details of these provincial regulations can be found in [17].

a system which rewards the capable and punishes the lazy and incompetent. The lead of the SEZs in these new practices regarding labor has been studied and observed by many Chinese officials on specially arranged visits to the SEZs. In addition, the managing authority of the Shenzhen SEZ serves as a model for a new type of efficient and independent governing body which coordinates physical and economic planning as well as the actual promotion and running of the SEZ. The role of foreign banks in financing and providing normal banking facilities within China is also put to test in Shenzhen where eight foreign banks are presently allowed to operate. Foreign participation in financing, planning, constructing, and managing of the basic urban infrastructure such as transport and communication is equally significant. The experience gained in the SEZs is almost certain to affect the attitude of the Chinese as they consider similar roles for foreign capital in other parts of China. Clearly, then, these experiences stemming from the testing out of some of these basic economic and management reforms are the most significant—though intangible—gains from the SEZs.

On April 6, 1984, China announced the creation of fourteen "open cities" along its long coastline and declared that they would have some of the "freedoms" and special arrangements for technology transfer and for attracting foreign investment enjoyed by the SEZs. This decision was reported to be a consequence of the success of the SEZs and it was maintained that the new open cities should closely follow the SEZ development example.[13] As a socialist state, China needs the SEZs to function as a bridge—one which can lead to a system that is more open and better able to serve the requirements of socialist modernization by combining the "best" of the two worlds.

V. CONCLUSION

The mayor of Shenzhen City, Mr. Liang Xian has categorically claimed that the Shenzhen SEZ provides a better environment for the attraction of foreign capital and industries of a technology-intensive nature than do the EPZs of Asia [1, p. 53]. To support his claim he cited his belief that the exploitation of oil in the South China Sea will bring in tremendous amounts of capital, besides supplying new raw materials for the energy and other industries. Second, he pointed out that the zone's proximity to Hong Kong enables it to avail itself of the best natural harbor in Asia, which is also unparalleled in terms of transport and communication facilities and convenience. The third reason cited by Mr. Liang is that China is different from other Asian countries because she is socialist. As such, China offers political stability not easily found in other developing countries in Asia. Moreover, he believes the socialist system will ensure stable land prices, stable and low wages and the state's willingness and capacity to intervene in solving capital and other problems that may arise from time to time due to fluctuating international supply and demand situations [1, p. 53].

It is fairly clear, from the progress of the SEZs and from what Chinese officials

[13] A Xinhua News Agency report reprinted in [17, opening page].

have said about them, that the SEZs, though in some ways showing a close congruence to EPZs, do have unique characteristics. In the short term, the pace and nature of their development seem to be much affected by the sway of investors who are mainly Hong Kong Chinese or overseas Chinese from Southeast Asia. In the long run, their edge as "free investment zones" will show its effect and they are not likely to move along the path of traced out by EPZs in Asia, to wit, providing merely cheap sites and cheap labor in return for some employment in the unskilled and semiskilled labor categories and the earning of foreign exchange. In many ways the Chinese SEZs are an ingeneous approach by a socialist country to opening up and modifying her existing system through "learning" from the non-socialist world along many fronts. In a sense, the SEZ may be described as a microcosm of two interacting worlds: the socialist and the non-socialist, but one which is under the control of the socialist initiator.

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