Issues & Studies 33, no. 6 (June 1997): 17-32.

Shanghai: The "Dragon Head" of China's Economy

Qi Luo

With a strong economic performance over recent years, Shanghai has risen to prominence again in the Chinese economic scene. However, its development has been marred by some major problems, including continued reliance on extensive rather than intensive growth; the poor performance of the state-owned enterprise sector; weak international competitiveness in the six "pillar industries"; a high level of unemployment; and overinvestment in Pudong's real estate sector, leading to considerable under-occupancy of buildings. In addition, many of the accomplishments achieved by Pudong and Shanghai as a whole over the years have been due largely to the central government's preferential policies. To become an international economic, trade, and financial center, it will not be sufficient for Shanghai to focus on the development of Pudong. More efforts should be made to achieve the globalization of production, distribution, and services throughout the city.

Keywords: Shanghai; preferential policy; six pillar industries; an international economic, trade, and financial center; globalization

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Shanghai lies on the eastern fringe of the Yangtze Delta, facing the East China Sea and the Hangzhou Bay to the east and south, and bordering Jiangsu and Zhejiang provinces on the west and southwest. It has a total area of 6,340.5 square kilometers, composed of 14 urban districts (Huangpu, Nanshi, Luwan, Xuhui, Jing'an, Changning, Putuo, Zhabei, Hongkou, Yangpu, Minhang, Baoshan, Jiading, and Pudong) and 6 suburban counties (Nanhui, Fengxian, Songjiang, Qingpu, Jinshan, and Chongming). The city center, or "old Shanghai," is situated on the west bank of the Huangpu River, or Puxi, while

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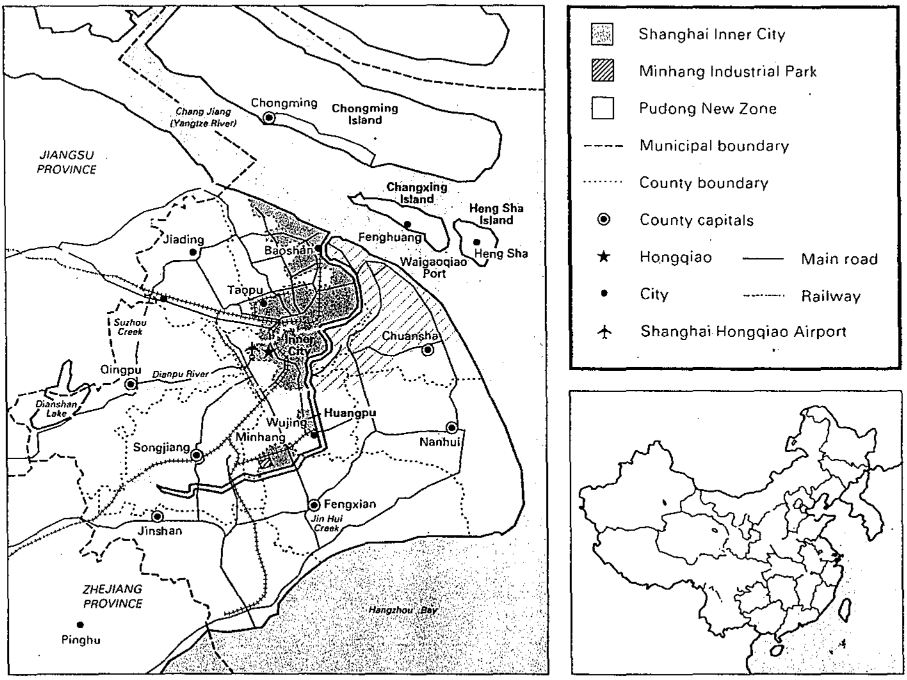
Map 1
Sketch Map of Shanghai



Source: HongkongBank China Services Limited, July 1996.

the new development area is on the east bank, or Pudong (see map 1). In 1995, the city had a population of just over 13 million, ranking as the fourth largest in the world. Traditionally, Shanghai has always been China's largest industrial and commercial city, but in the 1980s it lost its eminence to southern China, which emerged as the country's most dynamic regional economy.

