USC Seminar Series No. 14

Distortions in the Opening

"Segmented Deregulation" and Weak Property as Explanations for China's "Zone Fever" of 1992-1993

David Zweig

香港亞太研究所
Hong Kong Institute of Asia-Pacific Studies
The Chinese University of Hong Kong
Shatin, New Territories
Hong Kong

Distortions in the Opening

"Segmented Deregulation" and Weak Property as Explanations for China's "Zone Fever" of 1992-1993

David Zweig

Hong Kong Institute of Asia-Pacific Studies
The Chinese University of Hong Kong
Shatin, New Territories
Hong Kong

About the Author

Dr. David Zweig is Associate Professor in the Division of Social Science, Hong Kong University of Science and Technology. He was a Postdoctoral Fellow at the Fairbank Center, Harvard University, and taught for 10 years at the Fletcher School of Law and Diplomacy, Tufts University. He is also a Research Associate of the Joint Centre on Asia-Pacific Studies, York University-University of Toronto.

His books include: *Freeing China's Farmers: Restructuring Rural China in the Reform Era* (1997), *China's Brain Drain to the United States: Views of Overseas Chinese Students and Scholars in the 1990s*, co-authored with Chen Changgui (1995), and *Agrarian Radicalism in China, 1968-1981* (1989). He co-edited *China's Search for Democracy: The Student and Mass Movement of 1989* (1992) and *New Perspectives on China's Cultural Revolution* (1991). His current book project, tentatively titled "Linking China with the World: The Political Economy of Internationalization," focuses on the role of Chinese society in opening China to the outside world.

ISBN 962-441-714-8
List price: HK$15.00

Distortions in the Opening

"Segmented Deregulation" and Weak Property as Explanations for China's "Zone Fever" of 1992-1993

About the USC Seminar Series

The Universities Service Centre (USC) was established in Hong Kong in 1963 by a group of Western scholars to facilitate the study of China. In the 1960s and 1970s, the Centre served as the main research base in the field for several generations of China scholars.

In the spring of 1988, the American Council of Learned Societies (ACLS), which had managed the Centre since 1971, and The Chinese University of Hong Kong (CUHK) reached an agreement to transfer the responsibility and ownership of the USC to the university. Thus, in that summer, the Centre was moved to expanded and upgraded quarters on the campus of CUHK.

Although field research is possible in China today, the Centre's library remains the most convenient base for documentary analysis. It is also useful as a station for supplementing field work in China. The Centre currently subscribes to 372 newspapers and more than 1,600 periodicals from Mainland China. One unique strength of the collection is a complete set, in bound hard copies, of major national and provincial newspapers published in China since the late 1940s. Other special materials include a complete set of provincial yearbooks and statistical compendia as well as an outstanding collection of local periodicals. Many of them are not found in most overseas collections on China.

The Chinese University of Hong Kong is committed to developing the Centre into a first-rate research library on contemporary China, open to scholars from all over the world. The Centre also assists them in applying for visas to Hong Kong, looking for accommodation, hiring research assistance, and so on.

In 1990, the Centre established the Academic Visitors Programme with a startup donation from the Henry Luce Foundation. The USC Seminar Series was subsequently introduced to publish seminars presented by some visiting scholars. Since the end of 1993, the Academic Visitors Programme and the USC Seminar Series have been financed by the South China Programme of the Hong Kong Institute of Asia-Pacific Studies. We thank Dr. Cheng Yu-tung and Dr. Lee Shau-kee for their generous donations which enabled the establishment of the South China Programme in 1991.

Distortions in the Opening

"Segmented Deregulation" and Weak Property as Explanations for China's "Zone Fever" of 1992-1993

Abstract

The East Asian fiscal crisis has awoken the world to the dangers that irresponsible loaning policies and blind property development can wreak on a county's political economy. Today, over-expansion of rental properties in Shanghai, Beijing and Shenzhen threaten China's economic miracle. Yet, this is not the first time this type of event has occurred in China. Between Deng's spring 1992 "southern trip" (*nan xun*) and summer 1993, over 8,000 new zones were created as "zone fever" (*kaifaqu re*) swept China. Provinces and localities ignored national laws. By the end of 1992, China's provinces had sold 4,000 pieces of state land (25,000 hectares), and by June 1993 another 3,000 parcels (22,000 hectares) had been sold.

This paper argues that "zone fever" had both policy and institutional roots and was the logical result of incentives facing local officials. First, Beijing opened urban areas to the outside world through a process I call "segmented deregulation," whereby reformers "gave policy" (*gei zhengce*) or exemptions from regulatory constraints to some localities and economic sectors, even as China's regulatory regime constrained global linkages for other parts of the country. One strategy for getting these policies was to build a zone.

Secondly, domestic economic institutions — urban planning, soft property rights in land, weak banking regulations, the normative acceptance of zone development as a means to link with the global economy, and the local state's predatory strategy towards tax and resource accumulation — formed the institutional bedrock of zone fever. It encouraged local officials to expropriate land, use it to get loans from local banks and then sell the land to other officials or development companies who followed a similar strategy.

