

Studies on the Chinese
Market Economy Series

New Progress in China's Special Economic Zones

Chief Editors:
Gao Shangquan
and Chi Fulin

FOREIGN LANGUAGES PRESS BEIJING

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Editors' Notes

After 15 years of struggle and exploration, China's special economic zones (SEZs) have played a tremendous role in pushing forward China's reform, opening to the outside world and economic development. China's SEZs are at a crucial development point in a situation where a socialist market economy has been adopted throughout the country, and China is working hard to join the World Trade Organization (WTO). Where do the SEZs stand under the new circumstances? What kind of role do they play in the overall stability of reform, opening up and the macroeconomy? How will the goals and tasks in further developing the SEZs be determined from a macro point of view, especially in regard to the overall strategy of China's economic development that will span into the next century, the whole structure of China's reform and opening up, and the formulation and implementation of effective macroeconomic policies? All these are major issues at the moment that urgently require our study and research.

The development of China's SEZs has long been the topic to which the China (Hainan) Institute for Reform and Development has paid great attention and has enthusiastically been working on. Over the past few years, the Institute has conducted a series of research projects on the reform and opening up in the Hainan Special Economic Zone (SEZ); it has achieved some research results on certain topics. With the major changes in the development of China's SEZs, and in order to better define their future development orientation and goals, the International Seminar on the Development of China's SEZs, sponsored by the Institute and the UN Development Program, was held from April 13 to 14, 1995. The 80 or so experts, scholars and officials from home and abroad held lively discussions on the new situations faced by

China's SEZs, the international comparison of the SEZs, and the goal patterns of their development, as well as recent countermeasures, etc. All participants agreed that, due to the development in the domestic and international situations, China's SEZs are presently at their crucial point of development and thus in transition to a higher developmental goal. In the process of further developing the SEZs, three major problems should be solved, i.e., first, position and role of China's SEZs in the new situation; second, the SEZs should create more advantages in the new situation while facing reality; and third, experience from other countries should be used for research and reference to promote a better development of China's SEZs. After the seminar, a report on policy proposals entitled *Proposals on the Further Development of the Special Economic Zones in Our Country (the 22 Proposals)* was written by the Institute and submitted to the related department of the central government.

This book has been compiled on the basis of the report and the materials and speeches given at the seminar. We would like to extend our heartfelt thanks to the experts from home and abroad whose ideas and views are mentioned in this book.

Gao Shangquan and Chi Fulin served as chief editors of the book. The latter was also responsible for finalizing the manuscripts. The chief compiler was Sun Xiuping, assisted by Chen Wen and Lei Xiansheng. Our thanks also go to the colleagues from the Research Department and the Comprehensive Data Department of the Institute, who have done a lot of work for this book.

We welcome criticisms and corrections to any inappropriate information which might inevitably appear due to the press of time in compiling this book.

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Chapter I

ACHIEVEMENTS AND ROLES OF CHINA'S SEZs

The birth of China's special economic zones (SEZs) is the most important component in China's reform and opening up policy, and is seen by the world as a sign of China's reform and opening to the outside world. Over the past 15 brilliant years, amazing achievements have been accomplished in China's SEZs, which have been considered as an "incredible miracle" by many. Fifteen years are but a fleeting moment in the history of mankind; yet, the tremendous success the policy has achieved in this period of time has caught the attention of people from both home and abroad.

I. The Background of Establishing China's SEZs and Their Present Conditions

By definition, a SEZ is an area opening to the outside world, which is assigned by a country or a region in light of its objectives of economic development, and where some special economic policies and measures are adopted. In accordance with the international practice of classification, over one thousand SEZs of all kinds exist in the 80 or so countries and regions throughout the world. Most of them are found in developed countries, especially the United States, which has more than 130.

China's reform and opening up since the end of the 1970s was initiated by establishing the SEZs. The market-oriented economic reform, first started in the SEZs, cities and regions opened to the outside world, has propelled the transition from a closed economy

to an open one.

