

THE TURNING POINT FOR CHINA AND THE ANSWER OF
THE PORTUGUESE TEXTILE INDUSTRY

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Abstract

The world has witnessed the incredible economic development of China in recent years. But there are few people that actually understand the causes and consequences of this development. It is the primary objective of this dissertation to explain how this process did occur. The study will be an attempt of locating the exact moment which was decisive and triggered the Chinese economic boom and made an impact worldwide. To find such moment, China's transition process analysis was divided in three main events that could represent that moment – the economic reforms and open door policy in late 1970s and 1980s, the economic performance of Shanghai and Pudong New Area in the 1990s, and the accession of China to the World Trade Organization in 2001.

The consequences of the Chinese economic development will not only be measured in the perspective of this country since they affected the whole world. For this reason, the impact that this economic boom had in a well-known reality – the Portuguese economy and particularly the textile industry – will also be analysed through an empirical research. Since the empirical research was narrowed to the textile industry, it will also be possible: to evaluate the reaction of this industry to the entry of Chinese competitors in the market; to suggest what could have been done to better prepare the firms against these new competitors; and to take lessons from the conclusions withdrawn from this study that may be valuable for companies which face the threat of being surpassed by their counterparts from an emergent economy.

JEL Classification System: M10, P20, L67

Keywords: Chinese economic development, Portuguese textile industry, World Trade Organization

Abstracto

O mundo tem testemunhado o desenvolvimento económico da China nos últimos anos. Mas poucas são as pessoas que realmente compreendem as causas e consequências deste desenvolvimento. Um dos objectivos desta dissertação é explicar como este processo decorreu. Este estudo é uma tentativa de localizar o momento exacto que despoletou o crescimento económico Chinês tendo, por isso, impacto à escala planetária. Para encontrar tal momento, a análise do processo de transição da China foi dividida em três acontecimentos que podem representar esse mesmo momento – as reformas económicas do fim da década de 1970 e da década de 1980, a evolução económica de Shanghai e Pudong na década de 1990, e a entrada da China para a Organização Mundial do Comércio em 2001.

As consequências do crescimento económico Chinês não serão apenas medidas na perspectiva deste país visto que afectaram todo o mundo. Por esta razão, o impacto que este crescimento teve na economia Portuguesa, e particularmente na indústria têxtil, também será analisado através de uma pesquisa empírica. Como esta pesquisa foi direccionada apenas para a indústria têxtil, também será possível avaliar a reacção deste sector para com a entrada de competidores Chineses no mercado, sugerir o que poderia ter sido feito na preparação dessa reacção e daqui retirar lições que constituirão informação valiosa para empresas ameaçadas pelas suas homólogas pertencentes a economias emergentes.

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Acknowledgements

The original idea for this study was to understand how China became a major concern for managers and governments worldwide. This process was not as sudden as one might think. Instead, it was thought through transition from a central planned economy to a more market-oriented one which Deng Xiaoping defined as “socialism with Chinese characteristics”. Doing research for such subject is not as easy as it seems because, although there are many authors discussing China, the information is much spread. Each author has his own perspective when dealing with China therefore there is a need of reading several in order to have a sustainable basis for any study on the subject. Choosing the best references, with so many available, was not an easy task and it would have been impossible to accomplish without the help and expertise of Professor Virgínia Trigo from ISCTE. She gave me always the necessary guidelines and with her support this dissertation gained a more practical perspective avoiding the danger of becoming too vague.

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I hope this dissertation lives up to the expectations of all these people.

Executive Summary

It is nowadays almost impossible to live without China. This country became the main provider of many items which are essential for our daily routine. The objective of this dissertation is to figure out how this process happened. Suddenly China became an integral and essential part of the world economy. It seems that on one day China was an undeveloped, almost third world country and, on the next, it became one of the world's most thriving economies. When explaining this transition process the main objective will be to identify the point when everything started to change. China's rising was so quick that it seems that it is possible to isolate one single day or event that marked the turning point of the country. That time that will be recorded in history as beginning of new era for the world economy – an era when the Chinese will have much more presence, importance and predominance in the destiny of the planet. And it is exactly this moment the first purpose of this study. The aim is to find it and describe the context in which it occurred, the background that led to it and the consequences that it had provoked.

However this process was not as abrupt as it might seem. It took 30 years for China to change from a planned central peripheral economy to a modern market-driven one which is now in the top three better performing economies in the world. Still, there three key moments in the recent history of China which were fundamental for its transformation. These three moments are the choices for being denominated as the Chinese turning point. The three referred moments are the economic reforms and open policy in late 1970s and 1980s with the establishment of special economic zones, the rising of Shanghai and Pudong New Area in the 1990s after the speeches of Deng Xiaoping in February 1992 in the south of China and finally the entry of China into the World Trade Organization in December 2001.

China's economic development had consequences both at internal and external level. Therefore the second part of this study will be focused on measuring those consequences. Since that the measurement of the impact that this economic expansion would be hard, if not impossible, to perform on a world level basis, the analysis was narrowed to the impacts on the Portuguese economy. Considering this, and in order to have even more accurate and meaningful results, the research was narrowed once again to the impacts felt by the Portuguese textile industry. The choice of this industry was

not random, since this was the sector in Portugal that was more affected by the Chinese upsurge. Analysing the impacts in only one industry brings the advantage of being able to compare how the different companies within the textile industry reacted to the new competitors coming from China. This way it will be possible to discover some trends and even to suggest what could have been done in order to avoid, to some extent, the damage that the Chinese competition has done to this sector. This part will be based on an empirical research enabling the suggestion of some strategies that may help the Portuguese enterprises to better compete against their Chinese counterparts.

The final result of this dissertation is a significant insight on different areas ranging from the Chinese economic development to the response from the Portuguese textile industry to that development. Hopefully, the conclusions withdrawn here may help firms, which can be located in any industry, interested in preparing their future not only against China but also against any emergent economy that may be entering into the international markets.

1. Introduction

China is nowadays in our daily life and, as hard as it might seem to admit it, this country has become indispensable for the process of accomplishment of almost all our basic needs. Many authors have already chosen China as a case study for a wide variety of reasons but it is since the country's opening to the outside world with the economic reforms in 1978 that articles and bibliography have flooded the academic and business world. China's unique development model has originated many discussions for many different reasons and, according to diverse perspectives and approaches, authors have arrived to many different conclusions.

In order to understand the scope of this dissertation it is easier to mention first the subjects which are not covered. This study does not want to discuss, question or even evaluate the quality, performance or validity of the Chinese model. Instead, the objective of this paper is to discuss when did China become a daily life concern, when it passed from an unexplored market with huge potential to a serious competitor that, as many may defend, has completely changed the political and economic world order. Using James Kynge (2009) perspective, the main purpose of this work is to find out when writers and researchers stop investigating on how the world was affecting China to start doing it on how China was affecting the world. In his book, *China Shakes the World – the rise of a hungry nation* (2006: 7), James Kynge uses a sentence from Napoleon: “*Let China sleep, for when she wakes, she will shake the world*”. According to the author there is no record of the context of this affirmation and he even questions its validity – “*the quotation itself may be inaccurate or even apocryphal*”. Regardless this fact, the truth is that if it really was Napoleon who said this, his sentence still applies nowadays. Taking the metaphor from the statement, it is the objective of this paper to discuss when did the alarm clock ring for China, when it waked.

It is now generally accepted the fact that China incurred in an enormous process of change in the last thirty years. The main question addressed here is: when did this change start affect not only China but also the rest of the world? Recognizing and understanding that the structural and economic changes in China are affecting the rest of the world is an easy task. James Kynge (2006: 7) argues that “*the events reshaping China are no longer merely resonating on foreign shores but actually changing the way the world works*”. Accepted the fact that China's reforms have consequences worldwide, the challenge that remains is to figure out when such consequences start

affecting other countries rather than China. About this, Kynge (2006: 6) notes that “*it is difficult to pinpoint when, exactly, that transition took place*”.

When trying to justify a precise time and date for China’s turning point all arguments are valid and it is quite difficult to find a stronger or better perspective. The first problem that arises is related with the attempt of finding arguments that prove that a certain time/date is more correct than other possibility. How to measure effectively when did the turning point for China occur? There are several indicators that can be used such as GDP, GDP per capita, FDI inflow in China and even the total value of exports can be included in the analysis. The challenge is, looking at these or more indicators, to find an explanation which has to be better and stronger than all other possible hypothesis and has to justify the initial choice convincingly. Why would the year of 1978 suit better for the explanation than 1992? It is not easy to find an unconditional truth that could answer this question. When analysing this subject, as many others in what respects to China, it all depends on the perspective of who is undertaking the analysis. At first, one might think that 1992 seems to be more appropriate than 1978 because it presents higher values of exports or of FDI in China which indicate deeper relationship with the outside world, a clear sign that China is affecting the rest of the world. However, was it possible for China to reach the values of 1992 if the results from 1978 would have been other? It is important to account with the economic evolution of the country instead of looking only to a specific year in order to arrive to a more comprehensive conclusion. Narrowing the analysis would only give a snapshot of the problem, the whole picture would be missed and consequently any conclusion would be limited. Furthermore, as Kynge (2006: 6) defends, “*it was unlikely that there would have been any single moment when everything changed*”. In country as big as China different regions progressed at different paces and asymmetries become a problem for the government to deal with.

So, in order to have a study as complete and meaningful as possible two variables must be considered: place and time. Economic reforms in China have affected different places at different times therefore the best way to perform this study is through a comparative analysis. Although China is a huge country with many differences among its regions, for the sake of simplicity, it is better to consider it as only one place otherwise the analysis might get too broad and results ambiguous. The same happens with the rest of the world – such a wide range of possibilities creates the need of narrowing the universe of hypothesis. For this reason, Portugal has been chosen to

represent the rest of world. Choosing Portugal has obvious reasons and it also brings extra value and relevance to the analysis because the results from it have direct impact in a well-known reality. The purpose of the project is then narrowed to when the Chinese economic boom did occur in China and when it started affecting Portugal. Comparing the two resulting dates will give an insight of the time that took for China to become a worldwide concern and, at the same time, the time that Portugal had to prepare itself for the uprising of the sleeping giant.

After reading some authors regarding the Chinese economic reforms and progress, there are three different dates of relevant significance and that might mark the turning point for the country: October 1978, February 1992 and December 2001 corresponding to the XI congress of the Chinese Communist Party (CCP), the speeches of Deng Xiaoping in the South of China and the entry of China to the World Trade Organization (WTO) respectively. All these events marked the beginning of periods when China experienced major economic and structural changes therefore this will be the starting point of the discussion. In what concerns Portugal, the analysis will be conducted in a more empirical way. It is better to perform our own study analysing empirical data than to just rely on the scientific studies already performed by other authors. This way the result of the study has higher chances of being updated and more meaningful (if the empirical research is well performed). The best method to measure when China did start affecting Portugal would be by consulting the economic agents, namely companies, and ask them when they did start to worry about China. For the sake of simplicity and in order to achieve a more accurate result, it is better to narrow down the universe of elements considered in the study. The companies that will provide more significant answers will be those that were more affected by the Chinese economic expansion. After consulting some experts and reading some articles, it was concluded that the textile sector was the one that was more affected. Therefore this industry will be the only one considered.

On the next section there will be a review of the literature used for supporting this study with reference of the different authors who are the basis of knowledge for the different sections of this dissertation. After that, a comparative evaluation of three dates proposed to be considered as the turning point for China. At this point a first conclusion can be made about the year that triggered the Chinese economic boom. In the following section, the Portuguese empirical study will appear and it will be possible to compare this value with the result from the Chinese analysis. Finally, a last conclusion can be

withdrawn from both results and an evaluation of the Portuguese response to the Chinese threat will be performed.

2. Literature Review

According to Virgínia Trigo (2003: 31) “*the objective of the literature review is, from a current knowledge base, to build a legitimate argument for the ongoing investigation*”. Since in this study the discussion on when did China start affecting Portugal, particularly the textile industry, is based only on empirical research, this section will not be included in this literature review. The literature used only approaches the “Chinese perspective” of the economic reforms meaning that this review will also only include the discussion on when did the turning point for China occur.

The initial source that inspired this study was undoubtedly the book from James Kyngé: *China Shakes the World – the rise of a hungry nation* (2006). The author has an interesting starting point for further investigation: to find out when China’s actions start affecting the rest of the world. In order to discuss such topic it is fundamental to understand first how China’s actions affected the country. To have a better and more complete perspective of the consequences of economic reforms in China to the rest of the world it is important to understand not only the scope of those reforms but also their direct results in China. Only after fully comprehending how this whole process changed China it is reasonable to try to figure out how it did change the rest of the world.

As it was already mentioned in the introductory part of this study to pinpoint one exact date for China’s turning point is not an easy task. China is one the biggest countries in the world both in area and in population and, obviously, the economic reforms took place and made an impact in different places at different times within the country. It is therefore impossible to establish one single date that marks the point from where the whole country started to change and became more competitive. So, the problem that arises is how to discuss different possible dates for China’s uprising if this process affected the country at different paces in different places at different times? In China is not possible, or at least it wouldn’t be reasonable, to talk about economy without mentioning politics since the two are interrelated. Any major change, in economic terms, that occurred in China was preceded by a political decision which had direct impact on the country’s economic performance. For this reason, in the search for a specific date for the beginning of the Chinese boom it is very likely to find some political event associated to such date. It is, consequently, reasonable to look to the

political events that triggered economic growing in the country in the last 30 years because one of these might be the one that initiate growth not only for the following years but also instigate a snowball effect that brought China to our daily life routines.

There were three major events that might be responsible for China's rising. The first, and probably most obvious one, is in 2001 when China finally becomes part of the World Trade Organization (WTO). The lifting of quotas and restrictions by other countries in what respects to Chinese products allowed China to flood markets worldwide. The second is the visit of Deng Xiaoping to South China in 1992 when he appeals for the 1978 reforms to be intensified turning Chinese economy into a much more market-driven one. In a authoritarian regime like the Chinese one "*conversations and speeches made by Deng Xiaoping (leader of CCP at the time) in South China in the beginning of 1992 contributed more for the revitalization of the whole economy than any formal law or regulation*" (Trigo, 2003: 110). Finally, the third moment that might be the starting point for China's economic upsurge is the XI Congress of the Chinese Communist Party (CCP) in 1978 when "*the mission of transforming China into a powerful socialist modern nation is reassumed*" (Nelson Santos António, 2008: 157).

Since the analysis will be focused on these three different events the literature will also be distributed according to these dates. Regarding the 1977 congress and its consequent reforms it is important to highlight the work from David K. Y. Chu and Y.T. Ng – *The Special Economic Zones of China, an economic-geographical appraisal* (1982) which portray the direct impacts of the decisions made in that congress analysing the economic progress of the Special Economic Zones (SEZ). These zones were created after this congress, were a direct result of the decisions approved in it, and were China's first attempt to introduce the capitalist system into its socialist economy. Kwan Yiu Wong *et alii* also gave an important contribution to this subject with their work entitled: *Shenzhen Special Economic Zone: China's Experiment in Modernization* (1982). Both these works make an analysis on the open-door policy adopted by the Chinese government after the XI Congress which was materialized in the creation of the SEZ. This policy had the objective of re-launching and modernizing the Chinese economy by "opening doors" to capitalist practices. Such measure was mandatory after some years of strong recession and economic decline due to other policies promoted by Mao Zedong such as the Great Leap Forward or the Cultural Revolution. These policies turn China into economic chaos and the CCP, after Mao's death, was "forced" to accept some capitalist practices within the country in order to guarantee not only the country's

economic revival but also its survival as the only political force in China. Trigo (2003: 20) mentions that “*in order to guarantee the continuity of its political power, legitimized by the obtainment of favourable results, the CCP was under intense pressure to revitalize and promote the economy.*” With the economic crisis that China was facing in the second half of the 1970s, the Chinese government had to take action and the decisions and policies adopted in the XI Congress marked the first meaningful intervention that may have had greater consequences than only the economic growth verified in the following years.

The 1980s are characterized by a steady economic growth as described by Jung-Dong Park in his work: *The Special Economic Zones of China and their Impact on its Economic Development* (1997). The difference between this author and previous two relies on the fact that the first two restrict their research to the take-off of China’s economic reforms and resulting SEZ, while Park enlarges his timeframe and includes the whole 1980s decade in order to better analyse the evolution of the performance of the SEZ and arrive to a more complete conclusion about the validity of the policy launched by the Chinese government.

In 1989, Chinese economy shrinkages in growth and activity due to the events occurred at Tiananmen Square in Beijing and in 1992, with the visit of Deng Xiaoping (CCP leader at the time), another turning point for China occurs. Mentioning Trigo (2003: 16) “*it had elapsed only three years from the events at Tiananmen, which were followed by a reduction of the economic activity, but the speeches of Deng Xiaoping, delivered in a celebrated visit to South China, between 18 and 21 February 1992, calling to the involvement of the productive forces, [...] gave an important contribution to the climate of prudent enthusiasm.*” As in 1977, the government intervened once again in order to foment economic growth and sustainability. After these speeches, the Chinese economy, despite the events in Tiananmen Square, recovers and the 1990s were a decade of prosperity. Wei Ge in his work – *Special Economic Zones and the Economic Transition in China* (1999) – has a good approach to this decade and he also compares the economic growth and development achieved then with those in 1980s forming a great basis for analysis of both timeframes.

Finally it is important to mention the many articles consulted in the Euro-Asia Journal of Management which has been published since 1991 and, in many of its pieces, approaches subjects related to the incredible growth that China witnessed in the last 30 years. Last but not least, the works of two authors already referred to previously in this

literature review: *Entre o Estado e o Mercado* (2003) from Virgínia Trigo and *Economia e Gestão Chinesas – Aspectos Fundamentais* (2008) from Nelson Santos António. These two authors have in their studies an overall picture of the evolution of the Chinese economic reforms and their ultimate results which were very useful to connect causes and consequences making a clearer picture for this 30-year interval.

Notice that there were no works mentioned specifically about the entry of China in the WTO, the last and final turning point for China. Regarding this matter all knowledge is based on quotes taken from already mentioned works and articles found in the internet. From these articles it is important to highlight that many of them are from the WTO website and WTO Press Releases. The remaining articles present perspectives from both eastern and western authors such as: Gong Baihua, Wang Yong, Leonard K. Cheng, Frederick M. Abbott and Margaret M. Pearson. Concerning WTO accession and specifically China's entry process, some information was found in a report from the U.S. General Accounting Office (GAO). Having perspectives on this subject from both eastern and western authors will give a better insight of the real consequences of China's accession to the WTO at internal level – within Chinese boundaries, and at external level – worldwide.

China's entry in the WTO can be seen as a reward for the Chinese government after all the effort put into developing the country's economy into a more stable and prosperous one with the minimum regulations required which ensure a feeling of security to investors and consumers. Entering in the WTO was the final step for China's globalization and expansion policy. This whole process of economic reforms and opening policies was a thought-through internal change which had effects worldwide.

