

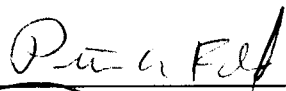
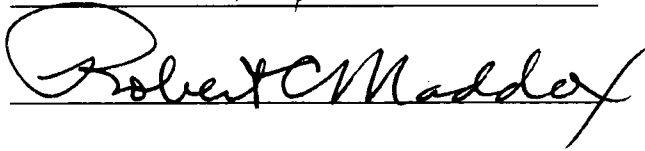
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I am submitting herewith a dissertation written by Jianxin Huang entitled "Special Zoning Strategy In The People's Republic of China, A Case Study: State's Capacity and Foreign Investment Policy Implementation." I have examined the final copy of this dissertation for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, with a major in Political Science.


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We have read this dissertation
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Accepted for the Council:


Associate Vice Chancellor and
Dean of The Graduate School

**SPECIAL ZONING STRATEGY
IN THE PEOPLE'S REPUBLIC OF CHINA:
STATE CAPACITY AND POLICY IMPLEMENTATION**

A Dissertation
Presented for the
Doctor of Philosophy Degree
The University of Tennessee, Knoxville

Jianxin Huang
May 1998

DEDICATION

This dissertation is dedicated to

My wife, Zhe, & my daughter, Eugina

and

My parents in-law, Mr. & Mrs. Yang

Who led me to a new direction of life.

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My final acknowledgments are to my wife, Zhe Yang, and my daughter, Eugina, and must be of a different but not less important sort. Their endless support offset the frustrations I have experienced over the past years, and their love will help me fulfill other goals in my life.

ABSTRACT

Foreign direct investment (FDI) plays an important role in socio-economic development in developing countries. After WWII, most developing countries have utilized a special zoning strategy (SZS) -- Free Trade Zones, Export Processing Zones, etc. -- to attract FDI and to propel their economic takeoff.

In the development literature, there have been three major competing arguments concerning special zoning and foreign capital's role in socio-economic development: liberal (or Neo-classical), Marxist (or Neo-Marxist), and statist. Liberal and Marxist approaches do not provide satisfactory answers to different causes and results of SZS in different countries. The statist approach tries to ease the tension between the two approaches by focusing on the state's role in socio-economic development, and applies a new dimension of research, i.e., state capacity, to the research. However, there have been few studies specifically focusing on SZS in developing countries.

This research adopts the third approach -- the statist approach -- to provide a case study about China's SZS and its state's role in foreign investment and socio-economic development in the perspective of political economy. It describes the effectiveness of FDI policy and SZS implementation, and contends that state capacity is a major determinant for the state to play an important and positive role in social-economic development. The author defines China as a strong state which can use its various capabilities to utilize SZS.

Variables used to measure the state control capability include "general state capacity" and "particular state capacity," which consist of six indicators.

The findings show that a developing country with a relatively strong state capacity can play a positive role in handling foreign capital inflow by using SZS. The China case provides an alternative route towards development which eases the tension between two opposite theories (Neo-Classic and Marxist theories) in political economy. It also provides a supplement for the Statist approach to development. That is, not only should a state intervene in socio-economic development in developing countries, but a state also needs to possess state capacity to implement the policies and fulfill the development goals. China's success in opening up to the outside world and maintaining its economic development under a relatively stable political condition shows that the state plays an important role in foreign investment and socio-economic development. Furthermore, a relatively strong state capacity provides a base for the state's positive intervention in FDI policy and SZS implementation.

TABLE OF CONTENTS

CHAPTER	PAGE
I INTRODUCTION	1
1.1 BACKGROUND	1
1.2 PERSPECTIVE: THE POLITICAL ECONOMY OF SPECIAL ZONING STRATEGY IN CHINA.....	8
1.3 RESEARCH METHOD	14
1.4 CHAPTER OUTLINE	15
II SPECIAL ZONES IN THE WORLD AND CHINA	18
2.1 THE CONCEPT OF SPECIAL ZONE	18
2.2 THE EVOLUTION OF SZs IN THE WORLD AND CHINA	21
2.2.1 The Evolution of Special Zones in the World	21
2.2.2 The Evolution of Special Zones in China	22
2.3 THE UNIQUENESS OF CHINA'S SZs	25
2.3.1 General Goals and Functions of SZs In The World	25
2.3.2 Uniqueness of Chinese SZs: Multiple Goals and Functions	28
2.4 EVALUATION OF SPECIAL ZONING STRATEGY IN CHINA	40
2.4.1 Criteria for Evaluation	40
2.4.2 Effectiveness of China's Special Zoning Strategy	42
2.5 SUMMARY	53
III ANALYTICAL FRAMEWORK: STATE CAPACITY AND STATE ROLE	55
3.1 STATE'S ROLE IN SOCIO-ECONOMIC DEVELOPMENT	55
3.2 STATE CAPACITY	62
3.2.1 State Capacity As A Perspective In Political Science	62
3.2.2 State Capacity And FDI Policy & SZS Implementation	67
3.3 REDEFINING THE CONCEPT AND RELOCATING THE MEASUREMENT	69
3.3.1 Definition of State Capacity	70
3.3.2 Measurement of State Capacity	71
3.3.3 Indicators For State Capacity and SZS Implementation In China	74
IV GENERAL STATE CAPACITY AND UTILIZING SZS	77

4.1 STATE'S CAPABILITY IN PLANNING SOCIO-ECONOMIC DEVELOPMENT	78
4.1.1 The State's Commitment To Modernization In China	78
4.1.2 The State Capability In Planning Socio-Economic Development	84
4.2 STATE'S CAPABILITY IN DEALING WITH INTERNATIONAL NORMS	94
4.2.1 Providing Incentives For Investors	95
4.2.2 Maintaining Policy Stability	99
4.2.3 Economic Co-Operation With Foreign Economies	103
4.3 STATE'S CAPABILITY IN UTILIZING DOMESTIC RESOURCES	106
4.3.1 Domestic Investment In The Zones	107
4.3.2 The Mechanism for Resource Allocation	108
 V PARTICULAR STATE CAPACITY AND UTILIZING SZS	110
5.1 STATE CAPABILITY IN INTERVENING SPECIAL ZONES OPERATIONS	110
5.1.1 Establishing The SZs	111
5.1.2 Administrative Formation	113
5.1.3 Policy Adjustment	116
5.2 STATE CAPABILITY IN DECENTRALIZING POWER	119
5.2.1 Rationale of Decentralization: Power Balance Based On Development Goals	121
5.2.2 Decentralization of Functional Power	125
5.2.3 Mechanism of Central Control Over Local Incompliance	127
5.3 STATE CAPACITY IN DEALING WITH REGIONAL ECONOMIC DEVELOPMENT	
INEQUALITY	139
5.3.1 Rationale Of Regional Policy Differentials	144
5.3.2 State Capability in Dealing with Policy Differentials	147
 VI CONCLUSIONS AND IMPLICATIONS	158
6.1 FINDINGS	159
6.2 THEORETICAL IMPLICATIONS	164
6.3 POLICY AND PRACTICAL IMPLICATIONS	167
 BIBLIOGRAPHY	175
VITA	204

LIST OF TABLES

TABLE	PAGE
1-1 Foreign Capital Inflows into Mainland China	2
1-2 Foreign Trade In China	5
1-3 The Growth Rate of GDP in China	6
2-1 Economic Growth in Five SEZs	46
4-1 Political Freedom and Economic Liberalization	89
5-1 New provincial appointments, 1978-1986	133
5-2 Geographical distribution of FDI in China	140
5-3 Comparison of Population and GDP Between The Three Regions in 1991	141

LIST OF ABBREVIATIONS

CIEC	China International Economic Consultants
EZs	Enterprise Zones
EPZ	Export processing zone
EPZs	Export processing zones
ETDZ	Economic and Technology Development Zone
ETDZs	Economic and Technology Development Zones
FEZ	Free Economic Zone
FEZs	Free Economic Zones
FTZ	Free Trade Zone
FTZs	Free Trade Zones
FDI	Foreign direct investment
HTDZs	High Technology Development Zones
OEZs	Open Economic Zones
SEZ	Special Economic Zone
SEZs	Special Economic Zones
SZ	Special Zone
SZs	Special Zones
SZS	Special Zoning Strategy
TNCs	Transnational Corporations

CHAPTER I

INTRODUCTION

1.1 BACKGROUND

After WWII many countries, especially developing countries, utilized a special zoning strategy (SZS) -- Free Economic Zones (FEZs), Free Trade Zones (FTZs), Export Processing Zones (EPZs), etc. -- to attract foreign investment, encourage exports, and propel their economic development. The strategy has played an important role in industrialization and economic development in both capitalist and socialist countries. The SZS outcomes in different countries raise some important questions: evaluating its role in economic development, examining the variations among different cases and explaining why so.

Like many other developing countries, China adopted an outward-looking policy to resolve the problem of insufficient amounts of foreign capital and to overcome technological and managerial backwardness. Since China promulgated the first far-reaching foreign investment legislation, "the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" at the second session of the Fifth National People's Congress in July 1979 (CIEC, p. 449), the Chinese government has used a variety of means to attract foreign direct investment (FDI). Establishing various Special Zones (SZs) is obviously one very important strategy. Those zones include Special Economic Zones (SEZs), Open Cities, Industrial Zones, Economic and Technology Development Zones (ETDZs), Free Trade Zones (FTZs), EPZs, etc. The first four SEZs (Shenzhen, Zhuhai, Shantou of Guangdong Province, and Xiamen of Fujian Province) were established in 1980. After 15 years of development, SZs have spread over the whole nation.

The outward-oriented economic reforms and FDI policy carried out by the Chinese government have received many positive evaluations in academia. The policy effectiveness is usually examined in three aspects: (1) shift of capital components from indirect investment to direct investment; (2) cumulation of the capital inflow; and (3) impact on the economy. Before 1979, China's foreign capital inflow was basically foreign aid and loans. After 1979, the ratio of foreign aid and loans to total foreign capital inflows has dropped sharply, while FDI has increased in a steady pace (Table 1-1 and Figure 1-1).

**Table 1-1. Foreign Capital Inflows into Mainland China
1979-1993**

Unit: billions US\$

Year	Total	Foreign Loans		Actual FDI		Others	
		Amount	%	Amount	%	Amount	%
1979	2.739	2.513	91.7	0.109	4.0	0.117	4.3
1980	3.383	2.893	85.5	0.195	5.8	0.295	8.7
1981	4.220	3.720	88.2	0.375	8.9	0.125	2.9
1982	2.298	1.745	75.9	0.440	19.1	0.113	5.0
1983	1.981	1.065	53.8	0.636	32.1	0.280	14.1
1984	2.705	1.286	47.5	1.258	46.5	0.161	6.0
1985	4.647	2.688	57.8	1.661	35.7	0.298	6.5
1986	7.258	5.014	69.1	1.874	25.8	0.370	5.1
1987	8.452	5.805	68.7	2.314	27.4	0.333	3.9
1988	10.226	6.487	63.4	3.193	31.2	0.546	5.4
1989	10.059	6.286	62.5	3.393	33.7	0.381	3.8
1990	10.289	6.535	63.5	3.487	33.9	0.268	2.6
1991	11.554	6.888	59.6	4.366	37.8	0.300	2.6
1992	19.202	7.911	41.2	11.008	57.3	0.284	1.5
1993	36.773	10.750	29.23	25.759	70.1	0.264	0.7

Source: Calculated from data presented in China Statistical Yearbook, various issues.

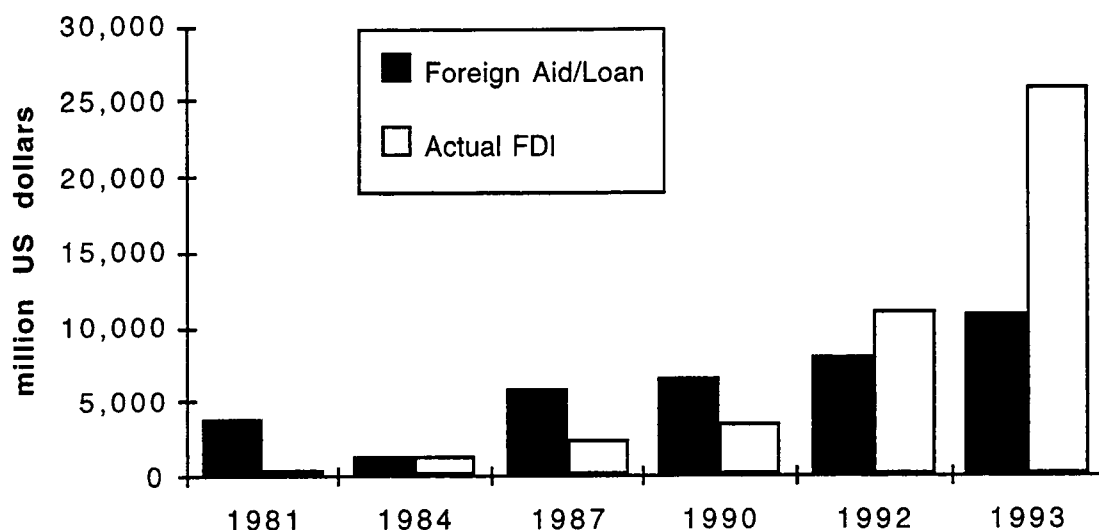


Figure 1-1 Increase of FDI in Foreign Capital Inflow, Selected Years

(Created from Table 1-1)

We can see from Table 1-1, that the initial response by foreign investors to the opening of China was much less than enthusiastic. However, the proportion of FDI steadily increased from 1983 to 1993. From 1979 to the end of 1981, actual FDI amounted to only \$679 million, less than 7% of all foreign capital inflows during the period. During the next three years, 1982-84, China was somewhat more successful in attracting FDI (about \$2.3 billion). The growth in FDI did not really begin to accelerate until after the mid-1980s, when a variety of measures were adopted to improve the investment climate in China. The actual realized total FDI in 1985-87 was more than \$5.8 billion, representing 29% of China's \$13.5 billion total for foreign capital inflows. The actual realized FDI in 1988-90 totaled \$10.0 billion -- almost double the amount of 1985-87. The growth of actually realized FDI accelerated in 1991-93, and \$41 billion was invested in China during this period. During 1979-93, China absorbed a cumulative total of nearly \$60 billion in actual realized FDI, accounting for 44.2% of China's impressive total foreign capital

inflows of \$135.7 billion. This further emphasizes the importance of FDI among all sources of foreign capital inflows. It is useful to notice that the actual realized FDI in 1993 totaled \$25.7 billion, which doubled the amount of actual realized FDI in 1992, and was about 43% of the total actual realized FDI through the entire 1979-93 period. Over the first ten years of opening up, FDI reached about US \$20 billion, increasing at an average annual rate of about 30% (Grub & Lin, 1). In 1993, \$26 billion of foreign capital flowed into China, ranked second only to the United States which received \$32 billion in foreign investments in the same year (Los Angeles Times). In 1994 and 1995 respectively, more than \$33 billion and \$38 billion of FDI were poured into China (The World Bank, 1996a, 110). From 1979 to 1996, pledged FDI amount in the same period was \$469 billion and actual FDI was \$176.5 billion. From 1993 to 1996, four years in a row, China received the most FDI among developing countries (People's Daily, Overseas Edition, 1997, May 3, p. 2).

Indeed, in the first five years after China opened its door to the outside world, only 188 joint ventures were established in China (Ji, 46-51). In 1987, some 4,000 foreign ventures were in operation. By the end of 1989, the Chinese authorities had approved agreements for 21,800 foreign ventures involving some \$33.8 billion foreign capital (People's Daily, 1989, November 8, p. 1). Over 10,000 of these ventures with \$15.5 billion investment commenced operation, including joint as well as wholly owned ventures (Wagner, 7-11; People's Daily, 1990, September 6, p. 1). From 1979 to 1996, China approved 283,380 foreign funded projects (People's Daily, Overseas Edition, 1997, May 3, p. 2).

The effectiveness of the economic reform and foreign investment policy can also be seen in the area of foreign trade. During the first ten years of the open-door policy, China's foreign trade rose by an impressive 300%, an unparalleled increase for any centrally planned economy and for most emerging economies of the world (Grub & Lin, 1). After

1989, according to International Monetary Fund, foreign trade has steadily increased (Table 1-2).

Table 1-2 Foreign Trade In China
Selected Years
 (Billion of US\$)

	<u>Year</u>		
	<u>1989</u>	<u>1992</u>	<u>1995</u>
Exports	52.92	85.49	148.76
Imports	59.13	81.84	132.01
Total	112.05	167.34	280.76
% change*	+17.9%	+47%	+37.3%

* The percentage change from the previous year.

Source: International Monetary Fund, Direction of Trade Statistics Yearbook, 1989-95.

Many assert that foreign capital inflows have played a relatively more significant role in accelerating economic development than the other variables (Chen, Chien-Hsun, pp. 64-66; Chen, Chang, and Zhang, pp. 691-703). Chinese economic development is very impressive: The average annual growth rate of real GDP in China from 1985 to 1995 is close to 10% (Table 1-3). Personal income increased from about 500 yuan in urban areas in 1982 to over 1,800 yuan in 1992. Household savings increased steeply, from about 60 billion yuan in 1982 to 1,150 billion yuan in 1992 (The Wall Street Journal, p. R12). Its GDP per capita in 1994 reached \$530 (Asian Development Bank, p. 204) from \$300 in 1979. As to the debt and foreign currency reserve, in which many developing countries were caught, China's total debt in 1996 was \$116 billion, which was an increase of 9% of 1995 debt. The pace of increase was very slow in terms of its capital inflow at the same

period. Foreign currency reserve was \$105 billion, which was an increase of \$31.4 billion from the previous year. Seven years ago, foreign currency reserve was only \$10 billion. China has a relatively strong payment ability, which provides a good base for absorbing more FDI (People's Daily, Overseas Edition, 1997, January 15 and 28). By the International Monetary Fund's reckoning in 1993, China already was the world's third-largest economy, although the way of calculation is disputable thus far (House, p. A1).

Table 1-3 The Growth Rate of GDP in China:
1985 - 1995

<u>Year</u>	<u>% change</u>
1985	12.9
1986	8.5
1987	11.1
1988	11.3
1989	4.3
1990	3.9
1991	8.0
1992	13.2
1993	13.4
1994	11.8
1995	10

Source: United Nations, World Economic and Social Survey, New York, 1995, p.301.

In order to contain the overheated economy, the Chinese government utilized a macro-control strategy, characterized with a tight monetary policy, and achieved a soft landing in 1995. Output growth slowed from the 13% pace sustained in the three years prior to 1995 to 10% in 1995. Consumer price inflation, which peaked at 24% in 1994, came down to 17% in 1995. The official forecast for annual GDP growth is 8-9% for 1996-2000, while inflation is targeted at less than 10% (The World Bank, 1996b, p. 56). In 1996, the government's macro control economic growth rate target was 8%, and the inflation rate was 10%. The actual growth rate was 9.7%, and the inflation rate was 6.1%, both of which were better than expected (People's Daily, Overseas Edition, 1997, January 22, p. 2).

There is not doubt that developing a country by attracting FDI is not an easy task for any developing country. Surprisingly, China has achieved a spectacular result in the short period of about 15 years. More interestingly, this is realized in a country with a highly-centralized political system and socialist ideology. Some scholars name this situation "economic reform without political reform." (Shirk, 1994). Amazingly enough, all these achievements are accomplished under the leadership of the Communist Party of China, which, according to its principles, is supposed to build a "communist country," instead of accepting a capitalism-oriented market system.

Although China's success still remains arguable, this old, agriculture-based, highly centralized, less developed, and socialist country has turned to be one of the fastest growing countries in the world. How does the Chinese government develop its economy by opening up the door, attracting FDI, and utilizing the SZS? What role does the Chinese state play in the process of this development?

This study attempts to provide a case about the state's role in foreign investment and socio-economic development by specifically analyzing SZS in China. It describes the utilization of SZS and FDI policy formulation and implementation, and examines the state

role to show the importance of the state's intervention in social-economic development in the People's Republic of China. It also tries to answer this important, but oftentimes overlooked, question: why some states like China's can play an important role in their countries' development while many others cannot. Several aspects are discussed and explored: the concept of special zoning or special zoning strategy; the evolution of special zones in the world and China; the uniqueness of China's special zones; the overall effectiveness of the strategy; the role the Chinese state plays in socio-economic development by using this complex SZS; the relationship between the state's role (intervention and control) and state capacity; and finally, and most importantly to this research, the factors reflecting state capacity in carrying out SZS and foreign investment policy in China. In a broader sense, the research provides an analysis of using SZS as one of the tools for foreign investment policy implementation and opening up the country in China in the perspective of political economy; that is, the interactions between politics and economy and between state and market.

1.2. PERSPECTIVE: THE POLITICAL ECONOMY OF SPECIAL ZONING STRATEGY IN CHINA

In the literature of foreign investment and special zoning policy, there have been three major groups of competing arguments concerning special zoning and foreign capital's role in socio-economic development: Liberal (or Neo-classical), Marxist (or Neo-Marxist), and Statist. The debate usually focuses on whether involvement of capitalist firms in developing economies fosters "modernization," "stagnation," or "dependency," and whether SZs are beneficial or harmful for the economic, social, and political development in developing countries (Gereffi, 1983; Biersteker, 1981).

The liberal approach emphasizes the positive aspects that foreign investment and SZs can bring to host countries. According to the Neo-classical economic perspective on economic development, FEZs provide exceptional opportunities to improve free market activities and to exploit comparative economic advantages. Focusing primarily on FEZs in industrialized market economies, Grubel (1982, pp. 46-47) emphasized FEZs as a useful instrument for selective deregulation to reduce the costs to all regions of a country resulting from total regulation (e.g., tariffs), thus "permitting in principle the development of an optimum pattern by regions." Extending the notion of selective deregulation to EPZs in developing market economies, Spinanger (1984, p. 65) argued that EPZs represent a second-best solution (the first option being complete free trade) for a country to integrate into the international economy without subjecting the entire economy to trade liberalization. Spinanger also suggested that EPZs produce benefits for the host country by attracting foreign investment, generating employment, increasing exports, and promoting domestic economic linkages via technology transfer and the use of local materials. In general, Neo-classical economic theory has a sanguine perspective that the deregulated economic environment of FEZs allows the zones to produce benefits locally and lead to a gradual and diffusive process by which these benefits could spill into the domestic sector. Generally favorable views of EPZs are also found in Basile and Germidis (1984), Dove (1977), Rabbani (1983), Vittal (1977), and Wong and Chu (1984).

The Neo-Marxist theory argues that foreign investment is not beneficial to host country development. Rather, transnational corporations (TNCs) capture a large share of the benefits of foreign investment at the expense of host countries. Many early postwar Latin American critics of foreign investment believed that the path of a host country's development would be conditioned solely by its place in the international economy and that extensive foreign control of the economy would lead to stagnation (Dos Santos; Cardoso; Evans, 1979; Palma; Biersteker, 1987). Immanuel Wallerstein's concept of "world system"

brings about the issue of isolation or independence, control or liberation, which focuses on the influence of economic relationships on state behavior and the importance of a country's role in the global market economy. In the capitalist world-system, countries are identified in terms of their role in this division of labor as dominating "core," ambiguous "semi-periphery," or exploited "periphery" (Wallerstein, 1974a). This concept in a sense raises critically important questions for all developing countries about the costs and benefits of their choosing to integrate their economies into the world market. This choice is especially difficult for socialist countries when considering integrating their economies into the *capitalist* world market (Ness). In the view of dependency/world-systems perspectives, SZs such as EPZs represent a typical situation of dependent economic development. The concessions and incentives offered in EPZs allow core-country investors to benefit disproportionately from cheap local labor and low taxes. The zones in peripheral countries become export enclaves dependent on foreign investment and unfavorably integrated into the globalized manufacturing process controlled by transnational corporations without creating healthy ties with the domestic economy. Critics of EPZs (Fröbel, Heinrichs, and Kreye; Hone; Kei; Morello; Safa; UNCTAD, 1983) also focused on such undesirable characteristics and consequences as excessive waste in infrastructure provision, fragmented production process, limited job creation, gender wage inequality, exploitation of the indigenous labor force, harsh factory conditions, lack of technology transfer, vulnerability to footloose industries, and a lack or absence of forward and backward linkages.

To ease the tension between the aforementioned two approaches, the third approach (i.e., state-oriented approach) is used to account for the effectiveness of foreign investment and special zoning strategy in developing countries. Perhaps the earliest view of the potential for a positive state role in economic development is the classic Gerschenkron study (Gerschenkron). This approach explains how SZS can be better utilized and how FDI can be better guided. Their undesirable consequences can be minimized through

appropriate policy and effective regulation by the host government. In the 1970s, studies of foreign investment in developing capitalist countries began increasingly to focus on the capacity of host states to formulate and implement controls over foreign investment (Biersteker, 1987; Cardoso; Evans, 1979). These studies identified a variety of possible regulatory mechanisms, including taxes, limits on foreign currency flows, restrictions on joint venture sales in the domestic market, requirements for local ownership and management, monitoring of technology transfer, and state approval at various stages of the investment process. Many policy makers in developing countries, particularly in the 1970s, also had similar points. Although these leaders believe that foreign investment produces some negative results, they have found the potential benefits of such investment -- as a source of capital accumulation, advanced technology, management skills, and access to international markets -- to be significant. They have attempted to limit the negative effects by establishing controls over a wide range of variables (Gerreffi, pp. 23-24) to provide protection for healthy socio-economic development in host countries. It also argues that the state is capable of playing a leading or guiding role in economic development. This role, however, varies across developing countries in terms of: a) the state's commitment toward development; b) its strength to bargain with TNCs; and c) its ability to mobilize and coordinate domestic resources (Evans and Stephens). This perspective also points to the state's initiative in setting up SZs and its capacity to intervene in their operation (Chang, Wei; EPZA; MOEA; Park).

Many of these same studies of capitalist developing economies, however, showed that host states in these countries had considerable difficulty formulating and implementing effective controls over foreign investment. That is, those states were not able to play a positive role in socio-economic development and to provide an effective intervention in foreign investment activities. It is argued that the weaknesses in state capacity vis-a-vis TNCs came from forces within the host country itself. Some studies have implicitly or

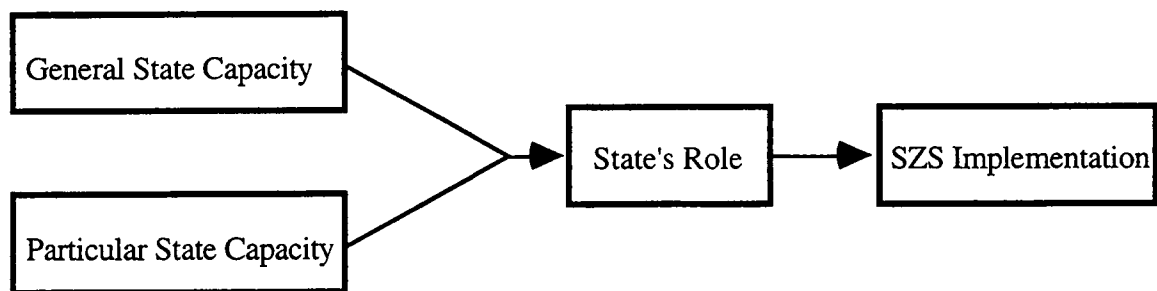
explicitly suggested that socialism in some form would overcome the problems experienced in capitalist developing countries. Influential dependency writers from Latin America have also prescribed socialism (Cardoso, pp. 213-214). Other writings from a dependency perspective suggest socialism, but less as a way of controlling foreign investment than breaking the ties with the capitalist world economy (Biersteker, 1987, p. 29). Even if there is no explicit call for socialism, strong state control is often the goal of critics of foreign investment (Evans, 1979, p. 278).

These three aforementioned theoretical perspectives offer different interpretations of the evidence on the impact of SZs and FDI on economic development and state's role in the process of the industrialization. FDI policy and SZS implementation in China over the past 15 years can also be explored from these perspectives, reflecting a tension between encouraging foreign business activities and maintaining state control over them. However, China's experience also represents an alternative to the first two aforementioned extremes. Thus, this study adopts the third approach (the statist approach), to explore the China case in the perspective of political economy: specifically in the relationship between the state and the market, and the state's capacity and role in socio-economic development. It is first to find the uniqueness of the Chinese case in utilizing SZS. And then, with a positive evaluation of SZS in China, the study explores the rationale of the state's control over foreign investment activities, and the state capacity that enables the government to play a positive role and impose an effective intervention in the foreign investment policy formulation and implementation. It emphasizes the state's strength and ability in controlling FDI and utilizing SZS. The study attempts to show that China is a strong state which can use its various capacities to increase the benefits and reduce the costs to the country's socio-economic development in changing international and domestic conditions. In other words, it is not only concerned with whether a state should or would play a positive role, but also concerned about a state being able to play that kind of role in FDI and SZS

implementation and its socio-economic development. Why can some states provide positive role in development while some others cannot? To what degree should a state intervene in economic activities according to its own political and economic situations? Focusing on the state capacity as a crucial variable, this study tries to provide a case which is useful to help answer these questions, and to offer a supplement to the literature of statist approach to the issues of special zoning, FDI, and thus socio-economic development.

In short, this study contends that effective SZS implementation depends on state's role or state intervention, and effective state intervention depends on state capacity. Six indicators show that China has a relatively strong state capacity in terms of SZS implementation (see Chart 1-1).

Chart 1-1 Relationship among SZS, State's Role, and State Capacity



<i>General State Capacity:</i>	<i>1. Planning socio-economic development; 2. Dealing with international norms; 3. Utilizing domestic resources.</i>
<i>Particular State Capacity:</i>	<i>1. Intervening special zones operations; 2. Decentralizing power; 3. Dealing with regional development inequality.</i>
<i>State's Role:</i>	<i>Various direct and indirect government interventions in development.</i>
<i>SZS Implementation:</i>	<i>Measured by policy outcomes against original goals and functions.</i>

1.3. RESEARCH METHOD

Although the literature on SZs and FDI policy in developing countries is quite extensive, four types may be distinguished: descriptive analysis, case studies, cost-benefit analysis, and theoretical analysis. The majority of the literature belongs to the first type, including studies conducted by international bodies and organizations, and provide comprehensive surveys of issues and problems related to SZs such as conceptualization, objectives, performance, and developmental impact (UNCTAD, 1985, 1993; UNCTC, 1991; UNIDO; ILO & UNCTC; and the World Bank, 1992).

This research is a single case study, which adopts conceptualization and analytical approach by using historical evidence and aggregate data. Chapter Two is about general aspects of Chinese SZS evolution and its evaluation and basically is descriptive. Chapter Three is to provide an analytical framework for the explanatory part which forms chapters Four and Five.

Data used in these analyses came from various sources and were collected through a systematic review of a major English publication: Foreign Broadcasting Information Service (FBIS), covering the period from 1980 to 1996. Other sources used in this study include government documents and information, scholarly articles and books, statistical source publications, etc., both in English and Chinese. Specifically they are: (1) books, newspapers, and journals published in China; (2) statistical sources published by two Chinese government agencies, the State Statistical Bureau and the Ministry of Foreign Economic Relations and Trade, provided increasingly reliable and usable summary statistics; (3) non-Chinese journals and newspapers, such as *The Wall Street Journal*, and *Far East Economic Review*; (4) relevant academic literature of FDI and SZS from a variety of sources in English; and (5) other documents and data from organizations like United Nations and International Monetary Fund.

1.4. CHAPTER OUTLINE

After the introduction, which serves as Chapter One, Chapter Two is set to discuss the overall evolution of SZs in the world as well as China, and to evaluate the SZS in China. It defines the concept of "special zones", and describes the evolution of SZs in the world and China. It also sorts out the differences and uniqueness of China's SZs compared to other zones in the world. Unlike most SZs in the world which focus on encouraging export and thriving foreign trade, China's SZs has multiple goals. Taking these factors into account, the evaluation criteria taken in the research is different from conventional ones. The author argues that the strategy overall has been successful so far, although it still has some problems remaining to be solved. The uniqueness, complexity, and effectiveness of SZS in China lays a basis for the question: How can China fulfill these tasks?

Chapter Three will lay out an analytical framework. It discusses in detail statist theory and approaches to the issue, defines the concepts of "state role" and "state capacity", and confines the dimensions and indications in analyzing/measuring state capacity in China. Focusing on the political economy of foreign economy policy, particularly the relationship between state's role and utilizing SZS in China, it projects the major proposition of this research: the reason China has been able to use this unique SZS effectively is rooted mainly in its state's relatively strong state capacity.

Chapters Four and Five examine six aspects to show the Chinese government's capabilities in dealing with foreign investment and using SZS: planning socio-economic development, dealing with international investment norms, motivating and allocating domestic resources, intervening in SZs' operation, decentralizing power, and coping with local economic inequality.

Chapter Four explores state capacity at general levels. Three factors will be examined: planning socio-economic development, dealing with international norms, and utilizing domestic resources. These three factors consist of basic state capacity for a state to play a positive role in developing its society and economy by attracting FDI and integrating its economy into the global one. They can be seen as a base for opening up the country and for economic reform as a whole.

