

The Dynamic Evolution of China's Special Economic Zones and Their Practice

Yuan Yiming

Abstract The establishment of special economic zones is a crucial strategic choice for China's development, and developing special economic zones first in order to stimulate the economic take-off of the whole country is China's way towards modernization, which is exerting a profound and far-reaching impact all around the world. In practice, China's special economic zones have dynamically evolved in terms of time dimension, in 35 years, by shifting a focus from institutional experiment to regional development to developmental issues, and changing the desired function from "overall" to "strategically regional" to "specifically local", with its essential connotation characterized by institutional experiment—comprehensive practice—path exploration; however, in general, the historical procedure of China's special economic zones centers on a target system, a developmental path and an institutional change mode for finding answers.

Keywords Special economic zones • Dynamic evolution • Choice of path

Special economic zones represent the choice of a path for avoiding risks on the route towards China's institutional reform, and they are basically designed to become the optimal combination of risks and institutional change, thus China's special economic zones are certainly of an institutional experimental nature during transformation from the planning system to a market economic system and are defined as experimental zones for reform.

In terms of the routine process, the dynamic evolution of China's special economic zones in 35 years resulted from a correct and incisive assessment of the situation by policymakers of the State. A systematic analysis shows that there is a dynamically deepening endogenous mechanism—a supply and demand mechanism for the institutional arrangement of special economic zones. Serious failure of the planning system occurred 35 years ago, leading to a severe lack of an efficient

Y. Yiming (✉)

China Center for Special Economic Zone Research, Shenzhen University, Shenzhen, China

economic system in China. Subsequently, special zones, including Shenzhen and Zhuhai, came into being. In the 1990s, spatial growth poles were increasingly important and severely inadequate; as a result, Shanghai and Tianjin became the important choices as the second-generation special zones. Developmental contradictions cropped up and specific regions were underdeveloped in the new period, thus the third-generation special economic zones emerged. Policymakers were wise to address the internal institutional needs in China's economic development, and they were courageous to remove ideological and thought dissensions, making such an endogenous mechanism a reality. In my opinion, the establishment and operation of such an endogenous mechanism is the important contents of China's path and also the primary cause for the difference between China's special economic zones and general special economic zones around the world.

1 The Dynamic Evolution of the Special Zones: From Institution-Focused Special Zones to Path-Focused Special Zones

The special economic zone phenomenon of great significance was formed on China's distinctive economic take-off and developmental path built in more than 30 years. Special economic zones established and developed during China's modernization are essentially different from the existing special economic zones around the world, while this difference originates from the differences in the starting point for establishing special zones (China's starting point is the planning system), basic motive for their establishment (the fundamental purpose for their establishment in China is to explore the economic system and developmental path) and connotation (though the construction of China's special economic zones focuses on the economic field, it also covers the administrative system, cultural reform, social construction, etc.).

The above differences determine the fact that the development of China's special economic zones features first, implementation in terms of time and experiment with regard to function (the experimental zone of the economic system), thus China's special economic zones have the nature of an institutional experiment and there is the Chinese-style development of the special economic zones compared with international special zones with a single function (introduction of foreign capital or export processing).

China's special economic zones are made up of special economic zones, new development and opening-up zones, free trade zones, etc. in different periods. In view of the logical basis for establishment, function and connotation, three generations of special economic zones arose and rapidly evolved in China in more than 30 years.

The first-generation special economic zones, represented by Shenzhen: four special economic zones concurrently established in the 1980s—Shenzhen, Zhuhai,

Shantou and Xiamen—share a common spatial feature—almost each special economic zone engaged in specific, well-targeted cooperation: Shenzhen is adjacent to Hong Kong, and Zhuhai is close to Macau, while Xiamen is opposite Taiwan, only Shantou has a broad and vague geographic space for cooperation since its cooperation involves overseas regions where there are a great number of immigrants from the Chaozhou-Shantou region.

It is evident that the first-generation special economic zones are based on strictly consistent logic for selection due to geographical location, while precise selection of the geographical location ensures the smooth development of the first-generation special economic zones and creates the key conditions for historical miracles, which reflects the wisdom of the policymakers involved in establishing the special zones.