Rising to Prominence Again

It is generally believed that the opening of the Pudong New Area in June 1990 marked an important shift in the regional development strategy of the Chinese leadership, which had always favored southern China for faster and more liberal economic expansion, especially the five special economic zones (SEZs—Shenzhen, Zhuhai, Shantou, Xiamen, and Hainan). Since that time, the central government has granted Pudong a series of preferential policies (*youhui zhengce*), some of which are said to be even more "radical" than the "special policies" (*teshu zhengce*) implemented in the SEZs, in order to accelerate its growth and hence enhance its role as the engine of Shanghai's development. But it was not until the Fourteenth Congress of the Chinese Communist Party (CCP) in October 1992 that Shanghai's key role in national economic development was finally confirmed. In his report to the congress, CCP General Secretary Jiang Zemin called upon Pudong to play the role of the "dragon head" (*longtou*) in developing Shanghai and the Yangtze River Delta Region. He also urged Shanghai to transform itself into an international economic, financial, and trade center by the early 2000s.[1]

Shanghai, on its part, responded to this call by producing rapid and yet steady economic growth in the Eighth Five-Year Plan period (1991-95), despite the implementation of a tight monetary policy nationwide. In particular, as can be seen in figure 1, between 1992 and 1995 the city's gross domestic product (GDP) expanded by more than 14 percent for four consecutive years, in sharp contrast to its performance for the previous six years (1986-91), when it trailed behind the national average growth rate. In 1995, the city contributed 4.2 percent of the country's total GDP, 8.7 percent of its exports, and one-tenth of the central government's revenue.[2] For the first half of 1996, the economy continued to expand robustly, with a growth rate of 12.1 percent, or 2 percentage points higher than the national level.[3]

The city has also witnessed a massive inflow of foreign capital since 1994. In particular, a 134 percent increase (see figure 2) was recorded in the first six months of 1996, compared with only 25 percent for the country as a whole. Unlike most regions in China, Shanghai's exports continued to expand during the first nine months of 1996, and its growth rate of 10.8 percent was among the highest in the country (see figure 3).

As a result of these strong performances in recent years, Shanghai's leading position in terms of several major economic indicators has either been restored or further strengthened. Table 1 shows that Shanghai was convincingly ahead of China's three other major industrial cities—Beijing, Tianjin, and Guangzhou—in all the indicators for 1995 except that of GDP per capita, where Shanghai was slightly behind

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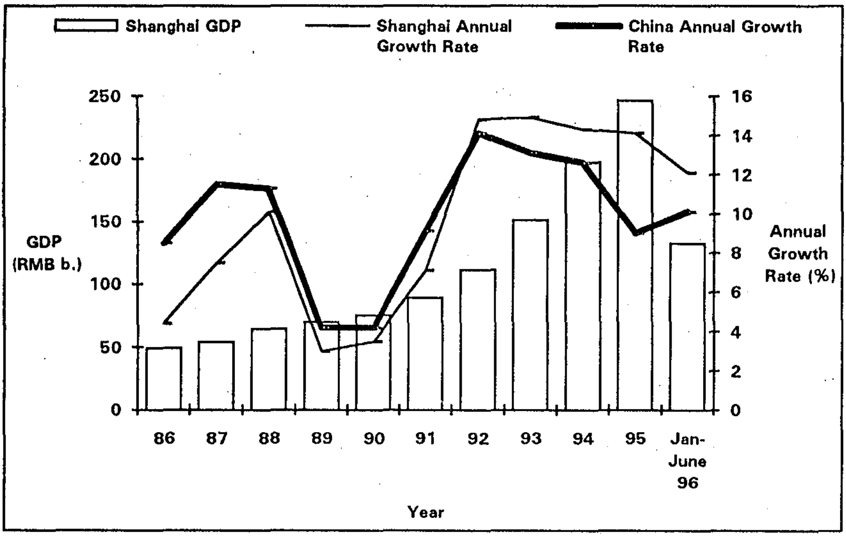
[1]*Zhongguo nianjian 1993* (China yearbook 1993), 15.

[2]*Zhongguo tongji nianjian 1996* (Statistical yearbook of China 1996), 43; *Shanghai Economic Focus* (Hong Kong), February 1996, 2; *Guoji maoyi* (Intertrade) (Beijing), March 1996, 64.