This study is, therefore, similar to those already mentioned from the Portuguese authors in the way that it also explains and analyses the last thirty years of the Chinese economic development. But, unlike the Portuguese authors, this study aims to measure the impact of this development both within Chinese borders and at a foreign level, the latter by including the Portuguese case. The objective of the study is to figure out if the impact was felt at the same time by Chinese and Portuguese. The best way to evaluate China's economic expansion impact on Portugal is through an analysis on the industrial sector which was more affected by this upsurge – the textile industry. So, basically the conclusions drawn for the first part of the study, which will give an insight on the turning point for China, will be compared against those from the Portuguese entrepreneurs. This way it will be possible to see the time interval between these two

dates. From this point many questions may arise, many conclusions may be achieved and many further studies may be requested. Were the Portuguese entrepreneurs ready on time for China economic boom? Should they have been ready earlier? Could they be better prepared for this Chinese “invasion”? Why did this expansion affect so much the Portuguese textile industry? Who should be blamed for the failure from the Portuguese side? Was there something more that could have been done? These are some of the questions that this dissertation tries to answer to. The final result will be a meaningful examination on what was done and on what should have been done and, hopefully, it will serve as a lesson for future challenges faced by the Portuguese industry. Such objective seems very relevant since nowadays competition became an international issue and emergent economies have to be always taken into account not only as a good opportunity but also as a great threat.

Any other references that may be used from internet articles or websites will be referred to in proper time. All the quotes used from Portuguese authors are translated in the best possible way and by using these quotes the objective is only to replicate their meaning and not to manipulate them to best suit a certain purpose.

3. China and the WTO

The best to approach this chapter is first to explain why was China’s entry into the World Trade Organization (WTO) chosen as a turning point for China. Only after understanding what this process involved it becomes reasonable to examine the process itself and how it changed both China and the rest of the world.

This chapter is structured as follows: first, the importance of approaching China’s accession to the WTO is discussed and only after understanding why was the entry to the WTO a fundamental strategic step for this country, the background to this scenario is presented. In the third section the accession process that each country has to embark on is carefully described. After this, there will be a discussion on China’s membership and related subjects, ranging from implications and consequences of this membership to benefits brought both for China and the international community. After understanding what the Chinese membership involved, the final considerations on this process are illustrated enumerating the various policies and measures that China had to implement and undertake in order to become a WTO Member. The final section serves as a bridge to the next chapter and approaches the efforts that China made for finally achieving WTO membership.

3.1 WTO accession as a turning point for China¹

China's accession to the WTO had consequences for both the country and WTO Members and Chinese leaders had an idea of the possible impact of the changes brought by this process. China's entry into the WTO was for the Chinese government not only one way to fully open the doors of China to rest of the world, while at the same creating the opportunity for Chinese companies to better penetrate diverse foreign markets, but also one method to accelerate domestic economic reforms. Wang Yong (2006) argues in his article "*China and the WTO: a Chinese view*" that "*by committing to China's WTO agreement, they [Chinese leaders] attempted to overcome stumbling blocks that hindered the governments' reforms efforts.*" These reforms concerned mostly the public and financial sector. According to Yong (2006) they "*aimed at weakening the links between state-owned enterprises (SOEs) and bureaucrats and at streamlining and reinvigorating the declining state-owned sector, inefficient but powerful government agencies, and the poorly performing financial sector.*" Chinese leaders used the external pressure introduced by the WTO agreement to trigger a quicker implementation of their internal reforms.

As already mentioned, China's accession to the WTO had also impacts to the global economy. These impacts, in opposition to those that affected China on internal level namely regarding the Chinese economic reforms, are external and had consequences in a way that changed China's economic performance and its position in world economy. Only five years after China's entry into the WTO, in 2006, its economy already had surpassed that of the UK and became the fourth largest economy of the world. In the same period, China also became world's third largest trading country, after U.S. and Germany, with its trade expanding on average 29% annually between 2001 and 2005. Total trade volume was \$1.4 trillion in 2005.

In what respects to foreign direct investment (FDI), China turned to be one of the most popular destinations for foreign investors attracting nearly \$230 billion between 2002 and 2005. This increase in the inflow of foreign investment leveraged China's integration with global economy. The first, and maybe most direct, consequence of the high levels of FDI in China was the transformation of the country into a major global manufacturing centre. This transformation, on one hand, benefited consumers around the world because of the lower prices coming from Chinese products

¹ All statistical data presented in this section comes from the article of Wang Yong (2006)

but, on the other hand, the country's rising exports became a frequent target of antidumping suits.

China also exceeded Japan as the world largest holder of foreign exchange with reserves reaching \$875 billion, \$257 billion of which was held in U.S. Treasury bills. Investment inflow was not the only type of investment that changed substantially the global economic conjuncture. The Chinese government, while encouraging FDI in China, also promoted outbound investment granting the country's access to energy, raw materials and foreign markets. Chinese investment overseas totalled more than \$60 billion between 2001 and 2005.

Since China's entry into the WTO there are two different perspectives that deserve observation. On one side, the country's "*economic expansion brought certain pressures to bear on the rest of the world*" but, on the other side, this "*economy, along with the one of the U.S., is one of the world's greatest engines of economic growth*" (Yong, 2006). Chinese imports from the U.S. rose annually, on average, more than 21% from 2001 to 2005 whereas overall imports increased 28.6% on average for the same period. This indicates active participation from China in regional and global economic integration. Such integration can be directly observed by the signing of free-trade agreements (FTAs) with several associations and single countries namely the Association of Southeast Asian Nations in 2002 and Chile in 2005. Wang Yong adds that China was negotiating FTAs with more than 20 countries in 2006.

It is undeniable that this process of the Chinese accession to the WTO created some friction and problems but, looking now backwards, "*China has more in common with the rest of the world than it did before 2001*" (Yong, 2006). International investment and trade have increased for both the international community and for China which has now a higher stake in maintaining this multilateral trading system. At internal level, China's entry into the WTO accelerated its economic reforms and policies turning what once was tight government control and protectionism to economic liberalization and globalization. "*China and the international community have changed significantly as a result of China's WTO entry*" (Yong, 2006). Many factors, both internal and external, have changed with the accession of China to WTO: business environment improved, trade and investment grew. This is why such event must be included and analysed in this study.

3.2 China and WTO – background

The WTO was established on January 1st 1995, as a result of the Uruguay Round of international trade negotiations. Its function is to give the institutional framework for the multilateral trading system. By providing this framework for the transnational flow of goods and services, “*the WTO promotes stability in international economic relations which is urgently needed in our intricately linked world economy*” (Abbott, 1998). According to the WTO agreements, the WTO applies rules for global trade, has a mechanism for settling disputes and provides a forum used for conducting trade negotiations meaning that it stands for the rule of law in international trade. The WTO together with the United Nations (UN) and the International Monetary Fund (IMF) is one “*pillar of a system of international institutions designed to promote a world of peace, financial security and economic prosperity*” (Abbott, 1998).

China’s entry into the WTO was always supported by major trading powers as the U.S., E.U. or Japan: “*How can the WTO claim to govern world trade while more than one fifth of world’s population, the second largest national economy, and one of the top 10 trading nations, is excluded from its ranks?*” (Abbott, 1998). There are several reasons why many governments around the world supported China’s accession process to the WTO. Membership in the WTO would mean that the country would have to assume the legal obligations applicable to all members such as: “*providing most favoured nation (MFN) treatment to goods and services of all WTO Members; treating goods imported into its market on the same basis as domestically produced goods; abandoning the use of quotas; protecting intellectual property rights (IPR)*” (Abbott, 1998). Nevertheless China also had internal reasons and motivations that influence its government in the decision of applying to the WTO. At that time, China’s economic integration with the rest of the world was already a reality and its stake in maintaining peaceful external relations grew higher for many reasons. With an economy which was increasingly export-oriented, the prospect that other countries might close their markets became a serious concern. By accessing to the WTO, China would achieve more stability in its trade relations with foreign countries. Its access to foreign capitals would also increase as investors would win more confidence in the country’s capacity to make and implement decisions in accordance with internationally accepted rules. Entering in the WTO would also have a positive impact on solving many problems that may arise

while trading with China because, with China's membership, all sides could settle trade disputes under the rule of law.

China was one of the 23 original signatories of the General Agreement on Tariffs and Trade (GATT) in 1948 but, after the revolution in 1949, the government in Taiwan decided to abandon this agreement. The government of Beijing never admitted this withdrawal decision and nearly 40 years later, in 1986, China announced GATT that it wished to get its status back as a GATT contracting party. This process was guided by a Working Party whose membership consisted of all interested GATT member governments. This party was established under GATT in 1987 and was focused on China's trade regime for goods. After 1995, with the conversion of GATT into WTO, the Working Party enlarges its concerns and includes: trade regime in services, new rules on non-tariff measures and rules related to IPR.

3.3 WTO accession process

The accession process has four different phases: fact-finding, negotiation, WTO decision and implementation. Negotiations in the accession process took place over 15 years at two different stages: bilateral and multilateral. Bilateral negotiations were *“design to secure China's commitment to remove specific market access barriers and open China's domestic market to more foreign goods and services.”* Multilateral negotiations occurred to *“ensure that China adopts all rules, practices and obligations required by WTO agreements to improve its general trade regime”* (U.S. General Accounting Office (GAO), 2000). As the name purposes multilateral negotiations involve China and all WTO Members which negotiate general trading terms whereas bilateral negotiations are between China and each WTO Member negotiating specific market access commitments concerning goods and services. The main purpose of these agreements is that WTO Members grant each other MFN status meaning that trade privileges given to one WTO Member must be also conceded to all remaining WTO Members in the same favourable way. This way, once bilateral negotiations are concluded, China's commitments will be extended to other members through its MFN obligations.

In what respects to multilateral negotiations, *“China agreed to: apply WTO rules throughout its territory; make its trading regime transparent; maintain independent tribunals for the review of administrative actions”* (Abbott, 1998). The last measure has relatively higher importance because having independent judicial review on trade

matters strengthens an independent judiciary which, in turn, helps a more effective establishment of the rule of law as a principle of domestic governance. *“China also agreed to refrain from establishing new non-tariff barriers to trade, to phase out existing GATT-inconsistent quotas and related measures in accordance with schedules, to comply with the terms of the Agreement on Technical Barriers to Trade”* (Abbott, 1998).

Regarding bilateral negotiations China has made substantial offers to reduce tariff barriers across a range of goods and to liberalize the service market including banking, insurance, telecommunications, distribution, legal services. Since at that time China’s service market was still a *“market in transition”* (Abbott, 1998), there was a discussion for allowing Chinese enterprises to adapt to market conditions before fully facing international competition from service providers.

A big part of China’s accession process to the WTO involved bilateral negotiations between China and WTO Members. Such negotiations took place at private level in WTO headquarters in Geneva or in the respecting country’s capitals. In these meetings several areas of China’s trade policy were addressed such as schedules of market access commitments in goods and specific commitments on services. The Working Party had the responsibility of having an overview of how negotiations were progressing while making sure that all aspects of China’s trade regime and policies were dealt with. It was headed by Ambassador Pierre-Louis Girard, a senior Swiss trade official, who, together with WTO Member governments and China, was supported by the WTO Secretariat which provided administrative and legal assistance as requested. In practical terms, the Working Party had two tasks: to compile a report based on its deliberations and to complete a Protocol of Accession. To this protocol many annexes can be, and many times use to be, added since they are an integral part of the protocol including specific issues on the applicant’s trade regime and are legally binding. These annexes have the objective of ensuring *“WTO members that the reforms, or other transitional measures, promised by the applicant will be actually implemented”*. They can be seen as a *“negotiated timetable for bringing the applicants trade regime into full conformity with WTO’s rules and obligations”* (WTO, 2001). Negotiations are only concluded after acceptance of these two documents: the Working Party report and the Protocol of Accession. The report is a *“narrative on results of negotiations and specific commitments made by the applicant regarding how it will meet WTO requirements”* while the Protocol of Accession *“contains the terms of accession and commitments*

affirming China's adherence to WTO guidelines and principles" (U.S. GAO, 2000). The Protocol of Accession defines "*China's specific obligations as new WTO member*" (Abbott, 1998).

The different entry processes vary in length but take usually several years to complete depending on the level of readiness from the applicant country to meet expectations and demands. These demands can be of different nature: from simple rules and obligations of WTO's market-economy principles and its policies of pro-competition and non-discrimination to market-access conditions for goods and services which have to be granted to other WTO Members. The whole process may delay even more because the Working Party decides by consensus meaning that all WTO Members and the applicant country must be in agreement in what respects to matching their individual concerns and solving their outstanding issues. This may create a lot of difficulties since one Member can disrupt the consensus of the decision-making process. For this reason the WTO elaborated voting rules that may be employed when a consensus cannot be achieved and may be used to avoid obstructionist behaviour by one or few Members. When the documents detailing all commitments made are finalised and the consensus is reached, the Working Party forwards the complete application package which includes a draft decision. In the third phase, the WTO decision, the WTO General Council, comprise of all WTO Members, approves or rejects the terms and conditions of the application package. At this stage, traditionally, decisions are made by consensus and if such harmony cannot be achieved, then a majority of two thirds can approve WTO membership. Any nation that decides not to offer or that simply cannot offer the benefits agreed must notify the WTO General Council before the approval takes place. After this approval the country seeking membership may start with the process of implementing the commitments which it had agreed with. This country becomes a WTO member thirty days after filing its acceptance.

3.4 Discussion on China's membership

The 17th September 2001 was one important date for China in what respects to its accession to the WTO. This was the day when negotiations on China's terms of membership were finally concluded after 15 years of discussion. Mike Moore, WTO Director-General at that time commented on that day that "*with China's membership, the WTO will take a major step towards becoming a truly world organization. The near-universal acceptance of its rules-based system will serve a pivotal role in underpinning*

global economic cooperation” (WTO News 2001 Press Releases). For China, WTO membership brought with it increased market access and, at the same time, protection for Chinese exports which are now under the rules-based system of the WTO. Nevertheless, Chinese government officials knew that becoming a member of the WTO would also bring “*the necessity of a large number of reforms in domestic economic policies, many of which would require adapting the outlook of Chinese business establishments*” (Baihua). Such adaptation was not an easy procedure and many changes required for the accession process were not as straightforward to implement as it might seem. So, on one hand, the expectations of China’s trading partners provoked a positive impact since they were the origin of the external pressure that the Chinese government could take advantage of in order to promote change. But, on the other hand, some of the required changes were real challenges for China and would result in policies which were harder to implement effectively and, in this case, the expectations of Chinese trading partners generated a negative impact because government officials became too pressured for achieving a goal that they new from the start that they were not able to accomplish.

Anyway, WTO accession brought to China more benefits than problems. As non-member of this organization, the country faced discriminatory treatment in what respects to its exports. Moreover, China was, at that time, “*making the transition from a centrally planed economy to one where market forces would set prices and determine resource allocation*” (Baihua). China was designated as a “non-market economy” and for this reason Chinese exporting firms were subjected to anti-dumping actions which were unfair.

The 15 year long negotiation process involved and included many different issues for discussion. Some of these issues will now be discussed using Leonard K. Cheng’s approach:

1) Stability in External Economic Relationships

Having more stable access to foreign markets mainly because of the reduction of disruptions in foreign trade which, in turn, were caused by the random policy shifts, allowed China to gain a better position in what concerns attracting foreign investors who would use China as an export platform. Such stability also attracted investors interested in developing China’s domestic market. Regardless the investment orientation, FDI in China brought in additional capital, management techniques, technology knowledge, market information, global production and distribution networks

which would link China to other economies at a global level. Obviously, trade and investment frictions between China and other economies did not cease with the country's accession to the WTO but, nevertheless, such frictions are better managed under WTO's rules, obligations and the dispute settlement mechanism. This caused a significant improvement in existing relationships between the different WTO Members where usually trade and investment disputes were solved with mutual threats and brinkmanship.

2) *Firmer and Speedier Economic Reform*

As was already mentioned, China also used its accession to WTO as a source of external pressure for the opposition of powerful domestic interest groups in what respects to the country's economic reform. SOEs were this type of powerful force which were blocking China's path towards a market economy. Leonard K. Cheng in an article argues that "*it would not be an exaggeration to say that bilateral and multilateral agreements behind China's accession to the WTO are a summary statement of China's economic reform*" (Cheng, 1999). These agreements form guidelines for the Chinese economic reform and, at the same time, because they are international treaties, "*they also serve as the country's commitment to a systemic reform and restructuring of national economy*" (Cheng, 1999).

WTO membership brought with it greater competition between Chinese and foreign companies both in domestic and international markets. As a consequence there was a large restructuring of Chinese industries with an exception for a few which were selected as "infant industries" and given some protection at initial stages. Such restructuring was based on China comparative advantages and disadvantages vis-à-vis other economies. Chinese economy has a clear advantage in what concerns to labour-intensive industries but it also has an apparent disadvantage in natural resource, technology or capital-intensive industries. Regarding skill-intensive industries both advantages and disadvantages may be found considering the Chinese economic conjuncture. Firms restructuring appears as a natural consequence of the Chinese industry restructuring. Enterprises, "*which were rewarded and disciplined by market forces, tend to have an ownership type that reflects their relative efficiency in organizing production and delivering goods and services*" (Cheng, 1999). Thus, more efficient ownerships structures would be adopted while the poor performing companies abandoned their own ownership styles.

According to Cheng, “*since capital flows into and out of China continued to be restricted before convertibility on capital account is attained, banks will be key in deciding which ownership type gains or loses*” (Cheng, 1999). Considering that the four state-owned banks have continued to play their dominant role in what respects to investment fund supply, their attitude towards the companies with different ownership structures became crucial. The changing process to more efficient ownership types may have been slower if lending decisions are made without giving primary importance to commercial principles. Moreover, the success or failure of the different ownership styles also depends on the government’s policy on both national and regional monopolies. In any case, the restructuring, both at industrial and firm level, would cause improved efficiency because of resource re-allocation at industrial level and ownership changes at firm level.

China’s economy in transition used the developed market economies as guideposts for its own regulatory reform and institutional building. The entry into WTO also contributed to this reform since the WTO rules were translated to national laws and regulations. Furthermore, best practices concerning regulation were mandatory in order to avoid systemic failures. As a result, WTO accession helped to accelerate the enforcement of existing laws. The improvement of the legal system benefited both foreign investors and Chinese companies which were better protected against poor ethical standard and outright cheaters.

3) *Long-Term Growth*

Potential economic benefits brought by WTO accession were not exclusively static gains from re-allocation of resources among industries and ownership changes among firms. When considering long-term periods, the increased competition brought by China’s accession to the WTO was more significant than the changes already mentioned and had an impact on dynamic gains instead of static ones. This competition would reward efficient and innovative firms regardless their structure – public or private, and origin – local or foreign, while, on the other hand, such competition would discard inefficient firms. IPR protection plays a very important role in helping building an engine for economic growth supported by technological progress since IPR are protected for both multinational and Chinese corporations.

Problems may had arise because of the duplication of investment and the excess capacity in many industries, both caused by “*a perverse incentive of investing public funds, but also the fact that there is too much money chasing after a limited number of*

viable investment ideas may also be a factor” (Cheng, 1999). This author argues that if this affirmation is true, the duplication of investment problem may become smaller when new ideas and innovations take place.