Consistency in thinking about the selection of space for establishing special economic zones is an important feature of the first-generation special economic zones rather than a substantive characteristic. After the chief architect of the reform and opening up, like-minded policymakers fully realized the problems and contradictions in Chinese society, and they especially clearly understood the root cause for these problems and contradictions, reforming the old system and establishing a new economic system became a strategic choice for China's development, while how to make institutional change—what path towards institutional change should be taken—was the next critical technical issue concerning reform. Calm policymakers followed Chinese culture by choosing the reform path: experiment—popularization—innovation, which was a sound path well known as “progressive reform”. The first-generation special economic zones were specific strategic arrangements made on this kind of path. “Handling special cases with special methods, dealing with new matters in new ways, keeping the stance unchanged, adopting new methods” for special zones was the requirement specified by Chinese top leaders and the overall line of thought for developing special zones [1], among which “special” and “new” gave a vivid expression to institutional experimentation. Obviously, the primary task and mission for the first-generation special economic zones were institutional experiment, system and mechanism exploration rather than the development of their local areas. Shenzhen, Zhuhai, Shantou and Xiamen became four samples for such an extensive institutional experiment in China.

Another important feature of the first-generation special economic zones is “overall”. This “overall”—“spatially overall” means that the establishment and development of the first-generation special economic zones served the building up of the economic system for the whole of China. In addition, their experiment was comprehensive and complicated but did not merely involve a single field. Special zones were identified by China's special zones in nature and were established by the Central Committee not by a province.¹ Apparently, being the first determines the overall nature of the first-generation special economic zones.

¹Gu Mu said, “The establishment of special economic zones is a great event advocated by Comrade Deng Xiaoping, decided by the Central Committee, legalized by the Standing Committee of the National People's Congress and carried out by the State Council”, see Ref. [1].

The second-generation special economic zones, represented by the Pudong New Area for development and opening-up, include the Binhai New Area of Tianjin for development and opening-up. Both areas have similar characteristics. They are significantly different from the first-generation special economic zones in the logical basis for their establishment, their basic functions and the space selection strategy.

The second-generation special zones, established in the 1990s, developed against a background that was different from that for the first-generation special zones. The biggest difference was that a consensus was reached on making a choice between the planning system and the market system and there was no dispute regarding this; more importantly, with institutional experimental exploration for more than ten years, the first-generation special zones started exporting their experience and acting as suppliers on the market system. Though the basic framework of the economic system had just developed, it was still extremely necessary for carrying out the exploration of the market system, but institutional experimentation was obviously not the primary mission for the second-generation special zones, at least not the only mission. Regional development was crucial in the functions and tasks of the second-generation special zones. The second-generation special zones were essentially designed to develop and cultivate key national strategic growth poles to produce a diffusion effect for boosting regional development so as to form new spatial developmental structures. Clearly, the establishment of national strategic growing areas was the fundamental basis for establishing the second-generation special zones. The logic for the selection of geographical locations is the same for both the Pudong New Area of Shanghai and the Binhai New Area of Tianjin. The same establishment of logic and the same basis for the selection of geographical locations enable evolution from institutional function to developmental function between the second-generation and the first-generation special economic zones.

The third-generation special economic zones, represented by Kashgar and established after 2000, include Kashgar and Zhoushan special economic zones, the early-established Wuhan, Changsha-Zhuzhou-Xiangtan pilot zones for the construction of a resource-saving and environmentally friendly society and the Chengdu-Chongqing Pilot Zone for Integrated Urban-Rural Development. Compared with the first and second-generation special economic zones, the third-generation special economic zones became diverse in the selection of their geographical locations and were no longer established on the same basis of selection. The characteristics of the geographical locations are greatly different between the westernmost Kashgar Special Zone and the eastern Zhoushan Special Zone, and among Wuhan, Chengdu-Chongqing, Changsha-Zhuzhou-Xiangtan pilot zones. Unlike the first-generation special zones, such as Shenzhen, the third-generation special zones evidently no longer aim at specific cooperation objects. All of the third-generation special economic zones were established in an issue-oriented way; for example, the Chengdu-Chongqing Pilot Zone focuses on coordinated urban-rural development; the Wuhan and the Changsha-Zhuzhou-Xiangtan pilot zones mainly involve coordinated resource and environmental development, while the Xinjiang

Kashgar Special Economic Zone centers on coordinated economic, social, cultural and political development.

