

The function of special economic zones in the modernization process of China

Pudong as the last Dragon Head



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Preface

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Abstract

The China (Shanghai) Pilot Free Trade Zone (CSPFTZ) has been established on September 29th 2013 in Shanghai. Shanghai has been the center of many historical events. In the 19th century, Shanghai was opened up to the outside world and forced to outside trade relations due to the Nanking Treaty of 1842 after the First Opium War (1839-1842) and was selected as a new port: the 'Shanghai International Settlement'. The British, American and French settled in Shanghai and after 100 years Shanghai developed as the largest foreign trade port in China. Meanwhile, during the first Sino-Japanese War of 1895, China was mauled by a strong, Western influenced Japan. Attempts to reform China into a modern nation failed but after the 1911 Revolution, Shanghai emerged as a center of modern activities. The population doubled between 1895 and 1910 from 245,675 to 501,541 people as many Chinese were attracted by the city. During World War I (1914-1918) many people left while the diminished supply of Chinese export goods led to a higher demand of these export goods. Especially in the 1920s and 1930s, Shanghai grew as many silk filatures, cotton mills, and chemical works emerged. In the 1930s, Shanghai's Port served as the main shipping center in the Far East; the city was seen as a cosmopolitan city. However, in 1937 Japan bombed Shanghai and occupied parts of China again, which lasted until 1945. People lived under brutal circumstances under the occupation of Japan and the conditions to develop into a cosmopolitan city moved from Shanghai to Hong Kong. In 1949, the CCP, led by Mao Zedong, took power and focused on rural regions resulting in neglected cities; the nation controlled Shanghai and the city was forced to dispose of its cosmopolitan life. However, when Mao Zedong died in 1976, the balance of power changed: Hua Guofeng established the 'Open Door' policy in 1977 before Deng Xiaoping returned to power in 1978. The new policy led to the beginning of its modernization process and several Special Economic Zones (SEZs) were established mainly to attract foreign direct investment.

Since the opening up until 1997, China attracted billions of foreign investment (US dollars) and by the mid-1990s, the economy moved away from a command economy to a functioning market economy. After 1978, China's modernization process took off really quickly and created a gap between South China including its coastal regions and North-East China as the South and its coastal areas are developing much faster. Therefore, China can be divided into two different phases of modernization according to Rostow's Five-Stages of Growth (1960). The South and its coastal regions can be assigned to the final phase of modernization while the North-East part of China can be assigned to phase three.

The SEZs which have been established since 1978 are particular geographic regions in countries used to encourage export services, industry, and manufacturing. In China, initially four SEZs were established in Shenzhen, Zhuhai, Xiamen and Shantou to test the new policies and new institutions for the market-oriented economy in order to improve China's economy. The role SEZs, and especially Shenzhen, played in China's modernization process was quite apparent as average annual growth has been 9.4 percent since the 1980s: the SEZs boost China's economy and moved towards a more technology-intensive and higher-value economy. 34 years later, on 29th September 2013, a new SEZ was established in Pudong, Shanghai: the CSPFTZ. The CSPFTZ has been established to enhance China's economic position globally and to develop a new, replicable financial and administrative system which can be implemented in every region of the country. Nevertheless, the privileged status of 'special' is diminished since there are already many SEZs in China. However, as analysis shows, the zone operates differently from the majority of the SEZs which enables the CSPFTZ to offer enough advantages to attract foreign investors to be successful. The chances of success nonetheless depend on the government. The government encourages so many aspects and is experimenting with so many measures that the chance of success is questioned. But, if the government is able to achieve its aims, the CSPFTZ

can be successful and could contribute to China's South and coastal regions' modernization process as the leading sectors shift towards more durable consumer goods and services in Rostow's final phase.

Introduction

China has a long history, but trade and growth should be understood in the context of developments in the 19th century. In the 19th century, Shanghai was opened to the outside world and exposed to outside trade relations (Keller, Li & Shiue 2012: 1). Shanghai, with a population of 23,019,148 in 2010 (National Bureau of Statistics: 2011), was first established as a fishing village in the 10th century. Many merchant families from Ningbo, a city near Shanghai, were specialized in the sugar trade. As sojourners in Shanghai, they caused an overlap with native-place organization and the organization of trade, resulting in an ethnic division of labor (Goodman 1995: 30). Ningbo families became an integral part of the coastal trading system and Shanghai grew into a regional commercial center (Wu 1999: 207). However, in the early Tang Dynasty (618-907), Shanghai already tried to set up a governing administration on the former Southern bank of the Suzhou Creek to regulate trade across this Creek. In the Northern Song Dynasty (960-1227) the government started to establish trading and shipping agencies in this region to settle the shipping market. Later, fairway channels and the land area of the Yangtze River Delta were changed due to the large amount of mud and sand in the river water. By the end of the Southern Song Dynasty (1127-1276), the port was moved to Shanghai County and in the beginning of the Ming Dynasty (1368-1644), the Huangpu River offered excellent fairways which boosted the development of the Shanghai Port (Shanghai Municipal Transportation Commission: 2010).

Only in 1843, after the First Opium War¹ (1839-1842) resulted in the Nanking Treaty of 1842², Shanghai was opened to the outside world (Reece 1985: 72) and selected as a new port because of its geographical location at the Yangtze River with potential access to seafaring routes. Before the war, Shanghai's foreign trade as a whole had been quite limited. Shanghai's trading partners were mainly Korea and Japan. Western goods arriving in Shanghai had to come by way of Guangzhou which was the only port open to Western traders since 1760 (Keller, Li & Shiue 2012: 1, 5-6).

The political structure which was created in Shanghai in 1845 on the basis of the 1842 Nanking Treaty was called the Shanghai International Settlement (Reece 1985: 72). The first foreign settlement in Shanghai was established by the British five years later in 1847. The British promulgated the right to own land, build roads, buildings, factories, and housing (Keller, Li & Shiue 2012: 1, 5-6). The British were soon followed by the Americans and the French with distinct areas of settlement in the North and South. A Municipal Council, elected and supervised by foreign taxpayers, was created by representatives of China and these three countries to administer the self-governing municipality under the terms of the Land Regulations³: the Shanghai International Settlement was established (Lockwood 1934: 1032). Hundreds of banks, shipyards and firms were established in the Settlement (Keller, Li & Shiue 2012: 1, 5-6). The Settlement had certain characteristics: it had explicitly been set aside by the Chinese government in order for foreigners to live there, it was never a possession of one of the Western powers and no single country was ever able to claim sovereignty, all foreigners in the settlement belonging to a treaty with China enjoyed extraterritorial rights: in law cases they were treated by the laws of their own country. The Shanghai International Settlement lasted almost a hundred years, from 1845 to 1943, whereby the

¹ The Opium War in 1839-1842 between China and Britain was proclaimed by Britain after a Chinese Customs Commissioner destroyed British-smuggled opium as China tried to prevent opium trade (Cannon & Jenkins 1990: xxi).

² The 1842 Nanking Treaty put an end to the Opium War and was signed between China and Britain; Hong Kong was ceded to Britain and trading rights were granted to foreign nations (Cannon & Jenkins 1990: xxi).

³ Land Regulations inside the Shanghai International Settlement assigned certain functions and principles of self-governing to the consuls of Britain, France and America. The regulations were binding for everyone in the Settlement for better security and government (Lockwood 1934: 1032-1033).

foreign trade value ensured that Shanghai remained the largest foreign trade port in China (Haan 1982: 31-33; Shanghai Municipal Transportation Commission 2010).

The last Chinese dynasty, the Qing dynasty which governed between 1644 and 1911 (Ter Haar 2009: XIII), had been mauled in the first Sino-Japanese War of 1894-1895⁴ by an extremely strong Japan (Zarrow 2005: 3-4). China's defeat made clear it was much weaker than Japan that had adapted more easily to Western influences. After the Treaty of Shimonoseki in 1895⁵, China wanted to develop political and educational reforms to modernize the country and in 1901, politicians tried a new modernization attempt as previous reforms failed: a 'Ten Year Plan'. An increasing number of young students supported these calls for reform and formed the National Alliance in 1905. The National Alliance grew and claimed a membership of nearly 10.000 people in 1911 and especially targeted the 'New Armies': an army set up by the Qing Dynasty to retain the Dynasty. On 10 October 1911 a rebellion broke out. The New Armies were unwilling to support the Qing as the elites did not prefer the Qing above the revolutionaries: the 1911 Revolution was born. By the end of October, seven provinces seceded from the Qing Dynasty, one month later another seven and in 1912, Sun Yat Sen proclaimed himself to be the provisional president of the Republic of China. Many activities took place in Shanghai that should shape modern China (Zarrow 2005: 14, 27, 32-37).

