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A child of China's economic reform special economic zones

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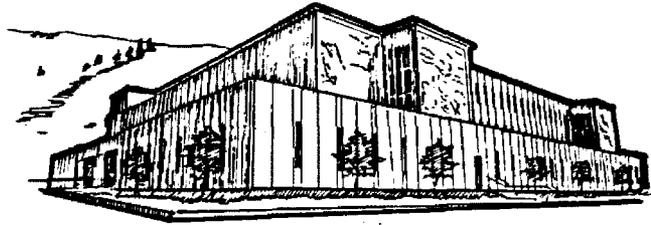
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University of
Montana

A CHILD OF CHINA'S ECONOMIC REFORM

SPECIAL ECONOMIC ZONES

By

Amanda Xu

B.A., Shanghai Foreign Trade Institute

1988, P.R. of China

Presented in Partial Fulfillment of the Requirements

for the Degree of

Master of Business Administration

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1991

Approved by:

L. Allen Fleming

Chairman, Board of Examiners

R. C. Murray

Dean, Graduate School

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INTRODUCTION

Since the end of the Second World War, developing nations in the Asian region have employed various strategies to speed up their industrialization and modernization processes. One move which has found favor among Asian governments and has achieved varying degrees of success is the establishment of export processing zones (EPZ). By offering a suitable package of investment incentives to both foreign and domestic entrepreneurs setting up of modern manufacturing plants within certain defined areas, it is hoped that overseas capital and technology can be attracted to accelerate economic growth and to promote exports.

China's special economic zones (SEZ) are being developed with similar objectives in mind and are basically modelled after the EPZ system. The SEZs are set up as experimental laboratories to test new concepts and policies of development and to expedite the process of modernization in China. Although China is a relative late-comer in this field of development, the SEZs have attracted a great deal of attention from all over the world partly because EPZs are typically found in countries with market economies, whereas SEZs are the product of an open economic policy in a socialist country. Much interest has been focused on the feasibility and implications of adopting such a model of development in a socialist setting. The purpose of this

paper, therefore, is to trace the establishment of SEZs, to analyze the impact of open-door policy, to explore the investment environment to foreign investors and to make some predictions about future prospects in SEZs.

More than one decade ago, the Chinese leader, Deng Xiaoping,¹ approved the formation of SEZs--the first child of China's Economic System Reform. This focuses on China's new economic initiative program, which features different sizes of private and semi-private firms and other aspects of economic reforms. It examines the implications of China's efforts, their success or failure, and the place of foreign businesses in this program. However, one event in particular, the suppression of the pro-democracy movement in June of 1989, has cast a great shadow on China's reforms. What impact would it have on the experiment laboratory-SEZ? Would SEZs be still so attractive to foreigners? How would SEZs survive? These are the topics the author will discuss in this paper.

This paper is divided into four chapters. Chapter one deals with the background of the establishment of SEZs in China and includes an analysis of a) the political environment, b) the economic and living standards, c) the foreign trade bottle-neck, and d) the establishment of SEZ. Chapter two looks at the success and problems in the Shenzhen² SEZ, including the topics of a) Shenzhen-China's boom town, b) electronic business in Shenzhen, c) local

private business in Shenzhen, d) contributions to inner China, e) brisk Shatoujiao, and f) problems in Shenzhen. Chapter three discusses an overall evaluation of the investment environment in terms of a) the investment environment, b) the administrative structure, c) the legal system, d) the banking and financial structure, e) the preferential treatment and investment incentives, f) the tax system, and g) the labor cost and productivity. Chapter four focuses upon a future prospect for SEZs in China and surveys a) austerity drive and political upheaval and b) impacts of 1997. Following chapter four is the summary and conclusion of the foregoing four chapters' discussions from the author's perspective.

As the nature of this paper is non-experimental, the data collected is mainly from Mansfield Library and China's official red-head documents.³ Statistics from other sources are also taken into consideration in the analyses.

CHAPTER ONE
SEARCH FOR A NEW MODEL - SEZ

Political Environment

The basic Stalinist political system and economic development model adopted by China in the 1950s was a highly centralized version of the Leninist system similar to Lenin's own communism of 1918. All key economic, cultural, and social entities were nationalized, and along with the national party and state organs, they were run as a single-party-social bureaucracy. Divided into functionally defined subsystems, such as those for finance and trade, for industry and communication, and for ideology and culture, this rapidly expanding bureaucracy monopolized decision making in all spheres. Individual units in this system tended to become multifunctional; for example, ministries, factories, or hospitals provided not only their main products or services but were also responsible for housing, medical care, education, counseling, and recreation for their employees. In a pyramid-style hierarchical structure, lower-level entities were absolutely dependent upon higher levels and were subordinate to their command.

Efforts to reform this basic model began early and continued throughout the next thirty years. Two competing modifications of the Stalinist model emerged: a radical, decentralized Stalinism associated with Mao Zedong, and a

moderate Leninism identified with Zhou Enlai and Chen Yun.*

By 1969, the "moderates" gathered around Zhou Enlai were able to convince Mao that the almost total isolation of China from the rest of the world had driven the country into a very precarious and vulnerable position. A series of policy modifications in the 1970s led to China's normalization of relations with the United States, Japan and many other countries. The exception was the Soviet Union and the East European bloc. A major consequence of this policy change was a dramatic expansion of economic transactions between China and the capitalist countries. Trade with non-communist countries increased from US\$3.5 billion in 1970 to US\$12.2 billion in 1975.

This policy shift, however, encountered persistent resistance from the ideological left led by the "Gang of Four." Beginning in 1974, Zhou Enlai and later Deng Xiaoping, who had been rehabilitated from political disgrace in 1973, became the targets for heated political criticism from this left-wing faction. Zhou was accused of being "an expert in fawning on foreigners" who had consistently "begged for foreign capital economically."⁵ Deng was charged with lust for foreign technology and equipment, and opposing the principles of independence and self-reliance.* Deng was consequently dismissed immediately after the death of Zhou.

The death of Mao in 1976 and the subsequent downfall of

the "Gang of Four" paved the way for the return to power of the twice-purged Deng Xiaoping and the official launching of the Four Modernizations' in 1977. A more relaxed and flexible approach to self-reliance and interdependence soon evolved: self-reliance was regarded as a long-term goal rather than as something to be put rigidly into immediate practice. Establishing contacts in all spheres with foreign countries means "absorbing the good experience and techniques from abroad for our own use so as to enhance our self-reliance capabilities and build China into a powerful, modern socialist country before the end of this century."*

Apart from stating that self-reliance is to be a long-term goal rather than an immediate necessity, the Chinese media has carried out a major ideological campaign to reinterpret Mao's principle of self-reliance. The hope is that this principle may be harmonized with the new economic programs which seek to resolve the practical needs of contemporary China. The reinterpretation of Mao's principle of self-reliance in China after 1976 emphasizes four major points: (a) the "Gang of Four" is alleged to have distorted the principle and exploited it for their own political gains; (b) the study of foreign ideas and the import of foreign technology do not contradict the basic tenets of the principle; (c) the change in economic and political conditions both within China and abroad makes it favorable today to adopt a more flexible approach to the issue of

self-reliance; and (d) a discriminating and planned absorption of foreign ideas and technology will further strengthen China's national self-reliance in the long run.

China has now recognized that self-reliance can only be a long-term goal and can only be realized through the short-term importation of factors of production such as technology, capital and management expertise from the developed countries. These imports are meant to tackle the current problems of China's economy. Participation in the international division of labor, borrowing from foreign banks and governments and setting up of Special Economic Zones (SEZ) are conceived as means to finance these imports and are thus given much weight in the current drive toward the modernization of China.

