MAIN ISSUES ON FOREIGN INVESTMENT IN CHINA'S REGIONAL DEVELOPMENT: PROSPECTS AND POLICY CHALLENGES

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This paper forms part of an OECD publication entitled "Foreign Direct Investment in China: Challenges and Prospects for Regional Development" (OECD, 2002). The views expressed in this report do not necessarily reflect those of the OECD or of the governments of its member countries.

Introduction

Globalisation is increasingly testing the ability of regional economies to adapt and maintain their competitive edge. Performance gaps are widening between regions, and rapid technological change, extended markets and a greater demand for knowledge are offering new opportunities for regional development. Yet this calls for further investment from enterprises, re-organisation of labor and production, upgrading skills and improvements in the local environment. Some regions with poor links to the sources of prosperity, afflicted by environmental problems, migration, and lagging behind in infrastructure and private investment, are finding it difficult to keep up with the general trends.

China is a country, where regional development is of a foremost priority. The population is dispersed, although unevenly, over a huge landmass, with rural regions being inhabited by more than 900 million people, some two-thirds of the population. Since the launch of the economic reforms in 1978, China's dominant development policies have gradually shifted from ones based on self-reliance to ones favoring comparative advantage and open door policy. A large amount of existing foreign direct investment (FDI) has been located in China's relatively prosperous coastal regions, without any significant catching up by the interior central and western regions. While the eastern coastal region accounted for 88% of the country's total FDI during 1978 to 1999, the central region attracted 9% and the western region only a minor fraction of the total $308 billion in FDI inflows.[1]

Chinese authorities are keen on redressing the growing imbalance in regional distribution of FDI. Foreign investors, however, maintain that conditions are quite difficult in the western region. The provinces that lie inland from China's coast cover an area almost twice as big as India (56% of the country's land area) and hold 23% of its population. Their per capita gross domestic product is only

60% of the national average. But seen as a labor-intensive manufacturing base, the region is plagued by poor transport and infrastructure that outweigh its lower cost structures. The central/western regions may therefore not be able to copy the export-oriented development strategy of the coastal provinces; therefore, a different development strategy would be defined and a different "type" of FDI to be attracted to the hinterland.

In an effort to close this economic gap, the Chinese government launched “the Western Development Strategy” (*Xibu Da Kaifa*) in January 2000.[2] “The Western Development Strategy” constitutes a cornerstone of the Tenth five-year plan (2001-2005), and is an ambitious top-down effort to steer state investment, outside expertise, foreign loans and private capital into the parts of China most in need but least likely to attract aid on their own. The area covered by this strategy includes six provinces (Gansu, Guizhou, Qinghai, Shaanxi, Sichuan, and Yunnan), five autonomous regions (Guangxi, Inner Mongolia, Ningxia, Tibet, and Xinjiang), and one province-level municipality (Chongqing).[3]

This highly ambitious programme, however, is not undisputed. Some critics point out that increased government spending in the west will reduce the amount of money available for current social programs, health, education and welfare, thereby aggravating the problems at another hot spot of China's contemporary development process. In the perception of some foreign enterprises, the programme is not tackling all the main issues at stake for foreign investments in the region. In addition, they recognize that the benefits of westward development could take generations to materialize.

This paper looks at the nexus between FDI and regional development in China. Starting point is an account of the diverging economic development in China’s regions and the geographical patterns of FDI-inflows to China. It is followed by some theoretical reflections on the determinants of location choice for FDI and the parameters of inter-regional competition for FDI inflows. The paper will then turn to the concrete experiences of FDI attraction in two regions located in the Chinese coastal belt and the ensuing growth impulses that FDI exerted on their economic development. These two case studies are then employed, as benchmarks against which the potential of FDI-driven growth processes in the Chinese hinterland will be discussed. It also examines the question of how far central and local government might make a contribution to kick-off and promote such a process. The final section will examine the impact of China’s accession to the World Trade organisation (WTO) and its possible consequences for FDI and China’s regional development.

General Patterns of Regional Development and FDI-Attraction in China

Since the launch of economic reforms in 1978, China has gone through an impressive economic development process. Economic growth, however, has not been evenly distributed, for a rather limited number of provinces[4] has been responsible for the greatest part of the enlargement of the national economy, the size of which more than quadrupled in the run of only two decades (World Bank 2000). Underlying this unbalanced growth experience is a bundle of factors, an incomplete list of which encompasses:

- political reasons including the role a region has been attributed in the reform process, the degree of local autonomy from central government, the degree of reform mindedness and entrepreneurial spirit of the local administrative bodies;
- historical reasons including parameters such as the involvement in former economic policy campaigns, the third front strategy and the resulting effects on the local industry

structures, and the emigration of parts of the population, which prospered in other regions of the world; and

- geographical reasons including the existence of natural resources, access to the seaports and inland waterways.

Diverging Economic Development in China's Regions

The Chinese economic growth process since 1978 has been accompanied by the evolution of a new economic geography[5], which is characterised by a steep east-west slope of economic development. The provinces located in China's eastern coast belt have experienced the most dynamic growth processes while the central and even more so the western provinces have been lagging behind. With the exception of the three traditional metropolitan centres of Beijing, Tianjin and Shanghai as well as the north eastern province of Liaoning, all the other coastal belt provinces have experienced exceptional growth, raising their share in the national GDP by more than 10 percentage points (see Table 1). In comparison, nearly all the central and western provinces have lost in relative importance for the national economy.

Data on GDP per capita, see Table 2, may give an even better impression of the growth dynamics and wealth of the various regions. With the exception of the metropolitan centres, which have lost part of their exceptional position, the inter-provincial divergence of GDP per capita has risen dramatically. While the coastal provinces feature values high above the national average, most central and western provinces are not only markedly below the average, but have lost substantially in comparison to 1980. These results, however, have to be seen *cum grano salis*, as the migrant population is not adequately represented. Migrants are included in their home provinces and not their real living/working places. The result is a downward bias in the GDP per capita shown for home (e.g. Guizhou, Sichuan) and an upward bias for the host regions (e.g. Fujian, Guangdong).

To put it in a nutshell: The diverging regional growth patterns of the past two decades have led to a polarisation of the Chinese economy into two separate relative income clubs (Aziz/Duenwald 2001, 13-15), i.e. the rich coastal and north-east provinces versus the poor hinterland provinces. While the members of each of these two clusters are experiencing a convergence of per capita income in an intra-cluster comparison, the two clusters themselves show a diverging development pattern.

With respect to the coastal belt economies of Guangdong (Pearl-River Delta Region), Shanghai, Jiangsu, Zhejiang (Yangzi River Delta Region), the degree of divergence in industrial structures of these provinces with the Central and Western Chinese provinces rose markedly during the 1990s. The only exception is Hubei, a province located upstream the Yangzi River, which has been able to reduce the divergence of its industrial structures with those of the Yangzi River Delta, but not with those of Guangdong.

The industrial structures of the Pearl-River and the Yangzi River Delta Regions feature a comparatively high similarity, although the divergence has risen during the 1990s. This development might indicate a rising complementarity between the two regions, a rising potential for labour division and a diminishing competitive juxtaposition on the national and international markets. Looking at the three provinces constituting the Yangzi Delta Region a great similarity in the early 1990s can be observed, which has since given way to higher divergence in the run of the decade. This development is an indication of a new pattern if intra-regional division of labour according to which Shanghai has been concentrating on the tertiary industries, while translocating part of its industrial production capacities to the neighbouring provinces.

Table 1: Provincial Growth Dynamics and Share in National GDP					
	GDP 1980		**GDP 1999**		**Change 1980-99 %**
	Billion Yuan current prices	**% of national GDP**	**Billion Yuan current prices**	**% of national GDP**	
Eastern Region	**197.919**	**45.03**	**4504.176**	**51.37**	**6.34**
Beijing	13.907	3.16	217.446	2.48	-0.68
Tianjin	10.352	2.35	145.006	1.65	-0.70
Shanghai	31.189	7.10	403.496	4.60	-2.49
Liaoning	28.100	6.39	417.169	4.76	-1.63
Shandong	29.213	6.65	766.210	8.74	2.09
Jiangsu	31.980	7.28	769.782	8.78	1.51
Zhejiang	17.968	4.09	536.489	6.12	2.03
Fujian	8.706	1.98	355.024	4.05	2.07
Guangdong	24.571	5.59	846.431	9.65	4.07
Hainan	1.933	0.44	47.123	0.54	0.10
Central Region	**168.565**	**38.34**	**3049.682**	**34.78**	**-3.56**
Hebei	21.924	4.99	456.919	5.21	0.22
Inner Mongolia	6.84	1.56	126.820	1.45	-0.11
Shanxi	10.876	2.47	150.678	1.72	-0.76
Jilin	9.859	2.24	166.956	1.90	-0.34
Heilongjiang	22.104	5.03	289.741	3.30	-1.72
Anhui	14.088	3.20	290.859	3.32	0.11
Jiangxi	11.115	2.53	196.298	2.24	-0.29
Henan	22.916	5.21	457.610	5.22	0.01
Hubei	19.938	4.54	385.799	4.40	-0.14
Hunan	19.172	4.36	332.675	3.79	-0.57
Guangxi	9.733	2.21	195.327	2.23	0.01
Western Region	**73.103**	**16.63**	**1213.255**	**13.84**	**-2.79**
Sichuan, incl. Chongqing	32.203	7.33	519.132	5.92	-1.41
Guizhou	6.026	1.37	91.186	1.04	-0.33
Yunnan	8.427	1.92	185.574	2.12	0.20
Tibet	0.867	0.20	10.561	0.12	-0.08
Shaanxi	9.491	2.16	148.761	1.70	-0.46
Gansu	7.390	1.68	93.198	1.06	-0.62
Qinghai	1.779	0.40	23.839	0.27	-0.13
Ningxia	1.596	0.36	24.149	0.28	-0.09
Xinjiang	5.324	1.21	116.855	1.33	0.12

Source: National Bureau of Statistics, China and own calculations.

