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Geography, and Growth Episodes in
China's Coastal Provinces:
Lessons for the State of Gujarat**

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Abstract

We believe that the State of Gujarat has a chance for a tremendous breakthrough in economic development during the current decade. There are several reasons for this view. Opening up of the Indian economy has produced new dynamism in India's western and southern states, most dramatically in the information technology sector, but in others as well. The new technologies especially information technology and biotechnology give new opportunities for economic and social development. In the post-reform period, Gujarat, in particular, has witnessed high growth in: chemicals and petrochemicals, engineering, agro and food processing. Demographic trends in Gujarat, especially a slowing population growth rate and a rising share of the population of working age, contribute to rising per capita income.

Gujarat, with a diversified industrial base, continuing improvements in the state's investment climate, one of the most attractive states' for domestic private investors, setting-up Special Economic Zones (SEZs), availability of large skilled managerial and technical manpower, exporting almost 20 percent of India's total exports, and last, but not the least, being a coastal state, with almost 1600 Kms of coastline, the State of Gujarat can become a major platform for labor-intensive manufacturing exports in the country, similar to what the coastal Chinese provinces have achieved during the last two decades. Briefly put, following an export-led growth strategy, Gujarat can get set for take off into a period of sustained high growth. In this paper, we analyze the growth experiences of China's coastal provinces in order to draw relevant lessons for Gujarat.

Briefly put, to attain and sustain high rates of economic growth, Gujarat needs to follow a two-pronged growth strategy, wherein the first prong is export-led growth, and the second prong is rural improvement. For the first prong, lessons from the Chinese coastal provinces are particularly instructive, since the Chinese provinces achieved in the past twenty years the kind of export-led growth that Indian states could have achieved, but have so far failed to achieve because of poor public policies. With regard to the second prong, Gujarat needs a specific strategy to bring modern economic growth to rural Gujarat, through a concerted campaign of infrastructure upgrading and appropriate re-design of state policy.

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Regional Economic Policies, Geography, and Growth Episodes in China's Coastal Provinces: Lessons for the State of Gujarat

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The regional dynamism that characterizes India's current economic landscape is somewhat the same as in eastern and southern China. As Fujian (annual per capita GDP growth rate over the period 1992-00 is estimated at 14.2%) Zhejiang, (13.4%) Jiangsu, (13.1%) and Guangdong (12.1%) and other coastal Chinese provinces became the engine of China's economic growth, we believe, that Gujarat too along with the other forward-looking Indian coastal states will help accelerate India's overall economic growth and the process of economic liberalization (refer to Table 1 for growth rates of all of China's provinces). We believe that the State of Gujarat has a chance for a tremendous breakthrough in economic development during the current decade. There are several reasons for this view. Opening up of the Indian economy has produced new dynamism in India's western and southern states, most dramatically in the information technology sector, but in others as well. The new technologies especially information technology and biotechnology give new opportunities for economic and social development. In the post-reform period, Gujarat, in particular, has witnessed high growth in the following sectors: chemicals and petrochemicals, engineering, agro and food processing. Demographic trends in Gujarat, especially a slowing population growth rate and a rising share of the population of working age, contribute to rising per capita income.

Since the Indian economy opened up to freer trade in 1991, Gujarat has sought to put in place a new policy regime to boost industrial production, improve the state's infrastructure, attract higher levels of domestic and foreign investment and spur employment. Since the year 2000, in particular, there has been evidence of quite dynamic reform in the way in which the government has sought to harness the new economic openness to further improve the State's attractiveness as an investment destination, achieve higher competitiveness through improved industrial infrastructure, and promoting manufacturing exports.

Gujarat, with a diversified industrial base, continuing improvements in the state's investment climate, one of the most attractive states' for domestic private investors, setting-up of Special Economic Zones (SEZs), availability of large skilled managerial and technical manpower, exporting almost 20 percent of India's total exports already, and last, but not the least, being a coastal state, with almost 1600 Kms of coastline, the State of Gujarat can become a major platform for labor-intensive manufacturing exports in the country, similar to what the coastal Chinese provinces have achieved during the last two decades. Briefly put, following an export-led growth strategy, Gujarat can get set for take off into a period of sustained high

¹ This paper has been undertaken as a part of the Columbia Earth Institute and the Indian Institute of Management's joint project for the State Government of Gujarat. Among others, discussions during the course of this study with Professors Ravindra Dholakia, Jeffrey Sachs, and Wing Thye Woo were very useful and are gratefully acknowledged. Nandita Dasgupta and Nicole Volavka provided excellent research assistance.

growth. In this paper, we plan to analyze the growth experiences of China's coastal provinces in order to draw relevant lessons for Gujarat. Additionally, we will undertake a case study of the Zhejiang province, which seems to have basic similarities with Gujarat in terms of population, area and coast line.

What is clear however is that the successful development strategies of some countries/regions cannot produce the same salubrious results when implemented in other national settings. When China opened some coastal pockets for foreign direct investment, these SEZs quickly blossomed into vibrant export platforms and created backward linkages with the immediate hinterland. Whereas, when landlocked Mongolia turned the entire country into a free trade and investment zone in the late 1990s, the inflow of foreign capital was a mere trickle compared to China's experience. The specific lesson in this case is that the time-tested effective growth policy package for a coastal economy, and minor modifications of it, are unlikely to work for an interior economy. Gujarat being a coastal state where a number of pre-requisites for attaining and sustaining high growth are already in place is a very strong candidate for following an outward-oriented growth strategy.

While China has indeed protected its large state-owned industrial sector, the source of dynamic growth in China lies in the *non-state sector*, which has operated much closer to market forces. Indeed, outside of the state-enterprise sector, the Chinese economy has much in common with the other East Asian economies, especially when these other economies were at an earlier stage of development. While the non-state Chinese economy operates without many of the legal underpinnings of a more advanced market economy, it is at least subject to the strong market forces, international trade, and low taxation. In China, the non-state sector is relatively unconstrained by government regulation while in India, the non-state sector (or the private sector) continues to be tied down by extensive regulations that hinder in dynamic development.

When Deng Xiaoping began market reforms in China in 1978, (*see Appendix I for a chronological listing of China's economic reforms*) state-enterprise employment was approximately 18 percent of the total Chinese labor force. Approximately 71 percent of the population was engaged in peasant farming, and another 10 percent or so operated in various non-state activities outside of agriculture, especially urban collective enterprises attached to state enterprises, and Industrial Township and village enterprises (TVEs). The Chinese "gradual" reforms after 1978 have involved the liberalization of the non-state part of the economy, while preserving the socialist character of the pre-existing state-owned enterprises. Thus, in terms of the labor force, roughly 20 percent of the labor force has been maintained in the socialist sector, while a little more than 80 percent of the labor force has operated in the non-state part of the economy.

China's boom has come in three main ways. First, agriculture boomed as soon as the commune system was dismantled, and peasant farming resumed on the basis of household plots of land. Second, rural industry was greatly liberalized after 1978, especially in the form of TVEs. Third, urban export-oriented enterprises were encouraged by the designation of a growing number of SEZs, coastal open cities, and economic and technological development zones (EDTZs), all designed to encourage manufacturing exports (*Refer to Appendix II for a timeline of China's regional preferential policies*). These special areas received various kinds of favorable tax and

regulatory treatment, such as tax holidays, duty-free access to imported inputs and capital goods needed for export production. Thus, the SEZs and other special areas were akin to the export processing zones that had been used in other parts of Asia as part of their initial export-led growth.

One key institutional support for rapid growth in China has been the *decentralization of economic policy making*. One of the reasons that state control on the non-state sector has been limited is that the power of the central bureaucracy in Beijing has been substantially weakened in favor of provincial and local governments. In particular, the coastal provinces have been relatively free to pursue market-oriented policies in support of export-led growth without being blocked by planners in Beijing. The provinces have a significant control over government expenditure and taxation; infrastructure projects; and even the policies regarding foreign direct investment (FDI). Indeed, the provinces have been competing actively with each other to attract foreign direct investment and to upgrade the infrastructure. The relative decentralization of economic policy making among the Chinese provinces contrasts markedly with the continued strength of the Indian Federal Government in Delhi in setting the overall economic agenda for India, including most major decisions over infrastructure expenditure and foreign investment.

If there has been one lesson of recent development experience, it is that rapid overall economic growth depends on rapid export growth. The strategy of inward-looking development, in which exports would be unimportant because imports would be held to a minimum, proved to be ineffective in all countries in the world, even the most populous such as Brazil, China, India, and the former Soviet Union. Even a large domestic market such as India's or Brazil's was not large enough to spur strong internal competition in the absence of vigorous competition from abroad. Protected home markets turned monopolistic or oligopolistic, because the minimum efficient scale of production often represented a large proportion of the home market. Domestic enterprises, unchallenged by foreign competition, turned lazy and relied on state largess rather than on their own efforts to survive.

SEZs in the manufacturing sector can play a major role in the overall growth strategy of the state. Virtually all of the East Asian countries have utilized SEZs to help attract foreign investment and to initiate the process of manufacturing export-led growth. EPZs have not aimed to pick "winners" in the classic sense of industrial policy. Rather, they have attempted to carve out a geographical zone in which export-businesses can conduct profitable export-oriented activities, exempt from costly regulations, tax laws, and labor standards that apply more generally within the country. In general, the relatively successful industrial policies have had a few common characteristics: (a) they have aimed to promote exports, rather than to protect the domestic market; (b) they have provided subsidies on the basis of successful performance (e.g. the growth of exports) rather than to cover losses; and (c) they have given temporary rather than permanent subsidies (e.g. a five-year tax holiday for new export firms). *Appendix 3 provides a comparison of India's SEZ & EPZ Schemes and benchmarks them against China's SEZ Scheme.*

China understood that the root of export growth would be diversification away from traditional sectors, especially raw materials, into non-traditional sectors especially manufactured goods. But China lacked the technology by itself to be competitive in manufactured goods. Therefore, it invited in foreign direct investors to provide the capital and the expertise to achieve export competitiveness in a wide

range of sectors, including electronics, apparel, plastic toys, stuffed animals, ceramics, and many other labor-intensive sectors. In each sector, the key was to link foreign investor capital and expertise with a large and low-cost Chinese labor force. The foreign investors brought in the product design, specialized machine tools, and capital goods, key intermediate products, and knowledge of world marketing channels. The Chinese assured these foreign investors certain key conditions for profitability, such as low taxes, reliable infrastructure, physical security, adequate power, decent logistics for the import and export of goods, and so forth.

At the center of China's export strategy were the special economic zones in which favorable export conditions were assured. These SEZs, along China's coastline, were designed to give foreign investors and domestic enterprises favorable conditions for rapid export promotion. All key aspects of the export environment were secured. Exporters, for example, were allowed to import intermediate products and capital goods duty free. They were given generous tax holidays. The exporters were assured decent physical infrastructure, often through the provision of land, power, physical security, and transport to the ports, within specially created industrial parks.

Table 2 summarizes some key geographical and economic characteristics of China in the six regional groupings that are useful for analyzing the post-reform, high growth period. Figure 1 shows the Chinese provinces and their location.

