Chinese Experience with Special Economic Zones

التجربة الصينية مع المناطق الاقتصادية الحرة

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Abstract

China's economic growth miracle can be largely contributed to its successful Special Economic Zones (SEZs) programs. The SEZ experiment has transformed China into one of the largest FDI recipients, exporters and foreign exchange reserve holders in the world. Chinese government now is trying to share this SEZs experience with other countries and among them Algeria. In this paper we will talk about the Chinese SEZs experience and the major factors for their success, as well as China's SEZs experience in Algeria.

Key words: *Special Economic Zones, China, Algeria, Free zones*

Résumé

Le miracle de la croissance économique de la Chine peut être largement contribué à son programme très réussi des zones économiques spéciales (ZES). L'expérience des ZES a transformé la Chine en un des plus grands: receveurs d'IED, des exportateurs et des détenteurs de réserves de change dans le monde. Le gouvernement chinois tente maintenant de partager cette expérience de ZES avec d'autres pays et parmi eux l'Algérie. Dans cet article, nous allons parler de l'expérience chinoise des ZES et les principaux facteurs de leur succès, ainsi que l'expérience chinoise des ZES en Algérie.

Mots clefs: *Zones Économiques Spéciales, Chine, Algérie, Zones franches.*

Introduction

Over the past few decades, China has achieved phenomenal economic growth, with GDP rising on average by 9.5 percent per year over the last thirty years. China now is a prominent economic power in the world economy with its overall share in world trade rising from less than 1 percent in 1979 to over 10 percent in 2013. The stock of FDI in China in 2010 is up to US$578.8 billion from US$25 billion in 1990. In 2014, China surpassed the United States and became the largest recipient of FDI with $129 billion inflows. This growth miracle can be largely contributed to its successful Special Economic Zones (SEZs) programs, which piloted many market-oriented reforms. The SEZ experiment has transformed China into one of the largest FDI recipients, exporters and foreign exchange reserve holders in the world. In 1979, with its "Open-Door" policy led by Deng Xiaoping and in order to attract foreign investment, China has established four special economic zones in the southeastern coastal region of the country. These zones were granted special financial, investment and trade privileges. These experimental reforms proved to be immensely successful, and the State Council subsequently opened up additional cities. In 1984, 14 coastal cities set up industrial and technological development zones, many of which nurtured clusters targeting a particular industry. More than a hundred zones of various kinds now have been established around the country. These SEZs (including all types of industrial parks and zones) have contributed significantly to national GDP, employment, exports, and attraction of foreign investment and new technologies, as well as adoption of modern management practices, among others.

As China learned the SEZ experience from other countries like Ireland with its Shannon zone and the Japanese model and in order to emphasize its policy of going global, China now is trying to share this experience with other countries. In 2006, the central government announced a policy decision to eventually establish up to fifty special economic and trade cooperation zones outside the country (World Bank 2010), seven of them were selected to be established in six African countries and among these countries there was Algeria.

The SEZs program can be an effective instrument to promote industrialization if implemented properly in the right context. As much as for China the SEZs experience was very successful, for Algeria this experience was relatively poor. Thus, this paper is intended to provide an overview of the Chinese SEZs experience and the major factors for their success, as well as China's SEZs experience in Algeria. For this purpose, the paper is structured in the following way: firstly, we present an overview on the Chinese SEZs where we cite the main characteristics of these zones and their performance, policies applied to them and the major factors for their success. Then, we demonstrate China's SEZs experience in Algeria where we try to analyze the key challenges in the establishment of the zone, and to find out what should Algerian government do to concretize the SEZ program. Finally, we conclude.

1. China's Special Economic Zones:

Special Economic Zones are not a Chinese creation, but China in particular realized tremendous success with this economic tool. Historically, the liberal business environment in these areas allowed foreign businesses to operate more comfortably in the Chinese business, sheltered from the bureaucracy and red tape that often characterizes the rest of the country. SEZs are successful in China primarily because of the central Chinese government's strong support and the relative autonomy of zone managers.