4) *Short-Term Costs vs. Short-Term Benefits*

Entering the WTO did not bring only benefits to China and some short-term costs had to be considered by the Chinese government when discussing accession to this organization. Such costs appeared in the form of bankruptcy of domestic companies and consequently an increase in unemployment. Nevertheless, companies which were able to survive were re-organized and, at the same time, the fact that some firms went bankrupt has released resources that new firms could utilize for growth or that existing firms could take advantage of for expansion. Anyway, the rising unemployment has created the necessity for the social security and health care systems to provide a safety net for these ex-workers.

WTO accession did not only bring short-term costs, it has brought some short-term benefits as well. From the Chinese perspective, becoming a member of the WTO would reverse the decreasing trend of FDI which was a major problem for the Chinese government at that time. The Chinese government had many difficulties in reversing this deflationary pressure by itself. With more stable external economic relationships, foreign markets became reliable to utilize the excess capacities existing in many industries since the quality of the products was good enough to meet the foreign consumers demand. Besides that, consumers’ new needs fomented the development of new products which, in turn, has created many gainful jobs. Opening the service sector to foreign investors also had a positive impact on employment due to the faster development of such sector which has created new jobs that also could offset the unemployment generated by bankrupt enterprises.

5) *Conclusions*

It would be unreasonable to deny that China’s accession has brought some short-term costs with it but, as Leonard K. Cheng defends, “*much of the costs would have to be incurred anyway*” (Cheng, 1999). Becoming a WTO Member gave China a timetable for the country to deal with its economic problems. Therefore, this membership have helped China to solve its short-term problems and, at the same time, brought long-term benefits to the Chinese economy. The remaining challenge was for the Chinese government to manage these short-term problems competently since, as time proceeded,

the longer-term benefits diminished these costs. As a result, the WTO agreement only caused isolated troubles and not a social crisis.

3.5 China's accession process – final considerations

As already mentioned previously, the 17th September 2001 marked the ending of 15 years of negotiations between China, WTO Members and the Working Party headed by the Ambassador Pierre-Louis Girard from Switzerland. One of the many outcomes of these negotiations was the agreement between the interested parties that China would undertake some commitments, in accordance with WTO rules, in order to open and liberalize its economic regime to better integrate into the world economy, and, to offer a safer environment for trade and foreign investment.

Some of these commitments that China had to undertake were already mentioned before but, it is important to have a concrete idea of what type of efforts were made by China when entering the WTO in order to understand how China was affected by this major change. The press release of the 17th September 2001 presents a reasonable article explaining many measures that China undertook at the time. These had the objective of open and liberalize China's economic regime in order to achieve higher level of integration with the world economy and a safer environment for trade and investment. Some of these measures are now presented: 1) China agreed to provide non-discriminatory treatment to all WTO Members regarding the right to trade. This was complemented by the elimination of dual pricing practices along with the differences in treatment for goods produced for sale in China in comparison with those produced for export. It was also agreed that price controls would not be used with the intention of protecting domestic industries or service providers. 2) After three years of China's accession, all enterprises were allowed to import, export and trade all goods with limited exceptions. As a result of this China did not maintain or introduced any export subsidies on agricultural products. The Chinese government kept the exclusivity for trading products as cereals, tobacco, fuels or minerals and some limitations were also unchanged on transportation and distribution of goods within the country. But still, many restrictions were lifted after this three year phase-out period. 3) In what concerns to IPR, China implemented the Trade-related Aspects of Intellectual Property Rights (TRIPS). 4) It was also agreed that, during a twelve year period and after the date of accession, a special Transitional Safeguard Mechanism would be created for the cases when *“imports of Chinese products cause or threaten to cause market disruption to the*

domestic producers of other WTO Members” (WTO News 2001 Press Releases). On the other hand, any prohibitions, restrictions or other types of measures maintained against imports from China which were conflicting with the WTO agreement would be phased out or dealt with according to terms and timetables which were agreed by the involved countries and specified in an annex to the Protocol of Accession. 5) All the previous commitments can be translated to one single measure and one main outcome: the gradual elimination of trade barriers and expansion of market access to foreign goods. This also applied to some service sectors such as telecoms, banking or insurance.

The WTO agreement caused the average bound tariff to decrease to 15% on agricultural products. Within this category the different tariff rates ranged between 0% and 65% where the maximum tariff applied to products as cereals. In the industrial sector, the average bound tariff was 8,9% ranging between 0% and 47%. In this case, photographic film, automobiles and related products were some examples of items subjected to the maximum rate (WTO News 2001 Press Releases).

Due to its relevance to the current study the textile sector will now be approached in a more detailed way. When China entered to the WTO it was also agreed that the country was to become a party of the Agreement on Textiles and Clothing being therefore subjected to its rules and obligations. Quotas on textiles were agreed to end by 31st December 2004 for all WTO Members but, as with many other Chinese imports, a safeguard mechanism was created permitting the Members’ governments to limit imports in the case of market disruptions caused by the exports of Chinese textiles. In what respects to this particular sector, the safeguard mechanism was to be maintained until late 2008. The implementation of the WTO agreement occurred by reviewing China’s domestic laws and enacting new legislation according to the agreement directives.

3.6 China’s path towards WTO membership

In the WTO Press Release from 10th November 2001, one month away from China official date of accession to the organization, Mike Moore, WTO’s Director General at that time, said that *“China, one of the fastest growing economies in the world, has made tremendous progress in the last decade in reducing poverty thanks to an economic system increasingly open to trade and foreign investment. Now that this economy will be subjected to the rules-based system of the WTO, something which is bound to enhance global economic cooperation”* (WTO News: 2001 Press Releases 10

November 2001). Note the reference made by the WTO's Director on the progress achieved by the Chinese economy. It is important to remember that WTO accession was not an isolated success for China. Instead, it can be seen as final step towards global integration and market liberalization.

So, entering into the WTO was only one more step of a bigger and longer process: to create a strong industrial economy that can carry China into the future. Hence, the WTO was only the mean to an end and not the end itself. Margaret M. Pearson in one article argues that *“it would be naive to think that China's rapid integration into global economic system has been driven by anything but self-interest”*. The primary goal for the Chinese government was always to make China a competitive and developed country and, in order to accomplish this goal, China needed to be integrated into the world economy otherwise it would be very hard to become a prosperous nation. The WTO was the perfect instrument for China to achieve that integration level. Nevertheless, remember that, in the attempt of becoming a developed nation highly integrated at international level, China never was a disturbing power meaning that it *“had to adapt to the existing system and not vice-versa”* (Pearson). Proving this is the fact that, in this integration process from China, global trade, investment, financial and institutional systems have remained stable.

China has a background in the global economy that dates back two decades. Using Pearson's approach, and in order to understand this history of complicity with the global economy, two different types of interactions will be used: business-to-business transactions and People's Republic of China (PRC) policymaking on trade and investment.

- ***Business-to-Business Transactions***

According to Margaret M. Pearson *“in twenty years the volume of business-to-business transactions engaged in by Chinese firms has risen from 0 or nearly 0 to among the highest in the world”*. Annual foreign trade rose from \$21 billion in 1978 to \$324 billion in 1998 and the amount of incoming capital increased from 0 in 1978 to \$110 billion in 1993. China became the second recipient of FDI in the world in mid-1990s only surpassed by the U.S.A. On the opposite direction, Chinese investment overseas also grew *“from a handful of politically motivated aid projects to commercial businesses ventures”* (Pearson). Despite the fact that China was affected by the Asian financial crisis, it became a commercial borrower of note in the financial markets. The

country has also participated in international capital markets issuing both stocks and bonds abroad.

All these changes in China's economic behaviour were a consequence from one major alteration in Chinese mentality and way to perceive the market. Chinese started accepting that "*the market is a natural, quick, and unbiased enforcer of its own rules*" (Pearson). Market enforcement is, therefore, seen as neutral and apolitical. However, it is important to understand that these changes were not only caused by the Chinese desire in becoming an industrialized and developed nation – they simply had nowhere else to go. The international markets were the only way for PRC to achieve the high level of integration with the outside world that would boost the Chinese economy and make China a superpower in economic terms. So, as Pearson defends, "*it is the Chinese who have travelled up the learning curve*" meaning that it was China that had to adapt to the norms and regulations of the international markets and not vice-versa. Yet, one might argue that some market dislocations did occur due to the emergent Chinese competition – the example of textile industry in Portugal is a perfect fit for this. But still, Pearson considers this as "*a natural occurrence in global markets*".

- ***PRC policymaking on trade and investment***

The main intention of the Chinese leaders back in late 1970s with the open door policy was to open China's economy to the outside world and absorb the benefits from the integration in international markets while, at the same time, avoiding negative effects on China's economy, sovereignty and culture by applying strong regulations and control. Consequently, many norms and regulations were created with the purpose of simultaneously attract and control foreign businesses. With the change in mentalities and perspectives about the market these controls started to be lifted and the overall norms and rules of the international markets start to be more widely accepted. Again, as it was already mentioned previously, this change in the way that markets were perceived was not only encouraged by a simple change in Chinese mentality but it also was a consequence of the existing conditions in the economic environment at that time. The Chinese government was unhappy with the level and quality of incoming investment and had no other option than lifting the tight controls over foreign businesses since such investment was fundamental for the development and industrialization of Chinese economy – the government's primary goal. According to Pearson "*changes have occurred in numerous sectors and functional areas including restructuring and decentralization of the foreign-trade system, tariff reduction, liberalization of controls*

on foreign exchange and profit-repatriation, greater transparency, and the establishment of rules for dispute resolution and contract enforcement". Thus, foreign enterprises gained higher market access in various sectors such as light industry, foodstuffs, automobiles, petroleum, chemicals, and more recently financial and other information services.

One of the most significant changes undertaken by China was related with IPR. Such concept has been changing in the country since 1979 *"from the view of intellectual creations as social goods subjected to state control towards the view of intellectual creations as property of the creator"* (Pearson). In practice, these changes materialized on: regulations involving copyrights, trademarks, patents; establishment of supervision and enforcement IPR-related institutions; adhesion to international conventions and organizations as the World Intellectual Property Organization (WIPO).

It is also important to consider that these changes are not only the result of the changes in mentalities or of the direct pressure employed by the surrounding environment. Besides all these causes for change, there were also some consequences, i.e., objectives which the Chinese government planned to achieve through this restructuring at institutional and regulatory level. WTO membership might be one of these objectives meaning that the pressure for change could also come from future intentions and not only from present needs. Pearson goes even further by defending that this pressure brought by expectations and future achievement may have had stronger influence than the one brought by external direct pressures or changes in mentality. The policy makers, although pressured by external environmental conditions, would not implement or stimulate change if they did not believe that the outcome that such change would provoke would be the best for the country's economy. So, for Chinese leaders, the most important issue was to achieve high level of industrialization and modernization in the economy through integration into international markets. Such integration brought external pressures for China which had to adapt its policies in order to reach these markets more effectively. Nevertheless, it was industrialization and economic modernization the final goal that policymakers took into account when promoting policy shifts and accessing overseas markets is only perceived as a mean to achieve this final goal. This way, the pressure brought by such future objective is, in the Chinese point of view, much higher than the one generated by the surrounding environment.

These changes at the regulatory and norm levels happened gradually and, subsequently, some industries benefited more than others due to the time differences on lifting controls in the different industrial sectors. Those industries which had higher leeway earlier enjoyed greater benefits than those that were controlled until a later date. About this Pearson adds that “*yet the effort to make China a more hospitable environment for foreign capital, both in terms of rules at the sovereignty level and operations on the ground, has continued slowly and steadily.*” Moreover, even after the events at Tiananmen in 1989, the government’s efforts continued since the Chinese knew that the liberalization of their economy was the only way to achieve their primary goal: high modernization and competitiveness for China.

This liberalization process is still underway and the “*reforms in the country’s foreign economic and trade policy continue to be works in progress*” (Pearson). For this reason business people still have some concerns regarding, for example, the transmission and enforcement of laws emitted by central government to local and regional administrations. While such concerns still exist, this process must continue especially in what respects to the development of the legal system which would regulate different areas as contract enforcement, dispute adjudication or even IPR protection. The challenge for the central government is to make sure that all laws and directives created at this level are effectively transmitted to the lower levels in order to ensure that this desired change takes place throughout the whole country. So, improvements were made involving legal enforcement but not in a consistent way because institutional and regulative developments occur gradually and in a country as big as China they will affect the different provinces at different times. It is very unreliable to consider that a supportive legal system can be quickly achieved in country like China where laws and norms from central government are interpreted differently by local administrations and thus also applied in ways which were not the expected by the Chinese leaders.

This complex political environment, where decisions made at the lower levels of the administration may not be coherent with the ones from higher levels, creates room for external pressures to arise. Since laws interpretation is different according to the different places within China, Chinese industries which are more vulnerable to the competition from international markets exert pressure over local administrations in order to make these laws better suit their interests and protect them. Pearson argues that “*this phenomenon contributed to the slow pace of China’s WTO accession negotiations*”. On the other hand, since China is now member of several global

institutions, government officials also use this form of external pressure to implement internal changes faster. Any attempt of change would grow stronger when the international community agrees and supports such change. This is the environment from the political and somehow economical perspective, where each party uses his influences, internal or external, to pressure for a desired outcome. The problem relies in the huge variety of different outcomes that each party perceives as ideal.

4. Shanghai and the Pudong New Area²

“Shanghai has been at the forefront of China’s economic reforms and opening-up to the outside world, and has played the leading role in China’s adaptation to world trade rules” (Baihua). It was the Shanghai Institute of Foreign Trade and its experts who first proposed, in 1985, to the Chinese government that China’s status at GATT should be resumed. At that time the Shanghai Research Centre on GATT was established. This Centre was sponsored by Shanghai People’s Municipal Government and *“is a professional, non-government consulting institution set up to provide legal and policy advice on WTO affairs, as well as WTO-related training services”* (Baihua). This Centre gave a great contribution in fulfilling China’s WTO accession commitments since it supported central and regional governments in their adaptation to the WTO trading regime.

From here one might conclude that if China’s entry into the WTO was the turning point for this country, than Shanghai and its WTO Affairs Consultation Centre was one main responsible for the creation of the possibility of such turning point to occur. It is undeniable that the Chinese accession to the WTO had a huge impact at international level and this is the main reason why such event should be considered as China’s economic and political turning point. Nevertheless, such turning point could not possibly occur without the strong development witnessed in the 1990s throughout whole China and especially in Shanghai. The remarkable increase in trade volume and the reduction in the number of people living below the poverty line were key factors which influenced the WTO officials to accept China’s accession to the organization. So, if China’s entry into the WTO was its turning point, it was the development that the country, and particularly Shanghai, achieved the responsible for such tuning point. Therefore one might ask: if the development of China and, in this case of Shanghai, was

² All numbers and statistics presented throughout this chapter (unless notified otherwise) come from the work of Wei Ge – *Special Economic Zones and the Economic Transition in China (1999)*

the main event which trigger WTO accession process could not such event be the turning point for the country? In this perspective WTO accession is not seen as the turning point for China but as the confirmation that such turning point had already taken place in Shanghai during the 1990s. For all these reasons, it is relevant to bring up for discussion the extraordinary development in Shanghai during that time in order to evaluate its consequences and impacts, not only at internal level within Chinese boundaries, but also at external level at the international stage.

Following Wei Ge (1999) structure regarding this particular subject, this chapter is structured as follows: the first topic to be approached is the establishment of Pudong New Area, an area east of Shanghai, which had great economic development during the 1990s and will be the main focus for this part of the study. After this introductory presentation, the development of this area will be examined considering five different perspectives which are: infrastructure development and financing; foreign investment; pattern of trade; emergence of non-state sector; economic growth and structural changes.

4.1 Establishment of Pudong New Area

“Pudong, also known as eastern Shanghai, is a triangular area of almost 523 square kilometres and a population close to 1.4 million at the end of 1990” (Ge, 1999). The area is located east of the Huangpu River and southwest of the mouth of Yangzi River. This area is often designated as the gold coast and waterway of China.

The motives behind the establishment of Pudong New Area are related with the status of Shanghai. Shanghai is one of four municipalities in China which is administrated directly by the central government. This municipality has a size of 6340,5 square kilometres and a population of about 13 million occupying much of the southern part of the Yangzi Delta. It has an excellent geographical location in the east coast of China and it is the country’s gateway to outside world linking it with Japan, the Americas, Southeast Asia, Oceania and other parts of the planet. Its location is also in the midpoint of the country’s east coast enabling the municipality to serve as the link between port cities in the northern and southern areas. *“It is 560 nautical miles from Dalian, a major port city in the northeast, 750 nautical miles from Tianjin, China’s economic centre in the north, and 910 nautical miles from Guangzhou, the largest metropolis in southern China and capital city of Guangdong Province”* (Ge, 1999).

Shanghai has a long history as a centre of international trade and finance in the Far East. From 1860 to 1930 Shanghai handled on average 68% of China's total exports. Its trade volume was 1% of world total in 1933. The banking and financial sector had a spectacular growth since the first foreign bank was established in Shanghai in 1847. One century later Shanghai had 14 foreign banks, 128 state and private-owned banks, 13 trust companies and 79 money exchangers. After the Chinese revolution in 1949, and with the establishment of People's Republic of China (PRC), Shanghai was transformed into the country's manufacturing centre. Then, in 1984, the city was one of the fourteen cities selected to become open coastal cities. At that time it contributed 5,6% to the national Gross Domestic Product (GDP) and 9,6% to the gross value of industrial output. The secondary sector was predominant accounting for 70,5% of Shanghai's GDP in the same year and the tertiary sector was the second in proportional terms representing 25,1% of the municipality's GDP which has a little above the national average – 22%. *“Among all provinces, municipalities, autonomous regions in China, Shanghai was the largest producer of light industrial goods in that year and the second largest in heavy industrial production surpassed by the north-eastern province of Liaoning”* (Ge, 1999).

The open-city status earned in 1984 brought an extra stimulus to the local economy. GDP grew on average 7,7% between 1985 and 1989 and exports increased from \$3.36 billion to \$5.03 billion in the same period. Consequently, the ratio of exports to GDP expanded from 23% to 27%. But, the indicator that had the most impressive evolution was undoubtedly the FDI which was non-existent in 1984 and, in 1989, achieved a cumulative amount of \$3.7 billion. Related with these developments or not, the fact is that the economic structure also changed in this time period with the secondary sector gradually losing its crucial importance – its GDP share decreased from 69,8% in 1985 to 66,9% in 1989. On the other hand, the tertiary sector witnessed a positive evolution in terms of the relative weight of the GDP from 26% to 28,8%.

At the end of this period Shanghai's expansion suffered a setback and, although there are several reasons for such decline, it is inevitable to relate this fact with the events in Tiananmen Square in 1989 which affected the economic performance of the whole country. Nevertheless Wei Ge presents some other reasons which could have been responsible for the shrinking of the economic activity such as: outdated production facilities and equipment; inadequate infrastructure; cramped urban space. In addition, the main problem for the municipality and central governments was that the renewal of

the existing infrastructures and production means had a cost which has beyond both governments' budgets. As a result, the Chinese leaders decided in 1990 to develop Pudong making it the first step of a policy which intended to revitalize Shanghai. Pudong had a superior geographical position, rich human resources and strong economic foundation. For these reasons, it was expected to incite the development of both Yangzi Delta and lower and middle Yangzi Basin. A successful transformation of Shanghai from a manufacturing centre to its older more service-based economy would speed up the desired economic transition planned by the Chinese government.