Table 2: Provincial GDP per capita					
	GDP/capita 1980		GDP/capita 1999		Change 1980-99 %
	Yuan current prices	% of national average	Yuan current prices	% of national average	
China	460	100.00	6.534	100.00	--
Eastern Region					
Beijing	1,582	343.91	19,846	303.73	-40.18
Tianjin	1,392	302.61	15,976	244.51	-58.10
Shanghai	2,738	595.22	30,805	471.46	-123.76
Liaoning	811	176.30	10,086	154.36	-21.94
Shandong	402	87.39	8,673	132.74	45.35
Jiangsu	541	117.61	10,665	163.22	45.61
Zhejiang	470	102.17	12,037	184.22	82.05
Fujian	350	76.09	10,797	165.24	89.16
Guangdong	473	102.83	11,728	179.49	76.67
Hainan	354	76.96	6,383	97.69	20.73
Central Region					
Hebei	427	92.83	6,932	106.09	13.27
Inner Mongolia	361	78.48	5,350	81.88	3.40
Shanxi	442	96.09	4,727	72.34	-23.74
Jilin	445	96.74	6,341	97.05	0.31
Heilongjiang	694	150.87	7,660	117.23	-33.64
Anhui	291	63.26	4,707	72.04	8.78
Jiangxi	342	74.35	4,661	71.33	-3.01
Henan	317	68.91	4,894	74.90	5.99
Hubei	428	93.04	6,514	99.69	6.65
Hunan	365	79.35	5,105	78.13	-1.22
Guangxi	278	60.43	4,148	63.48	3.05
Western Region					
Chongqing			4,826	73.86	--
Sichuan	329	71.52	4,452	68.14	--
Guizhou	219	47.61	2,475	37.88	-9.73
Yunnan	267	58.04	4,452	68.14	10.09
Tibet	471	102.39	4,262	65.23	-37.16
Shaanxi	338	73.48	4,101	62.76	-10.71
Gansu	388	84.35	3,668	56.14	-28.21
Qinghai	473	102.83	4,662	71.35	-31.48
Ningxia	433	94.13	4,473	68.46	-25.67
Xinjiang	410	89.13	6,470	99.02	9.89
Source: National Bureau of Statistics and own calculations.					

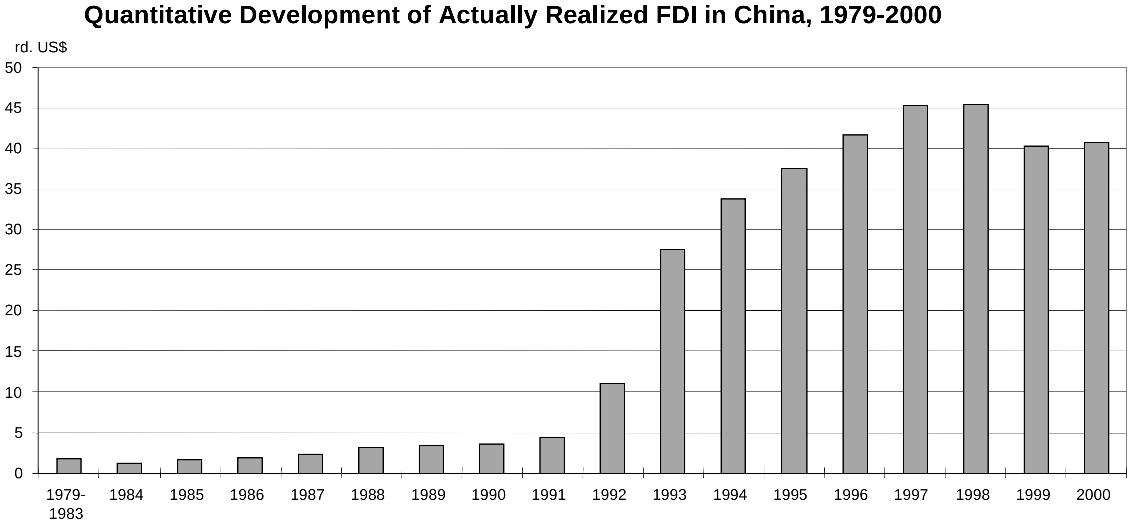
The patterns of China's FDI-inflows show a marked similarity to the patterns of regional development described above, raising suspicions of some potential causal relationship between regional development and attraction of FDI. As a matter of fact, a recent quantitative study indicates just this: there seems to exist a reinforcing effect between the inflow of FDI and industrial growth in China. FDI is a cause for industrial growth and economic development, which in turn causes the inflow of new FDI (Shan/Tian/Sun 1999). A recent IMF study comes to the conclusion that the regional disparities are probably primarily determined by the relative importance of FDI to the various regions (Dayal-Gulati/Husain 2000, 4).

The initial legal and institutional basis for an inflow of FDI to China was established only in the late 1970s and early 1980s. Since then China has taken a number of measures to intensify the flow of FDI to the country or regions thereof. Special economic zones and industrial parks have been established within which foreign invested enterprises (FIE) experience a better regulatory environment and infrastructure facilities than in other parts of the country. They have been given tax benefits, a relatively liberal foreign-trade regime, and granted other diverse special conditions under which the business activities of companies with foreign participation are subject to considerably different conditions than businesses that are financed purely by Chinese capital (Khan 1991, Appendix 4).

But still seriously constricted by regional, sectoral restrictions and specific qualifications (concerning forex balances, local content regulations, access to the local goods and factor markets, etc.) which had been motivated by ideological reservations that FIE might constitute an instrument of foreign capitalists exploiting the country (Hsu 1991, 134-136), FDI inflows picked up only slowly in the 1980s. It was not before China's strong commitment to a market economy in the early 1990s that the country was able to attract truly substantial amounts of FDI. [6] Since then the development has been dramatic (see Figure 1).[7]

Between 1995 and 1999 China absorbed 7.5% of global FDI flows and about one quarter of all FDI flows directed towards developing countries. In the years 1993 to 1996 China was even host to more than one tenth of global FDI. The accumulated FDI stock of China amounted to more than 6% of the global total in 1999 (UNCTAD various). The bulk of these massive FDI inflows did not stem from the world economy's industrial growth centres. The triad economies of the EU, Japan and USA each accounted for less than 10% of all China-bound FDI, while Hong Kong, Chinese Taipei and Singapore commanded in excess of one half of all China-directed FDI flows (National Bureau of Statistics, China and OECD 2000, 7).

Figure 1: World FDI inflows to China



Data: Guojia tongji ju [National Bureau of Statistics] various. HKTDC.

In terms of their regional distribution FDI inflows have been heavily concentrated in China's coastal provinces (the "eastern" region), while the central and western regions have attracted only marginal shares of the national FDI inflows (Table 3).

Table 3: Geographical Distribution of FDI Stock in China			
	1983-1998	1980s	1990s
Eastern Region	87.8	90.0	87.6
Central Region	8.9	5.3	9.2
Western Region	3.3	4.7	3.2
See table 1 for the provinces constituting the three regions. Source: OECD 2000, 8f.			

This highly unbalanced picture is reproduced when looking at the province level. Here Guangdong seems to constitute a class of its own. During the 1980s Guangdong absorbed nearly one half of all FDI China attracted during this period. In the 1990s, when the volume of China-bound FDI rose exponentially, the province still hosted more than one quarter of the national FDI stock. Taking the period as a whole Guangdong has absorbed nearly one third of all FDI stock China attracted since the beginning of the reform era (OECD 2000, 8f.).[8]

The next most important host provinces for FDI have been Fujian and Jiangsu with a share of about 10% of the national FDI stock each. In the central region the most attractive regions are Henan, Hubei and Hunan, while Sichuan and Shaanxi lead the western provinces.

These relative degrees of importance and the dynamics of the last decade are also reflected in Table 4, where the provinces' share in total FIE industrial output value and its change is documented. As can be seen, the eastern region has lost some of its importance as a production location for FIE, but has still a share of nearly 90%. Nearly all the losses of the eastern region have been absorbed by the central region, leaving the western region with a still negligible share in FIE industrial production.

Table 4: Contribution of FIE located in various provinces to national total industrial output value by FIE				
	1999			**Change to 1991 in %points**
	FIE	**# FFE**	**# HMT**	**FIE**
Eastern Region	**88,40**	**86,94**	**90,06**	**-4,65**
Beijing	4,12	5,82	2,25	-1,05
Tianjin	5,16	7,94	2,09	1,82
Shanghai	14,91	19,96	9,33	-2,65
Liaoning	3,21	4,70	1,56	-1,99
Shandong	5,20	7,29	2,89	3,68
Jiangsu	11,72	14,37	8,79	1,69
Zhejiang	4,81	4,01	5,70	1,62
Fujian	7,14	3,77	10,86	1,71
Guangdong	31,92	18,88	46,37	-5,77
Hainan	0,21	0,20	0,22	0,35
Central Region	**8,98**	**10,08**	**7,77**	**4,08**
Hebei	1,73	1,53	1,95	0,32
Inner Mongolia	0,23	0,19	0,29	0,06
Shanxi	0,24	0,17	0,32	0,15
Jilin	1,19	1,88	0,43	1,03
Heilongjiang	0,59	0,65	0,52	0,26
Anhui	0,79	1,05	0,51	0,47
Jiangxi	0,43	0,57	0,28	0,17
Henan	1,22	0,97	1,49	0,65
Hubei	1,56	1,82	1,26	0,79
Hunan	0,48	0,49	0,46	0,19
Guangxi	0,52	0,76	0,26	-0,01
Western Region	**2,61**	**2,97**	**2,17**	**0,57**
Sichuan, incl. Chongqing	1,26	1,72	0,74	0,47
Guizhou	0,08	0,09	0,06	-0,24
Yunnan	0,29	0,30	0,27	0,16
Tibet	0,00	0,00	0,00	0,00
Shaanxi	0,67	0,64	0,70	0,16
Gansu	0,12	0,04	0,22	0,09
Qinghai	0,02	0,00	0,04	0,02
Ningxia	0,08	0,12	0,03	0,03
Xinjiang	0,09	0,06	0,11	-0,12

FIE: foreign invested enterprises (comprising FFE and HMT)
FFE: foreign funded enterprises excluding those with capital from Hong Kong, Macao and Chinese Taipei
HMT: enterprises with capital from Hong Kong, Macao, Chinese Taipei
Source: National Bureau of Statistics, China and own calculations.

Main Determinants of China-bound FDI Flows: Theoretical Considerations

Any analysis of the development of FDI inflows over time and their regional distribution must consider why an enterprise should engage in investment projects outside its home region. The production of goods and services in a foreign country will incur additional costs arising from the need to dispatch personnel abroad, international communication and travel/transport, language and cultural barriers, increased costs of information gathering and securing contractual security. This section will therefore first look at the motives for FDI from a corporate perspective; and then, against the background of the investors' motivation for FDI, will move on to the perspective of the prospective host regions. It will then try to identify the parameters with which various locations are competing for FDI inflows and the manipulation of which might influence the location choice of multinational enterprises (MNEs).

