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Evaluating China's Special Economic Zones

by

Ann Fenwick†

INTRODUCTION

In July 1979, as part of the People's Republic of China's (hereinafter the PRC or China) post-Mao reorientation toward rapid economic modernization, the State Council and the Central Committee of the Chinese Communist Party jointly issued a directive allowing the two southern coastal provinces of Guangdong and Fujian to undertake special policies and flexible measures to promote foreign trade and investment.¹ The most important outgrowth of this directive was the rapid establishment of four Special Economic Zones (SEZs), three in Guangdong² and one in Fujian.³

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¹ Beijing has never published the directive itself. However, its contents were revealed in August 1979, in a speech by Xi Zhongxun, then First Party Secretary of Guangdong Province. According to Xi:

The central instructions state: Guangdong and Fujian provinces are close to Hong Kong and Macao. There are many overseas Chinese there and their resources are relatively abundant. They possess many favorable conditions for speeding up economic development. The central authorities have decided to adopt a special policy and flexible measures with regard to the external economic activities of these two provinces, and to give the local authorities greater initiative so that they can bring their superior conditions into play, take advantage of the present favorable international situation and go a step ahead of the others in order to promote the economy as rapidly as possible. This is an important policy decision with major significance for speeding up China's Four Modernizations.


² In Guangdong, SEZs were set up on 327 square kilometers in Shenzhen municipality, a border town just north of Hong Kong's New Territories; on 14.1 square kilometers within Zhuhai municipality, a rural area on the west bank of the Pearl River estuary next door to the Portuguese colony of Macao; and on 6 square kilometers in Shantou municipality (the nineteenth century treaty port of Swatow), approximately 200 kilometers northeast of Hong Kong. The Zhuhai SEZ began as 6.8 square kilometers in December 1979. In mid-1983, its area was more than doubled. See China Province Widens Special Economic Zone, Asian Wall St. J., July 29–30, 1983, at 10.

³ In Fujian, initial plans to establish several SEZs were eventually discarded in favor of concentrating investment on the 2.5 square kilometer Huli district near the harbor of
These four SEZs enjoy a significance far out of proportion to their relatively tiny size and population. While variants on the SEZ—such as export-processing zones and free-trade areas—are a longstanding staple of Third World development programs, the segregation of geographic areas for direct, preferentially treated foreign investment was unprecedented in PRC history. Further insight into the significance of the SEZs comes from considering the PRC’s broad aims for these enclaves. China views the SEZs as key conduits for foreign investment, advanced technology, and managerial expertise and as sources of increased employment and manpower training. The PRC also regards the SEZs as major components of its increasing efforts towards meeting two of its biggest foreign policy objectives: reintegration of Hong Kong and Taiwan with the mainland. Demonstrated success in administering the looser, more market-oriented economies of the SEZs will, China hopes, help allay fears in both Hong Kong and Taiwan about reunification. Finally, the SEZs are regarded by China as social and economic laboratories in which new, controversial approaches to the challenges of modernization may be tried out, with the potential for future far-reaching national emulation.

The PRC was aware from the outset that the high levels of long-term foreign investment on which the SEZ concept depends could not be attracted without special legislation to promote and guarantee investor security and confidence. Accordingly, five sets of legislation specific to Guangdong’s SEZs have emerged, indicating the PRC’s intention to endow these zones with a legal framework distinct from the evolving regime governing foreign investment elsewhere in China.

While the SEZ concept itself is unprecedented in PRC history, it is not without analogs both internationally and domestically. The trade zone as a means of promoting foreign commerce has existed for centuries. Today, it flourishes under various names in more than 350 areas of seventy-five countries, including States with socialist economies, such as Yugoslavia and Xiamen (formerly Amoy), an industrializing port city with historically strong links to both the overseas Chinese community and to Taiwan. On Fujian’s original plans to establish several SEZs, see South China’s Other Export Zones, CHINA BUS. REV., Mar.–Apr. 1980, at 33, 35. On the financially based decision to focus solely on Huli, see Pattison, Special Economic Zones in the People’s Republic of China: The Provincial Experiment, 1 CHINA L. REP., 141, 158–59 (1981).


5. See, e.g., Sun Ru, A Discourse on the Significance and Role of the Special Economic Zones from the Aspect of Strategic Aims, Nanfang Ribao, Guangzhou, June 7, 1982, reported in FBIS, June 14, 1982, at P4.

Romania. Known variously as investment promotion zones, free trade zones, and export processing zones, these enclaves are all:

Industrial estates wherein trade barriers applicable to the rest of the national economy do not apply and where export-oriented industries can operate free of import duties or quantitative restrictions and are granted other advantages, including tax exemptions.

Indeed, by the time the Chinese espoused the SEZ, the export processing zone had become a common component of the modernization programs of most Asian countries, including South Korea, Taiwan, and the Philippines. In fact, the PRC carefully researched other Asian zones before launching its own. The second round of China's SEZ legislation was prefaced by missions of official delegations to study the operations of such zones in other developing countries.

While awareness of other countries' experiences with free trade zones undoubtedly shaped the PRC's decision to develop SEZs, the Chinese may also view the SEZs as the evolution and expansion of their own export commodity production bases. Established under the aegis of the late Premier Zhou Enlai in the early 1970s, the export commodity production bases, which now number twenty-seven, are centrally designated prefectures in which agricultural and/or industrial production is oriented toward export needs, under the supervision of local foreign trade organs. Although they lack the SEZs' emphasis on direct foreign investment and management, the apparent success of the export commodity production bases probably eased the transition to SEZs by providing the Chinese Communist Party familiarity with foreign commerce-oriented enclaves. Moreover, the establishment of the earliest of these bases in Foshan prefecture of Guangdong province, next door to what later became the Shenzhen SEZ, probably did much to bolster local bureaucratic support for the controversial SEZ concept.

In examining the evolution of China's SEZs, this Article will focus on the legal framework structuring these zones. This Article will argue that the vagueness of the SEZ legislation and the reactive, piecemeal nature of its implementation is reflected in the legal framework.
evolution combine to make certain underlying nonlegal factors crucial to effective implementation. Therefore, key political, economic, social, and cultural variables shaping application of the SEZ legislation will also be considered. With both the legal framework and social context in mind, this Article will critically evaluate the prospects of the SEZs as unique socialist experiments involving the economic aspects of capitalism.

