

Foreign Direct Investment In China: What the Figures Don't Tell Us

In the now considerable literature on Foreign Direct Investment (FDI) in China, one of the recurring themes is to emphasise the significance of “Chinese” investment into the PRC. Be it investment from “Chinese” states such as Hong Kong, Macao, Taiwan or Singapore, or by the huauqiao and the Chinese diaspora in other states, the significance of such Chinese investment is indeed considerable. But in recent years, the share of investment from Latin America has increased dramatically, to the point that Latin American investment exceeds investment from North America and also from Europe. Almost all of this Latin American investment comes from the British Virgin Islands, (now the second largest investor in China) and the Cayman Islands (now eighth), and the majority is widely accepted to originate in Hong Kong and Taiwan. So if we can discount investment from the Virgin Islands as really originating in the Virgin Islands, how can we rely on bilateral figures as an indicator of who is investing in China?

As such, the purpose of this paper is to question the extent to which this Chinese investment is really “Chinese” in origin, and the extent to which using bilateral figures underplays the significance of the global dynamics of inter-regional economic interaction in East Asia. It is widely recognised that bilateral trade figures distort an understanding of the real direction of Chinese trade – in great part because of the continuing role of Hong Kong as a conduit between China and the rest of the world. In a similar vein, I argue that we need to disaggregate investment figures and consider the implications of Post-Fordist production networks and trans (and multi) national capital flows. By doing so, the significance of “national” or “territorial” conceptions

of investment (and trade¹) declines, and a greater emphasis is placed on the role of non-state actors in “commodity driven production networks” and “contract manufacturing companies” that are both transnational in nature.

As such, I argue that the dominant literature on investment in China over-emphasises the significance of intra-regional investment in general, and investment in what has come to be known as “Greater China” in particular. This is not to say that the regional dynamic is unimportant – far from it. But it is to suggest that regional processes of integration are themselves dependent on extra-regional actors and processes.

Beyond Bilateralism

It has always been the case that students of Chinese trade could not simply rely on bilateral figures to really understand the origin and destination of Chinese trade. The special role of Hong Kong as a transit point for Chinese imports and exports makes bilateral figures all but useless in trying to determine the real importance of other states for Chinese trade. Hong Kong’s position as a link between China and the world has declined slightly in recent years as trade has followed investment further north along the Chinese coast to Shanghai, Dalian and so on. Nevertheless, it remains a key element of China’s trade regime – and a dominant element in Hong Kong’s evolving position as a global city as the sheer fact that Hong Kong’s trade to GDP rate is around 259 per cent perhaps indicates. According to statistics collected by the Hong Kong Customs and Excise Department, the value of Hong Kong's re-exports grew

¹ Though this is not the focus of this paper.

from \$535 billion \$13,270 billion in the decade from 1991 - an average annual growth rate of 10 per cent².

Thanks to the statistics collected in Hong Kong we do have some ability to disaggregate Chinese trade that passes through Hong Kong and work out the real direction of trade. According to Hong Kong customs statistics, the percentage of re-exports to imports in 2001 was 84.65 per cent, with the percentage for consumer goods reaching 105.01 per cent. Hanson and Feenstra calculate that between 1988 and 1998, just over half of all Chinese exports were routed through Hong Kong³.

But even with the relatively sophisticated data available in Hong Kong, it is still difficult to get precise figures. There are a number of reasons for this statistical uncertainty. First, we need to consider the extent to which goods are “round-tripped” from China into Hong Kong and then back into China again to take advantage of tax and other incentives for foreign investors. Second, there is the related issue of trade fraud and smuggling. As Chinese producers can claim a 15 per cent VAT rebate for exports, there is an incentive for producers to overstate the value of exports, or even to totally fabricate exports:

“many Chinese firms claim export rebates by producing fake tax receipts, export orders and customs papers. Having claimed the rebate, goods are often sold on the domestic market. "This is quite a common practice," said one former executive of a Chinese tobacco firm who asked not to be identified.

² Figures from Hong Kong Government Information Centre.

³ Hanson, Gordon and Feenstra, Robert (2001) “Intermediaries in Entrepôt Trade: Hong Kong Re-Exports of Chinese Goods” NBER Working Paper 8088: 2.

"You simply sort out the export papers and then sell the stuff on the domestic market. It's money for nothing."⁴

As of March 2001, Chinese officials were investigating cases in 11 provinces with a total estimated fraud of US\$6 billion. In Guangdong province, export rebate claims increased by 185 percent in the first half of 2000 – a figure that was far from matched by the real value of provincial exports.

The flip side of the coin is that much trade goes un-reported because of smuggling. The highest profile case uncovered to date in Fujian Province suggest that between 1996 and the first half of 1999, provincial officials conspired to smuggle more than 4.5 million tons of refined oil, more than 450,000 tons of vegetable oil, more than three million cases of cigarettes, 3,588 automobiles and large amounts of raw materials for manufacturing Western medicines, chemicals, textiles, and electro-mechanical goods, with the total value of US\$ 6.38⁵. Chinese customs officials investigated 9,818 smuggling cases in 2002 alone, involving US\$637.6 million of fraud and 3,491 individuals⁶

Third, goods that are re-exported through Hong Kong from Taiwan often themselves originate in third countries, or are subsequently re-exported from Taiwan to other destinations. This issue is closely related to Taiwan's position in global production chains – a matter we will return to later.

⁴ "China investigates multi-billion dollar tax rebates fraud" Taipei Times, 3 March 2001.

⁵ The officials included the former Vice Minister of Public Security, the deputy Party secretary of Xiamen City, the vice mayor of Xiamen, the head and deputy head of the Xiamen Customs, the deputy director of the provincial public security department, the president and deputy president of Fujian Provincial Branch of the Bank of China; and the president of the Xiamen Municipal Branch of the Industrial and Commercial Bank of China.

⁶ "wo guo qunian waimao zongzhi tupo 6200 yi meiyuan (Chinese Foreign Trade Reached US\$620 billion last year)" in *Renmin Ribao (People's Daily)* 10 Jan 2003: 1.

Finally, there is the issue of the extent to which goods in transit through Hong Kong count as Chinese re-exports, or exports from Hong Kong. Re-exports are defined as where Hong Kong actors have “not changed permanently the shape, nature, form or utility of the basic materials used in manufacture”. Thus, value added of re-exports in Hong Kong can simply take the form of a mark up in prices, or shipping and insurance costs, or minor additions such as packaging. Such value added can be considerable. Hanson and Feenstra calculate that the average value added whilst in Hong Kong was 24% of the value of the good, accounting for 10 per cent of Hong Kong’s GDP⁷. Chinese figures, however, suggest that on average, once the good leaves China, there is an extra 40.7 per cent value-added in the third place, and in the case of toys and textiles, the subsequent value added even exceeds 100 per cent – a disparity which is largely a consequence of transportation costs from Hong Kong to the final market. Thus, China calculates that 60 per cent of exports to the US pass through a third place on route - primarily Hong Kong – while the US claims it is 80 per cent.

As Chinese customs statistics value the goods as they leave China, and importers value the goods as they arrive at their market, there can be massive disparities between bilateral export and import figures. As Feenstra et al note:

“It is quite incredible that while the negotiations of China’s accession to the World Trade Organisation (WTO) are greatly influenced by the deficit that the

⁷ Hanson, Gordon and Feenstra, Robert (2001) “Intermediaries in Entrepôt Trade: Hong Kong Re-Exports of Chinese Goods” NBER Working Paper 8088: 2.

United States runs in its trade with China, the actual size of the US-China bilateral trade deficit is not actually known!”⁸

For example, according to US official estimates, the US-China trade imbalance in 1998 was around US\$57 billion while Chinese official data showed an imbalance of “only” US\$21 billion⁹. Feng and Liu (1999) have recalculated Sino-American trade taking into account the difference between FOB and CIF prices, re-exports through Hong Kong, and smuggling. They conclude that the Sino-US trade imbalance in 1998 was around US\$35 billion – almost (but not quite) half-way between the Chinese and American figures¹⁰, which still leaves billions of dollars unaccounted for.

These discrepancies are not just a matter of statistical interest. As Chinese exports have boomed, so trade friction has increased between China and the US in particular, and the West in general, impacting on negotiations over the conditions of China’s WTO entry. And the size and importance (or otherwise) of China's trade surplus with the West varies depending on which figures you use. Thus, the Chinese authorities are accused by some in the West of deliberately deflating the importance of Chinese trade, while some Chinese accuse the West of unfairly exaggerating the significance of Chinese exports. Or as the Minister of Foreign Economics and Trade (now Cooperation), Li Lanqing, put it when Western governments questioned Chinese trade figures in 1992:

⁸ Robert C. Feenstra, Wen Hai, Wing T. Woo and Shunli Yao (1998) “The u.s.-china bilateral trade balance: Its size and determinants” University of California Davis Department of Economics Working Paper 98-09: 1.

⁹ And while trade with the US dominates discussions within China, similar discrepancies can be found in bilateral trade with virtually every nation - while China reported a US\$1473 million trade deficit with Germany in 1996, Germany reported that China had a US\$4690 million surplus. *Zhongguo Tongji Nianjian (China Statistical Yearbook)*, Beijing: China Statistical Information and Consultancy Service Centre, 1997, and *IMF Direction Of Trade Statistics Yearbook*, Washington, DC: International Monetary Fund, 1997.

¹⁰ Feng Guozhao and Liu Zunyi (1999) “A New Estimation on the Trade Imbalance Between America and China”, *International Economic Review (Guoji Jingji Pinglun)* (5-6).

We are of the view that these trade imbalances [are] caused mainly by *unreasonable* methods of keeping international trade statistics” [emphasis added] (Chen, 1993: 15)

What the Figures Do Tell Us

For the purpose of this paper, the inconsistencies in trade figures simply show how difficult it is to really know who is trading what with who, even when we have fairly reliable customs statistics. Furthermore, the relationship between investment and trade is a particularly notable feature of China’s re-engagement with the global economy. The extent to which trade through Hong Kong originates and ends in third countries gives an indication of the complexity of transnational nature of Chinese trade, and the problems of deploying purely bilateral perspectives.

There is a considerable literature on the investment and the trade-investment linkage in China¹¹. Those readers familiar with the literature on China might want to simply skip over this section. At the risk of oversimplification, the main findings of this literature can be summarised as follows.

Growth of investment

China became the second biggest recipient of FDI in the world after the United States in the 1990s, and FDI has grown more than twenty-fold since the beginning of reform period. In 2002, China actually surpassed the US as the world’s major recipient of FDI¹². Cumulative FDI in China in the reform period exceeded US\$400 billion at the start of 2003, and China accounts for something like 20 per cent of global FDI in

¹¹ Add details here.

developing countries. There have been four major turning points in China's policy towards FDI. At the risk of further oversimplification, we can divide the opening of China into four stages. The first, from 1978 to 1986 marked the gradual opening of parts of China to the global economy¹³. Following the Third Plenum, China opened four Special Economic Zones with the freedom to conduct international economic relations¹⁴. At the Fifth National People's Congress in July 1979, the government passed a supporting law that provided a legal basis for the existence of joint ventures and foreign investment. These SEZs were conceived as "windows on the world" for China – allowing international economic contacts to grow, but limiting them to specific areas to allay fears from political conservatives that such contact would lead to bourgeois spiritual pollution¹⁵. The initial success of these SEZs in attracting investment resulted in considerable lobbying from other coastal cities to be allowed the same access to the global economy. For example, after an inspection tour by Deng Xiaoping to the South in February 1984, the government decided to open five more cities to trade. But during a special State Council and Secretariat forum, representatives from other cities argued their case, resulting in a total of 14 cities being opened up¹⁶.