Meanwhile, the Shanghai Municipal International Settlement controlled all non-private tramways and the presence of foreigners in Shanghai, British, American, French and later Japanese turned Shanghai into a legend (Abbas 2000: 774-776). Different concessions with their own sets of extraterritorial laws ruled the city creating a decentralized system controlled by many different hands. The population doubled in the fifteen years between 1895 and 1910 from 245,675 to 501,541 people (Martin 1996: 28), as many Chinese were attracted by the city. However, during World War I (1914-1918), Western people left and the diminished supply of Chinese export goods led to a higher demand of these Chinese goods. The rich grew richer and started to invest in light industries, resulting in a changing industrial landscape (Dong 2000: 75, 94). Especially in the 1920s and 1930s, Shanghai was subject to multiple perspectives from different nationalities. The city negotiated at every initiative and it developed its own special 'brand': a cosmopolitan city of extraterritoriality (Abbas 2000: 774-776) which again attracted many (im)migrants to the Chinese Municipality. Shanghai grew as many silk filatures, cotton mills, and chemical works emerged. Modern banks were founded by native investors on the Bund, young people started to enjoy entertainment such as Ping-Pong and various goods from around the world were imported. Unfortunately, the migrants formed a workforce of 300,000 poor people living in dirty suburbs and nearly half of the workers were in debt. As the 1911 Revolution partly failed, new politicians emerged. On May 4th 1919, various groups protested as the Treaty of Versailles⁶ leased Germany's former territories in China to Japan (Ter Haar 2009: 534). Large violent demonstrations occurred in all of China against Japan. Many workers left their jobs in Shanghai and organized a boycott of Japanese goods. Shanghai became the center of the May 4th Incident (Dong 2000: 95-96, 155-156).

In the 1930s, Shanghai's Port served as the main shipping center in the Far East and in 1931, its transshipment of goods amounted up to 14 million tons ranking Shanghai seventh in the world in terms of entry ship tonnage (Shanghai Municipal Transportation Commission 2010).

In 1937, Shanghai was bombed by the Japanese Navy as they blamed Chinese for kidnapping one of their soldiers. After months of fighting, Japanese troops occupied Northern China followed by the

⁴ The first Sino-Japanese War (1894-1895) between China and Japan was caused by an, according to China, 'interference' of Japan in Korea resulting in a declaration of war towards Japan (Ter Haar 2009: 474-481).

⁵ The Treaty of Shimonoseki was signed at the end of the first Sino-Japanese War. Heavy demands had been included whereby China recognized full independence of Korea and agreed to pay large debt payments towards Japan (Ter Haar 2009: 476).

⁶ The Versailles Treaty between Germany and the 'English-French alliance' dealt with the aftermath of World War I (Cannon & Enkins 1990: xxi).

fall of Shanghai. The International Settlement remained intact, but the Chinese part of the city fell under Japanese occupation. In 1941, the Japanese attacked Pearl Harbor and extended their occupation to the whole city including the International Settlement. The United States, Britain and France (also known as the 'Allies of World War II' including China) joined the fight against Japan in December. Many foreigners left Shanghai and American companies moved their headquarters to Hong Kong and later Manila after Japanese occupation of Hong Kong in 1941-1942. In 1943, Shanghai was ruled by Japan. Systematic repression carried out by Japan turned Shanghai into a poor city until the liberation in 1945 after the Soviet Union declared war on Japan in August 1945. Shanghai had been the first large metropolis to bear a modern warfare and became the scene of extremely violent acts (Henriot & Yeh 2004: 1-4).

In 1949, the Chinese Communist Party (CCP) grasped power, cities were neglected, and in particular Shanghai, as rural spaces gained a crucial role in modern life. From 1949 until 1978, the nation controlled Shanghai, many foreigners left and extraterritorial laws disappeared. Shanghai remained a city of industrial production, but was forced to dispose of its cosmopolitan cultural life. The city was used to finance the modernization of the rest of the country and to obey the CCP. China moved into the phase of national rebuilding and the conditions for the emergence of a new cosmopolitan city moved to Hong Kong (Abbas 2000: 774-776).

In 1979, after the death of Mao Zedong, important shifts took place in China. Deng Xiaoping returned to power in 1978 and national policies changed. Special Economic Zones (SEZs) were established to carry out the 'Open Door' policy of Hua Guofeng already in 1977 (Joseph 2010: 105-107). The SEZs had a few main aims: liberalization of foreign investment, trade relations with the world economy to improve China's economy, and furthermore to develop an export-economy (Wong 1987: 27-28, 38-39; Ter Haar 2009: 544-547). In 1980 and 1981, four SEZs were established: Shenzhen, Zhuhai, Shantou, and Xiamen (Qian, Roland & Xu 1999: 1095). Yet, 34 years later on 29th September 2013, a new SEZ was established in Pudong, Shanghai (Alder, Shao & Zilibotti 2013: 2).

By the end of March 2013, the Premier of the State Council, Li Keqiang, gave his approval for the establishment of this new SEZ. The Shanghai Municipal Government discussed this new SEZ at the Executive Meeting of the State Council in June and gave its approval. The Zone started operation on 29 September as a pilot to deepen market oriented reforms. The SEZ-district in Pudong covers almost 29 square kilometers and possesses several functions which will be described in Chapter Two and Four (Free Trade Zone declared open for business, 2013-09-30).

Just like the first four SEZs, the SEZ in Pudong has been criticized by foreign economists who have doubts about its benefits: "*It's a hopeful sign, but there are questions about just how far it will go,*" said Gary Hufbauer, senior fellow at the Peterson Institute for International Economics in Washington (Lelyveld 2013). Is Pudong really going to make a difference and will it contribute to China's modernization process or is it just another experiment? Aside from these questions, I am interested in the difference of Pudong in comparison with the earlier established SEZs.

The thesis will typically focus on the period since 1978 due to China's opening up and the establishment of the first SEZs. I will explore the establishment of the Pudong SEZ in the form of a Free Trade Zone (FTZ) since 2013 and its expected contribution to China's modernization process using the following main question: *What is the expected contribution of the China (Shanghai) Pilot Free Trade Zone to the modernization process in China analyzed from 1979?*

I will start with defining SEZs, FTZs and describing China's modernization process since 1978 using Rostow's Five-Stages of Growth (1960) as a theoretical framework. Second, after outlining the methodology, I will analyze the SEZs in China and their effects in contributing to the modernization process including analyzing the conditions of the Pudong FTZ followed by an estimate of the expected effectiveness of the Pudong FTZ in contributing to the broader modernization process. Finally, I will analyze the expectations of the Pudong FTZ in comparison with the earlier SEZs-expectations and their potential effects on China's modernization process after which I will offer a discussion and conclusion.

2. Theoretical Framework

2.1 Special Economic Zone

Special Economic Zones are particular geographic regions in countries used to encourage export services, industry, and manufacturing (Wang 2009: 2). *Special* refers to the regime which distinguishes the zone from the domestic economy. *Economic* refers to the type of activities allowed in the zone. *Zone* refers to the visible and legal region of the 'economic space' in the domestic country or territory (Farole 2011: 26-27). SEZs benefit from more liberal laws and economic policies in comparison with the nation's general economic laws (Wang 2009: 2).

Special Economic Zone is a general term and exists in different forms (Wong 1987: 27). Certain zones are often established when modernization is desired as the economy, including its technology, are undeveloped and weak (Nishitateno 1983: 176) and have 'direct' and 'indirect' benefits. Direct benefits of a SEZ can be employment generation and foreign exchange earnings, indirect benefits can be technology transfer and export diversification (see Appendix 1 on page 29) (Zeng 2011: 4-6). SEZs are established to achieve four specific goals: (1) to attract foreign direct investment including advanced technology of developed countries in exchange for land, materials and labor resources in the country of the established SEZ (Nishitateno 1983: 176), (2) to soften large-scale unemployment, (3) to support an economic reform strategy, for example the open policy in China, (4) as an experiment for implementing new policies or systems (Farole 2011: 25-26).

The basic form of a SEZ is constructed through a 'top-to-bottom' approach by the government and contains the following characteristics: (a) a designated area (b) which possesses a single management or administration whereby the zone (c) benefits from its physical location and (d) comprises a separate customs' area and streamlined procedures (Zeng 2011: 4-6). Farole (2011: 24) uses the following main features to characterize SEZs:

1. Zones are primarily, formally designated regions of the national country and, secondarily, areas accommodated with a more liberal and administratively efficient set of investment and operating rules and trade than enterprises in the rest of the country. Therefore, zones are defined by a specific regulatory regime which can be contained by dedicated laws.
2. The regime's administration often requires a centralized, dedicated governance structure. The characteristics of this structure depend on the nature of the zones' regime and should ensure efficient management and profits for investors.
3. Infrastructure and facilities like real estate, roads, electricity, water and telecommunications in the zone support the economic activities of the firms and enterprises. Key transport infrastructure connects the zone to its markets, sources and its economic hinterland.