In 1978, the Third Plenary Session of the 11th National Congress of the Communist Party of China (CPC) made the strategic decision to shift the focus of work to modern construction of socialism. At the same time, it also formulated the principle of carrying out the socialist economic structural reform and opening China to the outside world on the basis of self-reliance and hard struggle. It directed that economic cooperation with other countries based on equality, mutual benefit and self-reliance would be developed, and that the world's advanced technology and equipment should be adopted. The decision made at the Third Plenary Session of the CPC 11th National Congress also called for people to make use of both domestic and international resources, develop both domestic and international markets, and learn two skills—how to run the domestic economy and how to develop foreign trade and economy. This major decision by the central government has won support from people nationwide.

In April 1979, a working conference was held by the central government to discuss how to implement the spirit of the Third Plenary Session of the 11th National Congress of the CPC. During the conference, on hearing the report by associates from Guangdong Province about how to develop Guangdong's economy by making use of its own advantages, Deng Xiaoping suggested that an area be assigned as a SEZ. In June of the same year, Guangdong and Fujian provinces, in accordance with the reform and opening up policy of the central government, submitted reports to the central government, asking for permission to adopt special policies and flexible measures in their foreign economic activities so as to give full play to their advantages of being close to Hong Kong, Macao and Taiwan; of having a large population of overseas Chinese, and of having easy access to the outside world. They hoped to make use of the favorable international situation and take a step in advance in the reform and opening up, thus promoting their economy in the shortest possible time. They also proposed that, in accordance with Deng Xiaoping's suggestion, export-oriented special zones be assigned in Shenzhen,

Zhuhai and Shantou of Guangdong, and Xiamen of Fujian, where overseas Chinese and business people from Hong Kong, Macao and other countries would be allowed to make direct investment in founding their factories, or could jointly run their enterprises. Their reports were soon approved by the Central Committee of the CPC and the State Council. Preparatory work for the SEZs was started in the two provinces immediately afterwards. In August 1980, the Regulations of Guangdong Province on the Special Economic Zones was approved and issued by the 15th Standing Committee of the Fifth National People's Congress (NPC), thus formally announcing to the world the birth of China's SEZs.

In the 1980s, another important decision to speed up the development and construction of Hainan Island was made by the central government. In September 1987, the Circular of Establishing Hainan Province and Its Preparatory Works was issued by the Central Committee of the CPC and the State Council, which also announced that the State Council would give more autonomy to Hainan Province and formulate more preferential policies to make it China's largest SEZ. On April 13, 1988, the resolution to establish Hainan Province and set up Hainan Special Economic Zone was passed at the First Plenary Session of the NPC.

Located along China's southeast coast and under the jurisdiction of Guangdong, Fujian and Hainan, respectively, these five SEZs cover an area of 34,813.5 sq km, or 0.35 percent of the country's land, and have a population of 9.79 million, or 0.8 percent of the country as a whole. Adjacent to Hong Kong, the Shenzhen Special Economic Zone has an area of 327.5 sq km and a population of 1.4 million; the Zhuhai Special Economic Zone is next to Macao and has an area of 121 square km and a population of 860,000; the Xiamen Special Economic Zone, containing the whole island of Xiamen and Gulangyu Islet (and opposite Taiwan Province), has an area of 131 sq km and a population of 400,000; the Hainan Special Economic Zone, the largest of all, covers the whole island of 34,000 sq km, and contains six cities and 13 counties under its jurisdiction and a population of 7.4 million.

The initial conception of the developmental pattern was that the Shenzhen and Zhuhai SEZs would develop into comprehensive zones with industry as their main pillar, while combining foreign trade and other businesses; and Shantou and Xiamen would become zones focusing on processing exported goods. The development of the SEZs, however, has proved that the comprehensive SEZs are the best to realize the intention of the central government in establishing the SEZs. Shortly after the setting up of the SEZs, the Shantou and Xiamen SEZs also developed in the pattern of comprehensive SEZs.

