

# Development of the Shenzhen Special Economic Zone

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## INTRODUCTION

As the 1970s drew to an end, China was experiencing a great transformation from its traditional planned economy to a socialist market economy. It was decided that such a great change could not be allowed to spread over the entire nation all at once, and thus it was determined that a precedent must be initiated and tested. Following Comrade Deng Xiaoping's proposal, and the legislation of the National People's Congress, China created six special economic zones, where practices were adopted similar to those in "free trade zones" and "export processing zones" in foreign countries. Such practices are embodied in special policies, flexible measures and special systems of economic management. They have played an important role in the nation's reform, its opening up and its modernization.

When first established, Shenzhen was the nation's largest special economic zone. The major role assigned by the central government to Shenzhen was that it become the nation's "window" to the outside world, its "area of experimentation" in the process of reform and development of the economic system, and a demonstration to the rest of the country. At the same time, Shenzhen should contribute to the return of a stable and prosperous Hong Kong to the motherland, thus promoting reunification with Taiwan.

## SHENZHEN'S DEVELOPMENT AND PROGRESS

Old Shenzhen was a small backward township near the border with urban Hong Kong. It was only 3 m<sup>2</sup> in area and had a population of less than 30,000. Life was hard and the standard of living was low. A large number of people migrated to Hong Kong, leaving large areas of farmlands unattended. But the special economic zone had the following achievements. In the past 15 years, the major economic indicators have grown at a rate of

30 to 50% per year and the economy has doubled in the last two to three years. The capacity for industrial production has increased to 100 billion yuan. In 1995, import and export trade reached 38.8 billion U.S. dollars, leading all cities in the nation. A modern city has now been built and total investment on infrastructure has amounted to 100 billion yuan. The living standard has been substantially improved and wages in 1994 were 12.7 times higher than in 1979. Shenzhen has clearly contributed to the nation's development—both financially and as a catalyst.

Shenzhen is one step ahead of the rest of the country and its successful experience has spread, thus fulfilling its role as an experiment. Shenzhen has also contributed greatly to the state financial sector. Up to 1994, city revenue directly turned over to the national treasury reached 4.5 billion yuan. Further, Shenzhen has become the base as well as the "window" to the interior for financing, international trade, technology transfer and upgrading of personnel. More important, Shenzhen has demonstrated to the world the success of China's policy of reform and opening.

### THE REASONS FOR SHENZHEN'S SUCCESS

In addition to its advantageous geographical position, Shenzhen was successful primarily because of its special preferential reform policies. The economy of Shenzhen is a composite system with multiple co-existing economic elements. The economy is financed primarily by foreign money, and goods are produced mainly for export. To both encourage and absorb foreign investment in Shenzhen, the central government adopted the following special policies.

**a. Taxation.** Taxes are low with several preferential reduction and exemptions. The income tax for enterprises in the special economic zone is only 15%. Enterprises specializing in harbors and docks and operating longer than 15 years are exempt from income tax for the first 5 years from the time it begins to make a profit. Further, income tax is halved for the next 5 years. If the period of operation is longer than 10 years, the enterprises are exempted from income tax for the first 2 years starting from when the enterprise begins to make a profit. From the third to the fifth year, income tax is halved. After the period of income tax reduction and exemption expires, the rate is 10%. For those enterprises whose export value is 70% or more of total product value, there is a tax exemption on remitted profits. Export of products produced in the special zone and imports used in production are exempted from custom duties.

**b. Land Use.** Land is provided for foreign investors for long periods at low fees.

**c. Foreign Exchange.** The foreign exchange from exports and the operational income of enterprises can be retained by the firms. The Bank of China and some foreign banks authorized by the Chinese government can process foreign exchange transactions. After income tax and salaries, legal profit can be remitted overseas. In addition, foreign businesses can obtain foreign exchange at the Shenzhen Center for Foreign Exchange Adjustment.

**d. Marketing of Products.** Foreign businesses can arrange their own means of export or they can entrust agents to export their goods in accordance with government regulations. Joint ventures are allowed to sell a certain portion of their products in the domestic market. If the products are manufactured from domestic raw materials, or advanced technology is provided by foreign investors, the portion of sales in the domestic market can be increased, and, in some cases, almost all products can be primarily sold in China.