Hereafter, the definition of SEZs formulated by Farole (2011: 23) seems the most useful:

'Demarcated geographic areas contained within a country's national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxations, and the regulatory environment; whereby the zone is given a business environment that is intended to be more liberal from a policy perspective and more effective from an administrative perspective than that of the national territory.'

However, as Wong (1987) describes, SEZs encompass not only the Special Economic Zone, but a variety of related concepts which includes Free Trade Zones (FTZ), Free Ports, Export Processing Zones, Foreign Free Trade Zones, Special Economic Zones, Free Export Zones, Trade and Economic Cooperation' Zones, Economic Processing Zones and Free Zones. These zones can also be broadly defined by the

definition provided by Farole (2011: 23) due to the little consistency which exists in the classification of the zones. The variety and multiplicity of names and forms of SEZs is the result of several factors: (a) the difference in form and function between the different types may differ extremely, (b) differences in certain terminology among countries, (c) zone promoters' desire to distinguish themselves with their product from those with competing names. Definitions can also vary among different continents and institutions, for example between Europe and Asia (Farole 2011: 23-24).

Nonetheless, some types of zones mentioned above do not belong to the definition of SEZs described in this thesis. The *Free Trade Zones* (FTZ), Commercial Free Zones and Free Zones are usually located in or near major international transport junctions under the administration of ports, directly or indirectly. These zones are often visibly separated from the outside and the port's main area by fences, walls or gates as they lie outside the country's custom territory. In paragraph 2.1.1., the FTZ is defined more specifically. *Export processing zones* (EPZs), which appeared in the 1950s and 1960s, accelerated industrialization and industry-related international trade in developing countries. In EPZs, investment is restricted to foreign capital and activities are focused on export markets and limited to manufacturing. *Free enterprises* or *single unit free zones* are a variant of the two types described above and are provided with the status of FTZ or EPZ allowing them to locate anywhere in the national territory. Such a status is often given to enterprises that want to have the benefits of the FTZ but whose relocation costs would be too high. *Freeports* are generally known as *Special Economic Zones*. However, Freeports are the largest type of all: they encompass a large territory including rural and urban areas and they incorporate large transport facilities such as ports and airports. Freeports can include entire economic regions, the working population, and all economic activities that take place in that region. On the basis of this classification, the Chinese SEZs can actually be called Freeports (Farole 2011: 27-30).

2.1.1 Free Trade Zone

As described above, the Free Trade Zone (FTZ) is usually located in or near major ports separated from the outside world (Farole 2011: 27-30). FTZs exist, just like SEZs, in various types used with different terms over time which often reflect the operations performed in the zone (Ilo & Unctc 1988: 5). FTZs' activities are limited to trade-related processes such as storage, sales, and exhibitions and light processing operations such as packaging, labeling, and quality control (Farole 2011: 27-30).

Many definitions of FTZs have been given whereby the following aspects can be seen as the FTZs' main characteristics: industrial enterprises specialized in and focused on production for export or importing materials for re-export which are entitled to free-trade conditions and more flexible business regulations compared to the general regulations applied to business in the country; industrial zones obtain special regulations and attractive incentive packages to attract foreign direct investment like exemptions from import duties on raw materials or from the payment of sales tax; clearly defined offshore regions often at a well-considered geographical location away from markets, to obtain lower production-costs; inside a national territory with an above average business infrastructure and services suited to the industrial operations and trade like office space, logistics services, and utilities (United Nations 2007: 5-7).

The primary objective of a FTZ is to have a positive effect on the economy that must be achieved by the generation of foreign exchange earnings, creating higher incomes and providing jobs: especially in developing countries where workers from the agricultural sector move into the industrial sector. In addition, FTZs need to attract foreign direct investment, gain technological knowledge and create higher quality standards which require extensive training of labor, staff, and management (United Nations 2007: 5-7).

2.2. Rostow's Modernization Theory

2.2.1 Modernization

According to Rozman (1981), modernization is the process whereby societies have been and are being transformed by the impact of technological and scientific revolutions. As can be seen in many modernized societies, such a modernization process affects all aspects of society. Some aspects change directly, like social elements, others more sustained, and for example when traditional aspects in historical contexts need to be abandoned. Essential elements associated with modernization are: growth in non-agricultural production, especially services; a movement from high death and birth rates to lower rates; constant economic growth; a better distribution of income; more specialized organization and skills; emerging bureaucratization; mass political participation; and expansion of education at all levels. Modernization is also seen as one of the most far-reaching and dramatic social changes in history whereby the effect of the process affects all people in society. Existing patterns become undermined and modernization becomes its goal (Rozman 1981: 2-5).

2.2.2 Rostow's Five-Stages of Growth

One of the theories which have been used to analyze nations in their modernization process is 'Rostow's Five-Stages of Growth'. According to Rostow (1960: 1-3), a society follows five phases in the modernization process. The phases are distinguished by economic features of the society whereby cultural and economic changes develop parallel. All the five phases are needed to become a modern country and it is possible to identify all societies within one of the phases. The phases can also be categorized according to Rostow as: traditional society; preconditions for take-off; take-off; drive to maturity; and the age of high mass-consumption (Rostow 1960: 3-6).

The first phase or category is 'traditional society'. A traditional society is developed with limited production functions and based on pre-Newtonian science⁷, technology and attitudes towards the physical world. Nonetheless, a traditional society is not static and it can develop in many ways. Acreage can be expanded; it should be possible to introduce some technical innovations in trade, agriculture, and industry eventually leading to higher productivity, for example, improvement of irrigation works. However, a 'ceiling' exists in traditional society on the level of feasible output per head due to the unavailability or non-application of modern science and technology. The area and population inside such a society changes and fluctuates due to, for example, social and political turbulences, the sequence of the harvests, war, incidence of plague or the inaccessibility of modern science to improve productivity. To obtain vertical mobility, these societies need to devote a high proportion of their resources to agriculture. Inside societies with an agricultural system, there exists a hierarchical social structure in which individuals can flow. In terms of history, the dynasties in China can be grouped in the phase of traditional society (Rostow 1960: 4-6).

Secondly, Rostow (1960: 6-7) designates 'preconditions for take-off' as the second stage of growth in which societies develop their conditions for 'take-off'. The first preconditions for take-off were already developed in the late 17th and early 18th century in Western Europe. Knowledge of modern science began to emerge in new production functions in agriculture and industry. At that time, the world market expanded and international competition rose. Britain was the first to develop the preconditions for take-off due to its beneficial geographic location, natural resources, and trading possibilities. However, the preconditions for take-off in general arose in traditional societies due to the intrusion by more well-advanced societies. These intrusions often shocked the traditional society resulting in a process whereby the traditional society began to develop ideas and thoughts to create and construct

⁷ 'Newton' is used in the concept pre-Newtonian as a symbol for people who widely believed that the external world was subject to a few knowable laws and capable of productive manipulation (Rostow 1960: 4).

modern alternatives, often economic, from the old culture. To enable private property, general welfare, a better life or vertical mobility, economic progress is a necessary condition. In some countries, change in education is required to satisfy the needs of modern economic activity. Due to the intrusion of advanced societies, new types of enterprise appeared like bank institutions and private enterprises to make profits, investments increased in transport and raw materials and the scope of trade widened, using new alternatives and methods. With the economic changes, social and political structures also improved. However, all these new activities and methods continued to operate in a limited space within an economy and a society still mainly based on characteristics of the traditional society. Building an effective centralized national society with new modern methods is a necessary condition for take-off, but also the decisive aspect of the precondition period (Rostow 1960: 6-7).

The third phase is called 'take-off' which, according to Rostow (1960: 7-9) can be seen as the great shift in the life of modern societies. In this phase, resistance is overcome and forces for achieving economic progress start to expand. Interest in institutional structure emerges and growth becomes a normal condition. In Britain, the stimulus for take-off was mainly technology and social overhead capital⁸, but in general, the emergence of political power related to a certain organized group, with emphasis on modernization, has been important as well. During the take-off phase, effective investment often rises from 5 percent of the national income to about 10 percent. New industries expand rapidly followed by a reinvestment in new operations using their earned profits. These new operations start to apply unused natural resources and methods of production which stimulate services to support the development of and further development in other manufactured goods. This process increases income of those who place their savings in the new modern activities resulting in a new class of entrepreneurs. Farmers accept the new methods and changes as new techniques are popularized in commercialized agriculture. Deep changes in the way of life arise and the basic economic, social and political structures are transformed in about two decades which are an essential condition for a successful take-off. A steady growth rate after the establishment of the right structures can be sustained. China launched its take-off around 1960-1970 according to Rostow (1960: 7-9).