The Investor's Motivation

The theory of the MNE as developed by Hymer, Kindleberger, Heckscher, Ohlin, Casson, Vernon and others, and integrated in Dunning's eclectic OLI paradigm (Dunning 1981) identifies four basic motives for FDI, a mixture of which usually determines the investment behaviour of MNEs (Stein 1991): resource seeking FDI; efficiency seeking FDI; market seeking FDI; and strategic asset / capability seeking FDI.

- *Resource seeking FDI* is motivated by the wish to exploit interregional factor price differentials for the MNEs production process. This type of FDI usually amounts to a vertical split of the MNEs production process between skill and/or capital intensive processes at the headquarter, and labour intensive manufacturing abroad. As the different factor proportions found in the host economy often go along with low local purchasing power, the FIE are mostly export oriented (Helpman/Krugman 1985).

- *Efficiency seeking FDI* follows a similar pattern. It is driven by the motivation to realise economies of scale and scope, to diversify the MNEs' risk exposure, and to take advantage of the different comparative cost advantages of various economies for the MNEs' production process.

- *Market seeking* FDI is motivated by the intention to supply a market that until then had been supplied with exports (if at all) with locally produced goods. It is not the differences in factor prices that lead to this move, but rather the appraisal of proximity to the foreign market versus the advantages of concentration of the production process at one location. Whenever the advantages of proximity outweigh those of concentration, FDI will appear to be a rational choice (Markusen/Venables 1998). This type of FDI may be classified as "horizontal" as the production process is not split, but rather duplicated at the foreign location. Specific reasons motivating market seeking FDI may include the potential of the foreign market, the need for complex product adaptations to local tastes and demand structures, the wish to follow important customers into the foreign market, etc. Given the existence of a reasonable market size, the willingness for market seeking FDI operations may also be prompted by the need to circumvent barriers to trade erected by the host economy.

- *Strategic asset / capability seeking FDI* is based on strategic considerations with the intent to consolidate and strengthen the long-term competitiveness of the corporation. Such FDI operations may be driven by the motivation to occupy market shares and achieve learning effects in an early stage of market development, to block or inhibit business activities of competitors, or to counter the move of a competitor already positioning himself in the foreign market.

The Host Economy's Perspective

Seen from the corporate perspective FDI operations are to be understood as rational management strategies devised to enhance corporate wealth in the context of specific environmental constraints. At the same time the active promotion of FDI inflows may also be the dominant strategy for local governments in order to promote regional economic development.[9] The main positive impulses FDI inflows may exert on the host country are:

- an expansion of domestic capital formation beyond the degree that could be financed with domestic savings;
- the provision of production and process technology formerly not known to the host country;
- the creation of jobs;
- the training of technical and managerial personnel;
- the introduction of modern management and organisational know-how;
- the possibility to use foreign invested enterprises (FIE) as a benchmark for local enterprises with respect to various parameters like capital and labour productivity, logistics, quality control etc.
- the promotion of the domestic export-industry plus the ensuing positive effects on the trade balance and the availability of foreign exchange.

Parameters of Locational Choice

The motivations for FDI are quite diverse. Accordingly, the demands MNEs have on a potential host economy can differ considerably, depending on the main motivation for the venture. Some of the parameters determining the investment decision of a MNE are lying beyond the influence of the potential host regions,[10] others however may be created deliberately in order to attract FDI.

Factors increasing the attractiveness of a region for any type of FDI include:

- the existence of a comprehensive and transparent *regulatory framework* covering all FDI respectively FIE related activities, which is also easily enforceable;
- an *efficient administrative apparatus* devoid of excessive red-tape and preferably servicing FIE with one-stop approval processes;
- a *coherent economic policy* that allows long-term planning;

- the availability of an *efficient infrastructure* in terms of transportation, telecommunication and financial services;

- the presence of FIE. The larger the existing *accumulated FDI stock* the more positive externalities (i.e. the availability of human capital, complementary industries, experienced local administration etc.) new FIE can expect to benefit from;[11]

- the availability of *local enterprises* able to provide complementary business services and engage in subcontracting.[12]

Policies offering fiscal and/or tariff incentives to foreign investors are often mentioned as a way to attract FDI. Empirical evidence, however, indicates that the impact of such policies on the inflow of FDI is only marginal (Wells 2001; Mintz 1990). Only in a stalemate situation, when two competing regions appear to be equally attractive to an investor, might such incentives have decisive influence on the location choice.

Resource and efficiency seeking FDI can be expected to pay special attention to the following parameters.

- *Access to local goods and factor markets.* The unimpeded access to local goods and factor markets is a precondition for any FIE engaging in manufacturing activities in a given region. The prevalence of grey markets, where administrative bodies, old boys networks and other informal arrangements dominate the allocation of inputs, inhibits the establishment of FIE.

- *Labour cost.* One of the most important determinants for resource seeking FDI is the availability and price (efficiency wage rate) of unskilled labour. In terms of the intra-Chinese competition for FDI, this factor, however, may be less important than might be deduced from the literature dealing with international location choices. The efficiency wage differentials between the various regions are comparatively minor, as a perpetual stream of migrants is flooding the centres for labour intensive manufacturing at the Chinese coast belt. This intra-Chinese translocation of unskilled labour is preventing the wages in the industrial growth centres from rising to prohibitive levels (Broadman/Sun 1997, 348).

- *Human capital*. A region's human resource endowment, however, may be regarded as an important differentiating factor. In China skilled labor is scarce and the non-availability of managers, engineers or skilled technicians in a given region might prove to be highly detrimental to the attraction of FDI.

- *Natural resource endowment.* The availability of abundant natural resources promotes the attraction of FDI. This, however, applies only to a comparatively small share of MNEs that are active in such natural resource intensive businesses.

- *Access to the world market.* Resource seeking FDI, which target the world market with their products, are dependent on an unrestricted access to the global market place. Inhibitions resulting from anti-trade bias of the host economy or trade barriers erected against the host economy, such as quotas, would remove one of the central preconditions for the execution of such FDI. Administrative measures adding to the transaction costs of trade activities have a negative effect on FDI attraction.[13] The provision of transaction cost saving infrastructure facilities, linking the host region with the target markets of its (potential) FIE in terms of transportation as well as communication will increase a regions attractiveness for FDI.

Market seeking FDI will first of all take into consideration the size and growth perspectives of a potential investment location. *GDP* and *per capita income* are important parameters to evaluate the potential demand of a region. They, however, show only a part of the picture, as only segments of the local market may be accessible. Taking into account the regional fragmentation of the Chinese economy and the existence of artificial barriers to intra-Chinese trade, the *size of the local market* (often identical to an administrative region) that can be supplied from a given location becomes a further important parameter for the investment decision. This point is highlighted by the exorbitant costs of intra-Chinese transportation,[14] which has resulted in the duplication of transportation and logistics networks, by MNEs already operating in China.

A further restriction of the relevant market size arises from restricted *access to distribution channels*, which may prevent FIE from realising potential business. A further parameter influencing the investment decisions of market seeking FDI might be seen in the degree of urbanisation, which may be taken as a proxy for a comparatively affluent population, autonomous and increasingly market oriented administrative bodies, and a favourable industrial fabric of private entrepreneurs, service orientated businesses and functioning trade mechanisms (Gipouloux 1998, 9f; Qu/Green 1997, 114).

The Role of FDI in Economic Development in China's Coastal Regions

Having outlined the main parameters determining the regional distribution of FDI, the paper will now turn to the concrete experiences of two regions that have been the main beneficiaries of FDI inflows during the past two decades. The identification of the factors contributing to their extraordinary success in the attraction to FDI, and their experiences in FDI induced economic development may provide some clues as to what could be appropriate measures to initiate a FDI-led growth process in the Chinese hinterland.

The Case of Guangdong and the Pearl River Delta

The province Guangdong, and especially its Pearl-River Delta Region, have, since the early 1980s, gone through a tremendous growth process propelling the province to the top of China's most affluent regions (see table 1 above). With an average real GDP growth of 14.2% per year Guangdong not only by far surpassed the national economy, which grew only by 8%, but topped the 'growth miracles' Hong Kong, Korea, Singapore and Chinese Taipei had featured in their 'take-off' periods, as well (Lan 1999, 210). These developments have been accompanied by an impressive accumulation of FDI in the province. As shown above, Guangdong absorbed nearly one half of all FDI China attracted during the 1980s, and was host to more than one quarter of the national FDI inflows in the 1990s.

Various factors have come together in order to facilitate this development process:

- First of all, Guangdong has profited immensely from its long coastline facing the South East Asian growth centres and its proximity to major international shipping routes providing it with easy access to the world markets. This geographical setting has provided the province with a logistical advantage vis-à-vis the interior provinces.

- In historical perspective Guangdong was fortunate to be outside the focus of Beijing's economic policy at a time when ideological and political considerations prevailed over economic calculus. During the early 1960s to the mid 1970s one of the main features of China's economic policy was the third front strategy (Naughton 1988). Expecting the outbreak of a new war, the Chinese government tried to transfer the industrial backbone of the Chinese economy from the coastal areas to the Western hinterland, where it would be much better protected against war destruction and could continue to supply the Chinese forces with military equipment. Guangdong's industrial basis was comparatively weak and technologically backward in the late seventies (Liao/Guan 1988, 118). Its state owned enterprise sector was much smaller and less important for the local economy than in other provinces. In retrospect, however, Guangdong has been profiting from the neglect it had experienced during the previous decades. In contrast to other regions, whose economic take-off in the eighties was seriously burdened by industrial structures inherited from the preceding three decades, Guangdong could enter the era of economic reform and opening without having to tear down a large inefficient state owned industrial sector first.[15]

– The population of Guangdong has strong ties to the global community of overseas Chinese. Guangdong is the home province of a community of about 19 million overseas Chinese (Zhang 2000, 130; Redding 1990, 22), a considerable number of which have come to affluence in other parts of the world. These overseas Chinese entrepreneurs have become important promoters of Guangdong's economic development (Sah/Taube 1996). Especially the population of Hong Kong has very strong ties to Guangdong. In 1981 about 40% of Hong Kong's population was said to have been born in mainland China. And in the early 1990s about 80% of Hong Kong's population were either born in Guangdong or could trace its family roots to the neighbouring Chinese province (Wu 1994, 16). These close (blood) ties could have been instrumentalized to create informal co-ordination mechanisms that were able to provide contractual security wherever formal regulations were missing (Ben-Porath 1980).