Pudong New Area was thus established in 18 April 1990. As already mentioned the purpose was to make Shanghai an international economic, trade and financial centre. The mission for Pudong New Area was to be the first in the process by developing "*into a modern urban area with open, market-driven economy*" (Ge, 1999). The economic structure of this new area was planned to be comprehensive including companies from all the three sectors but, the development of trade and financial service-oriented activities would be the main focus in accordance with the overall strategy set for Shanghai and already mentioned to previously.

Pudong New Area was planned to include four sub-zones along with manufacturing establishments and each one of these sub-zones was to specialize in one concrete economic function. The first of these sub-zones is Lujiazui Finance and Trade Zone which had a planned size of 16,82 square kilometres and was to concentrate on international trade, financial and commercial activities. This sub-zone was also to become part of the central business district of Shanghai. The second sub-zone is the Jinqiao Export-Processing Zone is located at the centre of Pudong New Area, had a planned size of 19 square kilometres and, as the name suggests, was to focus on export-processing and trade-related services. Waigaoqiao Free-Trade Zone was the third sub-zone with the planned dimension of 10 square kilometres and it was located in the northeast part of Pudong New Area. Its main objective was "*to become the most comprehensive free-trade zone in China*" (Ge, 1999). Last but not least, Zhangjiang High-Tech Park was to be settled in the south of Pudong New Area comprising 17 square kilometres and, according to the initial plan, was to embrace "*education and R&D-related activities and to be developed into one of the leading biochemical and pharmaceutical research centres in the country*" (Ge, 1999). It is important to notice that all together these four sub-zones only occupy 12% of the region which is designated as the Pudong New Area. The remaining part, among other things, was to be

developed as an extension of the Shanghai urban district incorporating public facilities such as: schools, libraries, theatres, museums, hospitals, fitness centres, parks, shopping centres and residential sections.

Pudong New Area is open meaning that no special permission is needed for persons to enter the zone. The same applies for enterprises, both domestic and foreign, which were encouraged to invest on the area if they were able to meet certain requirements. The initial plan also previewed the development strategy for Pudong New Area which was divided in three phases: first – raise the area up to operational level by 1995; second – by 2000, to have formed the basic economic structure as planned and in line with the overall objectives set for the Shanghai municipality; third – to become a mature, open, market-driven economy and to support Shanghai in the accomplishment of its main goals turning the municipality into a international centre for trade and finance in the first half of the 21st century.

4.2 Infrastructure Development and Financing

The upgrading of the existing infrastructure was, logically, the first step that Pudong undertook in the initial phase of development. Such upgrading had two different orientations: on one hand, the development of the four sub-zones and, on the other hand, the reinforcement of the link with Shanghai. This construction phase started in 1990 after the Pudong New Area establishment. On this matter, Pudong is a special case when compared to similar situations in China like other Special Economic Zones (SEZ) in the 1980s. Unlike these, Pudong restructuring involved only the simple upgrading of an already built area. *“The degrees of urbanization, population density and manufacturing concentration were the same as Shanghai’s average”* (Ge, 1999). At the time that Pudong New Area was established, there were already substantial industrial organizations in the region along with some agricultural and tertiary firms. These were responsible for \$6 billion-worth of goods and services which corresponded to 8% of Shanghai’s municipality total GDP. In what concerns to percentages of Pudong’s GDP, the economic structure was as follows: the primary sector accounted for 3,7% of the total and the tertiary sector had a share of 20,1%. The remaining 76% were from the secondary sector where the manufacturing industries were dominant. Industry and population were concentrated in a 25 kilometre-long and 2 kilometre-wide area along the Huangpu River, more or less the same area for the proposed Lujiazui Finance and Trade Zone.

With the goal of building a first class international business centre, Shanghai's municipal government contracted foreign urban planners and designers to work with the Chinese equivalents, an action which had never been attempted before in Chinese urban development history. Their objective was drafting the blueprints for this zone which was accomplished only after seventeen rounds. The restructuring of the designated Pudong New Area involved the relocation of the existing facilities and residences so that the area could then be reconstructed with offices, residential buildings, and production and public facilities of different types. At a first phase, in 1990, ten major projects worth 8 billion Yuan were launched including the construction of facilities such as water, gas and electricity supplies as well as road, port and telecommunications systems. The previous also comprised bridges and tunnels across the Huangpu River which would improve the link with western Shanghai. By 1993, and two years ahead of schedule, most of these projects were completed. For this reason, the second round of infrastructure construction started one year later embracing another ten major projects which incorporated the construction of an international airport, a deepwater port, an underwater subway tunnel crossing the Huangpu River and a telecommunication and information network. All together these two construction phases involved a cumulative investment amount over 120 billion Yuan from 1990 to 1996. This investment was destined to Pudong's infrastructure and fixed capital assets development and was twenty times bigger than the region's GDP in 1990. These construction projects were financed by raising investment funds from diverse sources – according to Pudong's administration, 42% of total investment in the period was self-financed mostly by firms' savings. The remaining was financed by domestic loans, which covered 28% of total investment, while foreign investment was responsible for 23% and central, Shanghai and Pudong governments had a share of 7%.

Since Shenzhen SEZ has witnessed a similar development in the 1980s and such development will also be subjected to analysis in this study it is interesting to compare the different sources of investment funds for the two situations. Notice that the data refers to three years after the establishment of each zone.

The first conclusion that one might withdraw from observing the table 4.1 is that domestic loans and self-financed funds were the two main investment financing sources for both Shenzhen and Pudong but their relative importance was different in each case. Domestic loans were responsible for 27% of Pudong's investment funding and in Shenzhen this category represented more than 37% while self-raised funds contributed

with 56% of total investment in Pudong and only 27% in Shenzhen. The relatively high share of self-raised funds in Pudong can be explained by the fact that this region, unlike Shenzhen, already had a strong enterprise base at this stage of construction which could support a big part of the investment. Pudong had been enforcing linkages with domestic parties – between 1990 and 1993, more than 3100 joint ventures were established with companies in inland regions generating an investment amount of 22 billion Yuan. Therefore, it is obviously concluded that, although Shenzhen also established linkages with domestic partners, such connections were not as strong as those made in Pudong.

Table 4.1 - Pudong New Area and Shenzhen Special Economic Zone: A Comparison of Source of Investment Funds

(Percentage Share)		
Investment Source	Shenzhen (1983)	Pudong (1993)
State Appropriation	5,2	0,8
Domestic Loans	37,3	26,5
Foreign Investment	26,6	9,9
Self-raised Funds	26,6	55,6
Other Funds	4,4	7,3

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 146

Turning now the focus of this analysis to state appropriations, it is observable that this category presents low percentage share in both cases but, the value in the case of Pudong is particularly small. Wei Ge argues that this was caused in part by the financial reforms undertaken in China at that time which attempted to transform investment funding from state appropriations to bank loans. However, this does not mean that Pudong had to find investment sources by itself since there was heavy support from central and Shanghai municipality governments in what respects to the region's development. Investment financing from these institutions essentially targeted projects which had more than one beneficiary as the two bridges linking Pudong and western Shanghai or the construction of the port and power-generating facilities. Furthermore, funds were reserved by specialized banks to the development of the area and foreign loans, mainly from World Bank and Asian Development Bank, were also materialized.

FDI had clearly a more important role in Shenzhen than it did in Pudong, having a percentage share of 26,6%, almost the same as self-raised funds for this region, while in Pudong this source of investment only accounted for 10% of the total. Wei Ge defends that this disparity “*was a reflection of the stage of China's economic opening, in general, and the nature of foreign capital inflow to the zones, in particular*” (Ge, 1999: 147). Given that China was more open to overseas investment in 1993, foreign

investors had more options to choose from for investment while in 1983 Shenzhen was one of the few locations where this type of investment funding was permitted. Regarding this matter Wei Ge adds that “*competition with its domestic counterparts may have had a role in preventing Pudong from receiving more foreign capital in the early phase of development*” (Ge, 1999: 147). Differences concerning foreign investment were also notable in the kind of investment made. While in Shenzhen investments from overseas were mostly directed to small, labour-intensive, low-technology, export-processing and assembly projects, in Pudong there were higher standards respecting the quality and quantity of investment undertaken. In this case there was a focus for attracting large-size, capital and technology-intensive investments. In order for these investments to occur, certain facilities are required for production and operation and this may be the main reason why Pudong started its development strategy by upgrading its infrastructures. This type of investment, although in the long term it may be valuable for Pudong in terms of technology transfers and longevity of projects, had immediate costs related with investment attraction which were relatively high and this can also be one more reason why this type of investment had such a low share in the total investment financed at that time.

Regarding only the case of Pudong, the category named “Other Funds” includes money raised through issuance of stocks and bonds. With the development of financial markets in China during the 1990s, this was somehow an experimental way of investment sourcing and consequently had only a complementary nature representing 4,2% of total investment funding.

4.3 Foreign Investment

Several policy incentives and regulations were announced to stimulate this type of investment in Pudong. Such policies covered a wide range of areas such as “*taxation, land use, custom duties, application and registration procedures, and business structure*” (Ge, 1999: 148). These incentives were created according to the overall industrial policies of Pudong and Shanghai so, only certain kinds of investment were subjected to such benefits. About this Wei Ge adds that “*using investment guidelines to direct foreign capital inflow was an important feature in Pudong*” (Ge, 1999: 148). Thus, projects involving energy, transportation, public utilities and those which had higher technology content and were more export oriented, and especially manufacturing projects with R&D components, had a more favourable treatment. In services, retail,

banking, finance, insurance and communications were preferred. Overseas investments were subjected to feasibility tests before being approved in order to ensure its quality. *“Regulations prohibited undertakings considered to be damaging to the environment or unhealthy for the cultural and social atmosphere”* (Ge, 1999: 149). Investors willing to participate in large-scale infrastructure development projects were allowed to build and operate certain facilities giving them back after an agreed period of time which used to be a decade or more. Real-estate projects could also be performed through leasing and by acquiring land use rights. B-shares, which could be bought by foreign investors, were issued on Shanghai Stock Exchange in order to increase overseas short-term capital. Many other reforms were introduced in Pudong to attract foreign investment and generate a favourable investment environment. *“These include developing capital, real-estate, land, and labour markets; restructuring distribution systems; improving the legal framework; and forming a leaner and more efficient administration to assist the transition toward a market-driven economic system”* (Ge, 1999: 149).

All these policy incentives and regulations together with the improved infrastructures had a beneficial effect on Pudong. There was an increasing trend in foreign investment into the area particularly since 1993.

Table 4.2 - Pudong New Area: Accumulated Foreign Investment, 1990-1996

(Amount contracted, millions of U.S. dollars; percentage share)		
	Amount	Share
Total	\$18.928,5	100,0
Foreign Investment by Type		
Joint Ventures	10.444,8	55,2
Co-operation	2.613,6	13,8
Foreign Enterprises	4.625,1	24,4
B-Share Enterprises	1.245,0	6,6
Foreign Investment by Sector		
Industry	7.202,7	38,1
Construction	443,7	2,3
Transportation	537,0	2,8
Real Estate and Public Utilities	7.699,1	40,7
Other	3.045,9	16,1

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 150

As we can see in the table 4.2 the cumulative amount of foreign investment in Pudong had reached in 1996 \$18.9 billion. From these, 92% were capital inflow which occurred since 1993. The pattern of investment in Pudong was similar to that of the rest of the country – joint ventures and foreign-owned companies were the major investors with 55,2% and 24,4% respectively. The remaining investment was made by co-

operation firms, with 13,8% of total investment, and B-share enterprises with 6,6%. The low relative importance of B-share enterprises might be the result of the safety measures adopted by both Chinese policy-makers and overseas investors. The financial market in China was still much undeveloped at that time therefore those who had access to these types of shares were afraid of contracting significant investments. According to Wei Ge the lower importance of this kind of companies in what concerns foreign investment could also be the result of the volatility of government regulations or the inadequacy of market information. Such fear was shared by the Chinese government because to raise foreign capital through stock issuance was experimental in China, and Pudong actually was the leader in this experiment at that time resulting in a cumulative foreign investment through this method of less than \$1.3 billion in the period considered in the table.

Real-estate and public utilities along with industry were the principal destinations of foreign investment during the period considered with 40,7% and 38,1% of total investment made respectively. On the other hand, the shares of transportation and construction were both below 3% of the total investment.

Regarding the changing patterns of the investment two different categories are worth mentioning. First, the remarkable increase of the investment made under co-operation deals. In 1990, this category recorded an amount of \$2.1 million corresponding to 4,2% of total foreign capital inflow in that year. Then, in 1995, the amount got bigger reaching \$362 million, 9,3% of total. And finally, only one year later there was a spectacular boost in investment made under these arrangements which recorded an amount of \$1.3 billion representing 27% of total. Wei Ge argues that this outstanding evolution “*may have been the result of Pudong’s efforts to attract foreign capital to large-scale infrastructure projects, such as co-development of a tunnel under the Huangpu River and the Pudong airport*” (Ge, 1999: 151). The percentage of foreign investment on construction also registered an increase from 0,8% of total inflow in 1995 to 5,8% just one year later.

Second, real estate and public utilities, although maintained the top position as main destination for foreign capital investment, it recorded a decrease from 1995 to 1996 after a continuous enlargement from 1991 to 1995. The cumulative value for this sector at the end of 1995 was \$6.5 billion and only in 1995 it achieved \$2.5 billion which was 64% of the total investment in that year. The year of 1996 was characterized by the already mentioned decrease in real estate and public utilities foreign capital

inflow which totalled \$1.2 billion at the end of that year, a 25% fall from the previous year. This behaviour can be explained by the over-extension of construction of office buildings in that year which caused vacancy rates of office space to be between 20% and 50%. Consequently, the market became less appealing for overseas investors and the central and Shanghai municipal governments had to intervene by emanating directives which consist in the relocation of some Chinese institutions to those offices. *“This helped to relieve some of the pressures on the real estate market in Pudong”* (Ge, 1999: 151).

From the 60 countries investing in Pudong, Hong Kong was the largest participant with more than 37% of total investment in the period between 1990 and 1997. Japan, the U.S. and Taiwan came as second, third and fourth biggest investors with corresponding percentage shares of 16%, 14% and 3%. Yet, since 1996 Japan has taken the first place in terms of investment in the area both in number of contracts signed and the absolute quantity invested. At that time from all large-scale projects undertaken by multinational companies, about one third were the responsibility of Japanese companies.

As was already discussed FDI in Pudong tended to be more capital and technology-intensive. The average amount per project registered a significant increase from \$1.2 million in 1992 to \$8.5 million in mid-1997 and was above national average which amounted to \$3 million in 1996. From all these investments projects nearly 10% reached more than \$10 million in absolute terms. In what respects to technology content, and according to Pudong’s administration, 40% of these large-scale foreign investments had technology meeting the standards of late 1980s while more than 55% were among the standards of early and mid-1990s. The remaining part of such projects was classified as being at the most advanced level of technology content. All these large-scale foreign capital inflows were mainly provided by internationally-known multinational firms.

4.4 Pattern of Trade

Trade expansion in Pudong recorded a remarkable evolution especially since 1993. Starting in this year and until 1996, the total trade volume more than tripled with exports increasing from \$1.2 billion to \$3.9 billion and imports from \$1.4 billion to \$4.2 billion. This trend of a negative trade balance at the initial stage of development was usually verified throughout other SEZ established in the country. Nevertheless some

differences arose and, regarding the Pudong case, trade deficits occurred in three of the four years here presented. The next table will compare imports, exports and trade balances for Pudong and Shenzhen SEZ at similar stages of development.

Table 4.3 - Pudong New Area and Shenzhen Special Economic Zone: Exports, Imports, and Trade Balance

(Billions of U.S. dollars)				
Pudong				
	1993	1994	1995	1996
Exports	1,2	2,3	4,0	3,9
Imports	1,4	2,4	3,2	4,2
Trade Balance	-0,2	-0,1	0,8	-0,3
Shenzhen				
	1983	1984	1985	1986
Exports	0,1	0,3	0,6	0,7
Imports	0,7	0,8	0,7	1,1
Trade Balance	-0,6	-0,5	-0,1	-0,4

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 153

Notice that for both areas the time considered comprises an interval approximately between the fourth and seventh year after the zone establishment. As we can see in table 4.3 Pudong had smaller trade deficit both in absolute terms and in its proportion towards total trade. The more robust export-producing sector that Pudong had at the initial stage of its development, when compared to the one of Shenzhen for an equivalent period, might be one possible explanation for the better performance of this zone. The exports value for Pudong in 1993 was twelve times higher than the one observable for Shenzhen at an analogous stage of development and three years later, in 1996, this value still was more than five times bigger than the one of Shenzhen in the corresponding year of 1986. The difference in imports was not as large as the one verified in exports although Pudong also recorded higher amounts in this category as well. Since Pudong was able to export more than Shenzhen did in the comparable period, it also could fund more imports and consequently maintain lower trade deficits.

The next table shows the composition of exports and imports for Pudong in the same period considered earlier. As we can see in the table 4.4 light-industry items were the most exported products with the textile industry alone being responsible for 40% of total exports. If the category “other products” is added to the equation, it is easily concluded that more than half of the exported products in the period considered comes from this industry. It is also possible to observe the changing patterns in terms of the type of exported products. Although light-industry products remain predominant relatively to exports, they present a declining trend while more technology and capital-

intensive products show a positive evolution. These products incorporate the categories of: chemicals and related products; machinery, electric equipment and accessories; locomotives, vehicles, aircraft, ship and related transportation equipment; and optical, photographic, medical instruments, precision instruments and equipment, related parts and accessories.

Table 4.4 - Pudong New Area: Composition of Trade, 1993-1996

(Percentage share)				
Exports				
	1993	1994	1995	1996
Minerals	1,0	0,9	1,0	1,3
Chemicals and Related Products	6,5	6,5	7,5	8,2
Plastics and Rubber and Related Products	2,7	2,7	2,8	3,3
Textile Materials and Products	41,5	42,0	40,1	37,3
Metals, Base Metals and Related Products	6,5	7,5	10,5	9,4
Machines, Electric Equipment and Accessories	11,6	11,8	11,8	15,1
Locomotives, Vehicles, Aircraft, Ship and Related Transportation Equipment	5,3	3,1	3,2	4,0
Optical, Photographic, Medical Instruments, Precision Instruments and Equipment, Related Parts and Accessories	1,0	1,0	1,2	1,6
Other Products	24,0	24,5	22,0	19,8
Imports				
	1993	1994	1995	1996
Minerals	4,5	2,5	4,0	3,6
Chemicals and Related Products	3,3	4,4	7,9	6,8
Plastics and Rubber and Related Products	2,6	2,7	3,5	3,4
Textile Materials and Products	9,5	9,4	13,8	12,0
Metals, Base Metals and Related Products	24,7	13,2	10,4	8,9
Machines, Electric Equipment and Accessories	43,9	36,6	35,6	39,8
Locomotives, Vehicles, Aircraft, Ship and Related Transportation Equipment	3,5	22,1	9,5	9,5
Optical, Photographic, Medical Instruments, Precision Instruments and Equipment, Related Parts and Accessories	2,3	1,7	2,4	2,8
Other Products	5,6	7,5	12,9	13,2

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 154

Trade structure in Pudong suggests the practice of intra-industry trade. From all the categories presented in the table 4.4, the imports and exports in seven of these have similar values. This especially applies to the classes: chemical and related products; plastics and rubber and related products; and optical, photographic, medical instruments, precision instruments and equipment, and related parts and accessories. This trend, although less notable, also applies to categories as: minerals; metals, base metals and related products; locomotives, vehicles, aircraft, ship, and related transportation equipment; and other products. In what concerns to the remaining product types, there is higher disparity between exports and imports but this distance seems to have been diminishing over the timeframe considered in the table 4.4. The

rising importance of intra-industry trade may be caused by the processing-oriented industry structure that Pudong possessed at that time. The influence that foreign-invested enterprises have in this structure is also a very important factor to consider since most of these companies used China just to process components of a certain product which was fabricated for exportation.