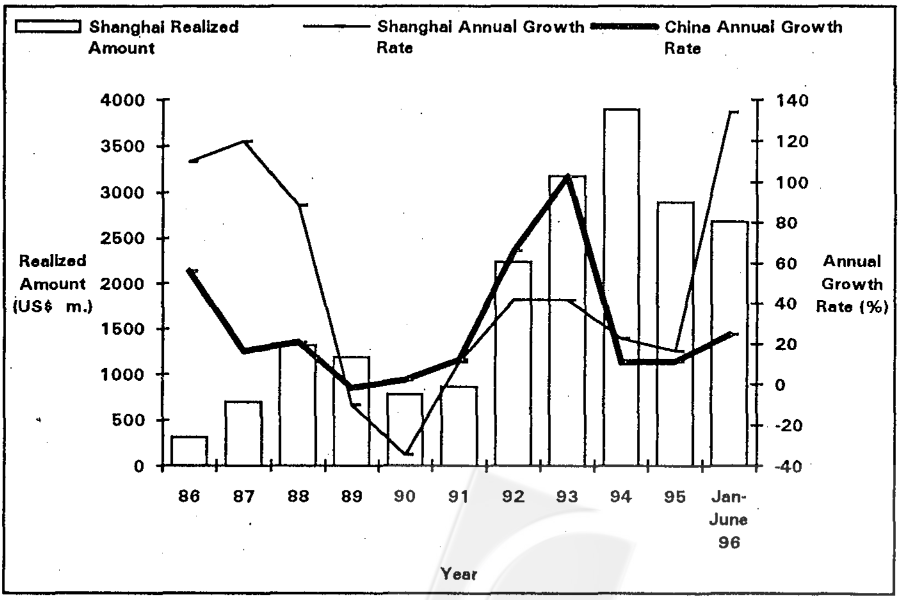
[3]*Shanghai Economic Focus*, July 1996, 3.

Figure 1
GDP Growth in Shanghai and China, 1986-June 1996



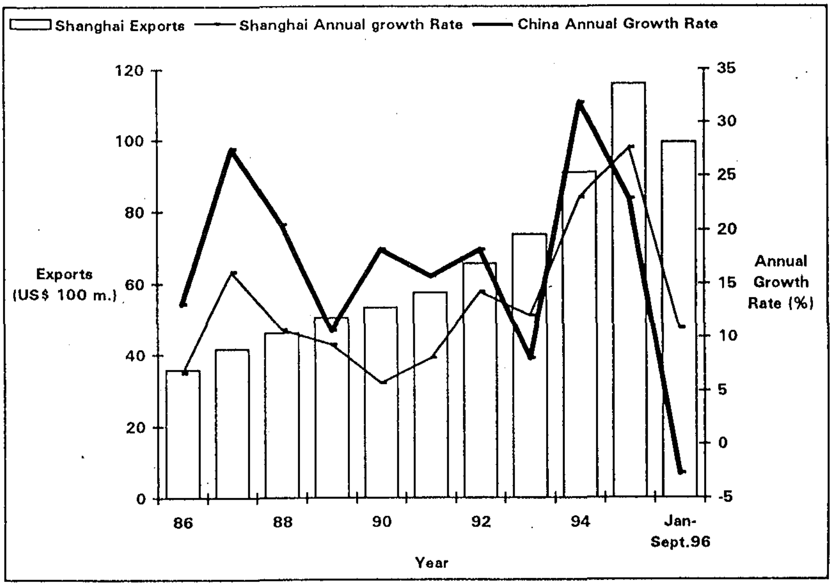
Sources: *Zhongguo tongji nianjian 1996* (Statistical yearbook of China 1996), 42; *Shanghai tongji nianjian 1995* (Statistical yearbook of Shanghai 1995), 20, 25; and *Shanghai Economic Focus*, July 1996, 3.

Figure 2
Growth of Realized Foreign Investments in Shanghai and China, 1986-June 1996



Sources: *Zhongguo tongji nianjian 1996*, 597; *Shanghai tongji nianjian 1995*, 23, 28; *Guoji maoyi* (Intertrade) (Beijing), 1995, no. 9:60 and 1996, no. 9:60.

Figure 3
Growth of Exports in Shanghai and China, 1986-September 1996



Sources: *Zhongguo tongji nianjian 1996*, 580; *Shanghai tongji nianjian 1995*, 23, 28; *China's Latest Economic Statistics* (Hong Kong), October 1996, 32; *Main Foreign Economic Data of the Coastland & Border Areas of China* (Shanghai), September 1996, 1.

Guangzhou. Today, Shanghai lies at the heart of the Chinese economic development strategy and with its political clout and economic muscle, nobody doubts its ability to regain its former status as a world-class metropolis in the near future.