I
THE LEGAL FRAMEWORK FOR SEZs

A. Evolution of the Legal Framework

A month after the central leadership's July 1979 directive sanctioning increased foreign trade authority for Guangdong and Fujian, Guangdong began drafting SEZ legislation. Over the next twelve months, in the course of many conferences with officials from Guangdong and economists from the PRC, Hong Kong, and Macao, eleven drafts of an initial set of SEZ regulations were produced. In December 1979, the Guangdong Provincial People's Congress (the province's highest legislative body) adopted draft regulations consisting of thirty articles, which were then sent to the State Council in Beijing for extensive discussion and revision. After approval by the National People's Congress in August 1980, this legislation, now containing only twenty-six articles, was promulgated as an ordinance known as “The Regulations on Special Economic Zones in Guangdong Province” [hereinafter the Regulations].

These Regulations remain the centerpiece of China's SEZ legislation. Although they govern only Guangdong's three zones, the Regulations provide a basic legislative framework upon which other such areas, including Fujian (the proposed regulations of which have not yet been promulgated) may build, and from which deviation is unlikely to be permitted. Moreover, the Regulations apparently supersede an earlier set of investment guidelines issued by yet another organ involved in SEZ management in Guangdong: the China Merchants Steam Navigation Company (CMSN). A Hong Kong-based arm of Beijing's Ministry of Communications, the CMSN had been authorized by the State Council to develop and manage the Shekou Special Investment Zone, located on a peninsula thirty kilometers west of, but still within the jurisdiction of, the Shenzhen SEZ. A zone

14. For discussions of the drafting process, see Kamm, supra note 13, at 28; Interview with the Guangdong Province Economic Special Zones Management Committee (discussing the SEZ ordinance in Guangdong), reprinted in Nanfang Ribao, Guangzhou, Sept. 4, 1980, reported in JPRS No. 76913, Econ. Aff. No. 100, Dec. 2, 1980, at 9 [hereinafter cited as Committee Interview].

within a zone, Shekou, through the CMSN, quickly issued its own set of investment guidelines in January 1980, the terms of which were looser and generally more favorable to foreign investors than were the centrally-approved Regulations.

In the absence of any official announcement, it became apparent only gradually that the Shekou Guidelines were restricted to contracts signed with the CMSN prior to the promulgation of the Regulations in August 1980, and that the Regulations governed all contracts signed with all Guangdong SEZs thereafter. In fact, uncertainty over the status of the Shekou Guidelines persisted for several years after the appearance of the Regulations, providing the first example of the vagueness and bureaucratic confusion endemic to the SEZs.

Because detailed textual exegesis of the Regulations is available elsewhere, this Article will address internal problems and major themes or terms distinguishing the SEZ legislation from: (a) the free trade zone concept espoused by other nations and (b) the legal framework governing foreign trade investment elsewhere in China.

B. Distinctive Features of SEZs

Probably the most distinctive feature of the Chinese SEZs is the breadth of foreign investment solicited. The scope of foreign investment sanctioned by the Regulations is not only the widest available anywhere in the PRC, but is also considerably wider than that allowed in most other countries' export-processing zones. While the latter confine themselves largely to labor-intensive industrial production, article 4 of the SEZ Regulations invites foreign capital to participate in "all items of industry, agriculture, livestock breeding, fish breeding and poultry farming, tourism, housing and construction, [and] research and manufacture." Although PRC officials have indicated that some SEZs will specialize in particular types of projects suited to their individual resource endowments, zones such as Shenzhen and Zhuhai were opened with the explicit goal of comprehensiveness. Article 5 of the SEZ Regulations extends the scope of proposed

16. For these guidelines, see INVESTOR'S HANDBOOK, THE SHEKOU INDUSTRIAL ZONE IN SHENZHEN, CHINA MERCHANTS STEAM NAVIGATION COMPANY, LIMITED OF HONG KONG, Jan. 1980 [hereinafter cited as CHINA MERCHANTS]. For an analysis of these guidelines, see Gelatt, supra note 4, at 180-94.
18. In December 1982, informed observers were still puzzling over the official status of the Shekou Guidelines. See, e.g., Gelatt, supra note 4, at 181.
19. See, e.g., Pattison, supra note 3.
20. PRC commentators have stressed this feature from the outset. See, e.g., Sun Ru Speech, supra note 4, at 48.
21. See Ji Honggeng & Li Zhaofen, supra note 7, at 36.
investment broadly, soliciting foreign capital even for basic infrastructural development such as public utilities, roads, wharves, and warehouses.

This unusually wide scope of sanctioned investment is largely a direct response to the potentially drastic problem of insufficient central government funding for SEZ development. The expansive legislative framework encouraged SEZ officials, such as those in Shantou—who from the start anticipated meager capital construction assistance from Guangzhou—to solicit foreign investment in order to launch and sustain SEZ development. With Beijing’s stringent budgetary retrenchment, beginning nationally in 1981, the Regulations’ sanctioning of a very broad scope of foreign investment became a lifeline for all SEZs.22

A second major aspect of the Regulations, and one central to the legitimacy of the SEZ concept in the PRC, is the theme of strongly guarded socialist political authority and national sovereignty as key prerequisites to the zones’ deliberate loosening of socialist economic principles.23 The treaty ports, concessions, and other foreign-dominated enclaves of pre-1949 China are inextricably linked in the public mind to national humiliation and foreign subjugation. The PRC has, therefore, repeatedly emphasized the differences between these pre-revolutionary zones and the new SEZs. Retention of political and legal sovereignty is a goal the Regulations emphasize consistently. Article 2 states that, in areas not covered by the Regulations, the zones are governed by the PRC’s other “laws, decrees and related regulations.” Article 3 establishes a new, omnicompetent organ, the Guangdong Provincial Administrative Committee in Charge of SEZs, to ensure retention by the PRC of the broadest possible administrative, political, and judicial authority in the zones. [Articles 7 and 23]. Finally, land rights are confined to rights of usage with China retaining ownership at all times. [Article 12]. As one particularly (and defensively) emphatic PRC article summarized it:

[A]ll sovereign rights within a special zone (including legislative, judicial, administrative, and economic rights) are controlled by our government. All units of enterprises and undertakings and personal activities within the special zones must abide by the laws of China. All administrative matters are handled by the Administrative Committee for Special [Economic] Zones . . . . [T]he direction of economic development of these zones and the con-


23. As the Chinese press put it, “It is our feeling that we can be somewhat lenient about various conditions [in the SEZs] as long as sovereignty is in our hands.” See Committee Interview, supra note 14, at 10.