In the autumn of 1993, Zhu Rongji cracked down on this frenzy. But, while the policy roots of "zone fever" may be gone, its institutional roots persist and are still fuelling a property boom that threatens China's reforms.

Introduction

The East Asian fiscal crisis has awoken the world to the dangers of unrestrained property development. Irresponsible loaning policies and blind property development can wreak havoc on a country's political economy, destroying its economic and political well-being. Today, China faces a similar challenge as overexpansion of rental properties in Shanghai, Beijing and Shenzhen, as well as other "hot" cities, threatens to bring China's economic miracle to a crashing halt. For example, in Pudong, the total office space in mid-year 1997 was 13.5 million square feet, "an astounding five times the 2.7 million square feet at year-end 1994."[1] By year-end 1999, total available office space could reach 26 million square feet. Clearly, a crisis is looming.

Yet, China faced a similar problem when land transfers and development underwent a similar and somewhat unexplainable frenzy. Between spring 1992, and Deng's "southern trip" (*nan xun*), and summer 1993, over 8,000 new zones were created as "zone fever" (*kaifaqu re*) swept China. The boundaries of existing zones ballooned by a factor of 10 or 20. Both Nantong and Yantai expanded their zones from four to 45 sq. km. in spring 1992, while in 1993, Qingdao's zone grew 10-fold, from 15 to 152 sq. km.![2] Jiangling county, along the Yangzi river in Hubei province, designated 18 sq. km. as the site for a high tech zone, while isolated Neihuang county, in northern Henan province, established six small industrial zones.[3] Even townships in Nantong county, north of Shanghai, drew plans for development zones. The types of zones also proliferated. By summer 1993, Jinan, capital of Shandong province, had established six zones, including a tourist zone, an agricultural high tech, a regular development zone and a high tech zone.[4] The boundaries of zones also became fungible, imparting the policy privileges available in zones to enterprises situated outside the zone. For example, the nationally recognized New High Tech Zone (*xin gao jishu kaifaqu*) in Chengdu municipality, Sichuan province, developed fungible boundaries, extending

its preferential policies to suburban university research labs which did not move their production facilities into the zone.[5] Changzhou municipality in Jiangsu province was particularly innovative, forming a joint venture development company to manage the zone. Thereafter, any firm entering the zone and linking with the development company instantly became a joint venture, replete with preferential tax and export policies. Small wonder firms in 1992 were flocking into the zone.

The frenzy was obvious. According to one mainland magazine, "development zones are being launched too fast and on too large a scale," betraying "a certain blindness."[6] A Jiangsu urban planner complained in spring 1992 that he was exhausted from drawing up zones for county seats province wide. "There is a 'development fever' in China these days; every city and town wants a development zone. Even cities closed to foreign investment want to build development zones."[7] In this fervour, provinces and localities ignored national laws and "passed approval on their own bids to set up various kinds of development zones."[8] As of the end of 1992, every province in China, excluding Tibet, had sold use rights totalling 4,000 pieces of state land, equal to 25,000 hectares, and by June 1993, another 3,000 parcels of land totalling 22,000 hectares had been sold.[9]

Land was being parcelled out for future development despite the fact there was not enough investment capital in all of China to build these zones. According to Beijing television,[10] as of summer 1993 there were 8,000 development zones across China, covering 20,000 sq. km. But international and domestic funds could develop only 20 per cent of the land taken by these zones.[11] The local gap between the planned area and capital available for development was enormous. Hunan province's 211 development zones would need RMB300 billion to develop; yet, total investment in fixed capital in all of Hunan province in 1988 had been only RMB14.2 billion.[12] According to Chinese reports, only 30,700 hectares, or 2 per cent of the 1.5 million hectares planned for development — most of it comprised of good farm land around cities and towns — was being developed. The remainder was left undeveloped, untilled and allowed to deteriorate.[13]

The Roots of "Zone Fever"

Why did this frenzy occur? Three factors seem central: soft property rights in land, a poorly regulated banking system, and the incentives generated by the policy process by which China opened to the outside world. All three factors pushed urban leaders, hungry for domestic and foreign capital for development, to turn zone construction into a key strategy for urban modernization.