The analysis now turns to the importance that the different trading partners had for Pudong.

Table 4.5 - Pudong New Area: Direction of Trade, 1993-1996 (Unit: Percentage share)

Exports					Imports				
Countries	1993	1994	1995	1996	Countries	1993	1994	1995	1996
Hong Kong	15,5	14,1	15,8	10,6	Hong Kong	5,1	5,7	6,8	6,4
Taiwan	1,1	1,5	1,5	1,4	Taiwan	5,2	4,8	4,4	4,4
Japan	21,0	24,5	26,5	26,5	Japan	29,9	24,3	25,9	21,9
United States	14,4	14,8	12,5	14,3	United States	11,2	15,4	14,1	13,0
Sub-total	52,0	54,9	56,3	52,8	Sub-total	51,4	50,2	51,2	45,7

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 156

The four principal trading partners already mentioned before, Hong Kong, Taiwan, Japan and United States were, on average, suppliers of 54% of total exports and receivers of 50% of total imports. As we can see in table 4.5 the differences between the outflows and inflows of products between Pudong and U.S. as well as Pudong and Japan were minimal. For Japan, the average amount of exports and imports was, respectively, 24,6% and 25,5% while in the U.S. this amount averaged 14% and 13,4%. These similarities confirm the practice on intra-industry trade already suggested previously since it seems that Pudong's exports absorb a significant part of its imports. However, the pattern of trade observed with Honk Kong and Taiwan leads to different conclusions. While exports to Hong Kong in the considered period averaged 14%, the imports from this region only amounted to 6% of total. In what respects to Taiwan the same situation is valid but in opposite terms with exports valuing 1,4% on average and the imports reaching 4,7%. Although these two economies also have presence in Pudong regarding processing and assembly activities, the relatively higher difference between exports and imports points to the practice of inter-industry trade and not intra-industry trade contradicting the reality of U.S. and Japan. Still, if the volume of trade of these two groups is matched, the intra-industry trade seems to have more weight for Pudong during the period considered.

4.5 Emergence of Non-State Sector

State-owned enterprises (SOEs) were dominant by 1990, the year of the establishment of Pudong New Area, employing almost 76% of the workforce in the industrial sector. Collective-owned companies also possessed some significance at that time with 22% of total workforce. The remaining employees of this sector were working on smaller companies which could be either foreign-invested firms or privately owned enterprises. These smaller types of ownership structure were responsible for only 2,4% of total employment in the sector. With the foundation of Pudong New Area this distribution suffered a great transformation.

Table 4.6 - Pudong New Area: Industrial Employment by Ownership, 1990-1996

(10 thousand employees; percentage share of total)								
Types of ownership	1990		1994		1995		1996	
	Number	Share	Number	Share	Number	Share	Number	Share
State-owned	19,6	76,0	28,5	68,8	27,7	64,6	24,5	60,3
Collective-owned	5,6	21,7	4,0	9,7	3,6	8,4	3,6	8,9
Other ownership	0,6	2,3	8,9	21,5	11,6	27,0	12,5	30,8
Total	25,8	100,0	41,4	100,0	42,9	100,0	40,6	100,0

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999, p. 157*

The first observation withdrawn from the table 4.6 is the declining trend in the SOEs which lost both in terms of number of workers and share of employment in the industrial sector. In 1994, this particular type of companies employed about 285.300 people corresponding to 68,8% of total employment in the sector and, only two years later, in 1996, this percentage went down to 60,3% representing a 14% fall in absolute terms. In what concerns to collective-owned enterprises, although it started the considered period with a significant drop both in terms of absolute number and percentage of workers employed, it did not vary much from 1994 until 1996. The most impressive evolution comes from the category “other ownership” which encompasses foreign-invested and privately owned firms. These types of organizations, which were irrelevant in terms of employment in 1992, achieved the extraordinary mark of 31% of the total in 1996. The number of employees in this group grew 41% in absolute terms in two years from 88.800 in 1994 to 125.200 in 1996.

According to Wei Ge this expansion was the result of two factors. “*First, the strong policies aimed at attracting foreign capital were responsible for the soaring activities of foreign-invested firms*” (Ge, 1999: 157). The reforms undertaken in Pudong not only aimed at attracting foreign investment, but also liberalized the private sector and therefore privately owned firms emerged nearly doubling in number between 1993

and 1996. This had obvious consequences in employment on this kind of enterprises which was also close to double in the same period. “*Second, to improve the performance of the state-owned enterprises, [...] (these organizations) have been encouraged to establish various linkages with foreign firms, especially through joint ventures*” (Ge, 1999: 158). At that time, the majority of large-size foreign investment projects were joint ventures between SOEs and overseas investors accounting for more than 76% of all investments made at this level. This resulted in increased performance of the SOEs which benefited from the inflows of capital, technology and knowledge. “*According to the Pudong administration, the productivity of these enterprises has been ten times as high as their domestic counterparts*” (Ge, 1999: 158). Since most of SOEs were located in industries considered fundamental for Pudong’s economy, and as the joint ventures continued to grow, this new type of companies, embracing both state and foreign owners, were very important in shaping industries as automobile manufacturing, electronics and electrical appliances, steel, petrochemical and chemical products, biochemical and pharmaceutical products. These different activities generated more than 30% of the total industrial output in 1996.

4.6 Economic Growth and Structural Changes

Pudong’s economy developed very fast. This is confirmed by the great evolution that its GDP recorded between 1990 and 1996 with an annual average growth of 23,9%, a value which clearly surpassed that of Shanghai and China which only achieved 11,7% and 10,1% respectively in the same period.

Table 4.7 - Pudong New Area: GDP Index, 1991-1996

(GDP in 1990 = 100)						
	1991	1992	1993	1994	1995	1996
GDP	118,8	151,8	272,2	483,4	688,3	843,5
Primary Sector	109,5	86,5	95,5	143,7	190,1	205,9
Secondary Sector	116,5	148,9	249,4	429,6	618,7	723,4
Tertiary Sector	129,2	174,9	391,0	749,2	1.043,0	1.414,6

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 159

Looking at table 4.7 it is observable that the primary sector experienced, to some extent, stagnation during the period considered and there were even recessions in the years of 1992 and 1993. On the contrary, the secondary and tertiary sectors registered a constant increasing trend with the secondary sector enhancing seven times, almost the same as overall GDP. Nevertheless, it was the tertiary sector which witnessed the most remarkable growth by escalating more than fourteen-fold between 1990 and 1996 and

becoming undoubtedly the main responsible for the positive evolution of Pudong at that time. Logically, Pudong's fantastic performance in economic terms had an impact on Shanghai's development.

Table 4.8 - Pudong New Area: GDP Share in Shanghai, Selected Years, 1990-1996

(Percentage share)				
	1990	1994	1995	1996
GDP	8,0	14,8	16,8	17,5
Primary Sector	6,8	6,6	6,8	6,4
Secondary Sector	9,5	17,2	20,1	21,0
Tertiary Sector	5,0	11,7	12,8	13,8
Transportation, Postal, and Telecommunication Services	5,0	6,1	7,0	7,6
Banking and Insurance	4,3	11,1	11,7	11,2
Commerce	3,6	8,7	12,9	18,3

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999*, p. 160

As the table 4.8 indicates, Pudong's GDP share in Shanghai enlarged from an insignificant 8% in 1990 to 17,5% in 1996. Even so, it was the secondary and tertiary sectors which contributed the most for Pudong's rising importance in Shanghai. The secondary sector went from 9,5% of Shanghai's total in 1990 up to 21% in 1996 whereas the tertiary sector registered an increase of more than 8%, from 5% in 1990 to 13,8% in 1996. The primary sector was the only area that ended the considered period with a loss recording 6,4% of Shanghai's total in 1996, down from 6,8% in 1990.

In what respects to the activities within the tertiary sector, commerce was the one which had a quicker growth going from 3,6% of Shanghai's total commerce in 1990 up to 18,3% in 1996. Banking and insurance was, from the activities which are discriminated in the table 4.8, the second fastest with an increase of almost 7%, from 4,3% in 1990 to 11,2% in 1996. The remaining activity only witnessed a moderate growth of 2,6% in the period under consideration. Pudong's impact on Shanghai's economy noticeably gained more importance. Wei Ge argues that *“the main source of economic expansion in Pudong and hence the greater significance of the area in Shanghai was the continued improvement in productivity, thanks mainly to the reform and opening efforts that fostered Pudong's favourable economic environment”* (Ge, 1999: 160).

As we can see in table 4.9, Pudong's performance in 1990 was still behind the one of Shanghai but the situation was reversed by 1994 both in GDP per Capita and GDP per Worker. Since 1994 Pudong proved to be more productive than Shanghai which confirms the continuous improvement in productivity advocated by Wei Ge. It is therefore undeniable that in those years Pudong started having higher importance for

Shanghai. Notice that, in the period covered by the table 4.9, Pudong finishes with a GDP per capita 52% higher than that of Shanghai and the GDP per Worker also presents a gap of 31% between the two regions. The extraordinary evolution of Pudong's economic performance had obvious consequences in the overall economic structure.

Table 4.9 - Pudong New Area and Shanghai: GDP per Capita and GDP per Worker, Selected Years, 1990-1996

(RMB Yuan)				
Pudong				
	1990	1994	1995	1996
GDP per Capita	4.498	20.087	28.127	33.904
GDP per Worker	8.637	27.813	38.939	47.949
Shanghai				
	1990	1994	1995	1996
GDP per Capita	5.910	15.204	18.943	22.275
GDP per Worker	9.603	25.087	31.007	36.601

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999, p. 161*

The primary sector in Pudong, which was already relatively insignificant for the area's GDP, lost even more importance in the period as it is observable in the table 4.10. It registered a fall of almost 3% from 3,7% in 1990 to 0,9% in 1996. Yet, it was the secondary sector which recorded the higher loss in percentage share of Pudong's GDP. This sector decreased 11% in the period from 76,2% in 1990 to 65,3% in 1996. This behaviour can be explained by the performance of the industrial sector whose share in GDP declined from 72% in 1990 to 59% in 1996. Finally, the tertiary sector was the only one which expanded throughout the considered period from 20,1% of total GDP in 1990 to 33,8% in 1996. This expansion could be related both with the real estate boost and the strong appearance of financial services during this same period.

Table 4.10 - Pudong New Area: Economic Structure, 1990-1996

(Percentage Share of total GDP)							
	1990	1991	1992	1993	1994	1995	1996
Primary Sector	3,7	3,4	2,1	1,3	1,1	1,0	0,9
Secondary Sector	76,2	74,7	74,7	69,8	67,7	68,5	65,3
Tertiary Sector	20,1	21,9	23,2	28,9	31,2	30,5	33,8
Transportation, Postal, and Telecommunication Services	7,3	7,5	8,5	8,7	3,1	2,9	3,0
Banking and Insurance	5,2	6,2	7,6	8,4	8,1	6,9	7,7
Commerce	3,1	3,1	4,2	4,0	6,2	8,4	11,4

Source: Wei Ge – *Special Economic Zones and the Economic Transition in China, 1999, p. 162*

Within the tertiary sector, commerce was the activity which grew the most – from 3,1% of total Pudong's GDP in 1990 to 11,4% in 1996. Banking and insurance also registered an increase of 2,5%, from 5,2% in 1990 to 7,7% in 1996. The fluctuation

of GDP's share of transportation, postal, and telecommunication services is also explained by the previously mentioned real estate boom. The large-size infrastructure projects held at the initial stage of development stimulated the construction sector and consequently transportation. Then, the also already mentioned crisis in the real estate caused by the over-extension of construction started affecting the market and spread until this sector. This is the reason why transportation, postal, and telecommunication services reported an increase until 1993 reaching 8,7% of Pudong's total GDP but ended the period with only 3% of such total.

So, the rising importance of the tertiary sector for Pudong's economic performance is a direct consequence of the policies undertaken in the area especially in the mid-1990s. These policies aimed mainly for open-up the service sector to foreign investment by ensuring citizen status to foreign-invested enterprises. It is also important to remember that such policies were in line with the efforts that China was making at that time to develop Shanghai into a centre of international trade and finance and ultimately to earn WTO membership. It was fundamental for the country to be open to the outside world in order to be accepted in the organization and this applied to all economic sectors. This is why Pudong's "*methods of attracting foreign investment have shifted somewhat from heavy reliance on preferential policy treatment to so-called functional opening-up*" (Ge, 1999: 162). This "functional opening-up" consisted in the opening of the tertiary sector to foreign investors, a sector that still had many barriers to new entrants in other parts of China. The service areas which were under this new measure involved foreign-owned retail stores, trading and insurance companies established together by Chinese and foreign investors, branches of international commercial banks which were allowed to conduct financial transactions in Chinese currency, accounting and management consulting services, and legal affairs. The objective of turning Shanghai into an international finance and service centre was so actively pursued that in the second half of 1996 Chinese organizations working in this sector moved into Pudong so that the tertiary sector gained even more importance by achieving higher concentration of this type of activities in the area. Among the relocated organizations there were: the Shanghai Stock Exchange; the Shanghai branch offices of the People's Bank of China and specialized banks; companies involved in trade, insurance, trust and investment activities; and certain commodity exchanges and technology trading firms. This relocation movement to Pudong was followed by multinational corporations and some major Chinese companies.

Besides the enlargement of the tertiary sector and especially the promotion of growth for banking, finance and insurance services, there were also policies directed to other sectors. Regarding the secondary sector, the focus was on developing the most important industries making of Pudong the industrial base of Shanghai in those fields. At last, and, although less important for Pudong's development strategy, the primary sector was also target of new policies which pointed to the modernization of the agricultural sector by launching advanced farming techniques and establishing large-scale commercialized agricultural units.

5. Special Economic Zones (SEZs)³

As it was already mentioned Pudong had a leading role in opening its economy to foreign investment in what respects to the service and especially the financial sector. Such policy was taken considering higher objectives that the Chinese central government had at that time as turning Shanghai into an international centre of trade and finance or assuring China's membership into the WTO, two objectives that were interrelated. In order to enter the WTO, China had to adapt itself to the market rules and obligations which obviously included allowing foreign investment in all segments of its economy. Pudong took an important step in the opening process of the only sector that still had many barriers to entry particularly for foreign investors. So, since Pudong represented the final effort made by the Chinese government to open its economy, could this be considered the turning point for China? It is hard to give a direct answer to this question and it is important to understand that all this economic opening-up and internationalization was a huge process that had many different phases which had three major different events: the SEZ in the 1980s, the efforts in the 1990s after the speeches of Deng Xiaoping in 1992 and China's entry into the WTO in 2001. All these are interdependent meaning that China's membership would not be possible without the efforts made in the 1990s and principally in Pudong for opening up the Chinese economy to the outside world. In the same way, the deepening of the opening-up process in this area would not be possible without the tests made in the SEZ one decade earlier. If China would not established the SEZ and through them start its opening

³ All numbers and statistics presented throughout this chapter (unless notified otherwise) come from the work of Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development (1997)*

process, the Pudong New Area would not even had exist with the success that it had. And this is the reason why the SEZ should be included in this study.

Before going into detail on the establishment and development of the SEZ, it is important to understand what a SEZ is and what is the different between the Chinese SEZ and other special zones established around the planet. This issue will be handled in the next section. After that, there will be a brief presentation on the background that led to the establishment of the zones. The third and forth section will deal with the reasons for choosing these specific areas to become the SEZ and the characteristics that such zones possessed and how they differ from the rest of the country. At this point there will be a focus on Shenzhen SEZ characteristics since that this special zone was the biggest and the one that caused more impact within China's economic performance. Finally, a description on the development of the SEZ in the 1980s will be executed.

5.1 Types of Special Zones

It is not an easy task to classify the different types of existent special zones since each case is unique and it becomes hard to create boundaries from one type to the other. On this matter the approach of Jung-Dong Park (1997) will be used here in order to overcome such challenge. The different types and consequent diverse designations for special zones here presented are the transit zones, the free ports, the export processing areas and the special economic zones.

- ***Transit Zone***

This type of zones is also designated as free zone or free transit zone and it *“is a port with a bonded warehouse that serve as a trade transit area”* (Park, 1997). The main objective of these zones is to expand the business opportunities to landlocked countries. Products which are brought into this zone are not considered imports and therefore are not subjected to custom duties since such products do not enter the country's domestic market. Thus, this type of zones has lower economic activity than a free port or an export processing area because of the many restrictions imposed.

- ***Free Port***

A free port is *“all or part of a trade port [...] at which imported foreign goods are not subjected to customs and permitted to enter freely”* (Park, 1997). Besides the freedom that products enjoy at these zones, there are other attributes which differentiate these from the Transit Zones – in free ports an economic agent can re-export, repack,

blend, process, manufacture, exhibit its commodities, establish sample markets and even construct or rent warehouses where finished goods may be kept.

- ***Export Processing Zone***

An export processing zone is an “*area near a port which is required to export all or some of the products it manufactures*” (Park, 1997). This type of zones benefits more those countries which follow an industrialization strategy oriented to export promotion. As in other special zones, organizations in export processing zones also benefit from custom duties exemption on imports of all kind of items – raw materials, finished products, semi-finished products, processing facilities, parts – and on exported products. The taxes rates for the companies within these zones are generally low and for new comers tax exemption is ensured for an agreed period. For foreign firms there are also some advantages as the freedom of profit transfer and foreign currency management. In addition, the government provides enterprises in the zone with facilities such as water, electricity, ports, warehouses, factories and boarding houses. Services ranging from communications and transportation to banking and foreign currency exchange are also granted. Park (1997) adds that “*an export processing zone is a special economic area established to facilitate export and trade of wholly domestic products via looser regulations on taxation and foreign currency management*”.

- ***Special Economic Zones***

Special economic zones, and particularly the Chinese special economic zones, “*can be seen as special areas open to foreign business, finance and trade*” (Park, 1997). Unlike the other types of special zones, SEZ do not enjoy a no-tax privilege and, in the case of Chinese SEZ, there is a 15% corporate income tax and personal taxes are also collected on monthly wages which exceed 800 Yuan. In what concerns to custom duties, only the materials which are destined for production or consumption benefit from exemption. The main difference between a special economic zone and a free port relies on the fact that the raw materials used in the special economic zone come from both external and domestic markets while in a free port there is higher dependence on imports. SEZ also have higher variety of industries than export processing zones incorporating commerce, housing and tourism, and public works as roads or electricity. These zones are established for supporting the accomplishment of certain economic objectives through the provision of determined conditions which, in the Chinese case, involve freer management systems. Such zones have higher integration of foreign businesses which assume different forms that can be either mergers with domestic

companies or independent management in wholly foreign companies. Basically, a SEZ “is an overall economic development area in which disparate business, such as manufacturing, agriculture, livestock, fishing, commerce, housing, tourism, banking, and insurance, are conducted” (Park, 1997).