1.1. Defining Special Economic Zones:

Special Economic Zones are geographically delimited areas, administered by a single body, offering certain incentives (including more liberal and simplified economic regulations) for businesses that locate and operate within the zone, they vary in size and scope and operate under different regimes such as Economic and Trade Cooperation Zones (ETCZs), Free Trade Zones (FTZs), Export Processing Zones (EPZs) and Industrial Zones (IZs).[1] SEZs offer a combination of serviced land, quality infrastructure, expedited customs and other administrative procedures, and other incentives that aim at overcoming investment barriers at a national level. SEZs are development tools that in several countries have helped to stimulate economic development by attracting local and foreign direct investment (FDI), enhancing competitiveness, and facilitating export-led growth. The basic concept of a special economic zone includes several specific characteristics: (a) it is a geographically delimited area, usually physically secured; (b) it has a single management or administration; (c) it offers benefits based on physical location within the zone; and (d) it has a separate customs area (duty-free benefits) and streamlined procedures (World Bank 2009).

Special Economic Zones confer two main types of benefit which we can classify into short run benefits (or direct benefits): they are derived through the use of economic zones as instruments of trade and investment and they include employment creation, foreign exchange earnings, export growth, foreign direct investment and government revenues; and long run benefits (or indirect benefits): they include skills upgrading, technology transfers, encouragement of domestic entrepreneurialism, economic diversification and the creation of economic openness, etc. All these benefits are summarized in Table 1.

Table 1: Benefits derived from SEZs

	Direct benefits	Indirect benefits
Foreign exchange earnings	•	
Foreign direct investment	•	
Government revenue	•	
Export growth	•	
Skills upgrading		•
Testing field for wider economic reform		•
Technology transfer		•
Export diversification		•
Enhancing trade efficiency of domestic firms		•

Source: Douglas Zhihua Zeng (2010), Building Engines for Growth and Competitiveness in China: Experience with Special Economic Zones and Industrial Clusters, World Bank Publications, P: 58

1.2. China's SEZs Performance:

In 1979, as a part of China's economic reform and open door policy led by Deng Xiaoping, the State Council and the Central Committee of the Chinese Communist Party jointly issued a directive allowing the two southern coastal provinces of Guangdong and Fujian to undertake special policies and flexible measures to promote foreign trade and investment. One year later, four SEZs were set up; three of them - Shenzhen (near Hong Kong), Zhuhai (near Macao), Shantou (a major home of overseas Chinese) - located in Guangdong Province and one at Xiamen (across Taiwan) in Fujian Province. These four SEZs were quite similar in that they comprised large areas within which the objective was to facilitate broadly based, comprehensive economic development, and they all enjoyed special financial, investment, and trade privileges. In these zones, local governments have been allowed to offer tax incentives to foreign investors and to develop their own infrastructure without the approval of the central government. Business enterprises have made most of their own investment, production, and marketing decisions, and foreign ownership of such ventures has been legalized. Though some of them began as little more than small towns, the new SEZs soon attracted foreign investment and became boomtowns, with rapidly expanding light and consumer-goods industries and growing populations. The economic development in Guangdong province was quite dramatic with the average growth rate of GDP of 14.2 % between 1978 and 1995, which is by far greater than the national average of 9.9 %. Fujian's annual average growth rate of GDP was enhanced drastically to 19 % in the first half of 1990s, almost twice as high as the rate recorded during the previous decade (1980s). Regarding investment flow and during the period of (1979-1987), about 60 % of the total FDI flowed into Guangdong province.

