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IMPLEMENTING FOREIGN INVESTMENT POLICY IN CHINA: THE ROLE OF EXPERIMENTATION

A Thesis

Presented for the

Master of Arts

Degree

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Yi Zheng

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ABSTRACT

It has been argued among some Western political scientists whether experimentation can be regarded as an effective strategy for public policy implementation. This strategy, however, has long been a practice by the leadership in P.R. China in its policy formulation and implementation. This thesis is a case study on how post-Mao Chinese leaders have used the experimentalist approach in implementing the policy made in the late 1970s to utilize foreign direct investment for China's modernization program. The study traces the implementation program from 1979 to 1988 by breaking it down longitudinally to four phases; it tries to show that Chinese leaders have used each of these phases of implementation as a pilot project for experimenting with the new investment policy. The study intends to provide a concrete case, within the context of a socialist country, to address the issue concerning the legitimacy of experimentation and adaptation as implementation strategies.

The study indicates that the experimentalist strategy has helped China develop the program to implement the investment policy. It has enabled China to try aggressively a new policy while maintaining firm control over its consequences. It also shows that the strategy is not without constraints, one of them being the tendency for reflective thought coming after compulsive acts. The study

concludes that one should regard experimentation and adaptation as legitimate strategies for policy implementation although caution should be exercised when one is engaged in such an approach.

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CHAPTER I

INTRODUCTION

1. EXPERIMENTALISM IN CHINESE POLITICS

The history of the People's Republic of China (PRC) indicates that there is a strong element of experimentalism in the Chinese leadership's view of the policy process. Policies on important issues have been made under conditions whereby the leadership simply envisioned a general goal to be attained without establishing specific procedures or forms for reaching that goal. The concrete meaning of such a policy would only be defined later when lower levels actually carry out the policy. The leadership often initially implemented new policies only within a limited number of units identified as "laboratories" and potential models. The experimental results generated from "practice" would then be used to modify and elaborate the meaning of the policy. 1 The refined policy will later again be tested, this time probably in a larger field, with the results being the basis for further modification of the policy. The specifics of a new policy and its

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1 For more details regarding experimentalism in Chinese politics, see James R. Townsend and Brantly Womack, Politics in China, Third Edition (Boston: Little, Brown and Company, 1986).

implementation are thus designed and developed gradually through the process of implementation itself. The origin of this experimentalism can be traced back to the late Chairman Mao Zedong's epistemological theory, namely, "(to) discover truth through practice, and through practice to verify and develop truth." 2 Evidence suggests that this experimental approach to the policy process has certainly been inherited by the post-Mao leadership. 3

2. EXPERIMENTATION AS A STRATEGY

The experimental approach to the policy process in China has provided a unique context from which an interesting question can be raised regarding policy implementation: Can experimentation be used as an effective strategy to implement public policies? Some scholars in the West regard experimentation and adaptation as appropriate implementation strategies. 4 This

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2 Mao Tse-tung, "On Practice." Selected Works of Mao Tse-tung. Vol. I (New York: International Publishers, 1954), p. 297.

3 See Zhao Ziyang's report to the 13th Congress of the Communist Party of China, "Advance Along the Road of Socialism with Chinese Characteristics." Beijing Review, November 9-15, 1987.

4 See Dennis J. Palumbo's introduction to "Symposium: Implementation: What Have We Learned and Still Need to Know." Policy Studies Review, Vol. 7, No. 1, Autumn 1987.

"adaptive implementation" school of thought holds that we need to encourage flexibility, continuous learning, and acceptance of change as normal and as opportunity. 5 However, this school of thought is challenged by others who argue that the evolutionary view of implementation results in a "tautology for evaluation." According to them, the adaptive approach does not provide standards whereby the success or failure of a program can be measured because it does not begin with precisely established objectives. 6 The Chinese case undoubtedly provides an interesting example through which the issue of experimentation as an implementation strategy can be studied.

3. FOREIGN INVESTMENT POLICY IN POST-MAO CHINA

This thesis is a case study of the implementation of the policy to attract foreign direct investment (hereafter

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5 For details about the adaptive implementation school, see P. Berman, "Thinking about Programmed and Adaptive Implementation: Matching Strategies to Situations." Why Politics Succeed or Fail, H. Ingram and D. Mann, editors (Beverly Hills, CA: Sage, 1980). Also see A. Brassier, "Strategic Vision: A Practical Tool." Bureaucrat. 14(3), Fall 1985; P. Drucker, Innovation and Entrepreneurship (New York: Harper & Row, 1985); G. Majone and A. Wildsvsky, "Implementation as Evolution." Implementation, Third Edition, J. Pressman and A. Wildsvsky, editors (Berkeley, CA: University of California Press, 1984).

6 S.H. Linder and B.G. Peters, "A Design Perspective on Policy Implementation: The Fallacies of Misplaced Prescription." Policy Studies Review, 6(3), p. 459-476, February 1987.

referred to as FDI) in post-Mao China. The study will examine, in the context of the FDI issue, the role played by experimentation in the process of policy formulation, implementation, and reformulation.

In July 1979, the National People's Congress of the People's Republic of China promulgated "The Law of the People's Republic of China on Chinese-Foreign Joint Ventures," which, for the first time in the history of the People's Republic, permitted large scale foreign direct investment in the country. 7 The objectives of encouraging foreign direct investment in China can be identified as: (1) to attract foreign capital; (2) to bring in advanced technology; (3) to utilize foreign management and marketing expertise; and (4) to increase the ability to generate hard currency, all of which China desperately needed for her ambitious modernization program. The joint venture statute, along with other "open door" policies, marked an end to Mao's "self-reliance" development strategy that China had been pursuing since the founding of the country in 1949. It proclaimed the beginning of a new era in which China would regard foreign direct involvement as an important means for her economic development.

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7 For the complete text of the statute, see China International Economic Consultants, Inc., The China Investment Guide 1986 (New York: Longman, 1986).

Ten years have elapsed since the promulgation of the joint venture statute in 1979. As of the end of 1986, a total of 7,800 foreign investment projects had been contracted. The total contract value amounted to US$ 19.1 billion, and the realized value totalled US$ 6.6 billion. There were 3,234 Chinese-foreign equity joint ventures, 4,405 Chinese-foreign contractual joint ventures, 138 wholly foreign-owned enterprises, 8 and 41 projects of co-operative offshore oil exploitation. Among these 7,800 projects, over 3,000 had been established and were in operation as of May 1987. 9

If mere numerical results are indications of success for policy implementation, the post-Mao leadership has certainly achieved a great deal in implementing its foreign investment policy. The government of the PRC is convinced that its program to implement the FDI policy has yielded substantial economic results. Minister Zheng Tuobin of the Ministry of Foreign Economic Relations and Trade (MOFERT) summarized the accomplishments as: (1) having produced capital that was urgently needed for economic development but which could not be provided from within China; (2)

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8 For definitions of equity or contractual joint ventures, see The China Investment Guide 1986, p. 337-338.

9 See Gan Ziyi, "China's policy on absorbing foreign investment and priority areas to be developed." Foreign Direct Investment in the People's Republic of China, United Nations Centre on Transnational Corporations, editor (New York: United Nations Publications, 1988).

having brought in advanced technology, equipment, and management expertise; and (3) having increased China's ability to generate hard currency. These results coincide with the objectives that the 1979 joint venture statute meant to achieve. 10

4. PURPOSE OF THE STUDY

This research project will study the policy process of the foreign direct investment issue in post-Mao China and try to answer the following questions: (1) Under what socio-economic conditions did the Chinese leadership decide to promote foreign direct investment in China? (2) What major factors contributed to the adoption of an experimental approach by the Chinese leadership? (3) How was the experiment controlled? (4) What role did the ideal "model" play in policy experimentation? (5) How was the model replicated? (6) What overall assessment can we make of the experiment on FDI in China to date? (7) What, if anything, can be learned from the Chinese experience with reference to the adaptive implementation school of thought in general and to the issue of experimentation as an implementation strategy in particular?

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10 See "Over Four Thousand Foreign-invested Enterprises Have Beneficial Results", People's Daily, November 1, 1987.

CHAPTER II

FORMULATION OF THE FDI POLICY AND ITS IMPLEMENTATION STRATEGY

1. SOCIO-ECONOMIC BACKGROUND

Until the late 1970s, the self-reliance principle formulated by Mao Zedong in the late 1950s [11] had always been the ideological cornerstone of China's domestic developmental policies and her external economic relations.[12] The main aspects of the principle can be summarized as: (1) to rely on the strength of the Chinese people to carry on economic construction; (2) to make full use of all internal resources available; (3) to generate capital for construction through internal accumulation; and (4) to gain experience in building socialism through China's own efforts instead of copying the experience of other countries. [13] In terms of economic theory, the principle

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11 See Mao Tse-tung, "On the Correct Handling of Contradictions among the People." Chairman Mao Talks to the People, Stuart Schramm, editor (New York: Pantheon, 1974).

12 For more details regarding the self-reliance principle, see Friedrich Wu, From Self-reliance to Interdependence : Post- Mao China's Interaction with Capitalist World Economy. Ph.D dissertation (Seattle: University of Washington, 1983).

13 See "How China Carries Out the Policy of Self-Reliance." Beijing Review, June 18, 1965, p. 12-15.

of self-reliance explicitly rejected the notion of international division of labor and comparative advantage propounded by Western economists. In terms of ideology, the principle condemned the "imperialist monopoly" of the world economy and advocated a self-reliance development strategy independent of the capitalist world economy so as to form an "international anti-imperialist united front" and eventually to replace the capitalist world-economy with a socialist world system. 14

The principle of self-reliance was, on the one hand, the creation of Mao's radical thinking and, on the other hand, the result of the adverse international environment at the time. This external factor, the international environment, is often neglected when people study the principle in retrospect. Ever since the founding of the People's Republic, the country had been confronted with continuous embargoes by Western countries. The West's economic blockade of China was at times even stricter than its control over shipments to the Soviet bloc. China was virtually denied participation in international economic activities and left with no other choice but relying on

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14 Friedrich Wu, "Socialist Development of Self-reliance within the Capitalist World Economy: The Chinese View in the Post-Mao Era." The End of An Isolation: China After Mao. Harish Kapur, editor (Dordrecht: Martinus Nijhoff Publishers, 1985).

herself. 15 Even had Mao formulated a more other-directed economic policy, it is unlikely that China would have been allowed participation in the international economy to any meaningful extent. Therefore, it is perhaps more reasonable to say that the self-reliance principle was a result of both Mao's radical thinking and the adverse international environment at the time.

Under such circumstances, foreign direct investment never played a significant role in China prior to Mao's death and the political downfall of the radical-left faction labelled the "Gang of Four". 16 Even as recently as early 1977, there was little evidence that a policy of attracting foreign direct investment on a massive scale would possibly be promoted in the foreseeable future. Peking Review, a major official publication issued in a number of foreign languages, specifically announced in February of 1977 that "we do not allow foreign capital to exploit China's resources nor do we run joint enterprises

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15 See An Chen, "China and Foreign Capital: The Legal and Organisational Framework." The End of An Isolation: China After Mao.

16 China had state-to-state joint stock companies with the Soviet Union in the early 1950s; it also set up joint shipping companies with Albania, Poland and Tanzania in the 1960s and early 1970s. These operations were justified as economic cooperations among socialist countries and contained a strong ideological element.

with foreign countries, still less beg them for loans." 17

However, from 1978 to 1979, China witnessed a fundamental shift in her political leadership. It was the end of the Mao age and the beginning of a new era in which the leadership, headed by Deng Xiaoping, was committed to a new approach toward the goals of the Party as well as of the country. The post-Mao leadership declared at the Third Plenary Session of the 11th Congress of the Communist Party (December 1978) that the primary goal of the Party and the country should be shifted from class struggle to "socialist modernization," in other words, economic development.18 This shift of priority fundamentally changed the country's course from one that was charted by Mao's radical ideology to a more pragmatic one which down-played the importance of ideology and emphasized national economic development.

As a matter of fact, the notion of modernization was first proposed by the late Premier Zhou Enlai prior to the disastrous Cultural Revolution (1966-1976), and was later promoted by the former Party Chairman and Premier Hua Guofeng in early 1978 in the Party's overly-ambitious ten-year plan to achieve the "four modernizations" of industry, agriculture, national defense, and science and technology. Deng Xiaoping's modernization program grew out of these

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17 Peking Review, February 25, 1977, p.18.

18 Peking Review, December 29, 1978, p. 6-16.

previous initiatives by the Party; its scope, however, far surpassed any of the similar endeavors in the PRC's history.

The post-Mao leadership, however, was confronted with the tremendously difficult task of executing its ambitious modernization program. First of all, China, like any other developing country, did not have adequate capital to carry out her modernization plan. There were roughly 400,000 industrial enterprises worth $250 billion that needed to be technologically upgraded. It was estimated that the equipment renovation alone of these enterprises would cost as much as 80 percent of their original value, which would make a total of $200 billion. However, only approximately $67 billion had been allocated under the sixth five-year plan (1981-1985) for this purpose, leaving a shortage of $183 billion. Another example is the exploration of China's natural resources, which were urgently needed for the development program. Although China was rich in natural resources, neither sufficient funds nor necessary knowhow to exploit them were domestically available at the time. An estimated $20 billion would be required just for the exploitation of off-shore oil. 19

The second obstacle to the modernization program was that even if China was able to procure this enormous amount

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19 See An Chen, "China and Foreign Capital: The Legal and Organisational Framework".

of capital for her economic development, it still lacked adequate technological and management expertise to upgrade her existing enterprises, not to mention what would be required to establish new enterprises.

The above-mentioned factors, among others, led the post-Mao leadership to reconsider its development strategy. Deng Xiaoping best summarized the situation when he addressed a preliminary meeting before the Third Plenary Session of the Party: "If we do not carry out reforms in our country right away, our modernization program and the socialist course will be ruined." 20 Zhao Ziyang, then Premier of the State Council, reinforced this sense of urgency when he told Armand Hammer, Chairman of Occidental Petroleum of the U.S: "If we had not engaged in reform now, we would soon have been deprived of our world citizenship."21 The Chinese leadership finally concluded that its modernization program would not be successful unless it reinterpreted the self-reliance principle and promoted economic cooperation with the outside world. Of course, by the late 1970s the international environment was also completely changed. China was no longer viewed by the West as a hostile nation and prevented from participating in

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20 "Zhongguo gaige de lishi fangwei" (The Historical Position of the Reforms in China), People's Daily, October 7, 1987.

21 Ibid.

world economic activities. That external factor was certainly another necessary condition for the reinterpretation of the self-reliance principle and the opening of China's door to the world. This was the background against which the "great leap outward" took place in China; this was also the context in which the new policy to utilize foreign direct investment was developed.

2. DECISION TO ATTRACT FOREIGN DIRECT INVESTMENT

Although China urgently needed a vast amount of capital for her 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 confronting constantly reminded Chinese leaders that China should not follow in their footsteps and rely heavily on foreign loans in her pursuit of economic development. The simple reason was that China, like those Latin American countries, might not be able to generate sufficient foreign exchange to pay back the loans once they got out of control. That was why the post-Mao leadership favored foreign loans but at the same time advocated caution when dealing with them. 22

Compared to foreign loans, foreign direct investment,

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22 See "Guoji zhaiwu weiji gei women de qidi" (The Lesson Drawn from the International Debt Crisis), People's Daily, December 1, 1987.

in Chinese leaders' opinion, is more advantageous. Foreign direct investment means that foreign investors have to share risks with the Chinese. If a joint venture fails to make profits or, more seriously, loses money, the foreign investor would be equally affected by the consequences. In the case of a wholly-owned foreign enterprise, the investor would be solely responsible for losses. This is very different from foreign loans, in which the foreign creditor would not be held accountable if the Chinese debtor is not doing well. The debtor would still be obligated to pay back interest as well as principal on schedule even if the business was not profitable. Another advantage of using foreign direct investment is that the foreign investor, in order to make sure that the invested enterprise becomes competitive, would have to bring in adequate technology and management expertise, which would also greatly benefit China. 23

The decision to employ foreign direct investment as a major means of developing China's economy was made at the Third Plenary Session of the 11th Congress of the Communist Party of China in December 1978. 24 The law on "Joint Ventures Using Chinese and Foreign Investment" was adopted

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23 Ibid.