Despite being inefficient, wasteful and, apparently, irrational, "zone fever" was the logical result of the incentive structures created by "segmented deregulation" and "reform by exemption." Rather than suddenly dismantle all bureaucratic regulations controlling global linkages, which could have triggered enormous collective resistance by government officials,[14] as well as serious economic imbalances across numerous sectors and regions, reformers deregulated exchanges between the international system and specific locations, industrial sectors and enterprises. In the Chinese policy parlance, the Chinese government "gave policies" (*gei zhengce*), granting localities or firms special exemptions from regulatory constraints, such as import duties, taxes for foreign investors, tax remissions or exclusions from labour regulations, all of which brought enormous savings in time and money for domestic and foreign investors. At the same time, the rest of the country remained constrained by the planned economy and the regulatory regime that managed China's global interactions.[15]

"Segmented deregulation" and "reform by exemption" generated their own pattern of central-local politics, characterized by pleading and lobbying,[16] where localities competed among each other for these exemptions which only the central administration could bestow. Unlike pluralist political systems, where potential

beneficiaries of internationalization lobby state leaders to dismantle laws that apply to the entire sector or economy,[17] China's political system created a policy climate where localities lobbied the centre to deregulate their locality's relationship to the global economy or exempt them from constraints still imposed on the rest of society.[18]

Yet, by the late 1980s, local officials had learned that the centre was willing to continue to expand the number of open areas consistently and bequeath preferential policies to areas that had already established the necessary physical or spatial infrastructure. This policy process created incentives for urban and provincial governments to establish zones in order to gain access to "policies" during the next round of deregulation. It also reinforced what Baark calls the "infrastructural model" of technological entrepreneurship, which stresses creating a conducive physical infrastructure for investors and is preferred by governments because it is based on inputs that they control.[19]

The benefits of deregulation, in particular its ability to attract domestic capital investment, had become clear with the development of Shenzhen and other Special Economic Zones (SEZ). While Shenzhen had been able to attract some foreign capital, the initial growth of its infrastructure had resulted from massive domestic investments which had sought to profit by working within its more deregulated political economy, characterized by lower transaction costs, freer global linkages, more flexible land policies and a more liberal labour market. In fact, SEZs acted like vacuums, sucking in domestic capital from all over China. Between 1983 and 1985, total investment in fixed assets (TIFA) in the four SEZs as a percentage of nationwide TIFA increased by over 100 per cent from 1.2 per cent to 2.4 per cent (Table 1).

In real terms, investment increased fourfold, jumping from RMB1.7 billion to RMB6.13 billion in a three-year period. And, while TIFA slumped in 1986, by 1988 it was up to RMB10.5 billion, or 2.35 per cent of national TIFA. Similarly, when he included investments in industry and commerce by Chinese organizations outside Shenzhen, as well as bank loans, Chan found that

Table 1 Total Investment in Fixed Assets in Open Coastal Regions, 1979-1991 (100 million RMB)

Year	National total	SEZs	Per cent of national total	OCCs	Per cent of national total	OCPs	Per cent of national total	Open areas as per cent of national total
1979	n.a.	n.a.		n.a.		n.a.		
1980	910.85	n.a.		n.a.		n.a.		
1981	961.01	n.a.		n.a.		n.a.		
1982	1,230.40	n.a.		n.a.		475.41	38.6	
1983	1,430.06	17.04	1.2	156.23	10.9	494.27	34.6	46.7
1984	1,832.87	29.27	1.6	191.45	10.4	680.57	37.1	49.2
1985	2,543.19	61.27	2.4	262.06	10.3	940.54	37.0	49.7
1986	3,019.62	51.33	1.7	303.84	10.1	1,167.77	38.7	50.4
1987	3,640.86	71.14	2.0	366.34	10.1	1,510.16	41.5	53.5
1988	4,496.54	105.47	2.3	507.51	11.3	1,907.25	42.4	56.0
1989	4,137.73	86.10	2.1	477.26	11.5	1,780.15	43.0	56.6
1990	4,449.29	92.77	2.1	463.34	10.4	1,911.52	43.0	55.5
1991	5,276.82	n.a.						

Note: OCC refers to open coastal city; OCP refers to open coastal province.

Source: This table is adapted from Table A3, in Y.Y. Kueh, "Foreign Investment and Economic Change in China," *The China Quarterly*, No. 131 (September 1992), p. 684.

Shenzhen's capital construction relied "partly on the ability of the city government to solicit domestic capital, and partly on local accumulation," but not primarily on foreign investment.[20] According to do Rosario, by the end of 1986, China had poured RMB8 billion into the four original SEZs, of which 7 billion had gone to Shenzhen.[21] In fact, if one looks at annual growth rates in TIFA in 1980-1985, for the major cities in China, Shenzhen, Zhuhai and Xiamen are in the top four, with the third being Haikou, capital of Hainan province, another city built from nothing and which was soon to become the centre of China's fifth SEZ (Table 2).

Table 2 Annual Growth Rates of Total Investment in Fixed Assets: Top 15 Cities in China, 1980-1985

Rank	City	Annual growth rate (%)
1	Shenzhen	71.98
2	Zhuhai	59.89
3	Haikou	54.07
4	Xiamen	45.85
5	Changzhi	37.17
6	Nanchang	35.65
7	Danjiangkou	28.32
8	Fuyang	28.07
9	Guangzhou	27.92
10	Zhanjiang	25.95
11	Beihai	24.87
12	Dalian	24.76
13	Suzhou	24.16
14	Hefei	23.90
15	Fuzhou	23.12

Note: Data are for city and its surrounding counties.