In 1984, and encouraged by the zones' success, the Chinese government opened 14 coastal cities to foreign trade and investment including: Dalian, Shanghai, Ningbo, Tianjin, Guangzhou, etc. Meanwhile, in 1988, the state decided to turn Hainan Island into mainland China's biggest special economic zone (approved by the 1st session of the 7th NPC in 1988). Subsequently, in 1990, the Chinese government opened the Pudong New Area in Shanghai to overseas investment, and additional cities along the Yangtze River valley, with Shanghai's Pudong New Area as its "dragon head." The pattern of granting SEZ status in earlier years is not purely random, according to state-council documents (1980- 1990), the central government chose municipalities to be granted with the Special Economic Zones based on better geographical location, industrial condition and human capital. From 1992 to 1994, the State Council has opened a number of border cities and all the capital cities of inland provinces and autonomous regions.

In 2014, there were 6 SEZs, 14 open coastal cities, 4 free trade areas and 5 financial areas. There were also 31 bonded areas, 114 national high-tech development zones, and many other types of SEZs at various levels. [2]

The role played by SEZs in China's economic growth is evident from the growth rates of its economy after 1980; it grew at a rate of 10.9 percent since then primarily because of the performance of the SEZs. The GDP per capita grew from Y 455 in 1980 to Y 4754 in 1995.[3] Between 1979 and 1995, the country received 40 percent of international FDI to developing countries; 90 percent went to the coastal areas; 40 percent to Guangdong Province (the three Guangdong zones absorbed 50 percent of that total).

In recent years, national SEZs have contributed 22 percent of China's GDP, 45 percent of total national foreign direct investment, and 60 percent of exports. SEZs are estimated to have created over 30 million jobs, increased the income of participating farmers by 30 percent, and accelerated industrialization, agricultural modernization, and urbanization.[4] China now is the world's largest Exporter of manufacturers and the leading recipient of FDI among emerging economies.

In addition, SEZs have significantly contributed to technological progress and innovation. Currently, China's overall technology commercialization rate is only about 10 percent, while industrial parks in China on average boast a commercialization rate of over 60 percent. In agriculture, the contribution of technological development stands at 55.2 percent, while in agro-tech parks and agricultural demonstration zones, the contribution rate of technology reaches roughly 70 percent, nearly the average level of developed nations. (Zeng 2015)

1.3. Economic policies in China's SEZs:

The SEZs were used as a test base for liberalization of trade, tax and other policies that were then gradually applied to the rest of the economy. In August 1980 the People's Congress passed the first legal rule on the SEZs: "the Regulation for Guangdong SEZs". This regional law was the first of its kind to be tested, which was drafted with the help of legal experts sent from the central government. When the experiment was expanded into other provinces, they also adopted and modified this law accordingly. The law of SEZs explicitly provides the following policy packages for foreign investors:[5]

a. Private Property Rights Protection; the SEZs encourage foreign investors, overseas Chinese, compatriots from Hong Kong and Macau and their companies and enterprises to open factories and set up enterprises and other establishments with their own investment or in joint ventures with Chinese. The SEZs guarantee to protect their assets, accruing profits and other rights in accordance with the law. (This is a very important commitment by the Chinese government since there was no constitutional protection of private property rights outside SEZs until recently (the 2004 constitutional amendment)).

b. Tax incentives; foreign investors can enjoy a reduced rate (15-24%) of corporate income tax compared to 33% paid by domestic firms. They bear virtually zero custom duties and can enjoy duty free allowances for production materials. There are income tax exemptions for foreigners working in SEZs as well.

c. Land use policy; under Chinese law, all land is under state ownership. Foreign investors may lawfully obtain the rights for land development, use and business. They may also transfer and lease land rights, or put them up for mortgage in accordance with the law within the stipulated purposes and terms of the use. For example: When foreigners invest in projects encouraged by the State for an operation term of more than 15 years, the construction land is exempt from land use fees for five years starting from the day when the enterprise obtains the use right, and the fee is collected at half price in the following five years.

d. Liberal economic and labor laws; there are limited restrictions on foreign ownership. More flexible labor markets; foreign invested firms have the power to hire and fire their employees.

e. Facilities to foreign investors; Give to foreign investors and their families' suite of residence and immigration procedures, also the right of repatriation of profits

The government made clear the targets of Special Economic Zones described by 4 principles: "Construction primarily relies on attracting and utilizing foreign capital; Primary economic forms are Sino-foreign joint ventures and partnerships as well as wholly foreign-owned enterprises; Products are primarily export-oriented; Economic activities are primarily driven by market forces".