– Guangdong was chosen by the central government as a forerunner of the Chinese reform and open door policy (Howell 1993, 53). Not only were three of the four Special Economic Zones established in 1979/80 located in Guangdong, but the provincial government was also granted considerable leeway in respect to the design of its economic institutions as well (Huang/Zheng/Ding 1993; Taube 1997). That way Guangdong gained substantial independence from the central government and was able to become detached from the much slower reform process in other parts of the country. By constituting the avant-garde of the Chinese reform movement Guangdong has been able to offer local and foreign entrepreneurs the most progressive institutional framework to be found in China's transformation economy.

– The economic development of Guangdong has, to a considerable extent, been driven by the entrepreneurial spirit of its local government cadres (Vogel 1989, 313-337), which have striven hard to make the best of the privileged position the province held in terms of its geographical, historical, cultural and political situation. For a substantial period of time Cantonese officials have been acting with a great degree of autonomy from central government and existing regulations.[16] This behaviour can be regarded as an expression of progressive forces driving the transformation progress ahead. To a considerable degree, however, it has also contributed to macro-economic instability and to the emergence of inflation, volatile growth cycles, and the build up of industrial over-capacities on a national level.

- The most important element in Guangdong's growth miracle, however, has probably been the fact that, when, in the late 1970s, the province reoriented itself towards the world economy, it was lucky enough to find right on its doorstep an economy that featured complementary industrial structures.

Whereas Guangdong disposes of an almost inexhaustible supply of cheap labour, continually augmented by a permanent stream of migrant workers from the hinterland, and has also been in a position to provide low-cost housing and land-use rights, Hong Kong's advantages lay in having enterprises featuring marketable products, precise knowledge of the global market, management staff who have learnt how to hold their own in an extremely competitive environment as well as efficient financial and logistic sectors. These respective endowments have been ideally combined since the late 1970s. Just when Hong Kong was approaching the limits of labour intensive manufacturing in the confines of its territory, the political changes in Beijing opened the possibility to relocate these production processes across the border to Guangdong.

The dominant mode of co-operation has been processing and assembling operations, with the Hong Kong side providing construction plans, raw materials and primary products to the Cantonese plant, where the labour intensive value-added processes are carried out. The finished products are then distributed via the global distribution network established by the Hong Kong office. In this form of labour division the Hong Kong side is responsible for market research, product design, quality control, customer-oriented packaging, and marketing, while the Cantonese side is in charge of the actual manufacturing process.

Over the past twenty years economic development in Guangdong, especially in the Pearl-River Delta, has been in tandem with Hong Kong, which has been the leading partner in this symbiotic relationship, while Guangdong has been absorbing nearly all labour intensive segments of the value chain from Hong Kong. The economic structure of Guangdong has changed dramatically (see Table 5). FIE have become the dominating enterprise form in an economy that is highly outward oriented.

Table 5: Developments in the economic structure of Guangdong, 1980-1999					
	1980	**1990**	**1999**	**`99-`90 in %points**	**`99-`80 in %points**
Share in National GDP	5.6	10.2	9.7	-0.5	4.1
Structural Composition of GDP					
Primary Sector	33.2	24.7	12.1	-12.6	-21.1
Secondary Sector	41.1	39.5	50.4	10.9	9.3
Tertiary Sector	25.7	35.8	37.5	1.7	11.8
Structure of Industrial Output Value					
Light Industry	63.0	71.3	66.0*	3.0*	-5.3*
Heavy Industry	37.0	28.7	34.0*	-3.0*	5.3*
Contribution to Industrial Output Value					
State Owned Industry	63.1	39.3	7.6	-31.7	-55.5
Collective Owned Industry	27.6	36.3	22.2	-14.1	-5.4
Foreign Funded Enterprises	1.9	6.9	48.4	41.5	46.5
Others	7.3	17.5	21.8	4.3	14.5
Ratio of FDI-Inflows to GDP	0.008	0.04	14.2	14.0	14.0
Contribution of FIE to Investment in Fixed Assets	n.a.	n.a.	20.3	--	--
Composition of FDI					
FFE	12.6**	25.4	34.9	9.5	22.3**
HMT	87.4**	74.6	65.1	-9.5	-22.3**
Ratio of Exports to GDP	15.2	34.3	76.0	41.7	60.8
Composition of Exports					
Primary Goods	n.a.	9.8	3.9	-5.9	--
Manufactured Goods	n.a.	90.2	96.1	5.9	--
Share of Processing and Assembling in Exports	4.2	72.6	77.7	5.1	73.5
Contribution to Total Export Value					
State Owned Industry	100.0	74.9	46.0	-28.9	-54.0
Collective Owned Industry	n.a.	n.a.	2.6	--	--
Foreign Funded Enterprises	0.0	24.7	50.7	26.0	50.7
Others	0.0	0.4	0.7	0.3	0.7

* Data for 1997 as in the following years a new statistical concept has been applied making a comparison over time impossible.
** Data for 1985.
Source: Statistical Bureau of Guangdong and Guangdong Statistical Yearbook.

A closer look at Guangdong's FIE shows that they are on average comparatively small, with over 90% belonging to the small and medium sized enterprise sector (Zeng 1999, 111). The key to the symbiotic growth partnership with Hong Kong has been the translocation of industrial production capacities from Hong Kong's industrial high rise buildings to the Pearl River Delta. FDI originating in Hong Kong has consequentially constituted the bulk of all FDI attracted by Guangdong. FDI originating in Hong Kong had a share of 82% of total FDI-inflows to Guangdong during 1985-95. In the latter half of the 1990s the share however dropped to about two thirds of total inflows (Guangdongsheng tongji ju [Statistical Bureau of Guangdong] various). There is a very strong concentration of industrial activities of enterprises funded by entrepreneurs from Hong Kong, Macao and Chinese Taipei in Guangdong.

The business activities of these FIE are overwhelmingly concentrated in low-tech, labour-intensive outward processing activities. The contribution of these outward-processing activities to economic development of Guangdong is quite substantial, despite the fact that only a comparatively small share of the outward processing exports constitutes value added in Guangdong. With a processing margin – which may be taken as a proxy for locally value added – of about 30% export processing contributed one sixth to one fifth of Guangdong's GDP in the late 1990s. It is important to note that this contribution to GDP does not go along with any major crowding out effects, but can more or less be regarded as a net addition to the province's economic performance, as these businesses employ production factors which had mostly been lying idle before. This applies first of all to the unskilled labour force, which, as the local population has long since been absorbed, is now recruited from the unemployed in the intra- and extra-provincial hinterland. The opportunity costs of land and capital, on the other hand, are comparatively small as neither factor is used extensively in outward processing businesses (Sung 2000, 64-66).

The impact of these enterprises on the development of the local industry, however, has to be evaluated as being comparatively small. Due to their outward orientation with respect to their inputs as well as their output no major interfaces with the local industrial sector exist and only minor spillover effects can be realised (Lemoine 1998, 102). One point, however, cannot be evaluated too highly: in Guangdong's 50,000plus processing plants a new generation of Chinese managers are educated and getting accustomed to the realities of doing business in a market environment[17].

In addition, FIE have also been highly instrumental in the build up of Guangdong's infrastructure, which in turn constitutes another prerequisite for the attraction of new manufacturing FDI. This effect results, on the one hand, from the generation of profits (tax revenues!) and accumulation of capital in the industrial sector, which enables the localities to improve the local infrastructure (Lau 2000, 99; Chan 1998, 62). On the other hand, substantial amounts of FDI have been directed into numerous ventures designed to improve the transportation network and other infrastructure facilities.

These self-enforcing effects have contributed to a continuous increase of FDI inflows to Guangdong. However, they have not been able to prevent a reduction in the relative importance foreign investors are attributing to the province. The percentage of overall FDI flowing to Guangdong has shrunk just as the share of Guangdong in national FIE industrial output (Table 5). In essence, the bulk of Guangdong's FDI stock can be characterised as strongly export oriented resource-seeking FDI, which has been attracted first of all by low labour costs and a favourable geographical location (with the necessary infrastructure having been constructed mostly parallel to the expansion of FDI operations). Highly important has been an entrepreneurial spirit in local administrations, which made the best of their "first mover advantage" in the national open door policy, and close relationships to the overseas Chinese community. The ability to substitute missing formal regulations with spontaneously created informal co-ordination mechanisms has given Guangdong an edge over other regions which could not take recourse to such informal institutions.

The Case of the Yangzi River Delta

While Guangdong and the Pearl River Delta had been China's most dynamic growth centre in the 1980s, the Yangzi River Delta has become the focal point of economic development during the 1990s. At the core of this newly evolving economic area of the Yangzi River Delta lies Shanghai, with the southern prefectures of Jiangsu province (Sunan) and the northern prefectures of Zhejiang province constituting the outer rim (Chan 1998, 51-55). When China entered the reform era in the late 1970s, this region had very different starting conditions from Guangdong and consequentially features a distinctly different pattern of FDI attraction and economic development.

At the outset of the reform era, in 1978, Shanghai was China's most important contributor to national income, industrial output and revenue (Wei 2000, 127). Its GDP per capita was the highest in all China, far above the national average (see table 2). The price for this exposed position, however, was very strict control by the central government and a dominating role of state owned industry. In 1978, SOE had a share of more than 91.1 % in Shanghai's industrial output – the highest ratio of all Chinese provinces.

The inclusion of Shanghai in the Chinese reform and open door policy has been a very slow process. Shanghai was not included in the pilot regions allowed to explore new modes of foreign economic co-operation. Instead of granting the local administration greater decision making powers, as was the case in Guangdong, central government was not willing to loosen its control over economic development in the city. At the same time, when Guangdong was profiting from a very favourable system of sharing its tax revenues with the central government, which not only allowed it to keep the larger part of revenues in the province but also entitled it to dispose of the revenues comparatively autonomously, Shanghai was in serious fiscal distress. The central government was siphoning off the larger part of its tax revenues, leaving the city with an inadequate budget (White III 1989), seriously inhibiting urban infrastructure development and industrial upgrading.

These structural characteristics proved to be a serious burden for the city's economic development during the 1980s and have only recently been overcome. Coinciding with a relative strengthening of Shanghai's position in the national political circles relative to Guangdong, in the early 1990s Shanghai has been able to reverse its disadvantaged situation. The city's fiscal situation has been dramatically improved and far-reaching decisions have been reached to reposition Shanghai in a national and international context. The implementation of the Pudong development strategy constitutes the core of this new development approach (Chan 1998, 49f.). See table 6 for some key indicators of this development.