The fourth phase is a phase of sustained progress in a growing economy and is called the 'drive to maturity'. Modern technology is spread over all economic activities and between 10 and 20 percent of national income is invested. The population is increasing, techniques are still improving and new industries emerge. Goods are produced at home instead of being imported, new import requirements and new export commodities develop, resulting in an economy which forms a part of the international market. These requirements and export commodities are made in terms of modern efficient production and supporting the growth process. Maturity is generally attained about sixty years after take-off begins and demonstrates the societies' capacity to move beyond the original industries. The economy, with its new technologies, in this stage is able to produce anything it chooses to produce whereby missing raw materials can be appropriated otherwise. The economy is developed in more complex processes of industry and technology, for example the shift in focus from coal, iron and heavy industries to machine-tools, chemicals and electrical equipment by the end of the 19th century in Germany, Britain, France and the United States (Rostow 1960: 9-10).

The final phase is the 'age of high-mass consumption'. The leading sectors in this phase shift towards durable consumer goods and services. Two things happened in societies which achieved maturity in the 20th century: the structure of the working population changed and the population working in offices and skilled factory workers increased. Real income per head rose which gave people

⁸ Social overhead capital is often required in developing economies for a higher standard of living. It is part of the total investment, largely financed by the State, whereby capital is spent on social facilities such as infrastructure, schools, universities, airports, harbors, museums, parks, hospitals and libraries (Kurihara 1970: 398).

the possibility to purchase more than only basic food, shelter, and clothing. The society accepts the further extension of modern technology leading to a welfare state. The decisive element has been the cheap mass automobile and the various electric-power household gadgets which start to be used. In the United States, the turning point would be 1913-1914 due to Henry Ford, in the 1920s and again in 1946-1956. Japan entered this stage in the 1950s (Rostow 1960: 11).

2.2.3 China's modernization process since 1978

As described in the introduction, important shifts occurred after the death of Mao Zedong in 1976. Hua Guofeng carried out the 'Open Door' policy in 1977 and Deng Xiaoping returned to power in 1978 (Joseph 2010: 105-107). China was in urgent need of change after the Cultural Revolution⁹ (Zeng 2011: 8-9). Many economic reforms were launched and a market transition was put in motion. Initially, the reforms were most successful in the countryside as contracting land to households spread rapidly throughout China and agricultural production increased. Reformers lowered economic barriers and opened up the system, private enterprises and individuals got the opportunity to meet market demands and operate more freely. The State's monopoly was reduced including a price decontrol and competition was on the rise resulting in more efficient business processes. In addition, the government took innovative steps to open new trade channels in Guangdong Province using the accessibility to Hong Kong and Taiwan. Hong Kong started with an 'export-processing' contract with companies in China and shortly after, the first SEZs were set up in Shenzhen, Zhuhai, Shantou and Xiamen (Zeng 2011: 8-9) to increase foreign investment, to establish trade relations with the world economy to improve China's economy, and furthermore to develop an export-economy (Wong 1987: 27-28, 38-39; Ter Haar 2009: 544-547). Foreign businesses were encouraged to operate in these zones as they would bring innovation and direct investment after the establishment of these first SEZs. Investment in many parts of Guangdong Province beyond the SEZs rose (Naughton 2007: 87-89, 97, 381, 407-409). In the 1990s, the government decided to open up more cities and establish more SEZs and in 2007, every province had at least such a zone (Naughton 2007: 407-409). In September 2013, the government decided to open another SEZ, Pudong FTZ which is called the China (Shanghai) Pilot Free Trade Zone (CSPFTZ) (Alder, Shao & Zilibotti 2013: 2, China [Shanghai] Pilot Free Trade Zone: 2013).

Since the moment China opened up its economy it has experienced an average annual growth of 9.4 percent, one of the highest growth rates in the world, now accounting for four percent of the world economy (Zheng 2005: 18). In addition, it has attracted almost 45 billion of foreign investment (US dollars) (Coughlin & Segev 2000: 1). Over the years, economic reforms have been adapted to face new challenges and transformation is even encouraged by the establishment of the CSPFTZ. By the mid-1990s, the economy successfully moved away from a command economy to a functioning market economy whereby export and import increased rapidly as shown in Appendix 2 (page 30) (Naughton 2007: 29-30).

Nevertheless, even today, China's transformation process is still not completed as there is a gap in growth rates between North and South China and East and West China. The South, including the coastal area, which accounts for 41 percent of the population, is developing much faster in comparison to North and West China and it may take much more time to initiate growth in these regions (Naughton 2007: 29-30).

Analyzing China's modernization process using Rostow's Five-Stages of Growth (1960), China had been in the third phase between the 1960s and 1970s according to Rostow (1960: 7-9). At the time China launched its Open Door policy, it raced partly to phase four as modern technology spread over economic activities and sustained progress was obtained. However, as described above, there has been

⁹ The Cultural Revolution (1966-1976) had been a period of political disruption and unrest as Mao encouraged groups of students, called 'Red Guards', to overthrow the entire CCP (Naughton 2007: 74-75).

a great difference between the Northern-Southern and the Eastern-Western parts and it would be an unsuitable choice to assign the country as a whole to phase four. It can even be argued to assign the South, including the coastal areas, in the final phase as the structure of the working population changed to more skilled workers and office workers; and North and West China in phase three as the region remains trapped in a less developed, rural economy (see Appendix 3 and 4 on page 31 and 32) (Naughton 2007: 29-30, 113-135).

2.2.4 China's modernization process and China (Shanghai) Pilot Free Trade Zone

As China's modernization process is launched after 1978, many SEZs have been established. Its economic growth rate has been 9.4 percent annually and SEZs have attracted 45 billion of foreign investment (US Dollars). However, China's modernization process and its transformation to a market economy are still not finalized. The new CSPFTZ should accelerate this modernization process and should put China in a better economic position globally. As China's motivation is clear and aims have been set up very clearly, the next hypothesis can be formulated:

H1: The China (Shanghai) Pilot Free Trade Zone will contribute to China's modernization process.

3. Methodology

3.1 Type of Research

Research can be done either through quantitative or qualitative measurement. Quantitative research uses instruments in a mathematical manner to gain results which can be generalized to a certain group or an entire population. Qualitative research aims at particular cases in which conclusions are drawn upon assertions or descriptions.

Since this thesis uses mainly books, academic articles and Chinese government documents and describes and links past and present events, qualitative research is a suitable choice.

3.2 Data

Academic articles, books and government documents will be gathered in desk research. Both books and academic articles will mainly be collected in libraries and through the University Library Catalogues. Government documents originating from China and translated into English will be gathered by using government websites to increase their reliability compared to potentially unreliable private documents derived from privately operated websites.

3.3 Method

The main research question will be answered by analyzing, evaluating and comparing past and present events between 1978 and 2013. According to statements derived from this analysis a forecast will be drawn up using Rostow's Five-Stages of Growth (1960) after which the hypothesis will be either rejected or accepted and a conclusion and discussion will be arrived at.

4. Data Analysis

4.1 Special Economic Zones in China since 1978

4.1.1 Special Economic Zones in China

When China launched its Open Door policy in 1977, it was in urgent need of systematic change after the Cultural Revolution. In 1980 and 1981 the four SEZs were established to test the new policies and new institutions of the market-oriented economy. These four regions were chosen because of their linkages with overseas communities, especially Taiwan, Hong Kong and Macao (Zeng 2011: 8-9).

The four SEZs do not belong to any of the previously described models, but are a category on their own. China's SEZs are much more complex in relation to general economic activities and services, resulting in a diverse functionality (Zeng 2011: 5). The government has established two models; one model was established in a big, comprehensive, economic development zone in less developed areas where foreigners provided advantages in production and in primary economic activities. This model was established in Shenzhen and Zhuhai in 1980. Another SEZ model, which was established in Xiamen and Shantou in 1980 and 1981, designated small areas in regions with established economies and denser populations for modern export activities (Wong 1987: 27). According to Nishitateno (1983: 177), four characteristics of the SEZ-model in China can be described as follows: (1) public facilities such as electricity and water supply are well prepared whereby it is expected that the total investment in the regions will be very favorable for foreign investment, (2) preferential treatment is given to enterprises inside SEZs regarding the use of land, tax and economic activities in order to attract foreign direct investment, (3) manufactured goods inside SEZs are intended to be exported and (4) SEZs conduct business in a manner similar to a free market economy.

With the advent of the SEZs, a new law was formulated to determine land-use, called the 'Regulations on Special Economic Zones'. The law provided enterprises more favorable conditions in length of tenure, rent and methods of payment. For example, the rent of land for constructing factories or buildings per square meter annually was much lower inside SEZs than in ordinary regions (Nishitateno 1983: 179).

The models that have been applied are seen as causing severe restrictions to the potentials of the SEZs by other Asian nations. Due to these considerations, China decided to reform Xiamen and Shantou into bigger and more comprehensive economic zones than Shenzhen and Zhuhai. However, the SEZs in China still have a much more limited scope in comparison with the free port cities of Hong Kong and Singapore (Wong 1987: 27).