The second key change came in 1986, with what has now come to be known as the "twenty-two regulations". These regulations created a more beneficial environment for foreign investors including lower fees for labour and rent, tax rebates for

¹² "China to Draw US\$50bn FDI, to be World's No 1 Recipient" *People's Daily*, 5 December 2002.

¹³ Howell, Jude (1993) *China Opens Its Doors - The Politics Of Economic Transition*, Boulder, Co: Harvester Wheatsheaf.

¹⁴ Zhuhai, Shantou, Xiamen and Shenzhen. Hainan Island was later added as the fifth.

¹⁵ Bachman, David (1988) "Varieties of Chinese Conservatism and the Fall of Hu Yaobang" in *The Journal of Northeast Asian Studies*, Spring: 22-46.

¹⁶ Hamrin, Carol (1990) *China and the Challenge of the Future*, Westview: Boulder: 83.

exporters, and made it possible for foreign companies to convert renminbi into foreign exchange and repatriate profits. It also extended the joint venture contracts beyond the original 50 year limit, and created a legal basis for wholly foreign owned enterprises (rather than investors having to sign a joint venture with a Chinese partner). This move considerably increased the attraction of investing in China to produce exports for other markets. While foreign invested enterprises only accounted for two per cent of exports and six per cent of imports before 1986, the figure increased to 48 per cent and 52 per cent respectively by 2000¹⁷.

The third turning point came in 1992. From 1989, Premier Li Peng instituted a retrenchment policy, with a limited reversal of reform in an attempt to bring inflation under control. China's international image was also somewhat tarnished by the 1989 Tiananmen incident, and the resulting "conservative" wind in policy. In a tour of southern China in 1992 (the *nan xun*) Deng Xiaoping effectively set policy in an ad hoc manner (Deng held no formal position of authority at the time) praising the emergence of proto-capitalist practices in open areas and calling for a new policy of rapid economic reform and further opening. Following Deng's exhortations, the Party Congress in October 1992 formally declared that China now had a "socialist market economy". There was more FDI into China in 1993 than in the entire preceding years of reform put together, and following the devaluation of the renminbi in 1994, producing for export in China became increasingly attractive¹⁸.

¹⁷ Braundstein, Elissa and Epstein, Gerald (2002) "Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?", CEPA Working Papers 2002-13, Center for Economic Policy Analysis (CEPA), New School University: 23

¹⁸ For some observers like Makin and Bergsten, this devaluation was the starting point for regional financial chaos that resulted in the financial crises of 1997. But in reality, the headline figure of a 50 per cent devaluation misses the point that most companies were already using the market rate for the majority of their foreign currency trading. As such, the headline 50 per cent devaluation was probably nearer 20-30 per cent for most exporters - and Fernald, Edison, and Loungani put the figure at a mere seven per cent. See Makin, John

The fourth key change came with China's entry into the WTO at the Dohar Ministerial meeting in 2001. Following WTO entry, China attracted a record of US\$52.7 billion in foreign direct investment in 2002. Chinese officials forecast that FDI will double to reach US\$100 billion in every year of the 11th Five-Year Plan period (2006-10)¹⁹. In particular, WTO entry is expected to increase investment aimed at accessing the Chinese market, particularly in banking, tourism, commerce, hospitals and education as China gradually lifts its restrictions on foreign investment in line with its WTO agreements. Nevertheless, the evidence from the first year of WTO entry is that export based investment continues to dominate²⁰.

Type of investment

FDI into China takes two forms – market accessing investment and investment for export production. The latter dominates FDI into China, accounting for at least two-thirds of all FDI. Until China's WTO entry, China ran a dualistic trade regime, with a relatively closed and protected domestic market and a relatively liberal export promotion regime²¹. Prior to WTO entry, some 40 per cent of imports entered China tax free in the shape of components to be processed for exports²². Foreign invested firms account for just over half of all Chinese trade. If we add domestic Chinese

(1997), "Two New Paradigms." American Enterprise Institute, (October); Bergsten, C. Fred (1997). "The Asian Monetary Crisis: Proposed Remedies," prepared remarks to the U.S. House of Representatives Committee on Banking and Financial Services, November 13; and Fernald, John, Edison, Hali and Loungani, Prakash (1998) "Was China the First Domino? Assessing Links between China and the Rest of Emerging Asia" Board of Governors of the Federal Reserve System International Finance Discussion Paper Number 604 March 1998: 2-3.

¹⁹ "Annual FDI to China Expected to Reach US\$100 Billion" *People's Daily*, 2 January 2003.

²⁰ "FDI in China surges despite weak global economy" *China Daily*, 18 February 2003.

²¹ Perhaps the best description of this dualistic system is Barry Naughton (2000) "China's Trade Regime at the end of the 1990s" in Carpenter, Ted and Dorn, James (eds) *China's Future: Constructive Partner or Emerging Threat?* (Washington DC: Cato Institute).

producers who produce under contract for export using foreign components, then the figure gets closer to 60 per cent²³.

Typically, the value added within China is relatively low in these export oriented FIEs. In an early work on FDI in China, Lardy (1994) calculated that imported components typically accounted for 90 per cent of the value of exports from FIEs²⁴. In 2000, the value of imports of foreign invested enterprises was 98 per cent of the value of exports - indeed, 1998 was the first year that the value of exports from FIEs actually surpassed the value of their imports - though this is a very rough indicator as it includes all imports, not just those used to produce exports. If we just look at the processing trade alone, then the figures show that imports accounted for 86.5 per cent of the value of FIE processing trade exports in 2000²⁵.

Despite the introduction of stock markets, and the ability of foreigners to buy B-shares, the overwhelming majority of this FDI is in productive capacity. The still relatively closed nature of the Chinese financial sector combined with lack of currency convertibility makes portfolio investments both difficult and unattractive.

²² Nicholas Lardy (2002) *Integrating China into the Global Economy* (Washington DC: Brookings): 36

²³ "Statistical Data" *China & World Economy* No 1, 2000: 57-61 Oct 2002.

²⁴ Lardy, Nicholas (1994) *China and the World Economy*, Washington: Institute for International Economics. This may partly be explained by transfer pricing. Despite considerable liberalisation in China, many foreign companies still face problems in repatriating profits due to incomplete currency convertibility and the imposition of myriad *ad hoc* charges on the profits of foreign funded enterprises. Furthermore, those foreign interests operating Joint Ventures with Chinese companies or local authorities have to share a proportion of any profits with their Chinese partners. As such, it would be rational for foreign companies operating in China to locate as much of their profits as possible in operations outside China by overcharging factories in China for imported components supplied by factories in other countries.

²⁵ Figures from China Association of Enterprises with Foreign Investment on <http://www.etisu.com/>

“foreign portfolio investment, compensation trade, international leasing and processing assembly, has accounted for 4.81 percent of cumulated foreign capital inflows between 1979 and 2000”²⁶

As China increasingly issues foreign bonds to fund a growing budget deficit, “financial” investment might increase in the future²⁷.

Around 65 per cent of FDI takes the form of contractual or equity joint ventures with Chinese companies. However, wholly foreign owned enterprises are now increasing their share, and account for roughly a third of the total. The primary sector accounts for only 2-4 per cent of FDI, the tertiary sector around 24-28 per cent (mostly in real estate), with the remaining vast majority in manufacturing. If we break down the manufacturing sector, then the majority of FDI goes into textiles, apparel and footwear, for the production of toys, and the production of electronic goods. It is this last sector where FDI is growing fastest, with a particularly striking growth of FDI in computer related manufacturing for export. Only three of the top 20 FIE exporters are not in electronic related manufacturing.

Determinants of Investment

Taking note of the dualistic basis of FDI into China, the determinants of FDI also need to be divided into two. For market-based investment, the main determinant is the size of the Chinese economy, and the prospects for future developments. While market-based investors can and indeed do make profits in China, for the majority, the decision is whether the *potential* of China in the future is worth putting up with the

²⁶ Chen Chunlai (2002) “Foreign Direct Investment in China: A Case Study” in Austrian Foreign Trade Yearbook 2001-2002, (Federal Ministry for Economic Affairs and Labour, Vienna): 2.

²⁷ Though we should note that with investments in bonds, we are not talking about the “hot money” that flew into and out of other regional states at great speed in the 1990s.

current obstacles that prevent full and free access to the domestic economy. As the SmithKline Beecham company argued

“China’s size today is not the truly significant fact; it is what it could become that is important”²⁸

a potential that many in the business community hoped would be unlocked by China’s entry into the WTO.

Market-based investors are realistic enough to acknowledge that the real market for foreign goods in China is nowhere near 1.3 billion, but much closer to around 150 million – a not insignificant figure. However, the sheer geographic size of China combined with an underdeveloped (though developing) infrastructure, makes it difficult (if not impossible) to produce in one part of China and expect to sell to the whole country. Commenting on this fragmented national market, the British Chamber of Commerce in China argue that:

“it is important to appreciate that the country is far more like the European Community of the 1970’s than the United States of America today”²⁹

For export based investors, the determinants of investment are rather straightforward, and are divided into “push” and “pull” factors. The push factors are effectively the rising production costs (primarily labour and land) elsewhere, particularly in East Asia. In addition, the importance of the US market for exporters meant that relative

²⁸ SmithKline Beecham noted that the average pharmaceutical spend per capita in China in 1999 was around \$4 compared to \$159 in the UK and \$379 in the US. Foreign Affairs Committee Tenth Report, Session 1999-2000 (2000) *Relations with the People’s Republic of China*, Norwich: HMSO, appendix 27.

²⁹ Foreign Affairs Committee Tenth Report, Session 1999-2000 (2000) *Relations with the People’s Republic of China*, Norwich: HMSO, appendix 15.

exchange rates and bypassing US quotas also acted as a push factor for Japanese exporters³⁰.

In terms of pull factors, Gill summarises the basic factors as follows:

“disciplinary neo-liberalism is connected to what I call the three "C's" of the power of capital. It involves the ways that public policy has been redefined so that governments seek to prove their credibility, and the consistency of their policies according to the criterion of the confidence of investors”³¹

In this respect, the legal changes outlined above combined with the changing ideational basis of Chinese polity after the *nan xun* conform with Gill's three C's. In addition, we should note that the Chinese regulatory framework provides considerable incentives to attract investors – tax rebates for exporters, tax free status for imported components, quick customs clearance and so on (see below for more details).

More specifically, the literature on FDI emphasises a number of specific pull factors. Perhaps the most important is an abundant supply of cheap labour, followed by cheap start-up costs and cheap land. In addition, Cheng and Kwan point to the importance of a physical infrastructure that facilitate the quick and easy flow of components into China and finished goods out³². In this respect, the Chinese government (both local

³⁰ Cumings, Bruce (1987) 'The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences' in Deyo, F.C. (ed.) *The Political Economy of the New East Asian Industrialism*, New York: Cornell University Press: 44-83.