24 See "Gu Mu tan Zhongguo duiwai kaifang xingshi" (Gu Mu Talks about the Open Door Situation in China), People's Daily, December 16, 1986.

later at the second session of the Fifth National People's Congress in July 1979, thereby legalizing the first organizational form for accommodating and encouraging foreign direct investment in China. The law's objective is to "expand international economic co-operation and technological exchange" by permitting foreign participants to "incorporate themselves, within the territory of the People's Republic of China, into joint ventures with Chinese companies...." The Chinese government promises to protect the resources, the profits and other lawful rights and interests of a foreign participant in a joint venture. The statute also briefly states how a joint venture should be formed. It provides that "the proportion of the investment by the foreign participant(s) shall in general not be less than 25 per cent" and that "the profits, risks and losses of a joint venture shall be shared by the parties to the venture in proportion to their contributions to the registered capital." The statute further specifies that the "technology or equipment contributed by any foreign participant as investment shall be truly advanced and appropriate to China's needs." 25

Although the fifteen-article statute singled out an organizational form to accommodate foreign direct investment in China, it left out many specifics regarding

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25 For the complete text of the statute, see Beijing Review, July 20, 1979, p. 24-26.

the procedures for establishing and operating joint ventures. Immediately after the promulgation of the statute various Japanese business interests, reportedly, called for further clarification on twelve of the fifteen articles. 26 The statute was, in essence, a general policy statement rather than a comprehensive law. It called for the utilization of foreign investment but left specifics to future amendments.

The Chinese leadership was aware that the statute was far from being complete. As a pioneer among socialist countries in the utilization of foreign direct investment on a massive scale, China quite simply lacked the knowledge needed to execute the plan. It approached the problem with a solution that was primarily experimental in nature. The joint venture law was intended to be a general policy statement, indicating what should be done without specifying how to do it. Specific procedures regarding the establishment and operation of joint ventures were expected to be provided later when experiences were accumulated in the actual implementation of the policy. The role of experimentalism can be clearly identified here.

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26 Y. Yamada, "Special Report: China's Foreign Investment Law and Problems Involved." China Newsletter, October 1979, p.18-22.

3. THE IMPLEMENTATION STRATEGY

Given the fact that China had formulated the policy to utilize FDI for her economic development at a time when Chinese leaders did not know exactly how to use it, it should not be surprising to find that Chinese leaders did not have a comprehensive plan for implementing the FDI policy once the statute was announced. Ample evidence indicates, however, that there has been a simple strategy consistently employed by the leadership since the early stage of implementation, namely that the implementation scope is to be enlarged only gradually and carefully with the help of the experience gained from the pilot projects. In retrospect, the implementation of the policy to attract foreign direct investment in China seems to have evolved through several stages. It started with the creation of the four Special Economic Zones (SEZs) in the provinces of Guangdong and Fujian in 1979. The subsequent phase began with the opening of the Fourteen Economic and Technological Development Zones in coastal cities in 1984. The third stage saw the promotion of the Three Open Areas of the Changjiang River Delta, the Pearl River Delta and the Triangular Area in Southern Fujian Province in 1985. The latest development in places like Hainan Island can be

viewed as the fourth stage (See Figure 1). 27 The first stage is the equivalent of a pilot project, designed to test the new policy within a controlled area. The second stage was intended to replicate the practices proven workable in the first stage and in the meantime to serve as another experimental program for the FDI policy. The third and the fourth stages are essentially the outgrowth of the previous two; they are expected to replicate whatever was proven to be successful in the previous programs and to modify those parts that have seemed unworkable.

This is, of course, not to suggest that the four-phase 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, foreign direct investment 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 on to other areas the experience accumulated by the pilot projects.

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27 See "Guowuyuan zhuguan bumen fuzeren zongtan kaifang jiunian" (The State Council Spokesman Talks about the Nine Years Since China Adopted Open Door Policy), People's Daily, October 13, 1987.

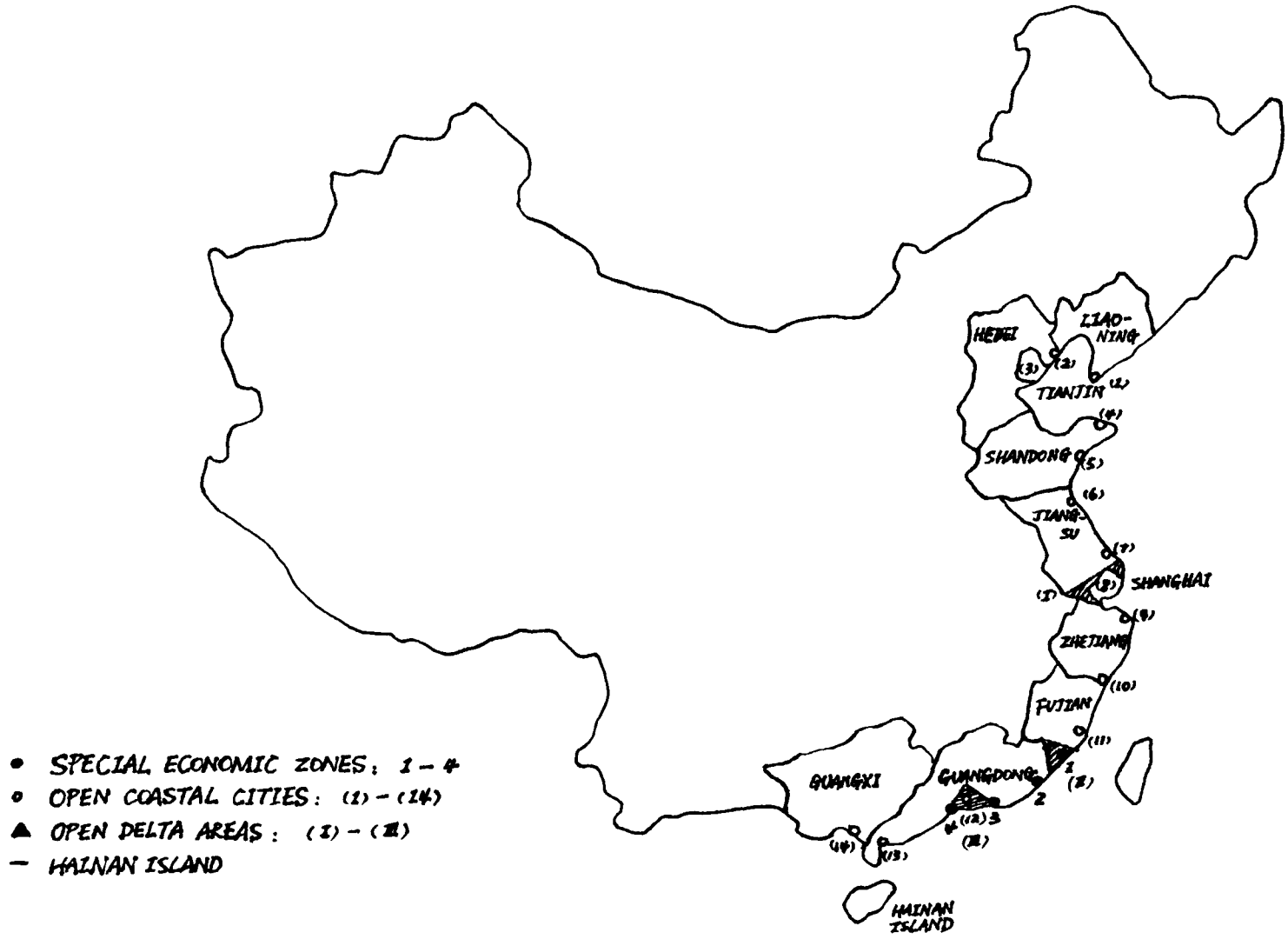


FIGURE 1. FOUR PHASES OF IMPLEMENTATION

4. REASONS FOR THE STRATEGY

We may identify some reasons for this experimental approach. First of all, utilizing foreign direct investment in a socialist country was an entirely new phenomenon; no previously successful model was available at the time to be emulated. (The Soviet Union, which once was the model for China's development, did not make its decision to allow Soviet-foreign joint ventures until January 1987. 28) China had no other choice but to rely on herself in finding a realistic way to implement the policy. Second, experimentalism had traditionally played an important role in the policy process in China as suggested in Chapter I; the post-Mao leadership remained committed to this approach. Former Premier Zhao Ziyang characterized this approach as "exploring less risky transitional forms." Though there were other lesser motivations, these two factors were the major reasons that the post-Mao leadership chose an experimental approach to implement the FDI policy in China.

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28 See "Su jueding xiafang jianli hezi qiye quanxian" (The Soviet Union Decided to Delegate Power over Joint Ventures to Lower Levels), People's Daily, October 6, 1987.

CHAPTER III

IMPLEMENTATION: THE FOUR SPECIAL ECONOMIC ZONES

1. THE FOUR SPECIAL ECONOMIC ZONES (SEZ)

The term "Special Economic Zones" (jingji tequ) refers to the four special investment areas created in the municipalities of Shenzhen, Zhuhai, and Shantou in Guangdong Province and Xiamen in Fujian Province (See Figure 2). As a result of the search by Chinese leaders for means to attract foreign investment and increase foreign trade, the three SEZs in Guangdong were established in 1979, with Xiamen becoming the fourth SEZ in 1980. Bordering Hong Kong on the south, the Shenzhen SEZ is the largest of the four zones with an area of 327.5 square kilometers, occupying approximately one-sixth of the total area of Shenzhen municipality. The Zhuhai SEZ, the smallest of the four zones, is adjacent to Macao. It started as a 6.8 square kilometer area and was extended to the present 15.16 square kilometers in 1983. The Shantou SEZ is located in the eastern suburb of Shantou city in the northeastern part of Guangdong province. It originally consisted of an area of only 1.6 square kilometers before it was expanded to the current 52.6 square kilometers in 1985. The Xiamen SEZ is situated on the coast in Fujian Province. It began with an area of 2.5 square kilometers in the Huli District of Xiamen City and was expanded to

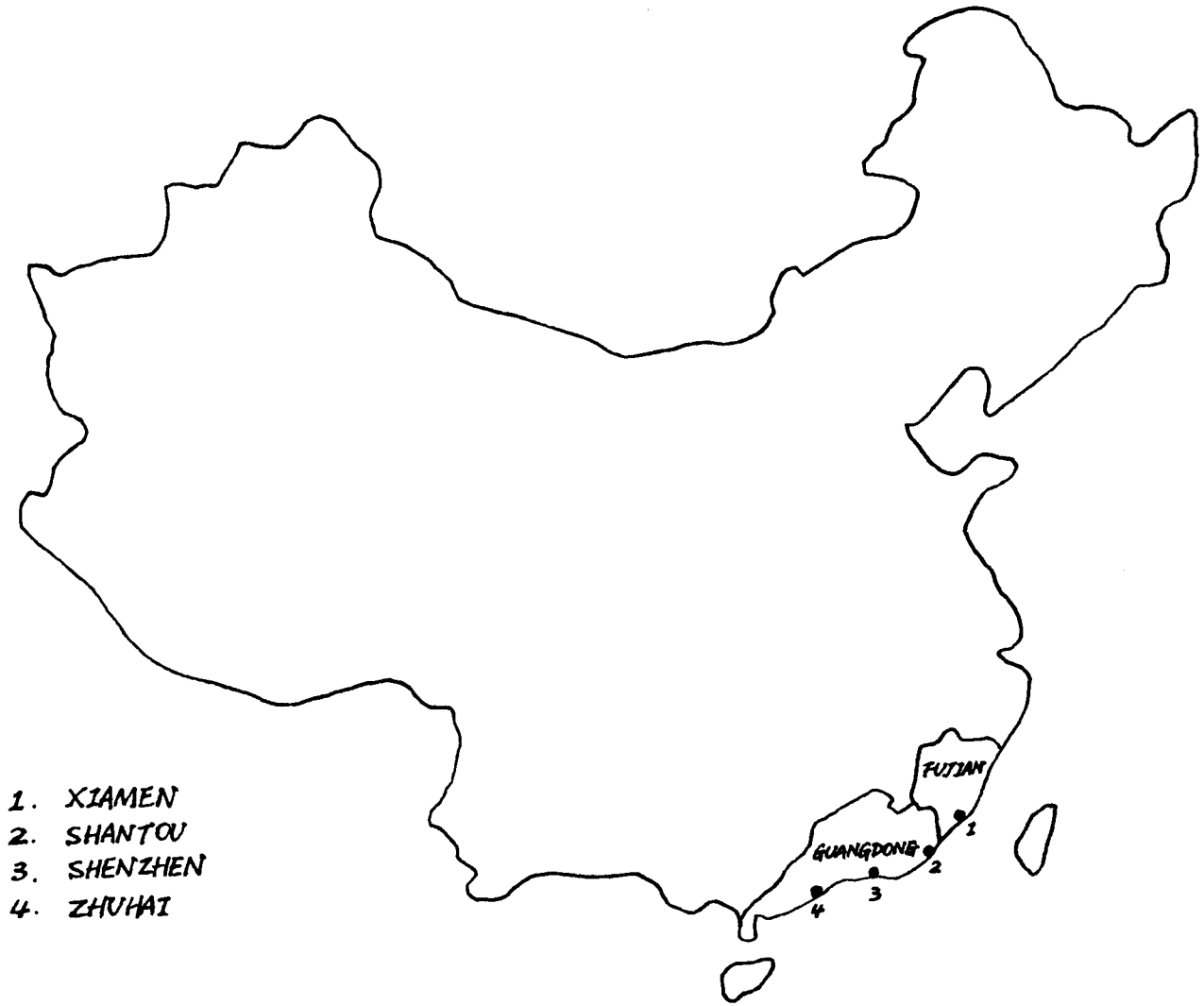


FIGURE 2. FOUR SPECIAL ECONOMIC ZONES

ncompass the whole city in 1984, totaling an area of 131 square kilometers. 29

2. FROM LOCAL INITIATIVE TO CENTRAL STRATEGY

The original idea of designating a geographic area specifically for foreign direct investment was more of a local initiative than a central strategy. The China Merchants' Steam Navigation Co. (CMSN), a direct subsidiary of the Ministry of Transport, initiated the notion in an effort to extend its business beyond shipping and to take advantage of its access to capital and other resources available in Hong Kong and Macau. 30 The idea was evidently borrowed from export-processing zones in East Asia and was allegedly recommended initially by Ye Fei, then Minister of Transport, in the autumn of 1978. After consulting with the Guangdong provincial authorities, CMSN made a proposal to the central government on January 30, 1979. The next day, the Party Central Committee and the State Council announced a joint decision to set up an "industrial zone" at Shekou near Shenzhen to be financed

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29 See The China Investment Guide 1986, p. 69-79.

30 Y.C. Jao and C.K. Leung, editors, China's Special Economic Zones: Policies, Problems and Prospects (Hong Kong: Oxford University Press, 1986), p.88.

and managed by CMSN. 31

Following the initiative by CMSN, the Guangdong Provincial Party Committee proposed to the central authorities in March 1979 that Guangdong be given special treatment in the state's economic policy in order to take advantage of its location. 32

As this notion of creating "industrial zones" was proposed at the local level, the central government reportedly dispatched a number of teams abroad in early 1979 and investigated 30 such "export" or "free trade" zones in more than 40 countries in a search for means to enhance the attractiveness of investment in China. 33 In April, paramount leader Deng Xiaoping, while talking to Xi Zhongxun and Yang Shangkun, the first and second secretaries of the Guangdong Provincial Party Committee, on the subject of Guangdong's proposal suggested that

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31 See Zhongguo jingji tequ nianjian (Yearbook of China's Special Economic Zones), (Hong Kong: Yearbook of China's Special Economic Zones Publishing Co., 1983), p.365; Also see Hong Kong Federation of Students, editor, Jingji tequ mianmian guan (Aspects of the Special Economic Zones), (Hong Kong: Wide Angle Press, 1983), p.89.

32 Zhang Hanqing, "Woguo shiban jingji tequ wenti" (A Preliminary Study of China's Experiment on Special Economic Zones), Xueshu Yanjiu (Academic Research), No. 4, 1982, p.6.

33 See F. Chi, "China's Newborn SEZs and Their Strategic Significance", Economic Reporter, August 1981, p.11.

Guangdong mark out an area in which to create a "special zone" to experiment with innovative economic policies. Subsequently, a central work team, headed by Gu Mu, a vice-premier of the State Council in charge of economic affairs, studied the possibility of establishing special economic zones in the provinces of Guangdong and Fujian. On the basis of the work team's findings, the Party Central Committee and the State Council issued a directive on July 15, 1979 delegating wide-ranging powers to Guangdong and Fujian in terms of adopting flexible economic policies to promote foreign investment, trade and tourism. 34 As part of the special policy for the two provinces, four experimental "special export zones" would be established in the cities of Shenzhen, Zhuhai, Shantou and Xiamen. In August 1979, Shantou municipality announced that it had set up a "trade and investment zone"; one month later, the municipalities of Shenzhen and Zhuhai both declared themselves "special export zones". 35 In October, the Guangdong provincial government submitted a report on the establishment of SEZs to the central authorities, using the term "special economic zone" for the first time. On

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34 See Nanfang Ribao (Southern Daily), July 16, 1979. For details about the central policy, see also Nanfang Ribao, June 8, 1980.

35 See J. Kamm, "Importing Some of Hong Kong ... Exporting Some of China," China Business Review, March-April 1980, p.28.