24. This article clearly establishes the nonautonomous legal status of the SEZs. Yet it also created potentially insurmountable problems for foreigners, whose SEZ investments are thereby made subject to innumerable “decrees and regulations” whose terms have never been openly published and which are sometimes selectively enforced. Gelatt, supra note 4, at 170.
struction of enterprises and undertakings must be examined and approved by the Special Zone Development Corporation.\textsuperscript{25} This same article lists as further evidence of the PRC's efforts to safeguard "the independent and sovereign status of the special zones,"\textsuperscript{26} the Regulations' strong strictures against the sale of SEZ products on the Chinese domestic market. [Article 9].

The PRC's insistence on sovereignty is understandable, as is its desire to protect its planned and self-reliant economy from dumping. Yet the closing of the domestic market is counter-productive to the objective of attracting foreign investment.\textsuperscript{27} China's greatest attraction is probably the size of its potential domestic market. To the extent the SEZs offer a position for future entry into that market they are an alluring investment prospect. The PRC has learned, since promulgating the Regulations, to use that card selectively, in order to draw attention to, and stimulate foreign interest in, the SEZs.\textsuperscript{28}

\textbf{C. Advantages and Disadvantages of SEZs}

While emphasizing that the Guangdong zones are subject to PRC laws, the Regulations establish a legal framework distinct from that applicable elsewhere in China. The Regulations sanction the existence of wholly-foreign-owned enterprises on PRC soil for the first time since 1949. [Article 1]. Unlike either the Joint Venture Law\textsuperscript{29} governing Sino-foreign joint ventures elsewhere in China or the earlier Shekou Investment Guidelines,\textsuperscript{30} both of which mandated twenty-five percent minimum foreign equity, the Regulations contain no minimum foreign-equity requirements.

\textsuperscript{25} Wang Shouchun & Li Kanghua, \textit{A Brief Discussion of the Role of Special Economic Zones in Our Country}, GUOJI MAOYI WENTI, \textit{[International Trade Journal]} Beijing, No. 1 (1981), reported in JPRS No. 78309, Econ. Aff. No. 143, June 6, 1981, at 63–64. These PRC authors incorrectly attribute to the Special Zone Development Company (Corporation) powers reserved in article 23 to the Administrative Committee. The functions of the Special Economic Zones Development Company are accurately set out in article 25.

\textsuperscript{26} Id. at 64.

\textsuperscript{27} SEZ authorities will grant permission to sell SEZ products within China based largely on whether the item is viewed as an import substitute. If permission is granted, the product then becomes subject to full import duties and taxes and perhaps even to "a further consolidated tax . . . if relevant, on the sale of the finished product into which the original item in question was incorporated." Gelatt, \textit{supra} note 4, at 159–60.


\textsuperscript{30} See CHINA MERCHANTS, \textit{supra} note 16.
The absence of any stipulation in the Regulations that joint ventures in the SEZs must first receive authorization by the central-level Foreign Investment Commission, a mandatory procedure for all such joint ventures elsewhere in China, reflects the unusual degree of autonomy granted SEZ authorities. Although never officially acknowledged, it has been reported that in a deliberate effort to cut through the bureaucratic red tape and delay bedeviling joint venture negotiations in other parts of China, Beijing granted Shenzhen and Zhuhai SEZ authorities independent power to approve foreign investments involving up to two million dollars in foreign equity. This is far above the half a million dollar limit imposed on other subprovincial areas in Guangdong. In fact, local initiative, at least in Shenzhen, the largest and most economically successful of the zones, has apparently gone far beyond this limit. Shenzhen authorities have indicated that negotiations involving considerably more than two million dollars have proceeded without central authorization.

Probably the chief investment incentive special to the SEZs is their fifteen percent corporate profit tax, far below the thirty-three percent rate imposed on joint ventures outside the zones (thirty percent national income tax plus an additional local tax of ten percent of the assessed national tax), and the thirty to fifty percent rate (national tax assessed at twenty to forty percent plus ten percent local income tax) levied by law on all non-joint venture foreign enterprises. Significantly, the fifteen percent tax rate also compares favorably with that of nearby Hong Kong, where industrial estates are subject to a seventeen percent corporate profit tax.

While some observers initially lauded the Regulations for providing "a high degree of specificity for the guidance of Western businessmen operating in China," others faulted the legislation, both for its relatively meager investment incentives vis-a-vis other nations' export-processing zones, and


32. See, e.g., Kamm, supra note 13, at 28; and Pattison, supra note 3, at 148. Once the two million dollar ceiling is reached, SEZ authorities need reportedly look only as far as the provincial level (and not all the way to Beijing) for authorization to proceed, at least with compensation trade negotiations. In this area, both Guangdong and Fujian originally had authority to approve all contracts involving under five million dollars, a ceiling then two million dollars above that accorded other provinces. Since 1981, Guangdong and Fujian have been able to approve all foreign investment projects in which sourcing, sales, and production are confined to the province. See Markscheid, Compensation Trade: The China Perspective, CHINA BUS. REV., Jan.–Feb. 1982, at 50, 51; Chu Baotai, Zhongwai Heziyingying Qiye Fa Ji Qi Shishi Jingyan Qiantan [A Discussion of the Chinese–Foreign Joint Venture Law and the Experience of Its Implementation] 83 (1983).