Source: *Zhongguo chengshi sishi nian* (Forty Years of China's Cities) (Beijing: Zhongguo tongji ju xinxi zixun fuwu zhongxin, 1990), pp. 266-67.

Similarly, the growth pattern of other development zones in open coastal cities (OCC), called "Economic and Technical Development Zones" (ETDZ), such as Nantong, Yantai and Qingdao, shows that spatial deregulation attracted domestic enterprises — *neilian qiye* — to leave their home region and move into deregulated spaces. As Table 3 shows, the ETDZs in many OCCs attracted many more domestic firms than foreign-oriented ones. In fact, to ameliorate the tax losses experienced by the former host cities of these factories that relocated to ETDZs, Nantong passed a special law that gave back some of the taxes paid to it by the relocated *neilian* factories.[22]

Nevertheless, the lessons had been clear and city leaders understood them well: deregulated physical spaces in which enterprises were exempted from regulatory constraints extant in the rest of the society attracted wealth, making the attainment of these preferential policies a key strategy of urban development in an internationalizing China.

The incentives to use development zones as a strategy to attract preferential policies intensified after Haidian district in northwest Beijing established a *test* "high tech zone" in 1988. Soon after, officials in Nanjing municipality began searching for land and capital for their high tech zone in Pukou district across the Yangzi river from the city core. Guangzhou municipality also began its zone at this time. In fact, 90 localities nation-wide began to develop zones in 1988, many with the help of their provincial governments. When these zones contacted the State Science and Technology Commission (SSTC) they were told that, if they could establish the necessary conditions (i.e., infrastructure and a scientific base nearby), they would be eligible for "special policies" as "new high tech zones" (*xin gao jishu kaifaqu*) as soon as the SSTC could persuade the State Council to agree. According to one SSTC official, "they came to see us, and we gave them nods that, if they could meet the necessary levels, if they could establish the necessary conditions, they were likely to be approved."[23] Following petitions from provincial governments and investigations by the SSTC, the State Council in March 1991 formally endowed 27 high

Table 3 Role of Domestic Firms in ETDZs in Open Coastal Cities, 1996

	Nantong	Qinghuang-dao	Dalian	Tianjin
1. Number of domestic industrial firms				
Total	337	198	570	760
Operational	171	95	—	210
2. Number of firms in tertiary sector				
Domestic	1,506	563	6,198	6,121
Foreign	62	35	265	597
3. Number of joint ventures				
Contracted	200	296	1,057	2,744
Operational	120	115	460	1,785
4. Exports (million US$)				
Total	296.1	96.9	1,255.2	1,450.2
By joint ventures	178.3	82.3	1,205.2	1,440.7
By domestic firms	117.8	14.6	50.0	9.5
5. Total employees	14,565	15,090	96,833	140,150
% in domestic firms	35%	25%	39%	29%

Table 3 Role of Domestic Firms in ETDZs in Open Coastal Cities, 1996 (continued)

	Yantai	Qingdao	Lianyun-gang	Caohejing	Hongqiao	Minhang	Ningbo	Fuzhou	Zhanjiang	Guang-zhou
1. Number of domestic industrial firms										
Total	175	—	253	391	—	—	118	254	55	—
Operational	51	—	207	391	—	—	48	—	49	290
2. Number of firms in tertiary sector										
Domestic	—	—	933	—	3	—	3,356	222	88	112
Foreign	—	—	81	—	83	—	73	149	16	6
3. Number of joint ventures										
Contracted	401	832	332	206	83	140	407	511	319	486
Operational	181	388	154	126	61	118	239	196	93	233
4. Exports (million US$)										
Total	209.9	239.7	80.2	309.0	892.7	295.2	481.4	402.8	138.4	460.0
By joint ventures	99.1	210.3	55.1	305.6	892.7	295.2	160.7	246.9	106.9	322.0
By domestic firms	110.7	29.4	25.1	3.2	—	—	320.8	155.9	31.6	138.0
5. Total employees	35,030	44,579	19,140	43,316	10,876	—	40,352	51,451	26,994	42,089
% in domestic firms	57%	62%	64%	61%	21%	—	50%	46%	72%	31%

tech zones with preferential policies previously reserved for SEZs and ETDZs in the 14 OCCs.[24] The decision in 1992 to recognize another 25 high tech zones, leaving another 35-36 unsuccessful petitioners, sent a clear signal to local and provincial bureaucrats all over China: build a zone, lobby, and your zone might be anointed with national preferential policies in the subsequent round of approvals.

After Premier Li Peng endowed Pudong — the major "open zone" for the 1990s — with new and enormous preferential policies aimed at attracting domestic capital for infrastructural development,[25] and announced that Beijing would invest RMB10 billion in the zone, local elites all over China prepared for the subsequent round of deregulation. Pudong's scale shocked local leaders who feared it would suck in all foreign and domestic investment.[26] So, they intensely lobbied for their own locality to be deregulated. Guangxi province petitioned the central government in March 1990 for more export quota and export licences to Hong Kong, more trade organizations with direct export power, more ports (*kou an*) serving Guangxi-Hong Kong and more direct transport links to Hong Kong. Many local openings in 1990 aimed at Taiwan money which became the major source of foreign direct investment (FDI) following the West's post-Tiananmen boycott of China. Fuzhou and Nanning municipalities and Shanxi and Guangxi provinces endowed new Taiwan investment zones with tax privileges the State Council's Tax Office declared were beyond their authority to grant.