The establishment and development of the third-generation special economic zones targets specific issues, while the basic task is to find solutions for specific issues such as those concerning resources and environment, rural areas, agriculture, farmers, including the overall path for addressing specific issues and regional, local solutions for specific issues.

Apparently, “well-targeted” and “specific” are the common characteristics of the third-generation special economic zones. The Kashgar Special Economic Zone is the typical example with both common characteristics. Special institutional arrangements are made to promote the economic take-off and development of Kashgar, an area with a special culture and a special geographic location, so as to boost the economic development of the whole Xinjiang area and maintain long-term peace and order.

As analyzed above, though special economic zones have existed for only 35 years in China, a developmental evolutionary process obviously marked by stages has appeared, which is a process in which the selection of spatial regions has shifted its focus from institutional experimentation to regional development to developmental issues, and the desired function has been changed from “overall” to “strategically regional” to “specifically local”, with its essential connotation characterized by institutional experimentation—comprehensive practice—path exploration. China's special economic zones have dynamically evolved. Though the first-generation special economic zones, including Shenzhen and Zhuhai established 35 years ago, remain available and still exhibit the special features of the first-generation special economic zones in many fields, in other words, institutionally and in several practices, they are still designated to take up the mission of serving as the vanguard of reform, the third-generation emerging special economic zones have advanced with times to make changes not seen in their predecessors. If the dynamic evolution of the special zones is not recognized and characteristics of the times in emerging special zones are ignored, it is very likely that the strategies for developing special zones will be improper.

2 Special Economic Zones have Found Answers for Target System, Developmental Path and the Mode for Institutional Change

In the past 35 years, with institutional change experimentation as the main mission, three major issues concerning China's development were mainly stressed to push ahead with practice, make explorations and find answers in the special economic zones represented by Shenzhen.

First, explore how to establish and improve the socialist market economy target system.

The task for institutional change lies in promoting institutional evolution to achieve a new institutional balance and generate a new driving force for development between the old unequal system and the new balanced system, so as to boost social and economic development. The exchange of old and new systems in the first-generation special economic zones including Shenzhen was made possible through a series of actions, such as transfer of land based on negotiated prices, which made a breakthrough in state-owned land use and management system, the establishment of such new systems as delegation and surrender of powers, introduction of foreign capital, price reforms, the reform of the labor employment system... The reform of the economic system focused on two factors, capital and labor. Changes in the status and identity of labor in enterprise organization and the “right of freedom” brought about by these changes were the key effects of institutional reform. Merely a change in Shenzhen’s land system can create miracles.

The following conclusions about the reforms in the special economic zones including Shenzhen can be drawn: first, new systems involving two factors, capital and labor, were established as substantive content from the perspective of the producer to break through the shackles imposed on capital and labor by the old system, and form specific subjects of rights including capital, land, labor and management, so as to create an incentive for factor owners, while such an incentive made it possible to change the urban economic system; second, the above reform of the system of pricing plus the establishment of a market trading system enabled the trading of factors and goods. After the institutional conditions beneficial for creating social wealth were developed, and the price reform and the trading system were put into place, the market economy could work. In my opinion, the establishment of the subject of factor property rights and a market trading system (including tangible place and intangible trading rules) constitute the basic framework for China’s market economy.

Second, explore how to realize the path for mode of transformation from growth to development.

Finding new driving forces for growth to smoothly stride over “China’s developmental trap” at the advent of accomplishing the mission for the growth of a labor-intensive economy is the new challenge for China. The path, built through effective practice in the special economic zones, for mode of transformation from growth to development has an important value for addressing the challenge of transformation nationwide, while such a value originates from the following connotation of transformation from economic growth to development:

1. Focus on social development. In order to encourage social development, first of all, it is necessary to provide an institutional guarantee of achieving the imbalance in social and economic development, which is an essential process of institutional change. The basic goal for China’s reform, whether in rural

institutional change in the early 1980s or the subsequent reform of the urban economic system, is to create efficiency and increase the level of wealth through efficiency; therefore, such a reform is “efficiency-driven” institutional change and systems are “endogenized” in the growth process of China's economy. In the reform of special economic zones in the new period, the first priority should be given to the process of social development which is an “equity-oriented” process of institutional change, while new systems are “endogenized” in the process of social development and become an important factor in social development.