Economic and Living Standards

After the downfall of the "Gang of Four," the Chinese economy deteriorated to such an extent that it fell into "an unsound economic cycle of high speed, high accumulation, low efficiency and low consumption." Measures to break the cycle were thus urgently required and a great strategic shift in China's socialist economic development was necessary. As far as external economic relations are concerned, SEZs represent part of the Chinese answer to their economic problems.

The growth rates of China's industrial and agricultural

productions have on the whole been fairly high. Between 1958 and 1978, the average annual growth rate of the gross value of industrial and agricultural output was 7.6 percent, with industry growing by 9.7 percent. However, compared to 1957, the total output value produced per hundred Ren Min Bi (RMB) of industrial fixed assets had declined by 256.4 percent by 1978, while the profits and taxes turned over per hundred RMB of funds fell by 30.3 percent. With more capital input and lower output of profits and taxes, the economic results clearly declined. Consequently, the high average annual growth rates of China's economy could only be sustained by very high accumulation at the expense of the people's everyday needs. The average wage for workers and staff members of state-owned enterprises rose from RMB 637 in 1957 to RMB 644 in 1978, an increase of only 1.1 percent over a period of 21 years. Since the cost of living index for workers and staff members of state-owned enterprises rose by 14.3 percent during the same period, real wages actually declined. The livelihood of the farmers was also difficult. The converted average wage of per capita income in 1957 was RMB 40.5, while in 1990 it was RMB 517. *

If the trend of declining economic results cannot be reversed by drastic changes in the economic development strategy, the targets set for the Four Modernizations by the turn of the century are unlikely to be met. To reverse the trend, more open foreign trade policies are required.

The Foreign Trade Bottle-neck

Up until 1978, Chinese foreign trade displayed five major characteristics.

(1) The small volume of trade

In terms of gross value (measured in RMB), China's foreign trade in 1977 was merely 6.6 times that of the low level of 1950. Consequently, in spite of its vast size and huge population, and a modest rise in its total trade value, China's proportion of the total value of world trade dropped from 1.4 percent in the 1950s to 1.1 percent in the 1960s and to only 0.8 percent in the 1970s, signifying that China's external economic links were shrinking during this period.

(2) Fluctuations in the rate of growth

The growth rate of foreign trade has not been stable. In every year from 1949 to 1979, the gross value of foreign trade increased from that of the previous year except for three major periods of fluctuation: a big drop in the three years after 1960, and two drops during the Cultural Revolution, which was a period of political interference from "leftists" who interpreted self-reliance narrowly.

(3) Changes in trading patterns

In the 1950s, some 65 percent of the gross value of China's foreign trade was with the Soviet Union and East European countries. After the rupture in Sino-Soviet

relations at the end of the decade, trade began to shift towards the capitalist market. This process accelerated during the 1970s with the improvement of China's relations with Japan, the European Economic Community (EEC) and the United States. However, China's trade with these capitalist countries was and still is in deficit. Chinese export commodities have difficulty in penetrating foreign markets.

(4) Changes in the structure of foreign trade

The fastest growth in export trade was recorded in light industrial products and textiles, and petroleum and chemical products which took over the place traditionally occupied by agricultural and mineral products. During the twenty-four years from 1955 to 1979, the proportion of agricultural and agriculture-related products dropped from 55.7 percent to 22.2 percent of the gross value of total exports, while that of light industrial products and textiles grew from 26.9 percent to 42.7 percent and heavy industrial products (including petroleum) grew from 17.4 percent to 32.1 percent. In the import trade, producer goods dominated the scene, except in the period between 1960 and 1965 when economic difficulties, a readjustment of the economy and large increases in grain purchases boosted the import of consumer goods to 40 percent of the total. In the 1970s, imports of consumer goods declined and settled at about 19 percent. Nevertheless, the Chinese government now recognizes that in the present structure, exports of high-

quality products with well-known brand names are lacking, and the import of complete sets of equipment is considered to be an inefficient method of technological upgrading.

(5) Unified state control

Throughout the period from 1949 to 1979, foreign trade was conducted under strict, unified state control. On the one hand, this is recognized to have had the merit of helping China to maintain its balance of international payments; but on the other hand, it has discouraged the initiative of the provinces and other local units to promote exports.

However, since 1978, recognition of the inefficiency of the trading system has stimulated new and more innovative methods of trading. The adoption of less rigid trading policies and trade financing represent a new attempt to give the necessary flexibility to China's trading system and to its rapidly increasing import trade.

Establishing SEZ

In 1978, the two southern coastal provinces of China, Guangdong and Fujian, were granted considerable autonomy in the development of foreign trade. Subsequently, the concept of SEZ was discussed and ideas were formulated. The first initiative to be taken was the formulation of an industrial zone on the Shekou Peninsula. The official status of Shekou

as a special economic zone was granted on January 1, 1979. The idea of setting up the Shenzhen, Zhuhai and Shantou SEZ was first discussed in July 1979, but a final decision was not reached until the end of 1979 and their legal status was not granted until August 26, 1980.¹⁰ The Xiamen SEZ was designated in October, 1980, two months after the Guangdong SEZ.

In order to justify the establishment of the SEZs, many Chinese scholars and officials have tried to affirm the socialist nature of these zones. They have attempted to find ideological support in the works of Marx and Lenin. While they do not have much success with Marx, they have found a few statements of Lenin useful and relevant to their justification. At first the policy researchers focused on Eastern European models, but they very quickly began to experiment with the concepts and methods of Western development economics. Researchers and policy-makers became more aware of the growing gap between China's performance and that of capitalist countries. Consequently, the policy-makers thought that a small element of capitalism in the national economy was incapable of undermining socialism, especially if the impact of the SEZ is confined to defined limits. Up to this moment, with a mixture of socialism, state capitalism and foreign capitalism, SEZ was finally established.

CHAPTER TWO

SUCCESS AND FAILURE IN SHENZHEN

Shenzhen-China's Boom Town

As the most productive of China's four SEZ, (soon there will be six with the addition of the undeveloped new province of Hainan island and an industrial area of Shanghai, Pudong), Shenzhen has a completely different feel from the rest of China. ¹¹

Less than a decade ago, Shenzhen was a sleepy railroad town of 30,000 whose main attraction was as a place to change trains between Hong Kong and People's Republic of China, a pleasant subtropical hamlet on South China Sea. Today, Shenzhen has a population of 700,000, traffic jams, ultramodern architecture including China's tallest building, and a hustling, free-for-all frontier atmosphere. Capitalizing on its adjacency to Hong Kong, Shenzhen is a boom town bustling with activity and enterprise, where hotels and shops quote prices in Hong Kong dollars instead of RMB. China's special economic zones are designed largely for export manufacture and have their own liberal rules and tax laws for foreign and joint enterprises. In contrast to export processing zones elsewhere in Asia, the Shenzhen SEZ was planned as a comprehensive economic entity, embracing tourism, manufacturing and agricultural production, as well as commercial and real estate development. However,

industrial growth has been accorded top priority and industrial production will form the basis of the zone's economy. Shenzhen is still in the formative period and has had some problems fulfilling this objective. The main reason is that investments in industry require a large capital outlay and a long period of return, whereas in real estate development, for example, the period of return is short and the profit margin is high. Furthermore, the lack of an efficient administrative, legal and financial system has also deterred many potential investors from putting large sums of capital into manufacturing undertakings. They prefer to wait and see how things develop before committing themselves. The inadequate provision of infrastructure also has a negative effect on investment. As a result, overseas participation in the initial period of Shenzhen's industrial development was confined primarily to small enterprises or businesses involved in intermediate processing of assembly work.