33. Markscheid, supra note 32, at 50.


36. Pattison, supra note 3, at 147.
for its intrinsic inadequacy and vagueness. The SEZ legislation is frustratingly silent, or at best cryptic, on matters of key concern to foreign investors. These concerns include dispute resolution procedures such as commercial arbitration, immigration procedures, the details of special preferential tax treatment promised for certain classes of enterprises, tariffs on consumer imports into the SEZs, and foreign exchange regulations. Studies indicate that low labor costs are the chief factor in an export-processing zone's success. Yet the Regulations provide no details or even parameters on wage levels, land rents, or lease durations. These gaps are probably deliberate, for they leave many crucial topics open to settlement through the preferred method of the Chinese bureaucracy, case-by-case negotiation.

Indeed, the Regulations offer fewer and less specific incentives than the Shekou Investment Guidelines they superseded. Missing in the Regulations, for example, are the Shekou Guidelines' promises of the lowest corporate tax rate in the world (ten percent) and an attractive three- to five-year tax holiday. The Regulations also compare poorly with terms offered by other countries' export-processing zones. Apparently, PRC officials drafted the Regulations with Hong Kong, their nearest geographic competitor, in mind, and did little to provide terms strongly competitive with export-processing zones in other parts of Asia. More specifically, the Regulations lack such preferential components of other zones as long tax holidays, a moratorium on electricity charges, subsidized utility services, preferential credit, exemptions from customs duties, and allied agreements with other states to prevent double taxation.

Within twelve to eighteen months, these inadequacies in the Regulations spawned several major problems in SEZ development. First, despite the PRC's explicitly articulated aim of attracting to the zones global foreign investment, infusions of capital came almost solely from Hong Kong. By the end of 1981, fully ninety-one percent of the foreign investment in Shenzhen came from the British crown colony next door. While the Chinese community in Hong Kong was willing to overlook the absence of a detailed, comprehensive legal framework for SEZ investment, and to rely instead on shared cultural affinity, family ties in China, or patriotism, other foreign businessmen from Japan and the West clearly were not.

37. See, e.g., Loong, supra note 35, at 56-59.
38. Stepanek, supra note 12, at 38.
40. For example, Sri Lanka offers foreign investors in its zones a ten year tax holiday and the opportunity to maintain Swiss-style secret numbered bank accounts in foreign currency. South Korea provides a five year exemption from corporate income, profit, property, and dividend taxes. See Loong, supra note 35, at 56, 58.
41. Id. at 56.
42. All Eyes are on Shenzhen, ASIAN FIN., June 15, 1982, at 68–69.
Second, the sectoral concentration of foreign investment in the SEZs was also unbalanced. While initial plans had envisaged comprehensive SEZs, by December 1981 a disproportionate seventy-two percent of Shenzhen's investment was concentrated in real estate projects, with only ten percent focused on the industrial development that Beijing had hoped would constitute the Shenzhen SEZ's focal point. This problem was a direct outgrowth of the preponderance of foreign capital from Hong Kong. With its severe overcrowding and exorbitant rents, Hong Kong looked to the SEZs for housing space for its excess population. Apparently, local authorities in the SEZ willingly fostered this emphasis at the expense of the industrial projects envisaged by Beijing as the engines to fuel the zones' long-term growth. This was logical, since local government retained a higher and quicker share of revenue from residential than from industrial projects. The gaps in the Regulations further exacerbated this trend, for they left open to bureaucratic maneuvering most of the key components of an industrial enterprise contract.

Third, almost forty foreign firms withdrew from Shenzhen only a year after the promulgation of the Regulations. Although these pullouts represented mostly small Hong Kong-financed textile projects, they reduced the prospects for realizing the PRC's ambitious goal of tripling Guangdong's foreign exchange earnings by 1985. Clearly, the SEZ investment environment, with its red tape and its labor and management problems, was already showing alarming signs of unpalatability, even to the optimistic investors of Hong Kong.

D. Recent Improvements in the Legal Framework for SEZs

The PRC was quick to recognize these major obstacles to SEZ development and to perceive the link between them and the need for additional legal safeguards. In mid-1981, an important troubleshooting meeting was convened in Beijing. Attended by SEZ officials, members of the State Council, economists, and provincial authorities, the conference spawned a second round of SEZ legislation. By late 1981, Guangdong had drafted five new sets of SEZ regulations, covering the problem areas of immigration, business registration, labor and wages, land issues, and SEZ administration. Administrative proposals under consideration included simplification of the often bewildering overlap of bureaucratic agencies simultaneously involved in SEZ contract negotiations and the establishment

43. Id.
44. Fung & Leung, supra note 22.
46. Guangdong Province in the 80's: Model for Growth Financed by Foreign Capital, in BRIEFING ON CHINA (U.S. Consulate General, Hong Kong, publ., May 23, 1980) at 2.
47. See, e.g., Wang Shouchun & Li Kanghua, supra note 25, at 68.
of a single unified SEZ administrative system for all zones. An arbitration center was also proposed for Shenzhen, in an obvious effort to stem the wave of pullouts resulting from unresolved disputes.49 Interestingly, the National People's Congress approved and the PRC promulgated on January 1, 1982 all the proposed legislation except for the draft on SEZ administration,50 leaving unresolved, at least by legislative means, the mounting bureaucratic problems in the zones.51

The second round of legislation brought about several important changes and clarifications in the legal framework on the zones.52 Entry and exit procedures were simplified, at least between Hong Kong and Macao and the SEZs but without concomitant simplification of the time-consuming customs inspection procedures. Labor and wage regulations, in a direct response to mounting complaints, strengthened investors' rights to advertise for, select, reward, and penalize workers, as well as to fire them, both for redundancy and for indiscipline, while at the same time maintaining complete silence on wage guidelines. Land regulations were promulgated only for Shenzhen53 and at last confirmed that that zone was indeed offering comparatively attractive investment incentives in the form of competitively priced land-use fees and long lease durations.