December 27, 1979, the Guangdong Provincial People's Congress, the provincial legislative body in Guangdong, approved the Regulations on the Special Economic Zones in Guangdong. The terms "special export zone" or "trade and investment zone" were then formally changed to "special economic zone". The establishment of the Xiamen SEZ in Xiamen, Fujian took place in October 1980, almost a year later than the three SEZs in Guangdong. 36

In March 1980, Gu Mu chaired a meeting participated in by officials from both Guangdong and Fujian, during which the territorial boundaries of the SEZs were formally drawn and some of the major issues concerning the SEZs were examined. In August of the same year, the Standing Committee of the National People's Congress, the national legislative body, approved the legal status of the SEZs. 37

From the above account of the initial development of the SEZs, it should be clear that the idea of establishing the SEZs in the provinces of Guangdong and Fujian originated from a local effort to broaden the business scope of a single enterprise; the initiative was soon considered by the central leadership as a major strategy to

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36 See Investment Guide to Xiamen Special Economic Zone (Hong Kong: Hong Kong and Shanghai Banking Corporation in association with The Construction and Development Corporation of Xiamen Special Economic Zone, 1984).

37 See Zhongguo Jingji Tequ Nianjian (1983), p.365-366.

implement its open door policy in general and the FDI policy in particular.

3. WHY THESE FOUR ZONES?

There were several reasons for selecting Guangdong and Fujian as the locations for the SEZs. First of all, both provinces are located along the coast, ideal for the importation of raw materials and the exportation of finished products. Second, both provinces, especially Guangdong, are close to Hong Kong, having easy access to one of the most important financial centers in the world. Finally, Guangdong and Fujian together constitute the ancestral home for most overseas Chinese; therefore, they hold a special attraction for those potential investors. Furthermore, many people in Taiwan have their origins in Fujian; the southern Min dialect is spoken both in Taiwan and in southern Fujian including Xiamen. As for Guangdong and Hong Kong, they also share a dialect. For many overseas Chinese, including people in Hongkong and Taiwan, the opportunity to help the development of the motherland and at the same time obtain a return on their investments holds both a sentimental and a practical appeal.

4. THE SEZS AND FOREIGN DIRECT INVESTMENT

The decision to establish the SEZs in the provinces of Guangdong and Fujian can be seen to have been motivated by

a number of objectives. Besides aiming to benefit from the economic development of the SEZs, Chinese leaders expected the zones to become a bridge for the introduction of foreign technology, know-how and management expertise to other parts of China. Furthermore, the SEZs were supposed to serve as centers for education and experimentation on new economic policies, particularly the FDI policy.

Vice Premier Gu Mu revealed this expectation when he announced in Tokyo in September 1979, following the promulgation of the Joint Venture Statute, that China was to set up two "special zones" in Shenzhen and Zhuhai and would welcome foreign investment in the two zones, either in the form of Sino-foreign joint ventures or as wholly-owned foreign ventures. To encourage foreign investment, those two zones would adopt economic measures that were far more flexible than those practiced in other parts of the country. In other words, right at the very beginning, the SEZs were expected to serve as pilot projects for the implementation of the FDI policy.

The SEZs were created as laboratories in which experiments on new economic policies such as the FDI policy could be conducted. The term "laboratory" was used here because it is "sealed off from the general public; special conditions prevail in it to ensure isolation of

experiments". 38 Within a controlled environment, China would be able to gain experience in dealing with capitalist economies and experiment with foreign investment. The four special zones comprise a total area of 526.26 square kilometers, which does not seem very significant considering the fact that China has a territory of 9,600,000 square kilometers (only 0.00548% of the total territory). However, the benefits that accrued to the country through the creation of the four SEZs go far beyond the SEZs' actual capacity to absorb FDI. Their intangible demonstration effect was surely the most important benefit the SEZs could bring to the rest of the country.

5. EXPERIMENTS WITHIN THE SEZS

The experiments on FDI have been conducted in the SEZs primarily in two areas: administrative structure, and legislative and regulatory framework.

(1) Administrative Structure

Despite the fact that China hoped to attract foreign investment for her economic development, the leadership remained committed to the basic principles of a planned socialist economy. As a result, the establishment and operation of a foreign invested enterprise in China is, to

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38 Michael Oborne, China's Special Economic Zones (OECD, 1986).

a large degree, subject to the government's strict control. However, from the very beginning, the Chinese authorities delegated more power to the SEZs to deal with investment issues in terms of administrative structure than to the rest of the country. The four zones were planned to be under separate administrative and political tutelage at the national level; a special SEZ office was established for this purpose which was attached to the State Council and headed by Vice Premier Gu Mu. This office was directly responsible for supervising activities in the SEZs and for intervening should problems arise due to friction with other central ministries or state supply companies.

At the provincial level efforts were also made both in Guangdong and Fujian to establish an appropriate administrative structure in order to execute the SEZ strategy. In this respect, Guangdong was a true pioneer. Regarded as the first piece of legislation in China promulgated specifically to govern business in the SEZs, the Regulations on Special Economic Zones in Guangdong Province (hereafter referred to as the SEZ Regulations) was adopted by the Fifteenth Session of the Standing Committee of the Fifth National People's Congress on August 26, 1980. The SEZ Regulations provided for the establishment of three different organizations, each of which was supposed to play

a role in administering the zones. 39

The most important of these three organizations is the Administrative Committee of the SEZ of Guangdong Province (hereafter referred to as the ADCOM), which was established to help relay information to Beijing and co-ordinate activities within the SEZ. More specifically, the office has a wide range of administrative powers within the SEZ including, among other things, the power: to formulate plans for development in the zones and to facilitate implementation of these plans; to approve investment projects; to coordinate business activities among banking, insurance, taxation, customs, post and telecommunications and other SEZ organizations; and to supply personnel to SEZ enterprises. 40

The second administrative body overseeing the SEZs in Guangdong is the Development Company for the SEZs in Guangdong Province (hereafter referred to as the Development Company), which is responsible for developing and coordinating local investment activities. It is empowered to provide foreign investors with business services, engage in trust and investment activities,

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39 For an English translation of the SEZ Regulations, see F. Chu, M. Moser, and O. Nee, editors, Commercial, Business and Trade Laws: People's Republic of China (Dobbs Ferry: Oceana Publications, Inc., 1982), p.14.

40 See SEZ Regulations, Art. 3, Art. 5 & Art. 23, note 39 above.

establish enterprises either independently or in co-operation with foreign investors, and serve as agent on behalf of foreign investors in purchasing or marketing in China. 41

The SEZ Regulations provide a third administrative form in each of the zones in the form of a local advisory committee, which serves as a consultative body to the ADCOM and the Development Company but has no administrative power itself.

Following in the footsteps of Guangdong, Fujian also established similar administrative bodies overseeing the operation of the Xiamen SEZ (See Figure 3).

(2) Legislative and Regulatory Framework

Since the establishment of the SEZs, the central government has encouraged the zones to develop a legislative framework for FDI which differs, in many respects, from the rules and regulations in other parts of the country. Among the four SEZs, the Guangdong zones, and particularly Shenzhen, have been vigorously pursuing this goal.

(a) The 1980 Guangdong SEZ Regulation

The basic legislative framework for attracting foreign investment in the Guangdong SEZs was established in August 1980, when the Regulations on the Special Economic Zones in

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41 See SEZ Regulations, Art. 25, note 39 above.

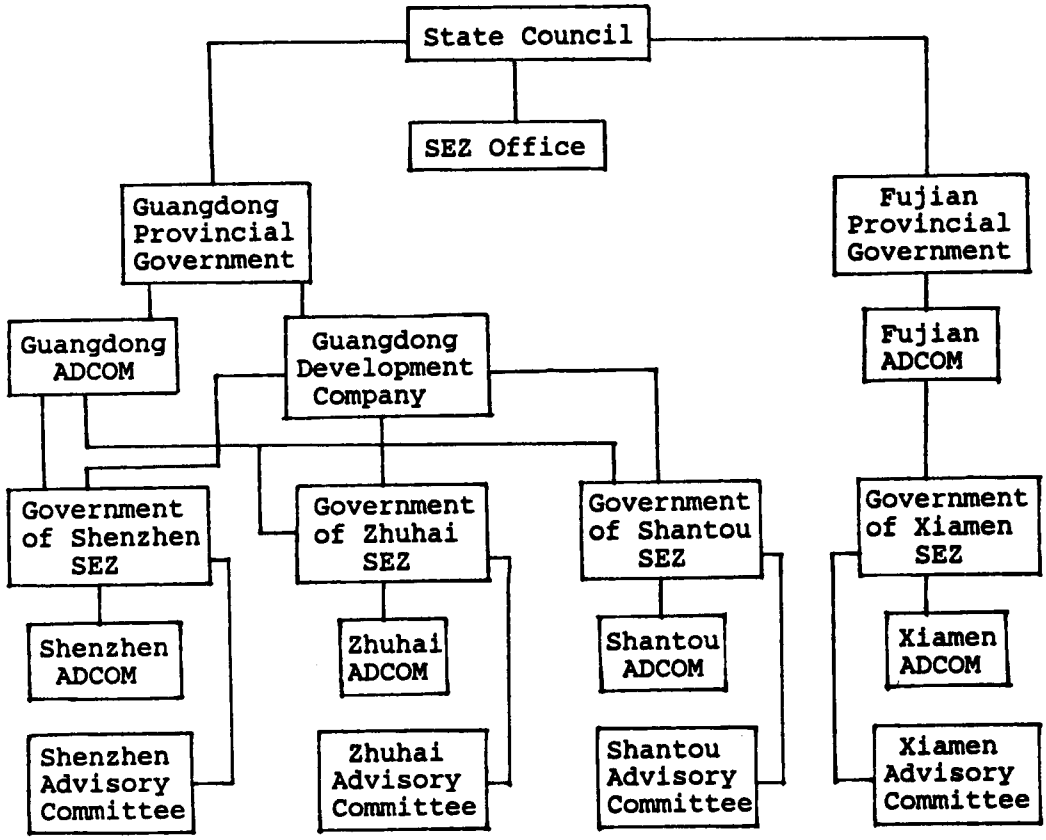


Figure 3. Diagram of the Administrative System in the Special Economic Zones.

Guangdong Province was adopted by the 15th Session of the Standing Committee of the 5th National People's Congress. Apart from providing the administrative structure for operating the SEZs as previously mentioned, the SEZ Regulations defined the basic preferential terms offered to foreign investors in the SEZs. It provided a separate environment in which innovative legislation and regulations regarding FDI, among other things, could be experimented with; they might eventually be incorporated into national law.

Under the SEZ Regulations, the SEZs enjoyed a special status with respect to FDI in the following areas:

(i) Forms of investment The SEZ Regulations provide that foreign investors may "open factories with their own investment" and "independently operate their own enterprises" in the SEZ in Guangdong. 42 Thus the SEZs in Guangdong were permitted to try one form of investment, namely, wholly-owned foreign enterprises, which the rest of the country was not allowed to try. The wholly-owned foreign investment pattern was not permitted outside the SEZs until mid-1984. 43

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42 See SEZ Regulations, Art. 1 & Art. 10, note 39 above.

43 Reportedly in 1983 the 3-M Corporation had received approval to establish a wholly owned plant in Shanghai; and an official from the Shanghai Foreign Economic Relations and Trade Commission told Pow that a Japanese company had also received approval to set up a

(ii) Power of approval The national Joint Venture Law requires that equity joint ventures be approved by the Foreign Investment Commission, which was subsequently changed to the Foreign Investment Bureau under the Ministry of Foreign Economic Relations and Trade (MOFERT). 44 This provision was later amended in 1983 by the Joint Venture Law's Implementing Act, which provides that MOFERT may in certain circumstance delegate its approval powers to lower level authorities. 45 As a general rule, a provincial government can only approve investment projects with a total investment of US$5 million or less. 46 All projects with a total investment in excess of this ceiling have to be approved directly by MOFERT. The SEZs, however, enjoy independent approval authority of heavy industrial projects with an investment of under RMB50 million (about US$13.5 million), of light industrial projects with an investment

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wholly owned enterprise. But the first legislation permitting this form of investment was not promulgated by the Shanghai municipal government until July 1, 1984.

44 See The Joint Venture Law, Art. 3.

45 See The Implementing Act for the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, promulgated by the State Council on September 20, 1983, Art. 8.

46 US Joint Ventures in China: A Progress Report, National Council for US-China Trade, Washington, DC, 1987, p.23.

of under RMB30 million (about US$8 million), and of nonindustrial projects such as hotels under RMB100 million (about US$26.8 million). 47 As a result, it can be argued that as a pilot project, the SEZs were encouraged to try FDI on a relatively larger scale at a time when the central government was not exactly sure what effect FDI might have on the whole country, and therefore was reluctant to try any bold measures regarding FDI at a national level.

(iii) Taxation The SEZ Regulations also provide provisions relating to the tax treatment of enterprises established in the zones. Such treatment is considerably more favorable than that which is provided for under tax rules applicable in China generally.

Under China's national legislation equity joint ventures are subject to a 30 percent income tax on net profits. In addition, such ventures also have to pay a local income tax equal to 10 per cent of the amount of national tax assessed. 48 In the case of co-production ventures the net profits of the foreign party are subject to taxation at progressive rates, ranging from 20 to 40

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47 Ibid, p.25.

48 See The Income Tax Law of the People's Republic of China Concerning Joint Ventures Using Chinese and Foreign Investment, adopted by the Third Session of the Fifth National People's Congress on September 10, 1980, Art. 3. An English translation of the law appears in Chu, Moser, and Nee, note 39 above.

percent. A local income tax of 10 percent calculated on the basis of taxable income is also levied on these ventures. 49

Under the SEZ Regulations, however, the income tax levied on foreign enterprises in the zones is a flat rate of 15 percent, only half of the rate levied in other parts of the country. This rate is applied not only to equity joint ventures but also to wholly owned foreign ventures and co-production ventures. Moreover, foreign ventures in the zones are not subject to any local income tax. In addition to providing a relatively low rate of taxation, the SEZ Regulations offer foreign investors a number of other tax incentives. For example, enterprises with foreign investment of over US$5 million, and enterprises involving high technology or a longer financing cycle are exempted from taxation for 5 years. Enterprises that reinvest their profits in the zones for five years or more may be eligible for a reduction of or even exemption from income tax on such reinvested profits. The individual monthly income tax rate is almost 30 per cent lower than that in other areas, with tax exemption for the first RMB800 and progressive rates ranging from 3 to 30 per cent

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49 See The Income Tax Law of the People's Republic of China Concerning Foreign Enterprises, adopted by the Fourth Session of the Fifth National People's Congress on December 13, 1981, Art. 3 & 4. An English translation appears in Chu, Moser, and Nee, note 39 above.

for monthly income above RMB800. Dividends and bonuses received from the joint ventures or enterprises within the SEZ are exempted from taxation. 50

(iv) Customs duties Goods imported with the approval of the provincial ADCOM to be used for production purposes in the SEZ are exempted from import duties. Similar preferential treatment may also be granted to necessary consumer goods imported for use by the personnel of SEZ enterprises. Products produced in and exported from the SEZs also are exempt from customs duties. 51

(v) Entry and exit The regulations concerning entry and exit of persons associated with foreign-funded enterprises are relatively simple.

(vi) Enterprise autonomy The SEZ Regulations provide for a relatively high level of autonomy for enterprises. For instance, investors may independently recruit employees with the prior consent of ADCOM. The wages paid by enterprises may take the form of payment by the piece, the hour, the day or the month. Employees may be dismissed in accordance with the provisions contained in the labor contract.

(b) Subsequent Legislative and Regulatory Development in

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50 See The SEZ Regulations, note 39 above.

51 US Joint Ventures in China: A Progress Report, p.25.

the SEZs

In November 1981, the Standing Committee of the National People's Congress adopted a resolution authorizing Guangdong and Fujian to formulate various specific economic regulations for their SEZs according to the principles laid down in the related laws and policies. 52 Thus the authority to make legislative initiatives was, to a certain degree, officially delegated to the two provinces. Guangdong was again ahead of Fujian in responding to this resolution (Fujian did not promulgate its regulations for the Xiamen SEZ until February 1985). After the resolution, a number of regulations which further specify the provisions contained in the SEZ Regulations were adopted by the Standing Committee of the Guangdong Provincial People's Congress. These, along with the SEZ Regulations, created the original legal framework for the Guangdong SEZs. (See a list of these regulations in Table 1) Among the SEZs, Shenzhen once again stood out as a major test ground for foreign investment-related legislation which could ultimately be incorporated into national law.

(i) The Entry and Exit Regulations In responding to foreign investors' complaints about complicated visa procedures in China, the "Regulations of the SEZs in Guangdong Province Governing the Entry and Exit of

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52 Jao, China's Special Economic Zones, p.126.