Reasons for High and Steady Growth

How did Shanghai improve its economic performance so drastically over the past few years despite the seemingly adverse macroeconomic conditions? There seem to be three main reasons for this achievement.

The fast expansion of six pillar industries: During 1991-95, Shanghai's industry grew at an average of 17 percent each year and contributed nearly 70 percent to the city's newly-increased GDP. The driving force behind this impressive industrial growth has been the six important branches—automobiles, petrochemicals, power equipment, telecommunications, iron and steel, and domestic appliances. Together, they expanded at an average of more than 25 percent each year, lifting

Table 1
Major Economic Indicators for Shanghai, Beijing, Tianjin, and Guangzhou, 1995

	Shanghai	Beijing	Tianjin	Guangzhou
GDP (100 m. *yuan* at current price)	2,462.6	1,394.9	920.1	1,243.1
GDP per capita (*yuan*)	18,923	11,917	10,284	19,221
Total foreign trade	190.3	53.1	65.5	96.9
Exports (US$100 m)	115.8	22.7	30.0	62.5
Realized foreign investments (US$100 m.)	53.0	14.0	21.1	22.5
Capital investments (100 m. *yuan*)	1,601.8	841.1	393.2	618.3
Cargo handled by seaports (10,000 tons)	16,567	n.a.	5,787	8,340
Budgetary revenues (100 m. *yuan*)	227.3	115.3	61.9	97.1
Budgetary expenditures (100 m. *yuan*)	267.9	154.4	93.3	112.8
Consumer price index (previous year as 100)	118.7	117.3	115.3	113.5
Employed population (10,000 person)	794.2	665.3	515.3	391.4
Residents' savings (100 m. *yuan*)	1,396.2	1,254.0	550.0	961.5

Source: *Guangzhou tongji nianjian 1996* (Statistical yearbook of Guangzhou 1996), 43-44.

their combined share in Shanghai's total industrial output value from 31.4 percent in 1990 to 45.1 percent in 1995.[4]

The rapid development of the tertiary sector: The Chinese government's decision to designate Shanghai as an international economic,

[4]Shanghai Statistical Bureau, "Shanghai Economic Development: Features in 1995 and Trends for 1996," *Shanghai gaige* (Shanghai Reform) (Shanghai), February 1996, 5; Le Yanmin, "Developing Six Pillar Industries and Realizing Two Important Economic Transitions," *Shanghai jingji yanjiu* (Shanghai Economic Studies) (Shanghai), March 1996, 29.

trade, and financial center has attracted many foreign and domestic banks, financial companies, insurance companies, law firms, property developers, tourist agencies, and retail chain stores to the city. Today, Shanghai boasts the country's largest financial market, which includes 141 foreign financial institutions from 20 countries and regions. This has greatly boosted the sector's revenue, pushing its share in the city's total GDP to over 40 percent for the first time (in 1995). As a result, the tertiary sector contributed 28 percent to the city's GDP growth in 1995.[5]

The dynamic effects of foreign capital: By the end of June 1996, Shanghai had signed more than 13,000 contracts with foreign investors, with US$38 billion of foreign capital pledged and over US$17 billion actually invested. More importantly, about 200 of the world's 500 largest multinational corporations (MNCs) have begun to operate in the city.[6] Consequently, the average size of foreign direct investment (FDI) projects in Shanghai has become the largest in the country; for example, it reached US$5.2 million in the first half of 1996, compared with a mere US$2 million in Shenzhen over the same period.[7] Foreign capital has played a crucial role in Shanghai's development, contributing to one-third of the city's capital construction funds during the period 1991-95 and one-sixth of its total GDP in 1994.[8]

Problems and Challenges

The good news may not last long, however. In fact, GDP growth in 1996 dropped to 13 percent, according to the latest statistics.[9] Clearly, the poor performance of the export sector since the beginning of 1996 has taken some steam out of Shanghai's growth engine. However, what is more likely to hamper Shanghai's growth in the immediate future is the weak competitiveness of its manufacturing industry, especially the six pillar branches, which have expanded rapidly in recent

[5] "Shanghai Economic Development," 5.

[6] *Xinbao caijing xinwen* (Hong Kong Economic Journal) (Hong Kong), September 30, 1996, 10.

[7] *Guoji maoyi*, September 1996, 61.

[8] Zhou Zhenhua, "Priorities and Transition Modes for the Shanghai Economy," *Shanghai jingji yanjiu*, October 1996, 10.

