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Improving Investment Promotion in Western China

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Introduction

Unlike most countries that are not well known to international investors, China, with its vast market potential and rapid growth, enjoys a high visibility among international investors. For the last two decades, a significant amount of foreign direct investment (FDI) has flowed into the country, mainly in response to the economic opening and policy reforms pursued by the Chinese Government. The result has been that China has become one of the most successful countries in attracting FDI in the last two decades. With a total of US \$347 billion in actual FDI utilized by the end of 1999, it is the second largest FDI recipient in the world, after the United States. However, despite the large annual flows, FDI in China has been distributed unevenly across the country, with the large majority concentrated in the eastern and southern parts of the country.

In June, 1999, President Jiang Zemin declared that the State would, in the next few decades, look increasingly westwards. This was implicit recognition of the fact that two decades after the start of economic reforms and opening up to the outside, China's development had become geographically skewed. Henceforth, the President declared, the Chinese Government would attach greater priority and devote greater resources to accelerating the development of China's poorer western provinces.

The President's speech was a signal of the central authorities' determination to redress the balance of development across the country and marked the official start of China's "Go West" Policy. The early stages of the implementation of the policy has subsequently generated a flurry of activity and China's western provinces see this as an important boost to their economic development ambitions. Following the announcement of the "Go West" policy, most inland provinces fought hard to be included in China's "western region", in the hope that they would benefit from any preferential policies that the Central Government may give to the western region as a whole. Presently, the western region, as defined by the Central Government, includes:

- six provinces (Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, and Qinghai);
- five autonomous regions (Tibet, Ningxi, Xinjiang, Guangxi, and Inner Mongolia); and
- one municipality directly under the State Council (Chongqing).

To oversee and set this policy in motion, a Go West “Leading Group” has been established, with Premier Zhu Rongji as its head and the State Planning and Development Commission (SPDC) as the Group’s General Office.

The challenge for the Government on FDI

Given the location choices made by foreign investors to date within China, the Central Government should be under no illusions as to the substantial challenges that it faces in its effort to attract greater FDI flows to the Western region. Convincing new and existing foreign investors that the West is a more attractive prospect than the already well-established and more experienced coastal provinces is not going to be easy, especially, considering the lower level of general development of the west’s “investment product” i.e. its investment environment.

What is now increasingly apparent is that, after more than twenty years of economic reform and opening to the outside by China, it is no longer sufficient for a provincial government to just to open it’s doors and to offer the same incentive schemes that once helped the coastal provinces attract FDI. Investment promotion today requires much more – effective strategic planning and aggressive, targeted policy actions supplemented by an appropriate organizational structure. For the Western Provinces, however, investment promotion is currently a relatively new concept.

Responding to the challenge

As the “Go West” policy gains momentum, China will need to examine the effectiveness of its existing institutions that have responsibilities for attracting FDI, at both the central level and within the western provinces. In assessing these “investment promotion agencies” (IPAs), it will need to address issues such as:

- the appropriate functions (from the full range of possibilities) to be undertaken by the IPAs at each level of government;
- the institutional and organisational arrangements for an IPA at national level, which can facilitate the attraction of FDI, for the country as a whole and within the context of the “Go West” policy, particularly the location of the IPA within the national government’s administrative structure; and
- the relationship between IPAs (and other institutions undertaking FDI related functions) at the national and local levels.

Appropriate functions

China has achieved considerable success in attracting FDI. However, to date, virtually all the focus at national level has been on “improving the product” (as opposed to “marketing the product”, the other way of increasing “sales”). Over the last decade, for example, the Chinese government, at both central and local levels, has made continuous efforts to remove the barriers to investment and progress has been made to improve the policy and legal regimes of foreign exchange, trade, and taxation. In conjunction with China’s aim of joining the World Trade Organization (WTO), China has also continued to deregulate the investment environment and to develop a commercial legal infrastructure that is closer to international standards.

Despite the progress achieved, however, there is still room for many improvements to be made to the investment “product”. Improvement of the overall business environment remains a major challenge in

China; among foreign investors, China is still reputed as a place where “shen-yi hao zuo, ban-shi nan,” “finding a business is easy, but doing it is difficult”.

By contrast, most of the countries that have been most successful in attracting FDI (e.g., in terms of inflow per capita) have paid continuous attention to “product” improvement while operating effective marketing programs in parallel. Therefore, China now faces a choice in its approach to FDI, especially if it is to be successful in its “Go West” policy. It must decide if it is now appropriate to add another element to the overall strategy for attracting FDI. Specifically, the choice is whether it should move to a dual focus of product improvement and effective marketing.