Table 6: Developments in the economic structure of Shanghai, 1980-1999					
	1980	**1990**	**1999**	**`99-`90 in %points**	**`99-`80 in %points**
Share in National GDP	7,1	4,1	4,6	0,5	-2,5
Structural Composition of GDP					
Primary Sector	4,0	4,3	2,0	-2,3	-2,0
Secondary Sector	77,4	63,8	48,4	-15,4	-29,0
Tertiary Sector	18,6	31,9	49,6	17,7	31,0
Structure of Industrial Output Value					
Light Industry	51,8*	51,5	43,1	-8,4	-8,7*
Heavy Industry	48,2*	48,5	56,9	8,4	8,7*
Contribution to Industrial Output Value					
State Owned Industry	n.a.	n.a.	23,0	--	--
Collective Owned Industry	n.a.	n.a.	10,5	--	--
Foreign Funded Enterprises	n.a.	n.a.	50,6	--	--
Others	n.a.	n.a.	15,9	--	--
Ratio of FDI-Inflows to GDP	0,1	1,1	25,1	24,0	25,0
Contribution of FIE to Investment in Fixed Assets	n.a.	8,5***	17,5	9,0***	--
Composition of FDI					
FFE	n.a.	n.a.	57,5	--	--
HMT	n.a.	n.a.	42,5	--	--
Ratio of Exports to GDP	18,2*	33,6	38,6	5,0	20,4*
Composition of Exports					
Primary Goods	n.a.	n.a.	4,1	--	--
Manufactured Goods	n.a.	n.a.	95,9	--	--
Share of Processing and Assembling in Exports	3,6**	39,1	46,2	7,1	42,6**
Contribution to Total Export Value					
State Owned Industry	99,4**	94,3	44,9	--49,4	-54,5**
Collective Owned Industry	--	--	--	--	--
Foreign Funded Enterprises	0,6**	5,6	55,1	49,5	54,0**
Others	--	--	--	--	--

* Data for 1978. ** Data for 1985. *** Data for 1995.
Source: Statistical Bureau of Shanghai and Shanghai Statistical Yearbook.

In line with these developments various stages of FDI attraction can be distinguished in Shanghai. While during the 1980s FDI concentrated mainly in hotels and other tourism related facilities, manufacturing directed FDI picked up only in the latter half of the 1980s. During the 1990s a comprehensive intensification of FDI inflows could be observed. FIE in the tertiary industries have been promoted by Shanghai's pilot role in opening various service industries, most of all in the financial sector, to foreign investors. With respect to manufacturing oriented FDI a bipolar structure has developed with small scale, export oriented enterprises on the one hand and large scale, local market oriented enterprises on the other hand. While the former are mostly ventures by Hong Kong and South East Asian investors, the latter are mostly FIE with European and US interests. A salient feature of recent FDI inflows to Shanghai is the comparatively large share of big item projects directed in capital and skill intensive industries (Tian 1999, 168f.).

Shanghai's FIE are on average larger and more capital and technology intensive than FIE in Guangdong. In addition much more FIE are 'market seeking', targeting the Chinese and not the world market with their products. All this implies that Shanghai's FIE do not only have a large potential for growth promoting spill over effects (in terms of their technological capabilities), they are also much more inclined to realise these spill over effects as they are more dependent on collaborating with local enterprises.

Analysing the factors determining the inflow of FDI to Shanghai during the 1990s, a couple of points seem to be of foremost importance:

- The take off in the 1990s has first of all been the consequence of a new orientation of central government policies towards Shanghai. This has allowed Shanghai to cast off some of the constraints preventing a dynamic development in the preceding decade. The fiscal situation improved, market mechanisms were allowed to take hold, the tertiary sector blossomed[18], and Shanghai caught up with other regions in terms of its openness to the world market.

- Shanghai has now become able to offer FIE very attractive supply side conditions. Shanghai's role as China's leading national financial centre guarantees comparatively easy access to financial services. In addition it disposes of a large labour market, attracting large numbers of unskilled labour as well as highly skilled managers, engineers and technicians from all over the country. As a consequence of a – now burst – real estate bubble even office space has lost in scarcity. All in all the city features the greatest range and availability of complementary services, FIE can probably find in China.

- Once the microenvironment had been made more attractive for foreign investments it has become possible to profit from the historical (pre-war) heritage of the city. This includes the revitalisation of historically strong links to industrialists whose families had come to riches in Shanghai and moved to Hong Kong or Chinese Taipei during the war period. But Shanghai gained also from its former image as an 'enigmatic' Asian metropolis, in so far as foreign experts could be quite easily attracted to the city's FIEs, while FIEs in other regions of the country had serious problems of finding qualified expatriates.

- Shanghai features a large market for industrial goods and is possessing one of the few consumer markets in China with a critical mass of people equipped with substantial purchasing power.

- Last not least the city is profiting from strong agglomeration effects. The concentration of FIEs in Shanghai allows for intensive inter-FIE labour division and has even created a local labour market for expatriates.

The rise of Shanghai has been complemented by developments in neighbouring Jiangsu and Zhejiang provinces. While Shanghai was still heavily constrained by its special relationship to central government, Jiangsu and Zhejiang were striving ahead in the promotion of township village enterprises (TVE) and private enterprises (Wei 2000, 132). These highly entrepreneurial small and medium sized enterprises have now become one pillar of a very successful integrated top down – bottom up regional development process. On the one side is Shanghai, which in the course of its own development process translocates 'old' industries to the periphery, while on the other side a bulk of highly flexible small and medium sized enterprises absorbs industrial processes no longer profitable in the metropolitan area, and complements Shanghai's industrial fabric.

The FIE located in the two provinces are taking advantage of exactly this mode of inter-regional co-operation. A large part of these ventures are resource seeking enterprises with capital from Hong Kong and Taiwan, producing mainly for the world market. The share of FIE in Jiangsu's total exports, e.g., is even higher than in Guangdong. These FIE are on the one hand profiting from the proximity of Shanghai and its tertiary industries, and on the other hand are taking advantage of the local enterprise sector, which is filling in the complementary segments up- and downstream the value chain.

Especially during the later half of the 1990s this symbiotic growth pattern between Shanghai and its periphery has been strengthened. A large number of manufacturing plants has been transferred from Shanghai to the adjoining industrial districts, while the city itself has concentrated on transforming itself into a centre for tertiary industries with the financial sector at its core (Boillot/Michelon 2000, 28). Shanghai is now more and more occupying a position similar to that Hong Kong has been playing for Guangdong.

In general, FIE in the Yangzi River Delta region are characterised by a comparatively higher percentage of FFE (less HMT) in FIE, which manifests itself in a smaller share of labour intensive outward processing in FIE business activities, and a larger scale and higher technology content of investment projects on average. As outward processing businesses are less important for their activities, FIE are obliged to integrate more with the local economies, thereby creating more growth enhancing spill-over effects to local industry than in Guangdong. These characteristics apply most of all to Shanghai, while the economic development process in the Yangzi River Delta Region in its entirety is becoming more and more similar to that of Pearl River Delta, with Shanghai as the leading service centre and the surrounding prefectures as a manufacturing base.

Towards FDI-Led Economic Development in China’s Hinterland

It should be stressed that the locational advantages a region offers to attract FDI inflows can only partly be shaped by government interventions. Other variables are based on geographic and historic circumstances and cannot be changed by politics (Knödler/Alberts-hauser 2001, 29f.). Therefore, some regions will always be advantaged or disadvantaged vis-à-vis others. There is no use in trying the impossible. Each region can only try to enhance its particular locational advantages and try to promote development processes corresponding to these. The hinterland provinces therefore cannot and should not try to copy those development strategies that have been so successful in the coastal regions. A different type of FDI inflows has to be targeted. In the following paragraphs we will therefore outline the Western region’s starting position in terms of locational advantages and disadvantages. Based on this knowledge we will then try to sketch some strategic choices the West has got in order to induce higher FDI inflows. We will then turn to the role government may play in order to kick-start and promote such a process, before we turn to the question how to derive maximum benefit from FDI inflows.

The starting position

The latecomers in the Chinese hinterland are certainly in a disadvantaged position with respect to their attractiveness for FDI. They are far removed from the world market, burdened with the remnants of a faltering state owned industry, handicapped by a reform and open door policy that has discriminated against them for at least 15 years, and possessing only a very restricted local market. In addition there was a substantial brain drain to be observed during recent years when the Western region’s most skilled and entrepreneurial youth migrated to the East Coast, where it could expect higher salaries and better living conditions. And contrary to political will – but very much in concordance with economic theory – net-capital flows have been moving from the West to the East belt, where much higher earnings could be realised, in such a way further draining the West of important resources for its own economic development.

In comparison, locational advantages may be identified with respect to abundant natural resources, strong agricultural foundations, a reservoir of skilled labor in former military managed enterprises, research institutes and universities, a huge mass of cheap unskilled labor, and numerous scenic spots with touristic potential.

Strategic Choices towards FDI-led growth in China's Hinterland

Against this sobering analysis of the West's locational advantages and disadvantages the question arises, which strategies might be most suitable to attract FDI to the region? Obviously the promotion of direct export orientation would run counter to the regions comparative advantages. It rather seems to be more promising to target resource-seeking FDI, which integrate the West into the value chains of the eastern coast's (export) businesses. This strategy aims on the one hand at investments from Chinese enterprises and FIEs (including transplants of FIEs already established in the East) whose value chains contain sizeable segments which do not have to be located close to the final customer. We may think e.g. of back office activities, call centres, accounting, processing of tickets (airlines) and bills (hotels). A sine qua non, however, would be the build up of a modern IT-infrastructure in the West and the prevention of a digital divide separating China's West from the Coastal belt. On the other hand improvements of transport logistics and the tearing down of intra-Chinese barriers to trade might give the West a chance to substitute those natural resource and labour intensive inputs which the Eastern Chinese enterprises are still importing from outside the country.[19] In the longer term it might be feasible to locate R&D facilities in the West and make use of the skilled labour until now absorbed in state and military enterprises.

A second, complementary strategy should target market-seeking investments and therefore try to bolster local purchasing power. This approach would be trying to attract investors that intend to produce for the local market and are therefore not predominantly looking at the local factor endowment.

As a general principle, the industries targeted by the various initiatives to attract FDI should follow a sequence of increasing infrastructure requirements, starting with those industries that require only minor (extra) infrastructure facilities and then moving on to projects requiring more and more complex infrastructure.

Central and Local Government as a Facilitator of FDI Attraction and Development

As there exist certain path dependencies and vicious / virtuous cycles tend to establish themselves according to which FDI attracts more FDI, leaving regions with low FDI inflows in the first round with less and less chances to attract any as time unfolds, it seems to be necessary that government becomes involved. Its role is to break the vicious cycles draining the Western region of human and financial capital to the East's benefit and to boost local economic development up to a certain threshold level from where on market forces will suffice to attract funds and human resources. Such efforts however should be restricted to the creation of an attractive investment climate. Administrative interferences on the enterprise level should be ruled out. Any political promotion activities should be terminated once the targeted development threshold has been reached and market forces can take over.