The cyclical nature of spatial deregulations, with spirals of openings and closings, pushed officials to move quickly in 1992, as China shifted into another upswing. During these openings, the state was more likely to distribute "policies," while constraints on domestic capital, loans, land and new bureaucratic posts eased.[27] The previous wave of internationalization, which occurred during the 1987-1988 "Coastal Development Strategy," had been soundly suppressed beginning in late 1988 and had continued through early 1992. That lesson had been clear: open phases could be short, so move quickly, create new organizations and take control of

resources and policies while the liberalization phase lasted. And, even if your locality's zone was not granted preferential status — either as a State Council ETDZ or a State Science and Technology high tech development zone (HTDZ) — it was important to confiscate land, get capital for investment and begin construction while the ethos of the system allowed it. This step was particularly important for "late openers" or inland areas that had received little benefit from China's internationalization. If they hesitated and missed this chance they would be poorly positioned to benefit from any subsequent opening, especially if they did not have land or capital on which to build or with which to attract foreign investors. As more and more localities rushed to build zones, the frenzy emerged.

Local Leadership Incentives

With gross value of industrial output (GVIO), and not profits, the criteria for promotions and mobility for local cadres, going into debt to attract more enterprises into one's locality was a wise strategy. Thus, during "zone fever" many localities poured funds into land development in the hopes that it would pan out into new investment. For cities that had few global linkages, alienating land was the first step towards attracting foreign investment and development capital. Thus, governments rented land to foreign businessmen whose global networks might attract joint venture partners and, in fact, during "zone fever," were accused of running "policy auctions" — selling land and "policies," such as lower taxes, to attract new plants.[28] One scheme that appeared at this time was to have foreigners put up funds for property development in the zone, of which 70 per cent was returned as working capital after the foreigners moved into the zone.[29] Zones let officials create new posts and new companies for friends and allies, strengthening their networks. These proliferating real estate and land development companies each took a share of the transaction fees that were charged at each step of the land transfer process.

China's political culture played a role as zones, like many other public projects since 1949, became monuments to the ruler's term in office. From the late-1950s through the mid-1970s, officials built water conservation projects as monuments to themselves. The slogan at the time was "*shuji diaodong, shuili zai nong*" ("when party secretaries change, water projects are redone"). In 1992, the local leader's search for prestige mixed with China's policy climate to trigger massive investment in non-productive activity as development zones became the 1980s manifestation of this "edifice" complex. In Jurong county, southeast of Nanjing, "the party secretary of the county 'caught a fever,' ignored our plan and didn't put the zone in its natural location, next to the old town."[30] Why? "He did it for visibility. Many new officials feel that if the zone is put in the old section of town, no one will be able to see clearly what they did. We have a saying: 'whenever you change the party secretary, you have to redo the urban plan'."

Zones became indicators of a leader's ability to modernize and promote science and technology. As neighbouring communities created high tech zones, each locality had to prove that it too could build a bridge to the 21st century. According to documents on the Nanjing's Pukou high tech zone, a "you follow me, I'll pass you" phenomenon emerged, where localities came to feel that "not going forward [with a zone] is going backward, and going forward slowly is in fact going backward."[31]

Economic Institutions: Soft Property, Loans and Taxes

Domestic economic institutions, in particular government planning, soft property rights, the normative acceptance of zone development as a means to link with the global economy, and the local state's predatory strategy towards tax and resource accumulation formed the institutional bedrock of "zone fever."

The nature of urban planning in China abetted zone fever. Socialist planning follows a pattern of "permissive sequencing," where enormous amounts of social overhead capital are spent in anticipation of directly "productive activities."[32] This pattern may be contrasted to market economies which follow a "compulsive sequencing" strategy, where the expansion of industrial enterprises determine the demand for social overhead capital. Therefore, localities first borrow money to build the spatial infrastructure, or what the Chinese call "building the nest to attract the bird." Also, because state-led development followed Baark's infrastructure model of development, because so much competition emerged among zones and cities to attract domestic and foreign investors, and because cities had put expansive urban development plans on hold following the restrictive fiscal climate of 1988-1991, as soon as a political and economic climate conducive to maximalist strategies emerged, cities all over China expanded extant zones, ignored earlier zoning decisions by government urban planners, expropriated land and took out loans from banks that otherwise would not have been available.