Even with these four new sets of regulations, the legal framework, recognized by all parties as crucial to the long-term viability of the zones, remains both incomplete and problematic. Since January 1982, PRC authorities have applied their typically gradualist and largely reactive legislative approach to the zones in the drafting of at least five other sets of specific regulations. These govern important investor concerns of foreign branch banks in the zones, protection of mortgage investments, technology transfer and foreign patent rights, economic contracts, and economic arbitration.54 Until this current round of legislation is completed, major invest-


50. The four sets of legislation which went into effect in 1982 were: Provisional Entry/Exit Regulations (Guangdong Special Economic Zones); Provisional Regulations for Business Registration (Guangdong Special Economic Zones); Provisional Labour and Wage Regulations (Guangdong Special Economic Zones); and Provisional Land Regulations for Shenzhen Special Economic Zone. For the Chinese texts and an unofficial translation of these regulations, see Guangdong Regulations, supra note 15, at 7–20, 37–55. No official translation has yet been issued. See also New Special Economic Zone Regulations Made Public, Ta Kung Pao, Hong Kong, Dec. 24–30, 1981, at 1.

51. Gelatt, supra note 4, at 165.

52. For analysis of the 1982 sets of regulations, see id., at 165–75; Moser, Guangdong's Special Economic Zones, China Bus. Rev., Mar.–Apr. 1982, at 40–44; and Stepanek, supra note 12, at 38.


54. See Fung, China Planning More Laws to Help Investors in Zones, Asian Wall St. J., May 20, 1982, at 1, 14; Interview with Premier Zhao Ziyang, reprinted in Wen Wei Po, Hong
ment questions will be left unanswered. Western investors will remain hesitant and, consequently, the SEZs will remain unable to fulfill their envisioned role as flagships in the PRC’s journey toward modernization.

II

NONLEGAL FACTORS SHAPING THE INVESTMENT CLIMATE

Because the legal framework surrounding the zones remains at best rudimentary, the SEZs’ fate hinges disproportionately on nonlegal factors influencing the investment climate. Above all, it hinges on the PRC’s ability to overcome certain long-standing and pervasive political, economic, social, and cultural problems which have frequently shaped and distorted the implementation of already existing SEZ legislation. The two principal nonlegal stumbling blocks to the zones’ development are the Chinese bureaucracy and the SEZ labor force. Both merit attention in a critical evaluation of the zones, not only because of the intractability of the problems they present, but also because of the concerted and at times highly innovative measures that have been taken to ameliorate their negative effects.

The bureaucratic problems facing the SEZs are not different from those complicating the Chinese modernization effort elsewhere. Structurally, these include a massive, overstaffed administrative hierarchy rife with overlapping, confusing, and often mutually undercutting lines of authority, with considerable built-in potential for delay and inefficiency. Staffing this hierarchy is Chinese “officialdom”, with its host of attitudinal shortcomings, ranging from overcaution and ideological mistrust of the SEZs on the one hand, to fascination with the material trappings of capitalism and a high susceptibility to corruption on the other. There is an almost universal paucity of managerial know-how. Taken together, these aspects of the Chinese bureaucracy confront SEZ proponents with a host of tightly intertwined and often deeply entrenched political, social, and cultural problems.

As noted above, bureaucratic obstacles were hardly addressed in the process of developing SEZ legislation. Yet the PRC had begun, even before the formal launching of the zones, to attack administrative obstacles. In an effort to streamline the lines of authority and communication between the zones and the provincial government (repository of power over all but

Kong, June 5, 1982, reported in FBIS, June 7, 1982, at W1; Liang Xiang (Vice Governor of Guangdong and Mayor of Shenzhen Municipality), Achievements in Construction of Shenzhen Special Economic Zone and Future Emphasis on Developing Industry, Wen Wei Po, Hong Kong, Sept. 11, 1983, reported in FBIS, Sept. 16, 1983, at W8.

Since the completion of this Article, the Standing Committee of the Guangdong Provincial People’s Congress has approved the first statute in the current round of SEZ legislation. On January 11, 1984, the Provisional Regulations for Importing Technology into Shenzhen Special Economic Zone were approved. These regulations were promulgated on February 8, 1984 by the Guangdong Provincial People’s Government. For an unofficial translation, see PRC Regulations for Importing Technology into Shenzhen, reprinted in Nangfang Ribao, Guangzhou, February 8, 1984, reported in BBC Survey of World Broadcasts, Far East, No. 7566, February 14, 1984, at C1–C4.
the most major of SEZ decisions), the administrations of both Shenzhen and Zhuhai were upgraded in early 1979 from town and county respectively to municipalities. This removed the prefecture as an intervening level of hierarchy. The Regulations concentrated administrative and managerial authority for the zones in a newly established SEZ Administrative Committee, a provincial-level organ with direct access to the Guangdong government and a staff of relatively sophisticated, experienced, and knowledgeable officials.

With the first complaints by foreign investors of administrative delays in contractual negotiations and bureaucratic overlap in the SEZs, a sweeping and largely unpublicized drive to prune and restructure the administrative hierarchy was quietly inaugurated in August 1981. Five months later, a leaner, restructured bureaucracy emerged in Shenzhen. A sixty-five percent reduction in personnel, from 2,237 to 867 people, was accompanied by the abolition of half of the sixty-five administrative agencies in the municipality. Again, an entire level of authority was eliminated, this time the district level under the municipality.

Paralleling these structural changes at the lower levels of the SEZ bureaucracy was a similarly significant change at the national level. Originally, overall policy for SEZ development was set by a committee within Beijing's former Import and Export Commission. In 1982, in a change indicative of the high degree of importance the central leadership accords SEZs in national development, responsibility for overall zone development policy was transferred to a new special SEZ office directly under the State Council. The consequences of these organizational shifts are by no means clear. Some observers have charged that the succession of structural reforms has in fact confused administrative authority in the zones even more.

Whether or not a streamlined bureaucracy with easy access to both provincial- and central-level leaders will function more efficiently depends in large part upon the bureaucrats themselves. At this microlevel of individual administrators, two key problems have already surfaced. First, the

55. See Sun Ru Speech, supra note 4, at 47; and Kamm, supra note 13, at 28.
56. See Guangdong Regulations, supra note 15, at arts. 3, 23, 24. See also Guangdong SEZs, supra note 17, at 82.
60. Id.; Kuang Yu, State Council Establishes Special Zone Office, Wen Wei Po, Hong Kong, June 24, 1982, reported in FBIS, June 24, 1982, at W1.
SEZ bureaucracy, and in particular, the Shenzhen bureaucracy, although staffed by experienced, sophisticated cadres sent from Guangzhou or even Beijing as much as by unskilled local functionaries, has been chided consistently by SEZ proponents for its conservatism. Since 1979, important central leaders have regularly visited the zones, in an obvious attempt to demonstrate the ideological legitimacy and continued strong political backing for the SEZs. A persistent theme of these well-publicized visits has been the urgent need for zone officials to shift from ideological hesitancy and suspicion of the economic liberalization on which the SEZ concept is grounded, to a stance of enthusiasm and forward-thinking leadership. For example, the official media have castigated hidebound SEZ officials who:

Carry on as usual according to the old rule, ignoring the characteristics of the SEZs completely; or worse . . . apply various restrictions, citing this “instruction” or that “regulation” of the past. No wonder a situation described by one comrade as . . . “chains on the ankles, handcuffs on the wrists, and a noose around the neck” can take place in matters related to the construction of the SEZs.