**e. Entry and Exit.** The port provides "special passage" for the convenience of passengers to and from Hong Kong and Macau. Cars with Hong Kong license plates have easy access to the special zone. All foreigners who either have investment or residential housing in Shenzhen can apply for multiple entry visas.

**f. Economic Autonomy.** In order to increase efficiency, all investments below 100 million yuan (for light industry, below 30 million and for heavy industry, below 50 million) can be approved by the Shenzhen Special Economic Zone. The Special Zone is also authorized to approve applications by Chinese citizens for travel abroad. Since October 1989, Shenzhen City has been listed separately in the national plan, and its economic authority has been elevated to the provincial level. In July 1992, Shenzhen was given the authority to enact legislation.

**g. The System of Financial Responsibility.** In the early years, the zone was responsible for its own revenue and expenditures. This encouraged an increase in income and a decrease in spending. Since 1990, a certain small proportion of revenue has been given to the central government. Credit and bank loans were made possible by linking loans with deposits. Thus larger deposits meant more loans. This did not change until recently. Currently, deposits in Shenzhen are larger than loans.

**h. Integrated Development of Coast and Hinterland.** The achievements in Shenzhen would have been impossible without the support of the central government, and the hinterland. The hinterland not only provides a gigantic market, but also supplies a large source of labor. Investment in Shenzhen from China exceeds 10 billion. There are some 6,628 enterprises comprising the backbone of Shenzhen's economy, contributing one quarter of Shenzhen's output value, tax and export revenue. Shenzhen has

continued to draw investment in its hinterland and strengthen its overall economy. And it has itself invested over 13 billion yuan and started 1,390 enterprises in other parts of the country. Shenzhen has also provided low interest loans and advice to the poorer areas of the country.

## **REFORM AND THE SOCIALIST MARKET ECONOMY**

Reform has helped modify the parts of China's old system which are no longer suited for economic development. Since the special economic zones were initiated, Shenzhen has carried out many reforms to meet its needs. In 1984, the Shenzhen special economic zone began to reform its pricing and market systems. Prices were open to competition and all coupons and ration cards were eliminated. The price of most commercial goods is based on their value and demand-supply regulations. Only a few commercial goods have fixed prices. A prosperous commercial market is gradually forming. With further development of reforms, Shenzhen will have a relatively complete market system including retail, real estate, futures, and wholesale markets, means of production, finance, stock and securities, labor, technology, information, auctions and medium and long term contracts.

The role of government has been changed, and macroeconomic management and the coordination and control system has been improved. The role of government has gradually shifted from direct to indirect, and from microeconomic to macroeconomic management. The state-owned property management system is being developed and a state-owned property management model has been formed. The registration of enterprises has been transformed from an examination-permission system to a standard-based system. The essential elements of production are mainly dependent on market allocation.

The old employment system was changed from a combination of regular workers, contract, and temporary workers to a labor market consisting mainly of contractors. The social security system has been reformed and a retirement program with medical insurance and housing has been developed combining social welfare and self protection. Injury insurance and unemployment insurance have been promoted. Finally, the Shenzhen special economic zone was given legislative power. Before this, the state legislative organization and authorized branches had promulgated 22 statutes. Since Shenzhen was given legislative power, it has promulgated over 60 laws concerning the market and its operations, city management, and social welfare, and it has developed some 100 administrative regulations. These reforms have changed the bureaucratic command

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management style to a service-oriented, coordinated indirect management system. As a result, it enables enterprises to be free and creative.

In 1995 the economic development of Shenzhen continued to show good progress. In June 1994, Chairman Jiang Zemin, on behalf of the central government, reiterated that the central government has not changed its determination to develop special economic zones; it has not changed its basic policies toward special economic zones; and it has not changed the historic status and functions of special economic zones in its national reform and modernization. The pioneers of Shenzhen are determined to turn Shenzhen into a modern cosmopolitan city.