Negative Aspects of Special Economic Zones in China

The general impression that China's special economic zones are a remarkable success is an incomplete one. Left out of the picture are inequities in development, arable land loss, real estate speculation and labour violence.

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Almost every aspect of the Indian debate on special economic zones (SEZs) is informed by a shared impression of the Chinese SEZ "success". As a member of Parliament argued during the debate on the passage of the Special Economic Zones Act, 2005, "China is a shining example of a country which has developed through its special economic zones. Various facilities given have attracted foreign direct investment and they have gone a greater extent in developing their economy".[1] Meanwhile, critics in India frequently use the Chinese policy as a benchmark for comparison. Key differences with India's policy often cited include the number of SEZs in China – ostensibly only six in total – the large size of Chinese zones and the fact that the government retains ownership over the land.

But this image of Chinese SEZs is both incomplete and, in many respects, simply incorrect. China has far more than six zones, they have by no means been an unqualified success, and they have brought about severe economic and social problems. This article discusses a few of the rarely noted points about Chinese SEZs, particularly in the 1980s and 1990s. It is not a comprehensive review of the Chinese zones, rather, the aim is to bring out some points that have not featured in the debate so far, as a more holistic view of Chinese SEZs is vital if we are to accurately gauge the Indian SEZ policy.

Economic Indicators

Even from the narrow perspective of economic indicators, Chinese zones have not had uniformly positive results. In their initial years, when the focus was on earning foreign exchange and encouraging regional development (in the traditionally backward southern coastal area), the use of zones was meant to insulate the rest of the economy from the disruptive effects of capitalism. Yet even at this early period, problems dogged the zones with the flood of durable goods entering through them (both legally and illegally) and threatening local industry, causing foreign exchange shortages and risking a rise in inflation [Reardon 1996]. In December 1981, the Communist Party imposed a moratorium on zones and banned imports of 17 durable goods to stop these trends [ibid]. There were also demands that the zones should be abolished.

It was after 1982 and the shift towards "market socialism" policies that the zones began to be viewed in a more positive light, as they assumed the role of "vanguards for market socialism" and were widely publicised as models for the Chinese economy. Yet, the successes that followed had several caveats. First, as the rest of China began to liberalise, the attractiveness of the SEZs diminished [Wong 1987; Reardon 1996]. Investment trends proved very sensitive to regulatory changes and liberalisation elsewhere; in 1986, realised investment was lower by 86.5 per cent than in 1985 [ibid]. Investment patterns also varied across the SEZs, with only Shenzhen really being a success [*Business China* 2006] – while through the 1980s Shantou hardly drew any investment [Wong 1987]. Second, the investment in SEZs was driven by capital from Hong Kong, Macao and to some extent Taiwan; 88 per cent of the new ventures in the SEZs in the early 1980s were by investors from Hong Kong and Macao [ibid]. By 1995, 96 per cent of Shenzhen's textile industry and 95 per cent of its garments industry were owned by Hong Kong investors [Lau 2001]. No such sources of convenient foreign capital exist for India. High levels of imports, both for production and for consumer durables [ibid], also affected foreign exchange earnings; the net exports of SEZs were barely 16 per cent of their gross exports in 1990, approximately half of the already low figures for most Asian export processing zones [Amirahmadi and Wu 1995].

Meanwhile, SEZs also had a wider set of socio-political impacts, two of which are very relevant to the Indian situation.

Speculation and Land Loss

Perhaps the biggest concern about India's SEZs is the potential for real estate speculation and loss of agricultural land. The Chinese experience on this is both instructive and frightening. Though land in China is state property, by the late 1980s efforts were on to create the legal foundations for trade in use rights and leases, especially in SEZs [Huang and Yang 1996]. Under China's 1987 Land Administration Law, use rights were created and provincial governments, municipalities and SEZs were also empowered to create their own land regulations [Cartier 2001]. As a result, by 1991 administrative allocation of land gradually gave way to property markets, with SEZs leading the way [Huang and Yang 1996].