While China's SEZs are different in many aspects from those export-product processing and free trade zones in other countries, they also share something in common. Their similarities are shown in the following:

(1) Economic policies and regulations different from those practiced in other parts of the country are adopted here;

(2) Preferential measures, such as tax reduction and exemption, are applied to foreign investors;

(3) Attention is paid to the construction of the environment so as to draw more foreign investment; and

(4) Enterprises in the SEZs are encouraged to expand their exports, enter foreign markets and participate in international competition.

The following shows how different China's SEZs are from those in foreign countries:

(1) With relatively large areas and populations and diversified industrial structures, China's SEZs have primary, secondary and tertiary industries, as well as a wide variety of industries, giving foreign investors more possibilities;

(2) They not only play the role of bases of opening to the outside world and showcases, but also serve as pilot places for economic reform, from which China can draw experience for its economic reform, in general; and

(3) No SEZs, except that of Shenzhen, have facilities that separate them from the outside, giving them an easy and close access to other parts of the country.

Since 1979, about one hundred laws and regulations on SEZs

have been formulated by the Standing Committee of the NPC, State Council, standing committees of the People's Congresses of Guangdong, Fujian and Hainan provinces, and other departments authorized by the state's legislative institutions. In addition, a series of policy-related documents have been issued by the CPC Central Committee and various provincial committees of the CPC. All these laws, regulations and policy-related documents have allowed special policies to be practiced in the SEZs. Generally speaking, these special policies include the following:

1. Governments of the SEZs are authorized to have relatively larger economic management power. They enjoy provincial-level power to examine and approve a project. They are also authorized to handle flexibly any work which is beyond the limits of unified authority of the central government, in accordance with related state laws and regulations and the actual situation of the SEZs. Special provisions on management of foreign affairs, public security, border defence, taxation, Customs, banks, foreign exchange, post and telecommunications, railways, harbors and aviation, which are within the limits of the unified authorization of the central government, shall be formulated by various departments in charge of the State Council in light of the specific situation of the SEZs. These regulations are subject to approval by the State Council.

2. The income tax rate for enterprises in the SEZs is 15 percent. Productive enterprises with foreign investment that have an operation term of more than 10 years will enjoy exemption from income tax in the first two profit-making years and pay half of the income tax (levied at 75 percent) for the next three years. After the expiration of the period for exemption and reductions, enterprises that make products for export will, after approval, pay income tax at a reduced rate of 10 percent; enterprises with advanced technology will, after approval, enjoy another three years during which the tax will be reduced by half. Non-productive enterprises with foreign investment exceeding US\$5 million and an operation period of more than 10 years will enjoy exemption from income tax in the first profit-making year and pay half of the tax for the following two years.

3. Customs duties and value-added tax will not be levied on export products manufactured by SEZ enterprises with imported materials; export duties and value-added tax will not be levied on export products manufactured with raw materials from China, except crude oil, finished oil and a number of products prescribed by the state.

4. Import duties and value-added tax will not be imposed on imported machinery equipment, spare parts, components, raw materials, materials and fuel, used for the construction and production in the SEZs by administrative departments, enterprises and institutions upon approval. However, when any of the above (including products manufactured by SEZ enterprises with duty-free imported parts) is transported from the SEZ to other parts of the country, duties and value-added tax shall be imposed.

5. Foreigners, overseas Chinese from countries or regions that have diplomatic or official trading relations with China, and compatriots from Hong Kong, Macao and Taiwan who come to the SEZs for scientific and technological exchanges, or visiting relatives or friends, or sightseeing, and who will stay in the Hainan SEZ for no more than 15 days, in Shenzhen SEZ for less than five days, or in Zhuhai SEZ for no more than three days, can have their entry visas issued at the ports of those three SEZs. Foreign investors, foreign staff hired by enterprises invested in by foreigners and their accompanying family members are entitled to apply for multi-entry visas.