In order to promote FDI inflows to and economic development in the western regions, government bodies both on the central as well as on the local level will have to become active. The central government is responsible for the integration of particular promotion policies in the context of the macro-economy and the national transformation process. It defines the freedom local governments have in creating their own microenvironment for FDI-attraction.[20] In addition it can direct resources under its control into the central and western provinces in order to improve the local investment environment. Last not least it has to act as a mediator, aligning the diverging interests of various actors and regions. The local governments will eventually be responsible for the creation of attractive micro-environments, providing the best possible bundles of immobile assets like infrastructure, services, supply networks, designed to complement the MNEs' mobile assets, the respective regions can offer.[21]

With the launch of “the Western Development Strategy” the Chinese central government has taken the initiative in order to attract and allocate money and other resources for the development of China's poorer, and during the last two decades more neglected, western region. It has steered $9 billion worth of state investment into the region in 2000 and plans to increase that annual figure this year and next. It is clear that support for some national-level projects will come from the central government, while a mix of provincial and national funds will support other projects. Support for still more projects will come from small townships and municipalities. In addition to government grants, some projects will be funded by private or semi-government funds, such as bank loans, equity financing, and bonds. In some cases, preferential financing will come from the government via preferential interest rates or repayment schedules. The State Development Planning Commission (SDPC) announced that the percentage of foreign preferential loans used towards western development would be increased from 60 to 70%.[22] This massive concentration of funds will greatly improve the physical infrastructure of the western region.

This build up of a physical infrastructure, however, will have to be complemented by an improved institutional set up of the market place. Especially the banking system will have to be modernized and freed of any “fiscal” functions it has still retained from the planned economic system. A greater availability of RMB-loans and an improved bankability of projects would be highly instrumental to attracting foreign investors, which until now shrink back from any engagement as they do not find the support by the financial system they need and are used to from ventures in other regions of the world.

In a move designed to prompt local initiative the central government has given not only greater authority to local governments in western areas to suggest their own strategies, but also has helped them in other ways. For instance, Beijing recently raised the provincial-level special economic zones of Changsha, Hunan Province; Chengdu, Sichuan Province; Guiyang, Guizhou Province; Hefei, Anhui Province; Kunming, Yunnan Province; Xi'an, Shaanxi Province; and Zhengzhou, Henan Province to national-level status, allowing them to offer more generous incentives to investors. All seven locations are viewed as strategically important to the development of China's interior.

It is also important to note that the wealthier and more developed eastern and coastal provinces are being asked to play a major role. The government expects them to provide special subsidies and establish joint ventures with western entities. They are called upon to develop new markets and bring advanced management and innovative production styles to less-developed western enterprises. Eastern China, most prominently Shanghai, has shown some commitment to funding parts of the western development program by signing 200 co-operative contracts with a total value of over RMB 10 billion ($1.21 billion).[23]

While the government is encouraging such assistance, the coastal regions do have some reasons of their own for wanting the west to develop. Not only will the west provide markets, energy, and a supply of raw and semi-finished materials that will contribute to the east's own economic restructuring. But the environmental and ecological programs in the upper reaches of the Yangzi River will also reduce flooding in the eastern provinces. Better infrastructure will allow the east to move its goods more easily to the west's 300 million consumers. And improvements in electrical grid distribution and the construction of more pipelines will directly benefit the east.

In its endeavours to attract FDI to make up for remaining shortfalls, the State Council has approved the “Directory of Dominant Industries in the Middle and Western Region”, which will encourage the efficient allocation of foreign funds invested in industrial sectors. Foreign-funded projects listed on the forthcoming “Catalogue Guiding Foreign Investment in Industry” will enjoy advantageous tax rates. For three years after the current preferential tax policy has ended, investors in these projects will enjoy an income tax rate as low as 15%. Enterprises with export volume exceeding 70% of total production may pay a rate as low as 10%. The Chinese government is relaxing its restrictions on where foreigners may invest. Foreign-funded retail firms, for example, may now establish operations in the provincial capitals of western China, and allowances for investment in telecommunications and insurance are expected to follow. In addition Chinese financial institutions will provide more loans to foreign-invested projects.

These various elements of the "Develop the West" strategy are certainly making an important contribution to the improvement of the Western provinces' attractiveness for FDI. This alone, however, will not be able to induce substantial FDI inflows to these provinces. Premier Zhu Rongji’s campaign to spur investment in western China is getting mixed reviews from foreign businesses. While some companies have taken the plunge and others are considering their options, many remain concerned about the lack of roads and facilities that far inland, corruption and a lack of business savvy among local officials. Nevertheless, some 80 multinational companies have already set up representative offices in western China, and 57 have invested directly, according to local media sources[24]. Some of the companies leading the charge are PepsiCo Inc., Coca-Cola Co., McDonald’s Corp., Carrefour, United Technologies Corp., and ABB Group. Exxon Mobil Corp. and BP Amoco Plc. are considering to develop a major oil and gas pipeline in the region, while Hewlett-Packard Co., Motorola Inc., Microsoft Corp. and Intel Corp. continue to size-up potential partners in the region, as well.

While the central government has dramatically improved the macro-environment of regional development and FDI attraction, local governments are now challenged. There seems to be still substantial potential for improvements in the design of local micro-environments for foreign investments. These activities, however, must be part of a comprehensive strategy encompassing the build up of a local industrial sector, and measures to prevent local capital and skilled labour from leaving the region – by market compatible incentives, not administrative interventions. A region that wants to attract foreign investments has to be attractive for local investments as well. FIE need a functional local industrial fabric to support their business activities.

An analysis of local strengths, their value for prospective FIE, and eventually ways to improve on these strengths may be a good starting point for the formulation of local strategies for FDI attraction. Strengths that the western local governments may build on their respective microenvironments for FDI inflows include:

- About 55% of China's idle land mass suitable for farming and 73% of China's pastures are located in the western region. By means of improving irrigation and introducing modern production systems these agricultural resources might be turned into very interesting assets, attractive for local and foreign investors. Top quality processed food specialties may even become very lucrative export goods.

- The heritage of a large number of military enterprises may not only constitute a burden on local development, but rather be turned into an locational advantage as these enterprises' workforce is characterized by a comparatively large share of engineers and technical personnel. Given a preparedness to change the existing business organisation and adopt modern management systems, these enterprises might be highly interesting partners (or takeover targets) for foreign investors.

- Provinces like Sichuan and Shaanxi have very strong research institutions and facilities of academic learning. These institutions have traditionally been emphasizing technological subjects and might be turned into interesting partners for R&D oriented FIE looking for human capital. The example of India shows clearly that a high level of human capital alone can attract substantial FDI inflows.

- The western region features some of the most enthralling scenic spots in all China. There seems to exist a huge potential for tourism industries. FIE may be included in opening up and marketing these resources to Chinese and foreign visitors.

It will be impossible to substantially improve the whole region's attractiveness for FDI at the same time. In the first phase of "the Western Development Strategy" efforts and resources should therefore be concentrated on the establishment of focal points of investment. Industrial districts for example may become the nuclei for industrial clusters thereby promoting the industrial development of a region as a whole.

The fight against corruption should constitute a further important element in local governments' strategies to attract foreign investors. It is an established fact that the spread of crime and corruption has a negative impact on FDI inflows, as they not only increase the investment risk and reduce transparency, but at the same time have the effect of a tax on the FIE's operations (Wei 1997). The Russian experience, however, shows as well that determined moves to counter corruption can increase a region's attractiveness for FDI (Brock 1993, 353).

The failure of numerous FIE projects caused by expatriates (and their families) not being able to settle down well in the host region and come to terms with the foreign environment, highlights an important soft factor of FDI attraction. Today many western enterprises face the problem that they might find personnel willing to move to the metropolitan centers at the eastern coast. But qualified people who are willing to move for two to five years to the central or even western regions are hard to find. Local governments able to create an attractive environment to skilled labor (Chinese and expatriates) will increase the chances of their region to attract FDI.

It remains questionable in how far promotional activities like tax breaks and tax exemptions granted to foreign investors are an auspicious means to stimulate FDI inflows. Not only is their effect on the locational choice of an MNE only marginal, but they may also be counterproductive. In so far as tax breaks and tax exemptions leave the local governments with inadequate means for infrastructure construction and the fight against crime and corruption the local microenvironment will remain in a sub-optimal state.[25]

The improvement of locational qualities alone, however, will not be sufficient to attract substantial amounts of FDI. The localities' endeavours to attract FDI are not conducted in the context of a seller's market, but rather a buyer's market (in the understanding that the localities are trying to sell their good "location"). It is therefore important that local governments not only permanently improve on their good "location" but take measures to attract the attention of potential investors as well. Due to the enormous information costs involved, even the largest MNEs will only test a small group of locations when considering a new foreign investment. Measures that raise the visibility of a region like the provision of information, image building etc. by an Investment Promotion Agency (IPA) might be a precondition for a region to enter the short list of a prospective investor and come under consideration for the location of a FIE at all (Metzger 2000, UNCTAD 1999, 319).

Once FDI has been attracted to a region, the localities should strive for repeat investments. By means of a proactive identification and satisfaction of the business development requirements of investors long-term win / win strategies to the benefit of the FIEs and the locality may be created and the potential for closures / translocations of local FIEs be minimised. By keeping close contact to the local enterprise sector IPA may not only play an important role in attracting FDI but also in keeping FIE in a locality and inducing repeat investments.

Linking FDI inflows with local enterprise development

The attraction of FDI will be a very difficult endeavour. But even this can only be a first step as at the same time it has to be made sure that the host regions actually benefit from the inflowing FDI. FDI inflows do not automatically benefit the host regions. Their potential for positive development and growth impulses to the host regions has rather to be actively explored by the regions.

One of the major structural disadvantages of the West not only making it little attractive for FDI but also seriously inhibiting its ability to profit from actually realised FDI inflows, is the insufficient availability of skilled labour. Due to their ability to pay higher wages, the application of modern management and production techniques and, last but not least, for image reasons, FIE are usually in the position to attract highly qualified personnel from all over the country. As a consequence, the country's elite tends to become concentrated in those regions where FIE are highly concentrated, which in turn attracts even more FDI. Regions, which have been successful in attracting FDI at an early stage of the Chinese reform era, have therefore not only been able to divert human capital from other regions, but have also initiated an agglomeration process which reinforces their competitive position vis-à-vis the latecomers.