4.1.2 The expectations of Special Economic Zones in China

The Chinese SEZs have been established in a period of reform and were expected to contribute to the process of modernization and encouraged to pursue and test the 'Open Door' policy (Wong 1987: 28). The new policy had to liberalize foreign investment to utilize foreign capital and evolve trade relations with the outside world to take advantage of its advanced technology. One of the most important objectives of establishing the SEZs was therefore the attraction of foreign capital. Besides these objectives, the SEZs should obtain an economic structure dominated by manufacturing activities, depend mainly on the attracted foreign direct investment, and be export-oriented (Wong 1987: 32, 36). Due to the focus on export-orientation, these SEZs were also called 'Special Export Zones'. If proven successful, the new policy would be implemented widely across the country (Zeng 2011: 11).

4.1.3 The contributions of Special Economic Zones in China

Due to China's open economy, the SEZs in total caused an immediate impact on increasing foreign direct investment and made crucial contributions to China's success (Zeng 2011: 9-12). Especially the first four SEZs successfully tested China's open market economy and new institutions.

At first, in the initial phase, the SEZs contributed significantly to the attraction of foreign direct investment as they accounted for about 60 percent of the total foreign direct investment already in December 1981 (Nishitatenno 1983: 179-180). Shenzhen only accounted for 50.6 percent of the total foreign direct investment. In 2007, the total foreign direct investment from the SEZs still accounted for about 46 percent of the national total (Zeng 2011: 13). Due to the successful rates of 1981, the government created some variants of SEZs: Economic and Technological Development Zones (EDTZs), also known as National Industrial Parks, and High Industrial Zones (HIDZs). EDTZs are often much smaller than SEZs and are located in suburban regions. Between 1984 and 1988, 14 EDTZs were established in coastal cities. In 1988, the province Hainan was designated as the fifth SEZ. In 1989 and 2006, Shanghai Pudong New Area (see paragraph 4.2) and Tianjin Binhai New Area were designated as SEZ as well. In 1992 the government even created another 35 EDTZs in inland regions to focus on technology-intensive industries. By April 2010, the total number of EDTZs increased to 69. HIDZs were established in 1988 to use the technological capacity and resources of universities to develop new and high-tech products. In 2011 there were 54 HIDZs in China whereby some function similarly to EDTZs (Zeng 2011: 10-15).

Second, SEZs contributed significantly to national employment. The initial four SEZs accounted for 15 million of the total employment in 2006, 2 percent of national employment. It is important to note that employment of SEZs is locally limited whereby it accounts for more than 10 percent in urban employment (Zeng 2011: 10-15).

Third, the SEZs were expected to import high-technology. However, it were mostly HIDZs which hosted high-technology firms. As HIDZs are a consequence of SEZs, the contribution to high-technology is linked to them. The SEZs have also contributed to the development of high-technology, but it was especially Shenzhen which set the pace for moving toward more technology-intensive and higher-value development (Zeng 2011: 10-15). Shenzhen had also been very successful in initiating the introduction of contract labor, a new wage system and the adoption of the tender system. Workers and staff were hired on contract rather than on a permanent basis like the 'iron rice-bowl'¹⁰ (Wong 1987: 31-33). Later, all relations between laborers and enterprises inside all SEZs were defined by contract (Nishitatenno 1983: 179-180). Another important development in Shenzhen is the development of education: economic development has stimulated educational expansion providing an upper-secondary education whose graduates served as human input in the economic sector (Xiao 1998: 17).

The role the SEZs played was quite apparent due to some success factors. At the beginning the status of the SEZs was quite uncertain, but despite this uncertainty, top-leaders were determined to continue reform. This determination of top-leaders ensured a stable and supportive environment which prevented political opposition to undermine the experimental SEZs. Top-leaders also created preferential policies including capital investment and inexpensive land which was favorable to attract skilled labor, subsidies for children's education and research funding. The SEZs were given great autonomy and were even able to develop municipal laws and regulations paralleling basic national laws like labor contracts. In addition, the Chinese diaspora¹¹ also played important roles in foreign direct investment. Especially in the initial phase, investment by the Chinese diaspora was dominant due to

¹⁰ The 'iron rice-bowl' is a concept which indicates the lifetime employment and cradle-to-grave benefits that were guaranteed to workers in urban enterprises, ministries and institutions (Joseph 2010: 404).

¹¹ The majority of foreign direct investment has come from Chinese diaspora: ethnic Chinese people who live outside the PRC in mainly Hong Kong, Macau, Taiwan and overseas Chinese people in Southeast Asia and elsewhere (Smart & Hsu 2004: 545).

cultural, linguistic and location advantages. Aside from the Chinese diaspora, the composition of people in the SEZs itself also helped innovation and entrepreneurship. SEZs were open to all qualified workers resulting in a large number of migrants from across the country searching for better jobs and new opportunities. These strongly motivated migrants caused an innovative, entrepreneurial culture and a dynamic SEZ (Zeng 2011: 15-23).

However, in terms of foreign exchange earnings and export growth, performances were under pressure. In the initial phase, much capital was spent on infrastructure and construction programs resulting in the neglect of 'productive' export-oriented activities. Since the latter half of the 1980s, central government policies changed: the export permit was partly withdrawn and the quota for zone products was reduced causing repercussions resulting in decreased foreign direct investment (Wong 1987: 31-34). Besides the export permit and change in quota system, the government continued opening up the economy whereby other open cities and districts were announced as EDTZs and HIDZs causing huge competition in attracting foreign direct investment (Wong 1987: 32: 177; Zeng 2011: 22). In addition to this competition, China's SEZs still competed mainly in low-cost manufacturing based on low-tech labor-intensive sectors and cheap labor. Thousands of firms competing on price caused sometimes illegal activities such as using cheap or even fake materials, pirating or child labor while economic competitiveness should hinge more on knowledge, technology and innovation. The heavily export-oriented economy increased its vulnerability to global market shocks and many SEZs did not have sufficient education and health services or were located like an 'isolated-island'. SEZs, apart from Shenzhen, have suffered due to their location: in the Southern part of China far removed from major agglomerations. Shenzhen, located close to Hong Kong, has become a success mainly because of Hong Kong investments (Zeng 2011: 36-38). The government selected these locations so they could control in- and outgoing movements and check potential effects on social and economic life in neighboring regions. Most SEZs had good access to major infrastructure such as ports and airports (Zeng 2011: 23), but the regions, particularly Shenzhen and Zhuhai, had a weak economic basis including bad infrastructure (Wong 1987: 35). Despite the government investments and its expectations (Nishitaten 1983: 184), problems like inefficient transportation, untrustworthy electricity and water supplies remained unsolved in mid 1980s and railway connections between the SEZs did not exist at the end of the 1980s (Wong 1987: 35).

In the early 1980s, critics already argued that the SEZs were foreign colonies sucking the blood of the country. In the early 1990s, the attacks on SEZs policy especially blamed the overall development strategy of China whereby local leaders claimed that foreign and domestic investment must be redirected to China's domestic economy. In 1996, the State Council decided to officially announce that the various preferential SEZs policies and regulations would be readjusted. SEZs could no longer import materials duty-free nor enjoy a low tax rate causing high input costs in the SEZs resulting in a decline in foreign investors as SEZs were not considered 'special' anymore (Reardon 1996: 281). According to Han Zheng (Hu 2013), the new SEZ in Pudong is considered 'special' again due to its different system and different assumptions such as the need to make the zone replicable to introduce successful innovations in other regions of the country.

According to Wong, these problems would have been greatly reduced when establishing a SEZ in an area like metropolitan Shanghai (Wong 1987: 34-36). However, in the long run, SEZs should have focused on quality rather than on quantity whereby further development would require better and more efficient institutions and the developing regions, such as SEZs, needed to be linked with underdeveloped regions (Zeng 2011: 36-38).

4.1.4 The role of the Special Economic Zones in China's modernization process

China's modernization process started after 1978. When using Rostow's Five-Stages of Growth, China can be assigned into two different phases. The South including the coastal areas can be assigned to

phase four and partly to the final phase. The Northern and Eastern regions conform more to phase three as these regions are trapped in a less developed economy as described in paragraph 2.2.3.

The SEZs did contribute to the modernization process as they caused an increase in foreign direct investment which made crucial contributions to China's success. The preferential treatment inside the SEZs lowered economic barriers and innovative steps were taken to open new trade channels in Guangdong Province using the accessibility to Hong Kong, Macau and Taiwan. Foreign businesses were attracted followed by innovations and foreign direct investment (Nishitateno 1983: 179-180). Shenzhen alone counted for 50.6 percent of total foreign direct investment. In 2007, total foreign direct investment in the SEZs accounted for about 46 percent of the national total (Zeng 2011: 13). The SEZs opened the door to foreign companies and established trade relation with the world, but were concentrated near Hong Kong, Taiwan and Macau due to their accessibility to and foreign direct investment from these regions. In addition, the four SEZs indirectly imported high-technology due to the emergence of HIDZs with an emphasis on Shenzhen. In the 1990s, the government decided to open more cities and establish more SEZs, as the four SEZs were successful enough.