TABLE 1
REGULATIONS ADOPTED IN THE SEZS IN GUANGDONG AFTER THE SEZ REGULATIONS IN 1980

Date	Regulation
Nov.17 1981	The Provisional Regulations of the SEZs in Guangdong Province Governing the Entry and Exit of Personnel
Nov.17 1981	The Provisional Regulations of the SEZs in Guangdong Province Governing the Registration of Business Enterprises
Nov.17 1981	The Provisional Regulations Governing Land in the Shenzhen SEZ
Nov.17 1981	The Provisional Regulations of the SEZs in Guangdong Province Governing Labour and Wages for Business Enterprises
Feb.7 1984	The Regulations of the Shenzhen SEZ on Foreign Economic Contracts
Feb.8 1984	The Provisional Regulations of the Shenzhen SEZ on the Introduction of Technology
June 2 1984	Measures of the Shenzhen SEZ Concerning the Adjustment of Land Use Fees and Preferential Treatment for the Reduction of and the Exemption from Land Use Fees
Apr.2 1985	The Regulations Governing Foreign Banks and Joint Chinese-Foreign Banks in the SEZs
1985	The Interim Measures of Shenzhen SEZ on Bank Mortgage Loans
Nov.22 1985	Shenzhen SEZ Land Use Fees Implementing Measures
Feb.14 1986	The Regulations Governing Accounting for Foreign Enterprises in the SEZs of Guangdong Province

Personnel" (hereafter referred to as the Entry and Exit Regulations) were adopted on November 17, 1981, at the 13th Session of the Standing Committee of the 5th People's Congress of Guangdong Province and became effective on January 1, 1982. 53 The major incentive provided by the Entry and Exit Regulations was that foreigners and overseas Chinese who "have set up factories or various other kinds of business" or who "have bought residences in or live inthe Special Zones" and who need to enter and leave "on a regular basis" are eligible for multiple-entry visas provided that they have "a verification letter" from the SEZ Development Company. 54

(ii) The Business Registration Regulations The "Provisional Regulations of the SEZs of Guangdong Province Governing the Registration of Business Enterprises" were adopted by the 13th Session of the Standing Committee of the 5th People's Congress of Guangdong Province on November 17, 1981, and came into force on January 1, 1982. 55 The Regulations established a number of specific rules

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53 For complete text of the Entry and Exit Regulations, see China's Foreign Economic Legislation (1982), Vol. I.

54 Entry and Exit Regulations, Art. 3(1).

55 For complete text of the Business Registration Regulations, see China's Foreign Economic Legislation (1982), Vol. I.

regarding registration requirements, including detailed procedures for making application with the SEZ's administrative organization for industry and commerce, for registration with the local tax authorities, for opening bank accounts with the Bank of China, etc.

(iii) The Land Use Regulations The SEZ Regulations briefly mentioned that separate stipulations would be formulated to offer preferential treatment to foreign investors with respect to land use. As a result, the "Provisional Regulations Governing Land in the Shenzhen SEZ" was adopted by the 13th Session of the Standing Committee of the 5th People's Congress of Guangdong Province on November 17, 1981, and put into effect on January 1, 1982. 56 The Shenzhen Land Regulations provide specific provisions regarding land rights, the acquisition of land, land-use fees, the duration of land use, etc.

Following the Shenzhen Land Regulations, two supplementary regulations were promulgated regarding land-use fees. One was the "Measures of the Shenzhen SEZ Concerning the Adjustment of Land Use Fees and Preferential Treatment for the Reduction of and Exemption from Land Use Fees," which was approved by the Guangdong provincial government on June 2, 1984. The other was the "Shenzhen

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56 For complete text of the Shenzhen Land Regulations, see China's Foreign Economic Legislation (1982), Vol. I.

SEZ Land Use Fee Implementing Measures," which were promulgated on November 22, 1985. These two supplementary measures contained detailed provisions regarding reductions of or exemptions from land-use fees.

(iv) The Labor and Wage Regulations The "Provisional Regulations of the SEZs of Guangdong Province Governing Labour and Wages for Business Enterprises" was adopted by the 13th Session of the Standing Committee of the 5th People's Congress of Guangdong Province on November 17, 1981, and became effective on January 1, 1982. These regulations defined a detailed labour management system, which the earlier SEZ Regulations touched upon only briefly.

Compared to the national joint venture labour rules, the SEZ Labour and Wage Regulations apparently provide investors with greater flexibility in a number of areas. For example, under the SEZ Labour and Wage Regulations, employees can either individually or collectively sign contracts with the employer; whereas according to the national rules, they are supposed to sign contracts with the employer collectively through the labour union. The SEZ regulations also provide a more flexible hiring system which gives investors more power in hiring employees. In addition, the SEZ labour rules contain provisions for the payment of wages and other benefits for employees that are more favorable to investors.

(v) The Shenzhen Contracts Regulations Although a national economic contracts law has existed in China since 1981, the "Regulations of the Shenzhen SEZ on Foreign Economic Contracts" was the first law regulating contractual relations between Chinese and foreign business entities. Promulgated on February 7, 1984, the "Shenzhen Contract Regulations" established the general principles governing the conclusion, performance, amendment, and termination of economic contracts. The regulations apply to contracts entered into among enterprises in the Shenzhen SEZs, including joint ventures, wholly owned foreign enterprises, and Chinese companies and governmental organizations.

(vi) The Shenzhen Technology Regulations The "Provisional Regulations of the Shenzhen SEZ on the Introduction of Technology" were promulgated on February 8, 1984. Being the first regulations relating to technology transfer in China, the Shenzhen Technology Regulations provide the statutory framework for technology transfer between foreign enterprises and Chinese enterprises in the Shenzhen SEZ. In addition to outlining procedures regarding technology transfer contracts, the regulations established a number of other key concepts such as the requirement that the technology to be imported be an advanced one and applicable to the Chinese situation, and that the contract for technology transfer should not

contain any unreasonable restrictions or unfair provisions.

The above-mentioned legislative and regulatory developments concerning the utilization of FDI in the SEZs are indications that the Chinese central authorities encouraged the SEZs to experiment with various implementing measures for the FDI policy. Since the Joint Venture Law of 1979 provides little more than a statement of general principles and leaves the details to be filled in by subsequent amendments, the legislative and regulatory experimentation in the SEZs is certainly important to the implementation program of the FDI policy.

6. PERFORMANCE OF THE SEZS

By 1985, six years after the promulgation of the Joint Venture Law, the four SEZs had all reached the start-up stage with foreign direct investment having been attracted in all four zones. Among the four, 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. Table 2 shows the development of the four zones through June 1985 with regard to the amount of FDI utilized.

TABLE 2
FOREIGN DIRECT INVESTMENT IN CHINA'S SEZS: 1979-JUNE 1985
(Cumulative/ Unit: US$ million)

SEZ	Up to Dec. '81			Up to June '83			Up to June '85		
	N	CP	CR	N	CP	CR	N	CP	CR
Shenzhen	1010	1463	n.a.	2266	1485	286	4700	2800	830*
Zhuhai	9	84	n.a.	n.a.	n.a.	29	n.a.	1680	240
Shantou	n.a.	106	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	198
Xiamen	5	74	n.a.	n.a.	161**	n.a.	153	545	n.a.
Total	1024	1727	-	-	-	-	-	-	-

Source: Oborne, China's Special Economic Zones, p. 134.
N = Number of contracts.
CP = Capital pledged.
CR = Capital engaged.
* Figures for Shenzhen are up to end of October 1985.
** Up to November 1983.
n.a.= Not available.

As the four SEZs were experimenting with and accelerating the process of utilizing FDI, the rest of the country was pursuing the same goal, although subject to more control over foreign capital, both loans and direct investment. We may summarize the investment performance of the SEZs by comparing it with the investment situation in the whole country.

First of all, the SEZs' capacity to absorb FDI seems quite impressive. Although for the period from January 1979 to December 1984 FDI absorbed in the SEZs only accounted for little more than 15 percent of total pledged foreign direct investment for China, in terms of realizedcapital from 1979 to June 1985 FDI in the SEZs accounted for more than thirty percent of the total amount for the country. Of course, if one takes into consideration many special legislative and regulatory provisions that provide preferential treatment for the four zones, one might conclude that the SEZs represented but a modest impact upon the growing inflow of foreign capital in the country. Moreover, basic construction costs by the Chinese government represent twice the amount of capital from direct foreign investment in the SEZs. Ten central ministries and central government committees invested more than RMB600 million during the period from January 1980 to September 1984. Overall, foreign direct investment accounted for less than 30 percent of the total investment

in the SEZs. 57 However, since the four SEZs only account for 0.0054 percent of the territory of China, their thirty percent share of total realized capital investment is certainly impressive. Furthermore, the significance of the SEZs cannot be judged solely on the actual amount of FDI absorbed in the zones. This leads us to the second point.

As a laboratory for testing the FDI policy, the SEZs' impact on FDI far surpasses their own ability to absorb it. From Table 3 we can see that although for the whole period from 1979 to June 1985, FDI only accounted for 26 percent of the US$18.7 billion foreign capital used in China (the rest being loans), FDI's share in foreign capital was growing steadily. Cumulatively, FDI represented only 14 percent of external capital for the period from 1979 to 1982, but it increased to 18 percent for the period from 1979 to 1983, and to 23 percent for the period from 1979 to December 1984, and to 26 percent for the period from 1979 to June 1985. If we look at the figures year by year, the picture is even more impressive. FDI represented 47 percent of foreign capital introduced into the country in 1983 and 54 percent in 1984. Therefore, it is reasonable to conclude that the policy of the post-Mao leadership to attract FDI was gradually being implemented; FDI was becoming a principal source of external capital to finance

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57 Oborne, China's Special Economic Zones, p.137.

TABLE 3

CHINA'S USE OF FOREIGN CAPITAL: 1979-1984
(Unit: US$ billion)

Items	'79 - '82	'79 - '83	Jan.'79 - Dec.'84	Jan.'79 - June'85
Loans	10.9 (86%)	11.9 (82%)	13.1 (77%)	13.9 (74%)
Direct Investment	1.7 (14%)	2.6 (18%)	4.1 (23%)	4.8 (26%)
Total	12.6 (100%)	14.5 (100%)	15.8 (100%)	18.7 (100%)

Source: Oborne, China's Special Economic Zones, p. 134.

China's modernization program as expected. The pilot project of the SEZs must certainly have had some positive impact on this result.

In January and February 1984, paramount leader Deng Xiaoping visited the Shenzhen SEZ and personally reaffirmed the SEZ policy. 58 Deng allegedly saw four basic "window functions" of the SEZs:

1. as a means of absorbing new technologies;
2. as a means of acquiring information about the world beyond by using foreign skills and techniques, and as a conduit of information about the international economy;
3. as a means of observing and absorbing new management techniques introduced from abroad;
4. as a place where there is experimentation with special policies not destined for the rest of the country. In short, the SEZs are being used as a means of implementing new foreign policy for the PRC, an "avant garde" of political thinking in the PRC.

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58 See People's Daily, September 16, 1987.

59 See Oborne, p.155.

CHAPTER IV

IMPLEMENTATION: THE FOURTEEN OPEN COASTAL CITIES

1. THE DEVELOPMENT OF FDI AT THE NATIONAL LEVEL AS OF 1984

As the four SEZs were experimenting with the measures to implement the FDI policy, the central leadership was closely reviewing the results in order to enact substantive rules for facilitating foreign direct investment at the national level.

On December 4, 1982 the National People's Congress adopted the current Constitution, which, for the first time in the history of the People's Republic, grants constitutional recognition and protection to foreign direct investment. Article 18 explicitly provides that

> the People's Republic of China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic co-operation with Chinese enterprises and other economic organizations in accordance with the law of the People's Republic of China.... Their lawful rights and interest are protected by the law of the People's Republic of China. 60

This provision was to alleviate the concern of foreign investors who were worried that, without explicit constitutional guarantees, the Joint Venture Law of 1979 and the ventures established under it might one day be

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60 See 1982 Constitution, Article 18, Beijing Review, December 27, 1982, p.14.

declared unconstitutional because they provided for foreign ownership of the means of production, which, under the 1978 Constitution, should be owned "basically" by the State and by collectives.

Between 1980 and 1982 a number of tax-related national laws and regulations were promulgated, such as the Joint Venture Income Tax Law, the Individual Income Tax Law, the Foreign Enterprise Income Tax Law and associated regulations. 61 In line with the principle of granting incentives to attract foreign investors in the SEZs, this national tax regime provides foreign investors with various kinds of preferential treatment. For example, under the Joint Venture Income Tax Law, any new joint venture scheduled to exist for a period of ten years or more is entitled to a full exemption from income tax in its first profit-making year and a fifty percent reduction in the following two years. These periods were subsequently extended to two years of exemption and three additional years of fifty percent reduction. In addition, the Joint Venture Income Tax Law allows foreign joint ventures which reinvest their profits in a Chinese joint venture for at

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61 "Income Tax Law of the People's Republic of China Concerning Joint Ventures Using Chinese and Foreign Investment" was promulgated on and effective from September 10, 1980; "Individual Income Tax Law of the People's Republic of China" was promulgated on and effective from September 10, 1980; "Income Tax Law of the People's Republic of China Concerning Foreign Enterprises" was promulgated on December 13, 1981 and effective from January 1, 1982.

least five consecutive years to qualify for a refund of forty percent of the income tax paid on the reinvested funds. 62

In addition to the tax regime, the State Council also promulgated a series of detailed regulations addressing specific issues regarding foreign investment, such as the registration of joint ventures, labor management, taxation, customs treatment, foreign exchange, and borrowing by joint ventures from the Bank of China. In 1983, China issued the relatively comprehensive Joint Venture Implementation Regulations, which consist of 118 articles attempting to pull together a number of earlier statutory threads and fill in the blanks left over by the skeleton Joint Venture Law of 1979.

2. DECISION TO OPEN THE FOURTEEN COASTAL CITIES

Although the Chinese leadership had never announced any explicit targets for the implementation of the FDI policy, the growth in foreign direct investment nationwide in the first four years fell short of expectations. Furthermore, the majority of foreign investment projects had been small enterprises, invested in by overseas Chinese from Hong Kong with low levels of capitalization and relatively

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62 For an overview of taxation in PRC, see Timothy Gelatt and Richard Pomp "China's Tax System: An Overview and Transactional Analysis", in Foreign Trade, Investment and the Law in the People's Republic of China, M. Moser, editor (Oxford University Press, 1987).

unsophisticated technology. Many foreign investors still maintained a "wait and see" attitude until there was a better investment climate in China, particularly a more comprehensive national legal framework regarding external economic relations. Deng Xiaoping visited the three SEZs of Shenzhen, Zhuhai, and Xiamen in early 1984 and expressed his satisfaction with the achievements of the zones. In an effort to accelerate the implementation of the FDI policy and enhance the nature of projects, the central government on May 15, 1984, announced its decision to expand the implementation program to its second stage by opening fourteen coastal cities as special investment areas. 63

3. THE FOURTEEN COASTAL CITIES

The "fourteen open coastal cities" were, from north to south along the coast of China, Dalian in Liaoning province, Qinhuangdao in Hubei province, Tianjin (autonomous municipality), Yantai and Qingdao in Shangdong province, Lianyungang and Nantong in Jiangsu province, Shanghai (autonomous municipality), Ningbo and Wenzhou in Zhejiang province, Fuzhou in Fujian province, Guangzhou and Zhanjiang in Guangdong province, and Beihai in Guangxi province (see Figure 4). Thus each of the eight provinces

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63 See David Brown, Partnership with China: Sino-foreign Joint Ventures in Historical Perspective (Boulder and London: Westview Press, 1986), p.115.