The metropolises of Beijing, Tianjin and Shanghai have province-level status. These are the richest pockets of China, and have had high growth in the 1990s. These cities are highly industrialized, and over 71 percent of their population lives within 100 kilometers of the coast or navigable waters.

The northeastern provinces of Heilongjiang, Jilin and Liaoning, which are collectively called Manchuria. In the national ranking of per capita GDP, omitting the three metropolises, Heilongjiang and Liaoning ranked first and second, respectively, in 1978, and ranked seventh and fifth, respectively, in 1998.

The coastal provinces are: Hebei, Shandong, Jiangsu, Zhejiang, Fujian, Guangdong and Hainan. These seven provinces have 82 percent of their population living within 100 kilometers of the sea or navigable rivers. They have grown the fastest of these six groupings in the 1978-2000 period, at an annual average of 10.7 percent. The result is that Zhejiang and Guangdong have soared to the top of the per capita GDP ranking, omitting the metropolises, from fourth and sixth, respectively, in 1978 to first and second, respectively, in 2000.

The central provinces are: Shanxi, Henan, Anhui, Hubei, Hunan, and Jiangxi, through which the plain runs relatively unimpeded from the north of the Yellow River to the south of the Yangtze River. The temperature and rainfall make this region the agricultural heartland of China, which explains why its population density is almost twice that of the northeastern and southwestern regions. The two large rivers and their many tributaries endow 57 percent of the population with easy water transportation. The Yangtze between Wuhan and Shanghai has the industrial potential of the Rhone Valley multiplied several times.

The northwestern provinces are: Inner Mongolia, Shaanxi, Ningxia, Gansu, Qinghai, Xinjiang and Tibet are truly isolated. The center of the land mass is 1,400 kilometers

from the coast. This region is more arid and steeper compared to the four previous groupings, and it is marked by desert on its western and northern borders. Furthermore, 5 percent of the land has a slope of greater than 10 percent compared to 2.5 percent for the northeastern, coastal and central provinces. The general lack of water makes the region difficult for agriculture, only 8 percent of the land is arable, which helps explain why it had the lowest population density in China in 1998, 46 persons per km² versus 126 persons per km² in the southwestern region, which has the next lowest population density.

The southwestern provinces are: Sichuan, Yunnan, Guizhou, and Guangxi have rainfall and temperature conditions that are ideal for crop cultivation, but they suffer from being too mountainous. The average elevation is 1,400 kilometers, the average slope is 5.2 degrees, and 14 percent of the land has a slope of greater than 10 degrees. The proportion of arable land of 10 percent is barely above that of the arid northwestern provinces. Lacking the mineral resources of the northwestern provinces, the southwestern provinces had the lowest GDP per capita in 1978, and the lowest growth rates in the period of market-oriented reform since 1980.

On a global scale, the wealth of nations is well characterized by two geographical divides. The first geographical divide emphasizes differences in ecological conditions, the temperate zone versus the tropical zone. The second geographical divide emphasizes differences in the ability to conduct international trade, the coast versus the interior. Both of these geographical divides are a combination of independent causes of economic wealth and of proxies for some important determinants of economic prosperity.

The empirical validity of the temperate-tropical divide is well vouched for by the fact that over 90 percent of the world's poor lives between the Tropic of Cancer and the Tropic of Capricorn. The result is a GDP per capita (PPP-adjusted) of \$3,326 in 1995 for tropical economies, and \$9,027 for non-tropical economies. This strong correlate between ecological zone and income level is not a new observation in economics, but it has not been a major analytical organizing principle in development economics. The incorporation of new insights from physical geography and societal dynamics have led several studies to focus on physical geography as an over-arching explanation of economic performance.

The coast-interior dichotomy highlights the importance of transportation cost in determining a country's participation in the international division of labor. In the industrial age, water transportation has the lowest cost for moving goods over extended distances. For example, the industrialization of central Europe was helped by the navigability of the Danube. Of course, the growth effects of trade are well known, beginning with Adam Smith's observation that productivity improvements are enabled by the greater division of labor that, in turn, is enabled by the expansion of the market. The clear policy lesson here is that investments in physical infrastructure and transportation technology can change the comparative advantage of a region.

Previous literature on the Chinese reform and regional performance suggests a long list of factors that may be responsible for regional differences. Although the geographic factor has not gone completely unnoticed, the role that it played in the reform period was however overlooked, thus, it was not adequately discussed. In

discussing the difference in the reform outcomes among the transitional economies in Europe, Sachs (1997) indicates that some effects of geographic factors might have been wrongly attributed to economic policies: “Correlation between economic performance and economic policy that neglects geography will misconstrue the role of economic policy ... the effectiveness of a policy variable may depend on the physical geography of the country”.

The location of China’s economic center has changed over time, moving eastwards from the Loess Plateau and the Yellow River Valley in the northwest (where Chinese civilization began in 2000 BC), which is about 1,000 kilometers away from the coast. The reason for this original location is because, in ancient times, high agricultural productivity and land-based trade was much more important than sea-based trade. The bulk of China’s international trade at that time was conducted through the famous Silk Route that went through the northwestern corner of China. The southeastern coastal region, where Guangdong and Fujian (two of today’s most dynamic provincial economies) are located, largely remained uncultivated and sparsely populated in early Chinese history. Although the natural conditions in the southeast were favorable for agriculture, farming was undeveloped because malaria and other subtropical diseases checked population growth, and the high temperature sapped human energy faster, resulting in lower labor productivity. Guangdong was considered an almost uninhabitable place in ancient times.

Over time, the pressure of expanding population and the frequent invasions by the northern tribes caused more of the population to move south and into the mid-coastal and southeastern regions. By the 12th century, the Yangtze River valley had become very developed and densely populated. The economic importance of the coastal region increased dramatically after the Opium War in 1840 when the Western powers forced China to first open several ports and then the whole country for trade. China’s economy and subsequently politics were quickly (by historical standards) transformed. International trade expanded, foreign direct investments flowed in, and local industrialists made their appearances, especially in the mid-coastal and southeast regions. The Qing dynasty was overthrown in 1911, followed by a long chaotic period of protracted civil wars and Japanese colonialism that ended with the foundation of the People’s Republic of China on October 1, 1949 by the Communist Party of China (CPC) under the leadership of Mao Zedong.

Regional Economic Policies in China:

The process of increased economic interaction with the outside world accelerated at the end of 1978 upon the decisive political victory by the rehabilitated cadres over the remnants of the Maoist establishment at the Third Plenum of the 11th Party Congress. The emphasis on the domestic front was the decentralization of agricultural production, the decentralization of the fiscal system, and the deregulation of prices; and the emphasis on the international front was the Open Door Policy.

Fiscal decentralization took the form of tax contracting between the central government and the provinces.² Each fiscal contract was individually negotiated, and it ranged from fixed lump-sum contracts for five years like in the cases of Guangdong

² For details, see Wong, Heady and Woo (1995).

and Fujian to highly complicated (province-specific) revenue-sharing formulae. The provincial governments in turn negotiated individual revenue contracts with the local governments. Since the marginal tax rate set by the central government varied tremendously across provinces, the incentive of the provincial and local governments to engage in local economic development in order to generate tax revenue also varied tremendously. Given the importance of Shanghai to the central coffers, its marginal tax rate was set higher than that of most coastal provinces until the early 1990s.

The fiscal decentralization might have helped economic growth, but this led to state revenue declining from 35 percent of GDP in 1978 to 14 percent in 1992, producing a near fiscal crisis for the state. The state lacked the funds to invest in infrastructure projects to remove production bottlenecks, and to undertake poverty alleviation programs. The practice of each provincial government covering more of its expenditure from local revenue necessarily meant reduced development expenditure in the poorest provinces that had been receiving fiscal subsidies from the center. The tax reform of 1994 that had the value-added tax as its center-piece has reduced the discriminatory elements of the fiscal system, and restored the fiscal capacity of the state to help the poorer provinces.

The deregulation of prices in the industrial sector mainly took the form of a dual track price system for industrial inputs Bajpai, Sachs and Jian (1997) and Bajpai and Jian (1996). Since the central and western provinces were the main suppliers of raw industrial materials, the continuation of artificially low prices for these industrial inputs meant that the dual track pricing system was in effect transferring income from the interior producers to the coastal factories. The elimination of the dual-track price system in the 1990-91 period was an equitable move from the viewpoint of regional disparity.

The Open Door Policy consisted in attracting foreign direct investment and promoting foreign trade in targeted areas. This opening up was initially limited to two southern provinces (Guangdong and Fujian), then gradually extended to larger geographical units: first along the coast, and then the inland provinces.

The Open Door Policy had five major goals:

- Import of foreign Capital
- Import of advanced technology
- Import of western management know-how
- Export promotion and import substitution
- Employment generation and improvement of skills for the Chinese labor force

Table 3 shows the degree of openness of the various provinces. The open economic zones provided investors with various preferential tax treatments, exemptions on duties and from labor regulations, etc.³ The implementation of regional preferential policies has gone through 3 broad stages:

Early 80s: limited extent to Guangdong and Fujian provinces, with the establishment of Special Economic Zones (SEZ) in 1979-80.

³ Details on the different preferential policies applied in these zones can be found in Yang (1997, chapter 3), Wang and Hu (1999, chapter 6), Chen (2000) and Démurger (2000, annex 1).

Mid to end of the 80s: coastal preference strategy enforcement, with the designation of Coastal Open Cities (COC), entitled to set up their own Economic and Technological Development Zones (ETDZ), in 1984, followed by the establishment of Coastal Open Economic Zones (COEZ) in 1985, an Open Coastal Belt (OCB) in 1988 and the Shanghai Pudong New Area in 1990.

Early 90s: further extension towards whole China, after Deng Xiaoping's southern tour in 1992. During this year, new open economic zones were officially started in Major Cities along the Yangtze River (MC), Border Economic Cooperation Zones (BECZ), Capital Cities of inland provinces and autonomous regions (CC), ETDZ and Bonded Areas (BA).

The acceleration in the opening-up process in 1992 led to an inflated number of so-called open economic zones set up by local official without proper authorization. Besides the official policy launched by the State Council, the 30 provinces, as well as hundreds of counties and townships indeed started to formulate their own preferential policies for foreign investment in specific “development zones”. As a consequence of this “zone fever” (Yang, 1997, p. 53), there were around 2,000 open economic zones of any kind at and above the county level by 1993 (and probably even more below the county level), offering tax exemptions and reductions of all sorts in order to attract investment. Following the implementation of the austerity program in 1993, most of these unapproved zones have been closed⁴, and regional policies have tended to equalize over time (at least up to the end of the 90s).

The leading role of this selective open-door policy in regional growth has been emphasized by a great number of studies (e. g. Lee, 1994; Mody and Wang, 1997; Berthélemy and Démurger, 2000; Chen and Feng, 2000; Démurger, 2000). Most of them found that FDI had an impact on economic growth that went beyond its addition to the capital stock, FDI also provided competition to domestic firms and hence forced them to raise their productivity, generated demonstration effects that enable domestic firms to improve their operations, provided the training ground for future managers of domestic firms in the same industries. Demurger (2000) concluded that FDI was a very effective channel for technology transfer that mainly benefited the coastal provinces, where it is highly concentrated.