5.2 Background to the Establishment of the SEZs

There were many factors influencing the establishment of SEZ in China. For the sake of simplicity such factors will be grouped in two major categories: economic factors – analysed separately due to their relevance and importance not only at that time for the Chinese central government but also for the objectives of this study – and other factors.

- ***Economic Factors***

With the Chinese Revolution in October 1949, People’s Republic of China (PRC) was born and the country was transformed into a socialist planned economy. Such transformation was justified by the low productivity and underdevelopment that PRC was facing at that time. The proposed solution was therefore to overcome this situation by promoting economic expansion within the limits of socialism. This strategy failed almost completely and two big problems arose in the economy: over-employed labour and paralysis of the accumulation mechanism.

At that time, although China was growing economically, there still was an excess supply of labour despite the increase in employment opportunities. This was mainly because of the higher participation of women in the economy. According to the 1983 Statistical Yearbook, 61,49% of total population in that year was considered employable population. From these, 82,7% were employed and the remaining 17,3% were students, high school graduates preparing for college entrance exams, homemakers, people who were retired from state organizations (retirement in these cases used to occur at sixty years of age for males and fifty-five for females), young people waiting for jobs and others. It is important to notice that unemployment among young people was not the real problem for the Chinese economy and it actually was no worse than in the countries at that time. “*The real unemployment problem in China lay in disguised employment*” (Park, 1997). This means that China’s real problem, the excess supply of labour, was hidden since that potential unemployed people were almost fully employed forming over-employed labour. There is an estimate declaring that 100 to 200 million workers in rural areas were in the condition of over-employed

labour. This phenomenon even occurred in state corporations which had 15 million over-employed people. Such number can increase into 20 to 30 million if collective firms are taken into account. China had many unemployed people and, because a key principle of the communist ideology is that unemployment does not exist in socialist state, and in order to eliminate this social problem, it absorbed this labour surplus both at urban and rural areas transferring the problem from excessive unemployment to over-employment. This problem gained more visibility in late 1970s with the implementation of a policy which consisted in sending young people to rural areas to be employed in relatives or acquaintances workplaces.

Table 5.1 - Average wage of Labourers and Employees

Years	Average wage of labourers & employees (Yuan)	Index (1952=100)		Average wage of labourers & employees in state-owned corporations (Yuan)	Index (1952=100)		Average wage of labourers & employees in collective ownership corporations (Yuan)	Index (1952=100)	
		Nominal	Actual		Nominal	Actual		Nominal	Actual
1952	445	100,0	100,0	446	100,0	100,0	348	100,0	100,0
1953	495	111,2	105,8	496	111,2	105,8	415	119,3	113,5
1954	517	116,2	109,0	519	116,4	109,2	464	133,3	125,1
1955	527	118,4	110,8	534	119,7	112,1	453	130,2	121,8
1956	601	135,1	126,5	610	136,8	128,0	547	157,2	147,2
1957	624	140,2	127,9	637	142,8	130,3	571	164,1	149,7
1958	536	120,4	111,0	550	123,3	113,7	470	135,1	124,6
1959	512	115,1	105,8	524	117,5	108,1	430	123,6	113,7
1960	511	114,8	102,9	528	118,4	106,3	409	117,5	105,4
1961	510	114,6	88,5	537	120,4	93,0	380	109,2	84,3
1962	551	123,8	92,1	592	132,7	98,7	405	116,4	86,5
1963	576	129,4	102,2	641	143,7	113,7	371	106,6	84,3
1964	586	131,7	108,1	661	148,2	121,7	358	102,9	84,5
1965	590	132,6	110,1	652	146,2	121,5	398	114,4	95,1
1966	583	131,0	110,1	636	142,6	120,0	423	121,6	102,2
1967	587	131,9	111,7	630	141,3	119,5	455	130,7	110,7
1968	577	129,7	109,7	621	139,2	117,7	441	126,7	107,2
1969	575	129,2	108,3	618	138,6	116,1	439	126,1	105,7
1970	561	126,1	105,6	609	136,5	114,3	405	116,4	97,6
1971	560	125,8	105,6	597	133,9	112,3	429	123,3	103,4
1972	588	132,1	110,5	622	139,5	116,8	465	133,6	111,9
1973	587	131,9	110,3	614	137,7	115,2	489	140,5	117,6
1974	584	131,2	109,0	622	139,5	115,9	441	129,7	105,3
1975	580	130,3	107,9	613	137,4	113,9	453	130,2	107,8
1976	575	129,2	106,7	605	135,7	112,1	464	133,3	110,1
1977	576	129,4	104,0	602	135,0	108,5	478	137,4	110,4

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

As already mentioned previously, China became a socialist planned economy in 1949 and, in 1953, a new system was introduced comprising uniform purchase and income, and state controlled prices in order to support the national low wage system. This so-called accumulation mechanism aimed to expand capital reinvestment and consequently increase production and consumption. The problem was that this was achieved by sacrificing both rural and urban labourer's wages. With low wages it would be much harder for populations to consume whatever products, even if production was increasing, and this is the main reason why the accumulation mechanism did not work as expected and farm production ended up not overcoming the stagnation point.

Table 5.2 - Grain Production per Rural Labourer (unit: kg)

Year	1952	1957	1962	1965	1970	1975
Production	947	1.010	752	831	863	966
Year	1976	1977	1978	1979	1980	1981
Production	972	963	1.036	1.129	1.061	1.139

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

Several conclusions can be withdrawn from tables 5.1 and 5.2. The most impressive is maybe the fact that the production level remained more or less the same from 1952 until 1978. This stagnation in farm production caused the impoverishment of rural labourers. *“People’s wage not increased for several decades but prices did increase because of the shortage of commodities”* (Park, 1997). Since the production level and the worker’s wage remained at the same level and, with increasing population, prices of products got higher, people started having less access to these products and consequently the living standard diminished to a level lower than in 1957. The food production grew just enough to meet industrial and population growth demands. Given this situation, China tries to recover its economy in the late 1970s by increasing purchasing prices of farm products and wages of urban labourers in order to support the farmers’ precarious condition. This signified the collapse of the accumulation mechanism which was based on low price of agricultural products and low wages of labourers. Jung-Dong Park enumerates various reasons for the stagnation of the economic system.

1) Loss of farmers’ work initiative due to ownership and distribution system

At that time the ownership system used was designated as Renmin Gongshe. Within this system there were three different types of ownership systems: at the lower level was the basic accounting unit which was designated as production division (or

shengahandai) and was responsible for the basic production means as land, livestock and agricultural tools; above this unit was the production battalion (or shengahandaidai) which used, owned and managed the remaining production means; and on the top of the hierarchy was the corporation (or gongshe) which coordinated the lower levels. The distribution system was the so-called partial wage-partial supply. The revenue earned from each accounting unit was treated in the following way. After the payment of agriculture and overall commercial taxes, profits and other obligations to the state plus the redemption of production costs and management expenses as well as spending for nonproduction sectors what was left was designated as consumption fund. This fund was distributed according to the socialist distribution principle called distribution by labour which is a combination of the wage and supply systems. From here the term partial wage-partial supply was born. Generally the wage is about 70% of this fund while the remaining 30% are the supply system. The wage is divided into two groups, basic wage and subsidy, with the first being determined by each management organization according to the public evaluation method while the second is divided into three parts each one for each ownership system presented previously. Since that this system is based on collectivism, individuals were not directly rewarded for their single efforts and this is the main reason why farmers loss their motivation and consequently work initiative. As a result, rural reforms were the first and probably most needed changes in China at that time.

2) High population growth rate

China before the revolution in 1949 had a high birth rate but also a high death rate and, therefore, the population growth rate stayed low. When the communist party became the only political force after the revolution, it implemented five-year plans. These plans were determined in the Chinese Communist Party (CCP) congresses which occur every five years and have three main objectives: “*to evaluate the work done since the last congress; to define priorities and orientations from where the most significant policies for the next five years are generated; and to appoint leadership at the top of the party*” (Trigo, 2003: 109). The five-year plan from 1953-57 included a population growth policy which resulted in a drop of the death rate from 1,7% in 1952 to 1,08% in 1957 while the birth rate remained high. In the 1960s the Chinese central government made some efforts to reduce the birth rate but these proved to be worthless because of the turmoil that China was passing by at that time with the Cultural Revolution which, basically, was a policy launched by Mao Zedong with the objective of fighting the

capitalism and “*create a perfect socialist era*” (Trigo, 2003: 117). This emphasis on fighting the capitalism neglected other policies as the ones regarding the population birth rate and thus a baby boom took place in during this period. In the 1970s birth control policies were taken into consideration again and late marriage was encouraged but, nevertheless, the connection between population growth and resource exhaustion was never really accepted and therefore the policy did not achieve the desired outcome. The situation reached an extreme and, in January 1979, the famous one child policy is implemented along with a full-scale birth control strategy. The concept of this policy was that one child was considered as desirable, two were the maximum allowed and people who did not respect this policy would not benefit from preferential treatment in many fields and would be subject to extra taxes. The population growth only became a problem because the production level was limited and could not keep up with the increasing population growth rate due to the lack of capital that China had at the time. Since the consumption function became bigger than the production function, the wages decreased and, as a result, accumulation also decreased and economic growth shrank diminishing the standard of living.

3) *Investment policy with emphasis on heavy industries*

There was a focus on investment in the capital material sector.

Table 5.3 - Growth and Structure of Chinese Industry (unit: %)

		1953-57	1958-62	1963-65	1966-70	1971-75	1976-80
Overall production in agriculture and industry	Agriculture	4,5	-4,4	11,1	2,9	3,4	3,2
	Industry	38,3	7,7	36,1	23,7	18,2	19,7
	Heavy industries	25,4	6,6	14,9	15,0	10,3	8,2
	Light industries	12,9	1,1	21,2	8,7	7,9	11,5
Distribution of investments	Agriculture	7,1	11,3	17,6	10,7	9,8	10,5
	Industry	42,6	60,4	49,8	55,5	55,4	52,6
	Light industries	6,4	6,4	3,9	4,4	5,8	6,7
	Heavy industries	36,2	54,0	45,9	51,1	49,6	45,9
	Other	50,3	28,3	32,6	33,8	34,8	36,9
		1952	1957	1965	1975	1979	
Structure of overall production in agriculture and industry	Agriculture	56,9	43,3	37,3	28,2	26,6	
	Industry	43,1	56,7	62,7	71,8	73,4	
	Light industries	27,8	31,2	32,3	31,6	32,1	
	Heavy industries	15,3	25,5	30,4	40,2	41,3	

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

As it is possible to observe from table 5.3, there was already a strong emphasis on heavy industry since the first five-year economic development plan (1953-57) which

became bigger, in terms of budget allocation, during the Great Leap Forward (1958-1960) and the Cultural Revolution (1966-1976). The Great Leap Forward “*was initiated in February 1958 by Mao Zedong with the objective of, through mass mobilization, doubling the industrial production in one year and exceeding Great Britain in some key sectors as the steel industry*” (Trigo, 2003: 116). With this policy farmers abandoned their farms and went to work on factories which caused, among other things, an economic crisis due to the shortage of farm production. Several other measures were implemented to benefit the heavy industry. The prices of agricultural inputs such as industrial goods, agricultural machinery, chemical fertilizers and insecticides were set high while the prices from farm produce were set low. Park (1997) describes those times as the “*heavy industry syndrome*” since this focus on heavy industry lasted for thirty years. The problem with these policies was that the heavy industry only satisfied the needs of related industries since steel, petroleum, chemicals, nonferrous metals and heavy machinery industries did not benefit farming based on traditional techniques, rural industry or small-and-medium-size firms as much as railroads, electric power or mining. Thus, the accumulation mechanism projected for the Chinese economic development and supported by people’s efforts did not return in to these people because the majority of the investment was made on heavy industry.

4) Problems in the corporate management system

At that time corporations did not have an independent management system and still had a tight vertical relationship with government administrative agencies. This way, top management at these corporations had to follow the orders given by the administrative agencies. Investment funds were provided by the governments’ financial fund exchange with no repayment obligations and no interest. Given this free flow of incoming capital, firms could guarantee these investments in order to alleviate their management operations, regardless their financial gains which could be small or even negative. Hence, corporations were allowed to increase their fixed capital and production and thus enlarge the benefits for their employees and expand their prestige and power. It was impossible for these companies to go bankrupt since that their survival was always assured by the state despite their performance and, therefore, employees’ position was also certain. Besides this, both local governments and firms had self-contained and self-sufficient organizational structure. Such structure was designated as “big and all, small and all” because all organization bodies such as schools, health care services or communist ideology groups in a city could also be found

within the smaller firms. This type of organizational structure slowed down the development of role specialization and effective division of labour in both the government agencies and the corporations. As a result, “*resources have been wasted, products have not been distributed efficiently, tensions have arisen between supply, production and sales*” (Park, 1997). In an attempt of solving this problem, the Chinese central government supplied more money but it only helped creating a vicious cycle of greater and greater, and many time meaningless, investments.

So, all the following problems cause the accumulation mechanism to fail and, subsequently, delayed the Chinese economic recovery. Ownership and distribution systems discouraged farmers’ work initiative provoking the decline agricultural production. High population growth rate made total consumption increase at a faster pace than total production. The accumulation from people’s savings and low consumption habits was invested principally on heavy industries. Moreover, the problems in corporate management systems spread economic stagnation nationwide. Finally, the end of the Cultural Revolution, which sent many youngsters to rural areas in order to fight the dissemination of capitalist ideologies, made these same youngsters come back to urban areas creating an employment problem for policymakers. The Chinese central government was therefore forced to reform the rural economic system and find new sources of accumulation as the introduction of foreign capital.

- ***Other Factors***

The first group of factors that might have influenced Chinese leadership to undertake the economic reforms in late 1970s could be designated as political factors. With the return of Hong Kong and Macao to Chinese sovereignty, the political problems with Taiwan and the emergence of other Newly Industrialized Countries (NICs), China was somehow pressured to reduce the economic gap between it and these economies. At that time China still had many barriers to modernization such as bureaucracy, lack of modern spirit and ideology of self-sufficiency and, with the pressure from the involving environment, its economy was in an urgent need of reforming. These external factors certainly played a role in pressuring for this change.

Besides the NICs, the national unification with Hong Kong, Macao and possibly Taiwan also exerted some pressure on Chinese policymakers. The adoption of the policy “one state-two systems” is based on the fact that capitalism and socialism coexist. On the Chinese case, the whole country remained socialist by nature but Hong Kong and Macao became local administrative units with individual governments and a

capitalist system. Any regulations and directives from these independent governments only have to be in line with the basic law and legal procedures of the special administrative regions created specifically for this event. So, these special areas might have laws and regulations which could not agree with those from other parts of China. At international stage, the representation of China continued to be made by PRC, although some liberties were given to Hong Kong and Macao to deal with foreign issues. The special administrative regions maintained financial independence in areas as finance, military, customs and issuance of currency and, thus, the monetary policy was managed independently as well as the judicial power. The case for Taiwan is more delicate because this region and China still have many political confrontations since the Chinese Revolution in 1949. According to Park (1997) "*Taiwan can decide freely its own foreign policy and keep its own army within a scale that does not threaten mainland*". This system could be way for a peaceful unification of the country but, in order to be successful, the Chinese central government had to acknowledge the advantages of capitalism and narrow the economic disparities between mainland and these areas.

It is also important to keep in mind that these areas could bring the solution for China's economic problems since they were sources of foreign currency and, at the same time, export markets. "*Hong Kong has acted as a window for China's exports by being the first or second largest trading partner since the 1960s*" (Park, 1997). The surplus generated by trading with this region was the needed margin that would balance the trade deficit that China possessed with western countries. Hong Kong is also the connection between China and Southeast Asia and Europe because it is the fourth largest international financial centre after New York, London and Tokyo. The relationship with Hong Kong brought many advantages to China such as fund security, access to an extensive information database, and the use of the region's resources – corporate management skills and skilled labour. The success of the Chinese economic development policy was therefore highly dependent on the economic performance of Hong Kong. For this reason, China invested continuously in Hong Kong in areas as manufacturing, finance, commerce, trade, transportation and real estate.

The unification with Hong Kong, Macao and Taiwan through the "one state-two systems" policy along with the end of the accumulation mechanism and the economic disparities between China and the Asian NICs pressured the Chinese government to transform and develop the nation's economy. This required the reform of the existent

economic system and the introduction of foreign capital and technology. Nevertheless, the original overall objective of the Chinese leadership was kept – to achieve industrial revolution – an objective which was not accomplished under the traditional system. The first measure of this economic reform and open-door policy was the establishment of SEZ.

5.3 Discussion on the location of the SEZs

Jung-Dong Park presents three main reasons that justify the location chosen for the SEZ. The first one is related to the already discussed “one state-two systems” policy used for approaching the return of Hong Kong, Macao and possibly Taiwan to Chinese sovereignty. As it was mentioned, under this policy capitalism and socialist are able to coexist in the same country. *“The special economic zones can be seen as a trial area for the construction of socialism based on this one state-two systems, idea which is unique to China”* (Park, 1997). For this reason, the SEZs location was planned to be close to Hong Kong, Macao and Taiwan, the target areas for the one state-two systems policy. Opening these areas to foreign investment and consequently enhancing its economic activity and influence were necessary measures that the Chinese government had to take not only to make the Hong Kong and Macao sovereignty change process smoother but also to try to solve any existent political confrontations with Taiwan. So, each SEZ played an appeaser role in the negotiations of sovereignty issues and political disagreements – Zhuhai for Macao, Xiamen and Shantou for Taiwan and Shenzhen for Hong Kong. Due to the strategic importance of Hong Kong to China, which was already discussed previously, the Chinese government tended to focus its efforts on Shenzhen SEZ rather than the other zones.

The second reason is somehow also related with the proximity of the SEZ to Hong Kong, Macao or Taiwan. By being close to these areas, the SEZ could more easily attract overseas investment from them and obtain the necessary means that would trigger the economic expansion and industrialization desired by the Chinese central government.

Last but not least, the third reason is related with the development model of China. China has a unique economic structure which contains different layers with different needs and development opportunities. Considering the size, both in geography and in population, of China and having in mind the disparities between the different provinces, it would be easier for policymakers to promote economic growth and

modernization by dealing with each zone separately rather than by implementing an uniform national-wide strategy which could fit some areas but, at the same time, could also completely inappropriate for others. SEZ establishment was the first step in the adoption of such development strategy. *“China can achieve advancement of the entire state economy only through the improvement of each economic area”* (Park, 1997). The symbolic start of this new perspective towards the Chinese development is encountered in the sentence of Deng Xiaoping *“it is necessary that some get rich first”* (Trigo, 2003: 30). In this perspective, China was helping the SEZ to help China meaning that the SEZ were using the resources that China could offer in order to get rich, and only then, they would spread their economic development model throughout the rest of the country so that China could finally become an industrialized modern nation.