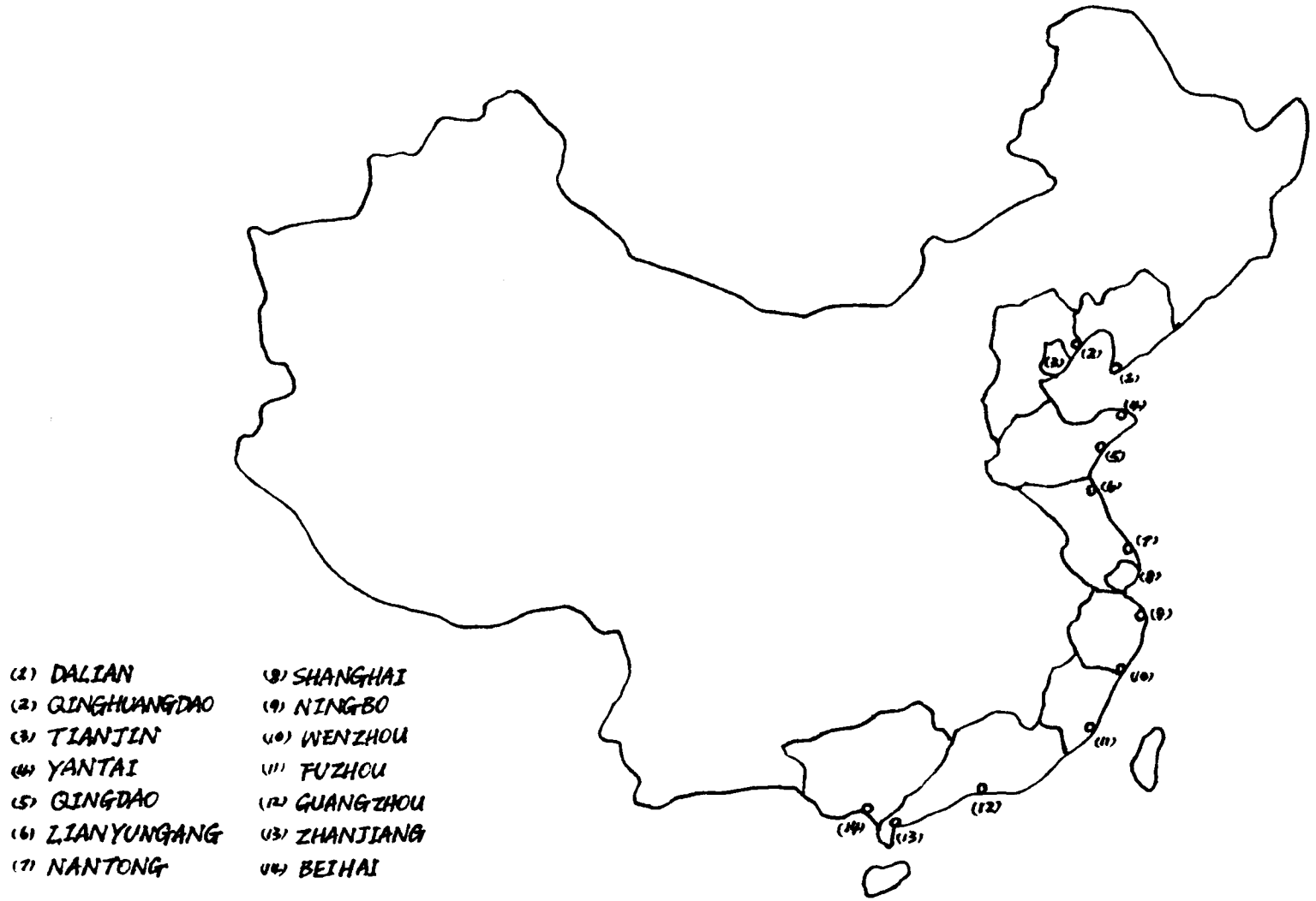


FIGURE 4. FOURTEEN OPEN COASTAL CITIES

and two autonomous municipalities along China's coastline are represented, although Guangdong is more heavily involved since it already had three other SEZs. Certainly there are differences among the cities. For instance, the gross value of industrial output (GVIO) in Shanghai and Tianjin in 1983 was RMB67.8 billion and RMB22.9 billion respectively, whereas the 1983 GVIO figures for Qingdao and Beihai were less than RMB150 million. 64 However, the collective force of the fourteen coastal cities is very important in China's modernization effort, as may be seen through the following statistics.

The population of the fourteen coastal cities exceeded 78 million, 7.8 percent of China's total. The combined value of their industrial output in 1983 amounted to RMB142.5 billion, equal to 23 percent of the nation's total. The profits and taxes from their industry made up a quarter of the country's total. The total volume of railway, highway and water-borne freight handled by the fourteen cities accounted for one-fifth of the nation's total; their harbors handled more than 250 million tons of cargo, 97 percent of the nation's total. The cities are undoubtedly better developed than any other areas in China. 65

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64 See The China Investment Guide, p. 83-119.

65 Xinhua, June 11, 1984, "Statistics Published on 14 Coastal Cities," in FBIS, June 15, 1984, p. K19. Also see Fujian Daily, October 12, 1987 and People's Daily, October

It is worth mentioning that all of the fourteen cities are also former treaty ports. Conditions for accommodating foreign direct investment are better than in other areas, including better infrastructure, more available industrial facilities, better trained labor force, preexisting contacts with foreign businessmen, and more developed scientific, educational and cultural establishments. If easy access to Hong Kong and Macao was the major reason for the four SEZs to be selected as pilot areas for the FDI policy, we then may suggest that better conditions in the fourteen cities to accommodate FDI led to the decision by the Chinese leadership to choose them as the second round special investment areas. As a matter of fact, as early as December 1981, the government emphasized the important position of the coastal cities in China's modernization program when Premier Zhao Ziyang declared that "... we must make full use of the coastal areas, especially the coastal cities." 66 The decision in May 1984 by Chinese leaders to convert the fourteen coastal cities to special investment areas reflected their belief that China had already passed the initial test on the new investment policy and that the time had come to expand the experiment to other areas.

30, 1987.

66 Xinhua, "The Present Economic Situation," in FBIS, June 15, 1984, p. K22.

4. REPLICATION AND MODIFICATION OF THE SEZ MODEL

The decision to open the coastal cities called for some special policies reserved previously for the SEZs to be applied to the fourteen cities. These special policies focus primarily on two aspects: preferential treatment regarding FDI and the extension of the decision-making power of local authorities in dealing with FDI. The fourteen cities were authorized to replicate as well as to modify those special measures in accordance with their own specific situations.

The legal framework for the opening of the coastal cities is found in 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 (hereafter referred to as the Tax Incentive Regulations), issued by the State Council in November 1984. On the other hand, each city tries to grant additional preferential terms to foreign investors as supplements to the national regulations. Following is an account of how the fourteen coastal cities applied the special policies to their areas.

(1) More Power for the Local Authorities

It was mentioned in Chapter III that as a general rule a provincial government can only approve investment projects with a total investment of US$5 million or less,

but that the SEZs are entitled to a higher approval ceiling. China's decision in 1984 to expand special investment areas brought the higher approval privilege also to the fourteen coastal cities. Shanghai and Tianjin, two major industrial bases, were granted the authority to approve investment projects with a total investment up to US$30 million. Dalian and Guangzhou had an approval ceiling of US$10 million, while the power of the rest of the fourteen cities was limited to US$5 million. 67

In the second half of 1985, Chinese leaders reportedly became displeased with the investment situations in the SEZs and the fourteen coastal cities. Senior Chinese officials openly expressed the view that some of the fourteen coastal cities did not seem to have a solid foundation to handle FDI by themselves and should be subject to more supervision by the central government when planning their development. 68 As a result, in April 1986 the central government rescinded the approval ceiling of US$5 million for the ten smaller coastal cities of Qinhuangdao, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Fuzhou, Zhanjiang and Beihai. Foreign-funded projects in those cities again would have to be approved by

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67 See US Joint Ventures in China: A Progress Report.

68 See "Zhongguo yanhai kaifangchengshi you shisige jianzhi sige" (Open Coastal Cities of China Reduced from 14 to 4), Ming Pao, p. 4 and "Special Powers for 10 Open Cities Curtailed", Intertrade, May 1986, p. 68.

their respective provincial governments. 69 On the other hand, efforts would be concentrated on the rest of four bigger cities, namely, Tianjin, Dalian, Shanghai and Guangzhou, which over time were to pass on their experience to the other open cities.

(2) A Zone within A Zone

As the fourteen coastal cities were being converted into special investment areas, another model offered by the SEZs concerning FDI was also being replicated there. The experiences gained at the Shekou Industrial District in Shenzhen and the Huli District in Xiamen provided the open coastal cities with a model, namely that a city might try to absorb FDI by initially concentrating on a relatively small area within the city. From September 1984 to January 1985, eleven such economic and technological development zones (ETDZ) were officially established in the coastal cities of Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Fuzhou, Guangzhou and Zhanjiang. The total area of the eleven ETDZs accounted for 114.42 square kilometers. As of August 1986, two more such zones were set up in the districts of Hongqiao and Minhang in Shanghai, which raised the total number of ETDZs in the fourteen coastal cities to thirteen. Wenzhou and Beihai did not follow in their footsteps because of their

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69 See US Joint Ventures in China: A Progress Report.

inadequate transportation facilities (see Table 4). 70

Of the thirteen ETDZs in the twelve cities, the two in Shanghai had previously been earmarked for special attention; the rest of the eleven ETDZs were newly designated special investment areas, typically located on the outskirts of the existing city. The zones range in size from an area of 4.62 square kilometers for Nantong to an area of 33 square kilometers for Tianjin.

The coastal cities have applied and modified the model of "a zone within a zone" provided by the SEZs. In accordance with the practices in the SEZs, the coastal cities tried to develop the ETDZs by initially concentrating on the construction of infrastructure facilities. However, in contrast with the SEZs, which tried to absorb foreign investment in all industries, the ETDZ in an open coastal city would only give priority to certain industries considered best suited to the city. Foreign businessmen who invested in the ETDZ were entitled to much of the preferential treatment designed previously for the SEZs. On the other hand, for the existing part of each city referred to as Old Urban Areas (OUA) the city authorities would primarily seek investment to renovate existing enterprises. In other words, generally speaking,

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70 "Woguo shisan ge jingji kaifaqu jingguo liangnian nuli chubu xingcheng youli waishang touzi de 'xiaoxihou'", People's Daily, June 10, 1987.

TABLE 4

THE FOURTEEN OPEN COASTAL CITIES AND THEIR ECONOMIC AND TECHNOLOGICAL DEVELOPMENT ZONES

City	Province	Area (square kilo-meters)	Population	ETDZ Area (square kilo-meters)
Dalian	Liaoning	12,574	476,000	20
Qinhuangdao	Hebei	7,752	2,280,000	1.9
Tianjin	Autonomous	11,305	8,048,000	33
Yantai	Shandong	18,900	8,190,000	20
Qingdao	Shandong	10,654	6,260,000	15
Lianyungang	Jiangsu	6,265	2,920,000	n.a.
Nantong	Jiangsu	8,000	7,450,000	4.62
Shanghai	Autonomous	6,186	12,170,000	n.a.
Ningbo	Zhejiang	9,397	4,877,000	3.9
Wenzhou	Zhejiang	11,784	6,292,000	none
Fuzhou	Fujian	11,968	4,888,000	4.4
Guangzhou	Guangdong	16,657	7,104,000	9.6
Zhanjiang	Guangdong	12,472	4,772,600	n.a.
Beihai	Guangxi	275	175,900	none

Source: The China Investment Guide 1986.

the coastal cities would not encourage investors to establish new enterprises in the OUAs. Preferential treatment for investments in the OUAs was not as favorable as that for ventures in the ETDZs. 71

(3) Administration

In conformity with the SEZs' practice of creating a separate government agency to administer the development of the zone, each open coastal city established a similar administrative committee to handle the development of its ETDZ. In general, the committee is empowered to formulate and implement the development plan for the zone, to examine and approve investment projects, to formulate and implement regulations for the zone, and to co-ordinate the work of various departments of the city government in the zone. 72

In contrast to the power range of the ADCOM in the

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71 "Zhongguo yanhai kaifangchengshi yu tequ" (Open Coastal Cities and Special Zones of China), Wen Wei Po, November 18, 1984, p. 2; see also interview with Gu Mu, State Councillor, reported in Wen Wei Pao, December 14, 1984, p. 3; see also 14 Coastal Cities of the PRC Handbook (Hong Kong, Wah kwong Newspapers Ltd., 1985).

72 See, for example, "Measures of Dalian Economic and Technical Development Zone Governing Enterprise Registration" promulgated by the Dalian Municipal People's Government on October 15, 1984; "Trial Measures of Guangzhou Economic and Technical Development Zone Governing Enterprise Registration", promulgated by the Guangzhou Municipal People's Government on April 9, 1985; and "Regulations of Tianjin Economic and Technical Development Zone Governing Enterprise Registration" adopted by the Twenty-first Session of the Standing Committee of the Tenth People's Congress of Tianjin Municipality on July 20, 1985.

SEZs, which covers practically the whole zone, the ETDZ administrative committee of a open coastal city only administers the ETDZ itself. Hence foreign investment in the OUA of the city is controlled by another agency of the city government, namely, the Foreign Economic Relations and Trade Commission (Committee), which used to be the agency in charge of foreign investment for the whole city before the ETDZ was established. The rationale of this parallel power structure lies in the fact that the coastal open cities have relatively larger OUAs to be developed in addition to the development of the new ETDZs. The SEZs were practically built from scratch and did not have to be concerned much about their existing industries.

Another modification the coastal cities made to the administrative model of the SEZs is that the fourteen cities have established other local organizations which can help foreign- funded enterprises deal with specific problems that the ADCOM or the ETDZ administrative committee are not able to solve. The experiences gained from the SEZs and the coastal cities indicate that bureaucracy can often obstruct the "one and only" ADCOM or the ETDZ administrative committee from efficiently handling FDI activities. Many times foreign investors were frustrated at not being able to get things done quickly. For this reason, the fourteen cities formed various local organizations to help foreign-funded enterprises with their

operations.

For instance, in Fuzhou the Fuzhou Coordinating Group for Enterprises with Foreign Investment has been set up to field investors' complaints. The Fuzhou Materials Supply Corporation for Enterprises with Foreign Investment and the Fuzhou Foreign Economic Relations and Trade Consulting Firm have also been established to assist enterprises with supply problems and to provide consulting services. In order to guarantee efficiency in approving projects involving foreign investment, the Fuzhou municipal government also stipulated that documents submitted to city authorities for approval must be decided on within 30 days of submission, while the registration of approved projects must be completed within 10 days of receipt of the required documents.

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 Foreign-funded Enterprise Materials Supply Corporation was established to help foreign investors gain

access to necessary raw materials. The Tianjin municipal government also announced that project proposals and feasibility studies submitted for approval must be acted upon in 7 days and 15 days, respectively. Action on a document submitted to government authorities for approval must be taken within one month of the date of submission; applications for registration must be processed within 7 days, and applications for tax reductions or exemptions must be handled within 15 days of receipt of the required documentation. A foreign investment working group and the management bureau for enterprises with foreign investment were established to strengthen coordination of local FDI policies. In addition, a foreign venture service company, a technological consulting firm and a material supply company were established to improve services to foreign-financed enterprises. 73

(4) Preferential Treatment

One of the major strategies that Chinese leaders use to replicate the SEZs model is to designate the fourteen open coastal cities as the recipients of preferential treatment that in a number of areas similar to that given to the SEZs. The State Council's Tax Incentive Regulations of 1984 outline the basic incentives for investment in all of the coastal cities. On the other hand, each city had also

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73 See US Joint Ventures in China: A Progress Report.

been providing its own items of preferential treatment as a supplement to the national regulations.

(a) Preferences for all the fourteen cities. As mentioned above, when the fourteen cities offer preferential treatment, they distinguish between investments in the ETDZs and those in the OUAs and provide more favorable treatment to the former. The preferential terms under the Tax Incentive Regulations can be summarized as follows:

(i) Investment forms. In terms of the forms of investment, all of the fourteen cities are permitted to have wholly owned foreign enterprises in addition to equity joint ventures and contractual joint ventures. Prior to July 1984 only the SEZs were allowed to have the former type of investment.

(ii) Income tax. All foreign-funded manufacturing ventures established in the ETDZs pay income tax at the rate of 15 percent. Under the national law, equity joint ventures are subject to a rate of 30 percent; a progressive rate of 20 to 40 percent is levied on other types of foreign ventures. According to the Tax Incentive Regulations, foreign-funded enterprises with a term of at least ten years may enjoy a tax holiday in the first two profit-making years and a 50 percent reduction in taxes in the following three years. Under national legislation, only equity joint ventures and other ventures that are

"low-profit operations" are qualified for this treatment.

In the OUAs, most industries are eligible for a 20 percent reduction of regular enterprise income tax rate; a 15 percent tax rate may be granted if the venture is technology-intensive, or if the enterprise involves more than US$30 million foreign investment, or if the project pertains to energy development (excluding oil), transportation, or port construction.

(iii) Withholding tax. Under national legislation, foreign ventures are subject to a 10 percent withholding tax on income obtained from the cities, including dividends, interest, rentals, and royalties. However, this 10 percent withholding tax on dividends is exempted for ventures established in the ETDZs. The withholding tax still applies to dividends remitted by ventures in the OUAs.

(iv) Import and export duty. Ventures established in the ETDZs are entitled to an exemption from the Industrial and Commercial Consolidated Tax when they import production equipment, building materials, raw materials, parts and fittings, components, motor vehicles, and office supplies for their own use. However, the products produced as a result will have to be marketed overseas. If the imported raw materials, spare parts, components or packing materials are subsequently used in products for sale in China, they have to make up the taxes.

For ventures located in the OUAs the terms are slightly less favorable. Production equipment, building materials, raw materials, parts and fittings, components, motor vehicles, and office supplies imported by them are exempt from the Consolidated Tax only if those items constitute part of the investment. Raw materials, spare parts, components or packing materials are exempt also if imported for producing export products.

Although the Incentive Regulations do not address the issue of customs duties, regulations subsequently issued by individual cities extend the concessions to include customs duties.