The establishment of the SEZs has accelerated China's opening to the outside world. Presently, both the domestic and international situations facing the SEZs are quite different from 15 years ago, when reform and opening up were initiated. Under the new historical circumstances, the SEZs, like elsewhere in the country, are faced with a severe test. The SEZs are being challenged both domestically and internationally in the following fields:

—With the speeding up of the internationalization of China's economy, China has more frequently joined international, regional, multilateral and bilateral economic and trading conventions and organizations. This has objectively limited the scope and

degree of discrepancy in the preferential policy of local economic development, especially the policy of foreign trade.

—Before the year 2000, Hong Kong and Macao will return to China. The economic ties between various provinces on the mainland of China, and Taiwan Province will be increasingly closer. Hong Kong, Macao and Taiwan all have had a long history of market economy. We can draw from their experiences of many common market economy laws, which will no doubt limit the SEZs in their role as an experiment in reform and opening up.

—Some inadequacies have appeared with the development of the SEZs. On the one hand, the cost of some essential factors of production, such as labor and real estate in the SEZs, have boomed, crippling the SEZ's competitiveness and making their future development more difficult.

—After 15 years of development, the industrial structure in some SEZs is under readjustment and upgrading, which is even more difficult than starting from scratch.

—Following the opening up of the 14 coastal cities in 1984, more regions have been opened up. They include the Yangtze River and Pearl River deltas, Xiamen, Zhangzhou and Quanzhou that form the triangle region in the south of Fujian Province, and the Shandong and Liaodong peninsulas. In 1990, the central government decided that Pudong in Shanghai be opened up and an investment zone for Taiwan business people be established in Fujian. In addition to the southeast coast, China's northeast, including Heilongjiang and Liaoning provinces, the northwest, including Xinjiang Autonomous Region, and the southwest, with the Lancang River as its developing center, have all been opened up. As the level of opening up is upgraded, there are more and more regions that can serve as the "windows" and "comprehensive trial zones" of the reform.

—The economic reform is being carried out nationwide. Many trial items experimented with in the SEZs, such as preferential taxation, reform of government organizations, change of operational mechanisms at enterprises, price reform, establishment of key-element markets, especially the founding of financial and securities markets, have spread elsewhere in the country.

Coastal and border regions, and areas along the Yangtze River and highways have become the leading areas. The economy in Shanghai's New Pudong Area, and the Pearl River Delta, Yangtze River Delta, the Bohai Sea Economic Zone is growing rapidly. The economic strength at economic and technological development zones and cities opening to the outside world is being increasingly strengthened. Among them, the emergence of Shanghai's New Pudong Area is worth mentioning. Starting from 1991, its economy has been on a fast track. From 1991 to 1994, its gross domestic product (GDP) increased to 7.579 billion yuan and the direct foreign investment rose from US\$101 million to US\$2.652 billion. All of the above factors will gradually reduce the distinction in economic systems between the SEZs and other regions, putting the SEZs under more severe competition and lessening their uniqueness.

First of all, internationally, the growth rate of the world economy and trade in the 1990s will slow down and Western countries will experience an economic recession. Influenced by the economy in the United States, the export trade in Western Europe and Japan has been reduced, and the possibility of expanding the domestic demand is unlikely. The 1990s will not see a remarkable economic growth in Eastern Europe or the former Soviet Union. Due to heavy debts, the economy in most of the developing countries in Latin America and Africa will still develop at a low speed or in a fluctuating state. As the developed countries take 70 percent of the worldwide nongovernment trade, its reduced growth will inevitably affect the growth of world trade. What is worth noticing is that the United States will continually adopt the policy of limited imports to free itself from the unfavorable balance of trade, which will affect the expansion of the trade in China's SEZs.

Secondly, the multipolarization of the world economy and trade protectionism are on the rise. As the development of the world economic pattern in the 1990s has become unbalanced and multipolarized, the world economy has been more regionalized and more group oriented, which will free trade even more and make it adopt preferential policies, internally, and trade protec-