[9] *Jiefang ribao* (Liberation Daily) (Shanghai), February 14, 1997, 11.

years due largely to fast-growing demands from the domestic market. That is to say, they have been basically substituting imports and hence generally lacked international competitiveness. For instance, nearly all products from the automotive industry, including cars, motorbikes, tractors, lorries, and engines, were sold to Chinese domestic consumers in 1994.[10] Furthermore, as most of the crucial technologies and equipment used in the six industries have been imported, the local users have not acquired the ability to develop and upgrade products independently. Another worry is that the pillar industries have been, to various degrees, supported and protected by the government.[11] Whether or not they can withstand direct and tough international competition after China joins the World Trade Organization (WTO) is therefore a serious concern. The Shanghai authorities must address this problem as soon as possible in order to avoid economic fluctuations in the future.

In addition, Shanghai's economic development during the first half of this decade also exhibited the following problems:

First, economic growth has still relied largely on the injection of new production factors. In recent years, the Shanghai government has launched a campaign to promote intensive, as opposed to extensive, growth, but only achieved limited progress so far. In 1995, for example, the city's capital investment in the technological innovation of existing enterprises increased by only 27.9 percent, whereas investment in the development of new projects increased by as much as 40.6 percent, causing the former's share in total capital investment to decline from the previous year's 19.5 percent to 17.8 percent.[12] One study estimates that 65-70 percent of the GDP growth in Shanghai over the last ten years has been due to the injection of new production factors, and only 30-35 percent due to the improvement of productivity.[13]

Second, the performance of state-owned enterprises (SOEs) has continued to deteriorate. As China's largest industrial city, Shanghai has a high concentration of SOEs in its economy. Despite a series of protectionist measures taken by the government, state-owned in-

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[10] *Shanghai jingji nianjian 1995* (Almanac of the Shanghai economy 1995), 184.

[11] Wang Xinkui, "Good and Bad News about the Fast Growth of Shanghai's Six Pillar Industries," *Lianhe Zaobao* (United Morning Post) (Singapore), August 4, 1996, 27.

[12] "Shanghai Economic Development," 6.

[13] Xiao Lin et al., "Basic Elements for the Transformation of Economic Growth Mode in Shanghai," *Shanghai gaige*, June 1996, 16.

dustrial enterprises as a whole grew by only 4 percent in 1995, or 13.4 percentage points lower than the city's total industrial growth. What is more, the number of unprofitable SOEs edged up to 577, accounting for 20.1 percent of the city's total, and their total losses reached 1.85 billion *yuan*, accounting for 50 percent of the city's total.[14] In particular, the small-sized SOEs, which numbered over 1,500 and employed 346,600 workers and staff (10 percent of the city's total industrial work force), have been the most problematic. In 1995, their average profits per employee was only 317 *yuan*, in contrast to the city's average of 7,531 *yuan*.[15]

Third, the structure of FDI has been far from ideal. Although Shanghai has succeeded in attracting a higher proportion of MNCs than the SEZs, 34 out of the 78 projects invested by MNCs in 1995 were actually set up by their overseas subsidiaries instead of their parent corporations. Only three projects had a capital of over US$100 million, and the smallest project was valued at only US$700,000.[16]

At the same time, many investors, especially those from Hong Kong, have rushed to Shanghai's property market. By the end of 1995, as much as 46.3 percent of the total accumulative foreign capital in the tertiary sector was invested in the real estate sector, with only 6.5 percent for transport, post and telecommunications, and storage services.[17] As a result, too many skyscrapers have been built, leading to an excessive supply of office space. Despite the high development costs of 800 million *yuan* per square kilometer, about 30 percent of newly-completed buildings failed to be leased out in 1995.[18] This situation was particularly serious in Lujiazui and Waigaoqiao, where there were many empty blocks and buildings.[19]

Finally, drastic economic reorganization and rapid social changes in recent years have led to a sharp increase in Shanghai's unemployed population. While the official unemployment rate for 1996 stood at

[14]"Shanghai Economic Development," 6.

[15]Zhou Xiaomen, "Opinions and Suggestions on the Deepening of State-Owned Enterprise Reform in Shanghai," *Shanghai jingji yanjiu*, August 1996, 36.

[16]Xia Xiaofei and Zhu Wenfei, "The Investment and Operation of MNCs in Pudong," ibid., May 1996, 31.

[17]*Shanghai tongji nianjian 1996*, 127.