On the other hand, with the exception of a small number of products controlled by the State, all other export products are exempt from the Consolidated Tax. 74

(b) Additional preferential terms In addition to the favorable terms outlined in the Tax Incentive Regulations, to which all the fourteen cities are entitled, each city has worked out a whole range of additional incentives to foreign investors in the areas of enterprise income tax, customs duties or the Consolidated Tax, land use fees and other special assistance. Some cities, such as Dalian, Ningbo, Tianjin, and Guangzhou, have officially issued comprehensive regulations specifying the incentives for their ETDZs. Other cities have merely announced the

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74 See "Tax Incentive Regulations".

incentives they are ready to offer and are yet to provide preferential terms on a more comprehensive basis. All the cities that have issued incentive regulations provide some sort of favorable terms to those who establish their ventures during the early development period of the ETDZs or who are involved in the development of infrastructure facilities in the ETDZs. The purpose of providing all these incentives is, of course, to encourage FDI in the cities, both in their ETDZs and in their OUAs. 75

One major characteristic of all these incentives offered to foreign ventures in the fourteen cities is that there is a clear distinction between investing in the ETDZs and in the OUAs and between ventures that are technology-intensive, export-oriented or involved in helping the development of local infrastructure facilities and those that are otherwise engaged. Clearly Chinese leaders give priority to the ETDZs and to ventures that are technology-intensive, export-oriented, or involved in the construction of infrastructure facilities. One may identify two reasons for these preferences. First, the fourteen coastal cities have to deal with the problem of developing both the ETDZs and the OUAs; priority then becomes an issue. On the other hand, the SEZs started almost from scratch and therefore,

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75 For more complete information, see US Joint Ventures in China: A Progress Report; also see The China Investment Guide 1986.

did not have to consider the problem associated with the existing areas. Second, the experiences of the SEZs show that in spite of five years' effort to attract FDI in the SEZs, the majority of foreign invested projects had been small enterprises with low levels of capitalization and relatively unsophisticated technology. That outcome was somewhat different from the scenario Chinese leaders had previously envisioned. They expected to see "advanced technology," "modern management expertise," etc. brought in along with FDI. Furthermore, because of the inconvertibility of Chinese currency into any foreign exchange, some of the ventures had encountered the problem of profits repatriation since they primarily market their products in China. In order to prevent those problems from happening in the fourteen cities and to be able to generate more hard currency for the country, Chinese leaders began to show preferences in terms of the types of ventures being established in the special investment areas.

(5) Other Replications of the SEZ Model

There are other regulations promulgated by the fourteen coastal cities that bear a heavy resemblance to the similar regulations in the SEZs. Regulations issued by the fourteen cities concerning FDI registration procedures, land use, labor and wages, economic contracts, technology transfer, etc. are all very similar to the relevant articles in the SEZ regulations and the Shenzhen

regulations.

5. THE ACCOMPLISHMENT OF THE FOURTEEN COASTAL CITIES

As of June 1987, foreign direct investment committed to the fourteen coastal cities amounted to nearly US$900 million. 76 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 percent of all the foreign-funded enterprises in China. As a result of the policy to give preferences to certain industries, more and more foreign investments established in the coastal cities were in technology-intensive or export-oriented industries in contrast to the ventures in the SEZs, which were primarily in service sectors. Some of the coastal cities, such as Guangzhou, Shanghai, Qingdao, Dalian, Tianjin, that had been important industrial cities all along, had become areas that assumed a major role in implementing the FDI policy in the country. 77

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76 See "Yanhai kaifangqu duiwai hezuo huo jinzhan" (The Coastal Development Zones Have Made Progress in Economic Cooperations with Foreign Countries), People's Daily, August 9, 1987.

77 See "Gu Mu tan Zhongguo duiwai kaifang xingshi" (Gu Mu Talks about the Situation Resulted from China's Open Door Policy), People's Daily, December 16, 1986.

As of June 1987, RMB2.35 billion (about US$630 million) had been invested in the construction of infrastructure facilities in the thirteen development zones. Altogether 165 FDI contracts had been signed, the pledged investment of which amounted to US$370 million. Of the 165 contracts signed, 56 projects had already received actual investment. The 13 development zones are becoming areas that can provide a relatively favorable investment environment described by the Chinese as "regional favorable climate" for foreign investment. 78

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78 "Woguo shisan ge jingji kaifaqu jingguo liangnian nuli chubu xingcheng youli waishang touzi de 'xiaoxihou'" (After Two Years' Effort, the Thirteen ETDZs Have Achieved Some Initial Results in Providing a 'Local Climate' Favorable to Foreign Investments), People's Daily, June 10, 1987.

CHAPTER V

IMPLEMENTATION: THE THREE DELTA OPEN ECONOMIC ZONES

1. DECISION TO OPEN THE THREE DELTA ZONES

After the first and second phases of experimentation with foreign investment in China, the country saw a preliminary development of foreign-funded enterprises, particularly in the four SEZs and the fourteen coastal cities. In February 1985, the Chinese government decided to expand the experiment on foreign investment to its third phase. It designated three more coastal areas to be special investment zones. These areas comprise the Changjiang River Delta Open Economic Zone, the Pearl River Delta Open Economic Zone, and the Southern Fujian Triangular Open Economic Zone. 79

2. THE THREE DELTA OPEN ECONOMIC ZONES (OES)

The Changjiang (Yangtze) River delta, the Pearl River delta and the Xia-Zhang-Quan triangular area in southern Fujian Province are three important areas that are also located on the Chinese coast line. (See Figure 5) The three open coastal economic zones include a number of cities and counties.

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79 See "China Opens Three More Coast Areas", China Daily, March 5, 1985.

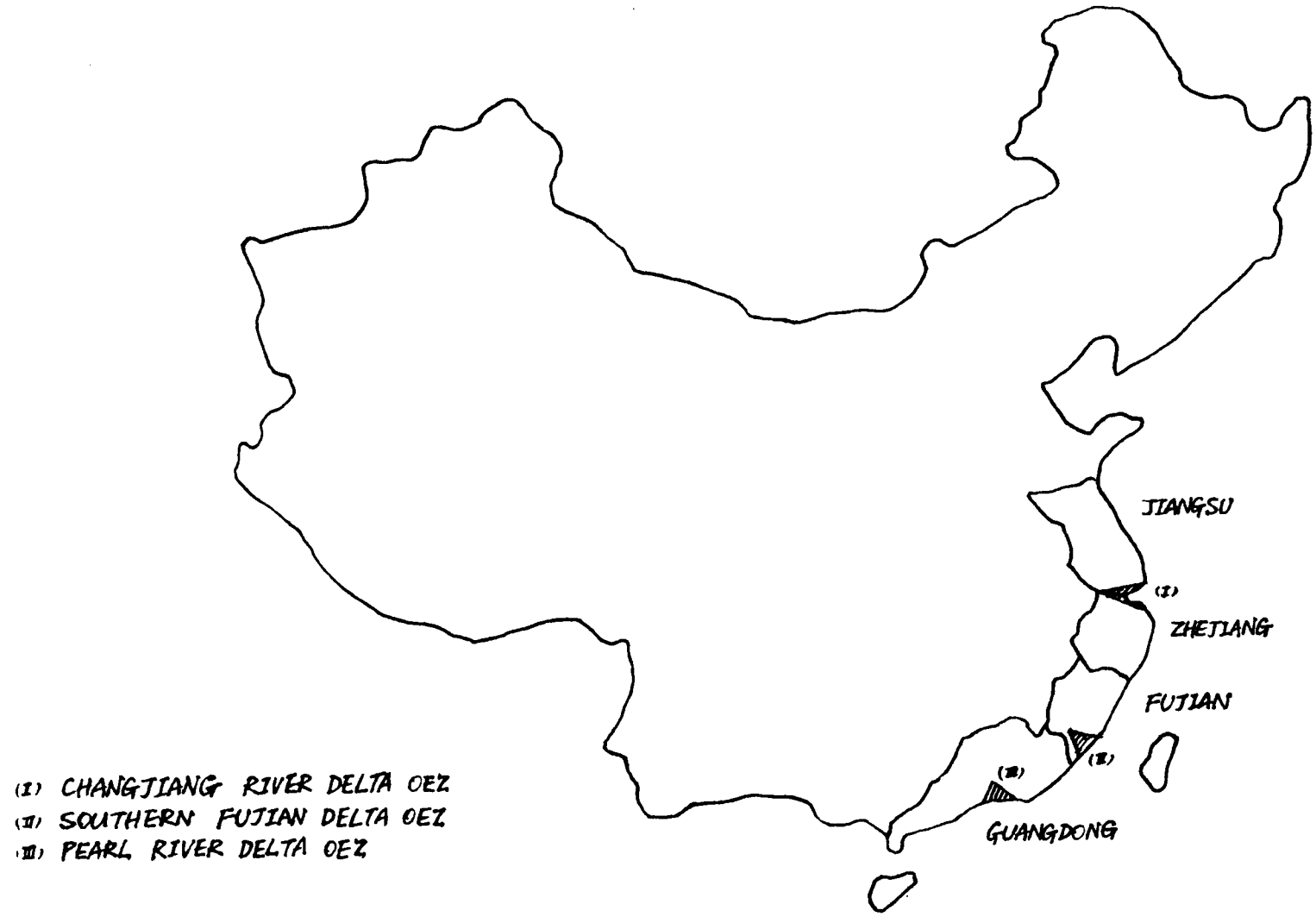


FIGURE 5. THREE OPEN DELTA AREAS

(1) The Changjiang River Delta OEZ

Located at the outlet of the Changjiang River, the Changjiang River Delta OEZ encompasses five cities in two provinces: Suzhou, Wuxi and Changzhou in Jiangsu Province and Jiaxing and Huzhou in Zhejiang Province. The zone covers an area of 27,000 square kilometers and is one of the most affluent areas in China. The region is also recognized as having a well-developed industrial base and transportation system. The cities are closely interconnected both geographically and economically. In 1984, the five cities had a combined industrial and agricultural output of RMB46.92 billion. 80 Some of the major statistics about this OEZ are shown in Table 5.

(2) The Pearl River Delta OEZ

Located in the southern part of Guangdong Province, the Pearl River (the Zhujiang River) Delta OEZ covers an area of 25,300 square kilometers and has a population of 13 million. Under its jurisdiction are Fanyu and Zengcheng counties in Guangzhou Municipality; Foshan City and its three counties, Nanhai, Gaoming and Shunde; Zhongshan City; Jiangmen City and its five counties, Heshan, Xinhui, Kaiping, Enping and Taishan; Baoan County in Shenzhen City; Doumen County in Zhuhai City and Dongguan County in Huiyang

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80 See The China Investment Guide 1986, p. 127-129.

TABLE 5

CHANGJIANG RIVER DELTA OPEN ECONOMIC ZONE

City	Province	Area (square kilo-meters)	Population	GVIO* (RMB/ billion)
Suzhou	Jiangsu	8,488	5,330,000	19.345
Wuxi	Jiangsu	4,650	3,890,000	18.194
Changzhou	Jiangsu	4,211	3,050,000	10.44
Jiaxing	Zhejiang	3,915	3,000,000	4.498
Huzhou	Zhejiang	5,700	220,000	2.397

Source: The China Investment Guide 1986.
Figures are up to 1985.
*GVIO: Gross value of industrial output.

Prefecture. 81 In 1985, the gross value of industrial and agricultural output in the zone amounted to RMB24 billion, of which RMB16.5 billion was attributed to industrial output. Just like the three SEZs in Guangdong, the Pearl River Delta OEZ enjoys the advantage of being in the proximity of Hong Kong. It also represents the indigenous home of thousands of overseas Chinese, many of whom retain a personal interest in seeing the development of the area. Foshan, Jiangmen and Zhongshan are three major industrial cities in the zone. Some of the statistics regarding the three cities are shown in Table 6.

(3) Southern Fujian Delta OEZ

Situated in southeastern Fujian Province, the zone covers Tongan County in Xiamen City; Zhangzhou City, Longhai County, Zhangpu County and Dongshan County in Longxi Prefecture; and Quanzhou City, Hui'an County, Nan'an County, Jinjiang County, Anzi County and Yongchun County in Quanzhou Prefecture. The zone has a total area of 24,900 square kilometers and a population of 9.51 million. The total industrial and agricultural output of the zone in 1984 was estimated to be RMB6.41 billion. Zhangzhou and Quanzhou are two major cities in the zone. Zhangzhou's GVIO in 1985 was RMB1 billion, and Quanzhou's figure for

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81 Ibid. p. 130-132.

TABLE 6

THREE MAJOR CITIES IN THE PEARL RIVER DELTA OEZ

City	Province	Area (square kilo-meters)	Population	GVIO (RMB/ billion)
Foshan	Guangdong	5,000	2,312,000	5.4
Zhongshan	Guangdong	1,680	1,020,000	n.a.
Jiangmen	Guangdong	16,700	3,319,500	2.5

Source: The China Investment Guide 1986.
Figures are up to 1985.

the same year was RMB1.8 billion. 82

3. REASONS FOR SELECTING THE THREE AREAS AS THE OEZS

The decision by Chinese leaders to designate the three delta areas as the third round special investment zones once again reflected their belief that China's coastal areas should be the pioneers in implementing the FDI policy. Similar to the four SEZs and the fourteen open coastal cities, the three OEZs were equipped with relatively better infrastructure for FDI. It was, therefore, logical to expand the experiment on FDI to the three areas once the initial experiment had been proved successful. The initiation of the third-phase implementation of the FDI policy resulted in the fact that all the major areas along the Chinese coast line, from Dalian in the north down to Beihai in the south, have become special investment areas. (See Figure 6) They include two centrally-administered municipalities, Shanghai and Tianjin, 25 provincially-administered cities and 67 counties, which comprise a total population of 150 million. 83

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82 See The China Investment Guide 1986, p. 132-134.

83 See "Guowuyuan zhuguan bumen fuzeren zongtan kaifang jiunian" (The State Council Spokesman Reviews the Nine Year Since China Adopted the Open Door Policy), People's Daily, October 13, 1987.

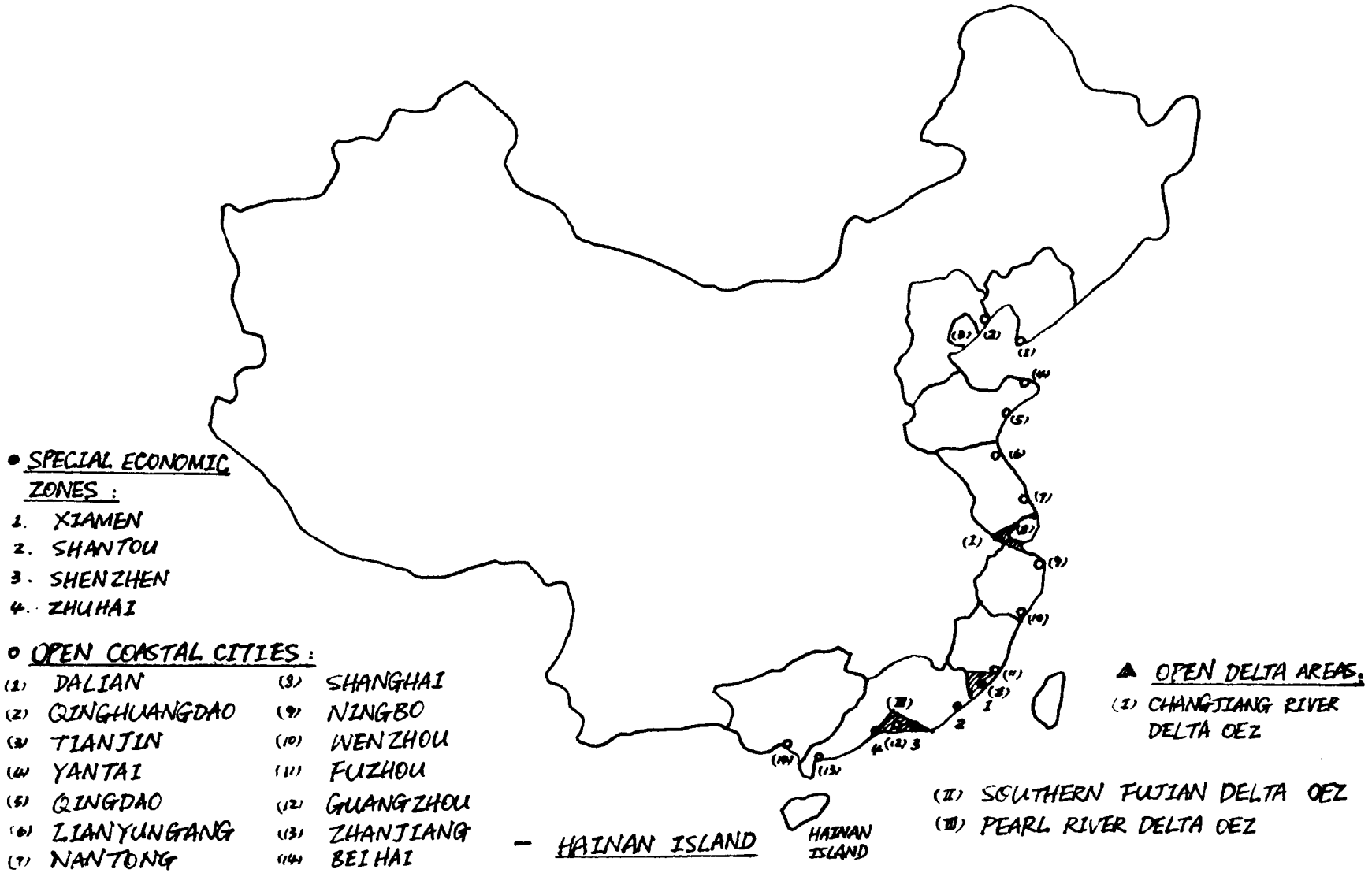


FIGURE 6. FOUR PHASES OF IMPLEMENTATION: A DETAILED LOOK

4. REPLICATION AND MODIFICATION OF THE MODELS OF THE SEZS AND THE OPEN COASTAL CITIES

Although the three delta OEZs are independent of the other special investment areas in developing their own measures to attract FDI, they are bound to be influenced by the experiments previously conducted in the SEZs and the open coastal cities, since all the four SEZs and some of the fourteen open coastal cities are located right within their boundaries. As a matter of fact, the three OEZs have replicated many measures adopted in the first two phases of experiment on FDI since they were designated as the third round special investment zones.