FDI inflows did not respond immediately in large volumes to the establishment of the SEZs in southern China (1979 in Guangdong, and 1980 in Fujian), partly because out of caution and partly because the liberal regulatory framework began to be introduced only in 1982.⁵ FDI flows started pouring in only from 1984 onward (when it doubled from US\$0.6 billion in 1983 to US\$1.3 billion in 1984). This jump in total FDI in 1984 was not simply due to the opening of 14 Open Coastal Cities and 10 Economic and Technological Development Zones that year, but because there was an enormous rise in FDI into the existing SEZs. FDI into

⁴ For example, the central government closed 1000 of the 1,200 economic development zones (EDZs) that it had not authorized in the coastal provinces of Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Fujian, Guangdong and Guangxi; “State closes 1,000 EDZs to better efficiency,” *China Daily*, August 13, 1993.

⁵ Jiang Zemin played a prominent role in getting the liberal regulatory framework for SEZs passed in November 1981.

Guangdong increased from US\$245 million in 1983 to US\$542 million in 1984, and FDI into Fujian increased from US\$14 million to US\$48 million in the same period. This acceleration in FDI in 1984 was most probably the result of foreign investors being finally convinced by the opening of the 24 more FDI zones of China's commitment to economic integration into the world economy. The second large acceleration of FDI inflow occurred in 1992 when FDI went from US\$4.4 billion in 1991 to US\$11.0 billion in 1992. This further increase in the confidence of foreign investors was undoubtedly brought about by Deng Xiaoping's call for increased economic openness when he toured southern China (the now famous *nanxun*, "southern inspection") in the beginning of 1992.

As far as FDI is concerned, Gujarat is not rated as one of the most attractive destinations for FDI in India, perhaps ranked around 5th or 6th out of 28 States and 7 Union Territories. It is interesting to note that while Gujarat is perhaps next only to Maharashtra as far as attracting domestic private investment is concerned, it does not score as well when it comes to foreign direct investment. This issue needs to be looked at from several different angles, for instance is the State doing enough on the marketing front, not just in the U.S., but also in other parts of the western world; have there been any exercises undertaken to understand what could be the issues and concerns of MNCs when it comes to investing in Gujarat; are the investment incentives offered by the State in line with others, such as Maharashtra or Tamil Nadu? Perhaps, a strategy focusing on the comparative advantages of Gujarat, relative to its other competitor states in India needs to be put in place that highlights for MNCs why they should consider Gujarat ONLY if investments are planned in X, Y, or Z sectors. Some of these issues will be dealt with in our next paper that will look at drawing lessons for Gujarat from the experiences of Chinese coastal provinces as far as attracting FDI is concerned.

Coastal, urban-based industry can serve both the internal market and the international market, and can more readily make logistical links with foreign suppliers and customers than can interior-based enterprises. New export-oriented units are therefore heavily concentrated on the coast. As China's experience demonstrates, trade liberalization in a low-wage, surplus-labor environment permits a rapid expansion of export-oriented industry, which can absorb large numbers of workers to provide goods for the world market in real, significant foreign exchange earning private sector activity. The concentration of FDI in the coastal provinces of China and especially in five of them has been increasing over time: from 1992 to 2002, coastal provinces received 80 percent of FDI (against 70% in 1979-1991). Foreign trade was even more concentrated in coastal provinces which was responsible for more than 90 percent of foreign trade (88% in 1992). Thus these coastal provinces showed a close relationship between FDI and foreign trade and this relationship has strongly influenced the economic openness of the coastal Chinese regions vis-à-vis the inward regions. As Table 2 shows, at the end of the nineties, non-coastal provinces were still closed economies, as evidenced by the ratio of foreign trade and FDI in GDP, whereas several areas of Eastern China were becoming internationalized economies (Guangdong, Fujian, Tianjin, and Shanghai).

The rapid expansion of export oriented industries based on imported inputs had accelerated the integration of coastal economies in international trade and production networks, but this had possibly been achieved at the expense of backward

and forward linkages with the rest of the economy and especially at the expenses of inland economies. Regional breakdown of FDI shows a dividing line between coastal provinces and inland provinces in attracting foreign capital. Since 1992, four fifths of FDI have been concentrated in coastal provinces and more precisely in five of them; Guangdong, Jiangsu, Fujian, Shanghai municipality and Shandong received more than 60 percent of total FDI. The private money inland has moved to the coast, with net capital flows moving from the lagging West to the prosperous Eastern belt, where earnings are much higher. Thus the coastal regions have grown extraordinarily rich and other regions do not have a share in their growth. Unemployment in other regions is rising and includes those leaving farms and others retrenched by state-owned enterprises (SOEs). To make matters worse, the inland region has suffered a brain drain, as skilled and entrepreneurial youth migrate East for higher salaries and better living conditions. Some 115 million migrant workers are seeking jobs as migrants in booming cities along the coast.

Provincial Differences in Growth (1978-00): Geography and Policy

As indicated by all the features highlighted in the preceding sections, a general comment on the reform period is that it has been characterized by a growing polarization between coastal and non-coastal provinces, in terms of both per capita GDP growth rates and levels. Among the reasons usually stressed as explanations for this evolution are:

Preferential policies: the implementation of preferential policies in coastal provinces as early as the beginning of the 1980s led to a rapid integration into the world markets, huge inflows of foreign direct investment and the development of modern industrial bases in these provinces.

Geographic reasons: better natural conditions in coastal provinces allow them to benefit from a higher percentage of arable land, better conditions to develop infrastructure and an easy access to the sea. Being coastal is all the more a convenient location for activities such as export-oriented processing industries, which have been developing very rapidly during the last two decades.

Further attempts to account either for the policy factor or for the geographical factor have been made separately by Wang and Hu (1999). Since provincial FDI is highly correlated with provincial GDP growth, Wang and Hu (1999) distinguish an “economic model”, which says that foreign funds flow to areas with best growth potential (indicated by adequacy of infrastructure, availability of educated workforce, and size of market) from a “policy model”, which says that foreign funds flow to areas with most preferential tax treatment. Their estimations show that the addition of a preferential policy index removes statistical significance of variables championed by economic model. Coastal growth would thus be more the result of preferential policies than of their more favorable economic conditions. In Chapter 4, Wang and Hu (1999) talk in detail about importance of physical terrain in determining economic growth. They also note that their “policy variable may also reflect a province’s geographical location.” Yet, their policy discussion ignores the geography factor as the main reason for the success of the coastal provinces.

Our thesis here is that the high coastal growth has been due to more than the preferential policies; it came also from advantageous location that enabled export-oriented industrialization; we quantify the relative contributions of geography and preferential policy. *Table 4 shows growth episodes of China by region.* We find that geography and policy had about equal influence on coastal growth (3 percentage points each). Geography affected growth with a much longer lag than policy, however. The policy index was highest for the metropolises (Beijing, Shanghai, and Tianjin) and lowest for the central and northwestern provinces. The preferential policies are to a large extent "deregulation policies" that enabled marketization and internationalization of the coastal economies and allowed them to become more like their East Asian neighbors (and competitors). The adjective "preferential" gives the misleading sense that the prosperity of these coastal economies had been mostly sustained by a steady flow of state subsidies, but this has not been the case. There was certainly pump priming in the beginning (i.e., state funds to build the infrastructure that would make these economic zones attractive as export platforms), but there have not been significant steady transfers to prop up failing enterprises in order to maintain the living standard in the region, as in the case of the northeastern provinces.

In terms of geography and growth performance of Indian states, empirical analysis in Sachs, Bajpai and Ramiah (2002) suggests that *urbanization* was a key determinant of economic growth in the 1980s and the 1990s, and that we should expect that already existent urban areas would be the preferred location for new investments in manufactures and services. The extent of urbanization varies widely, between a low of 10.4 percent in Bihar to 43.8 percent in Tamil Nadu as of the 2001 census. 37.67 percent of Gujarat's population resides in urban areas. In Gujarat, the growth of population of urban areas in the decade 1991-2001 is as high as 33.15 percent compared to the population growth rate over the same period of 16.78 percent in rural areas. Interestingly, while in 1991, there were twenty-one Cities/Urban Agglomerations having a population of 100,000 (called Class-I city), in the year 2001, the number has jumped to twenty-seven⁶.

As most of FDI in China is export-motivated, FDI would (*ceteris paribus*) prefer provinces that provide easier access to sea transportation. Unlike Policy, however, geography has another key growth mechanism beside FDI, and that second growth mechanism (which is more important) is rural enterprises. Since a large (and growing) proportion of China's exports are produced by rural enterprises, it has been natural for these export-oriented rural enterprises to be established in the coastal provinces. Our view is that these rural enterprises had generated agglomeration effects that induced new rural enterprises (not necessarily export-oriented) to locate themselves in the same localities. The prediction of this agglomeration effects hypothesis is that the positive impulse from export would create a vibrant rural industrial sector that would make the coastal region a major growth pole.

Zhejiang province – A Case Study

Zhejiang Province is located on China's southeast coast, south of the Yangtze River Delta. Adjacent to the north is Shanghai, China's largest city, while a vast

⁶ Excluding the towns of Bhuj, Gandhidham and Morvi where census could not be conducted due to the earthquake that hit the region on January 26, 2001.

hinterland stretches westward. Zhejiang covers a total area of 101,800 sq km, of which 70.4 percent is mountainous or hilly. Plains and basins make up 23.2 percent, and rivers and lakes make up the other 6.4 percent. It also occupies a large sea area. Along the coast, there are 3,061 islands each having an area of more than 500 sq m. This brings the total coastline to 6,486 km, the longest in China. Areas under cultivation total 1.613 million ha. Land used by forestry covers 6.397 million ha. There is a combined fresh water surface area of 224,000 ha. and over 100,000 ha. of shallow sea and shoals are suitable for aquaculture. With regard to administration, Zhejiang is divided into ten cities and one prefecture at the provincial level: Hangzhou, Ningbo, Wenzhou, Jiaxing, Huzhou, Shaoxing, Jinhua, Quzhou, Zhoushan, Taizhou (the ten administrative cities) and Lishui (an administrative area). There are 39 counties, 25 cities and 24 districts at the county level. The total population of the province is 44.56 million, over 300,000 of whom belong to 47 ethnic minorities. She and Hui are the two biggest minority ethnic groups.

The provincial GDP amounted to Yuan 674.8 billion in 2001, increasing by 11.1% over the previous year, with added value growth rates of the primary industry, the second industry and the tertiary industry of 5.5%, 11.3%, and 8.9% respectively. In the year 2001, Zhejiang accounted for 3.7 percent of China's population; 7 percent of China's GDP; and 7.2 percent of China's total trade. Zhejiang received FDI worth U.S.\$2.2 billion in 2001. So far, 8 state-level and 51 province-level economic and technological development zones have been established in Zhejiang. After years of establishment and growth, these zones have begun to be major contributors to the province's economic advance. By the end of 2000, in the province's economic and technological development zones, a total of 16,690 enterprises had gone into operation and their output was worth 28.6 billion Yuan, accounting for 5.7 percent of the province's GDP. By the end of 2000, the development zones in Zhejiang had invested over 20 billion Yuan in the construction of high-grade roads, underground pipelines, customs office buildings, commodity inspection office buildings, thermal-electric power plants and substations, sewage treatment plants, docks, schools, parks, sports centers and other important facilities and services. Totally they have a developed area of 178 sq km.