Despite the fact that tourism and real estate development have initially had greater success than manufacturing in attracting overseas capital to Shenzhen, the number of investment projects in industry far exceeds that of other activities. In August 1981, 66 percent of the total number of projects in Shenzhen were connected with manufacturing,¹⁸ and by the end of 1989, the figure had increased to 83.7 percent.¹⁹ These covered a wide variety

of ventures ranging from the basic light industries such as electronics and textiles to more sophisticated industries like motor vehicle assembly, printing and container manufacture. However, the industrial structure of the Shenzhen region has so far been heavily biased toward light industrial production.

Electronic Business In Shenzhen

In 1987, Shenzhen became China's leading city for electronics exports, accounting for almost 25 percent of country's total--\$202 million. Its main export products are color televisions (almost a million units) and tape recorders (more than 7.5 million, almost half of China's total production). Shenzhen's ambition is to become one of world's leading producers and exporters of VCRs.

In 1989, 43 percent of the special economic zone's total annual output of US\$1.37 billion was electronic products.* Seventy percent of the electronic output comes from the Shenzhen Electronic Group (SEG). Established in 1985 by the municipal government, SEG now consists of 155 companies. 45 of those are joint ventures with foreign or domestic companies. One of the group's biggest companies is Huagiang Sanyo Electronics Co. Ltd., a joint venture in which Japan's Sanyo Corp. owns 49 percent. The operations, scattered in several plants, produce 1,200 color television sets a day, some with remote control and some with

electronic tuning. It also produces 1,200 stereo cassette radios daily under the Sanyo and Fisher labels. Many of the components-picture tubes, circuit boards, semi-conductors come from Japan.

SEG exports 55 percent of its output. Of its remaining production, 30 percent is sold in mainland China and the rest in Shenzhen's own booming economy. Until the austerity program began in 1988, SEG's growth had been spectacular. In 1986, its first full year of operation, SEG's revenue was US\$257 million; in 1987 revenue was US\$359 million, another 40 percent increase. But in 1988, revenue fell for the first time to US\$327 million, a victim of the Chinese austerity program. For SEG, 1991 should shape up as a better year. Probably the best news for SEG was the central government's decision in 1990 to cut the tax on color television sets to an average of US\$58 per set.

Shenzhen's electronics factories rely heavily on Hong Kong as a first destination for end products; about 80 percent of foreign investments in Shenzhen are through Hong Kong companies. Many of Shenzhen's electronics are shipped first to Hong Kong, then exported to final destinations.

Shenzhen is eager to produce more sophisticated consumer electronics, and is anxious to take over from Korea as major source of technology. The problem is that the Japanese only want assembly projects in China. They don't want to share the technology. Shenzhen authorities have even

more plans. They are looking for big American partners and hope to build a plant to supply U.S market in the Mexico border zone, either as a wholly owned project or as a joint venture.

Local Private Business in Shenzhen

Shenzhen was established in 1979 to facilitate international trade and give experimental private ownership firms the opportunity to succeed. Many private by operated, state-licensed firms have been started as a result of the recommendations of the Chinese Research Society for the Modernization of Management. In China, a small business is broadly defined as an enterprise with less than one thousand employees. Some small businesses in other parts of China operate under state and local government control. In Shenzhen, small businesses function more freely. One of the successes of China's open-door policy is the growth of small business operations, relative to the large state-owned companies which, until recently, were predominant.

These new, small businesses are very flexible and can turn out new products in shorter periods of time than other Chinese enterprises. In addition, they have become a major source of new employment and are providing much needed modern technologies.

Individuals or groups that contracted with the state to conduct small business operations enjoy higher incomes than their counterparts who work for a monthly salary. Based on

the contract or lease agreement, a percentage of profits is paid to the state while the remainder is used by the contractors for salaries, reinvestment, and a welfare program which includes community and/or staff bonuses. For example, one of the individually owned small enterprises in Shenzhen was the brainchild of two middle-aged Chinese. The owners held degrees in engineering and had worked for the same state corporation for nine years. Taking advantage of the reformed system, the two partners raised RMB20,000 in capital to manufacture electronic components for local factories. The company currently employs 110 workers with an average income of RMB1,100 per month, as compared to the RMB400 grossed by the owners when they worked for the state in Shenzhen.¹⁵ Both owners and workers expressed great satisfaction in their ability to succeed. The company contributed money to the state through corporate net income tax and personal income tax system that is required by the government if your monthly income exceeds RMB800.

The successful operation of small businesses in Shenzhen, has promoted several reforms to attract both Chinese and foreign enterprises to the zone. For example, businesses in SEZ operate under more liberal administrative policies than other enterprises in China. Except for small businesses started by individuals in Shenzhen, the ownership of "initiative-based contract responsibility system" enterprises still rests with the state. But the contractor

is said to enjoy full managerial authority, with the government not interfering in management decisions unless the operation becomes unprofitable. The individual contractor is put on probation after the first year in which the enterprise fails to generate profit. A subsequent year of no profit usually results in the cancellation of the government contract. An enterprise in Shenzhen can employ workers based on their qualifications and make labor contracts with these employees. Enterprises outside the SEZ, on the other hand, receive employees as authorized by the state, regardless of the particular enterprise's needs and requirements.

The Contribution to Inner China

One of Shenzhen's key contributions to the national economy was, and still is, to provide links within China. The local government leaders want units in other parts of China to invest in Shenzhen's development and to cooperate to help raise Shenzhen's level of technology. They send cadres to visit advanced research and technology centers in various parts of China, especially in Beijing, Shanghai, Tianjin, and the Northeast. Central government leaders are favorably disposed to help Shenzhen, and Gu Mu,¹⁶ with a small group he headed directly under the State Council, provided a critical liaison to make this possible. His strong identification with the zone's success made it easy

for local officials to confide in and work with him.

By 1981, as Shenzhen began to take shape, many enterprises in other parts of China were eagerly responding to the call of Beijing to establish branches there. Companies found that it was an attractive base for the final preparation of goods for export and for gaining information about new technology and new export opportunities. By 1987, over two thousand "domestic link" ventures, under some twenty-five different central government ministries, had established Shenzhen offices.

The enterprises that responded most eagerly to the call to set up branches in Shenzhen were generally "third front" enterprises. In the 1960s and early 1970s, the enterprises had been moved inland when Chinese leaders, preoccupied with foreign tensions, feared establishing industry in coastal areas. After reforms began, the government was not only reluctant to make new investments in poorly located inland plants but encouraged them to move and establish branches elsewhere to help achieve profitability in the new area of more open markets. Shenzhen afforded an opportunity to set up a branch that could absorb new technology and pass it on to its old inland plant. The branch could also obtain better information about market opportunities abroad and could package and market the company's products or get the home plant to adapt products accordingly.

There was a growing awareness that technology was a

commodity and those firms in Shenzhen with new technology could make it available for sale whether through sales, friendships, or brotherly company assistance. Considerable technology and expertise was acquired by the third front branches and transferred to inner China. It would be an exaggeration to say that information from Shenzhen branches radically changed many home companies, but it did play a continuing role in stimulating new practices and the adaptation of inland factories to the international markets. By 1987, 2,658 enterprises in Shenzhen had some kind of inner link.¹⁷

Brisk Shatoujiao

Commodity economy used to be less developed in Shenzhen due to a small consumer population. Since 1979, a sudden increase of Chinese and foreign consumers, tourists and passengers has resulted in an acute supply-and -demand problem.

The reform of the currency circulation system has facilitated the flourishing business and prosperous commerce of Shenzhen. In 1984, commercial units reached 5,050, an increase of 26.6 times over that of 1980; more than 35 thousand people were engaged in commerce and business with a turnover of RMB 2 billion for social commodities, 16 times that of 1979.¹⁸ Shenzhen is becoming a shop-window for famous brand native products and a new import and export

commercial trading center.