Since 1978 and the opening up, China's average annual growth has been 9.4 percent and increased its contribution to world economy from one to four percent. Despite the readjustment of various preferential policies in 1996, the SEZs certainly have boosted China's economy, accelerated China's modernization process and met their main objectives: to attract foreign capital.

4.2 Free Trade Zones in China

Another SEZ was established in 1989 in Shanghai and is called the Pudong New Area. Pudong New Area was based on the model of China's SEZ (see paragraph 4.1) to contribute to Shanghai's revival. A new district which was located to the East of the city and the Huangpu River and covered a total area of 522 square kilometers, larger than the central city of Shanghai. The first FTZ was created in 1990 inside Pudong New Area and was called Shanghai Waigaoqiao (Wu 1999: 207-210). The first FTZs which have been established in China were set up to experiment with free trade before accession to the World Trade Organization (WTO). The Chinese FTZs had three functions: (1) to encourage export, (2) to expand foreign trade and (3) to improve logistics and bonded warehousing¹². The FTZs functioned outside of customs regulations whereby companies in the FTZs were eligible for import duty exemption, tax refunds on exports and concessionary value-added tax. In 2011, a total of 15 FTZs were established in the coastal cities. When China joined the WTO in 2001, the advantages of the FTZs faded and the government decided in 2004 to link them with nearby ports to maintain their competitive characteristics. As a result, the size of the FTZs expanded whereby their focus was directed to international trading (Zeng 2011: 11-12).

4.2.1 China (Shanghai) Pilot Free Trade Zone since September 2013

Pudong was merely a SEZ designed to become a new center of industrial and commercial activities including an international airport to increase transport capacity to expand trading volume. According to Wu (1999: 207-210) Shanghai was undergoing wholesale changes to become the new economic powerhouse of China and the East Asian region and to become cosmopolitan again as in the 1920s (see introduction). The special regulations of the SEZs had been extended to Pudong: tax redemptions for enterprises doing business with foreign enterprises; tax exemptions for new enterprises; and a bonded zone for duty-free imports of raw materials. Most of Pudong New Area businesses were banks and importers of raw materials to assemble final goods for export. Aside from SEZ regulations, Pudong New

¹² A bonded warehouse is a warehouse controlled by customs for the retention of the imported goods until the duty owed is paid (Oxford Dictionaries, 'bonded warehouse': May 12th 2014).

Area was supported by China's strongest industrial, technological and science capabilities and by government investment to modernize public works (Wu 1999: 207-210).

24 years later, on September 29th 2013, Pudong New Area, including Shanghai Waigaoqiao, Shanghai Pudong Airport and Yangshan Bonded Port¹³, was included in the CSPFTZ, which covers 28 square kilometers. According to the Chinese government, the CSPFTZ meets the international Free Trade Zone-standards including a plan to develop a 'convenient investment and trading framework in line with international norms' (China [Shanghai] Pilot Free Trade Zone 2013: 1).

The zone may increase China's competitiveness and scientific progress. Many tasks and measures are financial and administrative procedures which are about to be tested in the zone and will be further implement if proven successful and thus, need to be replicable. According to Shanghai party leader Han Zheng, the CSPFTZ is market oriented and based on an innovative system with an extensive market mechanism. The most important task will be to open up the system and the reform of the administrative system as the current system is inefficient and not useful within the move towards a market economy and additional international norms (Hu 2013).

4.2.2 Conditions of China (Shanghai) Pilot Free Trade Zone

To achieve the two major goals of the CSPFTZ, tasks and measures have been formulated by the Shanghai Municipal People's Government (SMPG). First, in two to three years, CSPFTZ shall speed up the transformation of the Chinese government and especially promote the transformation of the foreign investment administrative system. The current administrative system does not meet the international trade and investment standards and needs to be transformed and become transparent. An online information platform seems a good solution to share information among different departments including a tracking system to track the location of products. Therefore, the CSPFTZ will try a foreign system to facilitate investment and trade that is in line with international standards. With this foreign system, fair competition can be protected as well as investors' interests. Another supervision system will be established to guard quality and technical, food and drug aspects, property, commercial, industry and tax administration. In addition, tax policies need to be implemented to boost investment and to promote trade. For example, a tax policy advantage is given to financial leasing companies inside CSPFTZ which are able to enjoy reduced import VAT on 'an aircraft with empty weight no less than 25 tons', to encourage leasing to a domestic airline. Additionally, tax refund policies on the port of departure will be improved and calculating import duty will be made possible. Furthermore, tax policies will be studied to support the development of overseas investment and offshore business (China [Shanghai] Pilot Free Trade Zone 2013: 1-2).

Second, the CSPFTZ shall accelerate the opening up of the investment sector in various aspects. The services sector including financial, transportation, commerce and trade, cultural, professional, and public services has been selected to open up. Even the market access restrictions, like the limitation on foreign participation, will be suspended or cancelled to create an equal environment. New investment service will be established as well to support and strengthen outbound investment projects. To open up the financial sector, several other services need transformation. In case of banking services, qualified foreign financial institutions will be allowed to set up foreign banks (foreign-owned or Sino-foreign joint venture banks) and qualified Chinese banks will be allowed to establish offshore business but only to improve related regulations and supervision. Foreign health and medical insurance institutions will help to improve the health and medical insurance which will be fully allowed inside CSPFTZ. In terms of financial leasing, the minimum capital required for a project company will be removed to lower the

¹³ Yangshan Bonded Port was established in 2005 as Shanghai had difficulties being a gateway and hub in one junction. The port is created as a transshipment hub with an integrated logistic/industrial center in the Asia-Pacific region (Wang & Ducruet 2012: 58).

investment threshold. Leasing companies will be allowed to commercial factoring related to its primary businesses. Regarding transportation services, limitations of foreign participation in Sino-foreign shipping enterprises will gradually become less to increase the number of cargo transition in CSPFTZ and Pudong airport in the short term. Foreign ships, directly or indirectly owned by Chinese enterprises, are allowed to try the coastal shipping in zone. In this manner, the government wants to attract qualified ships to register in the CSPFTZ whereby the registration system will be simplified to create a more efficient registration system to expand ocean transportations. In case of commerce and trade services, foreign invested telecom enterprises are allowed to 'engage' in specific value added telecommunication services and are allowed, only with approval by the State Council, to become involved in the production and sales in the market of entertainment and gaming consoles. Concerning professional services, the following measures will be allowed: a cooperative mechanism between foreign and Chinese law firms, an incorporation of foreign credit information companies, the engagement in overseas (except in Taiwan) tourism business activities by Sino-foreign tourist enterprises registered in the zone, the construction of Sino-foreign joint venture human resource agencies with a foreign participation of 70 percent or below excluding Hong Kong and Macau. Relating to the cultural services, there will be no limitation on foreign participation in entertainment artist agencies and fully foreign-owned entertainment facilities and agencies will be allowed to register and provide service in CSPFTZ and Shanghai. Finally, the establishment of Sino-foreign education, vocational skills training and medical institutions will be allowed regarding to public services (China [Shanghai] Pilot Free Trade Zone 2013: 2).

The third task of the CSPFTZ is the promotion of the change and transformation of the trade development approach. The zone needs to construct new trade forms by focusing on developing new technology, service, brands and quality to improve China's global position and to increase China's competitive advantages. Shanghai has been chosen to promote these newly constructed trade forms as it is designated as the international trade center of China. Enterprises inside the CSPFTZ are encouraged to set up a plan to integrate in domestic and foreign trading business and multinational enterprises are even encouraged to set up headquarters in the Asia-Pacific region. To fully integrate in domestic and foreign trading business, the port in the CSPFTZ will need to develop a shipping system and model that will realize huge global competitive advantages. In addition, shipping related services as financing, international ship transport, management and brokerage will be encouraged to support the new shipping system (China [Shanghai] Pilot Free Trade Zone 2013: 2-3).

Fourth, CSPFTZ will innovate and open up financial services. The government will try to liberalize interest rate and encourage cross-border use of RMB such as cross-border financing whereby enterprises have to use domestic and international market resources. In addition, the finance sector will be encouraged to innovate the financial market and will be fully opened up to private investors and foreign investment institutions whereby a platform will be established to manage and regulate international transactions (China [Shanghai] Pilot Free Trade Zone 2013: 3).