(1) The Pearl River Delta OEZ

In October 1985, the Guangdong provincial government announced a series of preferential treatments offered to foreign investors who establish operations in the Pearl River Delta OEZ. 84 Many such incentives are very similar to those set out in the Tax Incentive Regulations for foreigners who invest in the Old Urban Areas of the fourteen open coastal cities. Similarly, the incentives offered in the OEZ primarily take the form of lower tax rates. For instance, foreign-funded enterprises in the OEZ pay income tax at a rate 20 percent less than the usual

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84 See Wen wei po, October 14, 1985, p.2 and October 30, 1985, p.3.

rate. This results in a tax rate of 24 percent for equity joint ventures and a tax rate of between 16 and 32 percent for other forms of foreign ventures. The local income tax can also be reduced or exempted. Moreover, a venture is only subject to a 15 percent income tax rate if it is involved in the construction of energy, transportation, or port projects; or if it involves intensive technology, or an investment of more than US$30 million and the period of investment recovery is long. Profits made by foreign investors are free from withholding tax when they are repatriated. Exempt from customs duties and consolidated industrial and commercial tax are items such as equipment and building materials that are part of the investment imported for the venture's operation; raw materials, spare parts, components, and packaging materials that are imported to produce export products; and office equipment and vehicles for the venture's own use. 85

Apart from comprehensively replicating the models established by the first two round investment areas, the Pearl River Delta OEZ, together with other special zones, has also learned a major lesson from the previous experiments, namely that special investment areas should regard the investment environment as a crucial element in their pursuit of FDI. Similar to what other open areas had begun to do, the Pearl River Delta OEZ set out to improve

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85 See Wen wei po, note 86 above.

its investment environment by focusing on the "hard environment" (yinghuanjing) and the "soft environment" (ruanhuanjing), two words borrowed from the computer terms "hardware" and "software." "Hard environment" refers to what open areas can provide to potential foreign investors in terms of investment infrastructure, energy resources, transportation and telecommunication facilities, etc. "Soft environment", on the other hand, 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. 86 The delta zone has paid special attention to its "soft environment" and tried to compete with other investment areas in attracting FDI by improving this aspect. The measures adopted by the delta zone to achieve this goal are none other than establishing government supervising offices such as was done in the first two phases of implementation. What is new in this case is that the local governments in the zone have taken advantage of the fact that their cities and counties are smaller in size, making it easier to have a government office closely oversee and coordinate investment activities within the

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86 See "Zhongguo jiang zhiding he caiqu youli cuoshi shi duiwai kaifang chuxian yige xinjumian"(China Will Adopt Effective Measures to Push for a Better Open Situation), People's Daily, October 30, 1987.

locality. The government of Dongguan County has since set up such an office which is entitled to the right to co-ordinate FDI related activities such as project negotiations, signing of contracts, approval of projects, control of labor costs, etc. This is expected to reduce bureaucracy and unfair treatment that foreign investors often encounter when they deal with their Chinese partners and their supervisors.

The Pearl River Delta OEZ is being developed at a faster pace than the other two delta zones. This is partly because of its proximity to both Hong Kong and the three SEZs in Guangdong Province. Its emphasis on "soft environment" has also brought tangible results to the area. As of May 1987, Foshan City had attracted pledged foreign investment of over US$700 million, of which over US$500 million had been utilized. Foshan, an insignificant city before, has now become one of the few cities in China that have their annual gross value of industrial and agricultural output exceed RMB10 billion. In terms of overall capability of enterprises, Foshan has even surpassed Guangzhou. The achievement made by Dongguan County in terms of foreign investment absorbed is another example. The number of its joint processing projects with foreign partners, most of which are with partners from Hong Kong, exceeded 2,400; they are distributed in 15 industries (having more than 4000 products) and are found in every

village of the county. 87

(2) The Southern Fujian Delta OEZ

Southern Fujian is the most prosperous region in Fujian Province. It is also the indigenous home of many overseas Chinese and retains special ties with people in Taiwan, Hong Kong and southeast Asian countries. Since the Xiamen SEZ is located in southern Fujian, it provides the delta zone with a realistic model.

The implementation of the FDI policy in the Southern Fujian Delta OEZ has also focused on the improvement of investment environment. Fujian provincial government has long been trying to improve the "hard environment" for investors in southern Fujian. Tong'an County has benefited from facilities built in the Xiamen SEZ, such as an international airport, a dock, a program-control telephone system, several tourist hotels, etc.. More infrastructure facilities related to energy resources are under construction. Another program-control telephone system has been built in Jingjiang County, the hometown of thousands of overseas Chinese. In Zhangzhou City, similar facilities

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87 For information concerning Dongguan and Foshan, see "Liyong waizi kaituo waixiangxing jingji, Foshan kuaru 'baiyi fuweng' hanglie" (Push for External-oriented Economy by Utilizing Foreign Investment: Foshan Joins the Team of "Multi-Billionaire"), People's Daily, May 15, 1987; also see "Guangdongsheng Dongguanshi jingji fazhan diaocha" (A Report of the Economic Development of Dongguan City, Guangdong Province), People's Daily, December 29, 1987.

have been completed, including six docks, two shipping lines directly connecting the city to Singapore and the Philippines, a program-control telephone system, etc.. Ten hydro-power stations are still being built in conjunction with Nanjing reservoir. Quanzhou City has also established a new shipping line to Hong Kong. A program-control telephone system will soon be put into operation there.

Apart from emphasis on the "hard environment," the delta zone in southern Fujian also tries to tackle problems concerning "soft environment." Following "Provision for the Encouragement of Foreign Investment" (see next chapter), 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. Among the new measures, the top priority was given to the autonomy of foreign-funded enterprises in the region. Other preferential terms were also specified. They covered areas such as customs duties for equipment, raw materials, parts and components imported for production use; price; working and trust funds; foreign exchange; income tax; etc.. Furthermore, various government agencies have since been established to provide foreign ventures with various kinds of services, including the supply of production materials, the supply of labor, arbitration, etc..

The effort to improve both "hard" and "soft" investment

environments in the delta zone has resulted in the improvement of the "local climate" (xiaoqihou) and in attracting foreign investors to the area. As of the end of 1986, 506 contracts to establish foreign ventures in the zone had been signed, comprising 63 percent of all such contracts signed in the whole province. Among the signed contracts, 297 projects had gone into operation, with realized foreign investment amounting to US$276 million. The first half of 1987 saw 44 more such contracts signed, which was more than half of all the contracts signed in the whole province. 88

(3) The Changjiang River Delta OEZ

The Changjiang River Delta OEZ is different from the other two OEZs mentioned above in two respects. One difference is that this area is not a so called "hometown

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88 For more information concerning FDI in the Southern Fujian Delta OEZ, see People's Daily, September 2, 1987, "Minnan sanjiaoqu zengqiang waizi xiying li" (The Delta Zone in Southern Fujian Pushes for Better Investment Environment); November 13, 1987, "Xia, Zhang, Quan sanshi fuzeren tan minnan jinyibu kaifang" (Chief Officials of the Cities of Xiamen, Zhangzhou and Quanzhou Talk about Further Opening Southern Fujian); October 16, 1987, "Zhangzhou touzi huanjing da wei gaishan" (Investment Environment in Zhangzhou Has Been Greatly Improved); October 18, 1987, "Gaige kaifang gei Zhangzhou dailai fanrong" (Reforms and Open Policies Have Brought Prosperity to Zhangzhou); April 9, 1987, "Quanzhoushi renzhen luoshi waishang touzi youhui zhengce" (The City of Quanzhou resolutely Implements the Policy of Offering Preferential Terms to Foreign Investors); June 6, 1987, "Quanzhou touzi xiaoqihou duoyun zhuanqin" (Local Investment Climate at Quanzhou Changes from Cloudy to Clear).

of overseas Chinese," a factor which could become a liability to the investment environment of the area. On the other hand, the area is different in the sense that it is more developed and enjoys better infrastructure facilities. For instance, the combined gross output value of industry and agriculture in the cities of Suzhou, Wuxi and Changzhou, the three major cities of the Changjiang River Delta OEZ in Jiangsu Province, is equal to 42 percent of the gross output value in the whole Jiangsu Province. The average income per person in the area reached RMB1,771 a year, twice as much as that in the rest of Jiangsu Province. Although it has fewer ties with overseas Chinese who are potential investors, 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. By the time the Changjiang River Delta OEZ was opened to FDI, many models were available for it to copy. In addition to the pioneer model of the SEZs, experiences gained by neighboring open coastal cities such as Shanghai, Nantong and Lianyungang, had provided the delta zone with options that were more easily adaptable to its own situation.

Since the opening of the delta zone, the local governments as well as the Jiangsu and Zhejiang provincial governments have been paying special attention to attracting foreign investment in export-oriented projects

and investment involving advanced technology. This is the direct result of one of the lessons the delta zone learned from previous experiences of other open areas, namely, that in order to develop foreign-funded enterprises, it is crucial to find a solution to the problem of profit repatriation, with which many foreign investors are faced. Since Chinese currency is not convertible, the profits foreign investors generated in China have to be remitted through other means. The trials in other special investment areas indicate that developing export-oriented projects can partially solve the problem. That is to say, a foreign investor can repatriate the profits made in China by marketing the product(s) of the enterprise overseas. On the other hand, in order to make the product(s) more competitive in international markets, it is crucial that the enterprise uses advanced technology in producing its product(s). The Changjiang River Delta OEZ has been following this rule of thumb, giving particular attention to the aspect of being export-oriented. The effort to improve both "hard" and "soft" investment environment mentioned before can also be identified in this area.

The years of 1985 and 1986, two years immediately following the opening of the delta zones, saw a tremendous growth of FDI in the Changjiang River Delta OEZ. 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. The Changjiang River Delta OEZ is now in full gear in utilizing foreign direct investment. 89

5. REMARKS ON THE THIRD-PHASE IMPLEMENTATION

The three delta OEZs are still at the initial developing stage. It is not yet clear exactly how the delta OEZs will coexist with the four SEZs and the fourteen open coastal cities in terms of their implementation of the FDI policy. As of the end of 1987, it seems that the SEZs and the open coastal cities will retain the most preferential terms ahead of the delta zones. The delta zones probably will increase their significance in the implementation of China's investment policy as time passes and eventually will enjoy the same status as the SEZs and the open coastal cities. Among the three delta zones, the Pearl River Delta OEZ will develop more quickly than the other two zones, at least in the immediate future. The influence of the three SEZs in Guangdong and its proximity to Hong Kong will give it more impetus for modernization.

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89 For information regarding the cities of Suzhou, Wuxi and Changzhou in the Changjiang River Delta OEZ, see People's Daily "Jiangsu queding Su-Xi-Chang jingji fazhan mubiao" (Jiangsu Province Set the Development Goal for the Cities of Suzhou, Wuxi and Changzhou), September 8, 1987; "Su-Xi-Chang waixiangxing jingji chuxian xin geju" (The External-oriented Economy in the Cities of Suzhou, Wuxi and Changzhou Has Reached a New Horizon), November 30, 1987; "Jiangsu dali fazhan waixiang xing jingji" (Jiangsu Province Strives to Develop Its External-oriented Economy), December 21, 1987.

CHAPTER VI

IMPLEMENTATION: RECENT DEVELOPMENTS

1. THE SEVENTH FIVE-YEAR PLAN

During the period of the sixth five-year plan for the national economy (1981-1985), China managed to absorb foreign direct investment with a total value of US$5.4 billion. The number of foreign-funded ventures with different investment forms exceeded 5,900. 90 The Chinese government expressed its general satisfaction with this initial phase of implementation when it concluded that China had "set up a positive foundation for opening to the outside world." 91

The fourth session of the sixth People's Congress, held in March of 1986, adopted "The Seventh Five-Year Plan for National Economy and Social Development (1986-1990)." The seventh five-year plan calls for greater effort to speed up foreign trade, utilize foreign capital and import technology. In order to use foreign capital effectively, China will continue to improve laws and regulations concerning the investment environment. The seventh five-year plan gives priority, on the one hand, to foreign

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90 Figures from United Nations Centre on Transnational Corporations, Foreign Direct Investment in the People's Republic of China (New York: United Nations Publications, 1988), p. 21.

91 Ibid, p. 22.

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.

2. THE SETBACK IN 1986

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. 92 In an effort to alleviate the situation, the central government tightened control over the expenditure of foreign exchange. This made it

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92 See Harry Harding, "The Investment Climate in China", The Brookings Review, Spring 1987.

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 percent, from RMB3.2 to the dollar in 1985 to RMB3.7 in 1986, which made the problem of foreign exchange shortage even more acute.

Many foreign-funded ventures were seriously affected by this foreign exchange problem, because many of them had to import a substantial amount of components for their productions in China. The devaluation of the Renminbi increased the cost of importing components from abroad, thus raising the price of the finished product. Because of the tightened controls over foreign exchange, foreign-funded ventures were not able to obtain hard currency in China with which to purchase foreign components, nor could they repatriate their profits, if any, after their products were sold in China in Renminbi. The growing dissatisfaction on the part of foreign investors with the foreign exchange issue and with other problems related to China's investment climate such as high costs of doing business, price gouging, limited access to the domestic market, lack of qualified local personnel, policy unpredictability, bureaucratic foot-dragging, etc., culminated in the spring of 1986 when the foreign business community openly expressed their frustration with the situation. The complaint was later echoed in even stronger

terms by the press in the West. 93

This negative publicity soon brought concrete effects to the investment situation in China. The amount of major foreign direct investment 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. 94

Outside pressure certainly had a considerable effect in persuading Chinese leaders to act promptly so as to restore the trust and good will of foreign investors. During the second half of 1986, Chinese leaders made a series of efforts to obtain a better understanding of the complaints and requirements of foreign investors. They requested Chinese professionals to study closely those complaints and

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93 For some of the press reports on the issue, see "Foreign Exchange Snag Slows Sino-US Jeep Firm," Journal of Commerce, April 3, 1986, p. 1A+5A; "China May Tighten Control on Investors," Journal of Commerce, April 16, 1986, p. 5A; "Peking Mayor's Motto: Pay Heed to Mop and Rail," New York Times, April 24, 1986, p. A2; "Chinese Mine Bedeviled by Bureaucracy," Asian Wall Street Journal, April 17, 1986, p. 1+13; "Search for Oil off China Tests Firms' Patience," AWSJ, April, 15, 1986, p. 1+7; "AMC to Suspend Chinese Venture's Jeep Production," Wall Street Journal, April 30, 1986, p. 23; "Taking the Mystery out of Investing in China," AWSJ, April 24, 1986, p. 12; "American Motors to Halt Production at Beijing Jeep," Journal of Commerce, May 2, 1986, p. 4A; "Spring Roll: Big Flavor, Small Sizes," New York Times, May 7, 1986, p. C1+6.

94 Some statistics of the Ministry of Foreign Economic Relations and Trade (MOFERT) state the figure for newly approved projects in 1986 as US$2.79 billion. Also notice that although the amount of major FDI contracted for in 1986 dropped shapely, the amount actually utilized rose 10 percent over 1985 to US$2.15 billion. See Foreign Direct Investment in P.R. China, p. 62.

requirements and to conduct research on the investment environment in China. They also arranged meetings between foreign investors and high-ranking Chinese officials, including both Zhao Ziyang and Deng Xiaoping.