[18]Zhang Guohua, "1996: Shanghai's Economic Development," *Shanghai jingji yanjiu*, January-February 1996, 61.

[19]Zhang Youwen, "Time to Change the Development Strategy of Pudong," *Shanghai jingji* (The Shanghai Economy) (Shanghai), May 1996, 7.

4 percent, according to Shanghai mayor Xu Kuangdi, an additional 8 percent should also be taken into account, as there is a portion of the work force which, though still on company payrolls, have no tasks to perform. The combined rate of 12 percent puts Shanghai's current unemployment at 1.6 million. Independent observers, however, estimate the rate to be as high as 20 percent, as in most places of China.[20] Inevitably, living standards for unemployed workers and pensioners have dropped considerably. In 1990, the consumption level for low-income families was only 40 percent of that for high-income ones; and by 1995, this ratio dropped further to 25 percent.[21]

Pudong: Still Some Way from Being the "Dragon Head"

The Pudong New Area is a large, triangular area separated from the inner center (old Shanghai) by the Huangpu River, with a total area of 522.75 square kilometers, or 8.2 percent of the whole city (see map 1). It consists of 11 subdistricts (32.96 sq km), 5 towns (34.17 sq km), and 27 townships (454.11 sq km), and had a registered population of 1.49 million at the end of 1995, or 11.4 percent of the city's total.[22]

With the fading of the original five SEZs, Pudong has quickly emerged as the nation's new model for development. At the moment, Pudong is concentrating its resources on the development of four zones with different functions: the Lujiazui Finance and Trade Zone (28 sq km), the Jinqiao Export Processing Zone (19.5 sq km), the Waigaoqiao Free Trade Zone (10 sq km), and the Zhangjiang Hi-Tech Park (17 sq km). As can be seen from table 2, during 1991-95, the area's GDP grew at an average of 23 percent per annum, or 10 percentage points higher than that for the whole of Shanghai over the same period. It has promoted Shanghai's economic growth by contributing nearly 17 percent of the city's total GDP, over one-fifth of its industrial output and exports, and more than a quarter of its total committed foreign investment in 1995. In particular, the area has attracted a large

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[20]*The China Diary* (Weekly) (Singapore), Issue 2, November 1996, 3.

[21]"Shanghai Economic Development," 6.

[22]*Shanghai Pudong xinqu tongji nianjian 1996* (Statistical yearbook of the Shanghai Pudong new area 1996), 14.

Table 2
Key Economic Indicators for the Pudong New Area, 1991-95

	1995 Record	% of Shanghai	Change over 1994 (%)	Average Growth Rate (1991-95) (%)
GDP	41,465 (m. *yuan*)	16.8	22.0	23.0
GDP per capita	27,898 (m. *yuan*)	147.4	40.1	44.0
Gross value of industrial output	112,222 (m. *yuan*)	21.4	19.3	20.4
Pledged foreign investment	3,256 (US$ m.)	25.9	25.6	148.4
Exports	2,475 (US$ m.)	21.4	37.5	56.3 (1993-95)
Capital investment	28,507 (m. *yuan*)	17.8	9.2	82.3
Total retail sales	11,000 (m. *yuan*)	11.3	32.9	50.4
Cargo handled by seaports	60.22 (m. tons)	36.3	–27.6	–2.5

Source: *Shanghai Pudong xinqu tongji nianjian 1996* (Statistical yearbook of the Shanghai Pudong new area 1996), 9-23.

number of the world's leading MNCs, which have had an eye on entering China's domestic market, instead of just making use of its cheap laborers.[23]

Pudong's approach to development has been quite different from that of the SEZs. It has succeeded in creating a strong impetus for expansion, but also sown the seeds of problems for development in later stages. When the Pudong New Area was first opened, the local authorities tried to raise funds for initial investment by turning the area

[23]The big names include AT&T; Ford; IBM; Hughes; Du Pont; Rosemount; Allied Signal; Crown; Molex; JVC; National; Hitachi; Xerox; Ricoh; Fujita; Mitsubishi; OMRON; Sumitomo; Johnson & Johnson; Coca-Cola; Pepsi; Sandoz; Unilever; Siemens; GPT; Christian; Rhone-Poulens; Schindler; Philips; BASF; Inchcape; GoldStar; etc.

into a giant real estate playground. Land was leased out in batches, banked, and then transferred at heavily inflated prices to eager foreign investors, especially savvy Hong Kong property developers. As a result, land prices rocketed, hitting US$190 per square meter at their peak.[24] Although the prices have decreased recently, they must be maintained at a high level because too many parties have spent too much money in property speculation, and hence nobody can afford to allow prices to come down.