Weak economic institutions allowed local officials access to domestic resources with little risk of penalty. Property rights on land in China have always been "soft," so after 1949, when development fevers or leftist "high tides" became the state's dominant ideology, local officials leapt at this opportunity to expand control over this valuable resource.[33] Thus, in both the Great Leap Forward and the Cultural Revolution, local officials, in particular commune leaders, were accused of "expropriating and transferring" (*ping diao*) property owned by villagers and their collectivities and placing it under their own command.[34] Moreover, the local state could simply sell the land's use rights, without giving up formal title. With land bureaus under the horizontal control of territorial governments, the vertical authority structures of the central government were ill-equipped to monitor land transfers.[35] Villagers and district governments surrounding cities might demand better prices, but when municipal party officials who outranked suburban officials pressed the case, resistance was futile. And, who could oppose preparing land for FDI in the development fever that followed Deng's trip south?

Secondly, soft property rights decreased any accountability if investments brought no returns. Who owned the zone, who was responsible if it failed, and who was responsible for the loans used to purchase the land if they were never repaid remained unclear. Opaque property rights were the norm, particularly in the early stages of zone development, when the government's management committee supervised the opening of the zone and before a director of a self-supporting (*zi fu ying kui*) development company, which might face greater economic constraints, took over the zone. But, cities lacking funds for urban development and facing serious difficulties getting collateral for loans could expropriate land and sell it to a newly formed development company which was legally incorporated to build a zone. Thus, most ETDZs set up independent management companies responsible for financing and supervising the construction of the zone. With the city's support, the development company could get bank loans to construct factory space in the zone, which they could sell to prospective investors. Yet, the director of such companies would also have little legal liability were the zone to default on the loan. Moreover, buying and selling land became an important income generating strategy for local governments and their allies in government-owned development companies in the 1990s. According to Beijing television, land speculators earned 500 per cent profit at each stage of the land sale process through a process the Chinese call "stir-frying land property" (*chao di chan*).[36]

For example, Qingdao's government established a local real estate company whose shareholders were comprised of the city government, the surrounding villages, and the villagers, each of whom was given shares based on their contributions to the company.[37] Rural residents and villages were compensated for the land, while the city government was given shares for the "use rights" that it reportedly transferred to the land management

company. To facilitate development, however, the zone's management committee (composed of city administrators) helped the management company get loans worth 70 per cent of the value of the land. In essence, the government expropriated land, transferred it to a management company and, then, loaned that company money to build the zone. While in this case the interest rate was set at 11.4 per cent, in some cases city governments subsidized the interest payments, allowing the management company to get the money for free. Speculation was further fuelled (but domestic funds raised) by leasing the land to domestic real estate investors at a rate that was 10 per cent below that charged to foreigners, insuring the real estate company an instant 10 per cent profit if it could find foreign investors. With city governments and zones raising capital for infrastructure development without serious financial liability, it is no wonder so many zones lay fallow.

Finally, taxes, the lifeblood of the local state, pushed local governments to develop unprofitable zones. A large percentage of government finances came from the transaction tax imposed on every sale that occurred within a government's territory, rather than its profits.[38] Since all land transfers, loans, property sales and construction created taxable funds for local government coffers, it became lucrative for governments to expropriate land from villagers, sell it to a development company and let these companies resell the land to different developers, as all these sales were taxable.

In the end, an enormous amount of revenue was generated for government officials, bureaucrats and semi-public companies, with very little risk. Why? The ethos of the period justified their behaviour; their political power and monopoly on coercion prevented serious opposition; the widespread nature of the phenomenon prevented recriminations; soft property insured that hidden profits were easy to take; and the awareness that this strategy might speed up a locality's internationalization and make the central government more willing to open their locality to deregulated global linkages, all legitimized this strategy and created an enormous problem for China's political economy.

The State's Reactions to Zone Fever

While concerns about this fever emerged in 1992, the state did not act until 1993, at which time the central government established a clear policy opposing this proliferation of zones nation-wide. Thus, in autumn 1992, conservative spokesman Yuan Mu criticized this phenomenon, but his voice was ignored as some leaders in Beijing worried that negative signals so early in the liberalizing cycle would dampen the local initiative Deng's southern trip had engendered. But, the widespread and corrupt nature of this phenomenon could not be ignored. In January 1993, Vice Premier Zhu Rongji criticized zones covering 20-30 sq. km. as "fantasy."[39] In early February 1993, Benxi, a large city in Liaoning province, closed two zones, while Anhui province closed all township level development zones, returning the land to farmers.[40] In July 1993, the afore-mentioned exposé appeared on national television, outlining the waste, corruption and role of personal networks in this fever. The sharpness and openness of the attack suggest that it might have been approved by the Standing Committee of the Politburo. As a result, in summer 1993, the State Council's Special Economic Zone Office (SEZO), which was responsible for approving State Council ETDZs, was overburdened with the task of investigating this policy aberration, and, in August 1993, Hu Ping, its director, reported that only 10 per cent of zones were beneficial, while 20 per cent were awaiting funds to start projects. By summer's end, coastal areas had closed over 75 per cent of their zones, while seven counties had cut the area of their zones by 89 per cent.[41] The fever had passed.