At the southeast tip of the Shenzhen city, 17 kilometers away from the city proper, lies a new thriving town popularly known as "the special area"--Shatoujiao, within the SEZ. The Sino-British street, less than 500 meters long and over 6 meters wide, lies in Shatoujiao. Its center line serves as a border line. The southeast area is under Chinese jurisdiction and northwest area is still under British jurisdiction. Yet unlike previous German Berlin, there are no tall walls and electrical nets, nor a military line where nobody can cross. Instead, roads and bridges are unimpeded and shops are facing each other. People from both sides come and go freely and trade with each other. Anyone who comes to Shenzhen wishes to visit Shatoujiao to see the peculiar scene of "two worlds in the same street."

For a long time, Shatoujiao was a "dead corner" with a backward economy and culture, inconvenient land and few commercial channels. Since the establishment of SEZ, the peculiar geographical environment has been put into full utilization, and foreign capital has been introduced in a big way to develop industry, commerce and tourism. At the same time, efforts have been made to initiate estate development projects. These efforts have resulted in vigorous economic development in Shatoujiao. There are 69 shopping centers with one thousand four hundred employees

working there." There is a superb collection of famous brand commodities and that is why people call Shatoujiao "a paradise for shopping in China."

Problems in Shenzhen

(1) The shortage of labor

Despite remarkable progress since Shenzhen's inception in 1979, a number of basic economic problems still exist. Similar to the suburban fringe of many other fast-developing cities, the farmers of Shenzhen are easily lured to more lucrative employment in the non-farming sector. This leads to a marked decrease in agricultural production because of the shortage of labor. Land is abandoned and left untilled. Consequently, Shenzhen has had to import farmers in order to keep the farmland in production. Some 2,000 vegetable farmers were hired from the Shantou district in 1979 and another 25,000 vegetable farmers were hired from the Guangzhou area in 1988.²⁸ But the problem is still not solved. According to the initial draft of the economic plan, Shenzhen will need as many as 32,000 farmers in 1992. Even without further losses, the existing 14,000 farmers active in Shenzhen will not be sufficient to maintain the level of farming production in the near future. The problem of a shortage of labor in the agricultural sector persists, for the wages and returns in the farming sector are much lower than those in the commercial and industrial sectors.

A shortage of labor is a problem not only in the agricultural sector, but also in the industrial and commercial sectors. These sectors do not lack unskilled laborers who are easily recruited from the local farming sector and nearby counties, but they are short of skilled and semi-skilled workers.²¹ Such workers can easily find employment in their local towns and in established inland industrial and commercial enterprises. Although the wages are higher in Shenzhen than in other parts of China, higher living costs, the lack of local recreational facilities and the disruption of social ties discourages workers from leaving their familiar working and social environment to work in Shenzhen. This is especially true of the middle-aged or married skilled workers.

(2) The shortage of medical and recreational facilities

Between 1979 and 1982, the expansion of medical facilities fell far behind the increase in population. Only one hospital (with 200 beds) and four clinics were available. This was definitely not enough to meet the demands of a city of 700,000 people. A large sum of RMB should be allocated to enlarge the hospital to provide medical facilities for the expanding population of the zone. Recreational facilities were also lacking. Workers still complain that there are not enough opportunities for them to relax and enjoy their free time. The tourist resorts such as those at Xili Reservoir are far too expensive for local

youths. Consequently, the only inexpensive way for them to spend their leisure is to watch television programs broadcast from the Hong Kong television stations. But Shenzhen authorities suspect that those programs may be harmful to the mental health of Shenzhen citizens as their society is still very different from the capitalist society of Hong Kong.

(3) The shortage of technical and international experience

From its inception as a special economic zone, Shenzhen was expected to rely primarily on foreign capital and to import modern technology. These goals proved to be far more difficult than planners initially expected. Many joint enterprises and wholly foreign-owned ventures did not go smoothly. Considering the unrealistic hopes that Beijing had for attracting the latest technology at virtually no cost, the political pressures on Shenzhen not to make concessions to foreigners, and Chinese officials' low level of technical and international experience, it is surprising that any of these ventures worked at all.

Chinese companies sought modern technology, but foreign companies had little incentive to provide it. Shenzhen lacked technical staff who could use, maintain, service, and repair modern machinery. Provincial and national officials tried to provide regulations giving the assurances that foreigners wanted, but without sacrificing Chinese

interests. Government officials had few staff members experienced in international law, and they were cautious about giving away too much. As of 1987, over 90 percent of the foreign investment in Shenzhen was from Hong Kong. But even Hong Kong companies were cautious; their investment was quite small and they too sought assurances, formal as well as informal.

CHAPTER THREE

FOREIGN INVESTMENT ENVIRONMENT IN SEZ

Evaluation of Investment Environment

In determining where to put his money, the investor will normally assess carefully the investment environment of various locations. Two different approaches are widely used in the evaluation of an investment environment. One is quantitative and the other is qualitative. The quantitative approach is generally regarded as more objective in nature. It employs a rating scale and assigns numeric scores to selected economic and political factors as the basis for the screening of the investment environment of a country. Based on eight screening factors, namely capital repatriation, foreign ownership, discrimination and controls against foreign business, currency stability, political stability, willingness to grant tariff protection, availability of local capital and annual inflation for the past years, a country's investment climate can be summed up to a certain numerical value. Most of these models are designed for the developing countries in the capitalist world, and their rating scale is therefore of limited use in assessing the SEZ of the People's Republic of China. In this chapter, the author adopts the alternative approach--qualitative analysis of the investment environment--in the hope that through such analysis, many key concerns of entrepreneurs and potential

investors can be discussed.

The Administrative Structure

Administratively, Shenzhen is part of the Shenzhen Municipality which is under the jurisdiction of the Guangdong Provincial Government. According to the Guangdong SEZ Regulations, Shenzhen is also managed by the Guangdong Provincial Administration of SEZ which was set up to exercise unified management of the special zones on behalf of the Guangdong Provincial Peoples's Government (Article 3). Investors wishing to open factories or embark on various economic ventures may apply to the Guangdong Provincial Administration of SEZ. Companies have been issued licenses of registry and certificates for the use of land after examination and approval (Article 7). Acting on behalf of the Provincial Administration of the SEZ, the Guangdong Provincial SEZ Development Company was set up to administer economic activities in the zones. Its scope of business includes fund raising and trust investment, operating enterprises or joint ventures with investors in the SEZ, acting as agent for investors in the zones in matters related to sales and purchases in China outside SEZ, and providing services for business talks (Article 25). In short, Shenzhen operates under the dual leadership of the Shenzhen Municipality and the Guangdong Provincial Administration of SEZ. Therefore, only land development,

investment projects and negotiations go through the Shenzhen Municipal Government. These various channels for negotiation are usually not clearly understood by potential investors, and this leads to unnecessary inconvenience and confusion.

The Legal System

On 26 August 1980, the Guangdong SEZ regulations were approved by the fifteenth session of the Standing Committee of the Fifth National People's Congress and thenceforth became effective. This was the first and most important set of regulations concerning the SEZ in Guangdong, and was made up of six chapters-General Principles, Registration and Operation, Preferential Treatment, Labor Management, Administration, and an appendix-with a total of twenty-six articles. Concerning the management of the SEZ, five more sets of SEZ Provisional Regulations were enacted on 17 November 1981 by the thirteenth session of the Standing Committee of the Fifth Provincial People's Congress of Guangdong. These are:

- (1) the provisional Labor and Wage Regulations;
- (2) the Provisional Entry/Exit Regulations;
- (3) the Provisional Regulations for Business Registration;
- (4) the Provisional Land Regulations for Shenzhen SEZ; and
- (5) the Provisional Administration Regulations for Shenzhen SEZ.