3. THE 22 ARTICLES

As a direct result of the setback in 1986, the State Council issued a major piece of supplementary legislation on October 11, 1986, namely, "Provisions for the Encouragement of Foreign Investment," popularly known as "the 22 Articles." 95

The provisions essentially provide foreign investors with four sets of incentives. First, the provisions offer to reduce the cost of doing business in China by lowering taxes, land use fees, labor costs, and utility, transportation and communications costs. Second, the provisions promise improved access to crucial inputs controlled by the central government, including raw materials, transportation and communication facilities, and loans in Renminbi. Third, the provisions call for an increase in the efficiency with which the government agencies approve or reject foreign investment projects. This will be accomplished partly by establishing deadlines

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95 For an English translation of the Provisions, see United Nations Centre on Transnational Corporations, Foreign Direct Investment in the People's Republic of China, (New York: United Nations Publications, 1988), p.99-102.

for the reviewing process. Finally, the provisions guarantee foreign ventures with greater autonomy regarding operations such as production plans, imports and exports, the wage and salary system, and the employment and dismissal of labor. 96

In addition to offering the four sets of incentives to foreign investors, the 22 Articles also indicate, for the first time, a considerable departure from the earlier national policy of differentiating the incentives provided to foreign investors on the basis of the form of investment. Instead of more preferential treatments for equity joint ventures than for contractual joint ventures and wholly-owned foreign ventures, the 22 Articles recognize two basic categories of foreign investment regardless of their forms. Those manufacturing ventures that are "export-oriented" or "technologically advanced" will be entitled to maximum preferential treatment. The first category is defined as those that, through exports, produce a favorable balance in their annual foreign exchange accounts. The second category includes those that use sophisticated equipment provided by foreign investors to manufacture new products, improved products, or products that would otherwise have to be imported. Foreign investments that do not belong to either category, again regardless of their investment forms, can only enjoy a

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96 Ibid.

limited number of the benefits the 22 Articles offered. Ventures in the service sector, such as hotels, are entitled to even less benefits.

A closer look at the 22 Articles will reveal that the provisions are a further development from the local investment regulatory initiatives in the previous three phases of implementation. First of all, the 22 Articles continue to offer various kinds of preferential treatment to encourage foreign investment, an approach used in all the first three phases of implementation. Some of the incentives, such as lowering various kinds of tax rates, are borrowed directly from the previous practices. In addition to following the practice of providing incentives to foreign investment, the 22 Articles also signal a new approach to the implementation of the investment policy, namely, the change of focus from equity joint ventures to export-oriented or technologically-advanced enterprises. The new approach reflects the recognition by Chinese leaders that both China and foreign-funded ventures will benefit more if the ventures are able to generate sufficient foreign exchange through exports and stay highly competitive by using advanced technology. The problem of balancing foreign exchange by foreign ventures came to the attention of the authorities of the special investment areas, particularly from 1985 on. The local efforts in the special investment zones to resolve the issue of foreign

exchange balance by encouraging the development of export-oriented ventures certainly has had an impact on the new approach adopted by the 22 Articles.

The 22 Articles have given rise to a host of local supplementary regulations which provide additional benefits to the two categories of foreign-funded projects. An interesting phenomenon thus occurred: Some of the measures that were experimented with in the three phases of implementation are recognized by the central government and are pronounced national measures for implementing the FDI policy. As a result of the national recognition, more local supplementary regulations are being issued to confer additional preferential treatments to the recommended categories of foreign-funded projects. This policy process of "from the locality and to the locality" demonstrates a unique pattern of policy formation when an experimentalist approach is used in policy implementation.

4. LAW ON WHOLLY FOREIGN-OWNED VENTURES

The year of 1986 also saw the promulgation of another law which concerns wholly foreign-owned ventures. As mentioned in the previous chapters dealing with foreign investment in the special investment areas, prior to 1984 the establishment of wholly foreign-owned enterprises was restricted exclusively to the SEZs. In 1984, permission was given to the 14 coastal cities. Hence, even before the

promulgation of the Law on Wholly Foreign-owned Ventures, more than 120 wholly foreign-owned ventures were approved to be established in the SEZs and the 14 coastal cities between 1979 and the end of 1985, involving investments of more than US$300 million. 97 The experiment with wholly foreign-owned ventures in the special investment areas finally led to the "Law on Wholly Foreign-owned Enterprises," promulgated on and effective from April 12, 1986.

The objective of the new law is to provide the formal legal groundwork for the establishment of wholly foreign-owned enterprises in China. The law lifts restrictions on such ventures and authorizes their nationwide establishment. The 24-article law is by no means comprehensive; it consists of some basic principles of the framework for regulating wholly foreign-owned ventures. It signals that the Chinese leadership no longer evaluates foreign investments by their forms. The development of the policy regarding wholly foreign-owned enterprises took almost seven years to emerge--from the promulgation of "the Law on Joint Ventures" in 1979 to the announcement of "the Law on Wholly Foreign-owned Enterprises" in 1986. This is another example of formulating implementation measures through pilot projects. After seven years, China finally

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97 Figures reportedly provided by the MOFERT. See Moser, p. 127.

managed to complete two important laws, one governing joint ventures, the other regulating wholly foreign-owned enterprises. One more law that covers Sino-foreign joint contractual ventures will then complete China's major legislative works that govern the three principal forms of foreign investment in China.

5. THE OPENING OF HAINAN ISLAND

Hainan Island is the second largest Chinese island (next to Taiwan) and has a total area of 34,000 square kilometers. It is located to the south of the mainland separated by the Qiongzhou Strait from Guangdong (see Figure 6 on p. 84). Although the island is rich in mineral, ocean and tropical crops resources, as a prefecture in Guangdong Province for more than three decades it had never been truly developed. In 1983, the central government decided to accelerate the development of Hainan Island. It took advantage of the island's rich resources and brought in some foreign investment to renovate old enterprises and set up new enterprises. In May 1984, Hainan was chosen along with the 14 coastal cities as a special investment area for the second phase of implementation program. However, compared to the 14 coastal cities, Hainan contributed little to the experimental program during a period of almost three years from mid-1984 to mid-1987. Although it remained as a

nominal pilot zone for the whole implementation program, the island itself had benefited from the attention by the central government. By 1986, the gross output value of industry and agriculture in Hainan had amounted to RMB4.1 billion, a 35 percent increase over the figure for 1978. Three major industries had been established, namely, the manufacturing of rubber, sugar and textile.

In September 1987, the central government decided to elevate Hainan from a prefecture of Guangdong Province to an independent province, making the island the 30th province in China (including Taiwan). The government also announced that it would make serious effort to transform Hainan Island into the largest special investment zone in China. According to the central government, investment measures authorized to the island would be even more flexible than that of the four SEZs. Foreign investment would be utilized on a more massive scale, and it would become the major source for the development of the island.

Xu Shijie, the head of the preparatory group for Hainan Province, the equivalent of the future governor of Hainan Province, announced in September 1987 that Hainan special investment zone would be more special than the four SEZs. He outlined some of the "more special" measures as: (1) foreign businessmen can enter and leave Hainan any time at their will; (2) funds are free to flow in and out; (3) the export of self-produced products is not subject to

internal quotas; (4) foreign exchange control is to be greatly loosened; (5) land can be leased; and (6) foreign-funded enterprises will be allowed to contract with Hainan government for the development of areas within the island.

The development of Hainan Island is only at its preliminary planning stage; whether or not it will initiate a fourth stage in the implementation of FDI policy remains to be seen. However, the experiments with FDI at the previous three stages of implementation have certainly had an impact on the development of the island. To begin with, the central government would not have been able to take such a big step in opening Hainan almost completely to FDI had there been no previous experience on FDI. Secondly, given the experience, the central authorities and Hainan government are able not only to replicate those FDI measures that have been proved workable elsewhere but also to go a step further to try some more innovative measures. The implementation program on the island is closely related to all the previous programs of the three phases of implementation. The fact that the two major officials in charge of the preparatory group for Hainan Province (Xu Shijie and Liang Xiang) are former key government figures in Guangdong and Shenzhen may add one more point to the argument that the previous experiment with foreign investment has had a tangible impact on the implementation

of the policy at a later stage. 98

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98 For more information on Hainan Island, see People's Daily, September 11, 1987, "Hainandao jingji riqu fanrong mianmao yixin" (The Economy in Hainan Island Is Improving Everyday); September 24, 1987, "Hainan jiang chengwei woguo zuida jingji tequ" (Hainan Will Become the Largest SEZ in China); September 28, 1987, "Hainan jian sheng yingqi waishang guanzhu" (Foreign Investors Have Noticed the Decision to Elevate Hainan to a Provincial Status); October 29, 1987, "Hainan jiang zhiding youhui zhengce xiying waizi" (Hainan Will Offer Incentives to Attract Foreign Investment); November 11, 1987, "Hainandao kewang minchun jiansheng, zhengce youhui huanying keshang touzi" (Hainan Island Expects to Become a Province Next Spring, and Will Offer Preferential Treatment to Attract Foreign Investment).

CHAPTER VII

CONCLUSION: WHAT CAN BE LEARNED?

So far it seems quite obvious that the policy to utilize foreign direct investment in China has been and is still being implemented. From 1979 to the end of 1986 Chinese entities concluded almost 8,000 contracts for foreign investment projects, covering major forms of foreign investment such as equity joint ventures, contractual joint ventures, wholly foreign-owned ventures, etc. Under these contracts, foreign companies have committed themselves to make investments in cash (foreign exchange), equipment, and technology totalling US$19.1 billion, of which some US$6.6 billion had actually been delivered by the end of 1986. 99 Table 7 presents a summary of the progress of implementation as of the end of 1986.

What, if anything, can be learned from the Chinese experience in terms of policy implementation strategy? Some preliminary reflections follow.

1. THE ROLE OF EXPERIMENTATION

The Chinese experience with regard to FDI offers a concrete example of using experimentation as a policy implementation strategy. When the Chinese government

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99 See Note 9.

TABLE 7
FOREIGN-FUNDED PROJECTS BY INVESTMENT FORM AND YEAR
(As of January 1, 1987)

	Joint Ventures	Contractual Ventures	Wholly Foreign-owned Ventures
Total Number (as of Jan. 1 1987)	3,233	4,403	138
Investment Commitments	$6.22 billion	$10.92 billion	$569 million
Amount Delivered	$2.92 billion	$1.6 billion	$127 million
Contracts Signed/1984	741	1,009	n.a.*
Contracts Signed/1985	1,412	1,611	n.a.
Contracts Signed/1986	891	500	n.a.

Source: Foreign Direct Investment in P.R. China, p. 59-61.
* n.a.= Figures are not available.

decided to utilize foreign direct investment for its modernization program in 1979, it had limited knowledge on how to actually materialize the plan. It has accumulated its knowledge on the subject by experimenting with various regulatory measures in the form of pilot projects. Therefore, what one sees is a unique situation of policy implementation where the detailed implementation program is designed in the actual process of policy implementation, and the implementation program is constantly being adjusted according to new situations. The Chinese experience of using experimentation as a policy implementation strategy offers a concrete case in support of the argument by the adaptive implementation school of thought (described in Chapter I), which believes that one should regard experimentation and adaptation as appropriate implementation strategies. Furthermore, this case study suggests that pilot projects can be used as test sites for the purpose of experimentation; the achievement from the experiment can then be emulated elsewhere as the implementation program progresses.

2. THE CONTROL OF EXPERIMENTS

The Chinese experience suggests that the experiment with a policy can be controlled within a certain scale in the process of policy implementation. The post-Mao Chinese leadership uses pilot projects (referred to as models in

China) as test sites. In a sense, these test sites are microcosmic Chinas where the effects of the FDI policy, be it positive or negative, can be evaluated. The authorities are then to quarantine measures that produce negative consequences so as to limit the damage to the country to the least possible degree. On the other hand, using those measures that have been proved successful, the policy maker will enlarge the scope of experimentation and implement its adjusted program in a larger geographic area, which may be regarded as the pilot project at its subsequent stage. This cycle of experimentation and adaptation can be repeated many times with one cycle as the basis for the other. Hence, the policy maker will be able to control its experimentation scope and to learn through experience by evaluating past performances, replicating successful measures, and adjusting future implementation programs.

3. HOW TO MEASURE SUCCESS OR FAILURE?

People who challenge the adaptive implementation school of thought argue that the evolutionary view of implementation will result in a "tautology for evaluation." The case study in this thesis indicates that there are still standards against which to measure success or failure of an evolutionary program. Since the primary objective of the FDI program is to absorb foreign direct investment, the standard against which one measures success or failure is,

of course, the actual amount of FDI that has been utilized in China. It is the implementation program that evolves according to experiences gained; the overall objective of the policy itself does not change. If the implementation program is not working, it will be adjusted. The purpose of adjusting the program is to better achieve the objective of the policy. Therefore, adjusting an implementation program will not necessarily prevent the program from being evaluated properly.

4. THE RELATIONSHIP BETWEEN POLICY FORMULATION, IMPLEMENTATION AND REFORMULATION

This study puts forward another argument with respect to the policy-making process, which differs somewhat from two conventional views on the subject. Most scholars believe that the policy-making process should be divided into three basic stages: formulation, implementation, and reformulation. Others believe that the conceptual distinction between formulation, implementation and reformulation could be challenged because (1) the adjustments that take place between goals and strategies among various actors are so pervasive that the distinction is meaningless, and (2) goals and programs are constantly modified to adjust to various constraints and to changing

circumstances. 100 In the context of the FDI issue in China, it seems that the experience suggests another approach to the policy-making process, which falls somewhere between the two conflicting views. Specifically, one may certainly separate the process of policy formulation from that of implementation. The former defines the goals to be reached, in this case, to attract foreign direct investment and advanced technology for China's modernization program. The formulation of the policy was completed in July 1979 when the joint venture statute was promulgated. The process of policy implementation is, however, too closely intertwined with the reformulation process to be separated from it. What one sees is constant interactions between the two, with policy implementation always being the basis for policy reformulation.

5. THE CONSTRAINTS OF THE EXPERIMENTALIST APPROACH

As Lucian Pye points out in his comment on Chinese pragmatism in the 1980s, there is a distinctive feature in the relationship between thought and action in Chinese political culture, namely, "a tendency for reflective thought often to come after compulsive acts." Frequently the emphasis is on getting ahead with the job, with only

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100 See Daniel A. Mazmanian and Paul A. Sabatier, implementation and Public Policy (Chicago, Illinois: Scott, Foresman and Company, 1983).

routine but unspecific cautions about not making mistakes. Thought and reflection come only afterward. The impression is one of "plunging in and then coping". 101

The fact of "plunging in and then coping" could become a major constraint if it happens to the experimentalist approach to policy implementation. Policy initiatives triggered with little preparation may lead to prolonged periods of reform and revision, which may bring damage to the program itself and may seem to others concerned a sign of instable policy commitments.

Another important standard in judging the experimentalist approach to policy implementation is whether or not the policy-maker is actually engaging in experimentation. One can seriously challenge the fact that thrusting first in one direction and then in another constitutes experimentation. What happened in China during the Mao Zedong era provide ample evidence indicating that many policy reversals then were less signs of experimenting than merely desperate responses to policy failure. In retrospect, it is hard to say what, if anything, was learned at the time. Thus one should always call for more systematic learning through action if he intends to engage in policy experimentation in its true sense.

A third potential problem associated with the

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101 See Lucian Pye, "On Chinese Pragmatism in the 1980s", The China Quarterly, Spring, 1986.

experimentalist approach to policy implementation is the fact that when overzealous lower level authorities are engaging in not only testing new policies ordained from the top but also initiating their own policies as a part of overall experimentation, it will be difficult for the policy-maker to present a unified implementation program. In the case of utilizing foreign investment in China, foreign investors frequently complain about the lack of a unified standard against which they can do business with China. One reason is that different areas are often competing with each other for more foreign investment by promoting more of their own "innovative" measures. Caught in the mist of all those competitions, foreign businessmen often find it frustrated to invest in China . How to balance the initiatives by lower level authorities with the overall implementation program in the process of "centralist policy experimentation" remains to be addressed.

The last but not the least constraint related to the experimentalist approach to policy implementation is the fact that a pilot project often receives more infusions of state resources than any of its subsequent emulators can hope to get. (The Shenzhen SEZ is such a model.) However, the program designed for emulators is based on the experience of the pilot project. It may well be the case that the emulators are expected to perform exactly like the

pilot project did even though they are entitled to different resources. Therefore, one should always be aware of this difference when replicating a pilot project.

6. A WORD OF CAUTION

Although it has been ten years since China first decided to utilize foreign investment for its modernization, the program to implement the policy is still in the process of being developed. Hence whether the program can ultimately serve as a sound case in support of the argument of the adaptive implementation school of thought remains to be seen. On the other hand, data from Chinese sources regarding the implementation of the FDI policy are often fragmentary (if they were ever made public), and are sometimes contradictory. The lack of complete and consistent information on the subject has rendered this study difficult. Hopefully it will serve as a first step in presenting a concrete case whereby the subject of the experimentalist approach toward policy implementation can be explored.

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Ming Pao

Nanfang Ribao (Southern Daily)

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Renmin Ribao (People's Daily)

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APPENDIX

MAJOR LAWS AND REGULATIONS CONCERNING FOREIGN INVESTMENT

The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment. Adopted on July 1, 1979 at the Second Session of the Fifth National People's Congress and promulgated on and effective from July 8, 1979.

Regulations of the People's Republic of China on the Registration of Joint Ventures Using Chinese and Foreign Investment. Promulgated by the State Council on July 26, 1980. Took effect on date of promulgation.

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Provisional Regulations Concerning the Use of Land for Construction by Joint Ventures Using Chinese and Foreign Investment. Promulgated by the State Council on July 26, 1980 and effective from date of promulgation.

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Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Co-operation with Foreign Enterprises. Promulgated on and effective from January 30, 1982.

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