Chapter Five explores state capacity in a specific aspect: special zoning. Another three factors will be examined: intervening special zones, decentralizing power, and coping with local inequality. These three factors reflect specific state capacity used to examine the state's role in dealing with SZ development. Some of them are unique Chinese phenomena, such as decentralization and local inequality, because of China's huge geographic and population size, and previously highly centralized power. Different from the first three indicators for state capacity, they are more related to SZS in particular.

Chapter Six concludes with the findings which show that the state in a developing country can play an important role in socio-economic development by attracting foreign capital and using SZS and integrating its economy into the global one. However, a strong state capacity is a prerequisite for a positive result of government intervention in foreign economic activities. Some developing countries cannot fulfill development goals, as many researchers noticed, because they lack strong state capacity, while some can. The Chinese case represents the latter. The success of China's opening-up to the outside world and maintaining its fast economic development under a relatively stable political-social condition shows that the state is able to play a positive role in foreign investment and socio-economic development without losing control of the political agenda.

It also summarizes the theoretical implications of the current research to explain the state-market relations in terms of SZS in China. The uniqueness of the China case provides an alternative route towards development which can ease the tension between the two

competing theories in political economy. Neither Neo-Classical nor Marxist theories fit the Chinese situation. While the Chinese case favors the third approach, the state-oriented approach, the study further suggests that researchers need to focus more on the state capabilities in FDI policy and SZS formulation and implementation, rather than on the state's role itself. Furthermore, in evaluating SZS, researchers need to put the issue in a specific place and time. In this sense, the Chinese experience should not be generalized to apply to any other socialist economies and developing countries. It is only a case in a specific situation and location (country).

Some policy implications are also made in terms of China's long term socio-economic development and its deep economic integration with the international economy. Although a strong state might help in formulating and implementing development policies, it is still potentially dangerous to have pitfalls in the process of further integration of China's economy into the global economy, and overall development in the society. Because strong state capacity can have negative effects on policy making, precautions should not be overlooked. The statist approach should not be overemphasized, nor the state capacity in China overestimated.

CHAPTER II

SZs IN THE WORLD AND CHINA

First of all, it is necessary to clarify the meaning of "special zone" in this chapter. Also, the evolution of SZs in the world and China is introduced, the uniqueness of Chinese SZs is analyzed, and the evaluation of the strategy in China is offered.

2.1. THE CONCEPT OF SPECIAL ZONE

In the literature of FDI, there are many different terms used to describe those zones specifically designated for foreign investment, export, trade, etc. The commonly seen forms of zones include EPZs, FTZs, SEZs, and "Industry Zones".

In most cases, researchers tend to use a specific term to describe a type of zone. Some researches try to bind several different types of zones under the term: FTZs (including EPZs, Free Ports, Enterprise Zones, and Free Banking Zones with some differences in their characteristics [Osborne, p. 75]).

Although EPZ is one of the FTZs according to this typology, EPZ is probably the most frequently used term in the literature, which can be defined as an industrial enclave that engages in export manufacturing with the assistance of foreign investment and enjoys preferential treatment (UNCTAD, 1993). However, the concept of EPZ is still vague, because there are at least 20 different but virtually synonymous terms to describe EPZs: customs zone; customs-free zone; duty-free export-processing zone; export-free zone; export-processing free zone; foreign trade zone; free economic zone; free export-processing zone; free export-processing zone; free export zone; and free production zone (UNCTC, 1991, p.3).

An analysis points out that, although so many terms have been used, several similar characteristics can be found in these zones. First, these zones are industrial estates which form enclaves within the national customs territory and are usually situated near an international port and/or airport. Second, the entire production of such zones is normally intended for export. Third, imports of raw materials, intermediate products, and equipment and machinery required for export production are not subject to the payment of customs duty. Fourth, time-consuming customs procedures on import into the zones and export from the zones is kept to a minimum. The main purpose of creating EPZs by developing countries is to promote the development of export-oriented manufacturing industries. Foreign investment is expected to provide the main impetus, while investors in EPZs benefit from fiscal and financial incentives. Other objectives could be: (a) generating foreign exchange earnings; (b) creating employment; (c) attracting foreign capital and advanced technology; (d) acquiring and upgrading labor and management skills; and (e) creating linkages between EPZ industries and the domestic economy, and experimentation with new industrialization strategies (UNCTAD, 1985. p. 4). This typological analysis shows that the defining characteristics of those zones are similar, with some differences among them mainly regarding their claimed objectives. Perhaps that is a major reason why most scholars and researchers tend to use EPZ as a general concept to cover a variety of such zones in the world. However, it still sounds awkward to use "EPZ" to generally describe these zones, because an EPZ is basically export-oriented, and other objectives are secondary to this main function. It also emphasizes export manufacturing too much to describe characteristics of other zones in a general sense. Since those aforementioned SZs are common in characteristics, it is possible for this study to find a better term to cover these zones.

Regarding China's SZs, although they originated from FTZ or EPZ, they are not exactly as the same as those zones in other countries. Also, China has created many

different types of zones, such as SEZs, Open Cities, and ETDZs. Using a specific term to describe so many different zones, as many studies do, is a hard task, because it can not portray the whole picture of SZs in China. Therefore, it is not appropriate to use EPZ to describe the zones in China, as most researchers tend to do, because export manufacturing is only one of the objectives for most Chinese SZs.

Some studies like to use SEZ to describe the Chinese special zones. However, SEZ in China has very strict meaning, which refers to the original four SEZs and Hainan Island SEZ. The Chinese SEZs are formally defined as "a small area demarcated within a country's territory and suitably insulated for adopting special and flexible policies in external economic activities to attract and encourage foreign investments . . .," "a special economic area open externally and insulated domestically", where "the market economy becomes the dominant law of value . . . foreign investors own the means of production, employ capital to exploit the workers, and take possession of part or the bulk of the fruit of labor without compensation" (Human Geography, pp. 68-9). It means they are not only different from EPZs in other countries, but also from all other major constructions in the past in that they are separated from the rest of the adjacent territories by what is known as the "second line", a quasi-political boundary. There are many other types of zones which have similar characteristics as SEZs but perform different functions. In other words, one has to recognize that territories with the formal title of SEZ and those with only SEZ policies and measures belong to two different categories.

Trying to solve this problem, the study uses a more general term, "special zone" (SZ), as a concept to describe those specially designated zones everywhere. As a concept, "special zone" or "special zoning" is not commonly used in the literature. The aforementioned typological analysis shows there are two important aspects in defining the concept related to special zones: characteristics and purposes. Summarily, all those SZs in the world usually have the following characteristics: industrial estates; enclave-forming;

within the national customs territory; situated near an international port and/or airport; custom-free for imports required for export production; export-oriented; cheap utilities and labor; better infrastructure; streamlined administration, such as minimum customs procedure on import and export; incentives for FDI, etc. Their purposes include: promoting the development of export-oriented manufacturing industries; attracting FDI; earning foreign exchanges; promoting export; promoting national or regional development, industrialization and modernization; encouraging technology, labor, and management skills transfer; promoting linkage; conducting experimentation, creating employment, etc.

Therefore, based upon their major characteristics and purposes, a broader definition is used in this study. *"Special Zone" refers to physical and administrative areas which are specially designated by the host government. Attracting foreign investment and encouraging export are usually their main purposes, and some other goals also possible. These zones are treated by the central government as a necessary and important step leading to foreign investment inflow and special policies usually applied to these areas.* In dealing with foreign investment and opening up the country to the outside world, "special zoning" as a strategy has been used by the Chinese government to develop its economy.

2.2 THE EVOLUTION OF SZs IN THE WORLD AND CHINA

2.2.1 The Evolution of SZs in the World

Well before China launched the program of SZs in 1980, many countries were already operating "special zones." Apart from the free ports, which can be dated back to ancient Roman times (Kreider, pp. 43-44), the first pioneer of the modern SZs with export processing as its major economic activity was that established in Ireland at the Shannon International Airport in 1956. It was in the developing countries, however, that the concept found its real "market." Since the 1960s, more and more developing countries have

implemented export-oriented growth strategies to promote industrialization and modernization. SZS is one of the most important means they used to attract FDI and obtain other benefits from integrating their economies with the international economy. From the birth of the world's first free port at Shannon in Ireland, through the emergence and expansion of most EPZs in many countries in Asia, Africa, and Latin America in the 1970s, to the establishment and development of SEZs in East European socialist countries, in different republics of the former Soviet Union, and in the People's Republic of China in the 1980s, there are about more than 1,000 SZs spread out in more than 80 countries and regions. The United States of America alone has more than 130 (Gao and Chi, p. 1). EPZ is perhaps the most common form in which industrialization strategy in many developing countries has been implemented. By 1986, there were 175 EPZs in more than fifty developing countries (ILO, 1988, pp. 1-2). Another source indicates that the zones in Asia are the most numerous and active, with more than 80 of some 200 EPZs in the world located there. Latin America and the Caribbean region rank second with about 80 zones (Amirahmadi and Wu, pp. 828-829).

Perhaps more important than the predictable growth of the zones in the developing world is the adoption and adaptation begun over 15 years ago with the creation of SZs in China.

2.2.2 The Evolution of SZs in China

China finally opened its door to the outside world in 1979. The first step of this opening up was to allow foreign investment and utilize SZs to attract FDI. The Law of People's Republic of China on Joint Ventures Using Chinese and Foreign Investment of 1979 is the first milestone for FDI in China. The beginning of Chinese special zoning was She Kou Industrial Zone created in January 1979. On July 5, 1979, the Chinese central government announced in another statement that the provinces of Guangdong and Fujian would be allowed to practice special foreign economic policies and to experiment with

"special export zones" at Shenzhen, Zhuhai, Shantou and Xiamen. In May 1980 the term "special export zones" was replaced with "special economic zones." The main reason for this change is that China's SEZs are comprehensive, involving industry, commerce, agriculture, housing and tourism, not merely export processing and trading (Ceng). Many see the birth of SEZs as one of the important components of China's economic reform, and as a symbol of opening up the country to the outside world (Gao and Chi, p. 1). In 1981, another SEZ, Xiamen SEZ, was established.

Based upon the experience of the first four SEZs, the central government of China decided to open fourteen coastal cities and to establish ETDZs within these cities in 1984. From the north down to the south, these were: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai. Basically the ETDZs within the 14 coastal cities enjoy the same preferential treatment for most items of the SEZs. As the ETDZs are industrial areas with functioning enterprises, much of the FDI sought is aimed at creating import substitution capacity rather than export capacity. This is one of the major differences from the SEZs, in which export capacity as an important function was promoted (Oborne, p. 93). They have been allowed to adopt more liberal economic policies than inland China and are able to award concessionary terms and carry out various types of reforms akin to those of the SEZs.

In 1985, Hainan Island became the fifth SEZ and the Hainan Administrative Area was established. In 1987, Hainan was granted the status of provincial administration, which means that the whole province was treated as an SZ. The size of the zone is rarely seen in other countries. Also in 1985, the three river deltas of the Yangzi (Changjiang), Pearl, and southern Fujian were opened to allow foreign investment. The total area opened extends to 18 provinces and municipalities and 122 counties (Guangming Daily, 1984,

June 11). Some comprehensive reform and open experiment zones were established in Guangdong and Southern Fujian. Coastal opening areas were formed until 1987.

Another important development of SZS in China was that in April 1990 the central government decided to open and develop Pudong of Shanghai, which is about the size of Singapore. Some observe that, beginning in the early 1990s, China shifted its development focus from Zhujiang Delta to Changjiang Delta (Wu, Zhe, p. 130). However, the spreading of SZs over the country did not stop there. Not long after opening up the Pudong Area of Shanghai, Shandong Peninsula, East Liao Peninsula, and Xingjiang Autonomous Region were opened for foreign investment. Also an Investment Special Zone for Taiwan Businessmen was set up in Fujian Province, which is closest to Taiwan. Thus far, China had developed a multi-level, multi-polar, and overall opening-up situation. Many reforms and special treatments have been spread out "along the coast, the river (Changjiang River), border lines, and the railroad (Long-Hai Railway)" ("yen hai, yen jiang, yen bian, yen lu") (Gao & Chi, p. 5). Up to the end of 1994, China had developed 5 Special Economic Zones, 14 Coastal Open Cities, Coastal Economic Open Areas (including 260 counties), 6 Open Cities along the Yangzi River, 18 inland Open Capital Cities, 13 Open Border Cities, 30 Economic and Technological Development Zones, 14 Tax Free Zones (bao shui qu), 14 Border-region Economic Cooperation Zones, and 52 National Industrial Development Zones for New and Advanced Technology. Officially approved on an experimental basis in the Zhongguancun area in Beijing in 1988, the State Council granted "National" status to these science parks located in 21 major Chinese cities, as well as those located in the Shenzhen, Xiamen, Hainan SEZs and the Shanghai and Dalian ETDZs, 11 National Resorts, and some Taiwanese Commercial Investment Zones (TCIZs) and Border-region Economic Cooperation Zones (BECZs). China now has also opened up 80% of cities and counties to foreigners. That is, foreigners do not have to get special permission when they want to get into these areas (People's Daily, Overseas Edition, 1996, February 5).

Besides these central government approved SZs, provincial governments have tried to copy the national SZ success by authorizing over 500 provincial development zones, while individual municipalities have established district- and county-level EPZs. For instance, since June 1992, Tianjin Municipality has approved 12 EPZs at the district- and county-levels encompassing 24 square kilometers. As of fall 1995, it had 717 foreign invested enterprises, of which 315 have commenced operations (FBIS, 1995, June 26, p. 47; October 17, p. 20).

2.3. THE UNIQUENESS OF CHINA'S SZs

The above review of special zone development in the world as well as China, shows that SZS is a common phenomenon in the post-WWII world, especially in developing countries. A further analysis helps sort out the uniqueness of China's SZs compared to those in other countries. Thus, it helps evaluate the effectiveness of SZS in China in an appropriate manner.

2.3.1 Goals and Functions of SZs In The World

As mentioned earlier, most SZs in the world have common characteristics. However, they can be different in terms of their purposes or goals. Consequently it is often problematic to make a correct and precise analysis of the goals pursued by the host country (Germidis). In order to better understand the uniqueness of SZs in China, this study makes three assertions: first, a demarcation should be made between goals and functions. Second, goals can be changeable; so can functions. Third, in a developing socialist country like China, functions are oftentimes more important than goals.

The difference between goals and functions of SZs

While the aforementioned summary of the basic goals of SZs remains largely correct, at least from the view of economics, some studies explore further and point out that all these zones bear some general functions in the perspective of modernization in developing countries. These functions, by and large, are modernizing, experimenting, and transitional. Experience shows that the influence of the zones on the local economy is quite significant. This influence essentially is of a modernizing nature and exerts itself through a number of channels, thus with experimenting effects. The first channel is the visibility of the initial zone in a country. Because of its novelty, the zone and the foreign industries are observed very closely by the local community. The second learning channel is the presence of domestic enterprises within the zone. The third one is the process of inter-firm migration of workers. Therefore, these zones can facilitate the transition from a closed economy to a more open economy. Because SZs are of an enclave nature, the process of opening up to the outside world can be controlled. In a sense, the transition mechanism between a closed and an open economy is more important than simply producing new types of goods and services for the export or domestic market (UNCTC, 1991).

This transitional function of a zone cannot be easily integrated into conventional cost-benefit analysis, therefore it is more easily overlooked by observers. But nevertheless it may represent the most important underlying arguments in favor of establishing zones. Therefore, when we evaluate an SZS in a specific country, we need to not only look at goals but also functions.

Goals and functions can be changed under different conditions over time

The second assertion is that goals are usually changeable, forcing the host government to adjust policies constantly. The changes are called by some scholars as "life

cycle" of SZs (Oh). The development of an SZ generally goes through several stages over time, and usually leads to changing functions of the zones. At the beginning, significant amounts of foreign investment flow in and one industry begins to gain dominance. When the zone takes off, the volume of production and exports rises significantly. But as it matures, foreign investment inflows tend to taper off, exports grow at a slower rate, costs and labor skill levels rise, and high-value-added industries start to replace processing activities. Toward the end of the life cycle, the importance of the zone in export promotion declines and the zone goes through structural change with its roles reappraised. Afterwards, it may evolve into a more high-tech industrial estate producing higher-value added manufactured exports, or into a development zone embracing other economic activities such as services and agribusiness. One study which made a comparison among SZs selected in three countries shows that the roles and functions of SZs are different in different countries, and changeable along with passing time (Chen, X.). Another study asserts that achievements and failures of SZs are hard to evaluate according to their original goals because their goals change constantly. The first, and perhaps most important, observation is that many zones never develop according to their original plan. The phenomenon is due to a number of complex sociological and economic reasons, which suggests that a zone, like any other complex social organization, has a life of its own and an internal dynamism (UNCTC, 1991, p. 5). Therefore, when we evaluate the effectiveness of the Chinese SZs, we need to assess the overall strategy by looking at not only initial goals but also long-term functions; not only the horizontal picture but also the longitudinal development.

Functions in socialist countries are more important

Modernizing and transitional functions in its operation are more salient in central-planning economies. Modern SZs are a novel idea in socialist countries. The idea

was implemented first in China, followed by other socialist countries such as Bulgaria, Hungary, Poland, Romania, Yugoslavia, and later the former Soviet Union. What do SZs such as EPZs or FEZs offer to a socialist country? UN research asserts that a socialist country hopes to derive from SZs: (1) The establishment of centers of managerial expertise as a model for the rest of the economy; (2) a testing ground for new forms of market mechanisms; and (3) a boost to the presence of a specific country in international trade. It further elaborates the impact of the zones on the national economy in three ways: (1) Economically, the zones will inevitably affect the system of production and management in a socialist country generally; (2) If the transition to a modern management and market economy is to be successful culturally, a change in attitude is absolutely necessary although the cultural and social impact will take longer to make itself felt; and (3) politically, it can be anticipated that political change will follow economic and cultural change (UNCTC, 1991, pp. 170-171).

These statements can be seen as a general conclusion on the common tasks of SZs in socialist countries. Overall, it is necessary to take functional goals of the SZs into account when we analyze the nature and evaluate the performance of SZs. Only taking economic purpose as the measurement is not sufficient to understand SZS in developing countries, especially socialist developing countries. China was facing the same tasks when it adopted SZS in 1979. The following analysis shows that while SZs in China share basic characteristics of general functions, they have their own uniqueness.

2.3.2 Uniqueness of Chinese SZs: Multiple Goals and Functions

Although China's SZs share many similarities with those in other countries, they also differ in many ways. For example, they have a larger area with a large population and multi-industrial structures. Even the smallest SEZ in China may be several times larger than many of those in other Asian countries (Pomfret, p. 34). They need to play a role not only

as a base and a window for opening up the country, but also as an experimental field for China's economic reform; and they have very close economic links with other parts of the country (Gao & Chi, p. 3). In the Chinese SZs, foreign companies are encouraged not only to engage in the exporting and importing business, but also in manufacturing, banking, insurance, real estate, and other business operations.

As we know, China had a centrally-planned economy and a totalitarian regime before it opened its door in 1979. The fundamental purpose of opening up the country by attracting FDI was always related to the goal of modernization and socio-economic development. However, the Chinese government was facing a dilemma: opening up the country and risking political and economic independence and developing its economy and society and losing political and social stability. SZs in China have been playing a very important transitional role in the country's opening up and market-oriented reform, besides the modernizing functions (economic, cultural, and political) which are seen in most developing countries. This unique situation is rarely seen in capitalist developing countries.

Moreover, compared to other socialist countries, there are two additional factors that make the Chinese case unique. First, China is the first socialist country which embarked on market economy reform and utilized SZS. It did not have any model among socialist countries to follow, which determines that China's special zoning development and FDI policy implementation would have a contingency characteristic. Thus, a gradual controlled manner of implementation and opening up followed. Second, it has its own political, societal, cultural, economic, and even geographical and demographic characteristics, which are bound to give the foreign investment policy and SZS a deep print. These factors determined that Chinese SZs would have multiple goals and functions, which are described by some observers as a "multifaceted role" (Robinson, p. 160). That is, their definition, purpose, and role are multifaceted and complex, and they are absolutely more than mere foreign trade zones. A newspaper article describes the functions from three

aspects: a "window" of reform and experimental field of an economic system, a bridge generating linkage effect between overseas and inland, and a political role in the reunification of the country; that is, economic exchanges with Taiwan, Hong Kong and Macao (People's Daily, Overseas Edition, 1996, April 5). Besides the economic dimension, we apparently need to bring political, socio-cultural, and other related dimensions in to evaluate and analyze SZS in China. Only in such a light may the uniqueness of Chinese SZs be well understood.

The most important uniqueness of Chinese SZs this research wants to justify is that they have some functions which are rarely seen in other countries. Although these functions are hard to turn into specific and explicit goals to measure, they are explored in the following three aspects: economic, political-social-cultural, and spatial.

Economic function

From the very beginning the Chinese leadership has emphasized the functional purposes of SZs where economic development goals are explicitly included. Wu Nansheng, the ex-mayor of the Shenzhen SEZ, stated in 1981 that the functions of Shenzhen were: to understand capitalist society, especially those aspects related to modern economic development, to experiment with different policies, and to study foreign advanced technology and management (Hong Kong Federation of Students, p. 92).

In achieving economic objectives, we can also find several unique patterns in the evolution of SZs in China.

First, different zones have different economic objectives.

When China set up four SEZs in the southern provinces of Guangdong and Fujian in 1979, the main economic aims of these zones were almost the same as other zones in the world: (1) Encouraging export-oriented enterprises; (2) increasing foreign exchange earnings; (3) increasing local employment opportunities; (4) improving major infrastructure

projects; (5) serving as centers for education, training and experimentation with different forms of economic co-operation; and (6) bringing in foreign technology, know-how and management techniques to other parts of China. Shenzhen SEZ was the biggest one among them which had comprehensive economic functions.

The economic function of the 14 open cities added new elements. One of them is that FDI was to be attracted for the renovation and transformation of old plants or for the construction of new plants with modern technology. Accordingly, many ETDZs were established in these port cities. Although FDI was still one of the most important goals to obtain, the purpose of using FDI was somewhat different from that in SEZs. More advanced technology and cooperation were encouraged within the ETDZs.

Opening up three deltas and the final formation of a coastal open belt around 1988 symbolized a change of economic function to comprehensive regional development with complex economic goals. For example, the economic development goals for Pudong New Area were set high: From the early 1990s to the year 2000, Pudong's annual economic growth rate is to be 25%; from year 2001 to 2010, the annual economic growth rate is to be 13.7%. The GDP will increase from RMB¥16.4 billion in 1993 to RMB¥80 billion in 2000, which is 10.5% and 26% of Shanghai's GDP total respectively; GDP will be increased to RMB¥281 billion in 2010, which is 40% of Shanghai's GDP total. GDP per capita will increase from US\$1,340 in 1993 to US\$6,240 in 2000 (Yao, p. 11).

Second, economic goals are changing and reprioritizing according to the development of SZs and different national economic needs and demands over time. A comparative study of the achievement of six development objectives in three SZs (Kaosiung of Taiwan, Masan of South Korea, and Shenzhen of China) shows that not only different zones have different goal priorities, but also these goals can be reprioritized. For the first objective, foreign investment attraction, all three zones have a mixed and dynamic effect that changes from strong positive at an earlier stage to a gradual weakening at later

stages. For the second goal, employment generation, China's Shenzhen has a mixed and dynamic effect that is weak earlier on but is strengthened at later stages, while the other two zones have the opposite direction of the goal emphasis. Regarding the third goal, export promotion, again China's Shenzhen has a weak effect earlier but is strengthened at later stages, while the other two zones have the opposite pattern. In terms of regional development goals, all three zones have mixed pictures from weak effect earlier but are strengthened at later stages. However, Shenzhen has a weaker technology transfer effect than the other two zones but a stronger effect on regional development than the other two (Chen, X., p. 19).

The Chinese government has stressed that SEZs should focus more on promotion of foreign investment and technology transfer than other goals such as employment generation. According to Xu Dixin, a leading Chinese economist, China's SEZs represent state capitalism, not socialism, because enterprises run by foreign or overseas Chinese capital constitute a type of capitalist economy. In a socialist economy like that of China, SEZs, by nature and by function, have a dual relationship (which is both contradictory and complementary) to the state (Xu, Dixin, 1984). The fastest way to modernize the backward sectors in China is to learn from the experience of developed capitalist countries. It is understandable that the government put FDI and technology as top priorities.

Thirdly, along with the development of national economic reform, the economic function has been increasingly more significant than other functions. Clearly, although there are many economic objectives for SZs in China, they are only one of the functional goals SZs China intends to pursue. As mentioned before, China's SEZs were largely replicas of EPZs in Asia. Before setting up the first four SEZs, the Chinese authorities took a careful look at the performance of the other EPZs in Asia when deciding the conditions for the SEZs (Zhongguo Jingji Wenti; Fitting). However, they knew that their zones were different in their functions and goals from the existing EPZs in Asia and other regions.

They chose the term "special economic zone" to differentiate their effort from other EPZs in the world. During this time, although they had explicit economic goals, the SZs' function was much related to political and spatial aspects.

At later stages of SZs development, more emphasis was put on economic development, especially when new SZs were established. Currently, the economic function of various SZs in China is more significant than ever before, partly because other functions are less important than they were in the early stages of opening up the country and partly because China has already built up a market system within a quite large area; and people are used to the new economic system and mechanism. The concept of economic function is now not only limited to FDI or GDP growth. For instance, the economic function was more fully developed in Pudong New Area, where economic function refers to multifaceted developments: adjustment and reform of industrial and manufacturing structures; urban and social development such as commercial and business centers, education zones, residence areas, transportation and communication, ecological balance and environment protection, etc. According to the Pudong development plan, Pudong will be developed into a modern, multifunctional, world-class city in the year 2010. Pudong will play the role of "dragon head" in leading Shanghai as well as the national economy. Before 2010, Pudong will be a financial and business center with a modern infrastructure and transportation system; a more developed free trade zone; a high-level export processing zone; and a new high-technology zone (Yao, p. 13). That is to say, it does not emphasize an experimental or window role of the zones, which were previously important due to the government's political consideration.

Political-social function

Opening up the country and developing the economy could bring about political, cultural and social changes in China. Establishing an overall stable investment environment

is another important objective the Chinese government wanted to reach in implementing FDI policy. Using SZS reflects this government's concern about political and social stability, which is probably the most important determinant for a good investment environment. Explicitly, avoiding social chaos, compromising between the conservatives and liberals to maintain policy consistency, and reunifying of the country are all within the scope of the political-social function.

a. Concern for political and social stability

Development of SZs is one of the significant policy changes undertaken in the process of modernization in China. This development is simultaneous with economic reform and the opening up of the country to the outside world. In the beginning, the adoption of SZS was largely a result of Chinese leaders' economic reforms. However, modernization expectations were mixed with the leaders' fears: loss of state control over the country's development path, loss of political independence, and the potential for foreign influences to contaminate traditional and socialist values. They also doubted China's ability to capture its share of economic benefits generated by foreign investment. Consequently, SZS was used by the government as an experiment which was under government control. The establishment of the first four SEZs reflected the aforementioned concerns in political and social dimensions.

An experimental and gradual strategy is necessary for China to maintain successful reform and avoid social chaos. The Chinese authorities may well have taken considerable political risks in promoting the idea of SZs within China. Any political or social instability could easily impede opening up and socio-economic development. A line between modernizing in a Chinese fashion and adopting a wholesale foreign model has been maintained at all times for the political authorities in Beijing. The absolute need to use SZs and other semi-market experiments is evident to all who wish to quicken the pace of

development in the country, but the risk is equally apparent: too much, too fast could once again introduce chaotic conditions (wide income differentials, poverty, high unemployment, a weakened state apparatus, inflation, and deficits). These were the same problems that brought about the Communist Party's rise to power in China in 1949, and many of these problems have occurred in developing countries which employed FDI policy.

Some studies have demonstrated that the single most important incentive for foreign investors in developing countries is political stability, overriding lower wages, manpower, land utility and fiscal considerations (Osborne, p. 77; Youngson, pp. 97-99). Chinese authorities tried to avoid political instability. Therefore, to ensure the image of a stable, more neutral political environment, the SZs were the areas for China to introduce special legislation.

b. Political balance: Conservatives vs. Liberals

The disagreement about the reform program and the process of opening up the country among the elites is another factor the Chinese reformers needed to consider. This political stand-off in China could accompany policy and strategy alteration. Policy inconsistency will cause problems and scare away foreign investors. Since drastic changes in economic and social policies are politically unfeasible, gradually opening up the country to foreigners by using SZs helps China gain experience and reduce the hidden dangers of further liberalization of later economic policies. The success of the SZ experiment was very important for the reform leadership to convince the conservative camp that the market system could work in China. The conservative camp, which constitutes a significant minority within the administration and the army, would evaluate SZs as channels of "spiritual pollution" or "deviation" from the socialist goals of the PRC (Osborne, p. 133). The experiment of SEZs is important because any failure could give the conservatives

excuses to kill the reform program. As long as reformers can make SZs successful economically, the conservatives would not get footholds to oppose the reform policy, thus the open door and FDI policies can remain stable and consistent. To reformers led by Deng Xiaoping, adopting a radical reform plan was not politically feasible because conservatives had enough political force to oppose any extreme liberal reform plans. Some of Deng Xiaoping's comments at the beginning of the reform and opening up the country show that putting a package of reform policies in some zones was partially out of political consideration. He once commented that some Party members "are not satisfied with the progress, thinking it much too slow . . . Of course, there are still some people hostile towards our current ideological, political and organizational lines, . . ." (Deng, 1980, p. 226). However, he was very assertive that the reform and open-up of the country was necessary. China should have this experiment and pay the price for progress. He said,

"In economic development, we are searching for a road that both conforms to China's actual conditions and enables us to proceed more quickly and economically. We are experimenting with such things as expanding democratic management and decision-making power of enterprises, increasing specialization and co-operation, utilizing the supplementary role of market regulation under the guidance of the planned economy, integrating advanced technologies with existing intermediate technologies, using foreign funds and expertise in a rational way, and so on." "While learning from all this, we have 'paid tuition fees' and suffered some losses, but the important thing is that we are accumulating experience, . . ." "These tasks are vital and we cannot afford either to approach them too hastily or to postpone them." Apparently, he was searching for a political balance, and calling for comrades to "unite, co-operate closely and learn from each other." (Deng, 1980, pp. 231-232).

c. National Reunification

Another respect of the political function is reunification of the country. SZs promote the "United Front" goals of integrating the Mainland with Hong Kong, Macao and Taiwan. As early as 1981, the Central Committee stated that the SEZs would "reassure the Hong Kong and Macao people and achieve the return of Taiwan to the Motherland" (Reardon, p. 59). The State Council gave specific guidelines for SZs' role and tasks in a series of documents. Besides economic goals, political reunification as an important task was explicitly spelled out: "they can contribute to reunification of the country -- helping promote the smooth return of Hong Kong and Macao to China, and maintain economic prosperity and social stability in these two areas, and urge Taiwan to reunite with the mainland" (Gao & Chi, p. 10). Like some countries such as Germany and Korea, China has a reunification issue. According to the authorities, there are three specific territories which will return to China, one way or another: Taiwan, Hong Kong, and Macao. SZs have since become a factor on the issue of political reunification.

To some extent, the location of the first four SEZs helps explain this concern. The first four SEZs were located in Southeast China adjacent to those territories. Shantou is a small coastal city to the north of Hong Kong; Zhuhai is behind Macao; Shenzhen lies behind Hong Kong; and Xiamen is close to Taiwan. Later, Hainan was designated as the fifth SEZ, which is another example showing the importance of location selection. Some Western observers also noticed that, besides the purpose of attracting foreign capital and advanced technology, these SEZs were chosen to facilitate the eventual reunification of China (Harding, 1987, p. 165).

There is ample evidence that China further developed its policy on SZs when formal negotiations between China and Britain started in 1982, with increasing freedom being granted to SEZs in preparation for the ultimate return of Hong Kong (and eventually other

territories). To deal with the reunification issue, Deng Xiaoping once announced a "One country, two systems" strategy. One of the purposes of establishing SEZs was to set examples for co-existence of the two different systems under a unified central government in Beijing; namely, a socialist one on the mainland, and a capitalist one in the other three territories. For example, the term used for proposed special status for Taiwan and Hong Kong is "special administrative area," a quasi-autonomous administrative and economic status which would allow for the continuation of a capitalist economy within the framework of the socialist Chinese state. Therefore, the success of SZs development bears much significance to the reunification of the country.