The first three sets of regulations are applicable to

all the SEZ of Guangdong, while the latter two are for Shenzhen SEZ in particular. The five regulations were published in December 1981, and came into force on 1 January 1982. Generally speaking, these regulations for the SEZ are supplements to the Guangdong SEZ Regulations.

In January 1984, two more sets of regulations were passed by the Standing Committee of the Guangdong Provincial People's Congress. One is the Foreign Economic Contract Regulations for Shenzhen SEZ. The other is the Provisional Regulations on the Introduction of Technology for Shenzhen SEZ. The first one contains seven Chapters and 41 articles. They aim at protecting the rights of all parties involved in foreign economic contracts and stipulate that Chinese enterprises inside the zone and their foreign partners must follow the principle of "equality and mutual benefits" when they embark on economic and technological co-operation. The latter one contains only one chapter and 25 articles and covers such items as the ways in which foreign technology can be introduced and the transfer of patent rights. Both sets of regulations were specially enacted for Shenzhen SEZ but they could also be applied to the other SEZ in Guangdong. Indeed, they are important landmarks in the development of a legal system in China in general, and in the SEZ in particular. This is especially true in the case of the Foreign Economic Contract Regulations because the Chinese contract law covering domestic economic activities

does not apply to activities involving foreign investment. The Foreign Economic Contract Regulations (which are not provisional) are directed at business activities involving foreign investors, such as joint ventures.

By 1990, new laws, regulations and rules were quickly worked out, including "Regulations on the Shenzhen SEZ," "Interim Provisions of Shenzhen City for Resident Representative Offices of Foreign Enterprises," "Procedures of Shenzhen City Concerning the Examination, Approval and Registration of Foreign-Contracted Enterprises," "Regulations of the Shenzhen SEZ for Companies" and "Regulations for the Registration of Enterprises in the Shenzhen SEZ."²²

With the enactment of the commercial laws and the greater availability of legal personnel, many mistakes made in the past should not be repeated. However, the commercial laws are no substitute for arbitration agencies. Before 1983, there was no arbitration agency or court for economic affairs in the Shenzhen SEZ. The absence of these institutions seriously hampered the proper functioning of the zone. Li,²³ a professor in the Law Department of Zhongshan University, advocated the idea of setting up an arbitration system for the SEZ. He pointed out that the zone should follow the common practice of international commercial arbitration in which a third party, independent of both contractual parties, should be appointed and

entrusted with the authority to mediate in any possible dispute. He further suggested that all contracts should incorporate a statement of arbitration, including (a) the place of arbitration; (b) the arbitration agency; (c) the procedures of arbitration; and (d) an agreement that decisions of the arbitration should be legally binding so that disputes could be dealt with more efficiently and pragmatically. He also advocated that the Shenzhen SEZ should have its own arbitration agency to deal with disputes quickly and with greater understanding of the SEZ environment. Only in complicated cases or cases involving a large sum of money should arbitration follow the process indicated in Article 14 of the Law of the People's Republic of China on Chinese-Foreign joint Ventures which states that

disputes arising between the parties in a joint venture which the Board of Directors fails to settle through consultation may be settled through conciliation or arbitration by an arbitral body of China or through arbitration by an arbitral body agreed upon by the parties.

In such cases, arbitration normally goes through the committee for Overseas Economic and Trade Arbitration in Beijing. Li's argument was endorsed by the Shenzhen SEZ government, and the Shenzhen Office of the Chinese External Trade Arbitral Committee was established on 2 April 1984. Moreover, eight well-known Hong Kong citizens have been

invited to join the team of fifteen arbitrators in order to give confidence to overseas investors.

A complete set of laws and a standard contract format, together with an efficient and just arbitration agency, are required to safeguard the interests of both the investors and the Chinese government. They are also necessary conditions for economic growth, especially in terms of raising the confidence of investors and generating a more favorable investment environment.

The Banking and Financial Structure

All the four major banks of China-the People's Bank, the People's Construction Bank, The Agricultural Bank and Bank of China-have branch offices in the Shenzhen SEZ. The People's Bank is a general purpose bank, whilst the remaining three are regarded as specialist banks.

Before 1982, most overseas investors in the Shenzhen SEZ had to rely on their own sources of capital. This explains why investment projects concluded in that period were either with large multinational corporations with strong financial back-up or with petty investors from Hong Kong investing mainly in small projects. Medium-scale investment projects in which the investors were in need of a bank's support were relatively few. One may attribute the lack of medium-scale projects in this period to the inadequacy of the banking system in the Shenzhen SEZ.

According to published statistics, since 1982 the branch offices of the four Chinese banks in the Shenzhen SEZ have been more willing to support overseas investors with loans. It is reported that the People's Construction Bank is prepared to support massive land development projects. The branch office of the People's Bank of China is said to be prepared to accept mortgages and consumer durable loans, and to advance loans and credits to ordinary citizens of the Shenzhen SEZ for private business and individual enterprises. Before granting the loan or acting as an underwriter, the bank undertakes a thorough investigation of the feasibility of the project and the investor's ability to repay. Hence, repeated examinations and investigations of the investment project minimize the possibility of blind investment and eventually benefit all parties concerned. After obtaining loans from the bank, enterprises have to meet standards for their system of accounting, which can only lead to healthier development of the enterprise. A well-established banking and financial system with a complete set of banking ordinances will provide a much better investment environment for investors in the Shenzhen SEZ.

Up to now, there are 22 foreign banks in Shenzhen. Among them are First National City Bank, Bank of Tokyo, Sanwa Bank of Japan, Commercial Bank of France, Banque Nationale de Paris, Banque de l'Indochine, Hong Kong and

Shanghai Banking Corp., Standard Chartered Bank, Royal Bank of Canada and Overseas Union Bank Ltd. of Singapore. All of them have extensive relations with other financial institutions in the world. They have facilitated foreign investment and improved the zone's financial market.^{2*}

Preferential Treatment and Investment Incentives

The primary objective of businessmen investing in the Shenzhen SEZ is to make a profit. The profit-capital ratio, the return period, and whether the money can be remitted out²⁵ freely are their main concerns. In deciding on the amount of investment and in evaluating the financial feasibility of a project, investors have to compare the opportunity cost of their investment. Under normal circumstances, an investment decision on a certain project is made only when its expected earnings are greater than those of other proposed projects. Apart from profit, the degree of risk involved is another prominent factor affecting investment decisions. Wherever risk is greater because of uncertainty, the profit margin should also be higher. Usually, a bank deposit is regarded as the safest investment, so that the interest rates of overseas banks can be taken as the minimum desirable rate of return for any investment program in the Shenzhen SEZ. A longer return period usually means greater uncertainty and thus involves more risk, so that the total profit margin of these projects

must be higher. The estimation of risk and uncertainty is very subjective, being based mainly on the investor's own personal experience, the experience of other investors, the amount of information available and official guarantees. At present, the Shenzhen SEZ is in an unfavorable position due to the insufficiency of information available to investors, the lack of a sound legal and financial system, the inadequate provision of infrastructure, the lack of enough successful precedents to support the investor's confidence, and most significantly, lack of stable political environment. These clouds of uncertainty concerning the structure and the operation of the SEZ have created a fairly high risk factor: as a result the investor must anticipate a higher level of profit before he commits himself. Only with a gradual improvement in Shenzhen's administrative, legal and financial systems and when the general regulations of the zone are more thoroughly understood by outsiders can the risk factor be reduced. Investors may then consider projects with lower profit margins and longer return periods as viable.