2. Focus on the quality of economic growth. Its basic point is that institutional change is made in order to alter the method for the utilization of resources, to improve the efficiency of utilization, to transform the growth mode and undertake the path towards scientific development so as to coordinate the contradictions between an increasing shortage of resources and a soaring demand.
3. Focus on coordination. Such coordination is defined at two levels: developmental coordination among regions and coordination among different fields within regions. The essential connotation of the former is that economic factors are reorganized among regions to achieve developmental integration, which refers to “spillover” development, while the latter is dominated by social, economic, cultural and environmental developmental coordination.

Third, how to transform, in institutional change, from “imported” institutional innovation based on imitation and reference to experience to self-dependent institutional innovation.

In the previous reforms, institutional change was mainly the construction of a mechanism for the operation of a market economy, which was carried out mainly by drawing upon experience from others, introducing several market means, testing and applying those market means; therefore, the key contents of institutional change were selection and introduction of a system. At the present stage, it is difficult for countries with an advanced market economy or emerging developing economies to offer available institutional choices which can meet the national conditions and the needs of institutional reform. Obviously, it is hard to finish the tasks of institutional innovation merely by means of simple learning, introduction and imitation. Institutional innovation has entered a higher level—it is more necessary to develop a set of suitable systems on the basis of existing systems, thus self-independent innovations of the systems must be emphasized. Such “self-independence” stresses “creativity”. Of course, the self-independent creation of systems is by no means conducted from nothing. Reference can be made to effective international systems and mechanisms, and then systems can be reconstructed to form new systems which cater to specific needs. Inevitably, such institutional change is hard-won compared with “imported” institutional innovations.

3 The Special Economic Zones Will Still Take up Two Missions in the Future: Institutional Innovation and the First Implementation of a Developmental Path

The special economic zones underwent arduous experiments in 35 years to provide a great deal of theoretical and practical experience for national development and reform; however, subsequently, their own development was inevitably faced with two problems:

The effect of the economic growth of institutional transformation is decreasing. Like the factors which boost economic growth, such as labor and capital, systems are governed by the basic law of economics of diminishing marginal productivity. The special economic zones are the result of the institutional arrangements from a planned economic system to a new market system during China's development, and they are also the product of changing the economic system from a planned one to a market one. Initially, against the background of an extensive traditional planned system, the new market economic system can generate enough incentives for production factor owners, while these "sudden" incentives produced in a short time are in sharp contrast with the severe shortage of incentives under the planned system; as a result, the market system brings about a great contribution from marginal growth, which is commonly referred to as the institutional growth effect. However, with the gradual establishment and improvement of the market economic system in the special zones, such a "sudden" incentive effect gradually wanes and the institutional gap is also narrowed little by little, thus the attraction for investments, talents and trade declines in the process of economic growth.

Resource constraints on the special economic zones are rapidly increasing. Resources are the important factors which restrict economic development. With economic growth and an increasing population in the special zones, the scarcity of resources becomes more and more obvious, and the natural environment is also subject to increasing pressure, thus threatening the sustainable development of the economy, the population and the resources. Though scientific and technological progress can increase the rate of the utilization of the natural resources, and such factors as a gradually increasing awareness of environmental protection can enhance the population's capacity to endure, their extent is very limited. Moreover, a great number of migrant workers are flowing into the special zones, which results in lowering the overall quality of the population, as educational investments are insufficient, there is a shortage of talents, while the lack of human resources also largely affects the pace of economic build-up in the special zones and has become a bottleneck for future development. With respect to the development and the future of China's special economic zones, before the modernization of the economic system is fully finished all over China, China's special economic zones will still enjoy a sufficient basis for their existence and will still be of great practical significance; furthermore, the existence and development of China's special economic zones remains the rational path to follow towards China's modernization, and the

special economic zones are heavily tasked; in order to fulfill their missions, the special economic zones need the following preconditions.

