

Deng Reforms China: The Role of SEZs

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ABSTRACT

Several decades of isolation and socialisation of economy in China rendered millions of people living in extreme poverty. The state planning failed to achieve desired results and the economy struggled with sluggish growth. Deng Xiaoping, on consolidating his position as the supreme leader, sought to reform the Chinese economy by opening it up for foreign trade and investment. Special Economic Zones came to be used as a tool by Deng for achieving the both. This paper seeks to analyse the extent of success SEZs could achieve for the Chinese economy.

KEY WORDS: Chinese economy, Deng Xiaoping, economic reforms, Special Economic Zones.

INTRODUCTION

After coming to power in 1949, the CCP sought to overhaul the socio-economic structure of feudal China they had inherited. For complete socialisation of Chinese economy, state planning - on similar lines as the USSR, was seen as the way forward. State controlled enterprise was to take over the industry and the private enterprise was to be eliminated gradually. The CCP achieved complete socialisation of the Chinese economy within the first decade of its rule (Shabad, 1955) and all the major industries now came under state planning. While this exercise was able to equalize the Chinese society, it at the same time had failed to make them all equally prosperous by the time Mao died in 1976. On the contrary the economy struggled with sluggish growth and merely keeping it afloat became a task (MacDougall, 1977). Deng Xiaoping came back to party posts in 1977 and soon enough consolidated his power becoming the de facto top leader of China. He now faced a burgeoning challenge in form of devastated economy which required quick but lasting solutions for keeping chaos at bay. Under his leadership, the party started on the route to liberalisation. The economy was to reintroduce private enterprise, produce for the market and try to attract foreign capital. Special Economic zones turned out to be a part of quick solutions in this scenario.

Special economic zones emerged as experimental zones in structural economic reforms and as training grounds for learning about production in market-driven economies (Stoltenberg, 1984). Their main functions were to attract valuable foreign capital, import modern technology and help Chinese youth gain employment. Deng Xiaoping was the inspiration behind China's economic reform and opening-up policy and under his influence, the central government established 'special export zones', which came to be known as Special Economic Zones (SEZs), in Shenzhen, Zhuhai and Shantou in Guangdong province and Xiamen in Fujian province. They were concentrated on the southern and eastern coastal areas to facilitate exports and imports. These were to signal the start of China's opening

to the outside world and attract further attention. Deng experienced strong criticism from the conservative factions of the party for his reforms and the policy leading to establishment of SEZs because they felt these establishments may lead to exploitation of workers and would promote the ugliest form of capitalism. In response to these criticisms, Stoltenberg (1984) observes, the policy makers argued that the socialist economy was still holding the dominant position and the special economic zones is only a very minor supplement hence, the kind of exploitation involved is nothing to be afraid of. They further added that the preferential treatment given to the foreign businesses in the SEZs is based on consideration of the economic situation at home and abroad and will strengthen China's socialist construction.

BACKGROUND

In 1949, 63.3% of the total industrial output came from the privately owned industry which progressively shrank as the first five-year plan took over and limited its contribution to 24.9% of the total industrial output by 1954 (Shabad, 1955). By the end of first decade of CCP rule, Mao had successfully converted China into an autarkic economy with minimal foreign trade (Prime and Park, 1997). The only business which China did with the outside world was with the USSR, that too only to fulfil its requirements of heavy industrial machinery. The Great Leap Forward campaign launched in 1958 sought to make China self-sufficient, which it hardly did and crisis ensued in the 1960 as food shortages started to be felt. Mao's Cultural Revolution of 1966 only added to the miseries of the Chinese people. When Mao died in 1976, the Chinese economy was still marred by slow growth rate, government struggled to provide basic goods and services, there were signs of social disintegration and poverty was widespread as the top leaders struggled to claim the top role (Meisner, 1996).