5.4 Development of the SEZs

In June 1989 Shenzhen was the largest receiver of foreign capital inflow followed by Zhuhai, Xiamen, Hainan Province and finally Shantou. From all the mergers, joint ventures and wholly foreign companies (in China companies which have foreign participation are designated as SanjiGiyie) in China, one seventh were located in Shenzhen. From those in the Guangdong Province one quarter are in Shenzhen. And from all SanjiGiyie located in coastal areas, one sixth are in Shenzhen. Unlike SanjiGiyie, the Sanlaiyibao did not involve foreign capital participation. These types of companies could assume four different forms: 1) processing on commission – the company imports raw materials, accessories and packaging materials from a foreign customer and after processing, delivers the finished product to this same customer and gets paid for this service; 2) manufacture on the basis of sample – in this case products are processed taking into account the instructions of the foreign customer but, unlike processing on commission, Chinese raw materials are used; 3) knockdown export – accessories are supplied by the foreign customer and the Chinese counterpart only deals with the assembling process; 4) compensation trade or distribution method – the foreign company supplies raw material and machine facilities and is repaid with finished products. One sixth of all Sanlaiyibao in China were located in Shenzhen and from all of those which were in the Guangdong Province, one third were in Shenzhen. From these numbers it is possible to have a general view of the importance of Shenzhen for China at that time.

Having this strong presence both from foreign capital and internal firms improved employment opportunities. There was an increasing trend in employment in the five SEZ since 1979 but Shenzhen and Shantou were the zones which recorded the most impressive results.

Table 5.4 - Changes in Number of Labourers and Employees in Shantou (unit: person)

	1984	1985	1986	1987	1988	1989
Number of labourers and employees at the end of the year	2.530	6.791	12.585	20.495	27.724	36.780
Male	1.230	2.234	7.116	8.974	12.468	16.354
Female	1.300	2.925	5.469	11.521	15.256	20.426
Number of labourers and employees in each sector						
Permanent labourers	673	1.918	3.862	4.672	5.830	6.602
Contract labourers	1.174	1.698	2.616	3.405	4.771	7.790
Others	683	3.175	6.107	12.418	17.123	22.388

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

As we can see in table 5.4, female employees in Shantou registered a higher enhancement than male employees did with a 1570% and 1320% increase respectively from 1984 to 1989. There were three different types of employment at that time: 1) permanent labourers which were mainly composed of the permanent population; 2) contract labourers which comprised the temporary population; 3) temporary labourers which designated as floating population and in the table 5.4 appear in the category “others”. It was precisely the employees under the temporary contracts which grew the most in absolute terms.

As it is observable from the table 5.5 there was a decreasing trend in rural sector which was balance by the enlargement in terms of employment in the industrial, construction and service sectors. In 1989 in Shenzhen, only 2,4% of all labourers employed were in the agricultural and fishery industry while 51,4% were in the industrial sector and the remaining 47,6% were in commerce, tourism and service sectors. The secondary and tertiary sectors were the main responsible of employment for the incoming population. The diminution of the agrarian population was caused in part by the industrialization and urbanization that Shenzhen suffered at that time. Nevertheless, the remarkable increase in temporary population caused the agricultural sector to increase particularly in what respects to contract with landlords under commission management. The industrialization and modernization of Shenzhen reduced the area of cultivated land but it did not affect the agricultural production which had an average annual increase of 10% in the period considered in the table 5.5. Park (1997) attributes this growth to “*improvements in farmland, agricultural technology, and crop*

variety, and the increased percentage of temporary population in agriculture through landlord contracts". According to statistics, temporary population in farming, dairy cattle, pig and poultry breeding, and fisheries was 37.700 in 1986 and about 69.400 in 1987. Furthermore, contracts under commission management were also made with floating population in addition to the temporary one. Farming was therefore commissioned, for the most part of it, to non-natives of Shenzhen meaning that commission management was even bigger than statistics suggest.

Table 5.5 - Changes in Employed Population by Industrial Sector (unit: 10.000 persons, %)

Shenzhen	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Avg. annual growth rate
Agriculture, forestry, livestock, fishery, and marine products	-	0,68	0,65	0,77	0,39	0,28	0,35	0,33	0,40	0,82	0,40	-5,7
Industry	-	0,61	0,96	1,36	2,86	4,35	5,75	7,51	12,12	16,33	21,18	48,3
Construction	-	-	0,10	0,71	2,84	3,39	2,78	2,99	2,54	3,27	3,58	56,4
Transportation and communication	-	0,21	0,28	0,70	0,46	0,74	1,29	1,44	1,48	1,59	1,73	26,4
Commerce and restaurants	-	0,55	0,87	1,60	2,25	3,85	4,43	4,62	4,39	6,28	5,93	30,2
Real estate and hotel management	-	0,03	0,08	0,43	0,44	0,75	1,55	1,95	2,80	3,43	3,61	70,3
Banking and insurance	-	0,05	0,07	0,11	0,13	0,22	0,31	0,36	0,49	0,63	0,74	34,9
Others	-	0,52	0,84	1,00	1,39	1,87	2,85	2,93	3,14	3,44	4,03	29,0
Zhuhai	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Avg. annual growth rate
Agriculture, forestry, livestock, fishery, and marine products	3,1	3,0	2,8	2,9	2,7	2,7	2,5	2,6	2,5	2,5	2,3	-3,0
Industry	0,9	1,0	1,0	1,2	1,4	1,6	2,0	2,4	3,3	4,1	5,1	19,3
Construction	0,1	0,2	0,2	0,2	0,3	0,2	0,3	0,3	0,3	0,3	0,5	15,0
Transportation and communication	0,3	0,3	0,4	0,4	0,4	0,4	0,5	0,5	0,5	0,54	0,6	7,1
Commerce and restaurants	1,0	1,1	1,3	1,5	1,6	1,9	1,7	1,9	2,0	2,3	2,7	10,3
Real estate and hotel management	0,04	0,1	0,1	0,1	0,1	0,1	0,6	0,7	0,7	0,9	1,0	59,3
Banking and insurance	0,1	0,1	0,1	0,1	0,1	0,1	0,2	0,2	0,2	0,3	0,3	17,9
Others	0,9	1,0	1,0	1,1	1,2	1,2	1,4	1,6	1,7	1,9	2,2	9,4
Shantou	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Avg. annual growth rate
Agriculture, forestry, livestock, fishery, and marine products	-	-	-	-	-	0,01	0,03	0,1	0,2	0,2	0,2	112,0
Industry	-	-	-	-	-	0,1	0,3	0,6	1,3	1,7	2,4	85,1
Construction	-	-	-	-	-	-	0,1	0,1	0,1	0,1	0,2	210,0
Transportation and communication	-	-	-	-	-	0,03	0,04	0,06	0,05	0,06	0,05	14,8
Commerce and restaurants	-	-	-	-	-	0,05	0,1	0,2	0,2	0,3	0,5	55,4
Banking and insurance	-	-	-	-	-	-	-	0,01	0,01	0,02	0,03	62,3
Others	-	-	-	-	-	0,03	0,1	0,2	0,3	0,3	0,4	111,0

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development (1997)*

It is also possible to observe from the table 5.5 that each SEZ had different characteristics. Tourism was a huge industry in Zhuhai, and, consequently, more than

half of the population was employed in the service sector. In what concerns to Shantou, the industrial sector is predominant but there also was an extraordinary increase in agricultural and fishery industry if compared with other SEZ. “*Shantou has traditionally been famous for herbal medicinal plants and the fishing industry was flourishing*” (Park, 1997). Note that Xiamen is not included in this analysis because the data from this SEZ only confirms what has been already concluded and does not bring any added value to this study. In the same way, Hainan Province is also not integrated since it has a shorter history as a SEZ – it was established only in 1988, eight years after the other four SEZ.

Table 5.6 - Changes in Foreign Revenues and Expenditures in Shenzhen and Zhuhai (unit: U.S. \$10.000)

Shenzhen		1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Avg. annual growth rate
Total foreign revenues		20.144	17.123	17.525	17.669	21.613	19.405	33.248	76.601	101.002	83.011	17,0
	Revenues from exports	9.188	10.457	11.562	11.426	9.866	7.861	19.425	56.725	70.368	47.708	20,1
	Revenues from the manufacturing industry	675	1.174	1.650	2.482	3.494	3.811	6.986	12.389	18.135	21.897	47,2
	Revenues from nontrade business	10.281	5.492	4.313	3.761	8.253	7.733	6.837	7.487	12.499	13.406	3,0
Zhuhai		1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Avg. annual growth rate
Total foreign revenues		-	-	-	-	-	3.947	3.309	19.818	30.057	8.464	115,5
	Revenues from exports	-	-	-	-	-	2.839	2.083	18.411	28.196	5.973	185,1
	Revenues from the manufacturing industry	-	-	-	-	-	484	612	945	1.368	1.556	34,8
	Revenues from nontrade business	-	-	-	-	-	624	614	462	493	935	17,4
Total foreign expenditures		-	-	-	-	-	3.798	5.082	19.835	37.034	18.226	89,9
Net balance		-	-	-	-	-	149	-1.773	-17	-6.977	-9.762	

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

Table 5.6 shows that most foreign currency was earned through exports with Shenzhen and Zhuhai having on average 57% and 71,9% of total foreign currency earned with exports respectively. In 1989, the five SEZ were responsible for 10% of total export volume. The products which were more exported were bicycles, TVs, tape recorders, telephones and calculators. Unfortunately the data regarding the expenditures in foreign currency was not available for Shenzhen but Park (1997) declares that “*Shenzhen over-imported in 1987 but kept balance of revenue and expenditure in 1989*” and Zhuhai finished the period with a deficit of 97.62 million USD.

Looking into table 5.7 it is naturally concluded that Shenzhen had the highest growth of income in budget from all the considered SEZ with an increase of 5200% from 1979 until 1989. The majority of this income came from industrial and

commercial tax revenues – 90% of total on average – finishing the period with 87,4% of the city’s total income. The enhancement in income, especially the enhancement in industrial and commercial tax, indicates that the organizations in Shenzhen were positively progressing. The economic developments witnessed in the area during the 1980s as well as the autonomy of the city’s financial management were the main causes for the increasing city’s income.

Table 5.7 - Financial Income in Special Economic Zones (unit: 10.000 Yuan)

Shenzhen		1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Total
Total income in budget		3.043	8.787	9.163	15.605	29.435	62.894	74.160	76.921	124.429	187.696	592.133
	Special zone	3.043	8.787	8.339	14.403	27.490	59.646	69.898	71.716	111.904	168.370	543.596
Corporate income		75	263	686	1.877	2.383	1.897	5.010	3.668	6.233	4.120	26.212
	State-run corporations income tax	-	-	-	-	-	1.727	3.079	2.596	6.042	3.878	17.322
Industry and commerce tax		2.721	8.310	8.126	13.155	26.607	59.972	65.644	67.449	109.604	164.140	525.728
	Customs	1.627	6.224	3.618	6.017	14.624	23.541	24.566	25.224	39.419	43.420	188.280
	Local tax	1.094	2.086	4.508	7.138	11.983	36.431	41.078	42.225	70.185	120.720	337.448
Agriculture tax		200	204	201	183	165	185	195	208	456	641	2.638
Other		47	10	150	390	280	840	3.311	5.596	8.136	18.795	37.555

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

One of the most direct consequences of the economic development was the improvement of the standard of living. “Shenzhen used to be a fishing area near Hong Kong and now it is a major industrial city” (Park, 1997). Shenzhen’s GNP increased, on average, 48,3% annually during the 1980s and its GNP per resident had, on average, an annual growth rate of 24,9% within the same period. Agricultural and industrial production also had an outstanding annual enlargement of 34,8% on average from 1984 to 1989. As a result, the yearly average wage of labourers grew 580% from 1978 to 1989 and the one of farmers raised 650% in the same period. Shenzhen’s income was very high when compared with other areas, even when the different costs of living are taken into consideration. With higher wages the level of quality of life increased. As it is possible to observe in the table 5.8, colour TVs, refrigerators and washing machines existed in higher number in Shenzhen in 1988 than in Beijing or Shanghai one year earlier – a clear sign that the quality of life was higher in that area. In what respects to colour TVs, the difference in absolute terms is particularly impressive and the elevated number of washing machines and refrigerators show that housework was being reduced quicker in Shenzhen than in the other considered in the analysis. Hence, one might say that, at that time, Shenzhen achieved incredible economic advancements. Park (1997)

argues that the main causes for the improvement in the standard of living in the area were the “*vitalization of the currency circulation and the private businesses*”. However, it is important to remember that the economic expansion of Shenzhen also generated negative side-effects such as smuggling and black-marketing of the products manufactured by foreign-capital companies. These were problems that could seriously jeopardize Shenzhen’s development since the area’s industrial expansion and modernization was highly dependent on the protection of the domestic industry and on a regulated foreign currency management.

Table 5.8 - Ownership of Consumer Goods per 100 Households (unit: each)

	Shenzhen 1988	Beijing 1987	Shanghai 1987	Guangzhou 1987	Hangzhou 1987
Automobile	184	210	87	192	236
Sewing machine	62	72	97	93	86
Wristwatch	195	238	298	290	281
Electric fan	300	109	144	299	216
Colour television	99	58	44	57	209
Black & white television	11	71	77	62	83
Refrigerator	93	72	62	59	73
Washing machine	84	83	49	74	58
Tape recorder	91	118	111	76	85
Camera	47	56	31	23	19
Air conditioner	9	0,1	0	0	0
Motorcycle	4	1,9	0,6	1	0

Source: Jung-Dong Park – *The Special Economic Zones of China and their Impact on its Economic Development* (1997)

After analysing all this data it is easily concluded that from all the five SEZ, Shenzhen was undoubtedly the most successful one. Several reasons may be behind the success of Shenzhen SEZ. It was the largest zone in area with 327,5 square kilometres and it had the largest scale of economic activity. Nevertheless, it was its proximity to Hong Kong the factor which contributed the most for this zone triumph. As it was already discussed, Hong Kong’s thriving economy was fundamental for China at the initial stage of its economic development. By being close to this area, Shenzhen SEZ not only benefited from the huge economy activity from its neighbour but also was the focus of the Chinese central government who put all its efforts in this zone since it was the mean for achieving a connection with the outside world at that time. As many authors argue, Shenzhen SEZ became China’s laboratory where the Chinese government could test different approaches towards the adoption of capitalist policies under a socialist regime. The Chinese leaders were, therefore, able to learn valuable

lessons from the experiments undertaken in Shenzhen SEZ and then transfer this new knowledge and apply it in other areas of the country such as the Pudong New Area. Thus, Shenzhen may also be considered a turning point for China since it was in this area that, for the first time, capitalist policies were adopted by the Chinese government. If Shenzhen never had been established and if it never had achieved the success that it did, it is reasonable to believe that areas as Pudong New Area would never have been created and possibly the accession to the WTO would have become jeopardized.

6. The answer of the Portuguese textile industry⁴

Before starting the analysis on the answer that the Portuguese industrial sector, and particularly the textile sector, had against the Chinese economic development it is important to understand the methods and reason of this empirical research. The main intention was to try to determine when the turning point of China started affecting the Portuguese economy. But, in order to accomplish that it would be needed a much longer and wider research. So, due to the shortage of both time and resources, the analysis had to be narrowed to only one industrial sector. This way it would still be possible to figure out when the Chinese economic development started having consequences on Portuguese territory and, at the same time, the study gained a deeper perspective because it was possible, to some extent, to measure how this industry reacted to that development. Such perspective was not possible or at least harder to achieve when analysing a whole economy.

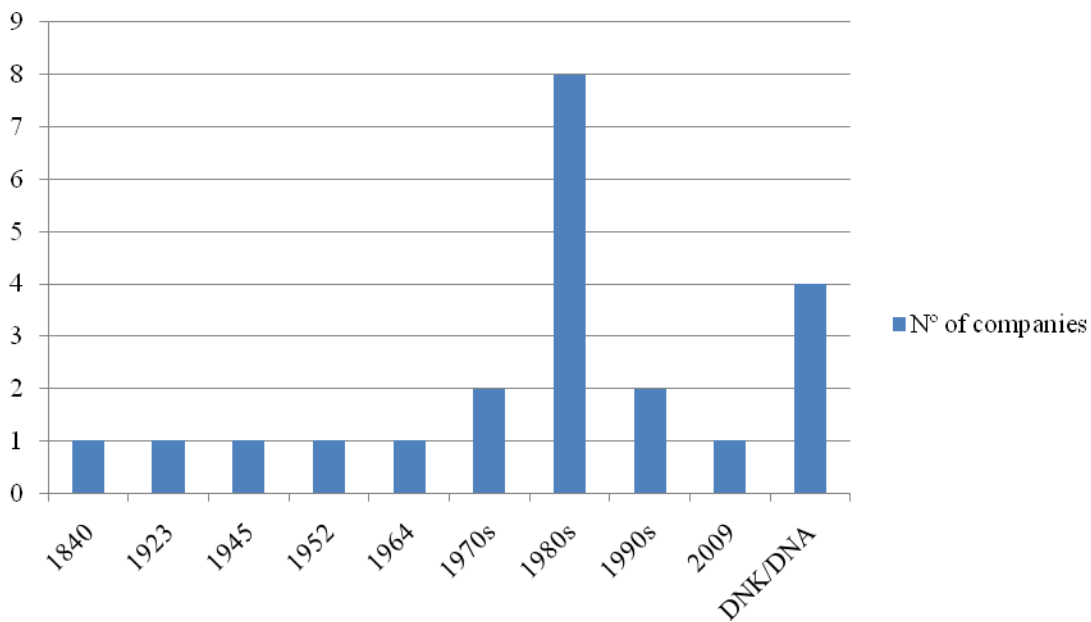
So, the challenge was to find out which industry would best fit this research purposes. Since different industries were affected at different times by diverse reasons, because each industry depends on its unique external factors, the choice of the right industry would be fundamental for the achievement of the desired outcome of this study. In line with the overall purpose of this research it was concluded that the industry best suited in this case would be the one which not only was the first one to feel competition from the Chinese but also the one that was more seriously hit by such competition. This way the result of the study would be as closest as possible to its main objective – to find out when the Chinese economic development start affecting Portugal and, at the same time, to understand how the Portuguese entrepreneurs reacted to this development. According to Virgínia Trigo and Miguel Crespo, the most fitting industry

⁴ All numbers and statistics presented throughout this chapter (unless notified otherwise) come from an empirical research conducted in the months of March and April, 2010

for this analysis was the textile industry since it clearly was the sector that was most affected by the Chinese economic development and modernization.

The empirical research was performed by sending inquiries to 501 different companies which were located in Portugal within the textile industry. This was made in the months of March and April, 2010. Unfortunately from these 501 inquiries only 22 answered and it is on this small sample that the following analysis is based on. The graph 6.1 shows the year of foundation of the companies within the sample. There is a clear predominance of companies established during the 1980s.