Zhejiang has seen a steady stream of foreign investment over the years. The development zones in the province had authorized 2,793 foreign-invested projects by 2001. The total contracted foreign investment came to 8.52 billion U.S. dollars, of which 3.91 billion U.S. dollars was actually utilized. These figures respectively account for 17.9 percent of all the projects, 43 percent of the contracted foreign investment and 46.8 percent of the actual utilization in the province. The scope of foreign invested enterprises has been expanded, and more high-tech enterprises have been authorized. The average foreign investment of each project in the development zones had reached 3.05 million U.S. dollars, twice the amount of the average scale in the province. 226 large-scale projects had attracted foreign investment of over 10 million U.S. dollars each. Many world famous transnational corporations have set up enterprises in the Zhejiang zones, including Motorola and Exxon from the USA; Mitsui, Itochu, Marubeni, Nissho Iwal and Matsushita Electric Industrial from Japan; Siemens, Hoechst and Robert Bosch from Germany, as well as the Royal Dutch/Shell Group and Chiatl.

The operation of new projects, especially of a number of large-scale foreign invested ones, has upgraded the industrial structure of the existing region. In the meantime, through the links with foreign investment, many former all-domestic enterprises have optimized their asset readjustment, which makes the province's industrial structure more reasonable. Due to its peculiar geographical location, the Ningbo Economic and Technological Development Zone has devoted itself to developing harbor-related industries. And it has basically established and developed industrial structures, including petrochemicals, iron and steel, and papermaking as its mainstays, and complemented by light industry, construction materials, textiles, food processing and steel structure material projects. And it has set up a harbor-related heavy industrial group coordinated with the large Beilun deep-water harbor.

The establishment of Matsushita Electric Industrial Area in the Hangzhou Economic and Technological Development Zone, has not only improved the zone's development, but also set up an exemplary role in the industrial adjustment of northern Zhejiang. The Wenzhou Economic and Technological Development Zone has improved the technology of traditional industries, including garment clothing, shoes, leather and furs. Also, its technology-concentrated industry guided by genetic engineering, meticulous chemicals and the integration of mechanic and electric manufacturing, has developed quickly. Zhejiang is actively fostering its key industries of machinery, electronics, chemicals and pharmaceuticals. Interestingly enough, small-scale enterprises account for 99.8 percent of all the industrial units in Zhejiang, employing 81 percent of the workers and producing 82 percent of the gross industrial output. Although, in recent years, along with the promotion of the formation of large-scale enterprises, the proportion of the output value of large and medium-size enterprises has continued to rise.

The Standing Committee of the People's Congress of Zhejiang Province and the provincial government have promulgated regulations on state-level development zones and interim provisions on improving the setting up and management of province-level economic development zones. The departments in charge of the development zones at various levels have also worked out concrete management regulations concerning the zones under their jurisdiction. The authorities concerned have also enhanced the management of the projects in the development zones. Always guided by the principles of simplification, high efficiency and consistency, the administrative committee of each development zone has set up management modes and service procedures to meet the international standards. The overall construction of the development zones is being institutionalized and standardized in a step by step manner.

240 kms of the coastline of Zhejiang is suitable for the construction of harbors. 58 harbors, the major ones being those of Ningbo, Zhoushan, Zhapu, Haimen and Wenzhou, have been constructed, with 41 berths of 10,000 dwt capacity or more. Shipping lanes stretch from these harbors to more than 400 ports in over 70 countries and regions worldwide, with regular passenger or cargo ship lines to the United States, Japan and Hong Kong. The port in Ningbo, one of China's four top transfer harbors, can handle freighters up to 300,000 dwt in size and is China's largest and is the best equipped one of iron ore transshipment base. In 2000, the volume of freight handled by Ningbo Harbor reached 87.09 million tons, ranking second in China. Zhoushan Harbor has become the biggest of its kind in China. Aoshan Harbor in

Zhoushan, with 250,000 dwt oil transfer berths, made Zhejiang the first province in China with the ability to accommodate oil transshipment from supertankers.

Zhejiang also has a flourishing road, rail and air networks. It has 6 national highways and 66 provincial arterial highways, with a total length of 38,900 km, of which 343 km are expressways. Following the completion of the Shanghai-Hangzhou-Ninbo expressway, the province is pushing ahead with the construction of the Ninbo-Taizhou-Wenzhou, Hangzhou-Jinhua-Quzhou, Hangzhou-wenzhou expressways. Some parts of the expressways have been opened to traffic. With the provincial capital of Hangzhou as the hub, Zhejiang's main railway lines are the Hangzhou-Shanghai, Hangzhou-Jiangxi and Hangzhou-Ninbo multi-track railroads and the Hangzhou-Xuanheng and Jinhua-Wenzhou railroads. Zhejiang has seven airports at Hangzhou, Ninbo, Wenzhou, Huangyan, Yiwu, Quzhou and Zhoushan (Zhujiajian) respectively and these operate over 160 domestic and international air routes. Construction of another international Airport in Hangzhou has already recently begun. *Refer to Table 5 for data on infrastructure availability by provinces and to Figure 2 for average transport network density.*

Zhejiang is one of China's most advanced provinces in the utilization of water, thermal, wind, tidal and nuclear power resources. Besides the large-scale electric power plants at Beilium, Zhenhai, Taizhou, Changxing, Wenzhou and Jiaxing, there are large-scale hydro-electrical power plants on the Xin'an, Fuchun and Wuxi rivers and at Jinshuitan. The first stage construction of the Qinshan Nuclear Power Station in Haiyan Country has been completed and put into operation. The total installed electricity capacity of the province is 14.33 million kWh. Total electric power generated in 2000 was 53.6 billion kWh. At the moment, preparations are under way for the construction of the Sanmen Nuclear Power Station and Tankeng Hydro-electrical Power Station. In addition, in the coming years, a number of large thermal power stations are expected to come on stream. All in all, the province has sufficient supply of electric power.

In the course of implementing the relevant state laws and policies, the Standing Committee of Zhejiang Provincial People's Congress and the provincial government have enacted more than 20 laws, regulations, administrative rules and policy documents, which concern the development of foreign trade, the establishment and management of economic development zones, favorable tax policies, loans, the right of use and transfer of state-owned land, real estate development, management of foreign exchange, guarantees for the autonomy of foreign-invested enterprises and simplification of entry and exit procedures. Laws and policies guaranteeing the autonomy of foreign investment have also been established. These clearly indicate that there are far more areas under state/province control in China as against those in India. In the Indian case, a lot of the above mentioned areas are still under the central government's control.

On the rural economy front, Zhejiang is an area noted for its high-yield agriculture, flourishing township enterprises and important bases for aquaculture. In 2000, the total output value of crop plantings, forestry, animal husbandry and fishery came to 100 billion Yuan, and that of township enterprises came to 1,000 billion Yuan. Towns and townships, each having a total output value of 100 million Yuan, accounted for two thirds the provincial total. Zhejiang's average per capita annual net

income in rural areas ranked third in China. 24 percent of rural households have washing machines, 32 percent have refrigerators, and 17 percent have motorcycles. Interestingly, there is more than one TV set per rural household. Zhejiang has well developed farming, forestry, animal husbandry and fishery, and has a liberal supply of farm produce.

In recent years, in the optimization of agricultural production structure, the province has not only maintained the advantages of a complete range of product sectors, but also made satisfactory progress in the comprehensive development of agriculture. The quantity and quality of edible oils, tea, bamboo and timber, aquatic products, commercial flowers and plants, and edible mushrooms have been improved considerably. In 2000, the total output of food grains reached 14.53 millions, that of rape seed reached 321,000 tons, and that of silkworm cocoons reached 104,300 tons. The output volume and of export volume of tea both led the county. As China's key base for aquaculture, Zhejiang's output of aquatic products came to 4.22 million tons in 2000, an increase of 11.9 percent over the previous year.

The township industry has tremendous strength, and the architectural industry, transportation, commerce and catering trade are thriving. Through the developments in the past two decades, township and village enterprises have been started all over the rural areas in the province, and 781 of them have become national large and medium-sized enterprise. Textiles, clothing and leather enterprises are leading the province's township industry, and their combined output value accounts for one-fourth of the total output value of township industry. In 2000, the total value of the province's township industry came to 170 billion Yuan. Meanwhile, the province's rural architectural industry developed quickly as well, and a number of township architectural enterprises were listed as the national first-level construction enterprise.

The transportation, commerce and catering trades have prospered and played an important role in the sale purchase of commodities. The province's township enterprises have recruited 36 percent of the total rural labor force, and three-quarters of the increase in the province's industrial output value came from township and village enterprises. In 2000, the province's township enterprises let the way in the payment of revenues, in the earning of gross profits, and in the total value of exports. The establishment of rural mini-towns has made great strides. In the province, the area of a township seat under its county seat averages two sq km, and the population averages 5,000 people. A number of centralized towns with over 50,000 inhabitants each have also emerged.

Manufacturing conditions continue to improve, and the management situation of industrialization is favorable. The province has never been slack in the basic construction of water conservancy works, and in recent years, a sustained increase of investment into agricultural machinery ensured the steady development of agricultural production. In 2000, 300 and 140 km standard protection dikes along the sea and rivers respectively were built. The available irrigated area of farmland has reached 1.38 million ha, and the area which can ensure stable yield despite drought or excessive rain has reached one million ha, accounting for 86 percent and 62 percent respectively of the total area of cultivated land. Mechanization or semi-mechanization has been almost completely accomplished in the areas of cultivation, irrigation and

drainage, processing and transportation. The province has made new progress in the industrialized management of agriculture in recent years.

Lessons from the Chinese Special Economic Zones:

- The SEZs have allowed for the transfer of management know-how from abroad. This is important to India/Gujarat as it expands its experiment with market based economic policies and tries to compete in the global marketplace.
- There is enough evidence to show that the SEZs have resulted in true export creation, not just diversion. Restrictions on exports and imports have also been liberalized, compared with pre-1979 levels.
- The domestic resource cost ratio, a measure of the financial benefit that an enterprise can generate from its exports, is significantly lower in the market oriented cities in China than elsewhere in the country. This shows also that these enterprises are operating as profit maximizers and are not being state-subsidized.
- Designation as an SEZ contributes significantly to developing infrastructure in the province in question. A case in point is Guangdong which lagged behind Shanghai significantly in terms of infrastructure. Now it has become one of the foremost developed areas in this respect.
- Enterprises in the SEZs are offered preferential treatment in terms of taxation, import licensing, and tariffs. The most important difference between the SEZs and the rest of China is that investment decisions are made autonomously, not subject to Central planning. Local authorities can implement policies to attract investment and to develop local infrastructure as long as they can raise the funds to do so. This has created a climate that is very conducive to foreign investment. Enterprises in the zones are both state-owned and non-state owned. Non-state owned enterprises can be fully foreign-funded and owned, equity joint ventures, or contractual joint ventures. Additionally, SEZs enjoy considerable autonomy in investment, pricing, housing, and labor and land management policies.