³¹ Gill, Stephen (2000) "The constitution of global capitalism" Paper presented to a Panel: The Capitalist World, Past and Present at the International Studies Association Annual Convention, Los Angeles, 2000 available on-line on <http://www.theglobalsite.ac.uk/press/010gill.htm>

³² Cheng, LK and Kwan, YK (2000) "What are the Determinants of the Location of Foreign Direct Investment? The Chinese Experience" in *Journal of International Economics*, No 51: 379-400.

and national) has spent huge amounts of money facilitating international economic interaction. As the German Bundestag study commission on globalisation noted:

“Transport and communications are ‘massively state-subsidised, and the overhead costs of transport and communication (e.g. policing, rules and regulations) are met not by the users but by the general public’³³

Tseng and Zebregs also point to the importance of “scale effects” - in essence, the greater the amount of investment, then the greater the confidence of others to invest³⁴.

Jiang Xiaoyuan has also demonstrated how once a specific industry has been established in an area, then others will follow to take advantage of the existing support for that industry. What is particularly notable in the Chinese case is that such clustering is built not only on the type of industry, but also the nationality of the investor (ie: Taiwanese computer firms in Dongguan)³⁵. For Zhang, while low labour costs are the main determinant of deciding whether to invest in China or not, the decision on where to invest in China is based more on cultural background and specifically incentives offered by local governments rather than comparative wage rates within China³⁶.

Location of Investment

It is further notable that of the 100 top FIE exporters, 24 are named as being located in Shenzhen (and a further five in neighbouring Dongguan) and 16 are named as located in Shanghai. This is a reflection of the high level of FDI that has gone to China’s

³³ German Bundestag Study Commission (Select Committee) (2001) *Globalisation of the World Economy – Challenges and Responses*.

http://www.bundestag.de/gremien/welt/welt_zwischenbericht/zwb003_vorw_einl_engl.pdf

³⁴ Tseng, Wanda and Zebregs, Harm (2002), “Foreign Direct Investment in China: Some Lessons for Other Countries” International Monetary Fund Policy Discussion Paper No PDP/02/03

³⁵ Jiang Xiaoyuan (2003) “Geographical Distribution of Foreign Investment in China: Industrial Clusters and Their Significance” in *World Economy and China*, 11 (1); 15-24.

coastal provinces – nearly 90 per cent of cumulative FDI since 1978. Indeed, statistics from MOFTEC show that FDI in Guangdong, Jiangsu and Shanghai alone accounted for roughly half the national total in 2000. Guangdong Province has been the single biggest recipient, though its share of investment has declined as more FDI has moved to other coastal areas such as Shanghai and Liaoning (58 per cent of all FDI in Liaoning goes to Dalian Municipality). Nevertheless, Guangdong, or more correctly, the Pearl River Delta, remains a major site for FDI. Only four provinces (Shanghai, Jiangsu, Fujian, and Shandong – plus of course, Guangdong itself) received more FDI than Shenzhen alone. As Table One shows, this uneven share of provincial FDI is also reflected in the uneven distribution of exports

Table One

Provincial Share of National FIE exports

Guangdong	44
Shanghai	12
Jiangsu	11
Fujian	7
Shandong	7
Tianjin	5
Liaoning	5
Zhejiang	4
<hr/>	
Coastal 8	95 %

³⁶ Zhang, Honglin (2002) “Why Does China Receive So Much Foreign Direct Investment” in

One of the explanations for the importance of Guangdong, particularly in the early years of reform, was the migration of Hong Kong's manufacturing capacity over the border into China. This process is often referred to as metropolitan or growth "spillover" or "extended metropolis"³⁷, and has led to some concern in Hong Kong that the domestic economy has become "hollowed out"³⁸.

After the initial boom of investment into Guangdong, and notwithstanding its continuing importance, there has been an increasing spread of FDI to other parts of coastal China. Following the establishment of the initial SEZs, and the creation of 14 open cities in 1994, there has been an explosion of different types of zones intended to attract foreign investment. Table two provides a list of the various types of zones along with a description of their activities. Appendix one provides an example of the types of incentives on offer for foreign investors from the Qidong Zone in Jiangsu Province³⁹.

Table Two

Multiple Development Zones in China

Bonded and Free Trade Zones

Often located around major seaports. Companies registered in bonded or "free trade" zones are exempt from complex customs regulations and tariffs and value-added taxes; they also enjoy a series of preferential access to foreign exchange. It is only when goods, products, or raw materials enter non-bonded areas from the bonded zones that the transactions are classified as imports or exports, and customs duties and

World Economy and China, 10 (3); 49-58.

³⁷ Chia Siow Yue and Lee Tsao Yuan (1993) "Subregional Economic Zones: A New Motive Force in Asia-Pacific Development" in Fred Bergstein and Marcus Noland (eds) *Pacific Dynamism and the International Economic System*, Washington, Institute for International Economics: 236.

³⁸ For example, see Phar Kim Beng (2002) "Is Hong Kong irrelevant?" in *Asia Times*, 28 November 2002; Richard Hornik (2002) "Who Needs Hong Kong?" in *Fortune*, 2 May 2002.

³⁹ See also Tseng, Wanda and Zebregs, Harm (2002), "Foreign Direct Investment in China: Some Lessons for Other Countries" International Monetary Fund Policy Discussion Paper No PDP/02/03: 14-15.

VAT are imposed. Particularly important in the processing trade as the speed of clearing customs etc for both imports and exports is much quicker than elsewhere. FIEs are generally subject to a 50 per cent reduction on enterprise income tax. Companies with a term of operation greater than 10 years are eligible for an income tax exemption for the first two profitable years followed by a 50 percent reduction for the following three years.

Shanghai Waigaoqiao Bonded Zone
Tianjin Port Bonded Zone
Qingdao Bonded Zone
Zhangjiagang Bonded Zone
Ningbo Bonded Zone
Fuzhou Bonded Zone
Guangzhou Bonded Zone
Shenzhen Futian Bonded Zone
Shenzhen Shatoujiao Bonded Zone
Shantou Bonded Zone
Xiamen Xiangyu Bonded Zone
Hainan Haikou Bonded Zone
Zhuhai Free Trade Zone

Hainan Yangpu Economic & Technological Development Zone

Although officially one of the National level development zones (and most sources will give the figure as 35 to include Hainan), the Yangpu Zone is in the unique position of being a combined special zone, economic development zone, bonded zone, and port zone.

Economic & Technological Development Zones

34 national level development zones established by State Council fiat to attract investment in nationally strategic areas. Designed to act as “growth poles” for the national economy as a whole. These zones have received massive central government investment, particularly in infrastructure projects (and particularly the construction or upgrading of ports). The Zone authorities have the right to approve investment projects of up to US\$30 million without approval from a higher authority. Many contain “zones within zones” - special industrial parks for specific industries, areas with preferential incentives, or special zones for investment from specific countries. For example, the Fuzhou zone contains the Fuzhou Hi-tech Industrial Park, the Fuzhou Bonded Zone, and the Fuzhou Taiwan Merchant Investment Zone. The zones can also be experimental – for example, over 90% enterprises in the Wenzhou development zone are private enterprises. Some zones specialise in specific industries or sectors (eg: automobile industry in Wuhan). The zones offer various fiscal incentives for investors.

Dalian Economic & Technological Development Zone
Qinhuangdao Economic & Technological Development Zone
Tianjin Economic & Technological Development Area
Yantai Economic & Technological Development Zone
Qingdao Economic & Technological Development Zone
Nantong Economic & Technological Development Zone
Lianyungang Economic & Technological Development Zone

Shanghai Minhang Economic & Technological Development Zone
Shanghai Caohejing New Technology Development Zone
Ningbo Economic & Technological Development Zone
Fuzhou Economic & Technological Development Zone
Guangzhou Economic & Technological Development Zone
Zhanjiang Economic & Technological Development Zone
Wenzhou Economic & Technological Development Zone
Kunshan Economic & Technological Development Zone
Yingkou Economic & Technological Development Zone
Weihai Economic & Technological Development Zone
Fuqing Rongqiao Economic & Technological Development Zone
Dongshan Economic & Technological Development Zone
Shenyang Economic & Technological Development Zone
Harbin Economic & Technological Development Zone
Changchun Economic & Technological Development Zone
Hangzhou Economic & Technological Development Zone
Wuhan Economic & Technological Development Zone
Chongqing Economic & Technological Development Zone
Wuhu Economic & Technological Development Zone
Guangzhou Nansha Economic & Technological Development Zone
Huizhou Dayawan Economic & Technological Development Zone
Xiaoshan Economic & Technological Development Zone
Beijing Economic & Technological Development Area
Wulumuqi Economic & Technological Development Zone
Ningbo Daxie Economic & Technological Development Zone
Shanghai Jinqiao Export Processing Area
Xiamen Haicang Investment Area

Regional Development Zones

Regional development zones are created by provincial or municipal governments, and offer a number of incentives for investors such as rebates on local taxes, waiving of fees for facilities for certain levels of investment, and so on. Incentives are usually differential for different types of investment based on factors such as size, if they take over loss-making domestic enterprises, local development strategy and so on. It is not uncommon for one city to have more than one such zone (Shanghai has nine), which often compete with each other as well as other province's zones for investment.

Anhui

- (1) Anhui Hefei Economic & Technological Development Zone
- (2) Anhui Hefei New Station Comprehensive Development
Experimental Zone
- (3) Anhui Fuyang Economic & Technological Development Zone
- (4) Anhui Anqing Economic & Technological Development Zone
- (5) Anhui Bozhou Economic & Technological Development Zone

Beijing

- (1) Beijing Linhe Development Zone
- (2) Beijing Yanqing Economic & Technological Development Zone

Fujian

- (1) Fujian Longhai Jiaomei Industry Comprehensive Development Zone
- (2) Fujian Investment Promotion Bureau Zhongyin Zhangzhou Comprehensive Development Zone
- (3) Fujian Zhangzhou Lantian Development Zone
- (4) Fujian Luoyuanwan Economic & Technological Development Zone

Gansu

- (1) Gansu Lanzhou Economic & Technological Development Zone
- (2) Gansu Jinchang Economic & Technological Development Zone
- (3) Gansu Baiyin Western District Economic & Technological Development Zone

Guangdong

- (1) Guangdong Maoming Shuidong Economic & Technological Development Zone
- (2) Guangdong Qingyuan Economic Development Experimental Zone
- (3) Guangdong Nan'ao Island Development Experimental Zone
- (4) Guangdong Jieyang Economic Development Experimental Zone
- (5) Guangdong Jiedong Economic Development Experimental Zone
- (6) Guangdong Wuhua Economic Development Experimental Zone
- (7) Guangdong Chaozhou Economic Development Experimental Zone
- (8) Guangdong Jianjiang Economic Development Experimental Zone

Guangxi

- (1) Guangxi Nanning Economic & Technological Development Zone
- (2) Guangxi Nanning Dashatian Economic Development Zone
- (3) Guangxi Guilin Xicheng Economic Development Zone
- (4) Guangxi Qinzhou Port Economic Development Zone

Guizhou

- (1) Guizhou Guiyang Economic & Technological Development Zone
- (2) Guizhou Guiyang Baiyun Economic & Technological Development Zone
- (3) Guizhou Zunyi Economic & Technological Development Zone
- (4) Guizhou Zhongshan Economic Development Zone
- (5) Guizhou Dingxiao Economic & Technological Development Zone
- (6) Guizhou Duyun Economic Development Zone
- (7) Guizhou Anshun Economic & Technological Development Zone
- (8) Guizhou Hongguo Economic Development Zone