Yet the very reticence derided by both Beijing and foreign investors as a potentially fatal obstacle to SEZ success is also an all too natural and ingrained manifestation of personal political prudence. The SEZ bureaucracy now exhorted to deal aggressively and enthusiastically with capitalist entrepreneurs is, after all, peopled with individuals who have learned in the course of decades that abandonment of political caution may ultimately bring personal disaster and career disgrace. Moreover, ideological misgivings are also understandable and rendered even more intractable at another level. SEZ policies predicated on promoting foreign investment have resulted in incongruous instances of local cadres having to welcome back to their native villages former politically-excoriated local landlords now transformed by the SEZ concept into sought-after Hong Kong capitalists.

The principal approaches toward rectifying attitudinal conservatism within the SEZ bureaucracy consist of transferring personnel and repeatedly calling for emancipation of the mind and emulation of the more progressive and market management-oriented CMSN leadership of the Shekou Zone. In contrast, a far harsher course has been taken against SEZ offi-


64. Lo Yukai, Peculiar Phenomena of Shenzhen Special Zone, Guang Jiaoqing, Hong Kong, No. 93, June 16, 1980, reported in JPRS No. 76081, Econ. Aff. No. 70, July 21, 1980, at 130.

65. Shekou is regarded by the PRC as a model zone within a zone. See, e.g., Fung, supra note 17, at 1.
cials guilty of a second and polar opposite attitudinal sin, corruption. Officials who have taken enthusiastic support for the SEZs' open door policy so far as to reap under-the-counter personal rewards have been purged and even criminally prosecuted. Severe penalties are quickly imposed because administrative corruption and materialism represent dangerous undermining of the staunch ideological purity and strongly guarded political sovereignty which the PRC sees as the key prerequisite to SEZ legitimacy. If ideological uprightness falls victim to graft and materialism, the PRC clearly fears that incursions into political sovereignty will not be far behind. 66

A 1982 national drive against economic crime was used to strike hard at bureaucratic culprits in the SEZs, described as:

"maggots of the special zone"... a handful of people who ignore the interests of the state and make use of their powers to engage in graft, embezzlement and bribery and who try by every means of smuggling and speculation to line their pockets. 67

The "handful" referred to in the article is an understatement. The 1982 campaign against economic corruption uncovered 154 cases in Shenzhen alone. Thirty-four of these were considered serious and twenty-five resulted in the extreme penalties of expulsion from the Party or dismissal from an official post. 68 Among these cases was that of Peng Guoxian, former deputy director of the political office of Shenzhen's municipal border defense. Peng was sentenced to twelve years in prison under China's new criminal code for swindling 10,000 yuan to finance the construction of a "palatial" private residence. A scathing press exposé documented in minute and fascinating detail the manifestations of Peng's corruption:

He built a private four-story house. The total area... was 308 square meters, including eleven rooms, four drawing rooms, three dining rooms and two kitchens with toilets. The whole building was finished with cement externally and was painted with latex paint internally. Of the four drawing rooms, the one on the first floor was floored with terrazzo, while the other three had "mosaic" floors. There was also a grape arbor on the roof. Compared with the housing of the people nearby, Peng's residence was like a crane standing among chickens. 69

A far more sensational case, of national import, involved the Shenzhen branch of the China Electronic Technology Import and Export Company. Several of the company's leaders were found to have conducted a major smuggling and tax evasion racket since the agency's establishment in May

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68. Shenzhen Cracks Down on Economic Crimes, Promotes Construction, supra note 66, at 64, 65.

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Both of the above cases provide vivid confirmation of the opportunities in the SEZs for temptation and aggrandizement of the local bureaucracy. In fact, they suggest that such opportunities exist in the zones on a scale and frequency probably unmatched elsewhere in China. Therein lies a major and quite possibly ineradicable obstacle to the evenhanded implementation of the SEZ legal framework so necessary to ensure investor confidence.

While bureaucratic shortcomings are deeprooted and of vital concern, probably the most constant and urgent problem threatening the viability of the zones is the labor force. The PRC launched the SEZs with at least two labor-related goals in mind. First, Beijing hoped that SEZ development would yield ever-expanding employment opportunities for the zones’ local, largely rural, population. Underemployment and the attraction of nearby Hong Kong had long created a drain of young people from areas such as Shenzhen. Second, the PRC saw the SEZs as a way to promote advanced management and labor skills among the zones’ population, with considerable potential anticipated for diffusion to non-SEZ China. The PRC was also aware of the need to relax its own ideological strictures and to approach with flexibility the question of labor in order to satisfy foreign investors’ desire for profits. Even exploitation would be countenanced in the zones to some extent. In the words of one Chinese authority:

Since foreign capital is employed to operate enterprises with a capitalist nature, there will certainly be exploitation. . . . [T]his point was clear to us long ago. To realize the four modernizations and develop the socialist economy, we shall tolerate a certain degree of exploitation.

The Regulations appeared to embody this bold flexibility toward labor. Foreign investors were given legal rights nonexistent elsewhere in China. These included the option of recruiting workers independently (rather than merely accepting governmentally assigned laborers), the right to test candidates prior to hiring, and the right to sign labor contracts with recruits, which countenanced at least the possibility of dismissal. This last right was in sharp contrast to industrial enterprises in other parts of China where workers have long enjoyed what is termed “the iron rice bowl,” guaranteed lifetime employment with dismissal virtually unknown.