These markets are, in some respects, uncannily similar to those in India. In China, urban land belongs to the state and rural lands to the village commune, though families had been given individual contracts to their lands as part of the village commune reforms in the 1980s [Weil 1996]. Only urban land use rights could be transferred to private parties; rural land use contracts could be transferred only to the state, which then could change it to urban land and sell development rights on it. As the Chinese state swung in favour of big business, this system made farmers' tenure insecure, especially in areas near expanding municipalities and within SEZs. Despite periodic revisions to the compensation standard, compensation for land acquisition was generally lower than the already low "market" value of these lands. Large-scale informal negotiations for land and administrative intervention also distorted the "market" [Cartier 2001].

The similarities with India's land market are strikingly apparent. In China, this produced a speculative market in land rights with requisition by the state followed by rapid transfer through speculators. This "stir frying" had major consequences: between January 1992 and July 1993, rights over 1,27,000 hectares of land were granted to real estate developers across China but only 46.5 per cent of this land was actually developed [Huang and Yang 1996]. This large-scale transfer of land to developers was partly driven by "zone fever", namely, the rapid multiplication of zones as a result of continual promotion of SEZs as models. The national government itself followed the initial SEZs with new technological zones, eventually reaching 54 such zones in 2006, as well as a new SEZ in Hainan in 1988 [Deheng 2006]. Meanwhile, provincial and local governments declared their own special zones, providing incentives and land to industries and real estate speculators. This trend rose so fast in the early 1990s that there were no accurate figures on how many "development zones" actually existed. 1993 estimates ranged from 6,000 to 8,700 such zones, and by 1992 their total area was estimated to be 15,000 square kilometres – more than the built-up area of the existing cities [Cartier 2001]. Many of these zones were established contrary to national or provincial regulations, and by 1994 the national government had cancelled over 1,000 such zones [Huang and Yang 1996].

"Zone fever" along with other real estate speculation led to a severe threat to arable land in the country. Between 1986 and 1995, approximately five million hectares of arable land were transferred to infrastructure and real estate development [Cartier 2001]. Between 1990 and 1997, the Fujian province (site of the Xiamen SEZ), alone saw more than 3,50,000 hectares of arable land transferred to industry [ibid]. Meanwhile, the threat of requisition in areas near SEZs or cities led farmers to reduce their investment in the land.

This trend continued within the existing zones as well. As early as 1986, the Chinese government restricted construction of hotels, restaurants and commercial buildings as it was hampering export production [Wong 1987]. The Hainan SEZ is a particularly striking example. In 1992, *The Economist* reported that Hainan was the "world's biggest speculative bubble"; Hainan had "few industrial firms and little industrial output". "Everyone in Hainan has money to burn... Nobody any longer keeps track of the number of 30- and 40-storey office buildings being put up", declared the magazine, stating that "This is not happening because anybody actually wants to use the space. Whole floors, indeed most floors, of the office buildings are empty, and practically none of the new flats and villas are lived in. What is going on? Speculation, almost pure and simple, and tax evasion." 1993 figures show that almost half of the available housing in Hainan was unoccupied, even as construction that would double the available housing units was underway [ibid]. In June 1998, the Hainan Development Bank, the main banker to the provincial government, closed down under bankruptcy [Cartier 2001]. It was followed soon after by the Guangdong International Trust and Investment Corporation of Guangdong province, where Shenzhen is located; this was the largest bankruptcy since reforms began [ibid].

By 1997, the central government was so alarmed by these trends that it imposed a blanket moratorium on land use conversion, and in 1998, it passed a new law for agricultural land conservation [ibid]. As Cartier (2001) puts it, "The SEZ concept promoted land development without directly addressing impacts on cultivable land and the natural resource base". The lessons from this experience are sobering for India, where "zone fever" has already begun.