Finally, to serve the needs of the CSPFTZ, the regulation and supervision systems need to be improved and enhanced. Current laws will be adjusted and again implemented in one to three years, starting from October 1 2013. In order to establish such a regulation and service system with international standards, a good supervision model is needed. This supervision model will facilitate transactions for all services and products under a transparent administrative system inside the CSPFTZ. The previous model will be simplified allowing enterprises to bring goods into the zone before completing their customs declarations formalities. The supervision model will also monitor goods and services based on their import status and the construction of separated service-trading-area and goods-trading-area. The service-trading-area will focus on opening up the service sector while the goods-trading-area will focus on facilitating products. Inside the goods-trading-area, an online information system will be established, as described in the first paragraph, with an entry and exit record list, physical

verification and risk analysis. In other words: an 'easily import and export system with strict quality and safety control' (China [Shanghai] Pilot Free Trade Zone 2013: 3-4).

The SMPG is willing to examine the possibilities to improve efficiency in general. They also shall cultivate an internationalized business environment and new trade forms to develop in one of the main international economic, trade, financial and transportation centers of the world (China [Shanghai] Pilot Free Trade Zone 2013: 1-5).

Despite all these tasks, measures and sectors which will be opened, the government released a so-called 'Negative List' of business where FTZ investors are not allowed to interfere. This list includes internet cafes, news organization, social surveys and lotteries; other types of activities are allowed and can start without government approval, as long as the authorities are informed (Hu 2013). The list contains 190 items in specified sectors where restrictions will remain for foreign enterprises (Free Trade Zone declared open for business: 2013). The so-called 'negative-list process' will tell companies in which sectors they can operate, but the process of manufacturing the products itself can be decided by the enterprises themselves. The list will be renewed every year and will accelerate the establishment of all business licenses. The previous system obliged companies to review and to register in various categories in the local Bureau of Industry and Commerce, but with the negative list it will take just a few days to register and get all licenses as there is only one category left: the businesses included in the negative list (Hu 2013).

In summary, the CSPFTZ will accelerate the transformation of the Chinese government and especially promote the transformation of the (foreign investment) administrative system and trade development approach. It shall expedite the opening up of several services: the investment sector, the financial sector (especially banking services and even innovations), the transportation sector, the commerce and trade sectors, the cultural sector, professional and public services and health and medical insurance. In addition, the zone needs to improve the supervision system and needs to construct new trade forms with new technology, services, brand and a higher quality to improve China's global position and to increase China's competitive advantages.

4.2.3 Expectations of China (Shanghai) Pilot Free Trade Zone

According to Han Zheng (Hu 2013), Shanghai could become an international financial and trade center associated with systematic and institutional innovation. Before achieving such a status, financial and administrative procedures are to be tested inside the FTZ first before implementing further economic reform in all of China. Therefore, the FTZ should be seen as a national strategy that can boost scientific developments, reform the administrative system and bring about major changes within the government. It is a move towards a better functioning of the market economy and integration with international rules. Within a period of three years, the numbers on the negative list will be reduced yearly which eventually should lead to enhancing China's economic position globally (Hu 2013).

As there are already many SEZs in China, the privileged status of 'special' will be diminished even more with the establishment of the Pudong FTZ. How does the CSPFTZ attract investment in an environment of enhanced competition? And does the CSPFTZ compete in different sectors or is it in the same economic sectors where all SEZs operate? Many special zones are government sponsored and too much competition might lead to a waste of public resources (Zeng 2011: 38-39). In addition, the government released a long list with many tasks and measures as described in paragraph 4.2.2 which are encouraged whereby it is not certain whether these tasks will be performed and measures will be taken.

4.3 Comparing the Special Economic Zones with China (Shanghai) Pilot Free Trade Zone

4.3.1 The difference between Special Economic Zones and China (Shanghai) Pilot Free Trade Zone

The first assumption that can be made concerns the reason of establishment. The four SEZs were established in a period of reform to test the new 'Open Door' policy and new institutions for the market-oriented economy. If proven successful, the policy would be implemented widely across the country. The CSPFTZ has been established to enhance China's economic position globally including improvement of competitive advantages. To enhance this position, tasks, measurements and systems are about to be tested. The government has decided to implement the systems of the CSPFTZ across the country when the tasks and systems will pay off. Thus, the CSPFTZ is just like the four SEZs, established as an experiment to test policies and regulations. The SMPG is even examining the possibility to develop the CSPFTZ into one of the main international economic, trade, financial and transportation centers of the world.

A second comparison can be made between the size and location of the SEZs and the CSPFTZ. The SEZs were established in regions with linkages to overseas communities, especially Taiwan, Hong Kong and Macau. However, the region and size of the four SEZs differ. Shenzhen and Zhuhai were established in big, comprehensive development zones in less developed regions while Xiamen and Shantou were established in smaller areas in regions with a denser population and a developed economy which were enlarged later on. The CSPFTZ is located in the coastal area which is a developed region and covers 28 square kilometers (Hu 2013). It can profit from its hinterland in comparison with Shenzhen and Zhuhai. However, as the CSPFTZ is much smaller than Shenzhen and it would take approval from the government to take CSPFTZ enterprises outside the zone, it makes all innovations limited to this 'small' area.

Third, enterprises inside the SEZs were given preferential treatment to the use of tax, economic activities and land-use in order to attract foreign direct investment. To determine land-use inside the SEZs, a new law was adopted with regulations giving more favorable conditions in length of tenure, rent and methods of payment resulting in, for example, a lower rent per square meter annually. To attract foreign direct investment inside the CSPFTZ, the supervision system shall need improvement, and a new foreign investment administrative system and trade development approach will be promoted. This systemic transformation shall expedite the opening up of various services like the financial sector, the investment sector and the commerce and trade sector. As foreign enterprises got preferential treatment in the SEZs, foreign enterprises inside the CSPFTZ get access to businesses which were previously inaccessible such as the financial sector resulting in new market opportunities.

Fourth, before the establishment of the SEZ, the government invested in the development of public facilities such as electricity and water supply which needed to be favorable for foreign investment. As the CSPFTZ is located in Shanghai, public facilities have already been developed years ago. Shanghai is even seen as one of the most modern cities in China (Naughton 2007: 3) resulting in different goals for government investment besides basic facilities.

Fifth, Zhuhai and Shenzhen were regions where foreigners could provide advantages in production and in primary economic activities and, including Xiamen and Shantou, were mainly focused on modern export activities to evolve trade relations with the outside world and take advantage of foreign advanced technology. The CSPFTZ is mainly focused on opening up service sectors to attract foreign companies in new market opportunities to become an international economic, trade, financial and transportation center. The purpose of the CSPFTZ in this sense differs from the four SEZs in that it is not only focused on increasing export activities, but much broader and oriented more globally. In addition, inside the SEZs, business functioned in a manner similar to a free market economy. Comparing this with the function of the CSPFTZ, the latter needs to encourage and accelerate the transformation of the market economy as a whole.

As sixth, a comparison of the restrictions of SEZs and the CSPFTZ is made. Although many preferential treatments were given to the SEZ, other Asian nations still saw severe restrictions to the potentials of the SEZs as many SEZs in other Asian nations obtained much more freedom. The CSPFTZ also faces restrictions referring to quite a long negative list which forbids enterprises to engage in certain businesses. The government is planning to reduce the numbers every year if this 'can' be done (Hu 2013).

In addition, it is important to note that Shenzhen has been the most successful SEZ as it set the pace for moving toward more technology-intensive and higher-value development including the initiation of contract labor, a new wage system, the development of upper-secondary education and the adoption of the tender system. The reason Shenzhen was successful is because it was the first SEZ and covered a very large region: it started with only 50 km² but has expanded to 123 km² in 1986 and 2000 km² in 1996 (Meekam 2011: 638). The CSPFTZ is but one of many FTZs in China and much smaller whereby the number of FTZs increases and spreads across the country, the privileged status of 'free' diminishes which can be a disadvantage if the aspects and advantages of CSPFTZ are not being considered by enterprises outside China.

5. Conclusion and Discussion

5.1 Conclusion

This thesis focused on the modernization process of China since 1978 after the establishment of the 'Open Door' policy and four important SEZs. The SEZs in China are analyzed to make a comparison with the CSPFTZ. A conclusion referring to future development and the expected contribution to China's modernization process in relation to the CSPFTZ can be defined hereafter.

Many tasks and measures have to be carried out by the CSPFTZ and many systems and procedures are about to be tested in the zone. Since the CSPFTZ is yet another special economic zone in China, the privileged status of 'special' is diminished and it needs to operate in an environment of enhanced competition. Despite the fact that the CSPFTZ and SEZs have been established to test policies and regulations, the main objectives of the CSPFTZ differ in comparison to the majority of the SEZs.

As the CSPFTZ is mainly focused on opening up service sectors like the financial services and the transportation sector, the reform of the administrative system, and the trade development approach to enhance the quality of Chinese products and services in order to increase China's competitive advantages and improve the function of China's market economy, it competes in different sectors than the majority of the SEZs.