The preferential terms offered in the SEZ help to raise the profit margin of investment. The tax exemption on imported capital goods for production help to reduce the overall cost of production. Cheap land, utility costs and wage rates, especially in comparison with Hong Kong, will increase the operating profit of investors. With these

preferential terms, investment conditions in the Shenzhen SEZ are, undoubtedly, somewhat more favorable than those of neighboring Asian countries. Nevertheless, whether these preferential terms are attractive depends not only on the size of the reduction in labor wages or land utility costs, but also on the investors perception of whether investing in Shenzhen can provide a higher profit margin, subject to the degree of risk involved, than investing in other parts of China, Hong Kong, or export processing zones in developing countries. If Shenzhen does provide a higher profit margin and less risk, the investment environment of Shenzhen can be regarded as attractive and competitive. If the anticipated profit margin is able to compensate for the degree of risk involved, Shenzhen would still be attractive. Otherwise, investors will adopt a wait-and-see strategy, or simply direct their investment to other places.

The Tax System

Investment in the Shenzhen SEZ enjoys a more favorable tax rate than it does in Hong Kong or in other parts of China. Prior to the promulgation of the regulations on SEZs in Guangdong Province, the tax rate was not uniform throughout the Shenzhen SEZ. The corporate tax rate levied on foreign enterprises in Shenzhen was usually 15 percent. Projects with a total investment of more than US\$5 million or projects involving advanced technology and long-term flow

of funds may enjoy exemption from income tax for two years and 50 percent reduction for another three years. Enterprises whose annual export value exceeds 70 percent of the total output value in the same year shall pay a 10 percent income tax.

By comparison, according to the income tax law for foreign enterprises applied to other parts of China, the tax rate ranges from 20 percent (on annual income of less than RMB 250,000) to 40 percent (on annual income of over RMB 1 million). In addition, a local income tax of 10 percent on the same taxable income is levied.²⁶

Income taxes on foreign enterprises are levied on an annual basis. After paying all the necessary taxes, overseas investors and workers in SEZ enterprises can remit their earnings out of China, provided that the special zone's foreign exchange control measures are not violated. Investors who choose to reinvest their profits in the zone can apply for exemption from income tax on that part of the profit being reinvested.

All the necessary means of production including machinery, spare parts and accessories, raw materials, and transport tools, are exempted from import duties. Depending on the individual case, import duties for consumer goods can also be exempted or charged at a reduced rate. However, all the items have to be used or consumed within the SEZ, otherwise duties will be levied in accordance with the

customs regulations of China.

Similarly, finished and semi-finished products manufactured by enterprises in the Shenzhen SEZ for overseas markets will be exempted from export duties; but if the products are for domestic sale, duties will have to be levied. In general, it is intended that products of the SEZ should be exported to the international market. Domestic sales are allowed only with the prior approval of the Guangdong Provincial Administration of the SEZs.

The Labor Cost and Productivity

Wage rates in the Shenzhen SEZ are generally higher than those in other parts of China, but the exact amount depends very much on the nature of the enterprise, the type of work and the level of skill required. There are four categories of labor in most industries (probationary, contract, skilled and technical workers) and four different wage rates. But on average, the monthly wage rate for workers employed in foreign enterprises is about HK\$750, which is much lower than that of Hong Kong. In addition to the basic wage, a bonus may be given to workers who have exceeded their production quotas.

It is generally agreed that depending on the proficiency of the workers an annual increment in remuneration of 5-15 percent will be made. The wage rates cited above represent the amount to be paid by the

entrepreneur. Of this, only 70 percent goes to the workers as basic and floating wages, 5 percent will be reserved for the employees' welfare fund and other benefits, and the remaining 25 percent is used for workers' insurance and the various forms of subsidy that the state provides for the workers.

According to the regulations on labor and wages in the Shenzhen SEZ, the enterprise is free to decide on the form and method of remuneration which does not need to be a fixed monthly salary. Payment can be made by hours or days, or according to piece-work. Various kinds of reward and bonus systems are allowed, and overtime pay is required for working hours in excess of those specified in the labor contract. Workers are entitled to public holidays, sick leave and special leave with pay according to the laws of the People's Republic of China.

Low labor costs alone, need not be the sole attractive locational factor. Of equal importance is labor productivity which depends on the education and technological capacity of the workers, their attitudes towards work, the absentee rate and the degree of resistance to new production and management methods. When Shenzhen was first established as an SEZ, inexperience of the new economic and production system, together with the generally low educational level of the workers, resulted in relatively low productivity, especially in comparison with neighboring Hong Kong.

Fortunately, improvements are gradually being made. The adoption of the piece-work and bonus system has provided incentives for the workers to increase their productivity. Investors have been free to decide upon the system of management of the enterprise, the recruitment and dismissal of workers, and the implementation of work by contract and other forms of payment terms. It is still felt that more long-term training programs need to be designed and implemented to upgrade further the level of labor productivity.

CHAPTER FOUR

FUTURE PERSPECTIVE OF SEZ

Austerity Drive and Political Upheaval

On 26 August, 1990, Shenzhen was 10 years old, yet celebrations were not the sort of extravaganza one might expect of such an anniversary. The reason is that China is still suffering from the after effects of two-year austerity drive and the bloody uprising of June 1989.

Installed after the political upheaval of 1989, the new leadership under party general secretary Jiang Zemin²⁷ is keen to imprint its own brand of reform and establish its own choice of personnel. In May, 1990, a new mayor was appointed to Shenzhen, replacing the 53-year-old Li Hao, who had been in charge for the past five years. Li retains his post as party secretary, thus providing a smooth transition in the SEZ's administration.²⁸

The new mayor, 56-year-old Zheng Liangyu, who spent much of his working life in Jiang's home province, Jiangsu, was party chief of the open city of Xuzhou before his current post. A mild-mannered and scholarly man, Zheng's style is expected to be radically different from the flamboyant manner of his predecessors. Partly for this reason, Shenzhen's 10th anniversary celebrations were a very low key affair.²⁹

Even though the SEZs together have achieved impressive

growth in the past 10 years, the central leadership has expressed dissatisfaction with the quality of the progress and the inefficient management. Profiteers, speculators and tax dodgers have lost no time in taking advantage of the exclusive incentives in the SEZs, causing losses and disruption in supplies in the rest of the country.

Although Beijing reaffirmed in February, 1990 that the SEZs would continue to play a vanguard role in the country's reforms and would continue to enjoy preferential policies,³⁰ the central government was non-committal about giving greater autonomy or more financial support to the SEZs. In fact, the SEZs were asked to rely on their own economic strength and the lead they had in China's opening to further their export growth and economic efficiency. Shenzhen was also asked to increase its contributions to China's central treasury.

The central government has been cool to efforts by the SEZs to regain some of their lost privileges, especially foreign-exchange retention rights. Since 1989, the SEZs have had to turn over 20 percent of their foreign-exchange earnings to the central government in return for RMB, while previously they were allowed to retain 100 percent. This rule does not apply to foreign-owned enterprises.³¹

The cut in retention rights has discouraged many inland companies from using Shenzhen as an export base for their goods, thus partially affecting the SEZs' export growth last

year. Beijing wants to encourage more exports of high value-added goods while the inland provinces have long been unhappy with their loss of export earnings as a result of more attractive tax concessions offered to the SEZs. The selective application of the reduced retention rights has forced Shenzhen to pay more attention to the development of its own export-oriented industries, particularly in sectors favored by the central government, such as electrical, electronic and mechanical industries, which are permitted total foreign-exchange retention.