Spatial development function

The third function is related to China's very unique situation -- it is a huge country in terms of its population and territory. It has 9.60 million square kilometers of territory. But the population in China in 1979 was already 975.42 million, or almost one fifth of the total world population. GNP was 399.81 million RMB yuan, and per capita national income was only 346 RMB yuan (approximately US\$90) at that time (China Statistical Yearbook, p. 3, 81). Regional development was unbalanced (Wolf, p. 12). In such a huge country, conducting such an unprecedented reform was not an easy task, especially when most of its people did not have much experience in dealing with the outside world and capitalism. Thus, the development of SZs in China followed a track which is called by some scholars "spatial characteristics" (Jao & Leung).

The strategy the Chinese government adopted was similar to one of the approaches used by other countries. The two different conceptual approaches to SZ development are the "territorial approach" and the "regime approach." The territorial approach sees an SZ as a specifically defined territory to which a certain regime applies, while the "regime approach" emphasizes that a regime grants certain benefits to firms located anywhere in the

host country as long as they fulfill certain criteria (UNCTC, 1991, p. 14). The arguments in favor of the territorial approach are that it allows for: (1) high-quality infrastructure which is unavailable elsewhere in the host country, and (2) the creation of adequate administrative facilities staffed with high quality personnel that cannot as easily be secured with the regime approach. Given the characteristics of China, it is reasonable to argue that a territorial approach is more appropriate at the early stages of the development of SZs, while a regime approach can be applied at the later stages.

Indeed, it is not merely a random process of accidental or local choices to have established various SZs. Rather it reflects the central government's spatial strategy, which means it would like to open up the country in a controlled manner, and to spread SZs which carry new policies and new market system over the main regions of the country step by step. It is because of the dualistic relationship between the SZs and the rest of the country that China, on one hand, finds the zones necessary and desirable for its current drive towards modernization, while on the other hand it tries as much as possible to restrict their influence on the masses. In other words, SZs are also spatial functional entities with their own territorial bases in activating the domestic economy and fostering inter-regional and inter-sectoral cooperation.

In a broad sense, the spatial function of Chinese SZs has the same meaning of linkage effect as most SZs in the world. However, in the China case, several individual SZs have limited impact on the inland linkage. But by establishing many SZs gradually in different regions and areas, China has made an impact on regional development. The continued extension of SZ status from the first four SEZs to 14 Open Cities and Hainan Island, and later to larger regions as well as even small townships and satellites, reflected that some inland areas were mature for open-up and reform. The spatial function of SZS is to pursue this result.

2.4 EVALUATION OF CHINA'S SPECIAL ZONING STRATEGY

2.4.1 Criteria for Evaluation

While there has been no shortage of positive evaluation among academics on the foreign investment policy and opening up the country in China, much criticism on SZS also exists. The main criticism is that special zoning has caused some problems in foreign investment policy implementation and socio-economic development. The first problem is that these zones failed to fulfill the original goals designated for them. In other words, China's SEZs' performance is not satisfactory in general (Wall; Crane). In the early 1980s, critics complained that the SEZs were foreign colonies sucking the blood out of the domestic economy. These criticisms culminated with Chinese scholars' calling for the abolition of SZs, who argued that the SZs have fostered a privileged clique contending for benefits with the central authorities (FBIS, 1995, September 27, p. 31).

A second problem is that it causes unbalanced regional economic development. As one observer points out, this regionally based strategy resulted in the saturation of investment in the SZs and coastal open areas, which in turn resulted in falling investment returns and dwindling investment expansion of foreign investment (Lu, Jianren, p. 75). Regional leaders in China's central and western provinces have argued that foreign and domestic investment must be redirected to China's interior economy. Proposals for a more "balanced" development strategy thus were a major theme of Premier Li Peng's 1995 Government Report and the 1996 annual session of the National People's Congress (Reardon, p. 282).

Why do many students of the subject hold positive evaluations of foreign investment and its impact on the economy while some have negative views on SZS in China? By and large, all these criticisms have several limitations: (a) Many observers only use four original SEZs in their early years as the cases, which cannot cover the variety of SZs utilized in China; (b) they explain the China case largely from an economic

perspective, which concludes with a more negative evaluation on the early SEZs in China, and (c) perhaps most importantly, they overlook the changing roles and multiple functions of the initiation and development of these zones (Wall ; Crane; Chen, X.; Yuan & Eden): in this case, multiple functions of the SZs in China.

It is true that evaluation of SZs is usually conducted within an economic perspective. Even some organizations which recognize the importance of transitional functions tend to evaluate SZs' performance in the context of industrial and export policies. Using this criterion, developing countries should define the specific goals of the economic functions they wish SZs to perform: earning foreign exchange, creating employment, enhancing profitability, exporting products, etc. (UNCTAD, 1985, pp. 6-8).

However, this economy-only criterion cannot be generally used to evaluate China's SZs. The analysis in the previous section shows that China has its own economic, political, social and spatial characteristics which make its SZs unique -- multiple functions. It is necessary to evaluate the performance of SZs and SZS according to their unique functions: economic, political, and spatial. It seems that more and more researchers have offered positive evaluations on China's opening up and foreign investment policy, as well as its SZS. Some look for answers in politics instead of economics. When they see the issue in the big picture of how China ended its long-held policies of economic isolationism and rejoined the world economy over the past 15 years or so, they tend to see China's foreign trade and investment reforms as a political success (Shirk, 1994).

This study contends that the evaluation of the effectiveness of the SZs and SZS in China should take these three dimensions into account: economic, political-social, and spatial. For this project, *effectiveness* refers to outcome and impact of the policy and is related to the extent to which the policy goal or goals are realized. It uses aggregate data and information to analyze it rather than systematically justifying the effectiveness of the strategy in a strict quantitative manner.

2.4.2 Effectiveness of Chinese Special Zoning Strategy

The effectiveness of the economic function

China's transformation from a virtually closed economy to one of the fastest growing countries and a major trading nation is "a success story" (Shirk, 1994, p. 1). Since China's market-oriented reforms began in 1978, its annual real GDP growth has averaged about 10%, and the inflation rate 6.9%. Average consumption was more than doubled, and over 170 million of the 270 million Chinese living in absolute poverty in 1978 were raised above the minimum poverty threshold. The open door policy toward trade and foreign investment supported brisk export growth averaging 13.7% over 1979-94 (Shirk, 1994, p. 1). Total foreign trade has increased from \$38 billion in 1980, to \$236 billion in 1994 (Li & Liu, p. 1), and to \$280 billion in 1995 (IMF, 1989-95).

Although there are many reasons accounting for China's fast economic development, one unequivocal reason is that foreign investment policies (including SZS) have been effectively implemented. Some Chinese scholars acclaim that development and achievement of SZs in China in the past 15 years have been an "incredible miracle." (Gao & Chi, p. 1). Indeed, China's efforts to promote foreign trade and investment have been an integral part of its overall reform strategy since 1979.

The economic achievements of SZs in China can be measured in many aspects: FDI, technology and new management skills, investment environment, infrastructure, communication, transportation, services, production ability, export, new industrial structure and system, and experiences for other areas of the country. This research examines several important indicators which closely measure the economic effectiveness of SZs: FDI, economic growth, and foreign trade.

a. FDI in SZs

It is true that at the early years of SZs (that is, the development of the first four SEZs), the efforts to attract FDI was not very effective. This is probably the main reason some studies drew conclusions about the ineffectiveness of FDI in SEZs in the early years. However, there were some objective reasons which account for this situation. First, China had just opened its door and foreign investors were still not sure the stability of the policies, and thus were very cautious. Second, at the beginning of setting up SEZs, there was a lot of infrastructure construction. However, if we do a longitudinal analysis, FDI in the zones as an important indicator of realizing economic goals has been accomplished.

For the period from January 1979 to December 1984, FDI in the four SEZs accounted for more than 15% of the total pledged FDI for China. In terms of realized capital, FDI in the four SEZs from 1979 to June 1985 accounted only for more than 30% of the total amount for the country. If we take into consideration many special legislative and regulatory provisions that provide preferential treatment for these zones, this records are not satisfactory. Moreover, basic construction costs by the Chinese government (ten central ministries and central government committees invested more than RMB¥600 million during the period from January 1980 to September 1984) represent twice the amount of capital from foreign investment in the SEZs. Overall, FDI accounted for less than 30% of the total investment in the SEZs. However, since the four SEZs only account for 0.0054% of the territory of China, their 30% share of the total realized capital investment is still "impressive" (Oborne, p. 137).

In the long run, most SZs have been successful in attracting foreign capital. Shenzhen emerges as the most developed SEZ, with pledged investment amounting to US\$2.8 billion from 1979 to June 1985. Zhuhai is not far behind in this respect, having accumulated pledged investment of US\$1.68 billion for the same period. Xiamen ranks third with a total of US\$545 million. Shantou is the least developed of the four zones and

lags behind in terms of the amount of FDI absorbed. Overall, the first four SEZs have an impressive record in foreign capital inflow. Recent development is more telling. For instance, in 1996, Shenzhen's actual FDI was \$2.4 billion, which was a 39.59% increase from the previous year (People's Daily, Overseas Edition, 1997, January 22, p. 2). Special preferential policies enabled the five SEZs to attract \$16.8 billion in overseas investment in 30,000 projects within the zones, which amounted to one seventh of all foreign investment in China between 1980 and 1994 (FBIS, 1996, March 15, p. 22). China's 14 Open Cities were fully operational in 1984. Fifty-nine percent of the 5,813 firms approved to operate in the zones through March 1994 are foreign-funded, accounting for \$3.4 billion of total investments amounting to \$8.8 billion. As of June 1987, FDI committed to the fourteen coastal cities amounted to nearly US\$900 million (People's Daily, 1987, August 9). State councilor Gu Mu revealed at the end of 1986 that with the help of foreign investment the fourteen coastal cities had successfully completed more than 4,000 major renovation projects. Foreign-funded enterprises established in the cities along the coast comprised 80% of all the foreign-funded enterprises in China (People's Daily, 1986, December 16). Pudong New Area, as another example, absorbed US\$101 million of FDI in 1991. In 1994, this number increased to US\$2.6 billion (Gao & Chi, p. 6). In 1996, it absorbed a pledged \$3.3 billion FDI and approved 800 projects. At the same time, high technology and new technology investment takes over 60% of the total FDI. Foreign investment projects in Pudong have been 96% successful. FDI as an important factor brought about fast economic growth in the area (People's Daily, Overseas Edition, 1997, January 18).

A comparison between China and other Asian countries helps further explain the effectiveness of China's SZs' absorbing FDI. EPZ's efficacy in the promotion of foreign investment is at best mixed in Asian countries. As developing countries move toward a more liberal trade regime, the importance of EPZs in attracting FDI tends to decline, although EPZs in Taiwan, Malaysia, and South Korea have also been relatively successful

in promoting FDI. In South Korea the EPZ share in total FDI at the national level went down from 23.2% in 1974, 9.4% in 1980, and 4% in 1985. The share of domestic investment in these EPZs is also rising over time, largely because of government policies that encourage local firms to operate in the zones. EPZs in other Asian developing countries attracted limited amounts of FDI. For example, in 1983 only 16.7% of the total investment in India's EPZs came from foreign sources. In the 1980s, only a limited number of developing countries were able to take in relatively large amounts of FDI; in Asia, these countries were: China, Singapore, Hong Kong, Malaysia, Thailand, Taiwan, South Korea, and Indonesia; together they shared over 90% of total FDI inflows to Asia. China has proved to be the most outstanding performer. For example, in 1988 China's five SEZs together attracted \$370.3 million in FDI and outperformed any other zones in Asia (UNCTC, 1992).

b. Economic growth

The effects of FDI on its economic development have been substantial, as such projects have come to account for nearly half of all capital investment in China (China Statistics Yearbook, 1993). And SZs have enjoyed a high rate of economic growth since its initiation in the late 1970s. A comparison shows that economic growth in the five SEZs is faster than other parts of the country (Table 2-1). Total GDP for five SEZs in 1993 was RMB¥99,396 million, which was 3.17% of China's GDP. The average growth rate from 1980 to 1994 was 30% (Gao & Chi, p. 8). At the same period, national average growth rate is only about 10.4% (UNCTAD, 1995, p. 4). Shenzhen in 1995 was ranked fifth among all cities (behind Shanghai, Beijing, Tianjing and Guangzhou) in its annual GNP (RMB¥56 billion) and total annual industrial value (RMB¥63.8 billion). Although the state invested RMB¥100 million during the past 15 years, proponents of the SEZs argue that Shenzhen remitted over RMB¥50 billion to Beijing, including RMB¥4.8 billion in taxes.

Table 2-1 Economic Growth in Five SEZs

Unit: million RMB Yuan

Special Zone	GDP, 1980	GDP, 1993
Shenzhen	270	41,354
Zhuhai	375	12,187
Shantou	889	12,404
Xiamen	640	10,936
Hainan	5,588	22,515

Source: Gao & Chi, 1996, pp. 7-8.

This translates to a ratio of 1:500. Shenzhen's transformation from a sleepy border village in 1978 to a modern, thriving city of 3 million people is undeniably amazing (Reardon, p. 281). Other SZs also enjoy faster growth rate than the national average. Pudong New Area started opening up in 1991, and had already realized RMB¥7,579 million of GDP in 1994. In 1996, the GDP in Pudong was RMB¥51 billion, which was 20% higher than the previous year; while the national growth rate was about 9.5%, and the growth rate in Shanghai was only 13% (People's Daily, Overseas Edition, 1997, January 18).

c. Foreign trade

Another indicator of the economic effectiveness of SZS is that China has developed a foreign trade system and established its export-oriented economy since it opened its door to the outside. Since 1979, the PRC has increased its exports at an average annual rate of 16.1%, and the country is now the tenth largest exporter in the world. Imports also have grown, at more than 15% a year. Annual growth rates for China's total trade were more than three times the world rates between 1978 and 1990. In 1993, according to Chinese

sources, China's foreign trade constituted 38% of its GDP (Shirk, 1994, p. 2). Total foreign trade amount was 38% of the GDP in 1993, and 45% in 1994 respectively (Gao & Chi, p. 16).

Over the past 15 years, the SZs' record in trading is impressive. Five SEZs established industrial-based export-oriented economic systems. In 1993, total foreign trade in the five SEZs was US\$27,832 million, which was 15% of the national total. The total export was US\$14,341 million, which was over 50% of the total national export. Shenzhen alone in 1993 had foreign trade as high as US\$14,880 million, in which exports were US\$8,335 million. It was already the largest foreign trade port in China (Gao & Chi, pp. 12-13). The export of Shenzhen SEZ ranked number one among cities in China from 1993 to 1996. In 1996, the total amount of export was \$21,208 million, 14% of the national total. Foreign trade surplus is \$3,362 million, which is 27.5% of the national total (People's Daily, Overseas Edition, 1997, February 18).

The effectiveness of political function

In the political-social aspect, the original goal for establishing SZs in China was to create a stable investment environment. Specifically, it should include keeping political and social stability and serving the purpose of reunification of the country.

a. Political stability and social stability

There are three aspects of political and social stability. First, Chinese authorities have always persisted in gradually opening up the country and tightening the control over foreign investment activities by using SZs, which they believe can increase political and policy stability. If adequate attention is given to the coordination and mutual promotion of reform, development, and stability, it would enable the national economy to maintain sustained, rapid, and healthy development. In Chinese and world history, lessons of not

paying enough attention to the relationships among reform, development, and stability are extremely common. The former Soviet Union, which started its reform in 1985, without considering the constraints of its economic situation at that time and the public's tolerance of *perestroika*, put forward a series of radical reform proposals, including "shock therapy" (sometimes is called "Big Bang") and the "300-day privatization initiative." For a time, industrial production declined at a double-digit pace and inflation showed a triple-digit increase, plunging the people's livelihood into an unprecedented plight. Eastern European countries used a shock therapy and also caused political fluctuation (FBIS, 1996, January 22, pp. 45-46). It is evident that Chinese society has been relatively stable since it opened its door in 1978. Since then, China has not had significant political fluctuations except the 1989 democratic movement. Compared to many socialist developing countries, "China is the only socialist regime that enjoys political stability and a booming economy" (Yong, p. 5). Second, social changes and political turmoil in most cases are inevitable in developing countries. Even if there is any political fluctuation, the important thing is that the government keeps the same policies for FDI and SZs. In China, the 1989 incident did not stop the implementation of FDI policy and SZS. Third, internal political disputes do not affect special policies offered to foreign investors and special areas. That is, incentives are relatively stable and consistent. Although there have been a lot of disagreements in terms of how to open the country and how to reform the economic system, the overall trend of opening up the country and absorbing FDI has been positive. FDI policy and SZS have been continued. This stable policy implementation is extremely important for attracting foreign investors.

b. Reunification of the country

SZs have at least made some contributions to the following for the purpose of reunification of the country:

1. Creating a positive condition for Hong Kong's return. Hong Kong was returned to Chinese sovereignty in July 1997 after more than 150 years as a British colony. The experiments in the SZs in Guangdong and Fujian Provinces had created very positive conditions for Hong Kong's return to China. Economically, for example, regional economic cooperation had been gradually formed. Shenzhen's capacity as an international port had been vastly improved by plans for a rail system and road network. Complementary trade could be maintained if Shenzhen concentrated on lower-priced goods, leaving Hong Kong ports the business of upscale consumer goods (Far Eastern Economic Review, 1992, May 14). This kind of increased business linkage between SZs and Hong Kong reduced the alienation of the people in Hong Kong. Politically, SZs have set a model of "One Country, Two Systems." Since different economic systems can be enjoyed in SZs, they certainly would be allowed in Hong Kong. Since Hong Kong is a "Special Administrative Area", special political and administrative treatment from the central government is also possible.

2. Having an influence on Taiwan's reunification with mainland China. Fujian was first selected as a province to establish SEZ to attract FDI, especially from Taiwan, because many business people in Taiwan had various links with their hometowns in Fujian. In order to build and strengthen economic and social links between the mainland and Taiwan, some cities and regions have built special areas or zones for Taiwanese businessmen to invest in. To accommodate Taiwanese investors in Fujian Province, the State Council approved the establishment of "Taiwanese Commercial Investment Zones" (Taishang Touziqu) in May 1989. There are at least five such zones which were ready for large scale investment from Taiwan. Located in the Xiamen SEZ and the Fuzhou Mawei ETDZ, these investment zones offered Taiwanese business people special privileges to establish

foreign-invested enterprises, especially smokeless industries that were not harmful to the environment. The efforts on improving investment from Taiwan were especially made by Fujian Province. Up to the end of 1996, the Provincial government approved 4,533 Taiwanese invested projects. The total investment reached \$9.3 billion. The Province also specially enacted the "Taiwanese Country Fellows Investment Protection Law."

Some large cities in other provinces also made efforts to attract Taiwan's investment. For example, investment from Taiwan in 1995 rose by more than six times over that of 1994 in Tianjin, the biggest port city in north China (FBIS, 1996, January 31). Compared to the Taiwanese investment in Southeast Asian countries, which has decreased in recent years, the investment from Taiwan in mainland China is a contrasting picture. According to a report in Taiwan, the trade between Taiwan and the mainland China in 1996 was \$22.2 billion, a 5.8% increase from the previous year. Taiwan held a surplus of \$1.7 million, an 8.7% increase from the previous year (People's Daily, Overseas Edition, 1997, March 6, p. 5).

Since the Taiwanese government first allowed military veterans to visit mainland relatives in 1987, over 5 million Taiwanese have visited the mainland, and invested over US\$20 billion in the coastal economy, including US\$2.4 billion in the Xiamen SEZ. In spite of the June 4th Incident of 1989, the new influx of Taiwanese investors fueled a jump in the Xiamen SEZ's realized foreign investment from US\$238 million in 1988 to US\$ 835 million in 1989 (Reardon, pp. 297-298).

Over the past 15 years, Beijing, Guangdong, and SEZ authorities (as well as private Hong Kong entrepreneurs) have financed railroad electrification and the construction of superhighways linking Hong Kong/Macao with the SEZs and the interior; simplified border crossing procedures; and increased cross-border policy coordination.

These developments set a good economic base for reunification of the mainland China and Taiwan.

The effectiveness of the spatial function

Since the beginning of establishing SZs in China, there have been two ways to understand the spatial function: (a) demonstration; and (b) linkage. Regarding the demonstration effect, it has been repeatedly stressed that the role of the SZs is to experiment with and to digest Western technology and management techniques so that the inland enterprises can benefit from their experience. As such, the relationship between the SZs and other parts of mainland China is a complementary one, because the former serves as laboratories for the latter. SZs' "four-window" role (technology window; knowledge window; management window; foreign policy window, an expression coined by Deng Xiaoping. See Liang, 1985) was played very well, especially in the first stages of opening up the country. Clearly, the mini-economic systems to be developed in SZs constitute a drastic departure from the system of the rest of the country. Before opening up the country, foreign investment in other regions of the country was relatively insignificant, a socialist economic system was well-entrenched, and the economy was still oriented inwardly and regulated through central planning. After SZs encountered early difficulties, they have realized high achievements, and set a model of development for the rest of the country.

In terms of linkage, which can also be referred as "domestic link," "industrial link," or "backward link," the result is more impressive than the demonstration effect. Compared to SZs in some other countries, China's SZs have also yielded more positive effects on inland linkage. Most EPZs in Asia, for example, have generated very limited linkage effects on domestic economies. Backward linkages in the form of subcontracting are also limited. Studies show that only in South Korea, Taiwan, Malaysia, and China have EPZs established substantial amounts of subcontracting (APHD; Wu, C.). In China, inland

subcontractors outside the zones are allowed to participate in the production process. Actually, China's government has encouraged inland enterprises to run their business in SZs. Since May 1983, there has been much discussion about the promotion of domestic links in the development of SZs. The idea is to provide preferential treatment to encourage Chinese firms from other parts of the country -- especially those with relatively advanced technology, good management and competitive products -- to set up production units, particularly in the Shenzhen SEZ. Through their interaction with foreign enterprises they are in a position to digest modern advanced technology and management methods, which could be transferred to other parts of China. Of course, these local enterprises most likely will use more domestic materials than foreign ones. If more than 70 per cent of the total amount of raw materials used comes from local sources, the enterprise can negotiate with the zone authorities to sell a certain part of its products within China (UNCTC., 1991, p. 189).

The expansion of the special treatment for SEZs to other areas later is another way of spatial linkage. Setting up other "quasi" SEZs or SZs along the coast of China and other areas also reflects the strategic consideration of gradual spatial development. In order to speed up the process of economic development nationwide, more SZs set up in inland provinces would not only be desirable but also necessary in order to diffuse newly gained experience quickly and adequately.

These results are consistent with some empirical observations obtained from China's case. One study demonstrates that the establishment of SZs is an effective policy instrument in transforming an inward-looking, technology-backward, and labor-abundant economy to a more open and efficient structure. Given certain conditions, if the scale of FDI within an SZ is large, and if the linkages between the SZ and the inland are strong, then the process of economic structural transformation is faster and the host country is better off (Ge).

2.5 SUMMARY

This chapter defines the concept of "special zone" and briefly reviews the evolution of SZs in the world and China, examines the uniqueness of Chinese SZs, and evaluates the effectiveness of SZS in China.

In order to solve the problem of China's SZs not fitting into a specific category of zones, such as EPZ, FTZ, FEZ, SEZ, this study, based upon those zones' major characteristics and purposes, uses "special zone" (SZ) as a concept to describe those specially designated zones everywhere.

Long before China launched the program of SEZs in 1980, many countries were already operating SZs, especially in developing countries after WWII. SZS is one of the most important means used by many developing countries to attract FDI and obtain other benefits from integrating their economies to the international economy. Most of these zones have common characteristics and functions.

China opened its door to the outside world and started using SZS to attract FDI and fulfill other goals in 1979: from 1979 to the end of 1994, China had developed many different zones. Although China's SZs have many aspects in common with most SZs in the world, at least in terms of their characteristics, they can be different in terms of their purposes or goals. This study explores the uniqueness of the Chinese SZs in three dimensions: economic function, political-social function, and spatial function.

In terms of the effectiveness of the strategy, this study yields a positive evaluation in the light of Chinese expectations, foreign business interest and the international community at large. Evaluation of the success or failure of SZs in China depends a good deal upon the point of view of the observer, and the standards applied to the analysis. In respect to the economic function, major indicators (such as FDI, economic growth, and

trade within the zones) as well as their impact on the national economy are supportive to the fulfillment of the economic function. The analysis shows that major political purposes of SZs have been realized. Demonstration effect and gradual development of this long-closed, backward, agricultural, socialist country are two main evidences of the success of spatial development function.

All in all, China has used a complex strategy to carry out its FDI policy, and the government's intervention helped realize the goals of SZS. The questions of how the Chinese government can play such a role and why it can play such a role will be answered in the following chapters in the perspective of state capacity.

CHAPTER III

ANALYTICAL FRAMEWORK: STATE CAPACITY AND STATE ROLE

This chapter is set to define the concept of "state capacity," and to confine the framework of analyzing SZS implementation within the scope of relationship between state capacity and state role.

The analytical framework of this research employs a conceptualization approach which identifies the relationship between state capacity and state role. This analysis is explanatory, not in a positivist sense, but in a historical, structural, and interpretive way. It is basically inductive, and explores variables crucial in measuring state capacity in China. The purpose of this analysis is to measure the state capacity, which affects the state role in socio-economic development.

3.1 STATE'S ROLE IN SOCIO-ECONOMIC DEVELOPMENT

The state has been one of the major foci in political science academia. The recent resurgence of interest and literature on the role and function of states have been trying to bring the state back in the research (Rueschemeyer & Skocpol).

In the abstract sense, the state is a political articulation of socio-economic relations and, at the same time, at the concrete level the state is a set of political institutions that form a policy-making apparatus in which the power and resources of political domination are concentrated (Esping-Andersen, Friedland, and Wright; Poulantzas; Hamilton; Benjamin and Duvall). Therefore the state is different from the political regime which refers to "the formal rules that link the main political institutions (legislature to the executive, executive to the judiciary, and party system to them all), as well as the issue of the political nature of the

ties between citizens and rulers (democratic, oligarchic, totalitarian, or whatever)" (Cardoso, p. 38).

Some scholars contend that it is the state, especially in developing countries, that serves as an autonomous, leading force behind social transformation, economic development, political evolution, and international interactions. Much recent research analyzing the role of states in both facilitating and hindering industrialization in contemporary developing countries tends to conclude that the state's role in development is extremely important. The state is the principal guide to and propeller of economic development, political, social structural changes, and international relations (Jia & Lin; Wang 1995; and Wong & Hu). The debates on the state's role usually focus on the relationship between politics and the economy, which has been an intriguing and continuous problem in political science. The neo-liberal, neo-classical, or the plural approach tends to see the state as a neutral arena in which various conflicts of society are resolved. Neo-Marxists argue that the state is only relatively autonomous from the dominant class in capitalist society; they thus attempt to explain how it functions to reproduce capitalist production or to maintain capitalist accumulation are related to state policies. For example, besides their neo-Marxist origin, dependency theories have given rise to a multitude of complementary and sometimes conflicting approaches to understanding the relationship between the state and foreign capital in developing economies (Baran, 1968; Frank; Furtado; Galtung; Ports; Wallerstein, 1974a; Wilber; and Packenham, 1992). The dependency perspective nevertheless offers an opposite approach which provides useful thinking about how to appropriately justify the role of the state in managing socio-economic development. For instance, early proponents of dependency portrayed the state rather crudely as a corporatist ally of foreign capital. This alliance is said to be facilitated by the co-optation of local elites, who serve as conduits for investment and also as the primary local beneficiaries (Baran, 1979). Despite its authoritarian power

domestically, however, the corporatist state remains fundamentally weak -- dependent upon and yet unable to control the foreign capital in whose service it operates.

The two major traditional approaches to the state's role in socio-economic development have their defects in interpreting the outcome of developing economies. The neo-classical approach to states and economic development is simply not borne out by historical evidence and when comparative evidence is examined closely, it turns out that states have played both positive and negative economic roles (Evans, 1995). The neo-Marxist theories are also not accepted by most developing countries. These two traditional approaches weigh down the importance of the state's role in socio-economic development, and tend to view the state as more problematic, and challenge the role of the state.

Thus, the state-oriented or statist approach, as this research calls it, has attracted a great deal of attention. This alternative view was popular in Latin America in the 1960s and 1970s, although the emphasis was more on controlling for negative results than capturing benefits (Gerreffi, pp. 23-24). However, the development in many countries after WWII has shown that the state does play an important role in socio-economic development. More successful examples can be found in many Asian countries such as Japan, Taiwan, Korea, and Singapore. That is, the development experiences of Japan and the East Asian Newly Industrialized Countries (NICs) suggest a positive role for the state in managing economic development. Many observers suggest as well that the state has played a critical role (Scalapino, Sato and Wanandi; Johnson; USITC, pp. 12ff. & 19ff.; and EIU), while the diverse economic developmental experiences of Japan and the East Asian NICs may be ascribed to a culture of neo-Confucianism that extols education and accomplishment (Vogel), or alternatively, to the influence of informal business networks (Chen & Hamilton, p. 3; Redding). Whether pursuing policies of import substitution, export-led growth, *entrepôt* growth, or other development strategies, the state has been seen as the

critical catalyst for development (Haggard, ch. 2). In Japan, the state was seen as a key actor in managing economic growth (Johnson). In South Korea, it was seen to transform national industrial structures as a precondition for development (Woo). In Taiwan, it was credited with facilitating development by mediating relations between foreign capital and local entrepreneurship (Gold, pp. 175-205). In Singapore as well, the state was seen as using market oriented economic policies to channel foreign investment towards the achievement of long-term development goals (Regnier; Lee, Soo; Lim).

Indeed, in terms of FDI policy implementation and socio-economic development, many developing states have attempted to limit the negative effects brought by opening-up and attracting FDI by using state intervention and establishing government control over a wide range of variables. Some successful cases show that the state's role in the development of SZs is one of the important factors determining the performance of those zones. Some suggest that three factors lie behind the relatively satisfactory performance of SZs in Korea and Taiwan. First is a successful overall national industrialization strategy in the host country. The second factor relates to the nature of governments in South Korea and Taiwan, which have successfully played the role of a developmentalist state through strong interventions. The last factor is a conducive international economic environment (Amirahmadi & Wu, p. 835). Putting the third factor aside, the first two factors are directly relevant to the state's role in foreign investment policy formulation and implementation.

In short, although debates on the state's role in FDI policy implementation and economic development have yielded different views, the state is an appropriate focus of inquiry in studying China's development efforts.

The role of the government should not be ignored in the process of transition from a central-planning economy to a market economy. State's role can be simply defined as direct and indirect government interventions in socio-economic development. In a modern market economy, state interference is a pre-condition for economic development. The state can

provide public goods, public investment, regulate the distribution of income and social wealth, stabilize the macro-economy and formulate industrial policies. For several reasons, in a country like China, the state role can only be strengthened in its economic development and market transition. First, the central government plays a decisive role in accelerating the establishment of a new mechanism and a legal framework for a market economic system. Second, the central government plays the role of a stabilizer of a macro-economic environment for the transition to a market economy. Third, the transition to a market economy is a process of readjustment of interests. Thus it is necessary to compensate people whose interests are affected. And fourth, the central government plays a key role in economic reforms which determine the outcome of the transition.

China's particular situation requires that the state's role should be stressed in the process of its modernization. China is a big, developing socialist country with very unique conditions. There are inevitable development problems (such as population, environment, infrastructure, and income gap) in the transition to a market economy. The above factors determine that the central government plays a leading role in the transition to a market economy. The fundamental role of the state in Chinese society and economy is articulated in the Constitution of the People's Republic of China (1982), particularly in Article 18 on foreign investment. The Amendments to the Constitution in 1993, expressing greater support for replacing the state planned economy with a socialist market economy, do not dilute the centrality of the state's role as the agent for development (FBIS, 30 March, 1993, pp. 42-43).

The strategy adopted in China in the late 1970s accorded with the statist approach. That is, neither did China adopt the liberal approach -- completely opening up the country to the outside world and liberalizing the economy at one time nor did it buy the Neo-Marxist theory -- viewing the capitalist world and the state as negative factors for national economic development, and thus keeping the door shut and isolating itself. The approach it

has been using since 1979 is a state-controlled opening-up and reform-based development strategy . For Chinese leaders, neither isolation nor dependence are workable or desirable conditions. Beijing wishes to walk a middle ground between these extremes. Some studies even suggest that the open door policy does not mean that China totally abandoned Mao's policy of self-reliance and independence. There is a logical and historical relationship between them (Tang). The "self-reliance" policies of Maoist China, while partly based on expediency (born of China's isolation from both the Soviet Union and the United States), were viewed as an alternative to the Stalinist and capitalist approaches to economic growth (Eckstein). And while the "open door" policy established in 1978 expressed the Chinese leadership's recognition of the failures of self reliance and its commitment to harnessing foreign investment in pursuit of economic growth, the new policies also express the view that China can find an alternative route (Dernberger; Harding, 1991). Ideally, China allows profit-oriented enterprises to operate with foreign participation, while it hopes to maintain centralized economic guidance of national resources; it can obtain the productive training, equipment, and technology from abroad without compromising other economic aims such as price control and foreign currency management; it can integrate its economy into the world economy without giving in its economic independence and welfare. All these measures reflect that the Chinese government has been walking on an alternative route, and trying to intervene in FDI activities and to harness the process of opening up the country. The development of SZS is one of the important state interventions with FDI policy implementation.