Whereas the CSPFTZ will innovate and open up financial services, it will be fully open to private and foreign investment institutions and create a more liberal environment in businesses and not only grant preferential treatments. And even though the CSPFTZ is much smaller than the most successful SEZ Shenzhen, it is established in a developed region where it can profit from its hinterland prosperity whereby government investment is directed to more specific targets instead of basic facilities. Both advantages can be reasons for foreign investors to consider the establishment of a company inside the CSPFTZ.

Although the zone seems to be very open and free from limitations, the negative list still contains 190 items of businesses that CSPFTZ investors may not pursue. It is the governments' target to reduce these numbers. In addition, when analyzing the numerous tasks and measures which are 'encouraged' by the government, there is little certainty whether these tasks really will be performed and these measures really will be taken. The success of the CSPFTZ is partly bound by the performance of the government itself when it 'encourages' businesses to take certain measures and engage in tasks, like the encouragement to set up a plan to integrate domestic and foreign trading businesses. Is the Chinese government aware of its responsibilities and the consequences if it fails to deliver on its promises?

Considering above formulations, hypothesis one can be rejected as it can be concluded that the CSPFTZ could only be successful if the Chinese government is capable of promoting the freedom and system improvements and is able to not only encourage, but also engage enterprises to perform the tasks and measures which have been set. If so, the CSPFTZ can contribute only to China's South and coastal regions' modernization process as CSPFTZ is located in the coastal region and leading sectors shift towards durable consumer goods and services as in the final phase of Rostow's Five-Stages of Growth.

5.2 Discussion

Many tasks and measures are about to be tested in the CSPFTZ and many services are to be opened up, resulting in more advantages for foreign investors. It is still unclear how much will be allowed and in what period which is causing many doubts among Western investors when it come to the engagement

in CSPFTZ. Western investors will only engage in the CSPFTZ if these uncertainties will diminish which will give the investors more certainty and confidence whereby they can make a forecast in their business performances as a forecast of business performances is very important for Western entrepreneurs.

The success of the CSPFTZ is partly linked to the performance of the government itself when it 'encourages' businesses to take certain measures and engage in tasks such as a plan to integrate domestic and foreign trading businesses. The government should be aware of its responsibilities and its consequences. Is the Chinese government able to not only encourage the people but engage them in these tasks and measures? If the government is aware of the importance of these measures and what it will do to Western investors and entrepreneurs, they might be able to engage the people and their enterprises with the tasks and measurements. But it is important to show the government the importance of all the promises they made; this can be done by listening and good collaboration with Western investors, entrepreneurs and companies through the Chinese government.

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Appendix 1

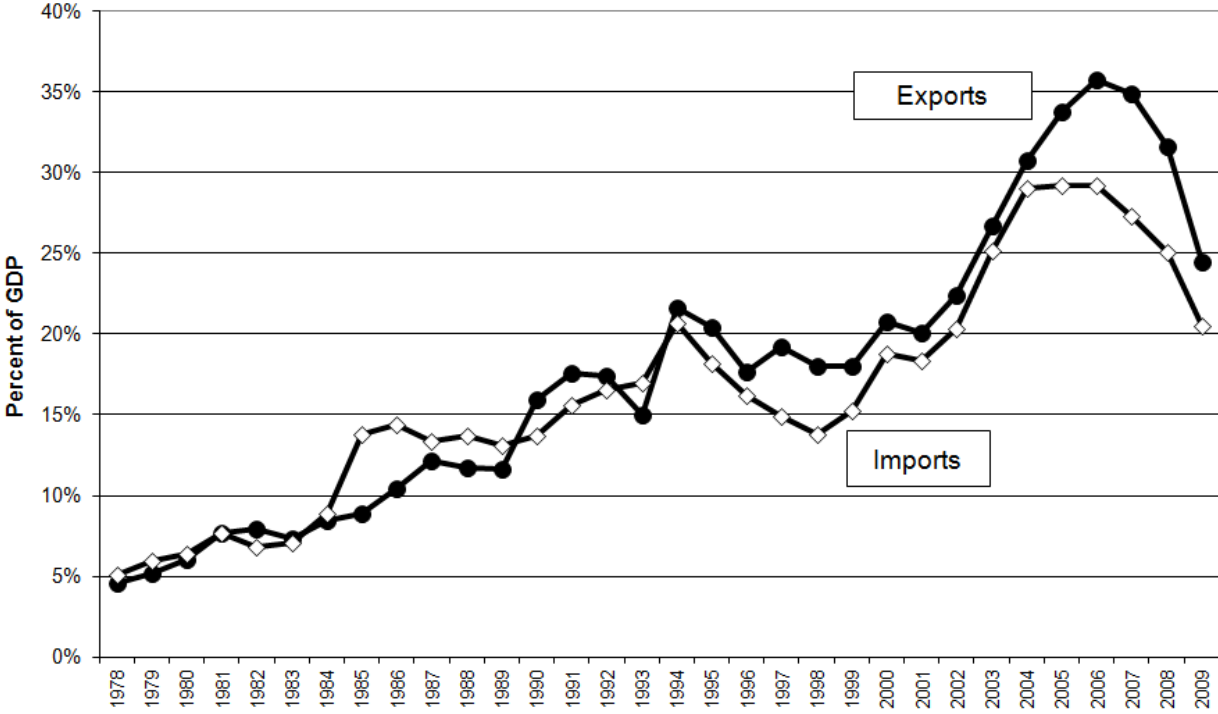
Potential Benefits Derived from SEZs

	Direct benefits	Indirect benefits
Foreign Exchange earnings	■	
FDI	■	
Employment generation	■	
Government revenue	■	
Export growth	■	
Skills upgrading		■
Testing field for wider economic reform		■
Technology transfer		■
Demonstration effect		■
Export diversification		■
Enhancing trade efficiency of domestic firms		■

Source: Zeng (2011: 4)

Appendix 2

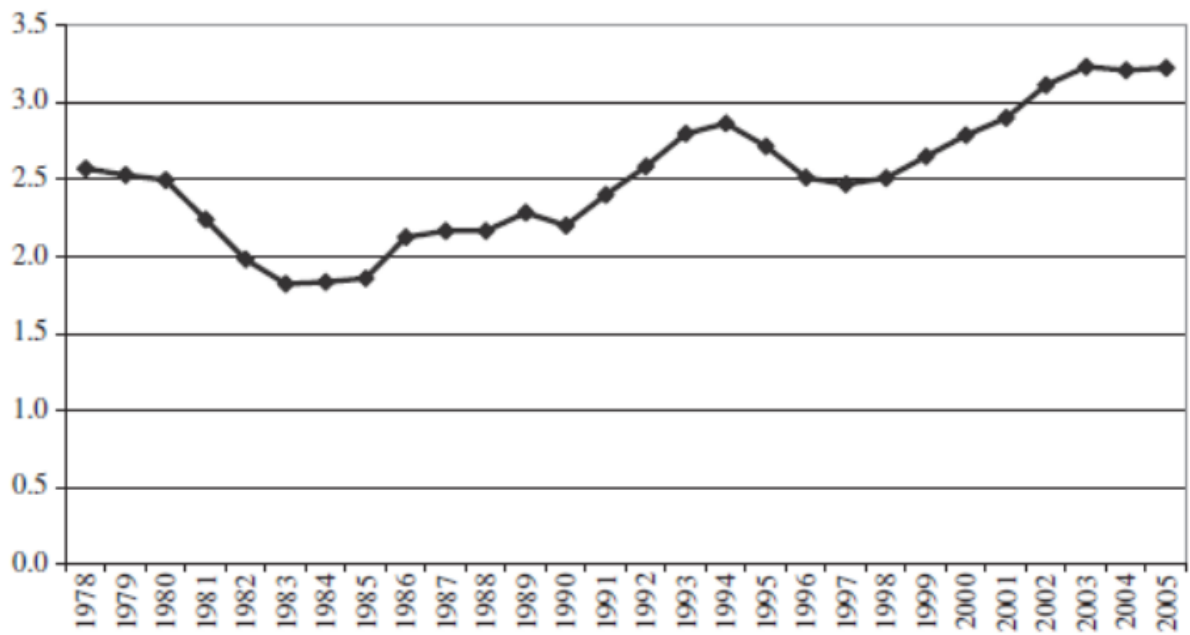
Export and Imports (Share of GDP)



Source: Naughton (2007: 378)

Appendix 3

Ratio of urban-to-rural household's income



Source: Naughton (2007: 133)

Appendix 4

Growth of real per capita household income

	Rural net household income	Urban disposable income
Income in constant 2004 prices (RMB)		
1978	(About 500)	1,701
1985	1,343	2,728
1991	1,585	3,612
2004	2,936	9,422
Average annual growth rate (percent)		
1978–1985	(About 15)	7.0
1985–1991	2.8	4.8
1991–2004	4.9	7.7

In 2004, one RMB was worth \$0.12 at the official exchange rate, or \$0.55 at PPP.

Source: Naughton (2007: 210)