Much to the unhappiness of the SEZs, the central government has insisted on applying preferential policies to industries rather than to localities as favored by Zhao Ziyang,³² the former party general secretary, who was removed after the student demonstrations. It is clear that the SEZs have lost priority under the new central leadership. Instead, Beijing has shifted its focus to Shanghai and the surrounding Yangtse region.

Ever since the SEZ concept was implemented in 1980 as part of Beijing's experiment with economic reforms, the central government has blown hot and cold towards the SEZs, which comprise Shenzhen, Zhuhai, Shantou, Xiamen and Hainan. Hainan was the recent addition, becoming both a province and an SEZ in 1988.

Hainan has not lived up to its promise that it would give autonomy and preferential policies to foreign investors

that bettered those offered by other SEZs. That was a concession that Beijing made to compensate for a lack of adequate financial support from the state. Instead, the Hainan leadership became an early casualty of Beijing's power struggle last year--the island's first governor fast-talking Liang Xiang was removed for alleged corruption immediately following the fall of Zhao, his most important supporter and mentor in Beijing. Liang is still under investigation.

New foreign investment to the island tumbled in 1989 and fell even more sharply in the first half of 1990, at a much faster rate than the national trend. Pledged foreign investments fell 26 percent in 1989 against 1988 to US\$280 million,³³ and by an astonishing falling in the first half of 1990 to US\$69 million.

International sanctions against China following the violent suppression of the pro-democracy movement also affected Hainan's plan to develop a second international airport at its southern resort city of Sanya, with French and German loans and expertise.

For Shenzhen, new investments of US\$489 million last year were no more than the previous year, though it has a better record of utilization than the rest of China. Utilized investment in Shenzhen last year amounted to 93 percent of pledged investment.

Since 1988, Xiamen's performance was the most

impressive among the five SEZs. Boosted by Taiwan interests, foreign contracts signed and utilized jumped three-fold in 1989 against the previous year to US\$835 million.⁴⁴ In contrast, foreign contracts for the whole of China rose only 6 percent in 1989.

Xiamen is likely to overtake Shenzhen in volume of foreign investments should direct trade established between China and Taiwan, but in the short term, this seems unlikely to happen, given Taipei's firm resistance to closer ties. Xiamen and the southern Fujian coast is particularly attractive to Taiwanese because of kinship ties, common language and culture.

The Impact of 1997

China's largest special economic zone - Shenzhen, across the border from Hong Kong - is in danger of being stifled by traditional Chinese bureaucratic and administrative practices. Unless comprehensive political and economic reforms are carried out, Shenzhen will be unable to maintain its present prosperity or serve a useful mediatory role between capitalist Hong Kong and the socialist mainland after 1997 when the territory returns to Chinese sovereignty.

The China System Reform Institute³⁵ puts its case in a wide-ranging and highly critical review of Shenzhen which exposes the inner working mechanisms of this model city. In

the past ten years, Shenzhen's gross product has grown by an average of 47.7 percent a year. In 1984-1985, Shenzhen was attacked for its reliance on state funds for growth, for speculative trading and other improper practices. Shenzhen has since made a comeback, enjoying a steady stream of domestic and foreign investment.

Behind its modern facade, Shenzhen still operates with a command-style hierarchy, excessive political interference in economic activity, and unfair competition generated by monopolies, personal connections and politically linked economic favors. These economic and social relations are seriously hampering the development of the market-oriented economy. Price, market and planning reforms touch only the surface of the old order. Deeply entrenched, complex and rigid government enterprises and institutions still dominate economic life in Shenzhen. Hence, freeing prices and eliminating old-style economic planning alone will not automatically create a fair and competitive business environment. To establish a new economic and social order, Shenzhen must combine economic reforms with political ones.

The current prosperity means that Shenzhen does not feel the immediate need for reform. But with more Chinese cities offering preferential treatment, the SEZ will become less attractive to foreign investment. Also, as 1997 nears, greater economic, political and social interaction between Hong Kong and Shenzhen will require more efficient and

better management if the SEZ is to be an effective cushion between Hong Kong and China.³⁶

Shenzhen is not an oasis untouched by the system dominant in the rest of China. Traditional values and ideas have made their way to the zone. Shenzhen, in its interaction with the rest of the nation, follows established rules of the game. For example, it still uses so called "red letter-head" (the documents used at all levels of the Chinese bureaucracy to transmit official information) official documents to regulate most economic and social activities. Readers are expected to grasp the spirit of the policy outlined through their reading of the prevailing political climate.

The dominant kind of economic relations in Shenzhen is the vertical-administrative type typical of the old centrally planned economy. Under such a system, enterprises find it difficult to survive without a supervisory official body, and individuals not attached to a work unit (such as private entrepreneurs or small businesses) can not enjoy social welfare and other benefits. As a result, enterprises are autonomous but not independent. The legitimacy of an enterprise's or individual's economic activity depends on the "understanding" of an official supervisory body. This "iron rice bowl system" continues to support heavily indebted and inefficient state enterprises.

Competition is fierce but unequal. Enterprises in

Shenzhen have their own established privileges. Foreign-trade companies have import and export rights, municipal-level firms can approve certain projects, mainland firms operating in Shenzhen have established access to raw-material supplies, and foreign investors control marketing channels for export. Enterprises spend much energy on trading such privileges among themselves.

To implement such progressive political reforms, Shenzhen's special political and legal status should be set out in a document similar to that of Hong Kong's Basic Law, the mini constitution which will outline how the territory should be run after 1997 and its relationship with the central government in Beijing.

CONCLUSION

The decade of rapid economic reform under the leadership of Deng Xiaoping was a time of transition from rule by a tiny oligarchy of revolutionaries toward a new, more open, and inclusive type of politics. As the leadership sought to revitalize the economy, they opened up channels for the commercialization, privatization, and internationalization of the economy. Economic development along these lines then fostered structural differentiation, cultural pluralization, and subsystem autonomy. The decade witnessed some changes in political and economical patterns necessary to accommodate these trends. These included a more collegial approach to decision making at the very top; retirements and the incorporation of younger and better-educated officials into senior decision making circles; a decrease in the political influence of military and security forces, thus increasing the influence of government officials, the people's congress, and people's political consultative conference; the regularization and improvement of bureaucratic policy data gathering, analysis, and implementation; the incorporation of the intellectual elite into public policy discourse and the lowering of secrecy barriers required to do this; the explosion of foreign contacts and the growing impact of foreign opinion, intellectual concepts, values, and methodologies on Chinese policy choices; the

transformation of the content of the media to include much rich and objective information about conditions in China and elsewhere, and using SEZs as the testing ground for fast economic growth.

The process of transition to more open politics has only just begun after eleven years of reform. Strategic decision making about China's future remains dominated by the party elite and constrained by the ideological and institutional imperatives necessary to retain that dominance. Although the climate in China had greatly improved in comparison with the economic stagnation and political stalemate of 1976, many basic political patterns were linked to the Leninist political structure. Thus, they had roots in the Mao era and would remain to shape Chinese politics after Deng and his revolutionary colleagues were gone.

The events of 4 June 1989 probably guaranteed what before was only a possibility—the eventual end of Leninist rule in China. They also guaranteed that China's road to modernization will be much slower and rockier. Deng Xiaoping's choice of military repression destroyed what he had worked a decade to gain — a revitalization and modernization of party rule and his own place in history as China's modernizer and reunifier. It will take at least a decade to refill the reservoir of confidence among China's urban citizens, residents of Hong Kong and Taiwan, and

government and business partners worldwide.