Hebei

- (1) Hebei Shijiazhuang (Liang Village) Economic & Technological Development Zone
- (2) Hebei Shanhaiguan Economic & Technological Development Zone
- (3) Hebei Langfang Economic & Technological Development Zone
- (4) Hebei Tangshan Economic & Technological Development Zone

Heilongjiang

- (1) Heilongjiang Mudanjiang Economic & Technological Development Zone
- (2) Heilongjiang Jiamusi Economic & Technological Development Zone

- (3) Haerbin Hi-tech Industry Development Zone
- (4) Daqing Hi-tech Industry Development Zone

Henan

- (1) Henan Zhengzhou Economic & Technological Development Zone
- (2) Henan Luoyang Economic & Technological Development Zone
- (3) Invest in Nanyang

Hubei

- (1) Hubei Huangshi Economic & Technological Development Zone
- (2) Hubei Yichang Economic & Technological Development Zone
- (3) Hubei Xiaogan New Industry Development & Open Experimental Zone
- (4) Hubei Gedian Economic & Technological Development Zone
- (5) Hubei Xiangfan Automobile Industry Economic & Technological Development Zone
- (6) Hubei Huangzhou Science & Technology Economic Development Zone

Hunan

- (1) Hunan Changsha Economic & Technological Development Zone
- (2) Hunan Yueyang Economic & Technological Development Zone

Jiangsu

- (1) Jiangsu Nanjing Economic & Technological Development Zone
- (2) Jiangsu Nanjing Jiangning Economic & Technological Development Zone
- (3) Jiangsu Changshu Economic & Technological Development Zone
- (4) Jiangsu Xuzhou Economic & Technological Development Zone
- (5) Jiangsu Rudong Economic & Technological Development Zone
- (6) Jiangsu Huaiyin Economic & Technological Development Zone
- (7) Jiangsu Haiyan Export-oriented Agricultural Comprehensive Development Zone
- (8) Jiangsu Jiangpu Economic Development Zone
- (9) Jiangsu Qidong Development Area

Jiangxi

- (1) Jiangxi Nanchang Economic & Technological Development Zone
- (2) Jiangxi Jiujiang Economic & Technological Development Zone
- (3) Jiangxi Gongqingcheng Open Development Zone
- (4) Jiangxi Sanghai Economic & Technological Development Zone

Jilin

- (1) Changchun Hign-tech Industry Development Zone
- (2) Changchun Jingyuetan Tourism Economic Development Zone
- (3) Jilin Hi-tech Industry Development Zone
- (4) Jilin Yanji Economic & Technological Development Zone
- (5) Jilin Antu Changbaishan Development
- (6) Jilin Changbai Economic Development Zone
- (7) Jilin Dunhua Economic Development Zone
- (8) Jilin Gongzhuling Economic Development Zone

Liaoning

- (1) Liaoning Benxi Economic & Technological Development Zone
- (2) Liaoning Anshan Economic & Technological Development Zone
- (3) Liaoning Jinzhou Economic & Technological Development Zone
- (4) Liaoning Fushun Economic & Technological Development Zone
- (5) Liaoning Donggang Economic & Technological Development Zone

Neimenggu

- (1) Huhehaote (Ruri) Economic & Technological Development Zone
- (2) Huhehaote (Jinchuan) Economic & Technological Development Zone

Shaanxi

- (1) Shaanxi Xi'an Economic & Technological Development Zone
- (2) Shaanxi Hanzhong Xinyuan Development Zone

Shandong

- (1) Shandong Rizhao Economic Development Zone
- (2) Shandong Zibo Economic Development Zone
- (3) Shandong Jiaozhou Economic & Technological Development Zone
- (4) Shandong Laizhou Economic Development Zone
- (5) Shandong Dongying Open & Development Comprehensive Experimental Zone
- (6) Shandong Liaocheng Economic & Technological Development Zone
- (7) Shandong Taian Economic Development Zone
- (8) Shandong Zhangqiu Mingshui Economic Development Zone
- (9) Shandong Laiyang Economic Development Zone
- (10) Shandong Zhoucun Economic Development Zone
- (11) Shandong Mouping Economic Development Zone
- (12) Shandong Gaomi Economic & Technological Development Zone
- (13) Shandong Rongcheng Economic & Technological Development Zone
- (14) Shandong Weifang Economic & Technological Development Zone
- (15) Shandong Pingdu Export-oriented Industry Processing Zone
- (16) Shandong Dezhou Economic Development Zone

Shanghai

- (1) Shanghai Songjiang Industry Zone
- (2) Shanghai Jiading Industry Zone
- (3) Shanghai Pudong Kangqiao Industry Zone
- (4) Shanghai Pudong Xinghuo Industry Zone
- (5) Shanghai Shenzhuang Industry Zone
- (6) Shanghai Jinshanzui Industry Zone
- (7) Shanghai Chongming Industry Zone
- (8) Shanghai Fengpu Industry Zone
- (9) Shanghai Baoshan Industry Zone
- (10) China Textile International Science &Technology Industry City

Shanxi

- (1) Shanxi Datong Economic & Technological Development Zone
- (2) Shanxi Xinzhou Economic & Technological Development Zone

(3) Shanxi Yuncheng Economic & Technological Development Zone

Sichuan

- (1) Sichuan Chengdu Economic & Technological Development Zone
- (2) Sichuan Chengdu Xindu Satellite City Industry Zone
- (3) Sichuan Chengdu Dujiangyan Industry Development Zone
- (4) Sichuan Yibin Economic & Technological Development Zone
- (5) Sichuan Luzhou Economic & Technological Development Zone
- (6) Sichuan Jiangyou Industry Development Zone
- (7) Sichuan Guang'an Economic & Technological Development Zone
- (8) Sichuan Suining Economic & Technological Development Zone
- (9) Sichuan Deyang Jinghu Economic & Technological Development Zone
- (10) Sichuan Shangxi Economic & Technological Development Zone

Tianjin

- (1) Tianjin Xiqing Economic Development Zone
- (2) Tianjin Tanggu Ocean High & New Technology Development Zone
- (3) Tianjin Wuqing Development Zone

Xinjiang

- (1) Xinjiang Shihezi Economic & Technological Development Zone
- (2) Xinjiang Kuitun Economic & Technological Development Zone

Yunnan

- (1) Yunnan Kunming Economic & Technological Development Zone
- (2) Yunnan Yuxi Economic & Technological Development Zone
- (3) Yunnan Chuxiong Economic & Technological Development Zone

Zhejiang

- (1) Zhejiang Jiaxing Economic Development Zone
- (2) Zhejiang Huzhou Economic Development Zone
- (3) Zhejiang Shaoxing Economic Development Zone
- (4) Zhejiang Yuyao Economic Development Zone
- (5) Zhejiang Jiashan Economic Development Zone
- (6) Zhejiang Jinhua Economic Development Zone
- (7) Zhejiang Taizhou Economic Development Zone
- (8) Zhejiang Ou Hai Economic Development Zone
- (9) Zhejiang Zhenhai Economic Development Zone

Border Economic Cooperation Zones

13 zones established by State Council fiat in 1992 (Erlianhaote in 1993) to facilitate cross-border trade eg: the Heihe Border Zone links Heihe City in Heilongjiang with Blagoveshchensk across the river in the Russian Federation. Primarily concerned with developing infrastructure to facilitate trade, though Erlianhaote Sino-Mongolia Zone has been designated a free-trade area.

- (1) Heihe Border Economic Cooperation Zone
- (2) Suifenhe Border Economic Cooperation Zone

- (3) Huichun Border Economic Cooperation Zone
- (4) Manzhouli Border Economic Cooperation Zone
- (5) Dandong Border Economic Cooperation Zone
- (6) Yining Border Economic Cooperation Zone
- (7) Tacheng Border Economic Cooperation Zone
- (8) Buole Border Economic Cooperation Zone
- (9) Pingxiang Border Economic Cooperation Zone
- (10) Ruili Border Economic Cooperation Zone
- (11) Wanding Border Economic Cooperation Zone
- (12) Hekou Border Economic Cooperation Zone
- (13) Erliaohaote Border Economic Cooperation Zone

Recognising the uneven spatial impact of FDI, the Chinese government launched a “look West” strategy aimed at encouraging more investment (both domestic and international) into non-coastal areas⁴⁰. This strategy is part of a wider attempt by China’s new generation of leaders to try to deal with the perceived down-side of the transition from socialism – to do something for the “underprivileged areas and people left behind in the breakneck transition to free markets”⁴¹. Notwithstanding considerable government support, the ultimate success of the project may rest on whether foreign investors want to invest in the West. And while the importance of getting components into China and finished goods to export markets remains a key priority of investors, then the strategy is likely to attract only few foreign investors⁴²

Evaluation of the Strategy

The vast majority of the literature on investment in China points to the benefits that have accrued. Annual average growth rates of around 8 per cent would have been

⁴⁰ Jiang Zemin (2000) “Western Development Key to China's Development Strategy” in *People's Daily* (English language on-line edition) 16 September. For details on the strategy for investment and trade in the West, see “To Accelerate the Great West Development by the Development of Foreign Economy & Trade” on the MOFTEC web-site at http://www1.moftec.gov.cn/moftec_en/xbkf/xbkf_01.html

⁴¹ Hutzler, Charles (2003) “China's New Leadership Indicates Change of Focus” in *Wall Street Journal*, 25 February: 1.

unattainable without the FDI-trade linkage; those areas engaged in export production have the highest per capita GNP rates; it has had a positive impact on balance of payments and foreign currency reserves; FDI has created new jobs; FDI has upgraded skills, raised factor productivity, increased technology transfer and encouraged reform of domestic Chinese industries⁴³.

The importance of the investment-trade nexus for overall growth has grown at times when the growth of the domestic economy has slowed. Two periods warrant special attention here. The first was when the then Premier Li Peng introduced an economic retrenchment campaign in the autumn of 1988. While official figures show that the economy continued to grow in 1989, Alwyn Young has recalculated these official figures using the government's own deflators to show that the economy actually contracted by in 1989:

“In 1989, a year of economic retrenchment, GDP is now seen to have fallen by 5.2 percent, as opposed to the 4.0 percent positive growth reported in official figures. This provides some insight into the forces which precipitated the political unrest of that year.”⁴⁴

The second period, ongoing since 1998, has seen the domestic economy in effective deflation. The declining profitability of TVEs (over 70 per cent of all TVEs were into debt by 1999) combined with the restructuring of the SOE sector, and an attack on inflation after 1994 has resulted in annual negative growth in retail and consumer

⁴² Sichuan University houses a project on the Western Development Strategy –details are available on <http://www.scu.edu.cn/3wpub/English/p13/Westdev.htm>.

⁴³ For example, see Houde, Marie-France and Lee, Hak-Loh (2000) “Main determinants and impacts of foreign direct investment on China's economy” *OECD Working Papers On International Investment*, Number 2000/4.

price indexes since 1998. Massive government spending (both through a budget deficit and through directed lending via the banking system) has helped maintain overall growth rates, but the major source of growth and in particular new jobs during this period has been foreign invested export industries.