The struggle finally ended with Hua Guofeng's ascendance to the apex leadership as he was Mao's choice and Deng Xiaoping was still in political exile. On 17th July 1977, the Third Plenum of the 10th Party Congress Deng formally returned to the positions he held before April 5, 1976: member of the Central Committee, member of the Standing Committee of the Politburo, vice chairman of the party, vice chairman of the CMC, vice premier, and chief-of-staff of the PLA (Vogel, 2011). Regaining his lost stature in party and the government he started to focus on the inherent problems of Chinese economic system. He saw realisation of Zhou Enlai's four modernisations as very crucial for achieving better standards of living for the Chinese people. The term 'four modernisations' was derived from Enlai's 1975 report to the National People's Congress wherein he called for rapid modernisations of agriculture, industry, national defence, and science and technology for transforming China into a strong modern socialist state (Meisner, 1996). Making the 'four modernisations' as its goal in third plenum of the eleventh Central Committee of the Communist Party of China (CPC) held between 18 to 22 December 1978, China turned from central planning to market exchange while opening up to international trade and investment (Fang et al, 2018). Deng's passion for laissez-faire culminated in the new economic policies that sought greater integration with the world economy for transfer of capital, technology, expertise and equipment. The new opening policy (*duiwai kaifang zhengce*), which

began in 1978 and accelerated by mid-1980s, encouraged both imports and foreign direct investment to improve the technological base (Prime and Park, 1997).

DEFINITIONS

As per World Bank (2009) a special economic zone can be defined as having following characteristics- it has to be a specific geographical area which is physically secured; managed by a single administration; it offers benefits based on physical location within the specified zone; and has a separate customs area offering duty-free and streamlined procedures. It usually has a more liberal environment in comparison to other regions of the country which should ideally attract more foreign capital and provide employment while helping the host country gain access to modern technology and its operational know-how.

Xu Dixin, the economist, defined Special Economic Zones as areas that are set up by enclosing a certain land which has exemptions from customs duty, and created preferential conditions and facilities to attract foreign investors to set up production units whose products are intended for exports (Stoltenberg, 1984). The setting up of these zones was considered imperative for realisation of Zhaou Enlai's four modernisations which would help raise the standards of living for the Chinese people and make the socialist country stronger. According to Deng Xiaoping in a speech in 1984 defined special economic zones as windows of importing advanced technologies, gaining knowledge of management and improving China's foreign policy (Na, 2019).

Special Economic Zone is an all-encompassing term for a wide range of economic zones such as the free trade zones, export-processing zones, industrial parks, free ports, enterprise zones (Zeng, 2010). Their functions are at times similar, overlapping or related giving rise to such a confusion that these terms are often used to refer to the whole bunch of these zones, especially in case of China. The differentiation, if any, is usually very minute but the over-riding characteristic, the lucrativeness due to low or no customs duty and absence of other barriers to trade, remains common to them all.

Xia Lu (2014) observes that the Special Economic Zones and other economic setups from the family have origins in the Leghorn free port which came into existence in 1547. Free ports attracted foreign merchant ships due to the tariff exemptions and engaged in transit trade wherein goods were imported and re-exported to foreign countries. These free ports contributed a great deal to the development of economies of areas adjacent to them. Irish Shannon free zone emerged as the first modern free trade zone. Unlike the free zones of the past, it wasn't a sea port, it was established on an airport. It facilitated the export processing of goods duty free and had low transaction costs.

OUTCOMES

Stoltenberg (1984) observes that the implementation of China's SEZ policy started with the State Council's directive of July 1979 which authorized Guangdong and Fujian provinces to take measures to develop tourism, foreign trade, and investment in their respective provinces. The state council responded by developing the required administrative structure along with regulations and guidelines

to eliminate any sort of uncertainties for the investors. In 1979, three SEZs-Shenzhen, Zhuhai and Shantou in Guangdong were developed, Shenzhen being the biggest of them with allocated area of 327 sq. km. Xiamen in Fujian province became the fourth SEZ in the subsequent year. Hainan Island was also made an SEZ in July 1985 with investment incentives better than the SEZs of Guangdong. By 1985, there existed five SEZs in total. This experiment was extended to 14 large cities in coastal areas in 1984 and a host of cities along the Yangtze River and interior border cities in the early 1990. By March 2013, there were 191 national Level Economic and Technological Development Zones (ETDZs) in China. Also, there are many other types of SEZs in China at various levels, including high-tech industrial development zones (HIDZs), free trade zones (FTZs), export-processing zones (EPZs), and others.