This "land rolling" (*tudi gundong*) strategy, as it is called locally, has brought the authorities a huge amount of capital necessary for initial development, resulting in hundreds of impressive skyscrapers and scores of new roads, bridges, and water and power supply facilities in the area in a short period of time. Indeed, in terms of speed and quality of infrastructure development, Pudong has performed better than the SEZs, but at a price. The high property prices and rentals have become so unbearable for established foreign investors that some of them have reportedly moved out of the area in search of better locations. In fact, other areas around Shanghai with much lower start-up costs have proven to be very attractive for foreign investors. For example, Nestle and Ford have decided against Pudong as a site for their joint ventures in China (a large foodstuff factory and a US$2 billion car plant, respectively). Instead, they chose Songjiang, a county-level zone and an hour's drive from Shanghai.[25]

In addition, Pudong's development has been marred by at least four problems.

An excessive role for foreign investors in the management of MNCs: A survey shows that 64 out of the 78 MNC projects already set up in the area have been, to various degrees, controlled by foreign investors. Even in companies where foreign investors are minority shareholders, they have still held more key positions than their Chinese partners. Typically, foreigners have been holding such positions as managing director, marketing director, supply/procurement director, and finance director.

This domination has led to two further problems: minimal technology transfer and demonstration effects; and the practice of transfer pricing, whereby MNCs have overpriced input procured from and

[24] *Business China*, October 16, 1995, 2. In contrast, in 1990 a square meter of land in Shanghai cost only US$25. See *Business Times*, September 8, 1995, 1.

[25] *Business Times*, September 8, 1995, 1; and *Business China*, October 2, 1995, 5.

underpriced output sold to their overseas parent corporations and/or subsidiaries. To maximize their gains, some companies have even insisted on importing all inputs in order to, as they put, "guarantee the quality of inputs."[26] Apparently, the local authorities have been aware of these problems but have not found an effective way of dealing with them.

Rising wages: At present, an unskilled worker in Pudong has to be paid 1,000 *yuan* a month, and with this, plus benefits and payments to the local foreign labor service company, his monthly wage could easily amount to 2,000 *yuan*, a figure totally unthinkable just a few years ago.[27] Obviously, this is also a deterrent to foreign companies planning to invest in Pudong.

Poor public transport links: Although a large amount of money has been spent in improving infrastructure facilities, the public transport system in Shanghai is still inadequate. Ordinary workers living in Puxi often take two hours or more to struggle, normally in an overcrowded bus, to work. Companies already located in Pudong have found it hard to recruit and retain good staff, while those intending to move from Puxi to Pudong face the prospect of losing some of their employees.[28]

Inadequate coordination between the development of Puxi's bund area and that of Pudong's Lujiazui Financial Zone: According to the city's grand plan, both the bund area and the Lujiazui Zone will be developed as the city's central business district, and the financial institutions currently located in the bund area will be gradually moved to Lujiazui. But the two areas, under different administrative authorities, have actually been competing with each other in attracting foreign financial institutions, which have often been confused by different preferential terms offered by the two separate authorities.[29] Obviously, this will retard the process of turning Lujiazui into Shanghai's new financial center and the centerpiece of Pudong for the next century.

Important Lessons

As the country's most powerful growth engine, Shanghai will

[26]Xia and Zhu, "The Investment and Operation of MNCs in Pudong," 30-32.
[27]*Business China*, October 2, 1995, 1.
[28]Ibid., October 16, 1995, 3.
[29]Wan Zhenrong et al., "A Study on the Development of Pudong's Different Functions," *Shanghai jingji*, April 1996, 10.

play a key role in leading China into the next century, and Pudong, as the officially designated "dragon head" of Shanghai and other Yangtze River regions, thus bears the brunt of this great responsibility. But if Shanghai is to become an international economic, financial, and trade center, it will simply not be sufficient to focus on the development of Pudong. More efforts should be made to create an environment of fair competition, an effective legal framework, an efficient government, and a thriving entrepreneurial society. Above all, Shanghai must achieve the globalization of production, distribution, and services. In this regard, Shanghai still has a long way to go before catching up with Hong Kong and Singapore.