The availability of human capital, however, is crucial to gather the positive impulses originating from FDI. As shown by Borensztein/DeGregorio/Lee (1998), the growth inducing impulses of FDI can be fully effected only when the host region possesses a minimum threshold stock of human capital. The host region must possess the capacity to absorb the advanced technologies and management skills made available by FDI-inflows in order to transform the FDI-induced growth potential into economic development. A principle task for government at all levels will therefore be the improvement of education and higher learning institutions and the creation of incentives and surroundings that keep qualified individuals from leaving the region.

Once the capacity of the region to absorb the positive impulses originating from FDI has been increased it will become of prime importance to create an environment that allows capturing the full benefits of FDI through linkages with local enterprise development.

FDI may lead to a crowding out of local investment and already established local enterprises, thereby reducing the positive effects of FDI to the host economy. Such an adverse effect may result from an uneven playing field, discriminating against the local enterprise sector, as FIE may have privileged access to global factor and goods markets. It may also be the result of differences in the stages of development local and foreign enterprises are in. Potentially competitive local "infant industries" might be unable to exist next to an FIE as they are forced to compete at a point in time when they are simply not fit to do so, yet. Crowding out of such infant industries would be economically undesirable and may become a topic of economic policy measures, if (a) local enterprises would be able to mature to full competitiveness if sheltered against FIE, and (b) this process will not take so much time that the discounted present social costs surpass the social benefits. (c) If net social costs exist, they must be outweighed by external benefits (UNCTAD 1999, 320).

FDI, however, may cause crowding in effects, as well, inducing local investment and strengthening the local enterprise sector. Such crowding in effects will be most likely if FIE introduce new goods and services to the host economy, and do not stand in direct competition with local investors. Local investment will be stimulated when FIE create new business opportunities in downstream or upstream sectors, as a FIE may create new stable demand structures, that provide local investors with a certain degree of planning security (UNCTAD 1999, 321).[26]

Crowding in effects are supposed to be the main channel of employment creation by FDI. While FDI themselves create numerous jobs,[27] it is the investment response of local enterprises that leads to the greatest employment effects in the host economy (Fitzgerald/Mavrotas 1997, 46). The example of Coca-Cola is a case in point: Coca-Cola and its bottlers directly employ about 14.000 people in China. These jobs, however, are dwarfed in comparison to the about 350.000 jobs which are said to have been created in Coca-Cola's supply chain and further 50.000 jobs being sustained by the distribution of Coca-Cola's products (Lawrence 2000, 50).[28]

With respect to the often stressed argument, that the hinterland provinces posses abundant natural resources which might attract FDI, it might be noted that empirical evidence suggests that only minor crowding in effects will result from mining and other raw material extraction projects as their potential for newly created linkages to the local enterprise sector is greatly restricted (UNCTAD 1999, 173). It seems to be advisable, rather, to emphasise the promotion of FDI in locally underdeveloped (light) industries catering first of all for the local market. These target industries seem to offer the greatest potential for backward and forward linkages.

The activities of the TVE and private enterprise sectors have proven to be highly responsive to market developments – much more so than the state owned enterprise sector – as documented by the rise of these types of enterprises in Guangdong and Jiangsu. Their promotion by means of an improved access to the goods and factor markets, an uncomplicated administration etc. is therefore not only expected to improve a region's capability to make the best use of the business potential arising from FDI inflows. In addition the existence of a strong sector of highly entrepreneurial small and medium sized enterprises will attract FIE that are looking for a vivid local industry, ready to complement their own business activities.

Impact of WTO Accession on Regional Development

Once China becomes a member of the WTO, the country will complete a total about-face from its earlier import substitution strategy to a strategy commenced in the 1980s known as the "open door" policy. It is expected that in the mid-term the WTO entry will boost economic development in China.[29] Growth impulses will result first of all

- from an improvement in terms of the organisational (institutional) set up of economic interaction in China itself and between China and the rest of the world,

- a more intense division of labour between China and the rest of the world which, in addition, will comply much better with the comparative advantages of the economies involved,

– productivity gains resulting from increased competition in the Chinese market.

These factors will lead to a substantial improvement of factor allocation in China and, therefore, a more efficient use of the resources available. At the same time the quantity of resources entering the economic process in China will be increased. Improved market access and a general liberalisation of the economic regime governing foreign invested enterprises will induce an upsurge of China-bound FDI. According to UNCTAD estimates, the FDI inflows to China may more than double to $100 billion a year in 2006 (UNCTAD 2000). Market seeking foreign enterprises can be expected to increase their commitment to the Chinese market considerably, as the adaptation period granted to China will probably be the last chance to position an enterprise in the Chinese market before market shares are distributed. But once these market structures are established, latecomers will be forced to commit disproportional higher financial and management resources, in order to establish their presence in the Chinese market.

The impact of China's WTO entry on economic development in the western region is not yet determined. On the one hand, the western provinces will be subjected to a severe shock as their agricultural sector as well as the majority of their SOE will face strong competition from foreign enterprises, which until now had not been allowed to penetrate the Chinese market by means of exports or FDI. On the other hand, it will be just those sectors, which had been most protected, that will be able to achieve the greatest productivity increases, when forced to compete with foreign enterprises.

The western provinces have a very realistic chance to profit from market seeking FDI, which in the pre-WTO era was prohibited from entering the Chinese market. Furthermore the promotion of mergers and acquisitions (M&As) involving FDI would provide the chance to substantially increase the inflow of foreign investments in the region, while at the same time finding a solution for the restructuring of ailing SOEs. (The East German experience, however, should remind all actors not to be too enthusiastic about this strategy.)

In order to facilitate increased FDI flows to the Chinese hinterland, China plans to relax restrictions on foreign investment in infrastructure construction and permit foreign investment on a trial basis in the service sector in central and western regions. The move is intended to attract more foreign capital and thus revitalise big and mid-size state-owned enterprises in these areas. The SDPC, the State Economic and Trade Commission (SETC), the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), and the Ministry of Land and Resources are working out the specifics of these policies.[30] The SDPC announced that foreign investors would be allowed to hold greater stakes in projects in central and western areas relating to the construction and operation of branch and local railways, urban subways and light railways, bridges, tunnels, ferry facilities, public docks, dock facilities for petroleum, petroleum transport, gas pipelines and the mining and processing of oil and gas resources[31].

However, foreign investors will not be allowed to wholly own key facilities directly affecting the national economy and the people's livelihood such as branch railways, local railways and bridges, tunnels and ferries. In line with agreements reached during negotiations for China’s entry into the WTO, foreign investment would be permitted on a trial basis in domestic commerce, foreign trade and tourism in central and western provincial capitals. Also, policies allowing foreigners to invest as minority partners in municipal facilities construction, public services, education and health care are being considered. Again, wholly foreign-owned businesses would not be permitted.

The SDPC is revising the "Provisional Regulations on Guiding Foreign Investment" and the "Guiding List of Industries Open to Foreign Investment" to meet WTO requirements. China will adhere to the agreed-upon timetable for opening its finance, insurance, tourism and telecommunications markets. In accordance with the "Notice on Strengthening the Assignment and Management of Infrastructure Property Rights and Interests" issued by SDPC in 1999, foreign investors are encouraged to participate in the transfer of state-owned enterprises' stock rights and operations in central and western regions to help activate dead capital and restructure the state-owned economy. Provincial governments will have the authority to examine and approve foreign investment in sectors where such investment is encouraged and shall report the investment to SDPC, SETC and MOFTEC for the record. Foreign investment in other areas will still have to be examined and approved in accordance with existing regulations.

Although there are many agreements under the umbrella of the WTO organisation, the four major legal obligations can be extrapolated from the major trade agreements, including GATT, TRIMs, and GATS: (1) Most-Favored-Nation status (MFN), (2) national treatment, (3) quantitative restrictions, and (4) transparency.[32] A further major achievement of the WTO has been the institution of dispute resolution mechanisms. Members are required to engage in consultation on trade issues. In the event of a failure to resolve outstanding differences, a member has the right to request the establishment of a panel, or a quasi-judicial committee, to adjudicate the dispute. All of the above-mentioned treaties and treaty obligations are expected to alter the investment environment in China in a dramatic way.

The day-to-day business of FIE in China will probably most of all be influenced by the stipulations on national treatment, quantitative restrictions and transparency. There are presently three major sets of foreign investment laws and regulations in China. The first is the Sino-Foreign Equity Joint Venture Law of 1979, as amended in 1990 ("JVL"), and the regulations promulgated under this law in 1983 ("RJVL"). The second is the Wholly Foreign Owned Enterprises Law of 1986 ("WFOE"), and the regulations for the implementation of this law promulgated in 1990 ("RWFOE"). The third is the Sino-Foreign Co-operative Joint Venture Law ("CJVL") of 1988, and its accompanying regulations of 1995 ("RCJVL"). They will now be measured up against the WTO requirements with a view to adjusting several provisions that are inconsistent with WTO treaty obligations. Generally speaking, WTO members are required to publish their laws and regulations, including trade and investment measures. In many agreements, members are required to notify not only the Secretariat or various Councils of the WTO, but also other interested members of their relevant regulations. There are also various obligations to engage in consultation and to provide information upon the request of other members. The transparency stipulations will undoubtedly be beneficial to all those conducting business in China.

Conclusion

Chinese government rightly worries about the growing disparities in per capita income between the fast growing, FDI-fuelled coastal provinces and the sluggish interior provinces. At the extreme, these disparities could lead to social tensions that could disrupt the generally harmonious character of Chinese society. On the other hand, in the name of preserving employment, the Chinese government pursues policies that arguably reinforce the already extant locational advantages held by coastal provinces with respect to foreign investment. Foreign investment in the interior, in particular, is likely, if it is to happen at all, to be characterised more by take-over of existing enterprises and less by greenfield investment than in the coastal areas. But, such take-over is effectively blocked and, indeed, policies are maintained that create inefficiencies in those foreign-invested enterprises that compete with incumbent domestic firms.

Premier Zhu Rongji has mentioned that the Western Development Campaign is to be a "long-term" program--one with a timeline of 20 or 30 years. This statement is likely an effort to underline that the program will be around for some time. This is also a realistic assessment, as China cannot afford to do everything at once, and the rate at which projects are approved will depend upon financing, foreign and domestic. China must combine the successful practices of the past with innovative techniques of the future. Many people may discover that when looking forward, it is not wise to leave behind the lessons learned in its coastal belt since 1978 and elsewhere in the world.