There has been a dramatic impact on employment generation in the SEZ provinces, and this has had favorable spillover effects on the rest of the country. Much of this is employment generation, not simply diversion. There is some concern that the jobs are primarily low-skill and low-paying. However, there is no question that labor is being released from the less productive agricultural sector to a more 'modern' sector with higher returns. This has stimulated the growth of light industry and service activities. The open door policies further helped because small-scale enterprises set up initially to meet domestic demand can expand by exporting labor-intensive manufactured goods. Thus the huge potential gains from specialization and trade have been effectively exploited, and significant amounts of employment have been generated through the zones.

Perhaps the most important lesson to be learned from the Chinese experience – consistent with the experience of other East Asian countries such as the Republic of Korea, Singapore, Taiwan, and Thailand – is that exports are key to high GDP growth rates. Successful export expansion in turn depends on a policy package which conveys a clear message that the country will give priority to export-oriented firms

rather than sheltering import-competing industries. China has benefited greatly from the clear direction its reforms have taken, in spite of occasional bumps along the way.

Concluding Remarks and Lessons for Gujarat:

We are of the view that in the current global scenario, it is possible for Gujarat to achieve very dynamic growth based upon labor-intensive manufacturing that combines the vast supply of its labor, including skilled managerial and engineering labor, with foreign capital, technology, and markets. On this basis, the East Asian economies have achieved growth rates consistently above 6 percent per year up until their financial crisis, and China has managed growth in excess of 10 percent per year in the 1990s. Export-led growth in manufactures, the more traditional textiles and apparel, in electronics and other labor-intensive operations remains an area where India in general and Gujarat in particular could do a lot more than in the past.

China has achieved a lot more in manufactured export production than India and for no particular reason. Gujarat has the resource base, it has the entrepreneurship, has the access to the sea coast, a vast labor force, it has everything that coastal China has had except the interest of the national/state government which neglected this for a long time and which even today underemphasizes the role of industrial facilities, underemphasizes the role of infrastructure, of land area, of effective port facilities that one needs to sustain high rates of growth. But it is, we believe, a place where one could find tens of millions of jobs over the next few years in real, significant foreign exchange earning private sector activity. This would require a change of attitude, a real promotion of these sectors both at the state and central government levels.

The reform process in India has so far mainly concentrated at the federal level. India has yet to free up its state governments sufficiently so that they can add much greater dynamism to the reforms⁷. Greater freedom to the states will help foster greater competition among themselves. The state governments in India need to be viewed as potential agents of rapid and salutary change. While some healthy competition is evident in India among the three southern states of Andhra Pradesh, Karnataka, and Tamil Nadu, and the two western states of Gujarat and Maharashtra, however, much of the rest of Indian states are yet to begin competing with each other. Brazil, China, and Russia are examples where regional governments have taken the lead in pushing reforms and prompting further actions by the central government. In Brazil, it was Sao Paulo and Minas Gerais which were the reform leaders at the regional level; in China, it is the coastal provinces, and the provinces farthest from Beijing, in the lead; in Russia, reform leaders in Nizhny Novgorod and in the Russian Far East have been major spurs to reforms at the central level.

Decentralization has been crucial in making the SEZs attractive to investment. Special policies that allow a greater portion of firms' profits to be retained instead of being transferred to the Center are notable. China's economic system is highly

⁷ India's constitution was designed to give primary economic policy making responsibility to the central government. Key fiscal, infrastructure, and regulatory decisions on economic management are therefore taken by the central government. For instance, in most infrastructure areas, the central government remains in control or at least with veto over state actions.

decentralized and policy implementation is now largely under the control of provincial authorities. Hence in fast growing provinces, provincial and local officials have been deeply involved in the development process in general and export promotion in particular. Besides their role in facilitating foreign investment, there are a number of ways in which local governments promote exports. The central government sets mandatory targets or export quotas for only a limited number of items or by volume. But in some provinces, like Jiangsu, the export quota system is far more elaborate. Moreover, taking advantage of their monopsony power, FTCs are able to buy goods at prices well below domestic prices, making their output competitive in the world market.

Operating within central government guidelines, provincial governments have been expanding Direct Export Rights to enterprises, but the criteria for doing so are very stringent. As a result only 5 percent of China's exports are produced by enterprises with Direct Export Rights. Also within central government guidelines, local authorities decide the allocation of imported raw materials by sharing locally retained foreign exchange earnings among enterprises, collectives, and town and village enterprises in different sectors. Provinces and cities also indirectly subsidize exports by providing critical inputs like electric power to export-oriented enterprises. Additional incentives are provided in the form of higher bonuses for managers and employees awarded on the basis of export performance. Finally, local authorities establish joint ventures between FTCs and enterprises to promote exports.

The export growth in China's provinces was based on core policy and economic management decisions carried out beginning in the early 1980s. These can be summarized as follows. First, China understood that the root of export growth would be diversification away from traditional sectors, especially raw materials, into non-traditional sectors, especially manufactured goods. But, China lacked the technology by itself to be competitive in manufactured goods. Therefore, it invited in foreign direct investors to provide the capital and the expertise to achieve export competitiveness in a wide range of sectors, including electronics, apparel, plastic toys, stuffed animals, ceramics, and many other labor-intensive sectors. In each sector, the key was to link foreign investor capital and expertise with a large and low-cost Chinese labor force. The foreign investors brought in the product design, specialized machine tools and capital goods, key intermediate products, and knowledge of world marketing channels. The Chinese assured these foreign investors certain key conditions for profitability, such as low taxes, reliable infrastructure, physical security, adequate power, decent logistics for the import and export of goods, and so forth.

At the center of China's export strategy were the SEZs in which favorable export conditions were assured. These SEZs, along China's coastline, were designed to give foreign investors and domestic enterprises favorable conditions for rapid export promotion. All key aspects of the export environment were secured. Exporters, for example, were allowed to import intermediate products and capital goods duty free. They were given generous tax holidays. The exporters were assured decent physical infrastructure, often through the provision of land, power, physical security, and transport to the ports, within specially created industrial parks.

India's export environment suffers from several institutional weaknesses. India's labor laws, noted unfavorably in the 2003 Global Competitiveness Report, make it very costly to fire workers in enterprises of more than 100 workers. The result is that formal-sector firms (those that are registered and that pay their taxes) are loath to take on new employment, and the vast majority of India's employment is informal, in small, tax-evading, inefficient enterprises. Equally remarkably, India's legislation continues to restrict the entry of large firms, or the growth of small firms into large firms, in several areas of potential comparative advantage. Thus, garments, toys, shoes and leather products continue to be reserved, to a varying extent, for small-scale producers. Such restrictions virtually assure China's dominance in these sectors compared with India. India's tax and tariff structures similarly remain anti-export biased. India's high overall tariff rates, especially tariffs on intermediate products that are used by exporters, impose a heavy indirect tax on export competitiveness.

Deregulation of the private sector is perhaps one of the most critical areas in the context of India's reforms. Since almost 90-plus percent of the workforce is in the informal sector, it is of utmost importance to deregulate the private sector so as to get the unorganized sector workforce in the mainstream. Workers in large firms in the formal sector have a virtual guarantee of continued employment according to the Industrial Disputes Act. For firms of 100 employees or more, reductions in the workforce must be upon the permission of state government, which is almost never granted. Remarkably, loss-making firms are also not allowed to close their operations without government consent.

The results of India's highly regulated labor markets have been devastating. Formal-sector employment in India is shockingly low, in large part because so much urban employment is carried on outside of formal registration. Out of a total labor force of around 406 million, formal sector employment was a meager 28.1 million in 1999/00, or just 6.9 percent! Of this, 19.4 million worked in the state sector (state enterprises and public administration), and just 8.7 million worked in private firms with formal employment. The unorganized sector workers are forced to engage themselves in subsistence agriculture or low-productivity informal employment. Indeed with a more open and deregulated economy, India may well be in a position to perform as China has done over the last two decades.

The proper elements of a revised growth strategy - rapid export-growth - should now be clear. Both the hardware and software of export-led growth need revamping. On the hardware side, the development of industrial parks for exports should be greatly intensified and enhanced. Private developers need the freedom to acquire urban and peri-urban land and to develop privately financed infrastructure in support of exports. The government must take urgent measures to reduce export costs, including private-sector provision of port services; zero tariff ratings on capital and intermediate goods imports used for export (based on an effective duty exemption scheme); enhanced export-oriented infrastructure, especially roads to the ports and airports, reliable power supply, and telecommunications facilities to support export zones. Labor legislation should be revised to allow managerial flexibility in the hire and dismissal of workers in export-oriented sectors. The reservation of labor-intensive sectors to small-scale enterprises should simply be scrapped. This is the kiss of death to effective international competitiveness in labor-intensive exports. The

government should actively encourage inward investment in export-oriented sectors, allowing 100 percent foreign ownership without administrative interference, and with the provision of generous tax holidays as necessary to attract internationally mobile capital from other locations.

In China, as we noted earlier, the real economic success has come in the coastal provinces, which can take advantage of export-led growth. The interior has done much less well. GDP growth in the hinterland has lagged behind the coastal states by several percentage points per year. The discrepancy in performance is leading inevitably to massive internal migration, with perhaps 100 million or more Chinese engaged in rural to urban migration, much of which is from the interior of China to the coastal states. In India as well, it is likely that a successful growth strategy will also result in differing performance among India's very disparate regions. Not all regions, for example, will be able to take advantage of export-led growth to the same extent.

As a general matter, coastal states will have an advantage over interior states, just as in China. Fortunately, there is a vast amount of economic reform that can be carried out to improve conditions in rural Gujarat. There is no reason for expensive and counter-productive charity for these parts of the state, and still less any case for holding back the fast-growing coastal regions. Perhaps the key step is to improve the most basic infrastructure so that the vast rural populations can take part in more rapid state economic growth. They will do so through increased exports to coastal regions, and greatly improved productivity for local production. We should stress that while China's hinterland has lagged behind the coastal regions, *the Chinese hinterland too has enjoyed rapid economic growth*

Rural Gujarat needs a new social contract, in which there will be a reliable infrastructure supplied at commercial prices rather than given for free. The Government's commitment, at the state level should be that every village will be assured at least minimal telephone service, clean water, a road to the regional market, and reliable power; but that every village will be responsible for covering the commercial costs of those services on a normal user-fee basis. Technological changes in each of these areas (telephony, water, road building and maintenance, and power) allow these key sectors to be organized, at least in part, on the basis of competitive, private-sector producers, who will provide the initial financing of the investments in return for a reliable stream of user charges over time.

The availability of infrastructure services, such as power, telecom, and roads in rural Gujarat can significantly help develop rural industry in Gujarat. Lessons from China are once again relevant here, especially the boom in China's Township and Village Enterprises. These are a mix of collective and privately owned enterprises in rural China. The TVEs operate outside of the state plan, and largely without funds from state banks. Therefore, they are subject to quite rigorous market competition and hard budget constraints. China's experience demonstrates that establishment of small townships to link the countryside with urban areas is a successful strategic policy for development. This will facilitate the transportation of goods between rural and urban areas, and rising income and productivity in rural areas. As for urban enterprises, this link would open up a bigger market and help in diversification or restructuring which is currently under constraint due to area limitations. Rural

enterprises can also compete in the cities with their products having the advantage of relatively low labor costs. In this way, they will help absorb surplus labor locally, thereby resulting in less rural-to-urban migration (population in urban areas have reached levels far above what the urban cities can efficiently accommodate given their capacity to provide urban infrastructure services). Urban enterprises will also provide more employment opportunities since they would have a larger market. In addition, the linkage will benefit the rural industries via flow of technology and information.