Nevertheless, there is a more sceptical note in the literature as well⁴⁵. There is considerable competition from the various zones noted above to attract investment (not to mention competition from other regional states deploying export oriented growth strategies)⁴⁶. This quote Braunstein and Epstein based on an interview with an official in Dalian aptly sums up the level of competition:

“We asked him, “Who is your greatest competitor when it comes to trying to attract foreign investment?” expecting the answer to be Vietnam, or Malaysia or, perhaps, Beijing. But his answer startled us: “Our biggest competitor is the export processing zone down the street.” Not only does one province or one town compete with another; but in China, there are numerous zones – export processing zones, high tech zones, industrial zones – all of which compete for foreign investment. The result is cut throat competition.”⁴⁷

Such competition has led some to conclude that notwithstanding the benefits of FDI in terms of job creation, technology transfer, increases in fiscal revenues, development of management techniques and so on, the emphasis on FDI-exports as an

⁴⁴ Young, Alwyn (2000) “Gold Into Base Metals: Productivity Growth in the PRC During the Reform Period” NBR Working Paper 7856: 17.

⁴⁵ See Breslin, Shaun (2000) “Wachstum auf Kosten der Entwicklung? Kritische Bestandsaufnahme des Exportorientierten Wachstums in China (Growth at the Expense of Development? Critical Reflections of Export Oriented Growth in China)” in *Prokla* No. 119 June: 211-228

⁴⁶ See Head, K. and Ries, J. (1996) “Inter-City Competition for Doreign Direct Investment: Static and Dynamic Effects of China’s Incentive Areas” in *Journal of Urban Economics*, No 40: 38-60.

engine of growth could have negative consequences. To keep wage rates low, a policy has emerged of recruiting young women from China's interior to work in FIEs on the coast, and Anita Chan elucidated the poor working conditions that many of them endure⁴⁸. There is also a wider literature on the extent to which such competition for investment leads to a "race to the bottom" or "downward levelling"⁴⁹ – in terms of labour wages and conditions, enforcement of regulations (including labour, safety and environmental legislation), and the extent to which government spending to attract investment might actually surpass (or at least significantly reduce) the fiscal benefits.

It is often difficult to argue that attracting low paid low quality jobs through attracting FDI is better than not having the jobs at all. In interviews with investors in Hong Kong, a local investor told me that he couldn't keep employees, as they left his factory (which stuck to legal limits for hours worked) to go to other factories where they could illegally work longer hours but make more money. Nevertheless, if we move away from purely national perspectives, and consider the impact on employment as a whole, then the diversion of jobs from higher wage countries to lower wage sites is an international issue of concern. There is concern, for example, in many South East Asian nations that increased FDI flows into China in the wake of WTO entry will divert "invested jobs" to China. Indeed, calculations by World Bank economists (Kawai and Bhattasali, 2001) suggest that China's entry into the WTO will harm those Southeast and South Asian nations that have a similar export profile

⁴⁷ Elissa Braunstein & Gerald Epstein (2002) "Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?," CEPA Working Papers 2002-13, Center for Economic Policy Analysis (CEPA), New School University: 27.

⁴⁸ Chan, Anita (1996) "Boot Camp at the Show Factory: Regimented Workers in China's Free Labour Market", *The Washington Post*, 3 November.

⁴⁹ See for example, Barnett, Richard and Cavanaugh, John (1994) *Global Dreams: Imperial Corporations and the New World Order*, New York: Simon and Schuster; Palan, Ronen and Abbott, Jason with Deans, Phil (2000) *State Strategies in the Global Political Economy*

to that of China. Indonesia alone is expected to lose US\$73 million as a result of China's WTO accession. The impact on certain sectors – notably textiles – will be even more dramatic⁵⁰. In short, these figures question how much room is there in the “market place” for so many countries searching for the same FDI to produce the same goods for export to the same markets. The potential problem for late developing states emphasising low costs as a means of attracting investment to spur export led growth is that an even later developer with even lower costs might erode their comparative advantage.

Nor is it simply an issue for developing countries. There are concerns in Japan that some industries – notably textiles – are becoming hollowed out as production moves to China where wages are just 4 per cent of comparable Japanese manufacturing wages⁵¹. The UK shoe manufacturer, Doctor Martins, has also relocated its production from Northampton in the UK, where wages were US\$490 a week, to China, where workers get US\$100 a month for a 69 hour week (plus accommodation)⁵². Viewed from a purely domestic context, then the argument that any job for a poor developing country is better than no job does have some credence. But if we move beyond simple national contexts and think internationally, then the argument loses much of its force.

(*Second edition*), London: Pinter; Brecher, Jeremy and Costello (2001) *Global Village or Global Pillage (Second Edition)*, Cambridge, MA: South end Press; and

⁵⁰ Kawai, Masahiro and Bhattasali, Deepak (2001) “The Implications of China's Accession to the World Trade Organisation” paper presented at Japan and China: Economic Relations in Transition Jan 2001 Tokyo. Cited with authors' permission.

⁵¹ Takeo Hiranuma (2002) Sugu soko ni aru kiki, shitsugyo maneku kudoka wa koshite kaihi suru (How to Avoid a Hollowed Out Industry That Will Lead to Unemployment) in *Toyo Keizai*, January 5, 2002. With thanks to Chris Hughes for the information and translation.

⁵² Roberts, Dan and Kynge, James (2003) “How Cheap labour, foreign investment and rapid industrialisation are creating a new workshop for the world” *Financial Times*, 4 Feb; 21.

Sources of Investment

FDI from “developed” states into China has increased in recent years. In 2002, in the wake of China’s WTO entry, for example, contracted investment by US investors increased by 25 per cent over 2001⁵³. Nevertheless, a dominant theme throughout the literature on FDI in China is the significance of investment that comes from the rest of Asia in general, and from “Chinese Asia” in particular. Houde and Lee calculate that between 1993 and 1998, Hong Kong provided over half of all investment into China, Taiwan nearly eight per cent, and Singapore around 4.5 per cent⁵⁴. Similarly, Charles Wolf calculates that “two-thirds [of all investment has] come from “overseas” Chinese, especially overseas Chinese in Taiwan, Hong Kong, and Southeast Asia.”⁵⁵. If we add in investment from Japan, then the figure for Asia as a whole rises to nearly 80 per cent, with Europe⁵⁶ and North America each accounting for between seven and nine per cent depending on which figures are used.

Not surprisingly, the extent of Chinese and Asian investment in China, combined with the concomitant trade flows, has led many to deploy regional perspectives of economic integration. And quite rightly so. There are perhaps three major sub-groups within this literature.

First, there is a strand of literature that emphasises the importance of links between expatriate Chinese businesses in the Chinese diaspora and investment into China. This

⁵³ O’Neill, Mark (2003) “Hong Kong, Virgin Islands take top places in China investment stakes” in *South China Morning Post*, 10 February.

⁵⁴ Houde, Marie-France and Lee, Hak-Loh (2000) “Main Determinants And Impacts Of Foreign Direct Investment On China’s Economy” OECD Working Papers On International Investment Number 2000/4: 7.

⁵⁵ Wolf, Charles (2002) *Straddling Economics and Politics: Cross-Cutting Issues in Asia, the United States, and the Global Economy* (Santa Monica, CA: Rand Corporation) :134

⁵⁶ The UK is the biggest European investor in China with nearly double the value of Germany in second place.

literature concentrates on the “bamboo networks”⁵⁷ that link Chinese Family Businesses (CFBs) to China’s growing international economic relations. This literature was largely developed to explain to an American audience why US companies had fared relatively poorly in comparison to Asian companies in accessing China. The emphasis here is on cultural ties between ethnic Chinese across Asia and the Chinese “homeland” – ties of loyalty and trust, cultural understanding, common language, and also closer ties with government officials than those afforded to non-Chinese. Furthermore, this network creates linkages between CFB across the region (not just between the CFB and China) expanding into trans-regional conglomerates⁵⁸.

The second strand of literature emphasises the emergence of an integrated economy spanning national boundaries of “Chinese” states – Macao, Hong Kong, Taiwan and the PRC. While Huntington used the phrase “Greater China and its co-prosperity sphere”⁵⁹ to define this process, most analysts steer clear of the notion of co-prosperity (with its connotations of military power and colonisation related to the Japanese effort of the 1930s) and stick with “Greater China”⁶⁰.

⁵⁷ Huntington used this term in Huntington, Samuel (1996) *The Clash of Civilizations and the Remaking of World Order*, New York: Simon and Schuster: 170. It was also used in the same year by Weidenbaum and Hughes in a book that did much to popularise the concept.

Weidenbaum, Murray and Hughes, Samuel (1996) *The Bamboo Network: How Expatriate Chinese Entrepreneurs Are Creating a New Economic Superpower in Asia*, New York, Simon and Schuster. The significance of CFBs was further popularised in 1998 by Haley, George, Chin Tiong Tan, and Haley, Usha (1998) *The New Asian Emperors: The Overseas Chinese, Their Strategies and Competitive Advantages*, Burlington MA: Butterworth-Heinemann.

⁵⁸ Rauch, J. E., and V. Trindade (2002), “Ethnic Chinese Networks in International Trade,” in *Review of Economics and Statistics*, 84(1): 116–130.

⁵⁹ Huntington, Samuel (1996) *The Clash of Civilizations and the Remaking of World Order*, New York: Simon and Schuster: 170

⁶⁰ There is a large literature on the concept of Greater China. For three accessible examples for the non-specialist, see Shambaugh, David (ed.) (1995) *Greater China, the Next Superpower?*, Oxford: Oxford University Press; Knanna, J. (ed.) (1995) *Southern China, Hong Kong, and Taiwan: Evolution of a Subregional Economy*, Washington, D.C.: The Center for Strategic

Even then, the term “Greater China” remains a contested one with no clearly accepted understanding⁶¹. Not least, there is the question of whether this integrated economy includes all of China, or just those coastal provinces that dominate China’s international economic relations. Even then, some argue that the low level of economic interaction between China’s “internationalised” provinces suggest that there is not a single region⁶², but as Figure One indicates, a number of overlapping sub or micro regions.

It is for this reason that Naughton’s framework provides the most efficacious understanding of Greater China – primarily because he eschews a definitive definition and instead deploys a fluid multi-level approach. At the lowest level, there is a Greater China circle which covers the most intense level of integration – that between Hong Kong and the Pearl River Delta of Guangdong (which accounts for over half of all investment in the province). The second level of integration covers the most internationalised provinces of China (Guangdong and Fujian), Hong Kong and Taiwan. The highest level circle, which has yet to see full integration, could comprise of the three Chinese economies in total.

Naughton further avoids the flaw of isolating “Chinese integration” from the East Asian regional economy as a whole. And it is the focus on East Asian regional

and International Studies; and Rowley, C. and Lewis, M. (eds) (1996) *Greater China, Political Economy, Inward Investment and Business Culture*, London, Frank Cass.

⁶¹ Harding, Harry (1995) ‘The Concept of “Greater China”’: Harding, H. (1995) The Concept of “Greater China”: Themes, Variations and Reservations, in David Shambaugh (ed.) *Greater China, the Next Superpower?*, Oxford: Oxford University Press: 8-34.