As mentioned in the previous analysis, China's SZs are complicated creatures among SZs in the world, at least in terms of their goals and functions. The multifaceted tasks are hard to handle for any developing country, which, however, are generally fulfilled in China. Apparently, state intervention is effective in utilizing this unique SZS to reach the specific goals. The main task the central government performed is that it has been

controlling foreign investment activities and internationalization of its economy by using its institutions and regulation mechanism. Specific indication for the state's positive role can be found in several areas in China: a comprehensive and relatively consistent development strategy and a gradual manner of opening up the country; an experimental approach in policy formulation and implementation; direct and indirect intervention to foreign investment activities and SZs' operation; central control over national resource allocation, and so on. The purpose of this controlled manner of development is to reduce the risk and to increase the benefits of opening up the country and marketizing China's economy. In a Chinese leader's words, the market role in China, a socialist country, "can only be brought into full play under the government's macro-regulation and control. The Chinese government will resort to multiple means to exercise macro-control over the economy, such as through the plan, through fiscal policies, and through monetary policy." (FBIS, 1996, June 27).

However, this type of active state's role in FDI and socio-economic development is not always fulfilled by developing states. For instance, many Latin American countries in the 1970s had a great deal of difficulty in effectively implementing FDI policies (Baran, 1979; Wilber; and Packenham, 1992). The former Soviet Union countries and Eastern European countries used an overall liberalized economic policies and did not yield satisfactory results (FBIS, 1996, January 22, pp. 45-46). In India, a country with a huge population, the performance of the two EPZs was not very impressive (Kumar). Some African countries with weak state cannot reach rapid economic growth: for instance, Ghana (Lawson). It is very obvious that the state's role in those countries remained relatively passive or their state intervention yielded negative results, and the weaknesses in state power vis-a-vis foreign capital came from forces within the host country itself. Although many researchers advocating state's intervention have explored many aspects of the issue such as state's nature, regulation mechanism, and types of intervention (for instance,

Pearson), few of them have explored in depth and answered questions as to why states undertake different roles and why some states can play a successful role and others cannot. In order to explore the issue further, this study examines the state role from a new dimension.

Thus, this research brings in another factor, "state capacity," which determines the state's role in development -- success or failure, positive or negative, to help answer the question. A major reason some states can play an important role and have positive intervention in their economic development, while some have trouble formulating and implementing effective controls over foreign investment, lies in their relatively comparable state capacity. In a word, state capacity is the key variable to determine the state's role as well as the outcome of state intervention.

3.2 STATE CAPACITY

3.2.1 State Capacity As A Perspective In Political Science

Historically, perception of the need for state capacity developed hand-in-hand with perception of the need for state intervention in the economy. Between the end of WWII and the middle 1980s, governments advocating state-sponsored social and economic change achieved power at one time or another in most developing countries. The measurement of state capacity is one of the major foci of contemporary political science. Samuel Huntington's 1968 classic study highlighted adaptability, complexity, autonomy, and coherence as measures of political institutionalization, defining the strength of the state in maintaining political order in developing societies (1968). Gabriel Almond and G. Bingham Power, Jr. (1978) focused on extractive, regulative, distributive, symbolic, and responsive capabilities of the state. Similarly, Joel Migdal suggested that state "capabilities include the capacities to penetrate society, regulate social relations, extract resources, and

appropriately use resources in determined ways." He argued, "Strong states are those with high capabilities to complete these tasks" (1989, pp. 4-5). These contributions focus mainly on the relative power of the state vis-a-vis society and external environments, which is vital to the success of the foreign investment policy implementation.

Efforts to develop a rigorous conceptualization of the state can be again found in debates between neo-Marxists and neo-Weberians. Both perspectives started their arguments by attacking the pluralist conception of the liberal state. While neo-Marxists accuse pluralists of dismissing class power in politics, neo-Weberians criticize them for not seeing an autonomous aspect of the state.

The "neo-Weberian" or "statist" perspective has emerged as a powerful challenger to both the pluralist notion of the neutral state and the Marxist view of the class state. Subscribing to Weber's fundamental claim that the increasing growth and autonomy of the state bureaucracy in modern politics make the state a formidable apparatus of domination for those who control it, statist attempt to conceptualize the state as an autonomous actor or an institution that has its own logic and interests independent from society (Nettl; Tilly; Krasner, 1978a; Stepan; Skocpol, 1979; and Evans, Rueschemeyer & Skocpol). The statist define state autonomy as official collectives formulating and pursuing goals that are "not simply reflective of the demands or interests of social groups, classes, or society" due to its organizational characters, not due to its relational character derived from class struggles in society and within the state (Skocpol, 1985, p. 9).

Another important dimension developed by the statist is state capacity, because many other perspectives have presupposed that autonomous goal formulation leads to its successful implementation (Krasner, 1978a; Finegold & Skocpol; Skocpol, 1980; and Skocpol, 1984, p. 9). This notion of state capacity is an important contribution to understanding the state. State institutions are products of historical processes of state-building and not easily malleable. Thus, the policy instruments based on institutional

resources are not readily available on a short-term basis and are constrained by the previous policy legacies (Heclo; Orloff and Skocpol; Weir & Skocpol). As Zysman suggests, "by shaping the routes to agenda-setting and policy instruments, institutions help determine which political issues emerge as subjects of debate, which groups become allies in the ensuing fight, and how capable of acting on its interests a given coalition will be" (Zysman, p. 295). Institutional arrangements are powerful forces in shaping state autonomy and state capacity. This organizational dimension of the state is a necessary correction to both the pluralist and Marxist conceptualizations the state should be seriously considered for concrete policy analysis.

In relation to this conception of the state as an actor, the typology of strong state versus weak state has acquired increasing attention as an explanation for differences in the political economy of advanced industrial societies (Katzenstein; Krasner, 1978b). The strong and weak state distinctions have been based on the degree of differentiation between the state and society and the degree of centralization of each. It tells us to what degree the state apparatus is insulated from the influence of social interests and formulates and implements state policies autonomously and effectively. This approach focuses on the formal institutional structure of the state, where the concept of state strength tends to be a virtual mix of state autonomy and state capacity. Many studies tend to take state autonomy and state capacity as a combination of their research. Some research contends that the development pattern of government policies (including the timing of the policy adoption, implementation, and reform, and the form and content of programs) can be explained by the interaction of the two major aspects of the state -- state autonomy (the state's position in relation to social classes) and state capacity (organizational characteristics of the state) -- in the context of the changing political economy (Chung, Moo-Kwon, 1992). In discussing the conditions underlying effectiveness of the state, emphasis has often been laid on "state autonomy." According to this view, the state is unlikely to be capable of formulating goals

or implementing them unless it is relatively insulated from the social structure. A weak state is one that is permeated by pressure groups, and a strong state is one that can resist private demands but is unable to transform private preferences. The strongest state may act at its will, having power to change not only the behavior of private actors but also the economic structure itself (Krasner, 1978b, pp. 56-57).

Although state autonomy is necessary for effective state intervention, it is a mistake to think that autonomy is sufficient in itself for effective state action, because the assumption that the state is monolithic is simply wrong. Some argue that the organizational dimension of the state should be equally weighed for the concrete analysis of socio-economic policies. According to some statist accounts (Katzenstein; Krasner, 1978b; Finegold and Skocpol; Skocpol, 1980 and 1985), state autonomy is mainly related to policy formulation and state capacity to policy implementation. Katzenstein tends to argue that policy goals are set by ruling coalitions while their implementation is determined by the policy network (1978). Furthermore, when statist argue that state capacity shapes major policy outcomes, the position of the concept of state autonomy is not clear in relation to the concept of state capacity. The concept of state capacity in their use in empirical research often presupposes state autonomy in either of the following two senses: (1) regardless of whether policy decisions are made autonomously, the capacity to implement them is crucial in determining their success or failure (Finegold and Skocpol); or (2) "states are autonomous sites, not reducible to the demands or preferences of any social groups" (Orloff & Skocpol, p. 730) and thus policy experts and administrators play a crucial role as final determinants of state policies (Orloff and Skocpol; Weir & Skocpol). The public sector in reality has a complex structure both horizontally in terms of numerous ministries and vertically in terms of different levels of government.

This study emphasizes the importance of state capacity more than the importance of state autonomy. A simple reason is that even though state autonomy can largely determine

state capacity, state capacity is a major defining factor for policy implementation. It explores state capacity as a key variable to determine its effectiveness of the state's role in socio-economic development in China, rather than reckoning the overall relationship between state autonomy and state capacity. That is, state capacity can more directly explain the effectiveness of state's role than state autonomy, or both, can. Due to the unique Chinese political system -- all competing centers of power within Chinese society were intentionally destroyed, and the Communist state in China is much more insulated from societal pressures than states in the West or in the Third World -- this study only takes state capacity as its analytical object. On the Chinese mainland, there has not been any political party or social organization which has been able to challenge the authority of the Communist Party of China and the government. In other words, the state enjoys high autonomy and does not have much social constraint when it makes decisions. Thus, the state should have more strength in its state capacity. However, this condition can only be satisfied if the administrative ability of the state -- bureaucracy -- is good. Therefore, taking the state autonomy situation in China for granted, this research focuses only on state capacity.

Recently, state capacity has been increasingly seen as the key variable in explaining the variations in the experiences and the outcomes of national policies and programs. A number of recent studies of developing countries focus on the strength of state versus traditional society in regard to their abilities to promote social changes (Kohli). State capacity is also viewed as important to the uneven economic performances among industrial societies (Hall). And the domestic structure and its impact on state capacity in shaping and implementing national foreign economic policies among developed countries is one of the foci of the discussion (Katzenstein).

Several recent case studies have explored the relationship between the state capacity and the realm of reform and democratization. One study emphasizes the importance of

reforming state structure to increasing the state capacity. Colombia's experience provides an example of how states shift development strategies and implement policy reforms in the context of a developing democracy. Unlike some interpretations of the earlier reform that emphasize "market forces," it argues that Colombia's development strategy more closely resembles the East Asian experience, as import substitution was complemented with export promotion, and stable macroeconomic management was enhanced by the creation of a competent technocratic bureaucracy. Institutional factors are crucial for explaining the character and direction in both policy reforms. The findings show that governments can increase state capacity for economic management through reforms that concentrate expertise in bureaucratic agencies insulated from outside pressures for patronage (Juarez).

Another research which examines the relationship between governmental performance and economic growth emphasizes the importance of state capacity in the process of economic growth. In addition to the quantity and quality of land, labor, and capital, a country's growth rate depends on the strength of its political institutions. By explicitly identifying the importance of state capacity in the process of economic exchange, it can be explained why some countries grow at higher rates than other countries. This model has been developed theoretically, and is empirically tested using a pooled cross-section and time-series design covering 86 countries over 26 years (Leblang).

3.2.2 State Capacity And FDI Policy & SZS Implementation

Comparatively, there is not much research done specifically on the relationship between state capacity and FDI policy and SZS implementation. Some scholars of political economy have explored the relationship between state capacity and integration of the economy into the global one since the 1970s. Studies of foreign investment in developing capitalist countries tend to focus on the ability of host states to formulate and implement controls over foreign investment. These studies range in their view of state interest in

capitalist societies from a Marxian structural dependency perspective (in which the state is the instrument of dominant classes in society and of historically determined structures that preserve capitalism) to a more conventional "liberal" perspective (in which the state is a pluralist arena in which different interests seek to assert their goals) (Biersteker; Cardoso; Evans, 1979; Gereffi). These studies also identified a variety of possible regulatory mechanisms, including taxes, limits on foreign currency flows, restrictions on joint venture sales in the domestic market, requirements for local ownership and management (often in joint ventures), monitoring of technology transfer, and state approval at various stages of the investment process. Obviously, the state capacity mentioned here is merely within the scope of mechanisms of state control over FDI. Some studies noticed that correlation between state political capacity and debt payment ability in developing countries (For example, Snider 1990b). However, few studies have been seen specifically in relationship between state capacity and SZS implementation.

And while there is much research on state capacity in China studies, little has been done directly regarding state capacity and FDI policy and SZS implementation in China also. In the field of China studies, there has been no shortage of interest or focus on the role of the state. Some recent researches show that there is an increasing interest in linking the research of state capacity and socio-economic development. For instance, one comparative study of four countries classified four types of economic development: state-led development, development from above, feudal-syncretic development, and peasant underdevelopment. China used "state-led development" and has been similar in many ways to "capitalist" development in other East Asian countries, despite its "socialist" orientation (Lawson).

Some observers tried to explain the relationship between the state capacity and government control over foreign investment by exploring joint ventures as an instrument. For instance, one researcher identified two sets of domestic political issues that are crucial

to understanding the ability of China's socialist government to control foreign investment: (1) The dynamics of China's political elite and the influence of these dynamics on the policy. Specifically, it concerns the conflicts between reformers and conservatives over the "open" policy; and (2) the specific regulatory mechanisms available to Chinese leaders to control foreign investment in the 1980s (Pearson). Although the monograph touched upon the state control over joint ventures and SEZs, the issue of SZS is not a salient one in the book. Another recent contribution examines changing central-local relations by focusing on the decade-long reform and state capacity in China (Jia and Lin). Although it provides some enlightenment for measuring state capacity in China, it is not a monograph specifically examining SZS implementation in China. Another recent treatise effectively explores the correlation between the reduction of the state extractive ability and the reduction of state capacity. However, this report only focuses on financial aspects of the Chinese state (Wong & Hu).

This study uses state capacity as a major factor affecting state role in FDI and SZS implementation in China. The concept of state capacity will be redefined, and indicators for state capacity measurement will be located in the following section.

3.3 REDEFINING THE CONCEPT AND RELOCATING THE MEASUREMENT

We can see that from the above accounts, there is a lack of a standard and unified definition for state capacity. Different researchers perceive the issue from different directions. In terms of relations between China's state capacity and FDI policy and SZS implementation, there have been no important monographs or other research papers published thus far. In order to evaluate China's state capacity in a reliable manner, it is

necessary to first clearly define the concept of "state capacity" and to locate ways of measuring state capacity.

3.3.1 Definition of State Capacity

State capacity is one of the defining characteristics of a political system (For discussion of the concept of "state capacity," see Almond & Powell; Katzenstein; Zysman; Evans, Rueschemeyer & Skocpol; Migdal; Idenberry; Organski and Kugler, 1980; Kugler, Organski, Johnson & Cohen; Kugler and Domke). Overall, although "state capacity" is a crucial or key variable in determining the state's role in socio-economic development, there has been a lack of strictly defined and commonly accepted concept and analytical dimensions as well as appropriate indicators measuring state capacity.

For example, while one study uses Migdal's definition (1989, pp. 4-5) of state capacity as a generally acceptable concept without specifically furthering its details (Jia & Lin, p. 6), another one takes an implementation direction and defines state capacity as the capacity to implement state-initiated policies which depend on the ability to tax, coerce, shape the incentives facing private actors, and make effective bureaucratic decisions during the course of implementation (Geddes). The latter research, apparently following the pattern of "bureaucratic competence" and viewing state capacity as expertise in government and the consensus among political leaders (Hirschman; Moran; Tugwell; Stepan; Fishlow; Haggard & Kaufman; Haggard), tries to identify the conditions that cause bureaucratic capacity to develop and flourish or stagnate.

Some studies describe state capacity as the capability of the state (central government) to transform its preferences and objectives into reality. Others simply refer to "state capacity" as the ability of a government in getting its jobs done, define it as a capability to mobilize and direct the resources of the society toward the ends chosen by the state elites (Krasner, 1978b; Finegold and Skocpol; Skocpol, 1980 and 1984, p. 9).

This dissertation defines the concept of "state capacity" without changing the essence of the above definitions, which emphasizes the state's "capability" in "getting the job done." However, an addition should be made to the definition here. The word "state" used here refers to regimes, governments, parties, and administrative agencies. As a whole, a state includes both central and local governments, especially in a unitary political system. So that, based upon aforementioned definitions of state capacity, summarily and in revision, this research defines state capacity as the *capabilities* a state (including central and local governments) possesses to maintain socio-political stability, to regulate the socio-economic activities, to distribute national resources, and, finally, to set up and fulfill development goals. A fundamental measurement of state capacity, in a broad sense, is that a state should be able to fulfill not only policy initiation and implementation, but also its socio-economic development goals. To enhance the state capacity, especially in developing countries, is to enhance the capabilities of the government to promote reforms and to accelerate the process of industrialization and modernization. If a state has a relatively strong capability to deal with policy formulation and implementation which lead to the fulfillment of developmental goal, it has a strong state capacity.

3.3.2 Measurement of State Capacity

Apparently, due to existing differences in their definitions, there could also be variations when indicators are used to measure different specific issues and policies in different countries. Also, state capacity is apparently more easily "asserted than measured" (Wong & Hu, p. 237). One study states that in the modern world, the survival and functioning of a political system depends on four basic state capacities:

- (1) the capacity to mobilize financial resources from the society for pursuing what the central policy-makers perceive as "national interests" (fiscal extractive capacity);

(2) the capacity to guide national socioeconomic development (steering capacity);

(3) the capacity to dominate by using symbols and creating consensus (legitimizing capacity), and

(4) the capacity to dominate by using and threatening to use force (coercive capacity).

Among these, the fiscal extractive capacity is the most important and the basis for realizing other state capacities; to strengthen the state capacity is to enhance the capacity of the state to mobilize and extract social resources (Wong & Hu, pp. 22-23). This is based on the assumption that a highly effective political system should be able to extract resources from the society, aggregate those resources into a national pool, and use them for national purposes. A government that is not able to generate sufficient resources for realizing its policy goals cannot be effective: thus state capacity is weak. Some empirical researches show that this dimension provides a useful analytical tool for explaining such divergent phenomena as the outcomes of major power wars (Organski & Kugler, 1978; Kugler and Domke), domestic political violence (Snider, 1990); demographic transitions (Kugler, Organski, Johnson & Cohen; Organski, Kugler, Johnson & Cohen), and the probability of developing countries' suspending their external debt service payments (Snider, 1988; 1990a; 1990b). However, this dimension is not sufficient to answer many questions facing developing countries' transitions to a market economy and democratic society. That is, many phenomena in developing countries cannot be explained only by financial ability of the state. It is more so in China. For example, the extractive ability in Mao's time was higher than the post-Mao time according to the percentage of the national revenue and the GDP. Socio-economic development level in the former era was much lower than that in the latter one; so fulfilling certain policies does not mean fulfilling developmental goals.

To enforce its authoritarian rule in a neo-Weberian or statist view, the state has to construct a set of state agencies which may develop their own preferences over time. In other words, these state agencies could become "power centers," competing with the rulers and threatening the coherence and stability of the state. The principal weak point in the state system thus is more likely to lie "within the regime itself, within the apparatus of the state," than "outside it..." (Schmitter). Thus, measuring state capacity by focusing mainly on bureaucracy and administration is surely a dimension. There are several aspects in which bureaucratic competence can be analyzed: (1) politico-administration relations (Hall; Zysman, p. 300); (2) centralization vs. decentralization (Katzenstein); (3) relationship among state agencies; and (4) policy legacies (Heclo, p. 315).

Therefore, state capacity can be explored in relation to state-society, state-market, center-locality, bureaucracy-pressure groups, etc. Since this study is designed to measure the relationship between the state capacity and the state's role in FDI policy and SZS development in China, some unique dimensions and factors should be taken into account. In fact, the specific conditions constituting state capacity are numerous and are contingent upon policy issues. Thus it is difficult to operationalize for general use. That is, measurement of state capacity can vary from case to case. Here I will discuss some important factors that reflect the level of state capacity in relation to socio-economic policy-making and implementation. Any factors -- political, social, economic, cultural, and external -- can be used to examine state capacity which enables the government to "get the job done": carrying out the policies and realizing the developmental goals.

By specifically analyzing several indicators in the policy making and implementation process of FDI and SZS, this research uses an inductive method to show that several government actions in economic development and FDI policy making and implementation can examine state capacity. In other words, the reason China's government

has been able to handle SZ development effectively is that it has relatively strong state capacity, which is reflected by these indicators.

3.3.3 Indicators For State Capacity and SZS Implementation In China

In the literature on the subject, researchers usually use several indicators for analyzing state capacity in terms of FDI and SZS. Indicators for evaluating state capacity in dealing with opening up and FDI in developing countries, according to many researchers, can generally be divided into four categories. The first three, which were well elaborated by Evans and Stephens (1988), include: (1) state commitment toward development and ability in planning socio-economic development; (2) state capability in dealing with international norms and its strengths to bargain with TNCs; and (3) state capability in mobilizing and coordinating domestic resources. The fourth indicator, specifically developed by some researchers on the subject of FDI and SZS (Chang, Wei; EPZA 1986a; MOEA; Park), is the state's ability to intervene in SZs' operations. The intervention includes setting and modifying the terms of foreign investment in zones, adjusting and reprioritizing the industrial structure in zones, and encouraging local inputs of capital and raw material into zones. Undoubtedly, these indicators are important to measure state capacity in different countries, and are useful in this dissertation.

However, since this study is examining the China case, which intends to show the relationship between the state capacity and state's role in socio-economic development by attracting FDI and using SZS, including policy formulation and implementation under China's conditions, the author would like to make two additions: (1) state ability to decentralize the power without weakening the central government's overall control; and (2) state ability to deal with regional inequality in order to obtain long-term development goals and maximize national benefits. There are reasons for these two indicators to be

included. First, the ability to decentralize power is a very important aspect for China's economic reform. Decentralization has been an old issue in the history of the People's Republic of China. Certainly, decentralization of power is a common phenomenon in most developing countries. However, it is more difficult for the Chinese government to carry this process, because previously China had a highly-centralized political and economic system and a socialist government. Second, local inequality is a salient problem waiting to be solved. Considering China's huge territory and population, its development could very easily cause regional and local disparities. To many this situation should be called "inequality" and "unbalanced development," and would be very hard to deal with by the central government. In summary, six indicators are used in examining state capacity: (1) planning socio-economic development, (2) dealing with international norms, (3) utilizing domestic resources, (4) intervening in special zones' operation, (5) decentralizing power without weakening the state control over foreign investment, and (6) dealing with local economic inequality. Tentatively, the author believes that these six indicators are sufficient for the evaluation of the state capacity in handling FDI and utilizing SZS in China. In order to avoid any ambiguity and confusion in using different indicators and dimensions, this study divides them into two groups: general state capacity and particular state capacity. The general state capacity, which is related to a state's general capability in dealing with overall socio-economic development and modernization, including FDI policy formulation, has three indicators: (1) the state's commitment toward development and capability in planning socio-economic development; (2) the state's capability in dealing with international norms and its strengths to bargain with TNCs; and (3) the state's capability in mobilizing and coordinating domestic resources. This general capacity provides a base for any developing country which is willing to open its door and develop its society by internationalizing its economy. The particular state capacity is related to state's specific ability in implementing FDI policy by utilizing SZS, especially for China. It includes another three indicators: (1)

State capability in intervening SZs operation; (2) state capability in decentralizing power; and (3) state capability in dealing with local economic inequality. The study aims at discussing the effectiveness of state control in several policy areas, analyzing the leading role of the central government in the transition to a market economy, particularly reflected by using SZS, which shows that China still has relatively strong state capacity.

CHAPTER IV

GENERAL STATE CAPACITY AND UTILIZING SZS

Chapters Four and Five focus on the political economy of SZS, particularly on the relationship between state's role and state capacity in China. The major proposition of the dissertation will be made: strong state capacity is associated with the outcomes of the state role/state intervention in economic development. The reason China has been able to use this unique SZS effectively is rooted mainly in the state's strength in intervening in economic activities, including foreign investment. The state of China is presumed to be a strong state with various capacities. By specifically examining six important state capabilities in economic policy initiation and implementation, it shows the Chinese government's strength in dealing with FDI, and answers why the Chinese government is able to use this complicated SZS well and reach the preset goals.

Chapter Four explores state capacity at the general level in China. General state capacity enables a state to play a positive role in socio-economic development and FDI policy implementation under contemporary international conditions. A relatively strong general state capacity can provide a basis for specific state capacity used to implement particular policies: specifically, SZS. In order to meet the requirements of modernization, a developing country urgently needs to enhance the state capacity to guide its modernization and transition.

Three factors will be examined: (1) state capabilities in planning socio-economic development, (2) dealing with international norms, and (3) utilizing domestic resources. These three factors consist of basic capabilities and preconditions for a state to play a positive role in developing its society and economy by attracting FDI and using SZS, thus integrating its economy with the global one.

4.1 STATE'S STRATEGIC PLANNING CAPABILITY IN SOCIO-ECONOMIC DEVELOPMENT

State capacity has a profound impact on the process of industrialization of a country. Probably the most important capability for a state to successfully implement its policies and intervene in various economic activities is that it should not only be committed to modernization of a country, but also able to plan its socio-economic development. This two-faceted issue cannot be separated when discussing state capacity and modernization. In the contemporary world, many developing countries were once either entangled by religious and ethnic conflicts, distressed by external forces, or tightly controlled by military regimes. Some countries could have commitment to modernization but lack ability in planning socio-economic development strategically. They simply cannot launch modernization programs or realize the goals of modernization. The following examination shows that China's state possessed the ability in planning socio-economic development strategically.

4.1.1 The State's Commitment To Modernization In China

One prerequisite for the development of a developing country is that the state should be committed to modernization of the country. That is, the people and their government should be willing to develop. Evidently, in the history of the People's Republic of China, the state made many efforts toward modernization, whether in Mao's period or the Post-Mao era.

Historical modernization commitment

Mao's era.

In China, open-door and foreign investment policies are originated from or the transformation of the so-called "Four modernizations." The open door policy does not mean that China totally abandoned Mao's policy of self-reliance and independence. There is a logical and historic relationship between them. The chronological review of the main stages of economic development since the foundation of the People's Republic in 1949 shows that the policies launched in December 1978 were the turning point in China's economic and political development.

In Mao's era, modernization was an important political agenda of the government and the Communist Party. The key difference is that during Mao's era, this kind of modernization happened behind the closed door. In the early 1950s, Mao proposed an approach to economic development based on socialist mobilization. But Mao called for autarkic development, which is the most radical form of inwardly-oriented development.

The adoption of the open door policy in the late 1970s reflected Chinese attempts at modernization which can be traced back to the early 1960s. It was envisaged that by the end of the projected Fourth Five-Year Plan in 1972 the modernization of industry, agriculture, science and technology, and defense could be realized. This wish was repeatedly expressed at the Third and Fourth National People's Congress in 1964 and 1975, respectively. It was at the Third National People's Congress that the need for "correctly handling the relationship between self-reliance and international co-operation" and for pursuing a "technological revolution" was first mentioned (Zhou, 1975). However, in the era of Mao's regime or totalitarianism from 1949 to the end of 1970s, the modernization drive was only a good wish, although the four aspects of the Chinese

modernization provided an initiation for the real modernization process in the 1980s. The economic system was highly central-planning, and the approach was basically self-sufficient and inward-oriented. This type of modernization was still a part of the communist utopia adopted by the Communist Party of China and its leader Mao Zedong. The result of this isolated socio-economic development strategy was certainly not satisfactory.

Deng's era.

It was in the post-Mao era, starting in 1978, that an outward-oriented modernization idea was gradually shaped. The goal of the previous Four Modernizations was formally written into the new constitution of the Chinese Communist Party, enacted at the Eleventh National Party Congress on 18 August 1977, and again incorporated into the new constitution of the People's Republic of China, promulgated at the Fifth National People's Congress on March 5, 1978. In the Fourth Session of the Fifth National People's Congress in November-December 1981, Zhao Ziyang, then Premier of the state Council, made his report on government work, and explicitly defined the new policies. In his report, he outlined ten principles as the concrete embodiment of the policy of "readjusting, restructuring, consolidating, and improving," and clearly stated that China will "persist in an open-door policy;" that it will give prominence to the development of consumer goods and service-oriented industries; that it will carry out a technical transformation; and that it will actively and steadily reform its economic system (Zhao, 1983; Hu). In the words of some Chinese scholars, the new policy called for a change of strategy from one of isolation and self-reliance to that of an open door. It was a change in the economic system from one based on egalitarianism, over-centralization, and collectivism to one allowing the co-existence of a variety of different economic and management structures (combination of

planned and market-oriented systems), while still insisting on the dominant role of state enterprises (Liu, pp. 23-27).

Some view that opening up the country initially was out of competition for party leadership between Deng and Hua, and Deng Xiaoping's decision to introduce reforms was dictated by his political interest in discrediting Hua Guofeng (Shirk, 1994, pp. 10-11). However, China's long-time modernization drive shows that this conclusion can be reconsidered. Also, considering Deng's strong political influence at that time, if Deng wanted to seize the power from Hua, Mao's assigned successor, it was easy for him to get it without launching the open-door policy. None of the leaders of these rival factions could challenge the seniority or personal authority of Deng Xiaoping: his smart strategy for gaining power, his military background and support of the army, etc. It can be also proved by the later actions taken by Deng himself: he did not take the highest positions both in the Party and the government.

In short, the impetus behind open-door policies by promoting foreign investment and technology came from long-standing striving towards socialist modernization and SEZs are simply the first test of the feasibility of such policies.

Two factions and one orientation to modernization

Another interesting phenomenon which helps show the state's commitment to Chinese modernization is that although there is a major split in the leadership, both political factions supported modernization and reform. It seems that the fate of China's opening-up has rested in the hands of the ruling elite coalitions and their particular vision of development. However, the difference between them is how and to what extent the reform should be carried out: that is, it has much to do with specific approaches rather than the common goals of modernization. Opening up the country and implementing national economic reform by setting up SZs are oftentimes under attack from the conservative camp.

For instance, the establishment of the first four SEZs caused conflict between the two factions regarding the new practices and existing state policies on customs, import and export controls, taxation and the like. However, both groups still had to keep the slogan of "Four Modernizations." That is, everyone in the elite group should support the modernization of the country.

It is evident that although there remains a strong conservative element amongst the Chinese leadership, the fundamental shift in development strategy has not been reversed since 1978. The conservatives' impact on national policy peaked in the 1983 campaign against "spiritual pollution" and from the mid-1985 crackdown on imports until the then-General Secretary of the Party, Hu Yaobang's resignation in January 1987. The first serious criticisms of the SEZs appeared in early 1982, when senior leaders in Beijing openly questioned the wisdom of opening the country to foreign residents and FDI in these "enclaves." By 1983, Chinese leaders looked carefully at the SZ experiment and made a number of critical observations; some complaints came from the conservative camp. They noted that domestic Chinese investment was much greater than foreign investment, and that the latter was chiefly in the area of real estate instead of manufacturing industries. This type of investment would not bring in the influx of new technologies that the Chinese had hoped for. Some negative effects were being felt on the neighboring provincial economies: uncontrolled immigration into the zone, smuggling, a black market for currencies, and so on. To conservatives, there was also a tendency to move too rapidly towards a "capitalist" management structure for the SEZs. However, these episodes were short-lived because the conservatives could not simply deny the experimental nature and the progress of the SEZs and other positive changes brought by economic reform and an open door policy.

Deng Xiaoping, although sympathizing with some of the conservatives' concerns, was apparently even more fundamentally committed to the opening up of the economy. In November 1983, and again in 1984, many senior leaders, led by Deng Xiaoping, made

official visits to the SEZs. This inspection tour resulted in stronger official support for the SEZs; at the same time, it provided the opportunity for the leadership to announce, in April 1984, the opening of the 14 coastal cities of the country to FDI. The visits concluded with general support for SEZs and a special zoning policy, declaring that having seen it for themselves, "reform leads to prosperity. Reform is convincing" (Xinhua). By the beginning of 1985, prospects were emerging for the SEZs. The conservatives were quiet again and had to follow the reform trend. In 1989, under the influence of the alleged leader of the conservative camp, Chen Yun, state economic planners led by Li Peng and Yao Yilin proposed in the Central Committee document 89.11 to continue the country's economic readjustment program approved in 1988. They also readjusted the previous market reform initiatives for the interior's economy. The new leadership coalition in Beijing thus was no longer as eager for the interior economy to experiment with the market reforms as carried out in the SEZs and the coastal provinces. However, they did not stop the process of industrialization and modernization in China, and this so-called "policy readjustment" was also short-lived. Deng Xiaoping's "Southern Tour" of 1992 prevented a full-scale retrenchment of China's development strategy (Reardon, p. 297). Deng's visit not only reinvigorated China's transition to outwardly-oriented development and the EPZ policy, but assured the formal adoption of the market socialism concepts at the 14th Party Congress (Naughton). While post-Deng policy elites such as Jiang Zemin and Li Peng might differ on the degree to which China should integrate with the international economy, there appears to be a fundamental agreement to continue the transition to outwardly-oriented development and further integration of the Chinese economy with the global economy.

