

Financing SEZs, China's Modernization Pacemakers

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Gradual Spread of SEZs

Pilot Stage (1980 – 1990)

- 4 cities + 1 Province/offshore (Hainan)
- 14 coastal cities + Pudong (Shanghai)

Expansion (after 1992)

- 15 National Free Trade Zones
- 32 National Economic and Technological Development Areas
- 53 National New and High-tech Zones
- Hundreds of Provincial, Prefecture and City level SEZs

Industry focus: From all to specialized

Market focus: From export oriented to integration of domestic market and export

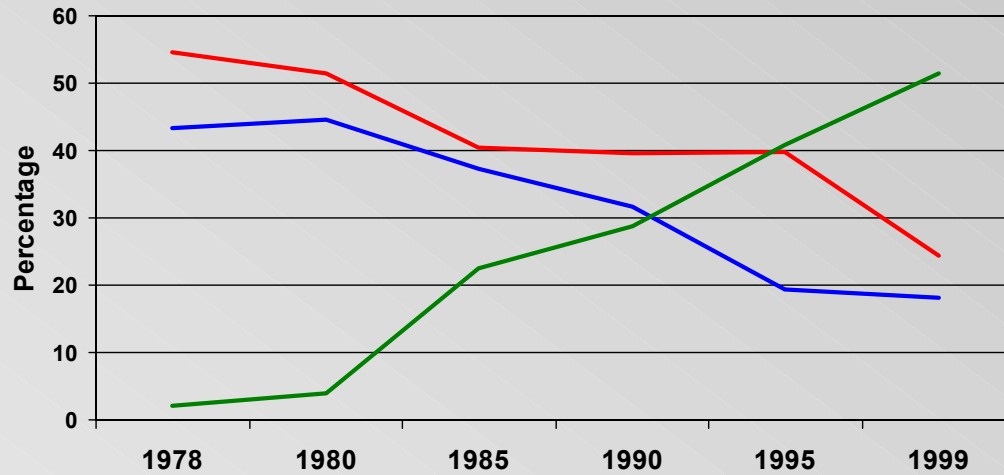
Drivers of Economic and Social Reforms

Establishment of a modern enterprise mechanism:

- Reforming systems of property rights, distribution, labor and personnel, social security
- Minimizing bureaucracy
- Example: The 53 national high-tech zones, accounted for half of China's total industrial output, \$208 billion in 2003

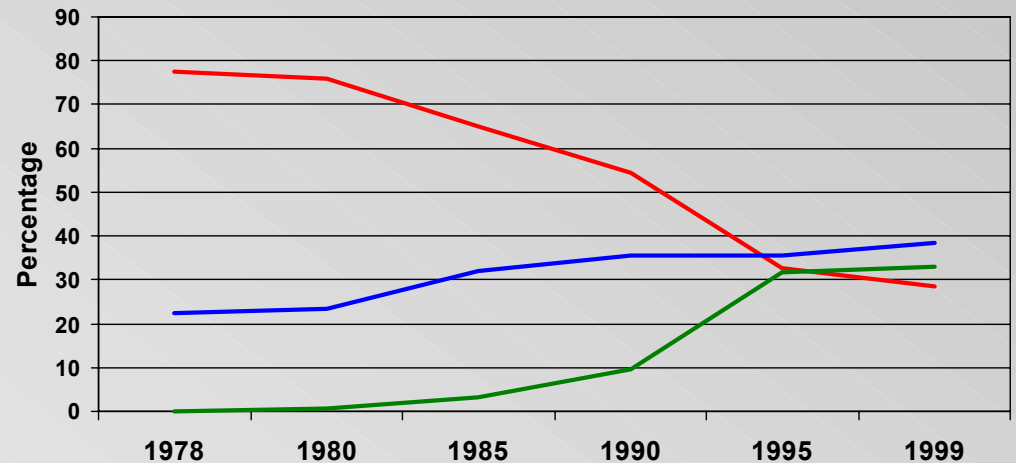
GROWTH OF PRIVATE OWNERSHIP IN CHINA

Ownership in Retail Sales of Consumer Goods (%)



- State-Owned or Controlled
- Collectives
- Private

Ownership in Industrial Output (%)



Yingyi Qian and Jinglian Wu; Working Paper #69;

Center for Policy Research on Economic Development and Policy Reform; Stanford University

Dual Roles

“Windows” in
developing the globally oriented economy

“Radiators” in
accelerating inland economic development.

Pre-requisites for Attracting Investment

- The “hardware”/geo-economics: Easy access - river delta or ports; large market for its products (for export and partial domestic market)
- The “software”: **Competitive Advantage**
 - Culture: Receptive to foreign influence
 - Entrepreneurial and managerial talent – clusters of companies
 - Legislative autonomy
 - Business-friendly government – one stop shop on approvals and services
 - Supportive banking system for transactions

Incentives to Attracting Investment

- To investors:
 - Preferential land use policy
 - Generous tax holidays
 - Favorable custom tariffs - imports of raw, intermediate and final goods as well as capital goods
 - Local banks lending support
- To non-government intermediary: Finder's fee: 1% - 3%
- To government operators:
 - Job promotions are linked to how much FDI the officials have attracted
 - Better office buildings
 - Retained local budget and increased revenues

Financing Models

- **Government Funding Leads**
 - Gov't budget
 - Bank lending
- **Foreign Funding Leads Contracted Area**
 - Suzhou-Singapore Industrial Park
 - Yangpu-Japanese and HongKong
- **Public and Private Mix**
 - Private Developers take the lead
 - Land collateral to get bank lending
 - Listed on stock exchange (for later stage development)

Infrastructure Financing - Private funding

- **Power plants: BOT or JV**
- **Water and sewage plants: BOT; guaranteed rate of return**

Land Development Financing - Private & Public mix

- **Local private developers' advantages over foreign developers**
 - Land incentives for private developers
 - Retail marketing advantage of local developers
- **Favorable Bank Lending: Land collateral**
 - government or state-owned banks
- **Innovative approach**
 - Gov't sharing the local income tax with private developers

Attracting Investment –Anchor Tenant Effect

- **Reduced land use fees**
 - **Minimum to free in the first 3 years**
- **Reduced income tax for additional years**
 - **50% less for additional 2-5 years**
- **Waiver of various auxiliary local taxes**
 - **2% - 3% of total investment**

The case of Motorola in TEDA

Attracting Investment – Combined Zone & Industry Specific Preferential Policies

- **Pudong – Shanghai, China’s banking center**
 - Allowing foreign banks to conduct RMB transactions
 - Within 2 years, 78 financial institutions (24 foreign funded banks) and \$30 billion (69 foreign banks and \$27 billion assets in 2004)
- **Zhongguancun – Beijing, hotbed for innovation**
 - “Can do anything as long as it is not prohibited by law”
 - In 75 square KM area: 232 research institutes and 68 universities
 - First Venture Capital Partnership
 - Over 80,000 companies and over half of the top Chinese IT companies are headquartered

Lessons Learned

- **Foreign Funding Leads Contracted Area**
 - Lack of local resources support
- **Government funding**
 - Insufficient funding and inefficient
- **Public and private mix**
 - Integrated incentives for all parties involved
 - Listing on the stock exchange for later stage development of the zones, a worth-noted financing vehicle

Relevance to the South Asia

- Unbalanced regional development in the South Asian countries
- Poor infrastructure
- Bureaucratic hurdles
- High tax levels

Developing SEZs

as WINDOWS to export oriented - globally integrated economy &

RADIATORS in accelerating the growth of the underdeveloped areas.