⁶² Katsuhira Sasuga (2002) *The Dynamics of Cross-Border Micro-Regionalisation Between Guangdong, Taiwan and Japan: Sub-national Governments, Multinational Corporations and the emergence of Multi-Level Governance*, University of Warwick: PhD thesis.

integration that constitutes the third major sub-group within the literature⁶³. These approaches are perhaps best summarised by Cumings assertion in 1987 that:

“it is misleading to assess the industrialization pattern in any one of these countries: such an approach misses, through a fallacy of disaggregation, the fundamental unity and integrity of the regional effort in this century.”⁶⁴

The major benefit of this approach over “greater China” conceptions is that it recognised the significance of Japanese economic interests – not only direct Japanese investment into China, but also significant role played by Japanese interests in investment from Hong Kong, Taiwan and elsewhere into China. It thus “attempts to introduce dynamism into traditional, otherwise static, trade theory”⁶⁵, and avoids some of the flaws of using simple bilateral trade and investment figures in considering the major external actors and interests in China’s opening to the global economy. It is an approach that also imposes an historical context to current processes.

Nevertheless, there remains a danger that in searching for regional integration, this approach misses the salience of extra-regional actors. Hou perhaps provides the most extreme interpretation of this approach:

“Much like the tropical forests of the Amazon River Basin, Asia is almost a complete ecosystem economically speaking....Just as it is hopeless for any individual biologist to unravel the interdependencies of the Amazon

⁶³ This approach often entails extending Akamatsu’s flying geese model of regional economic integration to include China Akamatsu, K. (1962) ‘A Historical Pattern of Economic Growth in Developing Countries’ *The Developing Economies* (March-August): 3-25.

⁶⁴ Cumings, Bruce (1987) *The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences* in Deyo, F.C. (ed.) *The Political Economy of the New East Asian Industrialism*, New York: Cornell University Press: 46

⁶⁵ Hatch, W. (1998) ‘Grounding Asia’s Flying Geese: The Costs Of Depending Heavily On Japanese Capital And Technology’ (NBR Briefing Paper).

ecosystem, it is impossible for any economists to fully characterize the multilateral trade/investment relationship between the Asian economies.”⁶⁶

Just as the literature on Greater China can run the risk of ignoring the importance of other East Asian regional actors in “Chinese” integration, so the literature on East Asian integration should avoid the flaw of ignoring extra-regional actors and interests.

Such an emphasis on these various strands of regional integration is both entirely understandable and important. As Naughton argues, there clearly has been rapid integration of the (sub) Chinese economies, both with each other, and with the wider regional economy. Nevertheless, I contend that by focussing in on the regional dynamics, extra-regional dynamics can too easily be overlooked. And this tendency to overlook the global or dynamics is reinforced by simply focussing on official investment figures which hide the significance of extra-regional actors and interests. What the investment figures don’t tell us is the way in which extra-regional actors are engaging with the Chinese economy. This is not to deny the importance of regionalisation, but to suggest that regionalisation and globalisation are symbiotic processes. In particular, I argue that enterprises in Hong Kong, Singapore, and Taiwan play a key role as intermediaries between China and the global political economy, suggesting that processes of regionalisation are themselves often dependent on global processes.

⁶⁶

Jack W. Hou (2002) “China’s FDI Policy and Taiwanese Direct Investment (TDI) in China”
Hong Kong University of Science and Technology Centre for Economic Development
Working Paper 0206: 1

What the Figures Don't Tell Us

But what we Already Know

It is generally accepted that FDI figures for China overstate the real extent of “foreign” investment due to the significance of “round tripping”⁶⁷. This refers to the process of domestic Chinese actors investing in Hong Kong (often through a shell company) to re-invest in China to take advantage of the preferential treatment offered to foreign investors outlined above⁶⁸. There is a considerable literature on the importance of round-tripping in FDI into China. But the very nature of the process makes it difficult to be exact about its extent. Both Lardy’s⁶⁹ and Harrold and Lall’s⁷⁰ studies put the figure at 25 per cent of all investment in 1992, while Huang comes up with a figure of 23 per cent for the same year, with two possible higher estimates of 36 and 49 per cent⁷¹.

More recent figures are even more difficult to find consensus over. Bhaskaran suggested a figure of around 25 per cent in his 2003 paper for Deutsche Bank⁷², while Wu *et al* argue that the figure is likely to be “much higher”:

“the Hong Kong-based Political and Economic Risk Consultancy (PERC) concluded in December 2001 that out of the US\$100 billion FDI to China and

⁶⁷ This process is referred to as “transit FDI” by UNCTAD, see UNCTAD (2001) *World Investment Report 2001*, New York: United Nations.

⁶⁸ In addition to the sources cited below, see Tseng, Wanda and Zebregs, Harm (2002), “Foreign Direct Investment in China: Some Lessons for Other Countries” *International Monetary Fund Policy Discussion Paper*, No PDP/02/03; Gunter, Frank R. 1996. “Capital Flight from the People's Republic of China,” in *China Economic Review* 7 (1) (Spring): 77-96; and Sicular Terry (1998) “Capital Flight and Foreign Investment: Two Tales From China and Russia”, in *The World Economy*, 21 (5): 589-602.

⁶⁹ Lardy, Nicholas (1995) “The Role of Foreign Trade and Investment in China’s Economic Transformation” in *The China Quarterly*, (144): 1067.

⁷⁰ Peter Harrold and Rajiv Lall (1993), “China Reform and Development in 1992-93”, *World Bank Discussion Papers*, No 215, Washington DC: World Bank: 24.

⁷¹ Huang Yasheng (1998), *Foreign Direct Investment in China: An Asian Perspective*, Singapore: Institute of Southeast Asian Studies.

⁷² Manu Bhaskaran, (2003) *China as Potential Superpower: Regional Responses* Berlin: Deutsche Bank Research Report, 15 January 2003.

Hong Kong in 2000, probably only US\$36 billion were real FDI, with most of that going to China”⁷³

The highest estimates for round tripping can be found in Indian sources. Subramanian suggests that the figure for round-tripping FDI in China is as high as 50 per cent of all FDI⁷⁴. If these figures are correct, then “real” FDI as a percentage of GNP in China and India is roughly equal at 2 per cent and 1.7 per cent respectively⁷⁵. However, I suspect that these figures are derived from a mis-reading of the World Bank *Global Development Finance* report for 2002, which reported that 50 per cent of all FDI from Hong Kong into China was round-tripping investment⁷⁶ - a figure which is in itself at the top end of estimates⁷⁷.

Tax Havens and Foreign Indirect Investment

The example of recycled investment shows us that we cannot simply take bilateral investment figures at face value. Further evidence is provided by the rapid growth of investment from Latin America noted in the introduction. The explanation for this rise in investment is found in the fiscal regimes of the Virgin and Cayman Islands. Investors from other countries – notably Hong Kong and Taiwan – incorporate in these tax havens in order to lower (or eliminate) their fiscal commitments.

As Palan puts it, companies:

⁷³ Wu, Friedrich, Poa Tiong Siaw, Yeo Han Sia and Pua Kok Keong (2002) “Foreign Direct Investments to China and Southeast Asia: Has Asean Been Losing Out?” in *Economic Survey of Singapore* (Third Quarter): 102

⁷⁴ Subramanian, K. (2002) “FDI: Any lessons from China?” in *The Hindu*, 18 November 2002.

⁷⁵ Anonymous (2002) “Round Tripping – FDI: China, India may be on par with such investments” in *The Financial Express*, 5 June 2002.

⁷⁶ World Bank (2002) *Global Development Finance 2002*, New York: World Bank: 41.

⁷⁷ Galloway argues the figure from Hong Kong is 30 per cent. Galloway, Colin (1999) “Fall in FDI tests economic resolve” in *South China Morning Post*, 10 June 1999.

“take advantage of the juridical facilities offered to them for what is euphemistically called “effective international tax strategy,” which is another way of saying avoiding or evading taxes”⁷⁸

The very nature of this type of investment makes it difficult to know where it originates. Wu *et al* point to the significance of Hong Kong companies, noting that:

“The number of companies in Hong Kong that are incorporated in Bermuda and the Cayman Islands jumped 5.2 times from 178 in 1990 to 924 in 2000.”⁷⁹

Other data, supported by interviews in the region, emphasises the role of Taiwanese firms - partly to take advantage of the tax regime, but also to bypass Taiwanese government restrictions on investment in the mainland. After China, the British Virgin Islands and Cayman Islands rank second and third respectively as the biggest recipients of Taiwanese outward investment. It is instructive that British Virgin Isles are now the largest source of inward investment into Taiwan itself. As foreign companies pay lower corporate tax rates in Taiwan than domestic firms, it appears that, as with China, there is considerable recycling of investment in Taiwan.

There are two conclusions and one hypothesis that can be drawn from this. First, it suggests is that Asian investment in general, and that from Hong Kong and Taiwan in particular, is more significant than recent bilateral figures suggest. For example, Chinese figures put investment from Taiwan at around US\$48 billion in the decade to 2000, whilst Taiwanese officials came out with a figure of US\$70 billion by including

⁷⁸ Palan, Ronen (2002) Tax Havens and the Commercialisation of State Sovereignty, *International Organization* 56 (1) (2002): 152.

⁷⁹ Wu, Friedrich, Poa Tiong Siaw, Yeo Han Sia and Puah Kok Keong (2002) “Foreign Direct Investments to China and Southeast Asia: Has Asean Been Losing Out?” in *Economic Survey of Singapore* (Third Quarter): 102.

investment routed through third places⁸⁰. Using slightly different data, Smith suggests that by including investment from the tax havens, the real figure was in excess of US\$100 billion⁸¹.

Second, even though we can have a pretty good guess at where the investment is really coming from the truth is that we don't really know. So while Wu *et al* can point to the growing number of Hong Kong companies operating via tax havens, they acknowledge that:

“This is still a lower-bound estimate of the number of tax haven companies in Hong Kong because such data for the British Virgin Islands are unavailable.”⁸²

And while Smith can come to a rough estimate of how much investment has gone across the Taiwan Straits, “the real level of Taiwanese investment in China is unknown”⁸³

The hypothesis that emerges from these examples, is a simple one – that official and bilateral figures are at best, only a rough guide to what is really going on, and at worst, actually mislead. And by considering the fragmented nature of production in the global political economy, then we can find evidence to suggest that non-Asian economic interests have played a much bigger role in the Chinese economy – particularly in the last few years – than studying bilateral figures will ever be able to reveal. The focus here is on three forms of foreign indirect investment or involvement

⁸⁰ Roberts, Dexter and Einhorn, Bruce with Webb, Alysha (2001) “While Taipei’s politicians defend independence, business leaders want to fully unite the economies” in *Business Week*, 11 June.

⁸¹ Smith, Matthew (2002) “Taiwan: Post-Congress push for China links” in *Asia Times*, 3 Dec.

⁸² Wu, Friedrich, Poa Tiong Siaw, Yeo Han Sia and Puah Kok Keong (2002) “Foreign Direct Investments to China and Southeast Asia: Has Asean Been Losing Out?” in *Economic Survey of Singapore* (Third Quarter): 102.

⁸³ Smith, Matthew (2002) “Taiwan: Post-Congress push for China links” in *Asia Times*, 3 Dec.

in the Chinese economy: Original Equipment Manufacturer (OEM) production, contract manufacturing via Asian intermediaries, and the increasing significance of Commodity Manufacturing Enterprises (CMEs).