In 1984, the Chinese government began, one, relaxing the restrictions on export activities and the establishment of non-state industrial enterprises in the rural areas, and, two, extending the preferential policies on FDI from the southern coastal provinces to other coastal provinces. Large numbers of rural enterprises and foreign-funded enterprises started sprouting in the coastal provinces, notably in Guangdong, Zhejiang, Jiangsu and Shandong. It is very fortunate for these coastal provinces that these policy changes took place. By 1984, the agricultural sector was beginning to reach the limit of the benefits created by the substantial (but still partial) deregulation of agriculture during 1979-82. These new policy changes regarding exports, non-state enterprises and foreign-funded enterprises thus encouraged the coastal agricultural provinces to switch their engine of growth from farming to rural industries just when the one-shot agricultural productivity growth impetus had spent its force. Without the same linkage opportunities to foreign-funded enterprises, and facing higher transportation costs in getting the goods to foreign markets, the rural enterprise sector in the inland provinces did not take off like in the coastal provinces. The inland agricultural provinces hence continued to rely mainly on farming, the flagging engine of growth, as its main economic activity.

The growth rate of the typical coastal province benefited about equally from its geographical location (2.6 percentage points) and preferential policies (2.7 percentage points), and the level of each type of benefit received by the coastal provinces was higher than the level received by provinces in other regions. Thanks to the navigable portions of the Yellow River and the Yangtze River, a central province received a boost of 1.8 percentage points to its growth rate, which is about the same size as the boost from preferential policies, 1.5 percentage points. Compared to a northwestern or a southwestern province, a northeastern province was more favored by geography and preferential policies. The growth decomposition yields two important observations for economic policy. First, the faster growth of the coastal provinces could not be largely attributed to the more preferential policies that they had received. The coastal location was as important as the preferential policies in promoting growth. Second, the difference in provincial access to preferential preferences was still quite large. It caused a one percentage point gap between the coastal provinces and the central, northwestern and southwestern provinces.

China's experience shows that if the preferential policies directed toward FDI had been absent for all provinces, the central provinces would have shown the highest growth rates (8.8 percent), but the coastal provinces would still have grown faster than the northeastern, northwestern and southwestern provinces. Furthermore, because the preferential policies had a positive impact on the growth of the inland provinces, the elimination of preferential policies to equalize policy treatment of the provinces would have been a negative shock to the inland provinces. Since the troubling aspect about the preferential policies was not their effectiveness but the unequal access to

them, the solution lies in increasing the access of the inland provinces to the preferential policies rather than in denying everybody access to these policies.

Lessons for Gujarat:

1) To attain and sustain high rates of economic growth, follow a two-pronged growth strategy, wherein the first prong is export-led growth, and the second prong is rural improvement. For the first prong, lessons from the Chinese coastal provinces are particularly instructive, since the Chinese provinces achieved in the past twenty years the kind of export-led growth that Indian states could have achieved, but have so far failed to achieve because of poor public policies. With regard to the second prong, Gujarat needs a specific strategy to bring modern economic growth to rural Gujarat, through a concerted campaign of infrastructure upgrading and appropriate re-design of state policy.

2) Establish SEZs all along the Gujarat coast on an expedited time table. This is critical in view of the fact that several Indian states are in the process of setting-up such SEZs and the sooner Gujarat's SEZs are up and running, the better it will be for attracting both potential domestic and foreign investors. Chinese SEZs are allowed to retain all their foreign exchange earnings in their foreign exchange account. China's SEZ companies are not bound by minimum export performance requirements. Companies need to balance or have positive net foreign exchange earnings. Put briefly, when benchmarked against Chinese SEZs, broadly, the Indian SEZs are by and large at par with them.

3) Identify key sectors where Gujarat offers comparative advantage for investors relative to other Indian states;

4) Working with the federal government move expeditiously to reform labor laws, especially with respect to the SEZs. Labor laws in Chinese SEZs are more favorable, allowing labor contracts to be modified or rescinded through consultations between both parties.

5) An exit policy needs to be formulated such that firms can exit from the market freely. While it would be incorrect to ignore the need for, and potential merit of, certain safeguards while designing an exit policy, it is also important to recognize that safeguards, if wrongly designed and/or poorly enforced would turn into barriers which may adversely affect the health of the firms. Exit policy needs to be designed in a way that it removes exit barriers and at the same time protects the necessary internal order in the firms.

6) Reforming the land laws. Presently, the land ceiling law, the Urban Land (Ceiling and Regulation) Act 1976, limits the growth of private enterprises. This Urban Land Act requires urgent modification to accommodate industrial restructuring.

7) Outside of the SEZs, firms in China's non-state sector operate largely on free market principles. In the Indian context, deregulation of the private sector is perhaps one of the most critical areas in the context of the on-going reforms.

8) Make investments on a much higher level to upgrade existing major port facilities and to use minor ports more efficiently.

9) Make the necessary changes to align Gujarat's incentives structures in line with other competitor Indian states.

10) As in the case of China's coastal provinces, where overseas Chinese in Hong Kong, Taiwan, and Macao have invested heavily in mainland China, develop networks with Gujarati Non-resident Indians for them to invest in Gujarat. As a follow-up of the Global Investors Summit, quick and timely follow-up action is critical, and

11) As in the case of China's provinces, explore if similar Township and Village enterprises (TVEs) can be set-up in rural Gujarat. The TVEs have huge potential to fuel growth in rural Gujarat.

Appendix I China's Policy Evolution 1978-2000

1978-83

Domestic Reforms

- 1979 · Decollectivisation of agriculture and introduction of the Household Responsibility System (HRS).
- Introduction of the single child policy (January).
- Prices of agricultural products rise by 25 per cent on average (April).
- Industrial reform ("Mandatory Rule for Introducing the Retained-Profit Scheme") (13 July).
- 1980 · Budgetary autonomy granted to provinces.
- Legalization of family farms (September).
- 1981 · Industrial reform ("Information on Implementation of the Economic Responsibility System in Industrial Production") (29 October).
- 1982 · Law authorizing limited-term employment contracts.

1984-91

- 1984 · Extensive program of reforms mainly targeting the urban industrial sector (Third Plenum of the XII Central Committee) (October).
- 1985 · Restoration of control by the central government (July).
- 1987 · Economic reform resumes (XIIIth National Congress) (November).
- 1988 · Official proclamation of the "coastal development strategy" by Zhao Zyang (January).
- Strict controls on investment and credit are reimposed (September).

Open door policy

- 1984 · Creation of 14 open cities (April).
- Proclamation of the decentralization of foreign trade (August).
- Creation of the Economic and Technological Development Zone (ETDZ) of Huangpu in Guangzhou (December).
- 1985 · First official swap center created by the Shenzhen branch of the People's Bank of China.
- The double exchange rate system is replaced by a single exchange rate set at 2.8 Yuan per US dollar (January).
- Opening of the Zhujiang delta, the Changjiang delta and the south Fujian triangle (Zhangzhou, Quanzhou and Xiamen) (February).
- Law on economic contracts with foreigners (April).
- 1986 · Devaluation of the RMB by 13.6 per cent (July).
- Law on wholly foreign-owned enterprises (12 April).
- Devaluation of the RMB (January).
- The "Law of 22 Articles " (measures to encourage foreign investment) (October).
- 1987 · Extension of the Zhujiang delta Economic Development Zone

- (December).
- 1988 · The contractual Responsibility System (CRS) is applied to the national Foreign Trade Companies.
- Law on co-operation between enterprises (13 April).
- Hainan Island becomes a separate province and an SEZ (April).
- Opening up of many areas in Liaoning, Shandong, Guangxi, and Hebei provinces (April).
- 1989 · Devaluation of the RMB by 21.2 per cent against the US dollar 4.7 Yuan/dollar) (December).
- 1990 · Creation of the Pudong zone (Shanghai) (April).
- Devaluation of the RMB by 9.57 per cent against the dollar 5.187 Yuan/dollar) (16 November).
- 1991 · Extension of the Contractual Responsibility System to provincial governments.
- Harmonization of fiscal measures concerning foreign investors (April).

Domestic reforms

- 1984 · The People's Bank of China becomes the Central Bank and four specialized state banks are created.
- Creation of township and village enterprises (TVEs).
- Industrial reforms (creation of director's responsibility system). (20 October).
- *The People's Daily* announces the elimination of the public monopoly on the purchase and sale of the main agricultural products (31 December).
- 1985 · Implementation of the fiscal reform adopted in September 1984 (1 January).
- 1986 · Legalization of the inter-bank lending market.
- Adoption of the Compulsory Education Act, which stipulates that obligatory schooling in most regions should be increased to nine years before the turn of the century (April).
- Law authorizing redundancies. Introduction of an employment contract system and an unemployment insurance system (July).
- Law on bankruptcies of state-owned enterprises. First introduced on an "experimental basis", it went into effect in 1988 (August).
- Industrial reform ("Decision on Intensifying the Enterprise Reform and Revitalizing Enterprise") (5 December).
- 1987 · First sale of user's rights to Chinese land at Chenzhen (September).
- 1988 · Price reform.
- Legalization of the rental of land use rights.
- Price liberalization is suspended (August).
- 1991 · Elimination of Guaranteed lifetime employment.
- Law on land administration (February).

1992-2000

- 1992
 - Deng Xiaoping's tour of the south (January).
 - The Politburo decides to quicken the pace of reform and opening up (9-10 March).
 - The Party calls for the establishment of a "socialist market economy" (October).
- 1993
 - "Sixteen Point Program" to bring economic overheating under control, fight corruption and put an end to rural unrest (July).
 - The Third Plenum of the XIVth Central Committee adopts a resolution On the "establishment of a socialist market economy system" (November).
- 1999
 - XVth Congress of the PCC and resumption of reforms (September).
- 1998
 - Zhu Rongji becomes Prime Minister (17 March).
- 1999
 - Constitutional amendment designation the non-state sector as a "major component" of the socialist market economy (March).

Open door policy

- 1992
 - Preferential policies for ten major cities.
 - Establishment of six development zones along with Changjiang valley.
 - All provincial capitals and 13 border cities are authorized to adopt an open door policy.
 - Foreign investment is authorized in sectors where it had been forbidden, such as finance and insurance (July).
- 1993
 - Abolition of import licensing for 9 categories of goods (31 December).
 - Tariff reduction for approximately 3000 products (31 December).
- 1994
 - End of mandatory planning of foreign trade.
 - Temporary (one-year) tariff reduction for 235 products (1 January).
 - Unification of the exchange rate (1 January).
 - Elimination of quotas and import licenses for 195 products (May).
 - Foreign trade law clarifying all existing regulations (1 July).
- 1995
 - Regulations concerning the opening of the services sector ("Provisional Regulations Guiding Foreign Direct Investment", June).
- 1996
 - Elimination of tariff exemptions for imports by foreign-owned enterprises (1 April).
 - The RMB is made convertible for current transactions (1 December).
- 1997
 - The average tariff rate is reduced from 23 per cent to 17 per cent (1 October).
- 1998
 - Re-establishment of some tax privileges for foreign-owned enterprises (1 January).
 - "Preferential taxation policies for FDI included exemptions from tariffs and import value-added tax for imports of capital goods by foreign-funded high-tech projects and 50% reduction of tariffs and import value-added tax for imports of capital goods by sectors where foreign investment is encouraged." <http://www.nber.org/~confer/99/indiaf99/India-China-FDI.PDF>
- 1999
 - The end of development zones (elimination of privileges with respect to business income tax), except for SEZs (1 January).