1.4. Major factors for China's SEZs success:

The Chinese experience suggests that a gradual approach works better than abrupt changes. The SEZs are set up as the laboratories to test the new policies so that the policies can be adjusted in time according to the result of application in the SEZs. According to Zeng (2015) and Yeung, Lee and Kee (2009), many factors are the origin of success of SEZs in China and contributed to their development, the major ones are: a. a strong support and engagement of the government to implement the "Open-Door" policy through a gradual approach. Such a determination ensured a stable and supportive macro-environment for the reform policies. The central government has also tried to decentralize its power and help create an efficient regulatory system and a conducive business environment within the zones. In addition, the government has put in place good infrastructures for the zones. b. Preferential policies and institutional autonomy. To encourage investment in the zones, the government has offered various facilities to investors, including preferential fees for land or facility use, reduced duties on imports, duty free imports of raw materials and intermediate goods, rapid customs clearance the ability to repatriate profits and capital investments, flexibility in hiring and firing workers, among others. Favorable policies were also in place to attract skilled labor, such as the provision of housing, research funding, education subsidies, etc. In addition, the SEZs had the legislative authority to develop local laws and regulations to manage these zones, which can help to make adjustments based on business needs and market conditions, as well as on development stage. c. Location advantages. Most of SEZs are located in the coastal cities, which have better links to the international market or have a history or tradition of foreign trading or business. Furthermore, they have good access to infrastructures, such as ports, airports, and railways. d. Foreign Direct Investment and the Chinese diaspora. The Chinese diaspora have played a prominent role in the success of SEZs by attracting capital investment, technologies, and management skills; generating learning and spillovers; and ultimately helping to build local manufacturing capacity. e. Technology learning, innovation, and upgrading. SEZs were characterized by a high concentration of very skilled people, especially R&D personnel in the HIDZs and ETDZs. Therefore, they provide a ground of knowledge and technology generation, adaptation, diffusion, and innovation. In addition to strong emphasis of government put on technology learning and innovation, as well as technology-intensive industries. f. Strong links with the domestic economy. The SEZs are closely linked to domestic enterprises and industrial clusters through supply chains or value chains. This can help to stimulates synergistic learning and enhances industrial competitiveness beside achieving economies of scale and business efficiency.

2. China's SEZ experience in algeria:

In 2006, at the Forum on China-Africa Cooperation (FOCAC) meeting in Beijing, the Program for China-Africa Cooperation in Economic and Social Development was launched, in which the Chinese government announced its intention to establish up to fifty special economic cooperation zones abroad. Following two rounds of tenders in 2006 and 2007, where more than 120 Chinese companies proposed projects and then judged by a panel of experts who considered their market potential and overall feasibility, host country investment environment and degree of support, and the capacity of the developer, China's Ministry of Commerce (MOFCOM) approved proposals for the development of seven SEZs in six African countries: one each in Algeria, Egypt, Ethiopia, Mauritius and Zambia (located in the Copper belt region with a subsection in the capital, Lusaka), and two in Nigeria (one near Lagos and the other in the Ogun region).

2.1. China's SEZ in Algeria:

In 2008, China and Algeria entered into an agreement to establish a second Chinese Special Economic Zone in North Africa, the Jiangling Economic and Trade Cooperation Zone, which was to be hosted in Mostaganem (western Algeria) with the focus on assembling cars. The agreement involved the Chinese Jiangling Automobile Group from Nanchang, Jiangxu province, Zhongding International Group, and their Algerian partner Groupe Mazouz.[6] Jiangling Automobile, one of China's leader companies, has more than 40 sales agents in Algeria and, by 2007, had taken one-third of Algeria's automobile market.[7] Zhongding International Group is the arm for overseas construction and engineering of Pingxiang Coal Group (PKCC). PKCC has been operating in Algeria for more than 17 years and contracted dozens of medium and large projects there.[8] When MOFCOM announce a call for applications to establish overseas SEZs and in order to establish a platform for the enterprises of Jiangxi province to go global, the Jiangxi provincial government coordinated an effort to link PKCC and Jiangling Automobile Group, to send the proposal. They won in the second MOFCOM bidding round in 2007.