The de-territorialisation of Production and Investment

OEM Production

OEM production provides the greatest degree of separation between China and “Western”⁸⁴ companies. Here, Asian companies produce goods using their own brand name, but under OEM deals with companies in third countries. The best, and most important example is in the Taiwanese computer industry. Around 70 per cent of all computer related goods produced by Taiwanese firms are based on OEM contracts with foreign firms – primarily from the US and Japan⁸⁵. The dominance of Intel processors and the Windows operating system in the PC market means that it is essential for producers to use these technologies in order to gain a market foothold – a phenomenon that has been dubbed “Wintelism”⁸⁶. Borrus⁸⁷, Borrus and Zysman⁸⁸ and Sturgeon⁸⁹ all argue to different degrees that the US electronics industry altered its

⁸⁴ A rather difficult concept as many Japanese firms also have OEM agreements with Taiwanese producers.

⁸⁵ Sasuga, Katsuhiko (2004) *Microregionalism and Governance in East Asia* (London: Routledge).

⁸⁶ Borrus, Michael and Zysman, John (1997) *Wintelism and the Changing Terms of Global Competition: Prototype of the Future?* Berkeley Roundtable on International Economy Working Paper 96b. Later revised and published as Borrus, Michael and Zysman, John (1998) “Globalization with Borders: The Rise of “Wintelism” as the Future of Industrial Competition” in John Zysman and Andrew Schwartz (eds) *Enlarging Europe: The Industrial Foundations of a New Political Reality*, University of California Press/University of California International and Area Studies Digital Collection : 27-62.

⁸⁷ Borrus, Michael (1995) *Left for Dead: Asian Production Networks and the Revival of US Electronics*, Berkeley Roundtable on the International Economy Working Paper.

⁸⁸ Borrus, Michael and Zysman, John (1997) *Wintelism and the Changing Terms of Global Competition: Prototype of the Future?* Berkeley Roundtable on International Economy Working Paper 96b.

⁸⁹ Sturgeon, Timothy (1997) *Does Manufacturing Still Matter? The Organizational Delinking of Production from Innovation*, Berkeley Roundtable on International Economy Working Paper 92B.

global strategy in the 1990s in response to challenges from Asia. Rather than simply competing with Asian producers, they instead created networks with Asian producers.

Most significantly for this study, Taiwanese computer companies have embraced this changing manufacturing structure and located themselves as key links in the production chain. At a “higher” level, they sign OEM agreements to produce computers using foreign technology and operating platforms – almost entirely with Japanese and US companies. At a “lower” level, they have outsourced the low-tech and low value added elements of production to maintain cost efficiency⁹⁰.

Such OEM based investment from Taiwanese companies in the computer industry is now a major source of Taiwanese investment in China. Indeed, nearly three quarters of China’s computer related products are produced by Taiwanese companies, which are themselves dependent on OEM contracts with Japanese and US companies⁹¹. It is particularly important in for three localities in China, where Taiwanese computer companies have agglomerated - Dongguan in Guangdong Province, Suzhou and Shanghai.. As such, these Taiwanese invested factories in China represent the end stage of a production process that spans the most industrialized global economies such as the USA and Japan, intermediate states such as Taiwan, and developing states like China.

⁹⁰ Shin-Hong Chen (2002) Global production networks and information technology: The case of Taiwan; *Industry and Innovation*, 9 (3); pg. 249-265.

⁹¹ Sasuga, Katsuhiko (2004) *Microregionalism and Governance in East Asia* (London: Routledge).

Disguised Investment

The degree of separation is less when foreign indirect investment takes place through subsidiary offices within East Asia, and in particular in Hong Kong. For example, Sanyo's business operations in China are managed and invested through Sanyo's subsidiary companies located in Hong Kong⁹². The use of subsidiaries in Hong Kong is a particularly important element in Japanese investment in southern China. Although sorting through the statistics is an inexact science, Matsuzaki has estimated that about 80 per cent of Japanese FDI in Hong Kong is subsequently reinvested in Guangdong⁹³.

But it is not just Japanese companies that choose to operate through Hong Kong. As of 1 June 2002, Hong Kong was the host to 3,119 overseas companies' regional offices or headquarters, and a further 1,230 local offices. Although Japanese companies are the largest representatives (471), US companies come a close second (437)⁹⁴. Of course, not all of these companies are in Hong Kong just to access China, and not all of them will be sources of "Hong Kong" investment. Indeed, it is all but impossible to calculate the extent to which investment in China from Hong Kong originates from these regional offices of foreign companies. Perhaps the best we can say is that Hong Kong remains an important platform for third party investment into China which is not revealed by looking at the official investment statistics.

⁹² Sasuga, Katsuhiro (2004) *Microregionalism and Governance in East Asia* (London: Routledge).

⁹³ Matsuzaki, Y. (1997) "Hon Kon: tai Chu kyoten to shite no genjo" in K Ishihara (ed) *Chugoku Keizai no Kokuzaika to Higashi Ajia* Tokyo: Ajia Keizai Kenkyusho): 160 - cited in Sasuga, Katsuhiro (2004) *Microregionalism and Governance in East Asia* (London: Routledge).

⁹⁴ China comes third with 170. Hong Kong SAR Census and Statistics Department (2002) *Annual Survey of Regional Offices Representing Overseas Companies in Hong Kong* (Hong Kong: Government Information Centre).

Sub-Contracted Investment

It becomes even more difficult to calculate the real extent of non-Chinese investment in China when we consider the extent of sub-contracted FDI. Here, third country investors do not directly invest in China either directly or through regional offices, but instead sub-contract production to investment companies within the East Asia region itself. Such investment has been a major element in western companies involvement in China in textiles, clothing and shoes, toys, and more recently, electronics. There have been a number of studies that trace such indirect investment in specific case studies. Anita Chan, for example, has investigated investment in the biggest sports shoe factory in the world in Guangdong Province. This factory is a joint venture with Taiwanese investment that produces sports shoes for Reebok, Nike and Adidas⁹⁵. Liaw has similarly outlined the significance of the Pou-Chen company in Taiwan which produces 15 per cent of the world's sport shoes in its factories in China (and now Vietnam) for a host of foreign companies - Nike, Reebok, New Balance, Adidas, Timberland, Asics, Puma, Hi-Tec, Lotto, LA Gear, Mitre and so on⁹⁶. The example of Mattell producing Barbie dolls in China via a Taiwanese intermediary, first aired in the Los Angeles Times⁹⁷, subsequently had the honour of being used in the State Council White Paper on the Sino-US trade imbalance⁹⁸.

In all the above cases, third party companies have sub-contracted to regional intermediaries that have then invested in China – often in joint ventures, though wholly foreign owned enterprises are now the investment project of choice. In these

⁹⁵ Chan, Anita (1996) "Boot Camp at the Show Factory: Regimented Workers in China's Free Labour Market", *The Washington Post*, 3 November.

⁹⁶ Liaw, Fann-Bey (2003)

⁹⁷ Tempest, Rone (1996) "Barbie and the World Economy", *Los Angeles Times*, 22 September.

⁹⁸ State Council (1997) *On Sino-US Trade Balance*, Beijing: Information Office of the State Council Of the People's Republic of China, March.

cases, investment figures for China will show a transfer from the intermediary company's country, and not from the original investor country. A second type of sub-contracting is where the third country company sub-contracts to a regional intermediary, which then produces in China on a contract basis. In these cases, no investment will be recorded as the transactions are on a processing fee basis, even further disguising the original investors' involvement in the Chinese economy.

Major investment companies such as the Swire Group and the Jardine Matheson Group (which incidentally, is incorporated in Bermuda) have long acted as intermediaries between China and the global economy. Perhaps less well known are the plethora of Hong Kong owned companies such as Li and Fung, which act as intermediaries in the global supply chain. More recently, Taiwanese companies have also developed such an intermediary role in accessing China through companies such as Pou-Chen, BenQ and Hon Hai Precision Industry⁹⁹.

There are three main reasons why these intermediary companies have established themselves as a link between foreign producers and China. First, Rodrik has noted a tendency to sub-contract to countries with poor labour standards rather than invest there directly¹⁰⁰. This assertion is supported by interviews with what must remain an un-named intermediary company in Hong Kong. Certain US based companies, which again must remain un-named, use sub-contracting through Hong Kong because they fear that being associated with sweat-shop production would severely damage their image (and therefore sales) at home. They can genuinely argue that they don't invest

⁹⁹ Luthje, Boy (2002) "Electronics contract manufacturing: Global production and the international division of labor in the age of the Internet" *Industry and Innovation*, 9 (3): 227-247.

in sweat-shops – but it does not necessarily mean that products carrying their brand names are not produced in sweat shops.

Second, the intermediary companies themselves market themselves as matchmakers with specialist expertise and specialist knowledge of China - technical, cultural and linguistic¹⁰¹. But it is not just a matter of having the correct connections in China. Many of these intermediary companies take responsibility for the entire production process, and not just the manufacturing element in China. As global supply chain manufacturers, they need to convince investors that they can provide all the raw materials and components needed to produce the specified good to the standards set by the investor company.

This is partly because of the flexibility it creates for “demand-responsive reflexive”¹⁰² producers. And it is closely related to the third explanation, which is that an increasing number of major multinational companies simply do not produce anything themselves anymore. As Chen notes:

“Many brand marketers tend to concentrate their core competencies on brand-name resources and R&D, whilst outsourcing the remainder of the value

¹⁰⁰ Rodrik, Dani (1997) *Has Globalization Gone too Far*, (Washington DC: Institute for International Economics): 46.

¹⁰¹ Yu Yongding, Zheng Bingwen, and Song Hong (2001) (eds) *Zhongguo “RuShi” Yanjiu Baogu*: Jinru WTO de Zhongguo Chanye (Research Report on China’s Entry into WTO: The Analysis of China’s Industries) (Beijing: Social Sciences Documentation Publishers): 6-9; Hanson, Gordon and Feenstra, Robert (2001) “Intermediaries in Entrepôt Trade: Hong Kong Re-Exports of Chinese Goods” *NBER Working Paper* 8088.

¹⁰² Hamilton, Gary (1999) “Asian Business Networks in Transition: or What Alan Greenspan Does Not Know About the Asian Business Crisis” in TJ Pempel (ed) *The Politics of the Asian Economic Crisis*, (Ithaca: Cornell UP): 60.

chain. As a result, former vertically integrated multinationals are increasingly becoming hollowed-out corporations”¹⁰³

They are variously referred to as “manufacturers without factories”¹⁰⁴,”turn-key production networks”¹⁰⁵, “global flagship networks”¹⁰⁶ and “virtual corporations”¹⁰⁷. Although different approaches point to different features¹⁰⁸, they share a basic understanding that fordist production process based on horizontal integration have given way to vertical integration between core companies and their production affiliates, supplier and sub-contractors.

Two key features are worth noting here. First, this vertical integration takes place across national boundaries, with different stages of the production process located in the most financially advantageous location. Second, the production process is often no longer controlled by the core company at all. Rather than operate through formal affiliates, production is placed in the hands of specialised companies. This is not a

¹⁰³ Shin-Hong Chen (2002) Global production networks and information technology: The case of Taiwan; *Industry and Innovation*, 9 (3): 251. See also Kotabe, M (1996) “Global Sourcing Strategy In The Pacific: American And Japanese Multinational Companies”, in G. Boyd (ed), *Structural Competitiveness in the Pacific*. (Cheltenham: Edward Elgar); and Swamidass, P and Kotabe, M. (1993) “Component sourcing strategies of multinationals: an empirical study of European and Japanese multinationals” in *Journal of International Business Studies*, 24(1): 81-100.