The range of functions allocated by various national governments to the IPAs they have established varies considerably. A listing of all the possibilities is surprisingly extensive. While no single IPA has a mandate that covers all the possibilities, IPAs typically undertake a combination of both regulatory and promotional functions. IPAs that are more of the regulatory type often perform such functions as project screening and licensing, approving investment incentives based on government criteria and issuing other permits needed by investors (e.g., expatriate work permits, land and import/export licenses, etc.). The more promotional IPAs, on the other hand, are more focused on image building, investment generation and investor servicing (or facilitation).

Historically, most of the early IPAs established started out with a combination of regulatory and promotional functions – though, in many cases, the latter were largely ignored. Over time, however, many have realized that an emphasis on regulatory functions prevents them from pursuing their principal objective – promoting investment by attracting investors. Thus, as IPAs have evolved, they have typically focussed more on promotional functions and those succeeding in making this transformation have become much more successful in attracting investment to their host economies. In addition, during the course of this transformation, many IPAs have played an important role of policy advocacy and pushed for the necessary reforms to simplify the regulatory requirements and to reduce the administrative barriers to investors.

There remains a good deal of debate over the appropriate balance between regulatory and promotion functions, which are undertaken by IPAs. Many of the existing agencies in Asia were established at a time (two and three decades ago) when the regulation of FDI (and the activities of multinational corporations – MNCs) was considered more important than investment attraction. However, the past two decades has seen competition between countries for FDI intensify, so that regulating the demand by MNCs for entry into the economy has become considerably less important. The need now is to generate that demand. Recognition of this change has resulted in additional promotional responsibilities being given to many of the predominantly regulatory agencies or their existing promotional responsibilities being given much greater emphasis.

Institutional and organisation arrangements

An appropriate organizational framework is increasingly recognised as the key to successful implementation of FDI related strategy and functions. Although the organizational structure and arrangements vary from country to country, a number of consistent features in the framework can be distinguished from the experience of many countries around the world.

In virtually all cases, countries have decided to nominate a single agency, at a national level, as the vehicle dedicated to leading on and implementing FDI related functions. This lead agency, generally referred to as the IPA, enables a government to centralize decisions on FDI regulation and promotion, coordinate other

key government departments involved in FDI process and provide a focal contact point with private investors.¹

Most IPAs that have been established have taken the form of either a government entity, or a “quasi government” entity, although, in few cases, the IPA has been a private entity. Whichever form is used, however, IPAs that are relatively successful typically exhibit a number of similar characteristics:

The strong political support of and access to the senior government leader

This is critical to the success of the IPA. International experience suggests that an IPA that is separated from regular line ministries and has the support of and reports directly to a senior level of government (e.g., the prime minister or a senior co-ordinating minister) has a significant advantage in addressing investor problems. Without such access and support, the views of an IPA which reports to a lower level – for example, a line minister – are discounted by other line ministries with equal status. Similarly, reform – even of relatively simple matters – is much harder to bring about and the IPA is unlikely to be seen as an effective mechanism for translating government policy objectives into specific FDI objectives. Nor can IPAs without a sufficiently senior level of support be effective in developing an effective promotion program in coordination with other relevant government departments and agencies. It is not a coincidence, therefore, that successful IPAs typically have political prominence, with direct access in some cases to the Prime Minister and/or the President.

Independence from other government departments and agencies

Independence from other government agencies allows IPAs the needed degree of freedom to develop an FDI strategy, deploy an FDI promotion program, take FDI related decisions and implement specific activities. All these help ensure their operational effectiveness. A certain level of detachment of the IPA from a government’s administrative bodies also allows it to function more like a commercial entity in what is a highly competitive market. In places where IPAs are not able to exercise a sufficient degree of independence, they have generally been more encumbered by bureaucratic interference and, thus, have tended to function less effectively. In addition, investors tend to have less trust and confidence in such an IPAs’ ability to provide them with the necessary support to implement an investment. Equally, in places where there are too many players involved in FDI promotion on behalf of the government, investors become confused as to which agency they should deal with and the use of the public resources is less cost-effective.

Inter-departmental cooperation and coordination

Though needing to be largely independent in their formal structure, successful IPAs around the world depend upon the understanding and support of other relevant ministries and authorities for their operational effectiveness. Such interaction needs to be based on pragmatic and mutually beneficial institutional mechanisms.² These mechanisms seldom permit the full delegation of the other agencies’ powers to IPAs, rather relying upon them to act as good investment facilitators through effective networking. For this purpose, many governments have resorted to a supervisory board or committee for the IPA including representatives of key departments. Such a board can meet regularly to discuss the critical issues brought to its attention and find solutions based on inter-departmental agreement. It can also review, provide input to and approve the corporate plans and budgets proposed for the IPA, as well as overseeing the latter’s

1 Louis T. Wells, Jr. and Alvin G. Wint, *Marketing a Country: Promotion as a Tool for Attracting Foreign Investment*, (Revised Edition), 2000; Foreign Investment Advisory Service, IFC and the World Bank; pp.50-52.