The encouragement of effective institutional innovation. Not all of the efforts towards institutional innovation can give birth to effective systems; in other words, only institutional change with a positive effect is meaningful, while institutional innovation with a zero, or even a negative, effect is ineffective change; such a reform wastes social resources and makes the society sustain reform costs. It is not easy to initiate ineffective institutional reform under a mechanism of induced change since institutional changes are based on social needs and are well-targeted, while it is easy to incur ineffective reform in a government-led compulsory mechanism of institutional evolution due to political achievements or to a lack of knowledge and information available to the executors of the reforms. If an emphasis is placed on merely the act of "change" rather than the effect of "change", this will certainly substantially reduce the effect of institutional reform.

The provision of adequate reform incentives. After a contract system with remuneration linked to output was implemented, the growth of land output highly incentivized the farmers stricken by widespread poverty, which was the cause for rapidly popularizing rural economic reform and bearing fruit. Afterwards, the state-owned reform of the economy, characterized by delegation and surrender of powers, made operators and employees share reform interests, thus delivering considerable incentives for urban residents with low wages. Meanwhile, the introduction of foreign capital and the development of the private economy greatly increased the average profit of capital owners; consequentially, innumerable villagers migrated from rural areas to cities in order to share city civilization and obtain more-than-expected labor returns, thus the incentives from reform were sufficient. Today's reforms in the special economic zones require institutional reform interests and interest sharing mechanism greatly different from that in previous reforms. With respect to institutional innovations that promote social development and institutional designs that transform the economic growth mode, boost the coordination of social, economic and environmental development, narrow the social developmental gap, etc., their change process is of a public welfare nature. The process of institutional innovation is also fraught with risks. The reform process involves adjustment of the existing interest pattern, giving rise to high reform costs. When governments are the subjects of reform, local governments are system creators and executors for the creation of specific institutional contents within the framework of the reform developed by the Central Government; subject to the above reform interests and costs, as system innovators, local governments are vulnerable to insufficient incentives for reform acts. Therefore, continuous institutional practice and practice regarding the path in the special zones requires the Central Government to grant local governments with the right to innovate systems, and an evaluation mechanism for the effect of the reform, a mechanism for the removal of reform risks, a performance reward and a compensation mechanism for effective reform, etc., should be developed to incentivize local officials to carry out reforms. A continuous incentive mechanism is the prerequisite for pushing ahead with reforms according to the plan.

It is more important to explore repeatable institutional contents. In the Binhai New Area of Tianjin and the Pudong New Area of Shanghai, reforms were concretized into urban developmental strategies and measures long ago, such as reforms in financial enterprises, financial business, the financial market and financial deregulation, the investment system, the administrative management system, etc. in the Binhai New Area of Tianjin; reform priorities including the transformation of the economic operational mode and the corresponding concrete actions in the Pudong New Area, e.g. the establishment of the “National Pilot Intellectual Property Park”, taking the lead in developing pledge business of intellectual property rights, the establishment of the tribunal of conciliation and arbitration for intellectual property disputes, etc. With regard to the motive force for development, the special economic zones have transformed their motive force from policy innovations to institutional innovations.

All of the special economic zones, including today’s free trade zones, have been seeking to fulfill the historical mission of proving experience and of becoming models for national reform and development; thus their primary task involves general systems, mechanisms and developmental methods that are of a higher level, are more universal or adoptable and are based on their own development. Only in this way can the reform, first implementation and experimentation in the special economic zones be more valuable for national development.

The unique basic feature of the special economic zones is their advantage over the hinterland in carrying out a market economic system during development. The existence of special economic zones is based on the institutional difference between China’s traditional economic system and the market economic system and on the full recognition of the efficiency of wealth creation of the market economic system. The basic framework for China’s market economy was basically established nationwide over the past 35 years. However, China’s market economic system is still underdeveloped, thus the task for the special economic zones as “institutional experimental sites” has not yet been accomplished. For the future of China’s special economic zones, before the complete modernization of China’s economic system is fully finished, the special economic zones will still have a sufficient basis for their existence and will still be of great practical significance, and the existence and development of China’s special economic zones will still be the rational path to undertake in order to achieve the modernization of China. There is still a long way to go for the future development of China’s special economic zones amid new issues concerning national development.

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Studies on China's Special Economic Zones

Yuan, Y. (Ed.)

2017, IX, 157 p. 4 illus., 3 illus. in color., Hardcover

ISBN: 978-981-10-3703-0