¹⁰⁴ Hamilton, Gary and Waters, Tony (1995) “Chinese Capitalism in Thailand: Embedded Networks and Industrial Structure” in Edward Chen and Peter Drysdale (eds) *Corporate Links and Foreign Direct Investment in Asia and the Pacific*, (Pymble: Harper). See also Borrus, Michael, Ernst, Dieter, and Haggard, Stephan (2000) “Introduction: Cross Border Production Networks and the Industrial Integration of the Asia-Pacific Region” in Michael Borrus, Dieter Ernst and Stephan Haggard (eds) *International Production Networks in Asia: Rivalry or Riches?*, (London: Routledge).

¹⁰⁵ Sturgeon, Timothy. (1999) “Turn-key Production Networks: The Organizational Delinking of Production from Innovation” in Ulrich Juergens (ed) *New Product Development and Production Networks. Global Industrial Experience* (Berlin: Springer Verlag).

¹⁰⁶ Ernst, D. (2001) “The new mobility of knowledge: digital information systems and global flagship networks” Honolulu, East-West Center Working Papers, Economics Series No. 30.

¹⁰⁷ Davidow, W. H.; Malone, M. S. (1992): *The Virtual Corporation – Structuring and Revitalizing the Corporation for the 21st Century*. (New York: Harper Collins).

¹⁰⁸ For a description and analysis of the various terms used and how they correspond with each other, see Berger, Suzanne., Kurz, Constanze., Sturgeon, Timothy., Voskamp, Ulrich., and Wittke, Volker (2001) “Globalization, Production Networks, and National Models of

new phenomenon – major sports-wear companies such as Nike have long been corporations without factories. But it certainly appears to be growing ever more significant in global production:

“Contract manufacturing is one of the fastest growing segments in the IT industry. Growth rates are currently averaging 20-25 percent per year. According to industry consultants Technology Forecasters, the global market volume in the year 2000 was US\$88 billion. The leading players of the industry, most of them former small subassembly companies, were hardly known a decade ago. Today, the biggest firm has annual revenues of US\$20 billion.”¹⁰⁹

Although some production for these hollow companies does take place through Taiwanese and Hong Kong intermediary companies, noted above, five major Commodity Manufacturing Enterprises (CMEs) of North American origin now play a pivotal role in the production of consumer electronics - Solectron, Flextronics, SCI, and Jabil Circuits from the USA, and Celestica from Canada¹¹⁰.

“unlike the more traditional manufacturers and multinationals, [CMEs] do not make their own brand-name products, instead deploying global networks with fast-response capabilities to provide production and other (mainly logistics) services to brand marketers.”¹¹¹

Capitalism - On the Possibilities of New Productive Systems and Institutional Diversity in an Enlarging Europe” University of Göttingen SOFI-Mitteilungen No. 29/2001.

¹⁰⁹ Luthje, Boy (2002) “Electronics contract manufacturing: Global production and the international division of labor in the age of the Internet” *Industry and Innovation*, 9 (3): 228-9.

¹¹⁰ Luthje, Boy (2002) “Electronics contract manufacturing: Global production and the international division of labor in the age of the Internet” *Industry and Innovation*, 9 (3): 227-247.

¹¹¹ Shin-Hong Chen (2002) Global production networks and information technology: The case of Taiwan; *Industry and Innovation*, 9 (3): 251.

As China has become the “world’s outsourcer of first resort”¹¹², it has become engaged in this global division of production – typically at the low tech and low value added processing stage. But although the major CMEs are North American in origin, they typically operate in China through regional affiliates. Singapore Flextronics, for example, invests in China on behalf of Microsoft, Motorola, Dell, Palm and Sony Erickson. In all these cases, the ‘Made in China’ brand will appear on the good – a good which carries a non-Chinese brand name, but the investment and trade figures will show inter-Asian trade and investment.

Implications and Conclusions

Statistics and Bilateralism

The most obvious implication of this investigation is that it is simply not possible to make meaningful generalisations by simply analysing bilateral investment figures. When considering Chinese trade figures, the flaws of taking simple bilateral approaches have long been accepted due to the role of Hong Kong as a link between China and the global economy. But assessments of investment still largely accept the figures and build their analysis on bilateral data. What this paper hopefully shows is that such bilateralism over-emphasises the significance of “Chinese” investment in China, and underplays the role of extra regional actors (and extra-“Chinese” actors in particular). The prima facie evidence suggests that US companies have been much more engaged with the Chinese economy than the investment and trade figures suggest – albeit through third party actors. The evidence also suggests that Japanese companies have been even more important than previous studies have suggested.

¹¹² Stephen Roach (2002) “Global: China’s Heavy Lifting” Morgan Stanley *Global Economic Forum*, 6 Mar.

But a logical conclusion of this paper is that it is almost impossible to gauge the full extent of this involvement due to the fragmented nature of production and investment. Virtually the only way of being sure is to trace the product processes involved for each specific good – a task that is likely to defeat all but the most fanatical academic.

The Nature of Industrial Competition

As noted above, there has been considerable debate over whether China's 1994 devaluation triggered the regional crises of 1997 and concerns in the region that:

“the PRC's entry [into the WTO] will lead to an acceleration of investment flows to the PRC and a corresponding reduction in flows to themselves.”¹¹³

Throughout Asia, this conception of China as a super-competitor is informing not only media debates, but also official policy. Lee Kwan Yew has famously described the economic relationship between Singapore and China as an “elephant on one side and a mouse on the other”¹¹⁴ (Eckholm and Kahn, 2002). Malaysia's Mahathir Mohamad has similarly aired his concern that “There's not much capital going around. Whatever there is gets sucked in by China”¹¹⁵ with claims that 16,000 jobs were lost in Penang alone in 2002 as major hi-tech producers move capacity to China¹¹⁶.

The concept of “competitive development” clearly is important for other export based regional states. But the China challenge is not always as clear as it is for the newly unemployed 16,000 ex-workers in Penang. For example, concern about the China

¹¹³ Braunstein, Elissa and Epstein, Gerald (2002) “Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?”, CEPA Working Papers 2002-13, Center for Economic Policy Analysis (CEPA), New School University: 2.

¹¹⁴ Eckholm, Erik with Kahn, Joseph (2002) ‘Asia Worries About Growth of China's Economic Power’ *New York Times*, 24 November.

¹¹⁵ Chandler, Clay (2003) ‘Coping With China: As China becomes the workshop of the world, where does that leave the rest of Asia?’ *Fortune*, 16 January.

¹¹⁶ Eckholm, Erik with Kahn, Joseph (2002) ‘Asia Worries About Growth of China's Economic Power’ *New York Times*, 24 November.

challenge in the US should be treated with some caution. US criticisms of China's compliance with WTO obligations became louder and fiercer in 2003. For example, in July 2003, US Secretary of Commerce Donald Evans issued a stinging attack on China's compliance record, complaining about the slow pace of reduction trade barriers and government subsidies to domestic producers, and lack of action over copyright infringement:

“We're going to be taking aggressive action. They need to be doing more. They need to be doing much more.”¹¹⁷

In addition, a new area of concern has emerged relating to the pegging of the RMB to the US\$. With the RMB pegged to a depreciating dollar, US economists have complained that this acts as a quasi devaluation of the RMB.

But while competition from China might be impacting on US jobs in some areas, it is often American companies that are reaping the rewards of China's growth through lower costs and increased profits. Similarly, while some Japanese workers have been losing their jobs as production (particularly in the textiles and apparel industries) moves to China, Japanese companies have maintained and increased their profits by outsourcing production to China – often through intermediary companies in Taiwan and Hong Kong. And many companies in Hong Kong and Taiwan have found new niches as intermediaries between China and the global economy whilst leaders express concern about hollow economies and dependence on China. Focussing on the nation state as the unit of analysis when it comes to considering competition, who wins and who loses, misses the point that it depends on which groups you are looking at within individual nation states. What is good for the company directors and

¹¹⁷ “Evans warns China to comply with its WTO commitments” in *Bloomberg*, 9 July 2003: 12.

investors might not be as beneficial for the ‘national interest’. And while China matters in one respect for workers who are fearful of their jobs migrating to lower cost production sites, it matters in a very different way for investors seeking to maximize profits.

FDI, Cultural Explanations and Regionalism

If the role of extra regional actors is greater than most analyses suggest, where does this leave those understandings that emphasise culture and the linkages between different Chinese populations in China’s global re-engagement? In some respects, these understandings hold firm. CMEs in Hong Kong and Taiwan deliberately market themselves as having the linkages – the *guanxi* 关系 – that are so important for doing business in China.

But we need to take care not to construct “closed” conceptions of regional interaction. It is true that through investment and trade, China (more correctly, coastal China), Hong Kong and Taiwan are now closely integrated – economically if not politically. But this economic regionalisation is dependent on extra regional actors. And the same is also true if we expand our regional perspective to a wider East Asian level to recognise the importance of Japanese actors – the regionalization process is still dependent on extra-regional markets, and extra-regional investors. It is not a case of the East Asian regional economy rising as a challenge to the US as some would suggest, but rather a case of US economic actors being inextricably interlinked with that regional economy itself.

Appendix One

Preferential treatment for foreign investors in Jiangsu Qidong Lusi Port Development Zone



1. Those foreign-funded enterprises established in the Zone shall be given a 50 percent refunding of the local taxes apart from the enterprise income tax paid in the period for the exemption from and the reduction of for two years and for three years respectively. A 100 percent and a 50 percent refunding of the paid enterprise income tax shall be given for two and three years respectively after the expiration of the two years and three years period for the exemption from and the reduction of enterprise income tax respectively. The last policy also applies to those newly approved non-productive foreign-funded enterprises from the first profit-making year.

The paid income taxes and the taxes on special agricultural products shall be refunded within ten years to those foreign-funded enterprises which are engaged in the comprehensive agricultural development in the zone with a registered period of more than ten years.

2. Thirty percent paid value-added taxes retained by local government shall be paid to the foreign-funded enterprises newly-established in the zone in the first five years after its operation. Fifty percent of it shall be refunded to those projects of large scale and high and new technologies.
3. The expenses for water expansion, facilities apart from transformer and the local power construction fund and the reforming expenses of low pressure cable network shall be exempted for those foreign-funded enterprises with an aggregate investment of over \$1 million of which is more than 70% foreign capital. Meantime, half of the earnest money for electricity and electricity meters shall be paid.
4. New productive foreign-funded enterprises shall be exempted from the expenses for afforestation, obligatory labor on Saturday, flood-fighting, local surcharge for education, management expense of township enterprises, management expenses of temporary resident population, public security guarantee, education fund, fund for grain risk, fund for market price adjustment, expenses for air defence and equipment for environmental protection.
5. The town land use expenses shall be exempted for those foreign-funded enterprises which obtain the leasehold of idle plants and land. The taxes derived from the handling of property right transfer shall be refunded after being paid.
6. The public facility expense shall be paid by a reduction rate of 50% by those foreign-funded enterprises which set up buildings for productive purposes or engage in the development of productive commodity buildings with a building area within 1000 sq.m. The expenses on the part over the 1000 sq.m shall be

paid by RMB 10 per sq.m. The public facility construction fees shall be paid by 30% by those foreign investors who engage in the development of commodity buildings in the Development Zone with a lump-sum building area of over 10000 sq.m. The fees shall be paid by 50% for the building with no more than 10000 sq.m.

7. Those foreign investors who are involved in large-scale and scientifically and technologically projects shall enjoy more preferential policies than the above-mentioned policies.