Graph 6.1 - Establishment year of the respondent companies



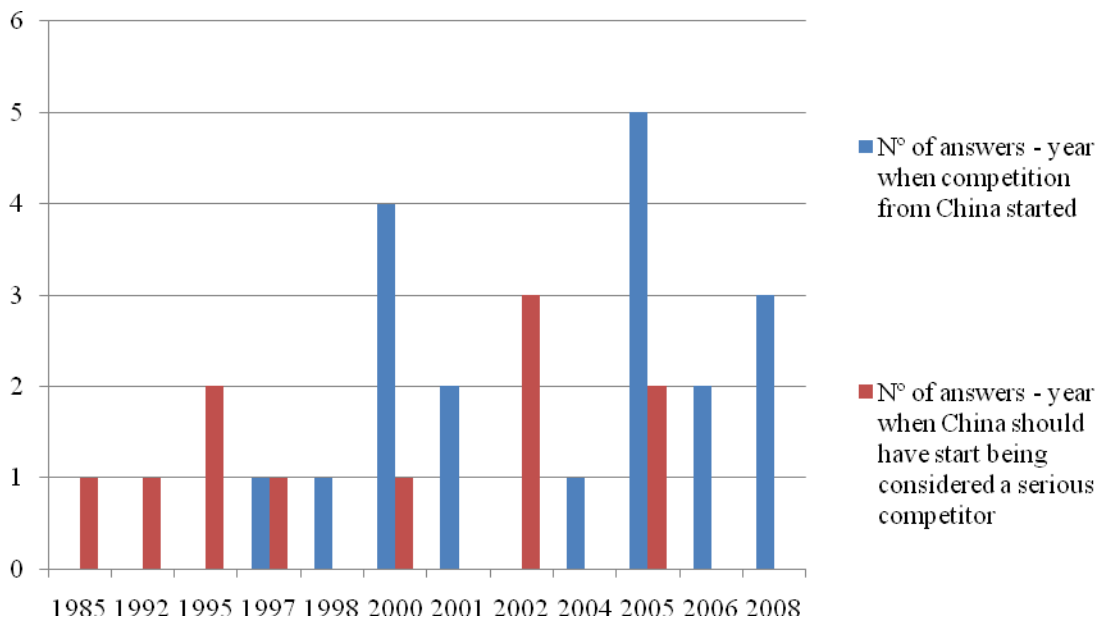
DNK/DNA - Did not know/Did not answer

The analysis will be structured as follows: each question of the inquiry will be presented individually together with a brief explanation of the objectives that such question was intended to achieve. After this explanation all the relevant results will be described and then process repeats itself moving to the next question. The conclusion will appear on the next chapter relating not only the outcome of this research but also including the results achieved in the previous chapters.

1) Since the first three questions are interrelated, they will be grouped together in this first section. In the first question it was asked for the respondents to point out what was the year in which, for the first time, they felt threaten by the Chinese economic development. In this question there were 19 valid answers, one invalid and the remaining two respondents affirmed that they still do not feel any threat coming from China. The second question asked if the respondents feel that they should have

considered the danger of the Chinese economic development earlier. From the 20 valid answers, 11 were positive meaning that the respondents regret their choice and 9 were negative meaning the opposite. To the respondents who answered positively to the previous question (those who feel that they looked to China too late), is then asked to point out in which year they should have started seeing China as a serious competitor. The questions objective was to understand when the Portuguese entrepreneurs started to feel competition from their Chinese counterparts and to figure out if they, nowadays, believe that they should have considered that hypothesis earlier. The answers to these questions will give a clear insight on the way that the Portuguese businessmen look to the Chinese turning point – the focus of this dissertation. Graph 6.1 presents the distribution of answers for the year in which they felt, for the first time, competition from China (in blue) and the year that they believe they should have started seeing China as a serious competitor (in red).

Graph 6.2 - Year in which the Chinese threat has started vs. Year in which China should have start being considered a serious competitor



As we the graph 6.2 shows there is a big concentration of answers in the years after the turning of the century, especially the years 2000, 2002, 2005 and 2008. Regardless the fact that those years correspond to the first time that competition was felt or to the time when China should have start being considered a serious competitor, the important factor here is that competition of China was a subject that only crossed the mind of the Portuguese entrepreneurs when there was a certainty that China would enter

into the WTO. Considering that the entry of China into the WTO had the direct consequence of the liberalization of trade with this country it seems obvious that Portuguese entrepreneurs only started seeing China as a competitor after the confirmation that this country could freely export into Portugal. The question that arises is if ignoring the development of China prior to its WTO accession was a wise decision. Should the Portuguese entrepreneurs have considered the economic evolution of China as a threat earlier? If the WTO accession was viewed as the final stage of a bigger process of internationalization and modernization could the Portuguese entrepreneurs anticipate this move from China and be better prepared for its coming? These are questions which stay open for further discussion.

2) The second set of questions is related to the measures that Portuguese entrepreneurs decided to take or not in order to fight against the Chinese competition. Logically, these questions intended to discover if the Portuguese businessmen reacted to the Chinese competition and how they did it. In two separated questions it was asked if any special measures were taken and if the respondents answered affirmatively they were then requested to point them out. Ten out of the 22 respondents declared that they took some action because of the Chinese competition while 9 said that nothing changed with the entry of China into the market and the remaining 3 were invalid answers. From all the different measures suggested it is important to highlight three which appeared more frequently: the improvement in the quality of products, the cost reduction and the modernization of equipment. Considering that China is well-known for its cheap low-quality products, it seems reasonable to invest on improvement of both the equipment and the product's quality in order to gain comparative advantage against the Chinese products. The cost reduction strategy might be related with other type of companies which could not afford to undertake investments at that time and, therefore, had to reduce costs to be able to fight the Chinese prices.

The next two questions were complementary to the previous ones. First it was asked if the actions took against Chinese competition were sufficient and if no, it was then requested for the respondents to indicate of what could have been done to better fight this adversary. Surprisingly, 14 of the 22 respondents affirmed that whatever had been done was not sufficient to better position the company against the Chinese competitors. It is important to notice that, considering the answers to the previous two questions, there were cases where no action was taken and, because of that, such approach was obviously not enough to compete against the Chinese counterparts. Four

respondents considered that the adopted strategies were sufficient and another four gave invalid answers. It is interesting to observe the two opposite views from the respondents in what respects to the additional strategies proposed. On one hand, there was a group of entrepreneurs advocating that the European Union and, to some extent, Portugal should restrict Chinese imports and the establishment of Chinese firms on national territory. This is a more conservative group that adopts a defensive posture and appeals for more protectionism to national corporations. On the other hand, there was other group of respondents which argued that companies should either go for internationalization expanding their markets, even into China in some cases, or create partnerships with their Chinese counterparts. These are more risk-taking entrepreneurs that believe that the best policy is do exactly the same thing that Chinese businessmen did – enlarge their market possibilities by going international. Again, which of these two would be the best option is left open to further discussion.

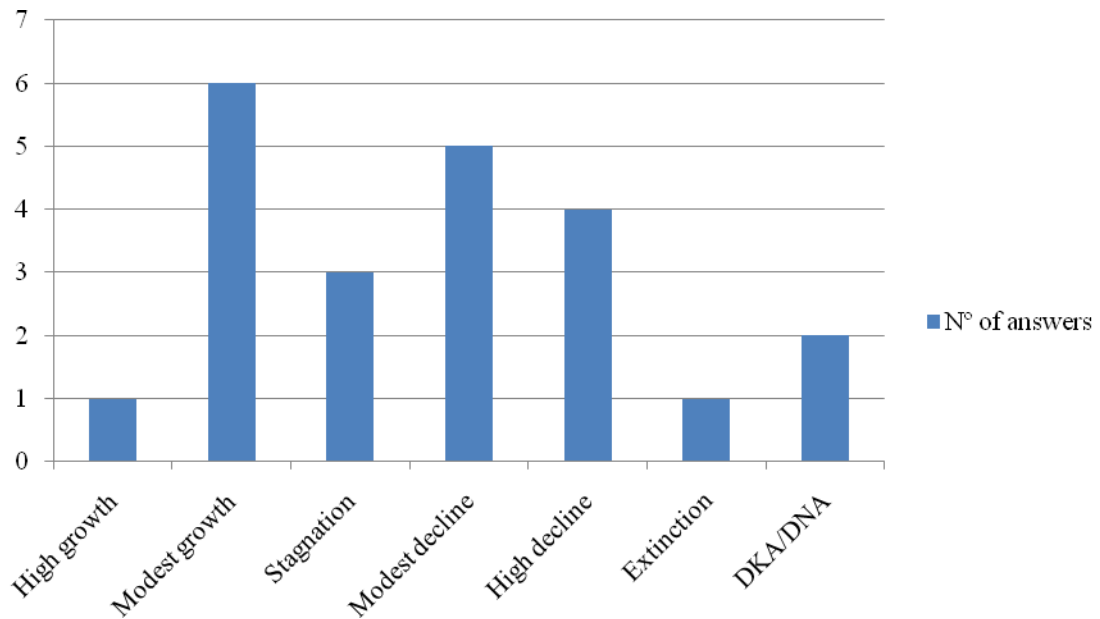
3) The third group of questions was related to the fall that the Portuguese textile sector had in recent years. The objective of these questions was to understand if the Portuguese firms blame the Chinese ones for its bad performance and to comprehend what other aspects could be responsible for the shrinkage of the sector. An amazing amount of 17 respondents blame Chinese entrepreneurs for the crisis of the Portuguese textile sector whereas only 3 believe that China had nothing to do with the bad performance from the Portuguese enterprises. The remaining two answers were considered invalid. When asked about what could be the other responsible for the decline in the industry, the respondents followed three major lines. There was the group of those blaming the Portuguese and European institutions for liberalizing trade without protecting national companies which were exposed to international risk. This group believes that the globalization, in what concerns to the Portuguese textile industry, brought more negative effects than positive ones. They feel that the competition from countries where costs are much smaller is not fair and it is impossible for a company established in Portugal, which has to fulfil many requirements regarding working schedules, social security or environmental issues, to fight against the prices from countries as China, India, Pakistan or Vietnam. The second group of respondents considered that there were the Portuguese entrepreneurs themselves the main responsible for the recent fall of the textile industry. They argue that businessmen are not well prepared, lack strategic and commercial vision and do not have enough training and that is why the competition surpassed Portuguese industries. Finally, there was a

third group defending that it simply was the development of the country that made the textile sector become obsolete. With the focus on activities from the service sector, the textile industry lost its attractiveness and people do not search for a career in this area also due to the considerably bigger workload and smaller wages comparatively to other sectors.

4) On the fourth part of the inquiry respondents were asked if they still feel threaten by their Chinese counterparts. This question aimed to understand the current perspective that Portuguese entrepreneurs have respecting Chinese competition. Not surprisingly 19 out of the 22 respondents affirmed that they still fell threaten by Chinese competition while only in one case declared the opposite. The remaining two answers were invalid. This means that China still is a major concern for Portuguese businessmen.

5) The fifth set of questions was about the future of the Portuguese textile industry. The distribution of answers appears on graph 6.3.

Graph 6.3 - The future of Portuguese textile industry



DNK/DNA - Did not know/Did not answer

As it possible to observe in the graph 6.3 there are two different trends. The majority of respondents believe that the Portuguese textile industry will continue in a decline period which can be a modest decline, where there is higher concentration of answers, or a high and more marked drop. Nevertheless, and unexpectedly, the higher amount of answers is within the category “modest growth”. Having two different perspectives concerning the future of textile industry makes it interesting to analyse

which are the main trends of future strategies. It was suggested for the respondents to point out measures which they believe that would be the most appropriate considering the future of Portuguese textile industry. From the 14 valid answers, three different trends were registered for this question. The first group of respondents considered that investment in R&D would be the best option to adopt. Words like innovation and design improvement were common in the answers of this group. There was also an emphasis, to some extent, on the creation of own brands. This is a group of real entrepreneurs who believe that Portugal still has worldwide reputation in the textile industry and, for that reason the investment on the “brand” Portugal is the best way to fight not only Chinese but all types of international competitors. There was a second group of respondents who also believe in an investment policy but targeted towards human resources development. This group believes that it is only through people, particularly employees, that it is possible to add value to their products. The quality in the service can only be improved if the labourers are well trained and in a market with huge variety of products as the textile one is, the only way to differentiate one product from the other is through added value and therefore through people. The third group of respondents preferred another type of approach. These defended that the best strategy would be to move towards the tertiary sector. Considering the development trend that Portugal has been following in recent years, the best way to secure the sustainability of the business was by following this trend moving from industry to commerce in the textile sector.

6) The last set of questions was related to the opportunities and threats that may exist for the Portuguese textile industry. The respondents were asked to designate what were the different opportunities and threats that they were facing nowadays. In what respects to the threats, from the 14 valid answers there were three major threats which were repeatedly mentioned. The first one is the already discussed competition from emergent economies including not only China but also India, Pakistan and Vietnam. Competition from these countries seems to be very hard to fight for Portuguese entrepreneurs. The other two more commonly mentioned threats are of internal nature and are related specifically with the Portuguese market. The first is the low prices which may seriously affected the profits of the industry and the second is related with the bankruptcy of many companies that recently has been affecting the Portuguese economy and, consequently, may signify a decrease in demand that directly affects whole the economy including the textile sector. Regarding opportunities, only 50% of the answers, 11 responses in absolute terms, were considered valid. Yet, two major trends were

identified. The first one of the two opportunities is the already discussed investment on own brands and designs which would improve the quality of the products creating a comparative advantage towards competition. The second mentioned opportunity is curiously related with China. There is a group of entrepreneurs who believe that China may also represent an opportunity for the Portuguese textile industry. These believe that internationalization of their companies is a great opportunity for expanding their markets and China, with its huge potential market, is also considered as a good destination for exports.

7. Conclusion

In what respects to the first part of this dissertation, two different perspectives may be concluded from the conducted analysis. However, both these perspectives share the same premise – it is very hard, if not impossible, to pinpoint exactly one turning point for China. These two perspectives, although are not absolutely opposite of each other, are somehow confronting perceptions of the same issue.

On one side, it may be concluded that the turning point for China was a 30-year process which started with the economic reforms and open policy in late 1970s and 1980s and ended with China's accession to the WTO. This perspective is based on the fact that each phase of the economic development of China is dependent of the previous one. The whole process started in October 1978 in the XI congress of the CCP when Chinese leaders realised that the only way of promoting economic development in order to turn China into an industrialized and modern country was by opening its economy to the outside world. This opening process started with the establishment of the SEZ and, regarding this aspect, Shenzhen SEZ was of fundamental importance. This zone was the laboratory where Chinese leaders experimented different approaches towards capitalists practices in a socialist state. The introduction of foreign capital was allowed and the economy became more market-driven. The success that this zone accomplished triggered a huge process which had repercussions throughout the whole country. The best practices achieved in Shenzhen were transferred to other zones and the “Shenzhen model” became the reference of economic development for the Chinese government. The Pudong New Area was one of the many areas chosen as destination for this development model. In the beginning of the 1990s China had a reduction in economic activity and expansion partly because of the events at Tiananmen, and, it were the speeches of Deng Xiaoping in South China in February 1992 which generated a new

wave of economic development swept the country. Pudong New Area was at the forefront of this new wave. The similarities between Pudong and Shenzhen are many since these two zones marked a decade of huge economic development and both were somehow pioneer in some field. For the case of Pudong the new policy tested on Chinese grounds was the opening up of the service sector, and especially the financial sector. All the development witnessed in these two decades paved the way for China's entry into the WTO, an accession which took 15 years to be completed and may be considered as the final step in this turning process from a central planned to a more market-driven economy. WTO was the official announcement that China had finally taken its position in the world economy. All these events are interrelated and interdependent and this is the main reason why the turning point of China may be considered a 30-year process.

On the other side, these three events may be individually considered. This perspective does not disregard the interdependence of these three events. It simply considers them as three different turning points instead of seeing the turning point as the whole 30-year process. Which of these two different perspectives is the most correct way to look for the Chinese economic development is a subject that stays open for further discussion but, it is important to keep in mind the relationship and interdependence of all three events which marked the Chinese economic development.

And this was exactly where the Portuguese businessmen failed. According to the empiric research, most of Portuguese entrepreneurs only considered China a competitor from the 2000 onwards. On one hand it is understandable that they only notice Chinese presence in the market once it was certain that Chinese products could freely enter into the European market which only happened after China's WTO accession. But, on the other hand, considering what was concluded in this dissertation, should not the Portuguese entrepreneurs be already aware of China's rising economic power? All the evidences that China was about to become a member of the WTO and flood international markets were there, so it is reasonable to believe that the Portuguese companies should had been better prepared for its coming.

However, not everything is bad about the answer of Portuguese firms to the Chinese economic expansion. The reaction to this new competitor was comprehensive with strategies involving several areas of management. Measures suggested in the empirical research involve fields as cost reduction, improvement in quality and means of capital, and market expansion through internationalization.

Chinese competition is considered one the main responsible for the crisis in the Portuguese textile sector but it is important to understand that there is no personal attack against Chinese corporations. Portuguese businessmen feel that globalization and liberalization of trade ruined their businesses and countries like India, Pakistan or Vietnam are very strong competitors which also had their share of responsibility. Both European and Portuguese government institutions are also blamed for not protecting national companies from overseas competition. Curiously, there were also some cases where the respondents blame the Portuguese entrepreneurs for the fall of the textile sector accusing them of lack of strategy and commercial view. Finally, another perspective advocated is that the textile sector simply lost its attractiveness because of the development model followed by Portugal which concentrated on the tertiary sector. Salaries and the workload on the textile industry are much less appealing than in a service company and there was nothing that textile firms could do that would significantly change this situation.

When asked about the future of the sector opinions were diverse. Two major trends arise point to either declining or growing of the sector. Despite whatever future is predicted for the sector, many strategies were purposed to face that future. At internal level the investment on R&D, design, quality of products, and human resources are the most common practises. Since Chinese products have the reputation of being low-cost and low-quality, a policy which adds value to the products seems like a reasonable option to fight competition. An alternative strategy suggested was a shift from the secondary to the tertiary sector, from industry to commerce, following the trend of the Portuguese economy and escaping, to some extent, from Chinese competition. Whatever the future reserves, the Portuguese entrepreneurs still consider their Chinese counterparts a major menace.

China along with other emergent economies like India, Pakistan or Vietnam is considered by many Portuguese entrepreneurs a threat for the future of the Portuguese textile industry. The low costs that companies have at these countries are very hard to compete with and this is the main reason why they represent such a big threat for the sector. The low prices of products, the bankruptcy of companies and the decrease in demand are other threat that the Portuguese firms in the near future. In what concerns to opportunities, the creation of own brands with own design and higher quality has to be highlighted and unpredictably there are some Portuguese businessmen which consider China a big opportunity for expanding their market. These are more risk-taking

companies that believe that enlarging their markets by internationalizing their products to countries like China, which have a huge potential market, is the best strategy to take advantage of the fact that these countries are now another variable to consider in the world economy and represent an extra possibility for the company's growth.

From the empirical research it can be concluded that there are two major groups of entrepreneurs in the textile industry in Portugal. The pessimists that believe that there is no chance of fighting competition from countries like China and that the future of the sector is condemned and the optimists who, on the contrary, interpreted China entry in the world economy as an opportunity to expand their business. Although they may pass through some difficulties because of cost differences, it is reasonable to believe that the Portuguese textile industry still has a future if the right strategies are adopted, and China may be ending serving the Portuguese companies' purpose instead of blocking it.

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