The Chinese constitute one fifth of the world population. Whoever is in power in China in the future, the conservatives or the reformers, will bear in mind that a sound and healthy economy provides a stable basis for political power. The present regime must therefore stick with the open-door policy, at least in some aspects, even though politically they are regressing in most other respects. The open-door policy has opened people's eyes and minds. There is no way to efface the people's political awakening or to bog down the economy. China is still the largest untapped market in the world. The huge potential of this market exists apart from China's political situation. It is unwise to neglect or to abandon this market.

It is now simply a matter of time, as the elders leave the stage one by one, when martial law will be rescinded and its implementors will be removed from office. The advanced age of the elders, the breadth and depth of opposition to current leaders within the elite, and global and regional trends will be important factors in this outcome. Few socialist nations in the midst of their own delicate reforms welcome China's reversion to Stalinism. The crisis of June has unified overseas Chinese minds and hearts in ways that may profoundly affect China's future.

China's chance in the world may have to await the eventual rise of a stronger middle class based on the

reconsolidation of economic reform along the south China coast of SEZs and the reconstruction of an educated and prosperous social-political stratum made up of modern civil service officials, intellectuals, and economic managers. Even these economic and social changes alone would not ensure China's full positive contribution humankind, that can come only with a deeper spiritual revival and cultural renaissance.

In order to maintain its unique function in China's future economic system and comply with the critical situation after 1997, I recommend that Shenzhen:

- further open up of the market to create a genuine "free investment zone."

- encourage more firms to issue stocks; government control over the economy would then be exercised via holding companies rather than administrative fiat. Laws should be the main regulator of economic and social activity.

- make administration efficient and clear; devolve power to the lower levels; allow enterprises to manage their projects and foreign trade freely.

- re-organize government departments to clearly demarcate more responsibilities at each level; standard and open up administrative procedures to enable policy changes to be transmitted promptly to individuals and enterprises.

- strengthen leadership; while Shenzhen's chief executive can nominate his own cabinet, subject to Beijing's

approval, greater public participation in politics and law drafting should ensure supervision of local government.

ENDNOTES

1. Deng Xiaoping: Secretary General of the Communist party and member of the Politburo standing committee after the 1956 8th party Congress and a chief victim of the Cultural Revolution. Deng was brought back to power by Mao in 1974 when it was learned that Premier Zhou Enlai was dying of cancer. Deng became paramount leader at the 1978 3rd Plenum after years of political struggle against Mao's close associates and Hua Guofeng. Now Deng is retired but still seizes the power behind the scene.

2. Shenzhen used to be a small town close to Hong Kong. Now it is the biggest and most successful SEZ in China.

3. Red-head documents: Official documents which are circulated among certain administrative level. Some confidential documents can reach only down to the provincial level while some can reach bottom level. Those documents serve as a kind of regulation which each level should abide by strictly. In Chinese we call it "Hong Tou Wen Jian."

4. Chen Yun: The most senior veteran of the revolution, having joined the select handful of top leaders in the 1930s and 1940s, when he served as a China's leading economic official in the 1950s, early 1960s, and 1970s, with strong influence on economic and organization/personnel affairs

through the 1980s despite age (born around 1900) and illness. A consistent advocate of a balanced sectoral development strategy and financial caution, Chen's views put him on the liberal end of the political spectrum in the Mao era and the conservative end of the spectrum by the late Deng era. By 1989, he was supporting Yao Yilin, Li Peng, and Song Ping.

5. Lu, Tian-Hong, "Anti--Revisionism," Hongqi, Aug., 1974.
6. Carol Lee Hmrin, " China and the Challenge of the Future," Westview Press, Inc., 1990:32.
7. Four Modernization includes modernization of industry, agriculture, science and technology and military defense.
8. See Endnote 7, Page 33.
9. The American Embassy, P.R. China (in cooperation with the U.S. Department of Commerce), "Marketing in China," Overseas Business Report, 1991:1.
10. The editorial staff, "New Model in China--SEZs," Wen Wei Po, 12 Sept., 1983.
11. Chen Zonglie, "Shenzhen: A Decade of Robust Growth," Beijing Review, 31 December, 1989:14.

12. Xu, Deliang, "Investment in Shenzhen," Economic Reporter, 11 November, 1981:15
13. T. Grimmer, "China's Slow Boat to Capitalism," Canadian Business 15 August, 1990:25.
14. L.H.Young, "A Touch of Chinese Austerity Doesn't Show Electronics Industry," Electronic Business, 23 July, 1990:33.
15. Chi B. Anyansi-Archibong, "Small Business in China's SEZs," Journal of Small Business Management, April, 1989:58.
16. Gu Mu: The vice premier of State Council.
17. Ezra F. Vogel, "One Step Ahead in China," (Harvard University Press, 1989) 142.
18. Lu, Tsu-fa, "New Look of Shenzhen Special Economic Zone," (University of Washington Press, 1985).
19. See Endnotes 15.
20. Wong, Kwan-yiu, Chu, David k. Y. "Modernization in China: the case of the Shenzhen special economic zone," (Oxford University Press, 1990).
21. David Newell, Linda Liu, "Slowing Down the Fast Lane," Newsweek 22 July, 1985:39.

22. By staff reporter, "Shenzhen to Improve Investment Climate," Beijing Review 3 June, 1990:35.

23. Li Dong, "Arbitration System in SEZs," Zhongshan University Press, 24 March, 1982:4.

24. By staff reporter Jing Wei, "Fruit of the Open Policy," Beijing Review, 28 August, 1990:3.

25. In China, because of the policy of foreign currency control, it is not allowed to remit out foreign currency freely. Therefore, it becomes the main concern to the foreign investors whether they can remit out their profit as well as their personal income.

26. By staff reporter, "An Introduction to Shenzhen SEZ," Beijing Review 3 September, 1989.

27. Jiang Zemin used to be the Mayor of Shanghai. Jiang is newly elected as the General Secretary of Chinese Communist Party after the political upheaval in 1989.

28. Chou, Shi-ping, "Trends in Chinese Business," Shenzhen Daily, 21 May, 1990:3.

29. Red-head documents issued in April, 1990.

30. Speech by Premier Li Peng in a SEZs conference in February, 1990.

31. Red-head documents issued in December, 1988.

32. Zhao Ziyang: A widely experienced provincial leader in south China before the Cultural Revolution, Zhao was sent to Deng's home province of Sichuan to get the economy back on its feet, which he quickly accomplished through rural reforms that they were adapted nationwide. Promoted to the premiership by Deng in 1980, Zhao quickly began to reshape national economic policy and institutions to promote reform and development. he fleshed out Deng's general guidelines with the help of the best minds in the nation, whom Zhao used to staff think tanks and whom he encouraged to boldly explore new ideas. When Hu Yaobang fell in 1987, Zhao quickly and ably limited the political campaign and purge, drafting a mandate for a bold reforms centered on marketization of the coastal economy, and its interdependence with the Asia-Pacific region's dynamic economies. Zhao helped protect reform intellectuals in 1983, 1987, and 1988 and into early 1989 tacitly sought their support as his political position began to slip. In the wake of the crackdown, Zhao and his associates were removed from office at the fourth plenum in late June 1989 and were placed under arrest and investigation for supporting counterrevolution. If convicted of such serious crimes rather than being accused of mistakes, Zhao and the others would be subject to trial or even more serious conclusion.

33. Louise do Rosario, "Old Ways Die Slowly," Far Eastern Economic Review, 15 December, 1988:118.

34. Figures from the Report of China Ministry of Foreign Economic Relations and Trade.

35. CSRI - a think tank under the State Council's commission for economic system reform and restructuring.

36. P.T. Bangsbeng, "China to Add Trade Zone Near Hong Kong," The Journal of Commerce, 8 January, 1990.