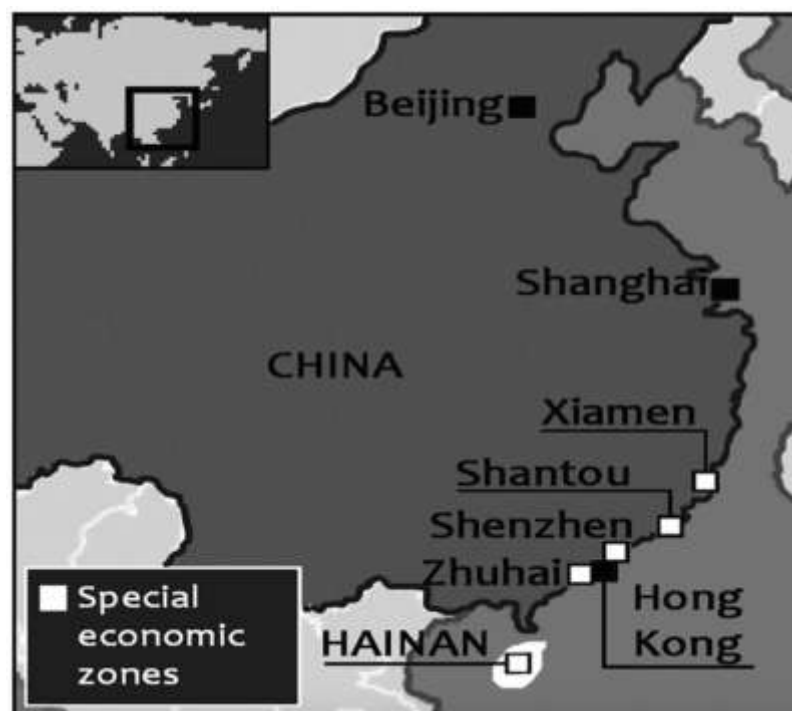
In Shenzhen, the initial outcomes were overwhelmingly positive as by the end of 1981, 300 new factories had been built and put into operation. Approximately 40% of the allocated areas were already under construction by 1981. Wong (1987) observed that as early as 1984, Shenzhen was showing promising results as the industrial output had increased by 30 times from 60 million yuan in 1979 to 1800 million yuan in 1984 and continued to grow at the rate of 92% in the first half of the following year. A similar trajectory of growth has been observed in terms of net exports which Wong believed had achieved a growth rate of over 59% by 1984. In the 1980s, the average annual growth rate of Shenzhen's GDP was 51.81%, which created a unique record - "Shenzhen Speed". In the 1990s, the average annual growth rate of Shenzhen's GDP was 29.87%, and the average annual growth rate from 2000 to 2016 was 14.65%. (Na, 2019).

Yin-Ping Ho (1993) observes that by 1992, Shenzhen SEZ alone accounted for 52.6%-US\$12.8 billion of the total trade volume associated with the five SEZs. Looking at the five SEZs, Yin-Ping Ho (1993) further observed that they reaped a US\$24.3 billion worth of foreign trade in 1992, representing 14.7% of the national total. The following year, their exports rose by 24.2% to US\$12.4 billion and imports hit US\$11.9 billion, up 16.6% over 1991. According to China's Customs data, some 47.9% amounting to US\$11.7 billion of the SEZs trade volume were generated by Foreign direct investment in the businesses; this was a 23% increase over 1991 and 26.6% of the total foreign trade created by all FDI ventures in China.