Summarily, in the development of SZS and national modernization movement, China's elites played an extremely important role in launching economic reform and mobilizing the necessary political support to see it through. Although their programs were potentially controversial from more aggressive programs to more orthodox, conservative

programs of modernization, their orientation toward modernization was the same. For example, the intellectual biographies of China's leaders give a clue to this similarity. Some of them, like Chen Yun, had long proposed economic reforms that would allow greater room for market forces, individual ownership, and foreign economic relations. Others, like Deng Xiaoping, appear to have come fully to this realization during the Cultural Revolution. Their commitment was intensified by their understanding that during the decade of the Cultural Revolution China had fallen behind the spectacular economic growth and technological development in many countries. While Deng's reform plan was toward more radical and liberal, Chen's formula remained conservative, which reflected an agriculture-based, limited reform with a somewhat characteristic of economic autarky. Only in this sense, Chen's group was perceived by outsiders as the conservative group, while Deng's group was called the group of reformers.

4.1.2 The State Capability of Strategic Planning for Socio-Economic Development

Having only the motivation to modernize is not sufficient to develop a country. This has been proved by experiences in many developing countries, as well as the Maoist regime in China. A state needs to possess the capability to plan the development according to its own socio-economic conditions. Besides its commitment to the modernization of the country, China's state in the post-Mao era also possesses certain capabilities to plan socio-economic development and modernization. Some foreign observers on the World Economic Annual Forum in 1997 also concluded that China's economic success can be attributed to the government's correct developmental strategy and plan (People's Daily, Overseas Edition, 1997, February 3). (To be sure, the term "plan" here does not refer to any specific plan in an administrative or managerial perspective. Rather, in a broader sense, it refers to the way the government can approach development issues, which is about how

the government uses development strategy, how to adjust it in a timely manner, and how to prioritize the development goals.)

Advantageous structure and institutions for planning

The first indication of this ability can be found in structural and institutional aspects.

First, China's pre-existing political and economic systems and institutions were relatively independent from internal and external influences. Historically, there was an absence of a continuing foreign influence from the nineteenth- and twentieth-century era of colonial expansion. The result was that it did not have strong and unsevered economic and political linkages with capitalist countries. It thus had more free play and independence in international political and economic activities. Due to the previous socialist nature of the system and centrally-planned economy, there were entrenched interests of neither foreign nor private capital to influence the policy from within. The result was that the state's policy formulation and implementation would not be influenced by those specific interest groups.

Second, although China developed a centralized political system and centrally-planned economy before opening up the door in the late 1970s, a unique feature of China's system, compared to the Soviet system, is that it was less centralized and less well institutionalized. One comparative study points out that the reason why China succeeded in carrying out economic reform without political reform, while the Soviet Union was unable to do so, is due to this Chinese version of Communist Institutions (Shirk, 1994). Although the two political systems were structurally similar, the Chinese version of communism proved to be more flexible than the Soviet. Unlike the Soviet Union, the Chinese command economy since the 1950s has been a multitiered, regionally based system in which local governments planned and coordinated much of the economic activity, while planners in Moscow issued orders to factories throughout the country. As of 1978 only 50-55% of gross industrial output was covered by the central plan in China; in

1980 only 3% of state-owned factories were directly administered by central government ministries (Wong, Christine, 1986). China's weakly institutionalized system was an advantage not only to Deng Xiaoping and his reformist allies in introducing economic reforms, but also to the central government's utilizing macro-control and local governments' becoming more involved in economic development.

Third, another structural advantage is that when China decided to absorb FDI, its pre-existing socialist planning mechanisms offered ready organizations and personnel to determine the role and function of foreign investment in China's economy. Both central and local economic planning and implementing ability could be fully used. A major goal of modernization in China is the transition from a centrally planned economy to a "socialist" market economy. In a planned economy, the state normally assumes the leading and guiding role in planning and plans for comprehensive development in order to satisfy social needs. Planning, by locating social overhead capital, determines the size, location and economic interrelationship of productive activities. Under this system, the state has a great deal of control over planning investment, spatial expansion, timing and scale of development. This structural advantage provides a base for the government to take a controlled opening up strategy when the government implements FDI and SZS. For example, China has a tradition of making "five-year" plans. Although under the old system these plans were by and large failures and thus were only plans on paper, this method continued to be used by the central government; not to manipulate every aspect of economic activity but to set and adjust priorities for macro economic control. For instance, the seventh five-year plan gives priority, on one hand, to foreign investment in energy, transportation, telecommunications and raw materials, particularly to the construction of electric power plants and ports, to the petroleum industry, as well as to technological updating of machine-building and electronic industries. On the other hand, emphasis is given to increasing foreign exchange earnings and achieving import substitutions. Those

priorities reflect the experience the country gained from the initial experiment with foreign investment; they set the tone for the implementation of the FDI policy in the entire second half of the 1980s.

In short, China does not have to destroy the old system to launch modernization just as some "shock" models pursued. Rather, those historical and structural features in China allowed the government to absorb investments from a highly controlled position in which it could choose the precise areas and the locations for the liberalization of control over investment and the pace of such liberalization. Also they strengthened the government's position in negotiating foreign contracts and overseeing operations. For example, the state's monopoly over joint venture approvals had potential to allow it to determine the range of terms for foreign investment contracts. Because joint ventures were formed with many state-owned enterprises, the state had the opportunity to directly foster its own ends and to control the role of foreign capital in China's development.

Examples of state's strategic planning ability

Cost vs. benefit

This planning ability can be seen in the government's reasonable reckoning of cost and benefit. The cost-benefit analysis is a classical approach for an SZ analysis. When the Chinese state launched modernization by using FDI and SZS, it needed to think about these questions: Are these SZs economically viable structures and capable of returns on investments that make them solvent and capable of surviving in the international market environment? Can they indeed be disconnected from the planned economy? If the congruence of SZs with national economic development objectives is to be established, their economic, social, and political benefits must be measured against their costs. Because benefits and costs are not all known or quantifiable, and they are not exclusively economic,

this assessment is difficult to make. Yet the practical aspects of this question become clear when national or regional authorities have to make decisions, be they political, social, or economic. Such decisions represent costs, which need to be analyzed against potential benefits.

In respect to FDI and foreign loans, although China urgently needed a vast amount of capital for development, the post-Mao leadership was acutely aware of the pitfalls associated with depending on loans from foreign countries. The serious debt problem that many Latin American countries were facing constantly reminded Chinese leaders that China should not follow in their footsteps and rely heavily on foreign loans (People's Daily, 1987, December 1). Undoubtedly, compared to foreign loans, FDI is more advantageous and safer for China.

Another feature of this strategic planning consideration is its balance of short-term and long-term interests. It has to do with the more intangible effects of the experiment and the reforms. For example, the first four SEZs were established to give China a base for importing new managerial skills, embodied technologies and "learning the capitalist" way. Setting up the SZs reflected economic and non-economic strategic considerations of the state within the large sociopolitical context of China for the purpose of exploring their impact on the country's FDI policy. SZs are avowedly capitalist economies, where the full strength of market forces has its effect. In this sense, SZs are a valuable element in the overall development strategy of the country. Regarding preferential policies for SZs and the central government's revenue loss, the government gives this short-term loss to the long-term development consideration. Obvious distinctions exist between relatively detached enclaves such as SZs and the urban growth centers embedded in the Chinese polity. Some SZs such as Shenzhen and Zhuhai have been granted almost complete fiscal autonomy. However, to the central government, this loss can be offset by the long-term development benefit. The long-term political and social cost of SZs is much more important

than the short-term balance-of-payment concerns. Narrow, short-term factors in themselves are considered as inadequate justification for the creation of the Chinese zones.

Gradual implementation

The planning ability can also be seen in a feasible implementation approach to economic reforms and FDI policy. Instead of rushing ahead with a comprehensive, radical transformation of the entire system that would threaten the vested interests of many groups and possibly destroy the whole system of the old (thus causing chaos) the reformist leaders were very cautious. One debate has been whether or not developing countries should follow a "big bang" or a gradualist approach to reform. Since more political freedom would usually bring more economic liberalization, many regimes prefer rapid reform to slow reform, given the breakdown in the central planning apparatus (de Melo, et al. p. 27). However, China's case is an anomaly (Table 4-1).

**Table 4-1 Political Freedom and Economic Liberalization
(1989-1996)**

Countries	Political Freedom	Economic Liberalization Index
Poland	6.00	4.14
Hungary	6.50	4.11
Bulgaria	6.00	2.96
Mongolia	5.50	2.27
Russia	4.50	1.92
Ukraine	4.50	0.80
China	1.00	3.08

Adapted from de Melo, et al. p. 54.

Another comparison may be helpful to explain the situation. The Soviet Union, at the beginning of designing its special zones for foreign investment in 1990, planned to launch about 60 free economic zone projects throughout the country (UNCTC, 1991, p. 47). The fact is, until now, no country in the world has ever considered setting up more than three or four such zones simultaneously, let alone 60. This means that there would be fewer opportunities to learn from experiences and mistakes, and to make minor adjustments or fundamental changes for SZs if too many zones are attempted at the same time, especially at the beginning of the opening up of the country and reform.

In China, however, the central government's cautious, controlling, and experimenting approach to development of SZs also showed its good strategic planning ability. The first four SEZs established in 1980 were conceived primarily as a laboratory for testing economic and structural changes that might eventually be introduced into the rest of the national economy. Some say that China actually did not have any plan of developing economy, its plans, if any, are contingent (Jao & Leung, p. 224). Yes, it is contingent, but it is still a way to plan too, as some Chinese leaders put it, "wading across a river on rocks" (FBIS, 1985, March 25, p. K26). A contingency plan or strategy can help the government follow the new experiences and adjust the policy constantly. A brief chronicle analysis of the step-by-step opening up of the country by setting up SZs can help justify this approach.

The first step of SZS development started in 1980, symbolized with setting up four SEZs, mainly for experimental purposes. As the four SEZs were experimenting with measures to implement the FDI policy, the central leadership was closely reviewing the results in order to enact substantive rules for facilitating FDI at the national level. To fulfill the experimental function, the SEZs became the "showplaces" of modernization. Managers, officials and scholars from all over China visited Shenzhen and Zhuhai to study their experiences and achievements. Managers from Shenzhen and Zhuhai joint ventures have

been sent to lecture tours within China to inform domestic enterprises about the operation of personnel practices and incentive schemes.

At the second step of the development of SZS, starting in 1982, there were some new important developments in FDI policy making and implementation. *First*, many more new laws and regulations were passed, and the investment environment was getting a stronger legal protection. *Second*, the central government made the decision to open the fourteen coastal cities in 1984. Thus, each of the eight provinces and two autonomous municipalities along China's coastline are represented, which means that SZS has spread on the coastal line.

The third step of SZS development is to open the three delta Open Economic Zones (OEZs). After the first two phases of experimentation with FDI in China, the Chinese government believed that they had gained enough experience to open more areas to foreigners and designated three more coastal areas to be special investment zones (China Daily, 1985, March 5). The initiation of the third-phase implementation of FDI policy and SZS resulted in the fact that all the major areas along the Chinese coast line have become special investment areas. They include two centrally-administered municipalities, Shanghai and Tianjing, 25 provincially-administered cities and 67 counties, which comprise a total population of 150 million (People's Daily, 1987, October 13). This step of SZS development is maturation of a nationwide development strategy, which is called by some observers "Coastal Development Strategy" (Tzeng). On February 6, 1988, the Fourth Meeting of the Political Bureau of the CPC officially adopted the Coastal Development Strategy whose ultimate goal is to enable China to link the coastal areas with the global marketplace and to promote export-oriented economic development through linkages to the inland areas. Its initiation was described as a vital innovation in China's economic reform (Dagong Daily, 1988, February 7, p. 1). Since 1979, when China opened its door, of the 4,300 foreign investment projects operating in China, almost 92.4% are located around

coastal areas. This coastal development strategy covers more than 284 cities and counties with 160 million in population. In fact, the strategy has become a vehicle to carry the open door policy through China's coastal areas. Setting up Pudong New Area in Shanghai in 1990 was symbolized as the completion of this step. The current trend of FDI policy SZS is to shape a nationwide economic reform, which emphasizes more on inland development (Beijing Review, 1988, pp. 10-11).

This review is not to suggest that these steps of development framework had been envisioned by Chinese leaders when the policy to utilize FDI was made in the late 1970s. What was planned with respect to the implementation of the policy was just a simple strategy which encouraged, in general, FDI in all parts of China but reserved the right to experiment with new implementation measures in a few selected areas, an effort both to avoid making major mistakes on a nationwide scale and to pass the experiences on to other areas. This implementation strategy went hand in hand with Chinese leaders' pragmatic philosophy when they dealt with economic reform and development. As Deng Xiaoping put it in 1985, "The opening policy is an experiment . . . We are very determined to implement our open policy, but we are also very cautious in the process of the opening up." (Deng, 1993, p. 133).

Macro control ability

Another example of China's state capability in socio-economic planning is that the state has relatively strong macro control over the economy. One important tool for macro-control over the economy is tightening the financial and money policy. From 1985 to early 1986, the Chinese economy became increasingly overheated, with excessive high levels of domestic investment. The result was a surge of imports of capital equipment and consumer goods without a corresponding increase in exports. China's foreign trade experienced a US\$15 billion deficit in 1985, causing the country's foreign exchange

reserves to drop from US\$16.7 billion at the end of 1984 to US\$10.3 billion at the beginning of 1986 (Harding, 1987b). In an effort to alleviate the situation, the central government tightened control over the expenditure of foreign exchange. This made it difficult for all enterprises in China, including foreign-funded ventures, to import things necessary for their operations. In July 1986, the government also devalued the Chinese currency by about 16%, from RMB¥3.2 to the dollar in 1985 to RMB¥3.7 in 1986, which made the problem of foreign exchange shortage even more acute.

The tightening policy yielded significant effects on the economy. The amount of major FDI contracted for in 1986 was only about half of that contracted for during 1985. The capital brought in by newly approved major foreign-funded projects declined to US\$3.3 billion in 1986 (Grub & Lin, p. 62). In the early 1990s, the economic growth rate was again faster than the government expected. The GDP growth rate was 13.2% in 1992, and 13.4% in 1993, respectively (UNDESIPA, p. 301). After the central government utilized a tighter screening of investments and stronger central control over the banking sector, speculative investments in real estate and the stock market were curtailed. The overall economic development speed was slowed down. GDP growth was 11.8% in 1994, 10.2% in 1995 (Asian Development Bank, p. 54), and 9.7% in 1996 (People's Daily, Overseas Edition, 1997, January 22, p. 2).

Another example can be found in the government's efforts toward taming inflation. This is a typical problem which once haunted many developing countries, especially in Latin America. Inflation increased after China opened its door and began the market-oriented economic reform. It peaked at 21% in 1994. The central government steadily applied monetary control and the reimposition of administrative controls over some food prices and the curtailment of public investment projects. The inflation rate finally came down to 14.8% in 1995 (Asian Development Bank, pp. 54-55), and 6.1% in 1996. The macro control approach realized the expected goals of curbing inflation while keeping

relatively high rate of growth. Currently, the financial policy is well implemented, and inflation rate is greatly reduced (People's Daily, Overseas Edition, 1997, January 14 and 22).

4.2 STATE'S CAPABILITY IN DEALING WITH INTERNATIONAL NORMS

The second indicator for evaluating China's state capacity in dealing with FDI policy implementation is that it has the ability to cope with international norms. That is, a state should not only be able to take advantage of a conducive international economic environment, if any, such as capital and technology, but also be able to meet international business standards. The conflicts between the state and foreign capital are also considered as an exogenous constraint on development. Peter Evans has pointed out a substantial difference between the logic of the state's development goal and the logic of foreign capital's global profit maximization (Evans, 1979, p. 212). The major objective is profit for foreign investors interested in participating in China's development. The Chinese state recognizes the facts and is willing to permit foreigners to make a "reasonable profit." Indeed, foreign investors' motivations may vary, but they certainly include one or more of the following: (1) receive assurance of a share of China's potential market and the rapid growth of its economy; (2) reduce production, labor, and other costs; (3) obtain raw materials available in the Chinese market; (4) meet their competitors' move to China and/or forestall or reduce competition from other firms' earning markets in the same geographical area; and (5) test the Chinese market as a potential for large scale investments at a later stage.

It is understandable for a host country, especially a developing country, to plan its development carefully, and to use numerous complex policies and strategies, such as SZS,

foreign currency control, export-encouraging, and gradual opening up of the country that bring more benefits to its own country. However, it is also reasonable for foreigners to perceive the host country in their standards. Foreign investors want to make good returns from investing in China; foreign governments have their expectations for China too (Some of the Pacific region industrial countries are concerned with both China's stabilization and peaceful transition and their own commercial benefits. Other industrial countries have more straightforwardly commercial attitudes about the SZ experiment). How to bring in more FDI while meeting international norms has been a challenging issue facing China's leaders. The most important strength is to build a favorable investment environment which is related to the host country's overall attractiveness to foreign investors. This is another dimension of testing state capability of a developing state. In China's case there are several aspects which show this kind of state capacity: incentives; policy stability; and international cooperation.

4.2.1 Providing Incentives For Investors

Indeed, the international situation since the 1980s has been favorable for China's foreign capital absorption. Most developed countries have been seeking opportunities for a higher return on their capital, for the growth of capitalist economies throughout the 1980s has been continuing at a slow pace. But how to bring foreign capital into the host country and finally actualize it is another question. A general approach suggests that a host country needs to meet international norms by providing incentives for foreign investors.

An IMF study summarizes basic incentives almost all countries offer to foreign investors. Direct incentives include offering either commodity or factor protection to foreign investors. Commodity protection refers to price alteration of goods and services bought or sold by a foreign firm, usually takes the form of reductions in or exemptions from both import and export duties. Factor protection means to reduce overall operating

costs (such as tax holidays, investment allowances, and sometimes even subsidies for training local labor). Indirect incentives include the following: simplified investment procedures; guarantees of capital flows and profits remittances; legal protection of industrial rights; and political and commercial risk insurance schemes (IMF, 1985).

China is not exceptional. It is true that China has a huge market. But it would not automatically become a factor for the success of FDI policy implementation. In order to promote FDI, the Chinese government has made a considerable effort to provide various investment incentives. Its incentives for FDI have focused on fiscal measures that are designed to reduce the tax burdens of foreign investors. These measures include tax holidays, concessionary rates, and exemptions from import and/or export duties. For example, China's current corporate tax rate for joint ventures is 15% in most areas, compared with an average tax rate of 30% or more in most neighboring developing countries (Grub and Lin, p. 65). In addition to tax incentives, the SEZs, opened cities, and many provinces also offer preferential land-use fees to foreign investors.

China's government tried to make a comprehensive incentive system by constantly setting new laws and regulations and amending old ones. Despite the increasingly liberalized investment policies and favorable incentives provided during the first part of the 1980s, foreign investors often complain about the Chinese investment environment: mainly the currency nonconvertibility problem, employment restrictions and the difficulty of dealing with local bureaucracies, as well as other operational problems. As a consequence, overall foreign investment declined sharply in 1986 due to foreign investors' dissatisfaction. The State Council issued a new set of regulations in October 1986, later known as the "22 regulations," designed to provide additional investment incentives to foreign investors: further reductions in the income tax rate, easier access to the financial resources available domestically, increased access to the domestic labor market, more autonomy and flexibility in hiring and firing, and other related decisions. Controls over the

remittance of profits in foreign currencies abroad were reduced. Principally, China had two purposes in issuing the 22 regulations: to improve the overall investment environment and to provide special incentives for the investment projects it particularly wanted. These incentives were directed toward specific ends, such as facilitating exports or giving joint ventures additional options for solving foreign exchange imbalance problems. But the real benefits, such as exemptions from certain payments and lower costs, were given only to those joint ventures that could fulfill one of China's two major goals for attracting foreign investment: expanding exports and introducing advanced state-of-the-art technology.

SZs provide a business environment different from that of the rest of the country. The preferential treatment offered in SZs are both administrative and economic. Authorities set up a less-cumbersome, more responsive bureaucracy to handle SZs' administrative procedures. Sometimes one central organization handles all investors' administrative matters, and thus reduces red tape substantially as compared to dealing with a large number of institutions spread all over the national bureaucracy. Movement of people and goods is expedited, thanks to simplified immigration and customs regulations and procedures. Labor, contract, and import and export regulations are less restrictive. Foreign exchange controls are either reduced or eliminated altogether. Even more attractive are the economic incentives. Fiscal regulations, including tax holidays and reduced rates, may be offered to investing firms, and they may qualify for additional tax breaks or subsidies if they make large capital outlays or bring in coveted technologies. Customs duties and other taxes on goods and materials imported into SZs for storage, handling, or processing are collected only when they enter the domestic market. Imported goods coming into SZs for the purpose of export, further processing, repackaging, and storage are exempt from customs duties and taxes. Domestic finished and semifinished goods destined for export entering the SZs for additional processing or packaging are exempt from various taxes. Authorities

provide adequate infrastructure and land, often at substantially subsidized rates (Robinson, 1987).

The government made some amendments to the joint ventures law in 1990. A big change was the elimination of the time limit on foreign contracts. In another amendment, the nationalizing of joint ventures after the termination of foreign contracts is to be stopped, except in exceptional circumstances in which "appropriate compensation shall be made." Also, a foreign partner is allowed to become chairman of a joint venture's board. Another incentive made recently by Chinese authorities is to relax restrictions on domestic sales of locally made items, ranging from electronic appliances to soap powders. Formerly they had to be exported. The general prohibition on investment in the retail sector was taken away in 1992. Since then, there has been a flood of projects in retail businesses. Many mall deals are going ahead without central approval (Goldstein).

Through the investment incentive system, not only was more foreign capital poured into China, but the state also strengthened control over foreign economic activities. For instance, the system, by relying on tax preferences, permits increased state monitoring over foreign investments. In order to access tax preferences, foreign investment enterprises must submit documentation indicating income and taxes due before the incentive adjustments are made. Current activities in this field show that legal protection for FDI is approaching the mature stage. One recent report suggests that foreign investment incentives themselves will be abolished in favor of an incentive system applicable to both Chinese and foreign investors. China's foreign exchange system has been reformed and the dual currency system eliminated (CEN, 1994, January 10, p. 9). The enactment of the Company Law of the PRC heralds an effort to unify the corporate legal status of Chinese and foreign businesses (CEN, 1994, Supplement No. 2, March 7). All this does not mean the preferential treatment toward FDI and SZs would be stopped soon. Rather, it is a symbol of mature legal protection of FDI, which is an important factor for a stable policy system

and a market economy in which foreign businesses can compete with Chinese domestic businesses on equal footing.

4.2.2. Maintaining Policy Stability

Political stability and policy stability are usually regarded as a necessity for FDI success. The Chinese government insisted on policy stability more than political stability, because the political situation can fluctuate but foreign investment policy can remain relatively stable.

Opening up the country to foreigners by allowing the building of joint ventures and establishing SZs represents a marked departure in China's foreign economic policy since 1949. That shift has been at the root of the disagreement on the part of many Chinese political and military leaders. This disagreement was evident especially at the beginning of the utilization of SZS. However, this disagreement was usually confined within the Party and the government. As a matter of fact, the open door policy and FDI policy have been steadily moving toward more openness and more liberalization. Sometimes, top leadership became directly involved in FDI policy to convince foreign investors of stable FDI policy. The crackdown of the 1989 democracy movement caused serious damage, at least temporarily, to investment policy implementation. Many foreigners were scared away from China. However, the Chinese leadership did not reverse the process of the opening-up, and did not change previous foreign investment policies. In order to encourage foreign investment and technology to enter China, an international symposium was held in Beijing on December 13, 1989, attended by many leading Western businessmen from Britain, Canada, Hong Kong, Japan, the United States, and West Germany. To assure foreigners' confidence, key Chinese leaders (including Jiang Zemin, General Secretary of the Party), addressed that meeting, saying that foreign investment was needed and foreigners were

encouraged to invest in China. The basic laws and regulations regarding FDI and SZs will remain in force (China Daily, 1989, December 14, p. 6).

Legal protection is a fundamental tool for policy stability. In the evolution of the foreign investment and SZs policies, the Chinese government has gradually provided legal protection for FDI. Mainly two types of laws contain the content of legal protection for foreign investors, and provide incentives -- constitutional laws and particular foreign economic laws. In December 1982, the decision to open up China to the world economy was formally included in the 1982 state constitution. Since then, there has been more legislation and regulations pertaining to offering incentives and preferential policies to foreign investors (Zhang, pp. 65-66).

It became clear to the Chinese leadership that uniformity in the interpretation and enforcement of laws rather than mere declaration of new policies was more important and necessary if China hoped to entice investors of the West into China with capital and technology. In other words, an internationally acceptable legal framework was essential to encourage foreign investment. There have been many laws and regulations concerning FDI and SZS passed by the central government. The most important documents include: The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investments of 1979 (Zhongguo Jingji Nianjian, 1981, pp. 145-147), which permits foreign firms to establish joint ventures in partnership with Chinese firms; Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investments (1983) (Zhongguo Jingji Nianjian, 1984, pp. 155-162); the Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Capital (1986); Regulations on Special Economic Zones in Guangdong Province (1980); Regulation of the People's Republic of China on Controlling Technology Import Contracts (1985); Tax Law on Joint Ventures (1980); and Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment (1980). And the

conduct of investment transactions with the PRC is also subject to a host of laws and regulations of general application. Of particular importance are the Foreign Economic Contract Law, the General Principles of Civil Law, and the Administrative Litigation Law of the PRC. Each of these measures seeks to entrench state control as a precondition for economic behavior by Chinese and foreign businesses alike.

Since the promulgation of the first joint venture law in 1979, China has announced over 500 laws, provisions and regulations with regard to foreign ventures (People's Daily, 1990, September 6, p. 1). No such laws and regulations existed prior to opening up the country. These laws and regulations, guided by a general economic development plan, provided incentives for FDI (especially those that would bring in technologies and access to foreign markets); set up rules for doing business between foreign and domestic enterprises, and greatly improved investment environment. In 1986, new provisions (such as reducing fees for labor and land use; establishing a limited foreign currency market for joint ventures; extending the maximum duration of a joint-venture agreement beyond 50 years; and permitting wholly foreign-owned enterprises) were established for the encouragement of FDI (Fung); in 1988, a "Cooperative Joint Ventures Law" was adopted; in 1990, amendments to the joint venture law were passed, greatly improving the investment climate in China and providing a significant provision of protection from nationalization (Beijing Review, 1992, March 23-29, pp. 6-7). Other important laws and regulations designated to encourage and protect FDI include: Implementing Regulations for the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment, 1983 (amended in 1986); Economic Contract Law of the PRC, 1981; Foreign Economic Contract Law of the PRC, 1985 (CCH, 5-500, 5-550, 6-550, respectively); Income Tax Law of the PRC Concerning Joint Ventures with Chinese and Foreign-Investment, 1980; Detailed Rules for the Implementation of the Income Tax Law of the PRC for Joint Ventures with Chinese and Foreign Investment, 1980; Foreign Enterprise Income Tax Law of the PRC, 1981; Detailed

Rules for the Implementation of the Foreign Enterprise Income Tax Law of the PRC, 1982 (CFEL, pp. 36-44, pp. 45-55, pp. 55-63, pp. 64-74, respectively); Income Tax Law of the PRC for Foreign Investment Enterprises and Foreign Enterprises, 1991 (CCH, 32-505); Provisional Regulations of the People's Republic of China Governing Foreign Exchange Control, 1980; Rules for the Implementation of Foreign Exchange Controls Relating to Enterprises with Overseas Chinese Capital, Enterprises with Foreign Capital, and Chinese-Foreign Equity Joint Ventures, 1983 (CCH, 8-550 and 8-670, respectively; McKenzie); Law of the PRC on Sino-Foreign Co-operative Enterprises, 1988; Law of the PRC on Wholly Foreign-Owned Enterprises, 1986 (CCH, 6-100, 13-506, respectively); Decision of the standing committee of the National People's Congress authorizing the people's congresses of Guangdong and Fujian provinces and their standing committees to enact various specific laws and regulations for the SEZs under their jurisdiction 1981; Regulations of Guangdong province for special economic zones, 1985 (SLR, pp. 1-2; Falkenheim); "Provisions of the State Council of the People's Republic of China for the encouragement of foreign investment", 1986 (CBR, 1987, January-February, pp. 14-15); Detailed Rules for the Implementation of the Individual Income Tax Law of the PRC, 1980 (CCH, 300-520); Decision on the use of interim regulations concerning value-added taxes, consumption taxes and business taxes on FFEs and foreign enterprises, 1993 (CEN, 1994, January 31, p. 7).

In addition, local governments, particularly those in the coastal regions and SZs, have published over a thousand pieces of legislation and regulations pertaining to foreign investment according to the central government's laws and regulations. For example, the central government issued the Provisional Regulations Regarding the Reduction of and Exemption from Enterprises Income Tax and Consolidated Industrial and Commercial Tax in the SEZs and the Fourteen Coastal Cities in November 1984. According to this guiding

document, each city tried to grant additional preferential terms for foreign investors as supplements to the national regulations (Zhang, p. 62).

To convince foreigners that China is serious in carrying its investment policies and protecting investors' interests, following international trade norms, China has signed bilateral investment insurance, mutual promotion and protection agreements with many countries such as USA, Japan, Germany, France, Italy, and Switzerland (Zhang, pp. 66-68).

Although the good result of FDI inflow can be partly attributed formulation and implementation of these laws and regulations pertaining to incentives and protection for foreign investors, obstacles to effectively implement laws and to positively manage foreign investment have existed. In a 1992 survey of American business executives with operations in China, problems with the regulatory problems were listed first among the obstacles to a good investment environment (CBR, 1992, Sept.-Oct., pp. 6-10). In addition, national regulations are subject to countermanding by local measures (Potter, p. 176). All these implementation problems pose particular problems for the state capacity to manage FDI in pursuit of national development goals. Thus, the legal environment urgently needs to be improved in China.

4.2.3. Economic Co-Operation With Foreign Economies

To Chinese people, at the beginning of the opening up the country, economic cooperation with foreign investors was a new form of economic activity. When China started to open up to foreign business, it soon became evident that the country needed forms of economic cooperation other than the traditional methods of foreign trade. The foreigners ready to invest in China demanded strict legal regulations as to investment guarantees and the safeguard of smooth business operations. Chinese administrative units were not in a position to interfere at random and indiscriminately into business operations.

One fact at the beginning of China's opening up was that private ownership is contradictory to the Constitution of the PRC. China declared itself a socialist country in nature. But if the state insisted on rejecting the notion of private property rights, foreign investors would doubt the government's honesty to offer policy incentives, and would have misgivings on the possible nationalization of private businesses. In order to convince the foreigners, the National People's Congress amended the Constitution, and added a provision indicating the protection of private property in 1982. Although this revision of the Constitution was reflected in Chinese leaders' pragmatism, it was very important because it helped eliminate those misgivings on property limitations that exist among both foreign and domestic businesses and provided a legal base for economic cooperation between Chinese and foreign businesses.

Still, private property rights in China tend to be more restricted than those in other countries. It is even the same within China's SZs. This can be seen from the ownership pattern prevailing in Shenzhen: four different forms can be found: namely state, collective, joint public-private, and private. The private form is subdivided into domestic and foreign ownership. There was little 100 per cent foreign ownership in the form of wholly owned foreign enterprise in Shenzhen (Jao and Leung). Nationwide, there were more state-owned enterprises than other forms of businesses. It would not be politically and economically feasible to turn the state owned enterprises into private business before they actually utilize foreign capital (which is private and capitalist) to form joint ventures with foreigners. Rather, the state enterprises were allowed to form joint ventures with foreign companies. By so doing, economic cooperation has been developed, through which Chinese enterprises benefited from experiencing and learning new managerial skills and technologies.

However, FDI in China can take some flexible forms to facilitate economic cooperation between Chinese and foreign businesses. Thus, foreign investment is more

broadly defined in China than in the Western world. Under the Chinese definition, foreign investment includes not only equity investment (both wholly foreign-owned and joint venture investment) but also contractual investment, and other forms of activities, such as compensation trade, processing and assembling arrangements, and international leasing. Consequently, there are a variety of investment alternatives available in China for foreign investors. The structure selected depends on the type of investment, needs, and desires of the joint venture partners and the specific market or markets for which the products are destined (Zhang, pp. 3-16).

China also has tried to cooperate with foreign economies by meeting challenges from the international community. The world's posture toward China was generally welcoming but increasingly demanding. The attitude of the international community (particularly the United States as the leading developed economy) was an impetus to China's integration with the global economy in the 1980s. The business community, governments, and international financial institutions welcomed China's emergence from economic autarky and political isolation, but they insisted that economic reform be a condition for China's economic integration with the rest of the world. China's efforts at conforming with the international standards have brought support from the international community. The willingness of the West in general to accommodate China's engagement with the international economy stands in sharp contrast to the more skeptical attitude toward the Soviet Union in the 1980s. The major international financial institutions (World Bank; International Monetary Fund; Asian Development Bank) also took an accommodating position toward China. No matter what their business -- import, export, or investment -- foreign entrepreneurs demanded a more transparent system of regulations, the further development of commercial law, and clearer lines of authority within the bureaucracy. In addition, the foreign business community was quick to criticize any return to political orthodoxy in China. Campaigns against "bourgeois liberalization" and "spiritual pollution"

in the mid-1980s were brought to an end partly because they threatened to reduce the inflow of foreign investment and to break down the economic co-operation.