2 In some countries, IPAs maintain informal contact with other key players. The Singapore EDB is perhaps the best example of this networking across government departments and agencies.

performance. Thus, the key departments gain a strong understanding and a sense of ownership of the IPAs' operation, while the IPAs gain a strong inter-departmental support.

Private Sector Cooperation

Successful IPAs treat investors as clients and partners. They emphasize the maintenance of a close relationship with the private sector through regular activities such as company surveys, factory visits, seminars and workshops. In many cases, the private sector is represented on the supervisory or consultation boards of IPAs, so that it can assist in identifying business issues affecting different sectors and voice investors' needs and requirements. Ideally, an IPA should report to a board, nominally chaired by at least a senior minister, and composed of both public and private sector representatives. The IPA then has its direction set by a group which represents a range of opinions and perspectives – a competitive tension, which has been shown to produce the most successful outcomes. Moreover, successful IPAs recruit staff from the private sector as well as the public sector – wherever the budget permits – so as to bring the private sector understanding and knowledge in-house.³

National and local relationships

In countries as large and diverse as China, increased attention has been given to developing an appropriate relationship between the national IPA and the various IPAs established by local (provincial and municipal) administrations. In many cases, it is clear that the range of parallel functions and the resulting overlaps which occur can be potentially wasteful. Such duplication also runs the risk of inconsistency and the possibility of causing unnecessary confusion to investors.

The range and number of initiatives, related to investment promotion and undertaken at local level, especially by the western provinces, can be expected to increase rapidly over the next few years. This makes it important that the national IPA is structured in a way that allows the national benefit realised from the efforts at all levels to be maximised. Indeed, the need to form local and regional IPAs to complement area development strategies, including the Western Development Strategy, is an example of the importance which national/sub-national relationships will assume.

Where does Western China go now?

The current functional, organizational and relationship arrangements for FDI attraction in China are far from ideal. Until recently, responsibilities at national level for FDI matters were dispersed among several key departments, including the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the Bureau of State Planning Commission and the Bureau of Economic and Trade Commission. Although MOFTEC was designated as the “coordinator” of the FDI process, it lacks an unambiguous mandate for FDI promotion.

The overlap in responsibilities FDI promotion at national level are also apparent at the Provincial Government level, where, for example, in Shaanxi Province, the responsibilities are spread between a number of national and provincial government agencies. On the one hand, such an arrangement – and the psychological distance from central authority – can lead to a more “flexible” and open-minded approach to handling investors. This has, to date, not generally been the case in Western China, with the result that it has, more likely, signalled to investors that FDI promotion is uncoordinated.

The need to establish a close relationship with the private sector clearly remains one of the biggest challenges, especially at the provincial level, with which the investor has much more immediate contact.

3 *Strengthening Investment Promotion Agencies: The Role of the Private Sector*, an internal note by FIAS, March 1999.

Currently, in Shaanxi, for example, none of the Government agencies actively involved have put enough emphasis on this. They have all been acting with a primary focus of implementing the administrative instructions. Consequently, their interactions with investors, particularly after an investment project has been implemented, have been minimal. This has largely limited their understanding of the commercial needs and requirements of the investors when designing and implementing their promotion activities, though exceptions to this situation are evident in some of the economic and technology development zones within the Province. The zone authorities appear to have been more willing to respond to market needs than to emphasize adherence to administrative instructions and guidelines. They also seem to have been more proactive in interacting with investors, both during and after the investment project implementation process.

Finally, an overarching objective should be to address the mindset, culture and skills of all Government agencies and officials at the various operational levels. Although a positive attitude towards FDI is evident at the senior level, many low-ranking officials appear somewhat ambivalent or, in some cases, negative. Many lower level officials involved in the FDI process are clearly not familiar with private business and many are distrustful of the motivations and culture of foreign investors. As a result, while Government policies officially encourage foreign investment, the implementation process is often unpredictable and drawn out.

To succeed in a focused FDI attraction program, both the national government and the provincial governments of Western China need to address the three main IPA issues identified in this paper: selecting and developing appropriate functions, creating an effective organisational structure and establishing mutually beneficial relationships between national and local institutions. The idea of creating a more focused national IPA, with a higher degree of independence and a clearer mandate to coordinate all investment promotion and facilitation activities, is worth serious consideration at both a national and local levels. Such a framework will help to clarify and bring together the various efforts already made across the country. It will also help the Government implement its FDI policies and strategy more forcefully and cost-effectively.

In creating an effective national IPA, the Central Government will need to demonstrate strong political support for the concept and build a political consensus among all involved parties, including the key departments and the private sector. Moreover, a prerequisite for success in this area will be a major effort to change the mindset, behaviour and skills of executing officials at all operational levels.