Conclusion

Zone fever had both policy and institutional roots. Political pressures, combined with weak property rights and financial constraints pushed local leaders to adopt zone development as part of their economic strategy. But, to what extent have China's leaders been able to ameliorate this problem?

Overall, the policy context, created by the strategy of "segmented deregulation," has changed significantly, as the process of global integration and the expansion of deregulated spaces has slowed. In fact, a major debate ensued in 1995-1996 over preferential policies, during which time the SEZs were almost closed down. But, the state has not proffered any new mechanism for spatial deregulation that could prompt a similar fever. Nevertheless, the decision to deregulate the majority of state-owned enterprises, while protecting about 500-1,000 of them, does follow a similar pattern and could lead to a similar fever of privatization.

However, institutional reform has come much more slowly; hence, China's current overinvestment in property. Property rights over land remain unclear. Villagers are seen to have some rights to compensation, since they occupy the land, and the state has decided to pay them for relocating into apartment houses. But, administrative authority still dominates, and suburban officials and their rural constituencies are unable to prevent these land confiscations. Moreover, after the land is resold at a much higher price to developers and villagers, now alienated from their land, are forced to retire from farming with no other means of employment, hostility can emerge. Similarly, while banking reform has moved onto the national agenda, in part the result of the East Asian fiscal crisis, slow steps in the reform process and strong opposition have prevented a full-scale institutional reform of this sector which contributed so strongly to zone fever.[42] For without the access to easy cash, cadres had less incentive and ability to follow the infrastructural model of development.

Thus, the real issue remains the need for significant legal, financial and ownership reforms that would undermine the institutional arrangements and speculative climate that emerged in China in the 1990s and which would no longer generate incentives for this type of non-productive economic activity. Zone fever may be over, but the institutional roots of that short-term frenzy persist and may be fuelling a housing and rental property boom that could bring a serious crisis to China's ongoing reform process.

Notes

1. Nicholas Lardy, "China's Precarious Future," *The Asian Wall Street Journal*, 5 February 1998.
2. Personal communication with Jae Ho Chung, 1996.
3. *China Daily*, 8 June 1992, p. 2, and 9 May 1992, p. 2, respectively.
4. Personal observations during a visit to Jinan in summer 1993.
5. Chengdu had centres of science and technology in the city and the suburbs, as universities had been set up in two locations. Although the city put its high tech zone in the city centre, after 1992 they expanded the zone to include labs in both parts of town.
6. "Obviously the fever must have gone to people's heads as they cannot ever develop the land they have obtained." *Liaowang*, overseas edition, No. 51 (21 December 1992), pp. 16-17, in *Foreign Broadcast Information Service* (hereafter, *FBIS*)-CHI-93-011 (19 January 1993), pp. 30-32.
7. Interview with urban planning official in Jiangsu, Nanjing, spring 1992.
8. Ibid.
9. This was the report by Wang Xianjin, director of the State Land Administration Bureau. See "With One-Third of Development Zones Suspended, Over 20 Million *Mu* of Land Has Been Recovered," *Ta Kung Pao*, 30 September 1993, p. 5, in *FBIS*-CHI-93-193 (7 October 1993), p. 20.
10. On 4 July 1993, Beijing Television Channel No. 1 broadcasted nation-wide a heavily sarcastic and decidedly critical programme, which sounded more like "60 Minutes" than Chinese television. That the programme openly attacked land speculators, particularly in Beijing and Beihai, Guangxi province, the poorest of the 14 open coastal cities, suggests that central leaders knew the problem they faced.

11. *Liaowang*, overseas edition, No. 51 (21 December 1992), pp. 16-17, in *FBIS*-CHI-93-011 (19 January 1993), pp. 30-32.
12. See *Zhongguo tongji nianjian* (Statistical Yearbook of China), *1989*, p. 479.
13. *Liaowang*, overseas edition, No. 51 (21 December 1992), pp. 16-17, in *FBIS*-CHI-93-011 (19 January 1993), pp. 30-32.
14. Reformers followed "the political logic of reform" because bureaucrats were both targets of reform and the state agents who were expected to introduce them. Susan L. Shirk, *The Political Logic of Economic Reform* (Berkeley, CA: University of California Press, 1992).
15. For the classic study on policy types and their impact on the policy process, see Theodore J. Lowi, "American Business, Public Policy, Case Studies and Political Theory," *World Politics*, Vol. 16, No. 4 (July 1964), pp. 677-715.
16. See Kenneth G. Lieberthal, "Introduction," in Kenneth G. Lieberthal and David M. Lampton, eds, *Bureaucracy, Politics, and Decision Making in Post-Mao China* (Berkeley, CA: University of California Press, 1992).
17. Helen V. Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton: Princeton University Press, 1988).
18. For an example of this process in Egypt, see Jeswald W. Salacuse, "Foreign Investment and Legislative Exemptions in Egypt: Needed Stimulus or New Capitulations," in Laurence O. Michalak and Jeswald W. Salacuse, eds, *Social Legislation in the Contemporary Middle East* (Berkeley, CA: Institute of International Studies, University of California, 1986), pp. 241-61.
19. Erik Baark, "Technological Entrepreneurship and Commercialization of Research Results in the West and in China:

Comparative Perspectives," *Technology Analysis and Strategic Management*, Vol. 6, No. 2 (1994), pp. 203-14.