From a strategic point of view, choosing relatively empty Pudong instead of the crowded Puxi or "old Shanghai" as the city's new growth center was certainly a wise decision. The potential for Pudong to create a superior infrastructure is unlimited, and the achievements over the last five years indicate that Pudong has the capability to deliver on this potential. Of course, whether or not the Lujiazui Financial Zone can become mainland China's Wall Street critically depends on whether or not *renminbi* can become fully convertible in the near future. The relationship between the People's Bank of China, the country's central bank, and other Chinese and foreign banks and financial institutions will also be a significant determinant. To facilitate the transition, it may be more important for the central bank to grant other banks and institutions greater autonomy in running their own businesses rather than offering them various preferential terms. In this regard, the People's Bank of China has much to learn from its counterpart in Hong Kong—the Hong Kong Monetary Authority.

As revealed by the above examination, Pudong's development has not been flawless. While the comment that "Pudong represents the best and worst of China's approach to development" may be a bit exaggerated, Pudong's experience can certainly serve as a good reference for authorities in China's open areas, especially the SEZs.[30] It seems that at least three important lessons can be drawn from Pudong's experience.

The danger of becoming a victim of fame: Obviously, the growing importance of Pudong and Shanghai as a whole is linked with the rising power of the so-called "Shanghai clique" (*Shanghai bang*) within

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[30]For the comment, see *Business China*, October 16, 1995, 1.

the present Chinese leadership, including Jiang Zemin, Zhu Rongji, and Wu Bangguo, who have all served as the mayor of Shanghai in the past. Beijing's favoritism and unwavering support for Pudong has raised the latter's status dramatically, especially vis-à-vis the SEZs, and attracted a great deal of enthusiasm from foreign and domestic investors. However, too much central attention and heavy state involvement in Pudong may result in the development of bureaucratic state capitalism, which tends to reduce government efficiency by ignoring market forces. In fact, investors have already found that Pudong has been puffed up so much that its administration has become increasingly "arrogant and difficult to approach." The disdain held by the local government toward prospective investors, especially smaller or lesser-known companies, has driven many businesses to other parts of Shanghai or the country.[31]

The drawback of the "land rolling" strategy: As discussed above, Pudong has quickly fallen into the trap of the "land rolling" strategy—infrastructure may be completed quickly, but sky-high land prices and rentals have deterred many potential investors, causing a large number of empty blocks and buildings in the area.

The limitations of preferential policies: Just as "special policies" have played a role in the success of the SEZs, the central government's preferential policies have been responsible for most of Pudong's achievements. Although largely in line with the "special policies," the preferential policies do contain some more liberal elements, especially in terms of opening financial and banking, trade, and real estate sectors to foreign investors.[32] However, Pudong should realize that the implementation of the policy and its effects will be short-lived, since the policy will either be abolished or heavily curtailed once China joins the WTO, which nullifies the granting of preferential treatments with a discriminative nature to either foreign or domestic companies

[31]*Business China*, October 2, 1995, 2; October 16, 1995, 2.

[32]For example, most of the recently announced preferential measures for Pudong have not been implemented in the SEZs. These measures include: (1) companies set up by other Chinese regions in Pudong being allowed, under certain circumstances, to deal in foreign trade businesses; (2) a few Sino-foreign joint foreign trade companies being set up on a trial basis; (3) the Waigaoqiao Bonded Zone being allowed to conduct any bonded business, except for retail activities; (4) a few foreign banks being allowed to conduct *renminbi* business; and (5) more foreign wholly-owned and Sino-foreign joint insurance companies being allowed to set up as soon as conditions permit. For details, see Pudong Reform and Development Topic Team, "A Study on the Policy Environment in Pudong," *Shanghai jingji*, April 1996, 13-14.

by member states. Recent improvement in the Sino-U.S. relationship clearly hints that China's entry into the WTO will take place soon, even if it will not be easier. Even if China remains outside the WTO for the time being, the central government will find it difficult to allow Pudong to continue to enjoy preferential policies while (as it is planning to do now) gradually phasing out "special policies" in the SEZs.

This means that, whatever happens, Pudong's policy advantage over other Chinese regions is only temporary, and it will have to rely mainly on its own resources to continue its economic growth in the future. It is important to understand that preferential policies cannot substitute for real economic reform and concessionary terms cannot add up to a market economy. In this sense, the real challenge facing Pudong and Shanghai as a whole has yet to come.