Main Issues for Discussion

In light of the preceding analysis, participants in the Xi'an conference are encouraged to discuss the following issues:

- what are the lessons to be learned from FDI in the coastal regions; how relevant could they be for the hinterland; what are the major similarities and dissimilarities;

- which development strategies would be necessary for the special situation in the Central and western regions of China and what role FDI may play in these;

- what role government may play in order to support such a development process – case from China and other countries; how could different international experiences with regional development relate to China;

- what preconditions the central/western provinces will have to meet in order to attract substantial FDI flows (including the establishment of subsidiaries of FIE located in the coastal belt); what are their comparative advantages;

- how best to capture the benefits of FDI through linkages with local enterprise development; what are the implications for labour migration and productivity;

- potential impact of China's WTO accession on regional development and regional distribution of FDI (further impulse for diverging development?);

- what are the areas of competition and/or tension between the central government and the local governments; and

- what are the public policy tools and measures for the central government and the provincial authorities to promote and facilitate investment, domestic and foreign alike, to the less developed regions.

NOTES

1 This paper has been prepared at a time when data for 2000 had not been available yet. The analysis and conclusions of this main issues paper have been confirmed by recently published data for the year 2000. For some data referring to the most recent developments please refer to the contribution by Jiang Xiaojuan in this volume.

2 The drive westward is intended to achieve several important goals, including the expansion of inland markets to relieve the country's dependence on exports and to boost consumer spending to stimulate economic growth. More importantly, the government hopes that companies inspired to invest in the west will provide employment in the future for workers laid off from flagging state-owned enterprises (SOEs).

3 Originally it was planned to promote the development of the central and western regions simultaneously. A lack of funds, however, led to a reformulation of the strategy. The government is now focussing its efforts on the western region and hopes that the 'sandwiched' central region will be pulled up by dynamic economic development in the eastern and western regions.

4 In this paper provinces are used as the main unity of comparison, although some considerable structural differences can also be observed on an intra-provincial level. In the province of Guangdong for example, can be found some of the richest as well as some of the poorest Chinese counties. The availability of statistical data, however, makes only an aggregated analysis feasible. See Herrmann-Pillath/Kirchert/Pan 2001.

5 Interestingly this new economic geography basically follows the patterns of the pre-PR China macro-regions (Gipouloux 1998, 8).

6 Such a wait-and-see attitude is consistent with the experience among other developing economies. Due to insufficient market information foreign investors delay their investment decisions until pioneer investors provide them with further insights into the market environment and the reliability of the host countries FDI pollicies (Huang/Shirai 1994, 19).

7 In 1992, the first year of substantial FDI inflows to China, FDI-flows to South Korea and Chinese Taipei dropped by 31% respectively 51%, thereby pointing at a considerable diversion effect in China's favor (UNCTAD various). It should also be noted that the upswing of FDI inflows to China coincides with a general increase in FDI flows to developing countries. Average annual flows directed towards developing countries in 1990-1993 were double those of 1987-1989 (UNCTAD various; Lardy 1995, 1066).

8 Bringing the analysis to the next level, one would observe that in Guangdong itself FDI have been highly concentrated in a few localities (i.e. the Pearl River Delta and the Shantou area) as well.

9 It is here assumed that FDI has a positive net effect on and is welcome in the host economy, without further discussing the various effects. For a discussion of this topic see Todaro 2000, 582-588.

10 These include, on the one hand, strategic decisions made against the background of the structural conditions of the (global) product markets the MNE is engaged in, the patterns of oligopolistic competition it is facing, risk diversification motives etc. On the other hand, they include peculiarities

of a given region, that cannot be altered in the short term, like geographical location, structural characteristics inherited from historical periods, etc.

11 The positive effects of such agglomerations will, of course, diminish when the agglomeration surpasses a critical size.

12 Gipouloux (1998, 8f.) argues that SOEs are not able to provide such services, resulting in a diversion of FDI inflows to regions with a comparatively small share of SOE.

13 It should be noted that import substitution policies, local content regulations etc. may, in the short run, promote the inflow of market seeking FDI, as foreign enterprises are prohibited from supplying the local market by means of exports. Market seeking FIE, once established, may also lobby for trade restrictions and market entry barriers, in order to strengthen their own competitive position in the local market.

14 TNT Logistics is reporting that 48% of total logistics costs in China are made up of losses and damages (!) (Boillot/Michelon 2000, 22).

15 Most of Guangdong's SOE have been set up only in the 1980s and 1990s. From the start they have been equipped with comparatively advanced technology and been led by a relatively progressive market-oriented management. On average, they have performed better than SOE in other provinces (Lan 1999, 221).

16 Their endeavours to promote local economic development have been characterised by Chen Yun, one of China’s leading economic policy makers, as a " 'traffic light philosophy', which he says originated in Guangdong, where the localities treat the centre's policies in three ways: 'When the red light is on, they make a detour and proceed as they were going; when the yellow light is on, they ignore it and keep going at the same speed; and when the green light is on, they rush ahead at full throttle.' " (Pye 1991, 459)

17 The training of young managers and engineers by FIE is also the starting point of a virtuous cycle promoting the inflow of new FDI and the further development of the local economy. The on-the-job training of managers and engineers increases the stock of locally available human capital. This enhanced stock of human capital, on the one hand, increases the attraction of the region for new FDI inflows and, on the other hand, enables the local economy to better absorb new technologies introduced by FIE.

18 It should be pointed out that the recent rise of Shanghai as a service center has not been a market driven process. Rather the central government's decision to concentrate the national finance industry in Shanghai has been the foundation for the dramatic growth of Shanghai's tertiary industry and the financial district in Pudong. Furthermore it has been strong administrative pressure that led to the concentration of the financial industry in Shanghai's Lujiazui Finance and Trade Zone. Foreign investment in the financial industry was not allowed to freely chose a location in China or even Shanghai; in order to receive a license offices had to be located in Lujiazui.

19 Until today the West’s cheap unskilled labor has been migrating to the capital concentrated in the coastal belt. Guangdong province with a native population of 80 million people e.g. hosts 12 million migrants. Now strategies might be conceived in order to bring the capital to the labor force and not vice versa.

20 The change in thought necessary for the successful implementation of the strategy calls for a detailed analysis to determine which solutions have and have not worked in China over the past 20 years. The central government is taking steps to ensure that local leaders do not initiate programs that are inconsistent with the strategy's goals.

21 It should be stressed that the western regions will have to strive to provide those general factors promoting the inflow of FDI described above in greater detail. Here, however, we do not wish to repeat these points, but rather concentrate on the specific conditions of the western regions.

22 Under this strategy, the majority of China's government spending will shift from coastal provinces to the west. Earlier in 2000, Zeng Peiyan, minister of SDPC, reportedly remarked that the state would pour 70 percent, or RMB 4.78 trillion ($580 billion) of fixed-asset investment and foreign loans in 2000 into the west--a 10 percent increase over 1999. In March, SDPC announced that the first investment of RMB 31 billion ($3.7 billion) would be made for infrastructure development.

23 At the same time, however, administrative bodies in Shanghai are lobbying to have electronics producer Changhong transfer its R&D activities from its home province Sichuan to Shanghai or otherwise make substantial investments in the city. These efforts seem on the one hand to stand in stark conflict with the national aim of promoting economic development in the western provinces. On the other hand it might be argued that this episode documents rising competition between provinces and should therefore give the western provinces unmistakable proof that they will have to improve on their own localities in order to attract investment (be it local or foreign). Furthermore it might be argued that such a linkage between Sichuan and Shanghai may create an axis along which further value chain linkages between the East and the West might be established.

24 Zimny, Joseph (2001): 'Go west' campaign gets mixed reviews from foreign investors, ChinaOnline News, 30 May 2001.

25 Eventually tax incentives cannot be avoided, if simply to level tax incentives granted in other parts of the country. An inter-regional race to the bottom in terms of tax incentives etc., however, should be averted under all circumstances. Here it might be even necessary to move in the direction of fiscal recentralisation. With presently 27 taxes at the sole discretion of regional government, the danger of an inefficient tax race to the bottom is real.

26 A FIE’s demand for locally produced inputs, however, may also be satisfied by “second-tier” FDI, undertaken by subcontractors / suppliers from the FIE’s home country. In this scenario, the overall volume of FDI inflows would increase, which might raise a whole sector’s vintage of technology. Potential crowding in effects would then have to be realized further downstream. Such “second-tier” FDI may be understood as a counter-strategy to accommodate local content stipulations in the host country whenever the local enterprise sector is seen as unfit to supply the required goods or qualities.

27 At the turn of the century the total number of people employed by FIE was reported to have been in excess of 20 million (Xie 2000). This figure, however, should not be interpreted as meaning that FIE have created 20 million new jobs on a net basis. FIE are responsible for streamlining most industries, leading to the expulsion of a considerable number of workers. But in most cases, the loss of jobs meant the transformation of hidden unemployment into open unemployment, contributing to a more transparent economic setting.

All in all it can be assumed that FIE did have a positive (direct) effect on the labor market, although the effect has been quite different, depending on the time period and the various segments of the labor market. FIE have certainly eased the strains on the market for unskilled labor. New ventures and the growth impulses originating from FIE have created new jobs (on a net basis) for an abundant pool of workers. With respect to qualified labor, FIE have (especially in the eighties) competed with local companies for scarce (human) resources and, due to their ability to pay higher wages and provide superior working conditions, have been able to crowd out local competitors. It has been only after a couple of years that, mostly by means of on-the-job training, FIE have over time also made a – considerable – contribution to the enlargement of the pool of qualified labor in the PR China.

28 The study identifying these employment effects had been commissioned by Coca-Cola and its Chinese bottlers. The net employment creation cannot be ascertained by these figures alone, as the simultaneous destruction of jobs in competing soft-drink plants is not known.

29 In the short term, however, the economy and society at large will have to master a period of instability as strains on the labor market will increase and discontent of a comparatively large group of people will grow, as for the first time in two decades of economic reform, they will have to suffer net-welfare losses (i.e. individuals with earnings stemming mainly from agriculture and state-owned industries).

30 According to Zhongguo Jingji Shibao (China Economic Times), 13 October 2000.

31 "Foreign Direct Investment in China's Energy Sector", Mehmet Ogutcu, in "Journal of Energy Geopolitics", Canada, June 2000

32 "The Impact of WTO Treaties on Investments in China", Thomas Weishing Huang, Holland & Knight LLP (Boston), presentation delivered at the East Asian Legal Studies Program at Harvard Law School on February 21, 2001.

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