These legal guarantees were weakened, however, by the twin problems of a bureaucratic implementation system and an unsatisfactory SEZ labor pool. Foreign investors complained from the outset of unskilled, under-
productive, poorly-motivated workers.\textsuperscript{74} Labor costs in the zones were thirty to forty percent less than in Hong Kong, but businessmen discovered to their chagrin that even after financing extensive training programs, local recruits, often uneducated former peasants, seldom achieved half the productivity of their Hong Kong counterparts. Moreover, despite the Regulations' provision for independent hiring, most entrepreneurs found it impossible to recruit laborers except by going through the SEZ labor bureau. Requests to promote efficiency and productivity by rewarding with bonuses and penalizing with dismissals met with bureaucratic opposition from local administrators obviously uneasy with the extraordinary leeway accorded zone investors in the SEZ legislation.

With SEZ wages higher than anywhere else in China, although still lower than Hong Kong,\textsuperscript{75} investor frustration soon translated into withdrawals or protest closures. Substandard workmanship forced one Shenzhen investor to pay U.S. $30,000 damages to his American retailer.\textsuperscript{76} Another businessman was forced to close down his Shenzhen spinning factory for two weeks before prodding the local bureaucracy into action to solve his mounting labor problems.\textsuperscript{77} One of Shenzhen's largest trade ventures, an assembly plant for Harpers International Corporation, a Hong Kong subsidiary of Sime Darby, collapsed largely as a result of losses incurred through unskilled labor.\textsuperscript{78} Forced to refund Harpers' U.S. $2 million investment and to watch between thirty and forty smaller concerns withdraw in the face of labor-management difficulties, the PRC at last acquiesced in investors' demands for sweeping changes.

One prong of the Chinese attempt to ameliorate zone employment problems came in the 1982 Provisional Labor and Wage Regulations. As one observer put it, these new regulations "have teeth", providing clear legal sanctioning for employers to mete out warnings, wage reductions, dismissals, and bonuses.\textsuperscript{79} Even more innovative measures were instituted to promote labor efficiency. Other zones were exhorted to emulate the pro-

\textsuperscript{74} This discussion of initial labor problems draws on the following sources: Fung, supra note 49, at 5; All Eyes are on Shenzhen, supra note 42, at 69; Special Economic Zones, FAR E. Econ. Rev., Oct. 1, 1982, at 62; Moser, supra note 52, at 42.

\textsuperscript{75} Pattison, supra note 3, at 154.

\textsuperscript{76} Id.


\textsuperscript{78} Li, supra note 31, at 42-43; All Eyes are on Shenzhen, supra note 42, at 68; Kraar, A Little Touch of Capitalism, FORTUNE, Apr. 18, 1983, at 122. For the PRC version of events leading up to Harper's withdrawal, see Lin Li, Keeping the Initiative in Our Own Hands, Serving Our Needs—Answering Some Questions Regarding Special Economic Zones, Renmin Ribao, Beijing, Aug. 23, 1983, reported in FBIS, Aug. 30, 1983, at K7. According to Beijing, Harpers left because China refused to allow it to "dump" its SEZ products onto the Chinese domestic market.

\textsuperscript{79} Moser, supra note 52, at 42; Guangdong Regulations, supra note 15, at arts. 4, 9, 16, 17, 19.
gressive labor recruitment approach utilized by Shekou. Shekou’s innovative administration looked beyond the zone’s population and scoured the immense national labor pool via advertisements, then picked the best qualified applicants for initial zone-financed training before recommendations to foreign enterprises. Having seen the difficulties caused by unskilled labor in Shenzhen, other zones took measures to reorient their educational systems to anticipate the needs of foreign enterprise employment. Shenzhen itself announced plans to raise the educational level of its labor pool, including the establishment of a university. Although the financial burdens of job-related training continued to fall disproportionately on the foreign investor, testing centers were set up in the zones to shift some of the initial costs of labor recruitment to the PRC.

Perhaps the most significant of all was the PRC’s decision to allow the zones to experiment with several revolutionary departures from the “iron rice bowl” policy. By May 1983, eighty-two SEZ enterprises in Shenzhen had replaced centrally assigned lifetime labor recruitment with a new contract labor system of voluntary application, examination, and competitive selection of outstanding candidates. This new system rewarded individual initiative, achievement, and productivity. Other zone enterprises and joint ventures pioneered a new wage system explicitly oriented toward maximizing labor efficiency by gearing remuneration to fluctuations in individual productivity. Under this new system, the former basic wage and numerous subsidies have been replaced by a basic wage supplemented by “post” or “job wages” (determined by a worker’s position), and exceeded in percentage of total salary by “floating wages” (determined by individual labor performance). In a clear example of the SEZ’s success as a policy laboratory, this floating wage experiment is already being implemented in other regions of China.

Yet even after these concerted, multiple efforts, the zones remain plagued by labor problems. Enforcement of the guarantees to foreign in-

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82. *China: How Trade Zones are Luring Foreign Investors*, BUS. WEEK, Jan. 11, 1982, at 50.
vestors enunciated in the SEZ legislation continues to be precariously dependent on the acquiescence of local labor bureaus whose bureaucratic interests are frequently at odds with the interests of foreign investors. Legislative provisions assuring rights of dismissal are seldom supported with enthusiasm by a bureaucracy charged with the difficult task of finding re-employment for unwanted or unruly laborers.84 In fact, despite the Regulations' explicit provisions, it appears that labor dismissals, either for redundancy or indiscipline, are just as rare in the zones as in the rest of China. Only one such dismissal had been documented by May 1983.85 Further managerial flexibility legally accorded SEZ investors has proven similarly illusory. For example, the superficially attractive option of seeking personnel through independently placed advertisements in non-SEZ areas of China has floundered as hinterland work units have jealously refused to give up skilled workers and technicians. A final labor problem worthy of note is one that will inevitably trouble the PRC increasingly as the SEZs develop, namely the increasing trend toward *embourgeoisement* of a labor force treated to both the nation's highest wages and its highest standard of living.86