Chinese elite support for greater interaction with the UN organization has promoted an initial acceptance of certain basic international economic norms, such as GATT's insistence on transparency (Jacobson and Oksenberg, pp. 139-152). In March 1996, the State Administration for Exchange Controls announced that China's current accounts (value of all imported and exported goods and services as well as the payment of receipt of dividends and interest) will be convertible by the year 2000 (China Daily, 1996, 27 April). On April 1, 1996, the Chinese government agreed to reduce their general tariff rates from 35.9% to 23%, eliminate import duties on 176 items and provide "national treatment" to foreign investors (The Economist, 1996, May 11, pp. 61-62).

Summarily, in both Beijing and the provinces, Chinese officials have come to understand that they could not reap the rewards of international integration unless they were willing to meet the terms established by various international regimes, the norms of the international trading system, and the standards of the international business community. Perhaps, without international pressure, China would have undertaken less wide-ranging integration than is presently the case. However, without the state's efforts in coping with international norms, China would not have succeeded in attracting such a large amount of foreign capital.

4.3 STATE'S CAPABILITY IN UTILIZING DOMESTIC RESOURCES

State capacity, as aforementioned, is one of the important conditions for a state to realize industrialization and modernization. Modernization is also about a state that can mobilize the resources available to launch industrialization. A developing state needs to possess the ability to control and allocate their limited resources in order to initiate

economic take-off and sustain development. In China, the state enjoyed its advantageous mechanism to allocate resources and provides needed domestic investment to help SZs' take-off.

4.3.1. Domestic Investment In The Zones

The first aspect of the state capability in allocating domestic resources can be found in domestic investment in SZs as an important impetus for SZs' early take-off. Oftentimes, according to a UN study, domestic investment in SZs in developing countries is necessary to attract more foreign capital, especially at the beginning of this process. SZs, whether EPZs, FEZs, FTZs, or SEZs, may be a very attractive instrument for stimulating the flow of inward FDI, but this flow can only begin to materialize once the host country has carried out very significant investments in its zones (UNCTC, 1991, p. 53). Given this relatively high initial investment, it is imperative for the zone's authority to succeed in attracting as many investors as possible as soon as the zone is operational, or an equivalent number of domestic investors. During the early period, the state poured a lot of money in SZs. Take the example of Shenzhen: investments from state, provincial, and city government sources between 1979 and 1983 accounted for at least 50% of total investment (Zhong & Xu, p. 22). The state invested RMB¥100 million during the past 15 years (Reardon, p. 281). On Hainan Island, at least 8,000 state enterprises have branch offices in the province up to 1994, many conducting what amounts to private business (Huus, pp. 46-48).

One of the criticisms raised in China about the country's SEZs is that the total foreign investment inflow in the early years did not match the infrastructural costs of the zones (UNCTC, 1991, p. 53). However, foreign capital inflow cumulation later proved that it was necessary for domestic investment to take part at the first stage of the opening up. Chinese social investment comes mainly from two sources: (1) domestic investment, which is generated from savings, usually savings are 30 to 35% of GNP, (2) foreign

capital. In the Eighth Five-year Plan (1991-1995), actual FDI in China was over \$150 billion. In 1994, actual foreign capital in China reached 17% of the total investment (People's Daily, Overseas Edition, 1996, January 11).

The situation shows that the state is able to allocate sufficient domestic resources, directly or indirectly, to SZs without having serious political objections. This is not a weakness of the state, but rather a strength for industrialization and modernization. Why the Chinese government can do so is another issue which deserves a brief discussion.

4.3.2. The Mechanism for Resource Allocation

The Chinese government can allocate resources to SZs because it has control of the economy in various fields.

Many legacies of the centrally planned period still operate in the SZs. To increase finance capital, Central Committee document 82.50 directed the Bank of China to issue more loans for SEZ development (Reardon, p. 285). The authorities in SZs continue to formulate an annual plan for the state enterprises under their ownership and control. These enterprises continue to receive directive targets from the government, which severely restrict their input and output decision-making powers. Supplies of certain important materials and machinery in SZs are still available only through planned channels. The transactions of joint enterprises with domestic enterprises are subject to various restrictions. The domestic sales quota for the former group of products does not usually exceed 20 per cent, though for the latter group it may (Jao and Leung, p. 149). Whereas in other Asian SZs, joint enterprises purchases from, and sales to, domestic firms are normally calculated in domestic prices and currencies, in China's SZs they are valued in two sets of prices and two kinds of currency.

The domestic sector of the economy is still largely separated from the foreign sector by various "isolation layers": (1) Domestic enterprises in general are not allowed to

participate directly in foreign trade. All their import and export transactions, as well as their dealings with foreign and joint enterprises in SZs, have to go through special foreign trade corporations, which control both the terms and the conditions of the transactions; (2) the inconvertibility of the Chinese currency, the renminbi (RMB) is the second one; and (3) The separation of domestic and foreign prices constitutes yet another isolation layer. Due to the existence of these isolation layers, foreign and joint enterprises are not fully integrated with the rest of the economy. They form a "quasi-enclave" in the local economic system. Thus, unlike domestic enterprises, they are not subject to centralized planning and control. However, they are required to develop their own economic plans and file these with their respective chief administrative bureau, which then incorporate them into the plan. These systemic differences make state allocation of resources easier.

The Chinese central government has been trying to gradually change the system to a more market-oriented one over the past years. The role of market forces has been increased and that of centralized planning and administration further reduced in SZs as well as nationwide; the SZs' economy is made more open and hence more integrated with the world. Still, about 50% of the enterprises in China are state-owned; macro-control has never been abandoned by the central government; in 1995, 80% of the Bank of China's loan increases went to state-owned companies (FBIS, 1997, January 13; 28) and central and local authorities still work out their plans, such as "Five-Year Plan." In other words, besides market allocation of domestic resources, planned allocation of domestic resources will still play a role in socio-economic development in China.

CHAPTER V

PARTICULAR STATE CAPACITY AND UTILIZING SZS

Chapter 5 explores state capacity which is more particularly related to the specific area: SZS. Another three factors will be examined: intervening SZs' operation, decentralizing power, and coping with local inequality. Some of them are unique Chinese phenomena, such as decentralization (because of the previous highly centralized power) and unbalanced regional development (because of China's huge geographic size). While a state needs general capacity in its overall socio-economic development under contemporary international conditions, it also needs particular capacities to fulfill preset development goals.

Like many developing countries, China does have some negative factors which hinder the effectiveness of FDI policy and SZS strategy implementation. For example, traditional factors in China -- *guanxi* (connection), bureaucracy, and localism -- weakened the state's centralized controls over foreign investment" (Grub and Lin, p. 25). How can the Chinese government overcome these disadvantages and realize preset policy and strategy goals? The three factors explored here will help show that China not only possesses the capability in formulating crucial development policies and strategies, such as SZS, but also the capability of implementing them.

5.1 STATE CAPABILITY IN INTERVENING IN SPECIAL ZONES OPERATIONS

In order to fulfill the development goals associated with FDI and SZS, the state may need to intervene in the operations of SZs.

The intervention with SZ operation, according to the experiences of some other countries, may take place through: (a) selecting ideal locations for opening up as SZs; (b) setting and modifying the terms of foreign investment in the zones; (c) adjusting and reprioritizing the industrial structure in the zones; and (d) encouraging the local inputs of capital and raw material into the zones (Chang, Wei; EPZA; MOEA; Park). All these intervention activities, from the establishment, selection and expansion of the SZs, to administrative set-up and policy adjustments, exist in China. Although SZs thus are the forerunners of national economic reform in China, they also receive direct and indirect ideological and administrative intervention: support, control, objection, adjustment from the central authorities. In short, SZS evolution reflects not only the interaction of ideology, policy and practice in the context of reform, but also changes under a close state control in a socialist regime.

5.1.1 Establishing The SZs

The arduous process of establishing the first four SEZs around 1980 also reflects Chinese state's capacity in direct intervention with SZ operation. The creation of the first four SEZs was the first necessary step. From the perspective of state elitists, to promote national economic reform and liberalize the economic policy and system needed some good examples and models to convince the Chinese people, to keep the conservatives quiet, and to legitimize ideologically opening up. Some contend that setting up the SEZs at the beginning was largely a local initiation. Only after 1982, as a result of central and local pressure, did the SEZs emerge as part of a national and global policy issue connected with China's national economic reform (Jao and Leung, p. 226). This argument, however, is only out of an observation that a local government first put forth a suggestion of setting up a special area, Shekou EPZ, to promote foreign trade. In China, although local governments are part of the state, most times they do not have much influence in decision

making. Actually, the central government directly involved itself in initiating the SEZs as a part of the national economic reform.

A brief review of the establishment of the original SEZs can help justify this view. Establishing some SZs was largely out of a new development of the central government's foreign trade reform. In the early 1960s, Zhou En Lai, then premier, proposed special areas of the country where export facilities would be set up for light manufactured goods. These were called "chukuo jiagong qu" in Chinese, a term later associated with EPZs in the world. Some 27 bases for exports and 98 specialized export factories were set up. But they were not actually put into any degree of operation until after the Cultural Revolution (Jao & Leung). This traditional zoning method could not help China improve its foreign trade, especially export, under new international and domestic environment. Chinese leaders and intellectuals were starting to look for other examples outside China.

The idea of putting aside a tract of land in China for foreign investment was first brought up in a meeting by the then minister of transport, Ye Fei. The idea was evidently borrowed from other countries' EPZs which Ye recommended to China Merchants' Steam Navigation Corporation (CMSN) as a new strategy of extending its activities beyond the traditional area of shipping, taking advantage of its access to capital and other resources available in Hong Kong and Macao (LaPalombara, p. 270). In April 1979, Deng Xiaoping suggested that Guangdong mark out an area in which to set up a special zone, which was called Shekou Industrial Zone. On the basis of the work team's findings, the Party Central Committee and the State Council jointly decided in July 1979 that both Guangdong and Fujian were to be authorized to carry out a special policy and adopt flexible measures in external economic activities. As part of the special policy for the two provinces, four *experimental* "special export zones" were to be set up in Shenzhen, Zhuhai, Shantou and Xiamen.

It is also evident that the central government was directly involved in setting up the SEZs and formulating SZS as a national policy. These zones were not only production bases for foreign trade, but also local governments with a sizable territory and population under their jurisdiction. At first, the central and provincial authorities took foreign EPZs, or FTZs, as the model for the special export zones. But they soon realized that fundamental differences existed between China's politico-economic system and the mostly capitalist system of EPZs in other countries. In October 1979, after a seminar on special export zones organized by the Provincial Party Committee of Guangdong Province, an "Outline Report on Some Problems Concerning the Setting Up of Special Economic Zones" was submitted to the Party Central Committee and the State Council. This was the first document in which the term "special economic zone" was used.

The process of establishing SZs nationwide was also guided by the central government. Almost all projects, both central approved and local government approved, were directly controlled by the central government. According to the regulations, some foreign funded projects under certain amounts can be granted by local governments. However, local governments still need to submit documentation of these projects to the central government. So it may constantly check the projects, and intervene in these projects if necessary (Zhang, p. 56).

5.1.2 Administrative Formation

The administration formation of SZs is also intervened by the central government. The administrative body of an SZ is usually both a local government or administrative jurisdiction and a management apparatus of a special economic organization. Its nature is partly determined by the more extensive territory of the SZ and the larger population attached. Another explanation was the desire to develop many of these SZs into comprehensive zones, with the emphasis not only on industry but also on the development

of agriculture, husbandry, tourism, commerce and services, real estate, and science and education, etc. (Deng, 1984b, p. 280). Because the laws and the regulations of these zones did not specifically define the terms of the administrative aspects of these zones, the setup of these zones' administrative structure and main personnel was determined by the higher levels of the governments. By doing so, it was easier for the central and provincial governments to monitor, and even control (either directly or indirectly) economic activities within these zones.

Building a correspondent local administrative organization or governmental agency is another means used by the Chinese government to control SZ activities. Usually, every SZ would create an administrative organization to carry out the policies and regulations. There is a special committee empowered to examine and approve investment projects, to formulate and implement regulations for the zone, and to coordinate the work of various departments of the city government in the zone. The fourteen open cities also established other local organizations which can help foreign-funded enterprises deal with specific problems. In Fuzhou, for instance, the Fuzhou Coordinating Group for Enterprises with Foreign Investment has been set up to field investors' complaints. In Shanghai, the Foreign Exchange Adjustment Agency was assigned by the city government to assist foreign-funded enterprises in buying and selling foreign exchange or RMB. The State Commodity Agency was designated to facilitate foreign-funded enterprises access to raw materials. In Tianjin, the Foreign Investment Administrative Service Center was designated to handle all administrative procedures regarding the operations of foreign-funded enterprises and provide legal, accounting and other services.

The central government improved the structure of administrative organizations in the three OEs later based upon previous experiments: namely, that special investment areas should regard the investment environment as a crucial element in FDI pursuit. These zones' administrators set out to improve its investment environment by focusing on the

"hard environment" (referring to what open areas can provide to potential foreign investors in terms of investment infrastructure, energy resources, transportation and telecommunication facilities, etc.), and the "soft environment" (refers to the efficiency of government agencies concerned, the autonomy that foreign-funded enterprises are entitled to, the availability of qualified labor forces, and the rules and regulations that protect the interest of foreign investors, etc.). These zones paid special attention to their "soft environment" and tried to compete with other investment areas in attracting FDI by improving this aspect. Besides establishing government supervising offices, the local governments in the zones had taken advantage of the fact that their cities and counties were smaller in size, making it easier to have a government office closely oversee and coordinate investment activities within the locality.

Take the delta zone in southern Fujian as an example. In order to tackle problems concerning "soft environment," the zone administration made a lot of efforts to improve the efficiency of the agencies in the local governments within the zone. Following "Provision for the Encouragement of Foreign Investment", promulgated by the State Council on October 11, 1986, the cities of Xiamen, Zhangzhou and Quanzhou respectively, announced their supplementary regulations in accordance with their own situations. The effort resulted in the improvement of the "local climate" (xiaoqihou) and in attracting more foreign investors to the area (People's Daily, 1987, November 13).

Besides the direct intervention of the central government in establishing SZs, structures, and functions, major personnel arrangements within SZs are also determined by higher levels of the government. In observing the modernization process in Communist states, socio-political scientists generally agree that bureaucracy as an organizational or structural factor is an important "modernizer" within the context of achieving rapid industrialization (Jao and Leung, p. 120). Some have concluded that Chinese politics are bureaucratized, while the regime tries to politicize the bureaucracy. Even some Chinese

scholars view this phenomenon only as a negative factor to modernization. The main reason for the lack of progress in modernizing China's traditional productive forces was the strenuous efforts made by the feudalistic bureaucracy to preserve the status quo in order to protect their vested interests. This two-way function between politics and bureaucracy largely crippled the functions of both politics and bureaucracy. Therefore, modernization is only slowly coming about in China (Wang, Yanan, chapter 13).

However, this apparatus provides a built-in mechanism in the system for the government to control and intervene in SZ activities. The continued existence of politicization in the state apparatus in SZs cannot be taken as proof of the insincerity of present calls for reform or merely obstacles for opening up the country. Rather, it may be interpreted as a natural outcome of a traditional and deep-rooted politicized system which is probably more suitable for a transitional economy. The administration remains politicized both in structure and function. Structurally, Party leaders are still assigned to government posts and occupy dominant positions. A few thousand Party cadres from all over China have been posted to various leading jobs in the economic field. Functionally, as long as this system plays a positive role in FDI policy and SZS implementation (both in SZs and elsewhere), it is a useful apparatus used by the state to monitor, control, promote, and adjust SZs operations (Jao and Leung, p. 122).

5.1.3 Policy Adjustment

A third important central government intervention with SZ operation is through policy adjustment. Policy mechanisms are becoming increasingly important as more localities seek more preferential and special policies. The central government, as the sole provider of such policies, can reward or punish the provinces with the designation or withdrawal of these selective incentives.

The government adjusted policies which often resulted in central government's legislation and laws. When the four SEZs first became operational in the early 1980s, they were the focus of much concern about potential negative results in the economic, political, and cultural spheres. For example, with regard to the economy, concern was voiced that the zones would fail to spread any of the economic benefits they accrued to inland areas. Leaders from inland regions also voiced concern about the political privilege that would accrue to the coastal areas by virtue of their stronger economic status: that is, political inequality. The primary political concern was that the SZs would become modern equivalents of the foreign concessions of prerevolutionary China. Moreover, conservatives and reformers alike were sensitive to evidence of "unhealthy tendencies" in the cultural realm, such as foreign values and foreign criminals, from entering under the cover of the "open" policy. All these concerns are linked to the Chinese situation and tradition which emphasize overcoming negative sides of the opening up and establishing SZs. The state tried to control the development of SZs and operation by constantly adjusting policies.

In 1982, FDI policy with which the SZ policy had been associated ran into difficulties: widespread smuggling and economic crimes, as well as chaos caused by the sudden decentralization of foreign trade controls, let alone that there was only a small quantity of FDI influx in the first two years. All these developments led the authorities to reconsider the SZ policies in relation to national economic reform. In September 1982, when the CPC held its Twelfth National Congress, the Party reaffirmed the need for further economic reform and placed it on a par with the policy of readjustment. The outcome of the meeting was two-fold: preferential policies toward SZs were liberalized, and disciplinary regulations were tightened.

In order to make the products more competitive in international markets, the government also facilitated technology transfer to domestic enterprises. The years 1985 and 1986, two years immediately following the opening of the delta zones, saw a tremendous

growth of FDI in the Changjiang River Delta OED. The zone accumulated foreign investment of more than US\$243 million, twice as much as the total amount of investment absorbed in the previous six years within the zone (People's Daily, 1987, September 8; November 30; December 21). Incentives for export-oriented and technologically advanced projects were soon applied to joint ventures nationwide. According to the new regulations, JVs received additional preferential treatment if they were categorized as either export-oriented or technologically advanced projects.

Hainan Island is the second largest Chinese island and has a total area of 34,000 square kilometers. In 1983 the central government decided to accelerate the development of Hainan Island. However, it remained as a nominal pilot zone from mid-1984 to mid-1987. The central government decided in September 1987 to elevate Hainan from a prefecture of Guangdong Province to an independent province, making the island the 30th province in China (including Taiwan). Hainan Island was turned into the largest special investment zone in China. The Hainan zone in many ways was more special than other SZs. These preferential policies included: (1) foreign businessmen could enter and leave Hainan any time at their will; (2) funds were free to flow in and out; (3) the export of self-produced products were not subject to internal quotas; (4) foreign exchange control is to be greatly loosened; and (5) land can be leased.

Policy adjustment oftentimes could be made by central government's persuasion of local governments, which would finally adjust their direction of local legislation and policy implementation according to the central government's guidelines. For example, the State Council once called on the five SEZs to improve their industrial capacity through investments in new technologies. While those SZs such as Open Coastal Cities and OEDs were picking up in their technology investment, China's five economic zones had relatively low technology investment although they reached industrial production valued at \$11.5 billion during the first nine months of 1994. The State Council argued that technology

investments would hold back the incidence of higher costs in the zones and called on zone management officials to advance their services and management systems (Bangsberg, 1995).

Along with the relative saturation of coastal economic development, the central government began to adjust policy toward SZs according to the national development needs. During the April 1996 State Council Conference on the SEZs, Premier Li Peng officially announced that the state would "readjust" various SEZ preferential policies. Li Peng stated that within five years, foreign and domestic investors in the SEZs could no longer import materials duty-free nor enjoy a low 15% tax rate (FBIS, 1996, April 8, p. 30).

5.2 STATE CAPABILITY IN DECENTRALIZING POWER

China was a highly centralized state before it opened its door to the outside world. This system proved to be ineffective in launching industrialization and modernization. In order to make lower level governments work effectively in promoting socio-economic development, decentralizing the power held by the central government was a salient issue in China.

The debate about power decentralization was a hot topic among China observers. For example, a debate among China scholars was on the center-provincial relations (Chung, Jae Ho), which focused overwhelmingly on decentralization in the 1980s; i.e., delegation of power from the central government to the provinces. The excessive centralization in the old central-planning system was blamed as a major cause for the economic stagnation in the pre-reform period in the PRC. The center was encouraged to provide more incentives to the provinces for local initiatives and innovations. Since the early 1990s, however, the predominant view is that, after a decade of decentralization, the

once mighty central government in Beijing was losing control (Shen and Dai; Shirk, 1990; White and Cheng; Wong, Christine, 1991, 1992). For instance, the central government tax base had shrunk from 31.2 per cent of GNP in 1978 to 14.2 per cent in 1992; meanwhile China's GNP was growing at annual rate of 9.5 per cent. So this high level of decentralization could cause chaos and disintegration of the nation (Friedman, 1993; Chang, Maria, 1992). One study points out that if a local government takes over government responsibilities under the conditions of a market economy, it is possible to create local protectionism, divide the domestic market, increase the economic gap between developed and undeveloped regions, and eventually harm national unification and the harmony among different ethnic groups. In order to avoid these negative results, the central government needed to strengthen its state capacity by increasing its ability to absorb revenue and taxes. It was suggested that the proportion of the central revenue in the total revenue should be 50% in the short term, and 60% in the mid-term, and 65% in the long term (Wong & Hu). Almost all these observations focus on the financial perspective of the state.

However, there are some problems in the assessments of the decentralization situation in China. First, decentralization, by definition, entails a reduction in central power. It does not necessarily mean that the provinces will exercise devolved powers in a manner that conflicts with central priorities. Nor does it necessarily mean that the center cannot return to centralized control when it sees fit (Breslin, pp. 82-98). Simply put, the central-local relations are not a zero-sum game (Zhong, Yang, p. 374). Second, analyzing central-local relations should not be only focused on the fiscal relationship between the central government and local government, other aspects should not be ignored. And third, the local governments in China should not only include the provinces, but also municipalities, counties, townships, work units, and villages that are all important players in policy implementation. Fieldwork findings show that local governmental power in China

has grown and local government functions have expanded over the past years, but the central government is not losing control; central-local governmental relations in China are far from being a zero-sum game, and the local government's functions are quite compatible with those of higher state authorities; the central government still wields tremendous power over the local government through personnel appointments (Zhong, Yang, pp. 371-372).

The examination of the situation in the FDI policy and SZS implementation field in China can help answer this question and show that the Chinese state still has control ability over local authorities. Three aspects are explored in this section: (1) Rationale of decentralization; (2) delegation of specific power; and (3) control mechanism.

5.2.1. Rationale of Decentralization: Power Balance Based On Development Goals

Decentralization of power in China is not only about how to balance the power distribution based upon separate central and local interests, but also about how to balance the local and central development tasks, goals, and objectives in terms of their common goals of the development and modernization.

First, local objectives and central objectives could be balanced according to national development goals. There are certainly different concerns about FDI. At the national level, the Chinese leadership believed foreign investment had the potential to generate negative effects in three major areas: outside influence over the direction of economic development; foreign investment would threaten China's independence and sovereignty; and the "national culture" might be contaminated by contact with the outside world. Certainly the central government is concerned about national economic development goals.

It is evident that the central government successfully controlled foreign investment activities and intervened in SZs' evolution. By and large, China has so far adopted four major management approaches to monitor and control foreign investment related projects

(That is, the central government controlled investment projects, provincial level government investment projects, county and city level controlled projects, and experimentation zones and its administration). However, in terms of jurisdiction over the projects and zones, there has never been a clear cut for power exercise within these projects. Higher levels of governments, mostly the central government, often interfered with the operation of these projects, while local governments tried to avoid these intervention by their own policy making and implementation.

The local level encompassed SZs, open coastal regions, and other regions and areas. Local officials were more concerned about their regional development, and also pressed to show rapid socio-economic growth at the same time that they were to monitor foreign investment and adhere to centrally dictated controls. Local officials also had a strong interest in showing quick benefits, for profitable projects would bring tax revenues and prestige to local governments and officials. Decentralizing the management power brought both positive and negative effects. Positive influence included: increase in the private sector; efficiency; management; foreign currency, and bank loans to the private enterprises, etc. The negative ones included, for instance, the economy became overheated, producing an inflation rate of 35% for 1988 (in some areas inflation was near 50%); 16% for 1989; 6% for 1990; and up again in 1991 (Grub and Lin, p. 7).

Local level concern also can be typically seen in financial policy. Resistance from the local to central policies and competition for central sources occurred both at the extraction stage and the allocation stage (Lamborn). Despite the fact that the traditional socialist system featuring centralization succeeded in mobilizing and amassing all kinds of resources and preparing good conditions for starting industrialization, it had a serious weakness: low efficiency and poor economic results in terms of the use of resources. Since the beginning of 1980, China began to introduce the contract system with regard to financial receipts and expenditure, a practice known as "eating from separate pots." Some

observers were worried that a negative change would be the rapid decline of the state financial capacity. The proportion of central government financial expenditure in the GNP was only 1.6 percentage points higher than that of the former Yugoslavia or equal to one-fifth to two-fifths of India, a big developing country with a population of over one hundred million (Wong & Hu, p. 29-30). However, most of the local retaining revenue and resources were put in use for development purposes, although local spending abuse sometimes in some places was possible. As long as the central government still has other control tools over local governments, the different proportion of revenue allocation between the center and local governments can still serve the same developmental objectives.

Second, the central-local relationship can be a non-zero sum game, and local interests and central interests are not necessarily against each other. China was a unitary state with a history of highly-centralized power before its opening up. When discussing the issue of power decentralization, the center and the local government should not be put in two different camps. That is, state capacity was reflected by both local and central governments, especially a unitary government like China's. Local governments' autonomy in policy formulation and implementation does not necessarily hurt central interests and national development goals.

One common conceptual problem is that, if a seemingly high level of provincial autonomy is detected, then it is automatically equated with the center having lost its overall control over local affairs. The crux of the problem is that some research is limited within fiscal measures as the sole indicator of central-local relationship. Such a dichotomous conceptualization, however, may often generate a false generalization of systemic changes and the zero-sum view of decentralization. Decentralization reforms should not be construed as necessarily and automatically weakening the overall control capacity of the center (Durasoff, p. 389).

Conflicts between the central authority and local governments also exist in the field of FDI and SZS. Often the central authority projects one investment policy while local authorities pursue another. Many Chinese leaders have repeatedly argued for the need to control overall investment and warned against the increasing investment in "misplaced projects." The central government was often upset by the competition among the provinces and cities for foreign capital and equipment created by the government's policy of decentralizing the power to negotiate with foreign firms. The central authorities also contend with the provinces over who should pay for the infrastructure investments that are needed to attract foreign investment and facilitate trade. For example, Fujian and Beijing clashed over financing the new Fuzhou airport, which would have been financed by the central government in the past (Tzeng, p. 280). All these conflicts are within the scope of functional power rearrangement such as administrative and economic power, which does not necessarily lead to zero-sum result.

And finally, decentralization can win over the local support on the economic reform featured with FDI and SZS. Many reform policies were designed to enhance the resources and economic control of local governments. For example, the 1980 fiscal decentralization was a successful measure to win local support for the reform drive. The consequence of these early moves was that every subsequent reform was framed in such a way as to delegate central economic authority: not to enterprises, but to local governments. As a senior foreign trade official observed,

"Decentralization . . . generally means expansion of decision-making power for the local or departmental administrative units, or the shift of power among the administrative departments without touching on the crucial issues of decision-making power for the foreign trade enterprises and the production enterprises. These enterprises are still subjected to departmental and regional administrative restrictions" (Zheng, Tuobing).

All in all, there was a necessity for power decentralization, because the previous highly-centralized administrative and economic systems did not fit industrialization and modernization in a country like China. The rationale for China to decentralize the power held previously by the central government was to fulfill the development goals. The purpose of decentralization was to encourage local governments to take more responsibility to promote their local interests, and thus, eventually national interests. The conflicts between central and local governments about implementation were inevitable. The whole process of decentralization has been to find an optimal power balance between central and local governments in terms of long-term and short-term development goals.

5.2.2. Decentralization of Functional Power

It is true that decentralization is about devolution of power. Since opening up the country and implementing FDI policy and SZS, local governments have been strengthening their power. However, they perform important functions for the central government in securing political control, maintaining social stability, and promoting economic development. This delegation of power is mainly economically related rather than politically related; it is within the scope of the administration, not fundamental political systems; and local governments receive limited autonomy, not independent policy making and implementation.

First, this decentralization is mainly economic. Some observers assert that economic reform and decentralization "eroded government authority over the economic activities", because "the authority over foreign investment was already transferred downward and diffused geographically." The reason is that many local governments, especially some provinces and cities in east China as well as SZs, were officially empowered to approve projects valued at as much as \$30 million without involving central authorities. Interior provinces and a few interior cities could approve projects valued at as

much as \$10 million (Feinberg and Kallab, p. 87). However, all these delegations were within economic scope, and necessary for economic reform. After all these years of highly centralized control over local government activities, industrialization and modernization needed to get active local involvement. And also the Chinese central government has been able to practice its overall control over the economic activities -- that is, macro-control. These areas were always the focus of unique concerns and were subject to a number of special controls. All these functional power delegations meant to facilitate capital inflow and establishment of more foreign enterprises.

Second, this decentralization was within the scope of administrative reform, rather than fundamentally ideological and organizational transformation. Bureaucrats' attitudes toward foreign investments in different areas in China were different. Some could be very radical, others could be very conservative. But most of them adopted a pragmatic approach to deal with FDI. The delegation of administrative power enabled local governments to act quickly based on their own local realities.

Third, limited autonomy, rather than independent legislation and policy implementation, was delegated to local governments. Decentralization includes two sides of the one issue: policy formulation and implementation. Although local governments have their autonomy in policy making and implementation, the process should follow the center's general policy, legislation, and guidelines. Regulations issued by provincial governments and SZs concerning FDI registration procedures, land use, labor and wages, economic contracts, technology transfer, etc., were largely consistent with the central government's policy and regulations.

Decentralization of authority does yield some problems. How to reduce local government's power abuse to a minimum was crucial to successful reform. More autonomy to city and provincial officials and state-owned enterprises also yielded negative

effects. Yet, the central government had its control mechanism to pull the local back to the track.

5.2.3. Mechanism of Central Control Over Local Incompliance

Decentralization is not new in the history of the PRC; it has been an entangled issue that puzzled several generations of leadership.

In terms of the relationship between the central and local governments in China, "the center" or "the central government" is treated by some as a homogeneous entity represented by what Levi calls "the rulers," (Levi) what Zysman calls "the national political executive," (Zysman) and what Krasner calls "central decision makers" (Krasner, 1978). In a unitary system, the central government usually plays a decisive role in policy making and implementation; local governments have limited autonomy in legislation and are mainly responsible for policy implementation and subordinate to the central government. If the central government decentralizes its authority, an urgent issue is that the center has to find some instruments to create compliance among local governments to prevent a centrifugal tendency. Some argue that the center can create compliance in one or more of three ways: persuasion, coercion, and inducement (Levi, pp. 48-70; Etzioni, pp. 3-21; Lindblom, pp. 12-13). Each of the three control methods has its pros and cons. Under a given condition, one may work more effectively than the others. In all, the center needs to have mechanisms to control local governments to maintain national development goals.

A typical problem in the history of the PRC was the vicious cycle of decentralization and recentralization, which is called in Chinese, "yi fang jiu luan, yi luan jiu shou, yi shou jiu si" (decentralization is followed by chaos; chaos followed by recentralization; and recentralization followed by stagnation). For example, in two mass campaigns, the Great Leap Forward (1958) and the Cultural Revolution (1966-1969), Mao Zedong sought to accelerate economic growth and social transformation over the objections

of status quo-oriented central bureaucrats. Some of the power was delegated to provincial governments. In the aftermath of the campaigns, both of which were ultimately viewed as failures, Beijing took back the power it had lost. The fundamental features of highly centralized economic and political systems remained unchanged. Local dynamics were completely subdued, which severely impeded socio-economic development in China.

The central control mechanism should be able to break this vicious cycle. The mechanism to be used is thus an important political decision for the central leadership to make, because the control should only be exercised to prevent and stop the real problems which hamper the national development goals.

Common problems

Over the past 15 or so years, the decentralization of authority to lower levels of government included: areas of enterprise ownership, taxation, government spending, credit allocation, investment project approval rights, price and wage control, foreign trade management, the formation of industrial policies, etc. While this form of deregulation has provided the localities with enormous incentives and autonomy in adopting policies for regional development, it has also provided local governments and officials with opportunities to shift away from the original development goals.

