

The Logic Behind China's Special Economic Zones and Their Economic Effects Before 2001

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Abstract: The Chinese SEZs are one of the most iconic symbols of the reform and opening-up era and are the shining beacon of Chinese economic progress, particularly before China's entry into WTO in 2001. This study is an analysis of the logic and trend behind the creation of SEZs and their economic impact before 2001. A better understanding of the logic behind SEZ's success can benefit many economies aspiring for growth. This study's methodology is based upon review and analysis of official government files and academic research. This study concludes that China's initial Special Economic Zones were carefully selected to serve as laboratories for reform which attracted foreign investment and tested market-oriented policies. They were also very effective from an economic standpoint, as evident in their rapid growth and foreign investment. This success was built upon a unique combination of policy autonomy, great geography, abundant labor, government support, and compelling privileges for foreign investors.

Keywords: Special Economic Zone; Reform and Opening-Up; Institutional Innovation; Economic Growth; Regional Economic Development

1. Introduction

Since the beginning of the reform and opening-up era in 1978, China's Special Economic Zones (SEZs) have played a major role in China's transition from a planned economy to a market economy. This study analyzes the logic behind the creation of SEZs and discusses their economic effects, especially before China's entry into the WTO in 2001, which marked China's successful transition to a market economy and opened up the entire country.

This study aims to discuss four main ideas. Firstly, why were the initial SEZs created in 1978? Secondly, why were the four initial SEZs (Shenzhen, Zhuhai, Shantou, and Xiamen) chosen as SEZs? Thirdly, exactly how effective were these SEZs economically and technologically? Finally, why did these SEZs become such powerful catalysts for China's transition to a market economy? It is important to understand the historical logic behind China's Special Economic Zones (SEZs) and their key role in shaping China's broader economic reforms. This could also help inform other developing countries in the world.

2. Evolving Logic and Strategic Goals of SEZs as “Laboratories for Reform”

2.1 Initial Conception

The history of Chinese SEZs can be traced back to the third plenary session of the 11th Central Committee of the Communist Party of China in December 1978, when China decided to adopt the reform and opening-up policy, which steered China towards a market economy and opened the country to foreign technology, capital, and investment.

Under this policy guideline, four Special Economic Zones—Shenzhen, Zhuhai, Shantou, and Xiamen—were set up almost immediately to attract foreign technology, capital, and investment. These regions enjoyed high levels of economic liberty and limited planned economy control relative to other areas in China. The creation of these economically liberalized zones was a calculated experiment designed to achieve specific goals. From official documents and the location of the SEZs, we can identify several key guidelines and goals in setting them up.

2.1.1 Gain experience in working with foreign investors and in market economy operations

Since China had essentially been closed to foreign investment (other than the Soviet Union) since 1949, the government had limited experience in working with foreign investors. Similarly, China had not experienced such a level of economic liberalization

in years. Thus, in accordance with the guiding principle of the initial reform and opening-up policy—“Practice is the sole criterion for testing truth”—the government had to set up small experimental practices to test policies regarding collaboration with foreign investment and to gain more experience ^[1,2].

2.1.2 Accessible and familiar to foreign investors

Similarly, foreign investors were not particularly familiar with China and could therefore be reluctant to invest. Furthermore, most initial foreign investment into China was aimed at utilizing China’s cheap labor force to produce price-competitive export goods. This was also the main goal of the Chinese government at the time ^[3]. Therefore, the location of SEZs had to be close to the sea, which was the case for all four.

In addition, these regions were geographically or sentimentally close to the initial sources of foreign investment. Shenzhen is next to Hong Kong and was aimed at attracting investment from Hong Kong, while Zhuhai is next to Macau and was aimed at attracting investment from Macau. Shantou, though not close to any major source of foreign investment, is the hometown of many overseas Chinese, many of whom are entrepreneurs. This bond meant that Shantou was in a great position to attract investment from these entrepreneurs ^[4].

2.1.3 Extremely limited in scale

Initially, SEZs were meant as small-scale experiments in an open market economy. While eventually these policies were rolled out across the country, the government and senior officials were still cautious about the progress of economic reforms ^[5]. Therefore, SEZs remained extremely small for an extended period of time. Today, Shenzhen covers 1,997 square kilometers, but initially, the Shenzhen SEZ’s area was merely 372.5 square kilometers, less than 20% of its size today .

2.2 A Phased Evolution

The initial successes of SEZs encouraged the government to set up more zones and expand existing ones. SEZs were also given new goals and roles. New SEZs were smaller and called Economic and Technological Development Zones (ETDZs). Between 1984 and 1988, 14 new ETDZs were set up in coastal regions such as Guangzhou and Ningbo . In 1992, 35 more ETDZs were created. While these ETDZs were still export-oriented, they were also aimed at developing more technology-intensive industries. High-Tech Industrial Development Zones served a similar purpose.