Labour Abuse

In addition to real estate speculation, zones also produced other problems. Ironically for an avowedly communist regime, abuse of labour is rampant in Chinese SEZs [ICFTU 2003]. Seven million people out of Shenzhen's total population of 12 million are migrant workers, with almost no legal or social protection [French 2006]. 1992 data for the Guangdong province, home of Shenzhen, shows very high death rates among industrial workers and more than 5,00,000 child labourers – a phenomenon which had been greatly reduced in post-revolutionary China [Weil 1996]. In 2003, at least half the firms in Shenzhen owed their employees wage arrears [ICFTU 2003], and at least one-third of Chinese zone workers received less than minimum wage [Jayanthakumaran 2003]. The labour turnover rate is more than 10 per cent [French 2006]. Indeed, Shenzhen workers are so desperate that despite the lack of any independent unions, more than 10,000 wildcat strikes took place in 2006 alone [ibid].

This labour abuse is accompanied, unsurprisingly, by crime. Shenzhen now has a crime rate that is nine times higher than that of Shanghai, and is notorious for the trafficking of women and sex trade [Goswami 1997]. Relaxed customs have also led to large-scale smuggling; two of the original zones, Shantou and Xiamen, were hit by massive tax and smuggling frauds in 2000 and 1999 respectively [*Business China* 2006].

Conclusion

These trends led to widespread concern. In 1994, a prominent Chinese academic called for the abolition of SEZs [cited in Reardon 1996]. In 1996, Li Peng announced that, within five years, foreign and domestic investors would no longer be able to import materials duty free nor enjoy such unusually low tax rates [Reardon

1996]. This announcement was understood by Reardon (1996) as "taking the 'special' out of special economic zones".

Thus, Chinese SEZs were criticised by significant sections of the Chinese leadership themselves. The zones dazzle with foreign investment and technological booms; they also have a dark side that is rarely acknowledged. Moreover, these events are occurring in a society that had made great strides in providing security of health, shelter and livelihood to its population. Child labour, distress migration and begging, all common features in SEZs and coastal provinces, were phenomena that had almost vanished after the revolution [Weil 1996]. What is happening in SEZs can be seen as progress, therefore, only insofar as aggregate investment is concerned; socially it is nothing but regression.[2]

All the elements of the Chinese policy that produced these consequences are present in India's policy as well. India's land market, segmented between agricultural and non-agricultural land produces ample opportunities for speculation, a possibility greatly exacerbated – but, contrary to popular notion, not produced-by state acquisition. The frantic pace of SEZ approvals demonstrates the eagerness of governments to condone land use changes, which are the real levers of speculation.

Most of all, in China the truly damaging development was the shift in zone and policy institutions, already authoritarian under one party rule, into powerful instruments of speculative finance capital and big industry. This was exacerbated by official praise of the SEZs as models. It was this combination that faciliated widespread real estate speculation, while ensuring that the repression of workers and peasants greatly increased. In this context, we should not be comforted by platitudes about India being a democracy and not a dictatorship. SEZs here are being planned along the same model of centralised rule, with no checks and balances on government institutions in any SEZ – the development commissioner will have power over everything from infrastructure through land through workers' rights, and this commissioner's mandate is the "development" of the zone through inviting investment capital. Moreover, at the policy level the Indian model goes one step further than China; it provides "zones on demand", where not only the zone institutions but the zone itself is created at the behest of investment capital, subject only to a centralised and utterly non-accountable and non-democratic Board of Approvals. This is very dangerous.

As such, the Chinese experience should be read not only as a model but also as a salutary warning. As Zhao Xiao, a former adviser to the Chinese State Council, said about SEZs in 2006: "This path is now a dead end... Governments can't count on the beauty of investment covering up 100 other kinds of ugliness" [French 2006]. EPW

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Notes

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1 Statement by M Ramadass, Member of Parliament, Pondicherry in the Lok Sabha on May 10, 2005.

2 A far more extensive argument on the social and political impacts of market socialism, of which SEZs are the best example, is presented in Weil (1996).

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