The first side effect of this decentralization is localism. Localism erodes the linkages between the locals, thus adversely affects national economic development. Local governments have tended to restrict competition in order to protect the local economies. These activities have impeded commodity flows and enterprise mergers and acquisitions across regions and sectors, and exposed business transactions to the risks of ad hoc "local government intervention" (Ma). From 1979 through 1991, actual investment amounted to about 59% of contracted investment, according to government figures. Yet local authorities have often understated the value of foreign joint-venture investments to keep project values

below levels that required central approval. Thus, the eventual amount of foreign capital would surpass the originally reported amount -- 59%; but in another situation in dealing with foreign investors, localities are competing among themselves to show impressive figures to attract more foreign investments (Goldstein, 1992). Chinese policy makers frequently contend with imperfect policy implementation. When a policy was made, lower level governments sabotaged a policy or implemented some aspects but not others. Despite periodic dispatch of work teams and liberal application of bureaucratic pressure, as well as increased reliance on newer instruments (such as laws), many national policies and central programs are distorted or implemented only in part. And the range of local responses to central initiatives can be remarkably varied.

A second problem can be found in the foreign trade area. Decentralization of trade authority is from MOFTEC (Ministry of Foreign Trade and Economic Cooperation) to provinces and ministries but not to firms, combined with particularistic contracts for sharing foreign exchange. Decentralization meant that provincial and municipal governments as well as ministries were permitted to establish their own trading companies in competition with the MOFTEC ones. The central trade monopoly was demolished. It also entailed shifting the authority to issue import and export licenses from central to local officials while expanding the number of products requiring licenses. One consequence of trade decentralization was the loss of national bargaining power with foreigners (Shirk, 1994, p. 44). Along with the further integration of the economy into the international economy, as the de-ideologization of politics and economic interdependence are emphasized, sub-national governments have been empowered to deal directly with foreign business interests. There are at least three different levels -- international, central and local forces -- making the problem more complex and requiring more wide-ranging analyses of their conflicting views and interests (Alger). Through various local networks of foreign trade, numerous counties have also become linked with international and multinational

interests. These new developments seem to point in the direction of undercutting the power of both the center and the provinces, thus further complicating the task of understanding central-local policy dynamics in China (Howell; Zweig).

A third and more serious problem allegedly associated with decentralization is corruption, which became a major issue several times over the past 15 years. The phenomenon not only hindered implementation of public policy, but also hurt the ruling party and the government reputation and has brought a lot of criticism by the people. The Hainan Incident is a good example. In 1985, high-ranking officials in Hainan were dismissed from office for severe abuses of preferential policies, such as importing tax-free cars, motorcycles, televisions and video recorders, and then reselling them at two or three times the initial price to less favored areas (Breslin, p. 66). Another typical example is that the central bank, the People's Bank of China, should play an important role in monetary and fiscal areas. However, some branches of the Bank had instead engaged in real-estate speculation and other activities at odds with government policy (House, p. A6). According to some people who have had experience in doing business in China, bribery and other economic crimes are rampant. A US businessman in China offered the following calculus on corruption: "To get a small contract, say \$20,000, I figure it's a couple dinners out and bowling. For a \$250,000 contract, it's a 'familiarization' trip for the official to the States. A contract of a million and above? Then we're talking about helping get a visa for the guy's son" (The Wall Street Journal, p. R1). Many foreign salespeople constantly complain they have to offer a wide variety of "incentives": money, or video cassette recorders (Brauchli, p. R3). A manager with one U.S. trading company says her rail-freight agent estimates that about 10% of her freight costs are for "gift giving." (Wong, Jesse, p. R4). In 1992 there were 101,000 cases of corruption reportedly handled by the courts (Potter, p. 181).

All these problems presented a serious political challenge to consensus decision making and implementation, because the local governments' mistakes and officials'

wrong-doings can affect national development goals in general, and hurt ruling party and central government images among the mass.

How to keep central control over foreign economic activities while decentralizing the power? In the history of the PRC, the dilemma of over-centralization versus decentralization always bothered Chinese leaders. Is it possible that the locals will be out of control? Fiscal and budgetary arrangements do not tell everything about the delicate balance between central control and local autonomy. Multiple indicators are needed to illustrate the delicate balance of power between the center and the local governments (Chung, Jae, p. 502). In this research, multiple mechanisms (such as party's control, personnel management, financial control, and policy process control) are explored to show that the Chinese central government still has the ability to control local activities and power abuse.

Party's leadership and central control over local governments

In China, the Party is essential and stands guard over socialism's highest achievements, the political coordination of the economy and the consequent integration of individual bureaucracies (LaPalombara, p. 234). Indeed, the Chinese Communist Party still rules. One of the measures in political or administrative reforms since the early 1980s is the attempt to separate the Party from the formal structure and function of the government. In Deng Xiaoping's (1984) words, "it is time for us to distinguish the responsibilities of the Party and those of the government and to stop substituting the former for the latter" in order "to facilitate the establishment of an effective work system at the various levels of government from top to bottom, and promote a better exercise of government functions and powers." The expectation was that, through the separation, Party officials could concentrate more on the Party affairs and interfere less in the day-to-day governmental business to raise the organizational efficiency of both the Party and the government.

However, the interlocking nature of the Party and government has not changed, and "the Party still rules" (Zhong, Yang, p. 371). It is true that the Party's control over the lower levels of government can be accomplished in several ways. During the decade of economic reform in China, party leaders delegated more discretion to the government in economic policy-making. But keeping the leash of the government in the party's grip was a way to raise the quality of decisions and the performance of the economy. Local officials, as appointees of the CPC, know that they cannot deviate too far from the preferences of a CPC leader.

The CPC's control over the government means that delegation of economic decision making is risk-free for the party. The party's power over bureaucratic careers guarantees that officials will not "cross the shadowy line between advocacy and pressure." (Brzezinski & Huntington, p. 196). The party, by establishing a particular set of government agencies and calling work conferences, has determined who gets to sit around the bargaining table. And the Politburo can always veto government policies, although such vetoes are extremely rare. This system is called "parallel rule" (Shirk, 1994, p. 16) by some scholars.

Personnel management and central control over local governments

Another means the Center possesses is personnel management, which is a key component in the balance between central control and local power. Indeed, appointments, transfers and dismissals of local leaders is the most important instrument of central control over the locals. In addition to control over provincial appointments, there are four main sources of central power: tripartite division of provincial power; control over mobile military units for use as a last resort; control of propaganda and media apparatus; and control over key economic resources (Lieberthal & Oksenberg, pp. 348-349). Among them, appointments (Table 5-1) and dismissals are two important means the center possesses. Personnel appointment power remains as the most effective mechanism in the

PRC to get lower level government officials to comply with decisions passed down from higher authorities. The frequent dismissals of local leaders is another means exercised by the central government. The reshuffle of Jiangsu's provincial leadership is a good example, since the transfer of its provincial Party secretary, Shen Daren, is attributed to his staunch opposition to the "tax-sharing" reform and policy mechanisms (South China Morning Post, 1993, December 8). The high turnover rate of governmental officials from 1990 to 1994 shows that this mechanism is actively used by the central government to influence the behavior of the local government. For example, the turnovers of provincial Party secretaries and governors between 1989 and 1995 was unprecedentedly high. In this period, of all the provincial Party secretaries and governors, only four kept the same job (Press Freedom Guardian, 1995, November 10, p. 3). According to one research report, the average tenure for provincial governors in the 1980s was only around three years (Huang, 1995, p. 61).

Table 5-1 New provincial appointments, 1978-1986

Year	Secretaries	Governors	Total
1978	100		
1979	110		
1980	52		
1981	78	63	141
1982	50	42	92
1983	114	120	234
1984	39	10	49
1985	102	60	162
1986	26	24	51

Source: Goodman, D. 1986. *China's Provincial Leaders, 1949-85*, Cardiff: Cardiff University Press.

Other means of central control over locals

Financial control.

The center can use financial and budgetary control tool to curb locals if any malfunctions in power occur. First, the central government often readjusted downward provincial budgetary sharing rates, reclassified certain taxes as central government revenues, established new taxes on extra-budgetary funds, and appropriated some of the most profitable enterprises in industries like automobiles, petrochemicals, non-ferrous metals and shipping, by incorporating them into centrally owned enterprises. Beginning in 1983, all local governments were levied a special 10 per cent charge on the total profits from extra budget funds, which was later raised to 15 per cent. The taxes so collected were used for infrastructural development (Wong, Christine, 1991, pp. 309-311). Second, the central government institutionalized a system of forced loans (*difang jiekuan*), by which means Beijing "borrowed" money from the provinces under a variety of pretexts but never paid it back. According to a recent study, in addition to the fixed remittances for five years, Guangdong had to provide at least four different revenue remittances for the Center, including remittances of State Energy, Transportation and Key Construction Fund and State Budget Adjustment Fund, and the so-called "extra contribution" (*duozuo gongxian*) remittances. And third, the central government also distributed provincial quotas for the purchase of national bonds. Guangdong, for instance, sold national bonds worth almost RMB¥2.5 billion from 1981 to 1989, which equals one-eighth of Guangdong's net fixed remittances for the period 1980-89 (Wong, Christine, 1991, p. 701). Furthermore, whenever its revenues ran short, Beijing did not hesitate to readjust the provincial revenue-sharing ratio in spite of the pronounced five-year commitment. More importantly,

the 1993 Third Plenum decision to implement the "tax-sharing system" (fenshuizhi) is another crucial indicator of the center's reassertion of its local control.

The policy process control

The Chinese government makes policy according to a tacit rule called by some scholars "delegation by consensus." (Shirk, 1994, p. 19). The CPC delegates to the State Council the authority to make specific economic decisions. The State Council leaders at the top of the government hierarchy delegate to their subordinates the authority to make decisions if the agents can agree. If the agents reach consensus, the decision is automatically ratified by the higher level; if the agents cannot agree, then the authorities step in to make the decision, or the matter is dropped or tabled until consensus can be achieved. Since most provincial and some subprovincial leaders have positions in the CPC, such as central committee members, representatives of the Party Congress, local officials are required to keep the same policy tone and reach policy consensus.

The effects of decentralization are not necessarily indiscriminate among different types of policy, since the center may be more willing to solicit local initiatives on some policies, while it insists on tightly controlling local compliance on others (Rhodes, p. 45). The core question is therefore how to differentiate the nature of variation in provincial compliance according to policy type. There are three factors -- the number of policy targets (policy can be divided into encompassing and selective policy according to their scope of application: encompassing policy is applied indiscriminately to all local units, while selective policy is applied only to some local units), the extent to which the policy entails resource allocation, and the degree to which the policy departs from the status quo may be used (Chung, Jae, pp. 504-505).

The Center also took steps to solve specific problems in particular areas. For example, in order to cut back on expenditures in the rapidly expanding SEZs, the center

revoked their 100 per cent foreign currency retention rights. Instead, they had to abide by the same 20:80 retention ratio applicable elsewhere (Wen Wei Po, 1988, Oct. 15). This meant that 80% of any foreign currency earned was given to the center, who would reimburse in RMB. The center also acted to prevent rich areas buying scarce produce at inflated prices. In an operation that perhaps fits the Chinese adage of "killing the chicken to scare the monkey", Hubei Provincial People's Government was ordered to carry out an in-depth self-criticism and return silkworms it had purchased at high prices from Jiangsu (Xinhua, 1988, April 11). Sometimes, the center called responsible officials from all provinces to Beijing to attend a special forum at Zhongnanhai. The central leaders asserted that if these provinces did not implement the policies according to the central government's guidelines, the center would have to step in to directly supervise these policies themselves (Xinhua, 1988, March 12).

Take tax policy as another example. The old tax system in China (which was highly centralized) was introduced in 1950. The practice of centralizing all financial receipts and expenditure led to waste, inefficiency, and reduced effort on the part of local governments. Reforms were introduced in 1979, and carried further in 1982 and 1985. Tax revenues were designated to be central, local, or shared. According to the tax sharing policy with local governments, local governments can set up their own businesses to gain their revenue. The procedure adopted for such decentralization affects the buoyancy of tax revenue and erodes the amount of revenue transferred to the central government. In China, local governments are responsible for the collection of virtually all major taxes. The revenue thus collected is shared upward with the next level of government. As a whole, since the inception of the reforms, the trend has been toward granting local governments a greater degree of fiscal authority and allowing them to retain more revenue. Clearly, local authorities have a stake in keeping as much of the financial resources as possible within their territory. Originally, foreign investment tax structure was like this: the general rate

was 33%; 24% in some selected cities, and 15% in the five SEZs. In reality, it's all mixed up. Many places, usually without central government approval, will offer the 15% rate in an industrial area or for a particularly sought-after business to do local or personal favors (Bussey & McGregor, p. R19). Indeed, the proliferation of self-styled free-trade zones created a headache for the tax authorities. Quite a few cities not included on the list decided to offer their own incentives. However, although with all these problems, "the present intergovernment fiscal relations are primarily a form of administrative decentralization under a highly centralized fiscal system" (Li, Jinyan, p. 141). Local governments have not been given a high degree of effective fiscal autonomy. So the central government constantly launches a crackdown on localities' unauthorized tax breaks. That is, if the center finds out any tax policy abuse, it possesses the ability to stop it and change it.

Overall, the above analysis shows that the state still has the ability to maintain the control over FDI policy and SZS implementation while decentralizing power. After counting the mechanism the Chinese state possesses, we can sense that for the same reasons the state can decentralize the power while keeping central control.

This argument is supported by some other recent research on the relationship between the Chinese central and local governments, which is explored in the implementation of other policies. For instance, one study (Brown, George P.) focuses on the effects that economic reforms since 1979 have had on China's rural political infrastructures. The efficacy of central state policy making is examined through a comparative study of four major policy arenas: family planning, land management, agricultural production and purchase policies, and regulation of rural industry. The reforms did not undermine the central policies in rural China. The findings for local compliance with central policies tested on two levels -- case studies of provincial, prefecture and county

levels -- show that the Chinese state has not been significantly weakened by the economic reforms.

It also seems wrong to infer that the center is completely helpless in restricting provincial and local autonomy as some "split China" scenarios project. Some observers worry that the relative growth in provincial autonomy at the expense of central control in the 1980s has prompted the suggestion that China may be in the process of disintegration. The division of the Soviet Union, Yugoslavia and Czechoslovakia into smaller national groupings has also brought the threat of disintegration in China into sharper focus. However, the case for disintegration is overstated. Economic autonomy does not necessarily lead to disintegration of a country. Ethnicity as a separation factor in China is not as serious as in the Soviet Union. Moreover, the central government still possesses powerful non-economic integrative mechanisms. It is true that there have been many problems caused by decentralization; local power abuse is not uncommon. Many have misgivings about the development of centrifugal trends which may lead to China's potential instability and possible disintegration of the nation. As mentioned before, China has been searching for the proper power balance between the central and local governments. It is harmful, thus unlikely, for the state to recentralize the power as it did in the past. Alternatively, the state can utilize existing mechanisms to control and limit local power abuse and reduce problems.

With the global trend for economics taking command and the ever-expanding programs of systemic decentralization, the central government of post-Mao China will remain willing to allow selective local autonomy as long as it helps the advancement of the national economy. At the same time, however, the center will try hard to intervene whenever the expanded local autonomy amounts to producing a system-wide penetration crisis. It seems that the Chinese government has already broken the vicious cycle of decentralization and recentralization repeated in the history of PRC, and stepped into a new

era of looking for reasonable power balance between the center and the local areas according to its developmental goals.

5.3 STATE CAPACITY IN DEALING WITH REGIONAL ECONOMIC DEVELOPMENT INEQUALITY

Another important indicator which can help analyze the state capacity in China is that the Chinese government still has the capability to handle regional economic development inequality. In fact, since opening up the country in 1979, regional inequality has increased. For example, about 90% of the cumulative foreign investments received by China have gone into the coastal provinces, 40% in Guangdong alone before 1992 (Goldstein, 1992, pp. 24-31). In June 1993, the government authorized 21 additional cities -- mainly along the Yangzi River valley plus several others in the northeast -- to offer additional incentives for foreign investors (Bennett, p. R5). The historically less developed inland and western regions have received the least FDI (Table 5-2).

It clearly reveals the fact that FDI in China was concentrated mainly in the coastal provinces, and particularly in the two southern ones, Guangdong and Fujian. Guangdong province alone accounted for more than \$9.1 billion -- 51.8% -- of the total FDI pledged during 1979-87, while the inland provinces' combined total was only \$2 billion -- a mere 11.3%. In 1990, the two southern coastal provinces' share was still about 50% of the total (actual) FDI. Although the share of the inland provinces was increasing, it was only 17.7% of China's total FDI in 1990.

The economic development gap between the east and the west is obvious (Table 5-3). The central and western regions cover a vast area. It contains 64% of China's 1.2 billion people and occupies 89% of the nation's territory. Nonetheless, the region's economic base is disproportionately small. For example, in 1994 the national GNP was 3,675 yuan per person. But in the five northwest provinces and regions (including Shaanxi

Table 5-2
Geographical distribution of FDI in China
(millions of US dollars and %)

	<u>1979-87*</u>		<u>1990**</u>	
	Pledged Amount	%	Actual Invested Amount	%
Total	17,726.42	100	3,487.11	100
<u>Major Cities:</u>				
Beijing	1,651.18	9.3	276.95	7.9
Shanghai	1,842.64	10.4	174.01	5.0
Tianjin	242.79	1.4	34.93	1.0
<u>Southern Coastal</u>				
<u>Provinces:</u>				
Guangdong	9,188.32	51.8	1,460.00	41.9
Fujian	821.94	4.6	290.02	8.3
<u>Other Coastal Provinces:</u>				
Liaoning	779.15	4.4	243.73	7.0
Hebei	98.42	0.6	39.35	1.1
Shandong	336	1.9	150.84	4.3
Jiangsu	219.85	1.2	124.16	3.6
Zhejiang	158.67	0.9	48.43	1.4
Guangxi	384.06	2.2	28.66	0.8
<u>Inland provinces:</u>	2,003.40	11.3	616.03	17.7

Sources: *Almanac of China's Economy. **China Statistical Yearbook 1991, p. 631.

Table 5-3
Comparison of Population and GDP Between The Three Regions in 1991

	Population(%)	GDP(%)
Coastal	37	57
Border	14	11
Inland	49	32
National Total	100	100

Coastal covers 11 provinces; Border covers 8 provinces and regions; inland covers 12 provinces.

Source: Edited from Wu, Zhe. p. 135.

Gansu, Qinghai, Ningxia and Xinjiang), the amount was only 2,577 yuan. Although the average farmer's annual income is 1,220 yuan nationwide, the average northwestern farmer only earns 811 yuan per year. The vast majority of China's 80 million poor people live in the central and western regions, where one out of every five persons is poverty-stricken (FBIS, 1996, January 22, pp. 42-43).

In 1993, GDP in the coastal area increased to 73%; the inland decreased to 19% of national total; and the border region still kept the same percentage. A research study predicts that the gap will enlarge in the coming years. Unbalanced development will still exist in China. The worst situation will be in the inland region because it neither has abundant natural resources nor central government's special subsidies, as the border region does. Also it has the biggest population of the country. Development is difficult (Wu, Zhe, p. 135). If the nation were to be divided into three parts (east, mid, and west): the eastern part would be the fastest growing area. The proportion of the industrial production of the

east increased from 60.7% of the national total in 1979 to 66% of the national total in 1993; while mid- and west regions' industrial production decreased from 39.3% to 34%. The difference of GDP per capita between the east and the west in 1978 was 214 yuan, and 724 yuan in 1992 (People's Daily, Overseas Edition, 1996, March 16, p. 2). According to the World Bank, coastal Shanghai and Guangdong had incomes per head of more than \$800 in 1992, while Guizhou, in the southern hinterland, had an income per head of only \$226 (Wolf, p. 12).

There has been criticism on this issue by both Chinese and foreign academics. According to liberal economics, regional development inequality can be balanced by market forces. However, some scholars observe that, according to the experiences in both developed and developing countries, only relying on "natural" market forces to balance the inequality cannot resolve the problem. Thus, government intervention is helpful, although it is not necessarily able to reach satisfactory results. Others focus on the proper ways of government intervention and contend that the Chinese government is willing to balance the regional inequalities, but lacks the capacity to enforce it. Two factors are taken into account when analyzing the effectiveness of government intervention: (1) Government's willingness to narrow the regional disparities, and (2) government's capacity to narrow them (Wang, Shaoguang). In short, neither market forces nor a weak government can provide a solution to the problem of regional unbalance. Only a strong and committed central government would be in a position to undertake such a task.

However, there are some justifications this study wants to make. First, China's unbalanced regional development is not a new issue, and the differences existed before the opening up. And the widely held belief that it has become worse throughout the reform period seems to be wrong. The inland and western regions have still made much progress compared to the pre-opening times. In a recently released paper, three economists at the Harvard Institute for International Development note that the gap in income per head

between Shanghai and Guizhou was as much as 11 to 1 in the 1950s (Jian, Sachs and Warner). Their broad conclusion is that regional inequality tended either to become worse or to stay much the same throughout the period of central planning. Then, after the economic reforms were introduced in 1978, inequality decreased considerably until about 1990 but then increased again. Probably because of a different regional categorization, this picture is a little different from the World Bank's, which argues that regional inequality has worsened since 1985.

Second, the regional differentials are necessary for the development of China's economy and society. The difference (or gap) among the regions in a sense reflects the state capability in carrying out the strategic policies. There is a rationale of strategic consideration contained in the regional development policy.

5.3.1. Rationale of Regional Policy Differentials

Further examinations in political feasibility of the regional development policy and the recent policy shift toward inland and western regions show that the state possesses the ability to deal with regional disparities. Indeed, there has been a pattern of degradation of opening-up levels in the process of spatial movement from coastal areas to the inland. That is, from coastal to inland areas, the closer to the coast, the opener the areas. There are several reasons to explain this situation.

First, there is a strategic consideration for the selection of special zone sites and their expansion. Lacking enough experience in market economy operation and complex foreign economic activities as well as corresponding conditions, spreading a market system nationwide in a very speedy manner would probably cause confusion and even chaos in the national economy. Indiscreet use and uncontrolled spread of SZs could create unintended negative consequences. Overall opening up the country at the same time could cause some unwanted problems: economic overheating; shortages of funds, energy, transport, and raw

materials; the appropriation of good farmland for factories; and competitive cutting of tax rates and land prices to attract foreign investors. It is necessary to first find some locations for experiments implementing FDI policy. This "selection approach," which is called by some researchers "particularistic contracting" (Shirk, 1994), was that, following the gradual open-up strategy, the central government chose only several places to start reform first. The reason for Shenzhen, Zhuhai, Shantou, and Xiamen being selected as the sites for the SEZs was largely because of their unique geographic locations. The construction of these SZs facilitated the introduction of foreign capital and technology and, thereby, stimulated the development of China's foreign economic relations and trade. This fact has propelled the development of the local economy and brought about great changes in the economic conditions of these zones. They were lucky to be selected, and had opportunities to develop first.

Extending the open policy in coastal regions is also out of strategic consideration for national economic development. Pressure from other provinces led the further expansion of SZS. But the central government did not select any place but the coastal area to develop SZs as a second stage of SZS evolution. The State Council in 1984 extended preferential policies to Hainan Island and fourteen coastal cities. To satisfy local officials in coastal areas that were not chosen as open cities, in 1985 the State Council extended similar treatment to the deltas of the Pearl, Yangtze, and Min Rivers.

In 1988 CPC general secretary Zhao Ziyang broadened the reach of the policy to the entire coastal zone with its population of over 200 million, which symbolized the formation of "coastal development policy." (Yang, 1991. p. 45). In this policy, Zhao defended the concept of unbalanced growth by arguing that the economic and cultural differences between the coastal and inland areas made it impossible for all parts of the country to develop at the same speed; therefore the coastal areas should be allowed to move ahead by using their better labor, communications and infrastructure, and scientific and technological

capacity to attract foreign business and expand exports. After Zhao was fired in 1989, Premier Li Peng adopted a succession strategy that involved coastal area development. Capitalizing on the resentment Shanghai had long felt toward Guangdong's special privileges, Li Peng became the patron of Shanghai's new Pudong economic development area and granted Shanghai both greater autonomy over foreign trade and investment and more revenues (Cheng, E., 1992, p. 61). Deng Xiaoping also advocated the unleashing of Shanghai's economic potential.

Second, coastal areas have a better investment environment. Coastal areas have much better infrastructure, labor force, and technology than inland areas, which are important conditions for foreign investors to pour their money in and for domestic business to succeed in cooperation with foreign enterprises. Therefore, a logical consequence is that China set SZs in the coastal area first to fit the transitional economic system and speed up the reform gradually in a wider space of the country. In other words, the strategy of gradual expansion of SZs was in accordance with the strategy of gradually opening up the country. There is no doubt tremendous pressure from other parts of China for the granting of the same or similar status of those SZs; yet their spatial characteristics and implications made it inefficient for SZs to be freely multiplied in number and form, especially at the early stages of the development. The inland and frontier minority regions do not have the advantages the coastal area does: natural conditions, transportation, development starting point and potential, etc. Since the investment environment in China's coastal areas have a relatively well developed infrastructure, better location, better human and physical resources, it was reasonable for the Chinese to develop the coastal area first. The appropriate slogan read: "First some regions shall become rich so that the other regions can follow later on" (UNCTC, 1991, p. 177). Even though the special policies spread to other regions later, the effect of the move was limited. The Changjiang River above Nanjing has already lost its ability to have direct shipping with foreign countries, due to its shallow

water. The only seaport of Longhai Railway is Lianyungang which is a mid-sized city. Its capacity to connect the inland area along the road with foreign countries is limited, at least in a transportation sense. As to border lines, most neighboring countries only have less developed economies. Other countries (such as Russia, Kazakhstan, Tajikistan, Mongolia, Afghanistan, Pakistan, Nepal, Bhutan, India, Burma, Laos, and Vietnam) are either under the control of struggling centrally-planned systems, or are in low-level development stages. The merchandise exchange and trade in border provinces with these countries was helpful, but still limited, for local economies (Wu, Zhe, p. 132).

Third, global competition for FDI was another factor the Chinese government needed to consider. Equalizing economic conditions and policies among different regions should not make SZs less attractive to world commerce. In other words, only good locations can attract FDI effectively. In 1987 one reformer asserted that if the gap between regions were to become too wide, the state would actively redistribute income (Pearson, note 187). However, the extension of the areas open to foreign capital to the coastal cities was a decision to concentrate further on industrial development in what were already China's most economically advanced areas, because foreigners were much more likely to invest in areas that already possessed an industrial infrastructure, and that foreign capital, technology, and management would be more easily assimilated in the advanced areas of China. Thus, Chinese leaders made a trade-off between promoting regional equality and concentrating foreign investment where they believed it would be most successful. For example, the Changjiang River Delta OZ is more developed and enjoys better infrastructure facilities. Although it has fewer ties with overseas Chinese who are potential investors, unlike other two OZs (Pearl River and Southern Fujian), the delta zone can take advantage of its relatively better infrastructure facilities and labor force to attract foreign investors who are looking for a better investment environment. So these relatively developed areas and regions can attract FDI more effectively than less developed areas. If

we take international competition for FDI into consideration, it is understandable that China's government used this strategy to achieve the success as a second largest FDI recipient in the world since 1994.

Apparently the development of the eastern part of the country at the early stages of opening up fit China's economic development level and investment environment at that time. The preferential policies were very important to attract FDI, promote local economies, and later the national economy. The development of the coastal area at least made two positive impacts on the national economy. First, economic development in the SZs promoted economic development in surrounding areas. Second, the economic differences among coastal areas has been greatly reduced. Nonetheless, the population in the coastal areas is about 50% of the national total. The increased gap between the coastal and inland areas does not mean the development of the coastal area is at the price of backwardness for the inland area. As a matter of fact, although the inland area has been growing at only a slower pace than the coastal area, its growth rate is much higher than before it opened up. SZS should not be blamed as the cause of unbalanced development. Currently, more concerns have been raised by scholars and practitioners in China in terms of expanding the opening up experience to the inland areas. Some new approaches, such as more allocation of government investment, have been developed by the government to overcome the problem. From an economic perspective, the preferential policies adopted may not have been optimal -- resources were wasted in payoffs to local officials and were not allocated efficiently -- but they succeeded in building political support for what was a fundamental turnaround in China's stance toward the world.

5.3.2 State Capability in Dealing with Policy Differentials

Regional inequality is a fact. The more important thing is that the state handles these differentials.

Regional competition and central government's early dealings with policy differentials

Certainly local interest groups do articulate their interests for their own local or regional development. However, interest groups articulate and promote their interests in ways that appear compatible with a country's social, economic, and political system. The extent that central authorities are able to articulate a policy, such as the establishment of SZs and generating wide support and commitment from various groups, is an indication of the potential success of a policy's implementation. Likewise important to successful implementation is the extent to which the authorities are able to respond rapidly to changes in national interests and introduce corresponding policy modifications. The creation and operation of SZs in China have presented such challenges.

Interior provinces tried to further their own local interests by hoarding raw materials, and interior leaders often complained of unfair treatment received by the coastal areas. The center's initial response to the growing resentment from interior provinces was a combination of promises, pay-offs and exhortations. For example, the commitment to developing the west was the focus of a special symposium in Lanzhou in August 1985. However, this would have to wait until coastal development was complete which, at the earliest, meant the end of the century. For the time being, the western provinces must content themselves with "laying an ideological and theoretical foundation for the future" (Pan). Apparently aware that promises on their own would not be sufficient to pacify the voices of protest, the central leadership also announced increases in its aid to the western Autonomous Regions and Yunnan, Qinghai and Guizhou provinces by ten per cent per annum. This move highlights an important element of the spatial impact of the 1980s reforms. Although many of the reform benefits accrued to enterprises and local authorities, the center bore many of the costs. In order to ameliorate the negative effects of emphasizing

coastal development, the center took on extra budgetary commitments at a time when central coffers were already under severe strain.

As the central government's preferential policies have largely been biased against non-coastal regions, high levels of discontent prevailed among inland provinces. On March 16, 1988, the party secretary of Shaanxi Province in association with the other eleven inland provinces organized a conference on "Western Reform and Development" that was held in Xian in June 1988 (Economic Daily, 1988, March 27, p. 2). Some leaders from internal regions pleaded for the "open door" benefits to be distributed beyond coastal areas. Some new regional blocs like the Regional Economic Co-ordination Association of Southwest China, the Northeast Economic and Technological Association, and the Northwest Economic Cooperative Council were formed after the mid-1980s. These organizations struggled to obtain as many preferential policies from Beijing as possible to cope with their economic problems (Zheng, Yong-Nian, 1994b). The situation like this in some way can help regional economic cooperation and promote exchanges between different areas. But regional blocs do hurt economic development because they establish some exchange barriers. In 1988, some impatient inland officials and local governments even established their own SZs without central government approval (Yang, Dali, p. 58). To deal with this problem, the State Council responded in 1993 by reinstituting the requirement of central approval for all new development zones. Governments below the provincial level were stripped of authority to approve development zones, and all approvals by provinces, autonomous regions, and municipalities had to be ratified by the State Council (FBIS, 1993, May 18, p. 43). CPC General Secretary Jiang Zemin ordered an inspection and rectification of all zones in order to close down those that lacked infrastructure and other conditions to support foreign firms. Premier Li Peng was assigned the job of heading the central interministerial inspection team (Shirk, 1994, p. 42).

Overall, the government's approach to regional development has been increasingly useful and helpful. But the economic development seemed to be at the expense of the less developed areas and regions, especially in the early stages. The problem of regional disparities became an important issue in terms of balanced national development. Some suggest that the government needs to implement several policy and strategic changes to correct the unbalanced development. The recommendations include: encouraging capital flow to those less developed regions; encouraging the information flow between different regions; encouraging technology transfer from advanced areas to backward areas; and dealing with labor flow, as well as encouraging the absorption of local surplus labor (Wong & Hu, p. 176).

All these changes require a gradual shift of the preferential policies from coastal regions to western and inland regions, which seems to be the right strategy, because China's future stability may hinge on putting large amounts of foreign funds to work in developing inland, poorer parts of the country. The recent policy and program development shows that the government has tried to make policy changes and to provide some other supporting programs for the inland and western regions since the early 1990s.

Shift of policy preference in the 1990s

The center has been gradually giving these inland and western regions more policy preferences since the early 1990s. In the Ninth Five-Year Plan enacted in the fifth session of the Fourteenth National Congress in 1995, a major component is the adjustment of the existing SZ policies and mid-western-China economic policies. Although high-level Chinese officials emphasized that current special policies for SZs remain unchanged, they also revealed that some preferential treatment could be adjusted according to China's new economic reform situation. The most important adjustment is that the tax rate in the SZs will be the same as that in other areas. However, besides the autonomy in project and

foreign trade approval, the most important preferential policy in SZs is tax reduction. Tax holidays and low taxes attracted a lot of foreign and domestic capital poured into SZs. If this adjustment was implemented, the tax rate would be changed from 15% to 33% (Ruo, pp. 54-55).