In 2006, the five initial SEZs accounted for 5 percent of China's total real GDP, 22 percent of total merchandise exports, and 9 percent of total FDI inflows (Zeng, 2010). In 2007, the actual utilized FDI of the five initial SEZs was about US\$7.3 billion. In 2006, the total employment of the initial five SEZs was about 15 million, accounting for 2 percent of national employment. The SEZs are also the hotbed of China's new and high-technology firms. In 2007, the 54 HIDZs hosted about half the national high-tech firms and science and technology incubators. They registered some 50,000 invention patents in total, more than 70 percent of which were registered by domestic firms (Zhong et al. 2009). They also hosted 1.2 million R&D personnel (18.5 percent of HIDZ employees) and accounted for 33 percent of

the national high-tech output (Qian 2008). Over the 15 years since the formation of HIDZs, they have accounted for half of China's high-tech gross industrial output and one-third of China's high-tech exports. (Zeng, 2010) In 2018, China's total FDI inflows had grown to USD 255 billion from only a quarter of that amount in 2000, surpassing the United States' USD 252 billion and becoming the most important FDI destination in the world (Song et al, 2020).

Observing the data provided, it can be stated that most of the SEZs in China, though differing in performance and speed, have been quite successful. Together, they have formed a powerful engine to drive China's reform process and economic growth. They have attracted an unimaginable amount of FDI and domestic investment making them powerhouses of production. They have also facilitated the transfer of technology and skills to the Chinese workers as expected by the reform planners of 1980s. The SEZs, as commented by Deng, also acted as the experiment fields for economic reforms in China and experience gained about industrial production and the market forces was used throughout China making it the largest producer and exporter of finished goods in the world in the 21st century. Most of the goals envisaged at the beginning have either been realised fully or partially as they have proved economically viable in their 40-year history. Despite their towering economic achievements, the SEZs too have some cost attached to them which cannot be ignored.



China's special economic zones (SEZ). Source: Yitao and Meng (2016)

DISADVANTAGES

While SEZs have fulfilled many a purpose envisaged by their policy makers they have at the same time led to regional disparities in China. The pilot SEZs are located in the eastern part of the country, with four of them located in the eastern coastal region and Hainan being an island. Their concentration to

the east led to the development being concentrated on the coasts. While it was done to provide the SEZ with the advantage to ports, their placement has led to other regions being neglected of the economic prosperity which the SEZs could offer. The regional disparity continues as the new free zones too remain concentrated to the coastal region towards the east.

Leong and Pratap (2011) observe that the SEZs are dependent mainly on migrant workers to maintain their competitive edge as these migrant labourers are paid significantly lower wages than the regular urban workers. Apart from low wages the workers in SEZs also have to endure long working hours, substandard living conditions, lack of enforcement of occupational health and safety standards, and restrictions of their right to join or form independent trade unions. The Hukou system has only added to the miseries of the huge migrant labour population as they lack domicile registration and are easily denied social security benefits which they otherwise would get.

Gopalakrishnan (2007) notes that SEZs like the ones in Fujian and Hainan have led to loss of huge swathes of arable land as new areas are undertaken for construction of infrastructure which at times is not even needed but only caters to the speculators planning. This has caused a severe threat to arable land in the country. Between 1986 and 1995, approximately five million hectares of cultivable land were taken for infrastructure and real estate projects (Cartier 2001).

CONCLUSION

The success of SEZs can be attributed to the strong commitment towards reform shown by the Chinese government under Deng Xiaoping's leadership. He was an admirer of foreign accomplishments and never shied away from accepting China's own drawbacks. Barry Naughton (1993) attributes to the success of reforms Deng's personal characteristics of a team player who believed in delegating authority and rewarding through incentives to keep individuals motivated. His support for decentralisation of decision making and proved helpful for the formation of SEZs. The SEZs seem to have fulfilled their promises as they have turned into powerhouses of production and have helped China achieve huge quantities of exports. The production of low cost goods was such that 'made in China' products started to flood the markets throughout the globe by 1990s. Foreign direct investment has been highest in these SEZs as compared to other regions. The experience gained in setting of the five pilot SEZs have proved instrumental in setting up of numerous new free zones throughout China. The governments have turned to setting up of free zones as a method of curbing regional disparity in terms of development, urbanisation and employment. While these new economic set ups have been instrumental in achieving prosperity, they have also led to the worst form of exploitation of the workers. The concern for environment is usually lacking as industries are hardly ever reprimanded for their neglect of environment laws. Despite their shortcomings SEZs have largely turned out to be a profitable proposition for the Chinese economy fulfilling all the major expectations that the policy makers had from them.

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