The Algeria Jiangling zone was projected to have a total investment of US$556 million and a land area of 500 hectares, with a first development phase on 120 hectares. It planned to attract 30–50 Chinese enterprises into an industrial park focusing on automobiles and construction materials (Brautigam and Tang 2011). In March 2008, Zhongding International and Jiangling sent a combined team to Algeria for preparation. Unfortunately, the project was suspended, when the Algerian government made the 2009 complementary finance law in which it changed its laws on foreign investment to require Algerian ownership of at least 51% of a project. This may not be acceptable to the Chinese developers.

Others have argued that the decision was influenced by ongoing negotiations between the Algerian government and the French car manufacturer, Renault, for the establishment of the Renault car-assembling factory in Algeria. Renault was said to be concerned that it would face stiff competition from Chinese car manufacturers if they were to also produce in Algeria. (Renault eventually withdrew its offer and opened a factory in neighboring Morocco). Subsequent interviews with Groupe Mazouz also indicated a concern over the quality of Chinese products given the high demands of the Algerian consumer and their attraction to anything produced by the West. Furthermore, the Chinese companies and their Algerian partners have been involved in fraud cases further damaging the reputation of Chinese companies.

2.2. Key challenges in the zone establishment:

As we have illustrated above, the successful implementation of any SEZ program requires strong political commitment and support for the development and operation of a SEZ. For the case of Algeria and to prepare for the operation launch of the zone, a Chinese delegation has paid a visit to Algeria. During their visit, the delegation was received in the Ministry of Industry and Investment Promotion and by the wali of Mostaganem. This was as part of the national development strategy and the government however has not provided a specific support to ensure the embodiment of the zone project.

The second important factor for success of a zone is legal and regulatory framework. Algeria has engaged in a process of comprehensive reforms since the 90s. As part of sectoral reforms characterizing its transition to a market economy it has opted for the creation of free zones and has promulgated the executive decree N° 94. In 1997, the free zone Bellara (Jijel) was selected as a first free zone in the country, but this project never saw the day. This failure can be explained by the difficult security situation in the 1990s, the slow pace of legal texts for the establishment of the zone and for the orientation of the Algerian economy to trade openness. In 2003, it was another attempt to revive the economic areas in Algeria after the promulgation of the Ordinance 03-02[9], which set the general rules governing these areas and the site Bellara was chosen again to host this project. But in 2006 the 06-10 law[10] has come to repeal the 2003 ordinance without the government gives convincing reasons on this repeal. In 2012, the Minister of Industry, SME and Investment Promotion announced that the Algerian government plans to revive the free zone of Bellara. Effectively, in March 2015, Algeria and Qatar have launched the construction of a steel complex in the framework of partnership between the Sider Group and Qatar Steel. Then, Bellara zone will have to finally welcome a major steel industrial complex rather than a free zone. We can conclude that there is no a free zone regulatory framework in the country, which present a major challenge for China as well as for foreign operators in realizing the SEZ project in Algeria.

In addition, another challenge that China has faced in its attempt to create the zone was the 2009 Complementary Finance Law, which states that foreign investments in any sector require a 51 percent Algerian partnership. This may not be acceptable for the Chinese developers who have passed by this in its experience with other African countries. In Egypt, in the first stage of the implementation of the zone, the major partners were Egyptian, but the joint venture failed to develop. The major reason according to china was the partnership which has not only hamper TEDA (Chinese part) to implement its ideas due to different perceptions of the business model and inefficiency in communication, but the local partners were even said to have embezzled funds from the zone. Similar difficulties were also reported, although not embezzlement, in the Sino-Nigerian co-managed Lekki zone.