The initial SEZs were also expanded in size and in liberty. For instance, the Shantou SEZ was expanded twice, in 1984 and 1991 . SEZs were also authorized to make local regulations for themselves to suit their needs. This meant that SEZs could essentially act on their own and sometimes adopt policies ahead of national laws. For example, in 1987, Shenzhen held the first land-use rights auction in the history of the People’s Republic of China. This was considered a potential violation of the constitution at the time. However, just a few months later, the First Session of the Seventh National People’s Congress passed a constitutional amendment explicitly stipulating that “the right to the use of land may be transferred in accordance with the law,” thus beginning a monumental reform of China’s land system.

While there were challenges to policies in the SEZs, the general trend during the reform and opening-up era was that policies experimented with or created in SEZs were later implemented across the country as the national economy recalibrated towards a market economy.

3. Economic and Technological Impacts between 1979 and 2001

3.1 Macroeconomic Contribution

Before China entered the WTO, SEZs accounted for the majority of China’s exports and were integral parts of the economy. The initial SEZs all experienced strong growth between 1979 and 2001. Shenzhen’s GDP surged from RMB 0.196B in 1978 to RMB 218.745B by 2000, and GDP per capita increased by more than 5,000%. Similarly, Zhuhai, Xiamen, and Shantou’s GDP and per capita GDP all increased more than thirtyfold. The SEZs were the fastest growing regions in the country. Research also suggests that state-level SEZs were linked to a 20% increase in GDP.

Furthermore, the SEZs also provided employment opportunities for China’s vast inland population. For instance, more than 1 million migrant workers had moved to Shenzhen by 1989 . Similarly, in 1985, over 70 percent of the 409 new industrial projects in Shenzhen had domestic linkages, which promoted employment for inland regions. Moreover, the SEZs also helped other regions economically. In 1986, Shenzhen alone had more than 1,900 projects linked with interior provinces or the central government.

3.2 Technological Contributions

SEZs, particularly Shenzhen, were very important in improving China’s technological abilities, especially industrially. During the 1980s and 1990s, Hong Kong was readjusting its economy from industry to services due to rising costs. Meanwhile, Shenzhen and

inland regions had an excess labor force. Therefore, many of Hong Kong's factories moved to Shenzhen. Hong Kong firms initially provided capital, technology, and skills, while Shenzhen provided labor. These projects introduced new industrial technologies to the Shenzhen SEZ and advanced its industry. These technologies were also used in collaborative projects with interior provinces and firms, helping the diffusion of technology. Overall, research suggests that most of Shenzhen SEZ's industrial advancements came from foreign investment.

4. Key Success Factors

Reviewing other research and official documents, five key success factors for Chinese SEZs can be identified:

(1) Policy autonomy: As previously established, the initial SEZs had relatively large economic and legal autonomy, allowing them to implement and explore policies that had not been tried before. These policies were often market-oriented and adapted for local situations. For example, Shenzhen's groundbreaking public land auction policy in 1987 had not been approved by provincial or national people's congresses. This policy allowed the market to distribute land and increased the Shenzhen SEZ's construction capital.

Another case was Shenzhen's labor market reform. Shenzhen pioneered a three-tiered wage structure (base pay + occupational pay + variable allowance), breaking Mao-era egalitarianism. The Shenzhen SEZ also offered better social security packages and a minimum wage. This attracted more workers from the interior to work in the SEZ.

(2) Geography and culture: It is clear that the SEZs, particularly Shenzhen, utilized their strategic positions to attract foreign investment and maximize exports. Shenzhen SEZ is both close to the sea and to Hong Kong, which made it the perfect place to host export industries relocating from Hong Kong. This allowed Shenzhen to utilize the investment, technology, and management knowledge from Hong Kong.

(3) Government investment and support: While the SEZs were primarily based on government policy, one cannot ignore the role of government funding, especially in infrastructure. Research suggests that local governments often invested heavily in the initial stages of SEZs to provide adequate infrastructure for industry, such as roads, water, electricity, gas, sewerage, telephone, and ports.

(4) High availability of labor: China was consistently the most populous country in the 20th century, which guaranteed the supply of workers to the SEZs' burgeoning industries. A high supply of labor meant lower labor costs compared to other parts of the world, such as Hong Kong. Data indicates that the massive surplus of rural labor kept wages in Shenzhen at 10% of Hong Kong levels.

(5) Privileges for foreign direct investment: In SEZs, foreign investment and projects enjoyed tax breaks, free or low duties on imported equipment and production materials, free or low-rent business accommodation, limited access to the domestic Chinese market for goods produced within SEZs, and more. These incentives attracted more FDI, which in turn helped develop SEZ industries, technology, and infrastructure.

5. Conclusion

This study has unraveled the logic behind China's initial Special Economic Zones and evaluated their economic and technological contributions in the years leading up to the nation's entry into the WTO in 2001. We have seen how these zones acted as "laboratories for reform," strategically positioned along the coast and close to foreign colonies to draw in capital and know-how, especially from neighboring Hong Kong and Macau, as well as the wider Chinese diaspora. Future research could aim to compare the Chinese SEZs with other SEZs globally to identify more universal factors for success.

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