**CONCLUSION: FUTURE PROSPECTS AND LONG-TERM POTENTIAL OF SEZS**

The success or failure of the SEZs will have an important dual impact. It will influence not only foreign investor confidence in China, but also Beijing's attitude and approach to foreign investment and trade elsewhere in China. Statistics paint a rosy picture of SEZ achievements to date, at least in the showpiece zone of Shenzhen. As of May 1983, Shenzhen had concluded 1,800 contracts with foreign investors, for a total of HK $11.2 billion pledged investment.87 In January 1983, fully forty percent of the total foreign investment in China was concentrated in Shenzhen, an amazing figure given the zone's geographic size.88 Shenzhen's foreign ventures now cover not only residential and tourist projects, but also a broad range of industries, including electronics, textiles, building materials, foodstuffs, clothing, and chemicals.89 Shenzhen's contribution to technology diffusion also seems at least statistically impressive; by July 1983, it had established over four hundred joint enterprises with cities and provinces elsewhere in

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84. Gelatt, *supra* note 4, at 170.
89. Liang Xiang, *supra* note 54, at W7; *Special Economic Zones, supra* note 74, at 62.
Moreover, dispute resolution procedures and implementation of the SEZ legislation in general may improve with the growth of a judicial infrastructure in Shenzhen, consisting to date of courts, a legal consultation center staffed by attorneys, a judiciary bureau, and a notary public department.

Obviously buoyed by these achievements, some voices within China have clamored for a vastly enlarged future role for all SEZs. Some envisage the zones as:

- Wide gates that open China to the world and . . . the world to China. They must be pivotal points for economic and technological cooperation between China and all countries and areas of the world . . . the centers of international trade . . . international finance . . . international economic and technological cooperation.

In fact, the SEZ concept has already been pronounced successful enough by key domestic political forces to expand elsewhere. Certain preferential foreign investment incentives that previously distinguished the SEZs have now been extended to such areas as the immense and richly endowed Guangdong island of Hainan, the interior autonomous region of Guangxi and, more recently, to fourteen coastal cities, including parts of China's industrial giant, Shanghai.

On closer inspection, however, this picture of success and expansion reveals many troubling problems which cloud the future viability of the SEZs. First, of Shenzhen's HK $11.2 billion in pledged investment, only about one-fifth has actually been expended in the zone. Construction has begun on only half the residential projects on which Shenzhen's overall pledged investment remains disproportionately concentrated. Also, non-residential investment is still confined largely to short-term processing and assembly projects.

94. Liang Xiang, supra note 54, at W6.
95. Fung, supra note 88, at 5.
Probably the key obstacle to Shenzhen's long-term success is its still overwhelming financial dependence on Hong Kong. To date, Shenzhen's financial health remains directly dependent upon infusions of capital from the British crown colony. It seems highly unlikely that the SEZ could survive the flight of billions of Hong Kong dollars, which is sure to accompany the colony's return to China in 1997, absent rapid and dramatic success in attracting non-Hong Kong investment into Shenzhen.

Turning from Shenzhen to the other zones, more problems are immediately apparent. Zhuhai and Shantou have had only modest success in attracting foreign investment, and Fujian's Xiamen is still struggling to complete the massive infrastructural transformation prerequisite to industrial development.96 Some of the delays plaguing the development of zones outside Shenzhen may also be the result of a lack of internal political consensus on overall zone policy. There are indications that Hainan Island's proposed preferential terms for foreign investment were rejected by the Guangdong provincial government for what was viewed as unfair undercutting of terms offered by other, formally constituted Guangdong SEZs.97 Similarly, the unusually long delay in national adoption of SEZ legislation proposed in March 1982 by the Fujian Provincial People's Congress is plausibly the product of high-level bureaucratic opposition. Fujian, after all, had boldly attempted to bolster its zone's competitive position with innovative investment incentives more attractive than those enumerated in the Guangdong legislation.98

Ironically, while internal political wrangling delays the appearance of legislation badly needed to promote investor confidence in all SEZs, the PRC has itself sanctioned a major trend which promises to have a far more threatening long-term impact on zone viability than would any minor interzone legislative variations. As discussed above, the PRC is now allowing the spread outside the SEZs of various foreign investment incentives previ-
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ously unique to the zones. For example, areas outside the SEZs now offer the zones' preferential fifteen percent tax rates for foreign ventures, and, more recently, Beijing has sanctioned the existence in non-SEZ coastal areas of wholly owned foreign enterprises. With the diffusion of these investment incentives to hinterland areas such as Shanghai, with its vastly superior infrastructural facilities and its sophisticated labor pool, the continued "special" role and relative economic attractions of the Special Economic Zones are inevitably thrown into question.

There remains a final overarching threat to the SEZs' long-term potential for success. An authoritative study based on the decade-long experience of many Third World nations has recently questioned whether export-processing or free-trade zones actually contribute to national economic development. Prepared in 1983 as a working paper for the International Labour Organisation, the study concluded that export-processing zones seldom fulfilled national aspirations for technology transfer, foreign exchange earnings, and job creation. The same study suggests that the hardest test for China's SEZs lies in the future, when Beijing will have to evolve strategies to cope with pullouts by fickle multinational investors. Other modernizing nations have found that large-scale foreign investment in export-processing zones tends to move quickly to greener pastures once initially low labor and land costs rise and once tax holidays end.

The PRC has indicated only sparsely its awareness of this broad critique of the SEZ concept. Yet occasional warning voices have been raised, showing that some educated observers in the PRC already doubt that the SEZs can fulfill the ambitious, multiple roles accorded them by an optimistic Chinese government in its plans for modernization. Future legal guidelines, if carefully formulated and dependably implemented, may go far toward steering China's SEZs around the severe problems encountered elsewhere. Should such legislation fail, however, these now isolated internal critics could find themselves successful in downgrading or even eliminating the PRC's bold "experiments with capitalism."

100. See Maex, supra note 8.
101. Id., at 88, 91.
102. Id.
103. A strongly worded critique of the SEZ concept is presented, for example, by Tang Huai in China's Special Economic Zones as Seen from Conditions in Export Processing Zones in the Developing Countries and Areas, Jingi Yanjiu, Beijing, No. 6, June 1981, reported in JPRS No. 78743, Econ. Aff. No. 160, Aug. 11, 1981, at 11–12.