Another factor for the success of a SEZ is the existence of modern infrastructure to and within SEZs as well as the provision of reliable utility services such as electricity and water. Despite the lack of basic infrastructure in Algeria, there is always an attempt to improve it. Under the previous five-year plans of 2010-14, a major government objective has been the modernization and expansion of Algeria’s transport networks. With some €229 bn have been allocated to the development of railways, airports, public transport, roadways and ports. Moreover, Algeria enjoys an electricity distribution network and gas that provides national coverage to 98%.[11] However, Alegria steel need to more develop its infrastructures.

An additional challenge to the previous ones is the transparency of regulatory system. Generally, Algeria's regulatory system is transparent, but decision-making authority remains opaque. Each ministry defines its rules for doing business in the sectors it manages, and regulatory bodies are established to administer them. Challenges arise in managing the bureaucracy, because authority is generally vested at the top of every organization, and access to decision-makers is often limited. Furthermore, the Algerian bureaucracy is slow and protocol-oriented, such that even minor deficiencies in paperwork can lead to significant delays and fines. In some cases, authority over a matter may rest among multiple ministries, which imposes additional bureaucratic steps and the likelihood of inaction due to errors or unusual circumstances.

2.3. What should Algerian government do?

The partnership to develop of SEZs is part of a long-term process of strategic engagement between China and Algeria and even with other foreign partners and firms who want to invest in Algeria. It offers a significant opportunity to contribute to job creation, industrialization, and poverty reduction in the country. To fulfill this potential, however, the projects must be successful from a legal, business, and social, perspective. This will require the following elements:

- High-level commitment and active engagement from Algerian government to support SEZs programs. The government has to reset the 03-02 Ordinance which represents the free zones regulatory framework and has also to make a long-term legislative continuity to give investors more confidence. In addition, the policies and development model need to be adjusted according to the stage of development.

- The government has to create these free zones basing on comparative advantages like oil sector and its derivatives. "Algeria has oil products and their derivatives like plastic with low costs, this is an advantage compared to other countries. Why not create a free zone specialized in refining."[12] In addition, other sectors are interesting and offer opportunities to foreign and domestic investors like food industry, chemistry, construction materials and pharmaceutical industry.

- The importance of a better business environment inside the zone, including efficient services, such as one-stop shop and good infrastructure. We need to provide all basic infrastructures with high quality whether in the zone or outside the zone (the zone need to have better linkages with local suppliers/clusters as part of their value chains).

- For technology transfer and skills development, we need to experts, exploitation licenses, training courses, etc. The government should also offer special incentives to attract high-tech firms.

- Respecting the notion of time in the realization of investment projects in general and the free zones in particular is an essential point that the Government should not overlook in order to achieve the objectives set.

- Finally, Algeria can follow China's strategy in considering these zones as a testing ground for economic and legal reforms, then these zones can serve as a way to test new laws and regulations and when these laws work successfully they can later regularly became national laws.

Conclusion

China has successfully implemented the SEZ programs and offers many very useful lessons and approaches for other developing countries. However, there is "no one size fits all" approach. All the experiences and lessons need to be adapted to the situations of the particular economy. That is how China learned from Western countries and succeeded, and the same should be true for any country. Meanwhile, China did not simply replicate models for reform but instead explored its own way toward a market economy, incorporating characteristics that fit China's unique situation. Such pragmatism is crucial for achieving any successful reform.

In the other hand, and to develop SEZ program in Algeria, this needs a long-term process of strategic engagement of Algeria with China or with other foreign partners and firms who want to invest in the country. The SEZ program offers a significant opportunity to contribute to job creation, industrialization, and poverty reduction in the country. To fulfill this potential, however, the projects must be successful from a business, social, and environmental perspective. Therefore, Algerian government should have high-level commitment and active engagement, ensuring the provision of quality off-site infrastructure, communicating and enforcing standards, implementing programs to promote domestic market linkages, and transparency and community relations.

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