The principle of giving more preferential policies toward inland areas and regions was recently supported by top leaders such as Jiang Zhemín, Lǐ Pēng, and Zhū Róngjī. These policies included tax return, low rate government loans, state investment in infrastructure and resource development in the regions, and incentive policies encouraging foreign capital inflow to the regions. The means of developing inland China include: (1) policies; (2) support from the coast; and (3) most importantly, market system. (People's Daily, Overseas Edition, 1996, March 14, p. 3).

One of the most effective measures for spurring inland provinces to engage in international business was the set-up of some SZs by the central government and the authorization of particular local governments to create special development zones where they were permitted to offer concessionary terms to foreign investors. Before the 1990s, the central authorities only extended some privileges to small batches of particular areas. For examples, in the early 1980s, the remote Xinjiang Province and Tibet were granted the same preferential 100% foreign exchange retention rate as Guangdong and Fujian. In 1985, the State Council approved a special 50% rate for four autonomous regions (Inner Mongolia, Xinjiang, Guangxi, and Ningxia) and three provinces (Yunnan, Guizhou, and Qinghai) in China's interior (Lardy, p. 56). The 1988 coastal development strategy policy included three localities in inland Sichuan among the eight granted special open zone status (Yang, 1991, p. 54). In 1992, Beijing authorized twenty-one additional cities, located along the Yangtze River and in the Northeast, to offer special incentives to foreign investors (Goldstein, 1992, p. 72). Chinese leaders also tried to strengthen economic development in the impoverished border regions dominated by ethnic minorities. In 1992,

the State Council approved the establishment of 14 Border-region Economic Cooperation Zones, which were designed to foster cross-border economic development in Northeast (Heilongjiang, Jilin, Inner Mongolia, Liaoning) and Southwest (Guangxi, Yunan) China (FBIS, 1996, February 12, p. 25). Almost 2,000 development zones were set up, a large proportion of them in inland areas. As a result, the inland provinces raised their 1992 share of foreign capital attracted to China from 7% to 10% (Lu, Ren, and Lu, Tong). By 1993 the press was reporting that "nobody knows exactly how many such zones, which attract investment with a variety of tax breaks and other favorable policies, have been launched in China." (Yin). According to this source, the State Economic Planning Commission estimates 1,700 zones, the State Council SEZ official, 1,800, the State Land Administration, 2,700, and the Ministry of Agriculture, 9,000, respectively (FBIS, 1993, February 12, p. 17).

Narrowing the gap between the east and west gradually is claimed by the government as an important strategic development goal of China's economy. The central government encourages foreign investors to invest in those inland and western regions. Indeed, the advantage of (cheap) manpower and (abundant) resources in those regions is very attractive. In 1996, the Chinese central government increased the authority of the inland area to grant foreign investment projects from \$10 million to \$30 million (People's Daily, Overseas Edition, 1996, Dec. 27). In the first half of 1996, the realized FDI in the inland regions was 10.2% of the national total, comparing to 9.6% of the same period in 1995 (People's Daily, 1997, January 8).

More importantly, there is a shift from policy advantages to local advantages. That is, policy differentials are being minimized gradually. According to the Mayor of Wuhan, for instance, Wuhan's FDI implementation experienced a shift from previous policy preferences to local-advantage dependence: perfection of related laws and regulations; high management effectiveness, and an attractive market (especially leadership's open

consciousness and efficiency) in order to shape a good investment environment (People's Daily, Overseas Edition, 1996, February 27, p.1). Some policy preferences for SZs will be taken away. For instance, most preferential policies for Pudong New Zone in Shanghai would be eliminated gradually before the end of this century. The leadership of the city and Pudong also regard the market and legal systems as important for establishing a good investment environment. The adjustment symbolizes a change of FDI policy and SZS, which aims at accelerating the speed of China's "socialist market system" integrating into the global market (People's Daily, Overseas Edition, 1996, March 23, p. 1).

Various supports for inland development

Since some problems in less developed regions cannot be resolved or reduced by only providing better policies, the Chinese government has so far launched some programs to allocate and redistribute resources and national income, and to help these regions and areas move forward and narrow the gap between the coast and the west-inland regions.

Economic linkages between regions

According to the noted economist Xue Muqiao, the best way to develop western China (without placing further strains on national finances) was to allow natural economic links to grow between the developed coast and the less-developed interior (Pan, p. 7). In 1982, the government began to encourage economic ties between SZs and enterprises in the rest of the country through the *neilian* (internal linkage) strategy. A central goal was to encourage enterprises from inland areas to set up joint ventures or other cooperative ventures with foreign firms in the zones. The central government also sponsored initiatives to encourage the growth of inter-regional trade and coordination between the developed coast and the interior. But structural differences between economies in the interior and on the coast, the coexistence of divergent pricing mechanisms, different center-province

revenue-sharing systems, and unequal access to domestic and foreign investment and markets, and inadequate national infrastructure all gave the coastal regions an advantage over the interior in trade between the two and distorted the "natural" impact of these inter-regional contacts (Breslin, p. 64). Even if this were the case, a new wave of cooperation between the eastern and the western regions has been an important phenomenon in recent years. Numerous domestic enterprises in the eastern region have already set up their business in the inland and western regions because of the lower cost of raw materials, resources, and labor in those less developed regions. Authorities and enterprises in inland and western regions use so-called "two wheel" strategy: that is, attracting FDI and linking domestic enterprises. According to one source, more than 1000 big corporations in the east have set up joint ventures or cooperative business in the northwestern region (People's Daily, Overseas Edition, 1997, April 29, p. 2). Approximately 200 enterprises from Shandong Province and 400 from Zhejiang Province have established operating units in the central and western regions (FBIS, 1996, January 22, p. 42). Until 1996, Shanghai had economic and technological cooperation with 12 western and inland provinces and regions, and total cooperation projects in various areas exceeded 1,000 (People's Daily, Overseas, 1996, October 30, p. 1).

Non-market support from the coast region

Another unique support from the eastern and more developed regions is a non-market means -- the government calls for the eastern area to help the west-inland. This type of inward link has begun to have impact on inland development. In government officials' words, the coastal area has already made a big step first: now it is the west's turn to develop and for the east to help the west-inland. For instance, among those corporations from the coastal area which had inland operations, many are not motivated by the search for higher profits and lower operating costs. Huaxi, a prosperous village in Jiangsu, has raised

money to help 6,000 Ningxia farmers move out of a barren mountainous area, resettle in a more productive area, and to build up another Huaxi village in Ningxia Province (FBIS, 1996, January 22, pp. 42-43). Yentai City vowed to build another city of "Yentai" in six to seven years in the mid- or western region. All these symbolize that China's "West movement" has really begun (People's Daily, Overseas Edition, 1996, March 16, p. 2).

Government programs supporting inland development

Since the linkage approach had limited economic impact on the inland area so far, especially for those very poor areas, the central and provincial governments have launched some special programs to support the backward areas.

Fuping Jihua (Helping the poor program)

According to this program, the center and local governments should provide poor areas with extra help. For instance, the National Development Bank has been adjusting credit structure, and providing preferential support and other "fuping programs" for inland and western regions (People's Daily, Overseas Edition, 1997, March 8, p. 2). The central government has invested massive amounts in the region's infrastructure during recent years. Those investments include 2.7 billion yuan for energy development and 8 billion yuan for railways. The CPC Central Committee's recommendations in the Ninth Five-Year Plan, and the plan focused on development until 2010 indicates the government's commitment to narrowing the gap between the coastal area and the central and western regions (FBIS, 1996, January 22, pp. 42-43).

Loans

A leading policy bank provided substantial support to the poor areas in 1995 through loans. The State Development Bank, one of China's largest policy banks, executed the central government's commitment to narrowing the economic gap between inland areas and developed coastal regions by granting loans totaling RMB¥58.4 million in 1995 to help

the country's backward central and western regions support their local economies. These loans accounted for 67% of the bank's total lending that year (FBIS, 1996, January 29, pp. 36-37).

Administrative support

In order to accelerate the economic development in the western-inland regions, some important cities are promoted to a higher level of administration. It is hoped these cities will act as axles around which regional economic development might revolve. For instance, Chongqin city was promoted to a provincial level municipality at the Fifth Session of the Eighth National People's Congress. One of the purposes is that the city is the biggest city in southwestern China: it has a population of 30 million, and 82,000 square kilometers in area. It will be an economic center which will lead the economic and social development in the southwestern region and upper part of the Changjiang River (People's Daily, Overseas Edition, 1997, March 7, p. 8).

The dispute about unbalanced regional development is still on. Although the result of regional policy differentials is that the general trend of development is positive for both inland and coastal regions, some contend that the coastal sector has integrated with the world market system, while the inland sector has become more isolated (Tzeng, p. 279), China now is "A country divided by growth" (Wolf, p. 12). Most inland provinces asked the State Council to formulate policies encouraging economic cooperation between eastern and western China so that more investment funds, technology, and trained people could be transferred from coastal areas to inland provinces. Obviously, no inland region is willing to be left out to fall further behind, and the economy as a whole just cannot afford a growing gap between the two economic sectors. The policy shift and the trend to equalize regional development will continue. There has been no sign of political crises caused by regional differences as some predicted: "The disparity of development has created a fair amount of

political dynamite, which might eventually result in an internal crisis in China." (FBIS, 1988, August 1, pp. 18-19). The above analysis shows that the Chinese state still possesses the ability to deal with economic and political problems caused by regional disparities.

The fact is that the disparities among regions and areas have narrowed. The growth rate gap among the three economic regions is shrinking. In the first quarter of 1996, Fujian Province had the highest growth rate, which was 15.6%; Tianjin and Anhui Provinces had the second highest growth rate, 14.7%; and the lowest growth rate was in the province of Liaoning, a coastal province; Xingjiang Province had 6.9%; and other provinces had 8% or more (People's Daily, Overseas Edition, 1996, June 24, p. 2). Some evidence shows that the central government recent policy adjustment and various supporting programs have yielded positive results -- the growth rate in the inland and western regions in recent years has been higher than the national average (People's Daily, Overseas Edition, 1997, January 20, p. 1). Thus, "as long as all parts of the country grow, even if some parts grow far faster than others, the answer" to the question of China's discohension and disintegration should be "no" (Wolf, p. 12).

CHAPTER VI. CONCLUSIONS AND IMPLICATIONS

This chapter summarizes the findings of the research so as to clarify the relevance of the conceptual framework outlined earlier, and to explain the state-market relations in respect of SZs in China. The findings show that China has utilized a unique strategy to open up the country to the outside world and attract FDI, and its strategy is quite successful in terms of its multi-functional goals. The reason the state can use this strategy so well is that the state has a relatively strong state capacity which enables the government to provide positive interventions for socio-economic development. The state can effectively handle foreign capital inflow by using SZS to increase the benefit FDI can bring to the country and to reduce the side effects and costs, thus to pursue the national development goals.

China's case provides an alternative route towards development, which eases the tension between two opposite theories in political economy. Neither Neo-Classic nor Marxist theories exactly fit the Chinese situation. The success of China's opening-up to the outside world and maintaining its rapid economic growth rate under a relatively stable political condition shows that the state plays an important role in FDI and socio-economic development. Furthermore, state capacity is crucial to fulfill the tasks of FDI policy implementation. It is only a supplement for the statist approach to understanding economic development issues in developing countries. It also suggests that in evaluating SZS in China, researchers need to put the issue in a specific place and time and to avoid some pitfalls.

Finally, by extension, it ends up with providing some policy and practical implications. Some remaining problems in the SZS and FDI policy field in China should be paid more attention. Under the new development of domestic and international situations,

the Chinese government needs to deliberate and adjust the existing policies according to its development goals. Some possible pitfalls are addressed.

6.1 FINDINGS

This study shows that the main reason China has been able to use a unique special zoning policy to reach multiple goals -- attracting FDI, developing socio-economy, and maintaining political-social stability, etc. -- lies mainly in its state's capacity to deal with state-market relations and economic activities. A developing country with a relatively strong state like China can effectively handle foreign capital inflow and increase the benefit FDI can bring to the country and reduce the cost it could cause.

Particularly, there are three major findings.

1. China has successfully implemented its unique SZS strategy.

China has a unique SZS which serves the purposes of its industrialization and modernization. They were originated from other SZs in the world, but they have their own characteristics. The SZs in China proved that a strategy can reach the multifunctional goals if it is implemented properly. Some contend that if too many targets are set, the overall results can be negative owing to the conflicting character of individual targets and the counter productive effects of the measures taken. The fulfilling of multiple objectives may involve trade-offs with other ones (Kumar). China's experience proves that SZs multifunction is possible. Zones should be selected in order to realize positive effects connected with good investment environment. The proximity of advanced local enterprises and research facilities certainly contributes to the success of such zones. Developing poor regions usually happens in later stages of the strategy.

When evaluating a country's SZS we must relate it to the purposes or goals of those zones. In this sense, China's SZs and SZS are quite successful so far in its opening up the country to the outside world and modernization.

2. It is necessary for a developing country to provide state control or state intervention over foreign economic activities. "Control" here is not used in a negative sense: rather, it means to produce more positive results by government intervention. In a country with highly centralized power, a huge population, backward economy, and a large geographical territory like China, the initial attracting of foreign investors was more difficult than many other developing countries. Opening up the country and absorbing FDI by using SZS and other control tools are reasonable, rational, and understandable. Though the strategy has succeeded in some areas while failing in others, a gradual opening up and a control strategy can bring more positive results than negative impact. China's experience also shows that not only a host country needs to use the state's control over foreign investment activities, but it also must possess a strong state capacity to practice this type of control.

3. China does possess relatively strong state capacity. That is the main reason China can effectively practice its SZS. More specifically, six aspects are examined to inductively show that China has strong state capacity.

1) A state in a developing country should be not only committed to modernization of a country, but also able to strategically plan its socio-economic development. That is, the people and their government should have the willingness and ability to develop. Evidently, in the history of the People's Republic of China, the state put a lot of effort toward the country's modernization. Although there was a major split in the Chinese leadership at the beginning of opening up, both political

factions supported modernization and reform. They differ in how and to what extent reforms should be carried out.

The post-Mao state also possesses certain capabilities to plan socio-economic development and modernization, which the Mao-era state did not have. This ability can be examined in structural and institutional aspects. First, an absence of a continuing foreign influence from the nineteenth- and twentieth-century era of colonial expansion resulted in weak economic and political linkages of China with capitalist countries. Policy makers thus can identify and solve policy problems based on their perception of the national interest, and are not necessarily motivated by self-interest or the interests of particularistic groups. Secondly, because of the previous socialist nature of the system and centrally-planned economy, there was no private capital to influence the policy from within, and the previously centralized system provided a ready planning structure and personnel which could be used after reform and improvement. Third, the Chinese state has tried to establish an economic legal system and has issued many laws and regulations concerning FDI and SZs activities. It has tried to legalize market-oriented modernization, which is against its Marxist orthodoxy, and commit to it.

2) The Chinese state has the capability to cope with international norms. That is, not only would it take advantage of conducive international economic environment and conditions, but it also should be able to push its business environment to meet international business standards.

China's government tried to make a comprehensive incentive system for foreign investors by constantly legislating new laws and adjusting old laws and regulations. It also insisted on policy stability and encouraging economic cooperation with foreign economies. To a degree, China has integrated its economy

with the global economy by using these measures. Although many problems still remain to be solved, progress has already been made.

3) A developing state needs to possess the capability to control and allocate their limited resources in order to initiate economic take-off and sustain development. This ability in China is assessed from two respects. First, domestic investment in SZs, especially at the early stages of opening up the country, is an important impetus for SZs' early take-off. Second, the Chinese state has a very unique mechanism for the allocation of domestic resources to SZs. That is, there is more government control of the economy in various fields and forms.

4) The Chinese state possesses capability in direct intervention with SZs operations. In order to fulfill the development goals associated with FDI and SZs, the Chinese state intervenes in the operations of SZs constantly in selecting ideal locations for opening up as SZs, setting and modifying the terms of foreign investment in the zones, adjusting and reprioritizing the industrial structure in the zones, and encouraging the local inputs of capital and raw material into the zones. The arduous process of establishing the first four SEZs reflects the Chinese state's capability in direct intervention with SZ operation. The administration formation within SZs is also directly intervened the by central and provincial governments. Policy adjustment is another important central government intervention with SZ operation. The central government can reward or punish the locals with the designation or withdrawal of these selective incentives.

5) The Chinese state possesses the capability to decentralize while keeping central control over the local areas. China was a highly centralized state before it opened its door to the outside world. Decentralizing power held by the central government was a salient issue in China. The rationale of decentralization is about power balance based on development goals. That is, the decentralization of

power in China is not only about how to balance the power distribution based upon separate central and local interests, but also about how to balance the local and central development tasks and objectives in terms of their common goals of the development and modernization.

The decentralization of power in China is within the functional scope. Local governments can perform important functions for the central government in securing political control, maintaining social stability, and promoting economic development. This delegation of power is mainly related to economics rather than politics; it is within the administration's scope, not party and fundamental systems; and local governments receive limited autonomy, not independent policy making and implementation.

In terms of power abuse caused by decentralization, the central government possesses control mechanisms: party leadership, personnel management and some other means of central control over locals: financial control, information flow control, and policy process control.

6) The Chinese state has the capability of handling regional economic development inequality. Several reasons can help explain the rationale of the regional economic development strategy: gradual opening-up manner, coastal areas' better investment environment, and consideration of global competition for FDI. Moreover, the state can handle regional inequality quite well by keeping inland areas the supporting central government's policy. Along with the coastal area development, the central government started to switch the policy toward less developed regions and areas, and provided more support for poor regions.

The analysis of these six aspects shows that China possesses strong state capacity in dealing with economic activities and development. The state capability, strictly speaking,

is an issue of policy implementation. Implementation, means "to carry out, accomplish, fulfill, produce, complete" (Pressman & Wildavsky, p. 407). Good implementation not only secures the fulfillment of objectives of a policy, but also provides a feedback to revise the policy. That is, state capacity is ultimately about implementation of the policies and strategies -- "get the job done"; implementation capability can be analyzed in the perspective of state capacity. In this respect, Chinese government has realized its national development goals and objectives.

More particularly, in terms of FDI policy implementation, a UN research emphasizes the importance of the implementation dimension in developing countries (DESD, p. 2). With appropriate foreign investment policies, promotion and regulation systems, and administrative structures and procedures, FDI and technology yield benefits to a country. However, foreign investment policies should be formulated and implemented well in three dimensions: (1) The policy system; (2) a foreign investment incentives system (with regulatory and promotional components); and (3) implementation through administrative structures and procedures (DESD, pp. 2-3). The effectiveness of development policies and plans cannot be divorced from the effectiveness of the administrative institutions that implement them. There must be a fit between the administrative capabilities, values, and willingness to implement the incentives system and the goals, policies and design of the system itself. The findings show that China has overcome many of its preexisting problems and effectively implemented its FDI policies.

6.2 THEORETICAL IMPLICATIONS

Lindblom opens his book *Politics and Markets* with the comment:

"Aside from the difference between despotic and libertarian governments, the greatest distinction between one government and another is in the degree to which

market replaces government. Both Adam Smith and Karl Marx knew this. Hence, certain questions about government-market relations are at the core of both political science and economics, no less for planned systems than for market system" (Lindblom, ix).

This statement about the government-market relationship, measuring the extent to which market replaces government, is an important issue of comparative politics.

This study, in a broad sense, looks for answers in relation to politics and economics. Economists often view China's post-1979 open policy as its leaders' rational response to the inefficiencies of the previous autarkic command economy (Perkins, p. 269), which does not provide an adequate explanation of the specific form and content of reform policies. Some focus on political institutions which tilt toward policy formation and implementation. One study comparing China and the Soviet Union suggests that one should study policy making in communist countries much as one would in democracies: by focusing on the competition among politicians who operate in an institutionalized political setting. It concludes that the reason China's leaders promoted economic reform is that China's version of communism was *less institutionalized* and *more decentralized* than the USSR's (Shirk, 1994). It provides a useful dimension to analyze communist systems and central-planned economies: scholars of communist systems usually ignore the institutional framework of policy making, and assume that institutional rules and lines of authority are irrelevant and that all decisions are made by a few top leaders.

This study explores the government-market relation in China from a different angle -- state capacity and the effectiveness of state intervention leading to the success of the reform and opening up. China's experience provides a case which shows that the state-oriented approach is effective for some countries like China. Its success proved the efficacy of direct market intervention to promote export-oriented production. The most important addition of this research to the literature is that it needs to focus more on state

capabilities in socio-economic policy making and implementation and in dealing with internationalizing the host country's economy, rather than only focus on the state's role itself in terms of government-market relations. That is, whether a host government should use more state intervention and how effective this utilization can be depends on its state capacity. Government can help enhance economic development by imposing positive state intervention only if it has strong state capacity. The liberal approach is seemingly out of date. Neo-Marxism only helps isolationism and causes continuous underdevelopment. The statist approach does not provide specific answers about why some states cannot play a positive role in development, and to what degree different states should intervene in economic activities.

The China case offers a new and very different model of economic marketization and internationalization under authoritarian rule. People in countries like North Korea, Vietnam, and Cuba, as well as non-communist state-dominated developing economies that admire China's success, may find this analysis helpful. However, it is not appropriate to generalize the conclusion and to apply it to other developing countries. There are also certainly some limitations to this study. This research only explores state capacity and state's role in economic development, specially in SZS implementation. Largely, the research is conducted within the scope of policy making and implementation, rather than the realm of the fundamental political system. Since China's political system has not been democratized, any overestimation of state capacity is harmful, even dangerous. The central government's ability to intervene in socio-economic policy is only effective under conditions of rational and relatively reasonable applications of specific policies and strategies. Pitfalls should be noticed and avoided: that is, the statist approach should not be overemphasized.

To be sure, China has made some progress in institutional reform, such as personnel systems. For instance, many old officials were replaced by the new appointees

with significant differences in age, education, and experience from those they replaced (Harding, 1987). However, China has not changed any fundamental systems. The reformers saw political reform not as an end in itself, as have democratic activists in Eastern Europe, but as a means of promoting adoption and implementation of their economic restructuring plan. China still lacks competitive elections, independent nongovernmental organizations, a genuine multiparty system, free press, and strong legislatures. That is, it is still possible for the central government to make policy and political blunders, since the state still largely relies on political intervention in socio-economic activities, rather than rule of law and a democratic legislative process.

Indeed, the Chinese Communist Party still rules in China. Many years ago, the Soviet Union's Mikhail Gorbachev was thwarted by the powerful Soviet central bureaucracy and checked by other party leaders. He had no choice but to shift authority from party to government, create a real legislature, and open the political process to ordinary citizens. These moves eventually produced the fall of the party and the disintegration of the country (Shirk, 1994). Unlike the Soviet Union, China's reform has not touched the party system yet. A new National Defense Law draft is being discussed now, in which the military forces are put under the leadership of the Communist Party of China (People's Daily, Overseas Edition, 1997, March 7, p. 1). Democratic political participation is not a part of life of the ordinary people, let alone a change in the party system and democratized institutions.

6.3 POLICY & PRACTICAL IMPLICATIONS

Developing host countries can use FDI to help their economic takeoff. A key factor is that leadership in the governments need to actively intervene with the economic activities by making and implementing a series of policies and strategies. However, the results of the

state intervention/state role usually depends on another factor: state capacity. The stronger the state capacity is, the more effective the state intervention is, if such intervention is necessary and correct.

SZS, according to China's experience, is a very useful tool for a country to open up and attract FDI in order to speed up economic development. Policy makers need to consider this strategy as an experimental approach to economic reform in the first place, then expand the policies and experiences to other areas. In order to fulfill this task, states in developing countries need to enhance their capacity in at least these aspects: commitment to modernization and planning development; meeting international norms; effectively using and allocating their limited resources; actively and positively intervening in SZs' operations; and dealing with other unique issues and problems their countries have which the new policies and strategies could cause.

However, SZS as a tool for state control over FDI has its limitations. The problematic performance of the zones and other related issues in China was also outstanding: bureaucratic corruption, inequality of regional economic development, weak linkage between the zones and inland areas, local power abuse, and so on. All these problems are more or less related to bureaucracy, which is an important medium to policy implementation, and state capacity. Bureaucracy plays a very important role in the improvement of the investment environment.

In China, bureaucracy is always powerful. But bureaucratic power is not the same as administrative effectiveness, because oftentimes, "A powerful bureaucracy is administratively weak" (Riggs, pp. 235-237). Powerful bureaucracy and weak administration in China can be found in the following aspects: *Guanxi* (Relations or connections) or kinship, bureaucratic inefficiency, and corruption. In order to get rid of many non-economic interferences from a variety of sources, some foreign companies have tried to find some natives who have connections with government officials to deal with

them. Foreign business people in China frequently complain about the lack of a centralized and consolidated supervisory agency over foreign investment. Too many agencies and levels of government are concerned, and bureaucratic red tape adds too much paper work. Lack of modern management and technology makes bureaucrats work inefficiently. Computers are still not widely used in the country, which causes low work efficiency. Official corruption is not uncommon, and sometimes is a very serious problem. Local officials easily can be a hindrance for foreign investors. So, improving bureaucracy and administrative efficiency is important to implementing FDI policy.

Recent conditions show that new domestic and international environments are very different from 15 years ago. Domestically, further integration of its economy to the global economy (e.g., joined more international economic and trade organizations, accepted international standards, signed treaties, made some efforts to join GATT) has restricted, to some degree, regional economic development favor policies such as coastal development strategy. Hong Kong is back in China's governance, and Macao will be soon. As a result, economic relations between the mainland and Taiwan will be more intertwined. Also, as Hong Kong, Macao, and Taiwan have had market economies for a long time, their experiences can easily be followed by other parts of the country. Hence, SZs' experiment effect will be decreased. SZs themselves are facing some new challenges. For instance, operation costs, such as labor and real estate, have increased so fast that SZs' competitive advantages have begun to weaken, and posed more difficulties for future development. More and more regions are opening to the outside world. Special policies have already spread to many areas and regions. Many reforms and preferential treatments, such as tax reform, administrative reform, transformation of the management mechanism, price system reform, and establishment of stock markets, have been implemented in many parts of the country. SZs are not "special" any more (Gao & Chi, p. 6). Although SZs still remain, special treatment has spread out over various regions in China. Most cities over the country

are allowed to establish their own SZs, such as industrial zones, and economic and technology development zones. The difference between a foreign funded enterprise in SZs and one in non-SZs is that foreign invested businesses in SZs get more benefits and preferential policies. For example, the tax rate is 15% in special zones, 24% in open cities, and 33% in other areas, respectively (Lu, Jianren). However, these preferential policies are being gradually taken away. There is also an important shift from policy advantage to local advantage. That is, instead of expecting central government's special policies, local governments should find their own local advantages and improve their investment environment. China has already developed a good and close economic relationship with neighboring countries: it should keep this trend and further develop its relationship with these countries. It is extremely important for developing inland and western China. Because of transportation difficulties for inland and western parts of China, developing economic and trade cooperation with Mongolia, Vietnam, Burma, former Soviet Union countries, and so on, can help bring the economy of these areas to a higher level.

The international situation has also changed. The competition among developing countries has increased steadily. More and more developing countries have adopted foreign-oriented developmental strategies recommended by the World Bank. These countries provide preferential policies and conditions in order to attract FDI. This could generate some adverse impact on Chinese SZs and foreign capital inflow. Some Asian countries (such as Thailand, the Philippines, Malaysia, and India) are very attractive to foreign investors, especially the Japanese, South Korean, and Taiwanese investors. Second, the United States, Japan and Western European countries have created several models of "market economy" in eastern European countries. This region can get technology and capital from those developed countries more easily than China, thus having advantages by doing business and trade with Western countries. Third, more SZs have been set up worldwide. They will absorb more foreign capital. Since the mid-1980s, there has been a

new trend of international capital flow from developing countries to developed countries. Currently, international capital flow concentrates on the USA, Canada, Northern Ireland, and South East Asian countries. Apparently, this trend is not good for China. SZs in China are facing new challenges as well as SZS.

All these remaining problems and new development of the world and domestic situations require that the Chinese government adjust their strategy, as it already is being done, in a way, and make some changes in FDI and other economic policies according to the new challenges and its long-term national development goals. Some appropriate approaches include: changing regionally based policy to industry-based, time-based, and even reversed regionally based policy (e.g., giving foreign investors investing in less developed regions more preferential treatments than former SZs and other more developed regions); reducing the government's direct intervention in foreign investment policy implementation, and increasing policy and law enforcement. One recommendation is that China establish brand new experiment zones which can meet international competition and global challenges. This type of zones should be at a higher level than the current SZs in China. In a very strict sense, China does not have any free economic zones (FEZs), because current SZs in China are not FEZs according to international standards. Establishing free economic zones according to international norms may be a good choice under new domestic and global conditions. The major reasons are: (1) International competition requires more competitive SZs in China. SZs should find their own position from the perspective of mainland China's open-up and reform, but also from the perspective of smooth economic development of the whole nation, including Hong Kong, Macao, and Taiwan. (2) SZs should follow more closely the international standards in their operation. If China joins WTO (formerly, GATT), market economy and free trade policy will be carried out in China. Since SZs have developed a higher market system than other areas, they can play an important role in implementing WTO's principles and policies.

These zones could be put anywhere, whether coastal or inland areas or border areas (Li & Liu, p. 5). By so doing, hopefully, China will continue to attract more FDI and narrow the gap between the inland and coastal areas.

Hence, China's SZS is at another turning point -- should it be continued, changed, or stopped? The state is facing new challenges. The state will also play a very important role in correcting the problems and achieving new development goals in special zoning and FDI policy implementation in China. Although its volume of foreign trade and investment has increased dramatically, China's economy is now only shallowly integrated into the world economy. As of 1994 China's domestic market remains protected: only some enterprises are allowed to trade directly with foreigners; exports are subsidized, and the currency is not yet convertible. State control over trading activities continues to be extensive. As Deputy U.S. Trade Representative Charlene Barshefsky described it, "China's import regime still remains the creature of central planners and state bureaucrats." (Goldstein, 1994). Reforming the foreign exchange regime and lowering import barrier are two urgent issues currently facing Chinese government. If China wants to bring more FDI and further its economic integration into the global economy, which requires numerous socio-economic policy reforms and improvements (such as competition and antitrust policies, technology policies, product standards, worker safety standards, environmental standards, corporate governance rules, regulation and supervision of financial institutions, tax policies, and monetary and budgetary policies), it should open its door much wider.

All major reforms in China will still occur in socio-economic scope instead of political arenas in the near future. Maintaining state security, protecting the national economy, and absorbing FDI are still two important factors the state pays a lot of attention to (People's Daily, Overseas Edition, 1996, Dec. 27). For all these reasons, further economic reform and deep integration into the world economy may prove highly controversial within the central leadership, let alone changes of the fundamental political

system in the near future, no matter if it is a reform or revolution type. In the political realm, any further political reform could loosen the Party's grip on power, producing either turmoil or the rise of a strong political opposition. One can say the present system fits the period of this transitional economy and society well. Possibly, reforming administration by depoliticizing the bureaucracy to a degree can be put on the agenda. Functionally, the current administration is still responsible for too many jobs which are still controversial. Its handling of these will continue to damage its competency, efficiency, credibility, neutrality and incorruptibility. Although a campaign for reform (such as delegating economic function to enterprises, streamlining the administrative structure, etc.) is being publicized, not much change has taken place. There are certainly some favorable factors for depoliticization in the SZs. For examples, a large number of investors have been favorable to the depoliticization of the state apparatus; the current trend of emphasizing consumer goods, housing, agriculture, and non-military technology in the SZs may also favor depoliticization; the policy of involving ethnic Chinese from Hong Kong, Southeast Asia and elsewhere is another factor favorable to depoliticization. However, as a transitional means, the bureaucratic system will not be completely depoliticized until the political system is democratized in China.

All in all, the Chinese state has played an important role in the socio-economic development over the past 15 years. China's economic reform success was achieved without political reform (Shirk, 1994). The same Communist Party and government that isolated China from the world economy for many years opened the door and implemented the economic reform. Since current institutions and policy process seem to fit China's transition, as least economically, it is possible for the Chinese state to continue its control and intervention over the foreign economic activities by using and enhancing its state capacity which largely yielded from old institutions. There is no reason to expect dramatic changes in the Chinese government's ability to maintain control over some areas of foreign

investment, or in its willingness to do so. The challenge for the Chinese leadership is to develop long-term strategies designed to move ahead with economic reform while at the same time preventing social unrest and chaos. Can the Chinese government continue to maintain economic development and social stability by using its state capacity? Can the economic reform and development finally lead to political reform, and thus lead to democratization of the political system? If so, will the political reform and democratization weaken or strengthen the state capacity? All these interesting questions remain unanswered as yet, but are beyond the scope of this study. China is the world's most populous country, borders 14 countries, and has a permanent seat on the United Nations Security Council. Most importantly, China's economy is the fastest-growing large economy in the world, ranking only behind the US and Japan (Franklin, p. 172). Its political and socio-economic development as well as its state's role in the development should not be overlooked.

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