20. See Thomas M. H. Chan, "Financing Shenzhen's Economic Development: A Preliminary Analysis of Sources of Capital Construction Investments, 1979-1984," *Asian Journal of Public Administration*, Vol. 7, No. 2 (December 1985), pp. 170-97.
21. Louise do Rosario, "Models in a Muddle: China's SEZs Are Struggling to Justify Their Role," *Far Eastern Economic Review*, 1 October 1987, pp. 102-03.
22. "Regulations of the Nantong City People's Government concerning Favourable Policies for Domestic Firms," in *Yanhai, yanjiang, yanbian kaifang falu fagui ji guifanxing wenjian huibian* (Compendium of Documents Concerning the Laws, Regulations, and Standardization of the Opening of the Coastal, Riverine, and Border Regions) (Beijing: Falu chubanshe, 1992), pp. 1801-03.
23. Interview with SSTC officials, Cambridge, MA, 1995.
24. These policies included duty free imports on high technology, greater freedom to hire and fire workers and a 15 per cent, not 55 per cent tax rate for high tech *domestic* firms who set up with new products in the zone. Not surprisingly, new domestic tenants lined up at the door. See David Zweig, "China's New Warlords," *Asian Wall Street Journal*, 3 August 1992.
25. Scholars debating Pudong decided that, despite assertions that domestic capital should play no role in Pudong's development, they would now argue that it had become absolutely necessary (*ying you de diwei*). See "*Jingji zhuanjia xuezhe yanlun Pudong kaifa guandian zongshu*" (Summary of Views of Economic Scholars and Experts' Research on Opening Pudong), *Renda ziliao* (People's University Reference Materials), SEZs and Open City Economies, F14, No. 12, pp. 53-58. The quote is from p. 57.
26. This and the following paragraph draw heavily on Zhang Jianxiu, "*Zhongguo xin yi lun kaifang qian zai shenme wenti?*" (Where Is the Problem in China's New Opening Cycle), *Guang zhao jing* (Wide Mirror, Hong Kong), published in *Editor's and Translators Reference Journal* (Beijing), No. 1 (1991), pp. 2-4.

27. Jude Howell, *China Opens Its Door: The Politics of Economic Transition* (Boulder, CO: Lynne Reinner Publishers, 1993).
28. *Zhongguo tongxun she*, 4 November 1992, in *FBIS*-CHI-92-228 (25 November 1992), pp. 28-29.
29. See *China Daily*, 10-16 May 1992, p. III.
30. Interview, Nanjing, 1992.
31. In Chinese, *bu jin ze tui, jin de man ye shi tui*. See "Nanjing Pukou xin gao jishu waixiang xing kaifa qu jingji guihua yanjiu" (Research on the Current Plan of Nanjing's Pukou High Tech Export Oriented Development Zone), *Keji yu jingji* (Technology and Economics), No. 3 (1991), pp. 29-45.
32. R. Y. W. Kwok, "Structure and Policies in Industrial Planning in the Shenzhen Special Economic Zone," in Y. C. Jao and C. K. Leung, eds, *China's Special Economic Zones: Policies, Problems and Prospects* (Hong Kong: Oxford University Press, 1986), pp. 39-64.
33. For an analysis of conflict over land between the state, local governments and farmers since 1949, see David Zweig, *Freeing China's Farmers: Rural Restructuring in the Reform Decade* (Armonk, NY: M. E. Sharpe, 1997), ch. 5.
34. David Zweig, *Agrarian Radicalism in China, 1968-1981* (Cambridge, MA: Harvard University Press, 1989).
35. One could see this as a principal-agent problem or simply what the Chinese see as *tiaotiao* (vertical or ministerial) control versus *kuaikuai* (horizontal or territorial) control.
36. Beijing Television Channel No. 1, 4 July 1993, as seen in Jinan, Shandong province.
37. Yang Wei, "A Study on Chinese Economic Development Zones," unpublished paper, Hopkins-Nanjing Centre, Nanjing University, 1992.

38. Andrew G. Walder, "The County Government as an Industrial Corporation," in Andrew G. Walder, ed., *Zouping in Transition: The Process of Reform in Rural North China* (Cambridge, MA: Harvard University Press, 1998).

39. See *Ta Kung Pao*, 17 January 1993, p. 2, in *FBIS*-CHI-93-011 (19 January 1993).

40. *FBIS*-CHI-93-027, 11 February 1993, p. 21.

41. *FBIS*-CHI-93-154, 12 August 1993, p. 32.

42. Peter Seidlitz and David Murphy, "Bureaucracy Hinders Reform of Mainland's Beleaguered Banks," *South China Morning Post*, 15 February 1998.