- 2000 · China published revised lists of sectors in which foreign investment would be encouraged, restricted or prohibited.
- In September 2000, however, the authorities lifted controls on interest rates on all foreign currency loans and on foreign currency deposits in excess of \$3 million.

Domestic reforms

- 1993 · Introduction of health insurance system for retired people.
- Law on competition.
- Abolition of swap centers (April).
- Implementation of a new accounting system for enterprises (1 July).
- 1994 · Liberalization of coal prices.
- Adoption of a new system of taxation standardizing the tax rate on domestic firms at 33 per cent, unifying the income tax rate for individuals and applying VAT to a broader range of products (1 January).
- Adoption of the first state budget bill by the National Congress (March).
- Adjustment of the price of oil (May).
- Adjustment of the price of cereal grains and other food products (June).
- Application of the "law on companies " authorizing the transformation of public enterprises into limited liability companies (July).
- 1995 · Labor law making employment contracts mandatory for all industries companies, including township and village enterprises.
- Introduction of the five-day work week.
- Law on the status of the Central Bank, making it more independent of the central government. (March).
- Legislation on commercial banks (adopted in May, took effect on 1 July).
- 1997 · Proclamation of the reform of public sector ownership during the XVth Congress (September).
- 1998 · Housing reform aimed at creating a property market (1 July).

APPENDIX II TIMELINE OF CHINA'S REGIONAL PREFERENTIAL POLICIES

| Year of approval | Number and type of opened zone | Location |
|-------------------------|--|---|
| 1979 | 3 Special Economic Zones | Guangdong. |
| 1980 | 1 Special Economic Zone | Fujian. |
| 1984 | 14 Open Coastal Cities 10 Economic and Technological Development Zones | Liaoning, Hebei, Tianjin, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong and Guangxi. Liaoning, Hebei, Tianjin, Shandong, Jiangsu, Zhejiang and Guangdong. |
| 1985 | 1 Economic and Technological Development Zone 3 Coastal Open Economic Zones | Fujian. Pearl river delta, Yangtze river delta and Fujian. |
| 1986 | 2 Economic and Technological Development Zones | Shanghai. |
| 1988 | Open Coastal Belt 1 Special Economic Zone 1 Economic and Technological Development Zone | Liaoning, Shandong, Guangxi and Hebei. Hainan. Shanghai. |
| 1990 | Pudong New Area | Shanghai |
| 1992 | 13 bonded areas in major coastal port cities 10 major cities along the Yangtze river 13 Border Economic Cooperation Zones All capital cities of inland provinces and autonomous regions 5 Economic and Technological Development Zones | Tianjin, Guangdong, Liaoning, Shandong Jiangsu, Zhejiang, Fujian and Hainan. Jiangsu, Anhui, Jiangxi, Hunan, Hubei and Sichuan. Jilin, Heilongjiang, Inner Mongolia, Xinjiang, Yunnan and Guangxi. Fujian, Liaoning, Jiangsu, Shandong and Zhejiang. |
| 1993 | 12 Economic and Technological Development Zones | Anhui, Guangdong, Heilongjiang, Hubei, Liaoning, Sichuan, Fujian, Jilin and Zhejiang. |
| 1994 | 2 Economic and Technological Development Zones | Beijing and Xinjiang. |

APPENDIX 3

Comparison of India's SEZ & EPZ Schemes and Benchmarking against China's SEZ Scheme

| | India's SEZ | India's EPZ | SEZ vs. EPZ | Comparing with China's SEZ |
|-------------------------|---|---|---|--|
| Restrictions on sectors | Open to manufacturing, services and trading activities | Open to manufacturing and trading activities. Services may also be considered | While SEZs are generally open to all activities, EPZs appear to focus more on manufacturing and trading | Indian SEZs appear to be as open as China's SEZs. (In both cases, there are sectors specifically identified in government regulations as prohibited for foreign investments) |
| Labor laws | No specific concessions for SEZs. India's Industrial Disputes Act requires prior government approval for effecting lay-off, retrenchment and closure for employers engaging more than 100 workers | No specific concessions for EPZs. Guidelines as stipulated in India's Industrial Disputes Act | Businessmen in India are urging the government to exempt SEZ companies from the application of this labor law. Should the government agree to the request, these SEZ companies will have greater discretion over labor policies | Labor laws in Chinese SEZs are more favorable, allowing labor contracts to be modified or rescinded through consultations between both parties |

| | | | | |
|--|--|---|---|--|
| Tax exemption | Companies in SEZs enjoy a 5-year corporate tax holiday, followed by 50% exemption for 2 more years | Companies in EPZs are exempted from corporate tax for a block of 5 years in the first 8 years of operation. However, under Section 10A of the Income Tax Act, this concession is to be phased out by 2009 | SEZs offer more attractive tax exemption incentives | Corporate tax benefits are better in the Indian SEZs. China's SEZs offer a 2-year tax holiday for manufacturers, followed by a 3-year discount of 50% on corporate tax. Service companies with a minimum 10-year contract and US\$5m investments are granted a 1-year tax holiday, followed by 2-years of 50% tax reduction, subject to approval by the zone tax bureau Indian and Chinese SEZs are on par as companies in Chinese SEZs are allowed to retain all their foreign exchange earnings in their foreign exchange account |
| Retention of foreign exchange earnings | Retain 100% foreign exchange earnings in Exchange Earner Foreign-Currency Account | Retain 70% foreign exchange earnings in Exchange Earner Foreign-Currency Account | Companies in SEZs would have better control over foreign currency in relation to purchases of imported inputs | Indian and Chinese SEZs impose similar requirements. China's SEZ companies are not bound by minimum export performance requirements. Companies need to balance or have a positive net foreign exchange earnings |
| Export performance (EP) & Net Foreign Exchange Earning as % of Exports (NFEP) requirements | No minimum EP required. Positive NFEP is required | Minimum EP and NFEP required (varies across industries and states) | Companies in SEZs enjoy more leeway in meeting export performance requirements | |

| | | | | |
|--|--|--|---|---|
| Duty recovery in case of failure to achieve positive NFEP | Duty recovery is in proportion to shortfall | Full duty recovery is imposed | Lesser penalty for SEZs failing to achieve positive NFEP could be an incentive for firms to re-locate from EPZs | Unlike in India, companies in China's SEZs are not penalized for negative NFEP. Companies here can offset a negative NFEP through local foreign exchange monitoring centers or through borrowing from overseas financial institutions |
| Domestic Tariff Area (DTA) sales Linkage of domestic sales with NFEP | Unlimited DTA sales on full duty No linkage with positive NFEP for domestic sales | Only 50% of exports qualify for DTA sales Domestic sales subject to achievement of minimum NFEP | SEZs enjoy greater access to domestic market SEZs enjoy greater access to domestic market | Indian SEZs enjoy unlimited access but in China SEZ authorities regulate access to domestic markets Chinese SEZ regulations do not specifically link domestic sales to positive NFEP. Thus, Indian and Chinese SEZs are on par |
| Duty-free imported raw material | Allowed. These duty-free materials are to be utilized over 5 years | Allowed but duty-free materials are to be utilized over 1 year | More flexibility in production and inventory planning for companies in SEZs | Indian SEZs and Chinese SEZs enjoy similar benefits. Chinese SEZs allow duty-free import but certain restricted commodities can only be imported by State designated companies |
| Certification of imports | Imports on self-certification basis | Imports require attestation of the Development Commissioner | Simplified customs procedures facilitate movement of imports into SEZs | Indian and Chinese SEZs enjoy similar ease. Upon registration with the SEZ authority, companies in the Chinese SEZs are free to import materials |
| Customs inspection | No routine examination of import/export cargo by Customs | Routine Customs inspections of import/export cargo | Expedited movement of goods in and out of SEZs | Indian and Chinese SEZs enjoy similar ease. However, Chinese SEZ companies may be subjected to spot-checks by customs. |

| | | | | |
|----------------------|---|---|--|---|
| FDI approval process | 100% FDI investment through automatic route available for manufacturing companies | Foreign Investment Promotion Board approval is required for FDI | Easier and quicker FDI flows into SEZs for manufacturing companies | Unlike India's SEZs where an automatic route is available, in China the SEZ authorities are responsible for examining, approving applications and issuing approval certificates for the establishment of wholly foreign-owned enterprises |
|----------------------|---|---|--|---|

Sources: Official SEZ India Website @ [www. Sezindia.nic.in](http://www.Sezindia.nic.in), Handbook on 100% Export-Oriented Units and EPZ/FTZ Scheme, EIU India Country Commerce Report, November 2001, China's SEZ and MOFTEC websites, EIU China Hand, and State Information Centre (Beijing.)

Notes:

1. As of 31 Mar 2002, 347 companies were operating in the 4 SEZs, with total investments of nearly Rs 7 billion. With the exception of Santa Cruz SEZ (which is confined to electronics, gems & jewelry), the other 3 SEZs are open to almost all manufacturing (Prohibited activities: manufacture of cigarettes, liquor, arms and ammunition, explosives, defense equipment, narcotics, atomic substances or hazardous chemicals, the distillation and manufacture of tobacco substitutes), service and trading sectors.
2. Projection based on export data for April 2001 to January 2002.
3. These are located in Dahej and Mundra (Gujarat), Nanguneri (Tamil Nadu), Dronagiri (Maharashtra), Kakinada (Andhra Pradesh), Indore (Madhya Pradesh), Paradeep & Gopalpur (Orissa), Bhadohi, Kanpur & Greater Noida (Uttar Pradesh), Kulpi (West Bengal), and Hassan (Karnataka).

Table 1 - Annual per capita GDP growth rates

| | <i>1979-84</i> | <i>1985-91</i> | <i>1992-00</i> |
|---------------------|----------------|----------------|----------------|
| <i>Metropolises</i> | | | |
| Shanghai | 6.6 | 5.5 | 12.7 |
| Beijing | 7.8 | 6.5 | 9.3 |
| Tianjin | 6.3 | 4.4 | 11.9 |
| North-east | | | |
| Jilin | 8.5 | 6.5 | 10.0 |
| Liaoning | 6.2 | 6.6 | 8.9 |
| Heilongjiang | 5.7 | 5.5 | 7.9 |
| Coast | | | |
| Guangdong | 8.9 | 11.0 | 12.1 |
| Fujian | 9.8 | 7.9 | 14.2 |
| Zhejiang | 9.7 | 6.6 | 13.4 |
| Jiangsu | 8.6 | 7.6 | 13.1 |
| Hainan | 9.0 | 7.7 | 9.0 |
| Shandong | 10.0 | 6.5 | 13.0 |
| Hebei | 6.1 | 6.0 | 12.1 |
| Center | | | |
| Henan | 9.2 | 5.7 | 11.5 |
| Hubei | 7.7 | 5.0 | 11.6 |
| Anhui | 8.6 | 3.4 | 13.3 |
| Jiangxi | 6.6 | 6.0 | 11.3 |
| Hunan | 5.8 | 5.0 | 9.8 |
| Shanxi | 7.8 | 3.8 | 9.1 |
| North / West | | | |
| Xinjiang | 8.5 | 8.0 | 7.5 |
| Inner Mongolia | 8.5 | 6.0 | 8.7 |
| Shaanxi | 7.4 | 7.4 | 7.7 |
| Gansu | 3.8 | 7.4 | 8.4 |
| Ningxia | 6.2 | 5.6 | 6.8 |
| Qinghai | 5.9 | 3.5 | 6.4 |
| South-west | | | |
| Yunnan | 7.7 | 7.3 | 8.8 |
| Sichuan | 6.3 | 5.4 | 9.2 |
| Guangxi | 6.2 | 4.5 | 10.3 |
| Guizhou | 8.6 | 4.6 | 6.5 |

Note: GDP per capita is measured at 1995 constant prices. Annual growth rates are calculated by regressing the logarithm of per capita GDP on a time trend. Tibet is not included due to missing data for GDP components.

Sources: NBS and SSB various years.

Table 2
Geographical characteristics by region

| | Metropolises | Northeast | Coast | Central | Northwest | Southwest | Total |
|--|--------------|-----------|-------|---------|-----------|-----------|-------|
| GDP per capita growth rate, 1979-1998 (%) | 8.5 | 7.9 | 10.7 | 8.4 | 7.7 | 7.8 | 9.0 |
| GDP per capita level in 1978 (yuan/person) | 3,645 | 1,700 | 1,154 | 941 | 1,045 | 814 | 1,355 |
| Population density (person/km ²) | 1,104 | 138 | 133 | 264 | 46 | 126 | 290 |
| Distance from the coast (km) | 77 | 380 | 86 | 492 | 1,383 | 656 | 547 |
| Pop 100km (% of population) | 65 | 17 | 60 | 0 | 0 | 4 | 24 |
| Slope>10 (% of area) | 1.4 | 2.2 | 2.6 | 2.7 | 5 | 14.1 | 4.3 |
| Average slope (%) | 1.2 | 1.6 | 2.4 | 2.4 | 2.8 | 5.2 | 2.7 |
| Average elevation (meters) | 135 | 314 | 267 | 428 | 1,971 | 1,428 | 804 |
| Temperature (degrees) | 10.9 | 4.5 | 16.4 | 14.9 | 6.8 | 16 | 12.2 |
| Rainfall (mm) | 63 | 50 | 103 | 90 | 26 | 98 | 74 |
| Arable land (%) | 36 | 21 | 29 | 24 | 8 | 10 | 21 |

NOTES:

GDP per capita compound annual growth rate throughout 1979-1998 and GDP per capita levels in 1978 are calculated at 1995 constant prices.

Pop100cr – proportion of the population distribution of a province in 1994 within 100 km of the coastline or ocean-navigable river, excluding coastline above the winter extent of sea ice and the rivers that flow to this coastline.

Pop100km – proportion of the population distribution of a province in 1994 within 100km of the coastline, excluding coastline above the winter extent of sea ice.

Slope>10 measures the percentage of area within a province with a slope greater than 10%. Temperature and rainfall are averages throughout the 1951-1998 period. Arable land is available for 1994.

Metropolises – Beijing, Tianjin and Shanghai.

Northeast – Liaoning, Jilin, and Heilongjian.

Coast – Hebei, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, and Hainan.

Central – Shanxi, Anhui, Jiangxi, Henan, Hubei, and Hunan.

Northwest – Inner Mongolia, Shaanxi, Gansu, Qinghai, Ningxia, and Xinjiang (Tibet is excluded due to missing data).

Southwest – Sichuan, Guizhou, Yunnan, and Guangxi.

Sources: NBS (1999) for economic and population variables; Wang and Hu (1999, Table 4.1, p. 83) for arable land.

Figure 1



Table 3

Degree of Openness of Provincial Economies , 1997

| | In % of GDP | | | Share of FIEs in foreign trade (%) | |
|-------------------|-------------|---------|------|---------------------------------------|---------|
| | Exports | Imports | FDI* | Exports | Imports |
| China | 20.6 | 16.1 | 5.9 | 41.0 | 54.6 |
| Coastal provinces | 31.6 | 25.3 | 7.5 | 44.7 | 56.4 |
| Tianjin | 34.6 | 36.9 | 16.8 | 68.1 | 79.0 |
| Guangdong | 86.1 | 64.2 | 14.3 | 48.4 | 57.8 |
| Fujian | 30.4 | 22.8 | 11.6 | 48.1 | 63.6 |
| Shanghai | 36.4 | 38.5 | 10.4 | 47.4 | 61.5 |
| Beijing | 26.7 | 44.8 | 7.3 | 19.8 | 23.9 |
| Jiangsu | 17.9 | 13.6 | 6.7 | 46.5 | 68.4 |
| Liaoning | 19.3 | 15.8 | 5.6 | 43.5 | 58.1 |
| Shandong | 14.6 | 10.3 | 3.5 | 43.9 | 54.5 |
| Zhejiang | 19.2 | 9.8 | 2.7 | 22.9 | 40.7 |
| Hebei | 5.5 | 2.8 | 2.3 | 2.4 | 4.2 |
| Others | 5.9 | 3.7 | 3.7 | 14.5 | 38.2 |

* Provinces are ranked by the share of FDI in GDP.

Sources: China statistical yearbook, 1998; China's Customs Statistics

Table 4 - Growth episodes by region

| | 1953-1998 | 1953-1978 | 1953-1958 Medium Growth | 1959-1965 No Growth | 1966-1978 Low Growth | 1979-1998 | 1979-1984 Medium-high growth | 1985-1991 Medium growth | 1992-1998 High growth |
|------------------|-----------|-----------|----------------------------|------------------------|-------------------------|-------------|---------------------------------|----------------------------|--------------------------|
| Metropolises | 5.6 | 3.3 | 5.4 | -4.6 | 6.5 | 7.9 | 6.8 | 5.5 | 11.4 |
| North-east | 4.2 | 1.7 | 5.5 | -6.8 | 3.6 | 7.3 | 6.4 | 6.2 | 8.7 |
| Coast | 5.5 | 1.8 | 2.8 | -1.0 | 2.9 | 10.3 | 8.8 | 7.7 | 13.1 |
| Center | 4.2 | 1.5 | 5.2 | -3.0 | 2.0 | 7.8 | 7.7 | 4.9 | 11.2 |
| North-west | 4.3 | 1.6 | 7.1 | -2.8 | 2.5 | 7.7 | 7.1 | 6.9 | 7.9 |
| South-west | 4.2 | 1.0 | 5.8 | -0.9 | 1.7 | 7.4 | 6.7 | 5.4 | 9.1 |
| National mean | 4.8 | 1.7 | 4.9 | -2.6 | 2.7 | 8.6 | 7.6 | 6.3 | 11.2 |
| Gap (in % point) | 1.5 | 2.3 | 4.3 | 5.9 | 4.8 | 3.0 | 2.4 | 2.8 | 5.1 |

Note: Annual growth rates are calculated by regressing the logarithm of per capita GDP on a time trend. GDP per capita is measured at 1995 constant prices. Tibet is not included due to missing data for GDP components.

Sources: NBS (1999), except for Sichuan, for which sources are SSB (1997), and SSB (1997-99)/

Table 5
Infrastructure Availability and Structural Characteristics by Province, 1985-1998
Average

| Provinces ^a | Transport network density (km/1,000 km ²) Railway | Transport network density (km/1,000 km ²) Highway | Transport network density (km/1,000 km ²) Waterway | Telecommunication (telephones/1,000 persons) | Population density (km ²) | Coal Production (tons/1,000 persons) | Electricity production (kWh/person) |
|------------------------|--|--|---|--|---------------------------------------|--------------------------------------|-------------------------------------|
| Zhejiang | 9 | 310 | 104 | 50 | 418 | 31 | 672 |
| Fujian | 9 | 350 | 32 | 38 | 250 | 289 | 594 |
| Guangdong | 4 | 372 | 61 | 59 | 360 | 137 | 796 |
| Jiangsu | 7 | 245 | 231 | 45 | 660 | 357 | 727 |
| Shandong | 14 | 301 | 12 | 23 | 547 | 803 | 646 |
| Hainan | 6 | 401 | 10 | 26 | 199 | 2 | 291 |
| Henan | 13 | 273 | 7 | 14 | 521 | 1,048 | 461 |
| Anhui | 12 | 226 | 43 | 16 | 409 | 636 | 406 |
| Hubei | 9 | 259 | 46 | 23 | 294 | 197 | 667 |
| Hebei | 17 | 252 | 0 | 25 | 327 | 1,085 | 748 |
| Jiangxi | 10 | 199 | 29 | 15 | 229 | 552 | 357 |
| Xinjiang | 1 | 17 | 0 | 17 | 9 | 1,443 | 558 |
| Jilin | 19 | 151 | 6 | 36 | 132 | 1,008 | 864 |
| Inner Mongolia | 4 | 38 | 1 | 19 | 19 | 2,410 | 957 |
| Sichuan | 5 | 173 | 15 | 12 | 192 | 687 | 383 |
| Yunnan | 4 | 154 | 3 | 14 | 96 | 628 | 419 |
| Guangxi | 7 | 163 | 19 | 13 | 183 | 237 | 356 |
| Shaanxi | 9 | 188 | 4 | 20 | 161 | 1,018 | 560 |
| Shanghai | 42 | 547 | 370 | 139 | 2,193 | 0 | 2,620 |
| Beijing | 58 | 617 | 0 | 159 | 665 | 859 | 1,114 |
| Tianjin | 42 | 370 | 15 | 90 | 798 | 0 | 1,275 |
| Hunan | 11 | 276 | 48 | 11 | 291 | 653 | 393 |
| Liaoning | 24 | 276 | 3 | 44 | 271 | 1,315 | 1,192 |
| Shanxi | 15 | 214 | 1 | 14 | 189 | 9,777 | 1,268 |
| Guizhou | 8 | 178 | 10 | 9 | 187 | 1,298 | 456 |
| Gansu | 5 | 76 | 0 | 11 | 50 | 750 | 845 |
| Ningxia | 8 | 125 | 6 | 27 | 72 | 2,931 | 1,416 |
| Heilongjiang | 11 | 102 | 10 | 31 | 76 | 2,131 | 896 |
| Qinghai | 2 | 23 | 0 | 21 | 6 | 620 | 1,194 |
| National average | 13 | 237 | 37 | 35 | 338 | 1,134 | 798 |

^a Provinces are classified according to their GDP per capita average annual growth performance from 1978 to 1998. Sources: State Statistical Bureau (various issues) and author's calculations.

Source: Demurger 2000

Figure 2



FIG. 3. Average transport network density at a provincial level, 1985–1998, including railways, highways, and inland waterways ($\text{km}/1000 \text{ km}^2$): dark areas, over 500; medium-dark areas, 350–500; medium-light areas, 200–350; light areas, less than 200.

Source: Demurger 2000

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